1990-91-92

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT (SELF ASSESSMENT) BILL 1992

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Treasurer,
the Hon John Dawkins, M.P.)

33179 Cat. No. 92 4417 3

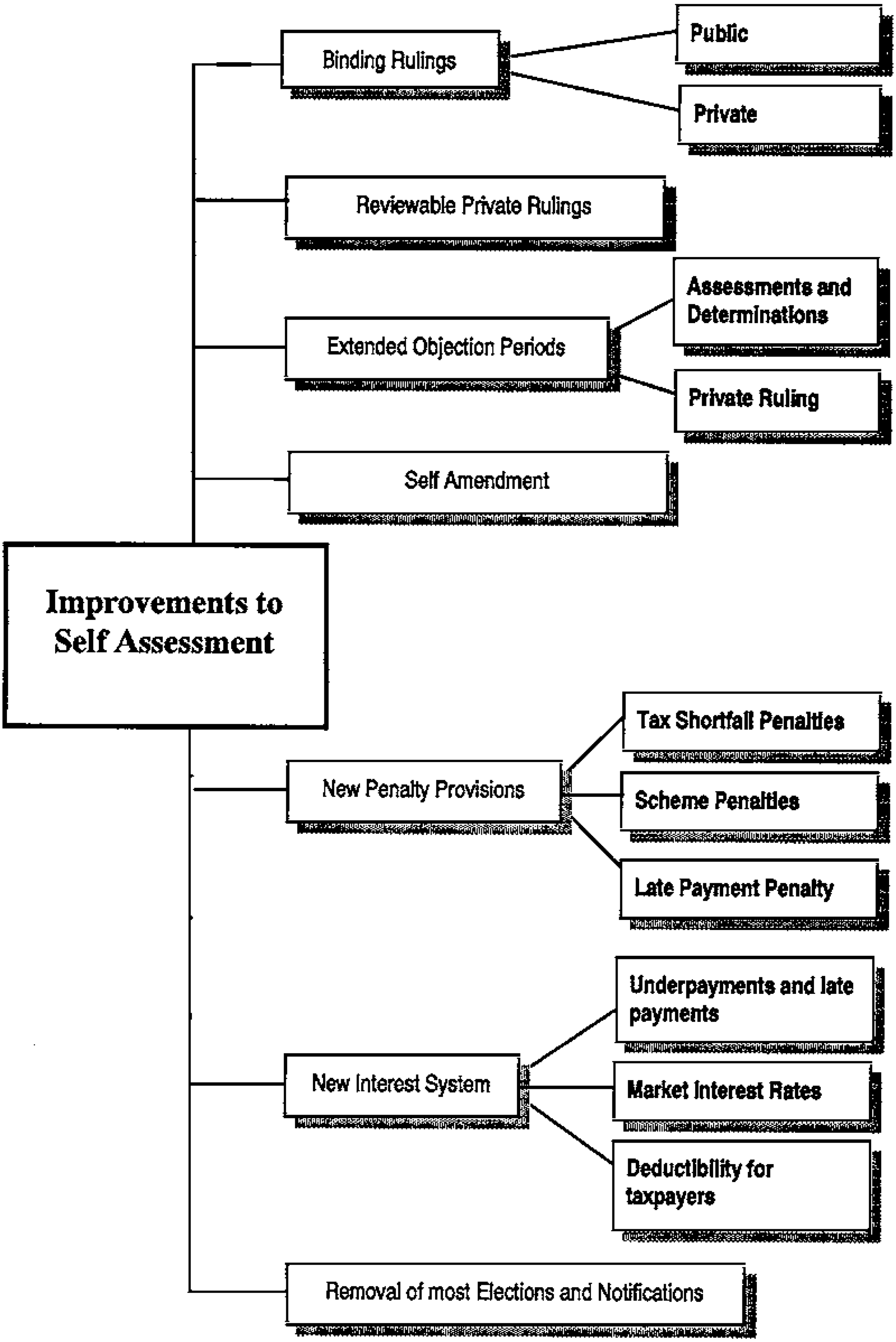
9 780644 227025

Printed by Authority by the Commonwealth Government Printer

Table of Contents

General Outline and Financial Impact

At a Glance


Improvements to Self Assessment
Binding Rulings
Public
Private
Reviewable Private Rulings
Extended Objection Periods
Assessments and Determinations
Private Ruling
Self Amendment
New Penalty Provisions
Tax Shortfall Penalties
Scheme Penalties
Late Payment Penalty
New Interest System
Underpayments and late payments
Market Interest Rates
Deductibility for taxpayers
Removal of most Elections and Notifications

Purpose of the Bill

The Taxation Laws Amendment (Self Assessment) Bill 1992 implements the Government's decision, announced in the Treasurer's statement of 13 December 1990 and in the 1991-92 Budget, to improve existing self assessment arrangements.

The Bill proposes changes to the law to:

(a) introduce a new system of binding Public Rulings applicable to income tax, Medicare levy, withholding taxes, franking deficit tax and fringe benefits tax;

(b) introduce a new system of binding Private Rulings for transactions or arrangements that are proposed, have commenced or are completed. The new system will also apply to income tax, Medicare levy, withholding taxes, franking deficit tax and fringe benefits tax;

(c) introduce a new system of reviewable Private Rulings which will generally allow taxpayers to have Private Rulings reviewed by the Administrative Appeals Tribunal (AAT) or a court;

(d) limit objection rights against an assessment to prevent a review of a matter that is already the subject of a review of a Private Ruling;

(e) extend the period within which a taxpayer can object against assessments and related determinations from 60 days to 4 years, and provide a broadly similar objection period for Private Rulings;

(f) allow the Commissioner, in making assessments, to rely on statements made by taxpayers other than in tax returns (eg., in a request for an amendment);

(g) introduce a new system of penalties for understatements of income tax and franking deficit tax liability. The penalties will be based on the requirement that taxpayers exercise reasonable care in carrying out their tax obligations. A more rigorous standard, the reasonably arguable position test, will apply to items which affect tax by more than $10 000;

(h) introduce a new interest system for underpayments and late payments of income tax, based on commercial principles and market interest rates;

(i) reduce late payment penalties to take into account the new interest system. This will allow for the separation of interest and penalties while providing an incentive for taxpayers to pay income tax on time;

(j) provide deductibility to all taxpayers for interest payments made to the Australian Taxation Office (ATO); and

(k) remove, in most cases, the requirement for taxpayers to lodge notices of elections or other notifications with the Commissioner.

The purpose of the Bill is to improve the self assessment system of taxation which Australia has had since 1986 so as to make that system fairer and more certain for taxpayers.

Application

The Bill will apply to all taxpayers.

Rulings and Review Rights

Taxpayers who are uncertain about the tax effect of an arrangement that is proposed, commenced or completed will be able to seek a Private Ruling from the Commissioner. The Commissioner will be bound by the ruling in that the tax that would be payable by the taxpayer will be reduced to reflect the ruling.

The Commissioner will continue to issue Public Rulings. These will be binding in the same way as Private Rulings will be binding on the Commissioner.

The Commissioner will only be able to withdraw the benefit of a ruling on arrangements that are not under review, or that have not yet been entered into, except where it would be grossly inequitable to allow a taxpayer to continue to benefit from an incorrect ruling.

A taxpayer will be able to have a Private Ruling, even on a proposed arrangement, reviewed by the AAT or the courts. When the review process is finalised, the decision of the AAT or court will be legally binding and conclusive as to the application of the ordinary provisions of the law to an actual arrangement not materially different from the proposal or arrangement to which the Private Ruling related.

Taxpayers will have 4 years to object against an assessment. Taxpayers will be able to object against a Private Ruling within the period ending:

- 60 days after receipt of the ruling; or
- 4 years from the last day allowed for the lodgment of the relevant return.

Extended Objection Period

The Bill extends the period within which a taxpayer can object against an assessment from 60 days to 4 years, and provides a similar objection period for Private Rulings.

Taxpayers will have full rights of review against a Private Ruling where there is no assessment covering the matter which is the subject of the Private Ruling; they will be able to object against an assessment except to the extent that the taxpayer has already objected against a Private Ruling in respect of that matter.

Self Amendment

The Commissioner will be able to rely on statements made by the taxpayer in a request for an amendment in amending the taxpayer's assessment (a 'self amendment') in the same way as the Commissioner can now rely on statements made by the taxpayer in a return when making an assessment (a 'self assessment'). However, the Commissioner may decide not to accept statements in the request for amendment and, for example, make enquiries as to whether the amendment is necessary.

The Commissioner is obliged to amend the taxpayer's assessment where the Commissioner is satisfied that the amendment is necessary to reflect the correct tax.

Where a taxpayer 'self amends' the Commissioner will have 4 years to review the item amended.

Understatement Penalties

Taxpayers who have exercised reasonable care will not be, in the vast majority of cases, subject to understatement penalties. However, for large issues which involve questions of law, taxpayers will also have to satisfy the reasonably arguable position standard.

There will be a specified level of penalties for categories of 'non-compliance'. These may be increased or decreased by 20% depending on whether there are aggravating or mitigating factors. Special rules apply where a taxpayer has entered into an arrangement with the dominant purpose of avoiding tax.

The Commissioner will continue to have the power to remit the penalty in whole or in part.

Where a taxpayer uses a tax agent the taxpayer will remain primarily liable for any penalty arising from the negligence of the tax agent. However, the taxpayer is entitled under section 251M of the Income Tax Assessment Act (ITAA) to recover the penalty in any court of competent jurisdiction.

Late Payment Penalty

The penalty for late payment is to be reduced from the current 20% per annum to 8% per annum, but will be complemented by the new interest system.

This penalty does not apply to debit amendments other than late payment of the increase in tax. Like other penalties, the Commissioner will have the power to remit the penalty in whole or in part.

Interest System

The Bill will provide for interest to be paid by taxpayers in relation to the underpayment and late payment of tax.

Interest for underpayment will apply irrespective of whether a taxpayer is subject to understatement penalties.

The Commissioner will have the power to remit interest.

Interest paid by all taxpayers to the ATO will be tax deductible.

Elections and Other Notifications

In most cases taxpayers will no longer be required to prepare and lodge written notices of elections. However, the records of taxpayers will need to reflect the decisions taken in calculating the taxable income.

Financial Impact

There will be revenue costs associated with the introduction of the new interest system (including reduced late payment penalties and deductibility for interest payments made by taxpayers to the ATO); otherwise the measures are generally revenue neutral.

The costs associated with the new interest system are estimated to be $20m in 1993-94, and $64m in 1994-95 and subsequent years. As these estimates are based on current market interest rates, the actual costs involved will vary according to the actual interest rates for any particular period.

These estimate are based on the current late payment penalty of 20% per annum, and interest on underpayments of 14.026% per annum, both of which are non deductible. Accordingly, any change in these rates would affect the costs of these measures. For example, a reduction in these rates would reduce the revenue costs.

Technical Overview: Scheme and Structure

At a Glance . .

Taxation Laws Amendment (Self Assessment) Act

Taxation Administration Act

Binding Public Rulings - Part IVAAA
Binding Private Rulings - Part IVAA
- Review of Private Rulings - Section 14ZAZA
- Limited Objection Rights - Section 14ZVA
- Objection Periods - Section 14ZW
- Review of Penalties - Section 14ZS

Income Tax Assessment Act

- Effect of Public Rulings - Sections 170BA, 170BC, 170BD and 170BF
- Effect of Private Rulings - Sections 170BB, 170BC, 170BE, 170BF, 170BG, 170BH and 170BI
- Self Amendment - Sections 169A and 170(1A)
- New Penalty Provisions -
  - Division 11 of Part IIIAA - Franking Deficit Tax
  - Part VII - Income Tax
- Reduced late payment penalty - Section 207
- New interest system - Sections 170AA, 207A, 214A and Schedule 3
- Deductibility of interest - Subsection 51(5)
- Changes to Elections as specified in Schedules 1, 2 and 4

Fringe Benefits Tax Act

- Effect of Public Rulings - Sections 74A and 74C
- Effect of Private Rulings - Sections 74B to 74F

Taxation (Interest on Underpayment) Act

Imposition of Section 170AA interest

Overview of the Chapter

This chapter deals with the title and commencement of the proposed Act and summarises the changes the Act will make to other Acts, and the scheme and structure of those changes.

Title and Commencement of the Act

When this Bill is enacted it will be called the Taxation Laws Amendment (Self Assessment) Act 1992. ***[Clause 1]***

The Act is to commence on the day it receives Royal Assent ***[Clause 2]***. However, most provisions will not apply before the later of Royal Assent or 1 July 1992 ***[Clause 34]***. For example, the amendments made to the Income Tax Assessment Act do not apply to elections made before the later of the commencement of this Act or 1 July 1992 ***[Clause 34]***. Similarly, taxpayers will not be able to obtain binding and reviewable Private Rulings before 1 July 1992 or for arrangements entered into before the commencement of this Act or 1 July 1992 ***[Clause 13]***.

Details of the commencement of the changes are outlined in the following chapters.

Scheme and Structure of the Legislation

The Act will amend the following Acts:

- Taxation Administration Act 1953 (Administration Act) ***[Clauses 3 to 14]***;
- Income Tax Assessment Act 1936 (ITAA) ***[Clauses 15 to 34]***;
- Fringe Benefits Tax Assessment Act 1986 (FBT Act) ***[Clauses 35 and 36]***; and
- Taxation (Interest on Underpayments) Act 1986 (Interest on Underpayments Act). ***[Clauses 37 and 38]***

Binding Public Rulings

Taxation Administration Act

The Bill inserts a new Part IVAAA into the Administration Act dealing with binding Public Rulings. *[Clause 4]*

Part IVAAA covers matters such as:

> interpretation and scope, including Part IVAAA's application to income tax (including withholding taxes and Medicare levy), franking deficit tax and fringe benefits tax; *[sections 14ZAAA - 14ZAAC]*
>
> the Commissioner's ability to make Public Rulings; *[sections 14ZAAD - 14ZAAG]*
>
> arrangements to which Public Rulings apply; *[section 14ZAAH]*
>
> the making of Public Rulings; *[sections 14ZAAI - 14ZAAJ]*
>
> the withdrawal of Public Rulings. *[sections 14ZAAK - 14ZAAL]*

The commencement of this Act is specified in Clause 2 of the Bill to be the date of Royal Assent to the Bill. Public Rulings will be able to be made on or after the later of the commencement of the Act and 1 July 1992 and will only apply to arrangements entered into on or after that date. *[Clause 12]*

Income Tax Assessment Act

The Bill inserts new sections into the ITAA to provide for the binding effect on the Commissioner of Public Rulings dealing with income tax, withholding taxes, Medicare levy and franking deficit tax, and to resolve which binding effect applies where there are conflicting rulings. As the Commissioner will be bound by the ruling, the tax that would be payable by a taxpayer will be reduced to reflect the ruling or rulings. Questions of conflict are resolved by providing the taxpayer with the greatest benefit consistent with all the relevant rulings. *[sections 170BA, 170BC, 170BD and 170BF - Clause 22]*

The relevance of Public Rulings to the new penalty provisions inserted by the Bill in Part VII and Division 11 of Part IIIAA of the ITAA is specifically dealt with by new sections 222C (for income tax) *[Clause 26]* and 160ARZD (for franking deficit tax) *[Clause 18]*.

Fringe Benefits Tax Assessment Act

Similar changes are made to the FBT Act to prescribe the binding effect of Public Rulings on fringe benefits tax and to resolve questions of conflict. *[sections 74A and 74C - Clause 36]*

Binding and reviewable Private Rulings

Taxation Administration Act

The Bill inserts a new Part IVAA into the Administration Act dealing with binding and reviewable Private Rulings. *[Clause 4]*

Part IVAA covers matters such as:

- interpretation and scope, including the application of Part IVAA to income tax (including withholding taxes and Medicare Levy), franking deficit tax and fringe benefits tax *[sections 14ZAA - 14ZAD]*;
- what a Private Ruling is - the Commissioner's opinion on the way in which a tax law or tax laws would apply to a person in respect of a year of income in relation to an arrangement *[sections 14ZAA, 14ZAE, 14ZAF, 14ZAG and 14ZAP]*;
- application for a Private Ruling *[sections 14ZAF to 14ZAJ]*;
- withdrawal of the application by the taxpayer *[section 14ZAK]*;
- dealing with a ruling application *[sections 14ZAL and 14ZAM]*;
- applications that do not have to be dealt with in certain specified circumstances *[sections 14ZAN and 14ZAQ]*;
- the giving of reasons for delays in making the ruling *[section 14ZAO]*;

  the making of a Private Ruling *[sections 14ZAP to 14ZAT]*;
- the withdrawal of a Private Ruling and its effect *[sections 14ZAU to 14ZAX and 14ZAZ]*;

the circumstances where a Private Ruling is taken to have no effect *[section 14ZAY]*;

objections, reviews and appeals relating to Private Rulings, thus providing for the review of Private Rulings *[section 14ZAZA]*. This provision enables a rulee (defined in section 14ZAA to mean the person the application to whom of a tax law is the subject of the ruling) to object against a Private Ruling in the same way as a taxpayer can object against an assessment. There is a consequential amendment to section 14ZQ of the Administration Act to include the term 'Private Ruling' within the definitions applicable to taxation objections, reviews and appeals *[Clause 5]*;

- the effect of the Commissioner's decision on a ruling where the taxpayer does not appeal against the decision or make an application for review by the AAT - the ruling is so altered *[section 14ZAZB]*;
- the effect of ruling application and objections against rulings on lodgement requirements and the Commissioner's assessment power - no effect *[section 14ZAZC]*.

