

AN ADMIRABLE SAFE HARBOUR? SAFE HARBOURS FROM ADMINISTRATIVE PENALTY FOR TAXPAYERS WHEN ENGAGING TAX AGENTS AND THE EFFECTS ON THE UNIFORM PENALTY SYSTEM

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[The Tax Agent Services (Transitional Provisions and Consequential Amendments) Act 2009 (Cth) creates safe harbours that protect taxpayers from administrative penalty for false or misleading statements and late lodgement. These will affect the vast majority of taxpayers because around 74 per cent of individual and 95 per cent of business taxpayers lodge income tax returns via a tax agent. This article provides an evaluation of these safe harbours in isolation and in light of the recent policy discourse of the Henry Review and taxation initiatives aimed at reducing the need for tax agents. While this article concludes that the safe harbours are mostly admirable, certain issues have been identified which require further consideration and action due to policy reasons.]

CONTENTS

I	Introduction	619
II	The Uniform Penalty System	620
	A Overview of Part 4-25	620
	B Subdivision 284-B — Former Shortfall Penalties	621
	C Subdivision 286-C — Failing to Lodge Documents on Time	622
III	Safe Harbour Provisions	623
IV	Issues with the Safe Harbours	626
	A Distinctions between Taxpayers — Whether or Not a Tax Agent Is Engaged	626
	B Distinctions between Taxpayers — When a Taxpayer Also Fails to Take Reasonable Care	627
	C Interpretive Issue — When a Taxpayer Fails to Take Reasonable Care, Is Reckless or Has Intentional Disregard	629
	D Evidentiary Onus	630
	E Too Narrow a Harbour? — The Tax Agent’s Intentional Disregard or Recklessness	632
	F Too Narrow a Harbour? — Only Agent-Lodged Documents Covered	633
	G Too Narrow a Harbour? — The Other Failure to Lodge Penalty	635
	H The Problems with an Absolute Absolution	635
	I Has the Bar of Reasonable Care Been Lowered?	637
	J The Safe Harbours Evaluated in Isolation	638
V	Taxation Policy	639
VI	Conclusion	640

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I INTRODUCTION

[T]here is no absolute safety even in ‘safe harbours’ — a reflection on Pearl Harbour and the Rainbow Warrior will attest to that. But there are many examples that show their potential to reinforce the trend towards efficient risk management by both taxpayers and the Tax Office in our complex system.¹

A ‘safe harbour’ was once solely a concern of men like Nelson, Villeneuve, Gravina and Decatur, but the phrase has taken on an importance for ordinary taxpayers; it still indicates protection and certainty, but from economic sanction rather than a lee shore. A safe harbour can be provided by legislation or by the Australian Tax Office and virtually guarantees that compliance with the conditions of the safe harbour will result in protection from liability.² Safe harbours can reduce compliance costs and taxation risks and ‘oil the wheels of the tax system.’³ Therefore, it is not surprising that new safe harbours have been enacted recently in relation to the use of tax agents by taxpayers. With tax agents lodging around 74 per cent of individual returns and 95 per cent or more of business returns,⁴ these safe harbours will affect the vast majority of taxpayers.

The *Tax Agent Services (Transitional Provisions and Consequential Amendments) Act 2009* (Cth) (‘*TAS TPCA Act*’)⁵ inserted the safe harbours into pt 4-25 of the *Taxation Administration Act 1953* (Cth) (‘*TAA*’), which contains the uniform taxation penalty system, and shifted some of the risk from the taxpayer to the agent. Broadly speaking, the new safe harbour provisions ensure that a taxpayer who engages a registered tax agent and provides all relevant information to that tax agent is not liable for an administrative penalty for making a false or misleading statement or for failing to lodge a document on time when either is caused by the tax agent’s failure to take reasonable care.⁶ The safe harbours have been enacted in conjunction with a broader reform of tax agent regulation.⁷ Tax agents are now encouraged to take reasonable care by the heavier sanctions that may be available to the new and empowered national Tax Practitioners Board under the new tax agent services regime of which the safe harbours are a part.⁸ The result of this is that ‘effective action’ can be taken against the tax agent for mistakes,⁹ thus making possible the enactment of the safe harbours.¹⁰

¹ David Vos, ‘Safe Harbours — The New Horizon’ in Michael Walpole and Chris Evans (ed), *Tax Administration: Safe Harbours and New Horizons* (Fiscal Publications, 2008) 59, 67.

² *Ibid* 61.

³ *Ibid* 60.

⁴ Explanatory Memorandum, Tax Agent Services Bill 2008 (Cth) 124. See also Review Panel, *Australia’s Future Tax System: Report to the Treasurer — Part Two: Detailed Analysis* (2009) 5 (‘*Henry Review Report*’).

⁵ *TAS TPCA Act* sch 1 items 23–4.

⁶ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 18.

⁷ See *Tax Agent Services Act 2009* (Cth).

⁸ Cynthia Coleman and Rodney Fisher, ‘Are You Being Served? The New Regime for Tax Agents’ (2009) 12 *Tax Specialist* 138, 144–6.

⁹ Nick Sherry, ‘Tax Agent Regulation for a Modern Economy — Launch of the National Tax Practitioners Board’ (Speech delivered at the Institute of Chartered Accountants of Australia,

This article starts by providing an outline of the uniform penalty system of which the safe harbours are a part. It then provides an outline of the safe harbours, covering both their operation and history, and it analyses various issues arising from this operation. Lastly, this article concludes by situating these issues within the context of current taxation initiatives and policy framework. While this article concludes that the safe harbours are mostly admirable, certain problems have been identified which are exacerbated by new initiatives proposed in the 2010 Federal Budget and the taxation policy discourse initiated by the Australia's Future Tax System Review ('Henry Review').¹¹

There are a number of issues with the legislation as drafted. The evidentiary onus of the safe harbours may limit their practical effectiveness and should be carefully reconsidered. Also, the way that the legislation is drafted creates, at best, an interpretive issue over the taxpayer's culpability and, at worst, a possible loophole contrary to the rationale for the enactment of the safe harbours. In addition, the safe harbours exclude the operation of the shortfall penalty adjustment provisions, and so fail to create an incentive to voluntarily disclose a shortfall. Lastly, certain passages in the explanatory memorandum to the Bill may be seen as lowering the standard of reasonable care expected of a taxpayer. Once again, this may create an interpretive issue or a loophole for the sophisticated taxpayer. This article outlines possible changes to address these issues.

Due to these issues, the safe harbours fail to align with certain key design principles of the tax system espoused by the Henry Review and the rationales for the enactment of the safe harbours. There is also a concern in relation to optimising the efficacy of the current taxation initiative aimed at tax agent use. Both the abstract future design argument and the current practical implementation argument provide policy grounds for amending and clarifying issues arising from the operation of the safe harbours.

II THE UNIFORM PENALTY SYSTEM

A Overview of Part 4-25

The pt 4-25 uniform penalty system applies to all taxation laws¹² but does not cover criminal taxation offences. It contains civil penalties,¹³ as well as a number of administrative penalties.¹⁴ In practice, despite these administrative and civil penalties, a taxpayer may receive some benefit from holding onto an amount of money that should have been paid to the Tax Commissioner, and this benefit may actually cancel out any penalty. Therefore, pt 4-25 imposes a shortfall interest

Sydney, 23 October 2009) <<http://treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2009/016.htm&pageID=005&min=njsa&Year=2009&DocType=1>>.

¹⁰ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17.

¹¹ *Henry Review Report*, above n 4.

¹² *TAA* s 3AA. The *TAA* is a 'Guide' as defined under *Income Tax Assessment Act 1997* (Cth) ss 950-150, 995-1(1) (definition of 'Guide').

¹³ *TAA* sch 1 s 290-50.

