Submission No: 36-2

CPA Australia Ltd
ABN 64 008 392 452

CPA Centre
Level 28, 385 Bourke Street
Melbourne VIC 3000 Australia
GPO Box 2820
Melbourne VIC 3001 Australia

T +61 3 9606 9606
F +61 3 9670 8901
E vic@cpaaustralia.com.au
W www.cpaaustralia.com.au

10 August 2007

Mr Russell Chafer
Secretary
Joint Committee of Public Accounts and Audit
Parliament House
Canberra ACT 2600

By email: jcpa@aph.gov.au

Dear Mr Chafer

Review of a range of taxation administration issues in Australia

I refer to our recent meeting with the Mr. Phil Barresi, MP - Chair of the JCPAA and you in relation to our organisation's earlier submissions to the above Inquiry.

We agreed to get back to you with some further details on the following items:

1. Personal tax reform
2. More contentious public rulings
3. Tax practitioner views on the current operation of the tax penalties and interest (GIC) regimes, and
4. Possible amendments to earlier submissions.

1. Personal tax reform

We have made arrangements for Professor Chris Evans (Atax University of New South Wales) to forward you a booklet on a Personal Tax Income Return Symposium held at UNSW on 2-3 April 2007 together with some information on further updates on this topic which are expected to be available shortly. In the meantime, the relevant Symposium papers can be accessed from the relevant UNSW/ Atax links[1].

2. Contentious public rulings

Contentious public rulings have not been a major source of member complaint for our organisation of recent times. However one recent case raised by our members is the correctness of TR 2005/ 12 - *Income tax: deductibility of interest expenses incurred by trustees on funds borrowed in connection with the payment of distributions to beneficiaries.* This relatively recent ruling is considered by many in the profession to be incorrect, and in that regard biased in the revenue's favour.

Also a number of more contentious ATO public rulings were raised by the joint professional bodies at the 28 June 2007 meeting of the National Tax Liaison Group (NTLG) - see the extract from the NTLG agenda in the attachment to this letter.

[1] See http://www.atax.unsw.edu.au/research/pitr-symposium-07/index.htm, and http://www.atax.unsw.edu.au/news/040407-pitrs.htm

We acknowledge that some contentious public rulings may have to be ultimately contested in the courts, and a recent example of this occurred in respect to GST Ruling GSTR 2006/2 titled *'Deposits held as security for the performance of an obligation'*. The ATO's position on this issue was recently contested in the 'Reliance Carpets' case, where the Federal Court held that no GST was payable on the forfeiture of a security deposit which was contrary to the position that the ATO had previously adopted in the above ruling. The ATO indicated in a media release (2007/39) of 3 August 2007 that it is seeking special leave to appeal to the High Court in this matter. The media release and further information on this matter are available from the ATO's website.

As suggested in the recent NTLG agenda item referred to above, rulings of the kind referred to and other administrative action by the ATO (including the application of the general anti-avoidance provisions) suggests that from time to time the ATO has seemingly adopted a narrow legalistic and 'pro-revenue' approach to the interpretation of the tax laws. However, we are not suggesting that this is the tax office's usual approach to legislative interpretation and the evidence would not seem to support such a view. It should also be noted though that the Commissioner argued strongly against this view at the NTLG meeting and indicated that such an outcome was not borne out by a recent internal survey of rulings, etc by the ATO.

It is of interest in this regard that the Federal Treasury's August 2004 'Report on Aspects of Income Tax Self Assessment' (ROSA) indicated at paragraph 2.4.3 that a number of submissions received by ROSA had argued that the ATO adopts a pro-revenue position in its private binding rulings (PBRs), and the report recommended that the Government should request that the Inspector-General of Taxation (IGT) undertake an evaluation of whether the pattern of PBRs indicates a pro-revenue bias.

Information published on the IGT's website indicates that the Minister for Revenue and Assistant Treasurer subsequently asked the IGT to review whether there is an ATO 'pro-revenue' bias in dealing with large complex PBRs with a focus on the following:

- evidence and extent of any revenue bias in dealing with PBRs
- basis for any perception of revenue bias in this area, and
- relevant governance measures.

We understand that this review is still in progress.

3. Tax practitioner views on the current operation of the tax penalties and interest (GIC) regimes

We are not aware of any significant concerns at this point in time on the part of members in respect to the ATO's administration of the tax penalties regime. This is perhaps not surprising given the improvements in this area arising out of the 2004 Treasury review of aspects of income tax self assessment.

