Reflections on being a large market tax adviser

Last updated 12 September 2019

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Jeremy Hirschhorn
Second Commissioner, Client Engagement
Paper delivered to large market tax advisory firms
July–September 2019

Things I wish I had known

When I was asked to present on this topic, it really got me thinking about what it means to be a good tax adviser in 2019.

Looking back at my previous self, working in tax, and as someone who was interested in the tax system and tax policy, I reflect on how academic the approach to tax questions was, approaching advice almost like an abstract take home exam, divorced from the reality of a system designed to collect taxes: I don't recall ever even thinking about how much corporate tax was collected each year from large companies.

Working in a firm, it is also all too easy to focus on work in progress (WIP) and lock-up, and where the next job is coming from, and viewing advice quality through the lenses of client relationship, negligence and firm exposure – in other words, a sense of as long as the clients keep coming back, and I don't get picked up in an internal file review, it must be going well. It's also very difficult to truly know how you compare to others in the market, even at your own firm let alone other firms. In fact, a key theme that is sprinkled through this speech is of difficulties in having an accurate perception of oneself and others.

The day I started at the ATO, my lens on the tax system had to fundamentally change. I became responsible for meeting revenue commitments, shaping the system through improved administration and legislation and being accountable to Ministers and parliament for my decisions and actions. There is nothing like sitting at the front table at a Senate Estimates hearing to focus the mind!

Having worked at the ATO for five years now, there are a few things that I think would have made me a better, certainly wiser, adviser, had I known them in my 20 or so years as a large market tax adviser.

So today I want to offer a perspective from someone who has looked back at the system from different angles and share some of the things that, as someone trying to be a good large market tax adviser, I would have wanted to know about the ATO – how the ATO thinks, operates and approaches issues – to give my clients better service.

Because that's basically it. All clients deserve the best possible service, based on wise advice. The importance of wise advice cannot be understated. In the large market, advising companies on investments into Australia, good advice is also critical in attracting and retaining foreign capital. On the flip side, when things go wrong, foreign investors do not carefully judge whether it was poor advice, unexpected shifts in administration or legislative change, they simply view it as a tax risk premium for investing in Australia, to the detriment of all Australians.

So as our key partners in the tax system, it would be remiss of me not to share these insights with you. It is important for us to be open not only about how taxpayers can get things right, but what good advice looks like from an ATO perspective. We also need your help to call out and tackle bad behaviour, for the integrity of your profession just as much as the rest of the tax system.

Coming back to difficulties in self-perception, one of the things that I have learned in my time at the ATO is that the spectrum of behaviour is much broader than I had ever thought: I had assumed that other advisers were relatively similar to me in their attitudes, and other taxpayers were relatively similar to my clients in their attitudes. I have also come to the opinion that the tax market seems to efficiently match conservative advisers with conservative firms and clients, and similarly match aggressive advisers with aggressive firms and clients. The combination of these factors means that few participants in the tax system fully understand where they sit in the risk spectrum (and ironically it seems that the more conservative participants worry more, but the more aggressive participants often honestly believe that they are more conservative than average (perhaps because they are currently more conservative than they have previously been in their career).

By working together we can improve the tax system and Australia as a jurisdiction for large corporates to invest and operate.

I have categorised my reflections into three main themes:

- the need to develop your philosophy or model for being a good tax adviser, rather than just going with the flow
- thinking about tax risk in a more sophisticated way, and
- some observations on how advisers can ensure that they provide their best service (and avoid traps) in a range of practical day-to-day aspects of the role.

Role of a large market tax adviser or tax firm

What does it mean to be a good large market tax adviser or law firm in 2019?

The role of a large market tax adviser is certainly not an easy one, a good tax adviser even more so.

You are required to navigate and apply difficult tax law in a constantly changing business environment, with high client demands. You are under competitive pressure from other smart, driven people across the industry.

Tax advisers also play a critical role in making the system work. Tax advisers are, by their very nature, the first line of defence of the tax system. Without high quality advice, many taxpayers could easily and inadvertently fall into one or more of the many “traps” in the Australian tax system, noting that the Australian taxation system has significantly fewer “loopholes” than tax systems foreign investors may be used to. In this way, tax advisers play a valuable and constructive role.

