PROVE IT

Evidence in Indirect Tax Matters

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INTRODUCTION

1. The Hon. JJ Spigelman AC, former Chief Justice of NSW, said that well over 90 percent of litigation is determined by findings of fact.[1] This is undoubtedly true for litigation involving indirect taxes such as GST. And I doubt that anyone would argue that this is equally true for any dispute involving GST even when they do not proceed to litigation. But, it does not end there. The facts are patently central to and usually dominate any audit, enquiry, either by or of the taxpayer, and include requests for rulings. So why is it that a disciplined approach to evidence of the facts is often until the matter is headed to litigation?

2. This paper examines the burden of proof in GST matters and considers evidentiary requirements for all dealings between the Commissioner, taxpayers and advisors.

3. In my experience evidence is often dealt with in a haphazard way particularly in the early stages of the engagement between a taxpayer and the Commissioner. Not enough thought is given to identifying the important questions that need to be answered and the evidence that will be needed to satisfy them. Sometimes the important evidence is identified but is overlooked or deliberately ignored by the decision maker. At other times the taxpayer misleads or simply fails to understand the important questions and does not prove his or her case.

4. What often gets lost is the notion that the dealings with the Commissioner always involve individuals, on both sides, with their own experiences, attitudes and beliefs. This necessarily influences the approach to be taken to gathering evidence and proving positions. A lack of empathy can have unfortunate consequences. If more effort is put into understanding the other side, better outcomes will eventuate.

5. This paper discusses some of the things that get in the way of getting to the facts and the evidence for them. It then deals with the burden of proof in taxation

[1] Sir Maurice Byers Lecture, "Truth and the Law", at the New South Wales Bar Association on 26 May 2011 (http://www.supremecourt.justice.nsw.gov.au/Documents/Speeches/2011%20speeches%20j%20j%20spigelman%20ac.pdf)

matters in Part IVC and other wise. Finally, it deals with some principles relevant to evidence gathering for any taxation matter whether it is the subject of a dispute or not.

GETTING TO THE FACTS

6. At the root of any issue between the Commissioner and a taxpayer are invariably the facts and the proof of them. The identification of what is relevant, the weight to be given to any particular item and the evidence to support it are all part of the question. There are any number of things that have the potential to get in the way of identifying and proving relevant facts.

7. The consequence of failing to properly identify relevant facts and proving them inevitably makes achieving consensus nearly impossible. This means that there is greater chance of dispute. This costs money for the Commissioner and for taxpayers and causes stress for the Commissioner and/or the taxpayer or its representatives.

8. Starting down the wrong path in relation to facts can lead to confusion and misconceptions that can be difficult to shift at a later time. This all adds to complexity and cost. More careful preparation by the Commissioner and the taxpayer can ensure that much of this pain is avoided.

9. Achieving consensus about the facts in all cases is impossible but there are some barriers and hurdles that do not need to be there. The difficulties are partly about process and partly about attitude. Sometimes there is, for any number of reasons a lack of a disciplined and appropriate process for the fact and evidence gathering task. Features of a poor process include:

    a. a failure to properly identify the question that needs to be answered;

    b. failing to apply a disciplined approach to the fact and evidence gathering task to ensure all relevant facts are identified and to the extent necessary evidence obtained;

c. taking into account irrelevances;

d. giving the wrong weight to evidence that is relevant, and

e. ignoring facts that do not support the desired position.

10. The identification of the relevant questions is critical. If the enquiry is performed appropriately at the start and communicated effectively, the greater the chance of obtaining relevant evidence and satisfying the enquiry one way or another. However, in my experience this often does not happen. Often, the Commissioner's people either do not know what question they need answered or, if they do, the taxpayer either ignores it or does not understand it. Either way it is not addressed.

11. The answer is early and open engagement between the Commissioner and the taxpayer with the object of achieving consensus about the questions that need to be answered. There is no disputing that the Commissioner has wide powers of access[2] and has coercive powers to require the production of documents or the giving of evidence[3]. However, the Commissioner is usually open to negotiation about what is relevant and what is not and what may be done to satisfy his enquiry.

12. Often the approach to the evidence gathering process is ill disciplined and inefficient. This is not helped by the fact that dealings are often performed remotely in a written form. It frequently results in a substantial waste of time and resources for both.

13. We often have what I describe as "submission ping pong". This involves the Commissioner sending out a detailed questionnaire to the taxpayer. Sometimes this happens without any clear communication between the parties as to the issues in dispute and the facts that need to be proved.

[2] s.353-15, Schedule 1, TAA 1953
[3] s.353-10, Schedule 1, TAA 1953

14. On receipt of the questionnaire the taxpayer, often through its representative, responds with a detailed submission which may or may not deal with the questions raised. Or they may give so much more information than is required that the answer is lost. This often arises because the taxpayer or its representatives do not understand what is being sought and why.

15. The taxpayer's response leads to another round of questions either because the first round were not adequately dealt with, the answers give rise to further questions or the enquirer thinks of a new tangent to follow. And so the process continues.

16. If there is early engagement about identifying the issues and the evidence needed for the relevant factual enquiry the process is invariably streamlined with savings in time and resources for all. It there is open engagement throughout the process, far better outcomes are achievable.

17. The responsibility for taking a more targeted approach to fact and evidence gathering lies with all of the parties. There has to be a willingness on both sides to engage. Sadly, this willingness is often absent in one or other or both of the protagonists.

18. The last three features of poor process I mentioned above of taking into account irrelevances, giving the wrong weight to evidence and ignoring "unfortunate" facts are things that done by both taxpayers and the Commissioner. Some taxpayers set out to deceive, others do these things out of ignorance and still others through a lack of skill or diligence.

