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Dr Sean Turner
Senate Economics Legislation Committee
Department of the Senate
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

8 January 2025

Dear Dr Turner,

Senate Economics Legislation Committee submission: Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024 [Provisions]

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 173,000 members in over 100 countries and regions. We make this submission to the Senate Economics Legislation Committee in response to the inquiry into **Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024** (Bill) on behalf of our members and in the broader public interest.

We urge the Senate Economics Legislation Committee to reconsider the Government's proposed denial of general interest charge (GIC) and shortfall interest charge (SIC) measures and not pass the Bill without amendments. CPA Australia has previously expressed significant concerns regarding this measure's disproportionate impact on small businesses, a lack of fairness in the treatment of taxpayers with cash flow difficulties, and the indiscriminate and punitive approach to introducing a blanket policy instead of a targeted measure to address accounts with high levels of tax debt. It is disappointing to note that the consultation process did not result in amendments to the Exposure Draft, *Treasury Laws Amendment Bill 2024: Denying Deductions for Interest Charges* released 24 September 2024 addressing these critical issues.

The proposal to permanently deny deductions for GIC and SIC represents a punitive measure that risks exacerbating financial hardship for small businesses already facing challenges such as high inflation, elevated interest rates, and cash flow constraints. By making these interest costs on tax debts non-deductible, the proposal risks accelerating the accumulation of tax liabilities of small businesses to unsustainable levels, potentially threatening the viability of many small businesses.

The differential treatment of deductibility of interest incurred on tax debts compared to other liabilities creates a hidden cost for taxpayers who are unaware that their effective interest rate is significantly higher than the published GIC/SIC as those costs are non-deductible. Taxpayers can be misled when comparing interest rates as they will not necessarily be aware of the additional costs, much like hidden fees in financial products. In the interest of transparency and fairness to taxpayers, it is most appropriate to influence repayment behaviour through a higher GIC/SIC margin rather than hidden costs that are realised through tax assessments.

Furthermore, this indiscriminate measure fails to adequately address scenarios where taxpayers have historically "done the right thing" or through no fault of their own, accrue these charges due to legitimate tax disputes or administrative delays.

This measure also comes at a time when the Australian Taxation Office (ATO) faces criticism from our members for long delays in service delivery and the uncertainty of inconsistent outcomes on GIC remission requests. The ATO's operational challenges also adds fuel to argument that the proposal to deny deductions for GIC/SIC unfairly penalise taxpayers who may already face delays in obtaining certainty and assistance from the ATO.

The Government currently earns a seven per cent margin on tax debts accruing GIC and three per cent on SIC. Given the ATO's recent adoption of stricter debt recovery measures, including the use of external debt collection agencies, and the current high interest rates resulting in the GIC exceeding commercial lending rates, we query the basis of this proposal, in particular that intentional recalcitrance or use of ATO as 'lender of first resort' is driving the behaviour as opposed to challenging economic conditions, sustained high interest rates and increasing expenses including from salaries, weaker Australian dollar and rising energy costs.

In 2023-24, the ATO received $8.8 billion in interest income from unpaid income and indirect taxes (2022-23: $5.3 billion). The Explanatory Memorandum to the Bill does not provide revenue estimates or modelling to demonstrate the expected improvement in undisputed debt balances. At a 25 per cent company tax rate and assuming taxpayers are able to pay, this could benefit the Government by up to a further $2 billion per annum at the expense of businesses and individuals who have paid their taxes late.

To better understand the impact of this measure, CPA Australia sought data from the ATO under the Freedom of Information (FOI) Act. Specifically, we requested granular data on interest accrued on undisputed debt by taxpayer size, including average and median debt payment times and amounts of GIC and SIC being incurred by and remitted to taxpayers. In response, the ATO cited that much of the requested data was not collected or accessible in a readily available form, resulting in a refusal under section 24A of the FOI Act.