¹⁴ See, eg, *ibid* sch 1 s 284-75.

charge ('SIC') that is applied when the Commissioner amends a taxpayer's assessment.¹⁵ Once an amount becomes due, the taxpayer is liable for the general interest charge ('GIC').¹⁶ Though not strictly part of pt 4-25, the GIC was part of the initial reforms aimed at creating a uniform penalty system.¹⁷ The GIC is imposed where an amount of tax is not paid by the due date for payment.¹⁸ Therefore, pt 4-25 and the provisions dealing with the GIC aim to neutralise economic benefits that taxpayers may receive from innocent taxation errors or intentional deceit through interest charges.¹⁹ The imposition of all the administrative penalties under pt 4-25 follows a four-stage process: liability;²⁰ assessment of the amount of the penalty;²¹ communication of liability to the taxpayer;²² and possible remission by the Commissioner.²³ Provided this process is followed, a great number of errors, oversights and activities are covered by the administrative penalties under pt 4-25. However, for the purposes of the safe harbours, only two penalties are relevant; what were formerly shortfall penalties and penalties for failing to lodge documents on time.

B *Subdivision 284-B — Former Shortfall Penalties*

Subdivision 284-B of the *TAA* contains administrative penalties for statements. There are four specific acts liable to penalty:

- (a) false or misleading statements given to the Commissioner or an entity that is exercising powers or performing functions under a taxation law;
- (b) statements encompassing not reasonably arguable positions ('RAP');
- (c) late statements; and
- (d) false or misleading statements given to an entity other than the Commissioner or an entity that is exercising powers or performing functions under a taxation law provided that the statement is or purports to be one required or permitted by a taxation law.²⁴

However, the safe harbours only cover both types of false or misleading statements and not the other acts.²⁵ In relation to false or misleading statements, the taxpayer is 'liable' to pay an administrative penalty if the taxpayer, *or their agent*,²⁶ makes a statement that is false or misleading in a material particular (whether by omission or commission) to the Commissioner or other entity

¹⁵ *Ibid* sch 1 s 280-100(1).

¹⁶ *Ibid* ss 8AAA-8AAH.

¹⁷ Explanatory Memorandum, A New Tax System (Tax Administration) Bill (No 2) 2000 (Cth) 7.

¹⁸ *TAA* ss 8AAA-8AAH.

¹⁹ *Ibid* sch 1 s 280-50.

²⁰ *Ibid* sch 1 s 298-5.

²¹ *Ibid* sch 1 s 298-30.

²² *Ibid* sch 1 s 298-10.

²³ *Ibid* sch 1 s 298-20.

²⁴ *Ibid* sch 1 ss 284-75(1)-(3).

²⁵ *Ibid* sch 1 s 284-75(6).

²⁶ *Ibid* sch 1 s 284-25.

exercising powers under a taxation law.²⁷ As there is no requirement for intent, this ground covers situations where there is an innocent mistake in filling out a tax return as well as where there is intentional deceit. Formerly, there was also a requirement that there be a shortfall amount, but this was removed in 2010.²⁸

This administrative penalty encompasses most errors, from the most common and innocent of mistakes to deliberate, wilful and substantial forms of tax avoidance. This is factored in at the penalty amount phase as the base penalty takes into account intent or lack thereof.²⁹ In relation to false or misleading statements, the base penalty is 75 per cent of the shortfall amount³⁰ for shortfalls resulting from intentional disregard of tax laws by the taxpayer or their agent.³¹ It drops to 50 per cent for those shortfalls resulting for recklessness by the taxpayer or their agent,³² and 25 per cent for those resulting from a failure to exercise reasonable care by the taxpayer or their agent.³³

C Subdivision 286-C — Failing to Lodge Documents on Time

Subdivision 286-C, which relates to failing to lodge documents on time,³⁴ is the other penalty covered by the safe harbours. This subdivision understandably overlaps with the late document penalty outlined above; however, sub-div 286-C imposes a penalty simply for the time during which the failure occurs before an assessment with a magnitude determined by time,³⁵ whereas sub-div 284-B covers situations that arise after assessment without the document and the magnitude of penalty is instead determined by the tax related liability.³⁶ Subdivision 286-C is a rather simple liability provision. A taxpayer is liable to an administrative penalty if they are required under a taxation law to give a document to the Commissioner in an approved form by a particular day and they, *or their agent*, do not give such a document in the approved form by that day.³⁷ The base penalty is 1 penalty unit³⁸ for every 28 days or part thereof that the docu-

²⁷ Ibid sch 1 ss 284-75(1)(a)–(b).

²⁸ *Tax Laws Amendment (2010 Measures No 1) Act 2010* (Cth) sch 6 pt 6 div 1 items 61, 66, amending *ibid* sch 1 ss 284-75(1)(c), (2)(c).

²⁹ *TAA* sch 1 s 284-90(1).

³⁰ The shortfall amount is the difference between the higher and lower tax liabilities or refunds had the statement not been false or misleading: see *ibid* sch 1 s 284-80.

³¹ *Ibid* sch 1 s 284-90(1) item 1.

³² *Ibid* sch 1 s 284-90(1) item 2.

³³ *Ibid* sch 1 s 284-90(1) item 3. See *Mezrani v Federal Commissioner of Taxation* [2009] ATC ¶10-103, 3055 [31] (Deputy President Tamberlin) for an excellent explanation of the sometimes ambiguous difference between recklessness and a lack of reasonable care:

It is well settled that recklessness requires something more than an oversight or inadvertence and something less than deliberate or intentional conduct. It involves an attribution of a state of mind. It can be inferred having regard to what a reasonable person would consider to be something more blameworthy than oversight yet not amounting to intentional conduct.

³⁴ *TAA* sch 1 s 286-75(1).

³⁵ *Ibid* sch 1 ss 286-80(1)–(2).

³⁶ *Ibid* sch 1 s 284-75(3).

³⁷ *Ibid* sch 1 s 286-75(1).

³⁸ Currently §110: *Crimes Act 1914* (Cth) s 4AA(1).

ment remains outstanding, up to a maximum of 5 penalty units.³⁹ The base penalty amount is multiplied by two if the taxpayer has an assessable income between \$1 million and \$20 million for the income year in which the contravention occurred.⁴⁰ It is multiplied by five for entities with an assessable income above \$20 million for the relevant income year.⁴¹ The penalty under this subdivision can be imposed by the Commissioner even if the overdue document has not yet been lodged, and the penalty can be increased later if need be.⁴² Having outlined the uniform penalty system, it is now possible to turn to the substantive provisions of the safe harbours.

III SAFE HARBOUR PROVISIONS

The aforementioned safe harbour provisions, which limit taxpayer liability in certain circumstances where a taxpayer engages a registered tax agent,⁴³ have been enacted as part of the tax agent services reforms that have occurred through a process of consultation over the last decade. By way of context, the idea of safe harbour provisions has been a feature of the reformation of the tax agent services regime since the new regime was proposed in 1998.⁴⁴ The media release at the time proclaimed that:

The proposals will give taxpayers who engage a tax agent a safe harbour from penalties, providing they exercise reasonable care in furnishing all the relevant taxation information to their tax agent. Taxpayers will no longer be vicariously liable for penalties imposed under the current law as a result of the actions of their tax agent.⁴⁵

These reforms were delayed by the express wish of the tax profession in order to allow the profession to focus on the introduction of the GST and associated changes in 2000.⁴⁶ In the intervening years, the reforms have been the subject of both confidential and public consultation.⁴⁷ Having finally been enacted in 2010, the safe harbours form part of a larger reform of the regulation and control of tax agents under the *Tax Agent Services Act 2009* (Cth) ('*TAS Act*').⁴⁸ Specifically,

³⁹ *TAA* sch 1 s 286-80(2).

⁴⁰ *Ibid* sch 1 s 286-80(3)(b).

⁴¹ *Ibid* sch 1 s 286-80(4)(b).