A new section 14ZVA is included in the Administration Act to avoid duplication of disputes where a rulee has objected against a Private Ruling, by limiting the rulee's rights to object to a subsequent assessment in respect of the same matter *[Clause 7]*. This complements paragraph 14ZAZA(2)(a) which specifies that a rulee may not object against a ruling where an assessment has been made in respect of the year of income relating to the arrangement dealt with by the ruling. A new provision, subsection 14ZW(1A) prescribes the time period within which a taxpayer can object against a Private Ruling. *[Clause 8]*

The commencement of this Act is specified in Clause 2 of the Bill to be the date of Royal Assent to the Bill. Applications for Private Rulings will be able to be made on or after or 1 July 1992 in respect of arrangements entered into on or after the later of that date or the commencement of the Act. *[Clause 13]*

The Bill also inserts new provisions in Part V of the Administration Act to ensure that the validity of a Private Ruling is not affected by non compliance with Part IVAA of that Act, and that the production of a notice of, or a notice of the withdrawal of, a Private Ruling or a signed copy of such a notice is conclusive evidence of the proper making of the ruling. ***[sections 15AA and 15AB - Clause 11]***

Income Tax Assessment Act

The Bill inserts new sections into the ITAA which provide for the binding effect on the Commissioner of Private Rulings dealing with income tax (including withholding taxes and Medicare levy) and franking deficit tax, and to resolve which binding effect applies where there are conflicting rulings. As the Commissioner will be bound by the ruling, the tax that would be payable by the taxpayer will be reduced to reflect the ruling or rulings. Questions of conflict are resolved by providing the taxpayer with the greatest benefit consistent with all relevant rulings. ***[sections 170BB, 170BC, 170BE and 170BF - Clause 22]***

New sections 170BG and 170BH provide that a decision of the AAT or a court order which is final is legally binding and conclusive as to the application of the ordinary provisions of the law to an actual transaction not materially different from the proposal or arrangement to which the Private Ruling related. Section 170BI deals with discretions. ***[Clause 22]***

The relevance of Private Rulings to the new penalty provisions is specifically dealt with by new section 226M in respect of income tax ***[Clause 31]*** and new section 160ARZE in respect of franking deficit tax ***[Clause 18].***

This new system of binding and reviewable Private Rulings supersedes the current system whereby taxpayers can, by raising in their return a question that is relevant to their liability to tax, require the Commissioner to give attention to that question. Accordingly, the Bill amends subsection 169A(2) of the ITAA so that it does not apply where the taxpayer is entitled to apply for a Private Ruling under Part IVAA of the Administration Act. ***[Clause 19]***

Fringe Benefits Tax Assessment Act

Similar provisions dealing with the binding nature of Private Rulings, conflicting rulings and the conclusive effect of a final AAT decision or court order are to be found in new sections 74B to 74F of the FBT Act. ***[Clause 36]***

Objections

As indicated above, where a rulee has objected against a Private Ruling in respect of a matter, the rulee is precluded from objecting against an assessment in respect of the same matter. ***[section 14ZVA of the Administration Act - Clause 7]***

A taxpayer can object against a Private Ruling in the manner set out in Part IVC of the Administration Act but must do so within the later of 4 years after the last day allowed for lodging the relevant return or 60 days after receipt of the Private Ruling. ***[section 14ZAZA and subsection 14ZW(1A) - Clauses 4 and 8]***

The Bill also amends the Administration Act to extend the period for lodging an objection against fringe benefits tax, franking deficit tax and income tax assessments and related determinations to 4 years from the notice of the taxation decision ***[subsection 14ZW(1)]***, or, where a taxation objection relates to an amendment of these assessments or determinations, the taxpayer has the later of 4 years from the original notice of assessment or determination or 60 days from the notice of the amended assessment or determination, within which to lodge an objection ***[subsection 14ZW(1B)]***. If an assessment or determination has been amended more than once, the relevant notice of the assessment or determination is the first notice ***[subsection 14ZW(1C)]***. Other taxation objections retain the 60 day objection period (existing subsections 14ZW(1)(a), (b) and (c)). Consequential changes are made to subsections 14ZW(2) and (3) to include a reference to the 4 year objection period. ***[Clause 8]***

Similarly, consequential changes are made to section 14ZX (applications for extension of time to object), and section 14ZY (decisions on taxation objections) to include a reference to the 4 year objection period. ***[Clauses 9 and 10]***

These amendments of the Administration Act are to apply to taxation objections against assessments etc. for the income year, franking year, or year of tax in which the later of 1 July 1992 or the date of commencement occurs and later years. ***[Subclause 14(2)]***

Self Amendment

The Bill amends subsection 169A(1) of the ITAA so that the Commissioner will be able to accept a statement made by or on behalf of the taxpayer in a request for an amendment for the purposes of amending the taxpayer's assessment. ***[Clause 19]***

Where the Commissioner has relied, in making a credit amendment, on a statement made by the taxpayer, the Commissioner will have 4 years from the service of the notice of amended assessment to increase the liability of the taxpayer in respect of the particular which was the subject of the amendment ***[subsection 170(1A) - Clause 20]***. However, where the Commissioner increases the tax liability of the taxpayer in these circumstances, the taxpayer is not entitled to a further credit amendment in respect of the particular, other than by disputing the Commissioner's assessment. ***[subsection 170(5A) - Clause 20]***

Understatement Penalties

Income Tax

The Bill repeals section 223 of the ITAA, which imposes penalties on taxpayers who make false or misleading statements ***[Clause 27]***. However, the operation of section 223 is preserved for the 1991-92 and prior income years and substituted accounting periods for the 1992-93 income year that commenced before 1 July 1992. ***[Subclause 34(7)]*** Consequential changes are made to section 170AA. ***[Subclauses 21(c) and (d)]***

The new penalty provisions will mainly apply where a tax shortfall is caused by the taxpayer's failure to exercise reasonable care in carrying out his or her tax obligations, or, for large items, by the taxpayer adopting a position which is not reasonably arguable.

The Bill introduces new tax shortfall provisions into Part VII of the ITAA which give rise to a liability to penalty:

section 226G -	lack of reasonable care (25% of part or all of the shortfall, as appropriate);
section 226H -	recklessness (50% of part or all of the shortfall, as appropriate);
section 226J -	intentional disregard of the law (75% of part or all of the shortfall, as appropriate);

section 226K -	no reasonably arguable position where the tax shortfall caused by a taxation statement exceeded the higher of $10 000 or 1% of the taxpayer's return tax (25% of all or part of the shortfall, as appropriate);
section 226L -	the shortfall arises in relation to a tax avoidance scheme which is defeated otherwise than by the use of specific anti-avoidance provisions (50% of all or part of the shortfall, as appropriate, or reduced to 25% where the taxpayer has a reasonably arguable position); and
section 226M -	Private Ruling disregarded by a taxpayer in making a taxation statement (25% of part or all of the shortfall, as appropriate).

These are the tax shortfall sections. *[Clause 31]*

Special rules will apply to the application of penalties in partnership and trust cases. The rules basically mirror the approach of the present subsections 223(2), 223(4) and 223(5) of the ITAA. *[sections 226N to 226T - Clause 31]*

The Bill also amends sections 224, 225 and 226 of the ITAA (the scheme sections), which deal with penalties applicable where anti-avoidance provisions apply, to modify the rates of penalty attracted and to include circumstances in which those rates will be reduced. Thus, sections 224 and 226 are amended to specify a rate of penalty of 50% of the difference between the tax properly payable by the taxpayer and the tax that would have been payable if the anti-avoidance provision had not been applied. However, where it is reasonably arguable that any pre-condition to the application of the anti-avoidance provision has not been met, or where it would be concluded that the opinion formed by the Commissioner was not according to law, the penalty is reduced to 25%. *[Clauses 28 and 30]*

A similar approach is taken to profit shifting cases covered by section 225, subject to the distinction already recognised in section 225 that profit shifting arrangements may or may not be entered into for the sole or dominant purpose of paying less tax. Under the amended section 225, where there is a dominant purpose of paying less tax, the rate of penalty is 50%, which is reduced to 25% where it is reasonably arguable that Division 13 of the ITAA does not apply. Where there is no dominant purpose of paying less tax the rate is 25% reduced in similar circumstances to 10%. ***[Clause 29]***

The Bill introduces into Part VII a number of interpretational provisions. Section 222A defines such terms as 'tax shortfall', 'statement tax', 'proper tax' and 'taxation statement'. For example, tax shortfall generally means the difference between the tax that would be payable if it were assessed on the basis of the taxpayer's statements (after allowing for credits), and the taxpayer's proper tax for that year. Section 222B complements the definition of 'taxation statement' by picking up the definitions in existing subsections 223(9A) to (9F). Section 222D deals with the case where a taxpayer treats an income tax law as not applying. Section 222E provides that a taxation statement can apply to different years. ***[sections 222A to 222E - Clause 26]***

Section 222C explains that a taxpayer's treatment of the application of a law will be 'reasonably arguably correct' for the purposes of provisions like section 226K and section 226L if, having regard to the relevant authorities and the facts of the case, it would be concluded that the treatment was **about** as likely as not correct. The section also provides guidance as to the operation of the reasonably arguable test in cases where the way in which an income tax law operates is dependent on the Commissioner exercising a discretion. This new section will also provide guidance on what is included within the scope of the word 'authority'. ***[Clause 26]***

The Bill will ensure that taxpayers will not be subject to penalties where they had previously sought a Private Ruling from the Commissioner but had not received that ruling at the time the relevant statement giving rise to the tax shortfall was made. Similarly, taxpayers will not be penalised where they act on advice provided by taxation officers or on general administrative practice ***[sections 226U and 226V - Clause 31]***. Taxpayers will also be protected from scheme penalties in the same circumstances. ***[sections 226A and 226B - Clause 31]***

Where 2 or more shortfall section apply to a particular shortfall, the taxpayer is only liable for whichever is the highest penalty applicable under those sections. ***[section 226W - Clause 31]***

The penalty applicable to part or all of a tax shortfall is increased by 20% of the relevant penalty where there are aggravating factors ***[section 226X - Clause 31].*** The penalty payable where a scheme section applies in similar circumstances will also be increased in the same way. ***[section 226C - Clause 31]***

Where a taxpayer notifies the Commissioner about all or part of a shortfall after being informed of a tax audit, the amount of penalty applicable to all or part of the shortfall, as appropriate, is reduced by 20% where this could reasonably be expected to save the Commissioner a significant amount of time or resources ***[section 226Y].*** Where there is a voluntary disclosure by the taxpayer before being notified of an audit, the relevant penalty is reduced by 80% or, where the penalty would be less than $1 000 - to nil ***[section 226Z].*** The Commissioner may treat a disclosure under section 226Y to be a disclosure under section 226Z where appropriate ***[section 226ZA - Clause 31].*** Similar provisions deal with disclosure where a scheme section applies, but there is no reduction to nil. ***[sections 226D, 226E and 226F - Clause 31]***

Section 226ZB will provide that the minimum amount of penalty under Part VII is $20. ***[Clause 31]***

A similar approach to that which presently exists will apply to taxpayers who use tax agents. That is, taxpayers will be vicariously liable for penalty in respect of the culpable errors of their tax agents ***[sections 226G, 226H and 226J - Clause 31].*** Taxpayers will continue to have available the remedy under section 251M of the ITAA, which will be amended to refer to interest payable by the taxpayer under section 170AA or section 207A. ***[Clause 32]***

The Commissioner will retain the remission power provided by section 227 of the ITAA.

Franking Deficit Tax

The Bill will introduce into Division 11 of Part IIIAA provisions, similar to those to be included in Part VII, to deal with tax shortfalls in relation to franking deficit tax:

> sections 160ARXA, 160ARXB and 160ARXC deal with interpretational matters; ***[Clause 17]***
>
> sections 160ARZA, 160ARZB, 160ARZC, 160ARZD and 160ARZE are the franking tax shortfall sections; ***[Clause 18]***

sections 160ARZF and 160ARZG apply where the taxpayer had previously sought a ruling or relied on ATO advice or practice; *[Clause 18]*

- sections 160ARZH deals with the case where 2 or more shortfall sections apply; *[Clause 18]*
- section 160ARZI deals with aggravating factors; *[Clause 18]*
- sections 160ARZJ, 160ARZK and 160ARZL deal with voluntary disclosures. *[Clause 18]*

Rights of objection and review

The Bill will amend the Administration Act to ensure that taxpayers have full rights of objection, review and appeal whatever amount of penalty is involved. *[section 14ZS - Clause 6]*

Commencement date

The new penalty provisions will apply to tax shortfalls and franking tax shortfalls in relation to a year of income or franking year that commences on or after 1 July 1992, excluding substituted accounting periods that commenced before 1 July 1992, where those shortfalls are caused by acts or omissions after the date on which the Bill receives Royal Assent. *[Subclause 34(2)]*

Interest

Payment of interest by taxpayer where assessment amended

The Bill amends section 170AA of the ITAA to require taxpayers to pay interest, at such rate as is specified in new section 214A, where there is an amendment to an assessment or determination, irrespective of whether the taxpayer is liable to penalty under Part VII *[subsections 170AA(1AA) and 170AA(2) - Clause 21]*. The Bill also ensures that for relevant entities, section 170AA interest will be payable from the prescribed due date for payment of tax for the relevant year of income. *[subparagraphs 170AA(4)(a)(i), (ia) and subsection 170AA(7) - Clause 21]*

The Commissioner retains the power to remit interest under subsection 170AA(11) of the ITAA.

The changes apply to assessments for the 1992-93 year of income and all subsequent years of income. *[Subclause 34(4)]*

The Interest on Underpayments Act is amended to make it clear that it only imposes any interest which is a tax that is payable under the ITAA. *[Clause 38]*

Penalty and interest for unpaid tax

The Bill amends section 207 of the ITAA by reducing the rate of penalty applicable where tax remains unpaid after the time it becomes due and payable from 20% to 8% per annum ***[amended section 207 - Clause 23].*** The Bill also ensures that in respect of relevant entities, penalty will apply from the prescribed due date for payment of tax for the relevant year of income. ***[subsection 207(1AA) - Clause 23]***

Interest on a judgment debt is not to be offset against the section 207 penalty. ***[subsection 207(1B) - Clause 23]***

The Bill ensures that section 207 will apply to interest under section 170AA. ***[subsection 207(3) - Clause 23]***

The Commissioner retains the power to remit the penalty under subsection 207(1A).

The Bill introduces a new section 207A into the ITAA which requires a person to pay interest at the rate prescribed in the new section 214A on unpaid tax. For the purposes of this section, 'tax' includes interest under section 170AA and penalty under Part VII. The Commissioner will be entitled to remit the interest having regard to criteria specified in subsection 207A(2). Notwithstanding section 207A, the Commissioner can sue for recovery of tax that is due and payable. Where a judgment debt carries interest, that interest can be offset against the interest payable under section 207(A). ***[section 207A - Clause 24]***

Consequential amendments are made to the ITAA as specified in **Schedule 3**. *[Clause 33]*

The amendments to section 207 and section 207A apply to late payments of tax in respect of the 1992-93 year of income and all subsequent years of income. ***[Subclauses 34(5) and (6)]***

Interest Rates

The Bill inserts a new section 214A into the ITAA which specifies that the interest rate for the purposes of section 170AA and section 207A is to be the weighted average yield for the 13 Week Treasury Note plus 4%. Section 214A also deals with the notification of the rate, its determination and the Treasurer's ability to determine the rate that should be applicable. ***[section 214A - Clause 25]***

Deductibility of interest

The Bill will make expenditure that consists of interest under section 170AA or section 207A an allowable deduction for all taxpayers. ***[subsection 51(5) - Clause 16]***

Elections

The Bill amends the ITAA in relation to the election and notification provisions specified in **Schedules 1, 2 and 4** of the Bill in the manner set out in those schedules. ***[Clause 33]***

The amendments to the election and notification provisions specified in **Schedules 1 and 2** do not apply to elections made before the later of the date of Royal Assent or 1 July 1992. ***[Subclauses 34(9) and (10)]***

Other Amendments

Consequential amendments to the ITAA are made by Clause 33 of the Bill. These amendments are set out in **Schedule 4** and their commencement date is specified in clause 34.

Chapter 1
Rulings

Key Features

This chapter deals with how rulings made by the Commissioner are to be binding and what review rights there are to be in respect of rulings. The key features are:

- the Commissioner will be able to make binding Public Rulings about how the tax laws apply to classes of arrangements or persons;
- taxpayers will be able to seek binding Private Rulings about their own particular tax affairs;
- the Commissioner will be compelled to adhere to a binding Public or Private Ruling if the ruling is favourable to a taxpayer;
- binding Public and Private Rulings may be withdrawn, but in general, not so as to disadvantage taxpayers who have acted in reliance on a ruling;
- taxpayers will be able to object to Private Rulings in the same way as they can object against assessments;
- taxpayers will also be able to seek review by the AAT or a court of adverse objection decisions.

Summary of Proposed Amendments

The Bill gives effect to changes announced in sections 8 and 9 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

Among other things, amendments proposed by the Bill will provide for a system of binding and, in some cases, reviewable tax rulings. These amendments will affect:

- Public Rulings - rulings issued by the Commissioner for the information of the public generally; or
- Private Rulings - rulings given to individual taxpayers about their own particular tax affairs.

Only Private Rulings will be reviewable by the AAT or courts.

The amendments affecting rulings are in two parts:

- amendments to the Administration Act deal with administrative issues, for example, how binding Public and Private Rulings are to be made and withdrawn, and review rights in respect of Private Rulings *[Clause 4];* and
- amendments to the ITAA and the FBT Act deal with substantive issues, like the effect Public and Private Rulings will have on assessments and the effect on an assessment of an AAT or court decision made following a review of an objection decision in relation to a Private Ruling. *[Clauses 22 and 36]*

The objective of the amendments affecting rulings is to ensure that rulings made by the Commissioner about the application of tax laws to arrangements are to be binding and that Private Rulings are to be reviewable in the same way as assessments are reviewable under Part IVC of the Administration Act.

Tax laws to which rulings may apply

The tax laws covered by binding rulings can relate to income tax, withholding taxes, franking deficit tax, Medicare levy and FBT *[sections 14ZAAA and 14ZAA of the Administration Act - Clause 4]*. Rulings on these tax laws will be binding where they would affect the amount of tax payable by a taxpayer. The new rules do not cover rulings by the Commissioner on procedural, administrative or collection aspects of the law [eg., rulings on Pay-As-You-Earn (PAYE) or Prescribed Payments System (PPS) matters] which do not affect a taxpayer's final liability to tax.

