Report on Aspects of Income Tax Self Assessment

August 2004

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FOREWORD

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I am pleased to present Treasury's final report of the Review of Aspects of Income Tax Self Assessment.

Adoption of the report's recommendations would improve significantly taxpayers' experience of the self assessing aspects of the tax system while preserving the capacity of the Tax Office to collect legitimate income tax liabilities.

The recommendations in this report improve taxpayer certainty through a better framework for Tax Office advice, reduce exposure to the risk of increased liabilities, and mitigate penalty and interest consequences of errors made by taxpayers who act in good faith. The recommendations will also provide for future improvements through better policy processes, law design and administration.

Consultation with interested parties has played a central role in the Review, and I take this opportunity to express my gratitude for this valuable assistance.

I commend the report to the Government.

Ken Henry
Secretary to the Treasury
August 2004

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CHAPTER 1: OVERVIEW

This Chapter discusses the principles of self assessment in Australia and provides an overview and important background to proposed changes to the system.

1.1 Initiating the Review

On 24 November 2003 the Treasurer announced the Review of Aspects of Income Tax Self Assessment (the Review).[1] The Review was asked to examine aspects of Australia's self assessment system for income tax to determine whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community.

The Review was not asked to consider fundamental tax policy changes, such as the extent to which tax returns, or categories of tax deduction, could be dispensed with, and the Review did not examine tax collection issues or assessment of other taxes.

Late last year, a team in Treasury considered a wide range of published material on self assessment, held discussions with representatives of taxpayers and professional associations, and sought the views of government agencies with an oversight role in the tax system. Following that initial analysis, on 29 March 2004 the Treasurer released a discussion paper that covered a range of issues and possible options for reform.[2] In response to the discussion paper, the Review received 30 comprehensive and detailed submissions from individuals, professional associations, companies and representatives of taxpayers.[3] The ideas in the discussion paper, as modified and improved in light of the submissions in response, form the basis for the conclusions in this report.

1.2 The self assessment system in Australia

The main objective of Australia's tax system is to efficiently raise revenue to be distributed to the community in accordance with government priorities.[4] The main aim

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1. Costello P (Treasurer) 2003, *Review of Aspects of Income Tax Self Assessment*, Parliament House, Canberra, 24 November 2003. Available at <http://treasurer.gov.au/tsr/content/pressreleases/2003/098.asp>.
2. The Treasury 2004, *Review of Aspects of Income Tax Self Assessment Discussion Paper*, Commonwealth of Australia, Canberra. Available at <http://selfassessment.treasury.gov.au>.
3. All submissions, apart from those provided in confidence, are available on the Review website, <http://selfassessment.treasury.gov.au>.
4. The income tax system sometimes also has the subsidiary objective of influencing behaviour by reducing or increasing the economic cost of particular activities that are subject to or exempt from taxation.

of the system of tax administration is to collect that revenue with minimum administration and compliance costs.

Since 1986-87, Australia has operated a system of self assessment of income tax, under which taxpayers' returns are accepted at face value in the first instance and the Tax Office may subsequently verify the accuracy of the information in the return within a prescribed period after that initial assessment. From 1989-90, the returns of companies and superannuation funds became subject to a system of full self assessment, under which the taxpayer calculates their liability and pays their tax when lodging their return.

Essentially, self assessment requires taxpayers to perform certain functions and exercise some responsibilities that might otherwise be undertaken by the Tax Office. Before self assessment, taxpayers provided the Tax Office with the relevant information to apply the law and assess their liabilities accordingly. Under the former system, a taxpayer's primary obligation was to make a full and true disclosure to the Tax Office and the assessment was left to the Tax Office.[5] After making an assessment, the Tax Office could amend that assessment to correct errors of fact or calculation, but they could not fix their mistakes of law. In this way, taxpayers had a measure of certainty, while the costs of some Tax Office errors were borne by the community as a whole.

With the move to self assessment, the Tax Office still issues notices of assessment (to create the formal obligation to pay tax), but returns are generally taken at face value, subject to post-assessment risk based audit and other verification checks. The Tax Office is allowed to amend errors of calculation, mistakes of fact and mistakes of law after processing the assessment and collecting the tax payable or paying a refund. Depending on the circumstances, returns may be re-opened many years after the original assessment. In this way, the introduction of self assessment meant a change in the balance of costs and risk between the Tax Office and the taxpayer. The change also meant that the Tax Office's resources could be used more efficiently, so that more revenue could be collected for the same administrative cost.

By the early 1990s, problems had been identified with the initial self assessment arrangements, particularly in relation to penalties and interest and the need to provide greater taxpayer certainty. The Government of the day responded by introducing changes in 1992,[6] the most notable being:

- a new system of binding public rulings

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5. An *assessment* is the end result of the process of ascertaining a taxpayer's taxable income and calculating the tax payable on that income (see *Batagol v Federal Commissioner of Taxation* [1963] HCA 51; (1963) 109 CLR 243).
6. Legislation giving effect to these changes was largely contained in the *Taxation Laws Amendment (Self Assessment) Act 1992*.

- a new system of binding private rulings
- an extension (to four years) of the period within which a taxpayer could object against an assessment
- a new system of penalties for understatements of income tax liability, based on the requirement that taxpayers exercise reasonable care
- a new interest system for underpayments or late payments of income tax, based on commercial principles and market interest rates.

Over the last few years, the present Government has shortened the period of review for taxpayers with straightforward tax affairs, introduced binding oral advice,[7] reduced the rate of interest on shortfalls and late payments,[8] and introduced the office of the Inspector-General of Taxation, a new statutory officer with governance responsibilities.[9]

1.3 International comparisons

In forming its recommendations, the Review has examined income tax systems in a number of other countries, especially Canada, New Zealand, the United Kingdom and the United States.[10] The Review has concluded that each system has a different mix of strengths. The Australian system is unexceptional on most points of comparison. The periods for amendment of assessment and the scale of penalties under the Australian self assessment system are broadly comparable with international systems. Australia has a more formal rulings system, but others achieve similar results through other means. While Australia's headline General Interest Charge (GIC) rate is higher, it is tax deductible in all cases.

1.4 Structure of the report of the Review

The discussion paper explained that one way to reduce the uncertainty faced by taxpayers under the self assessment system would be through taxpayers being confident

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7. Both measures were introduced under *A New Tax System (Tax Administration) Act 1999*.
8. The rate of interest on shortfalls and late payments was reduced by Schedule 4 of the *Taxation Laws Amendment Act (No.3) 2001*.
9. The Inspector-General of Taxation has responsibilities for (i) reviewing and reporting on the Tax Office's systems for administering the tax laws and its systems for dealing and communicating with the public, individuals and organisations, and (ii) reviewing and reporting on the administrative aspects of systems established by the tax laws (see section 7 of *Inspector-General of Taxation Act 2003*).
10. For a detailed comparison, see Appendix 4, the Treasury 2004, *Review of Aspects of Income Tax Self Assessment Discussion Paper*, Commonwealth of Australia, Canberra.

that they are assessing their income tax liabilities in line with the Tax Office's interpretation of the law (through rulings and other advice). Chapter 2 contains recommendations to improve the framework and practice of the provision of advice.

Another way to reduce uncertainty is to give earlier finality to taxpayers who have tried to comply by shortening the period in which their assessment can be amended to increase their liability. Once the Tax Office can no longer amend a particular year's assessment, taxpayers can stop worrying about whether they 'got it right'. Chapter 3 contains recommendations to shorten certain periods for the review of assessments.

Penalties and interest charges are potential consequences of uncertainty for taxpayers. Chapters 4 and 5 contain recommendations to improve the transparency and fairness of penalties and interest charges respectively.

Other sources of uncertainty (and compliance costs) derive from the Tax Office's interaction with taxpayers and agents and from issues relating to the design of tax policy and laws. Chapter 6 makes recommendations on a range of administrative issues associated with the self assessment system. Chapter 7 contains recommendations for improvements to policy processes and law design.

1.5 Finding a balance between competing objectives

As pointed out in the discussion paper, sometimes improving one aspect of the system might adversely affect another. For example, the shorter the period for the Tax Office to amend assessments, the sooner a taxpayer obtains finality for a particular income year. However, taking this approach to extremes could encourage non-compliance and prejudice revenue collection to the extent that the resources of the Tax Office would need to be significantly increased.

The Review has concluded that there are a number of refinements to the present arrangements that would improve certainty and reduce compliance costs for taxpayers without significantly affecting the capacity of the Tax Office to collect legitimate income tax liabilities. While few of the report's 54 recommendations represent major changes to the established system, their collective effect will be considerable. These changes are not without costs — some will require the Tax Office to do more and others recognise that some revenue might be foregone.

The most important recommendations in this report:

- improve certainty through providing for a better framework for the provision of Tax Office advice and introducing ways to make that advice more accessible and timely, and binding in a wider range of cases

- improve certainty by reducing the periods allowed to the Tax Office to increase a taxpayer's liability in situations where the revenue risk of doing so is low or manageable

- mitigate the interest and penalty consequences of taxpayer errors arising from uncertainties in the self assessment system

- provide for future improvements through better policy processes, law design and administrative approaches.

The recommendations in this report will move the balance of fairness markedly in favour of taxpayers who act in good faith and build flexibility into the self assessment system. However, nothing in these changes will weaken the capacity of the system to cope with aggressive tax planning, avoidance and evasion.

CHAPTER 2: RULINGS AND OTHER TAX OFFICE ADVICE

This Chapter examines the role of Tax Office advice in the self assessment system and recommends changes to the framework for the provision of Tax Office advice to improve its reliability, accessibility, timeliness and accuracy.

2.1 The role of the Tax Office in providing advice

Australia's system of self assessment for income tax relies heavily on the principle of voluntary compliance and on taxpayers (or their advisers) having a good understanding of the tax law in order for them to meet their obligations.

The shift to self assessment in 1986-87 heightened the importance of these principles by placing more responsibility on taxpayers to correctly interpret the law.

Over the last 25 years, there has been a significant increase in the complexity of business and personal affairs and tax laws have had to become longer and more comprehensive. The proportion of individual taxpayers seeking professional assistance to complete their tax returns has risen from approximately 20% in 1980 to around 76% in 2002.

Few taxpayers use the tax law itself as a primary source of information, so Tax Office advice (and advice from tax agents) plays a crucial role in bridging the gap, by providing summarised, understandable advice that taxpayers rely on.

The Tax Office accepts the importance of this advising role and acknowledges that, as the administrator of the tax laws, it must operate 'as a trusted authority on the law and a professional adviser and educator, ensuring that people have the information and support needed to meet their obligations'.[11]

Further, the Tax Office's compliance program is built around the idea that to maximise the number of people who choose to comply, it is necessary to make 'it as easy as possible for people to understand their obligations'.[12] This reinforces the notion that the Tax Office's role as a regulator is broader than simply enforcing the law. Ideally, the Tax Office's 'policing' role will be minor compared to its support for voluntary compliance.

11. Australian Taxation Office 2003, *Strategic Statement 2003-05*, Australian Taxation Office, Canberra.
12. Australian Taxation Office 2003, *Compliance Program 2003-04*, Australian Taxation Office, Canberra, inside front cover.

2.1.1 Tax Office advice and uncertainty

In the discussion paper, the Review highlighted that a lack of confidence in Tax Office advice could lead to significant adverse impacts on taxpayers, the system of tax administration and the economy as a whole. The discussion paper proposed that taxpayer confidence is enhanced when Tax Office advice is high quality in terms of its reliability, timeliness, accuracy and accessibility.

Consistent with these sentiments, in 2003, the Tax Office's *Making it easier to comply* initiative identified that the key improvements that small businesses and individuals wanted were for the Tax Office to 'better understand their circumstances and to provide quick and accurate advice that we [the Tax Office] stand by'. [13]

In the submissions received by the Review, improving advice quality was endorsed as an important way to reduce uncertainty. Most submissions acknowledged that the self assessment system was unfair if the tax administrator (who should arguably have the best knowledge of the tax system) could provide advice that was wrong and taxpayers who have relied on that advice to their detriment bore the consequences.

2.1.2 Types of Tax Office advice

The Tax Office provides taxpayers and practitioners with a range of advice on applying the income tax law, through formal rulings and other products.

There are currently three main types of formal income tax ruling: public rulings, private binding rulings (PBRs), and oral rulings. The advice in formal rulings is binding by law on the Tax Office and a taxpayer covered by a formal ruling is therefore protected from retrospective amendment, even if the Tax Office subsequently changes its interpretation of the law.

Public rulings provide written guidance to taxpayers generally. They state the Tax Office's view on how the income tax law applies to a type or class of arrangements. They are provided at the discretion of the Tax Office and are prepared in conjunction with panels containing representatives from the accounting and legal professions.

PBRs provide written advice to a given taxpayer on how the Tax Office considers the law applies to a specified arrangement for particular income years.

Oral binding rulings provide specific advice on a limited range of income tax matters to taxpayers with simple tax affairs.

13. Australian Taxation Office 2003, *Making it easier to comply*, Australian Taxation Office, Canberra, p. 5.

The Tax Office also provides a wide range of other written advice in the form of manuals, booklets, schedules, fact sheets, press releases, Interpretative Decisions, taxpayer alerts and *TaxPack*. A considerable amount of this advice is available on the Tax Office website. In addition, the Tax Office provides advice in person and by telephone. Advice provided through these mechanisms is not legally binding, however some advice is treated as administratively binding, meaning the Tax Office will not apply penalties or interest if the advice is wrong, while other advice will only provide protection from penalties.

2.2 Improving the framework for Tax Office advice

Currently, different types of advice confer different levels of reliability. This can produce uncertainty when taxpayers are not clear about what advice they can rely on.

Noting the role of Tax Office advice in the self assessment system outlined above, the Review has concluded that, as a general principle, taxpayers who have acted in good faith should not suffer adverse consequences as a result of having relied on incorrect Tax Office advice. Such consequences should properly be borne by the community as a whole. Although this will not be a great cost (as Tax Office advice will be correct in the great majority of cases), it will relieve a major source of uncertainty for taxpayers.

For these reasons, the Review recommends that all Tax Office advice should provide a level of protection for taxpayers who have acted in good faith and reasonably relied on Tax Office advice that subsequently turns out to be incorrect.

The level of protection conferred will depend on the type of Tax Office advice. In the case of advice that is legally binding, including the expanded categories of legally binding advice recommended below (see subsections 2.3.1 and 2.4.1), taxpayers should be protected from amended assessments raising further primary tax, penalties or interest charges. In the case of any other written advice, oral advice about an individual's circumstances or longstanding administrative practice,[14] taxpayers should be protected from both penalty and interest charges.

Of course, there will be circumstances where the Tax Office may need to express views without binding the Commissioner, for example, in relation to consultation drafts, discussion papers canvassing alternative options, or in providing general oral advice. Recognising this, advice that is clearly labelled as non-binding will not automatically provide protection to taxpayers. For oral advice, it may prove unmanageable to have the Tax Office bound by all the oral advice it provides, largely because such an approach

14. Longstanding administrative practice refers to issues that the Tax Office has specifically considered and applied consistently over time. Mere inaction or the failure to rule would not be taken as longstanding administrative practice.

would introduce complicated evidentiary requirements about the advice a taxpayer received. To avoid this problem, only responses from formal enquiry centres will provide taxpayers protection from penalties and interest.

This new framework for protection from the consequences of incorrect advice could apply from 1 July 2005, provided enabling legislation has received Royal Assent.

Recommendation 2.1

Taxpayers who reasonably rely on Tax Office advice should receive a level of protection as follows:

- For all legally binding advice, taxpayers will be protected from amendments raising additional primary tax, penalties and interest charges.
- For all other written advice (unless that advice is clearly labelled non-binding), and oral advice provided by formal enquiry centres, taxpayers will be protected from penalty and interest charges.
- No penalties or interest will apply where taxpayers follow long standing Tax Office administrative practice.

2.3 Improving public advice

2.3.1 Expanding the category of legally binding public advice

Recommendation 2.1 seeks to make reliance on Tax Office advice more certain and less risky for taxpayers. Expanding the types of advice that fall into the legally binding category will further decrease that risk.