They also have a critical role in facilitating investment – by demonstrating Australia is an economy and tax jurisdiction worth operating in.

However, it must be noted that the role also has the potential to have a negative impact on the system.

The proposition that I would like to put to you today is that the good large market adviser of today should focus on being “wise”, not “clever”, and in suggesting reasons for this shift in focus, I acknowledge in advance that I will be focussing on some of the flaws of the current “clever” approach to tax advice, and not focussing on the “pro-system” work that most large market tax advisers currently perform all or most of the time.

Introducing the concept of the systemically important firm and why it matters

From an administrator’s perspective, there are fundamental differences between boutique and systemically important firms.

Boutique firms operate within a system and can, in a sense, view the system as a constant environment in which they operate. However, once a firm becomes systemically important, any actions of the firm will change the system, and other participants in the system (including the ATO and Government) will respond.

As such, a systemically important firm cannot simply view itself as a club of boutiques. If you describe a partnership as like a franchisor/franchisee model, where each partner runs their own franchise, this means that a systemically important firm must have much tighter controls over each of the franchise businesses, to ensure that they are operating consistently with the core brand.

To make this more tangible, where a partner in a boutique firm comes up with a “cute” piece of tax planning, which is then implemented by one taxpayer, the ATO will see this as a “one-off”. If, by contrast, a partner in a systemically important firm comes up with the same idea, the potential (or reality) of that idea being rolled out across Australia’s highly concentrated corporate tax base will mean that the ATO must respond more forcefully.

For those at “Big 4” firms, the concept of a “systemically important” firm plays out even more at a broader level: you are systemically important in terms of your broader effect on the capital markets, and I would put it to you this affects your licence to operate across a range of areas (as is currently playing out), but provides a further system constraint on “clever” advice.

Alignment of ethical framework in advance

Once you have established yourself as a large market tax adviser, it’s important to think about the type of adviser you want to be. Your own ethics and how this aligns – or doesn’t – with your firm’s ethical framework may also define what ‘good advice’ looks like from your perspective. At the outset, I certainly don’t view myself as in a position to tell anyone what their ethical position should be, but I would definitely recommend that every tax adviser should self-reflect and reach a considered position.

What is your model of an ethical tax adviser?

A couple of years ago I came across a paper in the Virginia Tax Review, which talked about various philosophies of tax lawyering[1] and really resonated with me.

The paper sets out several models for tax advisers, including:

- ‘Tax Lawyer as Hired Gun’ where the adviser basically puts all options (no matter how aggressive) to the client (with appropriate provisos) and then follows the client’s direction (this can be problematic where a “Hired Gun” meets an unsophisticated client, including one who does not appreciate differences between their own country and Australia)
- ‘Tax Lawyer as Guru’ where the adviser is guided by their own moral choices (this can lead to the tax lawyer effectively imposing their judgment and risk appetite on the client: again problematic where the risk appetite of the adviser exceeds that of the client)

- ‘Tax Lawyer as Ideal Judge’ where the adviser tries to simply consider the abstract legal merits of their position (this can be prone to excessive focus on tax technical interpretation risk, and also prone to a risk of hubris – when even Federal Court judges are overturned on appeal more than a quarter of the time, one should be cautious as to whether one could ever achieve ideal judgment no matter how many hours hit the timesheet …)
- ‘Tax Lawyer as Friend/Counsellor’ where the adviser focusses on the client’s needs
- ‘Philosophy of Tax Lawyer Self-Interest’ where the adviser prioritises the personal consequences of their actions (including defending their firm from civil exposures).
- Different people will have different views as to what are appropriate ethical guiding frameworks. My proposition, as was the author’s, is that you should be self-aware and consciously choose your ethical framework before you are in an ethical quandary. Following an ethical framework in the real world can be difficult, and developing one mid-quandary is impossible.
- As an aside, I would note that I have seen some advisers who seem to operate almost on the basis that tax is discretionary or for people who are not as clever as them or their clients. In my experience, this category of adviser can be over-confident in their own ideas and fail to put appropriate rigour in their technical analysis. This leads to their clients taking positions which are (often significantly) riskier than they understand them to be. In the framework above, they seem to often self-identify as something akin to “ideal judge” and that counter positions taken by the ATO (or more conservative peers) are revenue biased, overly cautious or even maladministration).
- I would posit that this type of ethical framework is not available to a large market adviser, particularly one in a systemically important firm in 2019 (if it ever was).

