

Penalties & reasonably arguable positions

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The increased incidence of audit increases the benefit of obtaining a RAP to protect a taxpayer from penalties.



Your opinion is yours, my opinion is mine.
If you don't like what I'm sayin'? Fine.
But don't close it, always keep an
open mind.
A man who fails to listen is blind.¹

Introduction

The Australian Taxation Office (ATO) has various powers to impose civil penalties to enforce compliance with the taxation laws and payment of tax assessments. The ATO generally has the power to remit civil penalties to avoid unreasonable or unjust results.

The ATO can also impose criminal penalties for taxation offences, which can overlap with the civil penalties. This article does not address criminal penalties.

The administrative penalty provisions are complex to apply. Different penalties and remission rules apply to different penalty classes and different taxes. The subject matter, scope and purpose of the penalty provisions can cause significant and subtle variations in the ATO's imposition and remission policies and procedures. The penalty provisions have undergone significant amendments, which increases the complexity in identifying and applying the relevant provisions.

Promoter penalties apply to deter and punish the promotion and implementation of a tax exploitation scheme (TES).² In contrast to administrative penalties, promoter penalties apply to the promoters of the TES rather than the taxpayer.

The ATO has published extensive guidance in rulings, practice statements and receivables policies. There is also extensive case law which supplements the ATO's published guidance. Care is required in selecting the correct penalty provisions and administrative practices applicable to the particular penalty assessment.

This article discusses the administrative penalty provisions applicable on and after 4 June 2010 and the promoter penalty provisions applicable on and after 6 April 2006 as well as the use of reasonably arguable position papers to protect taxpayers and promoters from penalties.

Administrative penalties

Introduction

The uniform administrative penalty provisions apply to statement and schemes penalties,³ failure to lodge penalties⁴ and certain miscellaneous penalties such as record keeping and registration defaults and hindering the ATO⁵ arising on and after 1 July 2000.⁶

The uniform administrative penalty provisions also impose penalties for failure to withhold⁷ or remit⁸ to the ATO amounts under the Pay-As-You-Go (PAYG) withholding regime.

For statement and scheme penalties, the base penalty is a percentage of the tax shortfall amount determined by the culpability of the taxpayer (such as lack of reasonable care (25%), recklessness (50%) and intentional disregard of a tax law (75%)). The base penalty amount for scheme penalties is higher than statement penalties. The base penalty amount is increased for culpable or decreased for exculpatory behaviour. Where there is no shortfall amount, penalty units are imposed based on culpability.

General interest charge (GIC) or shortfall interest charge (SIC) may also be imposed on the tax shortfall amount and penalty.

The ATO must serve written notice of the administrative penalty liability on the taxpayer. The liability is payable on a day specified in the notice, which must be at least 14 days after service of the notice.

GIC is payable from that date on any outstanding balance.⁹

The ATO is empowered to remit penalties, GIC and SIC in appropriate circumstances. From the 2004/2005 income year or fringe benefits tax (FBT) year, the ATO must also give written reasons for the administrative penalty¹⁰ or administrative penalty remission decision.¹¹

Combined administrative penalty and tax assessments are severable where the administrative penalty assessment is invalid.¹²

A taxpayer may object to an administrative penalty assessment¹³ or administrative penalty remission decision¹⁴ within 60 days or 2 or 4 years where there is an extended period of objection for the related tax assessment.¹⁵

Legislative amendments

The administrative penalty provisions have undergone two significant amendments and numerous minor amendments that must be carefully considered so that the correct provisions and administrative practices are applied.

Significant amendments were made for the 2004/2005 income year including:¹⁶

- enactment of the SIC provisions;
- enactment of the requirement to provide written reasons for remission decisions;
- the correction of the reasonably arguable position test; and
- the repeal of administrative penalties for ignoring a private ruling.

Further significant amendments were made on and from 4 June 2010 including to:¹⁷

- extend the penalty regime to impose penalty units for false and misleading statements that do not directly produce a tax shortfall amount;

- extend the penalty regime to impose penalties for false and misleading statements made to persons other than to the ATO exercising a power or performing a function under the taxation laws (such as PAYG statements made by employees to employers);
- extend the culpability increase and decrease of the base penalty amount in a similar manner to the new penalty unit regime where there is no tax shortfall; and
- enact the registered tax agent safe harbour where the tax agent takes reasonable care for false or misleading statements made on and after 1 March 2010.¹⁸

These extensions to the penalty provisions increase the risks of exposure of taxpayers to penalties. The tax agent’s safe harbour will refocus imposition of penalties on the practices and procedures of tax agents.

