28 May 2004

The Review of Self Assessment
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs,

Submission on *Review of Aspects of Income Tax Self Assessment*

Introduction

The Taxation Institute of Australia (Taxation Institute) welcomes the March 2004 release for public comment of the consultative paper: *Review of Aspects of Income Tax Self Assessment* (the Discussion paper) and appreciates the opportunity to respond to the questions posed.

By way of background the Taxation Institute was established in 1943 and has a membership of over 15,000. Our members, which are located throughout Australia, range from small rural and suburban accountants to senior members of the bar specialising in tax.

This submission has been compiled from comments made by senior tax practitioner members of the Taxation Institute. Therefore, this submission highlights the key concerns of senior tax practitioners representing and advising on all areas of Australian business. Although it was suggested in consultation that Treasury preferred a joint professional body response, the Taxation Institute, in light of the importance of the issue, believes that more is to be gained by broader community comment on the Discussion Paper.

General Observations on the Document

Before addressing specific options canvassed in the Discussion paper the Taxation Institute has some concerns/observations about the focus of the review, and about its scope.

Focus of the review

The Taxation Institute believes that the focus should be on the objectives of self assessment and how the costs and burdens of achieving these objectives ought be shared more equitably.

It is essential that for any tax system to operate effectively it should be *perceived* as equitable, both in the way tax is levied and in the administration of the system.

It will be remembered that the Asprey Committee, in considering the essential aims of efficiency, fairness and simplicity in a tax system, said:

> "Thus, the Committee is to consider the effects of the system upon the 'economic and efficient use of the resources of Australia', the desirability that there should be a 'fair distribution of the burden of taxation', and that revenue-raising be 'by means that are not unduly complex and do not involve the public or the administration in undue difficulty, inconvenience or expense".[1]

Section 1.1.1 of the consultative paper makes it clear that the move to self assessment was driven by the desire to increase the cost efficiency of revenue collection by liberating assessing resources within the ATO to audit activities.

Self assessment has to a very large extent thrown onto taxpayers disproportional additional burdens and uncertainty with the imposition of significant penalties and GIC if their view of what are often overly complex legislative provisions is not "as likely to be correct as incorrect, or is more likely to be correct than incorrect".

Taxpayers have had to bear virtually all, or at least a disproportional share of, the burden of moving to self assessment. *The Taxation Institute is of the view that this burden should be shared more equally.*

Scope of the review

The Taxation Institute has some concerns/observations arising from limiting the scope of the review to income tax self assessment.

First, a self assessment system was applied in respect of Fringe Benefits Tax (FBT) at the same time as income tax and unlike income tax was not subjected to subsequent review. As a result the self assessment process in respect of FBT still contains some crucial legislative defects.

For example, there are inconsistencies between s 74(3) and s 72 of the *Fringe Benefits Tax Assessment Act 1986.* While s 74(3) still embodies the concept of "full and true disclosure" in the making of an assessment, s 72 deems the making of an assessment when the taxpayer lodges his return. This inconsistency raises the issue as to how can a full and true disclosure can be made when returns are in the main lodged electronically. The effect of this inconsistency is that the period for amendment is effectively always six years rather than the intended three year period. As a result the Taxation Institute believes that the scope of the review should have been extended to cover this aspect of FBT self assessment.

Second, the Discussion paper does not directly address the issue of a standardised ruling system for both income tax and indirect taxes. The ruling system for indirect taxes (the Goods and Services Tax (GST), wine and luxury car taxes) under s 37 of the *Taxation Administration Act 1953* has an administrative basis of operation, while the income tax system is a statutory regime that sets out rights and, in particular, makes public and private rulings binding.

Third, as the Australian Taxation Office (ATO) has been granted responsibility for the administration of superannuation, those rules do not contain the provision for rulings to assist with that administration and to ensure taxpayer certainty. Therefore, it is disappointing that the Review did not explore the issue of binding rulings in this context.

The Taxation Institute has been concerned since 1999 about the inconsistency between the two ruling processes. To this end the Taxation Institute has written to the Treasurer in August 1999 and in October 1999 to the then Assistant Treasurer,

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[1] Preliminary Report of the Taxation Review Committee (Asprey Committee) June 1974 at para 3.6. See also Review of Business Taxation (Ralph Committee) July 1999 at pp 15-17

Senator Rod Kemp expressing our concerns. The Taxation Institute has also met the ATO on 18 January 2000, and subsequently provided the ATO with a joint body view on whether GST rulings should be included in the global rulings system and provided comment on the recommendations on rulings contained in the final Report of the Review of Business Taxes, *A Tax System Redesigned*. The question of uniformity of all the ruling systems should have been included in the paper.

The structure of the submission

The following submission is prepared in light of these concerns. The submission will address the proposed changes in the attached materials under each of the headings in the Discussion paper, i.e.:

- Chapter 2: Rulings and other Tax Office advice;
- Chapter 3: Review and amendment of assessments;
- Chapter 4: Penalties;
- Chapter 5: General Interest Charge; and
- Chapter 6: Other Issues.

The submission will attempt to address each question raised in each chapter. However, prior to addressing each question some general observations will be made on the discussion in each chapter where necessary.

Conclusion

The Taxation Institute views the outcome of this consultative process as crucial to the Australia's future development. The Taxation Institute strongly urges the Government, in light of the importance of the various reform options, to proceed quickly to remedy those of the highest priority.

Should you require clarification of any of the matters contained in this submission, please do not hesitate to contact at first instance Michael Dirkis, Tax Director of the Taxation Institute on (02) 8223 0011.

Yours faithfully

Neil Earle
President

Submission by

The Taxation Institute of Australia

In response to the Treasury Discussion Paper

Review of Aspects of Income Tax Self Assessment

May 2004

Chapter 2: Rulings and other Tax Office advice

1. General observations

The Taxation Institute has long held concerns about the ability of taxpayers to know their legal rights and obligations. Under self assessment taxpayers are theoretically required to have detailed knowledge of the Commissioner's views on matters of policy, procedure and interpretation of tax law. The complexity of the law and the inability of taxpayers to have easy access to rulings and other taxation advices have meant that taxpayers cannot realistically have this knowledge.

