The ATO - Judge, jury and executioner

A cautionary tale that must be addressed

This article is long and involves a complex area of R&D tax law. But if you can persevere, you will discover that the ATO’s current decision making process for specific R&D Tax Incentive concepts (specifically feedstock) and the resulting degradation in the robustness of Australia’s taxation system is a real and live issue. These concerns appeared to be confirmed during the recent ABC and Fairfax investigation into practices within the ATO which, in my view, only exposed the surface of the problem.

Some relevant background information

The current R&D Tax Incentive program was introduced in 2011 and replaced the former R&D Tax Concession. The publicly stated policy intention of the program is to incentivise companies to conduct R&D activities they would not have otherwise conducted, and to support R&D activities that have some flow on benefits to the wider scientific and business community.

While there are a significant number of differences between the former R&D Tax Concession regime and the current R&D Tax Incentive program, this article will focus on the differences in the application of the feedstock provisions.

The feedstock legislation

Under the former R&D Tax Concession regime, s 73B(1) of the *Income Tax Assessment Act 1936* (Cth) (‘ITAA 1936’) defined feedstock expenditure as:

> In relation to an eligible company, means expenditure incurred by the company in acquiring or producing materials or goods **to be the subject of** processing or transformation by the company in research and development activities, and includes expenditure incurred by the company on any energy input directly into the processing or transformation.

Under the current R&D Tax Incentive regime, s 355-465(1)(a) of the *Income Tax Assessment Act 1997* (Cth) (‘ITAA 1997’) states that a feedstock adjustment to assessable income applies if:

> …it incurs expenditure in one or more income years in acquiring or producing goods, or materials (the feedstock inputs) transformed or processed during R&D activities in producing one or more tangible products (the feedstock outputs).

During the public consultation process for the R&D Tax Incentive legislation, the new feedstock provisions were identified as an area of concern for companies affected. On the face of it, if a good or material is transformed or processed during R&D activities, it has to be included in the feedstock calculation. This would mean that any material or good that was somehow changed, transformed, or involved in a process as part of the R&D activities, would need to be included as feedstock (not just the goods and materials in the end product which the provisions are meant to claw back). This was seen as a significant divergence from the former legislation contained within s 73B(1) of the ITAA 1936, which only required materials or goods **that were the subject of** processing or transformation in R&D activities to be included in the feedstock calculation. If the materials or goods **were not the subject of the processing or transformation** (i.e. were involved in the R&D activities but not the ‘subject’ of the processing or transformation themselves) the expenditure on these materials and goods was not required to be included into the feedstock calculation and could be claimed (to the extent the activities and expenditure was eligible) as ‘other R&D expenditure’.
Clarification as to the operation of the new feedstock provisions

In response to concerns raised during the consultation process as to the potential impact of the changes between the old and new feedstock provisions, commentary was included within the Explanatory Memorandum to the Tax Laws Amendment (Research & Development) Bill 2010[2], which stated at section 1.30:

*The new R&D Tax Incentive also retains a feedstock rule consistent with the existing R&D Tax Concession. However, under the bill, the feedstock adjustment takes the form of an increase in assessable income, rather than a reduced deduction (or offset).*

With this clarification, the application of the new feedstock provisions appeared straightforward because, despite the changes in the wording of the new legislation, it appeared the intent of the Federal Government, the legislators and the ATO was that the new feedstock provisions should be interpreted in a manner consistent with the former feedstock provisions, in that only the expenditure associated with materials or goods that are the subject of processing or transformation in R&D activities needed to be brought into account when applying the feedstock provisions.

The first about face – Taxation Ruling TR2013/3

In August 2012, the ATO released a draft Taxation Ruling TR 2012/D6 Income Tax: Research and development tax offsets – feedstock adjustment. In this draft taxation ruling, the ATO considered certain aspects of the new feedstock adjustment within subdiv 355-H of the *ITAA 1997*. To say the draft ruling was a significant divergence from the position outlined within the Explanatory Memorandum (i.e. the new feedstock rules should be interpreted consistent with the old feedstock rules) is an understatement. The extent of the divergence from guidance material within the Explanatory Memorandum was highlighted in para 18 of the draft ruling, which stated:

