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**SELF-ASSESSMENT:
ARE WE THERE YET? ARE WE THERE YET?**

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I INTRODUCTION

Australia embarked on the journey towards self-assessment some 20 years ago and it is appropriate, following the implementation of the Review of Self-Assessment ('ROSA') in 2005/06, to evaluate the progress towards an effective self-assessment system. It is important to bear in mind that a good tax system seeks to balance potentially conflicting objectives including revenue collection, economic efficiency, equity and other social goals, while minimising administrative and compliance costs,¹ providing adequate certainty and finality and making it easy for taxpayers to comply with their tax obligations in a timely and cost-effective way.

II PROBLEMS WITH SELF-ASSESSMENT IN AUSTRALIA

ROSA focused on several areas as particularly meriting attention, including:

1. The extent to which taxpayers could obtain and rely on ATO rulings and other advice;
2. The time limits within which the ATO could amend tax assessments;
3. Inconsistencies in the imposition of penalties; and
4. Interest on tax shortfalls.

Reforms to address these problems have been introduced through legislative change – with others to be implemented through ATO administrative action.²

¹ Commonwealth, Treasury, *Report on Aspects of Income Tax Self Assessment* (August 2004) 65 (hereinafter referred to as 'ROSA').

² The Hon Peter Costello (Australian Treasurer), 'Outcome of the Review of Aspects of Income Tax Self Assessment' (Press Release, 16 December 2004), No. 106/04; The Schedule is reproduced in Stephen Graw, 'Living with ROSA' (Paper presented at the Taxation Institute of Australia National Conference, Gold Coast, 7 April 2006).

Looking at the areas in turn:

III ATO ADVICE

Although an effective rulings system is critical to the operation of the Australian self-assessment system³ there have been a number of problems with the Australian rulings system, including that:

- binding ATO advice was only available on a limited range of topics;
- ATO advice was not always easily accessible;⁴
- ATO advice was not always timely;
- the ATO could not use additional information obtained from other sources but which had not been included in the ruling application; and
- ATO rulings were not always consistent, accurate or reliable.⁵

ROSA's response to these issues involved nine reforms.

A Expansion of the Areas Covered by Private Binding Rulings -and the Persons Who Can Rely on Them

1 Expanding the scope of rulings

The new s 357-55⁶ significantly extended the range of matters on which Private Binding Rulings ('PBRs') can be given. Previously, PBRs could only be given on matters which related to 'liability for taxation' – eg the calculation of the amount of tax payable, but not on issues relating e.g. to investigations, or collection or recovery of tax.

³ See ROSA, above n 1, 7: 'Few taxpayers use the tax law itself as a primary source of information, so that Tax Office advice plays a crucial role in bridging the gap by providing summarised, understandable advice on which taxpayers can rely'.

⁴ See ROSA, above n 1, 79.

⁵ This was a major focus of many submissions to ROSA: see above n 1, 8; See also Robin Woellner, Stephen Barkoczy, Shirley Murphy and Chris Evans, *Australian Taxation Law* (16th ed, 2006) 1,795.

⁶ In combination with ss 358-5(2), 359-5(2) (cf ROSA recommendation 2.11).

Binding rulings can now be obtained ‘about any of’ the provisions listed in s 357-55 as ‘relevant for rulings’: namely tax; Medicare levy; FBT; franking and withholding and mining withholding tax; and the administration and collection of those taxes (as well as certain grants and benefits and their administration or payment). As a result, private binding rulings can now be obtained on a very wide variety of matters.

While the changes introduced under ROSA significantly expand the scope of areas available for binding ATO rulings, these changes do not affect the fundamental point that a ruling only protects a taxpayer whose situation falls within the scope of that (public or private) ruling.⁷ There are cases where a taxpayer has sought to rely upon an ATO ruling only to have the court rule that the taxpayer’s facts fall outside the scope of that ruling, and the taxpayer is therefore unable to rely on it: see for example *Bellinz Pty Ltd v FC of T* (*‘Bellinz’*).⁸ ROSA has not remedied this problem.

2 Widening the range of persons who can rely on rulings

The new s 359-30 overcomes the previous doubt about whether advice obtained by a trustee on behalf of the trust could be relied on by a new trustee of that same trust (even where there has been no other change to the trust or its activities). Section 359-30 expressly empowers the new trustee to rely on the existing ruling.⁹

3 Situations where the ATO may decline to provide a private binding ruling

There are a number of situations where the ATO may decline to issue a private binding ruling when one is requested. These exceptions are significant because, where the ATO properly declines to make a ruling, the applicant has no right to object under Part IVC of the *Tax Administration Act 1953* (Cth) against that decision. This is because ss 359-50(3) and 359-60(1) limit the right to object under Part IVC to

⁷ A ruling will be binding whether or not the taxpayer is aware of it, provided it applies to the taxpayer and the taxpayer relies on it (by acting or omitting to act in accordance with it): s 357-60; taxpayers can stop relying on a ruling by acting (or omitting to act) in a way not in accordance with the ruling: s 357-65. The potential breadth of these provisions is breathtaking, as is their potential to apply at the most unexpected times.

⁸ 98 ATC 4,634, per the Full Federal Court, 4,645-7.

⁹ ROSA, above n 1, 22-3, recommended that the protection of PBRs not be extended to third parties, as some suggested.

situations where the ATO fails to rule ‘and has not otherwise declined to make the ruling by the end of the [relevant] period’¹⁰ – though the applicant may still be able to seek a remedy under the *Administrative Decisions (Judicial Review) Act 1977* (Cth).

