



## Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005

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## Glossary

The following abbreviations and acronyms are used throughout this Bills Digest.

| <i>Abbreviation</i> | <i>Definition</i>  |
|---------------------|--|
| ANAO 2001 Report    | <i>The Australian Taxation Office's Administration of Taxation Rulings</i>   |
| ANAO 2004 Report    | <i>Administration of Taxation Rulings – Follow up Audit</i>  |
| ATO                 | Australian Taxation Office   |
| Commissioner        | Commissioner of Taxation   |
| IGT                 | Inspector-General of Taxation  |
| ITAA 1936           | <i>Income Tax Assessment Act 1936</i>  |
| ITAA 1997           | <i>Income Tax Assessment Act 1997</i>  |
| PBR                 | Private binding ruling   |
| RIS                 | Regulation Impact Statement – Chapter 4 of the Explanatory Memorandum to the Bill  |
| Sherman Report      | <i>Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office</i> |
| SPOR                | shorter period of review   |
| TAA 1953            | <i>Taxation Administration Act 1953</i>  |
| the Report          | <i>Report on Aspects of Income Tax Self Assessment</i>   |
| the Review          | <i>Review on Aspects of Income Tax Self Assessment</i>   |

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## **Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005**

**Date Introduced:** 10 November 2005

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** Royal Assent. Some parts of the Bill are expressed to *apply* to certain financial periods. These are outlined in Main Provisions section below.

### **Purpose**

On 24 November 2003 the Treasurer announced the Review of Aspects of Income Tax Self Assessment.<sup>1</sup> The review was conducted by the treasury and reported in August 2004. On 16 December 2004, the Government announced its intention to adopt all 30 legislative recommendations made in the report. This was achieved, in part, through the enactment of the *Tax Laws Amendment (Improvements to Self Assessment) Act (No.1) 2005*. The purpose of this Bill is to complete the process of implementing the recommendations made in the report.

### **Background**

Brief outline of the Australian self assessment system and the binding public and private rulings system

Since the 1986-87 financial year, Australia has operated a system of self-assessment of income tax. Under that system taxpayers' self-assessed returns are accepted at face value in the first instance, but the ATO may subsequently verify the accuracy of the information in the return.<sup>2</sup> Prior to that period, the ATO would make the assessment, based on information provided by the taxpayer. From 1989-90, a similar system of self-assessment was applied to the returns of companies and superannuation funds.<sup>3</sup>

In 1992, in response to the identification of problems with the self-assessment system, and the need to create greater taxpayer certainty, the Government introduced changes including:

- a new system of binding public rulings
- a new system of binding private rulings

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- a new system of penalties for understatements of income tax liability, based on the requirement that taxpayers exercise reasonable care
- a new interest system for underpayments or late payments of income tax, based on commercial principles and market interest rates.<sup>4</sup>

## Public discontent with the self assessment system and the rulings system

In early 2000 there was considerable publicity in the media both before and after the arrest of a former senior ATO officer who was alleged to have issued private rulings in inappropriate circumstances whilst in the employ of the ATO.<sup>5</sup>

In response, the ATO in May 2000, commissioned Mr Tom Sherman, the former head of the National Crime Authority, to undertake a review of the private ruling system and to provide the Commissioner with an early assessment of that system with particular attention to the quality, consistency and integrity of private rulings.

### **The Sherman Report (2000)**

Mr Sherman's report titled [Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office](#) the (Sherman Report) recommended that a number of measures be implemented to enhance public confidence in the private ruling system.<sup>6</sup> The main recommendation was that all private rulings should be published on a public data base. The published ruling should be the private ruling with taxpayer identifiers deleted, otherwise the published ruling will be the same as the private ruling.

The Sherman Report, also in paragraphs 1.111, cited a number of previous external reports of inquiries into various aspects of the private ruling systems and, in paragraph 1.121, listed a number of external commentaries on the private rulings system.

### **The ANAO 2001 Report**

The Australian National Audit Office (ANAO) undertook a performance audit of the ATO's administration of the ruling system in March 2001. Its findings and recommendations are set out in a report titled [The Australian Taxation Office's Administration of Taxation Rulings](#) (ANAO 2001 Report).<sup>7</sup> As stated in paragraph 1.29 of the ANAO Report 2001, the timing of the ANAO's audit received an impetus with the high level of public and Parliamentary interest following the laying of charges against a former senior executive of the ATO involved in issuing private rulings.

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## ANAO 2004 Report

In August 2004, the ANAO released a follow up audit report on the rulings system.<sup>8</sup> It commented adversely on the lack of integration of systems and inadequate systems controls in relation to private rulings which undermined certainty, fairness and consistency of treatment for taxpayers. A summary of its findings is set out below.

In summary, we concluded that the processes for the production of public rulings of high technical quality operated effectively overall; but the collection, analysis and use of performance information could have been enhanced in some areas. We also considered that the mechanisms in place for public rulings substantially provided for consistent and fair treatment for taxpayers. This positive assessment for public rulings contrasted with the situation for private rulings.