⁴² *Ibid* sch 1 s 286-80(6).

⁴³ *Ibid* sch 1 ss 284-75(6), 286-75(1A).

⁴⁴ Commonwealth, *Parliamentary Debates*, House of Representatives, 24 June 2009, 6980 (Craig Emerson). However, the process of reforming the tax agent service regime which had existed since the 1940s started with the '*Tax Services for the Public* report released [in 1994] by the Steering Committee of the National Review of Standards for the Tax Profession [which] recommends a suite of legislative changes, given the movement to a tax regime based on self assessment principles': Chris Bowen, 'Bill to Regulate the Provision of Tax Agent Services' (Media Release, No 099, 13 November 2008).

⁴⁵ Rod Kemp, 'New Legislative Framework for Tax Agent Services' (Media Release, No 014, 6 April 1998).

⁴⁶ Explanatory Memorandum, *Tax Agent Services Bill 2008* (Cth) 8.

⁴⁷ *Ibid* 8-9.

⁴⁸ See Tristan Webb, 'Penalty "Safe Harbours" under New Tax Agent Services Regime' [2009] (16) *Tax Week* ¶1359, 1; Michael D'Ascenzo and Tony Poulakis, 'Self Assessment: *Quo Vadis?*' (2002) 36 *Taxation in Australia* 412, 415-16.

the safe harbours reflect the fact that under self assessment, there is more responsibility placed on taxpayers⁴⁹ and greater importance placed on the function of tax agents.⁵⁰ Moreover, under the new regime, tax agents can be more easily disciplined if they make an error.⁵¹ The safe harbours are therefore justified as creating a proper balance of responsibility between taxpayers and tax agents.⁵² They aim to ‘enhance the protection of consumers of tax agent services’ and reduce the level of uncertainty imposed on them under self-assessment, improve tax agent regulation and ‘strengthen the integrity of the tax system’.⁵³

The enacted safe harbours are set out as follows in the *TAA*:

284-75 Liability to penalty

...

- (6) You are not liable to an administrative penalty under subsection (1) or (4) if:
- (a) you engage a registered tax agent or BAS agent; and
 - (b) you give the registered tax agent or BAS agent all relevant taxation information; and
 - (c) the registered tax agent or BAS agent makes the statement; and
 - (d) the false or misleading nature of the statement did not result from:
 - (i) intentional disregard by the registered tax agent or BAS agent of a taxation law; or
 - (ii) recklessness by the agent as to the operation of a taxation law.
- (7) If you wish to rely on subsection (6), you bear an evidential burden in relation to paragraph (6)(b).

286-75 Liability to penalty

...

- (1A) However, you are not liable to an administrative penalty under subsection (1) if:
- (a) you engage a registered tax agent or BAS agent; and
 - (b) you give the registered tax agent or BAS agent all relevant taxation information to enable the agent to give a return, notice, statement or other document to the Commissioner in the approved form by a particular day; and

⁴⁹ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17; Coleman and Fisher, above n 8, 145.

⁵⁰ See Treasury, Australian Government, *Review of Aspects of Income Tax Self Assessment*, Discussion Paper (2004) 74.

⁵¹ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17; Commonwealth, *Parliamentary Debates*, House of Representatives, 24 June 2009, 6980 (Craig Emerson).

⁵² See Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17.

⁵³ Explanatory Memorandum, Tax Agent Services Bill 2008 (Cth) 129.

- (c) the registered tax agent or BAS agent does not give the return, notice, statement or other document to the Commissioner in the approved form by that day; and
 - (d) the failure to give the return, notice, statement or other document to the Commissioner did not result from:
 - (i) intentional disregard by the registered tax agent or BAS agent of a taxation law; or
 - (ii) recklessness by the agent as to the operation of a taxation law.
- (1B) If you wish to rely on subsection (1A), you bear an evidential burden in relation to paragraph (1A)(b).

As can be seen, the taxpayer is subject to a number of conditions before the safe harbours are available. First, the taxpayer must engage a *registered* tax agent or Business Activity Statement ('BAS') agent. Secondly, the taxpayer must provide the agent with 'all relevant taxation information'. Thirdly, the agent, *and not the taxpayer*, must make the false or misleading statement or fail to give the return, statement or other document to the Commissioner. Lastly, and perhaps most significantly, the false or misleading statement or failure to lodge cannot result from intentional disregard of a taxation law or recklessness as to the operation of a taxation law by the agent. Note that this last condition says nothing explicitly about the behaviour of the taxpayer. The taxpayer bears an evidential onus in relation to proving that all relevant taxation information was provided to the agent. This onus is a significant change from the original exposure draft of the provisions.⁵⁴ These safe harbours apply to statements and failures to lodge when the due date for lodgement or the actual lodgement occurs after the commencement of the legislation.⁵⁵ However, liability is not simply transferred to the agent;⁵⁶ rather, the actions of the agent have to be dealt with separately under the new disciplinary regime contained in the *TAS Act*.⁵⁷ This new disciplinary regime includes a national Tax Practitioners Board to oversee registered agents, a statutory code of professional conduct and sanctions for breach of this code.⁵⁸ The concept of a centralised board is novel, and in comparison to the previous regime, the scope of the powers of this new board is broader and the sanctions available are harsher.⁵⁹ In summary, the new safe harbour provisions ensure that a taxpayer who engages a registered tax agent and provides all relevant information to that tax agent is not liable to an administrative penalty for making a false or misleading statement or for failing to lodge a

⁵⁴ Exposure Draft: Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) items 22–3.

⁵⁵ *TAS TPCA Act* sch 1 item 26.

⁵⁶ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 18.

⁵⁷ *Ibid* 24.

⁵⁸ See *TAS Act* ss 30-10, 30-15, 60-5. See also Coleman and Fisher, above n 8, 138.

⁵⁹ See Coleman and Fisher, above n 8, 144–5.

document on time when it is caused by the tax agent's failure to take reasonable care.⁶⁰

Thus the safe harbours are not overly complicated and are quite narrow when compared to the number of other acts prohibited by administrative penalty that are not included within the safe harbours. However, with tax agents lodging around 74 per cent of individual returns and 95 per cent or more of business returns,⁶¹ these safe harbours affect the vast majority of taxpayers. While the evidential onus is on the taxpayer to show that they provided all relevant information to the agent and answered all the agent's questions truthfully and fully,⁶² the new safe harbours have been widely accepted as a beneficial amendment for taxpayers and agents.⁶³ However, there are some issues that remain unresolved despite the lengthy consultation process. This article now considers these issues and evaluates the provisions in light of taxation policy.

IV ISSUES WITH THE SAFE HARBOURS

A Distinctions between Taxpayers — Whether or Not a Tax Agent Is Engaged

Many issues were raised in the submissions that were provided to the Treasury as part of the public consultation process surrounding the new safe harbour provisions. The Commonwealth and Taxation Ombudsman's submission raised the issue of a dual penalty standard.⁶⁴ The Ombudsman was concerned that where there is a failure to take reasonable care, there is a distinction between the application of penalty provisions to taxpayers based on whether or not they have engaged a tax professional.⁶⁵ However, there can be two different types of distinctions between taxpayers, only one of which is problematic. The first distinction is between a situation where the *agent* fails to take reasonable care (where the taxpayer engages an agent) and a situation where the *taxpayer* fails to

⁶⁰ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 18.

⁶¹ See above n 4 and accompanying text.

⁶² TAA sch 1 ss 284-75(7), 286-75(1B).

⁶³ See, eg, Michael Blissenden, 'Draft Legislative Regime for Tax Agent Services' [2007] (24) *Tax Week* ¶511, 3; Webb, above n 48, 2; Commonwealth and Taxation Ombudsman, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 31 March 2009, 1; CPA Australia, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 25 March 2009, 2; The Institute of Chartered Accountants in Australia, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 1 April 2009, 1; National Institute of Accountants, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 27 March 2009, 1; Superannuated Commonwealth Officers' Association Inc, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 24 February 2009, 1; Taxation Institute of Australia, Submission to Treasury, *Exposure Draft Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009*, 26 March 2009, 1.

