The Tax Institute

25 October 2024

Director
Personal Deductions and Fringe Benefits Tax Unit
Treasury
Langton Crescent
Parkes ACT 2600

By email: deductions@treasury.gov.au

Dear Director,

Denying deductions for the general interest charge and shortfall interest charge

The Tax Institute welcomes the opportunity to make a submission to the Treasury in respect of its consultation on the exposure draft legislation (**draft Bill**) and explanatory materials (**draft EM**) proposing to deny deductions for the general interest charge (**GIC**) and shortfall interest charge (**SIC**) incurred for income years starting on or after 1 July 2025 (**proposed measure**).

Our comments in this submission are focussed on policy concerns and the proposed measure's impact on taxpayers and the tax system.

The Tax Institute supports the government's intention to improve self-assessment accuracy and promote timely tax payments. However, given that the availability of a deduction for the GIC and SIC has been integral to the tax system for an extended period, we recognise that this is a significant change for taxpayers to navigate. We are of the view that unintended consequences can be minimised by implementing legislative amendments to ensure equity and transparency, and that this will assist taxpayers to adapt to this change.

Our recommendations to support taxpayers through this transition may be summarised as follows:

- clarify whether the proposed measure applies to amended assessments issued on or after 1 July 2025 that are referable to income years beginning before 1 July 2025;
- reduce the fixed percentage point uplift for both the GIC and SIC from 7% and 3% respectively, as the proposed measure will exacerbate the already onerous burden of these large uplifts by up to 88%. This recommendation is of particular importance as the proposed measure is slated to apply in an environment that is likely to continue to be challenging for taxpayers due to relatively high interest rates and inflation over a protracted period;

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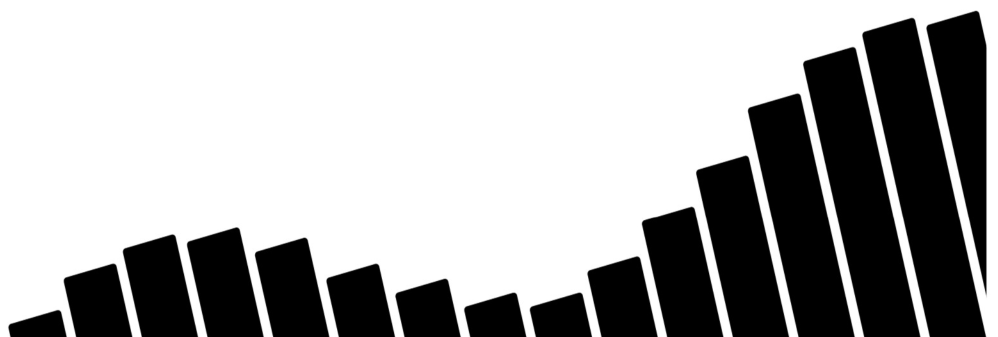

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- restrict the denial of the deduction to the relevant uplift component of both the GIC and SIC such that only the base interest component remains deductible, though we acknowledge there would likely be administrative challenges in implementing such an approach;
- enhance fairness in the remission process by ensuring that remission decisions in relation to both GIC and SIC are unconditionally reviewable. Where this is not possible, we recommend that, as a base line, remission decisions pertaining to the GIC should be open to challenge on the same basis as those pertaining to the SIC; and
- while we acknowledge that the assessability of interest payable to a taxpayer on an overpayment, early payment or delayed refund of tax is a separate issue, we recommend that, in this process, the Treasury also consider the measures in place to encourage and ensure accuracy and accountability of government, specifically the ATO, in issuing amended assessments. This may assist to create a more level playing field in the context of both over and under-payments of tax.

Our detailed response is contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact our Senior Counsel – Tax & Legal, Julie Abdalla, on [redacted].

Yours faithfully,

Scott Treatt
Chief Executive Officer

Todd Want
President

APPENDIX A

We have set out below our detailed comments and observations for your consideration.

Preliminary comments

The Tax Institute acknowledges that where a country operates a self-assessment system, there is an argument for incentivising taxpayers to both pay the correct amount of tax and also to pay that tax on time. Appropriately designed interest charges can provide a mechanism that create equity among taxpayers and compensate the government for the deprivation of revenue that is not paid on time. Charging taxpayers interest for incorrectly assessing their tax liabilities and/or making late payments of tax due is an internationally recognised way of achieving these objectives. However, there are certain important features that need to be built into interest charge regimes to ensure they stand up to the principles of good tax law.

