

Penalties and interest

Penalties

How the ATO determines the penalty amount

- 6.1 There is a long list of matters for which the Australian Taxation Office (ATO) can issue penalties. These include a failure to keep or retain records, failing to issue a tax invoice and failing to withhold as required.¹ These are called administrative penalties because the ATO can issue them itself, rather than needing to take a taxpayer to court.
- 6.2 There were two main penalties that concerned the Committee during the inquiry. The first was for statements and unarguable positions that lead to a shortfall of tax. That is, where the ATO believes that the taxpayer has a greater tax liability than is shown in the return. The second was for failure to lodge a return or other document.
- 6.3 Shortfall penalties largely depend on the taxpayer's conduct. The main penalties are calculated as a percentage of the taxpayer's shortfall amount. Table 6.1 shows the various penalty amounts.
- 6.4 The two key definitions in the table are 'reasonable care' and 'reasonably arguable.' Section 284-15 states that a taxpayer has taken a reasonably arguable position where their tax return is, 'about as likely to be correct as incorrect.' The ATO advised the Committee on the difference between exercising reasonable care and a failure to do so:

1 Division 288 in Schedule 1 to the *Taxation Administration Act 1953*, ATO, sub 50, p 46.

Reasonable care for a taxpayer is determined by the individual circumstances of that taxpayer taking into account age, health, education, culture and other individual factors. It is not intended to be difficult for the taxpayer to exercise reasonable care...

Generally a taxpayer has failed to take reasonable care if they have not done what a reasonable person in similar circumstances would do.²

Table 6.1 Base penalty amounts for tax shortfalls as a percentage of the shortfall amount

Taxpayer's conduct	Penalty
Intentional disregard of a tax law	75%
Recklessness as to the operation of a tax law	50%
Scheme with the sole or dominant purpose of reducing tax	50%
Entered into a scheme where the treatment was reasonably arguable	25%
Lack of reasonable care	25%
Treatment not reasonably arguable and the shortfall amount is more than the greater of \$10,000 or 1% of the taxpayer's total income tax liability for that year	25%
Reasonable care	Nil

Source ATO, sub 50, p 44, Subdivision 284-C of the Taxation Administration Act 1953.

6.5 The ATO advised the Committee that it increases the base penalty by 20% if the taxpayer:

- took steps to prevent or obstruct the Commissioner from finding out about the shortfall
- became aware of the shortfall but did not inform the Commissioner in a reasonable time, or
- was previously liable to a penalty for having a tax shortfall.³

6.6 The ATO decreases the base penalty if the taxpayer tells the ATO about the shortfall. The reduction depends on when the taxpayer makes the disclosure. If the taxpayer does so before an audit commences, then the reduction is 100% for a shortfall of less than \$1,000 or 80% for a shortfall of \$1,000 or more. If the taxpayer tells the ATO after an audit starts, the reduction is 20% if the disclosure saves the ATO significant time or resources.⁴

2 ATO, sub 50, p 44.

3 ATO, sub 50, p 45. See also section 284-220 in Schedule 1 to the *Taxation Administration Act 1953*.

4 ATO, sub 50, p 45. See also section 284-225 in Schedule 1 to the *Taxation Administration Act 1953*.

- 6.7 The commencement of an audit is a key date for taxpayers. Chapter five discusses the need for the ATO to communicate more clearly with taxpayers about the start of an audit.
- 6.8 The base penalty for failure to lodge a return or other document is one penalty unit for each 28 day period, or part thereof, past the due date. A penalty unit is \$110.⁵ The maximum number of penalty units under the legislation is five. The ATO multiplies the base amount by two if the taxpayer is a medium enterprise (for example, it has a total annual tax liability between \$1 million and \$20 million). The ATO multiplies the base amount by five for large enterprises (for example, a tax liability over \$20 million).⁶
- 6.9 The ATO advised the Committee that it is prepared to take taxpayers' previous good conduct into account in applying penalties for failure to lodge:
- We recognise that even with the best intentions events will arise that mean people will not always meet their lodgement obligations on time. Consequently, penalties will not generally be applied in isolated cases of late lodgement unless we have already contacted taxpayers because the document was not lodged and issued them with a warning.⁷
- 6.10 The legislation and the ATO's approach to penalties help reinforce a compliance culture among taxpayers. For example, the penalties for both a shortfall amount and a failure to lodge are reduced or eliminated where taxpayers approach the ATO first, rather than waiting for the ATO to come to them. The Ombudsman noted:
- ...the current differential levels of penalty applied by the exercise of judgment informed by fact, law and administrative guidelines is both a fair and reasonable response to individual acts of non-compliance and an effective means of encouraging greater voluntary compliance.⁸

Are penalty amounts appropriate?

- 6.11 The Committee sought to compare tax penalties in Australia with overseas countries to determine if the amounts in Australia were excessive or too

5 Section 4AA of the *Crimes Act 1914*.

6 ATO, sub 50, p 45. See also section 286-80 of the *Taxation Administration Act 1953*.

7 ATO, sub 50, p 45.

8 Commonwealth Ombudsman, sub 38, p 15.

low. For convenience, the Committee selected all English-speaking OECD countries for comparison. The results are in table 6.2 on the next page.

- 6.12 Overall, it appears that tax penalties in Australia are broadly in line with the other comparison countries. For tax shortfalls, the maxima range from 50% to 200%. The maximum in Australia is 75%.

Table 6.2 Tax penalties, English-speaking OECD countries, 2006

Country	Shortfall amount	Failure to lodge
Australia	25% (lack of reasonable care) to 75% (deliberate acts)	\$A110 per 28 days late, up to \$A550. Multiplied by 2 and 5 for medium and large taxpayers
Canada	Up to 50%, depending on the seriousness of the offence	5% of unpaid tax, plus an extra 1% per month of delay
Ireland	Up to 100% for neglect and up to 200% for fraud	5% if less than 2 months late (€12,000 max), or 10% over 2 months (€63,000 max)
New Zealand	20% for lack of reasonable care and up to 150% for serious fraud	\$NZ50 to \$NZ500, depending on the taxpayer's income
United Kingdom	Up to 100%, depending on the seriousness of the offence	£100 for late returns, extra £100 for 6 months late and 100% of tax if not filed within one year
United States	20% to 75%, depending on the seriousness of the offence	5% per month or part thereof delayed, up to 25%

Source OECD, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006)*, October 2006, pp 57, 69-71, viewed on 31 January 2007 at <http://www.oecd.org/dataoecd/43/7/37610131.pdf>. This series is published every two years.

