



THE TAX INSTITUTE

A man with dark hair, a beard, and glasses, wearing a white button-down shirt, is sitting at a desk. He is looking down at a document he is holding and writing on with a pen. A laptop is visible to his right. The background is a bright, out-of-focus window with white curtains.

3 things you need
to know about the
burden of proof

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THE TAX INSTITUTE

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Our growing membership base includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Over 7000 of our members hold the Chartered Tax Adviser (CTA) designation, the internationally-recognised and respected mark of technical excellence and professional integrity.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. As Australia's tax system has evolved and has become more complex, the Institute has grown in its reputation, its responsiveness and its contribution to shaping the changes that benefit its members and taxpayers.

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Overview

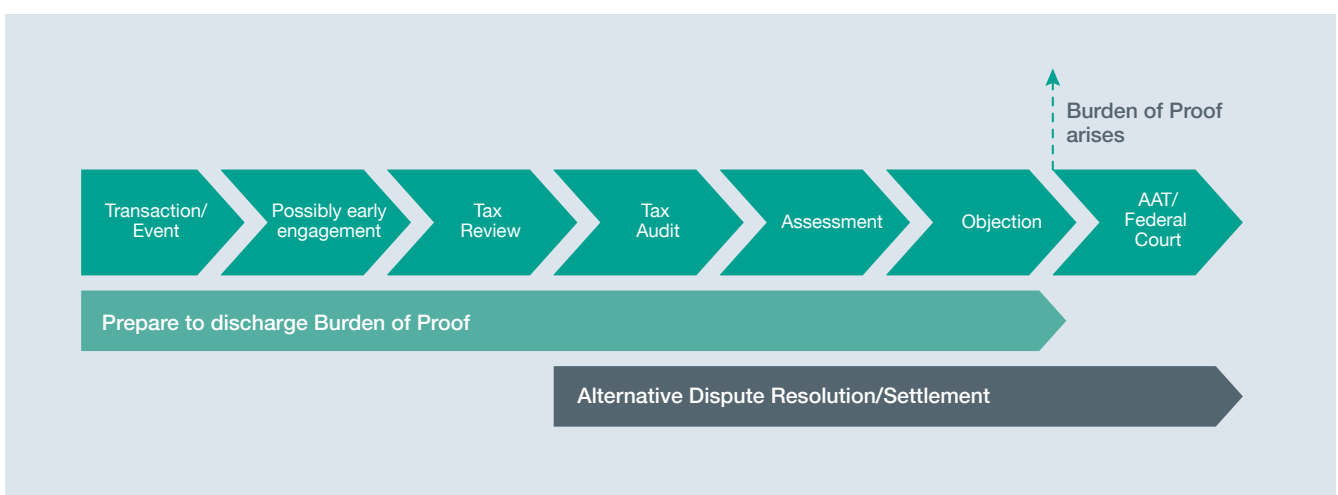
Sections 14ZZK and 14ZZO of the *Taxation Administration Act 1953* (Cth) (**TAA 1953**) place the burden of proof in a tax appeal on the taxpayer. This means that the taxpayer must prove, on the balance of probabilities, that an assessment is excessive.

The burden of proof becomes relevant to not only the conduct of a tax appeal, but also the resolution of tax matters at all stages of the dispute lifecycle. Increasingly, we observe that the Commissioner of Taxation (**Commissioner**) is seeking to test the evidence supporting statements made by taxpayers in a return, at earlier stages of a dispute lifecycle. This is often by employing his formal information gathering powers. Burden of proof can also become key to achieving settlement outcomes.

Our practical experience demonstrates that most well advised taxpayers do not fail to support their tax position taken because they incorrectly apply the technical provisions of the tax acts, but rather because they fail to retain sufficient evidence to prove their position.