These exceptions where the ATO may decline to issue a ruling are where:

(a) The ATO considers that making the ruling would prejudice or unduly restrict the administration of a taxation law: s 359-35(2).¹¹ The Explanatory Memorandum indicates that situations falling within this exception would include those where:

- the ATO takes the view that the application is frivolous, vexatious, or not seriously intended;
- complying with the request would not have any practical consequences for the applicant (eg, because the relevant amendment period had already expired); or
- where making the ruling would unreasonably divert resources from other matters to which the ATO must attend in the course of administering the taxation laws;

(b) The matter sought to be ruled on is already being, or has been, considered by the ATO for the applicant: s 359-35(2)(b);

(c) The matter sought to be ruled on is ‘how the Commissioner would exercise a power under a relevant provision and the Commissioner has decided or decides whether or not to exercise that power’: s 359-35(3). This is an interesting provision, reflecting the view that rather than giving a ruling on how he would exercise a power, the Commissioner may simply elect actually to exercise that power (or to decline to exercise the power);

¹⁰ See Graw, above n 2, 16, n 38.

¹¹ Somewhat similar to the former *Taxation Administration Act 1953* (Cth), s 14ZAN(g), (h) and (j).

- (d) The Commissioner has requested additional information from the applicant and it has not been supplied within a reasonable time [ss 357-105(1), (2)].¹²
- (e) The ATO considers that the correctness of a private or oral ruling would depend on assumptions the ATO made about a future event or matter [s 357-110(1)(a)].
- (f) The applicant has not agreed to pay the fees involved in having a valuer review a valuation involved in a private ruling.¹³

The lack of a procedure enabling a taxpayer to challenge a decision by the ATO to decline to provide a ruling through the normal Part IVC objections and appeal process is unsatisfactory, and a matter for concern.

B Accessibility of Rulings

While the ATO has improved the quality of its data-bases making it easier for tax advisers to find specific information or rulings¹⁴ there is still room for improvement and ROSA recommended improving that accessibility by:

- (a) drafting rulings and other advice in 'plain language', with minimal qualifying statements;¹⁵
- (b) gathering all aspects of the ruling that are binding in one place within the ruling and clearly labelling them as binding;¹⁶
- (c) not trying in PBRs to address all possible issues beyond those raised, especially when doing so would be likely to confuse the reader;¹⁷ and

¹² Cf the former *Taxation Administration Act 1953* (Cth), s 14ZAN(i).

¹³ Subsections 359-40(1)-(4); See Graw, above n 2, 18-9.

¹⁴ See ROSA, above n 1, [2.8-2.9]; Cf Commonwealth, Inspector-General of Taxation, *Self-assessment*, Issues Paper No 3 (2003) [35].

¹⁵ Ibid, Recommendations 2.8 (public rulings) and 2.20 (binding private rulings).

¹⁶ Ibid 11-12, Recommendation 2.4.

¹⁷ Ibid 11.

- (d) reducing the volume of the tax law, to make it easier for taxpayers and their advisers to find the law;¹⁸ and
- (e) minimising costs. Taxpayers should have the right to know their tax position without bearing undue expense. If the ATO were to charge for rulings (as in New Zealand) this could make it too expensive for many taxpayers to seek PBRs. Accordingly, ROSA recommended that the ATO continue its policy of not charging fees for private rulings.¹⁹

C Timeliness of Rulings

Previously, there was no direct time-limit within which the ATO had to decide whether or not to issue a ruling²⁰ - and there was a widespread perception that the ATO was often slow in issuing rulings.²¹ There was also a perception that where the ATO was pressed for time, it would simply issue a negative tax ruling, leaving the taxpayer to object.

Section 359-50 now provides that within – normally - 60 days of a request for a private ruling, the Commissioner must either make the ruling or advise the applicant that he declines to do so. This 60-day period can be extended in a range of circumstances listed in the Table in s 359-50(2).

¹⁸ Ibid 76, Recommendation 7.9; This recommendation was acted on in 2005-6, with legislation being introduced to remove some 4,100 obsolete provisions, see Taxation Laws Amendment (2006) Repeal of Inoperative Provisions Bill (Cth). There are also calls for further cuts, see C John Taylor, 'Beyond 4100' (a report on measures to combat rising compliance costs through reducing tax law complexity, Taxation Institute of Australia, 2006).

¹⁹ ROSA, *ibid* 23, [2.4.9].

²⁰ *Tax Administration Act 1953* (Cth), s 14ZAO required only that – following an initial request - the ATO provide an explanation every 90 days on why it had not issued a ruling – this had not proven a satisfactory remedy. The Taxpayers' Charter indicates that the ATO will normally provide a response within 28 days of receiving all necessary information, or else (if it raises complex issues) contact the taxpayer within 14 days to seek information needed and contact the taxpayer within 14 days to 'negotiate an extended reply date': *The Taxpayers' Charter*, Explanatory Booklet No 3, 2; Cf ROSA, *above* n 1, 18.

²¹ See Commonwealth, Auditor-General's Report, No.3 *Self Assessment*, (2001/02) [5.89] (the Auditor-General's Report No.7 (2004-05), [4.8] noted that the ATO had improved its performance in these areas, and had set a benchmark of 80 per cent responses to be completed within the Charter time-periods); See also Inspector-General of Taxation, *above* n 14, [41] et seq.

