TREASURY

REVIEW OF ASPECTS OF INCOME TAX SELF ASSESSMENT

SUBMISSION BY CORPORATE TAX ASSOCIATION AND ERNST & YOUNG

27 May 2004

ERNST & YOUNG

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The Review of Self-Assessment
The Treasury
Langton Crescent
CANBERRA ACT 2600

The Corporate Tax Association and Ernst & Young are pleased to respond to the Review of Aspects of Self Assessment in line with the discussion paper released in March 2004.

The review is timely, given the period since the introduction of the Self Assessment system, and given the developments since that introduction, including in particular the highly desirable series of income tax reforms introduced into the Australian tax system in the period from 1999 to date and continuing. Given the reforms and the need of taxpayers for certainty, various refinements are necessary to:

a) Processes involving the Australian Taxation Office;

b) Statutory and other rules regarding aspects of self assessment; and

c) Processes around the introduction of new income tax legislation.

Recognising the need for the best practice in relation to self assessment and its administrative infrastructure we respond to the review and highlight the following critical issues for action:

- The general interest charge (GIC) requires adjustment to remove the intimidatory and penal policy settings, and for GIC to be imposed at a commercial interest rate.
- In relation to guidance materials, the Tax Office processes delay the issue of guidance in a form which taxpayers can use. We suggest Tax Office focus on three areas - more timely issue of materials from the Tax Office, a more transparent disclosure of unresolved or uncertain issues, and a focus on the use of administrative compliance shortcuts.
- Tax Office material should be legally binding wherever possible. As well, Tax Office changed positions should be operative on a prospective basis and not retrospectively.
- Improved processes for appeal against private binding rulings.
- It is imperative for the Tax Office to be current in its reviews of taxpayers' affairs by way of reviews, tax audits, risk reviews etc. Tax Office delays in compliance processes frustrate taxpayers, increase compliance costs and increase risks for Government in delaying identification of trends and any law improvements. We agree that the Tax Office should notify any taxpayer selected for audit within two years of lodgment of a return.
- We also note a surprisingly large range of tax issues where the four year period for amendment of assessments does not apply and recommend an across the board limitation of **all open periods for amendment of assessments** to a four year period.

We would be pleased to discuss these matters with you in more detail. Please contact:

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- Ernst & Young –Tony Stolarek on 03 8650 7654 or John Gonsalves on 03 9288 8699 or at Ernst & Young, 120 Collins Street, Melbourne Vic 3000.

Yours truly

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CTA CORPORATE TAX ASSOCIATION

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Overview

The Corporate Tax Association and Ernst & Young support the action of Government and Treasury in reviewing aspects of the self assessment system.

We support the ongoing tax reform initiative in Australia, which is a necessary part of the modernisation of the Australian tax system. To ensure that Australia has an internationally competitive tax system, it has been necessary to undertake the significant reforms initiated through the Ralph Review of Business Taxation, the reform of Australia's indirect tax system, and for the Government and Australia to continue to focus on ongoing desirable tax reform.

We recognise also the actions of Government, the Treasury and the Tax Office in altering their focus and increasing their resources to deliver the necessary improvement of our tax system.

The tax environment in Australia now differs from that when self assessment was introduced, so the self assessment system and its supporting mechanisms need refinement.

Taxpayers in a self assessment system must have a clear understanding of their tax obligations because self assessment places the primary compliance obligation onto taxpayers. It is therefore bad policy for taxpayers not to have certainty and not to know the areas of uncertainty or unresolved issues affecting the administration of the law affecting their tax liability. There are also issues affecting tax legislative processes for delivery of law and a clearer technical corrections process, some of which are touched on in Appendix 3 of the paper. We note but do not address legislative policy processes in detail in this submission.

Recognising the need for best practice in relation to self assessment and its administrative infrastructure, we respond to the review and highlight the following critical issues for action:

- The general interest charge (GIC) requires adjustment to remove the intimidatory and penal policy settings, and for GIC to be imposed at a commercial interest rate. A high-penalty environment overlaid over ambiguous tax law penalises taxpayers for the consequences of ambiguity and uncertainty in the tax law or Tax Office delays in action.
- In relation to guidance materials, the Tax Office has various quality assurance processes, probity and governance processes. However it does appear that these processes delay the issue of guidance in a form which taxpayers can use. We suggest Tax Office focus on three areas - more timely issue of materials from the Tax Office, a more transparent disclosure of unresolved or uncertain issues, and a focus on the use of administrative compliance shortcuts.
- Tax Office material should be legally binding wherever possible. As well, Tax Office changed positions should be operative on a prospective basis and not retrospectively.
- Improved processes for appeal against private binding rulings.
- It is imperative for the Tax Office to be current in its reviews of taxpayers' affairs by way of reviews, tax audits, risk reviews etc. Tax Office delays in compliance processes frustrate taxpayers, increase compliance costs and increase risks for Government in delaying identification of trends and any law improvements. We agree that the Tax Office should notify any taxpayer selected for audit within two years of lodgment of a return. However we also note a surprisingly large range of tax issues where the four year period for

amendment of assessments does not apply and recommend an across the board limitation of **all open periods for amendment of assessments** to a four year period.

Uncertainty is not acceptable for taxpayers, the Government or the Revenue

Uncertainty creates major deadweight costs for the economy, and adversely affects:

- Taxpayers, their compliance processes and costs and confidence in proceeding with commercial arrangements and business dealings;
- The ability of the revenue (Tax Office and Government) to respond to developments in the community; and
- The ability of Australia to creatively respond to ongoing commercial, economic and tax developments.

We submit that the administration of the tax system in Australia has not paid sufficient regard to the uncertainty to which it has squarely contributed and the need to resolve issues of uncertainty in a timely manner.

A focus on timely resolution of uncertainty requires:

1. A Tax Office that is focused on timely issues management, timely administration and timely execution of reviews, audits and processes. If the Tax Office takes years to resolve positions this creates major frustration, tax penalty and GIC exposure for taxpayers, and unnecessary uncertainty for all stakeholders.

2. A need for best practice approaches to the introduction of tax reform. We recognise that Treasury and the Government have committed to improved consultation, including involvement of the business community on tax reforms using various models based around confidentiality, and that the current processes are much improved over those of the past. However, we identify opportunities for further improvements to the benefits of Government and the community:

    - In many matters there is not the same transparent consultation as seen for example, in relation to the Review of International Tax Arrangements, or indeed this review of self assessment, with the release of Treasury discussion papers ahead of the development of detailed law;
    - In many reforms, the reform is announced but with no clear program laid out for future measures to be legislated, or (after delivery of an initial tranche) for the legislative program to be completed. We recognise a desirable model is in relation to tax consolidation where the 4 December 2003 announcement by Government set out the broad direction on 30 implementation legislative issues.

3. A focus on delivering completion of reforms with the inevitable technical corrections. We applaud Treasury and Government for the tax reform process, but accept as tax professionals and business people that there will always be technical corrections and issues not identified when the law was first introduced.
    - If the legislation to deliver business tax reform is delayed, protracted or incomplete, a major increase arises in the uncertainty in the tax system, with pressure on the Tax Office to cover the gaps using administrative practices.

- Using Tax Office administrative practices to cover legislative gaps is dangerous, unless taxpayers are provided with certainty to be able to rely on such practices without risk of a subsequent Tax Office "change of mind".

