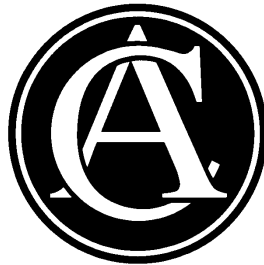


# **Submission to The Treasury**

## **Review of Aspects of Income Tax Self Assessment**



**The Institute of Chartered Accountants in Australia**

**26 May 2004**



**The Institute of  
Chartered Accountants  
in Australia**

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The Review of Self Assessment  
The Treasury  
Langton Crescent ACT 2600

Dear Sir/Madam

The Institute of Chartered Accountants is pleased to offer its submission in relation to The Treasury's Review of Aspects of Income Tax Self Assessment , in particular the discussion paper of March 2004.

Should you have any questions or require further information, please do not hesitate to contact me:

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We would also like to confirm that the attached submission may be made public.

We look forward to The Treasury's report and recommendations and would be pleased to participate in any further consultation on the matter.

Yours sincerely

Ali Noroozi  
Tax Counsel



## Introductory comments

1. The Institute of Chartered Accountants in Australia (ICAA) is the leading professional accounting organisation in Australia, representing some 40,000 members in public practice, commerce, academia, government and the investment community. The ICAA's members are advisers to businesses at all levels, from small and medium sized businesses to the largest global corporations operating in Australia and overseas.

2. The ICAA welcomes Treasury's Review of Aspects of Income Tax Self Assessment (ROSA) and offers the comments set out below in response.

3. By way of introduction, the ICAA would like to emphasise that these comments are offered in the spirit of cooperation with a view to improving the state of the tax system. They are not intended to be critical but rather an honest appraisal of the tax system as we see it. We also appreciate that the design of the self-assessment system must balance the competing interests of the taxpayer community and advisors to it, against those of the Tax Office.

4. Some of the questions raise complex issues to which there is no obvious answer and are worthy of a comprehensive submission on their own. As such it would seem desirable that there be further consultation on many of the proposals put forward in the discussion paper when the various stakeholders have had an opportunity to understand and appraise each others' perspectives.

5. Australia's tax system has undergone some significant changes in recent years as a consequence of the rapidly evolving reform environment initiated by the Government. This has presented a challenging environment for the self assessment system to operate in. It is inevitable that a system under pressure will experience weaknesses at some points. To the extent that the ICAA's submission draws attention to these weaknesses, it is done not so as to dwell on the past but with the hope that lessons might be learned going forward.

6. With the benefit of hindsight it would seem that many of the concerns with the current tax system outlined in our submission are a consequence of three key factors in combination:

- the significant quantity of complex and often retrospective legislation introduced with limited opportunity for meaningful consultation with the profession;
- a lack of skilled staff and other resources within the Tax Office; and
- the difficulties experienced in updating the Tax Office's administrative systems to accommodate the New Tax System and the volume of administrative work this has created for tax practitioners.

7. The ICAA is pleased to observe that the Tax Office's systems have significantly improved. The legislative reform process appears to now being progressed at a more manageable pace and there is more cooperation between Treasury, the Tax Office and the profession as regards consultation. Nonetheless, there are still recent examples, such as the foreign currency gain and loss (forex) measures, which it is felt would have benefited from further consultation and a greater lead-time to identify the myriad of technical and administrative issues that are becoming apparent after the legislation has taken effect.

8. There appears to be a view within the Tax Office that recent tax reforms have been "bedded down" and the emphasis should now be on enforcement. As outlined in our submission, this is not accurate – practitioners and taxpayers are still absorbing the various tax reforms introduced in recent years and are having to cope with the new measures that continue to be introduced.

9. The ICAA has grave concerns about the current level of Tax Office resourcing. There is a pressing need for improving the technical skills and quantity of staff available to provide competent guidance on how these tax reforms are applied in practice. Problems in obtaining resolution of a



myriad of interpretive issues relating to consolidation and the foreign exchange measures are examples.

10. An ongoing concern that troubles the ICAA greatly is the difficulty in achieving amendments to the existing tax laws. There is a disconcertingly large number of technical problems and gaps with the current law in need of amendment, many of which were identified and acknowledged years ago. We have been frankly informed that it could be 3+ years before the backlog of identified amendments are legislated. This problem appears only to escalate as tax reform process continues with insufficient opportunity to identify drafting issues prior to its release.

11. Finally, the ICAA observes that as a result of the significant changes to Australia's tax system coupled with changes to the broader economic environment it is becoming apparent that various aspects of the self-assessment system are in need of refinement. Many of the proposals contained in the ROSA discussion paper are forward-thinking and to be commended in this regard. As such this review is appropriate and well timed. The ICAA is pleased to be involved in the consultation process and looks forward with interest to further consultation to progress the various initiatives.



## Chapter 2 Rulings and other Tax Office advice

### 2.A. Is Tax Office advice sufficiently accessible?

12. ICAA member feedback suggests that Tax Office advice is definitely not sufficiently accessible. It is a major concern and source of frustration for tax practitioners and received one of the highest ranking in the ICAA's member survey of tax administrative "bug bears" in 2003.

#### Technical knowledge

13. The most common concern is the lack of Tax Office staff technical knowledge and as a consequence being transferred through the maze of staff to get to someone who has the necessary knowledge. A particular frustration is Tax Office staff not having the necessary breadth of knowledge about different taxes (for example income tax, GST, CGT, FBT, international tax) to be able to discuss the full range of tax issues applicable to a transaction. Practitioners are transferred between different parts of the Tax Office, with the time consuming exercise of repeatedly explaining their issue and only getting disjointed parts of the total answer each time.

14. A lack of understanding of "the real world", particularly commercial transactions and commercial practices, further exacerbates the problem as it results in misunderstandings and additional time and frustration for the practitioner in having to provide background explanations.

15. Another problem becoming increasingly apparent is difficulty in resolving tax issues arising out of the interaction of different tax measures, for example consolidation and CGT. There appears to be a lack of coordination between Tax Office Centres of Expertise, with neither taking accountability for resolving the issues.

#### Volume and organisation of material on Tax Office website

16. The Tax Office produces a very significant volume of public rulings and other material that practitioners are expected to have regard to, as the following statistics illustrate\*:

	2001	2002	2003	Year to May 2004
Taxation rulings	14	21	16	4
Draft taxation rulings	16	13	13	0
Taxation determinations	27	28	32	16
Draft taxation determinations	16	16	23	9
GST rulings	8	6	16	3
Draft GST rulings	9	11	9	1
GST determinations	2	5	3	3
Draft GST determinations	1	5	5	3
GST Bulletins	3	0	2	0
Practice statements	15	20	13	9
ATO Interpretative Decisions	805	1116	1200	435

17. These figures do not include the many withdrawals and addenda issued periodically, the large number of class rulings (333 during the same period) and product rulings (477 during the same period) which practitioners may find useful to have regard to, nor rulings and determinations on specialist



topics such as superannuation guarantee, excise, product grants and energy grants. There are also a large number of fact sheets, information booklets and other guidance material which practitioners and taxpayers may find useful when seeking assistance at a more basic level.

18. Given the sheer volume of this advice and guidance material, practitioners are very reliant on searching for this advice on the Tax Office website and unfortunately it is not always easy to locate. Subject to the comments below, rulings are not grouped by tax topic. The website search engine is very basic and the results are very dependent on what search term(s) the practitioner thought to use. The website can also be extremely slow at times and because of the separation of the main Tax Office website and ATO Legal Database, practitioners must search twice to see what other Tax Office guidance material is available.

19. The ICAA notes that the Tax Office website has a separate section for consolidation, which includes a separate listing of public rulings and ATO Interpretative Decisions relating to consolidation. We understand that this initiative is being 'rolled out' to capital gains tax as well. The ICAA has received positive feedback in relation to this initiative and suggests it be further extended to other tax topics (we note that ATO Interpretative Decisions are also grouped by topic but feedback suggests that sub-topics would be useful and that listing under more than one topic might also be appropriate).

20. In short, the process of locating relevant advice on the Tax Office website can be a time consuming and frustrating exercise and one is not always sure whether all relevant material has been located. If one considers the accessibility of publicly accessible Tax Office advice in the sense of "ease of access", then even though it exists – in great quantity - this advice cannot be regarded as sufficiently accessible.

#### Lack of timely guidance material on new measures

21. A further problem particularly prevalent in recent years is the lack of timely guidance material on the interpretation and administration of new (and often retrospective) tax measures. Examples include the Part 3-90 ITAA 1997 group consolidation provisions, with significant areas of interpretation still requiring rulings more than 2 years after the date of effect (for 'early balancers') and the Divisions 775 and 960C ITAA 1997 foreign exchange provisions, with very little guidance material available at the time of writing (mid-May 2004) for a measure which is effective from 1 July 2003.