If the ATO has not taken either step at the expiration of the 60 days (or any extended period), the applicant may then give the ATO written notice requiring it to make the ruling within a further 30 days, and if the ATO has not made or advised that it declines to make the ruling within that additional period, the applicant may then object against the ATO's failure to make the ruling.²²

The new provisions should improve the position of taxpayers, though the Commissioner could still issue a negative ruling, or simply not provide a ruling. Where the ATO declines to rule, it would seem that the taxpayer cannot object against this decision under the *TAA*, because s 257-50(3) restricts objection rights to situations where the Commissioner 'fails to rule or has not otherwise declined to make a ruling'. The taxpayer may however be able to seek redress under the *Administrative Decisions (Judicial Review) Act 1977* (Cth).

D Community Perception of a Pro-Revenue Bias in ATO Private Binding Rulings

ROSA suggested that there is a strong perception of a pro-Revenue bias in PBRs (though the statistics do not support this perception) and recommended that the Inspector-General of Taxation investigate this issue.²³ The Inspector-General began this investigation on 25 August 2005 and it is still in progress.

E Use by the ATO of Additional Information

This has three key aspects:

- (a) The ATO can now take into account information from a third party, provided it discloses that information to the applicant before using it, and

²² Though the applicant must lodge a draft ruling with the objection: s 359-50(4). This will often involve some delay and considerable expense for the taxpayer.

²³ ROSA, above n 1, cited the 2002-03 statistics showing that the ATO issued 7,361 Private Binding Rulings in that period, with 4 150 wholly favourable to taxpayers, 1,246 partly favourable, and 2 235 unfavourable to the taxpayer's position.

gives the applicant a reasonable opportunity to respond to it.²⁴

- (b) The ATO is no longer limited to using information supplied in the ruling application. Section 357-115 now expressly empowers the ATO to take into account additional information supplied by the applicant after the application was made.²⁵

Moreover, while the ATO always had *power* to ask the applicant for additional information to make the ruling, it was not *obliged* to do so. ROSA has introduced two important changes in this area:

First – the ATO is now *obliged* to seek additional information where it considers that further information is required for it to make a binding private or oral ruling: s 357-105(1).

Second – previously, whenever the ATO sought further information, that request restarted the period within which the ruling was to be provided. Some were unkind enough to suggest that the ATO may have used information requests on occasions as a ‘ploy’ to extend its time for amendment. Following ROSA, however, while a request by the ATO for further information still ‘stops the clock’, it does not ‘renew’ the consideration period. That is, if the ATO requests further information on the 58th day of the ‘request period’, when the information is supplied, the time period restarts at Day 58 and the ATO will have only two days within which to make the ruling on that point.²⁶

- (c) ROSA recommended that the ATO limit its rulings to issues directly raised in the ruling application²⁷ and not, as had occurred in the past, rule on issues

²⁴ And its disclosure to the applicant would not breach the tax secrecy provisions, privacy legislation, or the confidentiality of the person providing the information Explanatory Memorandum, Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005 (Cth), [3.43], [3.44], [3.81]; See also ROSA, above n 1, Recommendation 2.17; and *Taxation Administration Act 1953* (Cth) sch 1 s 357-120.

²⁵ See ROSA above n 1, 22, Recommendation 2.21 – now embodied in *Taxation Administration Act 1953* (Cth) sch 1 s 357-115.

²⁶ This seems implicit in ROSA, above n 1, [3.39], [3.41], [3.45] which refer to the period being ‘suspended’ until the information is provided.

²⁷ *Ibid*, Recommendation 2.16.

‘extraneous’ to the application, unless the applicant agrees.²⁸

F ATO Advice on Part IVA

ROSA recommended that in applications for PBRs where Part IVA might apply:

- (a) The applicant should have the option of advising that the ATO need not consider Part IVA [Rec. 2.12]. Taxpayers would need to be very comfortable with high risk, or else very confident of their position to adopt this approach – though the ATO could be more willing to issue a ruling more quickly, and less likely to decline to make the ruling; and
- (b) The ATO should indicate (by way of substantive comment or disclaimer) whether it has considered the possible application of Part IVA in making its ruling.²⁹

G Expanding the Protection Given to Persons Relying on ATO Advice

It would be anomalous if taxpayers who relied on ATO advice could subsequently find that the advice was wrong and they were exposed to penalties although they had ‘done the right thing’.³⁰

Accordingly, ROSA recommended that ‘as a general principle, taxpayers who have asked in good faith should not suffer adverse consequences as a result of having relied on incorrect Tax Office advice’.³¹

²⁸ Thus example 3.4 in ROSA indicates that where a taxpayer seeks a ruling on whether a receipt from an asset sale is ordinary income, but in examining the application the ATO considers that there would also be CGT implications, the ruling should address (only) the income tax question, simply noting that there may be CGT implications, but not addressing them.

²⁹ ROSA, above n 1, Recommendation 12.

³⁰ ROSA, above n 1, 8; compare the concern by the Inspector-General of Taxation that taxpayer protection was also being eroded by the increasing tendency of the ATO to substitute non-binding ATOIDS for binding rulings: Inspector-General of Taxation, above n 14, [27]-[30].

³¹ ROSA, above n 1, 9.

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The 'new' levels of protection after ROSA are summarised in the following Table:

Levels of protection after ROSA ³²			
Persons relying reasonably on ATO advice are protected (to the extent their position falls within the scope of the advice) against:	Additional primary tax	Penalties	Interest
1. 'legally binding' public or private binding written or oral ruling	X	X	X
2. all other ATO advice, whether written or oral – including ATO advice to non-business individual self-preparers ATO advice		X	X
3. ATO general administrative practice		X	X
5. ATO advice expressly labelled as 'non-binding'			

There are some interesting aspects of the new position:

(a) *Legally binding advice*: Section 359-20 provides that 'a private ruling must...specify the relevant scheme and the relevant provision to which it relates' so the ruling will only bind the ATO where:

- the facts, assumptions and conditions in the application were correct and accurate, with no material facts omitted;
- the ruling covers the applicant's situation and the arrangement is implemented in the way set out in the ruling; and
- the taxpayer's situation falls within the scope of the ruling and the taxpayer relies on it (by acting consistently with it – whether aware of it or not).