Australia's interest regime has operated since 1992. The GIC was introduced in 1999 and the SIC was introduced in 2005. A brief survey of its history shows that Australia's current approach has been formally acknowledged by the International Monetary Fund (**IMF Report**), as being an example of good practice in relation to the clarity that surrounds the calculation of interest charges for late payment.

The IMF Report also references other features of interest charge regimes that are considered to be good practice. For example, the setting of a rate for late payment that is higher than the commercial rate, which may be achieved by way of fixed percentage point uplift (**uplift rate**) to, for example, the central bank lending rate.

We consider that it is crucial to carefully consider the proposed measure's implementation within the broader social and economic context in which it will operate. While the intent of the proposed measure appears to be to promote timely tax compliance, the immediate impact on taxpayers, particularly those already facing overdue tax liabilities, could be profound. Increased financial pressure may force businesses to divert resources from critical operations such as payroll or purchasing inventory, putting their long-term viability at risk. This could, in turn, have significant consequences for the wider economy (a potential rise in business failures could lead to increased unemployment, reduced consumer spending, and slower economic growth, creating a cycle of hardship that affects not only those taxpayers, but the community as a whole). Financial strain is likely to be compounded by emotional and psychological distress – effects that extend beyond the purely economic impacts.

We consider that the government can achieve its objectives without placing undue strain on taxpayers or the economy by considering some of our recommendations outlined below. Aopting one or more of these recommendations may assist in the proposed measure achieving its objectives while ensuring the broader economic and social fabric are safeguarded.

Reducing the uplift rate

We recognise that the GIC uplift rate has been constant at 7% for some time and that the IMF Report cites both the Australian uplift approach and rate as an example within the best practice section of its 2019 report. However, if the proposed measure is enacted as currently drafted, our view is that the uplift rate should be reduced. This is particularly so given the proposed measure significantly increases the effective cost of GIC by up to 88%. To illustrate this impact using a simple example; if a taxpayer (who is taxable at the highest marginal rate (being 47% including the Medicare Levy) is liable for $100 of GIC, under the current rules, they would save $47 in tax after claiming the deduction, meaning that the ultimate cost of the GIC liability in this case is $53. However, if the GIC is non-deductible, the ultimate cost of that liability is the entire $100. This is an 88% increase in the ultimate cost of the GIC liability to the taxpayer compared to the existing rules.

A reduction in the uplift rate sends a message that the policy approach for interest charges is to deter rather than punish. It would also somewhat soften the financial impact of the proposed measure on taxpayers who may already be stretched financially and who are operating in a challenging economic environment that has been exacerbated by high interest rates and inflation for some time, among other things.

Application to amended assessments

The proposed measure is stated to apply to deny deductions for the GIC and SIC incurred in income years starting or after 1 July 2025 in the draft EM. As the term 'incurred' is not defined within the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**), the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), nor the *Taxation Administration Act 1953* (Cth) (**TAA**), it is necessary to refer to judicial decisions and, where relevant, ATO guidance.

According to the Federal Court decision in *Commissioner of Taxation v Nash* [2023] FCA 336 (***Nash)***[1], a taxpayer incurs a GIC liability when served with a notice of assessment (**NoA**) triggering the liability to pay income tax to which the GIC relates. While *Nash* involved the GIC, the ATO has indicated that it will apply the same interpretation of 'incurred' in relation to SIC. On this basis, the proposed measure appears to apply prospectively to any NoA issued for income years beginning on or after 1 July 2025. We are supportive of the prospective application of the proposed measure in this regard. However, we note that some uncertainty remains as to the manner in which the proposed measure will apply to amended assessments issued after 1 July 2025 that are referable to income years starting before that date.

In the interests of clarity and certainty around how the proposed measure applies to amended assessments, we recommend grandfathering the tax treatment of liabilities in relation to both GIC and SIC where they are referable to income years starting before 1 July 2025.

