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Appendix A

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1. Overview - Rod Douglass Case

The defence of Rod Douglass is one case to which Self-Employed Australia has devoted major resources given that we view his treatment by the ATO as grossly unjust amounting to major abuse. The treatment of Rod by the ATO demonstrates many of the conclusions, allegations and criticisms we make of the ATO.

(Note: Rod has granted us approval to provide information on his case in this submission.)

Rod's case is in two parts. The first has been through the courts to a conclusion in which the ATO withdrew its allegation of fraud/evasion. The second is in continuing dispute with the ATO.

There two parts to Rod's case as follows:

a) Allegation of Fraud/Evasion
The ATO alleged that Rod committed a 'blameworthy act or omission …and that the avoidance of tax was due to fraud or evasion' where he made 'false or misleading statements'.
**After some 18 months of maintaining its allegation, the ATO eventually withdrew the allegation giving a court undertaking to this effect.

b) Personal Services Income; Results test
Whether Rod's business satisfied the Personal Services Income tax laws.
**Some two years into the case the matter is undergoing protracted court hearings.

1.1 Sequence of events of Rod's situation : to July 2015

- Rod is a highly skilled information technology engineer specializing in the mining/resources sector in Western Australia.
- Now in his late 50s, Rod has worked as a self-employed person for close to 30 years. He has always submitted his own tax returns and normally operated a partnership with his spouse distributing the partnership income according to what the ATO said was acceptable from time to time. (Note the ATO's position on this has shifted frequently over many years.)
- In 2005, ATO Commissioner Carmody issued a Practice Statement published on the ATO website which stated that splitting income with a spouse was legal and acceptable. The reasoning was that, under partnerships, individual partners cannot avoid partnership losses and therefore are entitled to partnership profits Carmody's statement had qualifications around passing the Personal Services Income tax rules, but was otherwise quite clear to the ordinary person. The Commissioner cited a precedent-setting court case supporting his Statement. The Statement seemed to settle the ATO's previously shifting views on the matter.
- Rod read Carmody's statement and, based upon that, from the 2006 tax year distributed 50 per cent of income to his spouse, a practice which he continued until 2015. He declared all income and paid all taxes due by both partners. The ATO processed and did not query the tax returns.
- In early 2015 the ATO audited Rod, asking questions.
- In July 2015 the ATO issued Rod a letter rejecting his income distribution through the partnership, backdated this to 2006 and issued him a hefty tax bill. After further correspondence from the ATO, the tax bill, including interest and penalties, amounted to around:
    - $440,000 for four of the seven years 2006 to 2012
    - $140,000 for the years 2013 and 2014.

- Rod approached Self-Employed Australia in July 2015 and made available to us all his tax records and ATO correspondence. After considering his situation we decided to assist.

1.2 The allegations against Rod by the ATO

Rod has given us permission to make public key correspondence from the ATO to him. See the (redacted) letter from ATO to Rod dated 30 July 2015.
http://www.selfemployedaustralia.com.au/Downloads/Taxation/ATO-to-Rod-Douglass-30-July-2015-Redacted.pdf

In this letter the ATO accuses Rod of committing "fraud or evasion", based on a "blameworthy act or omission" where he made "false or misleading statements". The 'evidence' upon which the fraud of evasion was alleged is that Rod:

- Did not keep a copy of the court decision or note the name of the court decision he said was included in Commissioner Carmody's 2005 Statement.
- Did not seek professional advice or contact the ATO.
- Understood the Personal Services Income rules.
- Could not provide past contracts with labour hire firms used.

In addition, the ATO said that the Carmody Statement was qualified by the need to pass the Personal Service Income tax rules and that Rod did not pass those.

2. Understanding the Fraud or Evasion 'trigger'

In 2005 Parliament reinforced existing laws that were supposed to bring high levels of certainty and fairness to people's tax circumstances. The law allowed people to self-assess their income and tax and to lodge their tax returns accordingly. For most individuals and small businesses the ATO has two (2) years in which to accept or reject the tax return. After that, the ATO cannot challenge the return. The law requires the ATO to be administratively efficient in processing tax returns and is intended to give tax certainty and comfort to each individual taxpayer after the two-year period. However, the law also allows that where the ATO 'forms an opinion' that the taxpayer has committed fraud or evasion, the ATO can investigate and challenge tax returns going back in time as far as it chooses.