As a consequence, it is imperative for taxpayers to focus early in the dispute lifecycle on capturing and retaining sufficient evidence to discharge their burden of proof and support their tax position. An “early engagement” approach to preparing to discharge the burden of proof can greatly assist taxpayers to mitigate risks associated with their taxation affairs, including to manage potential penalties. The gathering of contemporaneous evidence can also assist the parties to narrow the issues in dispute and therefore expedite the resolution of the dispute and minimise costs for all stakeholders.

This paper considers the burden of proof in tax matters and why in a changing tax environment it matters more than ever. We outline the primary types of evidence that may be used to support the taxpayer’s position, the weight of evidence that must be adduced to discharge the burden of proof, as well as the importance of assessing the credibility of the portfolio of available evidence. In addition, we offer some guidance for taxpayers to ensure they are best placed to discharge their burden of proof.



1

Burden of Proof in Tax Disputes



1

Burden of Proof in Tax Disputes

It has been described as a “cardinal principle of our system of justice”¹ that the prosecution, and not the defendant, will bear both the legal and evidentiary burden of proof in criminal matters. The underlying rationale for the presumption of innocence was that to place the burden of proof on a defendant was “repugnant to ordinary notions of fairness”,² given the considerable imbalance of resources between the State and the defendant.³ Income tax is one area of the law which reverses this position. At a policy level, this may be considered a necessary counterbalance to a self-assessment income tax system.

The taxpayer bears the burden of proof, to the ordinary civil standard on the “balance of probabilities,” in respect of appeals commenced in the Federal Court or Administrative Appeals Tribunal (AAT).⁴ This burden consequently becomes relevant to the resolution of tax matters at earlier stages of the dispute lifecycle. Increasingly in the authors’ experience the Commissioner is requiring taxpayers to produce evidence to support their tax position at earlier stages of the dispute lifecycle. Therefore, it is imperative that taxpayers focus early in the dispute lifecycle on gathering and retaining evidence to support their tax position.

This article considers the taxpayer’s evidentiary burden and the practical ways in which taxpayers can best prepare to discharge this burden.

1.1 How the Burden of Proof Permeates the Tax Dispute Lifecycle

Our observation is that the Australian Taxation Office (ATO) is increasingly encouraging, and in some cases requiring, taxpayers to take an “early engagement” approach to their tax affairs and to provide evidence to support their positions. This allows the ATO to obtain greater assurance

that taxpayers are meeting their tax obligations in a timely and transparent manner and to focus its resources in the right places.

The need for documentation is not new. In the Decision Impact Statement for the decision in *FCT v AXA Asia Pacific Holdings Ltd*⁵ (this case concerned the operation of Part IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) (Part IVA)) the Commissioner clearly indicated he will seek objective evidence supporting assertions or statements made by taxpayers. Our experience demonstrates the Commissioner will test this evidence with some rigour.

Notably, the Commissioner stated in the Decision Impact Statement to the AXA case:⁶

“A clear implication of the Court’s decision is the need for the Commissioner to test any evidence supporting assertions or statements made by taxpayers about what would or might reasonably be expected to have happened absent a scheme.”

Depending on the particular facts of the case, it may be necessary to undertake more forensic exercise in analysing all possible counterfactuals subject to the proviso that they are not speculative or have no direct relevance to the impugned scheme.”

¹ *Sorby v Commonwealth* (1983) 152 CLR 281, 294 (Gibbs CJ).

² Attorney General’s Reference No 4 of 2002; *Sheldrake v DPP* [2005] 1 AC 264, [9] (Lord Bingham).

³ Andrew Ashworth, ‘Four Threats to the Presumption of Innocence’ (2006) 10 *International Journal of Evidence and Proof* 241, 251.

⁴ TAA 1953 sub-ss 14ZZK(b)(i) and 14ZZO(b)(i).

⁵ (2010) 189 FCR 204.

⁶ Decision Impact Statement: Commissioner of Taxation v. AXA Asia Pacific Holdings Ltd.