- 6.13 For failure to lodge, the penalty is calculated either as a percentage of the tax liability or as a dollar amount which increases in line with the extent of the delay. The percentage approach gives a greater penalty, especially for large taxpayers. The failure to lodge penalty in Australia is higher than that in New Zealand. Where the delay is less than one year, Australia's penalty is higher than in the United Kingdom.
- 6.14 In the Review of Self Assessment (RoSA), Treasury noted that submissions did not criticise the scale of penalties.⁹ The same occurred in this inquiry. The Committee agrees that penalty amounts in Australia appear satisfactory overall.
- 6.15 CPA Australia did express concern about the timing method used for calculating failure to lodge penalties:

A potential problem with the current ... arrangements is that the penalties for those taxpayers who lodge later than the due date for lodgement ... seem to be more severe than in the case of a

9 Treasury, *Report on aspects of income tax self assessment (2004)* Commonwealth of Australia, p 44.

taxpayer who either fails to lodge at all or lodges very late. This is because the maximum penalty under the current ... system arises when a return is 113 days overdue, although the general interest charge ... continues to apply to any amount that remains unpaid after this period.¹⁰

- 6.16 However, the Committee does not wish to suggest any changes to the structure of failure to lodge penalties. The main reason is that tax liabilities are much more collectable when they are recent. For instance, the Australian National Audit Office (ANAO) found that the ATO collected as much tax debt (after lodgement and assessment) in 1998-99 within 30 days as it did in the next 330 days.¹¹ A similar principle probably applies where taxpayers fail to lodge a return. The longer the delay in lodging, the less collectable any potential debt is likely to be. It is likely that any significant delay greatly increases the chance that the taxpayer is non-compliant. Therefore, targeting failure to lodge penalties within the first six months of the due date appears to be an appropriate strategy in promoting taxpayer compliance.

Consistency across the ATO

- 6.17 In its 2000 performance audit on penalties, the ANAO found that ATO senior management could not be sure that the ATO was applying penalties consistently and as described in the legislation. The ANAO stated:

We found that, although penalties are an important enforcement strategy featured in the ATO Compliance Model, the ATO lacks appropriate control structures to oversight the accountability, consistency and effectiveness of its penalty administration. Currently, ATO management is unable to provide assurance to the Commissioner that penalties are being applied consistently and in accordance with the legislation.¹²

- 6.18 The ATO agreed to all of the ANAO's recommendations. The ones that related to consistency were:
- establishing organisation-wide quality assurance of the ATO's penalty administration

10 CPA Australia, sub 36, p 15.

11 ANAO, *The Management of Tax Debt Collection*, Audit Report No. 23 1999-2000, 20 December 1999, p 74.

12 ANAO, *Administration of Tax Penalties*, Audit Report No. 31 1999-2000, 16 February 2000, p 11.

- including guidance in the ATO's technical training material on the application of penalties to different scenarios in the compliance model
 - investigating a web-based decision making tool for staff.¹³
- 6.19 In 2005, the Inspector-General of Taxation completed a review of the ATO's administration of penalties and interest arising from active compliance. The Inspector-General noted that the ATO had deferred investigating a web-based decision making tool because of the introduction of major tax reform at the time of the ANAO report. To assist implementing the reforms, the ATO applied concessions to penalties, which resulted in reduced usage.¹⁴
- 6.20 The Inspector-General reported that the ATO was conducting an internal review of penalties, which had resulted in a draft report at that stage. Its topics included quality assurance over penalty decisions, staff expertise, and the relevant systems and infrastructure. The Inspector-General's main recommendations in relation to penalties were that the ATO:
- implement all remaining recommendations from the ANAO report
 - develop uniform governance arrangements for penalties to apply across all business lines
 - consider the various improvements suggested by stakeholders during the review (for example, better training, communication with taxpayers and decision making tools).¹⁵
- 6.21 During this inquiry, however, the Committee received evidence that concerns still remain about the imposition of penalties. The Taxation Institute of Australia stated:
- There is a perennial problem in respect of the imposition of penalties ... by the ATO. Often they are imposed arbitrarily, without due regard to whether a taxpayer has a reasonably arguable case or special circumstances...
- This view is reflected in many court and AAT [Administrative Appeal Tribunal] cases where the level of penalty is reduced on appeal. It appears that it is mainly in egregious scheme cases that the courts and the AAT uphold the penalties imposed.¹⁶
-

13 Id, p 15.

14 Inspector-General of Taxation, *Review into the Tax Office's Administration of Penalties and Interest Arising from Active Compliance Activities* (2005) Commonwealth of Australia, pp 4-5.

15 Id, pp 5, 7, 36-37.

16 Taxation Institute of Australia, sub 40, p 9.

- 6.22 To help improve consistency in applying penalties, the Institute of Chartered Accountants in Australia (ICAA) recommended that staff making decisions about penalties should be separate from those conducting audits in the ATO. The ICAA also suggested that the ATO should have a formal, internal review procedure for penalty decisions at the request of either the ATO or the taxpayer.¹⁷
- 6.23 In *An Assessment of Tax*, the Joint Committee on Public Accounts (JCPA) recommended that staff who made penalty decisions should be legally qualified and be independent from audit staff. The Committee's concern was that combining investigations with punishment placed too much power in audit staff. Its first preference was to remove the ATO's power to impose administrative penalties.¹⁸ The division of duties was its alternative recommendation. The ATO declined these proposals.¹⁹
- 6.24 ATO administration has improved since the JCPA's 1993 *An Assessment of Tax* report, and the law is fairer after various reforms, including those under RoSA. Currently, the Committee believes that penalties play an important role in helping the ATO to promote a compliance culture among taxpayers. On this basis, the Committee believes that the ATO should retain the power to impose administrative penalties.
- 6.25 The ATO provided the Committee with data on the technical quality reviews of its penalty decisions. Twice a year, the ATO samples its interpretive decisions and subjects them to internal peer review. The ATO analyses the results to target areas for improvement. It also publishes the results in its annual report.²⁰ Whether a taxpayer complains or not does not affect the technical quality review. The focus is on the quality of the decision itself.
- 6.26 For the period from August 2006 to January 2007, 92.1% of penalty decisions received an 'A' rating and 97.2% received a 'Pass' rating. The ATO's benchmarks for penalty and other debt decisions (such as shortfall interest remissions) are 85% and 95% respectively.²¹ While this is a competent level of performance, it implies that 2.8% of taxpayers who receive a penalty probably did not receive fair treatment. The Committee regards this as too high.

