CHAPTER 2

Treasury Review of Income Tax Self Assessment

Introduction

2.1 On 24 November 2003, the Treasurer initiated a review of aspects of income tax self assessment (the review). The review, which was to be conducted within Treasury, was asked to examine aspects of Australia's tax self assessment system to determine whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community.

2.2 In announcing the review, the Treasurer stated that it would seek to identify whether there are refinements to the present arrangements that would reduce the level of uncertainty for taxpayers, reduce compliance costs and enhance the timeliness of Australian Taxation Office (ATO) audits and amendments, while preserving the capacity of the ATO to collect legitimate income tax liabilities. The review was to consider the self assessment of income tax returns, especially:

- protection for taxpayers from unreasonable delays in enforcing the tax law;
- the statutory timeframes for amending assessments;
- the length of tax audits;
- aspects of the operation of the general interest charge;
- the level of reliance taxpayers can and should be able to place on taxation rulings and other forms of ATO advice; and
- the circumstances in which the ATO should undertake earlier examination of tax returns.[1]

2.3 The review was completed in August 2004. On 16 December 2004, the Government publicly released the review's report and announced its response.

2.4 Treasury's review recommended legislative and administrative changes to aspects of the self assessment regime. In releasing the review and the Government's response, the Treasurer stated that 'the recommendations will move the balance of

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[1] Media release, at http://www.treasurer.gov.au/tsr/content/pressreleases/2003/098.asp

fairness markedly in favour of taxpayers who act in good faith and will build more flexibility into the self assessment system'. [2]

2.5 The most important recommendations are intended to:

- improve certainty for taxpayers who rely on ATO advice;
- ensure that ATO advice is more accessible and provided in a timely manner;
- reduce the periods applicable to retrospective amendment of a taxpayer's liability where the revenue risk is low;
- 'mitigate the interest and penalty consequences of taxpayers' errors arising from uncertainties in the self assessment system'; and
- introduce improvements for better legal and administrative approaches to tax system reviews and design.

2.6 The Government announced that it would implement the review's legislative recommendations to commence from the 2004-05 income year.[3]

The self assessment system

2.7 Australia has operated a system of self assessment of income tax since 1986-87.[4] Taxpayers' returns are accepted at face value in the first instance and the Australian Taxation Office (ATO) may subsequently verify the accuracy of the information in the return within a prescribed period after that initial assessment. The law provides a period in which an amendment to a tax assessment may be made. This is:

- 2 years after the date tax became due and payable under the assessment if the taxpayer is subject to a shorter period of review
- 4 years after the date tax became due and payable under the assessment
- 6 years after the date tax became due and payable under the assessment, where the assessment provided the taxpayer with a 'tax benefit', or
- at any time, where there has been an avoidance of tax due to fraud or evasion.[5]

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2 http://www.treasurer.gov.au/tsr/content/pressreleases/2004/106.asp

3 The Treasurer's media release No. 106, 16 December 2004 is at http://www.treasurer.gove.au/tsr/content/pressreleases/2004/106.asp?pf=1. Attachment A of the release lists Treasury's recommendations and Government action proposed in relation to the recommendations.

4 This section is taken from the review: The Treasury, *Report on Aspects of Income Tax Self Assessment*, August 2004, pp. 2-3.

5 From ATO website at: http://www.ato.gov.au/businesses/content.asp?doc=/content/19395.htm&page=2&H2

2.8 From 1989-90, the returns of companies and superannuation funds became subject to a system of full self assessment, under which the taxpayer calculates their liability and pays their tax when lodging their return.

2.9 Generally speaking, the ATO does not examine the taxpayer's return in detail before making an assessment. It is allowed to amend errors of calculation, mistakes of fact and mistakes of law after processing the assessment and collecting the tax payable or paying a refund. Depending on the circumstances, returns could be re-opened many years after the original assessment.

2.10 In response to problems with the initial self assessment arrangements, the Government made changes in 1992 to introduce:

- a new system of binding public and private rulings;
- an extension (to four years) of the period within which a taxpayer could object against an assessment;
- a new system of penalties for understatements of income tax liability, based on the requirement that taxpayers exercise reasonable care; and
- a new system for underpayments or late payments of income tax, based on commercial principles and market interest rates.

2.11 In recent years, the Government has shortened the period of review for taxpayers with straightforward tax affairs, introduced binding oral advice, reduced the rate of interest on shortfalls and late payments, and introduced the office of the Inspector-General of Taxation.

2.12 Once an individual lodges their tax return, the ATO issues a notice of assessment which creates the formal obligation to pay tax.[6] For 'full self assessment' taxpayers, such as companies and superannuation funds, the taxpayer calculates their liability and pays their tax when lodging their return. The return is deemed to be a notice of the assessment of the entity's taxable income or net income.

2.13 Where an assessment has been amended to increase the amount of tax payable by a taxpayer, in certain circumstances the taxpayer will be currently liable to pay a General Interest Charge (GIC) on the amount of the increase. The GIC is imposed on a daily basis. The rate of the GIC is:

$$\frac{\textit{the yield on 90–day Bank accepted Bills + 7 per cent}}{\textit{the number of days in the calendar year}}$$

2.14 The Commissioner of Taxation (Commissioner) has the power to waive (remit) all or part of the GIC. The *Taxation Administration Act 1953* sets out very limited guidance on eligibility for remittance. The Commissioner is not required to supply a statement of reasons at the time the decision is communicated to the

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6 Parliamentary Library, Bills Digest, Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005, p. 2.

taxpayer. The taxpayer has limited scope to appeal the merits of the Commissioner's remission decision.

Penalty charges

2.15 Penalties may be imposed where a taxpayer makes a statement (or fails to make a statement) that results in an underpayment of tax. A penalty may be imposed where, for example:

- a statement is false or misleading;
- the taxpayer has failed to lodge a statement;
- the taxpayer has entered into a tax avoidance scheme; or
- the taxpayer has disregarded a private ruling; and

this results in an underpayment in tax.

2.16 The Commissioner has the power to waive (remit) all or part of the penalty. The Commissioner is not required to supply a statement setting out the reasons for his decision.

Application of the general interest charge (GIC) and penalties

2.17 The Treasury's review recommends that a reduced interest charge should apply to pre-amendment assessments. Changes are also proposed to improve the transparency of the penalty regime and ensure that the ATO provides sufficient guidance to taxpayers on its approach to penalties. These changes are to be implemented by the bills currently being considered by the Committee.