Compliance costs increase with uncertainty and delayed guidance

In relation to the delivery of desirable tax reforms, uncertainty in terms of incomplete law or Tax Office guidance not only adds to taxpayer compliance costs, it undermines confidence in a workable, transparent system of tax administration.

Uncertainty results in compliance rework costs. That is, taxpayers are obliged to carry out their compliance on one basis at the time of entry into a transaction, and then again through a review through to final resolution. If the resolution of the uncertainty takes time, then taxpayers may need to:

- Be involved in lengthy discussions with various Tax Office sections, which often involves introducing further advisors and time-consuming document searches.
- Adjust their systems and processes.
- Adjust their income tax calculations for financial statement and income tax return purposes.
- File amended returns with the Tax Office.

thus creating additional and in many cases, onerous compliance costs.

Again, while we recognise that clear legislation is not the primary focus of this review, we submit that improvements in that process will help the operation of the self-assessment system.

Converting Government policies into legislative form

It is noted that there needs to be a clear "flow through" of tax policy formulation and consultative understandings into legislation and subsequent administration.

It seems to us that, too often, a focus on speedy execution, bureaucracy and "the system" causes a failure to document clearly the policy links in the legislation. Then, when the Tax Office and its auditors come later to administer the system, they are so far removed from the initial policy process that they fail to have an understanding in regard to the underlying policies, as these have not been expressed very clearly in the law. This further serves to create uncertainty unnecessarily after the fact. Therefore, while the current separation of the ATO from the policy making role of Treasury is desirable, the ATO has a role to play in the consultation process and needs to understand the policy framework that underlies the legislation.

This disconnect which arises between Government policy and what was envisaged in the mind of business or consultees about the law, and the product of the process, is a major cause of uncertainty for taxpayers as often there are changes in the interpretation or the application of the law as compared to what was intended to occur in the drafting of a relevant section of the Act.

Court decisions and Tax Office changes in interpretation after returns have been lodged

It is unreasonable to expect taxpayers lodging income tax returns under self assessment to know anything more than might be **reasonably** expected at the time of lodging tax returns. In particular, in a self assessment system, there is a major issue of whether taxpayers should expect, or should be penalised for, future changes in 'interpretation' or ground breaking legal precedents established in cases with potential retrospective effect in relation to tax returns already lodged. In a self assessment system, our core proposition is that the penalty and General Interest Charge (GIC)

rules should not cause the Tax Office to be 'opportunistic' in seeking to recover more than the primary tax and reasonable interest in such circumstances. These comments are discussed in our responses to chapter 3.

Rulings and other Tax Office advice

Taxpayers need neutral and timely advice from the Tax Office

The tax legislative policy development process was changed in 2002 as outlined by the Federal Treasurer in that year. Tax policy and legislative development are now the responsibility of the Federal Treasury and tax administration is the responsibility of the Australian Taxation Office.

The 2002 restructure was driven by, in part, taxpayer input that the Tax Office administration of tax policy prior to that time had a lack of clarity and a pro-revenue bias.

One opportunity coming out of the 2002 changed responsibilities was that the Tax Office could provide more neutral tax advice. The Tax Office responsibility should be to comment on the precise meaning of the law as passed by the parliament.

We agree with the analysis of the respective roles of parliament through its laws and regulations and the Tax Office, which was put by the Federal Treasurer[1]:

> "Mr. COSTELLO-…The tax office has an obligation to administer the law as passed by this parliament and a tax practitioner has an obligation to abide by the law as passed by this parliament. To say that there is some fundamental conflict of interest is complete rubbish- too clever by half, if I may say so…. In administering those laws, my view is that taxpayers have an obligation to comply and the tax office has an obligation to comply. Why do I say that? One of the principles of our society is the rule of law - that is, be you ever so high, the law is above you. That means that the law is above both the tax office and the taxpayer and both are obliged to observe it."

The Tax Office is not the tax legislator. It is the tax administrator.

We recognise that any advice provided by the Tax Office about perceived gaps in the law or policy will involve the Tax Office, in parallel, providing an update to Government and to the Treasury about the need to amend the tax law. For example, the New Zealand Tax Office has a process where a Policy Advice Division (PAD) interacts with the Treasury. When the New Zealand Inland Revenue issues a ruling about the operation of a particular law to a taxpayer, which also calls into question the impact on revenue, we understand that the PAD provides input to the New Zealand Treasury about the need for potential amendments of the income tax law. We understand that a similar process operates within the UK and within other countries. We do not question the need for a Tax Office intelligence function and the need for appropriate ongoing revision of the law by Parliament.

However, in a self assessment system, business needs the Tax Office to provide unbiased, clear, timely and transparent answers on the operation of the law as it currently stands so that particular transactions can be undertaken.

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[1] [1] House Of Representatives Tuesday, 30 March 2004, Hansard 26402

Responses to the specific questions in the discussion paper

2.A Is the Tax Office advice sufficiently accessible?

As noted above, in relation to advice about tax reform, any Tax Office process that delays such guidance or conceals such guidance within the Tax Office in a non-transparent form creates:

- Problems for taxpayers in effectively complying with the law, and
- Problems for the legislative process, Government and the interests of the community in delaying the desirable technical corrections and maintenance of the law.

We submit that the Tax Office could streamline its current guidance processes, which have inadvertently created confusion in the business community. The combination of tax rulings, tax determinations, Tax Office interpretative decisions, Practice Statements, fact sheets, reference manuals, and the register of private binding rulings have created a level of confusion in the community as to the precise standing to be given to these various interpretative documents and have also created difficulty for some taxpayers in identifying all of the relevant documents. Taxpayers are then frustrated when the Tax Office does not "stand behind" these public views, changes its mind and challenges its own view on which taxpayers have relied.

As well, we perceive that the Tax Office does not transparently deal with issues where the law has not yet been fully implemented.

We submit that the Tax Office advice products should be classified and improved into the following bands:

1. Those materials which are legally binding, which will presumably be tax rulings and practice statements around law administration (as have recently been commenced by the Tax Office) confirming its practices. We see practice statements as falling into the category of legally binding guidance.

2. Materials (such as ATO advice, opinions, or pre-lodgment guidance), which represent considered views of the Tax Office that should initially be administratively binding. These should not remain in a not-legally-binding state as this conflicts with the policy objective of self assessment. Additionally these should not be subject to unrestrained amendment without consideration of taxpayers, which have relied upon them in formulating their tax returns. So:

   a. for smaller taxpayers (below a threshold to be determined) these should become legally binding immediately on issue, and

   b. for larger taxpayers, these should become legally binding 12 months after issue, (thus giving the Tax Office the ability to consider and adjust the materials for any errors) and

   c. for all taxpayers, any changed Tax Office positions should have a prima facie date of effect being prospective. We reiterate that the Tax Office must, when contemplating retrospective position changes, consider the compliance costs for taxpayers and the administration costs for itself, in addition to the penalty and GIC exposures created for taxpayers, before instituting any retrospective change in its position.

3. Discussion materials clearly identified as non-binding discussion materials, which might set out some preliminary views, should be provided transparently to the business community to add to the education of the business community. Such discussion materials would not be binding but would be very useful to the business community in indicating some preliminary views or signalling Tax Office concerns in particular areas.

An example of such discussion materials might relate to unlegislated law. Currently the Tax Office considers itself unable to provide any interpretive guidance where the Bill has not yet been passed or has not yet received Royal Assent. We submit that the Tax Office should be enabled to provide guidance of an interim nature that, as soon as the legislation receives Royal Assent, could become binding as discussed above.