⁶⁴ Commonwealth and Taxation Ombudsman, above n 63, 1.

⁶⁵ *Ibid.* See also Superannuated Commonwealth Officers' Association Inc, above n 63, 2. As to the value of consistency in penalties, see Australian Law Reform Commission, *Principled Regulation: Federal Civil & Administrative Penalties in Australia*, Report No 95 (2002) 897-8.

take reasonable care (where the taxpayer does not engage an agent). Superficially, one taxpayer is penalised and one taxpayer is not penalised for what could be the same error. The Ombudsman later emphasises that relief should be linked to culpability,⁶⁶ and this is reflected in the distinction between the two different taxpayers. It is the authors' opinion that this distinction protects consumers from their agent's errors but otherwise puts some responsibility for errors on the taxpayer. Some level of individual responsibility is a key part of the integrity of the tax system; without it, the self assessment system would by definition become difficult to operate.⁶⁷ To emphasise an earlier point, the safe harbours aim to enhance the protection of consumers and reduce the level of uncertainty imposed on them under self-assessment, and, importantly for this issue, improve tax agent regulation and strengthen the integrity of the tax system.⁶⁸ This type of distinction is arguably aligned with the rationales for the safe harbour provisions, since it balances risk and protects consumers from some errors not of their making while also protecting the integrity of the tax system.⁶⁹ Thus, it is not problematic. However, the other type of distinction is more problematic.

B Distinctions between Taxpayers — When a Taxpayer Also Fails to Take Reasonable Care

The second type of distinction is between two taxpayers who fail to take reasonable care in their own tax affairs based on the current definition, but where one engages a tax agent and gives that agent all of their documents. Of course, the tax agent would also have to fail to take reasonable care in the case of the taxpayer who engaged the tax agent. The Tax Office states that 'even though the standard of care is measured objectively, it takes into account the circumstances of the taxpayer.'⁷⁰ This position is supported by the explanatory memorandum to the A New Tax System (Tax Administration) Bill (No 2) 2000 (Cth), which states that '[t]he effort required is one commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.'⁷¹ Thus, the current definition of reasonable care is partly subjective, even though the word 'subjective' is not used explicitly,⁷² and may require more sophisticated taxpayers to be more involved in their tax return even if they engage a tax agent. A taxpayer may therefore have to scrutinise the prepared return provided before it is lodged by the tax agent. *Re Necovski and Federal Commissioner of Taxation*

⁶⁶ Commonwealth and Taxation Ombudsman, above n 63, 3.

⁶⁷ See Michael Carmody, 'Tax Reform: The Lessons for Tax Administration in Australia' (Speech delivered at the American Chamber of Commerce, Sydney, 2 May 2000).

⁶⁸ See above n 53 and accompanying text.

⁶⁹ See Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17.

⁷⁰ Australian Taxation Office, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard*, MT 2008/1, 12 November 2008, 6.

⁷¹ Explanatory Memorandum, A New Tax System (Tax Administration) Bill (No 2) 2000 (Cth) 22.

⁷² Australian Taxation Office, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard*, MT 2008/1, 12 November 2008, 6.

(‘*Necovski*’)⁷³ is illustrative of a situation where both tax agent and taxpayer fail to take reasonable care. However, this case occurred before the enactment of the safe harbour provisions. In *Necovski*, interest payable in relation to a mortgage over Mr *Necovski*’s principal place of residence was treated as deductible by Mr *Necovski*’s tax agent.⁷⁴ It was clear that the tax agent had failed to exercise reasonable care, but this did not absolve Mr *Necovski* of responsibility. Member Frost stated that:

As for Mr *Necovski* himself, although I accept that he placed his trust in the agent, he should not have allowed the returns to be lodged as they were. He did not review them, before lodgement, with the level of care that could be expected of a reasonable person. By treating the signing of his returns as a mechanical exercise, he denied himself the opportunity to query the claims and to satisfy himself that the claims were in order, or to have them removed from the return.⁷⁵

Thus, it is possible that both the taxpayer and the tax agent can fail to exercise reasonable care when preparing a return. If the taxpayer prepared the same return with the same error themselves, without engaging a tax agent, there would be no question of a safe harbour since there is no agent engaged. On the other hand, the safe harbour is conditional on the fact that the false or misleading statement did not result from the tax agent’s ‘intentional disregard’ or ‘recklessness’ as to a taxation law.⁷⁶ Due to the way that the safe harbour is worded — saying nothing about the culpability of the taxpayer — the above hypothetical taxpayer who engages a tax agent *may* be absolved under the new safe harbours because technically, the error did not result from the tax agent’s intentional disregard or recklessness. According to Blissenden, there is doubt about whether the legislative provisions actually require the taxpayer to take substantive reasonable care.⁷⁷ The explanatory memorandum states that ‘[b]y supplying all relevant taxation information the taxpayer is taking reasonable care’,⁷⁸ but it does not appear to extend to a more substantive standard of reasonable care. Then again, the government admits that a taxpayer should not be subject to a penalty as a result of the actions or omissions of their agent in the absence of recklessness or intentional disregard by either party, but there is no mention of a lack of reasonable care by the taxpayer,⁷⁹ which is perhaps telling. This issue creates a theoretical distinction between different taxpayers, and, if this occurs in practice, it would be contrary to the basis for the safe harbours since it may create uncertainty. If a taxpayer is required to exercise reasonable care even when he or she has engaged a tax agent, then that should be made clear in the legislation.

⁷³ (2009) 75 ATR 152.

⁷⁴ *Ibid* 154 [12] (Member Frost).

⁷⁵ *Ibid* 154 [13].

⁷⁶ *TAA* sch 1 s 284-75(6)(d).

⁷⁷ Blissenden, above n 63, 3.

⁷⁸ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 19.

⁷⁹ See *ibid* 17.

If there is an ability to hide a lack of reasonable care behind a tax agent, this creates problems in regards to one of the principles contained in the *Henry Review Report* and one of the tax system changes in response to the Henry Review. First, there may be unequal treatment of similar taxpayers with similar culpability all because of the engagement of a tax agent, which is contrary to the key design principle of a modern tax and transfer system in the *Henry Review Report* that it 'should treat individuals with similar economic capacity in the same way'.⁸⁰ More importantly, however, the Henry Review aims to reduce the need for and the use of tax agents (which is high in Australia) by recommending simplified pre-filled returns and introducing standard deductions.⁸¹ In the 2010 Federal Budget, the government proposed such a standard deduction.⁸² For such a measure to effectively reduce the need for taxpayers to incur tax agent fees, the possible incentive to use a tax agent contained in the safe harbours as outlined above should be removed. Otherwise, it is possible that taxpayers will take advantage of the standard deduction of \$500 (from 1 July 2012) or \$1000 (from 1 July 2013)⁸³ while still using a tax agent, as this may provide them with an unequal level of protection from a failure to take reasonable care. Thus, in order to maximise the effectiveness of the standard deduction provisions based on the Henry Review and proposed in the Federal Budget, it would be best to resolve this issue.

C Interpretive Issue — When a Taxpayer Fails to Take Reasonable Care, Is Reckless or Has Intentional Disregard

A second problematic distinction is systemic of a broader issue not raised in any of the submissions about the draft legislation. As the safe harbour provisions say nothing about the culpability of the taxpayer, it is possible that a taxpayer *may* escape liability under the legislation despite displaying recklessness or intentional disregard of a taxation law. For example, though it would be an extremely rare situation, it is possible that a tax agent may make an error in a return through a failure to take reasonable care and the taxpayer pick up on this error yet ignore it and let the agent submit the erroneous return. Despite the fact that the error results from the taxpayer's intentional disregard, technically, it did not result from the *agent's* intentional disregard or recklessness, so the taxpayer could be protected by the safe harbour in the legislation. Such an outcome would obviously be entirely counterproductive towards the overall aim of the safe harbour to protect innocent taxpayers.