22. In defence of the Tax Office, they are in the unenviable position of having to prepare guidance material with very limited lead-time on measures that have often yet to go through the Parliamentary process and may be changed before enactment. Furthermore, due to restricted and/or time-constrained consultation on the design of new legislation, it is often only after the final legislation is made public and practitioners "at the coal face" have an opportunity to consider how the provisions will work in practice that interpretive and administrative issues become apparent, and the Tax Office is then bombarded with urgent calls for advice on unanticipated issues.

#### Measures announced but not legislated

23. A further extension of this problem relates to taxation changes announced by the Government, again often with retrospective effect, but not yet legislated. Practitioners need guidance on how the Tax Office will interpret and apply these new measures, but the Tax Office is unable to provide guidance on announced changes that are not yet law (see practice statement PS LA 2004/6).

24. The Tax Office and professional bodies are working cooperatively regarding protocols (for example GIC and penalty implications of lodging tax returns on the basis of the announcement rather than the current law), but only on an ad hoc basis. This does not ameliorate the core uncertainty and frustration experienced by practitioners and taxpayers dealing with measures announced by not yet legislated.

#### Private binding rulings published on website

25. The ICAA notes that although edited PBRs are published on a register located on the website, access is essentially restricted to the recipient who has the PBR number. The register cannot be



searched by others with a view to seeking guidance on how the Tax Office has applied the law in a particular instance. As such the PBR register serves an integrity purpose only.

26. Despite Tax Office assurances that PBRs with any precedential value are converted into ATO Interpretative Decisions, members are nonetheless frustrated that they are denied access to this source of guidance.

**Recommendation:**

- Improve the technical competence and breadth of skills of Tax Office staff.
- Improve interactions between Tax Office Centres of Expertise.
- Improve the organisation of material on the Tax Office website
- Ensure that Tax Office staff have the necessary level of skills and experience for the type of advice they are providing.
- To the fullest extent possible, when designing new legislation allow sufficient time for consultation to assist identify and resolve issues, information needs, effective communication tools etc.
- To the fullest extent possible, increase the 'lead time' between finalisation and release of new legislation and its date of effect to enable the Tax Office (and practitioners) to be better prepared for it, particularly production of the necessary public rulings and other guidance material.

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

27. The ICAA's preference is that the Tax Office indicates whether Part IVA applies to an arrangement as a matter of course, unless the taxpayer indicates that they do not require a ruling on Part IVA.

28. A private binding ruling (PBR) will often be sought to provide certainty regarding the taxation treatment of aspects of a legitimate transaction where the potential application of Part IVA is not a concern to the taxpayer. The ICAA has concerns that in practice the additional process of ruling on Part IVA may slow down the process of issuing the PBR. As such these taxpayers may decide that they do not wish to obtain that additional certainty.

29. It is important that the Tax Office issue rulings on Part IVA without prevarication and on a timely basis (anecdotal feedback suggests there are currently problems in both regards).

**Recommendation:**

- Tax Office advice to consider Part IVA as a matter of course, unless the taxpayer indicates that they do not require this.

**2.C. Do taxpayers and their advisers currently encounter delays in obtaining Tax Office advice? If so, what strategies might allow the Tax Office to provide advice on a more timely basis?**

30. Anecdotal feedback from ICAA members indicates that they often encounter delays in obtaining Tax Office advice well in excess of the Tax Office's administrative undertaking of 28 days. Members have reported:

- Ruling requests (particularly PBR and class rulings) extending well beyond a year.



- Being effectively requested to withdraw ruling requests, the inference being that the topic was too problematic and the Tax Office unwilling to set a precedent either way.

31. This appears to be a particular concern to practitioners advising taxpayers with complex affairs and the application of new and/or complex legislation, particularly corporate restructuring where the plethora of anti-avoidance and 'integrity' measures must be considered.

32. There are examples where significant transactions have gone ahead on the basis of the considered view of advisors because the Tax Office did not issue a PBR or class ruling on a timely basis, only to have the an adverse ruling subsequently issued such that the transaction would not have been undertaken had they known the ATO's view in advance. One example is the delays in issuing a class ruling for the listed company Sipa Resources Ltd with shareholders disadvantaged as a consequence – see the company's statement to the ASX dated 22 October 2003 for details.

33. Another unfortunate example of Tax Office delays is taxpayers affected by the non-commercial losses provisions. The minutes of the National Tax Liaison Group meeting for 3 December 2003 report that the average completion time for rulings for the exercise of the Commissioner's discretion under section 35-55 ITAA 1997 was 94 days in 2002-03 and 66 days for the year to 30/10/03. In the ICAA's view these delays are indicative of both the complexity and volume of information that individuals are required to provide and also raises questions as to the efficiency of ATO processes in analysing and processing the applications

#### **Recommendation:**

- Improving Tax Office resourcing and internal processes to improve the timeliness of Tax Office advice.
- Introduce statutory time limits for the issuance of rulings, with a positive ruling in favour of the taxpayer deemed to have been issued in default should the time limit not be met.
- Investigate the merits of introducing an independent tribunal or arbitration process as a means of "fast tracking" a speedy resolution on complex matters.
- It can also be observed that an inevitable consequence of complex tax legislation is a greater need for timely advice. As such the ICAA urges Treasury and the Tax Office to ensure that when new tax measures are introduced in future, in addition to ensuring sufficient 'lead time' for both the Tax Office and practitioners to prepare for the new measure, the Tax Office is adequately resourced to issue timely advice.

## **2.D. Are there significant problems with the accuracy of Tax Office advice? If so, how should they be addressed?**

### Oral advice

34. Inaccurate Tax Office advice is a particular concern with oral advice from call centre and field staff who it would seem do not have the necessary training or experience. Most practitioners have experienced ringing up the ATO to clarify a technical or administrative matter, are given an answer to which they think "that can't possibly be correct", ring up again only to receive a completely different answer.

35. In addition to the practitioner's wasted time and, therefore, cost to the taxpayer, the verbal advice is generally not binding on the Tax Office and in the event of an audit and the Tax Office adopting a contrary position the taxpayer can suffer additional tax, GIC and potentially penalties.

36. One possible solution in this regard is for call centre staff to confirm the oral advice they have provided to a taxpayer or practitioner by email. The email should include a message explaining the extent to which the advice provided is binding on the Tax Office. The ICAA understands that call





centre staff make a record of advice provided for internal purposes, in which case forwarding such an email should not be too onerous.

#### Private binding rulings

37. ICAA members also report receiving draft PBR and class rulings with blatant technical mistakes or omissions, requiring the practitioner to effectively “rewrite” the PBR for the Tax Office prior to its finalisation. This adds to the time taken to issue the ruling, as well as the practitioner’s time and therefore cost to the taxpayer.

38. Practice statement PS LA 2001/11 sets out a procedure for periodic internal technical quality reviews of written interpretive decisions. The ICAA is not in a position to judge the effectiveness of this process, but notes that the extent of feedback from members raising concerns suggests there is room for improvement. The ICAA also notes that practice statement PS LA 1999/1 (Tax Consultants Register) anticipates the use of external consultants with specialist technical skills to assist resolve significant issues. We are unaware of the extent to which the avenue is utilised, but it would seem worth exploring greater use of the concept with a view to improving quality and timeliness of advice.

39. Ultimately inaccurate Tax Office advice erodes confidence in the tax system generally. It also builds resentment amongst practitioners who feel “I’m expected to know it all and get sued if I don’t, yet the so-called experts who enforce the law can’t get it right”.

40. Upgrading Tax Office staff skills urgently requires additional resourcing. Again, the complexity and volume of legislation introduced in recent years appears to have significantly contributed to the extent of the problem, particularly where there was minimal ‘lead-time’ and retrospective dates of effect – training staff and updating material for new tax measures is a challenge for the Tax Office as much as for tax practitioners.

#### **Recommendation:**

- Improve the technical competence and experience of Tax Office staff.
- Improve internal Tax Office review processes, but not at the expense of timeliness.
- Call centre to email the taxpayer or practitioner a record of oral advice provided as suggested above.

### **2.E. Is there evidence of pro-revenue bias in Tax Office advice? What measures would improve confidence in the objectivity of Tax Office advice? Would an independent evaluation assist?**

41. Anecdotal feedback is that there is a pro-revenue bias in the Tax Office, however this would seem inevitable given the role of the Tax Office.