Does this align with your firm’s local or global model?

Of course once you have identified your own ethical model, you also need to think about whether this aligns with your local firm’s or global firm’s model. If they don’t align, is that a deal breaker or something you are willing to work through?

Are systemically important firms constrained in their ethical framework choices?

From the perspective of the firm, it's important to think about the alignment of their governance framework and target ethical framework.

As above, to me there is an open question as to whether a systemically important firm (or sub-franchises of that firm) can safely or sustainably adopt a "hired gun" framework, or have a loose governance framework that explicitly or implicitly allows (or encourages) this ethical framework to be chosen by "sub-franchisees", noting that high risk–high reward businesses often look deceptively like high reward businesses in the short to medium term.

Taking the next step, how will the firm then deal with divergent ethical framework choices of its partners and employees, who may often be the highest fee-earning partners if one does not factor in a risk-return discount (and the risks will often emerge down the track).

Understanding what is important to the system

Ultimately a tax system is about collecting tax to fund the country to be what it wants to be under its social contract. Australia is fortunate to have a robust tax system and an effective tax administration which supports the social benefits we all enjoy.

Understanding large corporates' contribution to the tax system

Importantly, the number of large corporate groups in the Australian tax system is comparatively small, yet the impact they have on revenue is significant, both directly and indirectly. They make a significant contribution to the Australian economy and play a critical role in the tax system.

The 1,470 large corporate groups each with turnover above $250 million contribute around 60 per cent of all corporate income tax reported, or 15 per cent of total ATO tax collections each year. The 10 largest groups alone pay almost 30 per cent of all corporate income tax reported. We estimate the level of compliance of large corporate groups is over 95 per cent, the vast bulk of which is paid voluntarily. The ATO aims to improve this to 96 per cent at lodgment, and 98 per cent after compliance activity.

Large corporates also play an important role in creating community confidence in our tax system and so we actively share our insights into the large market with the community. Confidence is gained directly by their tax contribution, and indirectly, because their (perceived) compliance underpins willing participation in other taxpayer segments.

Despite the strength of Australia's corporate tax system and these world-leading levels of tax compliance, our latest perceptions survey shows that only about forty per cent of big businesses are believed to be paying the correct amount of tax. This compares to about ninety per cent of an individual's family and friends.

We know the community's interaction with the tax system is directly impacted by their perception of compliance of the large market: tax compliance by large corporates sends a clear signal to other taxpayer groups that the system is "fair".

Properly communicating tax risk

Excessive focus on technical interpretation risk can easily overshadow the context in which the advice is being provided, how it will be used and viewed. As an adviser, it's important to understand where your firm or your client fits in this whole-of-system perspective.

Are you too focussed on technical interpretation risk?

Traditionally, when judging the riskiness of a piece of advice, the focus has been on whether the advice meets a bar such as "reasonably arguable", sometimes implicitly "non-negligent". This analysis was often through an academic technical lens.

I would posit that this approach is insufficient for several reasons, including:

- it is very hard to self-judge your own ideas ("I consider that I am right: but I will now objectively quantify how likely am I to be wrong"), and so any meta-analysis of advice runs the risk of being too optimistic – this implies you need to leave a "buffer" – maybe a "strong should" is the true "more likely than not"?
- failing to appreciate the context of the advice in the real world of the tax system means that you are not fully judging the risk of your position being disputed

- this type of analysis is very difficult for trickier questions: the position may ultimately not be judged based on today's perspectives, but on the perspectives of five or more years into the future.

In evaluating tax risk it is also worth considering:

- within your firm – whether you have a "house view", or your approach is to allow each partner to hold their own view (and how you, as a firm, can maintain a "no house view" position)
- for yourself – whether your risk appetite is consistent with your or your firm's ethical and/or governance frameworks.