17 ICAA, sub 37, p 12.

18 JCPA, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) Report 326, pp 299-300.

19 ATO, 'Final Report on the Implementation of the Recommendations of Report 326' *An Assessment of Tax*', correspondence, 20 October 1998.

20 ATO, *Annual Report 2006-07*, p 42.

21 First biannual meeting with the Commissioner of Taxation, ATO, sub 3, p 21.

- 6.27 The Committee accepts that the ATO has made significant progress since the ANAO's performance audit in 2000. It appears that the ATO is now at the stage of refining its practices, rather than radical change. Therefore, the Committee does not believe it is necessary to stipulate new processes for the ATO. Instead, it proposes two courses of action.
- 6.28 Firstly, the ATO needs to increase its performance targets. The current pass benchmark of most technical quality reviews in the ATO is 95%,²² whereas for penalty and other debt decisions it is 85%. The Committee sees no reason why the ATO should be achieving a significantly lesser standard for penalty decisions. The ATO should develop new targets and use these as a focus for further improvement.

Recommendation 15

- 6.29 **The ATO increase its benchmarks for the technical quality reviews of penalty and other debt decisions.**
- 6.30 Secondly, the Committee believes that it may be prudent for the ATO's external scrutineers (the ANAO, Inspector-General of Taxation and the Ombudsman) to conduct additional work on the ATO's penalty and debt practices to ensure that the ATO's performance continues to improve over time. For example, the Inspector-General's review of GST audits for large taxpayers found issues with the ATO's decisions on shortfall penalties. These included a significant number of cases where the ATO:
- concluded that a taxpayer was reckless, despite the matter being arguable at law
 - applied the penalty at the full rate, despite prior disclosure by the taxpayer
 - applied a different penalty rule to large and small taxpayers.²³
- 6.31 The Committee believes penalty and debt decisions warrant continued external scrutiny.

22 ATO, *Annual Report 2006-07*, p 42.

23 Inspector-General of Taxation, *Review of the Tax Office's Administration of GST audits for Large Taxpayers* (2008) Commonwealth of Australia, p 5.

Interest

How the ATO calculates interest

- 6.32 There are two interest charges for overdue amounts. The interest charge applied in most circumstances is the general interest charge (GIC). The Government introduced it in 1999 to replace a large number of interest charges and penalties. It is tax deductible. Penalty payments are subject to GIC once they become overdue.²⁴
- 6.33 The *Taxation Administration Act 1953* sets the GIC at a high rate to encourage taxpayers to promptly pay their tax debts and prevent them from using the ATO as a source of cheap finance. The GIC is set at the Reserve Bank's (RBA's) monthly yield of 90-day Bank Accepted Bills plus 7%.²⁵ It has generally been between 11% and 14%.²⁶ Due to recent changes in interest rates by the RBA, the GIC was 14.69% for the June quarter of 2008.²⁷
- 6.34 GIC is calculated on a daily basis. The GIC is divided by the number of days in the year and then this figure is applied to the taxpayer's outstanding balance each day.²⁸ This calculation technique increases the GIC. For example, a 12.5% rate compounds to 13.3% over 12 months.
- 6.35 The other interest liability is the shortfall interest charge (SIC), which arises following an amended assessment. It applies to tax shortfalls in the period between the first day when the taxpayer was due to pay income tax and when the ATO notifies the taxpayer of the shortfall. The SIC commenced on 1 July 2005 in relation to the 2004-05 financial year.²⁹ It is also tax deductible.³⁰
- 6.36 Treasury recommended the introduction of the SIC in RoSA. Its reasoning was that the incentive for taxpayers to avoid the GIC through prompt payment did not apply during the period before an amended assessment.

24 Treasury, sub 51, p 10, section 298-25 in Schedule 1 to the *Taxation Administration Act 1953*.

25 Ibid.

26 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, p 50.

27 ATO, 'General interest charge (GIC) rates,' viewed on 18 March 2008 at <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/2832.htm&mnu=4823&mfp=001/005>.

28 Section 8AAD of the *Taxation Administration Act 1953*.

29 Section 280-100 in Schedule 1 to the *Taxation Administration Act 1953*, ATO, sub 50, p 47.

30 ATO, *RoSA in brief – Shortfall interest charge* (2007) Commonwealth of Australia, p 4.

Taxpayers generally would not be aware that they had a shortfall during this time.³¹

- 6.37 In RoSA, Treasury argued that the philosophy behind the SIC should be that taxpayers should not receive a loan benefit from a shortfall. Therefore, the SIC is set at the Reserve Bank's monthly yield of 90-day Bank Accepted Bills plus 3%. In other words, the SIC is 4% less than the GIC.³² The SIC is also calculated on a daily basis and compounds, increasing an 8.5% rate to 8.9% at the end of one year.
- 6.38 The ATO gives taxpayers who receive an amended assessment requesting payment of a shortfall amount 21 days in which to pay. SIC applies to the debt up to the date of the amended assessment. If a taxpayer does not repay the debt by the payment date, then GIC will apply to the unpaid amount.³³
- 6.39 The Committee supports the introduction of the SIC. Taxpayers should not be subject to high interest rates for tax shortfalls where the ATO has not notified them of their tax status. The National Institute of Accountants described the SIC as a 'welcome policy initiative.'³⁴
- 6.40 The ATO does not have discretion in applying these interest charges. The *Taxation Administration Act 1953* requires the ATO to do so. The ATO may remit the interest charges at a later date and has considerable discretion. This topic is discussed below.

Are the interest rates appropriate?

- 6.41 In considering this issue, the Committee compared the interest charges in Australia against other OECD countries, in particular those where English is an official language. The results are in table 6.3.
- 6.42 The first observation is that New Zealand has much higher rates than all the other countries in the table and appears to be an outlier. Apart from this, Australian rates are very similar to those in other countries. The one exception to this appears to be the GIC, which edges higher than other countries' rates as time progresses. However, the Committee does not believe that rates in Australia overall are sufficiently different to these comparison countries to warrant change.

