The Tax Institute

The Tax Summit

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Session 6.2: Give me instructions that fit the facts – What will the issues be before the AAT

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1. Introduction

1. This paper addresses common evidentiary difficulties arising in the conduct of taxation litigation in the Administrative Appeals Tribunal, soon to be replaced by the Administrative Review Tribunal.
2. A key focus of the paper is upon default assessments and assessments. Not only does challenging such assessments give rise to special challenges, but also the Commissioner's reliance upon default assessments is increasing and expanding well beyond the more traditional categories involving gambling receipts, organised crime, and the like, and into circumstances involving ordinary derivation issues.

2. Context

3. Taxation litigation is different to most other forms of litigation. First, it is because the onus of proof is placed upon taxpayers,[1] who are otherwise substantive defendants.

4. Secondly, unlike most other forms of litigation, the carriage of a dispute during the audit and objection stages prior to litigation often lies with accountants and tax agents rather than lawyers. The focus of taxation audits and objections is often upon technical, policy or fairness considerations in the application of the taxation legislation. The means by which taxpayers must satisfy their onus of proof of facts is often not treated as an important consideration, or a consideration at all.

5. Thirdly, the issue is compounded because the administrative processes of the Tribunal (and the Federal Court) assume that evidentiary and factual issues have been fully considered during the audit and objection processes, often placing taxpayers under significant time pressures if a dispute is referred to the Tribunal for review.

6. Finally, although as a matter of practice the Commissioner asserts in Tribunal proceedings that he has not been party to the transactions that are the subject of the dispute and therefore all e knowledge lies with the taxpayer, the Commissioner will often have obtained evidence of which the taxpayer is unaware.

[1] *Taxation Administration Act 1953* (Cth) (TAA53), s 14ZZK.

3. The assessing provisions and onus of proof

7. The Commissioner's main assessing power arises under s 166 of the *Income Tax Assessment Act 1936*. That power also encompasses issuing amended assessments. Where an amended assessment issued under s 166, the onus upon a taxpayer wishing to challenge it is to establish the particulars to the amendment are incorrect and what the amount is. For example, if the Commissioner increased an assessment on the basis that receipts in a year of income were on revenue account and not non-assessable gifts, the taxpayer would succeed by establishing the receipts were non-assessable gifts.

8. The Commissioner also has assessing power under s 167. That section provides that:

> "If:
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> (a) any person makes default in furnishing a return; or
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> (b) the Commissioner is not satisfied with the return furnished by any person; or
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> (c) the Commissioner has reason to believe that any person who has not furnished a return has derived taxable income;
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> the Commissioner may make an assessment of the amount upon which in his or her judgment income tax ought to be levied, and that amount shall be the taxable income of that person for the purpose of section 166."

9. In other words, once s 167 is enlivened (including by the Commissioner not being satisfied by a return), the Commissioner may estimate the taxpayer's taxable income and issue an assessment in the amount of the estimate. Thus, in *Trautwein v Commissioner of Taxation (Cth)*, Latham CJ stated:[2]

> "In the absence of some record in the minds or books of the taxpayer, it would often be quite impossible to make a correct assessment. The assessment would necessarily be a guess to some extent, and almost certainly inaccurate in fact. There is every reason to assume that the legislature did not intend to confer upon a potential taxpayer the valuable privilege of disqualifying himself in that capacity by the simple and relatively unskilled method of losing either his memory or his books."

10. Such an estimate must be grounded in logic and not plucked 'from the air'.[3] However, it is correct unless or until the taxpayer demonstrates otherwise.[4] The taxpayer must therefore choose between paying 'tax according to the Commissioner's assessment under s 167 or … establish' the correct amount of tax.[5] By reason of the onus of proof being placed upon a taxpayer, that

[2] *Trautwein v Commissioner of Taxation (Cth)* (1936) 56 CLR 63, 87 ("*Trautwein*").
[3] *Re DCT (WA); Ex Parte Briggs* 87 ATC 4278, 4294.
[4] *Trautwein*, 88.
[5] *Rigoli v Federal Commissioner of Taxation* (2014) 96 ATR, [25] ("*Rigoli*"). \

burden is upon the taxpayer. As Brennan J explained in *Federal Commissioner of Taxation v. Dalco* ("*Dalco*"):[6]

> The manner in which a taxpayer can discharge that burden varies with the circumstances. If the Commissioner and a taxpayer agree to confine an appeal to a specific point of law or fact on which the amount of the assessment depends, it will suffice for the taxpayer to show that he is entitled to succeed on that point. Absent such a confining of the issues for determination, the Commissioner is entitled to rely upon any deficiency in proof of the excessiveness of the amount assessed to uphold the assessment, though the taxpayer is limited to the grounds of his objection.