With regard to private rulings we found that the administrative processes had operated poorly in many respects. We also found that the lack of integration of systems and inadequate systems controls undermined certainty, fairness and consistency of treatment for taxpayers. Although the ATO was taking steps to address these deficiencies as part of the Provision of Advice (PoA) Project, we considered that the ultimate test would be in the results achieved. The ANAO made 12 recommendations aimed at improving the ATO's administration of taxations rulings. The ATO agreed to all of the recommendations.<sup>9</sup>

## Government's decision to review aspects of income tax self assessments

In a press release on 24 November 2003 titled [\*Review of Aspects of Income Tax Self Assessment\*](#) (the Review), the Treasurer announced a review of the income tax self-assessment regime to be undertaken by the Treasury. The Treasurer stated:

The review will seek to identify whether there are refinements to the present arrangements that would reduce the level of uncertainty for taxpayers, reduce compliance costs and enhance the timeliness of ATO audits and amendments, while preserving the capacity of the ATO to collect legitimate income tax liabilities. The review will consider the self-assessment of income tax returns, especially:

- protection for taxpayers from unreasonable delays in enforcing the tax law;
- the statutory timeframes for amending assessments;
- the length of tax audits;
- aspects of the operation of the general interest charge;
- the level of reliance taxpayers can and should be able to place on taxation rulings and other forms of ATO advice; and

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- the circumstances in which the ATO should undertake earlier examination of tax returns.<sup>10</sup>

On 29 March 2004, the Treasurer [announced](#) the release of a discussion paper indicating options for making changes to Australia's income tax self assessment system.<sup>11</sup> This [discussion paper](#) considered the right balance to be struck between protecting the rights of individual taxpayers and protecting the revenue in making changes to the self assessment system.<sup>12</sup> The discussion paper also considered comparable arrangements in other [jurisdictions](#).<sup>13</sup>

## Report on Aspects of Income Tax Self Assessment

On 16 December 2004 the Government released the [Report on Aspects of Income Tax Self Assessment](#) (the Report). The [Treasurer](#) indicated that the Government would implement the Report's legislative recommendations, and strongly encourage the Tax Office to implement the administrative recommendations as soon as practicable.<sup>14</sup> A full list of the legislative and administrative recommendations in the Report was included in the [Attachment](#) to the Treasurer's Press Release.

## Implementation of the recommendations in the Report of Aspects of Income Tax Self Assessment – Stage 1

The *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* implemented part of the Government's response to the Report. It amended the then existing law to reduce the consequences of uncertainty that goes with taxpayers having to cope with interpreting complex tax law in the self assessment system by mitigating the interest and penalty provisions applicable to taxpayer errors.

The reader is referred to the [Bills Digest](#) to the relative Bill for further details.<sup>15</sup>

## Main Provisions

### Schedule 1 - Amendment of assessments

Currently, the provisions of section 170 of the ITAA 1936 deal with the time within which the Commissioner may amend various types of assessments. The amendments proposed by **items 1 to 18** of **Schedule 1** restructure and renumber the provisions of section 170 to reduce the periods during which the Commissioner may amend various types of assessments generally from 4 years to 2 years subject to various qualifications and exceptions. However, the Commissioner may amend an assessment at any time if in the Commissioner's opinion there has been fraud or evasion.

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Apart from section 170 of the ITAA 1936, there are also provisions in other tax laws that give the Commissioner unlimited periods of review. The amendments in **Schedule 1** bring these tax laws in line with the measures in **proposed section 170**.

### **Part 1 – Amending assessments**

The amendments proposed by **item 1** of **Part 1** of **Schedule 1** of the Bill repeal subsections 170(1) to 170(7). **Proposed subsection 170(1)** includes a table covering 6 circumstances when the Commissioner may amend assessments. Column 2 of the table indicates the time period within which the Commissioner may amend different categories of assessments. Column 3 of this table sets out the qualifications that attach to the application of time periods in column 2. A helpful table setting out a comparison of the new and existing law can be found in the Explanatory Memorandum to the Bill.<sup>16</sup> The reader is referred to paragraphs 2.23 to 2.80 on pages 15 to 30 of the Explanatory Memorandum to the Bill for detailed explanations of the amendments.

Other exclusions from the standard period for amending assessments to be prescribed by regulation

It will be noted that column 3 of the table in proposed subsection 170(1) also indicates that further qualifications may be prescribed by regulations. (Schedule 1, item 1 - paragraph (f) in column 3 of item 1, paragraph (e) in column 3 of item 2 and paragraph (d) in column 3 of item 3). The reason for this is, according to the Explanatory Memorandum:

2.33 Because taxpayers' financial affairs are constantly evolving and from time to time new arrangements emerge, the law includes a mechanism by which sets of circumstances can be excluded from the standard amendment period by allowing for exclusion 'in any other circumstance prescribed by the regulations'. The *Legislative Instruments Act 2003* restricts the retrospective application of regulations and provides for consultation on regulations affecting businesses.<sup>17</sup>

Under **items 1, 2 and 3** of the table in **proposed subsection 170(1)** the standard assessment time is 2 years and if the conditions in **items 1, 2 and 3** are not satisfied the standard assessment time is 4 years as provided under item 4. Under **item 5** in the table in **proposed subsection 170(1)** the Commissioner may amend an assessment at any time if he or she is of the opinion there has been fraud or evasion. The question arises whether the regulations can prescribe a time different from 2 or 4 years for taxpayer involvement in evolving financial arrangements and products. If this is the case it brings in an element of uncertainty as to whether a higher standard than 2 or 4 years will be prescribed by regulation for involvement with certain new and evolving financial arrangements and products.