42. As for how to improve confidence in the objectivity of the Tax Office, the ICAA does not have strong views on the matter. An independent evaluation process might not be practical and it would seem there is scope to improve existing measures.

#### ATO internal review processes and culture

43. It is the ICAA’s perception that the Tax Office’s internal review processes have improved and become more formalised and structured in the last few years. Practitioners can ask to have a matter escalated within the ATO hierarchy, and tax agents can raise concerns with their Relationship Manager as can large corporates with their Key Client Manager. However:

- The ICAA routinely finds members are unaware that they can initiate an internal review and it seems the process is not formal nor documented. Similarly, it seems many practitioners are unaware that they can contact their Relationship Manager to look into the issue.



- Where the practitioner anticipates ongoing interactions with the Tax Officer that the concerns relate to (eg part-way through an audit), there is a fear of “pay back” should the practitioner voice concerns and thus and a strong reluctance to “rock the boat”.

#### Public Rulings Panel

44. Although the Public Rulings Panel includes external practitioners, their role is merely to offer input and the Tax Office is not required to follow their recommendations.

45. In this regard the actual and perceived objectivity and independence of the public rulings process could be improved by giving more status to the views of external members, increasing the number of external members on the panel and perhaps making the chair of the panel an external member.

#### Legal objection & review framework

46. The existing legal framework of objection and review rights is an important measure for protecting taxpayer rights, but it has its limitations:

- It is a daunting and expensive exercise, particularly for less sophisticated advisors and taxpayers and realistically will only be utilised by taxpayers where significant amounts are involved and they are sufficiently confident of success to go through the process.
- A taxpayer is unable to have reviewed the merits of some decisions, for example, the exercise of the Commissioner’s discretion.
- An objection/review of a PBR is restricted to the information that the taxpayer provided to the Tax Office, which can disadvantage the taxpayer where it becomes apparent that additional information may have assisted their cause.

#### Inspector-General of Taxation and the Tax Ombudsman

47. These officials are also available to hear from dissatisfied taxpayers; the ICAA is not aware of any concerns amongst practitioners or taxpayers in this regard.

#### **Recommendation:**

- Improve practitioner and taxpayer awareness of the Tax Office’s internal review and escalation processes.
- An ongoing commitment from the Tax Office to improve its internal culture, emphasising objectivity, accountability and acceptance of taxpayers activating the Tax Office’s internal review and escalation processes.
- Improve and expand the scope of the objection and review legal framework. This should involve further in-depth consultation with the profession.
- Improve the independence of the Public Rulings Panel as suggested above.
- Further investigate the merits of undertaking an objective independent assessment of Tax Office responses to PBR requests to highlight ways in the process could have been improved. For example providing clearer explanations of the considerations taken into account, or by identifying other relevant tax issues which have not been directly raised by the taxpayer



## **2.F. How should Tax Office advice be framed to assist taxpayers — by explaining contending views of the law, or by setting out how the Tax Office intends to apply it? Does this impact on the way that advice is expressed?**

48. The preferred manner of presenting advice is likely to vary depending upon the level of sophistication of the taxpayer (or their advisor), the nature of the advice sought and the motivation for seeking it. Having said that, ICAA member feedback suggests that on the whole, taxpayers and practitioners would prefer advice to be framed in a comprehensive manner, discussing contending views of the law and how the Tax Office intends to apply it. This includes both public and private rulings as well as other advice provided by the Tax Office.

49. It has been observed that the Tax Office often tends to focus on the specific issue or legislative provision raised by the taxpayer. For example the taxpayer may be advised that a deduction for interest on borrowing to pay income tax is non-deductible under section 25-5(2) ITAA 1997, but not be told that a section 8-1 deduction may be available for business taxpayers in certain situations and that there is a ruling (IT 2582) on point. In this regard a more expansive discussion of the law relevant to the situation being considered is desirable.

50. Practitioners relying on public rulings for guidance on the Tax Office's interpretation of an area of the law will benefit from a comprehensive discussion where the situation they are considering is not on "all fours" with the factual situation on which they are advising. Acknowledgement in the ruling of contending views of the law will also add legitimacy to (though not necessarily an assurance) a taxpayer's position should they adopt an alternate view and maintain they have a 'reasonably arguable position'.

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

51. Further consultation on this issue with a range of taxpayers (eg individuals, SME business taxpayers) on this issue would be desirable. ICAA member suggestions include:

- A 'simple English' A4 fact sheet which sets out a matrix of the different types of advice a taxpayer might receive, circumstances in which the Tax Office is bound by it, and implications should the Tax Office subsequently take a contrary position.
- This fact sheet could be included with written advice provided to a taxpayer.
- When providing oral advice, the Tax Officer could briefly explain the extent to which it can be relied upon, explain how to find the fact sheet on the Tax Office website and offer to mail it to the taxpayer.

52. As discussed above at [2.D.], the ICAA recommends that Tax Office call centre staff providing oral advice should email a record of the advice provided to the practitioner or taxpayer, including a statement explaining the extent to which the advice is binding on the Tax Office.

## **2.H. Is there value in making more Tax Office advice legally binding? What additional safeguards would be required?**

53. As a broad principle there is definitely value in making more Tax Office advice legally binding – many believe the "TaxPack promise" should be extended for example to ATO Interpretative Decisions, fact sheets, issues registers, and material such as the Consolidation Reference Manual. There is a particularly strong case for making ATO Interpretative Decisions legally binding on the Tax Office, given they are based on PBRs and must be followed by Tax Office staff preparing advice.



54. Despite the present assurance that this material is “administratively binding” on the Tax Office, there are enough instances where the Tax Office has deviated from their stated but not legally binding position that practitioners and taxpayers are sceptical about the value of this administrative promise.

55. On a practical level, the ICAA has concerns that if more material were legally binding then the ATO might take longer to issue it, to the detriment of practitioners / taxpayers (although this could presumably be rectified by improving Tax Office resourcing). Furthermore, it is not uncommon for this material to be withdrawn or updated, which creates timing issues and the importance of the date of effect to be apparent. These concerns would need to be explored further.

**Recommendation:**

- Increase the range of advice and guidance material that is legally binding on the Tax Office, but not at the expense of timeliness.

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

This issue is discussed further below as part of question [4.B] – [4.C].

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

56. It is generally understood (and Treasury’s ROSA discussion booklet infers) that a failure to follow a PBR is commonly taken to indicate that the taxpayer has failed to take reasonable care and does not have a reasonably arguable position. Thus if a taxpayer who did not follow a PBR receives an amended assessment, they can still expect to be charged a penalty in addition to the tax shortfall and GIC and thus will want to defend their position.

57. On a more basic level, the vast majority of taxpayers are honest and do genuinely seek to comply with the law. As such, it is important that there are effective review and appeal processes by which a taxpayer can challenge a PBR that they do not agree with.

58. Accordingly, direct appeals against PBRs will remain desirable irrespective of whether a specific penalty applies for failing to follow it, presuming the alternative would be to object against the assessment(s) involving the transaction in question, which could make it a more drawn out process.

**Recommendation:**

- Retain direct appeals against PBRs.

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

59. Consultation with practitioners who specialise in tax litigation would be desirable to further explore this question.

60. ICAA member feedback suggests there would be benefit in introducing an arbitration process involving an independent panel, as would reviewing the appeal process as it applies to PBR appeals, to see if it can be made easier for the taxpayer. Cost and the time involved to resolve these disputes are of particular concern to practitioners.

61. There is a clear concern amongst practitioners that when appealing a PBR outcome the taxpayer can only rely on material provided to the Tax Office when they applied for the PBR. This can particularly disadvantage less sophisticated taxpayers with less experienced advisors who may not have presented their case effectively during the PBR application process. It also contrasts notably with the general approach of the courts to accommodate and encourage the fullest disclosure of relevant material to ensure the court is fully informed and the parties not disadvantaged.



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

62. ICAA members feedback indicates a strong lack of support for (and indeed outrage at) the proposal of being charged for Tax Office advice (particularly PBRs).

- The issuance of rulings and other advice is an inherent cost of the self-assessment system. Rulings and other advice are an essential mechanism by which taxpayers can obtain certainty that they are meeting their obligations. There have been significant savings to Tax Office from introducing the self assessment system and the cost of issuing rulings is simply a cost of operating it.
- Many practitioners feel compelled to obtain rulings due to the complexity of the law. They maintain that if the government introduces complex laws it should accept that providing taxpayers with guidance on how to comply with them is a natural consequence.
- Taxpayers will expect a timely and quality response if they are required to pay for advice and there is some scepticism as to whether the Tax Office has the ability to deliver this.
- A further concern is that paying for advice could lead to a perception of a lack of independence, ie that the payment could be seen to influence the outcome.

