

4 June 2004

Mr Paul McCullough
General Manager
Review of Self Assessment
The Treasury
Langton Crescent
PARKES ACT 2600

**Business
Coalition for
Tax
Reform**

Dear Mr McCullough

Review of Aspects of Income Tax Self Assessment Submission

The Business Coalition for Tax Reform (BCTR) is an apolitical body whose members are industry and professional associations representing all sections of the Australian economy, including small, medium and large businesses. A list of BCTR members is in Attachment 2.

The BCTR welcomes the opportunity to provide input into the Government's Review of Income Tax Self Assessment.

The BCTR congratulates the Government on taking the initiative to review such a crucial aspect of Australia's Tax System. The BCTR is interested in all aspects of Australia's tax system and methods of making it more effective and efficient minimising distortions to the economy while maintaining revenue integrity.

We are aware that many of the members of the BCTR are already providing extensive submissions to this Review. However, we feel that these issues are of such importance that we have taken this opportunity to highlight what we see as the key factors which need to be addressed.

At its highest level the income tax self assessment system shifts risk in the revenue collection system to the taxpayer. The income tax system (like goods and services tax and other Federal and States taxes) requires a self assessment system because the information upon which the tax is assessed is uniquely within the control and knowledge of the taxpayer themselves.¹ There is also a strong public policy argument for risk to reside with the private sector rather than Government. However, in the case of the current self assessment regime this risk is compounded by a system which is complex and contains both significant uncertainty and timing issues. For self assessment to operate effectively it requires that taxpayers also have the knowledge of the manner in which the income tax law applies to their particular facts. In this respect, the present system is has a number of shortcomings that this Review could usefully address.

¹ This is not the case for example in some customs duty and excise regimes where a classification and assessment can be made on the physical movement of goods.

At the broad economic level, our tax system needs to have revenue integrity and must minimise distortions to normal business practice. Uncertainty and time delays can create significant dead weight costs to the economy. These costs must be minimised wherever possible. It is our hope that this review will go a substantial way towards achieving this outcome.

From the feedback provided by our Members it is clear that there is a high level of complexity and uncertainty surrounding the operation of both the income tax laws and the associated compliance processes. This complexity and uncertainty damages the self assessment system compromising not only efficiency but also equity.

The BCTR aims to promote ten principles for Australia's taxation system. These are:

1. The tax system should be simple, transparent and should minimise uncertainty.
2. The design, administration and operation of the tax system should be undertaken with full and effective consultation with relevant stakeholders including the business community.
3. The tax system should fairly balance the need to protect the taxation revenue base with the principles of a good tax system, i.e. efficiency, fairness (horizontal and vertical equity), simplicity, clarity, certainty and low compliance costs.
4. The tax system should enhance competitiveness by providing a climate conducive to improved investment in Australia and from Australia for Australian-based entities and individuals.
5. Indirect taxation at the state and territory level should be more efficient and competitive.
6. The pattern of Federal/State financial relations should be transparent, efficient and sustainable.
7. The tax treatment for savings should be consistent with an overall savings policy that encourages the sustainability of strong, ongoing growth.
8. The tax, and social security, treatment of personal income and fringe benefits should conform to the principles of fairness, efficiency and simplicity.
9. The tax system should avoid the double taxation of business income and provide relief for all business expenses.
10. The tax system should not impede organisational restructuring.

In addition to these ten general principles, a number of which are directly relevant to a review of income tax self assessment, the BCTR submits the following specific principles upon which an effective system of self assessment should operate:

1. The income tax laws to should be sufficiently clear and certain to ensure that taxpayers are able to ascertain the extent of their obligations and comply with those obligations;
2. Parliament must enact protections for taxpayers (in the form of safe-harbours, derogations and similar mechanisms) in any case where compliance with the strict requirements of the law would be unreasonable;
3. Whatever the period of statutory limitation on the ATO amending assessments might be, sanctions be introduced if the ATO seeks to override those limitations by threat of arbitrary amendment within the statutory timeframe;
4. The legislative regime, compliance obligations and recourse to accurate and timely ATO advice should operate to facilitate taxpayers voluntary compliance with the law and the minimisation of taxpayer risk. In particular, the penalties and rulings system needs to be adapted to recognise taxpayer risk.

Thank you again for this opportunity to comment on the Review of Aspects of Income Tax Self Assessment Submission. Attached is the Submission by the BCTR covering some of the above issue in more detail. The BCTR would be happy to discuss these issues further. Freya Marsden, BCTR Secretariat, can be contacted on 03 8664 2609 to arrange a meeting.