*Other amounts incurred to bring a feedstock input to a state where it can begin to be transformed or processed, such as insurance for it while in transit and administrative costs associated with transporting and inspecting it, are also within the first condition. This applies whether or not the expenditure is incurred merely in acquiring the feedstock inputs or is incurred as part of the process of producing them.*

In short, TR 2012/D6 took the position whereby, unlike the former feedstock provision that only required materials or goods that were the subject of processing or transformation in R&D activities to be included in the feedstock calculation, all expenditure on materials or goods involved in processing or transformation in R&D activities had to be included in the feedstock input calculation. The extent of the ‘about face’ by the ATO was further highlighted in the ATO’s responses to the comments and questions raised in response to the Draft Ruling, which were collated and presented in TR 2013/3EC. In TR 2013/3EC, which is the *Compendium of Comments* related to draft ruling TR 2012/D6, a number of specific questions were put to the ATO, the purpose of which was to understand the impact or reasoning behind the ATO’s position on feedstock, as outlined in TR 2012/D6. The following questions and the ATO’s responses provide significant insight into the ATO’s position in drafting TR 2013/D6, and represent how complete the ‘about face’ was from the previously understood position on feedstock.

These questions included:
These two questions, and the responses provided by the ATO are in sharp contrast to all previous guidance provided throughout the R&D Tax Incentive consultation process, and the guidance detailed in the Explanatory Memorandum accompanying the introduction of the legislation. Yet, despite the widespread condemnation of the concepts incorporated into TR 2013/D6, the draft ruling was formalised as Taxation Ruling TR 2013/3 with only minor changes.
The impact of the GHP case

Following the finalisation and release of TR 2013/03, uncertainty regarding the application of the feedstock provisions under the new R&D Tax Incentive program prevailed. The decision in GHP 104 160 689 Pty Ltd v Commissioner of Taxation [2014] AATA 515 (the GHP case) was the first AAT decision to directly address this issue. This case considered whether certain expenditure was ‘feedstock expenditure’ under the former R&D Tax Concession regime. While the Tribunal was asked to consider a number of issues, one particular issue related to the treatment of a range of items (such as mill liners, grinding media, oxygen, chemical consumables) with the Commissioner contending such items related to feedstock expenditure for the purposes of s 73B(1) of the ITAA 1936.

In deciding against the Commissioner, the Tribunal considered that things acquired to be the subject of an activity or process could not share a common identity with those acquired to subject them to that activity. For example, as the grinding media was acquired to subject the copper to a process or activity, the costs associated with acquiring the grinding media did not form part of the applicant’s feedstock expenditure.

The Tribunal concluded that the ATO was forcing an erroneously broad interpretation of the application of the feedstock provisions onto companies, far outside what the wording of the legislation allowed.

GHP Decision Impact Statement

As this case related to claims made under the R&D Tax Concession regime, rather than current R&D legislation, it was not particularly useful in influencing current R&D tax claims. That is, until the release of the ATO’s Decision Impact Statement on the case. In its Decision Impact Statement on this case, the ATO acknowledged that the case related to the former s 73B(1) of the ITAA 1936, but stated that:

the ATO also considered that the Tribunal’s decision is of assistance in interpreting the feedstock adjustment provisions in section 355-465 of the Income Tax Assessment Act 1997. The ATO will take the Tribunal’s reasoning into account in applying those provisions to analogous cases.

In additional to the Decision Impact Statement, the ATO also amended the Taxation Ruling TR 2013/3 noting:

the revision (to TR 2013/3) has clarified the distinction between expenditure on materials or goods to be the subject of processing or transformation and expenditure on actions or processes which thereby subject those material or goods to processing or transformation

Taxation Rulings are binding on the Commissioner and a review of the amendments to TR 2013/3A1 identified a significant change in the ATO’s previous interpretation of s 355-465 of the ITAA 1997 (as previously outlined in TR2013/3) such that it achieved a second ‘about face’ in how certain goods or materials are classified when it comes to calculating the feedstock amounts. This ‘about face’ was achieved by omitting para 8 from the original ruling, and replacing it with the following paragraph:

There is a distinction between goods or materials that are the subject of transformation or processing during R&D activities and those that subject those goods or materials to transformation or processing; see further paragraph 18 of this Ruling.