31 Treasury, *Report on aspects of income tax self assessment* (2004) Commonwealth of Australia, pp 51-54.

32 Id, pp 53-54, Treasury, sub 51, p 11.

33 Treasury, sub 51, p 11.

34 National Institute of Accountants, sub 31, p 6.

Table 6.3 Interest charges for late payment of tax, English-speaking OECD countries, 2006

Country	Calculation method	Effective rates		
		3 months	6 months	1 year
Australia (SIC)	RBA's bank bill rate plus 3%	2.1%	4.3%	8.9%
Australia (GIC)	RBA's bank bill rate plus 7%	3.2%	6.4%	13.3%
Canada	90-day Treasury bills plus 4%	2%	4%	8%
Ireland	0.0322% per day	3%	6%	12.5%
New Zealand	5% of tax, plus 2% per month	11%	17%	29%
United Kingdom	5% of tax, plus 5% after 6 months	5%	10%	10%
United States	0.5% of tax per month	1.5%	3%	6%

Source OECD, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2006)*, October 2006, pp 57, 69-71, viewed on 31 January 2007 at <http://www.oecd.org/dataoecd/43/7/37610131.pdf>.³⁵ This series is published every two years.

6.43 The National Institute of Accountants suggested to the Committee how the interest charges might operate differently. It suggested that the legislation split the GIC into two components. The first would be a base rate of the RBA's bank bill rate (historically between 4% and 7%). The second would be the uplift factor (7% for the GIC and 3% for the SIC). The ATO would apply the base rate in all cases and the uplift factor where the taxpayer has committed some wrongdoing.³⁶

6.44 The Institute's argument was that:

While the NIA understands the need for the GIC and to have the GIC set at a rate that discourages the use of public funds as an alternate source of finance, many taxpayers to whom the GIC has and will apply to, do not have the intention of using public funds as a source of finance and nor have they benefited from being late in paying their tax liability.³⁷

6.45 Although the Committee appreciates that some taxpayers may not benefit from incurring the GIC, there are several reasons why the Committee does not support the proposal. The first is that it would turn the interest charges into penalties. There is already a straightforward system of penalties in place which, in the view of the Committee, does not need significant change.

35 Australian bills rate was approximately 5.5% in 2006, see Treasury, sub 51, p 10. Canadian bill rate in 2006 was approximately 4%, Bank of Canada, 'Treasury Bill Auction - Average Yields - 3 Month,' viewed at http://www.bankofcanada.ca/pdf/annual_page3_page4.pdf on 1 June 2007.

36 National Institute of Accountants, sub 31, p 6.

37 Ibid.

- 6.46 The second reason is that some taxpayers do use the ATO as a source of finance. Treasury made this argument,³⁸ as did the ATO in evidence:

In fact, one of the reasons we have concerns about debt at the microbusiness end of small business is that, because they do not need to apply and they do not need security, they can pay off their suppliers using amounts that should have been used to pay off tax debts...

Research we have done is that one of the reasons the debt figure tends to be higher in small business, particularly microbusiness, is that the facility of incurring the debt by not paying the tax is convenient to them...³⁹

Low-doc and no-doc loans are secured against real estate – that is how they work – whereas these people often have their assets fully charged and ... this is a very easy line of credit to obtain.⁴⁰

- 6.47 The Committee does not believe this category of taxpayer should benefit from accessing cheap finance from the ATO. Further, the Committee can foresee that there would be considerable difficulties in distinguishing between taxpayers who intended to use the ATO as a cheap source of finance and those who did not. Instead, taxpayers who have a good record and make a reasonable attempt to meet their tax obligations will have a good case for requesting the ATO to remit the interest charges.
- 6.48 Generally, the Committee would prefer that the systems for penalties and interest remain as simple as possible. The Commissioner has discretion for remitting penalties and interest and this is the stage where the system can take individual factors into account.

Remissions

How the ATO remits penalties

- 6.49 Section 298-20 in Schedule 1 to the *Taxation Administration Act 1953* gives the Commissioner wide discretion to remit penalties. The only requirement the section makes of the Commissioner in making a decision

38 Treasury, sub 51, p 10.

39 D'Ascenzo M, transcript, 20 April 2007, p 6.

40 Konza M, transcript, 20 April 2007, p 6.

is that the ATO must give an explanation if it does not remit the entire penalty.

- 6.50 The ATO has drafted policies on remitting penalties. In relation to a tax shortfall, the main factor relevant to remitting a penalty is whether the taxpayer has a good compliance history. This occurs where the taxpayer:
- meets all lodgment obligations
 - pays all non-disputed debt or has a payment arrangement in place
 - has no recent history of a shortfall penalty.
- 6.51 The ATO notes that taxpayers who demonstrate that they have taken reasonable care will not receive a penalty in the first place. Requests for remitting a shortfall penalty will come from taxpayers who, at the minimum, have not exercised reasonable care. The ATO sees little likelihood of remitting a penalty involving recklessness or intentional disregard.
- 6.52 The sort of example where the ATO envisages that it might remit a penalty for lack of reasonable care would be where the taxpayer:
- has a good compliance history
 - makes an isolated, unintended record keeping mistake
 - the mistake is not related to an extraordinary event (e.g. a large or infrequent transaction).⁴¹
- 6.53 In relation to a penalty for failure to lodge a document, the taxpayer must usually demonstrate that this occurred due to circumstances beyond their control. They should also explain why they were unable to request an extension from the ATO. However, if a taxpayer cannot meet these requirements, the ATO will still consider the request for remission. The relevant criteria are:
- the length of time the document was overdue
 - the taxpayer's and tax agent's circumstances
 - the taxpayer's lodgment history
 - any relevant contact with the ATO before the document was due.⁴²

41 ATO, 'Administration of shortfall penalty for false or misleading statement,' PS LA 2006/2, paras 136-58, viewed on 4 June 2007 at <http://law.ato.gov.au/atolaw/print.htm?DocID=PSR%2FPS20062%2FNAT%2FATO%2F00001&PiT=99991231235958>.

