Inquiry by the Joint Committee of Public Accounts & Audit, reviewing a range of taxation issues within Australia

A submission from Resolution Group Australia

9 March 2006

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Submission to Inquiry into Taxation Matters

This submission focuses on the Inquiry's first three criteria (listed in Part A of the Committee's Terms of Reference announced on 8 December 2005) in the context of past events, specific provisions of recent legislation and changes in administrative practice proposed by the new Tax Commissioner.

- **The impact of the interaction between self-assessment and complex legislation and rulings;**
- **The application of common standards of practice by the ATO across Australia;**
- **The level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge;**

Following the passage in December 2005 of the Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005, the exposure of taxpayers to retrospective amendments and additional liabilities has increased. Although the legislation was a result of recommendations from the Department of Treasury's Review of Self-Assessment (ROSA) some of the legislative provisions finally introduced were a reversal of the ROSA recommendations.

The new Commissioner's public statements indicate an increased use of discretionary power and administrative practice rather than strict compliance with the legislation. While taxpayers' may initially welcome the more flexible approach, the recent legislation allows the Commissioner to alter position at a later date and retrospectively impose liabilities. Uncertainty and lack of finality for taxpayers is thus increased.

Overview

An inherent part of the Australian Taxation Office (ATO) Commissioner's general power to administer the tax laws is the power to make judgments about the interpretation and application of the tax law.

In his second public statement after taking over as Commissioner this year, Mr D'Ascenzo said the tax office would be "practical" when it came to complying with tax law - relying more on procedural rulings, and **less on legislation**.[1]

The article also reported that the Office of the Inspector-General is keen to review the Tax Commissioner's inherent powers in its inquiry on self-assessment in April. Acting Inspector-General of Taxation (and former ATO Assistant Commissioner) Mr Matthews referring to Mr D'Ascenzo's statement is reported to have said: "He holds the need to be consistent and very careful -- **misuse of the general powers can lead to adhockery in administration and perceptions of inconsistency.** The aspirations for using it - where it makes good administrative sense **seems sound** - but they need to be exercised carefully." (emphasis added).

The Commissioner's discretionary power to interpret and apply the tax law creates uncertainty and difficulty for taxpayers. The uncertainty and difficulty arises because:

- Tax law is complex;
- The Commissioner's interpretation and application of the law is historically inconsistent and varies from taxpayer to taxpayer; and
- The Commissioner often alters the interpretation and application of the law and applies the altered view with retrospective effect to the detriment of taxpayers.

Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005 contains a provision that legislatively endorses the Commissioner's authority to alter position and impose retrospective tax liabilities on taxpayers. Instead of improving clarity and certainty in tax administration section 361-5 of this legislation increases the uncertainty for taxpayers.

Over the last ten years hundreds of thousands of taxpayers have incurred tax liabilities that are still outstanding and disputed. A primary cause is the retrospective application of changes in interpretation and application of tax laws by the Commissioner.

The Tax Laws Amendment (improvements to Self Assessment) Bill (No 2) 2005 requires amendment to remove the Commissioner's authority to alter position

[1] Elizabeth Colman, The Australian 7 February 2006 "Tax red tape rethink"

and impose liabilities on taxpayers who have acted in accordance with the Commissioner's previous interpretation and application.

Specific legislation

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

Division 361 – Non-ruling advice and general administrative practice

361-5 Non-ruling advice and general administrative practice

*(1) You are not liable to pay the *general interest charge or the *shortfall interest charge under a relevant provision to the extent that the charge would relate to a *shortfall amount that was caused by:*

(a) you reasonably relying in good faith on:

*(i) advice (other than a ruling) given to you or your *agent by the Commissioner; or*

(ii) a statement in a publication approved in writing by the Commissioner;

unless the advice, or the statement or publication, is labeled as non-binding; or

(b) you reasonably relying in good faith on the Commissioner's general administrative practice.

*(2) However, subsection (1) does not apply to any *general interest charge accruing more than 21 days after the Commissioner notifies you of the correct position.*

(3) Ignore the operation of section 284-215 in applying subsection (1).