Statement and scheme penalties

Introduction

An administrative penalty may be imposed for statements that are false or misleading or are not reasonably arguable or for entering into a tax scheme.

A clear distinction must be maintained between each type of administrative penalty.

The extent of the penalty imposed is determined by the behaviour of the taxpayer and the taxpayer’s advisers.¹⁹

Specific liability attribution rules apply to trustees,²⁰ partners,²¹ consolidated group head entities²² and the directors of the corporate trustee of a self-managed superannuation fund (SMSF).²³ The trustee, partners and directors of the corporate trustee of a SMSF special liability attribution rules impose joint and several liability for penalties. Any penalty submission and penalty remission request should be made for all liable persons.

The penalties are summarised in Table 1.

Statement penalties

An administrative penalty for false or misleading statements is based on a percentage of the tax shortfall or, on and from 4 June 2010, for penalty units where there is no tax shortfall.²⁵

A statement must be false²⁶ or misleading²⁷ in a material particular because of something that it contains or which is omitted.²⁸ To be material, the statement

Table 1

Penalty Basis ²⁴	Penalty Amount			
	Base Penalty Amount	Adjusted Penalty %		
		Culpable Behaviour + 20% [^]	Voluntary Disclosure	
			During Audit - 20%	Before Audit - 80%
Intentional disregard of the law	75% shortfall	90%	60%	15%
Recklessness as to the operation of a law	50% shortfall	60%	40%	10%
Failure to take reasonable care to comply with tax law	25% shortfall	30%	20%	5%
Taking a position that is not reasonably arguable*#+	25% shortfall	30%	20%	5%
Failure to provide documents under sec. 284-75(3)	75% total tax	90%	60%	15%
Disregard private ruling pre 2004/2005 income year	25% shortfall	30%	20%	5%
Penalties relating to Schemes				
Taking a position that is not reasonably arguable	50% shortfall	60%	40%	10%
Taking a position that is reasonably arguable	25% shortfall	30%	20%	5%
Transfer pricing or DTA position that is not reasonably arguable (no avoidance dominant purpose)	25% shortfall	30%	20%	5%
Transfer pricing or DTA position that is reasonably arguable (no avoidance dominant purpose)	10% shortfall	12%	8%	2%

[^] Note: Hindering ATO, repeat offences and failure to disclose within reasonable time of becoming aware of shortfall

* Note: No penalty unless results from a change of more the A\$10,000 or 1% of income tax payable

Note: No penalty in relation to a trust unless results from a change of more the A\$20,000 or 2% of trust net income

+ Note: No penalty in relation to a partnership unless results from a change of more the A\$20,000 or 2% of partnership net income

must affect the decision calculating the entity’s tax liability or entitlements.²⁹

The penalty is imposed on the shortfall amount. The shortfall amount is the reduction in tax liability arising as a result of the relevant statement being false or misleading when compared to the amount properly payable under the relevant law.³⁰

An administrative penalty for a false or misleading statement can be imposed even if the statement is retracted.³¹ An administrative penalty can be imposed where a false or misleading statement is made to an entity other than the ATO exercising powers or performing functions under a taxation law.³²

Where a false or misleading statement is made that does not produce a tax shortfall, an administrative penalty of 20 penalty units³³ (A\$2,200) for lack of reasonable care, 40 penalty units (A\$4,400) for recklessness or 60 penalty units (A\$6,600) for intentional disregard will be imposed.³⁴

The tax agent’s safe harbour protects the taxpayer from administrative penalties for false and misleading statements by a tax agent or BAS agent provided the taxpayer provides all relevant taxation information.³⁵ The tax agent’s safe harbour does not apply where there has been recklessness or intentional disregard of the law by the taxpayer, tax agent or BAS agent or the penalty concerns a tax avoidance scheme.

While the tax agent's safe harbour appears generous, it is effectively limited to circumstances where there is a lack of reasonable care. Penalty submissions will be important to persuade the ATO to impose a penalty for lack of reasonable care to fall within the safe harbour.

The safe harbour will also refocus the enquiry of reasonable care on the tax agent and BAS agent's information gathering and review practices and procedures. It is unclear whether the absence of robust information gathering and review practices will increase the risk of the ATO alleging recklessness by tax agents.