As an aside, I would also caution that if you have come up with a new and clever idea which gives non-policy outcomes, you should be very careful: very few ideas are truly new, and often there will be an old provision, so successful that the behaviour stopped and the provision is "forgotten", that is directly relevant to your idea. There have been many very clever tax advisers, and it would be a rare idea indeed that is completely new.

Do you have different standards for "tax infrastructure" and minor issues?

- In any risk analysis, it is important to judge not just the risk of something going wrong, but the consequence if it goes wrong.
- In my experience, advisers and their clients have not sufficiently distinguished between:
  - tax matters which go to the very heart of their structure
  - matters which potentially have material exposures if they fail (I would refer to these two categories as "tax infrastructure"), and
  - day-to-day matters which might be very interesting, but are not really that important (and failure can be tolerated by the client).

- If an analogy is drawn with your client's physical infrastructure, their desired confidence might be 99 per cent or more: should their tax infrastructure be at "more likely than not" or a "weak should"?

Does your advice reference the likely ATO response or relevant ATO views?

- An adviser's role (looking deeply at an individual case) is often at odds with the role of an ATO officer who is looking at the system in practice and thinking about the 'others'. What will others do? When you have a good idea, be aware it will not be considered by the ATO as a "one-off".

Instead, we will prioritise or triage actions or risks based on:

- potential risk to revenue
- likely proliferation in the market, including the likelihood to flow through to smaller players
- wilful subversion or confrontation of policy intent.

As an administrator we deal with risks through prevention – where possible – through guidance and alerts – and correction through assessments and litigation where necessary.

Particularly in such a concentrated system as Australia's large corporate tax environment, the ATO will be acutely focused on the risk of a "race to the bottom". Where a race to the bottom gets out of control, this is also prone to trigger a legislative response. One way of thinking about this from an adviser's perspective is "what would happen to tax collections if everybody did this?"

Is your advice consistent with your client's stated tax risk appetite or governance framework?

Of course your client's perspective on what 'good advice' looks like should largely be determined by their tax risk appetite or governance framework.

In all too many cases, we see taxpayers with stated conservative risk frameworks enter into aggressive tax structures. We can only assume that insufficient consideration has been given to the risk framework and/or contradictions with the risk framework have not been brought to the board's attention. (As an aside, we also see taxpayers with governance positions which state that they will fully co-operate with the ATO in the provision of information taking aggressive positions around privilege to hold back information – perhaps a flow-on from initially taking a position outside the stated risk framework?)

How have you helped your client understand the Australian environment?

When investing in Australia, many multinationals assume that the tax environment in Australia is broadly equivalent to that in their home country (and vice versa – some advisors assume that other countries are broadly equivalent to Australia).

It is therefore important to advise your client on how the Australian environment differs to ensure that they are making their tax risk appetite decisions on an informed basis. Some key areas to flag might include:

- higher levels of transparency to the public, combined with community attitudes to and awareness of the levels of tax paid by multinationals
- high political interest given the relatively high reliance on corporate tax collections, coupled with a tax base that is highly concentrated across relatively few large corporations – this also leads to rapid action to protect the tax base when threats emerge [refer for example the Multinational Anti Avoidance Law (MAAL), the Diverted Profits Tax (DPT), pragmatic and rapid implementation of other BEPS measures, e.g. hybrids etc.]
- higher levels of transparency to the administrator (ATO), including reporting like the Reportable Tax Position Schedule
- higher levels of coverage of the large market (with full annual review coverage of the top 100, full annual risk model coverage of the top 1,000 and full review coverage on a rolling four-year cycle) means that detection risk is extremely high compared with other countries, and
- (I would like to think) a well-staffed, global best practice ATO Public Groups & International team focused on the important tax issues and with extensive transfer pricing/mis-pricing expertise.

Understanding the stated and actual tax risk profile of a client

The ATO is focusing on whole-of-taxpayer profiling and risk assessment. This helps us understand the taxpayer's business model and any tax planning motivation and opportunities they may have. This profile and the risks involved tell us what we need to do to gain confidence each taxpayer is paying the right amount of tax.