Another example might relate to the period during which binding Tax Office advice is being developed, but some indication of the issues involved is desirable.

The Tax Office already has a mechanism of this type, being its discussion papers. Our proposed approach does not maximise taxpayer certainty but it would be a significant improvement over the current situation of Tax Office inability or refusal to provide guidance, which causes delays in many taxpayers' compliance processes.

2.B Application of Part IVA in Tax Office Guidance?

In relation to public rulings and guidance material, the Tax Office should not be compelled to provide **exhaustive analysis** of Part IVA in each and every such guidance document.

However the Tax Office must proactively raise any concerns which it has about the possible application of Part IVA to any matter in a public ruling or guidance material or in relation to any transaction the subject of a private ruling or guidance.

The Tax Office should also anticipate and consider guidance material providing "safe harbours" in relation to Part IVA so that taxpayers can understand the areas of tax planning which the Tax Office will not challenge.

It may also be useful, as a separate project, for the Government (perhaps through the Board of Taxation) to review the policy intent of Part IVA and its operation in a self-assessment environment, given taxpayer concerns have about the way the ATO is using the provision to challenge commercial transactions.

The Tax Office should, as part of its stronger focus on understanding developments in the community and monitoring these, promptly identify any concerns it may have in relation to Part IVA and communicate these wherever possible. However, this Part IVA communication or "jawboning" power must not be used improperly and in particular in regard to normal commercial dealings. We perceive that Part IVA has become its own source of unnecessary uncertainty for taxpayers and this needs to be addressed so that "safe harbours" from the general anti-avoidance section are clear and widely understood. Currently the power of a court to 'objectively' decide an outcome without regard to taxpayers' subjective purpose creates enormous uncertainty and provides the Tax Office with a powerful negotiating tool without appropriate checks and balances for the taxpayer.

We observe that various difficulties which arose in relation to individuals' superannuation arrangements relating to control of superannuation were the result of guidance which issued from the Tax Office itself, but which had not been identified as having revenue risks, and which was not withdrawn in a timely manner on the subsequent change of mind by the Tax Office.

The Tax Office needs to have processes whereby, if revenue issues are identified after the issuance of rulings and guidance material, then the Tax Office has the responsibility of highlighting these in the guidance materials. This could be done by way of cautions or by notes or separate communications. A precedent is the creation of the Taxpayer Alert process in 2002 that does not imply that the arrangements are ineffective but clearly signals a caution to taxpayers by the Tax Office so that taxpayers and their advisers may take additional care in their analysis.

2.C Delays in receiving Tax Office advice

We consider that there are currently delays in the Tax Office issuing advice even in strategic highly significant cases, and the delays suggest the need for an improved process.

Some taxpayers are able to achieve quick turnaround on Tax Office guidance, and in relation to simple issues the Tax Office provides feedback promptly. The problem arises in complex areas or where the Tax Office internal processes slow down the issue of guidance. As well, the Tax Office often seems in PBR requests to ask for many facts and further particulars of no particular relevance, which also slows down the guidance process.

There are solutions within the control of the Tax Office in relation to guidance processes and procedures. As well, some further action involves legislation and Tax Office initiatives around penalty and GIC issues.

We submit that solutions include the following:

1. The Tax Office to be formally responsible for and expected to provide advice to taxpayers on compliance shortcuts. As noted earlier, we perceive that the Tax Office has become stymied by a combination of its internal governance procedures, over-emphasis and concern about its new role separating tax administration from tax policy and concern about its statutory powers to provide shortcuts or guidance, and by inappropriate key performance indicators for its people of providing accurate delivery of advice.

2. Better Tax Office statistics and tracking stratified by size of issue. We note that Tax Office timeliness of tax advice, viewed in aggregate appears to be acceptable[2] but we think these statistics are distorted by the mixing of individuals and micro business queries together with other business and larger business queries.

   It would be useful for the Tax Office to segregate its PBR responsiveness statistics by the amount of tax involved in a PBR or an item or correspondence, perhaps into:
   - Under $1,000 tax
   - $1,000 to $1,000,000
   - over $1,000,000

[2] see table 2.1 of the discussion paper

Such statistics, which may possibly already be available within the Tax Office, would provide better information for the community in terms of the resource requirements.

3. The Tax Office appears, in dealing with some PBRs, to ask for a large array of facts, some of which take a lot of time and add little or no value to the PBR. We support the basic proposition of the taxpayer having the opportunity of providing further information to prevent the Tax Office suggesting that they did not know about a material fact. However, in some cases, where the supply of the information would be a protracted process, the Tax Office should be more willing to issue a PBR (with the agreement of the taxpayer) with a disclaimer that the PBR is based on the facts and circumstances as presented. The Tax Office has ample protection from taxpayers providing incorrect, incomplete, or misleading information in PBR requests.

4. Transparent delivery of discussion draft material in emerging unresolved areas (to provide taxpayers with at least an indication of Tax Office direction or thinking). In particular, the precedent of discussion papers, which are circulated to working groups in relation to consolidation and foreign exchange, should be circulated more broadly, clearly marked as having absolutely no binding status, in order to communicate Tax Office research and discussions more broadly.

5. Requiring the Tax Office to confirm publicly that it has capacity to deliver compliance shortcuts and administrative concessions. We note that the Tax Office has ample power in our view and should use the power it already has, but this issue must be resolved unambiguously between the Tax Office, Treasury and Government.

6. In relation to transfer pricing issues, the OECD and other international processes sometimes delay the resolution of issues. The Tax Office should be alert to such delays and identify interim positions with affected industries.

2.E Pro-revenue bias in Tax office actions or omissions?

The Tax Office has improved its processes to reduce pro-revenue bias in its publicly issued material. Where once Tax Office rulings often had questionable interpretations to suit the interests of the revenue, our perception is that the introduction of the rulings panel and other quality assurance processes have improved the neutrality of Tax Office communications which actually make it into the public arena.

However we see a culture in the rulings process that seems to reflect an apparent concern about providing a ruling favourable to a taxpayer or, conversely, no process for accelerated resolution of issues among the various stakeholders within the Tax Office. As noted above, we recognise that PBR requests will often expose perceived gaps in the law or policy and we fully expect that the Tax Office will, in parallel, provide an update to Government and to the Treasury about the need to amend the tax law, as occurs in New Zealand. However the Tax Office has a responsibility to provide the right answer to taxpayers and not to withhold an answer.

We see a pro revenue bias in **uncommunicated issues** in that there is a lack of transparency and **delays** in the issue of guidance about uncertain issues or issues, which are perceived to be against the interests of the revenue.

Some of those uncertain and unresolved legislative measures await action in parliament and the release of legislation, but the Tax Office needs to have a much more transparent communication to the public of its views.

> We submit that action might include:
>
> 1. The Tax Office should be more clearly responsible for transparent guidance in relation to the state of the law as it currently is, disclosing competing views, and that the performance expectations of the Tax Office rulings-issuing groups should highlight the need for timeliness and neutrality of rulings issuance. We recognise that Tax Office suggestions for improvement and changes to the law are a necessary process but separate from the responsibility to taxpayers seeking rulings.
>
> 2. As noted above at 2.A we accept a non binding "discussion" category of advice to deal with unresolved and uncertain issues.
>
> 3. The Tax Office and Treasury might consider whether its emerging Technical Issues Management process operates to best advantage and whether this process can be improved, while preserving the current formal separation of the Tax Office from the policy making role of Treasury.

