Review of Self Assessment

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NFF Submission to Review of Self Assessment
1. Introduction

1.1 Importance of Farming to Australia

Farming is a significant sector of the Australian economy. The following data shows the importance of agriculture prior to the 2002-03 drought.

- Agriculture made up 4 percent of Australia’s GDP in 2001-02, with a value added of $26.0bn\(^1\). The gross value of production was $39.9bn. Forecast production for the current financial year (2003-04) is $36.1bn.

- It provided 20.3 per cent ($31 bn) of our goods and services exports in 2001-02 (an estimated 18.2 percent or $27 bn in the 2002-03 drought year)\(^2\).

- Many rural communities depend upon agriculture for their prosperity. Agriculture directly contributes more than 30 per cent of employment in 66 per cent of small non-coastal towns\(^3\). Of course, farming indirectly provides a great many more jobs.

- Farmers are vital custodians of the land, with agricultural activities covering 60 percent of the Australian landmass\(^4\).

- Agriculture is one of the largest employers in Australia, providing more than 380,000 jobs in 2001-02 (or 4 percent of Australia’s labour force) – the ninth highest industry subdivision out of 53. The employment level has increased in the past five years, even with substantial improvements in productivity over this timeframe\(^5\). Employment figures have partly recovered from the drought, to stand at 318,200 as at February 2004.

- Agricultural productivity increased by 3.3 per cent per year between 1988 and 2000, well above the average of 1.2 per cent and the second highest in the market sector (after communications)\(^6\).
  - This fact in particular should dispel the myth that the agricultural sector is ‘old economy’. Farmers have been adopting new technologies and improving practices with fervour.
  - This productivity growth has been driven by declining farm terms of trade (prices received divided by prices paid). Since 1960, farmers’ terms of trade have declined by more than 50 percent\(^7\).

- Agriculture also represents a significant input into many other industries, particularly the food processing industry, which had a value added of $14.5 bn in 2002-03 (2.0 percent of GDP). Food processing is the second largest industry subdivision of total manufacturing by value added and employment, employing 188,000 people in 2001-02\(^8\).

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2. Source: ABARE, Australian Commodities, tables 5 and 27. Exports are greater than value added, because export value includes value added in non-agricultural industries.
3. Agriculture contributes more than half of total employment in 28 per cent of small non-coastal towns. Source: ABARE (2001), Country Australia, p38
4. Source: ABS, Agriculture (Cat no 7113.0), table 5.1
5. Source: ABARE, Australian Commodities, table 10.
8. Source: ABARE, Australian Commodities, table 10
2. Rulings and Other Tax Office Advice

2.4.1 Accessibility and 2.6 Funding rulings

Recommendation: Australian Tax Office (ATO) advice should be stated in clear straightforward language but include lengthier explanations of principles in “small print” for practitioners and more sophisticated taxpayers.

Justification: This would allow ordinary taxpayers with fairly straightforward tax affairs to get clear understandable guidance, yet allow practitioners and sophisticated taxpayers to gain insight into the principles that are used by the Tax Office.

2.4.2 Timeliness

Recommendation: Introduce fee for service in the provision of complex Private Binding Rulings (PBR) with statutory and contractual deadlines for the provision of these PBRs. A definition of “complex” would be required. NFF has no opinion on the proposal to have default positive or negative ruling.

Justification: Firstly it would create an obligation on the tax office to provide PBRs on a timely basis similar to any other provision of service contract. Secondly it would provide the tax office with the funds to provide the resources needed for the timely provision of PBRs. Finally the taxpayers who seek PBRs are those with complex tax arrangements and presumably have the financial resources to pay for conclusive advice. Also reduce the occurrence of wasteful requests for complex PBRs.

2.4.3 Accuracy

Recommendation: Systemic reviews of rulings by independent body.

Justification: Would help ensure tax office advice is consistent. Could possibly be carried out by the Inspector – General of Taxation.

2.5 Rights of Appeal

Recommendation: Allow AAT and Federal Court to consider additional facts.

Justification: Current rules mean that matters have had to be referred back to the ATO, increasing duration and cost of the review process.
3. Review and Amendments of Assessments

3.4.1 A shorter amendment period for individuals and very small businesses

Recommendation: Shorten amendment period for individuals and businesses with straightforward tax affairs to 2 years. The criteria for shortening the amendment period would be based on the complexity of the tax affairs rather than turnover and other measures of size.

Justification: The tax office has indicated that it deals with the majority of individual and very small business assessments within two years. The tax office could determine those who fit into the straightforward category by simply asking taxpayers to tick a question box in their tax returns. The question box would presumably ask whether the taxpayer has made any capital gains etc. Using the simplified tax system (STS) criteria would exclude many businesses that have a high turnover but low profit margins, such as farms.

3.4.2 A new amendment period for arrangements conferring tax benefits

Recommendation: Shorten amendment period for making determinations under Part IVA, to 4 years.

Justification: The tax office has indicated that it would process the majority of cases including ones that have complex tax affairs within four years. In exchange for the shorter amendment period, taxpayers that enter into transactions that might be covered by Part IVA would be required to submit all the details of such transactions to the tax office with their tax return.

There may be a need to ensure that audits can continue beyond four years if needed – by agreement as currently, or perhaps by application to outside authority.

A shorter period should not mean significantly more information needed in tax returns.

3.4.3 Early notification of intended compliance activity

Recommendation: Early notification of taxpayer of further scrutiny at half the applicable amendment period. The notification would include notification of general areas of interest to the tax office, to allow taxpayers to prepare. However, if a taxpayer is not notified it would be unlikely for the tax office to amend their assessment.