As part of the focus on early engagement, the ATO has recently launched its Justified Trust initiative, a concept from the Organisation for Economic Cooperation and Development (OECD). The ATO has stated that in practice this means:

“To achieve justified trust, we seek objective evidence that would lead a reasonable person to conclude a particular taxpayer paid the right amount of tax. This is a higher level of assurance than confirming certain risks do not arise.”⁷

In a transfer pricing context, the Practical Compliance Guideline 2017/1 (PCG),⁸ further emphasises this point by illustrating the importance of maintaining evidence to support transfer pricing positions taken in the area of pricing related party debt.

The PCG sets out the ATO’s compliance approach to the taxation outcomes associated with an inbound or outbound ‘financing arrangement’ or a related transaction or contract, entered into with a cross-border related party. The PCG provides transparency in relation to the ATO’s approach to the pricing of related party debt, as well as the evidence a taxpayer is required to keep depending on its risk profile.

“55. Whilst there is no statutory requirement for you to have transfer pricing documentation beyond your normal record keeping obligations, if you do not meet the transfer pricing documentation requirements in Subdivision 284-E of Schedule 1 to the TAA and the Commissioner makes a transfer pricing adjustment, you will be taken to have an undocumented transfer pricing treatment and precluded from taking a reasonably arguable position in regard to that transfer pricing treatment for the purposes of administrative penalties.

56. The Commissioner views Subdivision 284-E of Schedule 1 to the TAA as an incentive for taxpayers to make a serious and genuine effort to correctly self-assess their tax positions under the transfer pricing rules and for that effort to be evidenced by documenting the transfer pricing treatment before filing their income tax returns for a given year.”

This necessitates not only maintaining TP documentation for the purposes of penalty protection, but also maintaining evidence about the underlying transaction so that a taxpayer can be in a position to support the position taken in the application of the substantive transfer pricing rules.

⁷ Australia Taxation Office, *Justified Trust* (15 May 2018) <<https://www.ato.gov.au/Business/Large-business/Justified-trust/>>

⁸ Practical Compliance Guideline 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution functions.

2

How a Taxpayer Can Discharge their Burden of Proof



How a Taxpayer Can Discharge their Burden of Proof

As a consequence of the burden of proof, taxpayers cannot defend a filing position in audit, on objection, or in the court, without positive evidence. This section of the paper provides an overview of the primary types of evidence that may be adduced in support of the taxpayer's position. We suggest it is best practice for a taxpayer to present a portfolio of various types of evidence that provide a coherent narrative, and that together, these various types of evidence can assist the taxpayer to discharge their burden of proof.

Furthermore, this section continues to explore the weight of evidence that must be adduced to discharge the burden of proof imposed by sub-ss 14ZZK(b) and 14ZZO(b) and how a court or tribunal might balance potentially competing evidence in order to make findings of fact on the basis of the balance of probabilities.

2.1 Documentary Evidence

Documentary evidence plays an important role in any tax dispute, both in evidencing facts in issue and in corroborating other sources of evidence.

The most probative forms of documentary evidence are generally third party records, including records produced by government organisations (for example, FIRB applications, tax clearances etc); and primary business records maintained by the taxpayer.

In the authors' experience internal documents, such as board minutes and email correspondence between key personnel, are also common forms of documentary evidence and can be helpful in discharging the burden of proof. Particularly in matters such as transfer pricing, where understanding the profile of a business is key, or anti-avoidance rules, where consideration of options or evaluation of plans are potentially relevant, this type of material can be key.

However, often board minutes or other formal company documents are brief and merely set out the formalities of the final transaction or arrangement. Such documents may fail to capture evidence of the various iterations of the transaction (including the change of direction of a project

at key stages), the commercial intent behind key decisions made and details regarding other options that were considered and dismissed. Further, board minutes may fail to appropriately articulate the commercial objectives of the transaction or arrangement. Given the importance of these aspects when in a dispute, and the likely questions from the Commissioner in this regard, it is important that evidence of the above points are captured contemporaneously in appropriate circumstances.