Meaning of 'binding'

A ruling will be binding on the Commissioner if the ruling can be said to be favourable to a person. A ruling about a matter can be said to be favourable if the way in which the tax law would apply to a person in relation to that matter is different to the way the ruling stated that law would apply and the tax payable under an assessment or an amount of withholding tax would, because of the difference, be more than it would have been if the ruling had been correct. The ruling will be binding in the sense that the tax payable or the withholding tax is not to be greater than it would be if the ruling applied. A taxpayer will be able to self assess in line with the ruling. If the Commissioner was to make an assessment involving that matter, he will be compelled by the law to act in accordance with the favourable ruling. ***[sections 170BA, 170BB, 170BC, 170BD and 170BE of the ITAA - Clause 22 and sections 74A, 74B and 74C of the FBT Act - Clause 36]***

Penalty if Private Ruling not followed

While the Commissioner will be bound to apply favourable rulings, a taxpayer who gets an unfavourable Private Ruling prior to self assessing will be penalised for not self assessing in accordance with the Private Ruling. *See Chapter 4.* A ruling is unfavourable if a taxpayer's opinion of how the tax law applies in relation to a matter is different to the Commissioner's view expressed in the ruling, and the tax payable under an assessment or an amount of withholding tax would be greater if the Commissioner's view is applied.

Review rights

There will only be review rights in respect of Private Rulings. This is because Public Rulings will not be specific to any particular person or arrangement. The rights of review for a Private Ruling will be the same as those available in respect of assessments. Taxpayers will be able to object against unfavourable Private Rulings and seek review by the AAT or a court of an adverse objection decision. *[section 14ZAZA of the Administration Act - Clause 4]*

While a taxpayer could not object against an unfavourable Public Ruling that deals with an arrangement proposed or commenced by the taxpayer, the person could seek a Private Ruling about the particular matter and pursue whatever review rights are available in respect of that Private Ruling.

Explanation of Proposed Amendments

Binding Public Rulings

A new Part is being inserted in the Administration Act to deal with the issue and withdrawal of Public Rulings that are binding at law *[Part IVAAA - Clause 4]*. For the purpose of the new Part, a Public Ruling is a determination by the Commissioner of the way in which a tax law or tax laws would apply to any person in relation to a class of arrangements, a class of persons in relation to an arrangement, or a class of persons in relation to a class of arrangements. *[sections 14ZAAE, 14ZAAF and 14ZAAG]*

The Commissioner makes known his views about the application of the tax laws in a number of ways. For some years now, the Commissioner has issued formal Taxation Rulings on the application of the tax laws generally (in the sense that they do not cover any particular taxpayer's affairs). These rulings are available through the Freedom of Information units in the ATO. More recently, the ATO Capital Gains Tax (CGT) Specialist Cell, a working group in the ATO that focuses on CGT issues, has issued formal CGT Determinations that give rulings about the application of CGT. The Commissioner's views about tax laws may also be found in other ATO publications, for example, return form guides, information booklets, Commissioner press statements and speeches.

Rulings about the application of the tax laws may still be made in any one of the forms just mentioned. But a ruling will only be a Public Ruling for the purpose of the new binding rulings provisions if it:

- is made available to the public; ***[subsection 14ZAAI(1)]*** and
- contains a statement that it is a Public Ruling for the purposes of the new provisions. ***[subsection 14ZAAI(2)]***

Date of effect for Public Rulings

Public Rulings about arrangements will generally apply to past as well as new arrangements. This is because a Public Ruling states the Commissioner's interpretation of the law and, subject to legislative change, that law is taken to have always applied. The exception to the general rule is where a ruling states that it only applies to arrangements commenced after a particular date. This might happen if the ruling applies to new tax law or if the Commissioner considers it would be unfair to apply a ruling to arrangements commenced before the ruling is made, even though there has not been an earlier ruling on the matter. ***[section 14ZAAH]***

Where a Public Ruling is issued about a matter and there is an earlier Public Ruling on the same matter, the earlier ruling continues to apply to arrangements commenced before the issue of the new ruling ***[section 14ZAAJ]***. Any conflict between the new and old rulings in respect of the period before the issue of the new ruling will be resolved by special rules ***[subsections 170BC(3) and 170BF(3) of the ITAA and subsection 74C(3) of the FBT Act]***. In general the ruling that gives the greater benefit to a taxpayer will apply (*see later notes on conflicting rulings*).

One consequence of Public Rulings having past as well as future effect is that where a ruling is favourable to a taxpayer, the taxpayer may self amend to give effect to the ruling in an assessment at any time before the amendment period for the assessment has expired. *See Chapter 3.* In practical terms this means that people will be able to gain the benefit of favourable Public Rulings for a period up to 4 years after an assessment is made. The Commissioner would not be able to make any change to the self amended assessment in respect of the matter covered by the ruling, even if the Commissioner's interpretation of the law was to subsequently change. In such a case, the law will compel the Commissioner to assess in accordance with his earlier favourable ruling (*see notes on effect of Public and Private Rulings*).

Withdrawal of Public Rulings

It will be possible for the Commissioner to withdraw either the whole or part of a Public Ruling by:

- giving written notice of the withdrawal for the benefit of the general public; ***[subsection 14ZAAK(1)]*** or
- issuing a new Public Ruling about a class of arrangements or persons that is inconsistent with an earlier Public Ruling. ***[subsection 14ZAAK(2)]***

Where a new Public Ruling is only partly inconsistent with an earlier ruling, the earlier ruling is to be taken to be withdrawn only to the extent of the inconsistency. ***[subsection 14ZAAL(2)]***

Effect of withdrawal of Public Ruling

To the extent that a Public Ruling is withdrawn, it will not apply to arrangements entered into after the withdrawal ***[section 14ZAAL]***. The time of withdrawal is the time when the relevant written notice is published or the relevant inconsistent Public Ruling is published or, if the notice or inconsistent Public Ruling specifies a later time, that time. A withdrawn ruling will continue to apply, in respect of arrangements commenced before the ruling was withdrawn. As already noted, a consequence of this is that there could be conflicting Public Rulings applying to an arrangement that has commenced, in a case where a Public Ruling is withdrawn by the issue of an inconsistent Public Ruling. Any conflict will be resolved under the conflicting rulings provisions. ***[subsections 170BC(3) and 170BF(3) of the ITAA and subsection 74C(3) of the FBT Act]***

There are two crucial issues in dealing with Public Rulings that are withdrawn. They are:

- where a ruling is only partly withdrawn - determining the extent to which the ruling is withdrawn; and

- in every case - deciding when it is that an arrangement can be said to have begun to be carried out.

Ruling partly withdrawn

The first issue is important because, to the extent it is not withdrawn, a Public Ruling continues to have effect.

Example

A ruling deals with expenditure connected with an employer sponsored superannuation fund. The ruling states that the relevant expenditure is deductible to:

(i) the superannuation fund itself, if incurred by the fund's trustee on its behalf; or

(ii) to the sponsoring employer, if incurred by that employer on the fund's behalf.

In this case both trustees of superannuation funds and employer sponsors of superannuation funds could rely on the Public Ruling when claiming a deduction for the type of expenditure covered by the ruling.

Some later time the Commissioner decides that trustees of superannuation funds are not entitled to deductions of the type covered by the ruling. The Commissioner publishes a statement withdrawing the ruling to the extent that it deals with trustees of superannuation funds.

In this case the ruling would continue to apply in so far as it deals with deductions available to sponsoring employers.

Deciding when arrangements have begun

The second issue involves a question of fact that must be determined on the basis of the actual facts in each particular case. It is important because a withdrawn Public Ruling only has application for arrangements commenced on or before the withdrawal. Where an arrangement will be carried out under a contract, the arrangement will be taken to have begun to be carried out at the time when the contract was entered into *[section 14ZAAB].* This could be before the time when the arrangement has actually commenced to be carried out. For instance, a builder might enter into a contract to build a home but construction of the home will not commence for a further 3 months. The arrangement of building the home will have begun to be carried out when the contract was made.

The definition of arrangement *[section 14ZAAA]* is very broad. There will be cases where an arrangement does not involve a contract, eg., a Public Ruling might deal with the deductibility of expenditure incurred in travelling to and from work. In this case each day's travel to and from work is a separate arrangement that is begun when a person embarks on the journey. If the Public Ruling was withdrawn it would only apply to journeys undertaken up until the withdrawal.

Binding Private Rulings

The Administration Act will also be amended by this Bill to insert a new Part that deals with Private Rulings *[Part IVAA - Clause 4].* The essential difference between Private and Public Rulings is that Private Rulings deal with specific arrangements that are proposed, or have been entered into or completed by a particular person or persons. This allows Private Rulings made by the Commissioner to be reviewable in the same way as assessments are reviewable.

The provisions dealing with Private Rulings are more comprehensive than those dealing with Public Rulings. This is because they have to deal with applications by persons for Private Rulings (the Commissioner may issue Public Rulings at his own discretion) and because Private Rulings are reviewable.

What is a Private Ruling

A Private Ruling is a written response from the Commissioner to a request for a ruling about the application of a tax law, or tax laws, to a person (the rulee) in respect of a year of income in relation to a particular arrangement *[sections 14ZAF, 14ZAG and 14ZAR].* In making a Private Ruling, the Commissioner may also make an additional Private Ruling on the way in which another tax law would apply, or how a tax law would apply to the person for another year in respect of the arrangement, or how a tax law would apply to the person in relation to a related arrangement. ***[section 14ZAP]***

The matter covered by a Private Ruling is specific to a particular person, tax law or laws, year of income and arrangement. This is important because it limits the extent to which a ruling is binding to that matter and, as already noted, allows for review of Private Rulings. Where the actual facts of an arrangement are materially different to those covered by a ruling, the ruling has no effect.

Applications for Private Rulings

People can apply for a ruling about a matter that affects them or, with the written consent of another person, about a matter that affects the other person ***[sections 14ZAF and 14ZAG]***. If two or more people want a ruling about an arrangement, or a class of arrangements, a person may, with the written consent of the others, make an application on behalf of all of those persons.

Form of application for a Private Ruling

An application for a Private Ruling must be made in a form approved by the Commissioner ***[section 14ZAJ]***. The Commissioner will be publishing standard forms that can be used to apply for a Private Ruling. These will be available from the ATO. A person need not apply on a standard form, provided an application contains all of the information that the Commissioner requires in an application to be able to make the ruling. It could be expected that a ruling application about a routine matter would not require the same degree of information as an application about a complex matter.

Insufficient information provided

There may be cases where the standard information required to be provided with applications will still be insufficient to allow the Commissioner to give a ruling about a matter. In this case the Commissioner must ask the applicant for the additional information needed to allow a ruling to be given ***[section 14ZAM]***. This ensures that the Commissioner cannot refuse a ruling request merely on the grounds that insufficient information has been provided by the applicant.

Commissioner may give additional Private Rulings

Where a Private Ruling request is very specific in its application to an arrangement and a particular tax law, the Commissioner may give such ruling as he thinks is appropriate. For instance a person might ask for a ruling as to whether an amount derived from the sale of an asset is assessable under section 25 of the ITAA. If the Commissioner considers that the amount is not assessable under section 25, he could give a Private Ruling simply stating that opinion. This would be so even though the Commissioner formed the opinion that, although no amount was assessable under section 25, an amount was assessable under Part IIIA as a capital gain. In this case, the law allows the Commissioner to give the applicant a Private Ruling stating both opinions or to give the applicant a second Private Ruling about the way Part IIIA would apply to the sale of the asset. ***[paragraphs 14ZAP(a) and (b)]***

Similarly, if an applicant asked for a ruling in respect of a particular year in relation to an arrangement that will be carried out over more than one year, the Commissioner may give an additional ruling or rulings covering the other year or years ***[paragraph 14ZAP(b)(ii)]***. Where relevant, the Commissioner may also give an additional Private Ruling about an arrangement that is related to the arrangement for which a ruling has been sought ***[paragraph 14ZAP(b)(iii)]***. In broad terms, two arrangements are related ***[section 14ZAB]*** if they are part of the same arrangement or both affect a person's tax.

In cases where the Commissioner considers it would be appropriate to deal with additional matters, such as a year or a related arrangement not covered by an application, he cannot give one Private Ruling covering both the matters covered by the application and the additional matters. This is because they relate to either a different year, or years, or to different arrangements. To enable review of Private Rulings they are to cover only one year of income and only one arrangement.

Assumptions made by the Commissioner

If the correctness of a Private Ruling would rely on assumptions made by the Commissioner, the Commissioner may either decline to make the ruling or make the appropriate assumptions ***[section 14ZAQ].*** The Commissioner may not make assumptions about information which the applicant could provide. As already noted, the Commissioner must ask for any further information needed to deal with a ruling request. But assumptions could be made about future events that are uncertain.

Example

> A person asks for a Private Ruling concerning a venture which is seriously contemplated but not all details are known. The arrangement involves a trust and it is not known whether the beneficiaries are residents. The Commissioner may make the assumption for the purpose of giving a ruling that even though the beneficiaries are not yet known, they will be Australian residents.

Dealing with applications for Private Rulings

The Commissioner will be obliged to comply with a ruling request ***[subsection 14ZAL(1)],*** except in a limited group of cases ***[section 14ZAN and paragraph 14ZAQ(a)].*** Even if the Commissioner is not compelled to give a ruling, he may still choose to give one. ***[subsection 14ZAL(1) and paragraph 14ZAQ(b)]***

Applications that do not have to be dealt with

There is a range of circumstances where the Commissioner does not have to respond to an application for a Private Ruling ***[section 14ZAN].*** As a general rule, the Commissioner will not have to give a Private Ruling about a matter if the matter has already been determined, or will be determined through a different process. To require rulings to be given in those circumstances would cause a duplication of work. In addition, the Commissioner will not have to deal with applications that are frivolous or purely hypothetical.

The exceptions to the general rule that the Commissioner must respond to a ruling request are where

- there is already a Private Ruling about the same matter; *[paragraph 14ZAN(a)]*
- the matter has already been decided by the Commissioner in making a Commissioner assessment; *[paragraph 14ZAN(b)]*
- the ruling would cover withholding tax that has already become due and payable; *[paragraph 14ZAN(c)]*
- the Commissioner considers the matter will be decided in the course of a tax audit that commenced before the ruling request; *[paragraph 14ZAN(d)]*
- the matter is covered by an objection against a self assessment and will be decided when the objection is decided; *[paragraph 14ZAN(e)]*
- the ruling request is made more than 4 years after the due date for lodging the tax return for the relevant year; *[paragraph 14ZAN(f)]*
- the application is frivolous or vexatious; *[paragraph 14ZAN(g)]*
- the arrangement covered by the application is not seriously contemplated; *[paragraph 14ZAN(h)]*
- the applicant has not satisfactorily complied with a request for more information; *[paragraph 14ZAJ(i)]*
- the Commissioner considers it would be unreasonable to have to comply, having regard to
  - the amount of resources he would have to apply to dealing with the ruling request; or
  - any other relevant matters. *[paragraph 14ZAN(j)]*

Some of these exceptions warrant further explanation.

Existing Private Rulings

The Commissioner will not have to comply with an application for a Private Ruling if there is already a Private Ruling about the matter sought to be determined. In this context, the 'matter' is the application of a tax law or tax laws to a person in respect of a year of income in relation to an arrangement. Because a matter is specific to a particular person this exception will not prevent another person from getting a Private Ruling about the same arrangement. In particular, where a person makes applications for rulings on behalf of a number of persons in relation to the same arrangement, the fact that one or more of those persons has already obtained a Private Ruling about the same matter will not prevent the remaining persons from obtaining rulings.

Matter decided

If a matter has been decided and has affected an assessment made by the Commissioner in respect of a taxpayer, the Commissioner will not have to deal with an application for a ruling about the same matter. Although in this case, the right to a review of a Private Ruling will not be available, the taxpayer will, of course, have review rights in respect of the assessment.

A decision about a matter may not affect an assessment until a later year of income. Where a matter is determined by the Commissioner but no assessment is made, eg., where there is a loss in that particular year of income and the Commissioner's decision would cause a smaller loss to be carried forward, a taxpayer will be able to seek a Private Ruling about the matter up until the time, if there is one, when the determination has an effect in a Commissioner assessment. A Commissioner assessment is one that is not a self assessment, ie., one where the Commissioner applies the law to the taxpayer's facts. The determination could affect a Commissioner assessment, for instance, in which the taxpayer seeks a deduction for the loss carried forward. The deduction for a loss carried forward sought by the taxpayer would be greater than that allowed by the Commissioner. At that stage the taxpayer will not be able to get a Private Ruling about the matter decided in the earlier year. But the taxpayer could object against the assessment in which the loss deduction is sought.

Example

A taxpayer calculates a loss of $1 000 for the 1992-93 income year on the basis that a $500 deduction is available for repairs.

The Commissioner decides that the expenditure of $500 is of a capital nature and, therefore, is not deductible. The Commissioner's view is that the loss to be carried forward is only $500.

At this stage the taxpayer could ask for a Private Ruling about the matter, since the Commissioner's decision has not had an effect in an assessment. The taxpayer would then have all the rights of review that attach to a Private Ruling.

Later, there is an assessment made by the Commissioner in respect of the taxpayer for the 1993-94 year of income. The Commissioner allows as a deduction against assessable income a loss of $500, giving a taxable income of $8 000.

The taxpayer thinks the taxable income should be $7 500, on the basis that the loss carried forward should be $1 000.

At this stage the taxpayer cannot ask for a ruling about the matter because it has had an effect in a Commissioner assessment. But, of course, the taxpayer could object against the assessment on the ground that the loss allowed as a deduction is incorrect.

Matter decided in the course of an audit

The Commissioner will not have to comply with a ruling request if the matter involved in the request will be determined in the course of a tax audit that commenced before the ruling request was made. Because a 'matter' is specific to the application of the law to an arrangement in a particular year of income, this does not prevent a taxpayer from seeking a ruling about how the tax law will apply to the same arrangement in a later year of income. Also, rulings could be sought about matters not within the scope of the audit.

Even if not obliged to give a ruling because an audit has commenced, the Commissioner may still give a ruling if he considers it appropriate ***[subsection 14ZAL(2)]*** For example, the Commissioner might give a ruling, despite paragraph 14ZAN(d), to deal with a question of law even though the actual facts of a matter had not been established through the audit. This might happen where the Commissioner did not intend to look at all the actual facts of that matter during the audit or where the Commissioner agreed to resolve the particular question early in the audit process.

