THE TAX INSTITUTE

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Mr Andrew Orme
Deputy Chief Tax Counsel
Public Advice and Guidance – Tax Counsel Network
Australian Taxation Office
GPO Box 9977
MELBOURNE, VIC 3001

By email: andrew.orme@ato.gov.au

Dear Andrew,

ATO Guidance

The Tax Institute has prepared the following submission to the Australian Taxation Office (**ATO**) in relation to ATO guidance. The purpose of this submission is to outline the Institute's concerns in relation to what we perceive to be growing trends in relation to ATO guidance.

Our National Technical Committee members have noticed a decrease in the quality of Explanatory Memoranda (**EMs**) being produced by Treasury. This has caused great concern among The Tax Institute's members, particularly as it seems to have allowed a chasm in interpretive guidance to grow. Members' perception is that the ATO is now moving to fill this chasm. Our specific concerns with EMs are contained in the submission entitled *Treasury – Explanatory Memoranda* dated 14 November 2019 (**Treasury Submission**), a copy of which is attached for your reference. While improving the quality of EMs would address this matter to an extent, regardless there are several other concerns that members have with the guidance being issued by the ATO.

Growing Trends

Our National Technical Committees have noticed what appears to be some concerning trends in relation to ATO guidance. The perceived trends that the Institute is concerned about, and are discussed in detail below, can be grouped as:

- Transparency;
- Foreshadowing positions;
- Decrease in binding guidance;
- Content of guidance; and
- Time taken to complete rulings.

We have discussed these trends below with the purpose of opening a dialogue with the ATO to discuss whether these trends, which appear to be widespread and systemic, are deliberate new directions of the ATO, and, if so, the reasons for such a change of direction.

1. Transparency

The Tax Institute contends that the ATO should be transparent in relation to competing legal interpretations.

The Institute considers that there is a growing trend for the ATO to take a position and provide legal analysis that is consistent with their position without acknowledging or refuting other widely and reasonably held legal positions or interpretations.

The Institute contends that it would be beneficial for the tax system if the ATO was open and acknowledged the existence of competing interpretations of the law which are reasonably held. Further, the ATO should refute or explain why they consider that the competing interpretations are incorrect.

One example where the Institute and other professional bodies specifically requested the ATO to acknowledge and explain why they did not accept a widely held industry view was in relation to the definition of 'central management and control'. During the consultation on *TR 2018/5 Income tax: central management and control test of residency and PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located*, there were differing views between the ATO and stakeholders regarding the decision in the *Bywater*[1] case and whether the case had enough impact to cause the ATO to revise its long-held views in relation to this residency test.

The ATO relied on the *Bywater* case to support revising its views on the central management and control test but did not provide an explanation regarding the change in its long-held view contained in TR 2004/15 *Income tax: residence of companies not incorporated in Australia – carrying on business in Australia and central management and control* (now withdrawn) that was widely accepted by industry.

The professional bodies asked for an explanation as well as examples to support the view the ATO now takes in relation to central management and control. In the absence of a proper explanation and supporting examples, and where the case law clearly doesn't support the ATO's interpretation, there is a lack of transparency as to how the view was arrived at.

Another example of this is the consultation that was conducted in relation to the negative control issue contained in the *Draft Privatisation and Infrastructure Framework: Control under Division 6C* document issued in 2017. The main contention was that the ATO's position that the ability of a shareholder to veto certain decisions gives that shareholder control of the company's business had no support in either the text of the legislation, the purpose for which Division 6C (*Income Tax Assessment Act 1936* (Cth)) was enacted or the cases cited by the ATO. The ATO officers involved in this consultation would not provide stakeholders with an explanation in writing of their view. (Refer to the Institute's submission for further information regarding this issue[2]). A current example of this is in relation to the consultation on draft *GSTD 2018/D1 Goods and Services Tax: determining the creditable purpose of acquisitions in a credit card issuing business,* which is about determining what is a supply in relation to a credit card issuing business. Members considered the analysis regarding basic elements of the issues raised in the consultation to be scant, with minimal case law support provided for positions taken. The case law support that was provided relied on minor statements in cases rather than the ratio.