2.2 Witness Evidence

Witness evidence can assist a taxpayer to discharge their burden of proof in a number of ways. First, witness evidence may assist the taxpayer to evidence facts that are otherwise unsubstantiated by documentary or other evidence. In particular, witness evidence may be necessary to substantiate the motive or intention of a taxpayer at the time (which is less commonly captured in standard corporate documents). An initial forensic analysis of contemporaneous documentation can assist a taxpayer to identify any areas of fact that are unsubstantiated and identify potential sources of witness evidence that may assist in closing these gaps.

Second, witness evidence may be useful in clarifying the contents of the documentary evidence. For example a witness may clarify the meaning of term or phrase used, the purpose for which a document was prepared or events that occurred subsequent to the preparation of document.

Witness evidence is also an effective way for the taxpayer to link the circumstances, intentions and documents if context is important. In addition, witness evidence may provide further support for and therefore enhance the credibility of other sources of evidence.

The most compelling witness evidence will almost always come from the key decision-makers of the transaction or arrangement that is the subject of the dispute. For corporate taxpayers, this is usually the directors and senior management responsible for the relevant transaction or arrangement. These key personnel are able to provide the court with insight into the context and intention of the taxpayer which may not have been recorded in corporate documents.

If a taxpayer is intending to rely on oral testimony, it is important to remember that a witness may be unavailable in future (they could have left the company, be deceased or otherwise be unable to give credible evidence). Further, often there may be many intervening years between the relevant event or transaction and the resolution of the dispute and witnesses' recollections can fade over time.

Where key personnel are not able to provide evidence, a taxpayer should be prepared to explain to the court why this is case or a negative inference may be drawn. The rule in *Jones v Dunkel*⁹ operates where there is an unexplained failure by a party to give evidence, to call witnesses or to tender documents or other evidence. This rule extends to situations where a party fails to ask questions of a witness.¹⁰ This may lead to an inference that the uncalled evidence would not have assisted that party's case. The rule in *Jones v Dunkel* was recently referred to in the decision of Robertson J in the case of *Chevron Australia Holdings Pty Ltd v FCT*.¹¹

The interplay between witness evidence and documentary evidence

In many circumstances, if there is adequate supporting evidence to lend credibility to the oral or written evidence of the taxpayer, this may be sufficient to discharge the taxpayer's burden of proof. As stated in the case of *Imperial Bottleshops Pty Ltd & Egerton v FCT*:¹²

“A taxpayer who does not keep records of his deductible outgoings faces a very difficult task. If he goes into the witness box and swears that he has incurred the outgoings he is making a self-serving statement...Some other corroborative evidence would normally be required which makes it more probable than not that his sworn testimony is to be believed. It must, however, be borne in mind that the evidence of a taxpayer is not to be regarded as “prima facie unacceptable”.”

The recent case of *Rowntree v FCT*¹³ further illustrates the interplay between witness evidence and documentary evidence, particularly in the context of undocumented loans.

Generally a loan or contract must be evidenced by documents or conduct. A common issue faced by taxpayers is the absence of documents to evidence a loan, particularly where there has been a refinancing. Where there is no document recording an alleged contract, it is necessary to examine the acts and conduct relied on in the context in which they occurred to ascertain whether objectively they evince a contract.¹⁴

In the *Rowntree* case the taxpayer, an experienced lawyer, received over \$4 million in numerous dealings with companies that he controlled and, for most of them, was the sole director. He appealed assessments including these amounts in his income on the basis that they were loans to him. The AAT found that two of the receipts (for \$1,000,000 and \$80,000) were received as loans, but that loans did not exist at the time of his other receipts. Notably, the Tribunal accepted that Mr Rowntree genuinely believed that he had entered into the loan agreements, however, that this view was mistaken (based on the documentary evidence available). Thus, despite Mr Rowntree's oral evidence, he failed to discharge his burden of proof. The fact that Mr Rowntree's oral evidence did not accord with the documentary evidence and that he had failed to evidence the transaction consistently with his belief, was a key factor in the Tribunal's decision.