The Review received a number of submissions suggesting that a wider range of written advice should legally bind the Tax Office. Indeed, some suggested that all Tax Office advice should be binding, as with the GST system. They also expressed dissatisfaction with the fact that the Tax Office is not bound on procedural, administrative or collection aspects of the law, or all statements forming part of the ruling.

The benefits of a broader scope for legally binding rulings were recognised in *Tax Reform: not a new tax, a new tax system* (ANTS),[15] however legislation to broaden this category has not been introduced. While these changes will allow more topics to become the

15. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra, p. 147.

subject of rulings, the decision to address particular issues in public rulings is a matter for the Tax Office.

Recommendation 2.2

The category of legally binding public rulings should be expanded to cover matters of administration, procedure, collection, and ultimate conclusions of fact involved in the application of a tax law.

The Tax Office produces a number of non-ruling products in which the public, especially those preparing their own returns, should be entitled to have a high level of confidence, such as *TaxPack*. The Review has concluded that, even if these products are not suitable for inclusion in the formal public rulings series, some of them should have the same protection as public rulings for self-preparer taxpayers. However, it would be extremely expensive and difficult for the Tax Office to attempt, in the short term, to review all its publications to determine whether they should be binding. The Review therefore concludes that this power should be confined to non-business individual self-preparers and used as existing premier products are updated.

Recommendation 2.3

The Commissioner should be empowered to declare that advice provided for the general information of non-business individual self-preparers (for example, *TaxPack*) is legally binding upon the Tax Office.

A number of submissions to the Review criticised the fact that important parts of public rulings were not included in the 'ruling' section of the publication. Taxpayers and their advisers currently have the opportunity to provide feedback on draft rulings, where they believe that certain content of the ruling should be included in the ruling section. Submissions were split between the competing ideas that the Tax Office should consider all alternative arguments in detail, and the notion that rulings should provide the Tax Office's view.

The Review concludes that the primary purpose of rulings should be to state the Tax Office's view. In doing this, other views should be discussed, if it is useful to do so. However, the Tax Office should not be obliged to address all possible other arguments, especially when to do so would be likely to confuse the reader. As a result, where competing views are raised during consultation and not addressed in the ruling, the Tax Office should provide feedback directly to people contributing those views. Finally, all aspects of a ruling that are capable of being binding should be drawn together in one section within the ruling.

Recommendation 2.4

All aspects of a public ruling that are capable of binding the Tax Office (including for example, worked examples) should be collected together and clearly labelled as binding.

In public rulings, alternative views need not be addressed if these are likely to confuse the reader. Where competing views are raised in consultation and not addressed in the ruling, the Tax Office should provide feedback directly to people contributing those views.

2.3.2 Managing changes to public advice

Another circumstance with the potential to cause uncertainty is where public rulings are withdrawn by the Tax Office and not replaced. This can leave taxpayers confused about how they should apply the law from that date on.

The Review has concluded that the Tax Office should ensure that some appropriate instruction replaces a public ruling as soon as practicable after it is withdrawn.

Recommendation 2.5

The Tax Office should take all steps necessary to ensure that an appropriate instruction or product replaces any public ruling as soon as practicable after it is withdrawn.

Many submissions expressed dissatisfaction about situations in which the Tax Office appeared to apply their interpretation of the law retrospectively. The issue was addressed in Joint Committee of Public Accounts *Report 326*:

> 'As interpretations of the law, Rulings of themselves neither create nor extinguish rights. Rather, as administrative instruments they indicate the intention of the ATO to assess obligations in a particular manner. The Committee considered that, in general, as statements of intent, Rulings should only be issued with prospective force and where one Ruling overturned another, the ATO should be obliged to give Rulings prospective application only.'[16]

The Tax Office has advised the Review that *Taxation Ruling 92/20*[17] publicly states its position that outcomes are only applied prospectively from the date of final issue, where a new ruling replaces another and is less advantageous for taxpayers.

16. Commonwealth of Australia Joint Committee of Public Accounts 1993, *An Assessment of Tax*, *Report 326*, 1993, Commonwealth of Australia, Canberra, p. 120.
17. Australian Taxation Office 1992, *Taxation Ruling TR 92/20*, Australian Taxation Office, Canberra.

In some cases, it may be in the interests of good administration to announce a date of effect some time after the date of the issue of the ruling, to allow affected taxpayers reasonable time to become aware of, and act upon, that new interpretation. This would not generally apply where rulings address tax avoidance arrangements, or in situations where the former ruling is being exploited.

Recommendation 2.6

Where the Tax Office changes a public interpretation or long standing practice to the detriment of taxpayers, that change should become effective prospectively and, where necessary, from a future date that allows affected taxpayers reasonable time to become aware of, and act upon, that new interpretation.

2.3.3 Improving the timeliness of public advice

In order to be useful, advice needs to be provided in time to meet the needs of taxpayers. This is especially important where a decision to enter into a prospective transaction is dependent on the Tax Office's view of its taxation consequences. However, draft public rulings can take many months, sometimes years, to become final binding rulings. Taxpayers do not have certainty if they rely on draft rulings and, in practice, they cannot usually get a private ruling while a public ruling on the same topic remains unfinalised.

A number of submissions advocated a statutory time limit within which draft public rulings become final. The Review has examined this idea, but concluded that it is not entirely practicable, and could prove counterproductive in some cases. At present, some delay is desirable between draft and final ruling to allow full consultation and time for responses to drafts. Moreover, public rulings panel processes necessarily take some time. The alternative may simply force the finalisation of a premature Tax Office position. Nevertheless, if a position cannot be formally finalised, the Tax Office draft position may be the best available in the interim.

The Review has therefore concluded that relying on draft public rulings should be grounds for a taxpayer to receive a full general interest charge remission and protection from shortfall penalties. This largely reflects current Tax Office practice.

Recommendation 2.7

Where taxpayers rely on public rulings while they are in draft form they should be protected from penalties and receive full remission of any interest charges in the event that the final ruling is issued in different terms, to their detriment.

2.3.4 Making public advice more accessible

Some submissions noted that advice provided by the Tax Office is not always easy to understand. These submissions proposed that advice should be written in a plainer and simpler style. However, submissions also recognised the balance that needs to be struck between providing advice that is clear and succinct, and ensuring that advice is accurate. They acknowledged that, depending on the taxpayer and the advice sought, varying degrees of technical language may be required or appreciated. Moreover, some taxpayers and practitioners have said that they would prefer a longer explanation in order to gain a better understanding of how the Tax Office might approach similar cases.

Nevertheless, the Tax Office is not in the business of being a paid tax adviser to individuals[18] and it should not feel obligated to provide its general advice in a way that only suits a minority. The main purpose of Tax Office advice is to inform the public about how it will interpret the law and act in a given situation. If that advice is written like some legal opinions, in complex language with caveats or qualifying statements, what is stated to be *public* advice, may not in fact be accessible by the general public.

The Review therefore encourages the Tax Office to provide general advice in a style that is as simple and easy to understand as possible. Some rulings with a potentially limited readership may need to be tailored to the special needs of the target audience.

Recommendation 2.8

Wherever possible, Tax Office general written advice, including public rulings, should be written in plain language, with a minimum of qualifying statements so that it is accessible to the general public.

The Tax Office's website contains a large amount of information and is increasingly relied on by tax agents. However, in consultations, agents reported that the website was not easily searchable or accessible, and did not contain a comprehensive index. A number of submissions to the Review also reported that Tax Office Interpretative Decisions did not have an effective search facility, making it difficult to find information.

18. On the question of the Tax Office potentially charging for advice, see subsection 2.4.9.

The Tax Office has recently updated its search facilities, website server and support for its legal database (<law.ato.gov.au>). People using the legal database search facilities will now find that Tax Office Interpretative Decisions, for example, can be comprehensively and easily searched. The Review encourages the Tax Office to continue to improve its website accessibility as the need arises.

Furthermore, agents complain that they have been sent large amounts of information by the Tax Office about changes to the tax laws, or relating to their clients. Keeping up to date with large volumes of information can be difficult. Indeed, many agents report that, in the past, so much material has been mailed out to them that it is virtually impossible to read it all. Tax agents also noted that electronic interaction with the Tax Office is more convenient for them, and that the new tax agent 'portal' (an electronic window to clients' accounts) is particularly valuable.

Recommendation 2.9

The Tax Office should continue to replace large 'mail-outs' to tax agents with more targeted electronic contacts, and a 'whole-of-agency' view should be applied to volumes of information distributed.

2.3.5 Improving confidence in the objectivity of public advice

A number of submissions suggested that confidence in the integrity of Tax Office advice could be enhanced if the Tax Office's views about the general anti-avoidance provision (Part IVA) were more transparent. The fact that statements on how the Tax Office considers Part IVA applies are spread across a number of products means that the Tax Office's approach is not easy to ascertain. This has created an impression that the provisions may be invoked arbitrarily, notwithstanding the Tax Office's processes to control the application of Part IVA, such as the Part IVA Panel.

The Tax Office has advised the Review of its intention to update its Part IVA Practice Statement in the next few months.

Recommendation 2.10

The Tax Office should update and consolidate its guidance on the way it interprets and administers Part IVA of the *Income Tax Assessment Act 1936* into a single comprehensive Ruling or Practice Statement.

2.3.6 Tabling public rulings in Parliament

Public rulings are not delegated legislation, so they are not tabled in Parliament.

Some commentators have argued that, as public rulings outline how the Tax Office considers the law applies and most taxpayers do not have the resources to challenge that interpretation, public rulings are effectively equivalent to the law. Therefore, to protect taxpayers' rights, it is argued that these rulings should be subject to the scrutiny of (and possible disallowance by) Parliament.

However, tabling public rulings in Parliament could delay the process of making rulings, introduce further uncertainty for taxpayers and would be likely to politicise the administration of the tax laws. If Parliament thought a public ruling incorrectly reflected the law, it could amend the law to re-state its meaning.

Furthermore, while it is true that public rulings are hard to challenge directly, a taxpayer dissatisfied with a public ruling can request a private binding ruling on the same terms and ultimately appeal it to a court.

The Review therefore does not recommend that public rulings be tabled in Parliament.

2.4 Improving private advice

2.4.1 Expanding the range of matters on which legally binding private rulings can be provided

To make reliance on Tax Office advice more certain and less risky for taxpayers, Recommendation 2.2 proposes that the category of legally binding public rulings should be expanded to cover matters of administration, procedure, collection and ultimate conclusions of fact.

Private binding advice could also be made more certain and less risky if the range of matters that can legally bind the Tax Office is broadened in the same way. However, as noted in the *Review of Business Taxation* (commonly called the Ralph Review),[19] such an expansion should not unduly limit the Tax Office's normal compliance activities.

19. Commonwealth of Australia 1999, *Review of Business Taxation: A tax system redesigned*, July 1999, Commonwealth of Australia, Canberra, p. 138.

Recommendation 2.11

The category of PBRs should be expanded to cover matters of administration, procedure, collection, and ultimate conclusions of fact involved in the application of a tax law. However, the Commissioner should not be obliged to rule where to do so would prejudice or unduly restrict the administration of the tax law.

2.4.2 Eliminating doubt about whether Part IVA has been considered

Private binding advice underpins self assessment by allowing taxpayers to seek reliable guidance on the interpretation of tax law in their particular circumstances. However, some submissions asserted that the Tax Office has refused to stand by private rulings that are silent on the question of whether Part IVA had been considered. Other submissions and consultations highlight that there is often doubt about whether Part IVA has been considered in private binding advice.

There may be situations where individuals do not want Part IVA considered in their PBR application, for example, where a taxpayer wants a response quickly, is sure that Part IVA is not applicable, or if they are willing to take the risk. While the Tax Office's role is not that of paid adviser and they may properly decline to give an assurance that Part IVA will not apply in certain cases, there should be no room for doubt about whether the issue has been considered.

The Review has concluded that, in cases where Part IVA could potentially apply to a PBR application, the Tax Office should indicate its view about Part IVA or that, while it may be relevant, it has not been addressed.

Recommendation 2.12

In PBRs where Part IVA could apply having regard to the facts provided in the PBR application, the Tax Office should indicate whether Part IVA has been considered. This indication may be by way of substantive comment on Part IVA's application, or by disclaimer. Where Part IVA had been substantively addressed and there has been a full and true disclosure of all material facts, the Tax Office should be prevented from reopening an assessment.

Taxpayers can advise in their PBR application that Part IVA need not be considered.

2.4.3 Improving confidence in the objectivity of private advice

Taxpayers and practitioners have a legitimate expectation that the advice they receive from the Tax Office will be accurate and unbiased. However, a number of submissions asserted that the Tax Office adopts a pro-revenue position in large complex cases, even though statistics suggest that such a perception may be unfounded.[20]

The discussion paper canvassed the option of having a suitable independent body undertake a systematic evaluation of PBRs to determine the objectivity of Tax Office advice. This approach was supported by submissions. Furthermore, from discussions with focus groups of tax agents, the Review has concluded that the perception of pro-revenue bias in PBRs is so strong that it needs to be independently examined.

Recommendation 2.13

The Government should request the Inspector-General of Taxation to evaluate whether the pattern of PBRs indicates a pro-revenue bias.

2.4.4 Ensuring private rulings are provided in a reasonable time

The current standard for replying to requests for PBRs is 28 days, or such further time as negotiated. If all the information needed to make a decision is not provided, the Tax Office will endeavour to contact the taxpayer within 14 days to request further information. If the PBR request raises particularly complex matters that will take more than 28 days to resolve after receiving all the required information, the Tax Office aims to contact the taxpayer within 14 days to negotiate an extended reply date.

Feedback through the consultation process shows significant concern about the turnaround time for PBRs. While major difficulties are not obvious from the available aggregated data on PBRs, that data is not published in a way that eliminates the possibility that tax agent cases are generally taking several months longer to complete.

Recommendation 2.14

The Tax Office should enhance its published performance reporting on PBRs to distinguish response times to individuals and very small business from those for larger businesses, and separately report agent and non-agent case statistics.

Tax agents have reported that delays in PBR responses, especially in relation to more complex requests, are so prevalent that they seriously threaten the usefulness of the PBR system. Apart from the lack of certainty, the lengthy period means that PBR applications can become a costly exercise for tax agents to pursue on behalf of their clients. Many tax agents now rarely use PBRs.

20. In 2002-03, the Tax Office issued 7,631 PBRs. 4,150 were wholly favourable to the applicant, 1,246 were partially favourable and 2,235 were unfavourable. It also finalised 3,674 applications without issuing rulings (usually because the application was withdrawn, deemed invalid or because the Tax Office refused to rule).

To address problems of long delay, the Review has concluded that taxpayers should be able to crystallise an answer to their PBR request. (Other ways to address this identified service gap are discussed at section 2.6.)

Recommendation 2.15

For PBR applications that are older than 60 days, taxpayers who have supplied all information required by the Tax Office should be able to request that the Tax Office determine their application within 30 days. If the Tax Office does not make a determination within 30 days, the taxpayer will be taken to have received a negative response to their application, thus triggering their objection and appeal rights.

The Review received submissions arguing that the PBR process allows the Tax Office too much latitude to request arguably unnecessary additional information to ensure that largely unlikely hypothetical circumstances are dealt with. Where this occurs, the taxpayer or agent is put to further cost, the Tax Office's response time target restarts, and the process can be further delayed.

The Review has concluded that, to enhance the provision of PBRs in a timely manner, issues not directly raised in a PBR application should not generally be ruled on. Information about how to request a ruling should advise taxpayers to raise all issues on which a ruling is required.

Recommendation 2.16

The Tax Office should refrain from ruling on issues not directly raised in PBR applications without the taxpayer's agreement. In cases where other aspects of the tax law could impact on the accuracy of the Tax Office's response, the response should contain appropriate caveats or statements that the advice is issued subject to certain assumptions or limitations.

Under the current law, the Tax Office can only rule on the information provided in the taxpayer's PBR application. This means that, where the Tax Office has access to additional information that might be relevant, they cannot use it, but must instead request the applicant to provide it.