As an adviser, if you also look at your client's tax structure and performance holistically, rather than individual transactions or issues in isolation, you will be in a better position to understand the tax risk profile of your advice and anticipate the ATO's likely reaction from the outset.

This is particularly important for transfer (mis) pricing matters. We often see a price set based on an optimistic application of one methodology. To truly judge the risk of a transfer pricing position, it is important to triangulate a range of methodologies, as well as to understand the big picture of where channel profit is being landed around the world (especially untaxed profits). In my recent opening address to the Taxation Institute of Australia I set out some of our concerns in relation to **transfer mis-pricing** in more detail.

Do you understand your client's tax profile relating to the Australian channel?

Understanding the effective tax borne (ETB) of the Australian channel is critical to the ATO understanding the tax risk profile. The ATO developed the ETB to address public commentary by large corporates who were asserting that they had an effective tax rate of about 30 per cent in Australia, when we knew that this figure didn't represent the amount of Australian corporate tax paid on their economic activities. The community can't be expected to understand this level of detail and their confusion led to distrust about the amount of tax large corporates were paying.

The methodology identifies an economic group's worldwide profit from Australian-linked business activities and the Australian and offshore tax paid on that profit. As an adviser, ETB is another tool which will provide you with an early insight into how your client may be profiled and risk assessed by the ATO, in an effort to establish justified trust. As above, it is also a useful sense check on any transfer prices and whether they are giving plausible, common sense outcomes. Further, it may flush out any upstream hybridity or non-taxation relevant to the anti-hybrid rules or the MAAL or DPT.

We are currently expanding our methodology to develop a GST equivalent and looking to bring within it both the Top 100 and Top 1,000 programs.

We are seeking to use an effective tax borne methodology for GST to address the following concerns:

- reliance on bottom up systems
- relatively frequent system failure (not technical interpretation failure)
- there is no natural systems check to determine if the results are plausible.

Ultimately, this should ideally be part of the client's governance systems, not an ATO review system.

Delivering advice – dealing with facts and assumptions

Tax matters are questions of fact in the main and the ATO is looking for the substance – we start with the substance and then apply the law to the substance.

We quite openly are particularly interested in purported non-tax commercial purposes, particularly where we perceive it should be fairly obvious to the firm that they are not true purposes.

At what level should facts and assumptions be tested?

Historically, the approach has been to take the facts and assumptions as given – why would anyone seek advice on incorrect facts and assumptions? In fact, through a negligence-avoidance lens, this is almost a benefit – there can be no negligence action in relation to advice on a transaction which did not occur.

However, I would suggest that this approach is short-sighted and can give rise to significant exposures for an adviser or firm. I will touch on this more in the next section which poses the question "Do you know how your advice will be used?"

In particular, there are severe risks with "push" transactions, i.e. transactions effectively initiated by the adviser. This is exacerbated by "push" facts, i.e. facts suggested by the adviser, especially if the fact "pushed" is a non-tax commercial purpose.

It's what I have described as the ethical "lobster pot" for advice – an adviser proposes a "tax beneficial" transaction and suggests non-tax commercial purposes that could operate as a "defence" to Part IVA, only for the client to request advice based on one or some of those purposes. The final advice, based on the assumed purpose, would

absolutely get top marks in a take home exam on Part IVA. But what if the purpose is not truly held (and you have suspicions of this)?

Going back to your own risk appetite, you might want to consider whether the bar for accepting “facts” and assumptions is set at a “plausibility” level, or whether you have a higher standard for contentious or critical assumptions. Should you require vouching by the client at senior levels?

Do you know how your advice will be used?

A non-negligence or reasonably arguable position approach to technical interpretation risk will not address misuse of advice, whether it be within your firm, internally by your client or externally to the tax authority.

Think about what happens if the facts or assumptions:

- are known to be incorrect by the taxpayer (or at least some people within the taxpayer) at the time the advice is prepared
- they are presented to the ATO as true in the course of an audit or review, and
- at the time of giving the advice, these facts were implausible on their face or implausible given specific knowledge of your firm.