11. The difficulty with challenging s 167 assessments is twofold. First, it is insufficient to show an error in the calculation.[7] Rather, the task for a taxpayer is to show that the amount of money for which tax is levied by a notice of assessment exceeds its actual substantive liability.[8]

12. Secondly, in that way, most s 167 litigation usually requires taxpayers to establish negative propositions. For example:

    a. In *Gashi v Federal Commissioner of Taxation*,[9] it was not sufficient for one of the taxpayers to provide an accountant's report of income because it was just based on instructions and did not contain proof of actual sources of income or explain increases in wealth.

    b. In *Rigoli v Federal Commissioner of Taxation*,[10] it was insufficient for the taxpayer to accept the Commissioner's estimate of income and assert an entitlement to depreciation deductions. Instead, the taxpayer also had to prove his income positively.

    c. In *Dalco*, it was for the taxpayer to establish his case, even in the absence of particulars from the Commissioner.

    d. In *Upson v Federal Commissioner of Taxation*,[11] It was not enough for the taxpayers to show that they had a business; they also had to explain how that business caused the deposits in their bank account.

    e. In *Zhang and Commissioner of Taxation (Taxation)*,[12] asserting that amounts deposited into a brothel's bank accounts were gifts did not prove that the amounts were gifts and were not income.

[6] (1990) 168 CLR 614, 624 ("*Dalco*").
[7] *Rigoli*, 25.
[8] *Dalco*, 623.
[9] (2013) 209 FCR 301.
[10] (2014) 96 ATR.
[11] (2014) 100 ATR 165.
[12] 111 ATR 960.

f. In *Zappia v Commissioner of Taxation*,[13] the Commissioner was not bound by "facts" stated in an objection decision because the taxpayer was required to establish the facts and the Commissioner had not agreed the facts for the purposes of the trial.

g. In *Sibai v Commissioner of Taxation*,[14] the Commissioner was not found to have impliedly accepted particulars of a taxpayer's returns by not disputing those amounts in its objection decision.

13. Further, in fraud or evasion cases, the only practical way to challenge the assessment is by proving the correct amount of taxable income, not by challenging the opinion about fraud or evasion.[15]

14. It is, of course, not possible to prove a negative proposition. Rather, the concept of establishing that something did not occur is engaged as a matter of finding on the balance of probabilities by the Tribunal. In the context of the evidence necessary to do so, what is required is evidence establishing what did occur combined with an explanation and direct statements that in those circumstances of that evidence, nothing else occurred. That is because a bare assertion of events in evidence will almost always be insufficient for the assertion to be accepted on the balance of probabilities.

15. It follows that establishing negative propositions as required by s 167 is usually a large, daunting and expensive task.

16. It also follows that almost every s 167 case will ultimately turn on oral evidence of a taxpayer as to events which did not occur being accepted. Every s 167 case is therefore, to some extent, a case that will turn on the credit of a taxpayer and any corroborating witnesses.

17. Those matters are all rarely considered during the audit and objection processes, which often focus on the particulars the subject of the review. The Commissioner usually provides his reasoning for reaching an estimated taxable income by referring to the potential operation of substantive provisions and applying those provisions as a tool for making the estimate. Applying the relevant sections becomes the tool for making the estimate in the same way that there may be any other basis for an estimate.

18. A key trap for taxpayers and their advisors is to avoid being lulled into thinking the case is about the provision rather than an identification of the true taxable income. To continue the above example about the receipt of gifts, absent agreement with the Commissioner confining the question, the question whether the receipts were or were not gifts would form only a small (albeit important) part of a taxpayer establishing that the assessment was excessive.

Objections

[13] 106 ATR 875.
[14] [2021] FCA 1353.
[15] *Nguyen v Commissioner of Taxation* 265 FCR 355.