19. Sometimes the Commissioner's officers fall into similar traps. In his report titled "The Management of Tax Disputes" in January 2015, the Inspector-General of Taxation (**IGT**), Mr Ali Naroozi said:

> *"Submissions, as well as those who testified at the Committee's public hearings, have also highlighted persisting concerns giving rise to unnecessary disputation, including those resulting from:*

- *unsustainable audit decisions due to a lack of auditor capability, engagement or inappropriate auditor conduct;…..".*[4]

20. At 3.9 the IGT goes on to refer to submissions that complained of unsustainable audit decisions that the reasons for them:

> *"Submissions to this review suggest a number of reasons for unsustainability of initial audit decisions. These include:*
> - *lack of opportunities or willingness for ATO officers to engage;*
> - *auditors lacking necessary commercial knowledge of the industries or entities they are examining;*
> - *auditors lacking technical capability leading to unclear risk hypotheses;*
> - *ATO requests for excessive information to be provided within short timeframes;*
> - *allegations of tax avoidance pursuant to Part IVA of the Income Tax Assessment Act 1936 (Part IVA), fraud and evasion are made without strong bases; and*
> - *perceptions that auditors have adopted an overzealous approach to compliance with a 'guilty until proven innocent' mindset."*

21. Some of these things may be explained by a lack of appropriate processes, ignorance or skill deficiencies but in other cases they reflect the guilty until proven innocent mindset to the point that the particular taxpayer is demonized. This is despite what is said in the Taxpayer's Charter. For example, the requirement to treat taxpayers fairly and reasonably including making fair and reasonable decisions become very difficult if the taxpayer has been labelled an evader or avoider before the evidence has been objectively considered. What is required is objectivity and, perhaps, professional detachment. Obviously this is easier said than done but that does not mean it cannot be an ideal to strive for.

22. At 3.16 the IGT says:

> *"The IGT has previously encouraged both the ATO and taxpayers to engage earlier during the compliance process to achieve a common understanding of the issues in dispute, including what information may assist to resolve these issues. Both taxpayers and revenue authorities benefit from full disclosure of*

[4] At 3.4

relevant facts and issues during the compliance stage, so that a sustainable original decision can be made. The ATO has recently noted that there is incentive for both parties to get 'all the facts on the table together so you can both meaningfully look at them' to seek agreement."

23. The issues identified by the submissions to the IGT in 3.16 all reflect either shortcomings in the fact gathering process or in the objective analysis of them. The recommendation for early engagement makes apparent sense.

24. Since at least mid 2014 the Commissioner of Taxation has been talking about reinventing the ATO and released in March 2015 the "Reinventing the ATO" Program Blueprint. There are a number of signs of improvement in relation to the dealing with disputes. They include the availability of independent review and other alternative dispute resolution processes, the allocation of objections handling and consideration to the Review and Dispute Resolution group and the reduction in the number of cases that the Commissioner takes to the Administrative Appeals Tribunal and the Federal Court.

25. However, it is my observation that there is still room for improvement in relation to the identification of issues and the resolution of them. There is certainly a need to improve the culture of the "compliance" functions within the ATO to attempt to eliminate some of the behavior referred to above. Whatever training the Commissioner has for these people needs to be about conditioning a more objective and reasoned approach.

26. This is not to say that all auditors are infected with a siege mentality or that they lack objectivity. Plainly most of them act diligently, reasonably and objectively in performing their functions. It is the outliers that let them down and damage the image of the ATO. What needs to be done is to ensure that there are rigorous processes employed that require early engagement that is open and transparent and attempts to achieve consensus about the issues and the strategies to resolve them.

27. From the taxpayer's side, they too, sometimes adopt a siege mentality. It gets in the way. And it is more difficult to remedy. As the Inspector General said, there

needs to be early engagement to reach a common understanding of the issues and the evidence required. This will go some way towards improving the overall engagement.

28. In my experience, most officers are ready and willing to enter into dialogue to identify the issues and what is needed and to streamline the process. The following example from a client of mine illustrates the point. The ATO auditor wanted access to a rather large contract and the notes and minutes of the negotiations. Because a large number of people had been involved in the negotiations this would have been a formidable task. After discussions between the taxpayer and the officer the request was reduced and the notes and minutes of negotiations were not required. Sensible negotiations almost always bring a good outcome

WHO BEARS THE BURDEN OF PROOF?

29. In proceedings in the Administrative Appeals Tribunal (**AAT**), the applicant has the burden of proving that the assessment, if any, is "excessive or otherwise incorrect" and what the correct amount should be or, if there is no assessment, the decision objected against should not have been made or it should have been made differently.[5] A person appealing to the Federal Court of Australia (**FCA**) has the same burden.[6] This is only provided for expressly in relation to Part IVC litigation. It does not apply to any other dealings with the Commissioner.

Assessments

30. There is nothing that deals with the evidentiary burden in relation to assessments, private rulings or any other dealings with the taxpayer. Should the Commissioner have a factual basis for any assessment he raises?