Imagine then that the ATO finds evidence which proves that the facts were never believed to be true, and even worse were suggested to the taxpayer by the adviser. And to make it even worse, imagine that some of the correspondence was kept back from the ATO by the taxpayer on the basis of an insupportable privilege or accountants’ concession claim (which your firm is unlikely to have had a say in because the taxpayer has brought in different lawyers to conduct the matter). And just to add to things, when a transaction your firm was instrumental in bringing to existence has gone wrong, how do you think your (perhaps former) client is going to allocate blame and/or seek recourse?

This leads to the proposition that you should aim to be confident that your advice is not just technically correct based on the facts and assumptions provided to you, but that those facts and assumptions have gone through an appropriate testing and “ownership” by senior levels of the client, particularly in the case of “tax infrastructure”.

Dealing with the ATO in an audit context

If ‘tax matters are generally questions of fact’, audits are primarily trying to establish the facts.

Do you know what is expected at audit?

Understanding your firm’s and your client’s past relationship with the ATO ahead of an audit can be useful in advance. Make sure you understand the entire relationship – including across taxes as we start to look at taxpayers, your clients, from a more holistic perspective.

Requests for Information (RFI) are a key tool for the ATO in an audit context and they will be used by our auditors to access information they think they need to establish the facts. Formal notices are generally used as an escalation point, either due to frustrations with responses to an RFI, due to previous problems with information provision, or where the transaction is considered to have a “red flag”.

If a notice or RFI is unclear or difficult to meet within the timeframe, talk about it early in the process to:

- understand the scope of the request
- properly test privilege claims and avoid blanket claims
- consider staged delivery of materials if privilege consideration is time consuming
- understand that drip-feeding or limping in, or conversely flooding teams with irrelevant information, will only delay the process and exacerbate tensions.

It’s a reality of the relationship between the ATO and advisers that issues will arise from time to time, and when they do it’s important to know how to raise them.

As a general rule of thumb, you will get further if you escalate issues early but also within the chain of command. For example, don’t go to the Commissioner, Second Commissioner or Deputy Commissioner if you haven’t spoken to the team leader or Assistant Commissioner first, and so on. In fact, escalating an issue prematurely out of the normal chain of command may inhibit future involvement by those officers due to the risk of perceived improper intervention or conflict. Also, escalate to deal with the blockage as you see it, not to ‘forum shop’ for a complete rehearing of the matter. That said, I emphasise don’t be afraid to escalate; we want cases to be raised when they are heading off track.

Also, remember ATO auditors are auditors. Arguing that an auditor doesn't need to vouch is like arguing that doctors can dispense prescriptions without seeing the patient.

To establish the facts, auditors need evidence, not summaries. Summaries can be useful as aids, but they are not substitutes. Providing facts and assumptions underpinning advice can also help speed up the process (because it will allow the audit team to focus first on vouching the facts that you and the client thought were "tax relevant").

In our experience audits work best where:

- there is a full and frank discussion of a transaction and its drivers
- the RFI is discussed to hone in on important elements
- evidence (source documents) is provided
- evidence of non-tax commercial purposes (often secondary information) is provided (including access to commercial staff and decision makers)
- "facts and assumptions" underpinning the advice is provided
- "filed tax outcomes" are provided
- there is an expedited discussion of refined risk hypotheses.

And then the process repeats.

For completeness, it is also important to note that statements in the course of an audit are statements to the ATO. They therefore must be true and evidence based, not on some form of "to the best of my current knowledge" or "off the cuff" basis. In practice, we do see advisers getting themselves into trouble by providing incorrect or misleading statements, usually inadvertently.

Remember also that you have a future relationship with the ATO to consider. I have seen advisers spoil their trust relationship with the ATO by presenting facts that are clearly not correct (sometimes under the caveat of "my instructions are that…"). It may be to the benefit of your immediate client, but to the detriment of all your future clients (because the ATO will find it difficult to take your representations at face value again).

As an aside, I would suggest being very careful where you "win" a small piece of a client's work, and are not given visibility of the totality

of their affairs (or at least a broader view of the relevant parts of their affairs). In my experience since joining the ATO, what is no doubt celebrated as the first tangible step in winning the tax work of a lucrative new client, may well actually be the renting of your and/or your firm's good reputation to try to mislead the ATO. This should be a risk you consider, particularly in your private wealth practice.