Practically this means that if a taxpayer enters into transaction in accordance with long-standing practice (e.g. advice, general administrative practice or public statement), the Commissioner is NOT bound and can adjust past transactions and retrospectively impose a tax liability.

General Interest Charge is incurred for amounts outstanding 21 days after notification from the Commissioner. Section 284-215 is not applicable.

Concern with legislation:

- Endorses the Commissioner altering position and retrospectively imposing tax liabilities;
- A retrograde step that creates more uncertainty and imposes greater liability than under current legislation;
- Does not rectify the mischief identified in the ROSA review, i.e. lack of certainty and fairness;
- Does not provide time to become aware of and act upon changes;
- "General Administrative practice" is not defined;
- Falls short of the recommendations from Treasury as necessary to "improve the self-assessment system";
- Only applicable to 2006 and later years. That means the protection against penalty and interest only becomes available to income years after that date;
- Overrides current provisions – refer 361-5 (3).

Because of the Commissioner's practice of changing position on the interpretation and application of the legislation and retrospectively imposing tax liabilities, Federal Treasury in the ROSA report recommended that changes in position should only be applied prospectively. In doing so Treasury recognised that the Commissioner's practices were incompatible with the principles of fairness, equity and certainty. Also, by recommending a legislative remedy Treasury clearly intended that there should be a clear restriction on the Commissioner's discretionary powers.

The current legislation actually goes in the opposite direction, because it enshrines in law the past conduct of the Commissioner by clearly allowing the Commissioner to retrospectively raise primary tax liabilities.

The legislation creates more uncertainty for taxpayers and allows the Commissioner to alter administrative practice, advice, statements or publications and retrospectively impose a tax liability. In addition, if the taxpayer disputes the liability and does not pay the tax imposed within 21 days, the general interest charge begins to accrue. In effect the Commissioner has been given legislative approval to use the excessive GIC rates as a means of intimidating taxpayers into immediate payment without time to dispute the correctness of the Commissioner's alteration in position.

Accordingly, rather than improving the balance of equity and certainty for taxpayers the legislation creates a tax environment of risk, uncertainty and liability. This legislation cannot be good public policy, especially when the legislation was introduced under the guise of "improvements to the self assessment system."

Context of concerns

Tax legislation is often necessarily complex in order to achieve the aims of the legislation and protect revenue. The complexity usually stems from the necessity to address all the multitude of circumstances that may arise in individual transactions and close all the loopholes that taxpayers and members of the tax profession may seek to exploit.

Complex legislation however, is inherently difficult to interpret and apply. These difficulties in application and interpretation impact upon taxpayers in the form of uncertainty and increased risk of non-compliance and consequent exposure to additional tax, penalties and interest. Taxpayers must, either take a conservative approach and risk the disadvantage of paying more than their fair share of tax or risk exposure to additional tax, penalties and interest. Taxpayers may incur significant costs for advice from tax professionals however, that outlay does not protect them from additional tax, penalties and interest when the ATO retrospectively disallows the transaction even though it was based on professional advice. In other words, complex, uncertain and undefined legislation imposes greater risk and compliance costs upon taxpayers.

The uncertainty and risk in the tax system is further compounded because of wide discretionary powers in the present framework of the tax administration.

Additionally, the self-assessment system itself increases the uncertainty and risk for a taxpayer. Under self-assessment, the taxpayer is fully responsible for ensuring that the correct tax is paid in each income year. Failure to pay the correct tax in every circumstance makes the taxpayer liable to heavy penalties and interest on the additional tax, penalties and interest. In other words, even though the legislation is complex and contentious the taxpayer bears the onus of interpreting and applying the legislation correctly or pays the consequences.

A critical part of the self-assessment equation is the authority of the ATO to amend taxpayer's returns two, four, six or more years after the returns are lodged and assessed to impose a tax liability.

Treasury on behalf of the ATO has given evidence during a Senate Inquiry[2] that on average 380,000 self-assessment taxpayers each year receive increased tax assessments as a result of ATO alterations to self-assessed returns. In addition to the Treasury estimate of affected taxpayers, since 1998 the ATO has targeted and reviewed specific groups and issued large numbers of additional ATO amended assessments.

