Practical Compliance Guidelines: Australian tax administration law innovation or overreach?

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Abstract

PCGs, ensuring consistency so as to secure the purpose of the PCG. In that limited

that the ATO in response to both ways could argue that, because a PCG involves no statement of law, either form of penalty protection has no application but the ATO position in Taxation Ruling TD 2011/19 does not take such a limited position and expressly extends to penalties. Instead, the Commissioner states that '[a] general administrative practice is a practice which is applied by the Commissioner generally as a matter of administration. It consists of the habitual or customary, that is repeated,

Australia's largest companies about tax risk and publishing a 'Governance Guide for Board Members and Directors', which was fully extracted in the Report and advocated for adoption by all OECD members. Tax risk assessment is now 'a key element of modern tax administration' according to the OECD, in 2017 citing the ATO as an exemplar with a centralised risk management function in the field of public and multinational businesses with cross-border intra-group dealings, prioritising transfer pricing risks. PCGs continue on the same strategic trajectory.

The legal and policy shift to self-assessment in the early 1990s reflected the realigning of the ATO and the tax system to primarily focus on risk. This shift was provided for in legislation to introduce the legal mechanisms for taxpayer self-assessment rather than assessment by the Commissioner, cognate changes to the system for penalties and interest to appropriately sanction taxpayer behaviour in instances of non-compliance and the development of the public and private rulings system and other forms of ATO guidance to help taxpayers voluntarily comply.

Importantly, the ATO compliance model, originally introduced in 1998 by the Cash Economy Task Force, included a pyramid from highly non-compliant to highly compliant, calibrating taxpayer risk profiles and ATO consequences. It has been developed and refined over time but the foundational thinking is well embedded in the ATO.

That foundation lies at the heart of the PCG and ATO compliance thinking to this day.
The scholarship of 'responsive regulation', especially in Australia led by academics John Braithwaite and Valerie Braithwaite, goes back well into at least the early 1990s. It has been directly influential on the development of the thinking of the ATO and tax authorities according to Professor Judith Freedman, Professor of Tax Law at the University of Oxford. Professor Freedman calls the compliance pyramid 'the Braithwaite model' and says it has been adopted by the ATO and other tax administrators.

ATO organisational arrangements in around 1994 shifted from functional divisions to being organised around taxpayer market segments so that risks were prioritised in tax administration. Whilst nomenclature has changed and the concept has evolved, the basic

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risk architecture of 1994 informs the current ATO structure. This is well apparent in the ATO organisational chart in which the divisions include the Client Engagement Group and its market/risk subdivisions. The central focus on risk remains core to the ATO and the deployment of PCGs, as explained by current ATO Second Commissioner Jeremy Hirschhorn, who leads the Client Engagement Group, who said in 2019, referring to PCGs in respect of transfer pricing:

> The ATO has been much more deliberate in exposing its risk analysis and frameworks to the taxpaying community. These are often in the form of PCGs, which set out rules of thumb for determining whether the ATO is likely to accept the price at face value, or will more deeply probe whether the price makes sense in the particular circumstances.
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> We are using PCGs more and more to allow companies to make informed decisions as to the risk profile that they wish to adopt, rather than potentially inadvertently taking on tax risk.

Under the rubric of the ATO compliance model there are many other compliance strategies which, like PCGs, aim to deter and prevent, such as ‘nudging’ taxpayers to comply by letter writing campaigns.

Obviously the ATO continues to develop its thinking and the risk model is not static. For example, in the context of the ‘Tax Gap’, there is a shift emerging from risk to tolerance.

2.3 Legal foundations for the PCG

2.3.1 The emergence of modern administra ! n e, ! tk

administrative law principles is mandated by the ATO in a Practice Statement published in 2009 and still current.

As D'Ascenzo explains, the modern framework of administrative law emerged in the 1970s and early 1980s. There were major changes to norms, values and processes in government and the rights of citizens based on landmark legislation, notably the Administrative Decisions (Judicial Review) Act 1977 (Cth) (ADJR Act) which will be discussed later and the Freedom of Information Act 1982 (Cth) (FOI).