The ATO further stated that the feedstock provisions should not apply to:

…goods and materials which are merely acquired or created to subject other goods and materials to transformation or processing during R&D activities. Such items represent a cost to the process of transforming or processing other goods or materials, rather than something to be transformed or processed in their own right.
The amendments to TR2013/3, which are binding on the Commissioner, confirm that the feedstock provisions in the current R&D Tax Incentive legislation should be applied to the cost of goods or materials that are the subject of processing and transformation in R&D activities, and not those goods and materials which are merely acquired to subject other goods and materials to processing or transformation in R&D activities.

Summary of the ATO’s position until 2017

The above provides an understanding of the uncertainty taxpayers and their advisors have had to deal with in interpreting s 355-465 of the ITAA 1997. In summary, there has been not one, but two complete ‘about faces’ on how materials such as consumables should be treated under the current feedstock provisions. However, with the release of the addendum to TR 2013/3 (which brings the ATO’s interpretation into line with comments made in the Explanatory Memorandum) one could be forgiven for thinking that the ATO’s position was finally settled, but alas, that is not the case!

The ATO’s most recent ‘about face’

Based on the ATO’s demonstrated incongruency with respect to the application of the feedstock provisions, one risk adverse company concluded that it would seek a Private Binding Ruling on the matter. Private Binding Rulings enable a taxpayer to seek an answer to a question regarding their situation, which is binding on the Commissioner. The client wanted certainty as to the treatment of some of their expenditure before lodging their R&D claim as part of their income tax return. Private Binding Rulings are a way in which taxpayers can clarify the treatment of expenditure before lodging their Income Tax Returns, and thereby eliminate the risk of having to repay amounts overclaimed should they be audited.

In the request for a Private Binding Ruling, the facts were outlined and the ATO was requested to make a decision as to the following:

Whether the cost of feed to an animal during experimentation which qualifies as research and development under the Income Tax Assessment Act 1997 is feedstock expenditure for the purposes of subsection 355-465(1)?

The response to the question (which was issued by the ATO in early 2017) was ‘No’, which was consistent with the treatment of such costs under the amended TR 2013/3, and the ATO’s Decision Impact Statement on the GHP case. The result of the ATO’s response is that feed is not classified as ‘R&D expenditure - Feedstock’. It needs to be classified as ‘R&D expenditure - Other’.

A Private Binding Ruling only binds the Commissioner to the applicant named in it. However, in this case, the Private Binding Ruling mirrors the ATO’s position in the amended TR 2013/3 and the Decision Impact Statement on the GHP case, and therefore could reasonably be expected to provide a high degree of certainty in treating the same costs the same way for a taxpayer in identical circumstances. With the confidence of the Private Binding Ruling, the amended Taxation Ruling, and a Decision Impact Statement, which all indicated the same, consistent interpretation, when other companies sought confirmation as to the correct treatment of the same expenditure categorisation, we relayed the ATO’s advice that feed fed to animals during R&D activities was not feedstock expenditure and, as such, should be categorised as ‘R&D Expenditure – Other’ (given these clients exhibited the exact same fact pattern as that outlined in the successful Private Binding Ruling).

Incredulously, less than half a year after the issuing of the Private Binding Ruling, the ATO perfectly contradicted itself again, as detailed in the following case. The following case demonstrates the ease at which the ATO can diverge from its own guidance material, without any recourse available to the taxpayer. The case also outlines the heavy-handed practices adopted by the ATO in order to achieve their desired outcome and hit their internal KPIs, at the expense of honest Australian taxpayers.
Timeline of facts

This case has been presented in a timeline format, the purpose of which is to outline the speed at which some ATO decisions were made, whilst highlighting how the ATO drew out a case that was reliant on a tax refund, to the point where the client felt (in their words) that the ATO was using ‘financial duress’ to pressure them into withdrawing part of their claim.

› The company is in the aquaculture industry and became aware of a Private Binding Ruling that mirrored their circumstances exactly. Taking into consideration the amendment to TR2013/3 and the Private Binding Ruling, the client lodged their 2017 ITR with certain R&D expenditure (i.e. the costs associated with the purchase of feed pellets) classified as ‘R&D expenditure – other’ (and not as feedstock expenditure). This ITR lodgement was made less than six months after the ATO had publicly stated in a published version of the Private Binding Ruling that feed fed to animals in the course of R&D activities should be classified ‘R&D expenditure – other’ and not classified as ‘feedstock expenditure’.