The sheer volume of information produced tends to overwhelm even practitioners. The following figures are indicative of the levels of information overload just in the areas of Taxation and GST Rulings and Determinations, Product Rulings and Class Rulings issued since 1992, totalling 3,667 final and draft statements.[2] These figures are further swelled with the addition of other types of binding statements issued over this period including statements in relation to Miscellaneous Rulings, Fuel Grant and Rebates, Wine Equalisation Tax, Superannuation Contribution, Superannuation Guarantee, Luxury Car Taxation, GST Bulletins and GST Issues Log.

	TR's		TD's		GSTR's		GSTD's		PR's	CR's
	Draft	Final	Draft	Final	Draft	Final	Draft	Final		
1992	40	20	235	201						
1993	47	41	294	244						
1994	42	32	116	98						
1995	31	36	29	63						
1996	21	27	18	45						
1997	20	25	10	25						
1998	13	23	19	29					5	
1999	21	19	103	84	14	1			104	
2000	19	18	23	54	23	37	6	12	119	
2001	16	14	16	27	9	8	1	2	177	85
2002	13	21	16	28	11	6	5	5	147	89
2003	13	16	23	32	9	16	5	3	82	112
2004	0	3	9	15	2	4	0	3	70	49
Totals	296	295	911	945	68	71	17	25	704	335

Add to this huge information flow the list of non-binding statements (on the taxpayer, contra for ATO staff) such as ATO Interpretative Decisions (ATOID), Taxpayer Alerts, Practice Statements, fact sheets and explanatory material (eg the Consolidation Guide, the Receivables Manual and ATO Access Guidelines).

The ATOID count for:

- 2002 at 1,116;
- 2003 at 1,135; and
- so far in 2004 at 435.[3]

While rulings play an important role in self assessment the impact of the general interest charge (GIC) and their binding nature upon the ATO means that in terms of

2 As at 26 May 2004
3 As at 26 May 2004.

the ATO's administration, they have attained a status of "defacto" law. This is well beyond their intended status i.e., binding statements of the Commissioner's opinion.

The system should be modified to redress the balance by measures such as removing penalties for non-compliance with rulings and removing the presumption of the need for an alternative "reasonably arguable" case where a taxpayer offends non-binding advice such as ATOIDs.

Although it is not uncommon for rulings to be favourable to taxpayers, there is a perception that the Commissioner is often reluctant to rule, or to rule in favour of taxpayers, on contentious issues (the main area where rulings would be expected). It is felt that the ATO will often rule to protect the revenue rather than to provide a fair view of the law. This perception will only be avoided if a system is devised whereby rulings can be issued by independent advisers in a timely manner. This could be done through the adoption of special tribunal of experienced practitioners who would rule on more complex issues. The cost of the system could be met through charging fees.

2. Chapter 2 questions

2.A Is Tax Office advice sufficiently accessible?

Difficulties in accessing ATO rulings and advice

Although the ATO has improved its online access to rulings and other ATO material, there remain a number of problems in accessing information. For example, there should be a requirement that when a ruling (booklet, website document etc) is altered to change a previous ruling, this change and the date of change are highlighted in any replacement ruling. This will ensure that taxpayers (particularly a small business person) relying on an industry fact sheet etc will be made aware of the changes, which impact upon their business, and the date of those changes.

Further enhancements to search engines are also required, such as allowing download of lists of particular categories of rulings/ATOIDS etc.

The Taxation Institute believes that the crucial question is whether taxpayers and tax advisers alike have access to sufficient resources to comply readily with the requirements of self assessment.

Further, in light of the lack of community understanding of self assessment illustrated by the mass-market scheme Inquiries, a concerted education program is required to fully inform the public about the impact of self assessment and to counter disinformation ("pub talk") on the system.

Difficulties in obtaining private rulings and advice

There are often significant delays in getting private binding rulings from the ATO and the ATO will not provide rulings in a number of areas. For example:

- Advice on the possible application of Part IVA is not readily accessible. In the past, the Commissioner has placed a moratorium on Part IVA advice. Even now, the ATO presently has an extreme reluctance of expressing any opinion of whether Part IVA applies, especially in a timely manner in relation to prospective transactions.

- Many unresolved issues still exist in the area of tax consolidations, where the views of the ATO have not been articulated making the preparation and lodgment of the first consolidated tax return difficult.

- Although the ATO has issued a number of lengthy transfer pricing rulings, there is still a need for more rulings that address the practical application of transfer pricing.

- Broadly, where the ATO feels that they cannot provide a PBR it also means extensive delays in getting any public ruling issued.

In summary, ATO advice is not sufficiently accessible.

2.B Should Tax Office advice indicate whether Part IVA applies to a particular arrangement as a matter of course, or only on request?

The Taxation Institute believes that the ATO should indicate whether in its view Part IVA applies to a particular arrangement. The ATO should provide this advice unless the request for a ruling expressly provides that such advice is not required.

Further, the ATO should not, as in the past, be able to arbitrarily refuse to issue rulings on topics, which are not expressly excluded by the legislation (eg Part IVA, EBA arrangements etc). The use of moratoriums to delay the resolution of difficult tax issues results in frustrations about delays as the very issues denied rulings are those most needing them. It is recommended that this practice should cease.

In fact, the Taxation Institute believes that rulings should be available on a wider range of issues, that is, the Taxation Institute supports:

- *A Tax System Redesigned*'s recommendation 3.1 that the ruling system should be expanded to make the Commissioner legally bound on matters of administration, procedure, collection, Part IVA and conclusions of fact;

- a system that also provides for the Commissioner to make rulings in respect of valuation issues. Although it is acknowledged that *A Tax System Redesigned*' stated that it would not be appropriate for the Commissioner to be obliged to rule on valuations, this view is not sustainable. Valuations are a form of ultimate conclusion of fact, and that accordingly the Commissioner should be able to rule;

- the *A Tax System Redesigned*' Recommendation 3.2(b) that the Commissioner could use facts from other sources is supported on the grounds that it is a positive measure to assist taxpayers and should lead to the more timely issue of rulings. The only rider was that any amendment should ensure that where the external information was the subject of confidentiality and privacy, which information not be taken into account.