Before these reforms, D'Ascenzo observed that:

> **There is some truth that, as with other public sector agencies, the internal workings of the ATO would have been somewhat opaque to many.**

In parallel with FOI has been the general practice of public service agencies publishing many internal manuals and circulars that otherwise would be unknown or unobtainable. With the rulings system starting in the 1990s, ATO transparency gained pace.

Of course, as has been earlier observed, this bias to publication has also been harnessed to drive compliance strategies. In that synthesis, PCGs can be seen as both reflecting transparency and compliance strategy.

To put this synthesis into a broader theoretical construct, it was observed by Australian academic John Bevacqua in 2018 that '[t]here is a solid foundation for the OECD's

That said, as Creyke notes, there are various 'soft law' instruments by Government or public officials to regulate third parties that fall short of being by or under legislation. PCGs arguably fall into this category.

Another example of 'soft law' in the tax sphere, referred to by Justice Jennifer Davies of the Federal Court (as she then was) in a 2020 article, is the integration into Australian law of OECD Model Conventions and Commentaries and the OECD Transfer Pricing Guidelines and the commentaries on the Multilateral Instrument. Her Honour presciently observed that:

> **It is likely that in the future the question of the use which can be made of, and**

Even before getting to the question of whether the exemptions in Schedule 1(e) apply, which is discussed at the end of this section, there is the threshold question of whether

> **decision would not ordinarily amount to a reviewable decision, unless the statute provided for the making of a finding or ruling on that point so that the decision, though an indeterminate decision, might accurately be described as a decision under an enactment.**

A PCG in and of itself will often not operate as a reviewable decision as explained in this passage because typically a PCG expresses an administrative policy that foreshadows other decisions that may be made in certain circumstances, some of which may themselves be final, operative and determinative such as an assessment of tax or penalties.

There is a separate question, assuming there is a 'decision', whether that decision is 'under an enactment'. A decision made under the GPA is not such a decision according to long standing authority of Hutchins, a decision of the Full Court of the Federal Court. Hutchins concerned voting by the Commissioner at a meeting of bankruptcy creditors. In addition to the GPA being the source of power it was relevant that the Commissioner's vote alone was not conclusive as to the rights of the applicant.

Aronson, Groves and Weeks seem to be of the view that Hutchins is no longer good law as to whether a decision under the GPA is not a 'decision under an enactment' given the High Court decision in Tang. In Tang, the majority of the Court appears to reject the reasoning in Hutchins that the decision was too remote from the GPA as a legislative source of power to be 'under an enactment'. The majority found that it was sufficient for a 'decision to be under an enactment' that the decision be required or authorised by the enactment, which in the case of a PCG appears to be satisfied by the GPA as a source of power. Nevertheless the majority did not overrule Hutchins as the decision did not affect the rights of the applicant.

Later cases have not gone quite as far as Aronson, Groves and Weeks in dismissing the reasoning in Hutchins in light of Tang but the writing is on the wall. For example, the reasoning of Hutchins that there was no decision under an enactment was considered by Gyles J in obiter dicta in a decision of the Full Court of the Federal Court in 2006, his Honour concluding that the majority in Tang had 'indicated … that the adoption of a proximate source test, such as applied by Black CJ in that case, was not appropriate'.

That said, in Bilborough, Kiefel J (then of the Federal Court and now Chief Justice of the High Court) did not go quite as far. In that case the Court rejected an application for judicial review of the decision of the Commissioner to reject a taxpayer's offer of

compromise of a tax debt. Her Honour appears to treat the reasoning in Hutchins as consistent with Bond and Tang and does not state that the Court is bound to reject the reasoning in Hutchins that was criticised in Tang. Her Honour instead concisely summarises the test in Tang and then concludes on the facts that the second part of the test is failed:

> **The majority in Tang 221 CLR at [89] concluded that the determination of whether a decision is 'made … under an enactment' involves two criteria, both of which must be met: the 'decision must be expressly or impliedly required or**

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(h) that there was no evidence or other material to justify the making of the decision;

(j) that the decision was otherwise contrary to law.