Only a brave taxpayer would rely on this technical argument, as court action would likely be needed to support it, and it may be argued successfully that this type of situation constitutes the taxpayer failing to give the agent all relevant

⁸⁰ Review Panel, *Australia's Future Tax System: Report to the Treasurer — Part One: Overview* (2009) 17 ('*Henry Review Report Overview*').

⁸¹ *Ibid* 31.

⁸² Treasurer and Minister for Finance and Deregulation, *Budget Measures*, Budget Paper No 2 (2010) 47.

⁸³ *Ibid*.

information. Furthermore, the explanatory memorandum states that the safe harbours do not apply where either the taxpayer or the tax agent has intentionally disregarded the law or acted recklessly.⁸⁴ However, explanatory memoranda are not legislation, and it would be prudent and enhance certainty to enshrine this important condition in legislation. While it is not argued that this situation *will* occur, it is possible on the current drafting, and the government would be embarrassed if such a taxpayer were to have the benefit of the safe harbour. At a minimum, even if the risk of this occurring is minute, having a key condition in the explanatory memorandum rather than in the legislation is contrary to a rationale for the safe harbours, as it does not promote certainty.

This issue and the distinction outlined above in Part IV(B) could be remedied by changing the subsection to read similarly to (changes in italics):

- (d) the false or misleading nature of the statement did not result from:
 - (i) *a failure to exercise reasonable care by the taxpayer*;
 - (ii) intentional disregard by the registered tax agent or BAS agent, *or taxpayer*, of a taxation law; or
 - (iii) recklessness by the agent, *or taxpayer*, as to the operation of a taxation law.

Such a change to the provisions would more closely carry out the rationale for the enactment of the safe harbours by only absolving from liability those *innocent* taxpayers who are victims of an agent's mistake. Such a change does not fundamentally change the machinery of the legislation or increase complexity. It may not even change the legislation's effect since the legislation may be interpreted in a similar way. However, if the government wanted these conditions, then for the sake of certainty, it should explicitly enact them in legislation. If it does not want these conditions, then the safe harbours arguably run counter to the rationale for their enactment.

D Evidentiary Onus

As a practical issue, the evidentiary onus placed on the taxpayer may be unfair and unreasonable considering that one rationale for the safe harbours is consumer protection. Apart from the express onus on the taxpayer to prove that all relevant information was provided to the tax agent,⁸⁵ a taxpayer may be called on to prove certain elements of the tax agent's state of mind or business practices in order to prove that the error did not occur through the tax agent's recklessness or intentional disregard.⁸⁶ Submissions on the draft legislation from professional organisations stressed that the taxpayer bears this onus.⁸⁷ The taxpayer may have to prove that the tax agent had a certain mindset, or that the tax agent's business practices and systems were inadequate but were not recklessly so, or simply that

⁸⁴ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17.

⁸⁵ TAA sch 1 ss 284-75(7), 286-75(1B).

⁸⁶ Commonwealth and Taxation Ombudsman, above n 63, 2.

⁸⁷ See CPA Australia, above n 63, 2; National Institute of Accountants, above n 63, 1.

the tax agent did or did not do a specific act.⁸⁸ Ordinarily, proving such things may be difficult for a taxpayer as they are often outside both the taxpayer's competence and awareness.⁸⁹ Furthermore, it may not be fair for the taxpayer to bear the onus of proving something about the tax agent's business practices and defending it,⁹⁰ especially considering that the taxpayer often does not have the right to control minute details in the tax agent's business. Also, the taxpayer relies on the tax agent to ask for and outline all relevant taxation information.⁹¹

This evidentiary onus is made even more difficult to satisfy by the nature of any likely dispute between tax agents and taxpayers when there is an error. While any disciplinary action against the agent for the error will be a separate proceeding,⁹² the agent has an obvious incentive, if only for reputational reasons, to avoid a finding of a lack of reasonable care in a proceeding related to the same error. Therefore, in proceedings deciding the question of any penalty to be imposed on the taxpayer, a taxpayer may try to prove that the tax agent did not take reasonable care, whereas the tax agent may try to prove that they did. Accordingly, the interests of the two parties are likely to be divergent. While this situation may have occurred prior to the safe harbour provisions, there has been a subtle yet significant shift in the likelihood of this occurring.

Prior to the safe harbours, while a taxpayer could attempt to prove that the tax agent failed to take reasonable care, such an outcome still rendered the taxpayer liable for an administrative penalty,⁹³ so there was little utility in doing so. Alternatively, the taxpayer could, and still can, attempt to prove that the agent did take reasonable care and, if proven, this would absolve the taxpayer of any administrative penalty.⁹⁴ Thus, even if there was a dispute over an error by the agent, both parties often had a common interest in proving that the agent exercised reasonable care, and the agent could work with the taxpayer to challenge the penalty. However, under the safe harbours, a taxpayer could argue with equal effect that the agent did not take reasonable care, which creates divergent interests because, presumably, the agent has an interest in proving that they did take reasonable care.

There may even be an issue of the tax agent obtaining separate representation in any court or Administrative Appeals Tribunal action challenging a penalty imposed on the taxpayer. It would possibly be unfair for the tax agent to have no say in such a proceeding; however, whether the tax agent could be legally represented or not is another issue. The effect of an extra opposing party is unlikely to reduce the costs of any action by the taxpayer to challenge a penalty. This runs counter to the consumer protection rationale of the safe harbours.

⁸⁸ See Commonwealth and Taxation Ombudsman, above n 63, 2–3.

⁸⁹ *Ibid* 2.

⁹⁰ *Ibid* 2–3.

⁹¹ The Institute of Chartered Accountants in Australia, above n 63, 2.

⁹² Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 24.

⁹³ See former *TAA* sch 1 ss 284–75, 286–75, later amended by *TAS TPCA Act* sch 1 items 23–4.

⁹⁴ See former *TAA* sch 1 s 284–215, later amended by *Tax Laws Amendment (2010 Measures No 1) Act 2010* (Cth) sch 6 pt 6 div 1 items 67, 79. See now *TAA* sch 1 s 284–75(5).

The overall effect of this new situation under the safe harbours is that when there is a dispute between a tax agent and taxpayer, the tax agent may be less likely to cooperate and provide information to the taxpayer because that information is more likely to be used against them. Thus, the evidentiary onus could be even more difficult for a taxpayer to satisfy. This specific difficulty created by the safe harbours, in addition to the general difficulty faced by taxpayers of obtaining sufficient evidence to discharge the onus, seems incongruent with the consumer protection rationale of the safe harbours. Perhaps once a taxpayer proves that they provided all relevant taxation information — which may be difficult in itself⁹⁵ and perhaps should be changed⁹⁶ — the legislation should explicitly put the onus on the tax agent to prove how and why the error occurred. The tax agent should have the required information and competence to do this better than the taxpayer, and such a course would more closely align with the consumer protection rationale of the safe harbour provisions. As the legislation currently stands, the evidentiary onus limits the consumer protection potential of the safe harbours because of the likelihood of dispute between tax agent and taxpayer when there is an error.