Removing the need for the Tax Office to request information that is readily available will reduce PBR response times, thereby improving certainty.

Recommendation 2.17

When making a PBR, the Commissioner should be empowered to consider information other than that supplied by the applicant, provided that such information is made known to the applicant before being used.

Some submissions pointed out that the design of the PBR application form contributes to delays in providing PBRs. It was suggested that the Tax Office should modify PBR application forms and related processes, to reduce the need for taxpayers to conform to complex procedures or for the Tax Office to seek additional information.

The Review has concluded that the Tax Office's PBR application forms should only require taxpayers to include the information reasonably required to determine their requests.

Recommendation 2.18

The Tax Office should continue to modify its PBR application forms and processes to reduce the need for taxpayers to conform to complex procedures, or for the Tax Office to seek additional information from taxpayers.

2.4.5 Managing changes to private rulings

At present, where a taxpayer has a PBR and the transaction that is the subject of the PBR has commenced or the income year has begun, the ruling cannot be withdrawn, even if the Tax Office decides it has issued the PBR incorrectly.[21] However, where the transaction has not been entered into and the income year has not yet commenced, a subsequent public ruling will override the PBR.

Revoking a PBR by a public ruling in these circumstances is rare. Nevertheless, the potential for a public ruling to revoke a PBR theoretically requires holders of PBRs to monitor public rulings constantly. The Review concludes that this is an unnecessary and inappropriate feature of the system, especially in the light of the 'reasonable period of adjustment' rule for new interpretations in Recommendation 2.6. The requirement to monitor rulings should be made more manageable for taxpayers. In recommending this, the Review does not envisage major changes are required to Tax Office practice to cater for these rare situations.

While the Review recognises that, occasionally, a PBR might continue in force when it otherwise would be withdrawn by a public ruling, this rare occurrence is preferable to the alternative of requiring taxpayers to monitor all changes to public rulings. Requiring

21. Paragraph 14ZAU(2)(a) and subsection 14ZAU(4) of the *Taxation Administration Act 1953*, outline the circumstances in which a private ruling can be withdrawn.

a taxpayer or their adviser only to examine public rulings at the start of a new income year to determine whether any of them override the taxpayer's PBR is much less onerous. Moreover, the Tax Office should be able to manage any revenue risk by noting large PBRs issued with significant lead times.

> Recommendation 2.19
>
> If neither the transaction nor the income year to which a PBR relates has begun, the PBR may be withdrawn by either:
>
> - notifying the affected taxpayer directly through a revised PBR
> - issuing a public ruling, provided that ruling applies to the taxpayer as if it was issued immediately before the taxpayer's next income year.

2.4.6 Making private rulings more accessible

Some submissions noted that PBR requests were often answered at quite a technical level. These submissions point out that qualifying statements in PBRs, combined with their length and technical references, can make them hard to understand, especially where the audience does not have a high level of tax expertise.

The Tax Office has advised the Review that its current objective is to issue rulings in language that reflects the needs of the applicant, while ensuring that the PBR is technically accurate and not misleading.

The Review concludes that the Tax Office's use of technical terminology may be inevitable in some cases, as the person requesting a PBR will be undertaking a complex transaction and have a good understanding of technical tax terms. However, as a general rule, explanations in plain language would be appreciated by the applicants.

> Recommendation 2.20
>
> PBRs should contain an answer written in plain language, with a minimum of qualifying statements.
>
> In addition to the plain explanation, the Tax Office may provide a more detailed or technical statement of its position, where it is necessary to do so.

2.4.7 Improving review processes for private rulings

Submissions to the Review suggested that taxpayers and their representatives appear to be insufficiently aware of the review processes available to them for PBRs.

The Tax Office has advised the Review that PBR responses now incorporate an explanation of taxpayers' review rights.

Under the existing arrangements, where taxpayers object to a private ruling, review is limited to the arrangement set out in the ruling application. Submissions to the Review have argued that the timeliness of this process would be improved if the Tax Office or reviewing authorities were able to take into account additional facts provided by taxpayers after they have lodged their PBR applications. Taxpayers would be able to clarify their position so that all the necessary information is presented to support the case for review of the decision. As is currently the case, where the arrangement identified by the taxpayer is materially different from that identified in the taxpayer's original PBR application, the applicant should make a fresh application.

Recommendation 2.21

In responding to a request for a private ruling, or determining an objection to a PBR request, the Commissioner, Tribunal or Court (as the case may be) should be able to take into account additional facts and particulars provided by taxpayers after they have lodged their PBR application.

Where the additional facts mean that the arrangement is materially different from that in the original PBR request, a taxpayer must make a fresh PBR application.

2.4.8 Extending private rulings beyond the applicant

PBRs bind the Tax Office to determine a taxpayer's obligations in a specified way for designated income years. A PBR cannot be relied on by other taxpayers.

Some submissions argued that PBRs should be able to be relied on by taxpayers other than the applicant. It was suggested that such a practice would reduce compliance costs and improve equity. However, if PBRs could be relied on by taxpayers other than the applicant, it would be virtually impossible for the Tax Office to determine which or how many taxpayers had relied on a given ruling. The possibility of a taxpayer believing that a PBR should apply to them, where the Tax Office did not, would only add to uncertainty.

In any case, the Tax Office already has a process whereby a single ruling can apply to more than one taxpayer, by issuing *class* rulings. With this process, the Tax Office knows precisely who will be relying on the ruling and can update or amend it as necessary.

The Review has concluded that a PBR should not be able to be relied on by taxpayers other than the applicant.

Tax agents have reported that trustees of a trust estate are currently uncertain whether they can rely on PBRs that were originally issued to previous trustees, as the advice does not clearly state whether future trustees are covered by the ruling.

The Review has concluded that a PBR given to a trustee of a trust estate in respect of that trust should also be able to be relied on by subsequent trustees, provided the circumstances in relation to which the PBR was given still apply.

Recommendation 2.22

Where the Tax Office has provided a PBR to a trustee of a trust estate, the PBR should be able to be relied upon by future trustees of the trust estate for the same income years on the same terms as the original PBR.

2.4.9 Charging for private rulings

In the discussion paper, the Review questioned whether the Tax Office should continue to provide advice free of charge, or whether alternative funding arrangements should be introduced (as a means of funding wider improvements to Tax Office advice).

Of the submissions received, almost all advocated no change to the current funding arrangements. The primary argument was that, within a self assessment environment, taxpayers have the right to know the manner in which the tax laws apply to their circumstances (rather than being a privilege that would justify charging a fee). Some submissions also noted that a 'user pays' system may raise concerns about the propriety of positive rulings.

The Review has concluded that private rulings should not be charged for.

2.5 Oral advice

Oral rulings provide specific advice on a limited range of income tax matters to taxpayers with simple tax affairs. As with PBRs, the Tax Office is required to provide an oral ruling unless the request falls into one of the specific exclusions contained in the legislation. Practitioners cannot apply for oral rulings on behalf of their clients.

ANTS proposed oral rulings to provide certainty in low revenue risk cases:

> 'The Government will ensure that taxpayers with simple affairs can rely on oral advice received from the Tax Office. Such advice will be binding on the Commissioner in much the same way as written private rulings.'[22]

While a number of submissions advocated extending the oral binding ruling system to tax agents, the Review has received advice from the Tax Office that it is advancing initiatives (outlined in the following section) that make it unnecessary to extend the oral rulings system to agents. Although there is no basis in principle to exclude tax agents from the oral binding ruling system, the Review has concluded that the alternative system for agents proposed by the Tax Office should be explored first.

Submissions also noted that the system's effectiveness was severely constrained because there was only a very limited range of circumstances in which the ruling could bind.

The Review has concluded that eligibility for oral rulings should be expanded to give effect to the goal in ANTS that the system be open to the majority of salary and wage earners who prepare their own returns.

Recommendation 2.23

The eligibility for oral rulings should be expanded to cover all non-business individual taxpayers who are self-preparers unless, in the opinion of the Commissioner of Taxation, the question being asked is complex and would require the question to be set out and answered in writing.

The Tax Office does not currently record the majority of its non-binding oral advice. Submissions received by the Review noted that a system to track Tax Office oral advice effectively would be welcomed.

Further support for improving the management of oral advice is highlighted in the Ombudsman's report *Issue relating to oral advice: Clients Beware*.[23] The Ombudsman's report recognises that not all government agencies are in a position to record the details of oral advice given, but suggests that recording advice, where a risk to the client and agency is high, is a sensible management strategy. With today's technology, the possibility of implementing a system to record oral advice is workable. The Ombudsman has raised this issue in Annual Reports since 1997.

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22. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra, p. 147.
23. Commonwealth of Australia Ombudsman 1997, *Issue relating to oral advice: Clients Beware*, Commonwealth of Australia, Canberra.

Recommendation 2.24

The Tax Office should explore ways to record oral advice as suggested by the Ombudsman.

2.6 Quick advice for tax agents

A common theme that the Review encountered in consultation meetings with groups of tax agents was that the current PBR system did not meet their needs.

Tax agents stated that:

- the system was not responsive enough (in that the Tax Office's benchmark of 28 days was not timely enough to make the system commercially acceptable)
- the effort needed to prepare a PBR application made relatively simple requests a fairly costly exercise
- the Tax Office often required additional particulars about the ruling circumstances, expanding and complicating even simple requests
- they often simply sought informed discussion with the Tax Office on the law in order to confirm their own views.

The Tax Office has advised the Review that it is already proceeding with some initiatives which may meet some of the needs that tax agents have expressed. For example:

- PBRs should be able to be lodged through the Agent Portal from July 2005.
- Short form PBRs are being progressively offered to taxpayers who do not require full written details (in the case of a favourable PBR ruling).

Progressively over the next three years, the Tax Office is also planning to:

- streamline the requirements for lodgment of PBRs
- consider using Express Telephone Advice for some PBRs
- explore ways to confirm telephone discussions to tax agents relating to straightforward issues.

Despite these advances, it appears that there is a potentially significant gap between the suite of services provided to tax agents and the services tax agents believe are needed.

The Review concludes that there is a need for a low cost, responsive advice system (or modification to the existing PBR or oral binding ruling systems) for agents seeking advice where the amount of tax in question is too small to justify the cost of seeking a PBR.

Features of such a system might include:

- It could be designed primarily for tax agents, to be used in a range of simple, low revenue risk circumstances.
- Requests could be submitted and discussed by phone, with responses being provided by phone or possibly e-mail, after being registered or recorded.
- In appropriate circumstances, the Tax Office could use the power given in Recommendation 2.3 to grant premium protection.

In developing any new system, regard will need to be had to the administrative cost.

Recommendation 2.25

The Tax Office should work with tax agents to identify improved ways or new systems to assist tax agents with responsive and timely advice on low risk enquiries.

CHAPTER 3: REVIEW AND AMENDMENT OF ASSESSMENTS

This Chapter recommends changes to the rules governing the amendment of assessments to reduce the time that taxpayers are exposed to Tax Office action to increase their liability.

The rules governing the amendment of income tax assessments attempt to balance two competing objectives, namely that:

- A taxpayer should pay the correct amount of tax according to law.
- Whether or not a taxpayer has paid the correct amount, eventually their tax affairs for a particular year should become final, unless they have deliberately sought to evade their responsibilities.

The law seeks to balance these objectives by allowing the Tax Office to amend assessments to correct errors, but only within time limits set out in the law.

The Review has examined this topic with a view to determining whether the current time limits get that balance right. In doing so, we have taken the perspective that, in order to promote certainty, the period permitted for an amendment to increase a taxpayer's liability should approach the minimum required for the Tax Office to identify the majority of incorrect assessments and take action to correct them.

3.1 The current amendment rules

The standard period now allowed for the Tax Office to amend an assessment (either to increase or reduce a taxpayer's liability) is four years.[24] For certain individuals with very

24. For individual taxpayers, the amendment period is calculated from the day on which tax became due and payable under an assessment. For full self assessment taxpayers (primarily companies and superannuation funds), the four year period is calculated from the day on which the assessment is deemed to have been made, which is the date the taxpayer lodged its return. Where the Tax Office has begun an audit of a taxpayer's affairs, but not completed it within the period allowed for amendment, the Tax Office can apply to the Federal Court for an order extending the amendment period, or request the taxpayer to consent to an extension.

simple tax affairs,[25] the period is two years. Within these time limits, the Tax Office effectively has an unlimited power of amendment.

There is a special period for amendment where Part IVA (the general anti-avoidance provision) is invoked. As before self assessment, the Tax Office has up to six years (from the date on which tax became due and payable under an assessment) to amend an assessment to cancel a tax benefit under that Part.

There are also numerous specific provisions allowing the Tax Office to amend an assessment to deal with special issues, regardless of the normal time limits. These special cases are discussed in more detail below at subsection 3.2.5.

The law also allows for 'self amendment' of assessments (to increase or decrease liability), meaning that the Tax Office can rely on statements made by a taxpayer in a request for amendment in the same way it can rely on a statement in a return.

Finally, if the underpayment of tax was due to fraud or evasion,[26] the Tax Office can amend the assessment at any time.

The periods of review that apply in Australia, Canada, New Zealand, the United Kingdom and the United States are broadly comparable.[27]

3.2 The time taken for Tax Office compliance activities

The discussion paper proposed that the period permitted for amendment should approach the minimum required for the Tax Office to identify incorrect assessments and take action to correct them. In this way, it was argued that unnecessary delays would be eliminated at no cost or risk to revenue collection.

The Tax Office currently tailors its compliance activities to meet the differing circumstances and characteristics of taxpayers. It does this by adopting a market

25. To be a Shorter Period of Review (SPOR) taxpayer, the taxpayer must be an individual deriving only salary or wages (or certain other income subject to withholding), interest or public company dividends. The taxpayer must not claim deductions except for gifts, account-keeping fees or government charges on account transactions and expenses of managing tax affairs. There are also disqualifying factors such as having a capital gain or loss. The Tax Office estimates that 1.5 million taxpayers are SPOR taxpayers.
26. The income tax law defines neither fraud nor evasion. The ordinary legal meaning of fraud is obtaining a material advantage by unfair or wrongful means (Osborn, P 2001, Osborn's concise law dictionary, 9th ed, Sweet & Maxwell, United Kingdom). It involves the making of a false representation knowingly, without belief in its truth, or recklessly. In *Denver Chemical Manufacturing Co v Commissioner of Taxation (NSW)* [1949] HCA 25; (1949) 79 CLR 296 at 313, Dixon J said that evasion requires a blameworthy act or omission by the taxpayer (or those for whom the taxpayer is responsible).
27. See Table 3.1 of the Treasury 2004, *Review of Aspects of Income Tax Self Assessment Discussion Paper*, Commonwealth of Australia, Canberra.

segment approach that distinguishes between businesses of various sizes, individuals who are not in business and not-for-profit taxpayers (for example, charities and government agencies).[28]

The length of time that the Tax Office takes to review returns therefore varies according to the compliance activities it undertakes.

For non-business individuals with simple affairs, the compliance activity is primarily based on processes such as income matching.[29] If these processes reveal likely non-compliance, the Tax Office may take audit action. Either way, the Tax Office is generally in a position to know whether an amendment should be made to a non-business individual's assessment in much less than the four years presently allowed.

On the other hand, audits of large business taxpayers with complex (sometimes international) affairs and transactions involving substantial amounts of money will require more time to complete. This reflects the nature of these taxpayers' affairs and the administrative processes (intended to protect taxpayers' rights) that accompany these audits.[30] Audit actions may be delayed by difficulties with access to the evidence, claims of legal professional privilege,[31] delays in responding to requests for information or time to comment on Tax Office statements of facts or position papers.