We recognise that there are current Tax Office and Treasury processes in place as discussed in the speech by Mr Michael D'Ascenzo to the 2004 CTA Convention, but we believe that the transparency of advice can be further improved.

2.F. Disclosure of Competing Views

As identified above, we perceive that the current Tax Office disclosure and advice processes focus on the communication of an outcome, without setting out competing views typically (we recognise that some tax rulings do set out competing views). As a result, where there are competing views, which are against the interests of the revenue, these are not transparently available.

> We submit that the Tax Office should disclose competing views in relation to uncertain issues in its Tax Office advice products. One format might be to have a technical addendum that sets out reservations or technical gaps or challenges.

We make this recommendation not so as to disadvantage the revenue, but so that taxpayers and the community at large can clearly understand the state of the tax law, and the application of the law to them.

2.G Reliance on Tax Office general advice

The key issues affecting larger taxpayers are that:

a) So long as GIC continues at its present high rate then it is inequitable for taxpayers to suffer the risk of GIC exposures in relation to ambiguous law and administration, lack of guidance emanating from the Tax Office and incomplete law within the preserve of the Government.

b) Taxpayers' positions are made more uncertain if the Tax Office can change its mind retrospectively in relation to various interpretations of the law, especially in tax rulings.

Tax Office changes of mind, particularly in relation to tax rulings, should only have prospective effect.

As discussed above, we perceive a difficulty in terms of the transparency of Tax Office advice in relation to challenging or high-risk areas.

> We submit that if the Tax Office has concerns about risks in relation to particular technical analyses which might affect general advice, then such general advice should have an addendum or cautionary notice which identifies Tax Office potential areas of concern, (see our previous comments with respect to the possible application of Part IVA).
>
> The GIC in relation to disagreements between taxpayer and Tax Office should be reduced from the present rate of the base rate plus 7% loading down to a more neutral rate, as discussed later in relation to GIC issues. This will remove much of the taxpayer tension arising from the current system surrounding Tax Office guidance and the community perception of the unreasonable leverage that the Tax Office has in negotiations with taxpayers taking account not only the primary tax relating to the issue, but also the punitive GIC and Part IVA threats made by Tax Office officers in reviews and audits.
>
> We submit that the Tax Office must, when changing its positions in public rulings or in other guidance, adopt a formal policy of making changes prospective in their effect. Any concern about revenue costs will be mitigated by Tax Office focus on more timely review, audit and advice issuance processes as discussed in this submission.

2.I&J. Not following Tax Office private binding rulings

> Taxpayers should not be penalised for not following private binding rulings when assessing their income tax liabilities when they have reasonably arguable positions. The Commissioner's view of the law is no more or less than the Commissioner's own view, and the Treasury paper discloses that no other jurisdiction surveyed imposes penalties for failing to follow the administrator's view.

As anticipated by Treasury in the discussion paper, if there was no direct penalty imposed for failure to follow a PBR, some of the pressure would be reduced from the requirement to make direct appeals against the issuance of PBRs.

The appeals processes do require improvement. A large range of areas for improvement in relation to private binding rulings has been canvassed in the discussion paper that Professor Graeme S. Cooper prepared for the ASCPA in December 1998, which sets out at pages 38 through 48 a number of problems with the private ruling system under the following headings/subheadings:

- Delay in Securing Rulings
- Limitations on Available Issues (Matters of Fact, Application of Part IVA)
- Issues of Collection, Tax Administration and Procedure (Writing and Actions Not Amounting to Rulings, Problem of Embargoed Topics, Quality of Private Rulings and Procedures)
- Incontestable in Reality (Which Facts and Information can be Considered ?, What do Those Facts Prove?, The Impact of Delays on Contestability)
- Time Limits on Rulings

- A Generally Uncooperative Approach

The private ruling system would also be improved by the development of a framework for the Tax Office to produce reasons for the likely positions to be adopted in a PBR to the taxpayer that would allow the taxpayer the opportunity to respond before the PBR is issued.

> We submit that Government should initiate a consultation process around:
> - Amending the income tax and ADJR law to improve the basis for PBRs to be challenged and appealed administratively and
> - an alternative-dispute-resolution or mediation process whereby an independent panel can assist to resolve disputes about PBRs issued by the Tax Office. We note for example the imminent creation of a valuation panel of independent persons by the Tax Office to assist in mediating disputes about consolidation. The proceedings for selection and establishment of that panel might be useful in this regard.

We look forward to participating in such a development process.

2.L. Should Tax Office Charge for certain Advice?

In relation to recently introduced reform measures, the Tax Office, Treasury and Government should allow for sufficient advice material to be provided to the community at no cost - as a part of the implementation of a reform measure.

Even outside recent tax reform measures, the self assessment system creates costs and risks to the taxpayer community and also to national tax revenues in the event of uncertainty. Therefore, recognising the major economic advantage which arises for the Tax Office and Government from the self assessment system, the Tax Office should devote sufficient resources to properly fund an effective and timely public rulings and private rulings process. It is essential that taxpayers have certainty as to the law and the Tax Office ought to recognise that as a fundamental ingredient to its effective administration.

We note that many small taxpayers seek Tax Office rulings on all matters, sometimes including trivial matters (such as the trend we have seen for large numbers of PBRs for work related expenses, many of which seem to be duplications of other PBRs). This trend should be reduced when small taxpayers have legal certainty in relation to Tax Office guidance material.

We do not consider that there is a great unwarranted demand for private binding rulings from the large business community, which diverts Tax Offices resources from other areas of administration. If there is some misallocation of resources we would be interested in discussing this and any necessary action.

Review and Amendment of Assessments

Slow Tax Office Response causes various problems for taxpayers and community

Long delays and open periods of review (Tax Office reviews and tax audits) create significant problems for business:

a) Various participants in transactions are no longer employed by the taxpayer;
b) Even for those remaining in the employ, recollections of events might be hazy; and
c) Significant escalation in the costs of disputes and back-tax GIC exposures.

As well, Government does not receive timely intelligence and policy advice about issues that require policy correction. Delayed action by the Tax Office frustrates the desirable policy and legislative development processes.

> We submit that the self assessment system requires, and should provide a strong incentive and signal to, the Tax Office to become more current in its issues management and audit activities. However, we again we emphasise the gathering of intelligence is a separate process from post-lodgment review of income tax returns by taxpayers, and the intelligence-gathering process should not be confused with or hamper the administration of the existing law.

Responses to questions asked in paper

3.D. Advance notice of audit

> We submit that the law around the review and amendment of assessments needs to provide strong signals to the Tax Office to refocus its:
> a) practices; and
> b) resourcing
> around a timely review and issues-management process.

We recognise that having a 2 year period for closure of tax audits and reviews for large business taxpayers is not in line with international comparisons[3].

> We submit that the law should require the Tax Office to commence within 2 years of lodgment of a return any tax audit (including broad based audits, specific issues audits and industry issues audits) in relation to taxpayers under the:
> - compliance risk management process around large corporates which have turnover of over $100m and are classed as being in the Large Business & International Group and
> - large individual taxpayers producing additional documents for the Tax Office under the High Wealth Individuals project.
>
> To further encourage the Tax Office to complete audits in a timely manner we submit that the GIC not be imposed for tax liabilities arising from an audit where the audit is not finalised within 12 months of the audit's commencement. This would provide the Tax Office with three years from the lodgment of the return to finalise an audit or forgo the GIC

[3] See table 3.1 of the discussion paper

beyond that time. This approach is consistent with the cap on the GIC as outlined in "Approach A" in section 5.4.1 of the discussion paper.