42 ATO, 'ATO Receivables Policy, Part F, Penalties and interest relating to receivables activities,

How the ATO remits interest charges

- 6.54 In the case of tax shortfalls and the SIC, the legislated principles that the ATO must take into account are:
- to remit where it would be fair and reasonable to do so
 - not to remit just because the taxpayer's shortfall benefit during the period is less than the SIC
 - to remit where the Commonwealth has contributed to the SIC.⁴³
- 6.55 The ATO has published its policy on shortfall interest in Law Administration Practice Statement 2006/8. The main reason for remission is delay. For example:
- ATO delay in commencing an audit or completing an audit leads to remission of interest charges to the base rate for that period
 - unreasonable delay by the ATO in conducting an audit leads to full remission
 - delay at the request of the taxpayer, if agreed by the ATO, leads to remission to the base rate
 - where the taxpayer requests a delay due to circumstances outside their control, there can be full remission.⁴⁴
- 6.56 There are also some circumstances where the ATO will remit interest as a matter of course. For instance, the ATO remits small amounts of interest automatically because the administrative costs of collection outweigh the revenue benefits. Another example relates to tax shortfalls from 2003-04 and earlier years. These taxpayers are legally required to pay the GIC on these debts. However, the ATO remits enough of the interest so these taxpayers are only paying the equivalent of the SIC from 1 July 2005 (the SIC's start date).⁴⁵
- 6.57 The ATO will also remit shortfall interest in full where legal change or incorrect ATO advice creates a shortfall. Examples of these situations are:

Lodgment penalty,' paras 98.4.16-98.4.23, viewed on 4 June 2007 at <http://law.ato.gov.au/atolaw/view.htm?DocID=RMP%2FRP0098>.

43 Section 280-160 in Schedule 1 to the *Taxation Administration Act 1953*.

44 ATO, *Remission of shortfall interest charge and general interest charge for shortfall periods*, PS LA 2006/8, pp 9-13.

45 *Id.*, pp 8, 18.

- where the ATO gives incorrect advice or has an incorrect general administrative practice
- where a taxpayer relies on an interpretive decision that is later found to be incorrect
- where a taxpayer relies on a judicial or tribunal decision which is overturned on appeal
- where a tax return is accurate at the time of lodgement, but later events trigger an additional liability.⁴⁶

6.58 For the GIC, section 8AAG of the *Taxation Administration Act 1953* outlines four main criteria for remission:

- the taxpayer did not cause the GIC accruing and they have attempted to mitigate the situation
- the taxpayer caused the GIC accruing, they have attempted to mitigate the situation, and it would be fair and reasonable to remit
- there are special circumstances making it fair and reasonable to remit
- it is otherwise appropriate to remit.

6.59 The ATO's receivables policy explains these criteria. For example:

- factors beyond the control of the debtor are limited to specific matters such as natural disasters⁴⁷ and industrial action, rather than general economic conditions
- taxpayers must take mitigating action promptly
- it would be fair and reasonable to remit where compliant taxpayers who meet their obligations would consider it fair and reasonable to do so for the taxpayer in question
- the ATO can take into account a taxpayer's compliance history
- the ATO is most likely to use the 'otherwise appropriate to remit' category for a group of taxpayers. One example would be the mass marketed investment schemes.⁴⁸

46 Id, pp 19-21.

47 The ATO has made allowance for taxpayers and tax agents affected by the Hunter Valley and Central Coast floods in June 2007. See ATO, 'Tax help for people affected by the NSW floods,' Media release 2007/25, viewed on 15 June 2007 at <http://www.ato.gov.au/corporate/content.asp?doc=/content/85462.htm>.

6.60 The receivables policy also outlines a number of particular circumstances where the ATO will remit some GIC. For instance, the ATO can remit GIC where a taxpayer is on social security and has no assets. Another example is where a taxpayer is in dispute with the ATO and pays all non-disputed tax and 50% of disputed tax. The ATO will remit 50% of the GIC on the unpaid disputed tax in these circumstances.⁴⁹

Groups of taxpayers in dispute with the ATO

6.61 In 2004, the Inspector-General of Taxation finalised a report on how the ATO remitted the GIC for groups of taxpayers in dispute with the ATO. The report focussed on employee benefit arrangements. The Inspector-General's main findings were that the ATO:

- was taking a narrow approach to remitting GIC, with the implication that it could remit more widely
- should differentiate how it remits GIC in relation to interest accruing before and after an amended assessment
- should base remission decisions on taxpayers' individual circumstances, rather than a 'one size fits all' approach
- should establish internal reviews of remission decisions involving large groups of taxpayers
- had inconsistently treated taxpayers between different employee benefit arrangements.⁵⁰

6.62 In contrast, the ATO argued that it was acting as the law required and that it did not have scope to compensate for inappropriate legislation. If there were problems with the tax laws, that was a matter for Parliament. However, the ATO agreed to establish a review panel of senior ATO officers to oversee remission decisions involving large numbers of taxpayers.⁵¹ Following the Inspector-General's report, the ATO made various settlement offers to taxpayers depending on their individual circumstances (discussed in chapter one).

48 ATO, 'ATO Receivables Policy, Part F, Penalties and interest relating to receivables activities, General interest charge,' paras 93.5.6- 93.5.24, viewed on 5 June 2007 at <http://law.ato.gov.au/atolaw/view.htm?DocID=RMP%2FRP0093>

49 Id, paras 93.6.2, 93.6.7.

50 Inspector-General of Taxation, *Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office* (2004) Commonwealth of Australia, pp 6-10.

51 Id, pp 68-69.

6.63 The Government addressed the issue of the rate at which interest accrues prior to an amended assessment by introducing the SIC.

6.64 The Ombudsman advised that the ATO responded constructively to the Inspector-General's report:

It is also important to acknowledge the ATO's positive response to the [Inspector-General of Taxation's] review in relation to areas over which it had some responsibility and ability to provide remedies. For example, the ATO undertook a review of its remission guidelines and established a panel of senior tax officers to consider when widely-based settlement offers are appropriate. It invited participants in [employee benefit arrangements] to apply for remission of interest and penalties based on their individual circumstances, and prepared guidelines outlining the circumstances that would lead to a remission being granted. We regard this as a tailored and appropriate response.⁵²

6.65 The Committee would prefer that situations such as the mass marketed schemes and employee benefit arrangements occur as rarely as possible. They threaten the integrity of the tax system. Further, the ATO's delayed response caused immense difficulty to the unsophisticated taxpayers involved. The consequences included suicide, broken marriages and acute personal distress.