Consequently, large audits often extend beyond the normal statutory limit, either with the agreement of the taxpayer, or by an order of the Federal Court.[32]

As canvassed in Chapter 1, the length of time that elapses before a taxpayer's assessment can no longer be amended represents an aspect of uncertainty for them. If that time can be reduced, the time that people experience the 'costs' of uncertainty will

28. The range of compliance activities that the Tax Office might adopt will vary according to the compliance profile of the taxpayer and the market segment to which they belong. While most returns are subject to office based analysis, such as risk profiling and data matching, relatively few are selected for comprehensive audit. Selection for audit is generally based on a risk assessment, rather than arising merely by chance, or because it is 'your turn'.
29. Income matching means comparing income returned by a taxpayer with information provided by third parties, for example, electronically comparing the database of information about interest paid by financial institutions and dividends paid by public companies with the information in returns.
30. These processes may involve the Tax Office issuing a statement of facts or a position paper on the legal issues, which a taxpayer can dispute or clarify, and further discussions, negotiations and exchanges of papers. At any stage either or both parties may need time to obtain legal advice, expert advice or valuations, etc. The taxpayer can also request that the Tax Office review its position and has the opportunity to provide a submission on any penalty issues that may arise.
31. Legal professional privilege is a common law ground upon which a party may object to the disclosure or inspection of confidential communications between a legal adviser and their client in relation to litigation taking place or being contemplated by the client.
32. The Federal Court can extend the amendment period where, because of any act or omission of the taxpayer, it was inappropriate or not reasonably practicable for the Tax Office to complete an audit within the normal period (see subsections 170(4)-(4C) of the ITAA36).

also be reduced. The following recommendations explore how this can be achieved without a significant negative impact on compliance behaviour or revenue collection.

3.2.1 Adopting a shorter amendment period for individuals and very small businesses

Many individuals who are not in business (and some very small businesses) have straightforward tax affairs. The Tax Office generally completes its compliance activity for the vast majority of these taxpayers within two years of the original assessment. Formalising this period will increase certainty for a very large number of people at virtually no cost.

Similar considerations apply to very small business taxpayers.

Recommendation 3.1

The amendment period for increasing the liability of individuals and very small businesses should be reduced from four years to two years, subject to certain exclusions dealt with in Recommendation 3.3.

Defining very small business

While there may be no ideal definition of *very small business*, the discussion paper proposed that the law would be simpler if it used a definition already in existence, and suggested that the current test for a Simplified Tax System (STS) taxpayer was appropriate, as it was designed to identify businesses with simpler income tax affairs.[33]

In submissions in response, the majority of tax professional bodies said that they would prefer very small businesses to be defined as those eligible to be STS taxpayers rather than those who have elected to be. A difficulty with this approach is that neither the taxpayer nor the Tax Office would be certain about the period for amendment for the taxpayer who may be eligible, but has not elected.

On balance, the Review has concluded that the better approach would be to initially make the shorter review period available to those taxpayers who have elected into STS (rather than those that are eligible). However, a flexible mechanism to give effect to these new rules should be adopted, so that the group of eligible taxpayers can be monitored and increased over time.

33. This test broadly requires that the taxpayer carries on a business in that income year, has an average annual turnover of less than $1 million (ignoring GST credits), has depreciating assets with an end of year value below $3 million and has elected to be an STS taxpayer.

Recommendation 3.2

For the purposes of the proposed two year amendment rule, a business should be treated as a very small business if it has elected to participate in the Simplified Tax System.

Exclusions from the two year period

The Tax Office cannot complete its compliance activities for all individuals and very small businesses within two years, as some have complex affairs and the relevant information is not always available within that period. Therefore, the Review has concluded that a mechanism to allow the exclusion of high-risk cases from the two year period should be adopted. As the circumstances justifying exclusion are likely to vary over time, a flexible mechanism is needed, such as allowing for future exclusions to be added by regulation.

Examples of exclusions from the two year period are:

- recipients of partnership income or trust distributions where the partnership or trust would not qualify for the shorter amendment period
- taxpayers who enter into or carry out schemes with the dominant purpose of obtaining a tax benefit.

Fraud and evasion cases will continue to have an unlimited period for amendment, as almost all respondents to the discussion paper acknowledged that people who engage in calculated behaviour to evade tax should remain permanently at risk.

Recommendation 3.3

The two year amendment period for individuals and very small businesses should exclude:

- partners in partnerships and beneficiaries or trustees of trusts where the partnership or trust has not elected into the Simplified Tax System
- taxpayers who get a tax benefit from a scheme entered into or carried out with the dominant purpose that they (or someone else) get a tax benefit.

The two year amendment period may also exclude other high risk cases by regulation.

3.2.2 Review periods for larger businesses

Audit cycle times for larger businesses are necessarily longer than discussed above. For medium to large businesses, the current four year amendment period is necessary to enable the comprehensive investigations required for taxpayers with complex affairs and to allow administrative procedures to protect taxpayers' rights.[34] Imposing a two year amendment limit for medium and large businesses, while supported by a number of submissions, would risk revenue or put unsustainable strain on the Tax Office's resources.

While the Review does not recommend a reduction in the statutory timeframe for amendments to larger businesses, steps to hasten audit conclusions and minimise the consequences of Tax Office delays are important. These have been addressed elsewhere in this report, by recommending that Tax Office delay be grounds for remission of shortfall interest (Recommendation 5.3) and that PBR applications be deemed to have been determined if the Tax Office delays finalising them (Recommendation 2.15).

3.2.3 Introducing a review period for loss and nil liability returns

Where an individual taxpayer returns a tax loss in an income year, the Tax Office currently has an unlimited period to review their affairs because the time limitations only start to run from when tax becomes due and payable. The same issue arises in other nil liability cases, for example, where the taxpayer's taxable income is below the tax-free threshold, or where the taxpayer's tax offsets reduce their tax payable to nil.

The Tax Office takes the same view for companies and superannuation funds that lodge nil liability returns, but this issue is currently being litigated.[35]

All submissions agree that there are no compelling reasons to distinguish so drastically between taxpayers who, for example, claim large deductions to reduce tax payable to a very small amount and those who do the same to reduce tax to zero. Taxpayers and practitioners have uniformly responded that it is unfair to face an effectively unlimited period of review in these circumstances.

Recommendation 3.4

From the 2004-05 income year, the period of review for loss and nil liability cases should be equivalent to the period for the Tax Office to amend assessments creating liabilities.

The deductibility of a tax loss will be determined in the year that the taxpayer has income against which to offset the loss, in accordance with normal deduction principles.

34. See footnote 30.
35. For full self assessment taxpayers (primarily companies and superannuation funds) the four year period is calculated from the date on which the assessment is deemed to be made. However, the Tax Office considers that there is no deemed assessment when a full self assessment taxpayer lodges a non-taxable return (Australian Taxation Office 2004, *Draft Taxation Determination TD 2004/D2*, Australian Taxation Office, Canberra). The Administrative Appeals Tribunal held in *BCD Technologies Pty Ltd and Commissioner of Taxation* [2004] AATA 496 that there was a deemed assessment where the company lodged a nil liability return. The Commissioner has appealed to the Federal Court.

For example, a company returned losses of $10 million in the first year, $12 million in the second year, $5 million in year three and $3 million in year four. In year five, the taxpayer returned a taxable income of $10 million after deducting $30 million for losses of previous years. During year six, the taxpayer is audited with the result that the company's first year return was incorrect and should have returned a taxable income of $8 million. Under Recommendation 3.4, the Tax Office would be unable to issue an assessment of a positive liability for year one. However, the year five assessment can be amended to deny the $10 million deduction claim for a loss in year one.

In addition, there should be transitional arrangements to ensure that nil liability returns from earlier years do not remain open to review indefinitely.

Many of the large number of nil liability returns for earlier years are loss returns. The Tax Office does not currently have complete and accurate information about taxpayers with carry forward losses (which in some cases may be quite old). Furthermore, many of these taxpayers have ceased to earn assessable income and may no longer be lodging returns. To concentrate the transitional arrangements on those taxpayers interested in finalising past years, transitional arrangements should apply to taxpayers with prior year losses who lodge a return for the 2004-05 income year, disclosing relevant loss information.

Other nil liability cases for previous years would generally be more straightforward (for example, individual taxpayers with a taxable income under the tax-free threshold) and could be finalised within four years.

Recommendation 3.5

Where a taxpayer's 2004-05 return discloses relevant loss information about any earlier loss years, the Tax Office should have six years from lodgment of that return to issue an assessment for those prior loss years. For other (non-loss) nil liability returns for years ended 30 June 2004 and earlier, the Tax Office should have until 31 October 2008 (or four years from the date of lodgment, whichever is later) to issue an assessment.

3.2.4 Adopting a shorter period for amendments relying on anti-avoidance provisions

Currently, there is a six year period for amendments to give effect to a determination under Part IVA, the general anti-avoidance provision. This is effectively a 50% extension on the standard time taxpayers are exposed to the risk of an increased assessment.

In an environment where even large and complex cases are generally able to be completed within four years, and records are usually only required to be kept for five years, a six year period is a comparatively long time. Therefore, the discussion paper suggested that the time allowed for amendments relying on anti-avoidance provisions could be reduced to the proposed normal period for larger businesses and complex cases, that is, four years. This has been strongly supported by submissions.

The Tax Office already has the power to require more information in the tax return about areas with a significant revenue risk.[36]

> Recommendation 3.6
>
> The present six year period for the Tax Office to amend using the anti-avoidance provisions should be abolished, so that a four year amendment period applies to arrangements entered into or carried out to obtain a tax benefit.

3.2.5 Replacing unlimited review periods with set periods

The law sets out over 100 instances where the Tax Office has no time limit on its power to amend. Examples include car expenses, expenditure recoupment schemes, private health insurance offsets, transfer pricing and research and development expenses.

The reasons for these unlimited periods vary. The most common reason is that the primary liability rules contain a condition that might only be satisfied (or cease to be satisfied) outside the normal amendment period. In some cases, the original reason is unclear or no longer relevant.

The Review has concluded that it is undesirable that a taxpayer who is not fraudulent or seeking to evade tax be exposed indefinitely to the possibility that their assessment will be increased to implement a particular provision.

> Recommendation 3.7
>
> Treasury should conduct a detailed review of the specific provisions with unlimited amendment periods to identify those that could have a set amendment period. Such set periods could be in line with the current general rules, or longer with good reason.
>
> This Review should identify appropriate transitional arrangements so that issues from earlier income years (for which there is currently an unlimited amendment period) become final where a finite amendment period is adopted.

36. In this respect, it is noted that, in the United States, corporate taxpayers that enter into 'reportable transactions' must (among other things) disclose details of the transactions to the Internal Revenue Service (IRS) in their annual tax return. Reportable transactions are ones identified by the IRS as tax shelter transactions or that have characteristics typically found in tax shelter transactions.

It is already apparent that some unlimited amendment periods are unnecessary. The substantiation and car expenses provisions have an unlimited amendment period although taxpayers are only required to keep the relevant records for five years.

Recommendation 3.8

The unlimited amendment periods should be abolished for the substantiation and car expenses provisions, so that the normal amendment limits apply.

3.3 Where the Tax Office fails to amend within a reasonable time of having all the material facts

Some submissions responding to the discussion paper criticised the Tax Office's handling of mass marketed investment arrangements because of the apparent delay between the Tax Office becoming aware of the details of the arrangements and taking action to amend assessments to deny deductions.

Having considered the merits of an approach that taxpayers be given a special remedy where the Tax Office has delayed unreasonably in issuing an amended assessment after it received all the relevant information,[37] the Review has concluded that recommendations under various headings adequately address that goal. With widespread shorter periods of review, a new framework for relying on Tax Office advice and a lower interest charge on tax shortfalls, the adverse consequences of any Tax Office delays have been significantly reduced. Moreover, as outlined in the discussion paper, an approach based on 'unreasonable delay' has considerable practical problems.[38]

3.4 Amendments to reduce a liability

Currently, the periods for an amendment *reducing* a taxpayer's liability mirror those for amendments *increasing* a taxpayer's liability. This approach has been supported in the past on the basis of fairness — if the Tax Office can increase a taxpayer's liability for a particular period, a taxpayer should be able to request a reduction for the same period.

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37. At pages 40-41, the discussion paper explored an approach based on the doctrine of laches.
38. An 'estoppel' approach would not fit comfortably with the long established principle that the law, rather than the Tax Office's actions, should govern the right to tax collection. (*Federal Commissioner of Taxation v Wade* [1951] HCA 66; (1951) 84 CLR 105 at 117 per Kitto J: 'No conduct on the part of the commissioner could operate as an estoppel against the operation of the Act ...') Statutory time limits already attempt to balance the merits of finality against the ideal of all taxpayers paying their correct liability. Superimposing a rule that would require the Tax Office to act within a reasonable time of having all the material facts would add significant complexity.

If there is a shorter review period for individuals and very small businesses as recommended, the question arises whether symmetrical periods should be maintained, or whether a set amendment period of four years for all amendments reducing a taxpayer's liability is preferable. Submissions were divided on this issue, with some support for each approach. The arguments are finely balanced.

The Review considered a standard four year period for all types of taxpayers because it would allow more time for them to correct their mistakes where they had overstated their liability and would promote certainty through a single rule. However, maintaining the existing formal symmetry of treatment in the law for amended assessments also had appeal from the point of view of balance and fairness. The Tax Office has advised the Review that both goals can be achieved by the Tax Office exercising its present legislative discretion to agree to a request to extend the time for an objection in circumstances where the new shorter review periods might otherwise deprive a taxpayer of a legitimate claim for a credit amendment. *Practice Statement PS LA 2003/7* outlines the Tax Office's present approach. Many late objections are currently accepted.

Recommendation 3.9

The Tax Office should generally accept a request for an extension of time to lodge an objection from individual or very small business taxpayers where the request is received within four years of the original assessment and the taxpayer has at least an arguable case for the objection to be allowed in whole or in part. However, such extensions would not usually be granted where the Commissioner is out of time to amend an assessment of an associated taxpayer to include income which was incorrectly included in the first taxpayer's assessment.

3.5 Extending pre-assessment agreements

Another way to reduce uncertainty for larger taxpayers would be to extend the Tax Office's existing pre-assessment agreements to cover a wider range of transactions or circumstances, wherever it is cost effective for both parties to do so.

Currently, taxpayers can enter into pre-assessment agreements with the Tax Office to bring greater certainty to some limited activities covered by the agreement, such as transactions relating to transfer pricing[39] and certain GST activities.[40] Other issues that might lend themselves to pre-assessment agreements include the valuation of trading stock and valuation issues under consolidation.

Recommendation 3.10

The Tax Office should extend its practice of entering into pre-assessment agreements to a wider range of transactions or circumstances, wherever it is cost effective to do so.

3.6 Earlier notification of an audit

There was widespread support for an idea canvassed in the discussion paper that the Tax Office be required to notify, at an early stage, those taxpayers it selects for further compliance activity. Taxpayers not notified would know that their assessments could only be amended in limited cases. The Tax Office would have, say, half the usual amendment period to notify a taxpayer that they will be subject to further scrutiny.

Although this idea seemed likely to increase taxpayer certainty, the Review has concluded that it has weaknesses making it unsuitable for present implementation.

A statutory notification period of this type may result in a significant loss of revenue, as the Tax Office does not currently identify all compliance risks within the time that would be allowed for notification. This is especially the case for larger businesses and complex cases. Furthermore, it could reduce the substantial number of taxpayers who self amend to increase their liabilities, as the period for amendment would be shorter for taxpayers not notified of further compliance activity.

Nevertheless, the Tax Office has advised that its goal is to make audits more current and it plans to trial a range of process improvements during the next financial year. The early notification of audit action may need to be reconsidered in future.

39. Transfer pricing agreements set out the transfer pricing methodology to be used in the future apportionment or allocation of income and deductions for income tax purposes. The benefit of these agreements is that the Tax Office will not make any adjustments to the tax liability established under the agreements provided the taxpayer has complied with the terms and conditions of the agreement.

40. GST pre-assessment agreements apply where the Tax Office is satisfied that businesses have appropriate internal controls in place to meet their full range of GST responsibilities. By obtaining an agreement with the Tax Office, businesses can reduce the risk of audits and penalties, provided they properly implement and maintain the agreed assurance processes.