Frivolous or vexatious application

Where the application for a ruling is frivolous or vexatious or is not seriously contemplated, the Commissioner does not have to comply with the application. Examples are:

- where it is obvious that the arrangements sought to be ruled on involve purely hypothetical situations; or
- where the request asks the Commissioner to confirm in respect of a tax return that all the income returned is assessable and all deductions claimed are deductible and the correct amount of tax has been assessed.

Information not provided with application

The standard application forms for Private Rulings will ask for certain basic information to be provided. If the standard information that the Commissioner requires in an application to make the ruling is not provided, the application will not be properly made. Where the standard information is given, the Commissioner will have to respond to a ruling request even if he considers that he needs more information before he can give the ruling asked for. *[section 14ZAM]*

Commissioner's resources

The Commissioner does not have to comply with a request where it would be unreasonable to comply in view of the resources of the Commissioner that would be required to comply. This provision would not normally apply. However, there may be situations where the resources required to deal with a ruling request would seriously impact on the Commissioner's ability to deal with other applications for rulings or other work. This might occur for example, where the Commissioner is asked to give an opinion as to an 'arm's length price' under Division 13 of the ITAA that would involve a study of the particular industry over a considerable period of time.

Time limit for applications

While the Commissioner may generally comply with an application for a ruling even though not required to ***[subsection 14ZAL(2)]***, he cannot respond to an application that is made more than 4 years after the due date for lodging a tax return for the particular year covered by the application. This deadline for lodging an application for a ruling is consistent with the similar restrictions in seeking an amendment to an assessment.

Applications and objections not to affect obligations and powers

The fact that a taxpayer has applied for, or objected against, a Private Ruling does not affect the taxpayer's obligation to lodge a tax return for the relevant year, or any other obligations of the taxpayer under the tax laws. Nor will it affect the Commissioner's power to make or amend an assessment in respect of the year covered by the application or ruling. ***[section 14ZAZC]***

Delays in dealing with applications

If the Commissioner has not dealt with an application for a Private Ruling within 3 months of the application being made, the applicant may ask for a written statement of the reasons for the delay. The applicant's request must be in writing. For this purpose an application is dealt with if the Commissioner gives the Private Ruling or advises the applicant that he does not propose to give a ruling. Where the Commissioner has asked the applicant to provide more information, the 3 month period commences when that information is provided to the Commissioner.

Once a written statement of the reasons for delay has been given to the applicant, the Commissioner must give further statements every 3 months until the application is dealt with. If during one of those 3 monthly intervals the Commissioner asks for more information from the applicant, the next statement of reasons will be required 3 months after the date when that information is provided to the Commissioner.

Form and content of a Private Ruling

Notice of a Private Ruling must be served on the applicant in writing and the notice must state that it is a Private Ruling for the purposes of the new provisions. Two or more rulings about an arrangement or related arrangements may be given in the same notice. *[section 14ZAR]*

A Private Ruling must identify the person, year of income and arrangement to which it applies and any assumptions made in the ruling. This is important for the purposes of determining the extent to which a ruling is binding and for allowing for the review of Private Rulings by the AAT and courts. Since the description of an arrangement might otherwise become quite lengthy, the law allows an arrangement to be identified in a Private Ruling by reference to a document which contains details of the arrangement, but only if the person to whom the ruling will apply has access to that document. *[section 14ZAS]*

Withdrawal of Private Rulings

Private Rulings may be withdrawn by the Commissioner, either wholly or in part, but generally not to the detriment of a rulee who has acted in reliance on a Private Ruling. *[section 14ZAU]*

The Commissioner may withdraw a Private Ruling with the consent of the rulee *[subsection 14ZAU(1)]*. The Commissioner can also withdraw a Private Ruling without the rulee's consent in certain circumstances but not if the ruling is still under review or has been reviewed by the AAT or a court.

A ruling is still under review if the Commissioner has made a decision about an objection against the ruling and:

the period within which the decision may be appealed against has not ended *[paragraph 14ZAU(2)(c)]*; or

- the period within which an application for review of the decision may be made has not ended *[paragraph 14ZAU(2)(d)];* or
- there has been an appeal or application for review which has not been withdrawn (whether finalised or not). *[paragraph 14ZAU(2)(e)]*

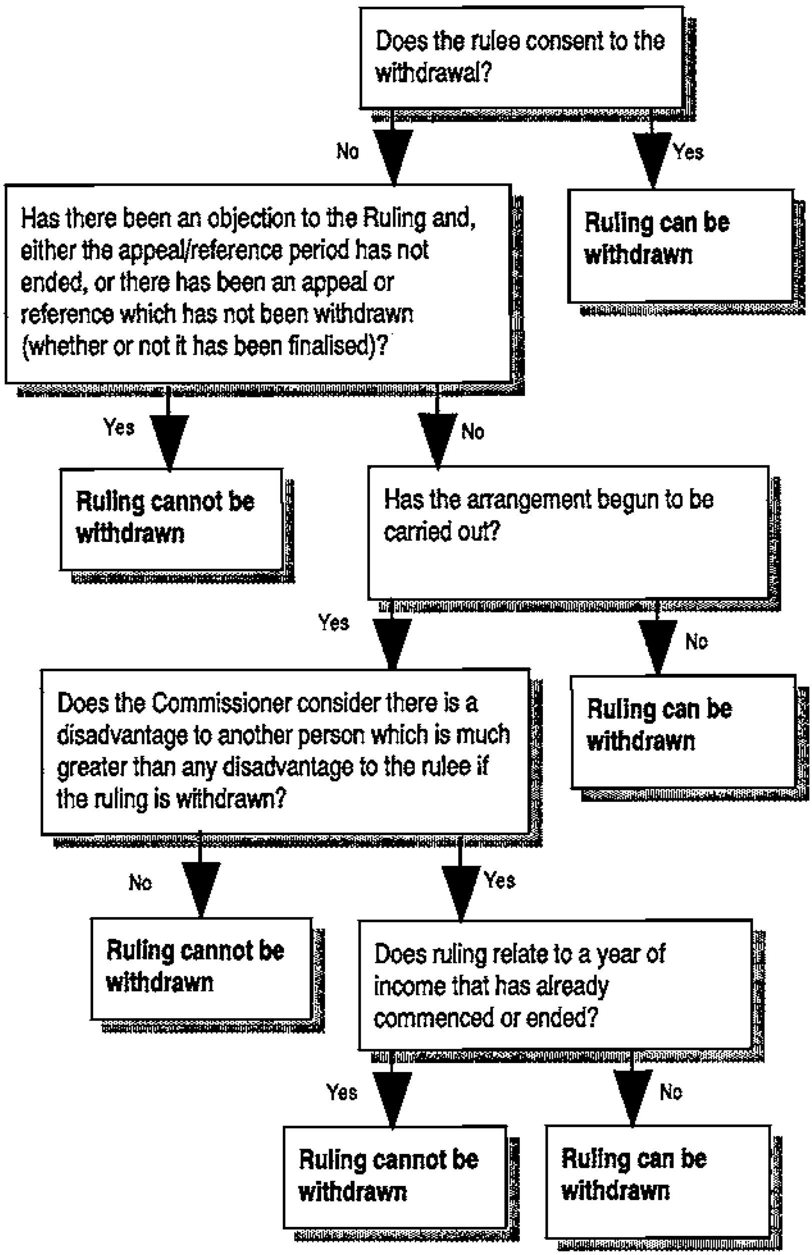
The circumstances where a Private Ruling may otherwise be withdrawn without consent are if:

- the arrangement dealt with in the ruling has not begun to be carried out *[paragraph 14ZAU(2)(a)]*; or
- the arrangement has commenced and the Commissioner considers that a person other than the rulee would suffer a disadvantage if the ruling is not withdrawn, and that disadvantage would be much greater than any disadvantage the Commissioner considers the rulee would suffer if the ruling is withdrawn *[paragraph 14ZAU(2)(b)].*

In determining whether the rulee would suffer a disadvantage if a ruling is withdrawn in relation to an arrangement that has already begun to be carried out, the Commissioner is required to take into account whether the arrangement covered by the ruling was entered into or commenced before the ruling was given. *[subsection 14ZAU(3)]* It is more likely that the rulee would be considered to be disadvantaged if the rulee only entered into an arrangement after getting a favourable Private Ruling.

Where a ruling is to be withdrawn even though the arrangement covered by the ruling has been commenced, the Bill ensures that the withdrawal does not retrospectively affect the rulee's income tax position. The Bill does this by providing that a Private Ruling cannot be withdrawn if the ruling relates to a year of income that has already commenced or ended. *[subsection 14ZAU(4)]*

Question · **In what circumstances can a Private Ruling be withdrawn by the Commissioner?**



The **diagram opposite** illustrates the circumstances in which a Private Ruling can be withdrawn.

Where it is authorised, a Private Ruling may be withdrawn by:

- the Commissioner giving written notice to the applicant; ***[section 14ZAV]*** or
- the Commissioner issuing a Public Ruling that is inconsistent with the Private Ruling. ***[section 14ZAW]***

Certain Private Rulings of no effect

A Private Ruling will not have any effect if it was given to the applicant about someone else's tax position and it is found that the other person's consent to the application being made was not genuine, or had been withdrawn before the application was made. ***[paragraph 14ZAY(1)(a)]***

Also, a Private Ruling will generally be of no effect if it is subsequently found that the Commissioner need not have complied with the application for the ruling ***[paragraph 14ZAY(1)(b)]*** because either:

- the Commissioner had already given a ruling about the matter;
- the matter covered by the ruling had already been decided and affected a Commissioner assessment;
- the ruling related to withholding tax that was due and payable;
- a tax audit had commenced and the matter sought to be ruled on was to be decided as part of the audit;
- the matter covered by the ruling request was already the subject of an objection against a self assessment.

Despite these provisions, the Commissioner may allow a Private Ruling, that would otherwise be of no effect, to remain in force if he considers it appropriate.

Obligation to give replacement for withdrawn Private Ruling

If the Commissioner withdraws a Private Ruling, he is generally obliged to give the applicant a new Private Ruling about the particular matter ***[subsection 14ZAZ(1)].*** The exception is where the ruling was withdrawn by the issue of a Public Ruling *[subsection 14ZAZ(2)]*. In this case the Commissioner would not necessarily know that a Private Ruling had been withdrawn.

Objections, reviews and appeals relating to Private Rulings

A rulee may object against an unfavourable Private Ruling in the same way as an objection can be lodged against an assessment *[section 14ZAZA]*. There are two instances where an objection cannot be made. They are if:

- an assessment has been made in respect of the arrangement and year of income covered by the ruling. In this instance the matter dealt with in the ruling may be reviewed if the person objects against the assessment *[paragraph 14ZAZA(2)(a)]*; or
- the ruling relates to withholding tax that has become due and payable *[paragraph 14ZAZA(2)(b)]*. This reflects the existing law which does not allow for objections to be made against withholding tax that has become due and payable.

Where an objection against a Private Ruling has been allowed in full, or the objection has been partially allowed and no further review has been applied for, the Private Ruling is taken to have been altered in accordance with the objection decision *[section 14ZAZB]*. Where an objection decision is disallowed the rulee may seek review of the objection decision by the AAT or a court.

A consequence of allowing matters covered by a Private Ruling to be reviewed is that objection rights in respect of an assessment that includes the matter covered by the ruling, are to be limited. It will not be possible to object against the assessment in relation to that same matter *[section 14ZVA - Clause 7]*. *See Chapter 2.* The reason for this limitation is to ensure that there are not two reviews of the same matter.

Time limit for objection

An objection against a Private Ruling must be made before the end of the later of:

> 60 days from the date the ruling is given *[paragraph 14ZW(1A)(a) - Subclause 8(g)]*; or

4 years after the last day allowed for lodging a tax return for the year of income covered by the ruling *[paragraph 14ZW(1A)(b) - Subclause 8(g)]. See Chapter 2.*

The second time limit will allow an objection against a Private Ruling where, despite a return being lodged, an assessment is not issued for some reason, eg., because a loss is incurred in the relevant year. This will enable a disputed matter to be determined earlier than otherwise would happen in some cases, eg., an assessment in which a disputed loss becomes an issue might not be made for some years. Where a return is lodged and an assessment is issued, a dispute may be resolved by objecting against the assessment.

The last day allowed for lodging a tax return is the date published by the Commissioner in the Gazette notices, unless the Commissioner has given an extension of the time to lodge a return.

When the new provisions apply from

Public Rulings cannot be made, and Private Rulings cannot be applied for, before the date of Royal Assent to the Bill, which is the general date of commencement of the Bill *[Clause 2]*. If Royal Assent is before 1 July 1992, then Public Rulings cannot be made, or Private Rulings applied for, before 1 July 1992. *[Clauses 12 and 13]* Applications for Private Rulings can only be made about arrangements that commence on or after the date of Royal Assent or 1 July 1992, whichever is later. Public Rulings will only apply to arrangements commenced on or after the date of Royal Assent or 1 July 1992, whichever is the later. *[Clauses 12 and 13]*

Rulings about arrangements begun before new provisions apply

People can get rulings about the application of the tax laws to an arrangement under existing legislation (subsection 169A(2)), by asking the Commissioner to make a decision about a matter when lodging a tax return. Since people will now be able to ask for Private Rulings about arrangements, subsection 169A(2) is being amended to allow people to get rulings about arrangements under subsection 169A(2) only in cases where a Private Ruling about the arrangement cannot be obtained under the new provisions *[Subclause 19(b)]*. This means people will still be able to get subsection 169A(2) decisions about arrangements begun before the later of the date of commencement of the Bill or 1 July 1992.

Evidence and validity of a Private Ruling or withdrawal

There may be occasions when either the Commissioner or a taxpayer wants to rely on the existence and validity of a notice of a Private Ruling or a notice of the withdrawal of a Private Ruling in an action under Part IVC of the Administration Act involving the review of, or an appeal against, an income tax or FBT assessment. This could happen, for instance, if the Commissioner failed to apply the binding rulings provisions to a matter in an assessment, even though he had given a favourable Private Ruling to a rulee about the particular matter, and for some reason argued that the ruling was either not made or was invalid because a provision of the law had not been complied with. In this case the rulee could present the ruling or a copy of it as conclusive evidence of the proper making of the ruling. In another case, the Commissioner might argue that a Private Ruling is of no effect because it was withdrawn. In this case he will be able to produce the notice of the withdrawal, or a copy of it, as evidence of the withdrawal and its validity. ***[sections 15AA and 15AB of the Administration Act - Clause 11]***

Effect of Binding Rulings

Public and Private Rulings

Public and Private Rulings will affect income tax assessments where:

- a ruling states that the law applies to a person in a particular way;
- the law applies to the person in a different way to what was stated in the ruling (ie., the ruling was incorrect, at least to some extent); and
- the tax assessed under an assessment less any foreign tax credits or offsets (the final tax), would be more than it would have been if the law applied in the way the ruling stated it would.

In these cases, the assessment and the final tax must be what they would have been if the assessment was made in accordance with the ruling. ***[subsections 170BA(3), 170BB(3) and 170BC(3) of the ITAA]***

A person will not be able to use the new provisions to obtain a double deduction (existing section 82(1) of the ITAA).

The binding rulings provisions are similar for FBT assessments, since the provisions that give effect to Private and Public Rulings about FBT are almost identical to those for rulings about income tax. ***[sections 74A, 74B and 74C of the FBT Act]***

What arrangements are covered by a binding ruling

A Public Ruling applies to a person, in relation to a year of income, where an arrangement the person has entered into is covered by the Public Ruling. Private Rulings are more specific than Public Rulings in that they specify the person, year of income and arrangement, covered by the ruling. A Private Ruling will apply to a person in relation to an arrangement, provided the arrangement is materially the same as the arrangement described in the ruling. There may be some minor differences between an arrangement dealt with in a ruling and the arrangement actually carried out, but provided the differences are not so material that the Commissioner might have given a different ruling, the ruling will still apply to the actual arrangement.

Example

> A taxpayer might obtain a Private Ruling about the deductibility of interest payments under a proposed loan contract with a particular financial institution. If the loan falls down but the taxpayer is able to obtain a loan on the same terms from another lender, the ruling will still be effective.

Assessments affected by ruling

Ordinarily, there will only be an application of the binding rulings provisions ***[sections 170BA, 170BB and 170BC of the ITAA, and sections 74A, 74B and 74C of the FBT Act]*** in an assessment for a year of income if there is a binding ruling that deals with an arrangement wholly or partly carried out in the same year of income. For instance, there may be an application of the binding rulings provisions in a 1992-93 assessment in respect of a ruling that certain expenditure incurred in the 1992-93 year of income in relation to an arrangement being carried out in that year is deductible under section 51. The binding rulings provisions would apply if, in fact, a deduction for some part, or all, of that expenditure was not allowable in 1992-93 and, therefore, the tax payable under the assessment would otherwise be more than it would have if the ruling applied. The binding rulings provisions will effectively ensure that a deduction is allowed for the otherwise non-deductible expenditure.

Example

The Commissioner gives a taxpayer a Private Ruling that expenditure of $5 000 on repairs incurred in the 1992-93 year of income is deductible under section 53.

The repairs are actually of a capital nature and the $5 000 expenditure is not deductible under section 53.

The taxpayer's taxable income for 1992-93 under the law is $15 000.

If the assessment was made in accordance with the Private Ruling, the taxable income would be $10 000.

In this case the final tax payable under an assessment made in accordance with the law would be more than the final tax if an assessment was made in accordance with the ruling. The binding rulings provisions would apply so that the taxable income was $10 000 and the final tax payable will be the tax on $10 000.