For those taxpayers, the Tax Office has available to it significant material, some in 'real time' plus announcements by large taxpayers, the review of income tax returns plus specific client risk reviews undertaken out of those returns. Against this wealth of information that the Tax Office has, it is inappropriate for the Tax Office to have the capacity to issue amended assessments after 4 years. Further, any such delay is inefficient for all stakeholders including the Tax Office.

Taxpayer disclosure issues

We submit that:

a) The Tax Office has ample power to require contemporaneous disclosure of whatever information it needs to identify risks and take audit or other compliance review action.

b) The Tax Office already undertakes various risk review action as noted above and this confirms that a two-year requirement for notification of audits in all cases is appropriate.

A two-year commencement period for tax audits appears quite workable to us, given the Tax Office additional compliance funding allocations in the 2003 Federal Budget and 2004 Federal Budget.

3.E Pre-assessment agreements

We support, as outlined above, an increased use of Tax Office guidance around administrative and compliance shortcuts and a focus on more current compliance action.

We support action by the Tax Office to undertake pre-assessment agreements in relation to the named areas of loss carry forward, R&D expenditure, trading stock valuation, capital allowance issues but also for these to apply broadly wherever possible and to include:

- Valuation issues
- Consolidation processes (we note action is already occurring here)
- Foreign exchange and financial-transactions policies.

In all cases such agreements must be optional for taxpayers and such agreements should not detract from a Tax Office systemic focus on improved compliance processes and certainty.

3.F. Uniform four year period – nil returns and currently unlimited returns

We submit that nil returns (for taxpayers currently in tax losses or having a nil tax payable due to dividend rebates etc.) should all be subject to the same four year period.

This four year limitation should apply with immediate effect to all returns lodged from the year ended 30 June 2004 onwards.

For nil tax payable returns of earlier years the Tax Office should have 2 years, until 30 June 2006, to resolve all of its issues. Effective from that date all income tax returns for nil-tax-payable returns (whenever they had been lodged) should be subject to the same 4 years standard limitation period.

The resolution of issues around long outstanding tax loss returns would provide additional certainty for taxpayers, for the Tax Office and assist the Government in relation to forward revenue estimates.

Section 170 of the ITAA36 also has an enormous range of exclusions from the 4 year amendment limit, which give effectively unlimited periods for amendment of assessments. Many of these are quite inappropriate. The listing of exclusions is principally in Sections 170(10), (10AA), (10AB) and (10A), and the list of exclusions has grown in the period of the Tax Laws Improvement Process. These unlimited periods, and the vast array of tax issues subject to the exclusions, have no place in a self assessment system with timely administration by the Tax Office.

As well we note that amendments to assessments under Part IVA have a 6 year time period.

This range of exclusions is inefficient for all, as it creates a complex array of provisions, which are not even well expressed in the law.

> We submit that:
> a) the self assessment law should provide for a four year time limit for amendment of all assessments in relation to all tax matters;
>
> b) if it is necessary to have exceptions then these should be justified and reviewed independently in a separate consultative process to ensure that the exceptions apply only in relation to fraud or evasion and do not unfairly create uncertainty or remove the obligation of the Tax Office for timely administration;
>
> c) the exclusions should be re-expressed in a single tabular format along the lines of section 170(10AA) for clarity of understanding by taxpayers and the Tax Office.

3.H. Unreasonable Delays in issue of amended assessments

> We submit that where the Tax Office delays unreasonably in issuing an amended assessment after it has the relevant information, that taxpayers should be entitled to tax relief by way of interest at the GIC rate.

However if the GIC rate is adjusted as we recommend then much of the taxpayer sensitivity arising from delayed Tax Office assessments will be reduced.

> GIC should only run from the time of issuing the amended assessment – not in respect of the period prior to issuing the assessment. As an alternative, GIC should only run to the time that the ATO has communicated its preliminary position to the taxpayer. (The correct imposition of penalty taxes under the existing Tax Office powers should be able to adequately deal with any perceived shortcomings from this approach).

3.I. Period of reduction of assessment

Question 3.I looks at the period for reduction of an amendment, and whether this should be held at the current period if the period for increase of an assessment for individuals is reduced. This issue is not relevant to large businesses, but we would support retaining the existing period for taxpayers

to identify errors and have their assessment reduced, notwithstanding a reduction in the open period for tax audits.

3.J. Processes for implementing these improvements

The Tax Office can easily implement administrative procedures. However, in relation to the time limits for open audits, and the requirement for commencement of audit activities, these issues require amendments to the law.

> We therefore submit that the Tax Office should implement the administrative procedures immediately and Government should confirm these in an announcement this year that will lead to amendment of the tax law. We suggest that the amendments would be simple.

Penalties

As noted in the discussion paper, taxpayers are penalised if they fail to take reasonable care in producing their return and do not have a reasonably arguable position.

The issue of reasonable care was highlighted in the MLC case[4], where the Tax Office imposed a penalty on the taxpayer in relation to a position even though the taxpayer had consulted with the Tax Office. Hill, J in the Federal Court, rejected that Tax Office imposition of penalties.

We suggest that this judicial review of the Tax Office attempt to impose reasonable care penalties in the MLC Case provides a significant indicator of the boundaries of what is reasonable care.

Following the MLC case, we submit that prescriptive guidelines are released in a Public Ruling to provide guidance as to what type of activity constitutes reasonable care.

Responses to questions asked in paper

4.A Reasonable care and reasonably arguable position

Reasonable Care

Prima facie there is no need for a revision of the statute around the definition of reasonable care, because a court can in the final analysis determine what is reasonable.

> However, as noted above, we believe that the issue of a public ruling outlining prescriptive tests of when the Tax Office considers a taxpayer has taken reasonable care would be desirable. This would assist the taxpayer in being able to determine whether they had taken reasonable care and as a result remove some of the uncertainty surrounding what constitutes reasonable care. For example, if the taxpayer had obtained expert tax advice, which considered the relevant authorities and provided a view as to whether the position adopted was as likely correct or not then the taxpayer should be considered to have taken reasonable care. For this purpose an extensive position paper which considered all the issues fully and was prepared by an experienced tax practitioner employed by the taxpayer should have similar status.

Reasonably Arguable Position

We note that the definition of a reasonably arguable position needs to be updated on the context of a continuously improving tax system.

> We submit that the term "relevant authorities" for the purposes of Section 284-15(1) should include tax advice obtained from Queen's Counsel, or other members of the Bar.
>
> We submit that the Tax Office might clarify or update the guidance in relation to a reasonably arguable position, to be more appropriate to the current tax environment and in particular in relation to its interaction with Part IVA as discussed below.

[4] MLC Limited V Deputy Commissioner Of Taxation, 2002] FCA 1491

There is an issue surrounding the application of culpability penalties when the Tax Office raises Part IVA assessments. The relevant penalty provisions are set out in Section 284-150 of the Taxation Administration Act and Section 226 of the Income Tax Assessment Act 1936.

