

CHAPTER 3

The bills

Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005

3.1 This bill introduces the shortfall interest charge and amends the penalty regime.

Interest on tax debts – the Shortfall Interest Charge

3.2 In introducing the new shortfall interest charge, the bill implements recommendations 5.1 to 5.4 and 5.6 of the Treasury review¹ into aspects of income tax self assessment. This charge will apply to under-assessments of income tax (that is, in tax shortfall cases), in place of the general interest charge (GIC).

3.3 The new shortfall interest charge rate is calculated in the same way as the general interest charge (GIC), but will be four percentage points lower than the GIC. That is, the daily shortfall interest charge rate is:

$$\frac{\text{the yield on 90-day Bank accepted Bills} + 3 \text{ per cent}}{\text{the number of days in the calendar year}}$$

3.4 The new arrangements for amended assessments provide a prospective due date, allowing a 21 day payment period for notified amounts of shortfall and related shortfall interest charge.² That is, the amount of tax and any shortfall interest charge that a taxpayer is liable to pay because of an amended assessment will be due 21 days from when the taxpayer is given notice of the amendment. If any of the tax or shortfall interest charge remains unpaid after the due date, the taxpayer is liable to pay the GIC on the unpaid amount.³

3.5 To cater for instances where application of the new shortfall interest rate could have a penalty effect such as where faults in the law or its administration had contributed to the shortfall, the review recommended that the Commissioner should have 'a broad discretion to remit the new shortfall interest charge where he considers it fair and reasonable' taking into account factors such as:

- the broad intention that shortfall interest should apply uniformly; and

1 The Treasury, *Report on Aspects of Income Tax Self Assessment*, August 2004, pp 54 and 57.

2 Explanatory Memorandum, p. 20.

3 Bill, Schedule 1, item 7, Subsection 204(3).

- the need for remission where circumstances justify the revenue bearing part of the cost of delayed receipt of taxes.⁴

3.6 The bill gives the Commissioner this discretion to remit.⁵ The Explanatory Memorandum lists the instances (referred to in the review) where remission of shortfall interest should be considered as follows:⁶

- ATO delay in completion of a tax audit;
- an 'abnormal time' elapsing between commencement and completion of a tax audit due to the complexity of issues involved;
- ATO advice or action contributing to the shortfall;
- the shortfall arising because of changes in the law or its interpretation subsequent to the taxpayer's assessment;
- retrospective legislative changes;
- a shortfall having a negligible revenue impact;
- the amount of the shortfall interest charge remitted is minor; and
- practical administration favours remission (for example, when precise calculation of the charge is complex, an approximation may be used).

3.7 Also, the Commissioner has the discretion not to remit where a taxpayer has acted in bad faith or where other circumstances mean that it would not be fair and reasonable to remit.

3.8 The review recommended that the ATO should advise taxpayers on how to seek remission when it notifies them of a shortfall interest liability. The Commissioner will implement this change administratively.⁷ Other related provisions in the bill that adopt the review's recommendations include:

- the Commissioner must give reasons for rejecting shortfall interest remission requests (Schedule 1, item 1, division 280-165); and
- taxpayers will be entitled to object to a decision not to remit where unremitted shortfall interest exceeds 20 per cent of the tax shortfall. Further, the review and appeal rights available in Part IVC of the *Taxation Administration Act 1953* will be available to taxpayers where the shortfall interest that was not remitted

4 The Treasury, *Report on Aspects of Income Tax Self Assessment*, August 2004, recommendation 5.3, Chapter 5, p. 56.

5 Explanatory Memorandum, p. 26; Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 1) 2005, Schedule 1, item 1, section 280-160.

6 Explanatory Memorandum, p. 25.

7 Treasurer's media release no. 106, 16 December 2004 at: <http://www.treasurer.gov.au/tsr/content/pressreleases/2004/106.asp?pf=1>; p. 1, and see item 46, Attachment A of the release.

exceeds 20 per cent of the tax shortfall (Schedule 1, item 1, division 280-170).⁸ It is important to note that previously, under the GIC, there was no mechanism to challenge a remission decision, and this provision introduces a new right for taxpayers.

Penalties

3.9 The Treasury review refers to submissions from practitioners and industry groups that argue for more clarity in the law governing the application of penalties; the abolition of penalties in some cases; and a greater transparency in the ATO's exercise of its power to remit penalties.

3.10 Accordingly, the bill modifies some penalty rules by implementing recommendations 4.2, 4.3 and 4.5 of the review.⁹ The changes to the penalty regime are as follows:

- the penalty for failing to follow a private ruling is abolished;
- the Commissioner is required to supply reasons why an entity is liable to a penalty and why the penalty is not remitted in full; and
- the definition of 'reasonably arguable' is clarified.

Abolition of penalty for failing to follow a private ruling

3.11 This penalty is seen as having the potential to operate as an inappropriate disincentive to seeking ATO advice and is therefore to be abolished.

Provision of reasons for penalties

3.12 Under the current law, the Commissioner is required to notify an entity that a penalty applies and of a decision not to remit a penalty in full. There is no requirement to provide reasons. The amendments impose a new obligation on the Commissioner to provide explanations in writing of the reasons for such decisions. The Explanatory Memorandum notes that it is important that taxpayers who are subject to a penalty understand why they have been penalized.

Definition of 'reasonably arguable'

3.13 This amendment clarifies the standard to be applied for judging whether a matter is 'reasonably arguable', implementing recommendation 4.2 of the Treasury review:

The definition of when a matter is 'reasonably arguable' should be amended to confirm that the relevant standard is *about* as likely to be correct as

⁸ These objection, review and appeal rights will not be available to taxpayers where the unremitted shortfall interest charge is below the 20 per cent threshold. (Explanatory Memorandum, pp 27-28.)

⁹ The Treasury, *Report on Aspects of Income Tax Self Assessment*, August 2004, pp 43 and 44.

incorrect (or more likely to be correct than incorrect) - not *as* likely to be correct as incorrect.¹⁰

3.14 According to the Explanatory Memorandum, the ATO has interpreted the current definition in accordance with the legislative intention that the relevant standard is *about as likely* to be correct as incorrect (or *more likely* to be correct than incorrect), not *as likely* to be correct as incorrect. The Explanatory Memorandum notes that 'However, on their face, the words of the definition require a higher standard'.¹¹

3.15 As such, the amendment does not represent a change in the standard of 'reasonably arguable' applied by the ATO, but rather, a technical correction clarifying the standard to be applied. The Committee notes with some concern the obscurity of the statutory language.

Shortfall Interest Charge (Imposition) Bill 2005

3.16 This bill is to ensure the constitutional validity of the shortfall interest charge. It provides that the shortfall interest charge, to the extent necessary, is imposed as a tax.

Impact of the bills

3.17 The bills will generally apply from the 2004-05 year, as announced by the Treasurer in Press Release 106 of 16 December 2004. They will not have any impact on prior year tax assessments of taxpayers who participated in mass marketed schemes, EBAs or other schemes which were common in the 1990s. However, the recommendations will go some way towards giving taxpayers additional protections in the future:

- where ATO advice is incorrect;
- from retrospective changes in ATO interpretations of tax laws;
- by reducing the time during which the ATO can issue pre-amendment assessments;
- by reducing the interest rate applicable to tax shortfalls; and
- by promoting a more transparent penalty regime in which taxpayers will have greater access to information affecting their affairs.

10 The Treasury, *Report on Aspects of Income Tax Self Assessment*, August 2004, p. 43.

11 Explanatory Memorandum, p. 33.