The sole or dominant purpose test appears to be objective by analogy to the wording in the general income tax and goods and services tax anti-avoidance provisions. However, the former provision was considered to apply a subjective test.⁴³ The enacting legislation and explanatory memorandum did not express any change in the interpretation of the test.⁴⁴

For GST matters, the test applies at the lower threshold where it is reasonable to conclude that the principal effect⁴⁵ of the scheme on the taxpayer⁴⁶ was to obtain the benefit.

While the reasonably arguable statement provisions do not apply to GST matters, the

Using a tax adviser does not automatically satisfy the taxpayer's obligation to take reasonable care⁵⁵ and the taxpayer remains vicariously liable for the tax adviser's degree of care having regard to the size, resourcing, degree of specialisation and client base of the tax adviser.⁵⁶

The extent to which the ATO relies upon the personal attributes of the taxpayer and the tax agent is controversial and arguably renders the test unnecessarily subjective.⁵⁷

The complexity of the law, the implementation of new measures,⁵⁸ the effort to research and determine the correct tax treatment and support the treatment adopted⁵⁹ and strength of the interpretation adopted⁶⁰ are relevant and reasonable care may require the taxpayer to make reasonable enquiries to resolve the issue. Failing to apply for a private ruling does not constitute failure to take reasonable care.⁶¹

Recklessness involves something more than mere inadvertence or carelessness. Recklessness is gross carelessness – the doing of something which in fact involves risk (whether known by the taxpayer) and the taking of that degree of risk would be described as reckless or unjustifiable.⁶² It is not necessary for the taxpayer to be acting dishonestly⁶³ – it is sufficient that the taxpayer displayed a high degree of carelessness and indifference to the consequences.⁶⁴ The test is objective.⁶⁵ The same factors as for reasonable care are applied.

Recklessness was not found where:

- a director signed commercial documents on the recommendation of a spouse without understanding their effect or nature or operation of the trust;⁶⁶ or
- a ship pilot provided personal services income through a company which was common in the industry.⁶⁷

A taxpayer intentionally disregards a tax law where the taxpayer is aware of the tax obligation and chooses to disregard the obligation and intentionally decides to bring about a state of affairs by the taxpayer's own act of volition.⁶⁸ The test is subjective.⁶⁹

A taxpayer that omits assessable income may be suspected of having done so intentionally, but in the absence of an admission from the taxpayer that the omission was deliberate or of conduct that may indicate deliberate evasion,⁷⁰ it is often difficult for the ATO to establish intentional disregard.⁷¹ Intentional disregard

Tip: Tax agent safe harbour

- The tax agent should pro-actively request information and corroborating documentation to engage the safe harbour.
- The tax agent should document the requests and responses to assist the taxpayer in discharging the onus to prove that all relevant information was provided to the tax agent.
- Tax agents should consider preparing a pro forma information request checklist to be completed by the taxpayers.
- Taxpayers should be advised in writing of the safe harbour as well as the additional continuing disclosure obligations.

Scheme penalties

An administrative penalty is imposed if a taxpayer would otherwise obtain a tax benefit from a scheme and having regard to any relevant matters it is reasonable to conclude that an entity entered into or carried out the scheme or part of it for the sole or dominant purpose of obtaining a scheme benefit³⁶ or the principal effect of the scheme or part of it is that the taxpayer would directly or indirectly get the scheme benefit.³⁷

The penalty is based on a percentage of the tax scheme shortfall³⁸. The penalty for transfer pricing or double tax agreement schemes differs depending on whether there was a sole or dominant purpose to obtain the scheme.³⁹

Scheme is defined in the usual broad terms and the scheme shortfall amount is the reduction in tax liability or increase in credit arising as a result of the tax scheme.⁴⁰

Where the antecedent provisions tax a matter so the scheme was ineffective to reduce the tax related liability, the scheme penalties do not apply.⁴¹ The ATO will usually issue alternate statement penalty assessments and scheme penalty assessments.⁴²

reasonably arguable test applies to reduce penalties where it is reasonably arguable that the GST anti-avoidance provision does not apply.⁴⁷

Base penalty amount – culpability

The base penalty amount for false and misleading statements penalties and scheme penalties is determined by the culpability of the taxpayer.