Perhaps the largest group reviewed by the ATO involved what the ATO termed as mass marketed schemes and impacted upon over 60,000 taxpayers across the country. Other group reviews include approximately 7200 employee benefit arrangements, 3000 retirement village investors and approximately 3500 securities lending arrangements.

The ATO also targeted several thousand taxpayers with charter boats and thousands of accountants, lawyers and doctors with service trusts. In relation to the charter boats, the then Minister for Revenue and Assistant Treasurer the Hon. Helen Coonan intervened to stop the ATO review. The service trust issue was the subject of similar action by a group of Government MPs and Senators that stopped the ATO review.

The common thread in all of the above matters is that all of these taxpayers were following established ATO practices and advice over significant periods of time. In every case every taxpayer had submitted income tax returns fully disclosing the tax transactions and in every case the ATO had processed the returns and allowed the transaction generally without query. In several cases the ATO queried the transactions and in those cases after audit allowed the transaction. The ATO even issued hundreds of advance opinions, advice and public and private binding rulings confirming that the transactions complied with the ATO interpretation and application of the existing legislation.

However, when the ATO after four to six years decided that these arrangements were having a negative impact on revenue, the ATO altered position and adopted the view that the transactions did not comply with the legislation or intent of the legislation. In making this change and imposing harsh penalties the ATO

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[2] E 30 Senate—*Economics Legislation Committee Hansard*, Tuesday, 14 June 2005. **Evidence given by McCULLOUGH, Mr Paul Andrew, General Manager, Tax System Review Division, Department of the Treasury**

. . . .

Senator MURRAY—Behind what I am asking you is this: the only alternative would be a legislative amnesty, without asking you a policy question. As far as I understand the government has nothing like that in its mind or in prospect with respect to these situations.

Mr McCullough—Certainly not. I am advised that there are something **like 380,000 a year** where there could potentially be an application of an interest charge at some stage. Remissions need to be considered for that. . . . . *(emphasis added)*

exploited the provisions of the self-assessment system, which places full responsibility on the taxpayer regardless of the complexity of the legislation and ATO administrative practice confirming the taxpayers understanding and application of the legislation.

Term of Reference Number 1 – Part A

The impact of the interaction between self-assessment and complex legislation and rulings;

The impact of the interaction between self-assessment and complex legislation and rulings is confusion, uncertainty and a high level of ongoing risk for all taxpayers. In particular upwards of 380,000 taxpayers every year receive additional tax liabilities related to prior years that are onerous, unexpected and in about fifty per cent of cases that are taken to appeal, unjustified.

According to the Tax Commissioner's online update of 14 February 2006, the Tax Office has over 800,000 small businesses carrying outstanding tax debts cases, with a total value of $6.5 billion (as at 31 December 2005).

Complex legislation, failures in the administration and excessive penalties and GIC are contributory factors to the outstanding small business tax debt. These taxpayers have been alienated by the tax administration. As Mr D'Ascenzo admits, the tax office has been unable to contact these taxpayers by the normal processes including letters and calls to their businesses and agents. The Commissioner now proposes to exacerbate the alienation by calling in external debt collectors.

In addition to the individual taxpayers and small business taxpayers, the large corporate entities are also well represented as receivers of tax adjustments, penalties and interest. Over the last two years large entities such as BHP Billiton, NAB and St George Bank,[3] as well as Accountants Ernst & Young and KPMG[4] have all received multi million dollar tax adjustments. When these large corporations with the highest levels of professional tax advice cannot get it right, it seems unfair to expect the average taxpayer to get it absolutely correct or face a penalty.

[3] The West Australian, Friday 24 June 2005 page 43 – "Mining giant disputes it must pay $935m bill over claims linked to failed WA projects." (other) "Big Tax Hits – St George Bank, $206m; Orica, $214m; BHP, $213m; NAB, $307m; Toyota Australia, $400m; Adsteam, $877m."
[4] John Garnaut, Sydney Morning Herald, 18 May 2004 – "Second big firm hit in tax sweep".