Tax Office Practice Statement PS LA 2000/10 sets out administrative guidance for Tax Office staff on the application of Part IVA. Paras 73 - 76 deal with the administration issues concerning the imposition of penalties where Part IVA applies.

PS LA 2000/10, in accordance with the relevant provisions of the law, advocates a penalty equal to 50% of the tax shortfall where Part IVA is applied or 25% if it is reasonably arguable that Part IVA does not apply.

Despite the above statements, the Commissioner (through audit case managers and other appropriate officers) seems to adopt the position that where Part IVA applies, a taxpayer cannot have a reasonably arguable position. As a result the Tax Office will always seek to impose a 50% penalty.

We submit that the Commissioner needs to have greater regard to the actual circumstances of a particular case before imposing a 50% penalty. Factors that would generally assist the taxpayer in demonstrating that it has adopted a reasonably arguable position are as follows:

1. where there is no intentional disregard for the law;
2. where the taxpayer has not recklessly approached its tax obligations;
3. where the taxpayer has good past behaviour;
4. where a genuine attempt has been made to comply with the law;
5. where external tax advice was obtained confirming that it was as likely as not that Part IVA would not apply;
6. as there is often uncertainty as the application of Part IVA which ultimately will be a question of fact;
7. despite various Part IVA cases, the law around Part IVA remains unsettled (as evidence by Hart's Case which is only the fourth time Part IVA has been considered by the High Court); and
8. the Tax Office approach of seeking to apply Part IVA to genuine commercial transactions (often through a narrow or artificial definition of the scheme) creates circumstances where Part IVA assessments are not limited to blatant, artificial or contrived arrangements.

As a result, despite facing Part IVA assessments, taxpayers can be considered to have a well-reasoned construction of the relevant provisions and to have adopted a position that is about as likely as not the correct interpretation of the law. There is also often a strong likelihood of the taxpayer's views being substantially upheld in Court.

> We submit, therefore, that the penalty regime should in all circumstances (including where the Tax Office seeks to amend an assessment using Part IVA) have appropriate regard to whether taxpayers have taken "reasonable care" and have adopted a "reasonably arguable position". In determining whether taxpayers have taken “reasonable care” and have adopted a “reasonably arguable position” it is recommended that the principles outlined in this section be implemented.

ERNST & YOUNG

4.B&C. Failing to follow private binding ruling

We submit that no penalty should be imposed for failure to follow a private binding ruling, as noted in response to questions 2.I and 2.J.

The General Interest Charge

The Treasury discussion paper correctly identifies that the General Interest Charge operates inequitably in relation to larger taxpayers.

The GIC was introduced in 1999.

Policy of GIC is to compensate Government not to intimidate taxpayers

The policy rationale of the GIC is expressed in the Auditor-General in Audit Report No.31 1999–2000 "Performance Audit - Administration of Tax Penalties - Australian Taxation Office" as follows:

> "**8.** A recent Tax Office review culminated in the passing of the *Taxation Laws Amendment Act (No.3) 1999.* The significant reform implemented by this Act was the introduction of a General Interest Charge (GIC). The GIC marked a major shift by the Tax Office towards a more commercial approach whereby taxpayers are required to compensate the Government for the time value of money. The GIC replaced the Late Payment Penalty regime on 1 July 1999 and is used to calculate a range of other penalties."

The Explanatory Memorandum stated that

> "The policy objective of this measure is to replace the existing late payment penalty provisions in various Acts for which the Commissioner of Taxation has the general administration with a single tax deductible general interest charge (GIC) on outstanding amounts. The new regime will be transparent, consistent, commercially based and easy to administer. A further objective is to encourage withholders who cannot remit deductions by the due dates to notify the Commissioner of the existence of liabilities and to make sure withholders send in their annual reconciliation statements of deductions."

So commerciality was the driver.

The GIC however operates in practice on the basis of a high basic 'sticker" rate exacerbated by highly restrictive Tax Office remission policies. This causes the GIC to operate so as to intimidate taxpayers into paying taxes quickly, even disputed taxes, or else risk major de facto penalty exposures. The GIC rate is also inappropriate in a low-inflation economy, with lower costs of funds, and is particularly inappropriate for larger taxpayers with access to cost-effective funding.

We submit that the policy rationale for the GIC does not integrate properly with the policy for tax penalties. The GIC, in relation to large taxpayers, includes a substantial effective penalty component, and effectively provides a double penalty environment. This is not consistent with the comments extracted from the Explanatory Memorandum. Section 5.1 of the discussion paper notes that the Government considered a 7% margin over the base rate appropriate for the policy reason that the taxpayer should pay their tax liabilities on time. In addition, the discussion paper states that the "uplift factor" was to encourage the payment of tax liabilities when due and compensate the Government for the cost of collection of tax debts and credit risk. Given the Crown has preference, in almost all circumstances, over other creditors it is surprising that credit risk was a factor in setting the uplift factor. The discussion paper also states that the uplift factor was not intended as a culpability penalty.

The perception is that the Tax Office has been slow to introduce policies for the remission of the GIC in appropriate circumstances. The perception is that the Tax Office has been using the threat of GIC, and its restrictive rules for the remission of GIC, to enhance its negotiating position with large taxpayers.

Australia's GIC regime is starkly uncompetitive when viewed against comparable countries as is clear from Table 5.1 of the discussion paper reproduced below.

Table 5.1: Interest payable on tax shortfalls

Country	Rate of Interest	Interest tax deductible?
Australia	Bank Accepted Bill rate plus 7%	Yes
Canada	Canada 90 day Treasury Bill rate plus 4%	No
New Zealand	NZ business base lending rate plus 2%	Only for business
United Kingdom	4.75% for corporations which pay their tax in quarterly instalments 6.5% for individuals and corporations which pay their tax annually	Only for corporations
United States	Federal short term rate plus 3% for individuals	Only for corporations

We agree with the proposition raised by Treasury that the impact of GIC differs across different segments of the market, in that:

a) For large business taxpayers the GIC rate is far in excess of the marginal borrowing rate by large taxpayers and as a result operates as a penalty.

b) The GIC double penalty outcome is less apparent for taxpayers having higher borrowing rates.

In this regard, the "Cameos" used in section 5.2 of the discussion paper demonstrate that while the GIC may provide comparative interest rates for certain taxpayers (and even a lower cost of funding in certain circumstances) the GIC is totally detached from reality in comparison to a "blue chip" company's (Cameo 1) cost of financing. In addition, the amounts of GIC are likely to be greater for larger taxpayers due to the greater amounts of tax that they pay. Once again, this outcome is inconsistent with the policy outlined in the Explanatory Memorandum and repeated in the discussion paper.