The ATO has discussed reasonable care, recklessness and intentional disregard.⁴⁸ These views will require amendment on and from 4 June 2010.⁴⁹

Reasonable care means a taxpayer must exercise the care that a reasonable, ordinary person, would exercise in the circumstances of the taxpayer to fulfil the taxpayer's tax obligations.⁵⁰ The test is objective⁵¹ having regard to the taxpayer's age, health, incapacity, background, knowledge, experience, education, skill, understanding of the tax law and other circumstances⁵² and the appropriateness of the record keeping procedures, reviews, sampling, staff training and experience.⁵³ There is no presumption that a false or misleading statement evidences a failure to take reasonable care and negligence must be established.⁵⁴

was not found where the failure arose from a migrant's limitation in relation to written and spoken English.⁷²

Statements not reasonably arguable penalties

An administrative penalty for a statement that is not reasonably arguable is also based on a percentage of the tax shortfall.⁷³

A statement is not 'reasonably arguable' if it would be concluded in the circumstances, having regard to relevant authorities, that which is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.⁷⁴

The statement not reasonably arguable penalties differ from false and misleading statement penalties in numerous respects including that:

- the tax agent's safe harbour does not apply; and
- the penalty unit provisions where there is no shortfall amount do not apply.

The reasonably arguable position provisions are discussed further below.

Adjustment of base penalty amount – culpability

The base penalty for false and misleading statements, statements not reasonably arguable and scheme penalties may be increased for culpable or decreased for exculpatory behaviour.

The base penalty will be increased by 20% if:⁷⁵

- the taxpayer took steps to prevent or obstruct the ATO from finding out about a shortfall amount or the false or misleading nature of a statement;
- the taxpayer did not tell the ATO or other entity within a reasonable time of becoming aware of a shortfall amount or the false or misleading nature of a statement;
- the taxpayer had a previous base penalty amount calculated under a similar culpability basis;
- the taxpayer took steps to prevent or obstruct the ATO from finding out about a scheme shortfall amount; or
- the taxpayer had a previous base penalty amount calculated under a scheme penalty provision.

Importantly, a taxpayer has a positive obligation to advise the ATO when the taxpayer becomes aware of the shortfall amount or false and misleading nature of a statement to avoid an increased penalty.

A taxpayer that makes a voluntary disclosure in the approved form to the ATO may have administrative penalties reduced:⁷⁶

- to nil where disclosure is made before an audit commences in respect of the income year and the tax shortfall was less than A\$1,000;
- by 80% where disclosure is made before an audit commences in respect of the income year;
- by 80% where disclosure is made after an audit commences in respect of the income year and the ATO exercises its discretion to treat the disclosure as if it had been made before commencement of audit;⁷⁷ or
- by 20% where disclosure is made after an audit commences in respect of the income year and the disclosure saves the ATO significant time and resources.

A detailed discussion on voluntary disclosures has been previously published.⁷⁸

Failure to lodge penalties

An administrative penalty is imposed if an entity fails to lodge a return, notice, statement or other document on time or in the approved form⁷⁹ to the ATO.⁸⁰ The penalties do not apply to superannuation returns, notices, statements or documents.

The failure to lodge penalties apply to statements required to be given in the approved form for other matters, including:

- superannuation contribution and rollover statements;⁸¹
- first home saver accounts;⁸²
- employee share schemes;⁸³ and
- consolidations leaving entity.⁸⁴

The base penalty amount is 1 penalty unit (A\$110) for each 28 days that the notice is late (up to a maximum 5 penalty units (A\$550)). The base penalty amount is multiplied by 2 for a medium reporting entity and multiplied by 5 for a large reporting entity.

Remission for reliance on ATO

On and after 4 June 2010, the base penalty amount will be decreased to the extent that it was caused by a treatment consistent with advice from, a general administrative practice of or a publication approved by the ATO.⁸⁵

A Practice Statement or an ATO document such as the ATO Receivables Policy will usually constitute a general administrative practice.⁸⁶ Establishing a general

administrative practice through other publications will often be controversial. A significant number of un-contradicted private rulings dealing with the same issue may constitute a general administrative practice.⁸⁷

Miscellaneous penalties

Various miscellaneous penalties can also be imposed.

A failure to keep or retain taxation records⁸⁸ or failure to retain or produce a declaration, and prevention of access by an ATO officer in the course of the officer's duty are subject to 20 penalty units (\$A2,200).

Alternatively, the ATO could prosecute for some of these penalties as taxation offences.

Remission of penalties and general interest charge

In addition to the taxpayer making submissions regarding the culpability of the taxpayer and the taxpayer's advisers, the taxpayer can request further remission of the base penalty. The ATO can initiate a remission or the taxpayer can request remission.