› Following the lodgement of their 2017 income tax return, the company (rather than the tax agent) was contacted by an auditor from the ATO’s Adelaide office on 4 September 2017. In this phone call, the ATO indicated they were withholding the refund (which related to their R&D claim) pending the provision of additional information to verify the claim. The ATO requested detailed working papers related to ‘all eligible costs except those classified as feedstock’. In their correspondence, the ATO indicated that this request for information was not a formal review. The client then requested that the ATO contact their R&D advisors (who are Registered Tax Agents) with respect to any future correspondence relating to the R&D tax claim.

› All requested information was provided to the ATO on 19 September 2017, along with extensive explanatory material (65 pages of data and explanation).

› 4 hours later, on the same day (19 September 2017) the auditor contacted the client directly (not the tax agent as previously instructed) and requested information related to how a specific non-deductible expense was calculated (unrelated to the R&D claim). The correspondence from the ATO reaffirmed the refund would not be released until all information had been provided. The requested information was provided to the ATO the following day, on 20 September 2017.

› On 26 September 2017, the ATO stated that they still had some concerns but, as the company was not under review, the concerns were being raised to enable them ‘to review their self-assessment’. The ATO auditor indicated he had concerns as to how feed costs had been categorised, which he believed should be classified as feedstock expenditure (without citing TR2013/3, which is binding on the Commissioner). The ATO auditor then suggested the client make a voluntary disclosure to reclassify feed from ‘other R&D expenditure’ to ‘feedstock expenditure’ (which, whilst not impacting the size of their refund, would significantly impact carried forward losses) for the 2017 year and earlier years. The auditor indicated his queries were still ‘informal’ as they had yet to go through a ‘formal’ review process. He indicated that this approach was to ‘minimise the need for the costs associated with an objection and maybe having to go through legal’.

› The response to the ATO’s further queries was provided by the client the following day (27 September 2017), highlighting the existence of a Private Binding Ruling (which mirrored the client’s circumstances exactly), as well as the amended TR 2013/3 and the ATO’s Decision Impact Statement. All other immaterial queries were also addressed. The client’s response also raised concerns regarding the length of time the expected refund was taking the finalise and the fact that the client was looking for a speedy resolution.

› On 28 September 2017, the company contacted the ATO to enquire as to the timeframe for processing. The ATO auditor indicated in the call he was unaware of the existence of the Private Binding Ruling and cautioned the client against relying on it (which the client was aware of). The ATO auditor indicated he would now review if the Private Binding Ruling was relevant and that this ‘could take at least a week.’
On 4 October 2017, the ATO Auditor contacted the company directly and indicated he had sought technical advice regarding the feedstock issue and, as a result, was requesting information related to how expenditure on the cost of feed had been treated from the 2011/12 R&D claim through to the 2015/16 R&D claim inclusive. He again asked the client to consider making a voluntary disclosure and requested they do not refer to a Private Binding Ruling provided to another entity in any response. At this point, it should be noted that feed costs had previously treated as ‘feedstock expenditure’ (per the initial TR2013/3 ruling) up until the 2015 year, but reclassified as ‘other R&D expenditure’ in the 2015 to 2017 R&D claims, following the amendment of TR 2013/3.

On 6 October 2017, the company’s R&D tax advisor contacted the ATO auditor and stated the following:

- re-emphasised the requirement to contact the advisor, not the client directly (per previous correspondence)
- requested a management plan, to stop the adhoc and random nature of the queries
- reiterated that they weren’t relying on a Private Binding Ruling provided to another entity, but were using a number of ATO releases (including the amended TR 2013/3, the Decision Impact Statement on the GHP case and s 355-265 of the ITAA 1997); and
- requested confirmation as to the basis for requesting information regarding past years of income, and how this related to the withholding of a refund for the 2017 year (auditor previously cited s 8AАЗLGA of the Taxation Administration Act 1953 (Cth)).

On 6 October, the ATO auditor provided the R&D tax advisor with an email, referencing the conversation that morning and noting:

- He had decided the cost of feed should be treated as feedstock.
- He required all information regarding how feed was classified from the 2012 – 2016 years.
- The receipt of any R&D tax refund is dependent on the provision of this information.
- He stated that he would not be providing the legislation that provided him the power to undertake a review of R&D expenditure associated with earlier years of income, but rather (in the interests of expediting the process) he would send through the request for additional information and wait until he had confirmation of his “water-tight case”.
- He reaffirmed his demand for amended figures to be provided for all relevant years requested.