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[1] *Commissioner of Taxation v Nash* [2023] FCA 336; Decision Impact Statement Commissioner of Taxation v Nash; TD 2012/2 Income tax: when is the shortfall interest charge incurred for the purposes of paragraph 25-5(1)(c) of the *Income Tax Assessment Act 1997?*

Restrict non-deductibility to the uplift component

The GIC is set at a base rate (currently, 4.38%) plus an uplift rate of 7%, resulting in an effective rate of 11.38% for the period from October to December 2024. The SIC is set at the same base rate with an uplift rate of 3%, currently equating to an effective rate of 7.38% for the same period. We consider that the uplift rates for both the GIC and SIC are higher than required to achieve their objective and may risk being perceived as punitive following the introduction of the proposed measure. We maintain that these rates should be reduced.

As a potential alternative, we recommend that due consideration is given to limiting the non-deductibility of GIC and SIC to the relevant uplift component. This would serve the dual purpose of somewhat reducing the financial impact of the proposed measure and helping to alleviate concerns that the interest charges contain a punitive component. However, we recognise that such an approach is likely to be administratively challenging and the practical implementation should be given further consideration.

Incentivising all participants in the tax system and fostering accountability

We acknowledge that the assessability of interest payable to a taxpayer on an overpayment, early payment or delayed refund of tax is a separate issue. However, it relates to the role of the ATO and the impact that it has on taxpayers in carrying out its functions. This is important in the context of the underlying policy of the proposed measure which is fundamentally to incentivise taxpayers to manage their tax affairs correctly and promptly.

We therefore recommend that, in this process, the Treasury also reflect on and consider the measures in place to encourage and ensure accuracy and accountability of government, specifically the ATO, particularly in issuing amended assessments and dealing with overpayments of tax. While the outcomes are distinct, ensuring the ATO is accountable and encouraged to issue accurate amended assessments and promptly refund overpaid tax may assist to foster a perception of a more level playing field in the context of over- or under-payments of tax.

Reviewability of GIC and SIC remission decisions

We acknowledge that the draft EM confirms that the right to request remission of GIC and SIC will continue under the proposed measure. The Commissioner has the discretion to remit these interest charges where it is fair and reasonable to do so, taking into consideration the circumstances that led to the delayed payment of tax liabilities or the tax shortfall. In doing so, ATO officers are expected to have regard to Practice Statement Law Administration PSLA 2011/12: *Remission of General Interest Charge* and PS LA 2006/8: *Remission of shortfall interest charge and general interest charge for shortfall periods*. However, feedback from our members suggests that the ATO has over time tightened its approach to the granting of remissions. The ATO's decision to deny the remission of GIC is not subject to internal review[2] (i.e., where a taxpayer disagrees with the ATO's decision not to remit the GIC, the only recourse available to the taxpayer is to appeal the ATO's decision in the Federal Court of Australia (**FCA**) under the *Administrative Decisions (Judicial Review) Act 1977* (Cth)).

[2] Section 14ZS, TAA.

While SIC decisions can be reviewed[3], the review process is subject to conditions that we understand limit accessibility in practice. If a taxpayer disagrees with the ATO's decision not to remit the SIC and the amount of the taxpayer's outstanding liability is more than 20% of the shortfall, then the taxpayer can object to the ATO's SIC remission decision (**20% outstanding liability test**). Otherwise, taxpayers can apply for external review before the Administrative Review Tribunal from 14 October 2024 (or the Administrative Appeals Tribunal prior to this date) or the FCA.

Given the proposed measure seeks to deny the deductibility of these interest charges, in the interests of fairness, we recommend making GIC and SIC remission decisions unconditionally reviewable. Where this is not accepted, we suggest that at a minimum, an equivalent test to the 20% outstanding liability test for SIC remission should also be applied to remission decisions pertaining to the GIC.

We consider that enhancing the remission review process is likely to encourage voluntary compliance, while fostering a more cooperative relationship between taxpayers and the ATO. To maintain trust and fairness, a transparent review process that applies equally to the GIC and SIC should be implemented. This will help to ensure accountability, uphold confidence in the system and dispel concerns that GIC operates on a strict liability basis. This is particularly necessary given the adverse financial impact of the proposed measure on taxpayers.

[3] Section 14ZS, TAA.