31. In *Gauci v Federal Commissioner of Taxation*[7], Mason J said:

[5] s.14ZZK(b), *Taxation Administration Act* 1953 (**TAA 1953**)
[6] s.14ZZO (b), TAA 1953
[7] [1975] HCA 54; (1975) 135 CLR 81

"The Act does not place any onus on the Commissioner to show that the assessments were correctly made. Nor is there any statutory requirement that the assessments should be sustained or supported by evidence. The implication of such a requirement would be inconsistent with s. 190(b) for it is a consequence of that provision that unless the appellant shows by evidence that the assessment is incorrect, it will prevail." [8]

32. In *Trautwein v Federal Commissioner of Taxation*[9] Latham CJ said:

"In the absence of some record in the mind or in the 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]

33. It is plain that the Commissioner is not required under the *Taxation Administration Act* 1953 (**TAA 1953**) or any of the federal taxation statutes to have an evidentiary basis for an assessment provided he acts bona fide in the exercise of his powers. Assessments that are the result of conscious maladministration would not be assessments and could be set aside without the need for Part IVC proceedings.[11]

34. What then of matters that do not involve assessments? For example, who bears the onus of proving that a taxpayer is entitled to be registered for GST if a taxpayer is dissatisfied with a decision by the Commissioner to refuse registration. This is a

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[8] At 89. The reference to s.190(b) was to that subsection as it appeared in the *Income Tax Assessment Act* 1936. To the extent relevant ss. 14ZZK(b) and 14ZZO(b) in the TAA 1953 effectively replaced s.190(b) and are in substantially the same terms as s.190(b) and have the same effect. Refer to the Explanatory Memorandum for the *Taxation Laws Amendment (No. 3) Act* 1991 introduced Part IVC into the TAA 1953.

[9] [1936] HCA 77; (1936) 56 CLR 63

[10] At 87

[11] C*ommissioner of Taxation v Futuris Corporation Limited* [2008] HCA 32; 237 CLR 146 at [25] per Gummow, Hayne, Heydon and Crennan JJ

reviewable GST decision and may be the subject of an objection by the taxpayer.[12]

35. Both ss. 14ZZK(b)(ii) and 14ZZO(b)(ii) in the TAA 1953 say in relation to any case that does not involve an assessment the taxpayer has the burden of proving "*that the taxation decision concerned should not have been made or should have been made differently*". Consistent with the decision in *Trautwein* quoted above the Commissioner is not obliged to have a solid factual foundation for any decision in relation to matters that do not involve an assessment such as registration decisions.

Private Rulings

36. In the case of a private ruling, when one is sought the taxpayer specifies the factual scenario, the scheme, in respect of which the ruling is needed and the Commissioner rules on the application of the law to the particular scheme. The word scheme is not used in a pejorative sense but refers to the factual picture that is the basis for the ruling.[13]

37. In Cooper Bros Holdings Pty Ltd trading as Triple R Waste Management and Commissioner of Taxation[14] Deputy President FJ Alpins summarized the provisions and some of the jurisprudence in relation to private rulings. He said:

> *"6. As the prefatory provision of Div 359 (s 359-1) explains, "[a] private ruling is an expression of the Commissioner's opinion". As that opinion concerns a particular question about the application of tax law to the facts identified in the ruling comprising the specified scheme, the Tribunal's jurisdiction is therefore limited to a review of the Commissioner's opinion on that same question. The question before the Tribunal is whether the Commissioner's opinion was correct (Federal Commissioner of Taxation v McMahon and Another [1997] FCA 1087; (1997) 79 FCR 127 at 132-134, 140-141, 149-150; Federal Commissioner of Taxation v Reef Networks Pty Ltd (2004) 57 ATR 375 at [6]; Lamont v*

[12] s.110-50 (1) and (2) (Table item 1), Schedule 1, TAA 1953
[13] See s.359-20, Schedule 1, TAA 1953
[14] [2013] AATA 99

Federal Commissioner of Taxation [2005] FCA 513; (2005) 144 FCR 312 at 319; Cooperative Bulk Handling Ltd v Federal Commissioner of Taxation [2010] FCA 508 at [13], [15][16]). The answer to that question therefore depends upon the scheme on which the ruling is founded – the Tribunal's review turns on the specified scheme just as the ruling did.

7. As Lockhart J said in McMahon at 133, quoted with approval by the Full Federal Court in Hastie Group Ltd v Commissioner of Taxation [2008] FCAFC 187; (2008) 172 FCR 496 at [3]:

> *When making a private ruling the Commissioner does not make findings of fact. He simply identifies facts and then states his opinion about the way in which the relevant tax laws apply to the applicant in relation to those identified facts. (see also McMahon at 149 per Emmett J; Lamont at [23]; Cooperative Bulk Handling at [15]).*

8. That being so, the Tribunal cannot make findings of fact in this proceeding. The Tribunal can only consider the stated facts comprising the scheme the subject of the ruling. Furthermore, the Tribunal cannot "redefine" the scheme (see McMahon at 133, 141, 144-146, 150) – the Tribunal is confined by the scheme <u>as</u> it has been described in the ruling and cannot depart from that description in any respect. The Tribunal cannot create its own description of the scheme, elaborate upon or make assumptions about the scheme, nor can the Tribunal add further facts, substitute other facts or otherwise alter the scheme (McMahon at 133-134, 140-146, 149-150; Bellinz v Federal Commissioner of Taxation [1998] FCA 615; (1998) 84 FCR 154 at 160; Reef Networks at [6]; Lamont at [21], [26]; Hastie Group at [3]; Cooperative Bulk Handling at [16])."

38. At the stage that a ruling is sought there is no necessity to prove the fatcts that are the basis of the scheme for the ruling. However, it may be that the Commissioner seeks further information including evidence to resolve any ambiguities or uncertainties about the scheme described. Beyond this there would not appear to be any rationale for the Commissioner seeking evidence as part of the rulings process.

39. Therefore, there is only one aspect of private rulings where evidence of the facts is relevant. It is when the scheme that forms the basis for the ruling is compared with what actually happens in circumstances where the taxpayer seeks the protection of the ruling. Then the burden of providing the evidence that the ruling

conforms with reality is borne by the taxpayer in Part IVC proceedings in the same way as for any assessment.

Part IVC

40. Part IVC of the TAA 1953 covers taxation objections[15] and reviews of objection decisions by the Administrative Appeals Tribunal[16] (**AAT**) or appeals on objection decisions to the Federal Court of Australia[17] (**FCA**).