Yours sincerely

John Stanhope
Chairman

REVIEW OF ASPECTS OF INCOME TAX SELF ASSESSMENT

BUSINESS COALITION FOR TAX REFORM SUBMISSION TO TREASURY

INTRODUCTION

The Business Coalition for Tax Reform remains committed the tax reform environment and initiatives which are a necessary part of the continued modernisation of the Australian tax system. To ensure that Australia has an internationally competitive tax system, it has been necessary to undertake significant reform including that initiated through the Ralph Review of Business Taxation, the reform of Australia's indirect tax system and the reform of Australia's international tax system. It is important for Australia's continued growth that the Australian government continue to monitor Australia's international competitiveness and undertake reform.

Given that the Australian tax environment has undergone rapid and extensive change since self assessment was introduced, it is necessary to consider some of the policy settings around the tax administration system generally, and to review whether self assessment is achieving its objectives.

BCTR considers that there are various strategic issues which require action in the course of ensuring that our self assessment system delivers on its objectives. The tax system needs to remain workable and acceptable to Australian taxpayers, without the tensions that have occurred in the last few years.

A high level of certainty for taxpayers as to their income tax position is required for a system of self assessment of taxation liability to operate effectively. Certainty is significantly diminished where law is unclear and open to multiple interpretations or where it is only partially enacted. Certainty is equally important in how the law is administered. Guidance by the Australian Taxation Office (ATO) that is unclear, contradictory, or incomplete will fundamentally reduce the certainty of the framework in which the taxpayer operates. Unfortunately a lack of certainty exists in all of these areas in the current system.

In a number of areas in our current system there are mechanisms for increasing the level of certainty for taxpayers. However, the impact of these is lessening when clarification cannot be provided in a timely manner. The commercial cost of uncertainty and risk is compounded by the cost of delay.

These three aspects, lack of:

- certainty in the law
- certainty in administration; and
- timeliness of ATO advice,

are exacerbated by the current penalty regime. The penalty system, we believe, includes the general interest charge (GIC) which goes further than the principle of the cost of borrowing. The GIC therefore acts as a pseudo penalty regime but

without many of the systems of redress. The result of these four aspects is an inequitable outcome for taxpayers.

SELF ASSESSMENT IN THE HISTORICAL CONTEXT

The Treasurer, in announcing the Review of Aspects of Income Tax Self Assessment stated that the aim of the review was to identify whether the laws achieve a fair balance between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community.

Chapter 1 of the discussion paper released in March 2004 discusses the nature of the current self assessment system and compares it with what the paper describes as the “full assessment system” it replaced. The BCTR, in making its submission, observes that the legislative changes made in 1986-87 and subsequently did not involve a substantial change, in practice, to the rights and obligations of taxpayers. Since at least the 1960’s Australia has operated a system of income tax that requires taxpayers to calculate their taxable incomes and to be subject to penalties where calculations proved to be incorrect.

Whilst there was a legislative mechanism to protect taxpayers from amendment where a full and true disclosure had been made, in practice, full and true disclosure of all material facts was the exception rather than the rule. Further, in reality, in all but a miniscule number of cases, the process of assessment within the ATO was not able to be undertaken in possession of all relevant facts.

Accordingly, the system of assessment that operated prior to the changes in 1986-87 was in fact, if not in legislative form, one of self assessment where the taxpayer was exposed to the risk of amendment and penalties in the event that the income tax return lodged was incorrect.

The main thrusts of the legislative reforms in 1986-87 were therefore threefold:

- the Commissioner was legislatively authorised in making an assessment to accept statements of assessable income, allowable deductions and rebates in the return lodged by the taxpayer;
- a taxpayer’s right to rely on the full and true disclosure to protect itself from subsequent amendment was removed; and
- where the Commissioner was required to exercise a discretion in making an assessment, the exercise of that discretion on objection against assessment was deemed to be made at the time the assessment was made.

The discussion paper indicates that the law was changed to provide a mechanism for taxpayers to seek advice when a return was lodged. In fact, this statutory device² was inserted during the passage of the Bill through Senate and, if the practice had been taken advantage of by taxpayers, would have defeated the entire object of the “self assessment” provisions.

The move to self assessment was, therefore, at least partly motivated by a strategic decision to reallocate resources from assessment to audit and investigation. This change in approach was more an acceptance of the reality that assessments were

² Refer Subsection 169A(2) of the ITAA 36.

no longer being made than a policy decision to make taxpayers more responsible for the accuracy of their income tax returns.