Chapter 4: Penalties

This Chapter recommends changes to improve the transparency of the process of imposing penalties on taxpayers who understate a tax liability and the abolition of the separate penalty for failing to follow a Tax Office private ruling. It also recommends administrative action to clarify the standard of care required of taxpayers.

4.1 Penalties and self assessment

Penalties exist as incentives for taxpayers to comply with their various tax obligations. The penalties relevant to this Review are those that apply where, in self assessing, a taxpayer understates their liability and therefore pays less tax than they ought to. The penalties that can apply in these circumstances are known as tax shortfall penalties.

Tax shortfall penalties may apply, depending on the degree of blameworthiness or culpability on the taxpayer's part, if a taxpayer has a tax shortfall resulting from any of the following:

- making a false or misleading statement. Omitting income, over-claiming deductions or claiming deductions that are not allowable will generally fall into this category
- failing to provide a document that the Tax Office needs to work out liability
- applying an income tax law in a way that is not reasonably arguable (but only if the tax shortfall amount exceeds the greater of $10,000 or 1% of the income tax payable by the taxpayer)
- disregarding a private ruling
- entering into a tax avoidance scheme or having a transfer pricing adjustment.

These culpability penalties are different from the General Interest Charge (see Chapter 5).

The same penalty regime generally applies to all taxes administered by the Tax Office.

4.1.1 Scale and remission of culpability penalties

The amount of shortfall penalty for which a taxpayer may be liable depends on the reason for the shortfall, as set out in the following scale.

Table 4.1: Scale of shortfall penalties

Cause of shortfall	Base penalty amount (% of shortfall)
Intentional disregard of a taxation law	75
Failure to provide a document necessary for the Commissioner to work out the liability	75
Recklessness	50
Lack of reasonable care	25
Taking a position that is not reasonably arguable on a large item	25
Disregard of a private ruling	25

The starting point (or base) for determining the penalty amount is a percentage of the shortfall. This can be varied up or down according to whether the taxpayer has hindered the Tax Office in investigating the shortfall, has previously had a shortfall with a similar cause, or has made a voluntary disclosure of the shortfall. The scale works so that a taxpayer is not penalised for making a false or misleading statement if they have taken reasonable care to be truthful and accurate in making the statement.

A taxpayer cannot be penalised for a shortfall caused by relying on Tax Office advice or general administrative practice.[41]

The Tax Office can reduce penalties partly or in full. This is known formally as the Commissioner's 'power of remission'. A taxpayer can apply for remission of penalty, or the Tax Office can remit the penalty on its own initiative. The Tax Office must advise the taxpayer in writing if it decides not to remit the penalty, or decides to remit only part of it. Objection and review procedures apply to the remission decision if the amount of the penalty not remitted exceeds two penalty units (currently $220).

4.2 Issues in imposing penalties

As explained in Chapter 1, penalties are a potential consequence of uncertainty for taxpayers. Before the preparation of the discussion paper, practitioners and industry groups said that:

- The meanings of key concepts such as 'reasonable care' and 'reasonably arguable position' were not sufficiently clear.

41. Subsection 284-215(1) of Schedule 1 to the TAA.

- The penalty for failure to follow a private ruling should not apply if the taxpayer has taken reasonable care and, for a large item, has a reasonably arguable position.
- When a tax agent makes a mistake, penalties should not apply to a taxpayer who has taken reasonable care to provide correct information to the agent.
- The Tax Office ought to be more flexible in remitting penalties.

Submissions responding to the discussion paper also argued that there needs to be greater transparency about how the Tax Office determines that a penalty applies and exercises its remission powers.

These issues, along with the appropriateness of the current scale of penalties, are considered in more detail below.

4.2.1 Clarifying the meaning of reasonable care and reasonably arguable position

'Reasonable care' is not defined in the tax law and 'reasonably arguable' is only defined in general terms. The Explanatory Memorandum to the *A New Tax System (Tax Administration) Act (No. 2) 2000* (the EM) provides some explanation of these concepts and the Tax Office has issued Taxation Rulings[42] to explain their meaning. More recently, the courts have also provided guidance, for example in the recent *Walstern* case.[43]

Lack of reasonable care

The EM makes the following points about the reasonable care test:

- The test requires a taxpayer to exercise the care that a reasonable person would be likely to have exercised in the circumstances of the taxpayer (including their knowledge, education, experience and skill).
- Taxpayers must take reasonable care not only in the preparation of their tax returns, but throughout the year on matters that may impact on their tax obligations, for example, record keeping.

42. Australian Taxation Office 1994, *Taxation Rulings TR 94/4* and *TR 94/5*, Australian Taxation Office, Canberra.
43. *Walstern Pty. Ltd. v Commissioner of Taxation* [2003] FCA 1428, which considered section 226K of the ITAA36, the precursor of the current penalty for not having a reasonably arguable position.

- The reasonable care test is not intended to be overly onerous for taxpayers completing their own returns. For most taxpayers, an earnest effort to follow *TaxPack* instructions would usually be sufficient to pass the test.

- On questions of interpretation, if the taxpayer is uncertain about the correct treatment of a tax-related matter, reasonable care requires that they make reasonable enquiries to resolve the issue. Reasonable enquiry would include consulting someone or reference to a Tax Office publication to satisfy themselves about the proper tax treatment of the matter.

- Where a tax agent completes a return, the standard of care expected of the agent is much higher than the standard expected of the client.[44]

Reasonably arguable position

For large items,[45] taxpayers must not only take reasonable care, but must also adopt a reasonably arguable position. A position is reasonably arguable if it would be concluded in the circumstances, having regard to relevant authorities, that it is at least as likely to be correct as incorrect.[46]

The EM explained that '[t]he test does not require the taxpayer's position to be the "better view"; the standard is "as likely correct as incorrect", and not "more likely to be than not"'.

Similarly, in the *Walstern* case, Justice Hill said (at paragraph 108 of his judgment) that '[t]here must, in other words, be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless "about" as likely to be correct as the correct view'.

Although some submissions advocated amending the law to clarify the meaning of reasonable care and/or reasonably arguable position, the majority argued that the concepts should be clarified by Tax Office rulings and developed as necessary by court decisions.

The Tax Office has advised the Review that it is currently drafting a ruling and addenda to existing tax rulings to further clarify the application of the concepts.

Because of the infinite variety of possible cases, it would be counter-productive for the law to attempt to prescribe in detail what constitutes reasonable care or a reasonably

44. The project on the regulation of the tax profession is considering the issue of the appropriate standard of care for taxpayers and tax agents (see below at subsection 4.2.4).
45. Large items are tax shortfalls exceeding the greater of $10,000 or 1% of the income tax payable.
46. Section 284-15 of Schedule 1 to the TAA.

arguable position in given cases. The current approach of relying on general principles is sound. However, it is important that the Tax Office provides taxpayers and practitioners with clear guidance as to the standard of care expected of them.

Recommendation 4.1

The Tax Office should revise its rulings on reasonable care and reasonably arguable position, with a view to providing clearer guidance and further examples as to what conduct will, or will not, attract a penalty.

One submission drew attention to a possible technical deficiency in the definition of when a matter is 'reasonably arguable'. The definition that applied up to the 1999-2000 income year (in section 222C of the ITAA36) said that the standard required was 'about as likely to be correct as incorrect'. The current definition (in section 284-15 of Schedule 1 to the TAA) uses the words 'is as likely to be correct as incorrect, or is more likely to be correct than incorrect'. The EM said that '[a]lthough the wording has been refined, the concept has the same meaning as in section 222C'.

The Tax Office has interpreted the current definition in accordance with the legislative intention that the relevant standard is *about* as likely to be correct as incorrect (or more likely to be correct than incorrect). However, on their face, the words require a higher standard. It would be better if the law clearly reflected the policy intent.

Recommendation 4.2

The definition of when a matter is 'reasonably arguable' should be amended to confirm that the relevant standard is *about* as likely to be correct as incorrect (or more likely to be correct than incorrect) — not *as* likely to be correct as incorrect.

4.2.2 Reviewing the scale of penalties

The scale of penalties in Australia is similar to that in Canada, New Zealand, the United Kingdom (UK) and the United States (US). The UK and New Zealand both have higher maximum penalties and the US and New Zealand have a slightly lower penalty (20% of the tax shortfall) for failing to take reasonable care.

The Review notes that the Tax Office has a liberal remission practice for taxpayers who fail to take reasonable care.[47] In particular, the Tax Office generally remits the penalty where a taxpayer's overall level of compliance is sound, and in all the circumstances of the case it is clear that the taxpayer has made an honest mistake. The result is that a

47. Australian Taxation Office 2004, *Practice Statement PS LA 2004/5*, Australian Taxation Office, Canberra.

taxpayer whose liability is being adjusted for the first time and who made an honest mistake normally suffers no penalty at all (rather than a 25% penalty).

The submissions did not criticise the current scale of penalties, which was enacted as part of the generic penalties regime in 2000 and closely followed the scale that applied for income tax from 1992 to 2000.

The Review has concluded that the scale of penalties need not be adjusted.

4.2.3 Abolishing the penalty for failure to follow a private ruling

Where a person has asked the Tax Office for a private ruling and failed to follow it, resulting in a tax shortfall, a penalty applies. This approach is not followed in Canada, New Zealand, the UK or the US. The original rationale for applying this penalty was that, where the Tax Office has issued a private ruling, the taxpayer has sufficient guidance as to the law and, if they disregard it, they have no longer taken reasonable care. Rather than simply ignoring a private ruling, a taxpayer can challenge it if they disagree — either through the objection and appeal processes or by assessing in accordance with the ruling and then objecting to the assessment.

The *Review of Business Taxation* (commonly called the Ralph Review) took a different view as to the role of private rulings and therefore recommended abolishing this penalty.[48]

Responses to the discussion paper almost unanimously supported removal of the penalty. They asserted that the penalty can operate as an inappropriate disincentive to taxpayers seeking Tax Office advice and that there are otherwise adequate protections for the revenue if the penalty were abolished. For example, a taxpayer not following a private ruling could still be liable for a penalty for failing to take reasonable care or, for a large item, not having a reasonably arguable position if that is what the facts showed. Also, it would be open to the Tax Office to implement procedures to check whether a taxpayer has followed a ruling, perhaps by requiring a declaration in their tax return.

Recommendation 4.3

The penalty for a tax shortfall resulting from a failure to follow a private ruling should be abolished.

48. Commonwealth of Australia 1999, *Review of Business Taxation: A tax system redesigned*, July 1999, Commonwealth of Australia, Canberra — the Ralph Review, Recommendation 3.4.

4.2.4 Applying a 'safe harbour' for taxpayers using tax agents

Under the existing law, as before self assessment, taxpayers are responsible for errors in returns made by their tax agents. There are no penalties directly for agents, although the criminal offence provisions can apply to them.

On 6 April 1998, the then Assistant Treasurer, Senator the Hon Rod Kemp, announced that the Government had approved a new legislative framework for tax agent services. He said that:

> 'The proposals will give taxpayers who engage a tax agent a 'safe harbour' from penalties, providing they exercise reasonable care in furnishing all the relevant taxation information to their tax agent.
>
> ...
>
> There will be no sanctions against tax agents who meet a defined standard of reasonable care in the preparation of tax returns ... Instead the tax agent may be subject to a disciplinary measure.'

At the request of industry representatives, the Government deferred the implementation of that announcement. There have been recent consultations between government officials and industry representatives about giving effect to this decision, in the context of developing a framework for the regulation of tax agent services.

As these issues are well advanced through a separate process, the Review makes no recommendation in relation to them.

4.3 Issues in penalty remission

The Tax Office's power to remit shortfall penalties is theoretically unrestricted. While the law does not set out any conditions or grounds for remission, the Tax Office has published guidelines for its staff in Practice Statements, the most recent being *Practice Statement PS LA 2004/5.*

The current system of imposition matches the base amount of the penalty to the seriousness of the wrongdoing and fine-tunes that base amount for aggravating or mitigating factors. Consequently, remission of penalties should not be as prevalent as it was before self assessment, when there was a statutory 200% penalty for false or misleading statements as the starting point before remission.

Practitioners and industry representatives have submitted that the Tax Office applies penalties in a 'speeding infringement' fashion, even where it may have contributed to the taxpayer failing to meet their obligations. However, the raw quantitative evidence does not show that the Tax Office applies penalties (or fails to remit them) indiscriminately.[49]

Although the Tax Office has issued a Practice Statement on exercising its remission power, most submissions have said that the Tax Office has not provided sufficient guidance about how it will exercise the power, especially in circumstances where it applies Part IVA (the general anti-avoidance provision).

Recommendation 4.4

The Tax Office should explain more fully, for example in a ruling or Practice Statement, how it exercises the discretion to remit tax shortfall penalties, including in Part IVA cases.

If the Tax Office decides not to remit a penalty in full, the current law requires it to notify the taxpayer in writing of the remission decision,[50] but does not require reasons for the decision to be given. Submissions to the Review expressed concern that the Tax Office does not adequately explain its penalty decisions — either why the penalty applied or why the Tax Office has not remitted the penalty.

As a matter of fairness, it is important that taxpayers who are subject to a penalty understand why they have been penalised. Furthermore, the Tax Office explaining penalty decisions is consistent with the Tax Office's *Taxpayers' Charter* which says that '[y]ou can expect the Tax Office to ... explain to you the decisions we make about your tax affairs.'

Currently, when the Tax Office finalises an audit case it gives the taxpayer a full explanation of any penalties imposed. In other cases, such as omission of dividends and interest from returns, the Tax Office provides a full explanation of any penalties on request, but not as a matter of course.

49. In the 2002-03 year, for example, the Tax Office initiated debit amendments for individuals not in business (excluding tax avoidance cases) that raised total primary tax of around $160 million. Although 90% of these amendments were for omitted income, the total penalty imposed was under $9 million.
50. Subsection 298-20(2) of Schedule 1 to the TAA.

Recommendation 4.5

Where the Tax Office decides that a penalty applies and should not be remitted in full, the Tax Office should provide an explanation of why the penalty has been imposed (for example, why the taxpayer has not taken reasonable care or does not have a reasonably arguable position) and why the penalty has not been remitted in full.

One submission argued that there should be a materiality threshold for tax shortfall penalties, when compared to the taxpayer's total liability. In exercising its remission power, the Tax Office does have regard to the materiality of a tax shortfall in some circumstances. *Practice Statement PS LA 2004/5* says at paragraph 43 that:

> 'If, during an audit activity, a tax officer finds a shortfall amount that results from a lack of reasonable care but in the circumstances of the case the amount is not material, the penalty will be remitted where it is evident that the taxpayer and the tax agent (if any) have, on the whole, made a genuine attempt to comply with the taxpayer's obligations, and the taxpayer's overall level of compliance is satisfactory.'

The Tax Office has advised the Review that it intends to draft another Practice Statement to further explain what understatements of liability it regards as immaterial for tax shortfall purposes. The Review has concluded that, because of the administrative action that the Tax Office has taken (and intends to take), it is unnecessary to amend the law to include express rules about remitting where the amount of tax shortfall is immaterial.

Recommendation 4.6

The Tax Office should further explain in a ruling or Practice Statement what understatements of liability it regards as immaterial for tax shortfall purposes.

CHAPTER 5: THE GENERAL INTEREST CHARGE

This Chapter makes recommendations for change to the design of the General Interest Charge (GIC) to improve its operation in the context of self assessment. It proposes a separate interest charge, with a lower rate, for shortfall cases.

The discussion paper noted that the GIC applies a uniform rate of interest to all overdue tax, whether or not a taxpayer has acted knowingly to create the debt. Thus the GIC outcome is the same for the taxpayer who assesses correctly and leaves $100 unpaid, as the one who under assesses by $100, but pays on time.

In response to the discussion paper, some submissions argued for a lower GIC rate overall. Most, however, focussed on the GIC that accumulates prior to the shortfall being identified and the assessment amended. Many felt that, as a general rule, the Tax Office is too reluctant to remit GIC from the statutory rate, despite seemingly wide powers. This Report proposes a reduced interest rate to apply to shortfalls during the pre-amendment period, and has identified categories of circumstances where interest should be remitted below this benchmark.