What this email effectively said is:
(a) the auditor had already made up his mind that feed should be treated as feedstock expenditure,
(b) the decision had not gone through a process to ensure his decision was ‘water tight’ before arriving at, and issuing, his decision, and
(c) he was not willing to put in writing the basis of his decision and, instead, wanted to request additional information for prior years in anticipation of an amendment by the client.

On 9 October 2017, all requested information was provided to the auditor, which confirmed the years in which the feed had been classified as ‘Other R&D expenditure’ (rather than feedstock) were the 2015, 2016 and 2017 years. This information confirmed the client would have sufficient losses carried forward to process the refund related to the 2017 R&D claim, regardless of how the cost of feed was classified.
The lack of formality, adhoc questions, and lack of transparency in decision making in the ATO Auditor’s email of 6 October, raised alarm bells with the client, their tax advisor and their R&D advisor. Therefore, on 11 October 2017, the auditor was contacted to request the name of his manager. The auditor responded by stating that all ongoing queries related to this issue should only be directed to him and once amendments had been made, the client should go through the ATO’s automated ‘where’s my refund’ process.

On 12 October 2017, the ATO auditor contacted the client by email directly (having attempted to contact them directly via telephone, despite numerous directions to deal directly with the R&D advisor) indicating his recommendations for the review had been approved by his manager, that decision being that the cost of feed stock should be treated as ‘feedstock expenditure’. While the ATO auditor indicated he was happy to discuss the client’s right to object, he knew the financial duress his decision was placing on the client and on the basis of this knowledge, proceeded to present ‘options’ to the client. The ATO auditor noted his decision to treat feed costs as ‘feedstock expenditure’ was not up for discussion, the only input he needed from the client was how to effect the amendment. One option proposed by the auditor would result in an outcome whereby the client could object the decision, but the auditor indicated this option would result in a significant delay in processing the refund. The other option presented by the ATO auditor would deny the client the ability to object immediately to the decision, but would release the refund quickly. The ATO auditor was aware of the ‘stressed’ cash flow position of the company.

At this stage, the ATO auditor had yet to advise the client that they were under a formal review, had refused to provide the name of his manager/anyone within the ATO to confirm that proper procedures/processed had been followed, had not provided any technical details as to the basis of his decision (a decision inconsistent with an ATO Ruling, an AAT case, a Decision Impact Statement, and a Private Binding Ruling for another entity with an *identical* fact pattern). In addition, the ATO auditor had not copied in, or involved, any other ATO officer in any correspondence (verbal or written) with either the client or the R&D advisor. By this stage, the client was under significant financial stress (which the auditor knew, as he referred the client to the financial hardship section of the ATO) and had been waiting for their refund for over 8 weeks, the result of which had a significant adverse impact on their ability to continue their commercial operations (ironically, to feed their fish). Given the financial duress the client was under, the client agreed to the amendment option which would release their refund as soon as possible, but gave up their right to object against the ATO’s decision until they generated assessable income (which could be many years into the future).

As an aside, the client did lodge an objection to the decision with the ATO on 11 December 2017, however as anticipated, the ATO responded by refusing to rule on the objection, on the basis that the company was not in a taxable position.

To date, the ATO auditor is yet to provide any information as to the technical basis of his decision, information that he indicated in writing (on 9 October 2017) that he would provide.

**Update on recent ATO actions**

Given the lack of information provided by the ATO to the client regarding the basis of the ATO’s decision to amend the treatment of certain costs within the client’s 2015 – 2017 R&D claims, on 13 April 2018 the client’s R&D advisor emailed the ATO auditor, requesting provision of the reasons for the amendment.

On 16 April 2018, the ATO auditor indicated he had “completed the pre-issue review as per instructions from the client in October 2017” and indicated he no longer worked in the area that completes pre-issue reviews.

This email presented significant concerns to the client, as it appeared the ATO auditor was asserting the amendments to the 2015 – 2017 R&D claims were made “per instructions from the client in October 2017”, effectively stating the client had made a voluntary amendment, which was not the case.
On 17 April 2018, a further request was made to the ATO auditor, with an email attached noting the ATO officer “will provide a more detailed finalisation email when I have time”. The ATO auditor was further requested to provide this information.