Just as the making of a full and true disclosure under the full assessment regime was not practical nor practised in the vast majority of cases, so too, the binding rulings regime introduced in 1992 has not afforded the taxpaying community with the degree of protection that it needs.

ISSUES AND SOLUTIONS

There are a number of areas in the design and implementation and administration of tax law which can be addressed to provide immediate benefits for commercial activity and the economy over all.

Enhancing Certainty in the Law

Although the Government has undertaken steps to address issues of 'legislation by press release' the speed in which legislation can be passed remains an issue for commercial activity. This is clearly a difficult area to address because it goes to the heart of the Government's significant legislative backlog and no guarantee that measures will be passed in parliament as they were announced or that there will not be a different technical interpretation through the drafting process.

Resolving this issue will require a range of solutions but could include:

- finding methods of fast tracking certain tax legislation through the lengthy parliamentary processes, especially technical corrections, perhaps through designated 'technical corrections' bills;
- encouraging parliament to indicate early what their position on the broad policy of the proposed tax law change will be;
- a statement from the ATO on how they will treat the issue in the interim period between announcement and before the law is taken through parliament enacted, amended or defeated.

A related issue is where legislation does not fully reflect the intended policy and requires technical correction, or where minor compliance improvements have been identified through practice. This leaves open the question of whether the taxpayer applies what is the agreed policy or the exact letter of the law, particularly where it is clear that the law will be amended. ***As suggested above we recommend that a 'technical corrections' bill be used where there are no questions of policy in order to provide more rapid certainty.***

Enhancing Certainty in Administration and Removing Time Delays

We believe that this function of the ATO appears under 'resourced'. The recent aggressive move to resource those areas of the ATO which are focused on compliance and audit has not been matched by similar resourcing of ATO officers in ensuring accurate, consistent and timely advice. This comes at a cost to commercial behaviour and therefore the economy. There needs to be a stronger focus on providing guidance to taxpayers and the examination of taxpayer affairs needs to be done in a way that is current (with consequences for the existing management). Undue delay does not provide the right incentives or results for revenue integrity or for commercial certainty. A key aspect of this is the response

times to the private binding ruling requests and the accuracy, reliability and timeliness of responses to general enquiries.

Given the general trend in the commercial world to efficiency, and timely execution rather than having issues remain unresolved for many years, taxpayers have enormous difficulties with perceived delays by the ATO in reaching decisions, and in reviewing income tax returns.

Streamline ATO Advice

In relation to ATO decision making processes, BCTR is not in a position to understand precisely the internal decision making structures and processes of the ATO but our input is as follows:

- The ATO has, understandably various quality assurance processes, and various probity and governance processes. However it does appear that these processes all delay the issue of guidance in a form which taxpayers can use. There is a need for stronger ATO processes designed to issue advice and rulings in a timely manner.
- The ATO does issue various guidance materials, reference manuals, fact sheets, tax rulings and determinations, ATO interpretive decisions, and also has its register of private binding rulings. BCTR understands this material was intended to be clearly accessible by all members of the public. Unfortunately this array of guidance material does tend to create confusion given that various “products” appear to have different status, involving a combination of:
 - legally binding material
 - administratively binding material
 - guidance material not binding

Taxpayers do not have a clear overview of the various strands of guidance materials.

BCTR believes that this series of actions, no doubt inadvertent on the part of the ATO adds to taxpayer confusion, and indeed we wonder whether it meets the objectives of the ATO itself. **BCTR recommends a streamlining of the guidance material so that taxpayers know:**

- **what is legally binding**
- **what is guidance material which is administratively binding (and we have further recommendations below)**
- **what material represents mere discussion around tax issues, which may be of benefit to taxpayers but is intended in no way to bind the ATO.**

Remove Retrospectivity

In relation to administratively binding and legally binding material, BCTR urges Treasury, Government and the ATO to provide an environment where revised ATO positions are operative on a prospective basis and not retrospectively.

BCTR recognises that a focus on prospective dates of effect might be argued by the ATO as representing a risk to the revenue. However, BCTR notes that Government operates on the basis of prospective changes in tax law except in the rarest of

cases, on the basis that retrospective taxation is anathema to public policy. In that environment, BCTR considers that:

- **The ATO, if it has a concern about particular arrangements or directions of taxpayer behaviour, should clearly announce its concerns by way of a mechanism similar to taxpayer alerts**, where the ATO puts taxpayers on notice about particular arrangements.
- Where a particular arrangement is NOT the subject of a taxpayer alert and thus taxpayers have no indication of ATO thinking, then **ATO positions ought to be prospective in their effect, or have their retrospective affect limited to the income of the last year of income**. The precise retrospective effect timetable is a matter for development in a consultative manner balancing the needs for revenue integrity and compliance costs. However BCTR emphasises that ATO changes of position on a retrospective basis, even where these are signalled in court cases and represent “the law as it was always meant to apply” do add significant compliance overlays onto the tax system and appear to us inconsistent with the policy settings of a self assessment regime.