As previously stated self-assessment places the onus on the taxpayer to correctly interpret and apply the legislation to individual circumstances and to pay the correct tax. Where the ATO imposes a tax liability greater than that self-assessed, the onus on disproving the additional liability rests on the taxpayer.

The ATO does not accept any responsibility for incorrect or misleading administrative practices or incorrect interpretation of the legislation. The courts have held that the Commissioner of Taxation cannot be estopped, although they have supported the Commissioner being subject to a quasi-estoppel in the form of a legitimate expectation.

An example of the confusion, extent of uncertainty and timeframe of ongoing risk of increased tax for taxpayers is the concept of “Assessment” under the legislation.

After a taxpayer lodges a tax return, the ATO issues a formal document titled “Notice of Assessment”. Where the taxpayer is an individual and liable to pay tax, the “Notice of Assessment” issued by the ATO is deemed an “Assessment” for the purposes of the legislation. Where the taxpayer is an individual and not liable to pay tax and even where withholding tax is paid but that tax is refunded and the net effect is that no tax is due under the self-assessment, the printed “Notice of Assessment” issued by the ATO to the taxpayer is deemed NOT an “Assessment” for the purposes of the legislation. It should be noted that taxpayers are not advised or made aware of this difference. Where the taxpayer is a company “Assessment” is deemed when the tax return is lodged.

The critical effect of the difference for the taxpayer is the taxpayer who receives an ‘Assessment” may only be subsequently amended by the ATO within specified time limits. For the taxpayer without an “Assessment” the ATO may issue an “Assessment” at any time without limit.

As a subsequent “Assessment” would only be issued if the ATO concludes that there is a tax liability, the “Assessment” must also impose additional tax in the form of penalties and interest for the period that the tax was outstanding, unless the Commissioner exercises his discretion to waive or reduce the additional amounts. Depending on how much later the ATO issues an “Assessment” the liability imposed under these circumstances would generally have a significant interest component.

Because of limited resources it is not possible for the ATO to audit every tax return and it is therefore accepted that the ATO requires a period of time to make amendments where required. However, that timeframe must not be unlimited in ordinary circumstances because taxpayers must also be entitled to certainty and finality in their tax affairs. For the average taxpayer the mere possibility of a tax liability dating back for an unlimited period is unacceptable. However, that is a

possibility because of the interaction of the self-assessment system, complex legislation and administrative exploitation by the Commissioner of Taxation.

On any reasonable view there should not be any possibility of Assessments dating back ten, twenty, thirty or more years except in cases of fraud or evasion. The time frame for fraud and evasion cases is unlimited under specific provisions of the Income Tax Assessment Act. However, the Commissioner obtained a similar unlimited time limit for zero tax returns by exploiting the interpretation of the legislation.

It is noted that the High Court endorsed the Commissioner's interpretation of what comprises an "Assessment" for the purposes of the legislation. However, this is just another example of a court judgment that defies commonsense and logic and ignores the fact that the document issued by the ATO to uninformed taxpayers clearly states "Notice of Assessment".

Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005 includes provisions to rectify this situation and makes a nil assessment an assessment and limits the time within which the ATO can make amendments in line with other assessments. However, the amendments only bring finality for taxpayers for the 2004-05 and later income years. Taxpayers in previous years remain exposed and uncertain for the unlimited period.

This example demonstrates how the Commissioner of Taxation exploits the interpretation and application of the legislation to increase the impact of his administration upon taxpayers. In this instance the legislators have recognised the inequity in the Commissioner's administration and introduced amending legislation to stop the Commissioner. However, it is clear that the Commissioner cannot be trusted to interpret and apply the legislation equitably, nor even with commercial good sense and in order to prevent continuing inequities legislation must wherever possible, be clear and certain. Legislators must not introduce undefined concepts or terms, knowing that the concept or term may be open to ambiguity and exploitation by both the Commissioner and taxpayers. Especially, when certainty may only be achieved after expensive legal action and interpretation by the Courts

Unfortunately, in Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005 and specifically section 361-5 of that legislation, this is exactly what the Government has done.