This is what the ATO did with Rod Douglass. By 'forming an opinion' that Rod had committed fraud or evasion, the ATO was able to revisit Rod's tax returns to 2006. Consequently the ATO was able to conduct an action against Rod claiming some $580,000 in tax owed instead of around a $140,000 claim if the claim had been restricted to the two years of 2013 and 2014.

3. Our commitment to the ATO to trial its processes

Self Employed Australia has had working relations with the ATO since our formation in 2000. We have had long experience on ATO small business consultative committees.

We have working relationships at senior levels in the ATO where they had offered to look into specific cases we brought to them. In Rods case we made a commitment that we would work through the ATO's internal review processes as an initial step and report back to them. This was accepted by the ATO as a sensible approach.

At the point of reaching this understanding with the ATO we were already involved with Rod. Hence his was one of the cases that we were using as a test. Rod's case was a good example because it contained within it a great deal of the ATO patterns of behaviour that we had witnessed in other cases. In fact we had specifically brought to the attention of senior officers at the ATO that we were actively involved in Rod's case and we provided them the appropriate references (with Rod's approval). Further, we described and informed them of the ATO review procedures that we were following. The process here was that Rod undertook all action and ATO communication. We provided advice, consultation, legal and other support in the capacity as his 'tax advocate'.

4. The sequence of ATO communication and review

4.1 July 2015 to June 2016

30 July 2015. Letter from ATO to Rod with allegations and claims as described/provided.

22nd August 2015. Letter from Rod to ATO rejecting claims and requesting ATO 'Alternative Dispute Resolution' (ADR) (see notes below).

Late August 2015. Rod lodged FOI request on the ATO for all files.

September 2015. ATO requested extension of time for Review.

29 October 2015. ATO responded to Rod's letter of 22 August essentially reiterating the ATO's position.

Mid-November 2015. ATO informed Rod that he'd completed the wrong Objection Form lodged in August and needed to fill out another form. (This was most confusing given that the ATO took two months to inform Rod of the 'correct' form.) It further transpired that the ATO only communicates on certain matters through the MyGov website, but Rod was not aware of this and the ATO did not inform him of this.

2 December 2015. Rod lodged new objection form.

Mid-December 2015. Rod travelled to South America with his wife to spend Christmas with his wife's family. Rod had now not had work since May 2015 due to the major downturn in the resources sector.

18 January 2016. ATO made a '50-50 payment offer' to Rod. Rod rejected this.

29 February 2016. ATO wrote to Rod reiterating its position yet again.

13 March 2016. ATO informed Rod that the 'In House Facilitation Process' cannot address or discuss 'technical' issues (for example, whether Rod has committed fraud or evasion).

21 March 2016. The new Review Officer who had been allocated to Rod and had genuinely tried to assist with the process informed Rod that he had referred the matter to 'technical advisors'.

21 March 2016. Rod wrote to the ATO that if In House Facilitation cannot consider 'technical issues' (for example, fraud allegation) can this be addressed in ADR.

31 March 2016. To enable a productive In House Facilitation/ADR process Rod asked the ATO to provide further details on its reasoning behind the fraud and other allegations. The ATO advised Rod that it would not be providing any further explanation other than that contained in existing correspondence. In

other words, the allegations are made without any detailed reasoning or justification provided.

11 April 2016. ATO advised Rod it would allow time for him to make pre-In House Facilitation submissions.

15 May 2016. Rod submitted his responses, including eight supporting files from ATO documents received under FOI.

15 May 2016. Rod became concerned that if he returned to Australia, the ATO would put a 'prohibition order' on his passport preventing him from leaving Australia even while the In House Facilitation was pending.

15 May 2016. ATO advised Rod that it could not guarantee that a passport prohibition order would not be issued. Further, the ATO officer organizing the In House Facilitation informed Rod that she was withdrawing from the process.

29 June 2016. Rod received a letter from the ATO rejecting Rod's objections and reiterating its position and claims against him.