E Too Narrow a Harbour? — The Tax Agent's Intentional Disregard or Recklessness

Many of the submissions on the draft legislation raised a concern about whether the safe harbours are too narrow. The submissions raised three instances where the safe harbours are arguably too narrow. The first is where the taxpayer is a victim of the tax agent's intentional disregard or recklessness.⁹⁷ In other words, the submissions indicated that the taxpayer should not be liable for any mistake of the tax agent. The legislation as it stands absolves the taxpayer of liability for what would normally be minor errors or oversights through a failure to exercise reasonable care by the tax agent. In effect, it allows the agent to operate within their competence without the taxpayer querying every decision. Such a situation may strengthen the taxpayer-agent relationship. However, the taxpayer has to oversee and look out for serious errors, though the new tax agent services regime should hopefully minimise these through education and experience requirements.⁹⁸ This is perhaps a correct outcome since the current safe harbours allow the taxpayer to delegate most of the responsibility for the preparation of their tax returns to someone arguably more competent. However, the safe harbours do not allow a taxpayer to avoid all responsibility; the legislation requires a taxpayer to look out for and prevent recklessness and intentional

⁹⁵ See Michael Payne-Mulcahy, 'Taking Care of Business' (2007) 42 *Taxation in Australia* 23, 27.

⁹⁶ See The Institute of Chartered Accountants in Australia, above n 63, 2.

⁹⁷ Commonwealth and Taxation Ombudsman, above n 63, 2; Taxation Institute of Australia, above n 63, 2.

⁹⁸ See Margaret McKerchar, Kim Bloomquist and Sagit Leviner, 'Improving the Quality of Services Offered by Tax Agents: Can Regulation Assist?' (2008) 23 *Australian Tax Forum* 399, 421.

disregard if they wish to take advantage of the safe harbours.⁹⁹ As discussed above, such oversight is difficult, but a taxpayer must bear some personal responsibility for their own tax affairs to enable a system of self-assessment to work effectively. After all, the tax agent is an agent, not a guardian, and is generally bound to comply with the dictates of the principal. Indeed, a taxpayer has broad power to direct a tax agent to file a tax return as drafted or to make changes to it. As long as a taxpayer has some power to control a tax agent, they must bear some responsibility for that agent's actions. The safe harbours have to protect taxpayers, since consumer protection is one rationale for their enactment, but they also have to maintain the notion of responsibility that is central to the integrity of the self-assessment taxation system. Thus, this narrowness serves the useful purpose of maintaining some level of individual responsibility. In any event, just because a taxpayer does not have access to the safe harbour does not mean that they will be liable to a penalty. The remission power¹⁰⁰ of the Tax Commissioner may be exercised to remit all or part of the penalty. So, with respect to those who have submitted that the safe harbours should be broadened to encompass all types of tax agent errors, there is a clear reason for keeping the safe harbours narrow in this respect.

F Too Narrow a Harbour? — Only Agent-Lodged Documents Covered

The second instance of narrowness is the requirement that the false document be lodged, or fail to be lodged, by the agent.¹⁰¹ The Taxation Institute of Australia submitted that the safe harbour should be widened to include the situation where the taxpayer lodges a return prepared by a tax agent.¹⁰² Currently, a taxpayer moves outside the protection of the safe harbours if he or she signs and lodges a return prepared by a tax agent. Therefore, if the tax agent fails to exercise reasonable care, the taxpayer could be liable for a penalty. There seems to be some merit in the Taxation Institute of Australia's submission; under the current legislation, there is a distinction between whether the tax agent or the taxpayer lodges the same return that has been prepared by the agent. To provide access to such a useful safe harbour based on who lodges the same return is unsatisfactory. With perhaps a little flippancy, it is but one small further step to distinguish between online and paper lodgement.

However, it is equally possible to argue *for* the narrowness of the safe harbour in this regard. First, most agents lodge documents for their taxpayer principals,¹⁰³ and therefore the safe harbours, despite this narrowness, could still be said to protect most consumers. Even where it would not be a taxpayer's normal routine to use a tax agent, a prudent taxpayer could direct the tax agent to lodge

⁹⁹ See *TAA* sch 1 ss 284-75(6)(d), 286-75(1A)(d).

¹⁰⁰ See *ibid* sch 1 s 298-20(1).

¹⁰¹ See *ibid* sch 1 ss 284-75(6)(c), 286-75(1A)(c).

¹⁰² Taxation Institute of Australia, above n 63, 2.

¹⁰³ See Australian Taxation Office, *Taxation Statistics 2007–08: A Summary of Tax Returns for the 2007–08 Income Year and Other Reported Tax Information for the 2008–09 Financial Year* (2010) 10.

their return for them. If the agent is not willing to do this, and the demand causes friction in the working relationship between tax agent and taxpayer, then it is probably a good idea to reconsider the relationship anyway. Secondly, in order to comply with the Taxation Institute of Australia's suggestion, the safe harbours would need to be amended to cover situations where the document is prepared by the tax agent but lodged by the taxpayer; this could create a new interpretive issue about the interpretation of the word 'prepared'. It is easy enough to see if an agent makes a statement because there will be a record of them lodging it. Thus, if there is no record, the agent did not make the statement. In contrast, there can be different degrees of preparation. An agent could fully create a document and the taxpayer only sign and lodge it. Alternatively, an agent could create the more complex parts of a return that relate to, for example, research and development concessions or capital allowances while the taxpayer simply inserts these into a return which they complete. With so many different levels and types of 'preparation', the term is ripe for interpretive disputes which will impede the certainty that the safe harbours strive for.

Lastly, this narrowness may protect the tax agent from a mistake outside their control. After all, despite the frequent references to consumer protection, part of the purpose of the tax agent regime (of which the safe harbours are a part), for some, is to protect the tax agent since they have heightened responsibility.¹⁰⁴ For example, it would be unfair to make the agent liable under the tax agent disciplinary regime for a mistake in a return they substantially prepared but did not lodge, if the mistake was due to the taxpayer modifying the return. If the agent lodges the return, document or statement, they have the ability to check it a final time. While the taxpayer does not have the opportunity to make a final check of the return in this situation, they have the possible benefits of the safe harbours. Therefore, keeping the safe harbours narrow in this respect is perhaps justifiable as a fairer balancing of risk in line with the rationale for their enactment. Thus, while the Taxation Institute of Australia's argument against the narrowness of the safe harbours in this respect has initial merit, keeping them narrow in relation to who makes a statement will still protect most taxpayers while also avoiding new uncertainty. It is still perhaps a fair balancing of risk.

Once again, however, this issue is also of relevance when the Henry Review is considered. The Henry Review, as already stated, recommends simplified pre-filled returns.¹⁰⁵ The current situation — which only protects the taxpayer if the return is lodged by a tax agent — may inhibit the Henry Review's aim to reduce tax agent use. A taxpayer may still use a tax agent simply to obtain the protection of the safe harbour whilst also obtaining the benefit of the standard deduction. Thus, the effect of the safe harbours must be considered when the government considers pre-filled simplified returns in the future. As discussed above, the safe harbours may also limit the effectiveness of the standard deduction provisions.

¹⁰⁴ See Association of Taxation and Management Accountants, Submission to Treasury, *Revised Exposure Draft Tax Agent Services Legislation and Explanatory Materials*, 27 June 2008, 3.

¹⁰⁵ See above n 81 and accompanying text.

G Too Narrow a Harbour? — The Other Failure to Lodge Penalty

The third and last instance of narrowness raised by the submissions is that one penalty for failing to lodge a document on time is covered, but not another. As discussed above, there are two penalty provisions applicable when a document is not lodged on time, but the safe harbours only apply to penalties for failure to lodge under s 286-75(1) of the *TAA*, not to those under s 284-75(3).¹⁰⁶ The Taxation Institute of Australia submitted that the safe harbours should be extended to cover both penalties.¹⁰⁷ A taxpayer may be liable for a penalty under s 286-75(1) for each 28-day period or part thereof during which a document is outstanding.¹⁰⁸ However, for a penalty to apply under s 284-75(3), the Tax Commissioner must have assessed the tax-related liability to which the document related. This will generally only occur after warnings to the agent and/or taxpayer and an audit or some information gathering process.¹⁰⁹ Once a taxpayer or agent receives a warning or notice of this failure, they can rectify it quickly and the taxpayer may fall within the safe harbour. However, if a warning or notice is given and the document is still outstanding for a length of time, the Tax Commissioner may carry out the assessment under s 167 of the *Income Tax Assessment Act 1936* (Cth).¹¹⁰ Thus, s 284-75(3) penalties are usually imposed in cases of recklessness or intentional disregard of the law, which the government does not seek to protect.¹¹¹ It is suggestive that the penalty for a s 284-75(3) breach is set at 75 per cent of the tax-related liability,¹¹² which is the same percentage as shortfalls caused by intentional disregard.¹¹³ Therefore, this last instance of narrowness, while seemingly odd at first glance, does have a supportable rationale behind it. However, there are two more issues, not raised in the submissions, that need to be mentioned: whether there has been an effect on the standard of reasonable care expected and the relationship of the safe harbours with the adjustment provisions.