This response raises significant concerns about whether this permanent measure is supported by robust evidence. Without critical data to analyse taxpayer behaviour and the concentration of taxpayer groups with collectable tax debt, this policy risks being misaligned with its intended objectives and result in overly harsh outcomes.

Recommendation

We urge the Senate Economics Legislation Committee to reconsider the Government's proposal to deny deductions for GIC and SIC and not pass the Bill as is without amendments.

A summary of our five key concerns and recommendations as previously set out in our earlier submission on the Exposure Draft is set out below:

1. **Disproportionate impact on small businesses**

   Small businesses already face significant challenges, such as high inflation, rising costs and interest rates, and limited access to affordable financing.

   Recommendation 1: Introduce targeted measures that focus on high-debt accounts rather than penalising generally compliant small businesses by denying a deduction for GIC and SIC.

2. **Existing penalty uplifts of GIC/SIC**

   Recommendation 2: If the government is to proceed with denying deductions for GIC/SIC, we recommend the base rate used (or the uplift percentage) be reduced down to a lower percentage.

   Alternatively, we suggest GIC should remain deductible for a reasonable period (e.g., 60 days from the date of assessment or amended assessment) to provide taxpayers with sufficient time to secure financing or refinancing.

3. **Retain deductibility for SIC**
   SIC, in particular, should remain tax deductible, as it reflects a different type of liability compared to the GIC The SIC is not related to late payments of tax but arises from tax shortfalls - meaning it is triggered by understatements or adjustments to returns.

   Recommendation 3: Retain deductibility for SIC to reflect its function as an adjustment-related charge, not a late payment penalty.

4. **Need for transitional rules**

A transitional rule is essential to prevent retrospective application. For example, if an amended assessment for the 2022 tax year is issued in July 2025, the SIC accrued before 1 July 2025 would unfairly become non-deductible under the new rules.

Recommendation 4: Subject to Recommendation 1 above, limit non-deductibility to interest accrued from 1 July 2025 onward to ensure fairness and prevent retrospective application.

5. **Addressing disparities in interest treatment**

The Bill only addresses the non-deductibility of GIC and SIC. Interest on overpayment of tax liability continue to be assessable.

Recommendation 5: There needs to be symmetry in the tax treatment for interest on overpayments of tax and interest on unpaid tax liability.

The proposal to deny deductions for GIC and SIC will create undue financial hardship for small businesses and individuals, exacerbating existing challenges in the current economic environment. A more balanced approach is needed - one that focusses on targeted recovery efforts and promotes voluntary compliance. We urge the Senate Economics Legislation Committee to reconsider the Government's proposed denial of GIC/SIC measures and not pass the Bill as is without amendments.

Please refer to the Appendix for our detailed discussions. If you have any queries, please contact Jenny Wong, Tax Policy Lead on [redacted] or Bill Leung on [redacted].

Yours sincerely,

[redacted]

Elinor Kasapidis
Chief of Policy, Standards & External Affairs

Appendix

Detailed discussion

The Government's announcement in the 2023-24 Mid-Year Economic and Fiscal Outlook to deny deductions for GIC and SIC from 1 July 2025 appears to be driven by the ATO's concerns over rising outstanding collectible business tax debt. Of the **$50 billion**[1] in outstanding debt, approximately $34 billion[2] is owed by small businesses - largely accumulated during the COVID-19 pandemic when ATO debt collection activities were temporarily suspended.

However, since 2023, the ATO has resumed debt recovery efforts with a significantly firmer approach, including the use of external debt collection agencies and the reporting of taxpayer debts to credit reporting bureaus. Given this shift, the introduction of legislation to deny GIC and SIC deductions is an excessive measure.

Disproportionate impact on small businesses

The proposal to make GIC and SIC non-deductible will place an undue burden on small businesses, who already face significant challenges in managing cash flow and accessing affordable financing options. Our members advise that many small businesses and individuals are already facing immense financial pressure due to rising costs, weak demand and the current high-inflation, high-interest environment.