During this period (detailed above) Rod also lodged a complaint with the Inspector-General of Taxation (IGT). The IGT is able to investigate the ATO's treatment of individual taxpayer cases but can only review whether the ATO has been following correct procedures. The IGT cannot investigate the substance of a case (for example, whether Rod had committed fraud or evasion). The sequence of events with the IGT was as follows:

4.2: 19 November 2015 to 30 September 2016

19 November 2015. Rod lodged a complaint with IGT. IGT made initial inquiries of the ATO. This resulted in the ATO allocating a new Review Officer to investigate Rod's case. It appears that the IGT informally monitored progress of the 'In House Facilitation'.

23 May 2016. Following the withdrawal/collapse of the In House Facilitation process Rod lodged a further complaint with the IGT.

25 May 2016. The IGT advised Rod that it had talked with the ATO who gave the reason that the withdrawal of the In House Facilitation was because Rod was not in Australia.

30 June 2016. Rod was also informally told by the IGT that the ATO advised that Rod had not objected to the penalty and that a different form should be used for this. Rod wrote to the IGT in dismay that no-one at the ATO informed him of this and asked whether objecting to the penalty was a tacit acceptance by him of the ATO's claims against him.

5. The Inspector-General of Taxation Report

30 September 2016. The IGT supplied Rod with a report on the actions taken and its findings on his complaint.

The IGT summarized Rod's complaints as being that

- "the ATO had reached a predetermined position at audit and had approached its information gathering on that basis;
- the ATO withdrew its agreement to in-house facilitation without warning; and
- the ATO audit decision was not clearly explained to you, in particular the evasion opinion, the application of the personal services income

(PSI) rules and the imposition of penalties."

The IGT report is an extremely detailed 21-page account of the ATO's actions and processes in handling Rod's case. It includes extensive references to ATO emails obtained by Rod under his FOI applications.

The IGT found that, overall, the ATO had not formed a predetermined position but made the following observations:

- "..the ATO officer/s has/have exposed themselves to valid criticisms that their approach in formulating the fraud or evasion opinion and the application of the law in relation to penalties was influenced by revenue considerations. Furthermore, until the ATO's response to the IGT's investigation on this issue, the ATO did not appear to have taken any steps to address your concerns in this regard which has placed the ATO in a position where the adverse perceptions have been exacerbated unnecessarily."

In response to the complaint about the withdrawal of the in-house facilitation, the IGT observed that:

- "…However, given your current concerns regarding the possibility of a DPO (passport prohibition order) being issued and the impasse that has been created, we are of the view that as a matter of good public administration and a sign of good faith the ATO should consider alternatives which may achieve similar outcomes, for example whether the in-house facilitation could be done by way of video conferencing."

In response to the issues of substance—namely, the PSI laws—the IGT observed that:

- "We understand that as the ATO had determined that the test could not be satisfied due to you being paid for your time rather than results of your work, the ATO was of the view that the remaining criteria need not be considered."
- "Whilst TR 2001/8 is not explicit in its requirement for ATO officers to have considered all factors set out in paragraph 110, we note that the lack of sufficient explanation as to why those factors were not addressed as part of the 'results test' can contribute to the adverse perceptions held by the taxpayer."

However

- "Ultimately, we note that the correctness of the ATO's view of what is needed to meet the relevant tests is an issue going to the merits of the decision. Such an issue falls outside of the jurisdiction of the IGT…"

In relation to the allegation of fraud or evasion by Rod, the IGT observed:

- "The Commissioner's opinion of fraud or evasion is a one with severe consequences for taxpayers. In addition to the connotations of criminality, it also allows the ATO to review and amend assessments for income years that are outside the statutory period of review."
- "However, in cases in which fraud or evasion has not been proven, but only an opinion formed, such an outcome would put the taxpayer at a disadvantage as they may not have the requisite evidence to

prove such assessments are excessive because they did not keep the records nor were they required to do so. The House of Representatives Standing Committee on Tax and Revenue in its *Inquiry into Tax Disputes* observed similar concerns."

- "We also note that neither the PSLA or Guidelines (relating to fraud opinions) imposes an obligation on the part of the ATO to provide an opportunity for taxpayers to comment."
- "Based on our review of the leading cases which are cited and quoted in these ATO publications, it would appear that some omission or intention to withhold information to prevent the Commissioner from uncovering the misstatements is also a necessary consideration. If it were not, there would be a real risk that such an approach to evasion would result in a large number of taxpayers being inadvertently or unintentionally caught out where they had done no more than fail to exercise appropriate diligence or made honest mistakes in discharging their tax obligations. Due to similar issues that have also been raised by other complainants, as well as comments made by the Standing Committee previously, the IGT may consider this as a topic for broader review at a later time."
- "…there appeared to be a degree of uncertainty regarding the blameworthiness of the your actions. In setting out your conduct, there did not appear to be sufficient discussion of the fact that you only adopted your PSI income splitting approach when you were married or any discussion on what material information was being withheld or concealed from the ATO. This could suggest the possibility that you had misinterpreted the information available to you rather than you seeking to conceal information."

