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Proposed denial of deductions for the general interest charge and the shortfall interest charge

KPMG Australia (**KPMG**) welcomes the opportunity to provide a submission on the exposure draft legislation (**ED**) in relation to the proposed denial of deductions for general interest charge (**GIC**) and shortfall interest charge (**SIC**).

KPMG is supportive of the Federal Government's efforts to ensure all taxpayers pay their tax on time and correctly self-assess their income tax liability, as well assisting in lowering the amount of collectable debt owed to the Australian Taxation Office (**ATO**).

However, KPMG considers that the existing policy in relation to deductibility of GIC and SIC reflects sufficient and appropriate compliance measures. Most relevantly, by targeting certain taxpayers that do not pay their tax on time or that have tax shortfalls because of not taking reasonable care or adopting reasonably arguable positions, the new policy setting will unfairly capture taxpayers that have tax shortfalls, notwithstanding they took reasonable care and adopted reasonably arguable positions. As such, the Federal Government should consider that the existing rules in relation to deductibility ought to be maintained.

Further, the increased economic cost of GIC and SIC will have a more acute impact on marginalised taxpayers particularly those who would otherwise be ineligible to access (or unable to comply with) an interest-free payment plan on outstanding tax.

While taxpayers may apply for a remission of interest depending on the circumstances, this application process may be relatively more difficult for marginalised taxpayers (e.g. due to insufficient resources, lack of awareness of administrative rules, etc). Noting this potential disadvantage, due consideration should be given to the impact as part of the assessment of the human rights compatibility, required to be undertaken in finalising the measure[1].

[1] All government and non-government Bills and disallowable legislative instruments within the meaning of section 42 of the *Legislation Act 2003* must be accompanied by a Statement of Compatibility. A Statement of Compatibility must contain an assessment of the Bill or legislative instrument's compatibility with the

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In the alternative, having regard to the underlying intention of the proposed measure, we consider that there should be different rules depending on taxpayer culpability. This would involve interest being deductible where it arises from income tax shortfalls (i.e. SIC) and the taxpayer has taken reasonable care and has a reasonably arguable position at law. All other interest (e.g. including GIC) would be non-deductible.

KPMG's observations and comments on the ED are set out below.

Original policy for the deductibility of GIC and SIC

The *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) first received royal assent on 17 April 1997. In its original form, the ITAA 1997 imposed late payment penalties through a tax deductible underpayment interest charge (**UIC**).

GIC was later introduced into the various Tax Acts by virtue of the *Taxation Laws Amendment Bill (No. 5) 1998* (Cth) (**GIC Bill**), which received royal assent on 31 March 1999. One of the main policy objectives of the GIC Bill was to replace the previous late payment penalty provisions with a single tax deductible GIC on outstanding tax debts.[2] The introduction of these measures sought to overcome problems with the incumbent penalty regime, particularly the complex and punitive elements that applied for the late payment of some taxes. Like its predecessor, GIC is a deductible tax-related expense.[3]

SIC was subsequently introduced into the various Tax Acts by virtue of the *Tax Laws Amendment (Improvement to Self-Assessment) Bill (No. 1) 2005* (Cth) (**SIC Bill**), which received royal assent on 29 June 2005. Amongst other things, the SIC Bill sought to provide a special interest regime that would apply to under-assessments of income tax. For income tax shortfalls, SIC replaced GIC with a charge that is four percentage points lower than GIC. SIC is also a deductible tax-related expense.[4] One of the main policy objectives of the SIC Bill was to ensure that taxpayers who understate their tax liabilities in self-assessing do not receive an advantage or a "free loan" from the ATO.[5]

Proposed amendments

The ED seeks to deny taxpayers a deduction for amounts of GIC and SIC, specifically in relation to assessments for income years starting on or after 1 July 2025. As such, the applicability of the ED is dependent upon the taxpayer's income year, rather than the point in time in which the corresponding GIC or SIC is incurred.

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rights and freedoms recognised in the seven core international human rights treaties which Australia has ratified.

[2] Explanatory memorandum to the *Taxation Laws Amendment Bill (No. 5) 1998* (Cth), paragraph [1.1].

[3] ITAA 1997, s 25-5(1)(c).

[4] ITAA 1997, s 25-5(1)(c); explanatory memorandum to the *Tax Laws Amendment (Improvement to Self-Assessment) Bill (No. 1) 2005* (Cth), paragraph [2.61].

[5] Explanatory memorandum to the *Tax Laws Amendment (Improvement to Self-Assessment) Bill (No. 1) 2005* (Cth), paragraph [2.18].