Division 361 and specifically section 361-5 relies on the concept of administrative practice. Prior to the introduction of this legislation several Government Senators and Members raised concerns with the Treasurer about the legislation and specifically that the term "general administrative practice" was not defined. In his response in a letter dated 10 October 2005 the Treasurer the Hon Peter Costello replied that the legislation "does not define the term 'general administrative

practice' leaving it to take its ordinary meaning, in line with current tax law." In other words taxpayers will be forced to litigate to establish the existence of a general administrative practice. It is apparent that the Treasurer has introduced legislation knowing that the interpretation and application will be the source of conflict and contention and require expense by both the ATO and taxpayers to obtain an interpretation.

While self-assessment was introduced as an improvement for taxpayers, it has been a trap for many and a bonanza for the revenue in the form of penalties and interest. Most taxpayers rely upon tax agents and a general understanding and perception of what the ATO accepts as sufficient compliance. Once a tax return is lodged and a refund is issued the taxpayer assumes that their tax affairs are in order. Consequently, when the ATO challenges the returns several years later and issues additional tax liabilities the impact upon many of these taxpayers is horrific. The combination of self-assessment and complex legislation has resulted in a greater impact because while the taxpayer may have unknowingly transgressed the tax law, the tax liability is usually higher because of the passage of time and the taxpayer is generally unprepared and often unable to cope with the liability.

Recommendation

- In the current system the taxpayer bears the onus of correctly interpreting and applying the legislation as well as proving that any amendment made by the ATO and increasing a liability is incorrect. In fairness, the responsibility for proving that an amended assessment increasing a liability is correct should be shifted to the ATO. This in our submission will balance the scales so that the taxpayer will still be obliged to get it right or pay a penalty but the ATO will have to prove that the taxpayer got it wrong.

Term of Reference Number 2 – Part A

The application of common standards of practice by the ATO across Australia;

In October 1995, then Commissioner Michael Carmody launched a draft of the Taxpayer's Charter. The Charter had been commissioned by the Federal Government to clarify the position of taxpayers and publish the obligations of the ATO in dealing with the public and business communities. Launching the draft Mr Carmody stated:

'While we have been given wide ranging powers to help us collect taxes effectively for the community, there must be a sense of balance between these powers and the rights of people in the community.'

'The ATO wants to approach the collection of revenue fairly and responsibly. The Taxpayers' Charter will provide people with more certainty and a greater awareness of their rights and responsibilities when dealing with us. It will help us develop a more open relationship with the community'.

When the final version was released in July 1997, Mr Carmody added:

"One fundamental right is that we treat a taxpayer as honest unless we have reason to do otherwise. This means that we are openly committing to the basic principle that when we deal with people, they are people."

Central to the principles outlined in the Charter was the commitment that the ATO would treat taxpayers fairly and always take into account their individual circumstances.

When the Mass Marketed dispute erupted in 1998, many taxpayers turned to the Charter to require the ATO to keep to it's commitments and consider their personal position rather than group them in a global campaign of retrospective amendment. Early in 2001, ATO officers were advising taxpayers that the Charter "wasn't black-letter law" and did not apply to investors in Mass Marketed schemes anyway because "there were too many of them". Written complaints to the "Complaints Resolution Service" provided by the ATO in accordance with the Charter, resulted in the Assistant Commissioner in charge of the global amendment campaign taking over from the Complaints Resolution Service and replying to all taxpayers with a common letter, in direct contradiction of the written commitments for individual and independent review promised in the Charter.

Although, some ATO lower level staff appeared prepared to discuss a taxpayer's affairs in the context of the Charter, the cavalier conduct of ATO management in excluding MMS taxpayers from the Charter provisions highlights the ATO's willingness to change standards when it suits. When considered in combination with the Commissioner's unique powers and relative immunity from intervention, taxpayers are left entirely exposed to the shifting sands of circumstances, management changes, differences of opinion between state offices and varying interpretations based on internal confidential decisions.

Since his appointment as Commissioner of Taxation Mr Michael D'Ascenzo has given several speeches on the future direction of the ATO that indicate this exposure is about to expand rapidly.