Demonstrating non-tax commercial purposes

In many cases, this is the critical element in an audit.

As above, these assertions should not be made lightly – representations to the General Anti-Avoidance Rules (GAAR) Panel should be true and evidence based.

I would note a few points that commonly arise in practice:

- assertions that a transaction which is Australian income tax advantaged was actually driven by avoiding other taxes (in Australia or elsewhere) will not be compelling to the ATO (and in many cases may be shared with those other taxation agencies under exchange of information)
- assertions that a transaction was driven by accounting or cash extraction purposes will not be compelling where there is no evidence that the accounting changed in a way that was relevant to the group (an Australian subsidiary having "neat" accounting is rarely that important in reality) or it did not make cash extraction easier (or indeed no cash extraction was ever intended to occur during the life of the transaction)
- this is especially the case where the transaction was sold as a tax advantaged transaction, delivered as a tax advantaged transaction, little work if any was spent by the client on quantifying or proving the non-tax commercial purposes and even worse where those purposes were suggested by the firm
- it is easy to fall into the "Orica fallacy", broadly that there are indirect non-tax commercial benefits from saving tax. Of course there are: nobody saves tax to bury the cash saving in a box and never use it again. In the case of Orica, the argument was that the tax cash saving increased profit, which indirectly increased the share price, and the purpose was to increase the share price. That indirect benefit cannot be a defence to Part IVA.

I note that, as in many spheres of life, a cover-up can have worse consequences than the original action.

Asserting client privilege in response to a notice

The ATO wants all taxpayers to get high quality professional advice, whether from a lawyer or accountant, as this underpins the self-assessment system. Most advisers, whether at accounting or law firms, give high quality advice.

We recognise that legal professional privilege (LPP) is an important protection for taxpayers in seeking independent legal advice. But it is the client's privilege, not the firm's to bestow or require.

On the other hand, we need source information to do our work, including underlying financial information and evidence of commercial purpose – we are not seeking legal opinions.

In short, we want to protect LPP, but also defend the tax system from its abuse.

That said, it has become evident that our understanding of what documents are subject to LPP significantly differs to some taxpayers and their advisers. Having a lawyer sign an engagement letter and/or the final deliverable, or be copied into an email, are not sufficient for clients to be able to claim privilege if the document is not part of the provision of independent legal advice by that lawyer.

We are increasingly seeing blanket claims for privilege – now in about 20 per cent of our audits of large companies – in response to requests for information.

When we challenge these claims, typically the vast bulk of the documents are ultimately produced at or near the courtroom steps. In many cases, most of the documents were clearly never privileged. This only slows down and frustrates audits and creates distrust and relationship breakdown.

In a small minority of cases, we have also seen instances where the documents produced:

- demonstrate false or misleading statements may have been made over the nature of the documents, and/or
- contradict previous evidence provided in the audit.

In practice, we have seen engagements truly under the control and direction of a non-lawyer be “dressed up” as being directed by a lawyer, or potentially embarrassing emails being subsequently copied to a lawyer in a desperate attempt to protect them from production. Unfortunately for those arrangements, reality will emerge – in the hurly-burly of professional life and the pressure of a deal, the carefully constructed artificial arrangements cannot hold and the true nature of the engagement becomes clear.

Have you represented that your advice may be privileged?

If your engagement is truly to provide independent legal or tax advice, then the client will be able to claim privilege over relevant documents.

However, if it is not, then there is significant commercial and legal risk to the firm in suggesting or worse promising that the advice or documents may be privileged.

The implications to your client or your firm of a subsequent privilege claim made by the client over documents which would reveal audit-critical information to the ATO (and the documents are not actually privileged) are worth considering before entering into an arrangement.

Usually a notice to produce documents will go to the taxpayer. The taxpayer may be reticent to provide documents to the ATO, and may be positively inclined to “over-assert” privilege. If then privilege is claimed over documents which could never be privileged, and the ATO ultimately demonstrates that they were not privileged, there is the potential for significant downside for both the taxpayer and the adviser.