19. A taxpayer's objection against an assessment must state 'fully and in detail, the grounds that the person relies on'.[16] The taxpayer must clearly object to the assessment, identify the issues, and provide reasons.[17] Unless the Tribunal grants leave otherwise, the taxpayer is 'limited to the grounds stated in the taxation objection to which the decision relates'.[18]

20. There is room for debate as to the appropriate form and content of objections. At one extreme are "short form" objections, which do no more than to refer to the application of a legislative provision. For example, in an objection against a s 167 assessment, it would be an entirely appropriate for a ground of objection to state the assessment was excessive as the true taxable income of the taxpayer was that stated in the taxpayer's income tax return and not otherwise. At the other extreme are objections identifying each and every fact relied upon by the taxpayer to establish the correctness of the proposition for which the taxpayer contends. There are, of course, numerous permutations in between. A common example is a short form statement of grounds to which is attached detailed submissions on facts and law, and often documentary evidence.

21. In the authors' view, a short form objection must be used where there are risks of criminal prosecution. Taxpayers in that position are therefore faced with the dual difficulty of both maintaining their right to silence and also satisfying a positive onus in a taxation case. Prudence would dictate that maintaining the silence prevails. Moreover, a criminal investigation or prosecution would probably result in an adjournment of the civil Tribunal proceedings behind the criminal processes. It would also be an appropriate basis for the Tribunal to grant leave to a taxpayer for further grounds to be relied upon at a later date when then those processes were complete.

22. The main disadvantage of a short form objection is that it is not conducive of a persuasive document. It will almost certainly result in the objection being disallowed.

23. To the contrary, not only is a fully stated objection (whether by grounds or submission or some variation in between) far more likely to persuade the Commissioner to allow it in whole or in part, it also sets the agenda for any objection decision. The Commissioner, in giving reasons for an objection decision, will almost always explain why he accepts or does not accept particular propositions of a taxpayer. Although those statements cannot of themselves operate as admissions of fact in the Tribunal, a taxpayer may rely upon them in focussing the evidence presented in the articulation of a case in the Tribunal. That is, although the taxpayer bears the onus of proof, the process remains adversarial in nature and a taxpayer who has an opportunity to frame the issues that will ultimately be in dispute. That, however, requires taxpayers to be advanced in their evidentiary position well before the objection is lodged. Moreover, as most taxation disputes follow an audit process in which taxpayers have significant opportunity to

[16] TAA53, s 14ZU(1).
[17] *H.R. Lancey Shipping Co Pty Ltd v Federal Commissioner of Taxation* (1951) 25 ALJR 145 at 147. .
[18] TAA53, s 14ZZK(a).

participate, it follows that the taxpayer should be considering their evidentiary position and the framing of their ultimate case well prior to assessment, let alone objections.

4. Evidence in the Tribunal

24. The rules of evidence do not apply in the Tribunal. However, as Perry J stated in *Federal Commissioner of Taxation v Rawson Finances Pty Ltd*, the rules of evidence are 'generally founded upon principles of common sense and fairness'.[19] In consequence, as a matter of practice, the further that evidence admitted into the Tribunal strays from compliance with the strict rules of evidence, the less weight is placed upon it by the Tribunal in making its decision. It follows that to the extent reasonably possible, evidence led in the Tribunal should follow the strict rules of admissibility.

25. With respect to documentary evidence, the production of original documents is generally unnecessary. The exception is if questions of probity arise. For example, when there is a dispute about requiring expert forensic analysis of a document.

26. With respect to oral evidence, principles of common sense and fairness require sworn evidence to be provided by way of evidence in chief, tested by cross examination, and with a right for questions in reply. Evidence in chief is mostly given on affidavit or by witness statement adopted in the witness box.

27. Affidavits and witness statements are not prepared as prose; they are evidence and should be stated chronologically. A useful starting point for structuring a witness statement is referencing the documents (for example, "on 10 August 2024, my accountant sent an email to me to the effect that I had to provide him with the contract for the sale of the property").

28. Additional detail and context can be added. However, it is essential to be conscious of the quality of the evidence. Good evidence is something the witness saw or heard. If the witness did not see or hear the relevant thing, consider whether another witness did and if they can provide the evidence. Witnesses may give evidence of their understanding of a document at a point in time, if that is relevant, but should not give opinions about its meaning and content or seek to interpret it.