6.66 The ICAA has also argued that settlement offers to participants in various schemes have not always been consistent.⁵³ As a solution, the Inspector-General of Taxation suggested to the Committee that the ATO should better explain how it constructs these offers:

The challenge for the Tax Office is to provide the rationale(s) behind these apparently different treatments and to demonstrate that they are consistent, and have a sound basis in fairness and good public administration. It needs to do this, because the community has developed negative perceptions that the Tax Office is not fulfilling its role as fair administrator and worse, that it is biased in favour of certain kinds of taxpayers.

Part of the Tax Office's explanation for these different compliance treatments may turn on its categorisation of the compliance behaviours involved.⁵⁴

52 Commonwealth Ombudsman, sub 38, p 14.

53 ICAA, sub 37, p 14.

54 Inspector-General of Taxation, sub 48, p 14.

- 6.67 In relation to mass marketed investment schemes, the ANAO noted that taxpayers were confused about some aspects of the settlement:

Although the ATO has not set out its rationale for making such distinctions in specific detail, its basis for judgement in relation to participants is suggested in sufficiently clear terms in the press release announcing the settlement and the Commissioner's letter of 15 February 2002 to scheme investors. In respect of the types of schemes, the rationale for limiting the settlement offer to only [mass marketed investment schemes] ... is not explicitly enunciated other than to allude to 'unique circumstances' in which the [schemes] were sold.

We are aware, from discussions with stakeholders and representatives of some of the tax professional bodies, that some investors have questioned the exclusion from the settlement process of certain 'mass marketed schemes' in which they were involved.⁵⁵

- 6.68 The Committee admits that the offers have logic in that they are graded in terms of taxpayer compliance. However, the community pays a great deal of attention to these offers and taxpayers have, in the past, been confused about some aspects of these settlements. It appears that further explanation from the ATO is necessary to provide additional assurance to taxpayers that ATO decisions for large scale disputes are consistent.

Recommendation 16

- 6.69 **The ATO explain the reasoning behind its settlement offers for large scale disputes in its public statements.**

Settlements

Introduction

- 6.70 Settlements occur where there is a dispute between the taxpayer and the ATO and the parties resolve the dispute through agreement rather than

55 ANAO, *The ATO's Management of Aggressive Tax Planning*, Audit Report No. 23 2003-04, 29 January 2004, p 102.

court action. In its annual report for 2006-07, the ATO outlines its philosophy behind settlements:

A settlement involves an agreement or arrangement between parties to finalise their matters in dispute where it is in the best interests of the Commonwealth to do so. While the Commissioner's basic duty is to administer tax law through assessing and collecting taxes and determining entitlements, he also has an obligation to administer the tax system efficiently and effectively.⁵⁶ Settlements usually involve the need to balance competing considerations, and call for judgment and common sense.⁵⁷

- 6.71 In 2006-07, the ATO settled 1,580 cases relating to schemes (including mass marketed investment schemes and employee benefit arrangements) and 225 non-scheme cases.⁵⁸ This report has already discussed these schemes and the settlement process. For example, the large number of affected taxpayers in those schemes meant that a settlement was administratively efficient. Significant ATO delay in responding to mass marketed schemes and the fact many (mostly unsophisticated) taxpayers were subject to heavy, inaccurate marketing was also relevant to the ATO making a settlement offer.
- 6.72 For non-scheme cases, the top three reasons for settlement were:
- the cost of litigating was out of proportion to the possible benefits, including the likelihood of success
 - the cases were complex or the ATO faced evidence problems
 - settlement was a cost effective way of securing taxpayer compliance in future.⁵⁹
- 6.73 In *An Assessment of Tax* in 1993, the JCPA noted complaints that the ATO lodged ambit claims with taxpayers prior to negotiation. The JCPA reported evidence that sometimes taxpayers paid and settled, just to get the process completed.⁶⁰

56 Section 44 of the *Financial Management and Accountability Act 1997* requires chief executives to use agency resources in an efficient, effective and ethical manner.

57 ATO, *Annual Report 2006-07*, p 113.

58 Id, p 114.

59 Ibid.

60 JCPA, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) Report 326, p 280.

6.74 In that report, the JCPA observed that settlements were an efficient way of balancing the competing priorities of taxpayer obligations under legislation and the cost of litigation and difficulty sometimes in obtaining sufficient evidence. Where the law is unclear, the JCPA argued that the ATO should fund test cases. Where the law is clear, the ATO should conduct settlements supported by robust processes. In particular, the JCPA recommended that three ATO officers be present at settlement negotiations and that the ATO take audio recordings of them.⁶¹ The ATO advised the Committee in 1998 that it had two or three officers attend settlement negotiations, depending on the complexity of each case. The ATO stated that it provided audio tapes of settlement negotiations to taxpayers on request.⁶²

6.75 In 2000, the Senate Economics References Committee tabled its report, *Operation of the ATO*. That Committee noted that settlements can be a two-edged sword:

The use of settlements is seen by the ATO as consistent with the 'good management rule', which has been upheld and encouraged by the courts.

However, the secrecy surrounding settlements has laid them open to the perception, both in the community and within some quarters of the ATO itself, that they are a device that can be used to provide favourable or "soft" treatment to certain taxpayers, mainly big business or high wealth individuals...

On the face of it, settlements make good sense, providing the ATO with the flexibility to enter arrangements that on balance are in the overall interest of the tax system. The onus is on the Commissioner, however, to ensure that settlements are resorted to only when prescribed. If not managed and controlled the potential for settlements to be misapplied or abused is significant.⁶³

6.76 The Senate Committee made recommendations to make the process more robust and transparent. In particular, it suggested that the ATO have the legislative power to record settlement negotiations, rather than relying on a taxpayer's consent. Further, it argued that the ATO should publish the following performance information on settlements:

- numbers of cases settled per annum

61 Id, pp 281-82.

62 ATO, 'Final Report on the Implementation of the Recommendations of Report 326' An Assessment of Tax'', correspondence, 20 October 1998.