For example, a small construction business operating under tight margins might delay a tax payment due to cash flow constraints. With GIC and SIC currently being deductible, the cost of falling behind on tax payments is mitigated to an extent. However, with the proposed change, this business could face significantly higher after-tax costs for tax debt, potentially leading to insolvency. Unlike large businesses, small businesses often lack the capacity to secure traditional finance at competitive rates, leaving them vulnerable.

The construction sector, which accounts for 30 per cent of all business insolvencies[3], would be particularly vulnerable to these changes. Businesses in this industry are already struggling with fixed-price contracts and rising input costs. Introducing additional financial burdens could accelerate the rate of insolvencies.

The Inspector General of Taxation in 2021 released a report[4] that highlighted that a small proportion of taxpayers hold a significant share of collectable debt. Specifically, only 5.09 per cent of accounts held 63 per cent of total collectable debt (FY20). The report highlighted a clear and consistent trend of a small proportion of debt accounts being responsible for a large amount of collectable debt. Most of these accounts are held by small businesses and Private or Wealthy Groups.

The proposal to deny deductions for GIC and SIC will impact on generally compliant individuals and businesses, even though collectable debt issues are heavily concentrated within a small segment of the taxpayer base. As a result, the denial of these deductions will disproportionately harm smaller taxpayers who may rely on these deductions to temporarily manage cash flow, while failing to address the structural issues associated with large debt holders.

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[1] Australian Taxation Office, Rob Heferen's address at the Australian Chamber of Commerce and Industry event, Melbourne 13 September 2024

[2] Nassim Khadem, ATO chases small businesses for $34b in debt, insolvencies tipped to hit post-global financial crisis levels ABC News 18 March 2024

[3] Chan, Patrick, Andre Chinnery, and Peter Wallis. "Recent Developments in Small Business Finance and Economic Conditions." *Bulletin – September 2023: Finance*, 21 September 2023

[4] Inspector-General of Taxation. An Investigation and Exploration of Undisputed Tax Debts in Australia. June 2021

Rather than applying a blanket policy, targeted measures addressing high-debt accounts would be a more equitable approach that mitigates the risk of financial hardship and encourages voluntary compliance across the broader tax system. It would also be consistent with the criteria for reporting business tax debts to credit reporting bureaus.

We urge the Senate Economics Legislation Committee to reconsider the Government's proposed denial of GIC/SIC measures and not pass the Bill as is without amendments.

Existing penalty uplifts for GIC/SIC

Unlike the Full Federal Court's decision in *La Rosa's Case*[5], where the government amended tax law to deny deductions for losses and expenses related to illegal activities, there is no comparable basis to deny deductions for GIC and SIC, which arise from legitimate business activities. The assertion in the Explanatory Materials that taxpayers receive a "free loan" through SIC or a payment delay advantage via GIC is not correct. Both GIC and SIC include an interest cost, with rates that already incorporate a penalty uplift factor.

Specifically, the GIC rate is determined by adding a 7 per cent uplift (resulting in 11.38 per cent from October) to the 90-day bank bill rate. Similarly, the SIC rate consists of a base interest rate with an additional 3 per cent uplift (7.38 per cent from October). These measures already impose a significant financial burden on taxpayers.

The denial of deductions, as proposed in the Bill, would make these charges even more punitive.

In addition, we highlight by making GIC and SIC non-deductible for tax, their true cost will be dependent upon the taxpayer's business structure and their taxable income. For example, a company, depending upon its size, may have a tax rate of 25 per cent or 30 per cent. A sole trader, as an individual taxpayer, is taxed on their marginal tax rate, and their tax rate, depending on their tax bracket, can vary from 0 per cent, 16 per cent, 30 per cent, 37 per cent or 45 per cent. Therefore, a business run by a sole trader could face a much higher cost for outstanding tax debt than a business in a corporate structure. Where the debt is not paid by the due date, it also means a much higher tax liability from 1 July 2025 as the interest charge will not be tax deductible. To illustrate:

A plumbing business has a taxable income of $400,000, operating as a sole trader versus a company.