63. While not necessarily supporting it, it is felt there is a stronger case for charging for product rulings. However this should not extend to class rulings as these can be made on behalf of “ordinary taxpayers” genuinely seeking certainty on how the tax law applies to them, but as a class of taxpayers in the interests of efficiency.

### **Recommendation:**

- The Tax Office should not charge for advice

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

64. To properly explore this question warrants further consultation between the Tax Office, professional bodies, industry representatives and possibly consumer bodies.

65. For example, perhaps the Tax Office could work more closely with financial institutions and product suppliers such that tax guidance in literature provided by them is “cleared” by the Tax Office and amounts to binding advice. For example trust distribution statements have been improved in recent years due to closer cooperation between the Tax Office and industry bodies.

66. Increased utilisation of external expertise to assist resolve significant interpretive issues also warrants further exploration.



## Chapter 3 Review and amendment of assessments

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

67. ICAA member feedback indicates a strong support for reducing the amendment period as suggested in the ROSA discussion paper. It would also be beneficial to engage in further discussion with Treasury and the Tax Office when there is a better understanding of what alternatives are regarded as realistically feasible.

- The current criteria for “Shorter Period of Review” taxpayers is too restrictive – many “average” taxpayers do not qualify either because they wish to claim certain deductions (eg work related expenses), have a rental property or capital gains.

Often these deductions are relatively minor and so pose minimal risk to the revenue. Dealing with audits years after the event, as memories fade and records get misplaced, can also be traumatic, costly and disruptive. It is felt that these taxpayers would certainly look favourably on having their tax affairs finalised after two years.

- Similarly, it is felt there is a strong justification for ‘very small business’ having this same shorter amendment period.

68. The ICAA does have some concerns about how the amendment period might operate as regards amendments to decrease the taxpayer’s liability. These concerns are discussed further below at [3.1.].

#### Recommendation:

- Reduce the amendment period for increasing the liability to two years for individual and very small business taxpayers.

### 3.A. What exclusions from a two year period would be appropriate?

69. As a general principle the exclusions that Treasury suggests are not unreasonable in the sense of being necessary to protect the integrity of the tax system:

- Capital gains
- Partnership income and trust distributions (for what ever the amendment period of the partnership or trust is)
- Part IVA schemes
- International transactions
- Fraud and evasion (unlimited period).

70. It would also seem desirable to undertake further consultation as to whether ‘fraud and evasion’ extends to the omission of significant amounts of income.

71. However the ICAA is concerned that there are ‘mum and dad’ taxpayers, who represent only a minimal risk to the tax system, with small amounts of the proposed excluded amounts (particularly capital gains, eg from the sale of a small parcel of shares or a residential rental property). It would be unfortunate if they were not eligible for the two-year amendment period as regards the entirety of their return.



**Recommendation:**

72. For the above reasons the ICAA suggests two alternate approaches which would enable taxpayers to benefit from the two-year amendment period where the transactions in question do not pose a significant risk:

73. One approach is for the two-year amendment period to apply automatically, with provision in the return to notify the Tax Office that they had transactions within the “excluded” categories. The various questions within, and schedules to, the existing tax return forms mean that the Tax Office already receives information about these transactions. Accordingly the Tax Office has two years to decide whether to further investigate these transactions and should it do so then a longer amendment period in respect of these transactions would be triggered. Non-disclosure could amount to fraud or evasion, enabling the Tax Office to amend the return over a longer period.

74. An alternate approach is to introduce some threshold for these exclusions below which the two-year amendment period would continue to apply. Further examination of the appropriate criteria would be necessary, but could include:

- the taxpayer is below the “sophisticated investor” test threshold for Corporations Law purposes, or
- the amounts in question are below a given threshold.

75. Consultation would clearly be needed, particularly if the exclusions were only to apply where the transaction in question exceeds a given threshold. It would need to be more than a token amount to make it serve its intended purpose and warrant the additional complexity it would create, yet not introduce unacceptable integrity risk.

76. Issues regarding record retention would need to be explored to accommodate the potential situation where the Tax Office maintains that an exclusion applies but the taxpayer maintains it does not and has not maintained records beyond two years.

**3.A. Should the eligibility of a very small business be based on whether it has chosen to be a Simplified Tax System taxpayer?**

77. The STS involves a very low threshold and many taxpayers would not be eligible for the reduced amendment period. A STS taxpayer’s average turnover must be less than \$1M, which can easily be exceeded by what would objectively be regarded as a “small business” taxpayer selling goods or otherwise engaged in business activities involving high operational costs and/or low margins. This threshold will also be eroded over time with inflation.

78. A test with a higher threshold would seem more meaningful in the sense of benefiting a wider group of taxpayers who would nonetheless generally be viewed as low risk and warrant being eligible for the two-year amendment period. It is regarded as important that the eligibility criteria chosen should ideally be a test already in existence – practitioners feel there are already too many eligibility tests throughout the tax system. In this regard the CGT small business concessions test is problematic to apply, and the GST \$20m turnover threshold for monthly BAS lodgment would be preferable.

79. If the STS is to be the basis for determining a ‘very small business’, it must be taxpayers eligible to adopt the STS, not those that have actually entered it. The STS is a voluntary regime with a low ‘take up rate’ for a range of reasons and taxpayers should not be effectively forced into it where they have otherwise chosen not to enter it.

**Recommendation:**

- Eligibility be based on a test with a higher threshold, eg the GST \$20m turnover threshold for monthly BAS lodgement.



- If STS is to be the criteria, it must be taxpayers eligible for it, not just those who have entered it. There should also be a commitment to expand the threshold once 'bedded down'.

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

80. For business taxpayers particularly, in addition to the dislike of an extended period of uncertainty as to the potential for an amended assessment, there is a significant cost and disruption to operations associated with being audited years after the period in question – materials have been archived / misfiled / lost, staff with key knowledge have left, memories have faded. As such there is a very strong interest in having the amendment period for medium and large business and other complex cases reduced to (say) three years. It is also noted that there is precedent for a shorter amendment period overseas.

81. However, it is also acknowledged that with its present resourcing and processes, the Tax Office does often utilise the current four-year review period. Treasury makes some reasonable observations about the need for checks and balances to preserve the integrity of the tax system.

82. Overriding this is also a very strong desire (amongst all types of taxpayers) for simplicity. Thus if a compromise involving various exceptions or overly invasive conditions were necessary to achieve a shorter amendment period, it would be both desirable and necessary to engage in further consultation to reach an acceptable compromise.

83. We also draw attention to the Large Business Compliance Project that the LB&I section of the Tax Office, headed by Deputy Commissioner Jim Killaly, initiated in 2003. There were some very encouraging and forward-thinking ideas explored during this consultation and it would be unfortunate if these were not further progressed and appraised.

#### **Recommendation:**

- Amendment period for medium and large business to remain at four years at present.

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

84. It would seem that the Tax Office's risk management and assessment procedures are now sophisticated enough that the current six-year amendment period for Part IVA arrangements is no longer warranted or justified. An unlimited review period for fraud and evasion would seem sufficient to protect the integrity of the system beyond the general amendment period.

85. To counter this, ICAA members have raised concerns as to whether reducing the amendment period for Part IVA might lead to the Tax Office more readily raising 'ambit accusations' of Part IVA when the amendment period is about to end – there is a definite perception this is currently happening on an ad hoc basis.

#### **Recommendation:**

- Reduce the amendment period for Part IVA to that which applies to the taxpayer generally.
- There be further consultation about how taxpayers might be protected against 'ambit' Part IVA claims – for example compensating a taxpayer where a Part IVA claim is raised inappropriately and without proper basis.





### **3.C. Should taxpayers be required to disclose certain tax planning arrangements more fully in returns?**

86. Preliminary consultation with members indicates a very strong resistance to the suggestion that taxpayers be required to disclose certain tax planning arrangements more fully in return.

87. There is grave concern about how this might work in practice, particularly as regards how the arrangements would be defined. In recent times there has been a notable difference in views between the Tax Office and the professional bodies as to how 'aggressive tax planning' and a 'promoter' should be defined.

88. In addition to being viewed as invasive and inconsistent with the principle of self-assessment, there are again practical concerns about it imposing yet more of a compliance burden.

#### **Recommendation:**

- Taxpayers should not be required to disclose tax planning arrangements more fully in returns.
- Should this idea be seriously entertained, that there be further in-depth discussions to explore the legitimate concerns raised above.