There will be some instances, though, where a ruling dealing with an arrangement carried out in a year of income can affect an income tax assessment for a later year of income. This could happen, for example, where the size of a loss to be carried forward and allowed as a deduction in a particular year of income would be bigger if a ruling dealing with the earlier loss year was applied instead of the law. In such a case the binding rulings provisions may apply in an assessment for a year of income that is later than the year of income covered by the ruling. A special provision in the law allows for this to happen in respect of Private Rulings, which deal with a specific year of income ***[subsection 170BB(4)]***. A similar provision is not needed for the binding rulings provisions for Public Rulings ***[section 170BA]***, since Public Rulings do not deal with any particular year of income. The binding rulings provisions will have effect if the final tax in an assessment under the law for a year would be more than the final tax if the law applied in accordance with the ruling, regardless of the year of income affected by the ruling.

Example

The Commissioner gives a taxpayer a Private Ruling stating that interest incurred in 1992-93 on a loan used to buy a home is fully deductible under section 51, despite the fact that the taxpayer intends to live in half of the house, while renting the other half. The amount of interest is $2 000.

Only 50% of the interest, ie., $1 000 is properly deductible under the law.

If the ruling applied, the taxpayer would have a loss for 1992-93 of $5 000.

Under the law, the taxpayer's loss is $4 000.

In 1993-94 the taxpayer's taxable income before allowing for any loss carried forward is $20 000.

If the actual loss of $4 000 was allowed as a deduction the taxable income would be $16 000.

If the loss calculated in accordance with the ruling was allowed as a deduction the taxable income would be $15 000.

In this case the final tax payable (tax on $16 000) in 1993-94 in accordance with the law is more than it would have been (tax on $15 000) if it was determined in accordance with the ruling. In such a case, the binding rulings provisions will apply to ensure that the final tax and assessment for the 1993-94 year of income are what they would have been if the law applied in the way stated in the 1992-93 ruling, ie., the taxpayer's taxable income will be $15 000 and the tax payable will be the tax on $15 000.

Dealing with conflicting rulings

There will be occasions where conflicting rulings apply to the same person in respect of a year of income, so that there could be different or multiple applications of new sections 170BA and 170BB of the ITAA and section 74A and 74B of the FBT Act in an assessment that is affected by the rulings. This could happen if a Public Ruling that is favourable to a person is withdrawn by the issue of another Public Ruling dealing with the same matter, that is different but also favourable to the person. Assume that the person has already begun an arrangement that is in a class of arrangements dealt with in both rulings. The new ruling has a past, present and future effect ***[subsection 14ZAAH(1) of the Administration Act]***.

The old Public Ruling, even though withdrawn, continues to apply to arrangements that have commenced to be carried out before its withdrawal. *[section 14ZAAL of the Administration Act]*

In these cases there is the potential for a dual application of section 170BA of the ITAA or section 74A of the FBT Act. There could be a similar conflict between Public and Private Rulings, for instance, where a Public Ruling is issued that conflicts with an existing Private Ruling and the Private Ruling cannot be withdrawn because it applied to an arrangement that has already been commenced. The same potential for conflict should not arise with Private Rulings, because they are required to be specific to a year of income and since a withdrawn Private Ruling is taken to have never been of effect.

The law will deal with cases involving conflicting rulings by ensuring there is only one application of the binding rulings provisions and that it is the one which provides the taxpayer with the greatest benefit. *[subsection 170BC(3) of the ITAA and subsection 74C(3) of the FBT Act]*

Conflict between income tax ruling and FBT ruling

The law does not deal with any conflict between rulings on income tax and FBT because, although the rulings might deal with the same subject, they would affect different taxpayers. For instance, an employee might obtain a ruling that a particular benefit is not taxable because it is a fringe benefit. The person's employer might get a ruling that the benefit is not taxable because it is not a fringe benefit. Although the rulings give conflicting views of how the tax laws apply to the benefit, there is no conflict in the assessment of either the employee or the employer. Both persons would be able to rely on their favourable rulings.

Effect of rulings on withholding tax

The effect of Public and Private Rulings on a person's liability to withholding tax is the same as the effect on a liability under an income tax or FBT assessment. That is, the actual withholding tax liability is not to be more than it would have been if the law applied in the way a Public or Private Ruling stated it would.

Where an amount of tax under an income tax or FBT assessment would exceed the amount of tax payable if the assessment was made in accordance with a ruling, the assessment is to be made in accordance with the ruling. This means that the excess tax will never be raised. But it is not possible to stop a withholding tax liability, which arises simply through operation of the law rather than because of an assessment, from being raised under Division 11A of Part III of the ITAA.

For that reason the provisions making rulings binding are different for withholding tax. They apply where an amount of withholding tax payable exceeds the amount of withholding tax payable in accordance with a Public or Private Ruling. Rather than requiring an assessment to be made in accordance with a ruling, the Bill prevents the Commissioner from seeking to recover the excess withholding tax and provides for the remission of the excess. ***[sections 170BD and 170BE]***

In a case involving a Private Ruling, the excess withholding tax is not automatically remitted. In this case the excess will only be remitted if there was no objection against the ruling before the withholding tax became payable or, if an objection was lodged, when the objection decision has been made and:

- if an appeal against, or application for review of, the decision has not been made, the appeal or review period expires; or
- if an appeal against, or application of, the decision has been made, the appeal or application is withdrawn.

In a case where an appeal or application for review is decided by the AAT or court, there is no need to remit the excess withholding tax. This is because the AAT or court decision determines the actual withholding tax liability. The Commissioner will have to adjust ATO records to reflect the decision.

Conflicting rulings on withholding tax

A special rule, similar to the rules for cases involving income tax and FBT assessments, will resolve any conflict between different rulings about the same withholding tax matter ***[subsection 170BF(3)]***. This rule will ensure that a taxpayer is given the benefit of the most favourable of the conflicting rulings.

Tribunal decision about Private Ruling

Where the AAT reviews an objection decision about a Private Ruling and determines the way the tax law applies to a person in respect of a year of income in relation to an arrangement, that will override any decision of the Commissioner as to the application of the law and also overrules the Private Ruling. In a case like this, the AAT will have decided what the law is in respect of the particular matter. ***[section 170BG of the ITAA and section 74D of the FBT Act]***

The AAT's decision has effect when the decision is final, ie., when the period for lodging an appeal against the decision has expired and an appeal has not been lodged, and the arrangement covered by the ruling has commenced.

The AAT's decision about how the law applies will be effective regardless of any conflicting decision by the AAT or court about the application of that particular law to someone else ***[subsection 170BG(3) of the ITAA and subsection 74D(3) of the FBT Act].*** This means that people affected by an AAT decision are not entitled to self amend to give effect to a subsequent AAT or court decision in respect of someone else that would be more favourable to them.

Court order about Private Ruling

Where a court makes an order that the income tax law applies in a particular way to a person in respect of a year of income in relation to an arrangement, that decides what the law is for that person ***[section 170BH of the ITAA and section 74E of the FBT Act].***

Nothing can change that, not even a conflicting decision by a higher court about the application of that law to another person. ***[subsection 170BH(3) of the ITAA and subsection 74E(3) of the FBT Act]***

As with decisions of the AAT, a court's order becomes effective in deciding the law when the order is final and the particular arrangement has commenced to be carried out. ***[subsection 170BH(4)]***

There will be cases where a court order about a Private Ruling does not decide the law that is to apply. This will happen where a court is asked to decide whether the Commissioner can lawfully exercise a discretion in the way specified in a Private Ruling (a court cannot exercise the Commissioner's discretions but the AAT can). If the court orders that the Commissioner can lawfully exercise the discretion in that way, and the Commissioner does so, the Commissioner will have acted lawfully ***[subsection 170BI(3) of the ITAA and paragraph 74F(3) of the FBT Act].*** There could not be any further review of the matter.

An order of the court to the effect that, if the Commissioner exercised a discretion in a particular way, the Commissioner will have acted lawfully, does not prevent the Commissioner from exercising the discretion in a different way. If the Commissioner does exercise the discretion in a different way and in a way that would cause the tax under an assessment to be more than if the ruling applied, the binding rulings provisions ***[sections 170BB and 170BE of the ITAA and section 74B of the FBT Act]*** ensure that any assessment that would be affected by the Commissioner's contrary decision is made on the basis of the Private Ruling.

Chapter 2
Objections

Key Features

This chapter deals with the rights of taxpayers to object against assessments and Private Rulings. The key features are:

- the period for lodging most objections will be extended to 4 years from the date of service of the notice of assessment, or determination of an offset or foreign tax credit;
- a taxpayer will be able to object to a Private Ruling up until the later of 60 days after receipt of the ruling or 4 years from the last day allowed for lodging the relevant return;
- where a taxpayer has objected to a Private Ruling the taxpayer cannot later object to an assessment on the same matter.

Summary of Proposed Amendments

The Bill gives effect to changes announced in section 9 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

At present, taxpayers dissatisfied with their assessment, or determination, may object in the manner set out in Part IVC of the Administration Act. Section 14ZW of the Administration Act permits a person making a taxation objection to lodge it within 60 days of service of the notice of the taxation decision (ie., assessment or determination - section 14ZQ) or 60 days after the granting of probate.

For most assessments and certain specified determinations, the Bill enables taxpayers to lodge an objection within 4 years from the date of service or publication of the notice of assessment, or determination, or the granting of probate. This only applies to assessments and determinations specified in section 14ZW. Other objection rights will retain the current 60 day objection period.

A rulee will be able to lodge an objection against a Private Ruling except where there is an assessment dealing with the matter covered by the ruling or where the ruling relates to withholding tax that has become due and payable. The rulee has until the later of 60 days after receipt of the ruling or 4 years from the last day allowed for lodging the relevant return to lodge the objection.

Where a taxpayer has objected against a Private Ruling the taxpayer cannot later object to an assessment in respect of the same matter.

In the case of amended assessments and determinations a minimum of 60 days is available to lodge an objection.

Explanation of Proposed Amendments

Section 14ZW of the Administration Act lists which objections to assessments and determinations have a 4 year objection period. These are:

- ITAA
    - determinations of foreign tax credits; (section 160AL)

- determinations of offsets on account of franking deficit tax; (section 160AQQ)

- franking assessments; (section 160ART)

- assessments and amended assessments; (section 175A)

- assessments due to delayed administration (beneficiary and trustee); (subsections 220(3) and (7))

- FBT

  - assessments; (section 78A)

  - assessments due to delayed administration (beneficiary and trustee). (subsection 98(3) or (7))

[amended paragraphs 14ZW(1)(aa), (ab) and (ac) - Subclause 8(c)]

Other objections to taxation decisions, such as those to Wool Tax assessments etc., or to other delayed administration objections, must be lodged within 60 days after service of the notice of the decision, or the granting of probate. ***[amended paragraphs 14ZW(1)(a), (b) and (c) - Subclauses 8(d) to (f)]***

Objections against a Private Ruling

A rulee who is dissatisfied with a Private Ruling can object against it in the manner set out in Part IVC of the Administration Act (ie., by making a written taxation objection which states the grounds that the person relies on) within the period set out in section 14ZW except where:

- an assessment has been made which deals with the same matter covered by the ruling ***[paragraph 14ZAZA(2)(a) - Clause 4]***; or

- the ruling relates to withholding tax that has become due and payable ***[paragraph 14ZAZA(2)(b)]. See Chapter 1.***

The period within which the objection must be lodged is the later of:

60 days after receipt of the Private Ruling; or

- 4 years after the last day allowed for lodging the return for the year to which the ruling relates *[subsection 14ZW(1A) - Subclause 8(g)]. See Chapter 1.*

Where a rulee has objected to a Private Ruling and there is a subsequent assessment for the year of income, the year of tax or franking year, which covers the same arrangement, or part of the same arrangement, the taxpayer cannot object to that part of the assessment which relates to the matter already objected to. Where an assessment relates to facts that are materially different to those dealt with in the Private Ruling, or deals with the application of provisions not dealt with in the Private Ruling, the taxpayer's right to object against the assessment is not restricted by this rule *[section 14ZVA - Clause 7]. See Chapter 1.*

Objections to amended assessments and determinations

If an assessment or determination has been amended, section 14ZV applies to restrict the objection to the particular which was amended. The time period for lodging an objection to the amended assessment, or determination, is specified in new subsection 14ZW(1B) as the later of 60 days from the date of service of the notice of amended assessment or determination, or 4 years after the service of the original notice of assessment or determination. *[subsection 14ZW(1B) - Subclause 8(g)]*

Where an assessment or determination has been amended more than once, the notice for the purpose of determining the objection period is the notice of the first assessment or determination in relation to the year of income, franking year or year of tax. *[subsection 14ZW(1C) - Subclause 8(g)]*

Therefore, if a notice of amended assessment was served on the last day of the 4 year objection period for the assessment for the year of income that was amended, the taxpayer would still have 60 days in which to object. If the notice of amended assessment was served more than 60 days before the end of the 4 year period, the taxpayer could object to either the amended assessment or the original assessment, for the remainder of the 4 year objection period applying to the original assessment.

Assessments amended under new subsection 170(1A) of the ITAA, (ie., self amendments) have the same objection period as other amended assessments, ie., the later of 60 days from the date of service of the notice of amended assessment or 4 years from the date of service of the original notice of assessment. *See Chapter 3.*

Section 14ZX, which permits the Commissioner to consider applications for extension of time to lodge an objection, and section 14ZY, which requires the Commissioner to make an objection decision where the objection is duly lodged, are amended to change references to '60 days' to read '4 years or 60 days'. ***[amended sections 14ZX and 14ZY - Clauses 9 and 10]***

Commencement Date

The new objection periods apply to objections to taxation decisions for the years of income, franking year or year of tax, as appropriate, in which the later of 1 July 1992 or the commencement date occurs, and all later years. ***[Subclause 14(2)]***

As applications for Private Rulings can only be made in respect of arrangements commenced on or after 1 July 1992, of if later, the commencement date ***[Clause 13]***, the new objection periods will apply to all Private Rulings.

Chapter 3
Self Amendments

Key Features

This chapter deals with self amendments. The key features are:

- the Commissioner will be able to accept statements made by a taxpayer when amending an assessment;
- the Commissioner will be able to review self amendments within 4 years of the amendment.

Summary of Proposed Amendments

The Bill gives effect to changes announced in section 10 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

At present, section 170 of the ITAA permits the Commissioner to amend an assessment by making such alterations or additions as he thinks necessary. However, the law does not provide for the Commissioner, when making amended assessments, to rely on statements made by a taxpayer other than statements which were made in a return. This means that neither individual taxpayers nor relevant entities can self amend in the way individual taxpayers self assess.

The Bill will allow the Commissioner, when amending an assessment, to rely on statements made by a taxpayer.

Explanation of Proposed Amendments

Accepted statements

Subsection 169A(1) of the ITAA is amended to allow the Commissioner to accept statements made by taxpayers other than in their return. This means that the Commissioner can rely on statements made by a taxpayer in a request for amendment and can amend without being required to consider whether the amendment is necessary to correct the assessment. ***[amended subsection 169A(1) - Subclause 19(a)]***

The Commissioner may decide not to accept statements made in an amendment request and may make enquiries as to whether the amendment is necessary. Where the Commissioner gives consideration to the amendment request and is satisfied that a particular amendment is necessary, the Commissioner is obliged to make the amendment. This includes correcting an error of law.

The Commissioner may want to examine requests for amendment in certain circumstances, for example, where:

> the assessment is a Commissioner assessment, eg., an assessment resulting from an ATO audit, or a section 167 assessment;

the Commissioner has commenced an audit in respect of that year;

the taxpayer has either appealed, or sought a review of an objection decision either in respect of an assessment or a Private Ruling on that matter;

- there is recovery action being undertaken for tax that has been assessed but is unpaid.

Review of amendments

The Commissioner is given an extended time under new subsection 170(1A) to review amendments favourable to taxpayers, where the Commissioner has relied upon a taxpayer's statement. This power to review the amendment and reverse it, wholly or in part, may be exercised within 4 years from the service of the notice of amended assessment which initially reduced liability. However, if the original 4 year objection period has expired, the Commissioner can only amend the particular that was the subject of the earlier amendment. ***[subsection 170(1A) - Subclause 20(a)]***

Taxpayers can object to that further amendment within the later of 4 years after the original assessment or 60 days after the notice of the amended assessment ***[subsection 14ZW(1C) of Taxation Administration Act - Subclause 8(g)]. See Chapter 2.***

Limitation on subsection 170(5) amendment

Subsection 170(5) gives the Commissioner an extra 4 years to reduce a taxpayer's liability in respect of a particular that has been previously amended to increase the taxpayer's liability. This power will not be available in respect of a further amendment made under the new subsection 170(1A). This provides a cap on further amendments, beyond the original 4 years, in relation to a particular which has been amended more than once. ***[subsection 170(5A) - Subclause 20(b)]***

Commencement Date

The amendments apply to assessments and amended assessments made after the date of Royal Assent of the Bill. This means it will apply in cases where:

- the statement being relied upon by the Commissioner may have been made prior to the date of Royal Assent of the Bill; or
- the assessment being amended was not made in reliance upon a statement under section 169A(1); or
- the assessment being amended was deemed to have been made under section 166A.

By virtue of section 173 of the ITAA the reference to assessment in subsection 169A(1) includes an amended assessment.

Chapter 4
Penalties

Key Features

This chapter sets out the operation of the new penalty provisions which govern the behaviour required of self assessing taxpayers. The key features are:

- all taxpayers will be required to exercise reasonable care in conducting their tax affairs. Failure to exercise reasonable care will attract a penalty of 25% of a tax shortfall or franking tax shortfall caused by the failure;
- taxpayers with large claims (generally $10 000 tax or more) will, in addition, be required to ensure that the positions they adopt are reasonably arguable. Failure to have a reasonably arguable position will attract a penalty of 25% of a tax shortfall or franking tax shortfall caused by the failure;
- a taxpayer who has received a Private Ruling from the Commissioner on a matter (see Chapter 1) but does not follow the ruling when preparing its return will also be liable to pay a penalty of 25% of a tax shortfall or franking tax shortfall caused by not following the ruling;
- taxpayers who behave recklessly with regard to their tax affairs, or who set out to deliberately evade tax will also be penalised (at 50% and 75% respectively) in respect of any tax shortfall or franking tax shortfall caused by their behaviour;
- taxpayers who enter into schemes for the sole or dominant purpose of avoiding tax will be liable to pay penalty of 50% of the tax sought to be avoided by the scheme, reduced to 25% if the position taken by the taxpayer is reasonably arguable. This will be so, irrespective of the provision of the ITAA used by the Commissioner to defeat the scheme;
- penalties may be increased by 20% of the penalty if a taxpayer hinders the Commissioner's enquiries, or decreased by 20% of the penalty if the taxpayer discloses a tax shortfall or scheme to the Commissioner during an audit;
- taxpayers who voluntarily disclose a tax shortfall or scheme to the Commissioner before the Commissioner enquires into the taxpayer's affairs will have the penalty reduced by 80%;
- all penalties will be subject to the Commissioner's discretion to remit the penalty in whole or in part;

the penalties mentioned above will be subject to full review rights.