- the recommendation in the Commonwealth Parliament's Joint Committee of Public Accounts in its *Report No. 326* handed down in November 1993 that hypotheticals should be ruled upon, resources permitting;[4] and

- the admissibility by the Courts and the AAT of additional evidence from taxpayers in determining a review of a negative ruling (recommendation

[4] Joint Committee of Public Accounts, *Report No. 326 - An Assessment of Tax - A Report on an Inquiry into the Australian Taxation Office* (Canberra: AGPS, 1993), recommendations 37-40; also see paras. 6.71-6.80.

3.2(2) of *A Tax System Redesigned*). This would be a positive measure to assist taxpayers and would lead to greater resolution of ruling disputes.

2.C (a) Do taxpayers and their advisers currently encounter delays in obtaining Tax Office advice?

The Taxation Institute has had concerns about timeliness of rulings, especially private binding rules on relatively complex matters.

It is not uncommon for transactions to depend on getting timely rulings. Some transactions may go ahead in the expectation that a positive ruling will, in fact, be given, but incur enormous costs when no such positive ruling eventuates, especially if the adverse tax implications of the transaction mean that it is no longer an economic proposition (i.e. transactions may be able to proceed where the tax result is neutral or positive, but not where it is negative).

In relation to obtaining private rulings, delays create difficulties for advisers in the commercial context, let alone on the ability to challenge an adverse finding (i.e. taxpayers are unable to use their appeal rights as often by the time the ruling issues, the financial year has elapsed). These delays often result in the need to resort to other options for the management of tax risk, such as obtaining external tax advice.

(b) If so, what strategies might allow the Tax Office to provide advice on a more timely basis?

Structural Change

A Tax System Redesigned' recommended (Recommendation 3.2(a)) a default system, where by the failure to issue a ruling would lead to a deemed adverse ruling by the Commissioner. A solution could be that 90 days after the application would be the trigger period for a deemed default, and the default would result in the maximum amount of final tax. It was also recommended in *A Tax System Redesigned* that an objection against a default ruling would be disallowed in order to speed access to the Administrative Appeals Tribunal or the Courts.

However, the preferred approach would be that at the expiration of 60 days after the lodgement of a ruling request, the ATO be required to refer any undetermined ruling request for review to a body nominated by the Commissioner, which contains external members (eg the Rulings panel).

The 60 day time period would suspend when information was requested, recommencing when all the information required has been supplied. The 60 day time period should not be able to be extended to accommodate further information requests. This body would be given a further 30 days to review the ruling request and facilitate a determination. A failure to rule at the expiration of this 30 day period would give rise to default.

The Taxation Institute strongly objects to the notion of default rulings based on the maximum amount of final tax on the basis that this is very difficult to ascertain. If a default mechanism is to apply, then any default ruling should be a positive one. For example, the taxpayer's position set out in the ruling request could be the default position if ATO did not rule within specified time. There is also statutory precedence for this approach in s 171 of the 1936 Act.

Process change

The ATO practice of asking as many questions as possible, and seeking information not particularly relevant to the interpretative issues that form the basis of the ruling, is generally unhelpful to the overall ruling process. We appreciate the need for the correct balance in this area but a mechanism is needed whereby the ATO can provide advice (both binding and non-binding) based on the material that the taxpayer can provide at the time of seeking the ruling. Areas of uncertainty or assumptions made by the ATO can be emphasised in the ruling.

2.D (a) Are there significant problems with the accuracy of Tax Office advice?

From time to time, issues are raised in ATO consultative forums that question the accuracy of ATO rulings and other advice material, such as ATOIDs. Many members felt that the accuracy concern is generally around the ATO not following case law when it is not in the ATO's favour (or simply ignoring it altogether). This can impact on the reasonably arguable position issue and penalties.

(b) If so, how should they be addressed?

The current process is haphazard, with the Commissioner retaining full discretion to determine the withdrawal/amendment of the ATO ruling/advice. There should be an independent panel in place that can arbitrate/review in a timely manner where such concerns are raised. It may be that the costs of such a panel will need to be borne in part by taxpayers wishing to avail themselves of this facility.

For call centre advice, the Taxation Institute recommends that the ATO should provide confirmation of advice sought by a taxpayer (either by email or letter), which sets out the scripted advice given and whether the ATO regards it as binding or not.

2.E (a) Is there evidence of pro-revenue bias in Tax Office advice?

It is the Commissioner's responsibility to administer the tax laws fairly. The Taxation Institute is concerned about situations where the interpretation of the law is in doubt and the ATO is known to take the pro-revenue view as a matter of course, even if it is at odds with the policy objectives of the law.

Whilst is may be in the purview of the Commissioner's role to have concern for the revenue, this should not be at the expense of administering the tax laws fairly. The Commissioner cannot ignore the fact that the Commissioner is in a position to influence the behaviour of taxpayers through the expression of his opinion on the operation of the law and does so.

As mentioned above, the ATO should provide the correct and independent advice, as opposed to advice that often appears to be driven by a perceived need to protect the revenue.

(b) What measures would improve confidence in the objectivity of Tax Office advice?

Public advice

Currently, the ATO issue draft public advice documents (e.g., rulings) and relies on the general public (including the professional associations) making submissions to provide comments and considered opinion. Often the time period for this process is

too short and even where amendments are suggested, in general the suggested changes are ignored.

Feedback on such submissions from the ATO is at best haphazard and rarely spells out the rationale for rejecting suggested improvements. As a result, the professional bodies are loath to invest any significant resources in these processes.

Therefore, to improve confidence in the objectivity of ATO public advice, mandatory obligations to provide feedback including reasons for rejecting suggestions must be put in place immediately to ensure some confidence in the consultation process.

Private advice

Confidence in the objectivity of ATO private advice would be improved through a more public approach to the education of ATO officers responsible for providing this type of advice. Such measures could include a requirement for ATO officers to undertake their continuing professional education (CPE) in public forums. In this way, they would not be getting an "ATO only" view of the world and would not develop a "closed shop" mentality. There would also be an added benefit for practitioners in hearing ATO arguments in a public education forum.

(c) Would an independent evaluation assist?

The existence of rulings panels and quality assurance reviews appear to have done little to ensure objectivity. A revamp of the membership of these panels with a balance between ATO and external membership with an independent chair could significantly improve objectivity. Further, such a balanced and independent panel would give taxpayers much greater confidence in, and respect for, rulings.