Relevantly, paragraph 25-5(1)(c) and subsection 25-5(7) (including the note) of the ITAA 1997 will be repealed, whilst the following subsection will be inserted after subsection 26-5(1) of the ITAA 1997:

> *"(1A) Without limiting paragraph (1)(a), you cannot deduct under this Act the * general interest charge or the *shortfall interest charge."*

Context of the proposed amendments

The context of the ED can be ascertained from the Treasury's exposure draft explanatory materials, which state that denying the deductibility of GIC and SIC will "*level the playing field for individuals and businesses who already correctly self-assess their tax liabilities and pay tax on time and assist in lowering the amount of collectable debt owed to the ATO*".[6]

Correspondingly, the ATO's shared view is that removing the specific deductions for GIC and SIC "*will enhance incentives for all entities to correctly self-assess their tax liabilities and pay on time, and level the playing field for individuals and businesses who already do so*".[7] The ATO estimates that the ED will increase receipts by $500.0 million over the five years from 2022-23.[8]

Submission comments

KPMG makes the following comments about the ED:

1. Inconsistency with original purposes of GIC and SIC

The measures proposed by the ED are inconsistent with the Federal Government's original policy positions for the historical UIC and the current GIC and SIC. GIC and SIC were introduced as incentives for taxpayers to correctly self-assess their tax liabilities and pay on time and their existing design adequately achieves this aim.

As discussed above, one of the reasons for the introduction of GIC was the abolition of punitive culpability elements that applied for the late payment of some taxes. In addition, GIC already discourages using the ATO as a source of finance through its generally higher than commercial borrowing alternatives. In relation to SIC, this was introduced to neutralise the 'loan benefits' that taxpayers could otherwise receive from the temporary use of the shortfall amount, with a lower interest charge to reflect benchmark business borrowing rates.

The introduction of non-deductibility therefore goes beyond the purposes of GIC and SIC, making these charges comparatively more punitive.

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[6] Exposure draft explanatory materials to the *Treasury Laws Amendment Bill 2024: Denying Deductions for Interest Charges*, paragraph [1.7].
[7] 2023-24 Mid-Year Economic and Fiscal Outlook, pages 192-193.
[8] 2023-24 Mid-Year Economic and Fiscal Outlook, page 193.

2. Punitive effect for 'model' taxpayers

Although Treasury and the ATO share the view that the removal of specific deductions for GIC and SIC will "level the playing field", the measure proposed by the ED is punitive in nature and will prejudice all taxpayers (particularly, marginalised taxpayers), regardless of whether taxpayers who self-assess their tax liabilities act with reasonable care and have a reasonably arguable position at law.

This paradox is most clearly illustrated with respect to the imposition of SIC, which automatically applies as soon as the Commissioner of Taxation (**Commissioner**) amends an assessment for an income year under subsection 280-100(1) of Schedule 1 to the *Taxation Administration Act 1953* (Cth) (**TAA 1953**).

Steward J in *Sole Luna Pty Ltd as Trustee for the PA Wade No 2 Settlement Trust v Commissioner of Taxation* (**Sole Luna**),[9] discussed a matter which was not one where the taxpayer had failed to take reasonable care, but rather one that was concerning a view of the law and an application of that view to facts reasonably perceived.[10] Steward J further observed that whilst the taxpayer took reasonable and prudent steps to retain a qualified tax agent, and took reasonable and prudent steps to seek tax advice about the application of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**) and ITAA 1997 from suitably qualified tax experts, the taxpayer's decision was ultimately incorrect.[11] Steward J found that the taxpayer's incorrect application of the ITAA 1936 and ITAA 1997 did not give rise to the conclusion that reasonable care had not been taken,[12] demonstrating that a taxpayer can take reasonable care in obtaining tax advice but still potentially attract SIC.

The increased economic cost of GIC and SIC proposed by the ED will undoubtedly target those taxpayers who are incorrectly self-assessing their tax liabilities, but it will also prejudice model taxpayers who have taken reasonable care and have a reasonably arguable position.

The increased economic burden of GIC and SIC may be more acute for marginalised taxpayers, particularly those who would otherwise be ineligible to access (or unable to comply with) an interest-free payment plan on outstanding tax.[13] Therefore, the punitive measures proposed by the ED may not achieve the stated policy objective of "levelling the playing field".

As such, where the Federal Government determines that the existing deductibility rules should not be maintained, as an alternative we recommend that there should be different rules depending on taxpayer culpability. This would involve interest being deductible

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[9] [2019] FCA 1195; (2019) 110 ATR 307.
[10] *Sole Luna*, [129].
[11] *Sole Luna*, [130].
[12] *Sole Luna*, [130].
[13] While taxpayers may apply for a remission of interest depending on the circumstances, this application process may be relatively more difficult for marginalised taxpayers (e.g. due to insufficient resources, lack of awareness of administrative rules, etc.).

where it arises from income tax shortfalls (i.e., SIC) and the taxpayer has taken reasonable care and has a reasonably arguable position at law. All other interest (e.g., including GIC) would be non-deductible.