29. A consequence of the onus of proof being placed upon taxpayers is that it is generally unnecessary for the Commissioner to call lay witnesses and with the exception of expert evidence, it is rare for him to call witnesses at all. However, procedural fairness dictates that the Commissioner directly put to witnesses any propositions he relies upon that are contrary to the witness's evidence to give them an opportunity to respond. A failure to do so may result in the Tribunal drawing inferences about the strength of the propositions.[20]

30. Expert evidence is different. It is required where opinion evidence is necessary, as lay evidence on a matter of opinion will carry little or no weight. Examples include evidence of valuations, or about scientific or engineering questions. If the Commissioner disagrees with a taxpayer about

[19] (2023) 116 ATR 458, [93].
[20] *Allied Pastoral Holdings Pty Ltd v Commissioner of Taxation (Cth)* (1983) 13 ATR 825.

such issues, it is common for both sides to call expert witnesses. The role of the expert is to assist the Tribunal and not to advocate for any party. Hence, instructions to expert witnesses must be in appropriate form and framed neutrally and non-tendentiously. Importantly, upon the expert being called, documents received by the expert cease to be confidential and legal professional privilege will not protect them.

5. The Commissioner's tools to obtain evidence your client has not volunteered to you

31. In making an assessment, the Commissioner can rely on any information available to him. Obviously, the Commissioner has extensive information gathering powers.[21] He commonly relies upon data matching and statistical analysis in deciding whether to assess, especially under s. 167. But, as discussed above, challenging that matching or analysis will not assist a taxpayer in the Tribunal in challenging an assessment and evidence of those processes will rarely be led.

32. The Commissioner is generally unrestricted in his capacity to rely upon information. For example, the Commissioner may use information received under warrants later declared invalid,[22] illegally obtained from employees,[23] subject to legal professional privilege,[24] and subject to the *Harman v Home Office* undertaking.[25]

33. The Commissioner collects intelligence to assess risk. He will obtain as complete a picture of the taxpayer's history as possible: compliance history, involvement with previous entities, associations with other people of interest to the Commissioner, previous legal disputes (including family law proceedings), and a complete profile of the taxpayer's family and "group." The ATO's website states that the Commissioner collects information from other sources to 'ensure the accuracy of information provided' to him and that the taxpayer 'may not be aware' he has 'received this information'. The Commissioner routinely collects information from employers, other payers, banks, financial institutions, share registries, super funds, treaty partners, government agencies and other statutory authorities. For example, the Commissioner might have access to loan applications where the purpose stated for loans or the entity receiving the funding differs from the purpose stated to the tax agent or accountant and, in turn, from the submissions made to the Commissioner. The Commissioner might also obtain information provided to regulators or insurers that estimate the cost of works, which differ significantly from what is ultimately returned. Information such as this can form the basis of a methodology for making default assessments. Other examples include access to documents to which taxpayers have no access at all, including internal confidential immigration records and inter-governmental information requests.

34. There is, of course, a difference between intelligence which may motivate the Commissioner not to accept a taxpayer's return, and evidence to be relied upon in the Tribunal. But where the Commissioner has relied upon a relevant document and the matter comes before the Tribunal, he is obliged to provide a copy of that document to the taxpayer.[26] In the authors' experience, that

[21] For example, TAA53 Sch.1, Div. 353 and Div. 396.
[22] *DCT v Awad* (2001) 47 ATR 310.
[23] *Denlay v Federal Commissioner of Taxation* (2011) 193 FCR 412.
[24] *Federal Commissioner of Taxation v Donoghue* (2015) 237 FCR 316.
[25] *Deputy Commissioner of Taxation v Rennie Produce (Aust) Pty Ltd (in liq)* [2018] FCAFC 38.
[26] *Administrative Appeals Tribunal Act 1975*, s 37.

obligation is often honoured in the breach. As the documents may later be relied upon in cross-examining the taxpayer, care must be taken in ensuring that all relevant documents have been provided.

6. Documentary evidence

35. The law does not demand documentary evidence. In *Federal Commissioner of Taxation v Cassaniti* the Full Court stated at [88]:[27]

> "…
>
> (2) … for that purpose [discharging the burden of proof] it is not obligatory for a taxpayer, in order to discharge his burden of proof, to call all material witnesses and to produce all material documents which support her or his or its position;
>
> (3) … there is no requirement that evidence can only be accepted as admissible and probative if it is corroborated;
>
> (4) … the tribunal of fact is free to accept the evidence of the taxpayer alone if it finds the taxpayer to be truthful;
>
> (5) … it would usually be prudent to corroborate the evidence of a taxpayer. It is also prudent to adduce contemporaneous objective evidence. But prudence should not be confused with the requirements of the law."

