Parliament of Australia
Department of Parliamentary Services

Parliamentary Library
Information, analysis and advice for the Parliament

BILLS DIGEST

10 May 2005, no. 150-151 , 2004–05, ISSN 1328-8091

Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005

Susan Dudley and Thomas John
Law and Bills Digest Section

Contents

Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005

Date Introduced: 17 March 2005

House: House of Representatives

Portfolio: Treasury

Commencement: With Royal Assent

Purpose

The Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005 (the Bill), in combination with the Shortfall Interest Charge (Imposition) Bill 2005 will:

- provide for a shortfall interest charge which will apply to under-assessments of income tax, and
- make several amendments to the administrative penalty regime under the *Tax Administration Act 1953 (TAA)*.

Background

Self assessment charges

The Australian taxation system operates on the basis of self assessment. Under self assessment, 'taxpayers' returns are generally accepted at face value, subject to post-assessment audit or other verification by the ATO.'[1] For individuals, once their tax return is lodged, the ATO then issues a notice of assessment which creates the formal obligation to pay tax. For 'full self assessment' taxpayers, such as companies and superannuation funds, the taxpayer calculates their liability and pays their tax when lodging their return. The return is deemed to be a notice of the assessment of the entity's taxable income or net income.[2] Generally speaking, the ATO does not examine the taxpayer's return in detail before making an assessment.[3] The ATO may, however, review and amend the assessment of both individual and full self assessment taxpayers within a prescribed period of time after the assessment has been made.[4]

Where an assessment has been amended to increase the amount of tax payable by a taxpayer, in certain circumstances the taxpayer will be currently liable to pay a General Interest Charge (GIC) on the amount of the increase.[5] The GIC is imposed on a daily basis. The rate of the GIC is:[6]

$$\frac{\textit{the yield on } 90\text{–}\textit{day Bank Accepted Bills} + 7 \textit{ per cent}}{\textit{the number of days in the calendar year}}$$

The Commissioner of Taxation (Commissioner) has the power to waive (remit) all or part of the GIC.[7] The legislation sets out very limited guidance on eligibility for remittance. The Commissioner is not required to supply a statement of reasons at the time the decision is communicated to the taxpayer. The taxpayer has limited scope to appeal the merits of the Commissioner's remission decision.

Penalty charges

Penalties may be imposed where a taxpayer makes a statement (or fails to make a statement) that results in an underpayment of tax.[8] A penalty may be imposed where, for example:

- a statement is false or misleading
- the taxpayer has failed to lodge a statement
- the taxpayer has entered into a tax avoidance scheme, or
- the taxpayer has disregarded a private ruling, and

this results in an underpayment in tax.[9]

The Commissioner has the power to waive (remit) or all part of the penalty. The Commissioner is not required to supply a statement setting out the reasons for his decision.

Review of income tax self assessment

In November 2003, the Treasurer announced that the Commonwealth Treasury would review aspects of income tax self assessment to examine 'whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community'.[10]

In December 2004, The Treasurer released the *Report on aspects of income tax self assessment* which set out the Treasury's findings in relation to the review.[11] The Explanatory Memorandum to the Bill notes that 'The Treasurer announced that the Government would adopt the 30 legislative recommendations made in the Report, and that the Commissioner of Taxation had advised that the ATO would implement the relative administrative recommendation as soon as practicable'.[12]

The Bill implements part of the Government's response to the report. In particular, the Bill implements the following recommendations as set out in the Treasurer's press release of 16 December 2004.

In relation to charges for amended assessments[13]:

Recommendation 42

> From the 2004-05 income year, the standard interest charge applying to income tax shortfalls (that is, the tax difference between the original and amended assessment) should be lower than the GIC rate, reflecting the benchmark cost of finance for a business.
>
> Recommendation 43
>
> The new lower uplift factor should be implemented by a separate pre-amendment shortfall interest charge, in lieu of the GIC. GIC will continue to apply to crystallised debts from the new due date.
>
> Recommendation 44
>
> The Commissioner should have a broad discretion to remit the new shortfall interest charge, where he considers it fair and reasonable.
>
> Without limiting the generality of the above:
>
> - Remission should have regard to the broad intention that shortfall interest be imposed at a uniform rate, rather than being tailored to the circumstances of particular taxpayers.
>
> - Remission should generally occur where circumstances justify the revenue bearing part of the cost of delayed receipt of taxes.
>
> Recommendation 45
>
> Where unremitted shortfall interest exceeds 20% of the tax shortfall, the taxpayer should be entitled to object to the decision not to remit. Objection decisions should be subject to review and appeal where the shortfall interest remaining after determination of the objection exceeds 20% of the tax shortfall…
>
> Recommendation 47
>
> The Tax Office should provide reasons for rejecting shortfall interest remission requests.