Accordingly there will continue to be situations such as those in *Bellinz*³³ (n. 8 above), where the taxpayer's fact situation does not fall within the scope

³² Ibid, 10, Recommendation 2.1.

of the ruling. Taxpayers and their advisers will therefore need to exercise care before relying on a ruling – particularly if some aspect of the taxpayer’s situation or plans change.

- (b) *‘All other ATO advice’*: This category covers ‘advice provided for the general information of non-business individual self-preparers (eg, *Tax Pack*)’.³⁴ Thus Category [2] in the Table above will include, for example, oral and written advice given by the ATO in manuals, booklets, fact sheets, press releases, Interpretative Decisions, and Taxpayer Alerts,³⁵ unless they are expressly labelled as ‘non-binding’.
- (c) *General ATO Administrative Practice*: This will only be established where the ATO has communicated a practice consistently to a wide range of taxpayers on a particular issue.

The Explanatory Memorandum states that Draft Public Rulings – at least where they represent the ATO’s only public statement on the issue - will fall within the ‘administrative practice’ exception.³⁶

However, to establish a ‘general administrative practice’, it is not sufficient merely to show that the ATO was silent or failed to take action, or exercise a power, or issue a ruling on a particular issue – there must be *positive* action by the ATO. However, ROSA suggests that the same effect can occur if the ATO ‘accepts’ – in an informal way - that a general administrative practice existed by simply declining to reassess a taxpayer.³⁷

- (d) *Advice expressly labelled ‘non-binding’ by the ATO*: The ATO can designate particular advice as ‘non-binding’, for example where it needs to invite opinions or express tentative views in the form of consultation drafts, discussion papers, or providing general oral advice not given by formal enquiry centres.³⁸ Naturally enough, taxpayers relying on expressly non-

³³ Above, n 8.

³⁴ Ibid, Recommendation 2.3.

³⁵ See ss 284-215, 361-5.

³⁶ Explanatory Memorandum, Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005 (Cth), [3.130].

³⁷ Ibid, [3.132].

³⁸ ROSA, above n 1, 9.

binding advice will not receive any protection against tax, interest or penalties.

H Withdrawal and Replacement of Rulings

One of the problems with the 'old' rulings system was the possibility that, if there was a delay between a public ruling being withdrawn and being replaced, taxpayers could be confused about how to interpret the law in the interim period.

ROSA has recommended that where the ATO withdraws a public ruling, it should take 'all steps necessary' to ensure that an appropriate instruction or product replaces it 'as soon as practicable'.³⁹

Moreover, where the ATO changes a 'public interpretation or long standing practice to the detriment of taxpayers', that change should only operate *prospectively* and where necessary, from a *future date* to allow affected taxpayers a reasonable time to become aware of, and act upon, that new interpretation.⁴⁰ This change should increase certainty and confidence in the rulings system.⁴¹

I Changes to Binding Oral Rulings

Prior to ROSA, the oral binding ruling system was very narrowly constrained – rulings could generally only be obtained for simple queries about simple issues. Consequently, oral rulings were rarely used and were of little real benefit.⁴²

However, binding oral rulings are now available on all non-business issues raised by self-preparing taxpayers, unless:

- (a) The issues are so complex the question should be set out and answered in writing;⁴³

³⁹ Ibid, Recommendation 2.5.

⁴⁰ Ibid, Recommendation 2.6.

⁴¹ See Ibid 21, Recommendation 2.19 and *Taxation Ruling* TR 92/20. Section 358-20 relates to public rulings; s 359-55 provides for a similar approach in relation to private binding rulings.

⁴² See Woellner et al, above n 5, 1,788-92.

- (b) The ATO considers that the issues relate to business or complicated matters;
or
- (c) The issue has been (or is already being) considered for the taxpayer.⁴⁴

This is a significant change but it is unfortunate that the opportunity was not also taken to permit tax agents (with the taxpayer's approval) to lodge applications for oral rulings. Tax agents lodge most tax returns, and should be able to articulate the situation more clearly and precisely, saving time and confusion.

The changes therefore did not go as far as they might have.

IV CHANGES TO THE ATO'S POWER TO REVIEW AND AMEND ASSESSMENTS

The ATO must have power to amend assessments it subsequently finds to be incorrect. However, this need must be balanced against the taxpayers' need for certainty. The time between lodgment and when a taxpayer's assessment can no longer be amended represents a period of uncertainty for them.⁴⁵

Before ROSA, there were a number of problems with the amendment powers, including a variety of amendment periods from 2 years up to indefinite terms, and a misperception by many taxpayers that an assessment notice was the ATO's 'last word' on their tax liability for the period it covered.

The major changes after ROSA include the following:

A Shortening the Basic Period for Review

The new legislation seeks to provide an appropriate balance between the need for an amendment power and taxpayer certainty by reducing the period for review to one

⁴³ ROSA, above n 1, Recommendation 2.23 – ROSA also recommended that the ATO explore ways to record oral advice: Recommendation 2.24.

⁴⁴ *Taxation Administration Act 1953* (Cth) sch 1, s 360-5(1).