BCTR agrees with the proposition that ATO guidance, at the small – taxpayer de-minimus level, ought to be legally binding. That is, for a particular category of taxpayer or for a particular category of tax issue, taxpayers ought not to have the risk (which is costly both for ATO and for taxpayers) of changes of position by the ATO.

The setting of the benchmark gets to the heart of who is not a sophisticated taxpayer. The benchmark might be set at a taxable income level, but turnover or gross income is a better reflection of a taxpayers 'complexity' of issues. The benchmark for the Simplified Tax System is a possibility although the STS eligibility turnover of \$1 million is already considered to be too low, so a higher turnover should be used. The CGT small business concession is too problematic to apply and ICAA suggested considering the \$20 million turnover threshold for monthly BAS lodgement.

The precise benchmark below which ATO advice should be legally binding is an issue in which BCTR can be involved. The STS threshold is attractive if the amount were lifted for this purpose.

BCTR considers that private binding rulings issued by the ATO represent, in relation to more complex areas, no more than ATO opinions. Given the environment of ongoing tax reform, ongoing change, and ongoing uncertainty:

- Private binding rulings should not have any penalty imposed in relation to failure to follow that PBR.
- If the ATO wants to know if taxpayers are not following PBRs then the ATO can develop an appropriate process to identify taxpayers which have sought and not followed PBRs. The ATO can then address the relevant action in an appropriate manner, which should not in the view of BCTR involve imposition of penalties.

BCTR recommends that the ATO should in its approach to public rulings and public guidance, transparently identify any areas where there is uncertainty or unresolved law.

BCTR does not intend this to in any way pressure Government or Treasury in relation to tax law, although BCTR does recommend some areas for improvement later in this submission.

Rather BCTR considers that the key issues are for taxpayers in a self assessment environment to have clear understanding of the tax environment in which they find themselves. That is, in a self assessment environment, where the design of the system places the primary compliance obligation onto taxpayers, it is bad public policy for taxpayers to not be aware of uncertainty in the law, and not to be aware of unresolved issues so that taxpayers can know where they must take their own views. For taxpayers to be denied a transparent understanding of the state of the tax law puts additional pressure onto taxpayers, and can affect their relationships with their advisers in that taxpayers may consider that the responsibility for ambiguity or lack of clarity is the fault of their advisers.

BCTR considers that the issues around unresolved technical corrections and issues in the law can be addressed by a clearer technical corrections process which can be instituted by Government and Treasury. This process can be developed in consultations.

However, it is clear that the continued highly desirable reform of the Australian tax system must involve at least two strains of policy development:

- Ongoing initiation of new measures and their implementation, which may require more than one Bill
- Ongoing technical corrections which will include points of details about interaction of a new policy development with pre-existing areas of the law. That ongoing implementation and technical corrections requires clear action in a self assessment regime, otherwise the progressive increase in uncertainty and ambiguity will over time increase the frustration for taxpayers and will tend to choke the system.

While this is not the primary focus of this submission, BCTR believes that there could be merit in Treasury, perhaps with the assistance of the Board, considering the best practice in relation to the management of, after the primary reform is introduced, of:

- The more minor but important implementation issues and interactions with other pre-existing areas of the law
- The management of technical corrections.

Actions might include:

- **Greater reliance on Government announcements which will be followed by legislation when developed** (we note for example the excellent initiative of Assistant Treasurer Senator Helen Coonan and Treasury in relation to consolidation where on 4 December 2003 Senator Coonan issued a press release about adding further clarity to the law, with a release of 30 short Treasury papers explaining the Government's intent, which papers are progressively being converted into legislation).
- **An annual 'technical corrections' bill, with a transparent pre announced program and request for general input from the community.**

Reviews and Assessments

BCTR considers that, in order to enhance the system of self assessment and the need for taxpayer certainty, the ATO must be current in its reviews of taxpayers affairs by way of reviews, tax audits, risk reviews and so on.