6. Our opinion of, and allegation against, the ATO about its use of fraud and evasion 'opinions': It's a scam!

Based on the Rod Douglass case, and many other cases, Self-Employed Australia has formed the view that the ATO routinely, and as a systemic process, concocts spurious claims of fraud and evasion against taxpayers that have dubious basis in fact, are unreasonable in the eyes of ordinary people and could ordinarily be expected to fail under the scrutiny of a court.

Our position on this arises from our view that 'opinion/s' of fraud or evasion, (certainly in Rod's case), allegedly come nowhere near the level of proof that would be required in a criminal allegation of fraud or evasion.

Further, the ATO knows its claims of fraud are spurious and unsupportable but deliberately follows this path because:

- The expense of conducting tax audits is such that the extra revenue to be gained from only undertaking audits over two years frequently does not justify the audit costs. However, if fraud is alleged, then much higher revenue can be gained. (For example, in the case of Rod Douglass, the fraud/evasion allegation led to a tax claim against Rod of an additional $580,000, whereas the two-year claim was/is for only $140,000.)

- The ATO knows/surmises that most individuals and small business people cannot afford the legal expense of defending themselves or the disruption to the income earning capacity of their business against such allegations. Consequently they are so intimidated by the process that they seek a settlement.
- The ATO knows/surmises that most individuals and small business people will seek assistance from a suburban accountant and/or lawyer who have little, if any, knowledge or expertise in such tax law and who can be easily intimidated by the tax specialist legal teams that the ATO can and does bring to such cases.

In addition, our understanding is that ATO audit case officers and their team supervisors are career assessed on the number of cases they 'close'. That is to say, if cases can be 'opened' and processes applied that bring enormous pressure to the small business taxpayer, it is likely in most cases that taxpayers will not be able to afford or have the resources to defend themselves and will 'fold' and seek to cut a deal with the ATO. In doing so, they are effectively admitting fault. The case is 'closed' in the ATO's favour and the case officer and supervisor have scored a career-enhancing 'scalp'. Given this, we allege that audit teams and their supervisors have a vested career interest in 'forming an opinion' of fraud or evasion.

We believe that this dynamic was in play in Rod's case when, on the 18 January 2016, the ATO made a '50-50' settlement approach to him (cited above). The ATO brought enormous pressure to bear on Rod, 'warmed him up' through intimidation, then offered him a way out that reduced his losses and costs but which required an admission of guilt on his part.

The ATO 'trick' is to do this within a bureaucratic system which, from the perspective of the accused taxpayer, is an opaque, impossible-to-understand 'dark tunnel'. From the perspective of the ATO and its administrative officers, however, it provides a cover of legitimacy. This allegation is admittedly cast in blunt terms. In its report to Rod the IGT uses (as could be expected) more circumspect language, but alludes to the problem nonetheless, saying:

> "..the ATO officer/s has/have exposed themselves to valid criticisms that their approach in formulating the fraud or evasion opinion and the application of the law in relation to penalties was influenced by revenue considerations."

An allegation of fraud or evasion, of course, is an allegation of criminal behaviour. The IGT in its letter to Rod states this well:

> "The Commissioner's opinion of fraud or evasion is a one with severe consequences for taxpayers … (including) …connotations of criminality…"

Under criminal law, an allegation of fraud is serious indeed and requires a high level of evidence and proof for it to be brought before a court for consideration. The allegation itself is devastating to an individual's reputational standing in the community. It is of the highest personal embarrassment and in the business environment cuts to the core of an individual's reputation for honesty. It has obvious consequences for the willingness of others to do business with that person. Such an allegation can have a serious negative impact on an individual's capacity to conduct his or her business and earn an income.