⁴⁵ ROSA, above n 1, 29; Similar issues arise for very small businesses, see 30.

approaching the 'minimum [period of] time required for the ATO to identify the majority of incorrect assessments of that type and correct them'.⁴⁶

As a result, the basic amendment periods for review of assessments have now been standardised at:

- (a) For most individuals and very small business operators who *have elected to participate* in the Simplified Tax System:⁴⁷ 2 years.

This period previously only applied to a limited number of Shorter Period of Review taxpayers, but now potentially covers more than eight million individual taxpayers and 745 000 very small businesses.⁴⁸

However, the new provisions are not without problems – for example, a partner or a potential trust beneficiary (who might not even know of their status) might find the whole of their tax affairs open to review for 4 years rather than 2 because they honestly but wrongly believed that the partnership or trust was in fact registered as an STS taxpayer.⁴⁹

Also specifically excluded from eligibility for the 2 year period of review by regulation are certain groups of taxpayers with 'higher risk tax affairs' who represent a 'present revenue risk'. They fall into three broad categories, covering broadly:

- individuals and small businesses involved in related-party transactions where the parties have different periods of review (eg a private company with a 4 year period of review, and its shareholders who have a 2 year period);⁵⁰

⁴⁶ Explanatory Memorandum, above n 24, [2.14]; See also ROSA, above n 1, 27. The length of time the ATO takes to review returns obviously varies according to the compliance activities involved – e.g. for non-business individuals with simple affairs, compliance is primarily based on income matching – and the ATO would generally know whether an amendment is needed in much less than the 4 years currently allowed: ROSA, above n 1, 29.

⁴⁷ ROSA, above n 1, 30, [3.2.1].

⁴⁸ Australian Treasurer, above n 2).

⁴⁹ See, eg, Explanatory Memorandum, above n 24, 2

⁵⁰ ROSA, above n 1, Attachment A to the Explanatory notes, 2; Cf 33-4 (Rec 3.5), 34-5 (particularly [3.2] and [5]).

- certain individuals and small businesses whose tax affairs require information from overseas sources and who have not included all income from foreign transactions in their returns; and
- situations covered by certain specific anti-avoidance provisions.

(b) For situations outside (i), but where there is no fraud or evasion: 4 years;⁵¹
and

(c) For situations where the ATO is of the opinion that there has been fraud or evasion: at any time (eg no time limit).

While more could probably have been done in this area to extend the shorter period of review to more taxpayers, considerable advances have been made.

B The Effect of Amending an Assessment

The new provisions have made a number of changes to existing rules, significantly increasing certainty and finality for taxpayers, and thereby improving the overall system.

In contrast to the 'old' system, where amending an assessment re-started the amendment period for all items in the original assessment, under the new provisions, the original amendment period continues to run for all aspects of the original assessment *other than* the particular item that was actually amended. Thus the ATO can only further amend the assessment outside the normal review period in relation to the particular previously amended, or where it is expressly permitted by *Income Tax Assessment Act 1936* (Cth) ss 170(3), (4) and it occurs within the initial applicable 2 or 4 year period.

C 'Nil' and Loss Assessments

Because the former *Income Tax Assessment Act 1936* (Cth) s 170(2) provided that the period for review ran from 'the day on which tax became due and payable' it followed

⁵¹ Item 4 in s 170(1).

that, if no tax was payable, the review period never began (and therefore never ended), so the ATO, in effect, had an unlimited period to vary such apparent ‘assessments’. This could create anomalous situations, because if a taxpayer had a taxable income of \$1, the ATO had only 4 years (usually) to re-assess, but if the same taxpayer had a taxable income of \$nil, or a loss, the ATO could re-assess at any time.⁵²

Under the amended *Income Tax Assessment Act 1936* (Cth) s 6(1), as from the 2004/05 income year, the definition of ‘assessment’ has been changed to include ‘nil liability’ assessments,⁵³ so the period of review will be equivalent to that for amending assessments creating liabilities.⁵⁴

However, this new definition of ‘assessment’ does not expressly cover tax losses, so that, while the period of review would begin to run from the ‘nil’ income year, the ‘actual’ or ‘effective’ deductibility of the tax loss will be determined in the year in which the taxpayer has income against which to offset it.⁵⁵

D ‘Mirror Image’ Time Limits

ROSA recommended that the time limits for amendments to reduce a taxpayer’s liability should mirror those for amendments increasing liability.⁵⁶ This symmetry is logical, but provides some potential disadvantages for taxpayers where it leads to a reduction in amendment periods.

⁵² ROSA, above n 1, 32, [3.2.3]; See *FCT v Ryan* 2000 ATC 4,079 (per the majority of the Full High Court). The courts on occasions seem to have attempted to correct or limit the anomaly: see *FC of T v BCD Technologies Pty Ltd* 2004 ATC 2,071 (followed in *Case 13/2005* 2005 ATC 213 by RNJ Purvis (Deputy President) but overturned on appeal by Heerey J in the Federal Court: 2005 ATC 4,522, 4,524-5.

⁵³ Under the new s 6(1), ‘assessment’ means ‘the ascertainment of the amount of taxable income (or that there is no taxable income) and of the tax payable on that taxable income (or that no tax is payable) ...’. Transitional provisions apply under *Income Tax Assessment Act 1936* (Cth) s 171A to nil liability assessments in earlier years (see Graw, above n 2, 25-7 for detailed analysis). There are however potential problems with the transitional provisions.

⁵⁴ ROSA, above n 1, 32, Recommendations 3.2-3.4.

⁵⁵ *Ibid* 32-3, Recommendation 3.5.

⁵⁶ *Ibid* 35-36, [3.4]; The ATO has a discretion to extend the period for review where a shorter period of review period would deprive the taxpayer of a legitimate claim for a credit amendment; See also 36, Recommendation 3.9, and PS LA 2004/7.