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[1] *Bywater Investments Ltd v Commissioner of Taxation and Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

[2] https://www.taxinstitute.com.au/tisubmission/draft-privatisation-and-infrastructure-framework-control-under-division-6c

For example, the Commissioner relies upon commentary in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122 (Amex) to essentially conclude that the provision of a credit card facility encompasses a bundle of rights supplied to the cardholder on the entry into the credit card contract which includes the cardholder's exercise of those rights (refer to paragraph 7 in GSTD 2018/D1). In fact, the parties to those proceedings agreed to adopt this proposition and there was no dispute between the parties on this point. The Court in Amex did not fully turn their minds to what constitutes the 'relevant thing supplied' to the cardholder and it is therefore open to conclude that Amex is not binding authority for this proposition.

The examples above demonstrate the importance of transparency in ATO views, particularly where the ATO's view represents a change from a past view or differs greatly from the profession's understanding of the case law and legislative guidance on a particular issue.

Different views in private rulings

GSTD 2018/D1 Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business is an example where the ATO view taken in the public guidance contradicts the ATO positions in private rulings that have been given to taxpayers directly affected by the public guidance. In effect, the public guidance overrides long-held positions confirmed by private rulings without an explanation as to why this change has occurred. Such a change in view in the absence of an explanation is confusing to the market place.

In the context of transparency, we also consider that the ATO should not remove private rulings from the online database. If the rulings no longer reflect the ATO's view, it would be useful if an explanation in relation to why the rulings are no longer consistent with the ATO view is provided or noted in the relevant private rulings.

2. Foreshadowing positions

Another trend that the Institute is concerned about is the perceived trend for the ATO to foreshadow their position before they have analysed issues in detail. This is a concerning trend as consultation in relation to legal interpretation should start with an open dialogue of all positions.

It was noted at the 4 April 2019 Consultation Steering Group meeting[3] that the ATO is looking to foreshadow the outcomes of ruling consultations by including an outline of what the ATO thinks the answer will be.

Members of our National Technical Committees have noted examples in the context of rulings and audits where they perceive that the ATO has reached a conclusion at the beginning of the process. There is a perception that the ATO then produces selective legal analysis to match their foreshadowed opinion.

The Institute would like to discuss the processes the ATO has in relation to reaching legal conclusions on interpretative issues. The Institute considers that it is vital for the tax system to have open dialogue about different interpretations of complex legal issues before a conclusion is reached. To foreshadow a conclusion

[3] We note this discussion was not recorded in the Key Messages from that meeting.

prior to performing such analysis (both in the context of rulings and audits) can have a potentially detrimental effect on the tax system.

3. Decrease in binding guidance

The Institute also considers that there has been a trend for the ATO to move away from binding advice. Members have perceived this as a deliberate change in approach to guidance. While we encourage all types of ATO guidance, whether binding or not, to be developed, there needs to be balance. Further, it is our position that non-binding advice is not the place for the ATO to outline their interpretation of legislation. This should be included in binding guidance documents such as Taxation Rulings (**TR**) and Law Companion Rulings (**LCR**). In fact, Institute members consider that an LCR accompanying new legislation should not be needed if EMs were better prepared (see below). A TR covering specific matters paired with a Taxation Determination (**TD**) or two (if required) should be sufficient. In the event the ATO considers that an LCR is required, the LCR should focus on how the ATO intends to administer the new law, not its interpretation.

It also appears that the ATO is producing more Practical Compliance Guidelines (**PCG**) than rulings and putting more effort into producing PCGs than binding rulings. Consequently, there seems to be a growing trend in the ATO using PCGs as an interpretive product rather than rulings. This is concerning if the ATO is then applying the PCGs as if they are a binding legal interpretation of the law.

We also note the increasing reliance on guidance material on the ATO website and 'Let's Talk' web page.