In relation to the recommendations, the Treasury considered that the rate of the charge for an incorrect self assessment should be lower that the current CIG. The review noted that the rate of the charge should be such that any benefits to the taxpayer of not paying the additional tax in the shortfall period (gained by way of investing the money etc.) is neutralised. The review therefore recommended that the rate of the charge should be:[14]

$$\frac{\textit{the yield on } 90\text{–}\textit{day Bank Accepted Bills} + 3 \textit{ per cent}}{\textit{the number of days in the calendar year}}$$

The report suggested that this lower rate of interest (the difference is 4 percentage points to the GIC) should apply to the period between when the tax liability should have originally been paid and 21 days after the taxpayer is notified by the ATO of the mistake in their self assessment and of their liability.

In relation to remitting the charge, the recommendations are designed to increase confidence in the remitting processes.

In relation to penalties, the following recommendations were made[15]:

> Recommendation 37
>
> The definition of when a matter is 'reasonably arguable' should be amended to confirm that the relevant standard is *about* as likely to be correct as incorrect (or more likely to be correct than incorrect) — not *as* likely to be correct as incorrect.
>
> Recommendation 38
>
> The penalty for a tax shortfall resulting from a failure to follow a private ruling should be abolished…
>
> Recommendation 40
>
> Where the Tax Office decides that a tax penalty applies and should not be remitted in full, the Tax Office should provide an explanation of why the penalty has been imposed (for example, why the taxpayer has not taken reasonable care or does not have a reasonably arguable position) and why the penalty has not been remitted in full.

Clarification of 'reasonably arguable' is designed to remove the ambiguity in relation to this term. The removal of the penalty for failure to follow a private ruling is to encourage taxpayers' use of the ATO and the amendments relating to the remission of penalties are designed to improve transparency in the penalty remitting process.

Main Provisions

Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005

Schedule 1, Part 1—Shortfall interest charge[16]

Item 1 of **Schedule 1** proposes to introduce into the TAA **new section 280-100.** Proposed **new subsection 280-100(1)** will create a liability to pay an extra charge in the form of a shortfall interest charge which will replace the currently applicable GIC. This charge will be payable in relation to any shortfall amount which arises as the result of a taxpayer's understatement of his or her tax liability. Importantly, the legislation will only impose this liability if the amendment to a tax assessment results in an 'additional amount', or—as the

Explanatory Memorandum puts it—'a shortfall does not exist unless the taxpayer's overall liability is increased—even though the Commissioner might have increased a particular element of the earlier assessment.'[17]

Proposed **new subsection 280-100(2)** specifies the period for which this charge will have to be paid by the taxpayer. Under this provision, the liability will exist for the period during which the understatement existed, that is from the due date for the understated assessment until the day before the Commissioner gives notice of the amended assessment.[18] This proposal deviates from the recommendation made in the Report to the extent that the 21 day period is not included in the calculation of the shortfall interest charge.

The proposed amendments will also make provision for two separate circumstances:

- *nil assessments*—these occur where a taxpayer has had a tax loss for an income year which under current law does not constitute a tax assessment. However, without a tax assessment, the shortfall period cannot commence. According to the Explanatory Memorandum:

  > The Government will introduce amendments later this year, as part of its proposed improvements to self assessment for amendment periods, that have the effect that the shortfall interest charge applies to cases where the taxpayer's liability is adjusted from nil to a positive amount.[19]

  Proposed **new paragraph 280-100(2)(a)** already contemplates these announced amendments by stipulating the commencement day of the shortfall period as the day at which the initial assessment would have been due if there had been one.

- *erroneous credit amendments*—these occur where a taxpayer erroneously requests an amendment to the tax assessment which reduces the tax liability. As the amendments aim at limiting the advantages taxpayers may derive from understating their tax liabilities, the proposed amendments will ensure that where a taxpayer receives a benefit from an erroneous credit amendment, the shortfall period will only commence when the actual benefit accrued, that is from the due date of the incorrectly amended assessment (proposed **new subsection 280-100(3)**). As this may be a nil assessment, the proposed amendment also contemplates the announced amendments discussed above.

Proposed **new subsection 280-105(2)** will specify the shortfall interest charge rate (rate). The rate is calculated in the same way as the general interest charge applicable to, for example, late payments. However, instead of providing for a percentage point uplift factor of seven percentage points above the base rate, the shortfall interest charge will have a reduced uplift factor of only three percentage points.[20] Under proposed **new subsection 280-105(1)**, the daily shortfall interest charge will be worked out on a compounded basis by applying the rate to the additional amount of income tax for the duration of the shortfall period.

Proposed **new section 280-110** provides that the liability for a shortfall interest charge will only arise if the Commissioner has notified the taxpayer of the liability. This notice will be, under proposed **new subsection 280-110(3)**, face value evidence of the matters stated in the notice, therewith effectively reversing the onus of proof by requiring the taxpayer to disprove any content in the notice.