In Australia the rule of law requires that a person is considered innocent until a court rules otherwise. This is the protection that people have against false and spurious allegations of fraud being made against them. But this presumption of innocence does not, we observe, apply in the case of the ATO's powers, behaviours and tactics in its treatment of self-employed small business people.

The ATO only has to 'form an opinion' of fraud or evasion for it to act, reviewing an individual's tax returns beyond the two-year limitation, issuing massive tax bills sufficient to bankrupt a person and to garnish an individual's bank accounts and/or require the bill to be paid before the person can appeal against the ATO's 'opinion'.

When Parliament granted this power to 'form an opinion' to the ATO, it was (presumably) assumed that the ATO, as a government instrumentality, would act with the highest standards of integrity, would apply proper principles of justice and that its 'opinions' would be based on criminal-like standards of evidence. This is not, however, what we have observed in how the ATO makes use of its 'form an opinion' powers.

Instead, the ATO is acting like a hired gun of the government in a 'Wild West' exhibition of unconstrained power. For example, part of the 'evidence' the ATO used to claim fraud or evasion against Rod was that he had not kept records that went back to 2006. In its report to Rod, the IGT commented in general on this saying:

> "… in cases in which fraud or evasion has not been proven, but only an opinion formed, … they may not have the requisite evidence … because they did not keep the records nor were they required to do so.

That is, the ATO 'formed an opinion' of fraud or evasion on the basis of the taxpayer's (Rod's) failure to not do something that the taxpayer (Rod) was not required to do.

The question must be asked: who is conducting fraud here? We suggest that it is reasonable to claim that it is the ATO itself which is conducting a fraud against the taxpayer. Certainly if the standards of behaviour required of private-sector businesses were applied to the ATO on this issue, then the ATO looks very much like it is conducting an orchestrated and organized scam.

That fact that this could be viewed as an orchestrated and organized scam is somewhat reinforced by the observation from the IGT that

> "… neither the PSLA or Guidelines (relating to fraud opinions) imposes an obligation on the part of the ATO to provide an opportunity for taxpayers to comment."

That is, the ATO can allege fraud, act on that 'opinion', issue tax claims and penalties, garnish the money and bankrupt the individual—and throughout all that not be required to provide the individual with an opportunity to respond to the fraud allegation.

Although the IGT is certainly not alleging a 'scam', the IGT does identify (again in more constrained, circumspect language) a problem with the ATO's approach to forming 'opinions' of fraud or evasion:

> "…there would be a real risk that such an approach to evasion would result in a large number of taxpayers being inadvertently or unintentionally caught out where they had done no more than fail to exercise appropriate diligence or made honest mistakes in discharging their tax obligations. Due to similar issues that have also been raised by other complainants, as well as comments made by the Standing Committee previously, …."

In other words, this is a problem identified not solely in Rod's case, but in other cases that have been seen by the IGT and by a Parliamentary Committee.

The IGT's report to Rod of 30 September 2016 drew an important conclusion, stating:

> "…there appeared to be a degree of uncertainty regarding the blameworthiness of your actions."

That is, the IGT effectively called into question the ATO's certainty of its 'opinion' of fraud or evasion by Rod.

The ordinary person perhaps could have reasonably expected the ATO to pause over the IGT's report and reconsider its 'opinion'. Further, to our knowledge, the ATO was well aware of the IGT's response to Rod. In fact the response was based on the IGT's close investigations done directly with the ATO. But none of this triggered any repositioning by the ATO in relation to Rod.

Given the IGT's report and our own observations of the ATO's treatment of Rod we concluded that there was no hope of Rod being treated with any fairness by the ATO. In fact we formed the opinion that the ATO was acting in breach of the law.

These views had been developing as early as March 2016 when the ATO informed Rod that the 'In House Facilitation' could not consider 'technical' issues. That is to say, the ATO's review process made available to Rod would not consider, or even discuss, the core issue of whether Rod had committed fraud or evasion. If this were the case, what then is the purpose of the ATO's review process? We progressively formed the opinion that it was (and is) a process to make the ATO look as though it is acting reasonably. In other words, it's a mask to cover the ATO's entirely unreasonable, unfair, unjust and possibly illegal practices. This view was consolidated when the ATO withdrew the In House Facilitation in May 2016.

Given this circumstance we had for some time since March 2015 been considering the need to facilitate legal support for Rod with a view to appeal to the Federal Court.