In terms of independent evaluation, the Taxation Institute believes that Treasury should explore the option of amending the law to allow some type of declaratory relief, such as the ability to challenge public rulings in court or before an independent rulings panel.

2.F (a) How should Tax Office advice be framed to assist taxpayers — by explaining contending views of the law, or by setting out how the Tax Office intends to apply it?

Currently, only small parts of any ruling are actually binding, being the text under the heading "Ruling".[5] Therefore, the Taxation Institute believes that the whole of the ruling should be binding.

However, in putting forward this proposition, the Taxation Institute is not inferring that there should be a reduction in the amount explanation that is sometimes provided in rulings. On the contrary, rulings should all contain this information where appropriate. It is important that where there are contending views, the ATO be forced to explain how they have arrived at their decision, and be bound by this view.

Furthermore, the approach of the ATO merely setting out how it intends to apply the law does little to provide understanding and could escalate the number of disputes as taxpayers in ignorance "seek justice".

[5] See generally Graeme S Cooper "Rulings" (1999) *Taxation Institute of Australia 7th National Tax Retreat (Tax Traumas: Rulings, Access and Tax Avoidance)* paper.

(b) Does this impact on the way that advice is expressed?

No.

2.G How might the Tax Office clarify the circumstances in which general advice can be relied upon?

All advice issued by the ATO should be binding, including general advice. If the Commissioner is concerned about the how certain examples may be misleading, then the Commissioner should not be issuing this advice, as taxpayers will rely on it.

Self assessment carries risks for taxpayers, these should be shared more equally with the Commissioner. Fundamental to self assessment is knowledge and the Commissioner should not be able to avoid the Commissioner's responsibility to issue rulings in areas of uncertainty merely because the Commissioner may make a mistake. The onus is on the Commissioner to review the advice given and to revise more general advice as the law develops.

2.H (a) Is there value in making more Tax Office advice legally binding?

As the Commissioner is in a position to influence the behaviour of taxpayers through the expression of his opinion on the operation of the law, it is imperative that the Commissioner is bound by his opinions.

Traditionally, the Commissioner's views could be found in publications like old series tax rulings, information booklets, return guides, press statements or speeches by senior ATO staff. However, these sources of information do not bind the Commissioner.

> *For example, assume Andy relies on TaxPack in preparing his annual tax return, but there is an error in TaxPack. The Commissioner can legally amend Andy's assessment despite the fact Andy relied upon the Commissioner's stated view.*

Although tax will be payable, the adjustment does not give rise to an additional tax penalty. [6] However, even having to unexpectedly pay the primary tax can cause hardship for many taxpayers.

The Commissioner's ability to amend arises from the fact that no conduct on the part of the ATO can operate as an estoppel against the operation of taxation legislation. [7] Even so-called "binding" rulings can be over-ridden by the ATO in a number of arbitrary situations. Put simply, taxpayers cannot, in strict legal terms, rely on ATO pronouncements except in quite restricted and specialised circumstances.

In order to support the self assessment system and provide a degree of certainty for taxpayers, the Taxation Institute holds the view that:

- all secondary material should be binding on the Commissioner; and
- the ability for the Commissioner to subsequently waive the binding nature of these publications should be severely limited.

Failure to address this now maybe merely deferring the inevitable developments in the law. Although *FCT v Wade* provides support for the view that no conduct on the

6 s 284-215, Schedule 1 *Taxation Administration Act 1953*.
7 *FCT v Wade* (1951) 5 AITR 214 and *AGC (Investments) Ltd v FCT* (1991) 21 ATR 1379.

part of the ATO can operate as an estoppel against the operation of the Tax Act. That decision, now over 50 years old, ignores the development of judicial review of administrative decision making that has occurred both formally and informally in other common law jurisdictions. This has given rise to a change in attitude about whether or not estoppel can in fact operate. In an article by Hind W, *"Stopping the Taxman"* 1991 BTR 191 the author refers to a number of more modern authorities that suggest that estoppel can in fact operate against the taxman, although it is yet to be applied in practice. More importantly, the doctrine of legitimate expectation has come to be factored into the consideration of administrative actions.

(b) What additional safeguards would be required?

There currently exists risk for the Commissioner arising from the Commissioner's failure not to build in automatic review dates to ensure that advice has kept up to date with changes in the law. Therefore, a current safeguard and safeguard for the future would be vigilant review of rulings by the ATO's tax counsel network.

2.I Should taxpayers be penalised merely for not following PBRs when self assessing their income tax liabilities?

The Taxation Institute supported *A Tax System Redesigned* Recommendation 3.4 that taxpayers that decline to follow a private ruling be subjected to same rules and penalties as those who decline to follow a public ruling (i.e. a reasonably arguable position). A PBR should just be one of the many opinions that a taxpayer should be able to take into account in finalising its position. Adopting a contrary view should not carry an automatic penalty.

2.J If no penalty applied, would direct appeals against PBRs still be required?

As taxpayers are intrinsically honest, many would find difficulty in opposing the Commissioner's view. Many would also prefer not to pay GIC if it could be avoided. Therefore, there is a need to retain appeals.

2.K If appeals are retained, how could the process be improved?

The biggest weakness of the rulings' appeal process is that delays in processing rulings within the ATO can lead to taxpayers losing their rights of appeal as the financial year has elapsed. In this context, it is also important to keep in mind the Taxation Institute's recommendation (in question 2B above) for the admissibility by the Courts and the AAT of additional evidence from taxpayers in determining a review of a negative ruling (recommendation 3.2(2) of *A Tax System Redesigned*). This would be a positive measure to assist taxpayers and would lead to greater resolution of ruling disputes.

Therefore, if the Taxation Institute's suggestions on deemed rulings were implemented, the Commissioner would have an incentive to ensure that timeliness is improved.

2.L Should the Tax Office be permitted to charge for certain advice?

In responding to this question, regard should be had to our comments in this submission (page 2) about the necessity to consider a system whereby rulings can be issued by independent advisers. This could be done through the adoption of special tribunal of experienced practitioners who would rule on more complex issues. The cost of the system would be met through charging fees.

That said, *A Tax System Redesigned* recommended (Recommendation 3.5) that the law should be changed to enable the charging for private rulings. This process is intended for the more complex tax matters involving "significant amounts of tax . . . or significant ATO time and resources . . . where the ability of the taxpayer to pay the charge is clear". It was proposed at the meeting that a power to charge for rulings be inserted into the Tax Administration Act 1953.