- Objections

41. There is no specific rule about whether the Commissioner or the taxpayer has the burden of proving its case in respect of an assessment. This only arises when the matter gets to the AAT or FCA.[18] But does that mean that the Commissioner shares some of the burden of proof? The answer is yes and no.

42. The legislation does not specifically provide for either party to bear the burden of proof in relation to an objection. However, the Commissioner has a duty to make an assessment[19] even if it is a guess[20]. He necessarily needs a basis for it even if it is his guess of what the liability should be. Otherwise it could fall into the category of not being an assessment at all or being tentative or provisional or involving conscious maladministration.[21]

43. The task of the objecting taxpayer is to convince the Commissioner that the original assessment was wrong and a different amount should have been assessed. In making the objection the taxpayer must state its grounds fully and in detail. The grounds are not the evidence but the assertions of fact and principle

[15] Division 3
[16] Division 4
[17] Division 5
[18] ss.14ZZK and 14ZZO, TAA 1953 respectively
[19] *F.J. Bloemen Pty. Ltd. v. FC of T* 81 ATC 4280; (1980-1981) 147 CLR 360 at 371 per Mason and Wilson JJ
[20] *Trautwien* supra nn. 6 & 7
[21] *Commissioner of Taxation v Futuris Corporation Limited* [2008] HCA 32 at [25] per Gummow, Hayne, Heydon and Crennan JJ

that justifies the taxpayer's objection. If a fact is asserted then evidence will be required to prove it to the satisfaction of the deciding officer.

44. The taxpayer necessarily bears the burden of proving his case to the Commissioner. It cannot work any other way. Otherwise, the task of the taxpayer would simply be to object setting out the relevant facts and principles and pass to the Commissioner, or somehow share with him, the burden of proving those facts.

- Administrative Appeals Tribunal

45. As noted, in the AAT, the taxpayer has the burden of proving that the assessment that it has objected to is excessive and what it should be.[22]

46. Section 33 (1) (c) of the *Administrative Appeals Tribunal Act* 1975 says in proceedings before the AAT "*the Tribunal is not bound by the rules of evidence but may inform itself on any matter in such manner as it thinks appropriate*".

47. In *R v War Pensions Entitlement Appeal Tribunal; Ex parte Bott*[23], Evatt J said of evidence in tribunals:

> *"Some stress has been laid by the present respondents upon the provision that the Tribunal is not, in the hearing of appeals, "bound by any rules of evidence." Neither it is. But this does not mean that all rules of evidence may be ignored as of no account. After all, they represent the attempt made, through many generations, to evolve a method of inquiry best calculated to prevent error and elicit truth. No tribunal can, without grave danger of injustice, set them on one side and resort to methods of inquiry which necessarily advantage one party and necessarily disadvantage the opposing party. In other words, although rules of evidence, as such, do not bind, every attempt must be made to administer "substantial justice.""*[24]

48. After referring to these observations, Brennan J (as his Honour then was) said in Pochi And Minister for Immigration and Ethnic Affairs[25]:

[22] s.14ZZO, TAA 1953
[23] [1933] HCA 30; (1933) 50 CLR 228
[24] At CLR 256
[25] [1979] AATA 64

"That does not mean, of course, that the rules of evidence which have been excluded expressly by the statute creep back through a domestic procedural rule. Facts can be fairly found without demanding adherence to the rules of evidence."

49. *Sullivan v Civil Aviation Safety Authority*[26] Flick and Perry JJ said:

"[t]*he procedural flexibility afforded to an administrative tribunal freed from the rules of evidence does not absolve it from the obligation to make findings of fact based upon material which is logically probative in which the rules of evidence provide a guide".*[27]

50. It is plain that in the Administrative Appeals Tribunal that rigid adherence to the rules is not required but that does not mean that they can be ignored. They provide a useful starting point for the reasons identified in *Bott*. In preparing evidence for proceedings in the Tribunal it is appropriate to take a flexible approach to the rules of evidence but to be cautious about straying too far from them.

- Federal Court of Australia

51. For litigation in the Federal Court the *Evidence Act* 1995 applies. This provides a strict code for the admissibility of evidence. The Federal Court does not have the flexibility of the AAT. This can have advantages and disadvantages. The advantages are in the that rigour can be applied to ensure that only relevant material that is probative of the facts in issue is admitted. The downside can be this is a double edged sword and material that is persuasive of the factual outcome sought may be excluded.

Which Standard

52. Everyone knows that there are two standards of proof in litigation: the criminal standard and the civil standard. The criminal standard requires that facts be

[26] [2014] FCAFC 93
[27] At [97]

proved beyond a reasonable doubt and the civil standard that they must be proved on the balance of probabilities.

53. In *McCormack v Commissioner of Taxation*[28] Gibbs J said:

> *"The taxpayer bears the burden of proving that the assessment was excessive. To discharge that burden in a case such as the present [also a sec. 26(a) case] he must prove affirmatively, on the balance of probabilities, that the property was not acquired for the purpose of profit-making by sale."*[29]

54. In a recent appeal to the FCA on a decision in the AAT of Deputy President Frost, Rares J was asked to consider whether the Tribunal had applied the correct standard of proof. The case, *Bai v Commissioner of Taxation*[30], concerned, among other things, the question of whether there had been an underpayment of income tax arising through fraud or evasion.