An article in The Australian dated 7 February 2006 titled *Tax red tape rethink* by Elizabeth Colman states:

> 'In his second public statement after taking over as commissioner this year, Mr D'Ascenzo said the tax office would be "practical" when it came to complying with tax law - relying more on procedural rulings, and **less on legislation'**.

The article also contained the following comments:

> ‘The Office of the Inspector-General is keen to review the tax commissioner's inherent powers in its inquiry on self-assessment in April’.
>
> Acting Inspector-General of Taxation Mr Matthews referring to the ATO Commissioner said ’He holds the need to be consistent and very careful -- **misuse of the general powers can lead to adhockery in administration and perceptions of inconsistency**’.
>
> ‘The aspirations for using it - where it makes good administrative sense **seems sound** - but they need to be exercised carefully.’
>
> ‘Taxation Institute of Australia senior counsel Michael Dirkis yesterday said the industry welcomed the approach. "I think what the commissioner is doing is good," Dr Dirkis said. "He's using inherent powers to make a bit wider the approach to compliance. He's signaled that where a rule is not wide enough, he's willing to stretch it, **despite what the law says**," he said.’

The problems and disputes with the previously mentioned groups of taxpayers have arisen because of the ATO Commissioner’s abuse of the inherent or discretionary powers of administration. In every case the ATO has accused the taxpayers of stretching the fabric of tax law and not complying with the spirit or intent of the legislation. The ATO has exercised the provisions of Part IVA of the Taxation Act to disallow transactions that comply fully with the general provisions of the tax act, because the discretionary power in Part IVA allows the Commissioner to override allowable transactions on the basis of a contention that the primary purpose of the transaction was to obtain a tax benefit.

Now the Commissioner is seen as signaling his intention to stretch the rules and disregard the law. While disregard of the law is not a new approach for the ATO, it seems that while the ATO may disregard the law without consequence, taxpayers are required to know and apply the law strictly even if the ATO is uncertain and pay enormous penalties for any transgression, real or implied.

The problem with the legislation is that it continues to give the Tax Commissioner wide discretion. The application of equity relies on the Commissioner exercising that discretion fairly, openly and consistently.

In relation to openness and scrutiny, section 16 of the Income Tax Assessment Act imposes a restriction on tax officers revealing tax information to anyone other than the taxpayer. The ATO use and exploit this provision as a weapon to conceal inconsistency and favouritism. Audit results and settlement arrangements are not open to scrutiny or external examination. The Gerard matter may be an example of favoured treatment or it may not, but because of the secrecy provisions the truth will never be known. The current system creates an environment where the ATO can act inconsistently and do special favours

knowing that there is no danger of being exposed. This is because any taxpayer who has received favoured treatment is not going to complain or reveal the details for fear of having them withdrawn and even those who know that special deals have been done cannot provide proof because neither the tax office nor the particular taxpayer will reveal the details. The problem stems from the width and scope of the Commissioner's discretionary powers.

The Commissioner has the discretion to audit one group of taxpayers without compulsion to do the same in respect of others, even if the issues are identical. That this is a regular occurrence is evidenced by the audits of the arrangements mentioned previously where certain groups were audited and penalised and for others the proposed audits were stopped. Similarly, the Commissioner is able to remit penalties and interest to nil for one individual or group but refuse to do so for others. In a recent enquiry by the Inspector-General of Taxation (IGT) and initiated by the then Minister for Revenue and Assistant Treasurer Helen Coonan the IGT concluded that the Commissioner's remission of interest was inconsistent for comparative groups of taxpayers. Despite these findings the Commissioner refused to correct the inconsistencies and apparently there was nothing that the IGT or the Minister could or would do to persuade the Commissioner to act consistently.

Where the Commissioner exercises discretion to remit penalties or interest for one taxpayer then every other taxpayer in the same circumstances should be automatically entitled to the same treatment. At the moment the Commissioner discriminates between taxpayers using a variety of reasons. In some cases the Commissioner claims better education or an expectation (regardless of the facts) by the Commissioner that the taxpayer must have a better knowledge or understanding of the tax law. This approach has been used, even in cases where the ATO themselves have been uncertain about the law over several years. Despite the ATO uncertainty of the law, the ATO deemed certain investors as "sophisticated" and treated them more harshly than "unsophisticated investors" although both taxpayers have acted identically.