7. The Federal Court action – Challenging the legality of the fraud or evasion opinion against Rod

7.1 Rod's defence

On 4 October 2016 a Statement of Claim in defence of Rod was lodged in the Federal Court. This action sought to test the allegation of fraud or evasion.

The Statement of Claim asked the Court to consider that

- The ATO does not have the legal authority to act on its opinion of fraud or evasion without first obtaining court approval.
  The Statement said;
  > "Section 170(1) Item 5 of the 1936 Act requires the existence of a valid fraud or evasion as a necessary jurisdictional fact prior to the issuance of any amended assessments issued under that head of power."

- The ATO's opinion of fraud or evasion is wrong because Rod had at all times disclosed all his income and work circumstances.
  The Statement said:
  > "The Purported Evasion Opinion was so unreasonable that no reasonable decision maker could have formed the view that there was evasion by the Applicants as the Applicants disclosed all material income to the Respondent."

- The alleged tax underpayment was not the result of fraud or evasion but a difference of view between the ATO and Rod as to the application of the PSI rules.
  The Statement read:
  > "The Purported avoidance of tax ...Was not the result of failure to disclose but instead as a result of the Respondent's differing view of the law, that is as to application of the personal services income rules."

7.2 Comment: Precedent against ATO practices

From a layperson's understanding, had the Court agreed with the Statement of Claim and ruled against the ATO, it would have set a precedent that for the ATO to act on its opinions of fraud or evasion it would first need to seek and obtain court approval. That is, it would have to apply to (say) the Federal Court.

In our view, the implications for the ATO would be extremely serious. It would effectively put a stop to the ATO acting exclusively on its 'opinions' of fraud or evasion. It would not be able to review tax returns reaching back beyond two years, issue huge bills and intimidate small business people into folding and 'cutting deals'. The ATO would be required first to have its 'opinions' tested before a court. And if the court found that fraud or evasion had occurred, then the ATO could act. This would, in our view, stop what we consider to be an organized and orchestrated process of scams being conducted by the ATO against self-employed small business people. Rod was and is just one example.

If the ATO is to act as a model litigant (as the Commonwealth Government asserts its departments do) the ATO should surely seek court approval before acting on an opinion of fraud or evasion. But, in our experience with small business people, the ATO behaves in every way that a model litigant should not behave.

The ATO asserts an authority to act on fraud and evasion opinions where we believe

the ATO most likely does not have the legal authority to do so. In our view, it acts illegally and is conducting a scam.

Not only do we contend that the ATO acts illegally but to the ordinary person the ATO defiles ideas of natural justice and the core principle of the rule of law. Natural justice holds that every person accused of a criminal act (in this case, fraud or evasion) has a right to have the allegation heard and tested before an independent review authority (the courts).

In its fraud and evasion actions, however, the ATO:

- Acts as inquisitor: Powers to interrogate self-employed taxpayers.
- Is policeman: 'Arrests' persons by way of issuing tax bills.
- Prosecutor, judge and jury in one: Compulsorily takes the money
- Jailer: Bankrupts people.

And the ATO does this without any effective independent oversight. If individuals wants to defend themselves, the only process is through the courts and most people cannot afford this. For example, if Rod Douglass had been obliged to pay for the support provided by Self-Employed Australia through the ATO review process and then in the Federal Court, his costs would have easily been in the order of $200,000 plus. There are few people who can afford this and the ATO know this, in our view. It is part of what we consider to be the ATO scam.

Following the filing of the Statement of Claim there were at least two confidential meetings between

- The Australian Government Solicitors and ATO lawyers and
- Rod's lawyers

The meetings were on 5 October 2016 and 25 November 2016. Neither meeting resulted in a settlement.

<u>7.3 The ATO withdraws. '…the opinion as to fraud or evasion was incorrectly formed…'</u>

On the 28 November 2016 Rod's matter was heard in the Federal Court in Sydney. The outcome was that the ATO withdrew its allegation of fraud or evasion against him.

In the court transcript the government's lawyer said:

> "The Commissioner has carefully reviewed his position in relation to the opinion as to fraud or evasion. As a result of that review, the Commissioner will no longer contend that there has been fraud or evasion…"

The Court Order stated:

> "The respondent (Commissioner of Taxation) undertakes to issue a letter … that, on the facts presently known to the respondent, the opinion as to fraud or evasion was incorrectly formed and, on that basis, is withdrawn.