The reference in paragraph (e) above to an improper exercise of a power shall be construed as including a reference to:

(a) taking an irrelevant consideration into account in the exercise of a power;

(b) failing to take a relevant consideration into account in the exercise of a power;

(c) an exercise of a power for a purpose other than a purpose for which the power is conferred;

(d) an exercise of a disn in i ℵ ue " po m ᴀ f of é " ec er;

One popular example is the perception that the use of PCGs is increasing. The facts tell another story. The numbers total 61 and have reduced every year since PCGs were introduced. Here is the breakdown:

2016 – 18 (17 + the PCG Policy statement in PCG 2016/1)

2017 – 10

2018 – 9

2019 – 8

2020 – 7

2021 – 5

2022 – 3

2023 – 1

This trend might be explained by a number of factors. The author speculates that, as the ATO gains more experience with PCGs, it is deploying them more selectively for cases such as Typologies VI–X, discussed below, where there is a risk matrix model (such as in the areas of transfer pricing, section 100A of the Income Tax Assessment Act 1936 and diverted profits tax). PCGs of the latter type are probably seen by the ATO as especially worth the investment because they are part of a major compliance risk strategy.

Another criticism is that the PCG is really the ATO making law. At its highest, PCGs are 'soft law' as discussed earlier. Nevertheless, PCGs are carefully drafted to not present a view of the law. Instead, where appropriate, the ATO issues legal views in Public Rulings that are a companion to a PCG, presenting a total package.

Although not presenting a legal view, PCGs bring a much needed discipline in certain

funds that provide a pension tax bonus to members where the superannuation funds are facing practical difficulties in complying with certain legislative requirements….

11. We recognise that some superannuation funds that wish to provide pension tax bonuses to members may need to modify existing systems to ensure full automation, and integration with core processing and integrity controls with respect to having the value of the pension tax bonus correctly reflected in the member's pension account balance. culties " † f Æns…fe t p tsi

3.6 Type IV: resolving uncertainty about tax rate changes

Clarity about what is the legislated tax rate is fundamental to taxpayer compliance but sometimes practical clarity can be elusive.

An example of seeking to address this problem is PCG 2018/8, which is entitled

PCGs within Type VI are very sensible and appropriate exercises of the Commissioner’s

Assessment Act 1997', which concerns the issue of non-share equity through permanent establishments and touches on transfer pricing and arm's length principles.

Type VIII PCGs have been issued in the context of international anti-avoidance rules such as PCG 2018/5, 'Diverted Profits Tax', and PCG 2019/6, 'OECD Hybrid Mismatch Rules – Concept of Structured Arrangement'.

Interestingly the PCGs include the statement that:

> **Notwithstanding strictly applied the law requires taxpayers to test for the existence of a structured arrangement each time a payment is made under a scheme, in practical terms the Commissioner recognises the significant compliance burden such an approach would entail.**

The PCG then offers a short cut method. This may be sensible but is open to the same criticism for Type I PCGs, eg, PCG 2020/7, 'ATO Compliance Approach to the Arm's Length Debt Test' and PCG 2021/5, 'Imported Hybrid Mismatch Rule – ATO's Compliance Approach'.

Type VIII PCGs have also been issued in a purely domestic tax context and include PCG 2018/2, 'Propagation arrangements adopted by Registrable Superannuation Entities' and PCG 2021/4, 'Allocation of Professional Firm Profits – ATO Compliance Approach', with no 'safe harbour'.

In the author's view, Type VIII PCGs, especially those on transfer pricing and others modelling that approach such as PCG 2022/2 on Section 100A (Type IX), represent the

in exercise of the GPA the Commissioner may decide only to allocate compliance resources in respect of a particular topic prospectively.

The occasion for and merit of the change of ATO view of the law is a separate question to the use and validity of the PCG.

PCGs of this type that simply reflect a change of ATO view because legal interpretations have changed represent one sub-type and all said and done are relatively straightforward as to role and operation of the PCG. An early example is PCG 2017/13, 'Division 7A –

light of the High Court decision in Bywater

with a debt instrument to eliminate tax benefits in another country but preserve tax benefits going forward, in the form of deductible debt, in Australia.

Sometimes PCGs are a means by which the Commissioner assists with the transition into new legislation or otherwise cushions taxpayers from the disproportionate burdens of new legislation. The goal is important but the question needs to be asked as to the cause of the problem and the methods to solve it. Passage and improvement of legislation is no doubt an ongoing challenge but pushing the problem back to the Commissioner as the administrator creates its own issues. Legislation will never be perfect legislation [illegible]