1. Operating as a sole trader

Tax on $400,000:	$146,138.00
Medicare Levy:	$ 8,000.00
Small business Income Tax Offset[6]:	$ (1,000.00)
Total tax:	$153,138.00

2. Operating as a company

Tax on $400,000 – 25 per cent:	$100,000.00
Difference	$ 53,138.00

In this example, the amount of GIC for the sole trader will be much higher than the company for any outstanding tax liability unpaid. As a result, the effective tax rate considering the fact that GIC is non-deductible will be much higher for the sole trader than the company.

[5] *Commissioner of Taxation v La Rosa* [2003] FCAFC 125 (5 June 2003)

[6] ATO, Small business income tax offset, 3 September 2020

Further, we note that the ATO website[7] states that its disaster support includes extra time to pay tax. Removing deductibility of GIC reduces the effectiveness of this tool to help businesses in times of need outside of their control.

If the Government's Bill with denying deduction for GIC/SIC is passed, we recommend the base rate used (or the uplift percentage) be reduced down to a lower percentage. Alternatively, we suggest GIC should remain deductible for a reasonable period (e.g., 60 days from the date of assessment or amended assessment) to provide taxpayers with sufficient time to secure financing or refinancing.

Shortfall interest charge

We submit that the SIC should remain tax deductible, as it reflects a different type of liability compared to the GIC. The SIC is not related to late payments of tax but arises from tax shortfalls - meaning it is triggered by understatements or adjustments to returns.

The Explanatory Memorandum[8] to the Bill introducing the SIC states:

> *"Liability to the shortfall interest charge is unrelated to penalties*
>
> 2.26 The shortfall interest charge applies regardless of whether or not the taxpayer is liable to any penalty. Liability to the shortfall interest charge does not depend upon - nor imply - culpability on the part of the taxpayer."

Where there is a shortfall, the SIC applies in addition to the shortfall penalty regime. Depending on the level of culpability, there could be penalties of up to 90 per cent of the tax shortfall imposed.

Denying a tax deduction for the SIC would, in effect, amount to an additional penalty. Given the cumulative nature of penalties already embedded in the shortfall regime, it would be inequitable to deny deductibility for SIC.

We recommend retaining deductibility for SIC to reflect its function as an adjustment-related charge, not a late payment penalty.

Interest on overpayments of tax

We highlight the existing disparity between the treatment of taxpayers and the Commissioner regarding late interest payments. When the ATO pays interest on overpayments or early payments of tax, it applies only **base interest rate** (currently 4.38 per cent). However, when a taxpayer incurs interest on a reassessed shortfall, the SIC **uplift rate** of 7.38 per cent applies, regardless of whether the shortfall arises from culpable conduct. Both situations involve delayed payments, yet taxpayers face a much higher financial burden.

Even if parity in interest rates between tax overpayments and shortfalls is not achieved, there should at least be parity in tax treatment.

We submit that if deductions for GIC and SIC are denied, interest on overpayments should be treated as non-assessable, non-exempt (NANE) income, necessitating the repeal of section 15-35 of the *Income Tax Assessment Act 1997* (ITAA 1997). Additionally, section 20-25(2A) of the ITAA 1997, which treats the remission of GIC or SIC as a recoupment, should also be repealed. While remission may not be assessable if GIC or SIC is non-deductible (per the **Table**[9] in section 20-30 of the ITAA 1997), this provision will become redundant under the proposed measures denying GIC and SIC deductions.