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## Application

**Item 15** of **Schedule 1** provides that the amendments made by **Part 1** apply in relation to assessments for the 2004-05 year of income and later years.

### Part 2 – Nil assessments

The measures proposed in **Part 2** of **Schedule 1** will amend the meaning of ‘assessment’ in the ITAA 1936 to include nil liability assessments. The present definition of ‘assessment’ in subsection 6(1) of the ITAA 1936 only covers the ascertainment of the amount of taxable income and of the tax payable on that taxable income or net income. **Item 16** of **Part 2** repeals this definition and substitutes a new definition into subsection 6(1) of the ITAA 1936. **Proposed paragraph (a)** of the new definition covers the ascertainment of the:

- amount of taxable income (or that there is no taxable income), and
- the tax payable on that taxable income (or that no tax is payable).

A taxpayer has no taxable income because total deductions equal or exceed total assessable income. A taxpayer may have no tax payable because the taxable income is below the tax-free threshold or because tax offsets (or rebates) reduce the tax payable to nil.

### Right of taxpayer to object to nil assessment in a limited circumstance

Section 175A of the ITAA 1936 provides that a taxpayer who is dissatisfied with an assessment may object to it.

The proposed amendments to the definition of ‘assessment’ by **item 16** of **Part 2** of **Schedule 2** would have enabled a taxpayer to appeal against a nil assessment in all circumstances under the existing section 175. However, the amendments proposed by **items 17** and **18** of **Part 2** restrict the ability of a taxpayer to object to a nil assessment to a situation where the taxpayer is seeking an increase in the taxpayer’s liability. In other situations, where the taxpayer wishes to dispute the amount of a tax loss, that can only be done in the income year in which the loss is deducted.

## Application

**Item 19** of **Part 2** provides that the amendments made by this **Part** apply in relation to the 2004-05 year of income and later years.

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### **Part 3- Making assessments for the 2003-04 year of income or earlier**

It was noted above that the amendments proposed in **Parts 1** and **2** of **Schedule 1** relating to amending assessments and nil assessments applied from the year of income 2004-05. **Part 3** of **Schedule 1** deals with the making of assessments for year of income 2003-04 and earlier years.

**Item 20** of **Schedule 1** inserts **new section 171A** to the ITAA 1936 to ensure that nil liability (non-loss) returns become final after 4 years and loss returns become final after 6 years. **Proposed subsection 171A(2)** provides that where the Commissioner is of opinion that there has been fraud or evasion, there will be no time limits on the Commissioner making or amending an assessment.

The reader is referred to paragraphs 2.63 to 2.70 on pages 26 to 28 of the Explanatory Memorandum for a detailed explanation of the proposed amendments and examples in illustration.

### **Part 4 – Consequential amendments**

**Part 4** of **Schedule 1** includes consequential amendments to other provisions in tax law in consequence of the changes proposed in **Parts 1, 2** and **3**. The consequential provisions cover certain provisions of the:

- Income Tax Assessment Act 1936 (ITAA 1936) ,
- Income Tax Assessment Act 1997 (ITAA 1997),
- Taxation Administration Act 1953,
- Taxation (Interest on Overpayments and Early Payments) Act 1983,
- Child Support Assessment Act 1989, and
- Income Tax (Transitional Provisions) Act 1997.

The reader is referred to paragraphs 2.71 to 2.80 on pages 28 to 30 of the Explanatory Memorandum to the Bill for a detailed explanation of the proposed consequential amendments.

## **Schedule 2 – ATO advice**

### **Part 1 - Rulings**

The *Taxation Administration Act 1953* (the TAA 1953) has the following provisions currently relating to rulings:

- Part IVAAA deals with public rulings,

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- Part IVAA deals with private rulings, and
- Division 360 of Part 5-5 of Schedule 1 deals with oral rulings for individuals.

The amendments proposed in **Part 1 of Schedule 2** to the Bill provide for a complete overhaul of the provisions relating to rulings. **Item 1 of Part 1 of Schedule 2** repeals Division 360 and inserts the following Divisions to Part 5-5 of Schedule 1 to the TAA 1953 in relation to rulings:

- **Division 357** to deal with the object and common rules in respect of rulings,
- **Division 358** to deal with public rulings,
- **Division 359** to deal with private rulings, and
- **Division 360** to deal with oral rulings.