While Figure 5.1 of the discussion paper illustrates the effect of compounding for an assumed GIC of 12.50% we have used the current GIC rate of 12.31% and 7.00% (being a proxy for the current home loan rate) to illustrate the vast differences between the cumulative effects of the comparative interest rates. Figures to illustrate this point can be found in the following table:

GIC Simple Annual Rate	**12.31%**					
GIC Daily Rate (Mar 2004)	0.03363388%					
Intial Tax Liabilty	100.0					
Year	1	2	3	4	5	6
Opening Tax Liability	100.0	113.06	127.82	144.52	163.39	184.73
GIC	13.06	14.76	16.69	18.87	21.34	24.12
Closing Balance	113.06	127.82	144.52	163.39	184.73	208.85
Cummulative GIC as a % of Primary Tax	**13.06%**	**27.82%**	**44.52%**	**63.39%**	**84.73%**	**108.85%**

GIC Simple Annual Rate	7.00%					
GIC Daily Rate (Mar 2004)	0.01917808%					
Intial Tax Liabilty	100.0					
Year	1	2	3	4	5	6
Opening Tax Liability	100.0	107.25	115.03	123.37	132.31	141.90
GIC	7.25	7.78	8.34	8.94	9.59	10.29
Closing Balance	107.25	115.03	123.37	132.31	141.90	152.19
Cummulative GIC as a % of Primary Tax	**7.25%**	**15.03%**	**23.37%**	**32.31%**	**41.90%**	**52.19%**

It can be seen that by applying the existing general interest charge over the 4 years that the Tax Office has to amend an assessment to the primary tax liability results in the cumulative GIC increasing to approximately 60% of the primary tax liability. Over the 6-year period that the Tax Office can amend an assessment under Part IVA the GIC actually becomes greater than the primary tax liability. It is submitted that the GIC creates an incentive for the Tax Office not to resolve disputes with taxpayers as the GIC provides the Tax Office with a substantial "bonus" for delaying settlement. In addition, when compared to the Australian Government's cost of funds of about 5.5% the GIC provides a margin of over 7.5%. Given that the taxpayers in dispute may have an extremely high credit rating the 7.5% margin can only be viewed as penal as it cannot be considered as compensation for the credit risk of the taxpayer or the time value of money. It follows that there is a real incentive to maximise revenue by not resolving disputes.

In comparison, if the GIC was 7.00% the percentage of the primary tax that the GIC would equal is approximately 32% after 4 years and 52% after 6 years.

Responses to questions asked in paper

5.A. Should GIC or penalty regime provide incentives to assess correctly?

> The signals to taxpayers to assess correctly are the function of the penalty regime and not the GIC, as noted above. The policy rationale of GIC should not be to provide double penalties for taxpayers so as to intimidate taxpayers having tax disputes or identifying inadvertent errors in their calculations of taxable income. GIC should only run from the time of the assessment.

The above figures show that the GIC can quickly become larger than the primary tax liability and therefore become a greater issue than the primary tax liability. Further, as the cameos illustrate, the rates used do not reflect the cost of finance for many taxpayers.

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

> We submit that the international comparison, plus the double penalty outcomes of the GIC for corporate Australia, raises a compelling case for the reduction of the GIC effective immediately.

5.C&D Approaches to address GIC - are other approaches appropriate?

The only issue is the precise mechanism and benchmark for the GIC.

> We submit that a twofold adjustment is needed:
>
> a. the core GIC rate should be reduced for all taxpayers to a more rational benchmark rate. We propose, in the interests of setting some economy-wide benchmark rate appropriate for all taxpayers, that the housing loan rate that is used for Fringe Benefit Tax calculation purposes should be used for this purpose.
>
> If some differentiation is required between taxpayers then for large business the benchmark rate should be no greater than the bank accepted bill rate plus 2%.
>
> b. Additionally, a cap on the GIC is a useful measure
>
> c. GIC reduction should be implemented by statutory amendment and not by any Tax Office remission policy, because Tax Office remission guidelines appear to be slow to issue and very limited, due in part to the restricted scope for remission in the statute.
>
> In the event that the above proposal is not acceptable to Government, the least problematical approach is "Approach A" as outlined in 5.4.1. That approach would need refinement because it does propose that after an amended assessment issues then the full "loaded by 7%" GIC should apply. That aside, we believe that this approach well balances the competing policy objectives, which include:
>
> - Simplicity;
> - Equality between taxpayers;
> - Encouraging the Tax Office to undertake and complete audits in a timely manner;
> - Making taxpayers responsible for their tax affairs in a manner consistent with the objectives of the self assessment regime; and
> - No culpability component in the GIC (as it is not intended to be a penalty).

5.E. Remission of GIC initiated by Tax Office?

We submit that the rules allowing the Commissioner to remit GIC were framed too narrowly, requiring in section 8AAG(5) special circumstances and that the Tax Office appears to have taken the special circumstances requirement to demand very restrictive approaches to remission[5] As well the remission powers under section 8AAG(3) and (4) are too limited.

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[5] Section 8AAG of the Taxation Administration Act 1953 requires that "the Commissioner may only remit all or a part of the charge in the circumstances set out in subsection (3), (4) or (5).

8AAG(3) [Delay not caused by person and reasonable]

The Commissioner may remit all or a part of the charge referred to in subsection (2) if the Commissioner is satisfied that:

(a) the circumstances that contributed to the delay in payment were not due to, or caused directly or indirectly by, an act or omission of the person; and

(b) the person has taken reasonable action to mitigate, or mitigate the effects of, those circumstances.

8AAG(4) [Delay caused by person, reasonable mitigation and fair and reasonable]

The Commissioner may remit all or a part of the charge referred to in subsection (2) if the Commissioner is satisfied that:

(a) the circumstances that contributed to the delay in payment were due to, or caused directly or indirectly by, an act or omission of the person; and

(b) the person has taken reasonable action to mitigate, or mitigate the effects of, those circumstances; and

(c) having regard to the nature of those circumstances, it would be fair and reasonable to remit all or a part of the charge.

8AAG(5) [Special circumstances]

The Commissioner may remit all or a part of the charge referred to in subsection (2) if the Commissioner is satisfied that:

We submit that, additionally to the legislative adjustment recommended earlier:

- the Tax Office should have a stronger power to remit GIC, and

- a factor in the remission would be for the Tax Office to consider the taxpayer's marginal funding costs reasonably available (by which we do not mean some formal Tax Office investigation of a taxpayer's funding costs but a recognition of the normal commercial options available for a taxpayer to fund the relevant tax debt).

- the Tax Office must have the power to remit GIC prospectively as well as retrospectively. That is, the Tax Office must unambiguously be permitted to confirm remission of GIC prospectively (for example in relation to significant disputes which are moving towards litigation) rather than taxpayers having large exposures in respect of which they must subsequently go cap in hand to the Tax Office to seek remission.

- the Tax Office must issue a tax ruling or practice statement confirming its power and practice in relation to remission including prospective confirmation of remission of GIC.

- ability to formally object to remission decisions under the Income Tax Assessment Act rather than have an administrative review only.

5.F. Standardising deductibility of GIC for non-corporate taxpayers

We submit that if:

- the GIC is restored to an equitable rate statutorily; and

- the Tax Office has clearer remission powers; and

- the Tax Office has clearer remission guidelines; and

- the Tax Office is tasked with resolving tax disputes effectively and in a timely manner

the differential between a 47%-taxable taxpayer and a 30%-taxable company or a 15%-taxable superannuation fund will become a secondary issue. So this additional aspect, while worthy, would add little to the self assessment system.

(a) there are special circumstances because of which it would be fair and reasonable to remit all or a part of the charge; or
(b) it is otherwise appropriate to do so."

Other Issues - Tax Office discretions, time limits for elections

6.A Earlier Tax Office examination of returns, what categories and why

As stated above, the compliance costs of providing answers after the event in relation to Tax Office reviews is much higher than providing information at the time the return is prepared or lodged or shortly afterwards.

Delayed queries and delayed Tax Office responses also cause wasteful compliance rework costs. That is, taxpayers are obliged to carry out their compliance on one basis at the time of entry into a transaction, and then again on an adjusted basis when the uncertainty is resolved which might require changed approaches, adding to compliance costs.