55. In the AAT decision Deputy President Frost said:

> *"I cannot exclude the possibility that these are receipts of income that Ms Bai knowingly failed to declare. In other words, and in respect of each of the relevant years, I am not satisfied that evasion was not present."*[31]

56. In his decision Rares J said that Deputy President Frost had applied the wrong test. His Honour said:

> *"I am of opinion that the taxpayer did not have an onus of excluding every possibility in order to negate the criterion to enliven the Commissioner's power to amend the 2005 assessment under item 5 of s 170(1). She bore the civil onus of proving, on the balance of probabilities, that there was no fraud or evasion if she were to prove that the challenged amended 2005 assessment was excessive in law."*[32]

57. He went on to say:

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[28] [1979] HCA 18; (1979) 143 CLR 284

[29] At CLR 303

[30] [2015] FCA 973

[31] [2013] AATA 612 at [48]

[32] At [28]

"There is a substantive difference in requiring the exclusion of a possibility and the conventional civil onus of proof of establishing a matter on the balance of probabilities. It is one thing not to be satisfied about a matter because, weighing all the evidence, the decision-maker is not persuaded that it is more likely than not that a fact existed or did not exist, and quite another thing to require the proof of that matter by excluding all other possibilities. The latter is akin to applying the criminal onus of proof beyond reasonable doubt. …."[33]

58. Determining something on the balance of probabilities requires consideration of the available evidence to determine what is more likely than not. While this may involve the consideration of what is possible it does not, as Rares J says, involve eliminating all of the possibilities.

Inferences

56. The balance of probabilities requires consideration of the the evidence to ascertain whether it is more likely than not that the asserted fact is true. It may involve direct evidence of facts, circumstantial evidence or inferences drawn from direct evidence or circumstantial evidence or a combination of them.

57. Inferences need to follow rationally from the factual foundation for them. For example, consider a manufacturer of widgets that have GST inclusive price of $110. There is a deposit of $550 in the manufacturer's bank account. The direct factual evidence includes the nature of the manufacturer's business the price of the widgets and the deposit. A reasonable inference that could be drawn from this is that the deposit represents the proceeds of a sale of five widgets. However, if the deposit was for $100,000 it would not be a reasonable inference without more of a sale of widgets; the sale would merely be a possibility.

58. In *Rawson Finances Pty Ltd v Commissioner of Taxation*[34] Jagot J discussed the requirements for permissible inferences. Her Honour said:

[33] At [31]
[34] [2013] FCAFC 26

"….permissible inference may be based on direct evidence or circumstantial evidence. The mere fact that evidence is circumstantial rather than direct does not convert permissible inference based on that evidence into impermissible conjecture. This was exposed by the discussion in Seltsam Pty Ltd v McGuiness (2000) 49 NSWLR 262; [2000] NSWCA 29. Spigelman CJ, at [80]-[91], there dealt with the common law test of the balance of probabilities. The following propositions emerge:

1. "The common law test of balance of probabilities is not satisfied by evidence which fails to do more than establish a possibility" (at [81]).

2. "It is often difficult to distinguish between permissible inference and conjecture. Characterisation of a reasoning process as one or the other occurs on a continuum in which there is no bright line division. Nevertheless, the distinction exists" (at [84]).

3. As stated in Carr v Baker (1936) 36 SR (NSW) 301 at 306 (at [86]):

> *The existence of a fact may be inferred from other facts when those facts make it reasonably probable that it exists; if they go no further than to show that it is possible that it may exist, then its existence does not go beyond mere conjecture. Conjecture may range from the barely possible to the quite possible.*

4. And as stated in Caswell v Powell Duffryn Associated Collieries Ltd [1940] AC 152 at 169-170 (at [87]):

> *Inference must be carefully distinguished from conjecture or speculation. There can be no inference unless there are objective facts from which to infer the other facts which it is sought to establish. In some case the other facts can be inferred with as much practical certainty as if they had been actually observed. In other cases the inference does not go beyond reasonable probability. But if there are no positive proved facts from which the inference can be made, the method of inference fails and what is left is mere speculation or conjecture.*

5. "Proof on the balance of probabilities, indeed on the beyond reasonable doubt standard, may be established on the basis of circumstantial evidence" (at [90]).

6. Any fact "can be established by a process of inference which combines primary facts like "strands in a cable" rather than "links in a chain", to use Wigmore's simile: Wigmore on Evidence, 3rd ed (1981) vol 9 at 412-444

[2497] referred to in Shepherd v The Queen (1990) 170 CLR 573 at 579" (at [91])."[35]

56. These propositions provide very useful insights into the balance of probabilities. For example, the suggestion by Spigelman J in *Seltsam Pty Ltd v McGuiness* that the common law test of the balance of probabilities is not satisfied by evidence which fails to do more than establish a possibility needs to be kept in mind by taxpayer and Commissioner alike.

57. Of particular importance is the recognition of the distinction between permissible inferences and mere speculation or conjecture. Taxpayers and the Commissioner need to be diligently objective about whether an inference can be drawn from known facts. While the Commissioner's assessment of liability can be based on a guess or conjecture there is a danger in basing that guess or conjecture on inferences that are no more than conjecture themselves.

58. The drawing of inferences by the Commissioner is not uncommon. Sometimes they flow logically from underlying facts. At other times they are merely one of a number of possibilities that could flow from an underlying fact or set of facts. Then the "inference" amounts to nothing more than mere conjecture and proves nothing. What tends to offend is the assertion that an inference can be drawn from facts when it is nothing more than a mere possibility.

ENFORCEMENT

56. At the stage when the Commissioner is conducting enforcement activities (often described as compliance activities) such as an audit, it is very important to be conscious of what is being provided to the Commissioner and to have an eye on the future. There are a number of reasons for this. Some of them were identified above under the heading Getting to the Facts.

57. At the enquiry stage the taxpayers should keep one eye on where the engagement with the Commissioner could end up. The material provided may end up in a

[35] At [88]

dispute and it may be used in evidence. Alternatively, it may be used in cross examination. Inconsistent or incorrect information is the fodder for cross examination and attacks on credibility.

58. Obviously, taxpayers have an obligation to provide the Commissioner with a truthful account and complete information but so often they provide material that does not tell the whole story or is simply wrong. When this happens it is a difficult task to retrace steps and correct the information particularly if the earlier incomplete or incorrect information shows the taxpayer in a bad light.