Our National Technical Committees have noted examples of the above including:

a) transfer pricing: *TD 2019/10 Income tax: can the debt and equity rules in Division 974 of the Income Tax Assessment Act 1997 limit the operation of the transfer pricing rules in Subdivision 815-B of the Income Tax Assessment Act 1997* – this is an example where members considered the ATO preferred to put out a PCG in relation to the application of the transfer pricing rules to inbound and outbound interest-free loans rather than support its view in a binding product. The request for binding guidance with respect to the application of the transfer pricing rules in Subdivision 815-B to inbound and outbound interest-free loans was originally raised in the Division 815 Technical Working Group. The minutes of the meeting held on 26 July 2016 record that the ATO had approved the listing of this issue on the ATO Rulings Program as a Tax Determination. The minutes of the same meeting also record that the ATO had listed the interaction between Division 974 and Subdivision 815-B as a separate Tax Determination on the ATO's Rulings Program. Subsequently the ATO decided, without external consultation, to combine both interpretative issues into a single Tax Determination and to issue guidance relating to how the transfer pricing rules apply in relation to inbound and outbound interest-free loans in the form of a PCG (see [3901] on ATO's Advice and Guidance).

b) *PCG 2019/D3 ATO Compliance Approach to the Arm's Length Debt Test* - unlike other PCGs which state that they outline the ATO's compliance approach[4], the first sentence of paragraph 1 of PCG 2019/D3 states that it 'provides guidance to entities in applying the arm's length debt test in Division 820 of the Income Tax Assessment Act 1997'. This statement is borne out when the PCG is examined in more detail as the discussion under the heading '*Applying the arm's length debt test*' covers in excess of 130 paragraphs (paragraphs 44 to 175) and relates to guidance with respect to application of the arm's length debt test and not to the ATO's compliance approach (which is discussed in

[4] See for example, paragraph 1 of PCG 2017/1, Paragraph 1 of PCG 2017/4, Paragraph 1 of PCG 2019/1.

paragraphs 11 to 43). Further, the discussion in PCG 2019/D3 needs to be considered in light of *TR 2019/D2 Income tax: thin capitalisation – the arm's length debt test* where the interpretative guidance relating to the factual assumptions (paragraphs 18-21) and relevant factors (paragraphs 22-23) covers 6 paragraphs and largely simply restates the legislation without providing any useful guidance.

c) Guidance relating to the Mutual Agreement Procedure (MAP) - the ATO withdrew *TR 2000/16 Income tax: international transfer pricing – transfer pricing and profit reallocation adjustments, relief from double taxation and the Mutual Agreement Procedure* on 21 November 2018 and replaced it with updated guidance on the principles and procedures relating to MAP on the ATO website. While a MAP request, in a number of respects, involves the application of processes – which do not lend themselves to being set out in guidance material – there are nevertheless a number of matters of an interpretative nature that were addressed in TR 2000/16 where it remains appropriate for the ATO to provide relevant guidance in the form of a ruling rather than on its website. As an aside, the Institute notes that there was no public consultation with respect to the proposed withdrawal of TR 2000/16 or in relation to the ATO website guidance that replaced it. If such consultation had occurred, matters being raised now may have been able to be addressed.

Particular comments in relation to PCGs

We refer to Practical Compliance Guideline PCG 2016/1 Practical Compliance Guidelines: purpose, nature and role in ATO's public advice and guidance which provides at paragraph 13:

> *13. Although practice statements are published in the interests of open administration,* ***their intended audience is ATO staff and they have a main purpose of providing instructions to staff on the manner of performing law administration duties****. Going forward, practice statements will align more closely with their main purpose and* ***practical compliance guidelines will be the appropriate communication product providing broad law administration guidance to taxpayers****.* [Emphasis added]

We also note paragraph 23 which states:

> *23. Practical compliance guidelines, on the other hand,* ***are not prepared for the primary purpose of expressing a view on the way a tax law provision applies.*** *They represent guidance material on how the ATO will allocate its compliance resources according to assessments of risk, and may outline administrative approaches that mitigate practical difficulties relating to the operation of tax laws. Accordingly, practical compliance guidelines will generally not be public rulings.* [Emphasis added]

Members have observed a number of particular matters in relation to PCGs. In our members' view, a PCG should clearly set out how the ATO will allocate its compliance resources when administering a particular piece of legislation in line with their intended purpose set out above. However, members have noted increasing use of PCGs for other purposes, such as taking positions on the law in the PCG which are not being supported and using a PCG as if it were equivalent to a Legislative Instrument.