The new regime will enable the Commissioner to remit all or parts of the shortfall interest charge if he or she considers the remission as fair and reasonable. This discretion is broad, but subject to two non-limiting guiding principles:

- a remission should not only occur because the benefit received is less than the shortfall interest charge (proposed **new paragraph 280-160(2)(a)**), and
- a remission should occur where the circumstances justify the Commonwealth bearing part or all of the cost of the delayed payment (proposed **new paragraph 280-160(2)(b)**). The Explanatory Memorandum notes that this principle covers those cases where the liability for shortfall interest charge is due, or partially due, to 'delay, contributory cause or fault on the part of the ATO or others.'[21]

The remission can be initiated by the Commissioner or may be requested by the taxpayer. In the latter case, the Commissioner is under an obligation to provide the taxpayer with reasons for a decision not to remit the shortfall interest charge (proposed **new section 280-165**).

Where the Commissioner has exercised his or her discretion not to remit the shortfall interest charge, the taxpayer will have the objection, review and appeal rights provided by Part IVC of the TAA to challenge the Commissioner's decision. However, this right is significantly curtailed, as the proposed amendment will only permit this kind of merit review where the 'amount of the charge that was not remitted is more than 20% of the additional amount of income tax' (proposed **new section 280-170**).

The *Report on aspects of income tax self assessment* justifies the threshold of 20% by arguing that

> Below this, the cost of objections and appeals would be excessive and may outweigh the potential for a penalty effect from the shortfall interest rate being above the taxpayer's borrowing rate.[22]

The Explanatory Memorandum repeats this argument.[23] Despite this threshold, the currently available administrative review mechanisms, such as to the Administrative Appeals Tribunal, will remain available to all taxpayers.

According to the Explanatory Memorandum, in the year 2003-2004, about 3 000 taxpayers would have been eligible to object to the Commissioner's decision not to remit the shortfall interest charge. It is further stated that the predominant number of taxpayers eligible to object are 'large' business taxpayers.[24] Parliament may want to consider whether the imposition of such a threshold is equitable.

Schedule 1, Part 2—Consequential amendments[25]

Item 7 of the Bill will repeal subsection 204(3) of the *Income Tax Assessment Act 1936* and substitute proposed **new subsection 204(3)** to provide for the relevant changes to the due date of assessments that have been amended by the Commissioner. Under the new arrangement, payments will have a prospective due date of 21 days. The Explanatory Memorandum provides detailed examples with respect to the calculation of due dates under the new regime.[26]

The payment period of 21 days will also be considered for the purpose of calculating the interest charges. Both the shortfall and the general interest charge will not apply during this payment period. **Items 7 and 29** will provide the necessary amendments to give the relevant effects to this change. For example, **item 29** proposes an amendment to paragraph 8A(1)(a) of the *Taxation (Interest on Overpayments and Early Payments) Act 1983* which will make taxpayers eligible for early payment interest on their early payment of shortfall interest charge.

The Bill will also make consequential amendments in relation to the interaction between the shortfall and general credit charges and credit amendments. **Items 3, 4, 6, 27** and **28** will make the relevant changes, for example to ensure that the shortfall interest charge is annulled in situations where a purported shortfall is later overturned or to entitle taxpayers to interest under the *Taxation (Interest on Overpayments and Early Payments) Act 1983*.

Like the general interest charge, the proposed amendments will ensure that the shortfall interest charge is also tax deductible (**item 20**, proposed **new paragraph 25-5(1)(c)** of the *Income Tax Assessment Act 1997*).

Schedule 2—Penalties

Schedule 2 of the Bill will make amendments to the tax penalty regime contained in Schedule 1 of the TAA.

According to the Explanatory Memorandum, the amendments seek to:

- abolish the penalty for a tax shortfall resulting from a failure to follow a private ruling issued by the Commissioner
- require the Commissioner to provide an explanation of why an entity is liable to a penalty and why the penalty has not been remitted in full, and
- clarify the definition of when a statement by an entity about its income tax liability is 'reasonably arguable' in relation to income tax law.[27]

Schedule 2, item 7 of the Bill will repeal subsection 284-75(4) of the TAA which currently provides an administrative penalty for not following a private ruling issued by the Commissioner.

Schedule 2, items 12, 13, 14, and **15** will make necessary amendments to the TAA to require the Commissioner to provide reasons as to why an entity is liable for a penalty. This requirement will be subject to section 25D of the *Acts Interpretation Act 1901* which sets out certain standards with which such written reasons must comply.

Schedule 2, items 3 and **4** will amend the definition of 'reasonably arguable' set forth in the TAA. This amendment implements Recommendation 4.2 of the *Report on aspects of income tax self assessment* (Recommendation 37 of the Treasurer's press release of 16 December 2004).