59. This often happens because taxpayer personnel have a reluctance to engage with the process. They may regard the enquiry as an intrusion, a waste of time or simply inconvenient. This is despite the Commissioner's plain right to make enquiries and obtain access to records and places. The result is that not enough attention is given to the enquiry at the beginning to ensure it is dealt with efficiently and expeditiously.

60. As the Inspector General of Taxation said in his report, early engagement is desirable.

61. At the enforcement stage, such as when audits are being undertaken, what standards apply to the Commissioner? The answer under the taxation law is probably none. However, there are other obligations that apply to the Commissioner and his officers.

59. Section 10 of the *Public Service Act* 1999 (**PSA 1999**) provides for the Australian Public Service (APS) values. These values include the following:

> *"Committed to service*
>
> *(1) The APS is professional, objective, innovative and efficient, and works collaboratively to achieve the best results for the Australian community and the Government.*
>
> *Ethical*

(2) The APS demonstrates leadership, is trustworthy, and acts with integrity, in all that it does.

Respectful

(3) The APS respects all people, including their rights and their heritage."

60. In my opinion, these values require, among other things, that persons evaluating evidence have appropriate skill levels, are objective and base conclusions on rational criteria. Inferences must be drawn on a reasoned and rational basis.

61. The APS Code of Conduct is contained in s.13 of the PSA 1999. Subsections (1) and (2) provide as follows:

"(1) An APS employee must behave honestly and with integrity in connection with APS employment.

(2) An APS employee must act with care and diligence in connection with APS employment."

62. This means that if there is evidence that supports a position, honesty and integrity dictate that it be given the weight that it deserves and not ignored merely because it does not serve a particular hypothesis. That weight might be zero but the weight to be given needs to be objectively determined as zero.

63. Care and diligence require, particularly in the circumstances of a full audit, that evidence gathering is undertaken objectively and not just with a particular hypothesis in mind.

64. The *Public Governance, Performance and Accountability Act* 2013 has similar requirements. Section 25 requires an official to exercise his or her powers, perform his or her functions and discharge his or her duties with the degree of care and diligence that a reasonable person in his or her position would exercise. Section 26 requires an official to exercise his or her powers, perform his or her functions and discharge his or her duties honestly, in good faith and for a proper purpose.

65. The observations by Rares J in *Rawson Finances* highlight the necessity to weigh evidence objectively. It means that a finder of fact needs to identify the evidence that is available. The available evidence may include not only what the taxpayer has provided but evidence from other sources as well. It may include evidence of industry practice.

66. The absence of an explanation may also be relevant. In *Federal Commissioner of Taxation v Dalco*[36], Brennan J said:

> *"….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. In Gauci v. Federal Commissioner of Taxation [1975] HCA 54; (1975) 135 CLR 81, Mason J. said (at p 89):*
>
> > *' The Act does not place any onus on the Commissioner to show that the assessments were correctly made. Nor is there any statutory requirement that the assessments should be sustained or supported by evidence. The implication of such a requirement would be inconsistent with s.190(b)* [now ss.14ZZK and 14ZZO, TAA 1953] *for it is a consequence of that provision that unless the appellant shows by evidence that the assessment is incorrect, it will prevail.'"*

67. However, prior to the issue of an assessment the Commissioner is the finder of fact. He needs to base any action including the raising of assessments based on the evidence that he has. Whatever the Commissioner has, needs to be considered objectively and not in a way that supports a hypothesis not based on fact. An absence of evidence such as an explanation is part of the evidentiary matrix. But if the weight of evidence supports the taxpayer, it is inappropriate for the Commissioner to take an exception to the weight of evidence and rely upon it to support the hypothesis.

68. Objective consideration of evidence is a matter for judgment. This is not an easy thing particularly when views have become polarized. In evaluating the evidence

[36] [1990] HCA 3, 168 CLR 624

before him the Commissioner needs to be conscious of the possibility that views may be polarized.

69. In my opinion, it is something that applies more to the Commissioner than to taxpayers. In this respect, I consider that different standards apply to the Commissioner and to taxpayers. The Commissioner's function is not to act as an advocate for any particular tax position but to ensure that the correct amount of tax is paid. In so doing, his obligation is to objectively weigh the evidence he has (including an absence of it) to get to the facts. He should not ignore evidence because it does not suit a particular hypothesis.

70. A taxpayer or its representative, on the other hand, have different obligations. Certainly they have a paramount obligation to be truthful. However, their obligation is to do the best for the taxpayer within the law. This necessarily makes them an advocate. As such, the weight to be given to particular aspect of the evidence may be a matter for advocacy subject always to the overarching obligation not to deceive or mislead.

RULES OF EVIDENCE

69. The rules of evidence mostly do not apply to dealings with the Commissioner prior to litigation. However, they are rules of common sense directed at rationally proving facts. It is remarkable how often taxpayers attempt to make their cases with the Commissioner based on assertion: "Black is white because I say it is". A bit more attention to actually trying to offer evidence that black is white makes everyone's life easier. Much of this falls in the court of the taxpayer.

70. If taxpayer's engaged more with the rules of evidence in their dealings with the Commissioner it would mean that questions are answered quicker with less aggravation for all. The most important rule of evidence is relevance. In the context of dealings with the Commissioner it is closely followed by credibility. However, for dealings with the Commissioner credibility is far wider than the relatively narrow rules in the *Evidence Act*. It is about believability. If it is lost it is difficult to get it back.

Relevance and Credibility

71. Under the *Evidence Act* relevant evidence is evidence that would rationally affect (directly or indirectly) the assessment of the probability of the existence of a fact in issue.[37] Proving a fact requires that relevant evidence is offered. It may be that each individual piece of evidence does not of itself prove a fact (it rarely, if ever, will) but a combination of evidence will prove the fact.