The ATO is empowered to remit penalties,⁸⁹ GIC⁹⁰ or SIC⁹¹. Relevant ATO publications on penalty remission include:

- remission of penalties for false and misleading statements;⁹²
- remission of penalties during implementation of the new tax system for the period to 30 June 2002;⁹³
- remission of penalties for failure to register for GST;⁹⁴
- remission of penalties for failure to withhold under PAYG Withholding;⁹⁵ and
- remission of superannuation guarantee charge (SG Charge) and SG Charge choice shortfall.⁹⁶

The remission of a failure to lodge penalty occurred where the book-keeper covered up the failure to lodge.⁹⁷

While these other ATO publications on penalty remissions are consistent with the ATO's general remission policies, there are subtle differences because of the structure of the particular taxes.

All communications should be on a without prejudice basis.⁹⁸ It is unclear whether without prejudice discussions can be used in determining culpability under a subsequent remission request.⁹⁹

A detailed discussion on remissions has been previously published.¹⁰⁰

Promoter penalties

Introduction

The promoter penalty regime applies to proscribed conduct on or after 6 April 2006.¹⁰¹

“A clear distinction must be maintained between each type of administrative penalty.”

An entity that engages in conduct after 6 April 2006 that results in that or another entity being a promoter of a tax exploitation scheme (TES) or implements a product ruling in a way that is materially different from that described in the product ruling may be subject to:

- civil penalties of up to 5,000 penalty units (A\$550,000) for an individual or 25,000 penalty units (A\$2,750,000) for a company or twice the consideration receivable by the entity in respect of the TES;¹⁰² and
- injunctions restraining the conduct (restraining injunction) or requiring the entity to do something (performance injunction);¹⁰³ or
- voluntary undertakings restraining the conduct or requiring the entity to do something.

The ATO can apply for orders or enforce the promoter penalties in the Federal Court of Australia.

The provisions apply to the taxpayer entity (partnership, company or trust) as well as its controllers (partners, directors or trustees).¹⁰⁴

The imposition of promoter penalties does not preclude the imposition of administrative penalties for the promoter or for participants in the scheme.¹⁰⁵ Promoter penalty proceedings take priority over other Commonwealth civil penalties but not criminal proceedings.¹⁰⁶

The Promoter Penalty Review Panel will review and provide analysis of the matter, although its review and recommendations are not binding on the promoter decision maker.¹⁰⁷

PSLA 2008/7 and PSLA 2008/8 express the ATO's view in respect of the scope of the promoter penalty regime.

Tax exploitation scheme

A scheme is a TES where it is reasonable to conclude that the promoter (alone or with others) entered into or carried out the scheme with the sole or dominant purpose of that or another entity getting a scheme

benefit¹⁰⁸ of paying less tax or receiving increased tax offsets.

A scheme is not a TES at the time of the conduct promoting the scheme if it is reasonably arguable that the scheme benefit is available at law or would be available at law if the scheme was implemented. Accordingly, the reasonably arguable test is effectively a defence to the promoter penalty provisions (discussed further below).¹⁰⁹

Promoters

A promoter of a TES includes an entity that:¹¹⁰

- markets or otherwise encourages¹¹¹ the growth of or interest in a scheme;
- receives (including where an associate receives) directly or indirectly consideration in respect of that marketing or encouragement; and
- it is reasonable to conclude that the entity had a substantial role in respect of that marketing or encouragement.

An entity is not a promoter of a TES:

- merely because the entity provides advice about the scheme; or
- merely because the employee distributes information or materials prepared by another entity.

The promoter must receive consideration in respect of the marketing or encouragement not for normal services at normal commercial rates¹¹² such as a participation or success fee calculated by reference to tax savings or scheme benefits provided.¹¹³ Accordingly, consideration which is calculated on some basis not linked to the outcome of the advice but is linked to the overall performance of the company should be acceptable.¹¹⁴ This nexus applies independently of the advice exemption.

Salary, wages and other professional fees that reflect time and expertise spent in advising clients about a scheme are unlikely to constitute consideration in respect of marketing or encouragement of a TES.¹¹⁵ An employee would not be a promoter if distributing information or material prepared by their employer even if receiving a bonus related to sales of investment products.¹¹⁶

The provision of independent and objective advice about a scheme (including tax and tax planning advice) that is favourable or provides alternate ways to structure a transaction or assesses tax risks of the alternatives but is later found to be a TES is not at risk of civil penalties.¹¹⁷ However, advice which is given in the capacity as an entrepreneur is not excluded.¹¹⁸ The exact scope of the advice exclusion is unclear in a number of aspects.¹¹⁹

PSLA 2008/7 and PSLA 2008/8 distinguish between promotion and provision of independent and objective tax planning advice. To assist advisers to identify circumstances when they may be at risk from the promoter penalty regime, the PSLAs make the following relevant statements:

- the mere provision of positive and supportive advice about an arrangement or structuring of an arrangement is not the promotion of a tax exploitation scheme;
- receipt of success or contingency fees, hourly billing in excess of time actually spent, mark-ups on normal fee rates generally or for skill care and attention or commissions will likely exclude the mere provision of advice exemption;
- the higher the degree of involvement in the activities the more likely to be a promoter (such as doing presentations to the adviser's clients explaining the advice);
- the higher the degree of involvement in the management of the deviser or marketing the more likely to be a promoter;
- the more robust the advice and review and quality assurance procedures the less likely an adviser will be a promoter; and
- well drafted scoping, qualification and disclaimer provisions in advice may reduce the risk that an adviser will be a promoter.

Care is required to ensure that tax and structuring advice provided by an adviser is not promotion of a TES.

Defences to civil penalties

A civil penalty must not be ordered where:¹²⁰

- the conduct promoting the TES was due to a reasonable mistake of fact or some act beyond the entity's control and the entity took reasonable precautions and exercised due diligence to avoid the conduct;
- the TES is based on treating a taxation law in a way that agrees with advice from the ATO¹²¹ or ATO publication;
- the application for civil penalties is made more than 4 years after the entity last engaged in the conduct promoting the TES unless the scheme involved tax evasion¹²²;
- the entity did not know, and could not reasonably be expected to have known, that the conduct would result in promoting the TES; or
- the entity was involved as an employee and the individual's employer is ordered to pay a civil penalty in relation to the TES.

The application of these exclusions to particular action of participants in an arrangements is complex and time consuming and subject to the particular circumstances of the matter.

Voluntary undertakings

The ATO may accept a written undertaking which may be withdrawn or varied at any time with the consent of the ATO.¹²³ The ATO cannot require an undertaking. The undertaking is enforceable in the Federal Court of Australia.

It is a precondition for a voluntary undertaking that the conduct is found to be a tax exploitation scheme.¹²⁴

In considering whether civil penalties or an undertaking is appropriate, the ATO will consider:¹²⁵

- the facts and circumstances of the conduct, such as the entity's motivations for engaging or not engaging in the conduct, the availability of alternative income sources, and other factors that may impact on its behaviour, such as the entity's health
- the seriousness of the prohibited conduct including:
 - the revenue potentially at risk
 - the level and extent of consideration received or payable

- the potential level and extent of participation (both generally and within industries or sectors of the economy)
- the consequences for participants such as the loss or damage suffered
- the degree to which the scheme benefit is arguably available at law, and
- the duration of the prohibited conduct,
- the deliberateness of the prohibited conduct, including whether the entity was wilfully blind to the result of its conduct and whether the results of its conduct were reasonably foreseeable
- the steps the entity took, if any, to restrict the effect of its conduct, such as internal governance procedures or controls and caveats or limitations in marketing documents
- the entity's compliance history and any relevant or related past promotional conduct
- the level of the entity's cooperation with the Tax Office's enquiries about their own conduct and the conduct of others
- the entity's willingness to address the potential prohibited conduct in the current case, including recompensing participants as well as altering its own future behaviour
- the merits and deterrent effect of each remedy including the effect of litigation on the entity and other relevant entities that may be affected
- balancing deterrence of prohibited conduct with the legal, administrative and commercial risks resulting from the action, and
- the current availability of other sanctions that are more appropriate for the entity's behaviour and circumstances.

Factors which might weigh in favour of the ATO accepting an undertaking will consider:¹²⁶

- the entity is willing to provide full disclosure about its own activities and the activities of others involved in the scheme
- the entity is willing to rectify its conduct including by recompensing participants
- the entity has alternative sources of income to engaging in the prohibited conduct
- the entity was lower in the chain of command/ decision making structure than other entities involved in the scheme
- the risk to revenue is low
- the argument in relation to the availability of the scheme benefit is not clear cut, and/or
- the conduct was apparently inadvertent

Accordingly, promoters of products and advisers to the promoters should exercise care that they have not contravened the promoter penalty provisions.¹²⁷

Reasonably arguable position (RAP)

Introduction

The adoption of a reasonably arguable position assists to protect a person from administrative penalties for taxation laws,¹²⁸ scheme penalties for anti-avoidance provisions¹²⁹ and promoter penalties.¹³⁰

The reasonable care and reasonably arguable position penalties are separate penalties. The taxpayer must establish that the taxpayer has taken reasonable care before the taxpayer can establish a RAP.¹³¹ If a RAP is prepared at the time of adopting a tax treatment, the RAP will likely also constitute reasonable care.