Summary of Proposed Amendments

The Bill gives effect to changes announced in section 2 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

The Bill will remove the present administrative penalty standard of 'false or misleading statements' contained in section 223 of the ITAA and replace it with a series of provisions which outline the circumstances when taxpayers may be penalised in respect of shortfalls in the assessment of their tax liability. Each of the shortfall sections prescribe the penalty attracted where the provision is breached, instead of the present approach of penalty being attracted at 200% in all cases subject to the Commissioner's discretion to remit. The Commissioner will however maintain a discretion to remit the penalty otherwise attracted in those cases where the penalties prescribed in the law may not provide a just result.

The changes to the penalty provisions should be read in conjunction with the changes to the interest system also introduced by this Bill. *See Chapter 5.* The penalties described in this chapter are flat percentage amounts which relate to the degree of culpability in understating taxable income. Interest under the interest system will be payable in addition to any penalty.

The changes to the penalty provisions are necessary because the current penalty standard no longer reflects what is required of taxpayers. Rather than making a full and true disclosure of all material facts to the Commissioner so that the Commissioner can actively assess a taxpayer's liability, taxpayers are now effectively required to determine their own taxable income. The new penalties set out the standards that taxpayers should meet in fulfilling their tax obligations in a self assessment environment. Similar changes are made in respect of company taxpayers who self assess their liability to franking deficit tax.

Generally, where taxpayers exercise reasonable care, and, for large items, have a reasonably arguable position, they will not be subject to penalties.

The Bill will amend Part VII of the ITAA to repeal section 223 and to insert a number of new provisions to reflect the circumstances where taxpayers will be subject to penalty, the rates of penalty and the circumstances in which the rates may vary (eg., aggravating factors and voluntary disclosures). Sections 224, 225 and 226 which apply where specific anti-tax avoidance provisions apply, will be amended to change the rates of penalty attracted under those provisions and to insert the circumstances under which the penalty may be reduced.

In addition, the Bill will amend Division 11 of Part IIIAA of the ITAA to make corresponding changes in respect of company taxpayers which are required to self assess their liability to franking deficit tax.

Finally, the Bill will amend section 14ZS of the Administration Act to ensure that the penalties mentioned above are subject to full review rights.

The **chart opposite** summarises the rates of penalty. All rates are expressed as a percentage of the tax shortfall caused by the culpable behaviour, or of the tax sought to be avoided through participation in a tax avoidance scheme, and are subject to the Commissioner's discretion to remit the penalty in whole or in part. Interest applies whether or not the penalty provisions apply.

Explanation of Proposed Amendments

Who the changes affect and when

The amendments to the penalty provisions introduced by the Bill apply to all taxpayers. The shortfall sections (sections 226G, 226H, 226J, 226K, 226L and 226M, and 160ARZA, 160ARZB, 160ARZC, 160ARZD and 160ARZE) apply to:

- tax shortfalls for the 1992-93 year of income and all subsequent years (but excluding substituted accounting periods that are in lieu of the 1992-93 year of income that commence before 1 July 1992); and

- franking tax shortfalls for the franking years that commence on or after 1 July 1992;

that are caused by acts or omissions that occur after the Bill receives Royal Assent. ***[subsection 34(2) of the Self Assessment Act - Subclause 34(2)]***

Summary of Rate of Penalty

Culpable behaviour	Primary penalty	Primary penalty increased or decreased to:		
		if hindrance	if disclosure	
			during audit	before audit
Deliberate evasion	75	90	60	15
Recklessness	50	60	40	10
Tax avoidance	50(25)*	60(30)*	40(20)*	10(5)*
Profit shifting (no dominant tax avoidance purpose)	25(10)*	30(12)*	20(8)*	5(2)*
No reasonable care	25	30	20	5
No reasonably arguable case	25	30	20	5
Private Ruling disregarded	25	30	20	5

* Bracketed rates of penalty apply if the position adopted by the taxpayer is reasonably arguable

The scheme sections (sections 224, 225 and 226), as amended by this Bill, apply in relation to assessments in respect of the 1992-93 year of income and all subsequent years, but excluding substituted accounting periods that are in lieu of the 1992-93 year of income that commence before 1 July 1992. ***[subsection 34(8) of the Self Assessment Act - Subclause 34(8)]***

While sections 223 and 160AS of the ITAA are repealed by the Bill, they continue to apply in respect of the 1991-92 year of income and earlier years, and substituted accounting periods adopted in lieu of the 1992-93 year of income that commence before 1 July 1992, and franking years that commence before 1 July 1992. ***[subsections 34(3) and (7) of the Self Assessment Act - Subclauses 34(3) and (7)]***

Scheme of the new penalties

The scheme of the new penalties is as shown in the **diagram opposite.**

Tax shortfalls

A tax shorfall is the difference between the tax that is payable by a taxpayer for a year in accordance with the law (the 'proper tax') and the tax that would have been payable by the taxpayer for that year if it were assessed on the basis of statements made by the taxpayer (the 'statement tax'). ***[section 222A - Clause 26]***

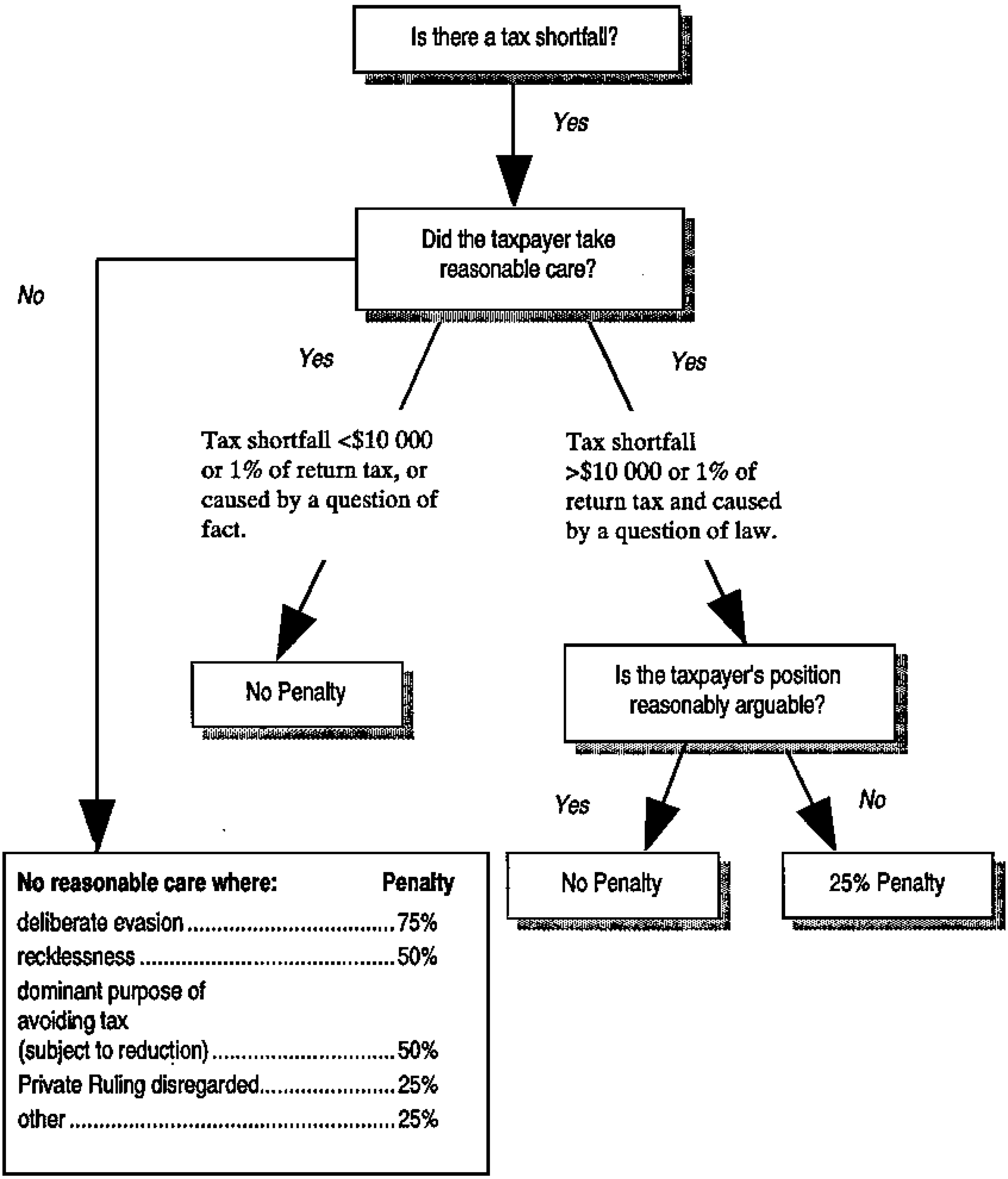
Example

- taxpayer's proper tax is $15 000
- the taxpayer omits $5 000 of income, so that the tax payable on the basis of the statements in the taxpayer's return is $12 500

taxpayer's proper tax	$15 000
taxpayer's statement tax	12 500
taxpayer's tax shortfall	2 500

A franking tax shorfall is calculated on a similar basis. It is the difference between the franking deficit tax properly payable by a company for a year (the 'proper franking tax') and the franking deficit tax that would have been payable by the company for that year if it were assessed on the basis of statements made by the company (the 'statement franking tax'). ***[section 160ARXA - Clause 17]***

Scheme of New Penalty Provisions (1)



(1) Rates subject to increase or decrease depending on the circumstances - see *'Summary of rates of penalty'*

While the explanation below is principally in respect of income tax shortfalls, similar considerations apply in respect of franking tax shortfalls. The references to clauses of the Bill include the references to the equivalent franking tax shortfall provisions, and additional comments are provided where appropriate.

It may be noted that a tax shortfall or franking tax shorfall is the gross amount by which a taxpayer has understated its tax liability. The shortfall sections operate to impose penalty in respect of the whole or a part of a shortfall, depending on how much of the shortfall was caused by culpable behaviour.

Proper tax

A taxpayer's 'proper tax' is the tax properly payable by the taxpayer in accordance with the income tax law ***[section 222A - Clause 26].*** While in theory there is only one proper tax, in practice the figure may vary as a matter moves through the dispute process. The new ruling provisions *(see Chapter 1)* will also have an impact on proper tax.

Thus, where there is a Public Ruling which is relevant to a taxpayer's circumstances, or the taxpayer has received a Private Ruling, the proper tax would be the tax that would be assessed on the basis of that ruling. If there has been an objection decision in respect of the Private Ruling and no decision has been made on a review of that objection decision, the proper tax at that time would be the lesser of the tax that would be assessed on the basis of the ruling and the tax that would be assessed on the basis of the objection decision. If there is a decision of the AAT or court in respect of the Private Ruling, the proper tax at that time would be the tax that would be assessed on the basis of the AAT or court decision.

These considerations are relevant for the purpose of determining the amount of a tax shortfall for the purpose of the penalty imposed for disregarding a Private Ruling, or where a taxpayer self assesses on a basis inconsistent with a decision of the AAT or court on a Private Ruling. *See 'Disregarding a Private Ruling' below.*

Statement tax

A taxpayer's 'statement tax' is the tax that would have been payable if it were assessed on the basis of 'taxation statements' made by the taxpayer ***[section 222A - Clause 26].*** The definition of a 'taxation statement' corresponds with the present definition of a 'statement' in subsections 223(8) and (9) of the ITAA, and includes statements made to persons other than taxation officers ***[section 222A].*** The special circumstances presently covered by subsections 223(9A) to (9F) of the ITAA in respect of statements about qualifying securities are also covered by the definition. ***[section 222B - Clause 26]***

For the purpose of franking tax shortfalls, the definition of 'taxation statement' corresponds with the present definition of a 'statement' in subsection 160AS(2) of the ITAA. ***[section 160ARXA - Clause 17]***

In practice the relevant statements will usually be those made in returns, amendment requests and objections, as well as statements of fact made to a taxation officer in the course of an audit of the taxpayer's affairs. Statements on the operation of the law made to a taxation officer during an audit or in response to a questionnaire sent by the ATO would not normally give rise to tax shortfalls.

The definition of 'taxation statement' is limited in one very important respect, in that it does not include a statement of a taxpayer's view of the operation of the law made in an objection against an assessment or against a determination of a credit or an offset. A taxpayer is therefore able to dispute, if the taxpayer so wishes, an area of the law which may appear on the face of the relevant authorities to be fairly settled, without the risk of being penalised. The taxpayer could do this by either 'self assessing' on a basis consistent with the settled treatment and objecting against the assessment, or by seeking a Private Ruling on the matter and objecting against the ruling.

In a similar vein, penalties do not apply in respect of statements made in an appeal against a decision of the AAT or court. Such statements are not 'taxation statements' and so cannot give rise to a tax shortfall.

In most cases, the statements affecting how a taxpayer may be assessed in respect of a particular year will be made in a taxpayer's tax return, so that the taxpayer's 'statement tax' will be the tax that would be assessed on the basis of the return. This will usually be the figure shown on a taxpayer's notice of assessment, although there may be cases where the Commissioner detects an error prior to issuing the assessment. In these cases the 'statement tax' is the tax that would have been assessed if the Commissioner relied on the statement in the return as allowed under section 169A of the ITAA.

Statements may, however, be made elsewhere than in the taxpayer's return, for example, in an amendment request or during an audit. At any particular time, the statement tax in relation to a year of income is the tax that would be assessed on the basis of the statements made at or before that time. Where, because of statements made at a number of different times, statement tax is calculated more than once in relation to a year of income, the taxpayer's tax shortfall for the year is calculated by reference to the smallest statement tax (ie., the statement tax that produces the largest shortfall for that year of income).

A statement may give rise to a shortfall in more than one year of income ***[sections 222E and 160ARXC - Clauses 26 and 17].*** For example, if a taxpayer makes a statement giving rise to a loss in one year which is carried forward to the next year there may be a shortfall both for the year in respect of which the statement was originally made and for the subsequent year. The shortfall in the subsequent year may be subject to penalty because of the statement made in the earlier year, depending on the circumstances which gave rise to that statement.

Two or more statements, each taken on their own, may give rise to the same tax shortfall, or the same part of a tax shortfall, but whether that shortfall or part attracts penalty depends on the operation of the shortfall sections. A shortfall section can apply only once in respect of a given shortfall or part.

Omitted income

Where a person omits from a return an amount of assessable income, the person is taken to have made a statement in the return that the income had not been derived *[section 222F - Clause 26]*. This makes clear that a taxpayer's statement tax is calculated on a basis which excludes the omitted income.

Certain shortfalls not shortfalls

Certain tax shortfalls are taken to not be tax shortfalls for the purposes of the shortfall sections and so cannot be subject to penalty *[sections 226U and 226V, and 160ARZF and 160ARZG - Clauses 31 and 18]*. A tax shortfall caused by a taxpayer adopting a favourable basis in respect of an arrangement will not be subject to penalty if the taxpayer has sought a Private Ruling on the arrangement prior to, or at the time of lodging the return which deals with the arrangement, and the Private Ruling has not been made by the Commissioner at the time the taxpayer lodges the return (provided the application is one the Commissioner is required to comply with) *[sections 226U and 160ARZF]*. A similar rule applies where a taxpayer seeks a Private Ruling in relation to a tax avoidance scheme. *[section 226A - Clause 31]*

If a Private Ruling, when made, is unfavourable to the taxpayer the Commissioner will amend the taxpayer's assessment and charge interest, as necessary. The protection provided by section 226U and 226A is only available if the arrangement set out in the ruling application is not materially different from the actual arrangement which was dealt with in the taxpayer's return.

A tax shortfall will also be taken not to be a tax shortfall if it was caused by a taxpayer treating the law as applying in a particular way, if the treatment agreed with advice given to the taxpayer by a taxation officer or a general administrative practice under the ITAA *[sections 226V and 160ARZG]*. A similar rule applies where a taxpayer's treatment of a tax avoidance scheme agrees with advice given or a general administrative practice. *[section 226B - Clause 31]*

Reasonable care

A taxpayer will be liable to pay a penalty of 25% of a tax shortfall or franking tax shortfall caused by a failure by the taxpayer to take reasonable care to comply with the ITAA or regulations. ***[sections 226A and 160ARZA - Clauses 31 and 18]***

The reasonable care test requires a taxpayer to exercise the care that a reasonable ordinary person would be likely to have exercised in the circumstances of the taxpayer to fulfil the taxpayer's tax obligations. Taxpayers must take reasonable care not only in the preparation of their return, but throughout the year on matters that may impact on their return, for example, record keeping. A tax shortfall may be caused not only by the taxpayer being careless in making (or not making) taxation statements, but also by the careless acts or omissions of the taxpayer which lie behind the statements that are (or are not) made. Whether a taxpayer has behaved reasonably will depend on all the facts of each case.

The test looks to whether an ordinary person, in all the circumstances of the taxpayer, would have foreseen as a reasonable probability or likelihood the prospect that the act or failure to act would result in a shortfall. It is not a question of whether the taxpayer actually foresaw the probable impact of the act or failure to act, but whether an ordinary person in all the circumstances would have foreseen it. The test does not depend on the actual intentions of the taxpayer.

Reasonable care requires a taxpayer to make a reasonable attempt to comply with the provisions of the ITAA and regulations. The effort required is one commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.

The reasonable care test is not intended to be overly onerous for ordinary taxpayers. For most ordinary taxpayers, an earnest effort to follow TaxPack instructions would usually be sufficient to pass the test. For example, if a taxpayer made a claim for a deduction without being able to substantiate the deduction in accordance with the substantiation provisions, then this would tend to indicate that the taxpayer had not taken reasonable care about the claim, since TaxPack makes plain the need to to be able to substantiate work related expenses.