72. It is common for taxpayers to offer both relevant and irrelevant material to the Commissioner in varying degrees. The irrelevant material often clouds the issue, causes confusion and leads to delay and cost. A more considered and diligent approach to evidence gathering inevitably saves time and money in the long run.

73. There are some specific rules of evidence dealing with credibility. However, I am referring to credibility in a broader sense. It is about being believed. Does the witness know, can they remember, can I trust them? The Commissioner has to be alert to the possibility that he is not getting the full story despite the suggestion in the Taxpayer's Charter that a taxpayer will be presumed to tell the truth and information given by the taxpayer is complete and accurate. These things are not incompatible.

74. But if the information provided to the taxpayer is not complete and accurate then credibility is lost and must be reclaimed. If more care was provided in understanding what is required, and why, so that complete and accurate material can be provided, it will inevitably lead to better outcomes.

Hearsay and Opinion

75. Direct evidence is evidence from a person about what they sensed through one of their senses, namely sight, hearing, touch, taste and smell. Evidence from a person of what someone else said that they sensed through one of their senses is hearsay. This includes written representations. For example, a statement by the chief executive officer about what his sales people do in the field would more than

[37] s.55, Evidence Act 1995

likely be hearsay unless the chief executive officer actually observed the sales people.

76. Generally hearsay evidence is not accepted as evidence. This consistent with the common sense notion of the rules of evidence. There are a number of exceptions to the rule that hearsay evidence is not acceptable.

77. Business records is one example. Business records are direct evidence of what what is on the page but are hearsay as to the underlying transaction that they represent. There is an exception to the hearsay rule for the records of a business that record transactions.[38]

78. Generally, opinions given orally or in writing are not accepted as evidence of the fact about which the opinion is expressed.[39] As with most rules of evidence there are exceptions. One exception is for opinions about something that the witness saw, heard or otherwise perceived about a particular event.[40]

79. Another exception is for opinions expressed by an expert in giving expert evidence.[41] There are special rules about the giving of expert evidence and how it is to be presented. It requires that the person giving it has some specialized knowledge or training gained from training study or experience. An example of this could be expert evidence on a particular process or on an industry practice.

Parol Evidence Rule

80. The parol evidence rule is a rule of evidence. It is a rule of evidence for identifying the intention of the parties to a contract. The rule is that the executed written document is the physical representation of the parties' subjective agreement that is accepted as evidence or proof of it. It becomes, usually, the primary objective evidence of the agreement.

[38] s.69, *Evidence Act* 1995
[39] s.79, *Evidence Act* 1995
[40] s.78, *Evidence Act* 1995
[41] s.79, *Evidence Act* 1995

81. It is a rule of common sense in that it avoids endless litigation about what the parties actually agreed. It mainly applies to contracts and is concerned with the principle that:

> *"if there be a contract which has been reduced into writing, verbal evidence is not allowed to be given of what passed between the parties, either before the written instrument was made, or during the time it was in a state of preparation, so as to add to or subtract from, or in any manner to vary or qualified the written contract.."*[42]

82. In the construction of written agreements the parol evidence rule limits the evidence that may be relied upon to ascertain the intention of the parties as they have expressed it in written form. This means that the parties' expression outside the four corners of the contract of what they intended will generally not be admissible. However, that is not the end of evidence of prior negotiations or the factual background to them.

83. In *Codelfa Construction Pty Ltd v State Rail Authority of NSW*[43] Mason J said:

> *"22. The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed.*
>
> *23. It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are*

[42] *Goss v Lord Nugent* (1833) 110 ER 713 at 716
[43] [1982] HCA 24; (1982) 149 CLR 337

admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intended or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parol evidence rule is to exclude them, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification." [44]

84. This principle may be very useful when it comes to the interpretation of contracts. An example of of circumstances where this principle could have had application but was not relied upon was the *South Steyne*[45] litigation. Consideration of the background material may have shed some light on the meaning of the contract in that case.

Jones v Dunkel

85. The rule in Jones and Dunkel derives from the High Court decision in *Jones v Dunkel*[46]*.* The rule is a rule about inferences that can be drawn from a failure to call witnesses or produce evidence. The basic rule is that this failure may lead to an inference that the evidence would not have assisted the party's case. As Menzies J put it:

> *"In my opinion a proper direction in the circumstances should have made three things clear:*
>
> *(i) that the absence of the* [evidence] *cannot be used to make up any deficiency of evidence;*
>
> (ii) *that evidence which might have been contradicted by the defendant can be accepted the more readily if the defendant fails to give evidence;*
>
> (iii) *that where an inference is open from facts proved by direct evidence and the question is whether it should be drawn,*

[44] At 352. See also *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* [2004] HCA 55; 218 CLR 471 at [33]
[45] *South Steyne Hotel Pty Ltd v Commissioner of Taxation* [2009] FCAFC 155
[46] [1959] HCA 8; (1959) 101 CLR 298

the circumstance that the defendant disputing it might have proved the contrary had he chosen to give evidence is properly to be taken into account as a circumstance in favour of drawing the inference."[47]

86. This rule applies to litigation but there is equally room for the rule, or a principle derived from it, in dealings with the Commissioner. It is fundamentally a rule of common sense. Failure to produce key documents inevitably leads to suspicion about the reasons for the failure. Despite the statements of Menzies J it is an easy inference to draw that the absence of the evidence proves the Commissioner's position. Then it is hard to shift and more resources are required to shift it than might have been required had the evidence been produced in the first place.

Privilege

87. There are two types of privilege for professional legal communications. Legal professional privilege arises under common law and client legal privilege arises under statute. Both of them protect from production certain documents connected with the obtaining or giving of legal advice and with legal proceedings.