Members also note their experience with ATO Tax Counsel Network staff and Audit teams refusing to move outside the 'green zones' provided in the PCGs, particularly during transfer pricing disputes. Rather than relying on a PCG as a 'risk assessment tool', members' experience is that PCG's are often being used by Audit teams as though they represent an interpretation of the law. An example of this is how both *PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution* and *PCG 2019/1 Transfer Pricing issues related to inbound*

distribution arrangements are being applied in practice. Members' experience is that the methodology and 'green zone' outcomes in each of these PCGs is being used as de facto interpretative guidance for the transfer pricing rules in SubDiv 815-B in audit cases or is being used by ATO officers to provide the underlying basis for any settlement. This is clearly not the purpose of a PCG.

The statements in paragraph 8 of PCG 2017/1 and paragraph 29 of PCG 2019/1 provide that the transfer pricing methodology used in the PCGs is for risk assessment purposes only. Where a matter has been escalated to an audit, Audit teams should be testing transfer pricing outcomes of distributor arrangements consistent with paragraph 8 of PCG 2017/1 and paragraph 5 of PCG 2019/1. As such, Audit teams do still need to follow due process and undertake appropriate transfer pricing analyses taking into account the particular facts and circumstances of each case when assessing the outcomes of a particular transfer pricing arrangement.

Further, a number of members have had ATO officers indicate to them that a PCG will be used to determine if a settlement is appropriate or not and will apply the PCG to determine the 'reasonableness' of the settlement. In this regard, a risk tool has now morphed into a quasi-Legislative Instrument and the arbiter of the appropriateness / reasonableness of settlement outcomes. Members believe this is not appropriate as risk tools are rarely designed to reflect accurately the relevant law and are thus inappropriate for use by ATO officers in making attempts to apply the law to the facts and circumstances of taxpayers.

Other uses of non-binding guidance

The Institute is concerned that the use of ATO non-binding guidance and correspondence to nudge taxpayers in certain ways without giving precise guidance on how the law will be administered will be interpreted as blurring the line between regulatory and prudential guidance. Such non-binding guidance in the form of bulletins and letters to nudge taxpayers have been issued without consultation which has caused uncertainty for taxpayers.

The Institute has prepared submissions on this issue in relation to SMSFRB 2019/D1 (confidential submission to the ATO dated 18 September 2019) and the ATO's recent letter to SMSF trustees on meeting diversification requirements (confidential submission to the ATO dated 17 October 2019) and the ATO's recent crypto currency warnings.

4. Content of guidance

Nature of analysis

The Institute also considers that there is a growing trend for ATO guidance to include analysis that should actually be included in the relevant EM. That is, the content of guidance issued by the ATO appears to be expanding to include outlining the ATO's interpretation of the policy intent of the legislation where this has not been adequately set out in the EM.

Separately, we have raised this concern with Treasury in the Treasury Submission. This is problematic from both an interpretation and evidentiary viewpoint. (Please refer to the letter to Treasury for further explanation.)

ATO interpretive guidance, such as an LCR or public ruling, is important and the Institute welcomes and encourages the ATO to continue to issue such guidance. However, it should not replace or reduce the guidance that should correctly be included in EMs.

Consistency of view

Members have also noted examples of where the content of the guidance can be construed in different ways giving rise to inconsistent views from the ATO. One example highlighted by members is paragraph 15 of *LCG 2017/3 Superannuation reform: Superannuation death benefits and the transfer balance cap* regarding binding death benefit nominations (**BDBN**).

For ease of reference, we have extracted the relevant paragraph:

> 15. A binding death benefit nomination, by itself, does not make a superannuation income stream reversionary. If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this. The binding death benefit nomination may have the effect of directing the superannuation provider as to whom the death benefit is to be paid and the form, but it cannot turn a non-reversionary superannuation income stream into a reversionary superannuation income stream.

Broadly, the competing views are:

- A BDBN cannot make a pension reversionary. This view is reflected throughout paragraph 15, especially the last clause of the last sentence;
- A BDBN can make a pension reversionary. This view gains support from the words 'by itself,' in the first sentence and 'If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this' in the second sentence (eg, the governing rules or the agreement/standards may expressly provide for a BDBN to so provide reversion).

The ATO holds one view publicly on how the paragraph can be construed. However, members note they have been advised on a confidential basis of the other view and have relied on it. A consistent view in all circumstances should be put forward by the ATO.

A more recent example can be found in the ATO's website guidance entitled *Death benefit income streams – meeting minimum pension payment requirements* last modified 24 July 2019. This article was "updated to clarify that this is in relation to reversionary pensions only". However, the first iteration was not only confusing, it was in conflict with TR 2013/5 paragraph 129.