The consequential amendments in **Part 2 of Schedule 2** to the Bill include the repeal of Parts IVAAA and IVAA by **item 16**.

Object of the new rulings regime

**Proposed Division 357-A** of Schedule 1 of the TAA 1953 deals with the objects of Part 5-5 and **proposed section 357-1** gives an outline of the framework of **proposed Division 357**. It states that:

- **Proposed Division 357** sets out the common rules that apply to public, private and oral rulings,
- A ruling is an expression of the Commissioner's opinion of the way in which a relevant provision applies, or would apply to any taxpayer,
- A ruling binds the Commissioner if it applies to a taxpayer and the taxpayer acts in accordance with it
- If a taxpayer acts in accordance with the ruling and the law turns out to be less favourable to a particular taxpayer than the ruling provides, the taxpayer is protected by the ruling from any adverse consequences.

**Proposed subsection 357-5** states that the object of Part 5-5 is to provide a way for a taxpayer to find out the Commissioner's view about how certain laws administered by the Commissioner apply to that particular taxpayer so that the risks of uncertainty when self assessing or working out tax obligations or entitlements are reduced.

The means to achieve this object are outlined in **proposed subsection 357-5(2)** as follows.

- (a) making advice in the form of rulings by the Commissioner available on a wide range of matters and to many taxpayers; and
- (b) ensuring that the Commissioner provides rulings in a timely manner; and

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- (c) enabling the Commissioner to obtain, and make rulings based on, relevant information; and
- (d) protecting the taxpayer from increases in tax and from penalties and interest where a taxpayer relies on rulings; and
- (e) protecting a taxpayer from decreases in entitlements where the taxpayer relies on rulings; and
- (f) limiting the ways the Commissioner can alter rulings to the taxpayer's detriment; and
- (g) giving the taxpayer protection from interest charges where the taxpayer relies on other advice from the Commissioner, or on the Commissioner's general administrative practice.

### **What is a public ruling?**

**Section 358-5 of proposed Division 358** to Schedule 1 of the TAA 1953 gives the attributes of a public ruling.

- (a) A public ruling is a written ruling that expresses the Commissioner's opinion of the way in which a relevant provision applies or would apply:
  - to entities or a class of entities, or
  - to entities generally, or a class of entities in relation to a class of schemes, or
  - to entities generally, or a class of entities, in relation to a particular scheme.
- (b) The public ruling may cover any matter involved in the application of the provision.
- (c) The ruling must be published and state that it is a public ruling.
- (d) The Commissioner must publish notice of the making of a public ruling. in the *Gazette*.

### Application of public rulings

A public ruling applies from the time it is published or from such earlier or later time as specified in the ruling as provided by **proposed subsection 358-10**.

A public ruling that relates to a scheme does not apply to a taxpayer, if the scheme had begun to be carried out when the ruling is published and:

- (a) the ruling changes the Commissioner's general practice; and
- (b) the ruling is less favourable to the taxpayer than the practice.

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This provision precludes retrospective changes to ATO practices on the application of the provisions of taxation law to schemes.

### What is a private ruling?

A private ruling, as provided in **section 359-5** of **proposed Division 359**, is an expression of the Commissioner's opinion in writing of the way in which a relevant provision applies or would apply to a taxpayer in relation to a specified scheme. A private ruling may cover any matter involved in the application of the provision.

The Commissioner makes a private ruling by recording the ruling in writing and giving a copy to the applicant (**proposed section 359-15**). A private ruling must:

- state that it is a private ruling,
- identify the entity to whom it applies, and
- specify the scheme and the relevant provision to which it relates (**proposed section 359-20**).

An application for a private ruling must be made in the approved form (**proposed subsection 359-10(2)**).

### Objections

**Proposed section 359-60** provides for a person dissatisfied with a private ruling to object against it under Part IVC of the TAA 1953. However, **proposed subsection 359-60(3)** provides that a person cannot object against a private ruling if:

- (a) there is an assessment for that person for the income year or other accounting period to which the ruling relates, or
- (b) the ruling relates to withholding tax or mining withholding tax that has become due and payable.

**Proposed subsection 359-50(1)** also provides for the applicant for a private ruling who has not received the ruling within 60 days of making the application to give a written notice to the Commissioner requiring him or her to make the ruling. The 60 day period is extended in the circumstances mentioned in the table in **proposed subsection 359-50(2)**. The applicant may thereafter under **proposed subsection 359-50(3)** object against the Commissioner's failure to make the ruling within 30 days of the notice given under **proposed subsection 359-50(1)**. The objection will be dealt with under Part IVC of the TAA 1953. The applicant must lodge with the objection a draft ruling.

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### What is an oral ruling?

An oral ruling, as provided in **section 360-5** of **proposed Division 360**, is the Commissioner's advice given orally, of the way in which a relevant provision applies or would apply to the taxpayer who makes an oral application for such advice. **Proposed subsection 360-5(1)** provides that the oral application can also be made by the legal representative of the taxpayer. **Proposed subsection 360-5(3)** states that the oral advice given by the Commissioner is an oral ruling.