5.1 How the GIC works

In formal terms, the GIC rate is determined by adding a 7% uplift factor to the 90-day bank bill rate (the 'base rate').[51] The base rate feeds through movements in the overall profile of interest rates, ensuring that the GIC retains commercial relevance. The uplift factor's role is to make the GIC rate sufficiently high to encourage the payment of tax liabilities when due, discouraging the use of tax debts as a source of business or private finance. Although the GIC is calculated by adding the uplift factor to the base rate, the uplift factor is not intended to reflect the risk premium that applies to the normal finance costs of affected taxpayers, nor to serve as a penalty for having engaged in blameworthy conduct.[52]

The nominal annual GIC rate is converted to a rate, which is compounded on a daily basis. For the quarter July to September 2004, the GIC rate is 12.51% per annum (0.03418033% per day). Allowing for daily compounding over a year, this would be

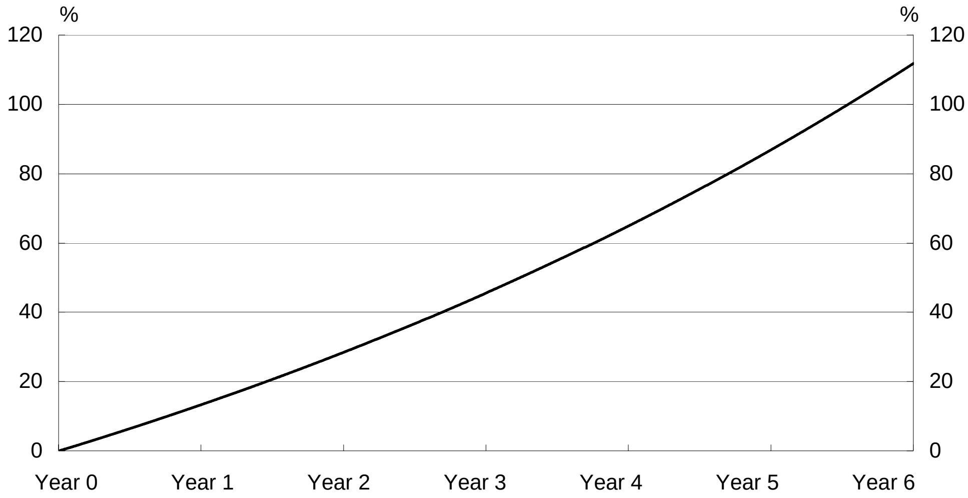
51. Section 8AAD TAA. More fully, the base interest rate is the monthly average yield of 90-day Bank Accepted Bills published by the Reserve Bank of Australia for the middle month of the preceding quarter. The uplift factor was reduced in 2001 from its original value of 8%.
52. Culpability penalties are discussed in Chapter 4.

equivalent to a simple interest rate of 13.32% per annum. That is, a $100 underpayment left to compound daily at the GIC rate would grow to $113.32 over a year.

In recent years, the GIC rate has varied between 11% and 14%.[53] For ease of discussion, this Chapter will adopt a 12.5% GIC rate unless stated otherwise.

The GIC resulting from a shortfall will escalate over time, due to the effects of compound interest. Figure 5.1 presents, as a percentage of the shortfall, the GIC that would accrue at an interest rate of 12.5%, for periods up to six years.

Figure 5.1: Accumulation of 12.5% GIC as percentage of shortfall



At a GIC rate of 12.5%, interest charges would be approximately 28% of the shortfall after two years, 65% by the end of the normal four year review period and 112% after six years.

In many (but not all) cases, these figures exaggerate the adverse impact that the GIC would have on a taxpayer, as they do not take account of the 'loan benefit' from the use of the shortfall funds. The extent to which a taxpayer receives a loan benefit that offsets the impact of shortfall GIC will depend on a range of factors.[54]

Businesses tend to carry tax deductible debt as part of their financing structure and the GIC is therefore primarily a cost of finance issue. By design, the GIC will generally

53. GIC rates can be viewed at <www.ato.gov.au/taxprofessionals/content /gic.htm>.
54. The discussion paper (pp. 60–63) illustrated these factors through a series of cameos. Key issues are the taxpayer's alternative borrowing rate, any abnormal benefit from tax deductibility and how the shortfall funds are applied.

impose a substantial premium over the rates at which healthy businesses would normally borrow, the extent of that premium varying according to the businesses' credit ratings.

With individuals and very small businesses, the impacts can vary significantly. For some, the net impact of the GIC could be favourable or negligible, while others could experience a penalty effect. The fact that many businesses incur GIC, rather than borrow commercially to clear crystallised tax debts, indicates that the GIC rate is not excessive in many instances — and may even constitute a 'soft', application-free source of finance. However, for others, rather than providing loan benefits, shortfalls can cause a cash flow crisis, or cause larger debts than a proprietor would voluntarily have allowed to accrue.

5.2 Principles for determining the proper rate for shortfall interest

The GIC was introduced in 1999 to simplify a complex array of penalties and interest charges applying to late payments and tax shortfalls.[55] In the case of shortfalls, this simplification exercise resulted in higher interest for the pre-amendment period.[56]

By design, for many affected taxpayers the GIC rate will be higher than a readily available commercial alternative. In the situation of non-payment of a known tax debt, this premium can be managed or avoided by arranging to use their alternative lower cost finance. However, in shortfall cases, taxpayers are unaware of their debts. Therefore, any differential between the GIC and their alternative borrowing rate strikes them as a penalty that has been imposed irrespective of whether the conditions for a formal culpability penalty (such as lack of reasonable care) have been triggered.[57]

Because taxpayers are not usually in a position to respond to the GIC in shortfall cases, the Review has concluded that full statutory GIC should not apply to shortfalls during the pre-amendment period. The extent to which the application of GIC to shortfalls

55. The Small Business Deregulation Task Force reported confusion among small business over how penalties were determined (Commonwealth of Australia 1996, *Time for Business: Report of the small business deregulation task force*, Commonwealth of Australia, Canberra – the Bell Report pp. 44–45). In response, the Government considered the complexity of penalty arrangements to be the major factor behind taxpayer confusion and misunderstanding, and asked the Tax Office to develop options for simplification (Commonwealth of Australia statement by the Prime Minister, the Honourable John Howard, MP 1997, *More Time for Business*, Commonwealth of Australia, Canberra).
56. Previously, income tax shortfalls were subject to Underpayment Interest, a (tax deductible) interest charge equal to the base rate plus 4%. An equivalent uplift factor applied to the interest charge (Late Payment Interest) imposed on late payments of assessed income tax — but such late payments were also subject to a (non tax deductible) Late Payment Penalty of 8% per annum.
57. Deliberate shortfalls are discussed at section 5.3.

needs modifying depends on which of three possible roles for shortfall interest charges is considered most appropriate:

- Should shortfalls attract a high interest charge to encourage taxpayers to assess correctly and avoid 'aggressive' interpretations of the law?
- Should shortfalls merely attract an interest charge sufficient to compensate the revenue for the delay in receipt of taxes?
- Should the purpose of the shortfall interest charge be to prevent a taxpayer benefiting from having made a shortfall?

5.2.1 Encouraging taxpayers to assess correctly

The discussion paper canvassed the idea that the GIC's 'incentive to pay' premium might be viewed as an 'incentive to assess correctly' in the shortfall context, irrespective of any culpability penalties that might apply. That is, the threat of the GIC (being at a high commercial rate) should encourage taxpayers to take steps to ensure they assess correctly and avoid 'aggressive' interpretations of the law. Shortfall GIC would therefore serve as a strict liability quasi-penalty in cases that fell below the 'lack of reasonable care' culpability threshold for applying penalties under the penalties regime. Respondents to the discussion paper overwhelmingly rejected such an incentive/penalty role for the GIC, viewing that function as properly the province of the penalties regime.[58]

This Review concurs with that view. An interest charge is ill suited to such a *de facto* penalty role, imposing an uncertain effect that depends significantly on factors other than the size of the shortfall and the degree of culpability. In particular, the effect of imposing a penalty interest rate on shortfalls would depend on the period taken for the shortfall to be identified and the rate at which the taxpayer would voluntarily have borrowed a similar amount. Furthermore, the perception that taxpayers are being penalised twice for the same offence, or being penalised where it was decided that no culpability penalty should apply, is undesirable.

In finding that the full GIC rate is excessive for shortfall cases, the Review also considers that capping shortfall GIC — either in proportion to the size of the shortfall or after it has accrued for a certain period — would not be a satisfactory solution. Capping would implicitly accept that a penalty effect was acceptable up to a point.[59]

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58. Some participants were, however, less concerned about applying full GIC to shortfalls that did not result from inadvertence or differing interpretation of tax law — particularly where fraud or evasion are involved (see section 5.3).
59. Capping can, however, be an appropriate tool where circumstances warrant partial remission of GIC that accrues on late payments of assessed taxes. See discussion paper at section 5.4.

The Review recognises that reducing shortfall interest charges might increase the incentives to deliberately under assess. However, this concern should be addressed through the culpability penalty regime, rather than by having a shortfall interest charge regime that implicitly assumes the worst about the cause of shortfalls.

5.2.2 Compensating the revenue for delay in tax payment

As noted in the discussion paper, a secondary function served by the GIC is to compensate government for the impact of late payments, as delays in tax receipts mean that government borrowing and interest costs are higher than otherwise need be. The base rate is generally accepted as indicating the 'time value of money' for government.

A number of submissions asked that the shortfall interest rate be set equal to the base rate (possibly with a small surcharge for administration costs), on the principle that this would put the revenue in the equivalent position to that which would have arisen from correctly assessing in the first place. However, for many taxpayers the base rate would be below — sometimes well below — their normal borrowing rate, potentially giving them significant loan benefits from having made a shortfall. This could provide an incentive for risk-taking across a wide range of high risk sectors. It should also be noted that, because of tax deductibility, the base rate would not normally compensate the revenue fully for the time value of money.[60]

5.2.3 Preventing taxpayers receiving loan benefits from shortfalls

The Review considers that, in principle, the objective of a shortfall interest charge should be to neutralise loan benefits that taxpayers might typically receive from their shortfall, so that they do not receive an advantage over those who assess correctly.

Ideally, the shortfall interest charge for a given taxpayer would be set at a level just sufficient to offset the loan benefit that the taxpayer received from the shortfall. Given that the GIC is designed to be higher than the borrowing rate for most affected taxpayers, an offsetting rate would, in most instances, be lower than the GIC. The level of that rate would also depend on whether the taxpayer normally had access to tax deductible financing.

In practice, it is not feasible to fine-tune the interest charge to the circumstances of each taxpayer. Further, it is not feasible to apply differential rates to different market segments (such as individuals, very small businesses and other businesses), because the loan benefit within segments can vary widely. Similarly, because tax deductibility is only

60. However, as noted in the discussion paper, this consideration need not preclude shortfall interest charges being at, or even below, the base rate, where there are reasons why the government should accept delay in revenue collection without full compensation (see subsection 5.4.1 of this report).

one factor affecting the impact of shortfall interest on a particular taxpayer, the Review does not recommend altering current arrangements whereby all GIC is tax deductible.

The Review therefore proposes a uniform interest charge on shortfall amounts. A consequence of having a single rate is that, in practice, some taxpayers will receive a loan benefit and some taxpayers will incur a penalty effect after paying the shortfall interest charge. Once the shortfall and related interest have been notified to the taxpayer, the GIC should operate normally at the usual rate.

Recommendation 5.1

From the 2004-05 income year, the standard interest charge applying to income tax shortfalls (that is, the tax difference between the original and amended assessment) should be lower than the GIC rate, reflecting the benchmark cost of finance for a business.

5.3 Method of implementing the lower charge

Review participants were overwhelmingly in favour of a lower shortfall interest rate being implemented through a legislative regime, rather than being subject to Tax Office discretion by implementation through remission powers.

The Review concurs with this approach. Legislating the new benchmark as a separate charge — rather than as a standardised remission of GIC — would provide better certainty and transparency for taxpayers.

Moreover, the Review was unable to identify circumstances that warrant retaining a discretion to apply the full GIC rate to shortfalls during the pre-amendment period. While several participants suggested retaining full GIC in cases of fraud and evasion, the Review considers that even these cases should be penalised under the culpability penalty regime, rather than through the uncertain impact of a high interest rate.

Recommendation 5.2

The new lower uplift factor should be implemented by a separate pre-amendment shortfall interest charge, in lieu of the GIC. GIC will continue to apply to crystallised debts from the new due date.

5.4 Issues in remitting shortfall interest

Section 8AAG of the *Taxation Administration Act 1953* provides the Tax Office with the power to remit GIC in certain circumstances. The Tax Office's remission policy is presented in Part F, Chapter 93 of its Receivables Policy.[61] However, both the Act and the Receivables Policy predominantly address GIC incurred on late payments of assessed tax, rather than remission in shortfall cases.

In interpreting how its GIC remission power should be used and requiring taxpayers to apply for remission, the Tax Office places significant emphasis on a presumption that full GIC should normally apply.

Under the current rules, if the Tax Office decides not to remit an amount of GIC in full, a taxpayer cannot use the normal objection and review provisions to obtain a review on the merits of the Tax Office's decision. However, the taxpayer can use administrative law actions to challenge whether a decision not to remit was made according to law.

5.4.1 Principles for remission from the new benchmark

Although the law ultimately places the responsibility for assessment on the taxpayer, the Review recognises that faults in the law or its administration can be a factor behind some shortfall cases. This will not be a problem where the shortfall interest charge merely offsets the loan benefit that a taxpayer received from having made a shortfall. However, even at the new, lower rate for shortfalls, there will be instances where a taxpayer will experience a penalty effect by virtue of that rate being above that at which they would knowingly have borrowed. The potential penalty effect makes it appropriate that remission of shortfall interest from the new benchmark should still be allowable.

Given that practical administration necessitates a uniform rate, the presence of a penalty effect should not, of itself, provide a basis for remission nor need it be established as a pre-requisite to remission. Rather, remission should generally require circumstances such as delay, contributory cause or fault on the part of the Tax Office or other parties that would justify the revenue bearing part of the cost of delayed receipt of taxes.[62] Where these circumstances are readily apparent, the Tax Office should initiate remission. To provide flexibility and to guard against taxpayers acting in 'bad faith', the Commissioner would retain the discretion not to remit.

Recommendation 5.3

61. Australian Taxation Office 2003, *Australian Taxation Office Receivables Policy*, Australian Taxation Office, Canberra, <http://law.ato.gov.au/atolaw/view.htm?docid=RMP/RP0001>.
62. A remission power would also give the Commissioner flexibility to remit where otherwise appropriate.

The Commissioner should have a broad discretion to remit the new shortfall interest charge, where he considers it fair and reasonable.

Without limiting the generality of the above:

- Remission should have regard to the broad intention that shortfall interest be imposed at a uniform rate, rather than being tailored to the circumstances of particular taxpayers.
- Remission should generally occur where circumstances justify the revenue bearing part of the cost of delayed receipt of taxes.

The following examples illustrate where remission in part would generally be appropriate and remission in full should be considered. None of these examples should be taken as grounds for remission unless the taxpayer has acted in good faith.

To limit the consequences of uncertainty that taxpayers face in undertaking self assessment, remission of shortfall interest should be considered where:

- the Tax Office took longer to complete an audit than could reasonably have been expected, having regard to all the facts and circumstances of the case
- even though there was no delay by the Tax Office, the complexity of issues involved resulted in an abnormal time between the commencement of the audit and the amendment of the assessment
- the Tax Office has, by advice or action, contributed to the taxpayer's error giving rise to the shortfall
- taxpayers relied on the statute law or judicial interpretation as it stood at the time, only to find that subsequent events proved they were not applicable
- taxpayers are affected by a retrospective change in legislation
- a shortfall caused negligible revenue impact. An example of this would be where joint income has been incorrectly apportioned between taxpayers with equal marginal rates. In such cases, shortfall interest should merely offset the related interest on overpayments.