For example, the ATO may take the perspective that the documents were deliberately obscured from the ATO to hinder its audit, with adverse implications for the taxpayer. If the firm sold the work on the basis that privilege was available, then at the very least you have a very unhappy client: the ATO may also take the perspective that the firm had a part in obscuring information from the ATO.

In some cases a notice will go directly to the firm. In such cases, if the engagement was not capable of conferring privilege, there is a significant risk of the firm being caught in the middle between a client who wishes the firm to aggressively defend the “privilege” it thought it had paid for and the statutory obligation of a notice (which attaches to a partner of the firm).

We recognise the need to protect the rights of clients to obtain independent legal advice, and at the same time allow the ATO to rely on compliance with information requests. Through the National Tax Liaison Group (NTLG) we are also working with industry bodies such as the Law Council of Australia, lawyers and tax advisers to develop guidance and standard approaches to both protect LPP and to protect from the tax system from its abuse.

Resolving disputes

Negotiated settlements will continue to play a role in the ATO's approach to resolving disputes in the large market.

That said, the ATO can only settle on a principled basis, and will only agree to a settlement after careful consideration of the risk to revenue, precedential value of the dispute, and likelihood of success in litigation.

We will continue to use litigation where we believe a point of law requires clarification or we need to call out unacceptable behaviour. For this reason, settlements are also less attractive to the ATO where we see systemic issues that need to be addressed.

Is your client's aim a settlement or a dispute?

We are being firm with taxpayers looking to settle with us and making it clear we will only do so where we can also lock in future compliance to achieve certainty of appropriate tax outcomes, which is particularly relevant for transfer pricing matters.

Settlements will generally need to not only address the back years, but forward years will need to be in the 'safe zones' set out in our guidance products to secure revenue and create certainty for the future. We have no interest in settling back years only to immediately kick off the next audit.

This ensures all arrangements meet what we have publicly stated as acceptable behaviour, and achieves consistency in our approach between like taxpayers and like issues (consistency being a critical element of tax administration).

There is a legitimate public interest in the quality of ATO settlements, but an interest which we recognise needs to be balanced against taxpayer confidentiality. As an administrator, the ATO needs to be able to assure the Australian community that a fair and reasonable outcome

has been achieved. Settlement decisions can also send a strong signal to the market of our focus on certain types of behaviours.

Particularly where a matter is already in the public domain, we are increasingly requiring taxpayers to include a public disclosure of the broad strokes of a settlement to assist in the community deriving confidence from the settlement (rather than a further detraction from confidence because of a perceived or alleged “sweetheart deal”).

Public disclosure by taxpayers also supports our own assurance and transparency to the community through:

- complementary public statements to provide general contextual information and in exceptional cases confirm a settlement has been reached
- ongoing use of our Independent Assurance of Settlements (IAS) program to review all significant settlements with public groups and multinational taxpayers
- public reporting of the total number and value of settlements and outcomes of the IAS program in our Annual Report.

Of course, access to the independent view of the courts is always available if a mutually acceptable settlement cannot be reached.

Conclusion

Thank you for the opportunity to share some reflections on the tax system and your role and contribution to the system.

The ATO and large market advisers will continue to be held publicly accountable that large market corporates are paying the right amount of tax under the current law.

I hope my reflections today have been useful in helping you gain a better understanding of the ATO’s perspective and might prompt a few reflections of your own:

- thinking about your own ethical model, your firm’s and your clients’
- understanding each other’s roles and motivations
- considering the lens through which you measure and communicate quality and risk

- thinking in advance how your advice may be used (or misused) in the future
- the importance of communicating early and accurately with the ATO.

As large market tax advisers and firms, you play an integral role in Australia's tax and super systems. By being a wise adviser, not simply a clever one, your actions can have a profound beneficial impact, far broader than the large market itself: not only leading to a satisfying and professionally rewarding career, but also to contribute to Australia's success.

1 Field, Heather M., Aggressive Tax Planning & the Ethical Tax Lawyer, 2017: https://repository.uchastings.edu/cgi/viewcontent.cgi?article=2560&context=faculty_scholarship

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