Federal Court of Australia
Order 28 November 2016
No: NSD1700/2016

<u>7.4 Comment: Is the ATO aware it possibly acts illegally?</u>

For some 486 days from 30 July 2015 to 28 November 2016 Rod had been under a reputational cloud that he had committed a criminal act based on the most spurious of grounds, accused by an all-powerful government instrumentality that arguably acted beyond its authority.

It was not until the ATO was faced with, in effect, a constitutional challenge to its system of acting against small business people on 'opinions' of fraud or evasion that the ATO withdrew. In our view, the ATO's withdrawal could easily have been on the basis that it did not want to risk a court ruling that

a) could expose ATO misbehaviour in its conduct of fraud or evasion opinions and/or
b) passed adverse comment on the ATO's legal authority to act on its opinions of fraud or evasion without first seeking court approval.

If there is some (commonsense-based) truth to our speculation about the ATO's motivation to withdraw its claim against Rod, this could suggest that the ATO is well aware that its actions on opinions of fraud or evasion are highly questionable from a legal perspective, possibly even illegal.

If our speculation makes sense and particularly if it were in fact true, this would provide substantial support to our view and allegation that the ATO is involved in an orchestrated and organized scam against self-employed small business people. Of course we are not in a position to know the collective 'mind' of the ATO on this matter. Our allegations must be restricted to conclusions we draw based on the behaviours we observe of the ATO.

Many additional ATO behaviours, however, provide even greater grounds for suspicion.

8. The strange, missing court reference from Commissioner Carmody's 2005 Practice Statement

The ATO made much of Rod's inability to cite the 'High Court' ruling that he remembered being in Commissioner Carmody's Statement of 2005. In fact, Rod's failure to remember the specifics of the case was used by the ATO to allege that he had committed fraud or evasion by way of (presumably) making a 'false or misleading' statement.

We at Self-Employed Australia were well aware of the Carmody 2005 Statement because we had at the time (in 2005-06) been in close consultation with senior ATO officers putting together a layperson's PSI 'Ready Reckoner.' In putting together the Ready Reckoner the senior ATO officers (since retired) brought the Carmody Statement on partnership income-splitting to our attention, highlighting the reference to an important test case cited in the Statement. This was the Ryan case. We published our Ready Reckoner and associated commentary that made reference to a test case.

What is curious and suspicious is that at some time between 2005 and Rod's case in 2015 the reference to the court case disappeared from the Carmody Statement. The Statement from the ATO's website in 20015 (which we believe is still current)

http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS200524/NAT/ATO/00001 (Attach B) reads in part:

> "…a husband and wife conduct a business in partnership and, as the relevant Partnership Act provides, share equally in profits and losses, notwithstanding that only one party performs the main bulk of the work. This arrangement has the effect of dividing income equally notwithstanding that only one of the partners is the main generator of the income of the partnership.
>
> However, the arrangement also has the very real financial consequence of exposing each partner to full liability for the debts of the partnership…."

What is missing from the current Statement is what appeared in 2005 (and, we presume, for some time beyond to some unknown date) namely:

> "…judicial guidance in the Ryan (*Ryan v FCT[2004] ATC 2181)* has resolved one of the issues we undertook to test…"

(There were many more references to the importance of the *Ryan* in the Statement.)

We have sourced the original 2005 Statement from archives at
https://web.archive.org/web/20060914193351/http:/ato.gov.au/print.asp?doc=/content/67313.htm

Rod was not in error about there being a referenced court case in the Commissioner's Statement. He mistakenly thought it was a High Court case whereas it was, in fact, a Federal Court case. But Rod was not misleading. If anything, it was the ATO that was misleading when it asserted to Rod that Rod was misleading.

There are two possible scenarios which could explain the ATO's actions in the removal of the *Ryan* court case reference. Both scenarios go to the heart of the integrity and honesty of the ATO in dealing with self-employed small business people.