Remission may also be considered to encourage taxpayers to voluntarily self amend when they become aware that they have a shortfall. This would not generally include cases where a taxpayer is merely responding to a Tax Office announcement that certain arrangements were ineffective — although the Tax Office may also offer interest incentives to settle in such cases. Similarly, specific interest rate remission policies could be adopted by the Tax Office as part of particular compliance programs.

5.4.2 Improving review and objection rights

Participants supported remission decisions being reviewable. The Review supports such a review right where the shortfall interest imposed exceeds 20% of the tax shortfall. Below this, the cost of objections and appeals would be excessive and may outweigh the potential for a penalty effect from the shortfall interest rate being above the taxpayer's borrowing rate. Reviews would be based on the considerations outlined above.

Recommendation 5.4

Where unremitted shortfall interest exceeds 20% of the tax shortfall, the taxpayer should be entitled to object to the decision not to remit. Objection decisions should be subject to review and appeal where the shortfall interest remaining after determination of the objection exceeds 20% of the tax shortfall.

To ensure taxpayers know their rights, the Tax Office should advise them how to seek remission when notifying them of a shortfall interest liability.

Recommendation 5.5

When notifying taxpayers of a shortfall interest liability, the Tax Office should advise taxpayers on how to seek remission.

To improve confidence in the objectivity of Tax Office remission decisions, the Tax Office should provide reasons for rejecting requests for remission of shortfall interest.

Recommendation 5.6

The Tax Office should provide reasons for rejecting shortfall interest remission requests.

CHAPTER 6: OTHER ISSUES

This Chapter deals with those issues raised in Chapter 6 of the discussion paper that did not neatly fall within the main themes of earlier Chapters. The Review has received a number of submissions commenting on these issues.

The discussion paper explained that one way to give taxpayers earlier finality would be for the Tax Office to undertake more pre-assessment examinations of returns, especially for taxpayers with straightforward affairs. This option received considerable support from submissions.

The Review has received advice from the Tax Office that it is exploring systems that will allow it to bring finality for a range of taxpayers with simple affairs at the time of their assessment. Moreover, other Review recommendations effectively deliver much of the outcome that was sought by this method (for example, the recommendations relating to more timely Tax Office advice and the extension of pre-assessment agreements would provide the type of early finality that was intended under this option).

Therefore, the Review has concluded that no recommendation is required at this time.

6.1 Improving taxpayer awareness of self assessment obligations

Many submissions agreed that large sections of the taxpaying community do not fully understand their responsibilities under self assessment, or the consequences of getting their returns wrong. The Tax Office has taken some steps in recent years to alert taxpayers to their responsibilities. For example, current returns show modified signature blocks to alert taxpayers to their obligations under self assessment. However, the Review concludes that more needs to be done.

Recommendation 6.1

The Tax Office should take further steps to make it clear that a notice of assessment can be reviewed and amended. These steps could include:

- changing the notice of assessment title or description to reflect that it is an assessment based on the face value of the return
- requiring tax agents to inform their clients of the applicable review periods that apply to their returns.

6.2 Dispute resolution and test cases

The discussion paper invited comment on whether an appropriate balance existed between the Tax Office and the taxpayer when it comes to formal disputation. In particular, the paper invited comment on whether sufficient alternative dispute resolution processes existed within the current governance framework, or whether additional mechanisms were needed, possibly modelled on the publicly funded taxation advocate that exists in the United States.

The majority of submissions expressed the view that, between the Tax Office's internal complaint and review mechanisms, the Tax Ombudsman, the Inspector-General of Taxation, the Small Taxation Claims Tribunal and the Board of Taxation, sufficient review mechanisms have been established in the current governance framework.

However, some submissions argued that changes were needed to the Tax Office's Test Case Litigation Program,[63] to improve its transparency and appearance of objectivity.

One of the issues raised was the use of the Program to test the efficacy of particular tax arrangements. Further issues related to the absence of clear criteria for selecting cases and, for cases where funding is rejected, concerns that the Tax Office does not generally communicate the reasons for rejection to applicants.

The Tax Office has published criteria for the Program on its website and has assured the Review that reasons are provided to applicants when applications are rejected. Funding test cases for schemes and similar arrangements may be done under the Program, where important principles are in dispute and it may be unfair to single out an individual participant and expose them to significant costs.

Recommendation 6.2

The government should request the Inspector-General of Taxation to evaluate the operation of the Tax Office's Test Case Litigation Program, with particular focus on:

- the suitability and application of the criteria used to select test cases
- the transparency of reasons given to applicants where funding is rejected.

63. The Test Case Litigation Program was established in the 1995-96 financial year to provide financial assistance to taxpayers to undertake certain litigation in relation to disputes with the Tax Office.

6.3 The Tax Office interacting with tax agents

A number of options canvassed in the discussion paper had the primary purpose of reducing compliance costs for taxpayers. These options related to:

- the review of tax agents' systems by the Tax Office
- a taxpayer's obligation to keep records and provide information to the Tax Office on request
- the appropriateness of the lodgment deadlines under the Tax Office's lodgment program.

Most of the submissions received by the Review suggested that compliance cost reductions could be achieved if the Tax Office:

- made better use of information that is available from third parties
- outlined the basis for future requests for information well before the commencement of the income year (so that businesses have sufficient time to design the most cost effective means of collecting the information).

Some submissions suggested that compliance costs could be reduced if the Tax Office consulted more with the tax profession in the development of return form stationery and issued draft stationery well before the end of the income year (so that businesses have time to put into place systems and documents to support that stationery).

Several submissions commented that significant compliance cost savings could be achieved if some of the more onerous recordkeeping obligations were streamlined, particularly in the areas of fringe benefits tax, motor vehicle log books, uniform capital allowances, substantiation, non-commercial losses, transfer pricing and capital gains tax.

In the case of the review of agents' systems, a handful of submissions suggested that compliance costs could be reduced if the Tax Office relied on the quality assurance programs deployed by an agent's professional association, rather than subjecting agents to additional Tax Office reviews.

Finally, although several submissions thought it desirable for more concessional lodgment deadlines to apply, there was no suggestion as to how this might be achieved without pushing deadlines into the following income year, an outcome that could have significant revenue ramifications.

Rather than make specific recommendations in each of these areas, the Review has concluded that suggestions on these topics should be referred to the Tax Office for their detailed consideration and appropriate action.

6.4 Examining discretions and elections

Most provisions of the law dealing with a taxpayer's liability are self operating, in that they require no decision of the Tax Office to have legal effect. However, the law also includes provisions that give the Tax Office the power to make decisions (discretions), or allow the taxpayer to make choices (elections) affecting their liability.

6.4.1 Discretions

Before the release of the discussion paper, practitioner and industry groups had expressed concern that self assessment cannot work properly where the calculation of a taxpayer's liability and lodgment of the return depends on a decision or determination by the Tax Office. Discretions are problematic because taxpayers cannot exercise the Commissioner's powers themselves and, under self assessment, the Tax Office will not normally consider the issue at the assessment stage.

A factor that reduces the uncertain impact of some discretions is that the Tax Office makes public rulings about how it will exercise certain discretions[64] and taxpayers can request private rulings on their particular circumstances.

The majority of submissions responding to the discussion paper favoured retaining some discretions, especially those that empower the Commissioner to relieve the taxpayer of the effects of not complying with every detail of specific regimes (for example, substantiation). Although the discussion paper asked that submissions identify the most important discretions to be removed or rewritten, few have been able to do so.

The Review has concluded that all remaining discretions affecting the calculation of a taxpayer's liability should be reviewed to see if they can be replaced with objective tests.

64. For example, Australian Taxation Office 1997, *Taxation Ruling TR 97/24*, Australian Taxation Office, Canberra, explains how the Tax Office exercises the discretion (in section 900-195 of the ITAA97) to grant relief where a taxpayer fails to substantiate expenses.

Recommendation 6.3

Treasury should conduct a detailed review of discretions that go to the determination of a taxpayer's liability and, wherever practical, recommend replacement tests that a taxpayer can apply at the time of lodgment.

6.4.2 Elections

Under self assessment, the Tax Office normally does not look at elections at the time of assessment. Consequently, taxpayers are not required to lodge most elections with the Tax Office — the taxpayer simply decides which provision of the income tax law is to apply in calculating a component of taxable income and keeps a record that verifies the calculation. Whether the taxpayer has made an election is evident from the taxpayer's records and the calculation of taxable income as disclosed in the tax return.

Taxpayers are generally required to make elections by a particular date, usually on or before the due date for lodgment of a return. The Tax Office can extend the date for lodgment of the return and the time for making many elections.

A small number of elections, because of their nature, must be in writing and/or lodged with the Tax Office. For example, a primary producer who elects to opt out of the averaging system must advise the Tax Office in writing so that the Tax Office, in issuing an assessment, can calculate the taxpayer's liability correctly. If an election affects the tax treatment of two or more taxpayers, usually those taxpayers must make the election jointly in writing. This prevents difficulties that might arise if taxpayers making joint elections claim to have made different elections.

Occasionally there is controversy about aspects of a particular election, such as the implications of making it, the time allowed for it, and whether the Tax Office has a power to extend that time. For example, earlier this year tax professional bodies argued that the requirements to make a valid family trust election were too inflexible. The Government responded to these concerns by announcing that it would allow family trust elections to be made at any time in relation to an earlier income year, subject to certain conditions.[65]

Submissions raised some significant law design issues about elections, most of which relate to when a taxpayer can exercise an election. One suggestion was that, in future, 'drop dead' dates should be avoided, while another proposal was that the Commissioner should have a general power to extend election times, subject to express exceptions. Other suggestions were that taxpayers should be able to make an election any time

65. Costello P (Treasurer) and Hockey J (Minister for Small Business) 2004, *Small Business Tax Simplification*, Parliament House, Canberra, 11 May 2004.

within the amendment period or that the Tax Office should have the power to accept a taxpayer's changed election where this is reasonable and appropriate.

One submission went further by suggesting a list of matters that should be taken into account in designing future elections. The matters included whether the conditions for making the election are reasonable and achievable and whether the consequences of not making an election are proportionate to any mischief involved.

The Review concludes that these issues should be considered in detail in the context of improving tax law design.

Recommendation 6.4

Treasury should conduct a review of the design of elections in the law and establish guidelines for framing those elections in the future.

CHAPTER 7: POLICY, LAW DESIGN AND ADMINISTRATION ISSUES

The development of tax policy and the resulting law design can have implications for the self assessment environment. This Chapter considers these issues.

7.1 The impact of tax design and policy processes on self assessment

Tax policy can have a major impact on the structure of the tax law, its administration and compliance costs for taxpayers. As noted in the discussion paper, tax policy balances potentially conflicting objectives including revenue collection, economic efficiency, equity and other social goals, while attempting to minimise administration and compliance costs.

In general, a smaller set of tax policies with broad application will involve fewer concepts, less law and be easier to comply with than a larger set of policies, each with narrower application. However, the latter approach allows distinctions between taxpayers and/or activities to be recognised through different tax treatments, which may be important for equity or other reasons.

Policy is rarely more complex than it needs to be to achieve its objectives — the difficult question is often the degree to which exceptions should be accommodated and measures should be targeted. As a practical matter, simplifying *policy* to reduce the costs of self assessment would often mean either the removal of established concessions, or altering their scope by adjusting means tests or entry criteria.

Tax law design is the process of turning tax policy into legislation that can be passed by the Parliament, administered by the Tax Office and complied with by taxpayers. A key design choice relevant to self assessment is the amount of detail set out in the law.

Much of the tax law remains long and complex. In 1958 Sir Robert Garran recognised the inherent complexity in the tax law:[66]

> 'When war expenditure compelled the Commonwealth to resort to direct taxation, our first Income Tax Assessment Act was a thing of beauty and simplicity that would not have shamed Wordsworth or T. S. Eliot. But a graduated income tax tempts the crafty taxpayer to all sorts of devices to reduce his assessment; and

66. Garran, Sir R 1958, *Prosper the Commonwealth*, Angus and Robertson, Sydney.

> just as in the Navy there was never-ending competition between guns and targets — armour being strengthened to stop missiles and missiles being weighted and hardened and speeded to pierce armour — so the battle of wits between taxpayer and taxation office led to all sorts of barbed-wire entanglements to keep the wily taxpayers from slipping through, till the Act became the literary monstrosity it is today.'

During the 1980s and 1990s the tax legislation set out in increasing detail how the law applied in a variety of fact situations. This was seen as desirable because taxpayers naturally want a high level of certainty as to whether and how the law will apply in their particular circumstances. While the 'detailed' approach to law does provide certainty where a taxpayer's circumstances are specifically addressed by a rule, laws designed in this way can never anticipate all the relevant circumstances for every taxpayer.

As factual circumstances vary greatly, covering a wide range of circumstances in detail is likely to result in law that is long and complicated. Complex circumstances are not easily clarified through elaboration in the law, at least not without generating legislation of inordinate length. Indeed, by introducing more boundaries between the legal concepts, potentially there is increased scope for ambiguity and uncertainty. Long and detailed law can also make it harder to find the underlying policy intent and thus increase the risk that the courts will interpret the legislation in a way unintended by Parliament. When a statute is cast in a very specific way, new circumstances can generate loopholes or inequities, requiring further specific legislation and so on.

For these reasons, there has been increasing recognition in Australia and overseas of the benefits of using high level principles, rather than black-letter approaches, to draft the tax law.[67] These principles synthesise the detail that would otherwise be set out in black-letter rules, to achieve the essential effect of the measure.

Treasury has been examining ways in which it might capitalise on the 2002 changes that brought the tax policy and the tax law design processes together within the Department.

A new design approach being developed by Treasury aims to write tax law in a series of operative rules that are principled statements about what the law is intended to do, rather than details about the mechanisms that get it there. This new approach will accommodate detailed or specific rules when required, but not as a matter of course. While not usually providing details about the cases it covers, it will provide a framework for working out how the law is to apply to each of them. Additionally, the approach will

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67. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra, recognised that the tax laws were too complex and announced that in the future the Government would endeavour to design the tax code using general principles in preference to long and detailed provisions (p. 149). See also Braithwaite, J 2003, 'Making tax law more certain: A theory', *Centre for Tax System Integrity*, Australian National University, Canberra.

impose a discipline on the development of policy that could, in itself, result in less complex policy choices.

Treasury proposes to use this principled approach for new tax measures, except where those measures simply amend existing black-letter detail structures in the law and using the new approach would require extensive rewriting of the existing law.

7.2 Consultation on tax law in Australia

In 2002, the Government undertook to carry out greater consultation in the development of tax policy and the design of the resulting law, including road testing draft legislation and related products prior to implementation. The Government's in-principle position is that consultation will be undertaken on all substantive tax legislation, except where there is commercial or market sensitivity, or revenue or tax avoidance sensitivity.[68] Treasury and the Board of Taxation carry out this consultation.

Consultation by Treasury

The type and extent of the consultation undertaken by Treasury on policy and legislative proposals depends on such issues as time constraints, the stage of the development process and the type of provision.[69]

Recent examples of consultation by Treasury include provisions for the taxation of discretionary trusts, the review of international tax arrangements legislation and many of the legislative provisions for the consolidation framework.

Treasury reports on consultations through the Board of Taxation.

Role of the Board of Taxation in consultation

The Board of Taxation is a non-statutory body established to advise the government on the development and implementation of taxation legislation and the operation of the tax system. A key objective of the Board is to ensure that there is full and effective community consultation in the design and implementation of tax legislation.

As part of this objective, the Treasurer has given the Board the role of monitoring the processes of consultation undertaken by Treasury. To assist in this role, Treasury reports

68. Costello P (Treasurer) 2002, *Reforms to community consultation processes and agency accountabilities in tax design*, Parliament House, Canberra, 2 May 2002.
69. See Commonwealth of Australia the Treasury 2004, *Consultation on Tax Design*, Commonwealth of Australia, Canberra, <http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=784>.

to the Board three times a year, detailing the consultation strategy for each substantive tax proposal and the progress of that consultation.[70]

The Board is also tasked with advising the government on improving the general integrity and functioning of the tax system and commissioning research and other studies on tax matters approved or referred to it by the Treasurer. The Treasurer has, on occasion, referred consultation on draft legislation to the Board. Recent examples include consultation on the taxation of discretionary trusts and on the workability of exposure draft legislation defining a charity.