Given the limitations on such a power recommended in *A Tax System Redesigned*, it should not impact upon small and medium size taxpayers. However, we have concerns that if the power inserted was merely a power to charge, without any qualification, it could lead to fees for all rulings being charged in the future, without the issue being considered by Parliament.

Therefore any amendment should include in legislation, or regulations, the charging guidelines. These guidelines should be developed in consultation with interested parties and be enacted at the same time as the charging power

2.M How could the Tax Office use more cost effective channels for the delivery of binding advice to taxpayers or through practitioners?

The proposed introduction of safe harbours under the Standards for the Tax Profession proposals should effectively remove the liability issue for individual taxpayers. Therefore, the ATO needs to concentrate on providing rapid rulings and advice support databases to practitioners.

Chapter 3: Review and amendment of assessments

3.A (a) Should the period for an amendment increasing the liability of an individual not in business, and/or a very small business be reduced to, say, two years?

Given that the ATO has access to real time information through BAS and IAS, there is a trend towards bringing forward of the lodgement of all tax returns, and the availability of computer matching and refined audit techniques, the rational of a four year review period is hard to fathom. This is particularly so given that the period of review 79 years ago under the Commonwealth's first income tax act was only three years[8] and continued to be three years, where there was true and full disclosure, with the introduction of the 1936 Act.

These long periods for review are excessive, particularly in respect of losses. They encourage lethargic administration, and may have been a contributing factor in the ATO's lax response to mass marketed schemes in recent times. As the ATO has moved to real time information collection the rationale for long review periods has disappeared.

Furthermore, the ATO should be prepared to bear some downside, i.e. the loss of the opportunity to amend where it fails to act efficiently. Therefore, the review period for the ATO in respect of all individuals should be limited to two years. The period of review for businesses should be reduced from four years to three years. A similar review period should exist in respect of Part IVA.

(b) Should the eligibility of a very small business be based on whether it has chosen to be a Simplified Tax System taxpayer?

No. There are fundamental problems with the definition and the rules, which have given rise to very low up take of STS. For example, of the eligible taxpayers who lodged their 2002 tax returns (as at 17 April 2003), only 14% have opted into STS. Although we have been advised this figure has increased "within expectations" with the lodgment of the 2003 returns, the figures mentioned of 30-35% are not the public expectations of Government (which touted in a number of press releases in 2000 that 95% of all businesses and 99% of farming businesses would be eligible for STS).

(c) What exclusions from a two year period would be appropriate?

The only exclusions would be where there is evidence of fraud or evasion.

Consequently, the Taxation Institute does not support the suggestions raised in the Treasury Discussion Paper that there needs to be an exclusion to allow the ATO more than two years to complete its compliance activity for some individuals and very small businesses with complex affairs and where information from third parties is not readily available. Unless fraud or evasion is involved, there is no need to exclude these types of cases from the two year period. Given the current level of onus on a taxpayer in the self assessment system, two years is more than adequate time for the ATO to establish whether or not there is fraud or evasion. It may be that in exceptional cases the ATO should be given the ability to apply to the Federal Court

[8] s 37(1) and (2) of *the Income Tax Assessment Act 1922*.

for an extension of time in the same manner as is currently provided for in s.170(4) of the 1936 Act.

3.B Should the amendment period for medium and large businesses and other complex cases remain as four years?

A maximum statutory three year time period should apply in all medium and large business cases, including cases where the Commissioner's amendment arises as a result of a Part IVA determination, transfer pricing amendments and nil assessments.

It was suggested during consultation on this paper that given the current continuous review conducted in respect of most large corporates, a lesser period was warranted.

3.C (a) Should the amendment period for arrangements conferring unintended tax benefits (including arrangements covered by Part IVA) be reduced from six years to, say, four years?

As one of the concerns with self assessment has been the potential continuing liability of taxpayers, it is important that finalisation of matters is achieved in a reasonable period. To ensure that the ATO is obliged to actively bring matters to an end, then the period should be reduced consistent with other time periods.

This would encourage the ATO to make a thorough and more robust assessment of issues at an earlier point in time, leading to greater taxpayer certainty. The magnitude and risk of penalties would be reduced where the ATO is tardy in reviewing issues and reaching its view on the application of the tax law.

(b) Should taxpayers be required to disclose certain tax planning arrangements more fully in returns?

This suggestion runs counter to the concept of self assessment and is only acceptable if the Commissioner is required to review and to sign off on these disclosures in close proximity to the lodgment of the return. It is only with such review and sign off that certainty is ensured and the current imbalance in respect of obligations and rights imposed on the taxpayers by self assessment is corrected.

3.D (a) Is there benefit in the idea of the Tax Office providing early notice to those taxpayers that it has decided to audit?

Such early notice may ensure greater accuracy, however it must be accompanied with mechanisms that allow quick resolution of any potential areas of dispute.

Any early notice must given prior to lodgment of the return and to ensure that they are not used as intimidation, must give rise to an actual audit (unlike current ATO pre-lodgment warning letters).

(b) What would be a suitable notification period?

The time period for notification would depend upon the lodgment date for the taxpayer and the availability of pre-dispute resolution mechanisms (i.e., quick rulings etc).

(c) What exclusions from the notification regime would be appropriate?

Where taxpayers have been audited in the past and found to be compliant, then they should be free from audit for some time unless major variations from the audit year in respect of income or expenses are identified.

(d) Would this idea still be beneficial if taxpayers had to disclose more information?

Again, this suggestion runs counter to the concept of self assessment and is only acceptable if the Commissioner is required to review and to sign off on these disclosures in close proximity to the lodgment of the return.

3.E Should pre-assessment agreements be extended to a wider range of cases?

Again, this suggestion runs counter to the concept of self assessment.

3.F Should a taxpayer who lodges a nil liability return be subject to the same time limits as apply in amending an assessment?

In light of *Commissioner of Taxation v Ryan* (2000) 201 CLR 109 and *Batagol v Commissioner of Taxation* (1963) 109 CLR 243, it has long been believed that where a loss occurs an assessment cannot be made under section 166 of the 1936 Act. The limitation period runs not from the year of loss, but the year when the loss is recouped and an assessment issues. The loss year thus remains permanently "open" to future ATO reconsideration.