The Commissioner may decline to give an oral ruling if the Commissioner considers that the advice sought refers to:

- a business matter or a complex matter, or
- the matter sought to be ruled on is already being, or has been considered by the Commissioner for the taxpayer making the oral application (**proposed subsection 360-5(3)**).

The Commissioner when giving the oral ruling must also give the taxpayer concerned or his or her legal personal representative a registration identifier for the ruling (**proposed subsection 360-5(4)**).

### Common rules for rulings

**Proposed sections 357-50 to 357-90** of **proposed Subdivision 357-B** to Schedule 1 of the TAA 1953 deal with certain common rules that apply to rulings whether public, private or oral.

**Proposed section 357-55** states that provisions of Acts and regulations of which the Commissioner has general administration are relevant for rulings if the provisions are about tax, Medicare levy, fringe benefits tax, franking tax, withholding tax, mining withholding tax, the administration or collection of those taxes and a grant or benefit mentioned in section 8 of the *Product Grants and Benefits Administration Act 2000* or the administration or payment of such a grant or benefit.

When rulings are binding on the Commissioner

**Proposed subsection 357-60(1)** to Schedule 1 of the TAA 1953 states that a ruling binds the Commissioner in relation to a taxpayer if:

- (a) the ruling applies to that taxpayer, and
- (b) the taxpayer relies on the ruling by acting or omitting to act in accordance with that ruling.

A taxpayer may rely on a ruling at any time unless prevented from doing so by a time limit imposed by a taxation law as provided in **proposed subsection 357-60(2)**.

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### Stopping relying on a ruling

**Proposed section 357-65** to Schedule 1 of the TAA 1953 gives a taxpayer the flexibility to stop relying on a ruling and subsequently to rely on that ruling, unless prevented from doing so by a time limit imposed by a taxation law.

A note to **proposed subsection 357-65(1)** states that there is no penalty for a shortfall resulting from failing to follow a ruling. However, it adds that there are penalties from shortfalls resulting:

- from failing to take reasonable care, and
- from taking a position about a large income tax item that is not reasonably arguable under Division 284 of the TAA 1953.

Commissioner may apply the law if more favourable than the ruling

**Proposed paragraph 357-70(1)(a)** provides that the Commissioner may apply a relevant provision to a taxpayer if it would produce a result more favourable than would be the case by the application of a ruling on which the taxpayer had relied. However, **proposed paragraph 357-70(1)(b)** states that the Commissioner may be prevented from amending an assessment by a time limit imposed by a taxation law.

**Proposed subsection 357-70(2)** adds that the Commissioner does not have a duty to apply **proposed subsection 357-70(1)** to any taxpayer. It may therefore be concluded that it is for any taxpayer adversely affected by the application of a ruling to request the Commissioner to apply the law which gives a result more favourable than would be the case by applying the ruling. The provisions of **proposed subsection 357-70(2)** are intended to relieve the Commissioner from a duty to amend the assessments of all taxpayers affected by the application of a ruling in the event that a particular taxpayer succeeds in an objection or appeal in securing an interpretation of a taxation law that is more favourable than that in the Commissioner's ruling. It would be an administrative nightmare to require the ATO to take the initiative to amend assessments, which are not open by objections, whenever a ruling is overturned on objection or appeal of a taxpayer to give a more favoured interpretation of a provision.

### Inconsistent rulings

**Proposed subsection 357-75** to Schedule 1 of the TAA 1953 sets out in a table the rules to ascertain which ruling applies where 2 rulings given at different times both relate to the circumstances of a taxpayer and the 2 rulings are inconsistent. The Explanatory Memorandum in paragraph 3.31 at page 41 sets out succinctly the outcome proposed in the table.

3.31 The rules governing cases where two inconsistent rulings apply to the same taxpayer are listed in the table at subsection 357-75(1). The structure of the table is

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such that a taxpayer may always choose to rely on a public ruling that applies to them and they may choose to rely on a private ruling that specifically addresses their circumstances, notwithstanding an apparent inconsistency with a prior public ruling. It allows the Commissioner to correct erroneous private and oral rulings by a public ruling, but only where the taxpayer has not already entered into the relevant scheme and the relevant income year or other period has not commenced. Finally, it allows a taxpayer to check or clarify a private or oral ruling (although the Commissioner may decline to rule if there is already a ruling on the matter, see paragraph 3.78), but only if they do so honestly, by disclosing the existence of the prior ruling when they apply for the later ruling. A special rule for revising private rulings allows the Commissioner to correct a private ruling with another private ruling in limited circumstances (see paragraphs 3.97 to 3.99). [*Schedule 2, item 1, subsection 357-75(1) of Schedule 1 to the TAA 1953*]

**Proposed subsection 357-75(1)** states that if 3 or more rulings apply to a taxpayer and the rulings are inconsistent, the rules in the table in **proposed subsection 357-75(1)** should be applied to each combination of 2 rulings in the order in which they were made to ascertain the ruling the taxpayer can rely on.