Justification: The early notification would provide certainty to taxpayers. It would also allow taxpayers that will undergo further scrutiny to prepare documents and evidence to support their assessments. By not stopping the tax office from amending assessments beyond the notification period, the tax office would still be given some flexibility.

3.4.4 Pre-assessment agreements

Recommendation: Taxpayers and the ATO should be able to enter into agreements over a wider range of transactions to bring certainty to tax treatments.

Justification: This would improve certainty for taxpayers and enable ATO to discover and deal with problems without audit.
3.4.5 Loss and nil liability returns

Recommendation: Limit period of review for loss and nil liability returns to the same time period for other amendments.

Justification: Currently returns that show a loss have an effectively unlimited period of time for review. There is no justification for this when the amendment period for large deductions is limited except in circumstance of fraud.

3.4.6 Unlimited review periods

Recommendation: set the statutory limit on amendments for Farm Management Deposits (FMDs) at the same period for other parts of the tax return.

Justification: Many farmers are currently at risk for amendment to their tax returns relating to FMDs. The statutory limit on ATO audit and amendment for FMDs should be set at the same for the rest of that taxpayer’s affairs.

3.4.7 Material Facts

Recommendation: There should not be a new limit on the ATO’s power of audit or amendment, based on when the ATO had access to all the material facts.

Justification: The proposal may introduce fresh uncertainty – particularly over when the ATO had all the relevant facts. It would be better for certainty to be increased by cutting the statutory time limits as proposed above.

3.4.8 Amendments to reduce liability

Recommendation: Uniform time period for amendments to assessments except in extenuating circumstances.

Justification: On the basis of fairness it would seem sensible to only allow taxpayers the same amount of time to amend their assessments as the tax office. Of course there will be extenuating circumstances, but this should be supported by documentary evidence.
4. Penalties

4.2.1 Meaning of reasonable care and reasonably arguable position

Suggestion: The tax legislation should use of the standard of care test that has been well established by the courts for the tort of negligence. The reasonably arguable position should be set such that the standard is “as likely correct as incorrect”.

Justification: The standard of care test used in the tort of negligence is well established and well understood. It is also flexible enough to set a lower standard for your average taxpayer yet set a very high standard for tax professionals. The reasonably arguable position test should not penalise a taxpayer for being incorrect, but on the other hand should discourage argument where the issue has been thoroughly investigated.

4.2.2 Penalty for failure to follow a private ruling

Recommendation: Abolish the penalty for failure to follow a private ruling where a fee for service has been paid. Instead introduce fee for service for private rulings.

Justification: This would be in line with the views of the Ralph review, which took the view that those that sought complex private rulings already had a good idea of how the law works but wanted to see what the tax office thought. It would also be consistent with the principles of the taxpayer taking reasonable care and having a reasonably arguable position. The charging of fee for service would also cover any increased administration cost.
5. The General Interest Charge

5.3.3 Compensating the government for delayed payment

Recommendation: The policy goal for the General Interest Charge (GIC) should be limited compensating the government for the cost of delayed tax payments. The GIC should be set accordingly with this principle.

Justification: The policy goal of ensuring that non-compliant taxpayers do not receive an advantage is at odds with reality. Most taxpayers would assess themselves with the aim of assessing correctly, accordingly incorrect assessments would be due to misunderstandings of the law or other honest mistakes. Those that incorrectly assess themselves on purpose should be dealt with under the penalty regime. The policy goal of providing a positive incentive for taxpayers to take steps to ensure that they assess correctly is also misplaced. The incentive for assessing correctly should be left solely to the penalty regime. Finally using the GIC for any other purpose than to compensate the government for delayed payment would be viewed negatively by a general public that already has a dim view of tax collection.

5.4.3 Approach C: Remit uplift factor

Recommendation: Reduce the uplift factor to a level that would cover the administration and collection of GIC, presumably 3-4 percent.

Justification: This would be consistent with the policy of only using the GIC to compensate the government for delayed payment. If we assume that the time period for the amendment of assessments is also shortened then the other approaches would not be necessary.

5.4.4 Tax Office initiated remission

Recommendation: Give automatic remission where taxpayer challenges assessment or amendment and takes reasonably arguable position.

Justification: Taxpayers should not be penalised by the GIC where they assume a reasonably arguable position and await rulings by the courts.
6. Other Issues

6.2 Awareness of self-assessment

Recommendation: Change the name of the notice of assessment to another term, emphasising the fact that the ATO has not ‘ticked off’ on the taxpayer’s self-assessment. Possibilities include “confirmation of tax return” or “receipt of self assessment”

Justification: This would make it clear that a taxpayer’s return can be amended by audit, for 2 or more years after the notice of assessment is issued. Studies show that many individuals think that an assessment is final.

6.3 Balance of power

Recommendation: Adopt a general policy of using alternative dispute resolution between the tax office and smaller taxpayers. The Inspector – General of Taxation’s office could possibly act as the mediator in such instances.

Justification: This would save costs and administration for both the tax office and the taxpayer.

6.6 Obligations to keep records

Recommendation: Limit record keeping time period to amendment period plus 100%. That is double the amendment period.

Justification: If the amendment period were reduced to 2 years for small taxpayers and 4 years for other taxpayers, then this would lead record keeping periods of 4 or 8 years. 4 years would not be unnecessarily odious for small taxpayers who would presumably have small amounts of records to keep. Whereas 8 years would be manageable for larger businesses given the increased use of electronic storage methods and other corporate regulations.

6.8.1 Discretions

Recommendation: Consult with stakeholders to prioritise the discretions that need to be overhauled. Then legislate changes in a gradual fashion.

Justification: Legislating all the changes to discretions in one large bundle would be administratively and legislatively troublesome.