The ATO considers that a RAP can apply to a part of a shortfall amount that resulted from taking the position that is not reasonably arguable.¹³² Complex nexus questions may arise to establish that the RAP position related sufficiently to the shortfall amount.

Reasonably arguable standard

A matter is 'reasonably arguable' if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect (or more likely to be correct than incorrect).¹³³

The original section omitted the term 'about' which was subsequently reinstated¹³⁴ correcting a potential change in the standard as identified by Robin Woelner.¹³⁵ *Walstern v FCT*¹³⁶ represents the orthodox expression of and approach to the test:¹³⁷

1. The test to be applied is objective, not subjective. This is clear from the use of the words "it would be concluded" in subs (1)(b) of the section.
2. The decision-maker considering the penalty must first determine what the argument is which supports the taxpayer's claim.
3. That person will already have formed the view that the claim is wrong, otherwise the issue of penalty could not have arisen. Hence the decision-maker at this point will need to compare the taxpayer's argument with the argument which is considered to be the correct argument.
4. The decision-maker must then determine whether the taxpayer's argument, although considered wrong, is about as likely as not correct, when regard is had to "the authorities".
5. It is not necessary that the decision-maker form the view that the taxpayer's argument in

an objective sense is more likely to be right than wrong. That this is so follows from the fact that tax has already been short paid, that is to say the premise against which the question is raised for decision is that the taxpayer's argument has already been found to be wrong. Nor can it be necessary that the decision-maker form the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision-maker considers to be the correct argument for the decision-maker has already formed the view that the taxpayer's argument is wrong. The standard is not as high as that. The word "about" indicates the need for balancing the 2 arguments, with the consequence that there must be room for it to be argued which of the 2 positions are correct so that on balance the taxpayer's argument can objectively be said to be one that while wrong could be argued on rational grounds to be right.

6. An argument could not be as likely as not correct if there is a failure on the part of the taxpayer to take reasonable care. Hence the argument must clearly be one where, in making it, the taxpayer has exercised reasonable care. However, mere reasonable [care] will not be enough for the argument of the taxpayer must be such as, objectively, to be "about as likely as not correct" when regard is to be had to the material constituting "the authorities".
7. Subject to what has been said the view advanced by the taxpayer must be one where objectively it would be concluded that having regard to the material included within the definition of "authority" a reasoned argument can be made which argument when contrasted with the argument which is accepted as correct is about as likely as not correct. That is to say the 2 arguments, namely, that which is advanced by the taxpayer and that which reflects the correct view will be finely balanced. The case must thus be one where reasonable minds could differ as to which view, that of the taxpayer or that ultimately adopted by the Commissioner was correct. There must, in other words, be room for a real and rational difference of opinion between the 2 views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless "about" as likely to be correct as the correct view. A question of judgment is involved.

The RAP should reflect the above approach in its structure.

The standard of the objective test is unclear and is presumably the average tax adviser.¹³⁸ While the qualities of the tax adviser are relevant for the reasonable

care test, it is unclear whether the same quality of tax adviser is applied to the RAP. Arguably, a higher quality of tax adviser is required for a RAP because a higher degree of care is required in establishing a RAP.

Susceptibility to RAP

A false or misleading statement RAP only applies to taxation laws. A taxation law most notably excludes GST and FBT. It will also exclude administrative and collection procedures and issues.¹³⁹ Accordingly, it is not possible to have a RAP for GST and FBT and at best, this constitutes a reasonable care position.

However, a RAP can be taken in respect of the application of other tax laws such as GST¹⁴⁰ and FBT¹⁴¹ for scheme penalties. It must be reasonably arguable that the taxation treatment is correct and that the ATO would not apply the general anti avoidance provisions.¹⁴²

A RAP only applies to an interpretation of an income tax law and will not apply where the reasonable argument concerns the existence of a primary fact (such as the existence of a business).¹⁴³ Often it is necessary to determine whether the RAP concerns the law, a fact or mixed law and fact to determine if the issue is susceptible to a RAP.

The Explanatory Memorandum stated:¹⁴⁴

- 1.20 'Reasonably arguable' is a standard about the position taken by a person on a question of interpretation, **including a conclusion of fact**.
- 1.22 A position taken by a taxpayer will be reasonably arguable if, on an objective analysis of the law and the application of the law to the relevant facts, it would be concluded that the taxpayer's position was about as likely or more likely to be correct as incorrect. **In other words, the position must be a contentious area of law, where the relevant law is unsettled or where, although the principles of the law are settled, there is a serious question about the application of those principles to the circumstances of the particular case.**

The RAP must relate to a contentious or unsettled area of law or application of settled law to primary facts.

