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Mr Paul McCullough
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Dear Mr McCullough

Commonwealth and Taxation Ombudsman's Comments on the Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 and Explanatory Material

I provide the following comments about the proposed 'safe harbour' provisions detailed in the exposure draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 and Explanatory Material.

The Commonwealth and Taxation Ombudsman has a role in dealing with complaints about the Australian Taxation Office. We have previously expressed support for the introduction of safe harbour provisions as important an feature of the new tax agent regulatory regime. Our submission to the Senate inquiry into the Tax Agent Services Bill 2008 supported the regulatory regime and noted that safe harbour provisions *'should provide greater certainty and protection for taxpayers who take reasonable care in the handling of their tax affairs, ensuring that they will not be subject to penalties as a result of the actions of tax professionals.'*

While the concept of providing relief to some taxpayers from administrative penalties resulting from the actions of their tax professionals is a welcome one, we consider that there are some issues with the proposed provisions that merit further consideration.

1. Penalty standard

The proposed provisions create a distinction between the application of penalty provisions to taxpayers based on whether or not they have engaged a tax professional. Where a failure to take reasonable care in preparing or lodging a tax statement causes a shortfall, a taxpayer who has engaged a tax professional may be entitled to relief from the shortfall penalty while a taxpayer who manages their own tax affairs would not be.

The link in the application of fault standards to the provision for relief from late lodgement penalties appears problematic. Section 286-990 of the *Taxation Administration Act 1953* does not impose penalties for failing to lodge documents on time based on the state of mind

of the taxpayer or their agent. Rather, late lodgement penalties are based on the number of days lateness that can be multiplied based on the amount of withheld tax, assessable income or GST turnover. The safe harbour provisions for late lodgement are based on the levels of fault standards applicable under the shortfall penalty regime even though the penalty itself is not based on this.

This is not to say that relief should not be provided for late lodgement penalties but the proposed approach is likely to generate interpretive problems and potentially unfair outcomes. The following examples in the Explanatory Material (EM) indicate the difficulty in applying the proposed distinction between failure to take reasonable care and recklessness as it would apply to late lodgement.

Example 2.3 discusses a hypothetical situation where 'through an oversight in [the agent's] office, the return is lodged late.' Because this is an administrative oversight, the taxpayer is not liable to pay the penalty. In contrast, Example 2.7 shows a taxpayer not being relieved of the late lodgement penalty because her BAS agent does not post the prepared return to her until after the due date because 'knowingly accepting too many clients and taking on an unmanageable workload, or adopting poor practice management practices does not constitute failure to take reasonable care by the agent.'

2. Lack of relief for most seriously disadvantaged taxpayers

The proposed safe harbour provisions will not provide relief for taxpayers whose have a penalty imposed on them as a result of their agents' failings, even where there is no suggestion that a taxpayer was at fault themselves. It is appropriate that a taxpayer should be relieved from a penalty that result from his/her agent's carelessness. However, where a taxpayer was themselves mislead or defrauded by their agent it is not clear why they should be denied relief from resulting penalties. This is particularly so in light of civil penalties in the new tax agent services regime that allow for imposition of penalties on agents who intentionally or recklessly make false, incorrect or misleading statements.

Improvements to the oversight of tax agent services should enhance the regulation of tax agents and include scope for sanctions for breaches of the Code of Professional Conduct. However, they do not provide a mechanism for taxpayers who are exposed to penalties as a result of their agent's recklessness or fraud to recover any penalties that the taxpayer incurs as a result. The only avenue available to taxpayers to seek to recover penalties imposed as a result of their agent's actions is through civil action, an option that might only exist in theory as it would often require resources in excess of the loss concerned.

3. Problems with evidentiary obligation

A taxpayer seeking relief under the proposed provisions would be required to satisfy an evidentiary burden that they would be ill-equipped to meet. A taxpayer can reasonably be expected to be made to account for their own actions and state of mind. However, establishing what their tax agent intended or what awareness their agent had about the operation of particular aspects of taxation law would require access to records and information generally outside of an individual taxpayer's access or control. The attitude of a tax agent might relate to the systemic practices of the tax agent's business or broader dealings that an individual client could not be expected to know or access documents about.

The examples in the EM also demonstrate the possibility for a taxpayer to be denied relief from penalties caused by actions of their tax agent that the taxpayer could not be expected to know of or anticipate. Example 2.7 discussed above where a taxpayer is denied relief from a late lodgement penalty because her agent failed to manage its workload appropriately

suggests a taxpayer could be expected to know how many clients a business has over time, what its staff capacity and productivity is, and whether there are any anticipated interruptions to workflow such as moving offices. Such an expectation goes beyond the information ordinarily available to taxpayers and is neither fair nor reasonable.

4. Relief not clearly linked to taxpayer culpability

The EM describes the rationale for the exemptions proposed on the basis that

'With the introduction of self assessment, the burden of applying the taxation laws to individual circumstances was shifted in some respects from the Commissioner to taxpayers. Whilst it remains appropriate, even in a self assessing environment, for taxpayers to be responsible for deliberate or reckless acts (whether their own or their agent's), this exposure draft recognises that the simple failure to take reasonable care by an agent should not result in a monetary penalty for the taxpayer.'

Taxpayers own culpability would seem to be a relevant criterion on which to base relief from penalties, however this does not fit squarely with the proposed provisions.

The potential for this limited relief to result in an unfair outcome and for dispute about interpretation is highlighted by Example 2.6 from the EM. This illustrates that a taxpayer whose agent was considered to have intentionally not lodged her tax return on time because of a dispute about the fees for preparation of the return would not be able to access the safe harbour provision. If the agent had merely been careless about timely lodgement, then the safe harbour provisions would exempt the taxpayer from penalty. While under the proposal the taxpayer whose agent acted deliberately could apply for remission of the penalty under the Commissioner's general discretion, it is unclear why the taxpayer should have to rely on a discretion that is less transparent and provides less scope for review than a clear statutory provision.

It would therefore seem appropriate for there to be some justification or further explanation for an approach that makes a taxpayer responsible for one form of default by their agent, which is outside the taxpayer's knowledge or control, and not for another such default.

Thank you for the opportunity to comment on the exposure draft package. If you have any queries about this response, please contact Diane Merryfull on (02) 6276 0177.

Yours sincerely



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