Comparison of key features of the proposed law and the current law on rulings

The Explanatory Memorandum gives a very helpful comparison of the proposed law and the current law at pages 35 to 38.

### **Non-ruling advice and general administrative practice**

Section 284-215 of the TAA 1953 at present provides protection from administrative penalties if a taxpayer acts in relation to a taxation law in reliance on advice given by or on behalf of the Commissioner in relation to that law, or general administrative practice in relation to that law or a statement in a publication approved in writing by the Commissioner in relation to that law.

**Proposed section 361-5** extends this protection to taxpayers from both the shortfall interest charge and the general interest charge if:

- they reasonably rely in good faith on advice (other than a ruling) given by or on behalf of the Commissioner, or
- a statement in a publication approved in writing by the Commissioner

unless the advice or statement or publication is labelled non-binding (**proposed paragraph 361-5(1)(a)**).

In addition a taxpayer relying in good faith has this extended protection if the taxpayer relied in good faith on the Commissioner's general administrative practice (**proposed paragraph 361-5(1)(b)**).

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The reader is referred to paragraphs 3.128 to 3.134 on pages 62 to 64 of the Explanatory Memorandum for details of the proposed changes.

## Part 2 – Consequential amendments

The most significant consequential amendment, as mentioned above, is the repeal of Parts IVAAA and IVAA of the TAA 1953 dealing with public and private rulings, by **item 16** of **Part 2** of **Schedule 2**. The other consequential amendments flow from the introduction of a new regime for advice and rulings.

As there is no special provision for the commencement of the amendments in **Part 2**, the amendments in this Part commence on the day on which the Act receives the Royal Assent under **clause 2** of the Bill.

## Part 3- Transitional

### Status of existing rulings

**Item 29** of **Part 3** of **Schedule 2** provides for the continuation of the public, private and oral rulings in force on the commencement day, and made under the existing regime which is to be repealed, as though they were made under the proposed new advice and rulings regime.

### Inconsistent rulings

**Item 30** of **Part 3** of **Schedule 2** ensures that the inconsistency rules that existed immediately before the commencement day continue to apply to inconsistent rulings made before the commencement day.

### Pending applications

**Item 31** of **Part 3** of **Schedule 2** provides for applications for private or oral rulings lodged before commencement day and not decided before that day to be treated as though:

- in the case of applications for private rulings, the applications were made under **proposed Division 359** of the TAA 1953, and
- in the case of applications for oral rulings, the applications were made under **proposed Division 360** of the TAA 1953.

### Commencement day

**Item 28** of **Part 3** of **Schedule 2** states that the commencement day means the later of:

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- (a) the day on which this Act receives the Royal Assent; and
- (b) 1 January 2006.

The transitional provisions in **Part 3** will take effect from the commencement day as defined.

## Application of amendments made by Schedule 2

**Item 32** of **Part 4** of **Schedule 2** provides that the amendments made by this Schedule apply to things done on or after the later of:

- (a) the day on which this Act receives the Royal Assent; and
- (b) 1 January 2006.

## Concluding comments

### Improvements to self assessment and the ATO advice and rulings system

The measures in the Bill are intended to set up a new framework within which the self assessment and the Commissioner's advice and rulings systems will operate. The regulation impact statement (RIS) in paragraphs 4.37 and 4.38 at page 74 of the Explanatory Memorandum expects the following overall benefits to taxpayers.

- 4.37 Overall, these amendments to the existing provisions will improve:
  - the flexibility in communication methods between taxpayers and the ATO;
  - timeliness of the provisions of rulings; and
  - certainty by making it clear that any written interpretative documents the Commissioner publishes may be declared to be a public ruling.
- 4.38 This measure will have a positive effect on the responsiveness and reliability of ATO advice. Taxpayers should gain confidence that they are assessing their liabilities in line with ATO's interpretation.

However, the RIS is also cautious in its concluding comments and recommended option for continuous monitoring of the implementation of these measures by the Treasury and the ATO. In paragraph 4.52 at page 76 it states:

4.52 The Treasury and the ATO will monitor the implementation of these measures, as part of the whole taxation system, on an ongoing basis.

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This is probably an acceptance that the new framework alone may not be the only answer to the problems of the self assessment and ATO advice and rulings systems.

The RIS, in paragraphs 4.39 and 4.40 at page 74, also states that the administrative costs of implementing the measures in the Bill, comprising additional funds for the ATO to improve quality and timeliness, are estimated to be \$23 million over 4 years. The RIS also adds that \$8 million will be allocated to improve the timeliness of private rulings and \$11 million has been allocated to improve the oral ruling system, including introducing a voice recording system.<sup>18</sup>

### Some problems with the self assessment and ruling systems that remain to be addressed

It was indicated above that the [ANAO 2004 Report](#) on the rulings system concluded that there was a lack of integration of systems and inadequate systems controls which undermined certainty, fairness and consistency of treatment for taxpayers.<sup>19</sup>

In relation to public rulings the ANAO 2004 Report in Recommendation 5 stated as follows:

To support the ATO's continuous improvement in the process of producing public rulings, the ANAO recommends that the ATO assess periodically, the timeliness, relevance, logic and clarity of expression of Income Tax, Fringe Benefits Tax, and Goods and Services Tax public rulings, after they have been issued.<sup>20</sup>

However, recent articles by tax practitioners appear to suggest that there are many problems with private and public rulings which will require continuous ATO attention as recommended in the ANAO 2004 Report. Some of these problems are briefly highlighted below, as they may require solutions beyond the measures provided in this Bill.