> Scenario A: Someone in the ATO at an unknown date 'updated' the Carmody Statement and the Ryan reference was not considered relevant anymore. Further, that by 2015, the Ryan reference underpinning the Carmody Statement was 'forgotten' in the ATO's corporate memory. If so, this damns the ATO's procedures, practices and record-keeping as incompetent at minimum. Such core information should not be 'forgotten', particularly given that it was central to the ATO's test case program.
>
> But then to use this loss of core factual evidence to accuse Rod of fraud or evasion is unacceptable and even suspicious. In our view, the ATO has not only acted with little accountability or regard for the repercussions of its actions, it has also failed to display the slightest remorse for its actions and the damage it has done to Rod's reputation and his ability to secure future work.
>
> Scenario B: This scenario is more sinister. In Self-Employed Australia's experience we have witnessed two competing internal ATO cultures in relation to small business people. The first culture sees the ATO 'at war' with the self-employed. The second views the ATO as needing to have a service culture with taxpayers being 'customers'. If the 'at war' cultural believers in the ATO have

gained ascendancy, this scenario would hold that the Ryan reference was removed with the specific intent of enabling the ATO to more readily act against self-employed persons operating through partnerships. This scenario would make it look as though Rod was deliberately 'set up' by the ATO in this aspect of the allegation of fraud.

Whichever of these scenarios is correct, and one of them must presumably be correct, Rod is a victim of the ATO's behaviour—either through its gross incompetence or its deliberate intent—to conduct a fraud against him. If our speculation on either scenario has veracity, then this adds more weight to our allegations of an ATO scam. Whether a scam is intentional or a product of incompetence is unknown because, as previously stated, it is not possible to know the 'state of mind' of the ATO as a collective. But the outcome (as they say) 'looks like a duck, quacks like a duck, it must be a duck!' Rod's treatment on this issue by the ATO 'looks like a scam, sounds like a scam, it must be a scam'.

9. The use of fraud or evasion to thwart the intent of parliament

In 2005 Parliament reinforced laws that were supposed to bring levels of certainty to taxpayers in their dealings with the ATO. The 2005 laws required taxpayers to complete and be responsible for their own tax returns. This was meant to increase efficiency in the administration of tax law across the economy.

Part of the new arrangement imposed on the ATO the requirement to accept or challenge individuals' tax returns within two years (for most individuals and small business people). This meant that, if the ATO operated efficiently, then after the two-year period people had certainty that their tax returns could not be challenged. This was (and is) a hugely important legislative initiative, particularly in the small business area. What small business people need is certainty in tax if they are to be able to operate.

The 'out' for the ATO was (and is) that if a taxpayer committed fraud, then the ATO could review a tax return outside the two-year period. This is an important provision to prevent tax fraud. But Parliament allowed that the ATO only had to 'form an opinion' of fraud for it to act. Parliament probably included the 'form an opinion' trigger because it realised that the ATO would sometimes need to move quickly against suspected fraud.

Further, Parliament probably assumed that the ATO, as a government authority, could be relied upon to act with honesty, integrity and within the law in applying this discretionary power. But, the Rod Douglass case (and many other cases we will mention) has demonstrated that the ATO has not acted with honesty and integrity. And on occasions, we assert, nor has it acted within the law.

Fraud or evasion in the tax context is ordinarily associated with a taxpayer not declaring all of his or her income. Rod Douglass did declare all income at all times and paid all tax due. The allegations of fraud or evasion against Rod were based on spurious, concocted assertions. The ATO totally withdrew these on 28 November 2016 in the Federal Court stating that the claims were 'incorrectly formed'.

The ATO make much of the fact that it has strict internal procedures to check the veracity of its claims of fraud against taxpayers. The internal tax documents received by Rod under FOI showed that his case had gone through these internal ATO checking and authorization procedures. That Rod's case could be escalated through the ATO procedures demonstrates that the procedures are either totally flawed or that the culture, intent and procedures of the ATO are geared to falsely accusing individuals of fraud or evasion.

We suspect the latter. We suspect that the ATO intentionally runs a system of claiming fraud or evasion against persons where the claims are not supportable by the facts and are spurious. We suspect this because we have seen too many examples of such cases. This is why we allege the ATO is conducting a scam. Of course we cannot prove anything because we do not know the collective state of mind of the ATO.

However, on any measure, what can be demonstrated is that the ATO is using its 'forming an opinion' of fraud or evasion to thwart the intention of Parliament to deliver to taxpayers certainty in the administration of tax. The ATO is abusing its powers. We believe that the ATO is breaking the law.