Similarly, a failure by a taxpayer to respond to a notice from the Commissioner under subsection 82KZA(2) to provide receipts required by the substantiation provisions would tend to lead to a presumption that the taxpayer had not exercised reasonable care in claiming the relevant deductions.

On the other hand, if a taxpayer who could not meet the substantiation requirements was able to show that he/she did not know and could not reasonably be expected to have known of the substantiation requirements, and had in fact incurred the relevant expenditure which would be deductible but for the substantiation requirements, the taxpayer would not be liable for penalty. Whether penalty is attracted will depend on the circumstances of the case.

For business taxpayers, reasonable care would require the putting into place of an appropriate record keeping system and other procedures to ensure that the income and expenditure of the business is properly recorded and classified for tax purposes. The fact that an employee of the business makes a careless error would not necessarily mean that the taxpayer is subject to penalty, provided that the taxpayer can show that its procedures are reasonably designed to prevent such errors from occurring. What is reasonable will depend, among other things, on the nature and size of the business, but could include, for example, internal audits, sample checks of claims made, adequate training of accounting staff and instruction manuals for staff.

On questions of interpretation, reasonable care requires a taxpayer to come to conclusions that would be reasonable for an ordinary person to come to in the circumstances of the taxpayer. If the taxpayer is uncertain about the correct tax treatment of an item, reasonable care requires the taxpayer to make reasonable enquiries to resolve the issue. Reasonable enquiry would include the taxpayer consulting someone or some text like an ATO publication or other reference in an effort to satisfy the taxpayer about the proper tax treatment of the item. The taxpayer would need to have reasonable grounds for believing the source consulted reflected the true tax position in respect of the item. A mere reading of a provision of the ITAA which the taxpayer believed to be the relevant one might not constitute a reasonable enquiry unless the taxpayer had reasonable grounds for believing that he/she had understood the requirements of the law. For example, a wrong interpretation of a statutory provision that is clear and unambiguous would tend to suggest that the taxpayer did not exercise reasonable care. The ultimate consideration would be the honest efforts of the taxpayer, as displayed by the actions of the taxpayer in the context of the taxpayer's circumstances, to ascertain the proper tax position.

The taking of a position with respect to an item that is frivolous, or which lacks a reasonable basis, would be a strong indication of a lack of reasonable care.

A taxpayer who prepares his/her own return would usually be taken to have exercised reasonable care if in doing so the taxpayer relies upon the advice of an accountant or lawyer or other person whom the taxpayer could reasonably expect to provide competent advice on the relevant matter. On the other hand, where such advice is not followed this would usually mean that the taxpayer did not exercise reasonable care.

If a taxpayer seeks to rely upon wrong advice, and the taxpayer's skill and education was such that the taxpayer could reasonably be expected to have known or suspected that the advice was wrong, the taxpayer would risk penalty. A taxpayer would also risk penalty if the taxpayer was careless in presenting all of the relevant facts to the advisor, and this had materially affected the advice on which the taxpayer sought to rely.

A taxpayer who relies upon advice from a third party of a fact that is material to the preparation of the taxpayer's return (eg., a bank providing a statement of the amount of interest earned by the taxpayer) will not usually be liable for penalty if the advice is wrong - taxpayers are ordinarily entitled to rely on such advice. However, if the taxpayer knew, or could reasonably be expected to have known or suspected that the advice was wrong, the taxpayer would risk penalty. For example, a group company may not have exercised reasonable care in claiming a deduction for a group loss transferred to it, if the company could reasonably be expected to have known or suspected (eg., because of common management and control of the transferor and transferee companies) that the deduction giving rise to the loss was not properly allowable to be transferor company.

For an explanation of the situation where a taxpayer uses a tax agent, see 'Taxpayer's who use tax agents' below.

Arithmetic errors may indicate a failure to take reasonable care but are not conclusive. For business taxpayers, as indicated above, it would depend on the procedures the taxpayer has in place to detect such errors. In other cases it may depend on the size, nature and frequency of the error, or the circumstances of the taxpayer in making the error, for example, if the taxpayer was under extreme stress at the time of preparing the return. If, notwithstanding that an arithmetic error was carelessly made, the Commissioner is convinced that the error was made honestly or inadvertently, the Commissioner may remit the penalty (section 227).

Reasonably arguable position

A taxpayer may be liable to pay a penalty of 25% of a tax shortfall or franking tax shortfall that is caused by the taxpayer taking a position on a question of interpretation (including a conclusion of fact, for example, whether the taxpayer is carrying on a business) that is not reasonably arguable at the time the position is taken ***[sections 226K and 160ARZD - Clauses 31 and 18]***. The application of this penalty is subject to a threshold test (see below).

A position taken by a taxpayer will be reasonably arguable if, on an objective analysis of the law and the application of the law to the relevant facts, it would be concluded that the taxpayer's position was about as likely as not correct ***[sections 222C and 160ARZD - Clauses 26 and 18]***. In other words the position must involve a clearly contentious area of the law, that is, one where the relevant law is unsettled or where, although the principles of law are settled, there is a serious question about the application of those principles to the circumstances of the particular case.

The test does not require the taxpayer's position to be the 'better view'; the standard is 'about as likely as not' and not 'more likely than not'. However, the reasonably arguable position standard would not be satisfied if a taxpayer takes a position which is not defensible, or that is fairly unlikely to prevail in court. On the contrary, the strength of the taxpayer's argument should be sufficient to support a reasonable expectation that the taxpayer could win in court. The taxpayer's argument should be cogent, well grounded and considerable in its persuasiveness.

For the purposes of determining whether a taxpayer has a reasonably arguable position for the tax treatment of an item, relevant authorities include the following *[subsections 222C(4) and 160ARZD(4)]*·

- an income tax law, for example a provision of the ITAA;
- material for the purposes of subsection 15AB(1) of the *Acts Interpretation Act 1901*, such as explanatory memoranda and second reading speeches;
- a decision of a court, the AAT or a Board of Review;
- a Public Ruling issued by the Commissioner under the new ruling system introduced by this Bill. *See Chapter 1.*

This list is not intended to be exhaustive, and a wider range of authorities may be taken into account in weighing up the merits of the competing arguments. For example, authorities relating to other areas of the law (eg., contract law) may provide support for a particular treatment of an item. Taxation rulings issued by the Commissioner prior to the new arrangements introduced by this Bill may also be considered.

A taxpayer may have a reasonably arguable position for the tax treatment of an item despite the absence of authorities other than the law itself. What is required in such cases is that the taxpayer has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation.

An opinion expressed by an accountant, lawyer or other advisor is not an authority. However, the authorities used to support or reach the view expressed by the advisor, including a well-reasoned construction of the relevant statutory provisions, may support the position taken by a taxpayer.

The relevance of any authority is a matter to be weighed against other authorities, including the applicable statutory provisions, and the facts of the case. An authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion is ordinarily less persuasive than one that reaches its conclusion by cogently relating the applicable law to the pertinent facts. It will be relevant, however, to consider the source of an authority. For example, a High Court decision on all fours with the tax treatment in question will be accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the AAT.

Pending the progressive removal of Commissioner discretions from the law and their replacement with objective criteria, there will be cases where a taxpayer, in applying the tax law to the facts, will need to make an assumption about the way in which the Commissioner would act. In these cases, a taxpayer will have a reasonably arguable position to the extent that the assumption is in the range of positions which, if decided by the Commissioner in the circumstances of the case, a court would be about as likely as not to conclude was decided according to law. This approach effectively puts the taxpayer in the shoes of the Commissioner, and looks to whether the taxpayer, in making the assumption, has taken into account all relevant considerations, and not taken into account any irrelevant considerations, that bear materially on the decision reached. ***[subsections 222C(2) and 160ARZD(3) - Clauses 26 and 18]***

Where a taxpayer is uncertain of whether the position the taxpayer wishes to adopt is reasonably arguable, the taxpayer can seek a Private Ruling on the matter. *See Chapter 1.*

Threshold

A taxpayer will only be liable for penalty for not having a reasonably arguable position where the shortfall caused by the position is greater than the higher of $10 000 or 1% of the tax that would have been payable on the basis of the taxpayer's return ***[paragraphs 226K(c) and 160ARZD(1)(c) - Clauses 31 and 18].*** The use of the threshold ensures that the reasonably arguable position standard applies to only a relatively small number of taxpayers.

Example

1. Tax shortfall less than the threshold:

    on the basis of a taxpayer's return the taxpayer is liable to pay $40 000 tax (the return tax) in respect of a year of income;

    - the taxpayer has claimed a non-allowable deduction, resulting in a tax shortfall of $6 000;
    - in this case, the higher of $10 000 and 1% of the return tax ($400) is $10 000;
    - because the tax shortfall ($6 000) is less than $10 000, the shortfall is not subject to penalty under section 226K (although it may be under another shortfall section).

Example

2. Tax shortfall greater than threshold:

    - a taxpayer's return tax is $10m;
    - the taxpayer has omitted income from the sale of property resulting in a tax shortfall of $500 000;
    - 1% of the return tax ($100 000) is higher than $10 000;
    - because the tax shortfall is greater than $100 000 the taxpayer must have a reasonably arguable position to support the non-inclusion of the income from the sale of the property to avoid being penalised under section 226K. **(Note: even if the taxpayer has a reasonably arguable position, the taxpayer may be subject to penalty under another shortfall section.)**

Where a position taken by a taxpayer results in a shortfall in 2 or more years of income, each shortfall is tested against the return tax for the year of income to which it relates, to determine whether the reasonably arguable position test must be satisfied in respect of that shortfall.

Example

- in year 1 a taxpayer has incorrectly claimed a deduction of $1m which has resulted in a loss for that year of $1m

  the 'loss' is recouped over the next 3 years in the amounts of $200 000, $750 000 and $50 000 respectively, leaving a return tax in year 4 of $6m for years 2 and 3 the taxpayer must have a reasonably arguable case supporting the claiming of the loss to prevent being penalised under section 226K, since the shortfalls (assuming a flat tax rate of 50%, $100 000 and $375 000 respectively) exceed the greater of $10 000 and 1% of return tax (0)

- for year 4 the shortfall ($25 000 ie., 50% of $50 000) is less than the greater of $10 000 and 1% of return tax ($60 000), so the taxpayer would not be subject to penalty under section 226K

Where a tax shortfall is caused by the taxpayer treating the law as applying in a particular way in respect of a number of different matters, the taxpayer will only need to have a reasonably arguable position in respect of the treatment of those matters that cause a part of the shortfall to exceed the threshold. However, if any of the matters are identical, for example, 2 separate lease payments for the same item of plant, the parts of a shortfall caused by the treatment of the 2 payments will be amalgamated for the purposes of testing that part of the shortfall against the threshold. This rule is designed primarily to prevent taxpayers seeking to split single matters up so as to come under the threshold. It is not intended, for example, that many small repairs to many substantially similar but discrete items of plant would be treated as a single matter. ***[paragraphs 226K(b) and 160ARZD(1)(b) - Clauses 31 and 18]***

Treating law as not applying

The term 'treating an income tax law as applying in relation to a matter in a particular way' is used in section 226K to focus on a tax shortfall or part of a tax shortfall brought about because of a position taken by a taxpayer on a question of interpretation ***[paragraph 226K(b)]***. The term, or variations of it, is also used in a number of other penalty provisions, for example, sections 226A, 226B, 226L, 226P and 226S and sections 160ARZD, 160ARZF and 160ARZG. For the purposes of the penalty provisions a taxpayer will be taken to have treated an income tax law as applying in a particular way even where the taxpayer treats a provision as not applying to a matter, for example, where the taxpayer treats a provision as not applying to include an amount in assessable income, or as not applying to disallow a deduction. ***[sections 222D and 160ARXB - Clauses 26 and 17]***

Disregarding a Private Ruling

A taxpayer who applies for and receives a Private Ruling on an arrangement is required to follow the ruling when determining his/her taxable income for assessment purposes. If the taxpayer does not follow the ruling and as a result there is a tax shortfall or franking tax shortfall, the taxpayer will be liable to pay a penalty of 25% of the shortfall. ***[sections 226M and 160ARZE - Clauses 31 and 18]***

For an explanation of how the shortfall would be calculated for the purposes of this penalty, refer to the explanation of 'proper tax' under the heading 'tax shortfalls' above.

This penalty does not apply if there has been a decision of the AAT or of a court that applies to the ruling ***[subsections 226M(2) and 160ARZE(2)]***. In such a case the taxpayer would be expected to follow the decision of the AAT or court when determining taxable income, even if the taxpayer has appealed against the decision. Failure to self assess in accordance with the decision of the AAT or court would ordinarily amount to a failure to take reasonable care under section 226G or 160ARZA.

Where a taxpayer seeks a ruling *after* lodging the relevant return of income, this penalty does not apply. If the Commissioner rules against the taxpayer, the Commissioner will amend the taxpayer's assessment to give effect to the ruling. The application for a ruling after the return has been lodged may, however, qualify as a voluntary disclosure, and so affect the rate of penalty that may be applicable to a shortfall.

Recklessness

A taxpayer will be liable to pay a penalty of 50% of a tax shortfall or franking tax shortfall caused by the taxpayer behaving recklessly with regard to the operation of the tax law. ***[sections 226H and 160ARZB - Clauses 31 and 18]***

A taxpayer would be behaving recklessly if the taxpayer's conduct shows disregard of, or indifference to, consequences forseeable by a reasonable person. A finding of dishonesty is not necessary for a taxpayer to be subject to this penalty.

For example, a taxpayer who purchases shares in a company, but who makes no attempt to find out the tax consequences of receiving dividends, and who destroys letters from the company (after banking the dividend cheque) without reading them would be penalised 50% of any tax shortfall which results from the taxpayer failing to return the dividends as income. The concept of recklessness for the purposes of this penalty covers behaviour which could be described as gross negligence.

For an explanation of the situation where a taxpayer uses a tax agent, see 'Taxpayers who use tax agents' below.

Intentional disregard

Where a taxpayer excludes from its assessable income an amount knowing it to be assessable, or claims a deduction, rebate, credit or offset knowing that it is not allowable, the taxpayer will be liable to a penalty of 75% of a tax shortfall or franking tax shortfall so caused. *[sections 226J and 160ARZC - Clauses 31 and 18]*

For an explanation of the situation where a taxpayer uses a tax agent, see 'Taxpayers who use tax agents' below.

Tax avoidance

Where a taxpayer enters into a tax scheme with the sole or dominant purpose of avoiding tax, the taxpayer will be liable to pay a penalty equal to 50% of the tax sought to be avoided. The penalty will be reduced to 25% if the correctness of the treatment of the scheme by the taxpayer was reasonably arguable ***[amended sections 224, 225 and 226, and section 226L - Clauses 28, 29, 30 and 31].*** There are no equivalent provisions that relate to franking deficit tax.

Tax avoidance caught by Division 13 and comparable provisions in Australia's double tax agreements (eg., through the use of 'non arm's length' prices in international dealings), but which cannot be characterised as having been caused by a scheme entered into for the sole or dominant purpose of avoiding tax, will attract a penalty of 25%, reduced to 10% where the treatment of the transaction or arrangement was at the time of lodging the return about as likely as not the correct treatment. ***[amended section 225 - Clause 29]***

Sections 224, 225 and 226 of the ITAA are amended by the Bill to reflect the new rates of penalty and the circumstances where the penalty may be reduced. The sections are otherwise unchanged by the Bill. Because these sections contemplate action by the Commissioner in applying a discretionary anti-avoidance provision against a taxpayer, the 'reasonably arguable' test looks at whether it is about as likely as not that the anti-avoidance provisions do not apply. This would be the case, for example, in relation to a scheme to which Part IVA had been applied, if there was a sound case for concluding that either:

- one of the pre-conditions to the operation of the Part had not been satisfied (eg., the scheme did not have the relevant dominant purpose); or
- the Commissioner had erred in law in making the determination (eg., had taken into account irrelevant considerations in exercising his discretion to make the determination). ***[paragraph 226(2)(b) and subsection 222C(3) - Clauses 30 and 26]***

In a case to which Division 13 of the ITAA applied a taxpayer would need to demonstrate that, for example, the price the taxpayer had used was about as likely as not the 'arm's length price' ***[subsection 225(1A) - Clause 29]***. A taxpayer would be best placed to show that its prices were 'arm's length' if it maintained documents that were brought into existence as part of the process of determining the prices.

Section 226L penalises at the same rates of penalty as sections 224, 225 and 226, schemes entered into for the sole or dominant purpose of avoiding tax, but in respect of which the Commissioner has not applied any of the anti-avoidance provisions covered by sections 224, 225 and 226 ***[Clause 31]***. This recognises that most schemes are found to be ineffective under the ordinary provisions of the ITAA (eg., sections 25 and 51) without recourse to the anti-avoidance provisions. Schemes defeated under the ordinary provisions face the same penalties as if an anti-avoidance provision had been invoked, if it can be concluded that the scheme was entered into for the sole or dominant purpose of avoiding tax.

Taxpayers who use tax agents

The ATO, in conjunction with taxpayer and tax professional representative bodies, is looking at whether tax agent penalties or some other form of regulation of tax agents is appropriate, and if so, the level of those penalties or the form of regulation.

Pending that review, and as an interim measure designed to protect the Revenue, the Bill maintains the current position that a taxpayer is liable to penalties for shortfalls caused by the culpable conduct of a tax agent in dealing with the taxpayer's affairs. Thus, where a taxpayer has a tax shortfall or a franking tax shortfall that is caused by a registered tax agent either failing to take reasonable care, behaving recklessly or intentionally disregarding the provisions of the ITAA, the taxpayer will be liable to pay penalty at the relevant prescribed rate ***[sections 226G, 226H and 226J, and 160ARZA, 160ARZB and 160ARZC - Clauses 31 and 18].*** Penalties attracted under the other shortfall sections or under the scheme sections fall on the taxpayer irrespective of whether the taxpayer uses a tax agent, since those penalties do not depend on a taxpayer's behaviour for their application.