### **3.D. Is there benefit in the idea of the Tax Office providing early notice to those taxpayers that it has decided to audit? What would be a suitable notification period? What exclusions from the notification regime would be appropriate? Would this idea still be beneficial if taxpayers had to disclose more information?**

89. The Tax Office already has an extensive process of giving early notice to various individual and business taxpayers that they may be audited or that they are required to provide additional warning. The Tax Office annual Compliance Program also now serves to give advance warning of the types of transactions, investments, or industries that are under scrutiny. Larger businesses have observed that they feel continually on notice due to the various compliance activities focused on that sector. As such, the ICAA perceives little benefit in formalising these processes.

90. However, members have observed that there are routinely instances where they know the taxpayer's Activity Statement or income tax return will trigger Tax Office attention due to unusual transactions resulting in, for example, a refund claim (income tax or GST). The practitioner knows at the outset that they are likely to be asked to provide further information to verify the legitimacy of the refund claim. However, there is currently no mechanism by which they can pre-empt this inquiry; instead they must wait for the Tax Office to contact them and then respond. This becomes a very drawn-out and inefficient process and also means the taxpayer's refund is withheld inappropriately with minimal if any compensation by way of interest. It would be very beneficial if taxpayers could pre-empt the inquiry at the outset.

#### **Recommendation:**

- Taxpayers already receive advance warning of Tax Office scrutiny, there is no perceived need to formalise this process.
- Introduce a procedure whereby a taxpayer can pre-empt Tax Office audit or verification attention as outlined above.



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

91. Pre-assessment agreements are viewed as a worthwhile initiative and the ICAA encourages the extension of them. Realistically, however, it is likely that they will predominantly be utilised by large business as smaller businesses are unlikely to find the benefits worth the time and cost involved.

92. Both the initial design and ongoing application of pre-assessment agreements also presumably places demands on Tax Office resources. However the ICAA would expect the Tax Office to view them as a worthwhile investment due to the additional assurance it would achieve as to the business's risk profile and insight into the business generally.

93. The ICAA expects that this initiative would be an administrative matter that Tax Office would formalise in consultation with the professional bodies and as such expresses its willingness to work with the Tax Office in this regard.

#### **Recommendation:**

- Pre-assessment agreements should be extended to a wider range of cases, subject to consultation with the professional bodies as to the topics selected and design of the processes involved.

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

94. The current distinction between a nil liability return and one involving a liability would seem a long-standing anomaly arising from legislative drafting – the ICAA is aware of no compelling rationale for retaining it.

95. Should the law be amended to rectify the situation, thought would need to be given to a possible transitional problem with work-loads being brought forward for both the Tax Office and practitioners, as nil liability returns tend to be 'pushed back' both as regards lodgment and audit programs. The ICAA does not envisage there being any longer-term resourcing implications.

#### **Recommendation:**

- That the law be amended such that taxpayers who lodge a nil liability return be subject to the amendment periods as would otherwise apply.

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

96. The ICAA is not convinced that an unlimited amendment period (except in the case of fraud or evasion) is necessary in any instance. Admittedly with the benefit of '20:20 hindsight', it would seem that the examples presently scattered through the legislation are an over-reaction to a perceived threat to the integrity of the system and perhaps the underlying policy concern could be achieved in a more balanced manner.

97. The unlimited review periods create no incentive for the Tax Office to review taxpayers affairs in relation to these issues on a timely basis, leading to inequity for the taxpayer whether or not an amendment is ultimately made.

#### **Recommendation:**

- That as a general rule of legislative drafting, unlimited amendment periods not be used in future tax bills.



- That a review be undertaken of all the provisions that currently have an unlimited amendment period and unless a sound justification can be given for them they should be removed or if felt necessary redesigned so as to achieve the underlying policy intent in a balanced manner.

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

98. The ICAA supports the underlying principle and would welcome further exploration of the proposals discussed in the ROSA discussion paper.

99. The ICAA is concerned that the Tax Office's approach to awarding compensation is still not publicly resolved. We have been closely involved in consultation with the Tax Office regarding its Compensation Guidelines dealing with how it administers existing legal and administrative bases of compensation for defective administration and negligence. These Guidelines have still not been finalised (the ICAA expressed very strong concerns about an earlier draft in 2002) and in 2003 the ICAA took the initiative of providing members with a "Compo Kit" due to concerns about the very narrow approach the Tax Office was adopting in practice.

#### **Recommendation:**

- Taxpayers should have a remedy where the Tax Office delays unreasonably in issuing an amended assessment after it has all the relevant information (and indeed in a range of other circumstances).

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

100. There are conflicting considerations in relation to this question – taxpayers broadly want to keep the tax system as simple and uncomplicated as possible, yet not at the expense of major inequities.

101. Consultation with members suggests it is broadly felt that as a general rule the two-year amendment period should apply to both increasing and decreasing amendments. However in certain circumstances there is the potential for inequity if a taxpayer is unable to amend a return to reduce their liability after two years. For example:

- There are many examples of retrospective changes in the law (both legislation and its interpretation by the courts) and of the Tax Office subsequently reversing its interpretation or administration of the law in the taxpayer's favour (eg the deductibility of sun protection items, study expenses, the King Island zone rebate).
- There can also be genuine contention about the correct interpretation of the law at the time a taxpayer lodges their return, where the Tax Office has adamantly expressed a view that is subsequently reversed by the courts – the test case program acknowledges this.
- Taxpayers can find that details they have relied upon when preparing their return contain a mistake of which they are only later notified (eg interest income/expense as advised by their bank, amounts in their group certificate, dividend statements).

102. These inequities could potentially be countered in a number of ways. For example the two-year amendment period could be the default and the taxpayer elects if they wish to be subject to an extended review period. Or the longer period could be the default and the taxpayer elects the shorter period, accepting that in doing so they also reduce their opportunity to amend.



103. A further alternative, which we suggest with some hesitation, is that the Commissioner be given a discretion to amend a taxpayer's return to decrease their liability at any time. We suggest the legislation should clearly set out the range of circumstances or considerations in which it might be exercised, to ensure that the Commissioner could not restrict the exercise of this discretion merely to 'exceptional circumstances'.

104. Another possibility where the interpretation of the law is contentious and the taxpayer has adopted the Tax Office position but 'under protest', is to allow the taxpayer to 'flag' this in the tax return such that if the issue is resolved in their favour at some later date then they can then amend their return in respect of that item.

**Recommendation:**

- The amendment period for increasing and reducing a taxpayer's liability be the same, subject to properly addressing the concerns and suggestions raised above.

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

105. As Treasury will be aware, there is currently a considerable list of outstanding problems identified with the tax law requiring amendment and due to various constraints it is understood that it may be years before these are cleared. New tax legislation is only likely to be presented to and passed by Parliament on a prompt basis where of a significant and urgent nature.

106. For this reason, the Tax Office is now working on a cooperative basis with the professional bodies to explore the use of "administrative concessions" with a view to administering the tax law in a pragmatic way to address what are effectively flaws or problems with the legislation. This is by no means the ideal solution – it is always open to the Tax Office to change its practices at a later date, and the 'solutions' can be a less than satisfactory compromise that the stakeholders can live with.

107. Accordingly, the ICAA welcomes the Tax Office's willingness to explore "administrative concessions" but views them as an interim solution only. Good tax law that is easy to comply with and administer from the outset is clearly preferable.

**Recommendation:**

- The ICAA supports the exploration of administrative solutions to the proposals raised in the course of the ROSA review.
- However to the extent that the existing law really does not allow the desired outcome, and legislative amendment is objectively necessary to achieve it, then this should be pursued. Bearing in mind the current constraints in this regard, administrative concessions should be explored, but only as a pragmatic interim solution, not as an alternative to legislative amendment.

**Additional ICAA comments - optional income tax returns for individuals**

108. The ICAA supports the concept of optional tax returns for individuals who have had all of their income subject to PAYG withholding and reporting at source (eg salary and wage earners with interest or dividend income). Those taxpayers wishing to claim deductions could chose to lodge a return. Taxpayers with assessable income not taxed at source (eg a rental property, capital gains) would be required to lodge a return.

109. More information about the ICAA's personal tax policy can be viewed on its website: <http://www.icaa.org.au/news/index.cfm?menu=297&id=A107990992>.



110. The ICAA urges Treasury to consider the proposal of optional tax returns at the same time that it considers the proposal at [3.A.] above of a two-year amendment period for individuals. Optional tax returns would simplify matters for these taxpayers yet one step further.