In practice, this feature of the tax law means that the ATO tends to ignore loss returns (except for very large taxpayers) until the businesses return a taxable income, which could be many years later. Naturally, this delay creates considerable taxpayer angst.

Therefore, the Commissioner's powers to review an assessment needs to be amended where a loss occurs.

This is even more urgent given the apparent inconsistency between assessments under section 166 and self assessment assessments under section 166A of the 1936 Act. In the AAT decision in *BCD Technologies* (handed down 19 May 2004) McCabe SM found that a nil assessment under section 166A was not subject to amendment outside the time periods set out in subsection 170(2) of the 1936 Act.

Any amendment should also represent a finalisation of any losses carried forward in respect to that year; otherwise it will never be a true finalisation of that year's tax return.

3.G What amendment periods should apply to cases that currently have an unlimited period?

For consistency, other than fraud and evasion, the time period should not exceed a maximum of four years.

3.H Should taxpayers have a remedy where the Tax Office delays unreasonably in issuing an amended assessment after it has all the relevant information?

Yes. Taxpayers should be provided with a range of remedies including compensation, approval, and market rate interest payments. This essential because there is a need to redress a fundamental perceived imbalance in self assessment so that the Commissioner bears some of the costs/downsides of self assessment, in the same way that taxpayers currently do.

For example, if the delay is in issuing a negative amended assessment, then perhaps the response or limitation should be that the ATO is not allowed to issue a negative amended assessment. If it is positive, then, if there are extensive ATO delays, the penalty should be that the amended assessment must be issued as presented by the taxpayer. Another alternative is to subject the ATO itself to some kind of penalty regime in the same way that taxpayers are.

3.I Should the period for an amendment reducing a taxpayer's liability be the same as for increasing liability, or be set at a fixed period?

It is important to stress that this reduction in ATO time periods time does not mean we support the rationale behind matching review periods for the ATO and taxpayers. Under this rationale, it is agreed that bnger periods of review are needed to give taxpayers the time to vary returns where they have made a mistake or where there is an ATO error.[9] However, this rationale is flawed as it proceeds on the basis that the Commissioner and taxpayers are on an equal footing. Given ATO dominance in the relationship, there is little reason to continue the matching principle in respect of the taxpayer's review period.

Consequently, the periods for review no longer need to match and the time period for credit assessment should be unlimited.

3.J Would it be better to implement some of the possible changes raised in this Chapter (for example, early notification of compliance activity) by changing administrative procedures, rather than by changes to the law?

As we believe that the purpose the review is to restore the balance between taxpayers and the ATO, administrative changes would only be supported where there are enforceable legislative changes that bind the Commissioner to carry out tasks in a more timely manner.

[9] Deductions for self-education expenses were handled incorrectly be *TaxPack* for a number of years. When the error wad discovered, many taxpayers were unable to access refunds because the 4 year period for amendment had elapsed. Thus, an ATO error resulted in a significant windfall gain for the ATO.

Chapter 4: Penalties

4.A What (if any) clarification of the terms 'reasonable care' and 'reasonably arguable position' is needed?

As a general position, the Taxation Institute is of the view that the terms *'reasonable care'* and *'reasonably arguable position'* should not be defined in the tax legislation.

For example, at the the NTLG meeting on 6 September 2001 concerns were raised about the narrow approach to the defining *'reasonably arguable position'* (see agenda item 20.4). It was noted that 284-15(1) of the *Income Tax Assessment Act 1997* (the 1997 Act) has altered the meaning of the concept of reasonably arguable, as that term was defined in s 222C(1) of the *Income Tax Assessment Act 1936* (the 1936 Act). Subsection 284-15(1) was inserted into the 1997 Act by *A New Tax System (Tax Administration) Act (No 2) 2000*, and replaced subsection 222C(1) of the 1936 Act.

Subsection 222C(1) defined a matter as being reasonably arguable if "it would be concluded that what is argued for is about as likely as not correct." In contrast, s 284-15(1) states that a matter is reasonably arguable if "what is argued for is as likely to be correct as incorrect, or is more likely to be correct than incorrect".

In spite of the opinion expressed in the *Explanatory Memorandum to A New Tax System (Tax Administration) Bill (No 2) 2000* at paragraph 1.20 that "…(a)lthough the wording has been refined, the concept has the same meaning as in s 222C…", the wording of s 284-15(1) alters the meaning of reasonably arguable because it establishes a more stringent test whereby the prospects that the taxpayer's treatment of a matter as being the correct treatment must be greater than 50%.

This conflicts with s 222C(1) where the test is "about as likely as not". As indicated in Taxation Ruling TR 94/5, this latter test simply means that there only has to be a substantial likelihood that the taxpayer's treatment of a matter is the correct treatment, whether or not those prospects are less than or greater than 50%.

The ATO confirmed no change was intentended. However, we believe there is a perception in the community that the meaning has changed as the words used in s284-15(1) seem to change the interpretation. At the meeting, the professional bodies suggested the definition use the words of s 222C(1) rather than s 284-15(1) to minimise confusion. The issue was submitted to the Tax Design Group as a suggested technical correction.

This has not yet occurred and remedial action is required.

4.B (a) What is the effect of the penalty for failing to follow a Tax Office private ruling?

The existence of additional penalties where a taxpayer declines to follow an adverse private ruling or determination (s 284-90(1) item 8) is an impediment. Despite *A Tax System Redesigned* recommendation 3.4 and the *Report No. 326* recommendation[10] to remove this impediment the provision has again been incorporated in the penalty tax rewrite contained in *A New Tax System (Tax Administration) Act (No 2) 2000*.

[10] Joint Committee of Public Accounts, *Report No. 326 - An Assessment of Tax - A Report on an Inquiry into the Australian Taxation Office* (Canberra: AGPS, 1993), recommendations 37-40; also see paras. 6.71-6.80.

The Taxation Institute supports the recommendation that taxpayers that decline to follow a private ruling be subjected to same rules and penalties as those who decline to follow a public ruling (i.e. a reasonably arguable decision).

(b) Do taxpayers only request PBRs when they are confident of a favourable ruling?