On 17 April 2018, a person who identified themselves as “Director of Risk Management and Strategy – R&D” emailed the R&D advisor, requesting the R&D advisor confirm their authority to act for the client. An email was provided to the ATO from the R&D advisor, attaching an email previously provided to the ATO where the client indicated Glasshouse Advisory were authorised by the client to deal with the ATO on this matter.

On 19 April 2018, the same person who have previously identified themselves as “Director of Risk Management and Strategy – R&D” contacted the R&D advisor. This time, they did not identify themselves as “Director of Risk Management and Strategy – R&D”, only that they worked in “Risk Management and Strategy – R&D”. This person indicated the email provided to the ATO (where the client authorised Glasshouse Advisory to act for them) related to “information supplied in an activity closed as per the client’s instructions in 2017”. The ATO officer then went on to note that as the matter was closed, the client’s previously supplied ‘authority to act’ did not apply.

On 19 April 2018, the client provided the ATO with authority to act for all matters related to the 2015 – 2017 R&D claims.

On 20 April, an email was sent to the ATO, detailing the client’s concerns that the ATO was portraying the amendments to the 2015 – 2017 R&D claims as a ‘voluntary amendment’, made at the client’s instructions. The email noted this assertion was abjectly incorrect, noting the initial ATO auditor’s comments in an email on 12 October 2017, where the ATO auditor:

- Confirms he has finalised his integrity check of the R&D offset of the client’s 2017 income tax return.
- Confirms his recommendations have been approved by this manager.
- Confirms he has decided the cost of feed and feed freight should be treated as feedstock expenditure.
- Confirms the result of his decision is that the client’s taxable income will be increased for the 2015, 2016 and 2017 years.
- Noted that the manner in which the amendment was to be made was outside the scope of his integrity check and he required the client’s decision in writing on these matters (i.e. the client needed to decide whether to make the amendment via a deduction of tax losses carried forward or via the utilisation of tax losses) before he could release the refund.
- Confirms that the client’s decision (re: how to make the amendment) will not indicate agreement with his decision (re: the reclassification of ‘other R&D expenditure’ to ‘feedstock expenditure’).
- Provided a table, confirming the amendments in red are made by the auditor and are not subject to the client’s agreement or approval.

To this date, we await the ATO’s response and provision of the details as to the reasons for amending the client’s R&D claims.

Summary of the ATO’s decision making and approach to client engagement

This case highlights the ATO’s ability to act as ‘judge, jury and executioner’ in its decision making (with no immediate recourse to object). It also highlights the ATO’s strategy to pressure taxpayers into making decisions that are later classified as ‘voluntary disclosures’, using financial duress as a tactic to get taxpayers to agree to decisions that are not in their best interests.
In summary, the issues arising from this case include:

› The ATO auditor made an initial decision against the client, without full knowledge of the ATO’s own internal position on the issue (i.e. the existence of a Private Binding Ruling and the reasons behind the Private Binding Ruling being approved, which were relevant to the client's case).

› The ATO auditor has made a decision which appears to be counter to the ATO’s Ruling that is binding on the Commissioner (TR2013/3) and related guidance, and the ATO Auditor has never provided the basis for his decision.

› The client, its R&D advisor, and its income tax advisor have no knowledge of any other ATO officer being involved in this case, and when the client requested for contact details of another officer, the Auditor declined to provide such information, directing all queries to himself.

› The auditor continued to contact the client directly throughout the review, despite multiple directions by the client to direct all correspondence to their R&D advisor.

› The ATO auditor was aware of the client’s precarious financial position and consequently presented options for the release of the refund in a manner that required the client to give up their rights to later appeal the decision.

› If the client currently has no ability to object against the decision, it runs the risk that the loss of knowledge that comes with an extended timeframe could adversely impact their ability to object against the decision in the future.

› The ATO is claiming the amendment was the result of the taxpayer’s instructions, effectively claiming the amendments were a voluntary disclosure.