## Chapter 4 Penalties

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

#### Reasonably arguable position

111. From the ICAA’s perspective, it would seem that the problem lies more so in how the Tax Office interprets the concept of a “reasonably arguable position” rather than the law itself.

112. A particular conundrum arising in recent years is the large volume of guidance material now available to taxpayers on the myriad of complex laws. On the one hand, practitioners express the view that if they find an ATO Interpretative Decision that is on “all fours” with their position, that should be sufficient to say that they had a ‘reasonably arguable position’ (even if the interpretative decision is subsequently withdrawn). On the other hand, practitioners are concerned that should they inadvertently overlook an ATO Interpretative Decision that goes against their adopted position (very easy to do depending upon how ‘savvy’ one is at using the website search engine), this should not be presumed to mean that they did NOT have a reasonably arguable position.

#### Reasonable care

113. In its recent submission to the Tax Office regarding the draft Practice Statement PS LA 2004/5 (Administration of penalties under the new tax system), the ICAA raised a number of concerns about the practice statement. Regarding ‘reasonable care’, the ICAA’s submission:

- Called on the Tax Office to acknowledge there may be occasions where the Tax Office has contributed to a mistake for example incorrect or misleading oral advice from the call centre. Providing the taxpayer has the records to evidence the advice they received, the ICAA is of the view that reliance on this advice should be regarded as having taken reasonable care.
- Disagreed with the Tax Office proposition that where a shortfall amount results from a tax agent not requesting information from the client which they should have known was necessary for correct completion of the return, that this does not constitute a lack of reasonable care. This proposition does not reflect the pragmatic approach that a taxpayer and their tax agent generally adopt to “scope out” what aspects of the tax return process the client undertakes and what degree of review and scrutiny the tax agent will apply.

114. As a related comment, the ICAA observes that Australia’s taxation laws are now so voluminous and so complex that practitioners often despair that as professionals they are expected to be “all knowing”, both in terms of the higher standard expected of taxpayers who use a tax agent when the Tax Office applies penalties and also their civil law obligations vis-à-vis their taxpayer client.

115. Yet this standard is humanly impossible to achieve. It has been said “you can be either a tax expert or a tax practitioner [in the sense of running a viable accounting practice], these days you can’t be both”.

116. This complexity and uncertainty should be a factor in determining whether a taxpayer or their tax agent has taken reasonable care. The ICAA is aware of wide concern amongst practitioners that the Tax Office does appear to give due weight or consideration to the issue in practice and suggests further investigation as to whether it should be incorporated into the law.

#### **Recommendation:**

- Recognition of the complexity and uncertainty of taxation laws as a factor in determining whether reasonable care has been taken.



- The Tax Office should revisit its position as set out in PS LA 2004/5 in relation to Tax Office contributing to an incorrect position adopted by a taxpayer.

#### **4.B. What is the effect of the penalty for failing to follow a Tax Office private ruling? Do taxpayers only request PBRs when they are confident of a favourable ruling?**

117. The penalty for failing to follow a PBR means taxpayers generally only apply for a PBR if reasonably confident of receiving a favourable ruling, or have a conservative risk profile and their primary concern is certainty (particularly where the decision will influence whether a significant transaction is undertaken).

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

***[Incorporating question [2.1] Should taxpayers be penalised merely for not following PBRs when self assessing their income tax liabilities?]***

118. The ICAA accepts that fundamental to the rulings system is that the taxpayer should not be able to simply ignore an answer that they do not like. They should also have an unfettered opportunity to challenge an unfavourable PBR if they believe it is wrong. The correct balance between the taxpayer's rights in a self-assessment regime and not constraining the Tax Office in its proper administration of the system is the challenge.

119. The current 25% penalty for disregarding a PBR certainly provides an incentive for taxpayers not to do so. It can also operate harshly where the taxpayer genuinely disagreed with it and the cost of initiating a review / appeal of it is regarded as prohibitive.

120. As such the questions raised here are complex and the ICAA would like to see more widespread and detailed consultation on the following:

- Is the current penalty system, and appeal process where the taxpayer does not agree with the PBR, a suitable and appropriately balanced 'incentive' not to disregard an unfavourable PBR?
- The relative merits of replacing it with some other measure (for example a declaration in the tax return).
- Whether there are already sufficient other disincentives built into the system such that the penalty could be removed without adversely affecting the integrity of the system or requiring other changes. The ICAA queries whether taxpayers are any more likely to disregard a PBR than is currently the case and whether the current situation whereby the Tax Office will only identify that a PBR was disregarded in the event of an audit is unsatisfactory? In this regard it is noted:
  - A taxpayer can be expected to give very serious consideration to a decision not to follow a PBR, as should their treatment be challenged and ultimately reversed they can expect to pay the tax shortfall and GIC as a minimum and probably penalties on the basis on not failed to take reasonable care and not having a 'reasonably arguable position'.
  - Simply by having applied for the ruling and set out the facts of the situation, the taxpayer has effectively alerted the Tax Office as to whether a controversial matter is involved and that they pose a potential risk.
  - While the lack of penalty might mean taxpayers will seek a PBR more readily, the ICAA is sceptical it would result in a significant increase. The reality is that the cost of seeking a PBR, in terms of the taxpayers time and resources and advisor's fees, means a taxpayer will still seriously assess whether to seek one.



**Recommendation:**

- Further consultation is desirable as outlined above. If the final recommendation were to remove the penalty but introduce other changes, the ICAA would want to be sure that these changes were not overly invasive or impose an additional compliance burden. Similarly, it is important not to perpetuate the current disincentive to only apply for a PBR where confident of a favourable ruling or where certainty is essential – this is not in the interests of either taxpayers or the Tax Office.

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

121. The ICAA has raised concerns with the Tax Office regarding its penalty remission policy on a number of occasions.

122. In its recent submission regarding Practice Statement PS LA 2004/5, the ICAA emphatically repudiated the Tax Office's suggestion that the New Tax System is now "bedded down" and that, on this basis, taxpayers should be fully familiar with the workings of the tax law such that even innocent mistakes warrant no automatic entitlement to penalty remission. Not only do the early tax reform measures continue to receive amendment and be the subject of numerous public rulings, and thus still be subject to much uncertainty in areas, new tax measures (eg consolidation, taxation of financial arrangements) continue to be introduced – again with much uncertainty. The Tax Office was not receptive to the submission and did not modify the practice statement.

123. Rather than the professional bodies having to forcefully advocate on an ad hoc basis for recognition of this issue as an ongoing valid consideration with policy remission, it would be preferred if the legislation formally acknowledged it.

124. As a further observation, anecdotal feedback suggests that when negotiating a settlement in an audit situation, remission of penalties vis-à-vis remission of GIC tends to be a bargaining chip, with the high rate of the GIC and non-deductibility at times distorting remission negotiations – ie the underlying policy reasoning for remission of both penalties and GIC may be discarded in favour of agreeing on a result that both parties can live with.

125. The ICAA also endorses Treasury's comments of a 'speeding infringement' approach. It would clearly be desirable if the Tax Office staff were required to apply more considered thought to whether, on the facts before them, penalties are in fact appropriate.

126. A particular concern in this regard is the automatic application of penalties (typically 50%) following an amended assessment based on Part IVA. There is a very strong perception amongst practitioners advising a wide range of taxpayers (individuals, SME businesses through to large business) that the Tax Office applies Part IVA on a "fall back" basis and the application of Part IVA is ultimately proven to be inappropriate. The automatic application of 50% penalty in these instances is felt to be particularly harsh, given the enormous power imbalance between the Tax Office and taxpayer. As such, greater consideration to the extent to which penalties are applied when Part IVA is alleged to be an issue is desirable.

127. It would seem that all of these issues can be addressed administratively through consultation between the Tax Office and professional bodies.

**Recommendation:**

- The Tax Office commit to consultation with the professional bodies to explore the concerns and suggestions raised above.





## Chapter 5 General Interest Charge

### 5.A. Should the GIC be set at a level to provide a positive incentive to encourage taxpayers to take steps to ensure they assess correctly? Or should this be dealt with exclusively under the penalty regime?