While the law recognises that the extent of knowledge, understanding or education may play a part in determining whether the actions were an intentional contravention of the tax law or deliberately dishonest, tax law is so complicated and uncertain that even the best practitioners are not always correct in their interpretation and application. For example, statistics show that on average the ATO succeeds in the Courts only fifty per cent of the time. In other words the ATO get it wrong fifty per cent of the time. It should follow that the allegation of deliberate evasion or avoidance should only arise in circumstances where the law is clearly established. In the various disputes that have been mentioned the law was and in most cases still remains unclear. Neither the ATO contentions nor the taxpayer contentions have been decisively determined.

In disallowing the tax arrangements previously mentioned the ATO were unable to determine which legislation taxpayers had contravened. Because of their uncertainty, the ATO disallowed the arrangements under the general provisions of the legislation and as an alternative under the anti-avoidance provisions. In the case of one group and because of their uncertainty the ATO disallowed the same transaction under three different legislative provisions as alternatives. These alternatives were the general provisions, the Fringe Benefit Tax provisions and the anti-avoidance provisions. It seems illogical that where the ATO themselves are uncertain of the interpretation and application of the general provisions of the legislation, they can use their discretion to assert and rely on anti-avoidance provisions. Because, the assertion of avoidance, inherently implies that the taxpayer had a better knowledge and understanding of the tax legislation at the onset than the ATO were able to obtain after examination of the transaction and the legislation.

It is clear what the reaction of the ATO would be to a taxpayer who lodged 3 separate returns, each “in the alternative”, to cover any uncertainty in his tax position.

Recommendations

- The Taxpayers Charter should be reviewed, given the power of law and to prevent discretionary adjustments by ATO management, placed in the hands of an external body or individual to adjudicate. It may well be a function that either the Ombudsman could inherit, or, with appropriate amendments and funding, an additional function for the Inspector-General of Taxation.

- The ATO should be prohibited from issuing multiple assessments, either original or amended and whether primary or alternative. The ATO should be required by law to determine the appropriate assessment and only issue and, if necessary, contest that one. The ATO should not be able to export its interpretive role and responsibility to a taxpayer, simply because of uncertainty in legislation or shifts in the application of the Commissioner’s discretion.

- The prohibition on revealing details of settlements that the ATO applies invites the possibility of special deals for some taxpayers, or exploitation of groups of taxpayers. A register on the ATO’s website should document the settlement agreements reached with taxpayers in specified circumstances, without revealing the identity of the taxpayer. This would level the field for dispute resolution and enable both taxpayers and the ATO to verify that taxpayers are being treated fairly and equitably.

Term of Reference Number 3 – Part A

The level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge;

In his report into the consistency of application of the General Interest Charge (GIC) to groups in dispute, the IGT concluded that the Commissioner of Taxation had been inconsistent in his exercise of the discretion to remit or waive the GIC.

The Commissioner of Taxation uses the discretion to remit as a bargaining tool to induce taxpayers to settle their tax liabilities and waive all their rights of review. Regardless of individual circumstances the ATO imposes the full GIC (currently 12.68% compounded and calculated daily) and only considers remission where requested by the taxpayer. Experience has shown that remission is rarely granted and only when the taxpayer can show exceptional circumstances and essentially force a remission.

Similarly, penalties are imposed at the highest level and bargained downwards either by the auditor in negotiations or at a settlement. By imposing the penalty and interest at the highest levels available, the ATO intimidates the taxpayer with a large liability and then induces a settlement by offering a reduction. The ATO is generally more likely to use this strategy in circumstances where the ATO position is contentious and they want the taxpayer to rollover with the least resistance.

This submission contends that the level of penalty and GIC should depend upon the individual circumstances. The Commissioner should be required by legislation to automatically remit penalties and interest based on the reason for the tax shortfall and to document reasons for non-remission. In this way, the Commissioner will be prevented from deliberately imposing penalties at the highest level with a remission as an inducement to settle.