E Extending the Pre-Assessment Agreements System

ROSA recommended that the ATO should extend its pre-assessment agreements system to cover issues such as trading stock and consolidation valuations, ‘wherever it is cost effective to do so’.⁵⁷ This reform is to be implemented by administrative rather than legislative action, and is aimed at improving certainty for taxpayers (and the ATO) by obtaining agreement on the tax effect of particular practices before an initial assessment is made.

F Earlier Notification of ATO Audit

ROSA noted that there was ‘widespread support’ for an idea canvassed in the Discussion Paper that the ATO should be required to notify, at an early stage, those taxpayers it selects for further compliance activity’, with the aim of providing greater taxpayer certainty by then also limiting the cases in which taxpayers not so notified could have their assessments subsequently amended’.⁵⁸

After further consideration, the Review concluded that because of the potential negative impact on the revenue as a result of the ATO’s current inability to identify all compliance risks (particularly for larger businesses and complex cases) within the time that would be allowed for notification, the proposal was ‘unsuitable for present implementation’. The Review therefore made no recommendation, and instead merely noted that the ATO had ‘advised that its goal is to make audits more current and it plans to trial a range of process improvements ...’, and that the question of earlier notification of audits may need to be reconsidered in the future.

G Correcting Taxpayer Misconceptions About the ‘Finality’ or Conclusiveness of ATO Notices of Assessment

Taxpayers often – understandably - regard an ATO assessment as being final - conclusively determining their tax position for the relevant year.⁵⁹ Consequently,

⁵⁷ Ibid 37, [3.5].

⁵⁸ Ibid 37-38, [3.6].

⁵⁹ Ibid, 59, Recommendation 6.1; similar concerns had been expressed by the Inspector-General of Taxation above n 14 [90-4].

some taxpayers have issues accepting that the ATO can later 'change its mind' and issue an amended assessment.

These misconceptions have remained despite the ATO's attempts to clarify the situation by including information in *TaxPack* and on the Notice of Assessment itself.⁶⁰

To remedy this problem, ROSA recommended⁶¹ that legislation be introduced to clarify the situation by steps that 'could include':

- changing the notice of assessment title or description to reflect that it is an assessment based on the assumption that the data contained in the taxpayer's return is complete and accurate; and
- requiring tax agents to inform their clients of the period within which their assessment may be reviewed.

The Treasurer's Press Release indicated that these recommendations would be implemented by legislation but the amending legislation to date has not addressed them. Moreover, tax agents⁶² have displayed little enthusiasm for the second recommendation, perhaps understandable given the possible review periods that could apply to a given assessment and the effect of facts that might not be known to the agent at the time.

V PENALTIES AND INTEREST

The interest regime is quite separate from the penalty provisions. Tax penalties are designed to 'punish' behaviour in breach of the legislation; interest imposed on unpaid tax is designed to discourage the use of unpaid tax as a source of business or

⁶⁰ Perhaps the fact that the ATO has placed this note on the back of page 1 of the Notice of Assessment – which few people probably read – may not be helping!

⁶¹ ROSA, above n 1, 59, Recommendation 6.1.

⁶² *Ibid* 7: agents now prepare over 75 per cent of individual and 90 per cent of business returns - up from just 20 per cent in 1980.

private finance, and to compensate the government for not having received all/part of the tax owing on the due date.⁶³

A The Former Position

It has been said, unkindly, that the move to self-assessment meant that the ATO was able to shift from having to understand and apply the legislation consistently across Australia, to ‘... the more comfortable position of armchair critic ... free to pick and choose when and where (if at all) it would examine any given taxpayer and their affairs’.⁶⁴

The former penalty and interest liability provisions exacerbated the problem, often being unclear and imprecise.⁶⁵ Concern increased in 1999 with the introduction of the GIC, which was widely perceived as being excessive, unfair and arbitrary – see below.

B Addressing Concerns Relating to the Penalty⁶⁶ Provisions

ROSA addressed the question of defining key terms – though the result was not entirely satisfactory:

1 The concept of ‘reasonable care’

Because of the almost infinite variety of possible circumstances, it was seen as counter-productive to attempt to define in detail the meaning of ‘reasonable care’, and ROSA accordingly suggested that the legislation should continue to rely upon general principles. However, it recommended that the ATO should provide clear guidance on its meaning.⁶⁷

This seems a reasonable approach.

⁶³ Ibid, 49, 50-53.

⁶⁴ Michael Inglis, ‘Taxing Times: Is Self Assessment Working?’, (Spring 2002) 18(3) *Policy* 4.

⁶⁵ ROSA, above n 1, 39 listed 5 key concerns in relation to self-assessment penalties. See Table 4.1, 40-1.

⁶⁶ For a discussion of the nature and role of penalties, see Woellner et al, above n 5, 1,923-4.

⁶⁷ See, eg, *Taxation Ruling* TR 94/4, ATO, Canberra and ROSA, above n 1, 41-2.

2 The concept of a 'reasonably arguable' position

For large shortfalls,⁶⁸ taxpayers will only escape a shortfall penalty if they have adopted a 'reasonably arguable' position.⁶⁹

Prior to ROSA, a position was 'reasonably arguable' when the taxpayer's argument was 'as likely to be correct as incorrect, or more likely to be correct than incorrect'.