In determining whether a matter is susceptible to a RAP the following principles are relevant:

- Where the primary facts are not in dispute, whether the matters are

within or outside the statute involves a question of law.¹⁴⁵

- Where the correct principles of law have been identified, the application of the principle to the primary facts is a question of fact (and a question of degree).¹⁴⁶
- The ordinary meaning of an expression used in legislation and whether the evidence is within or outside the expression is a question of fact however, the technical meaning of an expression and whether the evidence is within or outside the technical expression is a question of law.¹⁴⁷
- A mixed question of fact and law is a question of law.¹⁴⁸
- The question of whether there is evidence to support the particular conclusion or inference of ultimate fact arising from a primary fact is a question of law.¹⁴⁹

The RAP should clearly relate to a question of law and should be expressed to clearly fall within one of these principles. The issue often arises in respect of conclusions such as tax residency and conducting a business. The issue can be expressed as follows:¹⁵⁰

In considering the case law relevant to the distinction between questions of law and fact, it is important to appreciate that there are two kinds of facts. The first kind are called "primary" or "evidentiary" facts and are provable by direct evidence. The second kind are called "ultimate" facts or conclusions of fact and are inferences drawn from the primary or evidentiary facts. Thus, in considering whether a taxpayer was resident in a particular place, the date of arrival in that place and the length of time the taxpayer spent there would be primary or evidentiary facts provable by direct evidence. The question of whether the taxpayer was resident in that place would then be an ultimate fact or conclusion of fact drawn from the primary or evidentiary facts that have been proved.

Care is required to ensure that the RAP concerns the law and not the existence of a primary fact.

Methodology of weighing indicia

It is unclear whether when making a determination of whether a matter is reasonably arguable in circumstances requiring the weighing of multiple indicia (such as the indicia of tax residency or conducting a business) it is necessary to have a reasonably arguable position in respect of each and all the indicia or on a balance of the indicia. Arguably, the

approach should be similar to the approach in weighing the indicia under Part IVA ITAA36 to ensure consistency in approach for adopting a RAP on primary issues and a RAP on anti-avoidance issues.¹⁵¹

Arguably in objectively weighing the multiple indicia, the objective opinion must be on the balance of the indicia, with the balance of all the indicia resulting in a reasonably arguable position. It would not matter that some indicia are unfavourable or not themselves reasonably arguable.

Relevant authorities

The RAP must be supported by authorities, including a taxation law, extrinsic explanatory material,¹⁵² court, tribunal or board decision or public ruling.¹⁵³

Recourse to extrinsic and explanatory material is usually only permitted to identify the purpose of the provision but is usually not permitted to change the ordinary meaning interpretation of a provision unless the provision itself is unclear, unreasonable or irrational.¹⁵⁴ The RAP should identify the basis for recourse to the extrinsic and explanatory material to ensure the reference is authorised.

The list of authorities is not exhaustive, so premier text books and peer reviewed journal articles may also be used.¹⁵⁵ A RAP can apply to the interpretation of the provision within its context according to ordinary rules of statutory construction.¹⁵⁶

The relative strength of the authorities must be weighed having regard to the persuasiveness, relevance, currency, degree of acceptance and source of the authority.¹⁵⁷

The Explanatory Memorandum¹⁵⁸ indicates that the opinion of an accountant, lawyer or other adviser is not an authority, although the authorities used to support the opinion are relevant authorities.¹⁵⁹ However, arguably an opinion of eminent senior counsel if directed at the actual facts of a case might fall within the definition.¹⁶⁰ Accordingly, the use of eminent senior counsel may be appropriate to establish a RAP.

Conclusion

The administrative penalty and promoter penalty provisions are extremely complex with substantive and subtle differences in their application and administration. Adopting a reasonably arguable position can, in appropriate circumstances, reduce the risk of penalties (particularly when it is prepared at the time of the tax activities or by senior counsel).

Advisers should ensure that taxpayers obtain a RAP in appropriate circumstances and ensure the RAP satisfies the legislative pre-conditions to ensure protection from penalties is obtained. The increased incidence of review and audit increases the benefit of obtaining a RAP at the time of undertaking the tax activities to protect a taxpayer from penalties.

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