Furthermore, there is evidence that the Commissioner manipulates the legislation to increase penalties and interest, to not only strengthen his bargaining position but also to penalize certain taxpayers more than others.

For example, particular taxpayers in Mass Marketed Arrangements were issued a “Notice of Intention to Audit” instead of the standard letter of advice inviting voluntary disclosure that was sent to the vast majority of investors in the same arrangements and on the same date. As a consequence, these taxpayers were deemed by the ATO to have received adjustments as a consequence of an audit and subsequently the penalty imposed was 50%. Also in these cases, if the taxpayer responded to the audit letter the penalty of 50% was remitted to 40%. In contrast the taxpayers who received the standard letter of advice had the penalty of 50% remitted to 10%. By issuing two different letters to taxpayers in identical circumstances the ATO were able to treat one taxpayer as having been

subject to audit and the other as having made a voluntary disclosure. This artificial manipulation of the legislative provisions results in a significant difference in impact upon the taxpayers. In the case of a taxpayer with an adjusted primary tax bill of $100,000, which was not uncommon, the difference is $40,000 plus interest.

The taxpayers who received the audit letter were generally accountants or financial planners and this was the sole reason for the differentiation. In one particular case the taxpayer contacted the Tax Office and was advised that the local office had decided to send the audit letter because “he should have known better”. Several months later, after obtaining details of his tax file under Freedom of Information, it was evident that no individual audit had been conducted or intended. Yet the additional penalty still stands. Such abuses of administrative process result in severe penalty and interest consequences for taxpayers who are targeted by individual tax officers or sections.

It seems to have become a common practice for the ATO to issue “alternative assessments” especially in cases where the ATO are unsure of their position. For example, the ATO may disallow a deduction under the general provisions of the legislation and as an alternative under Part IVA, the anti-avoidance provisions. The ATO are well aware that if a deduction is not allowable under the general provisions of the legislation then Part IVA has no application, because Part IVA can only disallow what is otherwise allowable. However, by using Part IVA the ATO claim justification for the imposition of a higher level of penalties and consequently interest/GIC.

Because, the GIC is calculated and imposed on the total tax liability, including penalties and accrued interest the level of penalty imposed has a significant impact on the total liability. A taxpayer with a primary tax liability of $100,000 and a 50% penalty has the liability immediately increased by $50,000. In addition, if the ATO have taken two years to make the adjustment the GIC is calculated initially on the $150,000 at the applicable rate (currently 12.63%) and subsequently on a daily compounding basis. In other words after the first day, the interest is imposed on the $150,000 plus accrued interest. Because, of the relationship between the level of penalty, the GIC/interest rate and the period of time before an adjustment is made it is crucial that the level of penalty and the rate of GIC be remitted to levels which appropriately reflect the level of wrongdoing and the ATO take responsibility for excessive periods before adjustment.

The ATO use of alternative assessments raises a very important question. If the legislation is so complex that the ATO is unable to determine with certainty which legislation has been transgressed, then how can the average taxpayer be held accountable? It seems that the ATO use of alternative assessments emphasises the need for greater clarity and certainty in tax law and administration.

Recommendations

- The shortfall interest charge and GIC/interest should not be imposed on the penalty amount. This is because the penalty is meant to reflect the level of wrongdoing and the amount imposed should be the same whether imposed immediately or two or four years later. In the current situation although the level or rate of penalty remains the same, the actual amount payable in relation to the penalty increases over time because of the application of interest.
- The ATO should be required by legislation to document reasons for non-remission of the penalty and be required to substantiate reasons for imposition of penalty.
- The ATO should be required by legislation to act in a timely manner and substantiate reasons for delays in initiating and finalising adjustments imposing increased liabilities.
- The ATO should be required to remit the shortfall interest and GIC to the applicable bank rate unless the ATO can substantiate reasons for a higher rate. The application of a rate above the bank rate is quite clearly a penalty component and the imposition of both interest on interest and penalty on penalty is draconian and inequitable.
- Taxpayers need to be protected against the ATO exploiting legislative or administrative provisions for the purpose of maximizing the amount of penalty and/or interest.

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