128. ICAA member feedback suggests that:

- Most practitioners are unconcerned about the underlying philosophy for the GIC rate – if the “uplift” component were more reasonable (say 2%), the current angst to a large degree would be avoided. It would appropriately compensate the revenue for the ‘time value of money’ and would broadly reflect the cost of funds for the majority of taxpayers. To the extent that individual taxpayers may, due to personal circumstance, have a higher cost of funds, it is inappropriate to effectively penalise the majority.
- There is no need for GIC to incorporate an incentive to correctly assess one’s tax – the penalty regime and principles of remission already effectively does this. The vast majority of taxpayers “do the right thing” and do genuinely try to correctly self-assess their tax.
- As regards the suggestion that the GIC uplift component recoups the ‘cost of collection’ and compensates for credit risk, the ICAA suggests that it is inappropriate to effectively penalise those taxpayers that do pay their tax debts through higher interest charges. Rather, the Tax Office should improve the effectiveness of its collection processes.
- The current tax environment would seem to be notably different from that when the GIC policy was developed, in that the law is considerably more complex and with recent developments particularly there are many uncertainties as to how it applies. And it appears this situation is unlikely to change in the short- to medium-term. Accordingly some “tweaking” of the GIC structure in recognition of the changed circumstances would seem warranted.
- Members have emphasised that there is a significant difference between:
  - a taxpayer choosing not to pay a tax liability that they are aware exists (in which case an uplift over the GIC base rate is not inappropriate), and
  - a taxpayer genuinely attempting to comply with their (very complex and uncertain) tax obligations and either having a legitimate dispute with the Tax Office as to how the law applies or finding out years later that they made an inadvertent mistake (in which case the current uplift over the GIC base rate is excessive).

To be charged the full GIC rate in respect of an inadvertent mistake that has not been identified is felt to be unreasonable in the circumstances and the Tax Office’s restrictive approach to GIC remission in this regard makes it particularly problematic.

- A further situation noted where the high rate and compounding nature of the GIC is felt to be overly harsh relates to where the taxpayer omits to pay some or all of a known tax debt through some administrative oversight or mistake of their own (eg simply overlook paying a quarterly instalment, or a tax debt is underpaid due to a clerical error). Although the Tax Office’s system shows an outstanding debt due it doesn’t “chase up” or issue a notice regarding the amount outstanding for an extended period at which point the GIC has compounded significantly. If the taxpayer had been made aware of the outstanding amount at the beginning they would have promptly paid the debt and GIC would have been minimal. The ICAA is under the impression that this problem has occurred in the past due to shortcomings in the Tax Office’s systems and that these are being addressed.



**Recommendation:**

- That the GIC “uplift” be reduced to 2% over the base rate.
- That there be an additional component added to the GIC rate that applies where a tax debt has crystallised and the taxpayer has not paid it after the notified date, as an incentive for taxpayers to promptly pay their tax.
- There is no need for the GIC to include a component to act as an incentive to encourage correct assessment of tax – the existing penalty regime already does this.

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

129. The current GIC rate is undoubtedly excessive. As noted above the “uplift” should be reduced to 2%.

**5.C. Are the approaches identified in this Chapter suitable to address identified concerns with the GIC? If so, by what mechanism should the approaches be implemented? Are there cases where full GIC should continue to apply to shortfalls?**

130. The ICAA suggests that it is appropriate to compensate the revenue for the cost of funds forgone on an unpaid genuine tax debt, provided the period during which an amendment can be audited and amended is reasonable.

131. That is, if the GIC rate approximated the current GIC base rate and the amendment occurred within a reasonable period, as a matter of principle there is no need to cap it. The current angst regarding GIC occurs because the rate is so very high and the compounding effect over time makes it particularly inequitable.

132. If the current GIC rate were not significantly reduced (eg down to 2%), the suggestion of capping the GIC is applauded.

- “Stopping the clock” after two years is regarded as preferable to say 25% of the tax debt, given interest rates can be expected to fluctuate over time.
- Two years seems a reasonable time for a taxpayer to identify a mistake and/or for the Tax Office to have audited the taxpayer.

133. Furthermore, as indicated above it is not unreasonable for a higher rate to apply once the tax shortfall has been identified and remains unpaid.

**Recommendation:**

- Reduce the GIC to the current base rate plus 2%. Introduce a new component to apply to unpaid tax debts once the liability to pay is known.
- If the GIC rate is not reduced to this extent the suggestion of capping the GIC after 2 years should be adopted.
- The Commissioner’s discretion to remit GIC should be amended to require the Commissioner to consider whether:
  - the mistake was inadvertent and a consequence of complexity and uncertainty in the law
  - the Tax Office contributed to the mistake, for example incorrect or misleading but non-binding advice by call centre staff.



- Allow a taxpayer dissatisfied with the Commissioner's discretion to seek a review of the merits of the decision.

**5.D. What priority should be given to simplicity in considering any changes to the current GIC regime? Should different market segments be treated differently for GIC purposes? Is it feasible to move away from a single, comprehensive system?**

134. This is a vexed issue. On the one hand, different treatment for different types of taxpayers allows a more equitable result to be delivered, though also raises concerns such as how does one differentiate between an extremely wealthy individual and 'the man on the street' for example? On the other hand, to differentiate between taxpayers for GIC purposes would add to the complexity of the tax system.

**Recommendation:**

- The ICAA's preliminary suggestion is that a single comprehensive system is preferable for the sake of simplicity. However further consultation between Treasury and the professional bodies may be beneficial once more basic decisions as to the structure of the GIC have been refined.

**5.E. Should remission of the GIC be initiated by the Tax Office in more circumstances? If so, what criteria should be used?**

**Recommendation:**

- If the status quo in terms of GIC structure remains, then GIC remission should most definitely be initiated by the Tax Office in more circumstances. Furthermore, the circumstances in which the Commissioner can exercise his discretion to remit GIC as set out in section 8AAG of the Tax Administration Act 1953 should be expanded to encompass, for example, the complexity and uncertainty of the law involved and whether the Tax Office contributed to any delay or mislead the taxpayer.
- If the GIC were restructured as suggested above then GIC remission would not be such a concern. There would still be situations where a taxpayer feels that GIC remission to some greater extent is appropriate and there it would be reasonable to expect the taxpayer to initiate the request.
- Lack of consistency in how individual Tax Officers apply the current remission policy has been noted as a concern. The ICAA recommends that the Tax Office gives further consideration to addressing this.

**5.F. Should the benefit from tax deductibility of the GIC be standardised, to eliminate the impact of varying tax rates? If so, how should this be achieved?**

135. There would seem to be three conflicting considerations here – equity as between taxpayers, simplicity and theoretical concepts of economic purity.

136. In this regard the status quo has the advantage of relative simplicity and the ICAA is unaware of any concerns amongst the taxpayer community of lack of equity due to varying tax rates. As such, unless Treasury can show some other compelling reason to alter the current rules allowing deductibility of GIC, the ICAA sees no reason to change them.



**Recommendation:**

- Should Treasury have a desire to investigate this proposal further, consultation between Treasury and the professional bodies would be beneficial once more basic decisions as to the structure of the GIC have been refined.

**Additional ICAA comments regarding interest on overpayments of tax**

137. The ICAA would like to comment on the 'flip-side' of the GIC, being the payment of interest by the Tax Office to a taxpayer in respect of an overpayment of tax.

138. Without addressing the topic in any depth here, we note that members have raised concerns regarding the inequity in certain situations of the lower rate of interest that taxpayers receive, especially when contrasted against the GIC rate the taxpayer is required to pay in the event of a shortfall.

139. A particular example is where taxpayer has an amended assessment to which they object, but they take a conservative / conciliatory approach and pay the assessed tax (or perhaps 50%), even though adamant that the Tax Office position is not technically sustainable. The court confirms that the taxpayer was correct and indeed the Tax Office had no strong bounds for their position. The taxpayer will only receive interest on the overpaid tax at the base rate, an amount that will never properly compensate the taxpayer for the lost use of those funds. This is regarded as particularly inequitable where the court confirms that the Tax Office should never have contested the issue.

**Recommendation:**

- If Treasury does decide to recommend a comprehensive 'overhaul' of the GIC system, the ICAA suggests that such issues of equity regarding the rate at which the Tax Office pays interest on over payments should also be considered.



## Chapter 6 Other issues

### 6.A. Should the Tax Office undertake earlier examination of any categories of return (or specific items)? If so, what taxpayers or specific items and why?

140. The ICAA would like to hear more discussion about how this proposal would work in practice before specifically endorsing it or otherwise. From the information contained in Treasury's discussion paper it seems questionable whether the proposal offers any benefits for the taxpayer over and above the certainty they can achieve by seeking a PBR for example.

#### Recommendation:

- Further consultation between Treasury and the professional bodies should Treasury wish to further pursue this proposal.

### 6.B. What further steps would promote taxpayer awareness of their obligations under self assessment? Could, for example, notices of assessment be better labelled?

141. It would seem that a lack of awareness of obligations under self assessment is primarily a problem amongst individuals and small business. The labelling of notices, tax return material and other Tax Office information could be improved in that regard.