As such, it is important to assess the full suite of evidence available to support the taxpayer's position and the interplay between various forms of evidence.

2.3 Expert Evidence

2.2.1 The Use of Expert Evidence in Tax Disputes

Expert evidence is playing an increasingly important role in the resolution of tax disputes. Commonly expert evidence is relied on in respect of areas of tax law that involve the valuation of assets, and economics in transfer pricing matters, accounting outcomes and matters involving Part IVA. We discuss below some examples of recent cases in which expert evidence has played a significant role in the resolution of tax disputes and aided the judge in making a decision.

Transfer Pricing

The decision in *Chevron Australia Holdings Pty Ltd v FCT*¹⁵ highlights the importance of having relevant and high-quality expert evidence in transfer pricing disputes. Over 20 witnesses and experts (from corporate banking, rating agencies, academia, oil and gas industry and transfer pricing specialists) were involved in this case. This number is not unsurprising given the case was complex, involved multiple facets of new law and necessitated the parties establishing what would have happened under a reasonable hypothesis.

⁹ *Jones v Dunkel* (1959) 101 CLR 298.

¹⁰ *Commercial Union Assurance Co of Australia Limited v Ferracom Pty Ltd* (1991) 243 CCLR 361.

¹¹ [2015] FCA 1092, [165].

¹² [1991] FCA 352.

¹³ *Rowntree v FCT* [2018] FCA 182.

¹⁴ *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd* (1988) 5 BPR [97326], 11,117.

¹⁵ *Chevron Australia Holdings Pty Ltd v FCT* [2017] FCAFC 62.

On one view, the Chevron decision at first instance may be considered a burden of proof case. The taxpayer was unable to discharge its burden of proof in part because some of the evidence it presented to demonstrate the excessiveness of the assessments was rejected. As held by Robertson J:¹⁶

“In my opinion, therefore, the applicant has not shown that the consideration in the Credit Facility Agreement was the arm’s length consideration or less than the arm’s length consideration nor proved that the amended assessments under Div 13 of the ITAA 1936 were excessive.”

In the Full Federal Court, the judges unanimously dismissed the appeal from the taxpayer.

Ultimately the taxpayer did not have sufficient evidence of the arm’s length consideration for the loan and was unable to discharge the burden of proving that the assessment was excessive.

Part IVA

Expert evidence can be effective in establishing the steps a taxpayer may reasonably have undertaken if they hadn’t entered into the scheme for Part IVA matters. Expert evidence may be useful in these circumstances as contemporaneous documentary evidence is unlikely to exist in respect of a counterfactual that simply was not considered by the taxpayer at the time of entry into scheme.

An example of where expert evidence was successfully lead by the taxpayer in these circumstances is the case of *FCT v Futuris Corporation Limited*,¹⁷ a Part IVA case concerning a restructure undertaken by the taxpayer.

The Full Federal Court acknowledged that reliability of prediction may be established through various means, including by expert evidence:

“The reliability of a prediction might be established by direct evidence of contemporaneous consideration of the alternative postulate; or by evidence from company officers as to established commercial parameters for sale and whether the alternative postulate met those parameters; or evidence from those who were involved in the transactions challenged under Pt IVA. But that is not the only way to establish reliability. To the extent that the Commissioner submits that it is only by such direct evidence that a reliable prediction can be made, we reject that submission. This much was recognised by the Full Federal Court in [FCT v Trail Bros Steel & Plastics Pty Ltd [2010] FCAFC 94].”¹⁸

In this case, the taxpayer adduced a report from an expert witness, who was an accountant. This report set out evidence regarding what the taxpayer may have “reasonably” done if it had not entered into the scheme. The Full Federal Court held that the report was relevant and persuasive:

“a prediction based on given facts, established market values, calculations based on unchallenged financial data, a stated goal and the application of Mr Duivenvoorde’s expertise in corporate finance and his experience as a chartered accountant. The definition of ‘tax benefit’ in s 177C(1)(a) requires that there be a prediction as to what “might reasonably be expected to have been included in the assessable income of the taxpayer.” That prediction necessarily involves an opinion as to events and transactions that have not taken place. It must be not just a possibility but “sufficiently reliable for it to be regarded as reasonable”: Peabody at 385.”¹⁹

Valuations

The case of *Resource Capital Fund IV LP v FCT*²⁰ illustrates the role experts have to play in cases involving valuations. RCF IV concerned the sale of shares in an Australian company, Talison Lithium. For our purposes, the question to be answered was whether the market value of Talison Lithium’s Taxable Australian Real Property exceeded the sum of the market value of Talison Lithium’s assets (other than Taxable Australian Real Property).

Both parties submitted expert valuation evidence, however, their values differed significantly in respect of the value of assets that were Taxable Australian Real Property versus those were not, because they adopted different assumptions and valuation methodologies. The Court stated that:

112. The Court is not well placed to resolve theoretical differences between competing experts whose judgments are soundly based and are responsibly held within established disciplines in areas of non-legal expertise...a judge should not be cast in the role of a third valuer. ... Ultimately, however, a court needs to be persuaded that one or other of the opinions is to be preferred by reference to the explanations and reasons given by the experts for their opinions.

The Court determined that ultimately they preferred the valuation methodology of the taxpayer’s valuers. This case demonstrates the importance of ensuring that the assumptions and methodologies used by experts are tested and able to stand up to the scrutiny of competing experts.

¹⁶ *Chevron Australia Holdings Pty Ltd v FCT* [2015] FCA 1092, [525].

¹⁷ *FCT v Futuris Corporation Limited* [2012] FCAFC 32.

¹⁸ *FCT v Futuris Corporation Limited* [2012] FCAFC 32, [80].

¹⁹ *FCT v Futuris Corporation Limited* [2012] FCAFC 32, [70].

²⁰ *Resource Capital Fund IV LP v FCT* [2018] FCA 41.

3

Effectively Documenting and Defending Your Tax Position



3

Effectively Documenting and Defending Your Tax Position

3.1 The Importance of Retaining Evidence

It is evident from the discussion in this paper, that it is imperative for taxpayers to capture and retain sufficient evidence to discharge their burden of proof and support their tax position. This need has been heightened recently due to the changing tax landscape, which is becoming increasingly complex and uncertain.

In the current tax environment, it is not sufficient to have simply formed a technically correct tax position supported by a reputable tax opinion. Taxpayer's need to ensure they maintain contemporaneous documentation supporting the facts upon which their tax position is based. Further, taxpayers need to ensure their transactions are implemented and structures maintained as intended.

The benefits of maintaining good records are articulated by the Commissioner as follows:

- “to provide written evidence of your income and expenses
- to help you or your tax agent prepare your tax return
- to ensure you are able to claim all your entitlements
- in case we ask you to prove the information you provided in your tax return
- reduce the risk of tax audits and adjustments
- improve communication with us
- resolve issues relating to disputed assessments or adjustments
- avoid exposure to penalties.”²¹

We suggest below steps taxpayers and their advisers can take to ensure they are in best placed to discharge their burden of proof and defend their tax position.

²¹ Australian Taxation Office, *Keeping your tax records* (5 October 2016) <<https://www.ato.gov.au/Individuals/Income-and-deductions/In-detail/Keeping-your-tax-records/>>

Conclusion

It is increasingly important in the current tax environment for taxpayers to focus early in the dispute lifecycle on gathering and retaining evidence to prepare to discharge their burden of proof and support their tax position. This approach can reap significant benefits in the future, in minimising risk and potential penalties, as well as assisting to reduce the duration and costs of reviews and disputes. For material transactions or events, taxpayers should engage with their advisers to develop a tailored plan and prepare to discharge their burden of proof.



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