Tax disputes

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[7] Australian Taxation Office, *Summary of our disaster support,* 23 June 2023

[8] ATO, Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005

[9] Section 20-30, ITAA 97

In addition, the non-deductibility of GIC and SIC imposes an unfair penalty on businesses engaged in legitimate tax disputes, especially when the outcome of litigation is uncertain. Businesses contesting complex tax matters often face prolonged legal proceedings, during which GIC and SIC accrue regardless of whether the ATO's position is ultimately upheld. If the taxpayer succeeds, the non-deductible nature of these charges means they are still penalised for disputing an incorrect assessment - effectively treating legitimate disputes as though they involved non-compliance. This creates an unjust financial burden on businesses for exercising their right to challenge contested tax liabilities.

We recommend that the Senate Economics Legislation Committee reconsider the Government's proposed measures to non-deductibility of GIC and SIC, particularly in the context of legitimate tax disputes.

Commencement date - discrepancy between the Bill and the Explanatory Materials

In the Bill, it stated the amendment applies 'to assessments for income years starting on or after 1 July 2025'. On the other hand, the Explanatory Materials stated, 'the Government will deny deductions for general interest charge and shortfall interest charge incurred on or after 1 July 2025'.

Unlike the Bill, the wording used in the Explanatory Materials means interest charges incurred on or after 1 July in relation to assessments for income years prior to 1 July 2025 will also be denied.

There is a discrepancy between commencement date in the Bill and the Explanatory Materials are not the same and should be clarified. If the proposals were to proceed, the amendments should only operate prospectively (see below).

Transitional rule

Subject to our previous recommendations, a transitional rule will be required for GIC or SIC incurred after 1 July 2025 but accrued prior to that date. Tax Determination TD 2012/2[10] and Practice Statement PS LA 2011/12[11] address the timing of when SIC and GIC are incurred, with both being tied to when assessments are issued, at least for income tax purposes. However, GIC can also accrue on other taxes without any notices.

For example, if an amended assessment for the 2022 income year is issued in July 2025, it may include three years of SIC. Even though the majority of the SIC relates to the period before 1 July 2025, the entire amount would become non-deductible under the new rules. In contrast, had the amended assessment been issued by 30 June 2025, all the SIC would remain deductible.

To avoid unfair outcomes and retrospective application, we submit that a transitional rule should be introduced to limit non-deductibility only to SIC or GIC accruing from 1 July 2025 onwards. This approach would ensure a fairer implementation of the proposed changes.

The Commissioner's discretion

While not directly related to the Bill, we would like to highlight concerns regarding the administration of GIC and SIC remission. Our members have reported inconsistent and widely varying outcomes when applying to the Commissioner of Taxation for the remission of GIC or SIC. These inconsistencies suggest that remission decisions are often subjective, appearing to depend more on the case officer managing the request rather than the merits of the case, even when the facts are identical. This variability persists despite the ATO's introduction of an interest charge remission form on **Online Services for Business and Agents**[12].

Another inconsistency reported by members relates to the differing instructions provided to taxpayers when remission requests are denied. In several cases, the ATO's communication outlined different methods for submitting additional information for review. For example, in three separate GIC remission requests involving the

[10] ATO, TD 2012/2 Income tax: when is the shortfall interest charge incurred for the purposes of paragraph 25-5(1)(c) of the Income Tax Assessment Act 1997
[11] ATO, PS LA 2011/12 Remission of General Interest Charge
[12] ATO, Remission of interest charges, 14 October 2024

same taxpayer - a director for all three companies - each with identical circumstances, the ATO issued two decline letters with inconsistent instructions:

- “Alternatively, if you believe there are further circumstances that we should have considered when making our decision, you may reapply”, or
- “Alternatively, if you believe there are further circumstances that should have been considered when making our decision, you can phone us on 13 11 42.”, or
- ATO asked the taxpayer to submit their request with more information.

These discrepancies raise concerns about the consistency and fairness of the ATO’s remission process. If the circumstances and taxpayer are the same, it is unclear how three different outcomes and varying instructions for further review were reached.

We submit that the ATO undertake a review of its GIC and SIC remission process to ensure greater consistency, transparency, and fairness in decision-making.