36. In practice, that prudence results in tax cases requiring extensive documentary evidence, particularly from source documents. For example, bank and credit card statements.

37. In that regard, it is a common error for taxpayers to rely overly upon their accounts and financial statements. Accounts record reality; they do not create reality (with very limited exceptions). Generally, an account or financial statement is no more than evidence of an opinion of the person who created the document at the time it was made about the state of affairs recorded in the document. Unless accounts are audited and an audit report is also available, they are of limited value as evidence in proving the truth of their content. Yet, it is often wrongly assumed that the existence of a particular financial state of affairs may be established by no more than the production of accounts.

38. Moreover, even assuming financial statements and accounts accurately reflect a state of financial affairs, they may not be supportable because the relevant source documents from which they were created (for example, bank statements, invoices and receipts) no longer exist.

39. Where those documents do exist, they are often voluminous. Managing cases in those circumstances can become difficult, and conflicts between the application of the substantive law (especially in s 167 cases) and the Tribunal's processes often arise.

40. The documents almost always have some gaps or anomalies. The key task then is to identify evidence necessary to bridge the gap, which will depend upon its size and importance. For

[27] (2018) 109 ATR 119 ("*Cassiniti*").

example, a single missing bank statement may not be of much moment if a chain of events is obvious from the surrounding materials. Missing transaction records would be a different matter entirely.

41. Not only is the Commissioner required by fairness to cross examine on propositions that he wishes to make, but he also generally relies upon cross examination to found factual findings contrary to taxpayer's interests. The main tool in cross examination is the identification of errors and inconsistences in the documentary evidence of a taxpayer ultimately leading to a submission that neither that evidence or oral evidence founded in reliance upon it is reliable.

42. There is not much than can be done to prevent this process. The key to mitigating the risks lies in anticipating the issues that will arise. The earlier the anticipation of issues, the better. A position addressed openly and consistently from audit is less likely to be fatal to a taxpayer than a position contradicted in cross examination by reference to a taxpayer's own documents. The taxpayer has the benefit of being able to control the narrative and define the relevant issues. But that requires the taxpayer to understand what the narrative and issues ought to be at the earliest possible stage.

7. Unflattering observations (or worse) about your client

43. A Tribunal member cannot decide a case without – even if only subconsciously – considering whether a witness's evidence is honest and reliable.

44. It is essential to establish credibility in the Tribunal because where 'findings of fact turn upon an assessment of credit, a court of appeal should not interfere with those findings unless they are demonstrated to be wrong by incontrovertible facts or uncontested testimony, or they are glaringly improbable or contrary to compelling inferences'.[28] For example, credibility was particularly significant in *Ma v Commissioner of Taxation*[29] .

45. There is only one way to entirely mitigate the risk of the Tribunal making unflattering observations about your client – do not run the case. That may be the only option if the case is hopeless, or if there are potential criminal or other consequences.

46. However, there are ways to manage criticism if a case is arguable. They all turn on proper witness preparation before hearing. Witness statements should be comprehensive and not shirk from facts that are unhelpful. Witnesses must learn to answer questions in cross examination precisely as they are asked, and not seek to hide or gloss over information, or give answers they think will be helpful.

47. In the worst possible scenario, where the Tribunal is left with unflattering thoughts about a taxpayer, the best approach is to ensure that the Tribunal deals appropriately with all other evidence. For example, in *Le v Commissioner of Taxation* ("Le"),[30] Logan J held that the Tribunal's reasons for decision did not deal with what may have been a logical explanation of the taxpayer's taxable income, and so the taxpayer's appeal was allowed, and the matter remitted to the Tribunal.[31] It was not sufficient to reject evidence by reference to credit if those findings are made without considering the relevant evidence and explanation.[32]

[28] *Cassiniti*, [36].
[29] (1992) 37 FCR 225.
[30] (2021) 390 ALR 132 .
[31] *Le*, [80].
[32] *Le*, [53]

8. Concluding remark

48. Facts – and the evidence that supports them – have always been critical in tax disputes. The Commissioner's increasing reliance upon his default assessment powers renders the collation and analysis of a taxpayer's evidence at the earliest practical stages of corresponding importance. That requires taxpayers and their advisors to contemplate the possibility of future proceedings well before the stages of a taxation dispute which at which they will be engaged; at the very least, a taxpayer's evidence should be fully consider ~~to~~ any objection being lodged; at best, taxpayers should be able to use their ultimate evidence to control and frame the issues arising during an audit.