As noted in our first submission to the Committee's current Inquiry on 8 March 2006, the main issue that has arisen in respect to penalties since the abovementioned review concerns the implications of failure to lodge on time (FTL) penalties for the potential non-lodgment of income tax returns. The issue is whether the current penalties provide appropriate incentives for taxpayers to lodge returns on time. We do not have anything further to add to our earlier comments on this matter except to note that the Inspector-General of Taxation (IGT) has currently listed this matter for consideration as part of his 2007/08 Work Program. Further details are available from the IGT's website[2].

[2] The IGT has listed the 'Non-lodgment of income tax returns' on his 2007/08 Work Program – see further information at http://www.igt.gov.au/content/work_program/work_program_2007.asp

The imposition of interest on late payment of tax under the general interest charge (GIC) and the more recent shortfall interest charge (SIC) arrangements are, of course, separate from the penalty regime in that these charges are designed to compensate the revenue for the time value of money. The SIC was introduced as a result of ROSA and seems to have ameliorated some of the earlier concerns in this area.

4. Possible amendments to earlier submissions

The only additional comments that we would make at this time is that we welcome the following developments which have occurred since we lodged our first submission to the Inquiry in March 2006:

- the significant improvements made to the simpler tax regime for small business taxpayers (including the increase in the turnover eligibility threshold to $2 million, removal of the $3 million depreciation limit and the automatic access provided to STS taxpayers to certain other concessions), and

- the payment of child care rebate (CCR) entitlements by the Family Assistance Office (FAO) directly into clients' bank accounts from 1 July 2007 (which eliminates the previous complexity arising from claims being made via individual income tax returns).

These changes address concerns our organisation has made representations on in the past and are most welcome.

If you have any questions regarding the above, please do not hesitate to contact me or Garry Addison FCPA - Senior Tax Counsel on (03) 9606 9771.

Yours sincerely

Paul Drum FCPA
Director - Policy & Research

T: 03 9606 9701
F: 03 9642 0228
E: paul.drum@cpaaustralia.com.au

Copy: K. Mayne
G. Addison
Prof. C. Evans (UNSW)

Enc

ATTACHMENT

Contentious public rulings

See extract from agenda of 28 June 2007 ATO National Tax Liaison Group (NTLG) meeting below:

Design Topics

Tax Office approach to the Interpretation and Application of the tax laws

The actions of the Tax Office in relation to debt deductions in agenda item 6 below, if confirmed, are suggestive of a pattern of behaviour that appears to rely on a narrow, legalistic and highly pro-revenue view of the tax laws. Some other recent examples include:

- Last year's Tax Office draft determination denying interest deductibility on funds borrowed in order to pay tax (withdrawn after being raised at NTLG).
- The issue of TR 2006/D2, which adopted a technically questionable approach to determining the effective life of mining rights – which in the end was overturned through legislation.
- The issue of a position paper (withdrawn for at least the time being) reversing the Tax Office's 20-year position on farm-outs which, if persisted with, would seriously impede the commercial operations of Australia's mining and petroleum sectors.
- The very broad and inappropriate scope of the foreign contractors WHT provisions applied in TR 2006/D3 – a position which was not reversed until representations were made to the Minister and industry bodies appeared before the International Rulings Panel.
- The technical position the Tax Office has adopted on the operation of sec 974-80, on which a broad industry submission has recently been made.

The professional bodies acknowledge that most of these issues involve a degree of technical complexity, and in a number of cases there has at least been some level of consultation before any compliance activity has commenced. Nevertheless, we are concerned that in all of these instances the Tax Office view, at least initially, has in our view been very pro-revenue, we are seeing the reversal of established positions (in the first three examples above), and there does not appear to be any evidence of consultation with Treasury on policy issues when that is what in our view ought to be happening

- Can the Tax Office understand why the professional bodies hold the view that the Tax Office is at times overly legalistic and highly pro-revenue?
- To help give the professional bodies a more balanced view about where things stand, can the Tax Office give concrete examples where it has recommended law changes that are helpful to taxpayers in circumstances where the law may not have been operating as intended?
- What systems and processes does the Tax Office have in place to identify and escalate issues that involve matters of policy?

Process:

For discussion at the meeting.

Kevin Fitzpatrick, Chief Tax Counsel will lead the discussion'.

Minutes of this meeting will probably not be available until after they have been formally adopted at the 5 September 2007 meeting of the NTLG. Minutes of past NTLG meetings are published on the ATO website (www.ato.gov.au).