### Readability and accessibility of ATO publications

In a recent article on rulings, Chris Wallis canvasses, from a practitioner's perspective, the readability and accessibility of ATO publications.<sup>21</sup> The problems highlighted include lengthy and obscure rulings, inconsistent expressions within publications, pointless discussions, poorly chosen examples, repetitious content, less than complete explanation and addenda without consolidation. The article does not canvass the 'correctness' of ATO publications. Some of these issues are probably tied up with the complexity of tax law itself and the difficulty of interpreting the general anti-avoidance provisions in Part IVA of the ITAA 1936 briefly discussed below.

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## Problems with interpreting the provisions of Part IVA of the ITAA 1936 in the self assessment and rulings system

In the Press Release of 16 December 2004, the Treasurer included in an [Attachment A](#), a list of the legislative and administrative recommendations from the *Report on Aspects of Income Tax Self Assessment*.<sup>22</sup> Attachment A also indicated whether the implementation would be carried out by legislative or administrative changes. Among the items listed for administrative changes are recommendations 10 and 12 relating to the operation of the general anti-avoidance provisions of Part IVA of the ITAA 1936. Recommendation 10 required the ATO to update and consolidate its guidance on the way it interprets and administers Part IVA of the ITAA 1936 into a single comprehensive Ruling or Practice Statement.

The Commissioner indicated in a [speech](#) on 17 November 2005, in the Leadership Matters event series that the ATO will shortly be issuing a detailed statement on the operation of Part IVA and it will be accompanied by a guide that will give practical tips on understanding the risk of Part IVA applying to particular arrangements. The Commissioner added that:

The more people are supported into low risk approaches, the more we can concentrate our compliance activities on the more egregious cases of avoidance or evasion.

At the time of writing this guide has not been issued.

Whilst Part IVA has been difficult to interpret, it has been an instrument available to the ATO to deal with taxpayers who take a high risk approach in organising their affairs with the dominant purpose of reducing their tax liabilities. Fairness to all taxpayers and maintaining the integrity of the tax system requires that those who take a high risk approach in organising their affairs should have the opportunity before embarking on such a course to have the promised ATO guide, so that they cannot be heard to complain that the reach of Part IVA is too wide and severe when it is applied to their detriment.

The usefulness of private rulings in cases where Part IVA has to be considered has been called into question in a recent article.<sup>23</sup> The author there cites the decision of Justice Hill in [Lamont v Commissioner of Taxation](#) (*Lamont*):

49 The ruling contains, as noted, a question as to the application of Part IVA of the 1936 Act to deny any deductions otherwise allowable.

50 In *Bellinz v Commissioner of Taxation* (1998) 84 FCR 154 at 170, I pointed out the practical difficulty which would be faced by the Commissioner in giving a private ruling as to whether Part IVA applied to a particular arrangement. The difficulty arises because of the need to consider the whole factual matrix in determining, for the purposes of s 177D(b), whether the eight factors there set out would lead to a conclusion that a person or persons who entered into or carried out the relevant

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scheme did so for the dominant purpose of obtaining a tax benefit in the defined sense of that expression (see s 177A).

...

53 There is much to be said for both of the arguments advanced by Queen's counsel for the applicant. In the circumstances, I am of the view that there should be excised from the ruling, both the questions and answers to the application of Part IVA. However, because it is possible that the Commissioner might in any year of income make a determination under s 177F(1) and because in light of the facts, that determination may be correctly made, the answers to the question of deductibility and the question of whether income is assessable should be qualified by words to the effect that the answers could be altered if a determination were made under the provisions of Part IVA which operated to disallow the deductions otherwise allowable.<sup>24</sup>

The general guide to the application of Part IVA promised by the Commissioner will in the circumstances be helpful to taxpayers and tax practitioners before entering into arrangements, if rulings have to be qualified in the manner suggested by Hill J in *Lamont*.

### Tax law simplification

One of the major problems, if not the most significant problem, with the self assessment system is that taxpayers are expected to self assess their tax liabilities by finding their way through a maze of complex tax law. This complexity of tax law also follows the ATO in formulating advice and rulings for the benefit of taxpayers.

In a Press Release on 24 November 2004 titled [\*Income Tax Act reduced by 30 percent\*](#) the Treasurer indicated that the Board of Taxation has provided a report to the Government on provisions of the tax law that are inoperative and can be repealed. The Treasurer added that the Board estimates that up to 28 per cent, or 2,100 pages, of the Attorney-General's Department's Scaleplus (now ComLaw [www.comlaw.gov.au](http://www.comlaw.gov.au)) version of the combined Income Tax Assessment Acts can be repealed. Whilst this repeal should result in a significant easing up of the problems of finding one's way through income tax law there is also a need for simplification of the balance 72 percent or some 5400 pages.