If the ATO takes years to initiate reviews of taxpayers' affairs and to issue assessments, then:

- Taxpayers do not precisely know their position
- ATO signals of its positions in relation to various unresolved issues are delayed, so that the ATO cannot influence the behaviour of other taxpayers.
- Litigation and resolution of issues in the courts (where necessary) is delayed
- Input to Government about necessary tax reforms is delayed.

BCTR notes that, surprisingly, there are large numbers of Heads of Tax where the four year period for amendment of assessments does not apply. The four year period is extended to six years in relation to transactions potentially the subject of the anti-avoidance regime (Part IVA), but surprisingly there are unlimited amendment periods in relation to an extremely large array of tax matters, contained in Section 170 of the Income Tax Assessment Act 1936. These unlimited amendment powers are in sub-sections (10) (10AA), (10AB) and (10A) and a 6-year extension in sub-section (13) and a list of the relevant Heads of Tax subject to unlimited amendment powers is pages long.

BCTR considers that having such unlimited powers of amendment is:

- Inequitable for taxpayers
- Does not send the correct signals to the Taxation Office to be current in its review of taxpayer tax compliance
- Creates problems for tax administration generally.

For this reason BCTR believes that there should be an across the board limitation of all open periods for amendment of assessments to a four year period. If Treasury considers that this requires more detailed study, then BCTR and its constituent organisations are interested in participating.

If it is considered that a uniform four year period will raise challenges in terms of ATO resources, then these need to be clearly identified, and it may be appropriate for a review of the operation of the ATO and its resourcing and allocation of staff.

BCTR agrees that in relation to a particular small category of taxpayers that there is merit in reducing the ATO review period to two years. The same benchmark for defining small taxpayers ought to apply as for purposes of ATO advice being legally binding (discussed above).

BCTR agrees with the proposition that the period of review in relation to taxpayers having tax losses should not be unlimited as it currently is, and that a standard four year period (or two year period for small taxpayers) should apply.

Penalties

If taxpayers have a high-penalty or high—general interest charge (GIC) environment overlaid over ambiguous tax law, then taxpayers are unjustly penalised for the

consequences of ambiguity and uncertainty in the tax law. It is clear that the GIC regime, introduced in 1999, now requires adjustment.

The GIC was not introduced as a penalty, and penalties for wilful reckless or unsustainable taxpayer positions in their income tax affairs are the subject of a separate well developed penalty regime. GIC was introduced as an administrative codification of various taxes imposed for late payment of tax, and should not operate as an additional source of penalty.

The design of the GIC has a very high headline rate of GIC (benchmark rate plus a 7% loading, tax deductible to business taxpayers) subject to remission by the ATO but only in rare circumstances. The ATO interprets the words of the legislation to restrict its remissions of GIC. As a result taxpayers have very high basic tax exposures under GIC unless and until the ATO remits. Given the restrictive approach of the ATO to remission of GIC, taxpayers have unacceptably high exposures. This discourages voluntary compliance where a taxpayer may discover an honest mistake some time in the future and consider making a debit amended assessment request.

This tension is worsened by the fact that, where a tax dispute arises, the ATO may impose multiple heads of taxation in order to protect its position, and as a result a taxpayer might have two or three or more different tax liabilities in relation to the same dispute. This can cause the tax in dispute in relation to a transaction very often to exceed the value of the deduction sought or income not included. GIC then accrues in relation to each of the multiple heads of taxation, thus further acting to intimidate taxpayers. An action here, clearly in the control of the ATO, is for a clear policy articulation of the ATO approach in relation to taxpayers' true exposures for multiple adjustments and GIC in relation to the same dispute – to identify the real tax in dispute.

The BCTR recommends the basic GIC policy be recalibrated, and for GIC to be imposed at a commercial interest rate, and not a penal interest rate subject to rare or uncertain powers of remission by the ATO.

ATTACHMENT 2

BUSINESS COALITION FOR TAX REFORM (BCTR)

MEMBERS

Australian Gas Association
Australian Constructors Association
Australian Food and Grocery Council
Australian Industry Group
Australian Institute of Company Directors
Australian Retailers Association
Australian Stock Exchange
Business Council of Australia
Corporate Tax Association of Australia
CPA Australia
Council of Small Business Organisations of Australia
Federal Chamber of Automotive Industries
International Banks & Securities Association Australia
Institute of Chartered Accountants
Insurance Council of Australia
Investment and Financial Services Association
Master Builders Australia
Meetings Industry Association of Australia
Minerals Council of Australia
Property Council of Australia
Real Estate Institute of Australia