Ancedotially, represented taxpayers will request a ruling in a variety of circumstances, not only where success is likely. PBR's tend to be sought where transactions are strategic and/or involve the Group's shareholders regardless of whether we are confident of receiving a favourable ruling.

Prudent taxpayers often insist on rulings (particular in the wake of the Mass Marketed schemes) to ensure peace of mind. Tax advisers may also seek a ruling where the outcome is believed to be unfavourable where the dient doubts the veracity of the advisor's advice as a "mate got it last year" etc.

In fact, in many cases the existence of penalty for failing to follow an ATO private ruling creates a reluctance to seek private rulings unless absolutely necessary

4.C If the penalty for failing to follow a Tax Office private ruling were to be removed, what other changes would be appropriate?

None.

4.D What further guidance on grounds for remission of penalties is required?

First, given the complex nature of the ATO Receivables Policy, the ATO should publish its penalty remission policy in a separate, more easily accessible document. The ATO needs to provide further guidelines on what factors will be taken into account in making a distinction between micro businesses and large corporates in its remission material.

Second, instead of relying on ATO remission, the Taxation Institute is of the view that penalties on shortfall amounts should not be automatically imposed for the period up to and including the first tax return following the first full year of the application of a new tax law (or such extended transitional period as determined from time to time).

Similarly, in relation to obligations for amendments that have been introduced but not enacted, the Taxation Institute recommends that shortfall penalties in these circumstances should never be imposed automatically in the first instance.

Third, in relation to Part IVA, the ATO practice of automatically imposing 50% penalties as a matter of course in cases involving Part IVA is unacceptable. Further, this process is contrary to the ATO's own guidelines set out in PS LA 2000/10 (paras 73 –76).

The ATO is using Part IVA to attack commercial arrangements, not just transactions that are blatant, artificial or contrived in nature. As a result taxpayers will often have taken reasonable care and have a reasonable arguable position dispute being challenged under Part IVA. Therefore, the Taxation Institute is strongly of the view that the Commissioner needs to have greater regard to the actual circumstances of a particular case before determining the level of penalty to apply in relation to Part IVA. The penalty regime therefore needs to reflect to the actual behaviour of the taxpayer and not just impose a 50% penalty as a matter of course.

It would also be useful if the ATO issued guidelines to assist taxpayers and ATO officers determine whether a reasonably arguable position has been adopted. A taxpayer should be able to demonstrate that it has a reasonably arguable position where:

- there is no intentional disregard of the law;
- the taxpayer has not recklessly approached its tax obligations;
- the taxpayer has good past behaviour in meeting its tax obligations;
- a genuine attempt has been made to comply with the law; and
- external tax advice was sought confirming on the application of Part IVA and the taxpayer acted in accordance with that advice.

Chapter 5: The General Interest Charge

5.A (a) Should the GIC be set at a level to provide a positive incentive to encourage taxpayers to take steps to ensure they assess correctly?

The current GIC is viewed as punative by most taxpayers. It does nothing to ensure that returns are correctly prepared as the majority of taxpayers in lodging their returns believe that they have complied with the law.

(b) Or should this be dealt with exclusively under the penalty regime?

The problem with GIC is that it gives the appearance of doubling up on penalties or continuing to apply a penalty where the penalty regime does not otherwise apply. Therefore, it should be dealt with as part of the penalty regime.

5.B Is the rate of the GIC excessive against this principle?

The rate of GIC is excessive particularly where persons make claims on the belief that the amounts are treated in a particular way by the law only to subsequently find two to three years later that the amounts were incorrectly treated and they have incurred GIC, which had the law been clear they would not have incurred.

Also, the current GIC is excessive to the extent that it contains a significant penalty component, especially where taxpayers' costs of funding is substantially less than the GIC. The inherent penalty component in the current GIC disadvantages large taxpayers who have complex businesses, large tax liabilities and as a result are in general more prone to tax adjustments (both favourable and unfavourable).

5.C (a) Are the approaches identified in this Chapter suitable to address identified concerns with the GIC?

The Taxation Institute believes that other than cases of fraud or evasion, GIC levied for the period between assessment and subsequent amendment should not apply where the shortfall arises. It should only apply from the date of amendment and any uplift should only be applied where there is evidence of fraud or evasion.

Unfortunately as none of the proposed approaches embody these concepts, we are unable to endorse any of the approaches identified in this Chapter.

(b) If so, by what mechanism should the approaches be implemented?

In light of the above, we cannot recommend that any of these approaches be implemented.

(c) Are there cases where full GIC should continue to apply to shortfalls?

In relation to the period between assessment and amendment, consistently with the above, GIC should only continue to apply where there is blatant fraud or evasion.

5.D (a) What priority should be given to simplicity in considering any changes to the current GIC regime?

In relation to the period between assessment and amendment, by adopting the approach recommened, i.e., GIC only applies in the case of fraud or evasion, this would achieve the required level of simplicity envisaged by the report. The other measures suggested are by their very nature complex and would impose further compliance costs on taxpayers.

(b) Should different market segments be treated differently for GIC purposes?

In relation to the period between assessment and amendment, given our recommendation that GIC should only apply in the case of fraud or evasion, there should be no need to differentiate different market segments.

However, in respect of GIC relating to a failure to pay by a due date, the analysis in the Chapter suggest that there is a need to provide differential treatment to salary and wage and small business taxpayers.

(c) Is it feasible to move away from a single, comprehensive system?

If the approach recommended by the Taxation Institute is adpoted, the complexities arising from the methods explored in the report do not arise.

5.E (a) Should remission of the GIC be initiated by the Tax Office in more circumstances?

Yes. The Taxation Institute believes that in all circumstances the uplift factor should be remitted unless circumstance exist which indicate the use of Commonwealth monies as a form of funding.

(b) If so, what criteria should be used?

As discussed in 5E(a).

5.F (a) Should the benefit from tax deductibility of the GIC be standardised, to eliminate the impact of varying tax rates?

No comment.

(b) If so, how should this be achieved?

No comment.

Chapter 6: Other Issues

6.A (a) Should the Tax Office undertake earlier examination of any categories of return (or specific items)?

No. Earlier examination of any categories of return runs contrary to the nature of self assessment.

(b) If so, what taxpayers or specific items and why?

Refer to response to 6.A(a) above.