The report of the Board to the Treasurer titled [\*Identification and Possible Repeal of the Inoperative Provisions of the 1936 and 1997 Income Tax Assessment Acts — A Report to the Treasurer\*](#) lists in Appendix 2 the provisions in the ITAA 1936 and ITAA 1997 that are to be repealed.<sup>25</sup> In the Executive Summary, the Board notes that the suggested repeal of inoperative provisions represents around 44 per cent of the Scaleplus version of the ITAA 1936 and 28 per cent of the same version of the two Acts combined. It may be appropriate for the Tax Law Improvement Project (now abandoned), whose work resulted in income tax law being settled in two Acts ie the ITAA 1936 and the ITAA 1997 to recommence its tax simplification work so that the balance 56 percent of the ITAA 1936

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could be transferred to a consolidated ITAA 1997 Act. Such a move will be of further assistance to taxpayers and tax practitioners in finding their way through income tax law.

### Revenue bias in ATO's dealing with private binding rulings

The Inspector-General of Taxation (IGT), at the request of the Minister for Revenue and Assistant Treasurer, is at present undertaking a review of whether there is a pro-revenue bias in private binding rulings (PBRs) issued by the Commissioner. The IGT's [website](#) states that based on consultations with private sector stakeholders, the IGT has decided to broaden the scope of the review to include PBR applications which taxpayers withdrew and PBR applications on which the Tax Office refused to rule. This will enable the IGT to review the potential for pro-revenue bias in the Tax Office's dealings with PBRs and to review the basis for perceptions of revenue bias in the PBR system. A recent press article highlights some of the problems which lead to this review.<sup>26</sup>

## Endnotes

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- 1 Costello P (Treasurer) 2003, Review of Aspects of Income Tax Self Assessment, Parliament House, Canberra, 24 November 2003. Available at <<http://treasurer.gov.au/tsr/content/pressreleases/2003/098.asp>>.
- 2 The Treasury, *Review of Aspects on Income Tax Self Assessment*, Report, Canberra, August 2004, p. 2.
- 3 *ibid.*
- 4 *ibid.*, pp. 2–3.
- 5 Fiona Buffini, 'Rich targeted in tax swoop', *Financial Review*, 27 March 2000.
- 6 Australian Taxation Office, *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office*, ATO, Canberra, 7 August 2000.
- 7 Australian National Audit Office (ANAO), [The Australian Taxation Office's Administration of Taxation Rulings](#), Canberra, 17 July 2001.
- 8 ANAO, [Administration of Taxation Rulings Follow-up Audit](#), Canberra, 9 August 2004.
- 9 *ibid.*, paragraphs 5 and 6.
- 10 The Hon Peter Costello MP, the Treasurer 'Review of Aspects of Income Tax Self - Assessment', Press Release No. 098, 23 November 2003.
- 11 The Hon Peter Costello MP, the Treasurer 'Release of Discussion Paper on Income Tax Self Assessment', Press Release No. 017, 29 March 2004.
- 12 The Treasury, *Discussion Paper Review of Aspects of Income Tax Self Assessment*, Canberra, March 2004.

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- 13 *ibid.*, [Appendix 4](#): International Comparisons.
- 14 The Hon Peter Costello MP, the Treasurer ‘Outcome of the Review of Aspects of Income Tax Self -Assessment’, Press Release No. 106, 16 December 2004.
- 15 Susan Dudley and Thomas John ‘Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005’, *Bills Digest*, no. 150, Parliamentary Library, Canberra, 2004-05.
- 16 [Explanatory Memorandum](#) to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005, page 15.
- 17 *ibid.*, paragraph 2.33, p. 18.
- 18 *ibid.*, paragraphs 4.39 and 4.40, p. 74.
- 19 ANAO, [Administration of Taxation Rulings Follow-up Audit](#), Canberra, 9 August 2004, paragraph 6.
- 20 *ibid.*, Recommendation No. 5, paragraph 2.25.
- 21 C. Wallis, ‘Why are rulings so difficult and time consuming to read?’, *Taxation in Australia*, Issue 39 No. 10, May 2005.
- 22 The Hon Peter Costello MP, the Treasurer ‘Outcome of the Review of Aspects of Income Tax Self -Assessment’, Press Release No. 106, 16 December 2004.
- 23 R. Richards, ‘Are tax rulings useful?’, *CPA Australia*, June 2005, volume 75:5, pp. 60–63.
- 24 [2005] FCA 513 (29 April 2005), pars. 49, 50, 53.
- 25 Board of Taxation, Identification and possible repeal of the inoperative provisions of the 1936 and 1997 Income Tax Assessment Acts, A Report to the Treasurer, October 2005.
- 26 Allesandra Fabro, ‘Tax bias claims reviewed’, *Financial Review*, 26 August 2005.

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