63 Senate Economics References Committee, *Operation of the ATO* (2000) p xiv.

- cases identified by business line
 - the difference between tax assessed and paid (by business line)
 - an explanation of why there are differences between the amounts assessed and paid.⁶⁴
- 6.77 The Senate is yet to receive a response to the Senate Committee's recommendations. While the issue of government responses to Senate committee inquiries is a matter for the Senate, this Committee is concerned that significant committee work is not being acknowledged in a meaningful way by the Executive.
- 6.78 The ATO reported to the Senate its progress in implementing the report as follows:
- The Australian Taxation Office has carefully considered the recommendations that relate to it, but several of the recommendations were overtaken by legislative and other developments. A report showing the current status of the recommendations is currently being prepared.⁶⁵

Code of settlement practice

- 6.79 The ATO's main policy in relation to settlements is the Code. The ATO first issued settlement guidelines in 1991. These guidelines were ineffective, due to control weaknesses and low levels of compliance within the ATO.⁶⁶ The ATO then revised the guidelines and retitled the document as the Code in 1999, with a further revision in 2001. The ATO released the current Code in February 2007.⁶⁷
- 6.80 The Code lists a number of reasons where it may be appropriate to settle a matter. They include the factors that the ATO's annual report lists, namely problems with evidence, complexity, securing taxpayer compliance in future, and costs of litigation outweighing the likely benefits. There are two other main reasons. The first is where the matter involves unique and special features making it unsuitable for litigation, such as a dispute over the valuation of an asset. The second is where taxpayers engaged in

64 Id, p 75.

65 'Government Responses to Committee Reports,' tabled by the Hon Senator Vanstone, *Senate Hansard*, 7 December 2006, p 113.

66 Senate Economics References Committee, *Operation of the ATO* (2000) p 71.

67 ATO, 'Code of Settlement Practice,' Background, viewed on 26 February 2007 at <http://www.ato.gov.au/print.asp?doc=/content/8249.htm>.

avoidance accept the ATO's view and settlement helps them unwind existing arrangements.⁶⁸

6.81 The document also gives a number of reasons for which it would not be appropriate to settle. They generally focus on implications of settlement for the tax system overall and the strength of the ATO's case. The reasons include:

- settlement would be contrary to policy reflected in the law
- the ATO wishes to internally escalate the matter to settle its view
- the matter is clear cut and none of the reasons to settle exist
- settlement would treat taxpayers inconsistently
- litigation could have a significant compliance effect for other taxpayers.⁶⁹

6.82 The Code sets out a number of processes to ensure internal accountability within the ATO for settlements:

- only certain senior officers with the appropriate delegations can authorise settlements
- the settlement process must be fully documented
- the ATO maintains a corporate register of settlements
- the ATO reviews a sample of settlements under its technical quality reviews.⁷⁰

6.83 Widely based disputes comprise a special category of settlements. The Code requires ATO officers to follow the principles and procedures described in Law Administration Practice Statement 2007/6 for the settlement of widely based tax disputes.⁷¹ A dispute must involve at least 20 taxpayers for the ATO to regard it as widely based.⁷²

6.84 The main additional procedural requirements for ATO officers involved in widely based disputes is that they must:

68 Id, para 26.

69 Id, para 25.

70 Id, para 6.

71 Id, Background.

72 ATO, 'Guidelines for settlement of widely-based tax disputes,' PS LA 2007/6, para 3, viewed on 26 February 2007 at <http://law.ato.gov.au/atolaw/view.htm?DocID=PSR/PS20076/NAT/ATO/00001&PiT=99991231235958>.

- obtain advice from the ATO's Tax Counsel Network
 - seek advice from the widely based settlement panel
 - discuss the advice with the Chair of the panel if they do not accept it.⁷³
- 6.85 The guidelines state that ATO officers are to divide a widely based settlement proposal into three parts. The first is the base settlement proposal. The other stages are to identify different grades of offer for groups of taxpayers and to establish procedures for the ATO to take into account individual taxpayers' circumstances.⁷⁴
- 6.86 In developing the proposal, ATO officers need to take into account the following factors:
- the cost to revenue
 - the impact of settlement on compliance, both with the taxpayers involved and the wider community
 - justifiability of the settlement to the wider community, including comparisons with previous settlements
 - the taxpayers' circumstances, including the nature of the advice they received
 - whether the legal status of the tax arrangement is clear or not
 - whether either party has rejected previous proposals to settle.⁷⁵
- 6.87 These guidelines reflect the ATO's experience with employee benefit arrangements. Then, the Inspector-General of Taxation criticised the ATO for not sufficiently differentiating between taxpayers. The Code and other guidance mean that, if another widely based dispute arises, taxpayers are more likely to receive a settlement offer commensurate with their circumstances.

Discussion

- 6.88 The Committee agrees that the ATO will need to settle disputes with taxpayers on a regular basis. Given the costs and uncertainty of litigation and the value of maintaining taxpayer compliance, settlements have a role in effectively and efficiently managing the tax system. The Full Federal

73 Id, paras 6, 8, 28, 32.

74 Id, paras 23-26.

75 Id, para 40.

Court has stated that settlements are consistent with the Commissioner's role:

Perhaps further discussions between the parties and their legal advisers will result in a sensible adjustment of the matters ... The alternative is probably further protracted litigation with its consequent delay and expense. We realise that the Commissioner is mindful of the important public duty which he has in administering the Act. Nevertheless, if this were a commercial dispute, there would be much to be said for the view that a further attempt at settlement should be made, perhaps with the aid of an appropriate mediator. We see no reason associated with the Commissioner's powers and duties which should dissuade him from that course if he thought it otherwise an appropriate one for him to follow.⁷⁶

6.89 The Taxation Ombudsman made a similar comment:

My office has taken a restrained approach in this area. We accept that while settlement proposals and processes fall within our broad jurisdiction, provided the settlement process is reasonably fair, open and equitable, settlement matters involving negotiation are often best left to the parties in dispute.⁷⁷

6.90 The Committee agrees. As long as the appropriate processes are in place, then settlements can be an effective, efficient and fair method of resolving uncertain and complex disputes, delivering a fair outcome to taxpayers entering into schemes marketed by others that are found to be non-compliant, or managing widely based disputes.