7.2.1 Process for minor and technical policy amendments

A number of submissions raised ways to streamline the process and time for Parliament to pass minor policy changes and technical amendments to the tax law.

The Parliamentary legislative timetable is determined by Government prioritising measures to be introduced in bills. Minor or technical amendments are understandably given a lower priority over other measures that are required to protect the revenue or implement the Government's policy platform. It may not be feasible for governments to introduce bills containing only minor or technical amendments on a regular basis, without delaying the introduction of other measures. However, minor and technical amendments are generally progressed each sitting in bills containing a number of miscellaneous tax measures. These may well be non-controversial bills and may therefore undergo a less rigorous and less time consuming Parliamentary process.

New Zealand approach to developing tax policy

One example of an attempt to streamline the tax policy process comes from New Zealand. In 1993, New Zealand developed the *Generic Tax Policy Process* (GTPP) as a result of Government dissatisfaction with certain tax policy outcomes and concern regarding the process for developing tax policy, legislation and consultation. The main objectives of the GTPP are to:

- encourage earlier, explicit consideration of key policy elements and trade-offs by Ministers
- provide opportunities for substantial external input into the policy formulation process, to increase transparency and to provide for greater contestability and quality of advice at both the conceptual and detailed design stages

70. These reports are available on the Treasury website <www.treasury.gov.au>.

- clarify the responsibilities and accountabilities of participants in the process
- ensure that the performance of tax policy initiatives, as well as the process of reform, is reviewed regularly.

Formal consultation (undertaken at different levels depending on the measure) can involve the release of issues papers, discussion documents and draft legislation. In addition, the Inland Revenue Department consults regularly with stakeholders on an informal basis (including before options are put to government for consideration and released publicly).

The process of policy and legislative development in New Zealand is characterised by a relatively high degree of transparency. However, it is generally accepted that proposals subject to the GTPP will take up to two years to develop and implement. Furthermore, it is not applied to a number of measures (particularly tax avoidance measures) and there is concern that too many documents are released for public comment.

Recommendation 7.1

The Board of Taxation (in conjunction with Treasury) should review international consultation processes with a view to identifying any improvements to the Australian system, especially in respect of non-controversial minor policy or technical amendments, and report to government.

7.3 Retrospective tax laws and other design issues

Submissions have also suggested that Parliament should not pass retrospective tax laws.

At various stages Parliament has reiterated its reluctance to pass retrospective tax laws except in limited circumstances. Evidence of this can be seen in comments made by the Scrutiny of Bills Committee, the Senate Standing Orders and Parliamentary debates.

The Scrutiny of Bills Committee examines all bills which come before the Parliament. It is governed by Senate Standing Order 24 and, in particular, the five principles set out in that Order. The relevant Order provides:

> '24. (1)(a) … the Scrutiny of Bills shall be appointed to report, in respect of the clauses of bills introduced into the Senate, and in respect of Acts of the Parliament, whether such bills or Acts, by express words or otherwise: i) trespass unduly on personal rights and liberties …'

This principle has been interpreted as requiring the Committee to draw the Senate's attention to legislation that is to apply retrospectively (if passed). Usually if retrospective legislation is introduced the Committee will comment that the provisions breach the principle in the Order. However, provisions that have a beneficial effect are less likely to be commented on adversely. This principle has also been interpreted as requiring the Committee to draw attention to legislation that is expressed to operate from the day of an earlier press release foreshadowing the legislation.

Senate Standing Order 30 also addresses retrospective bills, solely in the tax context. The Order states that, where tax bills have been announced by press release more than six months before their introduction into Parliament (or publication), they will be amended to provide for a commencement date after the date of introduction (or publication). In this way, the Senate Standing Order is intended to reduce the period of retrospectivity, so that the law may commence no earlier than the time the bill was made public.

The Review concludes that the application date of measures should remain an issue to be examined and determined by Parliament on a measure-by-measure basis. While ideally, tax measures imposing new obligations should apply prospectively, retrospective start dates may be appropriate where a measure:

- corrects an 'unintended consequence' of a provision and the Tax Office or taxpayers have applied the law as intended
- addresses a tax avoidance issue
- might otherwise lead to a significant behavioural change that would create undesirable consequences, for example bringing forward or delaying the acquisition or disposal of assets.

7.4 Tax law improvement

Some submissions suggested that the Government should reactivate the Tax Law Improvement Project. That project arose out of a recommendation in 1993 by the Joint Committee of Public Accounts that a task force be established to restructure, renumber and rewrite the *Income Tax Assessment Act 1936*.[71] The first package of draft legislation developed by the project was introduced in 1995 (the *Income Tax Assessment Act 1997)*. Tax Acts introduced since 1997, have, wherever possible, been drafted in the style developed by the project.

71. Commonwealth of Australia Joint Committee of Public Accounts 1993, *An Assessment of Tax, Report 326*, 1993, Commonwealth of Australia, Canberra.

As the project was designed to rewrite the tax law over a considerable time, the Australian tax system concurrently has two operating income tax assessment Acts.

In 1998, the Government released a tax reform package titled *Tax Reform: not a new tax, a new tax system* (ANTS).[72] The project was subsumed into tax reform so that drafting energies could focus on new law.

In 2003, the Board of Taxation began to scope a possible project for rationalising the ITAA36 and ITAA97. The Board's purpose is to see whether there may be relatively straightforward options for reducing the volume of tax legislation and making it easier to use for taxpayers and their advisers — both in the short-term and by providing a better platform for longer-term improvement.[73] The Government is currently awaiting advice from the Board on this issue.

7.5 Application of recommendations to other taxes

The Review was originally asked only to review aspects of the *income tax* self assessment system and, therefore, the Review has limited its recommendations to those pertaining to the income tax system and not other taxes (such as fringe benefits tax, the goods and services tax, or the various excises). However, a number of submissions have suggested that some of the recommendations should apply to all federal taxes.

For example, for the purpose of simplicity, it would be ideal if the same penalty, interest, advice and period of review regimes applied to all federal taxes, where appropriate. Where variations are necessary to suit the circumstances of particular taxes, those variations should be changes from a common base, rather than being given effect through a different system.

The penalty system for tax shortfalls is already implemented through provisions in the *Taxation Administration Act 1953* (TAA) and applies to all federal taxes.

Application of the general interest charge is also provided for in the TAA.[74] The Division that provides for it lists the circumstances in which the interest charge will apply (including application to other federal taxes beside income tax).

72. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra.
73. Commonwealth of Australia Board of Taxation 2003, *The Board of Taxation 2002-03 Annual Report*, 2003, Commonwealth of Australia, Canberra, <www.taxboard.gov.au>.
74. Part IIA, Division 1, TAA.

The rules for taxpayer protection by Tax Office advice vary across the different federal taxes. Although the TAA provides for the application of private binding rulings and public rulings under the current system, these provisions do not apply to all taxes.[75]

The periods of review applicable to income tax are provided for in the ITAA36 and therefore apply only to income tax.[76]

The Review team concludes that a more uniform application of the core provisions for each of these categories across all federal taxes should be closely examined.

> Recommendation 7.2
>
> Treasury should review the possible application of the recommendations contained in this report to all federal taxes.

7.6 The role of the administrator

In order to fulfil his role in the tax system, the Commissioner of Taxation has a general power to administer the income tax laws.[77] This power has been provided for because it is recognised that in order to administer the Australian tax system efficiently and fairly, the Commissioner must necessarily make judgments and take actions, in the interest of good management of the system, that are not necessarily spelt out in detail in the statutes.

In practice, this 'power' means that the Commissioner has the ability to make administrative decisions in a way that will give effect to the object and purpose of the legislative provision being applied, improve the smooth running of the tax laws and assist taxpayers to more easily comply with the tax law.

Several submissions asserted that the Commissioner could make more effective use of the administrative power by adopting the extra-statutory concessions (ESCs) system used in the United Kingdom (UK).

The UK Inland Revenue ESCs are relaxations of the strict interpretation of the UK's tax laws for the purposes of making administration of the tax laws easier or to provide taxpayers with relief from hardship at the margins of the tax law. For example, where a new tax law produces unintended consequences which could be resolved with a lengthy statutory remedy, the Inland Revenue can instead grant an ESC to produce the same effect, whilst avoiding the time delays and cost associated with a statutory change. ESCs

75. Part IVAAA and Part IVAA, TAA.
76. Section 170, Part IV, ITAA36.
77 Section 8 of the ITAA36: 'The Commissioner shall have the general administration of this Act'.

are published by the Inland Revenue and can be relied on by taxpayers to bind the Inland Revenue, provided they are not used for tax avoidance.

Using slightly different means, the Australian system achieves the same result. Through the binding ruling system (especially as modified by the recommendations of this review) and the general administrative power, the Tax Office may make statements of interpretation or intended compliance practice. Having made such a statement, any favourable application of the law by the Commissioner under the statement will effectively bind the Commissioner, even if his opinion is later found to be incorrect at law. All that is required is that such action be taken in good faith, in the interests of the proper administration of the system and that the position is not detrimental to taxpayers compared to the position under the law.

Moreover, the Tax Office has not requested further specific powers to facilitate its administration.

Accordingly, the Review has concluded that no further statutory provisions are required for the Commissioner to fulfil his duties as administrator of taxation laws in Australia.

7.7 Remedies for defective administration

A number of submissions raised questions about the appropriate method for compensating taxpayers who have suffered detriment caused by actions of the Tax Office.

There are a number of compensation mechanisms already available under both the common law and Commonwealth legislation[78] for detriment caused by Commonwealth agencies, including the Tax Office.

The scheme most closely aligned to ideas raised in submissions is the scheme for Compensation for Detriment caused by Defective Administration (CDDA). The CDDA provides Commonwealth agencies with a discretionary authority to compensate persons who have suffered detriment due to the 'defective' actions or inaction of such agencies, where the claimant has no legal or statutory right of redress.[79] The administration of the scheme is overseen by the Department of Finance and Administration.

Defective administration refers to any of the following:

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78. For example, the *Financial Management and Accountability Act 1997* provides for act of grace payments and waiver of debts.
79. Department of Finance and Administration 2004, *Finance Circular 2001/01,* Commonwealth of Australia, Canberra, viewed on 28 June 2004, <www.dofa.gov.au/finframework/attachment_a_to_finance_circul.htm>.

- a specific and unreasonable lapse in complying with existing administrative procedures
- an unreasonable failure to institute appropriate administrative procedures
- an unreasonable failure to give the proper advice that was within the official's power and knowledge to give (or reasonably capable of being obtained by the official)
- the provisions of advice that was, in all the circumstances, incorrect or ambiguous.

The Australian National Audit Office recently released its report, *Compensation payments and debt relief in special circumstances,*[80] in which the Department of Finance and Administration announced that it would examine the workability of the CDDA scheme.[81]

Other Commonwealth compensation mechanisms include:

- act of grace payments. These are compensation by way of special discretionary payments where there is no other viable avenue of redress available and the Minister or delegate considers the payment is appropriate because of 'special circumstances'
- release from tax liabilities in cases of serious hardship
- waiver of debts owing to the Commonwealth and postponement of the right of the Commonwealth to recover a debt in priority to another debt
- write-off of debts owing to the Commonwealth.

In addition, common law remedies of misfeasance and negligence may apply.

The Review is in favour of maintaining the current uniform systems, rather than introducing a tax specific compensation regime. In view of the Department of Finance and Administration's announcement that it will review the CDDA, the Review concludes that no specific recommendations are required at this time.

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80. Auditor-General (Australian National Audit Office) 2004, *Compensation Payments and Debt Relief in Special Circumstances*, Commonwealth of Australia, Canberra, viewed 29 June 2004, <http://www.anao.gov.au/WebSite.nsf/Publications/3A8DD195C428BCC2CA256E5F006EE481>.
81. Auditor-General (Australian National Audit Office) 2004, *Compensation Payments and Debt Relief in Special Circumstances*, Commonwealth of Australia, Canberra.

7.8 Administration of anti-avoidance provisions

Many submissions voiced concern with the lack of transparency of the administration of the general anti-avoidance provision (Part IVA). The fact that the Tax Office's view on how it considers Part IVA applies is spread across a number of products means that their approach is not easy to ascertain. This has created an impression that the provisions may be invoked arbitrarily, notwithstanding the Tax Office's processes to control the application of Part IVA, such as the Part IVA Panel. Other submissions suggested that a review should be undertaken to determine whether Part IVA is currently operating in a way that reflects the policy intent.

In order to help address the first of these concerns, Chapter 2 recommends that the Tax Office consolidate its advice on the way it interprets and administers Part IVA into a single document.[82]

In response to the latter, the Review considered whether a formal review of the operation of the provisions should be commissioned. Since release of the discussion paper, the Tax Office has announced that, in order to enhance the Part IVA Panel's consideration of particular cases, they will:[83]

- introduce arrangements to allow taxpayers the opportunity of personally presenting the facts and their position to the panel
- promulgate guidelines for taxpayers and advisers appearing before the panel
- invite the Corporate Tax Association to nominate a Panel representative.

The Review has concluded that these initiatives will go a long way to improving perceptions of fairness and transparency in the application of the general anti-avoidance provisions and that, accordingly, no formal review of Part IVA is necessary at this time.

However, there are a number of specific anti-avoidance provisions remaining in the tax law. ANTS recognised the need for a review of these provisions in order to identify which could be consolidated or removed.[84] This was supported in the *Review of Business Taxation* (the Ralph Review).[85]

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82. See Recommendation 2.10.
83. Carmody, M 2004, The art of tax administration: two years on, address by the Commissioner of Taxation to the 6th international conference on tax administration, Sydney, April 2004.
84. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra, p. 150.
85. Commonwealth of Australia 1999, *Review of Business Taxation: A tax system redesigned*, July 1999, Commonwealth of Australia, Canberra, Recommendation 6.6.

Treasury has begun reviewing the specific anti-avoidance provisions in order to determine whether they are necessary, and will report to government in due course.

7.9 Volume of the tax law

Many submissions identified the volume of income tax law as an issue. However elegantly written, well laid out or helpfully structured, the sheer volume of information in tax laws can be a barrier to their usefulness. While it is true that few taxpayers ever need to deal with more than a few provisions of the law, nevertheless those parts are scattered throughout the Acts, amongst more obscure and sometimes inoperative material.

The Board of Taxation is currently in the process of identifying the inoperative provisions in the income tax law and will report its recommendations to Government. These recommendations could potentially include repealing some inoperative provisions.

Another approach suggested is to collect the relevant operative provisions for individuals and small business into a separate Part. That is, it may be possible to place all of the material required by large numbers of taxpayers with simple affairs together in one spot. This could reduce the number of provisions these taxpayers and their advisers need to be aware of and understand in order to fulfil their obligations under self assessment.

Recommendation 7.3

Treasury should examine the possibility of reducing the volume of law that needs to be accessed by individuals and small businesses with very simple affairs.

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ABBREVIATIONS

ANTS	*A New Tax System*
CDDA	Compensation for Detriment Caused by Defective Administration
CLR	Commonwealth Law Reports
Commissioner	Commissioner of Taxation
Discussion paper	*Review of Aspects of Income Tax Self Assessment Discussion Paper*, March 2004
EM	Explanatory Memorandum
ESC	Extra-Statutory Concession
GIC	General Interest Charge
GST	Goods and Services Tax
GTPP	New Zealand Generic Tax Policy Process
IRS	Internal Revenue Service
ITAA36	*Income Tax Assessment Act 1936*
ITAA97	*Income Tax Assessment Act 1997*
Part IVA	Part IVA *Income Tax Assessment Act 1936*
PBR	Private Binding Ruling
Ralph Review	*Review of Business Taxation*
Review	Review of self assessment
SPOR	Shorter period of review
STS	Simplified Tax System
TAA	*Taxation Administration Act 1953*

Tax Office	Australian Taxation Office
UK	United Kingdom
US	United States