We support the recent initiatives of the Tax Office to distribute its Compliance Plans, the increased disclosures by the Commissioner of Taxation and the public release of standard questionnaires by the Tax Office in relation to consolidation issues. All such developments add transparency to the self assessment system and allow taxpayers to understand precisely what is expected of them ahead of time, to plan for necessary changes to their systems, and to prepare documentation for eventual possible review by the Tax Office.

We submit that the Tax Office should have a clear administration approach of:

1. Identifying its tax risks for early public announcements and for examination to be initiated as soon as returns have been lodged

2. Advising business taxpayers through alerts and other mechanisms **well ahead of time** any specific documentation and compliance material that it wishes taxpayers to retain or analyses that taxpayers must prepare to support their tax returns. This process must not involve mere 'fishing trips' for non-needed information.

   In relation to any documentation requirements or queries involving tax return processes the Tax Office should seek to issue drafts of business tax returns well before the commencement of each year to give the taxpayer community time to prepare for document retention and preparation and for any systems changes.

   This same approach should apply to all categories of taxpayer information requests and reviews including issues around:
   - Transfer pricing
   - participation in tax shelters, etc

   and is a critical part of our recommended approach of a Tax Office focused on timely execution of issues and response to and communication with the community rather than one relying on long drawn-out processes which cause problems for community and Government.

   We observe that the Tax Office has ample statutory powers in relation to specifying disclosures by taxpayers in tax returns.

3. Requests for information by the Tax Office should refer to the Tax Office Access guidelines and as set out in its Access guidelines the Tax Office should not seek taxpayer

production of non-source documents, restricted source documents or legally privileged documents in its requests.

6.E What information can the Tax Office collect more efficiently

We have referred at 6.A. to the practices that the Tax Office should adopt for all information requests after lodgment of returns.

We submit that, when seeking information from large business taxpayers, the Tax Office should specify information requests well ahead of time where they relate to information from business processes and IT systems. A desirable objective is for the Tax Office to identify the information requests in relation to a year prior to the commencement of the year in order that a taxpayer can prepare their information-collection processes.

6.H Discretions as to liability that might be rewritten or added

We agree that it is inappropriate for the Tax Office to have general discretions that can significantly affect taxable income.

The tax law improvement process involved an extended approach of eliminating Tax Office discretions and seeking to replace these with “objective” tests or tests which look to the taxpayer to establish whether it is reasonable to infer compliance with the relevant law.

Unfortunately however, the introduction of objective tests and requiring taxpayer inferences is very problematical against an environment where:

(a) there is much uncertainty in relation to the law, and
(b) taxpayers are looking towards some compliance shortcuts or accommodation by the revenue collector in terms of what is reasonable.

In some cases the withdrawal of Tax Office discretions results in taxpayer concern and requests for improvement of the law because taxpayers consider themselves unable to determine whether it is reasonable for them to assume compliance with various aspects of the law. An example arose in relation to company losses where the previous Tax Office discretion to accept compliance with the rules for the continuity of ownership test (COT) was replaced by a requirement for a taxpayer to consider it reasonable to assume compliance. The Tax Office considered itself unable to give guidance as to when a taxpayer can consider it reasonable to assume compliance. Taxpayers had uncertainty as to their outcome, and this caused pressure on Government to amend the COT. A briefing note to the National Tax Liaison Group meeting of 6 December follows:

> “The Commissioner recognises that various practical difficulties can and do arise in applying the tests in Subdivision 165-D of the *ITAA 1997* for finding out whether a company has maintained the same owners. Generally speaking, the tests require an examination of the facts and the circumstances in each case to determine whether it is objectively reasonable to assume that continuity of underlying ownership has been maintained. Without a factual basis for an assumption of continuity, it cannot be a reasonable assumption.
>
> Some of the specific matters raised highlight the problem that it is often difficult to establish sufficient facts to support an assumption of continuity.
>
> Nevertheless, under the current law the Commissioner has no discretion to not apply the tests in specific cases or to determine that they should not apply to certain classes of case which regularly pose practical issues. In these circumstances, it is a matter for Government to determine the need for and direction of

legislative change. Accordingly, the Commissioner cannot provide commentary on likely timetables and actions to resolve the difficulties…"

We recognise the Commissioner's view but consider it unreasonable in a self assessment system for the administrator to consider it unable to provide guidance or certainty to taxpayers.

> We submit that, in relation to any issue where there is an "objective reasonableness" test in the tax law, that the Tax Office should be authorised to and expected to rule that it will accept that it is reasonable to assume that a taxpayer has complied with the requirements of the test.

Compliance Shortcuts, whether by added discretionary or existing powers

The Tax Office must be able to accept taxpayer compliance shortcut approaches as constituting acceptable compliance with the requirements of the law where such shortcut mechanisms may result in compliance with the law in a more efficient manner.

The Tax Office appears to us to have ample power under the general administration powers but occasionally the Commissioner and various senior officers suggest restrictions to their power pursuant to the Financial Management Accountability Act 1997 or under the Taxation Administration Act.

Uncertainty cannot be allowed to continue as a hindrance to effective administration.

The need for compliance shortcuts is seen for example in relation to consolidation and in relation to foreign exchange transactions, where the law is highly complex and prescriptive, making strict compliance with the law extremely costly and unrealistic for many corporations.

> We submit that there are various actions to enhance compliance shortcuts in a self assessment environment:
>
> 1. Increased emphasis on regulation making power in the tax law, enabling Treasury and Government to introduce regulations which will enable more efficient methods of compliance to be specified whenever needed, without the requirement for the legislative processes and delays;
>
> 2. The Tax Office should publicly state its policy and authorisation in relation to the development of compliance shortcuts in the manner discussed below;
>
> 3. The Tax Office to accept compliance shortcut processes from individual taxpayers, and to prescribe administrative shortcuts for categories of taxpayers in relation to particular tax rules to enable taxpayers to efficiently comply with the policy intent of the law. A series of factors which might be included in Tax Office acceptance of compliance shortcuts include:
>
> - Tax Office compliance shortcut acceptance processes being exercised so as to reduce taxpayer compliance costs;
> - Tax Office shortcuts not to be compulsory (that is, allowing taxpayers who are prepared to incur the costs of the longer form statutory approaches to do so, thus providing an additional layer of protection against unwarranted operation of this power by the Tax Office); and
> - the Tax Office to publicise such shortcuts publicly.

6.I. General issues relating to time limits for taxpayer elections

Taxpayers should have the ability to make elections, as a statutory right, within 4 years of lodging the relevant tax return (ie the same time as for making amendments to tax returns). In a self assessment system, it is not appropriate for taxpayers to rely on the Commissioner's discretion to allow a taxpayer more time to make an election.

If the above approach is not acceptable, there is a need for some latitude or discretion for the Tax Office to accept delayed lodgment or preparation of various elections and notices.

> We submit that consideration be given to providing taxpayers with the right to make elections within 4 years of lodging the relevant tax return, where the taxpayer has not previously made the relevant election.
>
> Alternatively, we submit that there is a need for a generic power for the Commissioner to administratively accept late lodgment of notices and elections, where it is reasonable to do so, in all but a few critical cases (an exception might be the notice of election to consolidate).
>
> As well, we submit that the Tax Office ought to have the power to accept amendments to elections where this is reasonable and appropriate.