An amendment to s 284-15 changed the test *back* to that under the former *Income Tax Assessment Act 1936* (Cth) s 222C - that it sufficed if the taxpayer's position was 'about as likely to be correct as incorrect, or is more likely to be correct than incorrect'. This seems to apply a more liberal test, though the wording appears to have little impact on the interpretation the ATO or the courts applied anyway!⁷⁰

However, the new definition does not increase clarity and finality for the taxpayer – indeed it is hard to imagine a vaguer test than whether something is 'about' as likely as not to be correct. ROSA therefore does not score highly on this criterion.

3 Removal of the penalty for failing to follow a binding private ruling

Under the former system, some taxpayers (or at least their advisers) might have been deterred from seeking a binding private ruling by the fact that, if they failed to apply that ruling, they were liable to an automatic penalty of 25 per cent of the resulting tax shortfall.⁷¹ ROSA recommended the abolition of this penalty,⁷² a recommendation

⁶⁸ See ss 284-75(2), 284-90(1), items 4-6.

⁶⁹ Section 284-15: see *Taxation Ruling* TR 94/5 and *Walstern Pty Ltd v Commissioner of Taxation* (2003) FCA 1,428; 2004 ATC 5,076; Cf Robin Woellner, 'Avoiding a bum rap' (2004) 8 *The Tax Specialist* 166.

⁷⁰ The ATO indicated that it had already been applying that test under the old wording. ROSA commented that the ATO had been interpreting the provision 'in accordance with the legislative intention' [ROSA, above n 1, 43, Recommendation 4.2]. As Hill J put it in *Walstern*, '[t]here must, in other words, be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong, it is nevertheless 'about' as likely to be correct as the correct view'. One might therefore wonder why they bothered to change the wording: see Woellner, above n 69, 166; Explanatory Memorandum 2004, ATO; and Robert Richards 'Coping with Self-Assessment' (1986) 56 *Australian Accountant* 43.

⁷¹ The rationale for this original penalty is discussed at ROSA, above n 1, 44, [4.2.3].

⁷² Ibid 44, [4.2.3], 44-5, Recommendation 4.3. The Ralph Committee had previously made a similar recommendation: Commonwealth, *Review of Business Taxation: A Tax System Redesigned*, 1999, Recommendation 3.4.

implemented by the *Tax Laws Amendment (Improvement to Self Assessment) Act (No.1) 2005* (Cth)'s repeal of the former s 284-75(4).

This removes one of the more irritating penalties, though taxpayers who do not apply a PBR may still face – depending on their fact situation - the possibility of a penalty for failure to take reasonable care, or to adopt a reasonably arguable position.

It will be interesting to see whether the ATO adopts the other ROSA suggestion that the ATO implement procedures to check on whether a taxpayer has followed an applicable ATO ruling⁷³ – which could be as simple as requiring a declaration or placing a tick-box on the return form.

4 ATO obligation to provide reasons for a decision declining to remit penalties

Previously, where the ATO decided not to remit a penalty, it had to notify the taxpayer of its decision, but not of the reasons for that decision. This could make it difficult for the taxpayer to challenge the decision and, though they could in some circumstances seek an order under the *Administrative Decisions (Judicial Review) Act 1977* that the ATO provide its reasons, that is a costly and often impractical solution.

This problem has been remedied by an amendment to s 298-20(2), which now requires that the Commissioner provide written notice of both his decision and the reasons for that decision.⁷⁴

This is a clear improvement over the previous system and will put taxpayers and their advisers in a better position to understand and decide whether or not to challenge the ATO's decision.

⁷³ Commonwealth, *Review of Aspects of Income Tax Self Assessment*, Discussion Paper (March 2004) 50; ROSA, above n 1, 44.

⁷⁴ As the ATO previously did on formalisation of an audit - see ROSA, above n 1, 46-7, Recommendation 4.5. This is consistent with the Taxpayers' Charter.

**VI INTEREST PAYMENTS – INTRODUCTION OF THE ‘SHORTFALL INTEREST
CHARGE’**

There were two main complaints with the former interest system:

- a perception that the General Interest Charge (‘GIC’) imposed an unfair and arbitrary burden on some taxpayers,⁷⁵ because it applied a substantial rate of penalty from the due date under the original assessment (so the size of the interest charge depended on whether a reassessment was made soon after the start of the review period, or towards the end – the latter resulting in a significantly larger penalty, with the taxpayer unable to influence the result);⁷⁶
- There was also a perception that the ATO was too reluctant to apply the statutory discretion to remit GIC payable – exacerbated by the fact that a decision not to remit was not subject to the normal objection and appeal procedures.⁷⁷

A Introduction of the Shortfall Interest Charge

To counter the first of these issues, a ‘Shortfall Interest Charge’ (SIC) replaced the GIC from 2005 for tax shortfalls for the period from the date the original assessment became due and payable until the day before taxpayers receive notice of their amended assessment⁷⁸ - a period during which they might reasonably have thought that they had met all their tax obligations, so there is no policy rationale for a culpability penalty.

⁷⁵ ROSA, above n 1, 51.

⁷⁶ See Commonwealth, above n 73, 55-68.

⁷⁷ *Nyack Investments Pty Ltd v FCT* [2005] AATA 468; 2005 ATC 2,173. However, a taxpayer could in appropriate circumstances seek a remedy under the *Administrative Decisions (Judicial Review) Act 1977* (Cth).

⁷⁸ Section 280-100(2); see Robin Woellner, ‘Tax Penalties – the good, the bad and the terrifying’ (Paper presented at CPA Australia, Townsville, 25 August 2005).