6.91 Therefore, the Committee considered whether current processes are sufficiently robust. Despite updates to the Code of Settlement, submissions raised the traditional concerns in relation to settlements. These were that the ATO makes ambit claims to encourage taxpayers to settle,⁷⁸ and that the ATO is inconsistent, including giving wealthy taxpayers preferential treatment.⁷⁹ The ambit claim allegation is

76 Sheppard, Foster and Whitlam JJ, *Groffam Pty Ltd v FCT* [1997] 660 FCA (26 March 1997) viewed at http://www.austlii.edu.au/au/cases/cth/federal_ct/1997/660.html on 15 June 2007.

77 Commonwealth Ombudsman, sub 38, p 12.

78 National Institute of Accountants, sub 31, p 7, name suppressed, sub 32, p 1, ICAA, sub 37, p 14, Resolution Group, sub 42, p 16. In 2007, the ATO settled a \$515 million case with Rio Tinto for one third of the ATO's initial claim: Kazi E, 'ATO repays \$42 million in tax to Rio Tinto,' *Australian Financial Review*, 15 June 2007, p 33.

79 Seage C, sub 23, pp 2-6, ICAA, sub 37, p 14, Resolution Group, sub 42, p 16, Robinson D, sub 45, p 2, Fitton R, sub 53, pp 1-2.

concerning, given that previous versions of the Code have stated that penalties and interest are not to be used as a lever to settle cases.⁸⁰

- 6.92 On the other hand, the Taxation Ombudsman noted the concern over consistency but was positive about how the ATO manages the process overall:

Inconsistency in ATO practices is often alleged in complaints about the ATO's handling of settlements, particularly in cases involving tax avoidance. In our experience, there have been some deficiencies and inconsistencies in the ATO's approach, particularly at the time this office prepared reports into the ATO's administration of the Budplan and Main Camp schemes. My office has since observed improvements in ATO practice that have resulted in a more coordinated, consistent and comprehensive approach. Now, the prevailing issue for my office mostly relates to delays in process rather than more 'substantive' concerns such as inequity or arbitrariness in decision-making.⁸¹

- 6.93 Despite the Ombudsman's positive overall assessment, the Committee is concerned at the negative perceptions about settlements. The Committee is of the view that the ATO's processes need further improvement, particularly with a view to showing taxpayers and the general community that it conducts its settlements fairly and consistently.
- 6.94 One way of addressing perceptions is to increase transparency. Currently, the ATO reports on the number of cases settled and divides them according to whether they are scheme or non-scheme matters.⁸² However, this information does not meet the concerns that wealthy taxpayers get treated more leniently or that the ATO uses penalties and interest as a lever to settle.
- 6.95 In 2000, the Senate Economics References Committee recommended that the ATO should publish more data on settlements, including the difference between the tax assessed and what was paid and differentiating the results between business lines.⁸³
- 6.96 Such data would help meet negative perceptions about settlements. The differences between business lines would show whether wealthy taxpayers receive preferential treatment. The difference between the tax assessed and what is paid would show whether the ATO uses penalties

80 ICAA, sub 37, p 14.

81 Commonwealth Ombudsman, sub 38, p 12.

82 ATO, *Annual Report 2006-07*, p 114.

83 Senate Economics References Committee, *Operation of the ATO* (2000) pp xiv-xv.

and interest as a negotiating tool. If particular patterns show up in the data, then the ATO has the opportunity to explain them in its annual report. It can also be held accountable for the information at the biannual meetings with this Committee or at Senate Estimates.

- 6.97 Currently, the Code of Settlement Practice lists a number of processes as promoting accountability and transparency. These include a register of settlements and fully documenting each settlement.⁸⁴ The Committee agrees that these make settlements more robust, but they focus on internal accountability, rather than making the ATO more accountable externally. Therefore, the Committee reiterates the recommendation of the Senate Economics References Committee in 2000.

Recommendation 17

- 6.98 **The ATO publish in its annual report additional statistics in relation to settlements, such as the revenue collected through settlements and the proportion of amended assessments that taxpayers agree to pay. The ATO should also comment on significant variations across business lines.**

Transparency

- 6.99 In discussing this chapter, the Committee considered it would be helpful to establish how much revenue was involved in relation to penalties, interest and remissions. In its 2000 performance audit on penalties, the ANAO reported that the ATO imposed approximately \$1 billion annually in penalties from 1995-96 to 1998-99. It generally remitted \$200 million of this amount each year.⁸⁵
- 6.100 The Committee saw value in reproducing recent data on penalties, interest and remissions but it appears little information is publicly available. The ATO does not publish this data in its annual report, apart from its financial statements. There, the ATO has a line for 'penalty remission expense', which was approximately \$1 billion in 2005-06 and \$1.6 billion in 2006-07.⁸⁶

84 ATO, 'Code of Settlement Practice,' para 6, viewed on 26 February 2007 at <http://www.ato.gov.au/print.asp?doc=/content/8249.htm>.

85 ANAO, *Administration of Tax Penalties*, Audit Report No. 31 1999-2000, 16 February 2000, p 21.

86 ATO, *Annual Report 2006-07*, p 332.

- 6.101 The management of penalties, interest and remissions is a major aspect of the ATO's interactions with taxpayers. It plays a key role in the ATO's compliance model. In the view of the Committee, the ATO should be producing regular public information on this activity as a matter of course.

Recommendation 18

- 6.102 **The ATO include in its annual report performance information about the amount of revenue collected through penalties and interest and the amount of revenue (divided between penalties and interest) remitted back to taxpayers. Where appropriate, this should be accompanied by discussion.**

Conclusion

- 6.103 In this chapter, the Committee has concluded that many of the policy settings for tax debt are appropriate. Further, the ATO's practices are generally adequate; the ATO has largely satisfied its external scrutineers. However, concerns about perceptions remain. For example the Committee received statements that the ATO makes ambit claims in settlement negotiations and gives wealthy taxpayers preferential treatment.
- 6.104 Therefore, the Committee has chosen to concentrate on transparency in its recommendations in this chapter. Decisions about penalties and, in particular, remissions and settlements involve the ATO applying its discretion in its decisions. If the ATO's practices are appropriate, it is now up to the ATO to demonstrate this to its stakeholders. Better reporting of its activities and raising its technical quality benchmarks for penalty and debt decisions so that they are the same as for the rest of the ATO's operations are important first steps in addressing these perceptions.