The Guidance included a context statement - *A number of questions have recently been raised by the SMSF sector around the interaction between compulsory cashing requirements following a member's death and the requirement to pay a minimum pension amount each year*. It would seem as though a more fulsome answer should have been provided however, the first iteration did not include the Commissioner's opinion as set out in a Public Ruling.

The Guidance was updated within a short period of time to ensure that it was clear that it applies only to reversionary pensions however, in the interim, it created uncertainty for the SMSF sector.

Consistency of approach

There is a clear difference between the approach taken in PCG (*PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution*) and the PCG which applies to inbound distributors (*PCG 2019/1 Transfer Pricing issues related to inbound distribution arrangements*).

PCG 2017/1 looks at certain profit level indicators (**PLI**) when considering the arms' length nature of transfer pricing arrangements and prescribes use of cost-based transfer pricing methods (refer for example paragraphs 139 and following). Paragraph 34 of PCG 2019/1 states that the ATO analyses the profit outcomes of inbound distribution arrangements using Earnings Before Interest and Tax (**EBIT**) relative to sales (ie an EBIT margin approach).

Stakeholders anticipated these PCGs would have a similar approach. It is understood that risk tools do not reflect the actual application of the transfer pricing rules, but (for the reasons noted in 3 above) inconsistency between these PCGs can lead to inconsistent treatment of taxpayers.

Change of view – retrospectivity

Where the ATO issues guidance which changes a long-standing view that it has held and is one which the profession has long accepted, such a change should not apply retrospectively. Members have noticed a trend towards the ATO changing long-held views contained in non-binding guidance which impacts on clients, for example the website guidance in relation to General Purpose Financial Statements which applies to significant global entities that have an Australian presence[5].

Another example is *Draft Taxation Determination TD 2019/D1 Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997?* regarding demergers. With this particular example, consideration needs to be given to whether boilerplate language, such as that included in paragraph 41 regarding the Date of Effect of the Taxation Determination, is appropriate for inclusion in all draft guidance. Inclusion of this language alone suggests retrospectivity[6]. In our view, guidance should apply prospectively from the date the guidance is finalised.

5. Time taken to complete rulings

Some members of our National Technical Committees have also expressed concerns in relation to the time it takes for the ATO to issue a public ruling. Members note it is often a lengthy process between the time a draft ruling is issued and the ruling is finalised. The delays between issuing in draft and finalisation of the ruling create uncertainty for taxpayers, particularly if the ATO's view changes between the draft and finalised ruling.

Members note as an example *TR 2004/D25 Income Tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997* regarding 'absolute entitlement' which has remained outstanding for 15 years. Delays

[5] https://www.ato.gov.au/Business/Public-business-and-international/General-purpose-financial-statements/Guidance-on-the-provision-of-general-purpose-financial-statements/

[6] For further information in relation to this draft Taxation Determination, please refer to the joint submission from The Tax Institute and Law Council of Australia (https://www.taxinstitute.com.au/tisubmission/draft-taxation-determination-td-2019/d1-joint-submission)

in the finalisation of a ruling need to be explained to stakeholders. Stakeholders are always more than happy to provide their technical expertise to assist the ATO in arriving at views.

Members have also raised *Taxation Ruling TR 2017/D6 Income tax and fringe benefits tax: when are deductions allowed for employees' travel expenses?* and the revisions to *Taxation Ruling TR 96/26 Fringe Benefits Tax: car parking fringe benefits*. Concern has been expressed in relation to the length of time it is taking to provide these interpretive materials. We have recently received an update from the ATO regarding the progress of these two rulings where the ATO acknowledged the delays with both these rulings (the ATO has since determined that it would be better to issue the content in TR 2017/D6 in three separate pieces of guidance and the update to TR 96/26 is ready for consultation)

While these materials remain under development, uncertainty remains for taxpayers and their advisers.

These are important issues causing considerable concern to a wide spectrum of our members. We look forward to discussing these issues with you. Please contact Tax Counsel, Stephanie Caredes on 02 8223 0059 or Tax Counsel Angie Ananda, on 02 8223 0050 to arrange a suitable time.

Yours faithfully,

Tim Neilson
President