Shortfall Interest Charge (Imposition) Bill 2005

Clause 3 of the Shortfall Interest Charge (Imposition) Bill 2005 provides that the shortfall interest charge, to the extent necessary, is imposed as a tax and therewith aims to ensure the constitutionality of the measures.

Concluding Comments

Costs of the proposed amendments

According to the Explanatory Memorandum, the implementation of the new measures will impact upon revenue as follows:

2005-06	2006-07	2007-08	2008-09
–$11.5 million	–$21.5 million	–$36.5 million	–$61.5 million

Improvement of the self-assessment regime

With respect to the self-assessment regime, Bills Digest No. 8 of 2004-2005 commented in August last year that:

> …, the Government seemed to have recognised that the simplification of taxation laws may require the modernisation of the entire self assessment regime. On 24 November 2003 the Treasurer commissioned the 'Review of Aspects of Income Tax Self Assessment'. The Discussion Paper was released by the Treasurer on 29 March 2004, outlining:
>
>> [A] range of issues and approaches for refining the operation of Australia's income tax self assessment system. In doing this,

> the paper examines whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the ability of the Australian Taxation Office to collect revenue.
>
> All interested parties are now invited to provide their view on the self assessment regime. But it has to [be] seen whether the review is a first step towards simplification or whether another layer of rules will be added to the '10,000 page monster', making it stronger and even more unworkable.[28] [footnotes omitted]

The changes proposed by this Bill will most likely not reduce the amount of tax legislation pages. However, the changes will introduce a regime acknowledging the difference between late payments and understatements. The benefit of this distinction is conferred upon those taxpayers whose amended assessment created a liability for an interest charge—according to the Explanatory Memorandum 270 000 taxpayers in 2003-2004.[29]

Endnotes

---

1 *Explanatory Memorandum*, *Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005 and Shortfall Interest Charge (Imposition) Bill 2005*, p. 7.

2 *Australian Master Tax Guide,* CCH Australia Limited, January 2005, p. 1299.

3 ibid.

4 *Explanatory Memorandum*, op. cit.

5 *Australian Master Tax Guide*, CCH Australia Limited, January 2005, p. 1299, section 8AAB *Taxation Administration Act 1953*.

6 Section 8AAD *Taxation Administration Act 1953.*

7 Section 8AAG *Taxation Administration Act 1953.*

8 *Australian Master Tax Guide*, CCH Australia Limited, January 2005, p. 1425, Schedule 1 Division 284 *Taxation Administration Act 1953*.

9 Schedule 1 Division 284 *Taxation Administration Act 1953*.

10 The Treasurer the Hon Peter Costello, *Outcome of the review of aspects of income tax self assessment*, Press Release, 24 November 2003, available at

[http://www.treasurer.gov.au/tsr/content/pressreleases/2004/106.asp], accessed 5 May 2005.

11 The Treasury, *Report on aspects of income tax self assessment,* August 2004.

12 *Explanatory Memorandum*, op. cit., p. 8.

13 *Outcome of the review of aspects of income tax self assessment,* op cit., p. 8.

14 Section 8AAD *Taxation Administration Act 1953.*

15 *Outcome of the review of aspects of income tax self assessment*, op cit., *p. 7.*

16 The *Explanatory Memorandum* contains several examples demonstrating the effect of the amendments contained in this Bill. For a better understanding of the proposed changes, the reader is encouraged to consult these examples.

17 *Explanatory Memorandum*, op. cit., p. 15.

18 M Hayes and J Wong, 'Proposed new shortfall interest charge – be aware of the details', Weekly Tax Bulletin, Vol. 17, Thomson ATP, Balmain, 2005, p. 619.

19 *Explanatory Memorandum*, op. cit., p. 16.

20 See above at p. 5 of this Digest. The base rate is the mean yield on 90-day bank accepted bills for the middle month of the preceding quarter.

21 *Explanatory Memorandum*, op. cit, p. 25, listing a number examples in which a remission should be considered by the Commissioner.

22 The Treasury, op. cit., p. 57.

23 *Explanatory Memorandum*, op. cit., p. 27.

24 ibid., p. 43.

25 This Digest only refers to the most important consequential changes. The reader is referred to the *Explanatory Memorandum* for further details and examples.

26 ibid., pp. 21-24.

27 ibid., p. 31.

28 B Pulle and T John, 'Tax Laws Amendments (2004 Measures No. 1) Bill 2004', Bills Digest, No. 8, Department of Parliamentary Services, Canberra, 2004-2005, pp. 10-11.

29 *Explanatory Memorandum*, op. cit., p. 43.

Members, Senators and Parliamentary staff can obtain further information from the Information and Research Services on (02) 6277 2784.