3. Disincentive to settle unresolved tax disputes

The duration of time associated with the tax dispute resolution process inherently depends on the complexity of the matter and the risk appetite of the taxpayer and Commissioner. Whilst most tax disputes settle at the pre-audit and audit stage,[14] if the taxpayer and/or Commissioner exhaust all possible appeal mechanisms and/or if there are complex factual and legal issues involved, resolving a tax dispute can be a costly and protracted process spanning several years.

Notwithstanding the likelihood of extended delays in resolving a complex tax dispute, the taxpayer's overall tax exposure continually increases throughout the tax dispute resolution process due to the compounding daily accrual mechanism of GIC and/or SIC on the disputed primary tax liability. The potential exposure to GIC and/or SIC therefore becomes exponentially onerous and prejudicial towards taxpayers with the passage of time.

For instance, the liability to SIC automatically arises when the Commissioner amends an assessment for an income year under subsection 280-100(1) of Schedule 1 to the TAA 1953. At this juncture, taxpayers seeking to challenge the imposition of the resulting amended assessment may choose to pay the income tax shortfall upfront (together with any SIC and penalties) or defer doing so until the tax dispute concludes. Notwithstanding the application of section 172(1) of the ITAA 1936, which provides that SIC is taken to have never been payable by the taxpayer to the extent that the primary tax is reduced, a taxpayer who is considering paying the SIC upfront before the resolution of their tax dispute will now face a substantially increased economic cost to do so as a result of the of SIC itself.

For these reasons, removing the deductibility of GIC and SIC will substantially reduce the commercial viability of taxpayers considering paying disputed amounts upfront or otherwise compromise on unresolved tax disputes with the Commissioner, and may instead incentivise taxpayers to continue their dispute simply because the economic cost of the dispute is increased. The possible uptick in taxpayers fighting cases may put a significant strain on the ATO's resources and may not be in the best interests of the Australian tax paying community.

For completeness, the Commissioner has specific powers to remit GIC and/or SIC in very limited circumstances.[15] However, the Commissioner's current policies on the administration of this specific discretion do not specifically contemplate the quantum of GIC and/or SIC payable as being a relevant factor in determining whether the exercise

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[14] Commissioner of Taxation's Annual Report for 2022-23, table 7.7, page 224.
[15] TAA 1953, s 8AAG; TAA 1953, Sch 1, s 280-160.

of the specific discretion is appropriate,[16] unless that quantum is minimal (with respect to SIC specifically).[17] On that basis, whilst the exercise of the specific discretion is broad and not exhaustive,[18] the increased economic burden on taxpayers brought about by the ED may not be relevant *prima facie* to the exercise of the Commissioner's specific discretion to remit GIC and/or SIC.

4. Inconsistency with assessable income provisions

The *Taxation (Interest on Overpayments and Early Payments) Act 1983* (Cth) (**T(IOEP)A**) applies in situations where an overpayment of tax has occurred, and the overpayment is the result of a successful objection or appeal by the taxpayer against an assessment of the Commissioner. Interest payable by the Commissioner under the T(IOEP)A accrues at the comparatively lower base rate (within the meaning of section 8AAD of the TAA 1953)[19] and on a simple (rather than compounding) interest basis.[20]

By virtue of section 15-35 of the ITAA 1997, a taxpayer's assessable income specifically includes interest payable under the T(IOEP)A, which becomes assessable when it is paid to the taxpayer or the taxpayer discharges a liability it has to the Commonwealth. Whilst the ED proposes to remove the deductibility of SIC and GIC, it does not contemplate the corresponding removal of section 15-35 of the ITAA 1997.

This incongruence is of further detriment to the taxpayer, as any interest received on an overpayment is still deemed to be assessable income, whilst any GIC and/or SIC incurred can no longer be deducted.

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Please contact us if you have questions in relation to this submission.

Yours faithfully	Yours faithfully
Alia Lum Partner, Tax Policy Lead	James Alsop Partner, Tax Controversy

[16] See PS LA 2006/8 titled *"Remission of shortfall interest charge and general interest charge for shortfall periods"* (**PS LA 2006/8**) and PS LA 2011/12 titled *"Remission of General Interest Charge"* (**PS LA 2011/12**).
[17] PS LA 2006/8, paragraph [26A].
[18] PS LA 2006/8, paragraph [7A]; PS LA 2011/12, page 4.
[19] T(IOEP)A, s 10(1)(b).
[20] *Consolidated Fertilizers Ltd v Deputy Commissioner of Taxation* [1992] FCA 224; (1992) ATR 305, [16], [25].

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