6.B (a) What further steps would promote taxpayer awareness of their obligations under self assessment?

One of the fundamental changes occasioned by the introduction of self assessment is that claims in returns are not verified by the ATO when the returns are lodged, and in the case of an individual, the ATO still calculates the taxpayer's liability and issues an assessment.[11]

An "assessment" is defined in s 6(1) of the ITAA 1936 (via s 995-1 of the Income Tax Assessment Act 1997 – the ITAA 1997) to mean the ascertainment of:

(i) the amount of taxable income and of the tax payable; or
(ii) the amount of additional tax payable under a provision of Part VII.

If the taxpayer's word is accepted without review it is difficult to see in the self assessment environment that the Commissioner has "ascertained" anything in issuing a "Notice of Assessment". At best a "Notice of Assessment" is no more than a notification of a liability in a self assessment environment. To imbue it with qualities of the pre-self assessment concept lacks logic, particularly when a nil notice (in the case of loss or where a person is below the tax threshold) is treated in law as not being an assessment.[12]

However, the word "assessment" has an idea of finality and legally it cannot be conditional.[13] Thus, the issue of a "Notice of Assessment" sits uncomfortably with the concept of self-assessment.

(b) Could, for example, notices of assessment be better labelled?

The word "assessment" should be replaced except where the Commissioner actually ascertains a tax liability. For example, an "assessment" could be issued following a tax audit. Thus, the existing document known as a "Notice of Assessment" should be renamed using words that convey that it is merely a confirmation of the information supplied by the taxpayer. Possible names could be "Interim tax calculation", or "Tax calculation sheet."

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11 In the case of individuals, whilst claims are not verified by the before an assessment is issued, nevertheless the lodgement of the return does not constitute a deemed assessment (as is the case for companies and superannuation funds), so that the ATO still issues an assessment notice.

12 The High Court in *FCT v Ryan* (2000) 43 ATR 694 held that until an amount is due and payable there is no assessment. Thus, the issue of an assessment notice for a 'Nil' amount is not an assessment. The implication of this for taxpayers is that that particular tax year can never be "closed", and is thus open for further ATO review/audit indefinitely.

13 see *FCT v Stokes* (1997) 34 ATR 478.

6.C In what circumstances is there a need for a Public Tax Advocate or greater use of alternative dispute resolution?

As noted earlier in our submission, the Taxation Institute has recommended the adoption of special tribunal of experienced practitioners who would rule on more complex issues in the case of issuing private ATO advice. This type of special tribunal could also be used as a vehicle for offering alternative dispute resolution for taxpayers and the ATO.

6.D (a) What is the impact of the Tax Office reviewing tax agent systems?

This question seems to be inconsistent with the discussion material in the Treasury Discussion Paper. Therefore, we have answered it in the context of the Paper's discussion.

Pre-assessment reviews do generate substantial compliance costs and in a number of cases, due to poor ATO compliance targeting, result in multiple checks of the same taxpayer. These costs are often difficult to collect from clients, as they believe that the checking arose due to a lack of diligence by the tax agent, not due to their particular circumstances.

(b) Could these reviews be improved, and if so, how?

The ATO needs to provide taxpayers with the opportunity in advance to pre-empt such a review by providing the necessary information. However, such a process questions once again the rationale of self assessment.

6.E (a) What particular information could the Tax Office collect more efficiently?

In light of the heavy data collection requirements contained in the tax return (e.g., depreciation schedules, losses schedules, etc) efficiency in collection will only be improved by streamlining and prioritising the information required to lodged with the return. As a result we have a situation where taxpayers are required to provide more information in a self assessment than they were required to do under the previous assessment system. Despite incurring these greater costs they have not benefited as there is no certainty despite there being a full and true disclosure. Under self assessment, the collection of information should be more restricted (thus more efficient and following on from that, able to be prepared earlier due to less time wastage).

(b) What is the optimal balance between the Tax Office giving early warning of information requirements and the need to be able to respond to issues emerging from tax returns?

As discussed above, any early information requests must be balanced with early resolution of any problems thereby providing certainty to taxpayers.

6.F What particular record keeping requirements are regarded as onerous?

The current record keeping requirements are onerous and changes need to be made in a number of areas. The following list is indicative of some of the areas that require attention:

- Capital Gains Tax (CGT) records in general (e.g., cost base adjustments, and share transactions).

- Uniform Capital Allowance (UCA) records.
- Fringe benefits tax (FBT) records, especially those relating to employee contributions.
- Some substantiation requirements (e.g., the manner in which motor vehicle log books, home office expenses, laundry and diaries for telephone use need to be kept).
- Documentation requirements in seeking exemption under the non-commercial loss rules.
- Transfer pricing records.

6.G (a) What specific income tax lodgement deadlines are difficult to meet?

Given the current income tax system creates a need for an extended lodgement program, it is difficult to see how the ATO can collect data any earlier than they currently do. Any change would have an adverse impact upon that program creating further stress on the adviser/government relationship.

The existing lodgement program, with the annual pay and lodge by early June extension, currently enables tax agents to meet their obligations. Removal of the June extension would create great difficulties. There are still some concerns about the timing of lodgment of FBT returns and self assessing superannuation fund returns, however agents seem to be coping with the assistance of the 10/10 rule.

(b) Are there other circumstances in which penalties should be remitted for late lodgement?

The current remission guidelines in respect of late returns have been operating for a couple of years and are generally seen as fair by most practitioners. However, where the lodgment is delayed as a result of new legislative announcements not being legislated or are about to be legislated prior to a due date, remission of penalties should follow.

6.H What are the most important discretions as to liability that should be removed/re-written?

There is a significant problem in relation to the use of 'drop dead' dates in respect to the exercise by taxpayers of particular elections, most notable in the areas of family trusts (the Family Trust Election – FTE), and access to the R & D concessions. This type of 'drop dead' date needs to be eliminated from the tax law.

6.I Are there any general problems that are affecting the operation of elections under the self assessment system?

The current law seems to create a technical inability for the ATO to even provide general advice about how its various discretions will apply. The ATO needs to have this ability in order to provide certainty for taxpayers.

The Taxation Institute is of the view that the tax laws need to be amended so that the Commissioner has a broad discretion to extend the time for the making of elections by taxpayers, unless there is an express provision to the contrary.