H The Problems with an Absolute Absolution

Before the next issue is outlined, some context is needed. The adjustment rules relating to the amount of any administrative penalty under the uniform penalty system encourage compliance even when a taxpayer is in error. The amount of the penalty is reduced to the extent that it is caused by following the advice of the Tax Commissioner, general administrative practice under the law or a

¹⁰⁶ See *TAA* sch 1 ss 284-75(6), 286-75(1A).

¹⁰⁷ Taxation Institute of Australia, above n 63, 2.

¹⁰⁸ *TAA* sch 1 ss 286-80(1)–(2).

¹⁰⁹ See generally Australian Taxation Office, *Making Default Assessments: Section 167 of the Income Tax Assessment Act 1936 and Other Similar Provisions*, PS LA 2007/24, 9 November 2010.

¹¹⁰ See generally *ibid*.

¹¹¹ See Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 17.

¹¹² *TAA* sch 1 s 284-90(1) item 7.

¹¹³ *Ibid* sch 1 s 284-90(1) item 1.

statement in a publication approved in writing by the Commissioner.¹¹⁴ Furthermore, a statement is not misleading or false if both the taxpayer and the tax agent took reasonable care in making the statement.¹¹⁵ Both of these could mean that the entire penalty is removed. The other increase and decrease provisions also encourage compliance in the instance of an error, but they generally do not remove liability entirely unless, for instance, there has been a voluntary disclosure and no shortfall.¹¹⁶ The base penalty is increased by 20 per cent if the taxpayer took steps to prevent or obstruct the Commissioner from finding out about the shortfall,¹¹⁷ or the taxpayer became aware of the shortfall in the statement after it had been made to the Commissioner but did not tell the Commissioner about it within a reasonable time.¹¹⁸ Therefore, a base penalty amount of 75 per cent would be increased to 90 per cent if the taxpayer tried to cover up the mistake. On the other hand, the penalty amount is reduced by 20 per cent if the Commissioner informs the taxpayer that an audit will occur and the taxpayer voluntarily informs the Commissioner of the shortfall and the voluntary disclosure can reasonably be estimated to have saved the Commissioner a significant amount of time or resources.¹¹⁹ If the taxpayer voluntarily discloses the shortfall to the Commissioner before an audit is announced or before the day that the Commissioner makes a public statement requesting voluntary disclosure, the penalty is reduced by 80 per cent if the shortfall is \$1000 or more and 100 per cent if the shortfall is less than \$1000.¹²⁰ The Commissioner is able to treat a voluntary disclosure as occurring before an audit is announced if it is appropriate based on the circumstances.¹²¹ Generally, there is value in an incentive to comply when in non-compliance with the law.¹²² Specifically, these adjustment provisions provide an incentive for taxpayers to voluntarily disclose errors and to attempt to comply with the tax laws even after an action liable to penalty. This in turn aids in maintaining the integrity of the tax system as a self-assessment system must rely heavily on self-confession and self-reprimand.

The way that the safe harbours are drafted may have unintended consequences for regulators and this issue has not been raised in the submissions on or commentary about the safe harbours. Under the safe harbour provisions, if the conditions of the safe harbours are met, '[y]ou are not liable to an administrative penalty'.¹²³ Therefore, if a taxpayer is within the safe harbour, there is practically no incentive provided by pt 4-25 to voluntarily disclose a shortfall to the Tax

¹¹⁴ Ibid sch 1 s 284-224(1).

¹¹⁵ Ibid sch 1 s 284-75(5).

¹¹⁶ See ibid sch 1 s 284-225.

¹¹⁷ Ibid sch 1 s 284-220(1)(a).

¹¹⁸ Ibid sch 1 s 284-220(1)(b).

¹¹⁹ Ibid sch 1 s 284-225(1).

¹²⁰ Ibid sch 1 ss 284-225(2)–(3).

¹²¹ Ibid sch 1 s 284-225(5). For the Commissioner's approach to this question, see Australian Taxation Office, *Shortfall Penalties: Voluntary Disclosures*, MT 2008/3, 12 November 2008, 9–10.

¹²² See Australian Law Reform Commission, above n 65, 888.

¹²³ TAA sch 1 ss 284-75(6), 286-75(1A).

Commissioner. The sole incentive is that a taxpayer may be covered by interest charges outlined above if the Tax Commissioner finds out about the error,¹²⁴ but this does not provide the same level of incentive. By removing this incentive, the safe harbours do not aid as much in preserving the integrity of the tax system, and this is counter to one of the rationales for the safe harbours. To make matters worse, the taxpayers most likely to become aware of an error are more sophisticated taxpayers and their compliance is an important example to other taxpayers, which aids in rigorous and honest self-assessment. The safe harbours should be amended so that they are included within the adjustment provisions. Otherwise, the safe harbours may be more useful to pragmatic and sophisticated taxpayers looking to avoid liability through technical correctness rather than the consumers of tax agent services that the safe harbours seek to protect.

Such an outcome would be contrary to the tax system design principles of the Henry Review. The Henry Review states that '[r]ules in one part of the system should not contradict those in another part of the system.'¹²⁵ The safe harbour provisions do not encourage voluntary disclosure and compliance, and this does not provide a level of internal consistency commensurate with a modern and well-designed tax system. Furthermore, the safe harbours should be as much as possible consistent with government policy.¹²⁶ Yet the lack of incentive when within the safe harbours is not consistent with the government policy of encouraging voluntary compliance to improve transfer system efficiency. Thus, if the Henry Review's design principles are used as the shining light of future reform, then it would seem imperative to revisit the safe harbours as part of any attempt to remove loopholes and generally improve the design of the tax system.

I Has the Bar of Reasonable Care Been Lowered?

The last issue is again one of interpretation and could be the most significant, as it is the one that could prove to be a popular loophole. As discussed above, the legislation says nothing about the culpability of the taxpayer. However, the Bill's explanatory memorandum states that:

Using the services of a tax agent or a BAS agent does not of itself mean that an entity discharges their obligations. It remains the entity's responsibility to properly record matters relating to their tax affairs and to bring all of the relevant facts to the attention of the agent in order to show reasonable care. By supplying all relevant taxation information the taxpayer *is* taking reasonable care.¹²⁷

While the first sentence echoes the current definition of reasonable care as espoused by the Tax Commissioner,¹²⁸ the second two propositions are more problematic. While recording tax affairs and providing all relevant information is

¹²⁴ See *ibid* sch 1 s 280-100.

¹²⁵ *Henry Review Report Overview*, above n 80, 17.

¹²⁶ See Review Panel, *Australia's Future Tax System: Consultation Paper* (2008) 35–6.

¹²⁷ Explanatory Memorandum, Tax Agent Services (Transitional Provisions and Consequential Amendments) Bill 2009 (Cth) 19 (emphasis added).