The rate of the SIC is four per cent lower than the GIC⁷⁹, the objective being not to punish the taxpayer, but rather ‘to neutralise loan benefits that taxpayers might typically receive from their shortfall, so that they do not receive an advantage over those who assess correctly’.⁸⁰

The SIC applies from the 2004/05 income year – the GIC will still apply to earlier years, and to periods during an income year before and after the SIC applies. However, there are perhaps now stronger grounds for taxpayers in appropriate circumstances to seek remission of at least part of the GIC for these earlier periods.

B Encouraging More Generous Remission of the SIC

The new s 280-160(1) provides a broad discretion empowering the ATO to remit all or part of the SIC if it ‘considers it fair and reasonable to do so’⁸¹ - reflecting the aim of encouraging the ATO to take a more generous approach to remitting the SIC in appropriate circumstances.⁸²

Such broad discretions are not new, but the legislation provides supporting provisions that may encourage the more generous approach. Thus, the legislation now imposes a positive duty on the ATO to provide written reasons for not remitting an amount of SIC in full or part⁸³ - though the obligation only arises where a taxpayer lodges a request for reasons.⁸⁴

⁷⁹ See Commonwealth, above n 73, 56.

⁸⁰ ROSA, above n 1, 53, Recommendations 5.1, 5.2.

⁸¹ The mere existence of a ‘penalty effect’ because of an interest rate differential, and that remission would ‘generally require circumstances such as delay, contributory cause or fault on the part of the Tax Office or other parties that would justify the revenue bearing part of the cost of delayed receipt of taxes’: ROSA above n 1, 55, Recommendation 5.3 – see the examples given on 56. It recommended that the ATO should explain more fully in a Ruling or Practice Statement, how it exercises its discretion to remit tax shortfall penalties, including Part IVA cases: see 46, Recommendation 4.4.

⁸² ROSA, above n 1, 43-4, noted that the ATO has a ‘liberal’ remission policy in relation eg to ‘reasonable care’.

⁸³ ROSA, above n 1, Recommendation 5.6.

⁸⁴ Section 280-165.

These changes will make the ATO's decisions more transparent and understandable, though it would have been preferable to impose the obligation to provide reasons automatically, rather than only where the taxpayer requests it.

In addition, s 280-170 provides that where the taxpayer seeks remission of the SIC and the interest payable after remission still exceeds 20 per cent of the additional tax, the taxpayer can object to the ATO's decision not to remit.⁸⁵ Where the unremitted SIC does not exceed 20 per cent, the taxpayer has no right of objection. This may be an incentive for the ATO to take a generous approach to its remission power and to keep unremitted SIC below 20 per cent.⁸⁶

VII THE OVERALL CONTEXT: TAX COMPLIANCE AND COLLECTION COSTS

The ROSA reforms must be analysed within the wider context of the extent to which the current self-assessment system minimises tax compliance and collection costs.⁸⁷

There have been numerous reports on the issue, most concluding that the Australian system imposes a comparatively high level of compliance costs on taxpayers and their advisers.⁸⁸

One significant aspect of cost is the requirement that taxpayers with simple tax affairs prepare and lodge a return. A number of approaches to solve this problem have been suggested. One solution (used in some other parts of the world) is the removal of 'troublesome' deductions (eg for work related expenses), which would leave millions of Australian taxpayers with few other relevant tax issues and substantially reduce the need for them to lodge tax returns.

⁸⁵ ROSA, above n 1, 57, Recommendation 5.4. Where the balance of unremitted shortfall interest after determination of the objection still exceeds 20 per cent, the taxpayer will have a right of review/appeal.

⁸⁶ Subsection 280-160(2) contains principles to guide remission decisions.

⁸⁷ ROSA, above n 1, 61-2.

⁸⁸ See, eg, from among many, Charles Sandford, M Goodwin and P Hardwick, *Administrative and Compliance Costs of Taxation* (1989); Chris Evans, Katherine Ritchie, Binh Tran-Nam and Michael Walpole, *A Report into Taxpayer Costs of Compliance* (1997); See generally Woellner et al, above n 5, 34-5.

Another approach is the use of 'pre-populated' tax returns.⁸⁹ This approach is used in a number of Nordic and other countries,⁹⁰ and involves the tax authority completing a draft return for the taxpayer based on information that the authority has or can obtain. This could be possible in Australia (with modifications) - the ATO already possesses or could obtain most of the information needed to 'populate' many taxpayers' returns - via payment summaries, various income-matching and other programmes, and third-party reports.

While either removing the need to lodge returns at all, or pre-populating returns would not be a panacea in the Australian context,⁹¹ such steps would certainly go a long way towards reducing compliance costs, and improving the Australian self-assessment system.

Unfortunately, neither proposal was directly on ROSA's 'remit', and their implementation must await a different impetus.

VIII CONCLUSION

Overall, how well is our self-assessment system faring? Have we reached the ideal (achievable) self-assessment system, with only the odd 'trivial fault', or do we still have some significant potholes to overcome?

As noted at the outset, a good self-assessment system must be judged by the extent to which it provide taxpayers with clarity, certainty and finality to support and assist them to determine and report their tax position.

⁸⁹ The use and success of pre-populated tax returns in other countries was discussed by Richard Highfield, 'Pre-Populated Income Tax Returns: The next "Big Thing" in reform of the administration of Australia's Personal Income Tax System' (Keynote Address at the 7th International Tax Administration Seminar, Sydney, 20 April 2006).

⁹⁰ See Highfield, above n 89, 5-10.

⁹¹ Highfield, above n 89.

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Judged by this standard, there is no doubt that the ROSA changes have improved the Australian self-assessment system but, even bearing in mind that we are not seeking perfection, it is still probably fair to say that we have not yet quite reached our destination – there are still some important areas that could be improved.