This lack of transparency and accountability by the ATO and the tactics used to get the client to acquiesce to an amendment driven by the ATO in order to receive their refund in a timely manner (a position that is counter to that outlined in the ATO’s binding TR2013/3) are the same tactics that were the subject of the recent ABC/Fairfax investigation into the ATO. Given the most recent correspondence with the ATO in this matter, they appear to continue such practices.

Comments on the ATO’s lack of transparency and accountability

Following the recent ABC/Fairfax investigation into the heavy handed audit practices within the ATO (particularly within the ATO’s Adelaide office), the ATO released a statement (on 10 April 2018) stating (amongst other matters) that:

Less than 0.1% of all interactions result in a complaint or an objection

And

There is absolutely no evidence that roughly 5% of cases the Tax Office gets it wrong. In addition, no review, scrutineer or credible source has ever found a pattern of abuse towards small business owners by the ATO

The above statements are obviously a deliberate choice of words. Consequently, the following should be noted:

› The 0.1% quoted by the ATO of interactions resulting in a complaint or objection is not reflective of the extent of the situation, as entities in tax losses are (except is special circumstances) unable to object against an ATO decision.

› The 0.1% quoted by the ATO of interactions resulting in a complaint or objection is not reflective of the extent of the situation, as entities decide not to object for financial or commercial reasons.

› In recent instances, the ATO has made amendments that go against its own binding Taxation Ruling, and their own guidance material, without providing the taxpayer with any reasons for their decision.
In recent amendments, the ATO has noted the taxpayer had no right to object against the decision (which could be a real concern if the ATO are targeting companies in a specific financial position such that the ATO can achieve internal KPIs, but in circumstances whereby the companies have no right to object and challenge the ATO's decisions).

The ATO officer involved indicated they did not agree with the ATO's published position (i.e. the addendum to TR 2013/3).

The taxpayer is an SME, who had previously taken the conservative position of categorising feed costs as 'feedstock expenditure' (given the ATO's published position and the initial draft of TR 2013/3) but requested an amendment to this position following the ATO's clarification of its position in the Decision Impact Statement on the GHP case and the addendum to TR2013/3 guidance on the matter and its redraft of TR 2013/3. By going down this path, the taxpayer has followed good corporate governance practices, complied with the legislation and associated binding guidance (i.e. amended TR 2013/3) and took into account (but not relied on) a recently released Private Binding Ruling, which had an identical fact pattern to their technical position.

The ATO is portraying the amendment as a voluntary disclosure and, thus, this would not be recorded in the ATO's 0.1% statistic.

Regardless of the technical correctness of either the client or the ATO's position, the ATO appeared to have targeted taxpayers with a specific profile, and in instances where the taxpayer was in financially challenging circumstances and had no right to object to the ATO's decision.

Summary

This matter highlights issues of transparency and accountability, raising concerns that the examples from the ABC/Fairfax investigation are just the tip of the iceberg. In the case cited within the article, the taxpayer was unable to voice their concerns regarding the position taken by the ATO, due to the inability to object to the ATO’s decision. This, coupled with the ATO’s failure to provide reasons for their decision to reject both clients’ positions on the application of the feedstock provisions, makes it extraordinarily challenging for taxpayers and their advisors to apply the law. Given our involvement in this case, we have firsthand knowledge of the ATO’s uncertain position on this issue, but there are potentially hundreds of taxpayers (and tax advisors) unaware of the ATO’s most recent (yet unsubstantiated) ‘about face’ on the application of the feedstock provisions.

What needs to happen?

Firstly, there needs to be an investigation into the high-handed practices within the ATO outlined in this article, particularly the practices in the Adelaide office where the ABC/Fairfax investigations’ whistle-blower came from and (coincidentally) the office dealing with the case mentioned in this article.

Secondly, there needs to be a change in the tax legislation, to enable taxpayers in losses to object against ATO decisions. Currently, the legislation does not provide any mechanism for loss making taxpayers to object/appeal an ATO decision.

Finally, a strong taxation regime relies on certainty of interpretation of the legislation. Where there is significant uncertainty as to how the ATO will apply the legislation, the ATO issues guidance in the form of binding Taxation Rulings. But, when the ATO diverges from its own binding rulings without explanation and without fear of being held accountable for these diversions, the integrity of the whole tax system is called into question.

Our hope is that this article and our associated submission to the Honourable Kelly O'Dwyer will be a step in the right direction to restore integrity back into Australia’s taxation system.