88. Client legal privilege is provided for in the *Evidence Act* 1995 (Cth)[48]. As mentioned above, this act applies to all proceedings in federal or Australian Capital Territory courts. Outside of this, the protection for qualifying documents is provided by the common law doctrine of legal professional privilege.

89. Under the *Evidence Act* there are two categories of client legal privilege, namely legal advice privilege and litigation privilege. Section 118 provides for legal advice privilege in the following terms:

"Evidence is not to be adduced if, on objection by a client, the court finds that adducing the evidence would result in disclosure of:

[47] At CLR 312
[48] Both New South Wales and Victoria have their own versions of this Act in almost identical terms.

(a) a confidential communication made between the client and a lawyer; or

(b) a confidential communication made between 2 or more lawyers acting for the client; or

(c) the contents of a confidential document (whether delivered or not) prepared by the client, lawyer or another person;

for the dominant purpose of the lawyer, or one or more of the lawyers, providing legal advice to the client."

90. Section 119 provides for the privilege under the litigation limb. It is in the following terms:

"Evidence is not to be adduced if, on objection by a client, the court finds that adducing the evidence would result in disclosure of:

(a) a confidential communication between the client and another person, or between a lawyer acting for the client and another person, that was made; or

(b) the contents of a confidential document (whether delivered or not) that was prepared;

for the dominant purpose of the client being provided with professional legal services relating to an Australian or overseas proceeding (including the proceeding before the court), or an anticipated or pending Australian or overseas proceeding, in which the client is or may be, or was or might have been, a party."

91. Client legal privilege and legal professional privilege are the client's privilege and not the lawyer's. It is for the client to claim the privilege. Plainly the communications must be confidential and they must be between the client and the legal advisor. The legal advisor does not have to be independent of the client and can be an employee employed as a lawyer to give "independent" advice.[49]

92. Privilege can be lost. One of the main ways is by the disclosure of the confidential communication. A knowing and voluntary disclosure of the substance of the advice or its disclosure with the knowing or implied consent of the client or other party will do it. For example, a loss of the privilege may be occasioned by

[49] *Archer Capital 4A Pty Ltd as trustee for the Archer Capital Trust 4A v Sage Group plc (No 2)* [2013] FCA 1098 at [73] per Wigney J

disclosing that legal advice has been obtained that a particular transaction is to be treated in a particular way. The written advice does not have to be shared for a loss of privilege to arise. But once the disclosure is made privilege is lost for the written advice.

Accountant's Concession and Board Papers

93. Advice given by accountants and others who are not legal practitioners does not enjoy the protections of legal professional privilege or client legal privilege. However, the Commissioner has made a concession to accountants in relation to certain non-source documents in his "Guidelines to accessing professional accounting advisors' papers.[50] These guidelines offer concessions in respect of documents identified as "restricted source documents" and "non-source documents". Access to these documents will not be pursued except in exceptional circumstances. Similar concessions are made to companies for advice to a corporate board on tax compliance risk.[51]

94. Despite this the usual mantra is; if the Commissioner wants them, he will get them. There is no legal protection for accountants' documents.

95. There is an exception to this. If the document has been prepared by the accountant for a client or a legal practitioner for the dominant purpose of the client obtaining legal advice or for anticipated litigation it will enjoy legal professional privilege.[52] Accordingly if an accountant or other professional is asked to prepare a report by the client or its lawyer and the dominant purpose for which it is produced is the obtaining of legal advice by the client, it will enjoy the protection of legal professional privilege or client legal privilege.

Other Rules of Evidence

[50] https://www.ato.gov.au/general/gen/guidelines-to-accessing-professional-accounting-advisors--papers/
[51] PS LA 2004/14
[52] *Pratt Holdings Pty Ltd v Commissioner of Taxation* [2004] FCAFC 122

96. There is a range of other rules of evidence that may need to be considered from time to time but mostly in relation to litigation. It is beyond the scope of this paper to deal with them.

CONCLUSION

97. The gathering of evidence in taxation matters would be assisted at the earliest stage in the engagement between the taxpayer and the Commissioner. It would eliminate some of the frustrations for the Commissioner and the taxpayer alike. A haphazard approach to fact gathering inevitable leads to delays and additional cost for the Commissioner and for the taxpayer. Any early engagement leads to better identification of issues, the facts that need to be substantiated and, inevitably, better outcomes.

98. Empathy plays a big part in any of this. Each side needs to put themselves in the other person's shoes. This gives far greater insights than the siege mentality that often characterises the engagement.

99. Taxpayers bear the burden expressly when contesting objection decisions in the FCA or AAT but they effectively bear it from the time that they lodge the BAS. On the other side, the Commissioner does have obligations, not to act recklessly or maliciously.

100. There are barriers to proving the facts that do not need to be there. Sometimes it comes from the behaviour of taxpayers, sometimes the behaviour of ATO personnel and other times both. Some of these are created by the ATO and some by taxpayers. If the parties engaged earlier in an open and honest way many of these difficulties would evaporate.

101. The rules of evidence do not always apply to evidence gathering but they provide a useful guide and ought to be at least shadowed in any exercise that involves dealing with facts in a taxation context.

102. There needs to be caution in relying on inferences that they flow logically from the underlying facts. They cannot be mere possibilities. There is a danger in

attempting to support a hypothesis with selective use of the facts that inferences drawn from them do not flow logically from them or that they are unsupportable when all of the facts are known.

103. There are a number of rules of evidence that as rules of common sense ought to be shadowed at the earliest stage in any engagement between the Commissioner and taxpayers. They provide a rational approach to evidence gathering that is far more likely to get to the truth that someone's assertion expressed as a fact.