¹²⁸ See Australian Taxation Office, *Penalty Relating to Statements: Meaning of Reasonable Care, Recklessness and Intentional Disregard*, MT 2008/1, 12 November 2008, 13.

part of exercising reasonable care under the current definition,¹²⁹ the explanatory memorandum could be interpreted as stating that this is all that is required to be done to exercise reasonable care. If this is correct, the explanatory memorandum may actually lower the bar in relation to reasonable care since the current definition requires more than this of the taxpayer.¹³⁰ This is only really an issue and a loophole for the sophisticated taxpayer, who may have to do more than simply provide information to the tax agent under the current definition.¹³¹ A taxpayer could simply bombard the tax agent with information, even if it is not asked for, in order to be certain of providing all information. A taxpayer would then only have to be wary of any *real* risk of error or incorrectness to avoid a finding of recklessness.¹³² With a professional and experienced tax agent, the real risk of error is not large. At a minimum, this issue creates some uncertainty that is counterproductive to the rationale underpinning the safe harbours. At worst, it creates a loophole which does not constitute a fair balancing of risk, which is another rationale for the safe harbours. Therefore, further guidance is needed in the extrinsic materials as to how the safe harbours affect the meaning of reasonable care. Once again, the same consistency of design concerns mentioned in the Henry Review¹³³ can be applied to this issue.

J *The Safe Harbours Evaluated in Isolation*

As discussed above, the safe harbours aim to enhance the protection of consumers and reduce the level of uncertainty imposed on them under self-assessment, to improve tax agent regulation and to strengthen the integrity of the tax system.¹³⁴ Generally, the safe harbours have been well drafted to achieve these ends. However, there are some problems that undermine these goals. This article has not questioned the wisdom or desirability of these ends, as the concept and aims of the safe harbours are the product of a decade-long period of consultation and review. However, since the actual provisions enacting these ends are, by comparison, rather new and untested, recommendations have been proposed in relation to the issues outlined above in order to improve the drafting of the provisions. This should more closely align the drafted safe harbour provisions with their aims.

One of the most important impacts of the safe harbours is on the agent-taxpayer relationship.¹³⁵ In most cases, the safe harbours will strengthen that relationship as agents can offer taxpayers protection from liability.¹³⁶ However,

¹²⁹ See, eg, *ibid*; *Mezrani v Federal Commissioner of Taxation* [2009] ATC ¶10-103, 3055 [34] (Deputy President Tamberlin).

¹³⁰ See, eg, *Necovski* (2009) 75 ATR 152, 154 [13] (Member Frost).

¹³¹ See *ibid* 153-4 [9]-[10].

¹³² *Mezrani v Federal Commissioner of Taxation* [2009] ATC ¶10-103, 3054 [29] (Deputy President Tamberlin), quoting *BRK (Bris) Pty Ltd v Federal Commissioner of Taxation* (2001) 46 ATR 347, 364 (Cooper J).

¹³³ See *Henry Review Report Overview*, above n 80, 17.

¹³⁴ Explanatory Memorandum, Tax Agent Services Bill 2008 (Cth) 129.

¹³⁵ See Webb, above n 48, 2.

¹³⁶ *Ibid*.

there is a chance that the safe harbours will prove to be a wedge between taxpayers and tax agents because one party may attempt to lay the blame on the other, rather than both parties adopting the same position. Positively, the safe harbours should 'effectively [protect] the client taxpayer where they act honestly and openly with their tax advisers'.¹³⁷ The safe harbours should also 'empower taxpayers to expect and demand higher standards from their tax agents'.¹³⁸ However, there are other issues which should also be addressed in the near future.

First, there may be an interpretive issue because the legislation does not say anything about the culpability of the taxpayer. It is suggested that the provisions be changed to remedy this. Secondly, the evidentiary onus of the safe harbours may practically limit the efficacy of the provisions and should be carefully reconsidered. Thirdly, the scope of the safe harbours is limited by the requirement that the tax agent, and not the taxpayer, make the false or misleading statement or fail to lodge the document. However, this may not actually undermine the goals of the safe harbours. Fourthly, the safe harbours do not operate in conjunction with the adjustment provisions that apply to shortfall penalties. This may prove to be significant once taxpayers realise there is no incentive to voluntarily disclose an error if the safe harbours apply. It is suggested that the provisions be changed to remedy this. Finally, the safe harbours may lower the bar in relation to reasonable care due to certain comments in the explanatory memorandum. This is a mere interpretive ambiguity that can be remedied with more guidance, but it could also turn out to be a popular loophole. Further guidance is required from the government. The fourth and fifth issues were not raised in any of the submissions to the Treasury.

These issues may detract from the aims of the safe harbours. All that remains in this article is to evaluate the safe harbours as part of the tax system more broadly and in light of the taxation policy discourse instituted by the Henry Review and current taxation initiatives based on the Review. It is the interrelationship between the safe harbours, current initiatives and broader taxation policy that makes the operation of the safe harbours more than just a technical concern.

V TAXATION POLICY

As discussed above, there are three other ways that the safe harbours and the aforementioned issues may play a role in wider policy discourse. First, some of the issues identified above are contrary to the design principles for the tax system outlined by the Henry Review. There is a lack of consistency, both internally and externally, and a lack of equality. Before new provisions and ideas are incorporated into the tax system, reform of existing provisions should be considered so that the new provisions fit better into the system from the outset. Secondly, while it is clear that a number of measures are being either imple-

¹³⁷ Sue Williamson, 'Tax Agent Services Bill' (2008) 43 *Taxation in Australia* 4, 4.

¹³⁸ McKerchar, Bloomquist and Leviner, above n 98, 421.

mented or considered which aim to improve the simplicity and cost of tax compliance for taxpayers who currently manage, or would be enticed to manage, their own affairs, the use of tax agents would not be removed entirely. There will remain those who will use tax agents for protection, convenience or for complex tax affairs. It would be unfair to leave these people out in the cold without the best designed safe harbours possible.

Lastly, the operation of the safe harbours may provide an incentive for taxpayers to use tax agents. As stated above, the Henry Review and the government have explicitly aimed to improve the simplicity of the tax system through, first, standard deductions and, perhaps later, pre-filled tax returns.¹³⁹ The potential efficacy of such measures in reducing the use of tax agents and their associated costs would be improved by small yet significant redesigns of the safe harbour provisions. By logic, any incentives that are designed to allow taxpayers to avoid tax agent use (which are currently being considered) must take into account any incentives to use a tax agent. To do otherwise would be to take too narrow a view. With a few technical amendments and clarifications of the safe harbour provisions, as outlined above, the potential efficacy of current initiatives can be improved. Therefore, the improvement of the safe harbour provisions is not just an issue of designing the tax system to push towards a number of abstract design principles for the future. It is about improving the safe harbours so that they more faithfully protect consumers and do not become loopholes for penalty avoidance in order to improve the efficacy of existing provisions.

VI CONCLUSION

The operation of the safe harbours will need to be revisited in light of new initiatives. It would not be comprehensive to consider incentives for taxpayers to choose not to use a tax agent without also considering incentives to use an agent due to the safe harbours. Thus, the operation of the safe harbours is not a future abstract issue; it could affect a key new taxation initiative and its efficacy. Furthermore, the safe harbours will have to be considered in light of certain failures to align with good design principles espoused by the Henry Review. Even if no current initiative were affected, the issues identified above in relation to the operation of the safe harbours would be just as significant and relevant. The issues discussed in this article could commonly arise, given that the safe harbours will apply to the large class of ordinary taxpayers who use tax agents. The effect that these issues may have on ordinary taxpayers may be significant. Based on this, the safe harbours would have to be a 'risk' requiring consideration and mitigation, perhaps through the recommended amendments and clarifications outlined in this article. To conclude, the new safe harbours are admirable, but not perfect. There are still some dangerous reefs, unpredictable winds and uncharted sandbars that may take aback the unsuspecting mariner.

¹³⁹ See *Henry Review Report Overview*, above n 80, 31.