#### Recommendation:

- Consumer groups representing the interests of these taxpayers are probably best placed to offer more detailed suggestions.
- Explore better utilising employers as a distribution channel, for example providing a pack of 'simple English' information to new employees.

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

142. Both of these proposals are encouraging and warrant further in-depth consideration. The ICAA's preliminary thinking is that a more formal and independent alternative dispute resolution (ADR) process could be positive, in terms of a cheaper and more timely process for resolving disputes – particularly large business audits.

143. However further consultation with stakeholders would be desirable to work through a range of issues (possibly other areas of the law utilising ADR processes have addressed and accommodated these matters) such as:

- The ADR process would need to be independent of Tax Office.
- Query whether it should be restricted the to application of facts or also to questions of law?
- Presumably the outcomes would not be public, so a lack of transparency as well as lack of creation of precedents would result.

144. As for a Tax Advocate, this role would presumably benefit the "battler" and that might be its primary role. The Whitaker CGT case is an example of where a Tax Advocate would have been of valuable assistance.



#### **6.D. What is the impact of the Tax Office reviewing tax agent systems? Could these reviews be improved, and if so, how?**

145. The ICAA is aware of significant concerns repeatedly raised by tax agents about the Tax Office undertaking a range of review exercises which are not strictly audits and which are time consuming for agents and difficult to recoup from clients (and indeed dissuade new entrants to the profession). However these exercises are not generally in relation to the tax agent's systems, but rather verification and other integrity checks of the tax agent's clients or to confirm details regarding the client's registration with the Tax Office.

146. Having said that, the ICAA is of the view that all Tax Office reviews of tax agents' systems along the lines of "quality assurance reviews" should be kept to a minimum. It is the ICAA's understanding that Tax Office risk profiling and analysis allows it to deduce which tax agents that have poor systems, in the sense of being behind in meeting their lodgment program or an unacceptable proportion of returns contain mistakes etc. It is understood that one of the roles of the new Relationship Manager Program is to investigate and seek to rectify these concerns on a cooperative one-on-one basis.

#### **6.E. What particular information could the Tax Office collect more efficiently? What is the optimal balance between the Tax Office giving early warning of information requirements and the need to be able to respond to issues emerging from tax returns?**

##### Information requests to individual taxpayers during audits or other reviews

147. Members repeatedly raise concerns about the inefficient way in which the Tax Office undertakes audits and other reviews of taxpayers' affairs. It seems that information requests are excessive, unnecessarily wide and untargeted, and drawn out over a longer period of time with follow up requests for information.

148. This adds to the cost of the audit from the taxpayer's perspective. Members who are advisors to small business particularly suffer, as they invariably do not pass on the full cost of their time. As one member put it:

*"When an ATO officer can take 20 hours of our time and our client's to perform a BAS review for a three month period, when this client turns over some \$100k per annum, it becomes ludicrous. It just isn't possible without being totally ruthless and heartless to charge the client our time cost. Also note, that review achieved a net return to the ATO of some \$200... so I guess they aren't doing real well on their time recovery either on that one..."*

##### Information requested in tax returns and schedules

149. The compliance burden associated with having to provide considerable quantities of information to the Tax Office in a self-assessment environment is a cause of much resentment amongst taxpayers.

150. The professional bodies have raised concerns and sought to consult constructively with the Tax Office on various occasions but with little positive result in that the ATO advises all the information requested is necessary and effectively non-negotiable.

151. The Large Corporate Compliance Project referred to above at [3.B] did examine the issue of more efficient and effective collection of information. Certainly advance warning of information requirements is desirable, both as regards tax returns and schedules thereto, and also queries post-lodgment of the return.



152. Overlaying this, it would be highly desirable if the Tax Office undertook thorough consultation with taxpayers to enable a proper appraisal of the cost involved in the taxpayer providing the information sought.

153. There are numerous examples of data sought which business taxpayers' accounting systems cannot easily provide and the cost of manually collating it with any accuracy is prohibitive – as a consequence many taxpayers provide a rough estimate at best. The data is thus not particularly reliable, making the exercise somewhat pointless. Through improved and earlier consultation it might be possible to identify a better way of meeting the Tax Office's data needs using data more readily accessible from the taxpayer's perspective.

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

154. The ICAA notes that at a general proposition:

- Record keeping for business taxpayers is a particular problem when the tax system requirements don't match what the taxpayer would otherwise be doing for ordinary business purposes or due to other regulations. Thus for example requirements relating to CGT, UCA, debt/equity, employee travel diaries, transfer pricing, fringe benefits tax generally and reportable fringe benefits particularly are problematic.
- Individual taxpayers and small business operators may not appreciate the extent of records that they are required to keep.
- In many instances the onerous requirements are a product of the design of the legislation, in other cases due to requirements imposed by the Tax Office (transfer pricing records keeping requirements are an extreme example).

155. The issue of onerous record keeping requirements has been raised on a more specific basis by both the professional bodies and the Tax Office on numerous occasions and more detail can be provided if it would assist. The ICAA is of the view that to lessen the record keeping burden would require a genuine commitment on the part of Treasury, the Tax Office and the profession to work together to find solutions that will address the legitimate objectives and concerns of all parties.

### **Recommendation:**

- If there is a genuine commitment to investigating ways to lessen the record keeping burden as outlined above, the ICAA would be pleased to contribute and assist.

## **6.G. What specific income tax lodgement deadlines are difficult to meet? Are there other circumstances in which penalties should be remitted for late lodgement?**

156. Tax agents suffered terribly during 2000 – 2003 in terms of the impossibility of meeting tax return and activity statement lodgement deadlines, largely due to the introduction of the New Tax System and other substantial tax reforms as well as shortcomings in Tax Office administrative systems.

157. It is the perception of the ICAA that this systemic problem has largely been overcome. However many practitioners still struggle with the demands of the new regime and the compliance burden imposed by both the legislation itself and Tax Office administrative requirements. Meeting deadlines after the Christmas and Easter breaks are always a particular concern, particularly for smaller firms with less staff.



158. The Tax Office works closely with the profession in designing the lodgment program and while the compliance burden imposed by the current tax system remains, it seems that little more can be done to alleviate the problem.

159. An ongoing problematic issue on which the ICAA continues to raise with the Tax Office on behalf of its members is the matter of remission of penalties for late lodgment.

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

160. This is a problematic issue requiring further in-depth consultation between Treasury, the Tax Office and the professional bodies.

161. On the one hand, taxpayers want clear and certain law so they know where they stand. The existence of discretions is arguably contrary to a sound self assessing system. On the other hand, as has become starkly apparent in recent years, where the law is not clear and certain, where there are requirements that can operate in a harsh manner, or there are “gaps” in the law, a Commissioner’s discretion may be the only way to enable a sensible and equitable result to be achieved.

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

162. At the most basic level, the ICAA is of the view that unless required for integrity reasons, elections should not need to be lodged with the ATO. Furthermore, we propose that the Commissioner should have a general discretion to allow a taxpayer to make or lodge an election after the prescribed date, unless the provision in question specifically states that this general discretion not apply.

163. Recent experiences with Family Trust Elections and to a lesser degree the R&D Tax Offset highlight the difficulties that can arise when:

- conditions surrounding the requirements for elections to be effective are inappropriately restrictive, and
- the consequences of elections not being correctly made are out of proportion with the “mischief” involved.

164. Serious problems with elections also arise when there are delays in legislation being passed. This was exemplified by the recent rules relating to foreign currency gains and losses which had an effective date of 1 July 2003, although the relevant legislation did not receive Royal Assent until the following December. There was an opportunity for a back-dated start choice to be made but broadly speaking, only 30 days was given from Royal Assent to make the elections. A repeat of this type of situation should be avoided in the future. It does not allow sufficient time for taxpayers to make informed decisions, particularly where such elections may be irrevocable. The ICAA, however, does support the Treasury’s approach in regard to such elections in not requiring them to be physically lodged with the Tax Office.

### **Recommendation:**

- Introduce a general discretion by which the Commissioner can allow a taxpayer to make or lodge an election after the prescribed date, unless the legislation specifically states that this general discretion not apply.





- When incorporating elections into new legislation, give greater consideration to matters such as:
  - Are the conditions imposed for the making of a valid election reasonable and achievable, particularly as regards deadlines?
  - Is it necessary to lodge the election with the Tax Office, or is it sufficient that the election be made and kept on file?
  - Are the consequences of an election not being validly made proportionate to the “mischief” involved?
  - Can an equitable mechanism be incorporated to enable an election to be made “after the event” in appropriate circumstances (or introduce a broad Commissioner’s discretion as suggested above)?