It may be noted that just because a taxpayer goes to a tax agent this is not conclusive as to whether the taxpayer has, for example, exercised reasonable care in carrying out his/her tax obligations. If the taxpayer does not provide a full and true disclosure of all the relevant facts to the tax agent, and that gives rise to a tax shortfall, the taxpayer would not have exercised reasonable care. Similarly, there may not have been reasonable care on the part of the taxpayer if the taxpayer could reasonably have been expected to pick up errors of fact or law when signing the return. Nevertheless, there will be cases where penalty is attracted solely because of culpable behaviour on the part of the tax agent.

A taxpayer who is liable to pay penalty because of the negligence of the taxpayer's tax agent is able to sue the tax agent for recovery of the penalty under section 251M of the ITAA. Section 251M is amended by the Bill to also provide for a taxpayer to recover from a negligent tax agent any interest payable under sections 170AA or 207A. ***[Clause 32]***

Where both the tax agent and the taxpayer have exercised reasonable care but there is nevertheless a shortfall, then the shortfall will not attract penalty. For example, where the shortfall arose through an inadvertent error or honest mistake of the tax agent in circumstances where reasonable care had been exercised (eg., a transposition error by a staff member), that shortfall would not attract penalty.

Partners and trustees

Special rules outline how the penalty imposed by sections 226G, 226H, 226J, 226K and 226L apply in the case of partners and trustees ***[sections 226N to 226T - Clause 31]***. The special rules basically mirror the approach of subsections 223(2), (4) and (5) of the ITAA. The other penalty sections operate according to their terms to all taxpayers, including partners and trustees.

A defaulting partner, that is, one who makes a statement relating to the net income or partnership loss of the partnership (a 'partnership taxation statement' - section 222A), the effect of which is to understate the net income of the partnership, or to overstate the partnership loss, may be liable to pay penalty in respect of each partner's 'partnership shortfall excess' that arises because of the statement. The defaulting partner will be so liable if the statement made by the defaulting partner:

- was caused by carelessness, recklessness, or intentional disregard of the ITAA or the regulations by the defaulting partner; ***[section 226N]***
- treats an income tax law as applying in relation to a matter in a particular way that is not reasonably arguably correct, where the impact of the treatment on the net income or partnership loss of the partnership would have exceeded the higher of $20 000 or 2% of the net income of the partnership as returned; ***[section 226P]***
- treats an income tax law as applying in relation to a scheme in a particular way, where the scheme was entered into for the sole or dominant purpose of avoiding tax. ***[section 226Q]***

A 'partnership shortfall excess' *[section 222A - Clause 26]*, in relation to a partner, is the difference between:

what would have been the partner's tax shortfall if the partner had returned what would have been his/her share of the net income, or partnership loss, of the partnership if the net income (or loss) were calculated on the basis of the defaulting partner's partnership taxation statement; and

- what would have been the partner's tax shortfall (if any) if the partner had returned his/her share of the correct partnership net income.

The rules in respect of trustees are basically the same as for partners. Thus, a trustee may be liabile to pay penalty in respect of each beneficiary's 'estate shortfall excess' that arises because of a statement by the trustee relating to the net income of the trust estate (an 'estate taxation statement' - section 222A). The trustee will be so liable if the trustee's statement:

- was caused by carelessness, recklessness, or intentional disregard of the ITAA or the regualtions by the trustee; *[section 226R]*
- treats an income tax law as applying in relation to a matter in a particular way that is not reasonably arguable where the impact of the treatment on the net income or loss of the trust would have exceeded the higher of $20 000 or 2% of the net income of the trust as returned; *[section 226S]*
- treats an income tax law as applying in relation to a scheme in a particular way, where the scheme was entered into for the sole or dominant purpose of avoiding tax. *[section 226T]*

An 'estate shortfall excess' *[section 222A - Clause 26]*, in relation to a beneficiary, is the difference between:

- what would have been the beneficiary's tax shortfall if the beneficiary had returned what would have been his/her share of the net income of the trust estate if the net income were calculated on the basis of the trustee's trust estate taxation statement; and what would have been the beneficiary's tax shortfall (if any) if the beneficiary had returned his/her share of the correct trust estate net income.

The definitions of 'partnership shortfall excess' and 'estate shortfall excess' work on the basis of the effect each statement made by the defaulting partner or trustee would have on the net income of the partnership or trust, and the consequence for each partner or beneficiary. To cover cases where an amount of assessable income is omitted from the partnership or trust return, section 222F provides that the person who omitted the income is taken to have made a statement that the income had not been derived. *[Clause 26]*

Nothing in the special rules relating to trustees is to be taken to mean that a trustee may not be liable (as a taxpayer) under any of the shortfall sections in respect of the trustee's own tax shortfall. *[subsections 226R(2), 226S(2) and 226T(2)]*

Hindering the Commissioner etc.

There are three situations where a taxpayer liable to pay penalty may be liable to pay a further penalty of 20% (eg., a taxpayer liable to pay a penalty of 25% may have that penalty increased to 30%). *[sections 226X and 160ARZI - Clauses 31 and 18]*

The first situation is where a taxpayer takes steps to prevent or hinder the Commissioner from discovering part or all of the tax shortfall *[subparagraphs 226X(b)(i) and 160ARZI(b)(i)]*. This would include, for example, unreasonable delay by the taxpayer in responding to enquiries by taxation officers, or the taxpayer failing to attend an interview at a time previously agreed without a reasonable excuse. It would also include instances where the taxpayer destroyed relevant records, or colluded with other persons (after the relevant statement had been made) to conceal part or all of the shortfall.

The second situation is where a taxpayer becomes aware of an error in calculation or fact that has caused a tax shortfall and fails within a reasonable time to notify the Commissioner of the error *[subparagraphs 226X(b)(ii) and 160ARZI(b)(ii)]*. This covers situations such as where a taxpayer relies upon factual information from a third party in preparing the taxpayer's return, and subsequently finds that the information supplied was inaccurate (eg., the separate net income of the taxpayer's spouse). This rule does not require a taxpayer to monitor developments in the law, but rather looks solely at errors of a factual nature.

The third situation where a taxpayer may be liable to further penalty is where the taxpayer has been penalised in an earlier year. If a taxpayer is liable to penalty for carelessness, recklessness or deliberate evasion (sections 226G, 226H or 226J, or 160ARZA, 160ARZB or160ARZC), and has been penalised in a prior year for one of those reasons, the further penalty is attracted ***[subparagraphs 226X(b)(iii) and 160ARZI(b)(iii)].*** However, if a taxpayer is liable to penalty because of the way in which the taxpayer treated the law as applying to a matter (sections 226K or 226L, or 160ARZD) the taxpayer will only be liable to the further additional tax if in an earlier year the taxpayer had treated the law as applying to that matter or a similar matter in the same way. ***[subparagraphs 226X(b)(iv) and 160ARZI(b)(iv)]***

Example

- a taxpayer claims as a deduction in year 1 legal expenses incurred in defending the taxpayer from takeover by a competitor
- the shortfall caused by the claim was subject to penalty under section 226K
- in year 2 the taxpayer claimed a deduction for legal fees incurred in defending itself from takeover by a different competitor, which also resulted in penalty under section 226K
- the further additional tax would be attracted in respect of the claim in year 2

Similar rules apply to impose further penalty where penalty has initially been attracted under a scheme section. ***[section 226C - Clause 31]***

Voluntary disclosures during an audit

Where a taxpayer voluntarily discloses to the Commissioner part or all of a tax shortfall and an audit has commenced or advice of an impending audit has been given, the penalty otherwise attracted will be reduced by 20%. For example, where the shortfall was due to a failure to take reasonable care, and the taxpayer brings the shortfall to the auditor's attention, the penalty will be discounted from 25% to 20%. *[sections 226Y and 160ARZJ - Clauses 31 and 18]*

The taxpayer's disclosure must be in writing, and must bring all the relevant facts and other information to the attention of the auditor that will allow the auditor to readily identify the amount and nature of the shortfall. The disclosure should be such that it could reasonably be estimated to have saved the auditor a significant amount of time or resources in looking into the matter disclosed.

A taxpayer need not admit liability in respect of the shortfall disclosed. A taxpayer is eligible for the discounted penalty whether or not the taxpayer maintains an opinion contrary to that of the auditor, or disputes the adjustment the auditor makes to the taxpayer's assessment.

Similar rules apply where a taxpayer makes a voluntary disclosure during an audit of a matter in respect of which the taxpayer is liable to pay penalty under a scheme section. *[section 226D - Clause 31]*

Voluntary disclosures before an audit

Where a taxpayer voluntarily discloses to the Commissioner part or all of a tax shortfall that is greater than $1 000 before any audit action has commenced, the penalty otherwise attracted in respect of the shortfall will be reduced by 80%. For example, where the tax shortfall is due to a failure to exercise reasonable care, and a voluntary disclosure is made, the penalty is discounted from 25% to 5%. *[sections 226Z and 160ARZK - Clauses 31 and 18]*

If a shortfall voluntarily notified to the Commissioner before an audit has commenced is less than $1 000, no penalty is attracted. *[paragraphs 226Z(d) and 160ARZK(d)]*

As with disclosures during an audit, disclosures before an audit must be in writing. Also, the disclosure must contain all the relevant facts and other information, including the amount of the shortfall, to enable the Commissioner to make an adjustment of the taxpayer's assessment. An application for a Private Ruling in relation to a completed transaction, made after the taxpayers relevant return has been lodged, would usually qualify as a voluntary disclosure.

A taxpayer need not admit liability in respect of the shortfall disclosed to qualify for the discounted penalty, provided there is full disclosure of the relevant facts and the other conditions of the section are satisfied.

Similar rules apply where a taxpayer makes a voluntary disclosure before an audit of a matter in respect of which the taxpayer is liable to pay penalty under a scheme section, except that the discount is 80% in all such cases. *[section 226E - Clause 31]*

Commissioner's discretion regarding when a disclosure is made

In some instances, even where an audit has commenced or the commencement of an audit has been advised to a taxpayer, it may be appropriate to grant the taxpayer the higher penalty discount of 80% in respect of disclosures. This may be the case, for example, where an audit of a group of companies has commenced and a company which is a part of the group, but not the focus of the audit, discloses a matter which was unlikely to have been detected by the audit.

To enable the Commissioner to grant this concession in the appropriate circumstances, the Commissioner has a discretion to deem a disclosure to have been made prior to the taxpayer being informed of an audit. *[sections 226F, 226ZA and 160ARZL - Clauses 31 and 18]*

Where more than one shortfall section applies

It is possible that more than one shortfall section may apply in respect of a tax shortfall. For example, a taxpayer may be careless in making a claim for a deduction, and so be liable for penalty under section 226G, and also be liable for penalty under section 226K for not having a reasonably arguable position in respect of the claim. In such a case the taxpayer is liable to pay only one of the penalties. If one penalty is higher than the other (eg., if sections 226H and 226J both apply), the taxpayer is liable to pay the highest one. *[sections 226W and 160ARZH - Clauses 31 and 18]*

Remissions

The purpose of the new penalty provisions is to reduce the risk of penalties for taxpayers who have not been culpable and to provide standards for taxpayers in carrying out their taxation obligations. With this end in mind the Bill prescribes specific penalties for breaches of the standards set by the Bill, which means that taxpayers will know what penalties will be attracted for delinquent behaviour. This replaces the previous system where penalty was automatically attracted at a rate of 200%, and remitted at the discretion of the Commissioner.

While the Bill provides a set of rules and accompanying penalties which will cover all but exceptional cases, there may be cases that do not fit neatly into a category, or for which the prescribed rates of penalty are inappropriate. For this reason the discretion which the Commissioner has to remit penalty in whole or in part (sections 227 and 160ASB of the ITAA) is not removed by this Bill, so that the Commissioner has the flexibility to deal with hard cases that may arise. The AAT is able to exercise this power of remission in appropriate cases when reviewing decisions of the Commissioner, and the courts are able to adjudicate on whether the discretion was exercised in accordance with the law.

Some examples of where it may be appropriate for the Commissioner to exercise the discretion to remit penalties are:

- where an authority that is material to whether a taxpayer has a reasonably arguable position is published immediately before a taxpayer lodges its return of income, in circumstances where the taxpayer could not reasonably be expected to have been aware of the authority's existence;
- where a taxpayer, because of an extraordinary transaction, exceeds the threshold beyond which the reasonably arguable position test applies, and the circumstances of the case are such that it would be unjust to penalise the taxpayer solely by reason of failing that test;

where the application of the special rules in respect of partners and trustees imposes an overly burdensome penalty on the defaulting partner or trustee.

Good faith

The August 1991 information paper 'Improvements to Self Assessment - Priority Tasks' outlined how certain 'good faith' considerations would be taken into account for the purposes of the new penalties. These are covered by the Bill in a number of areas. For example, a taxpayer who has been misguided by advice from the ATO or by an ATO administrative practice will not be subject to penalty on a shortfall caused by relying on the advice or practice ***[sections 226V and 160ARZG - Clauses 31 and 18].*** Also, for the purpose of determining whether a taxpayer has exercised reasonable care, it will be relevant to consider whether:

- the taxpayer has genuinely misunderstood the requirements or the application of the law;
- the taxpayer has made an isolated arithmetic or transposition error that was honestly made;
- the taxpayer did not know and could not reasonably be expected to have known or suspected that a statement misrepresented the true position.

Finally, the retention of the Commissioner's discretion to remit the penalties otherwise attracted covers any 'good faith' considerations not specifically picked up by the Bill.

Liability and review

Penalties covered in this chapter will be assessed by the Commissioner and the taxpayer notified accordingly (sections 227, 160ARL and 160ARM). The Bill amends section 14ZS of the Administration Act so that all penalties imposed under the shortfall sections or the scheme sections will be subject to full review rights, including a right to review by the AAT irrespective of the amount. ***[Clause 6]***

Where an amount of penalty would otherwise be less than $20, the amount is increased to $20. ***[section 226ZB - Clause 31]***

Chapter 5
Interest

Key Features

This chapter deals with the requirements for taxpayers to pay interest in those cases where any amounts of income tax are underpaid or paid late. The key features are:

- taxpayers will be required to pay interest on all debit amendments issued as a result of an underpayment of tax;
- taxpayers will be required to pay interest (in addition to a late payment penalty) on all income tax payments made after the due date;
- the existing late payment penalty will be reduced from the present 20% per annum to 8% per annum to complement the new interest system;
- interest paid to the ATO will be deductible for all taxpayers;
- the rate of interest payable by taxpayers will be set periodically by reference to the weighted average yield for 13 Week Treasury Note tenders plus 4%, and will normally be adjusted on a six monthly basis.

Summary of Proposed Amendments

The Bill gives effect to changes announced in section 7 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

The amendments proposed by the Bill will provide for interest to be paid by taxpayers in relation to the underpayment or late payment of income tax and will make associated changes to late payment penalty. These amendments will affect existing provisions dealing with late payment penalty and interest on underpayments and will introduce new provisions dealing with the payment of interest by taxpayers in specific situations.

The Bill will amend the ITAA to give effect to the new interest provisions and to separate interest and penalties. The rate of interest is to be based on market rates and the Bill will make interest paid to the ATO deductible to all taxpayers.

Interest will be payable by taxpayers in circumstances where penalties now apply for late payment and understatement of taxable income (where this results in an underpayment of tax) and in those cases of non-culpable underpayment of tax where interest is now payable. The payment of statutory interest in circumstances where penalty provisions now apply for late payment of tax or understatement of taxable income (and hence underpayment of tax), is to be complemented by changes to the penalty provisions. *See Chapter 4.*

The Bill applies to all income taxpayers. However, in recognition that full self assessment arrangements presently apply to some taxpayers (ie., companies and superannuation funds) a number of provisions in the Bill deal specifically with these taxpayers.

Explanation of Proposed Amendments

Interest for underpayment of tax

A taxpayer will be liable to pay interest where an amendment of an assessment increases the tax liability of the taxpayer. Interest will apply regardless of whether the increase in tax liability also attracts penalty under the penalty provisions of Part VII of the ITAA as modified by the penalty provisions contained in this Bill. *[section 170AA - Clause 21]*

The existing section 170AA provides for the payment of interest by a taxpayer where an amendment of an assessment is made increasing the taxpayer's liability. However, by virtue of subsection 170AA(2), this requirement to pay interest on an underpayment of tax does not extend to taxpayers who are liable to pay additional tax by way of penalty imposed under the penalty provisions contained in Part VII of the ITAA. This is because the existing penalty provisions have been administered to include a per annum component to compensate the Revenue for not having the funds for the relevant period. The new penalty provisions do not seek to compensate the Revenue for the time value of money, but rather, penalise specified culpable behaviour. *See Chapter 4.*

The new subsection 170AA(1AA) will ensure that interest is payable where an assessment is amended irrespective of whether the taxpayer is liable to a penalty under Part VII. Similarly, interest will apply where a determination is amended even where penalty is payable. ***[subsections 170AA(1AA), 170AA(2) - Subclauses 21(a) and (b)]***

The existing subsection 170AA(2), which prevents interest under subsection 170AA(1) being imposed where additional tax under Part VII has been imposed, will be deleted.

Under the existing subsection 170AA(3), interest can be imposed on a taxpayer, a partner or a trustee in cases where an amended assessment is made increasing the liability of the taxpayer, the partner or the trustee to additional tax. This subsection will be amended to reflect changes made by the new penalty provisions of the Bill. As a result of the repeal of section 223 ***[Clause 27]***, the reference to subsections 223(2) and 223(4) in paragraph 170AA(3)(b) will be changed to reflect the new special rules under which a partner or trustee may be liable to pay additional tax under Part VII. The reference to subsection 223(2) in subparagraph 170AA(3)(b)(ii) will be changed to 'sections 226N, 226P or 226Q'; and the reference to subsection 223(4) in subparagraph 170AA(3)(b)(iii) will be changed to 'sections 226R, 226S or 226T'. ***[Subclauses 21(c) and 21(d)]***

To ensure that interest will be payable by relevant entities (ie., companies and superannuation funds) from the prescribed due date for lodgment of the original return and payment of tax to the issue date of the notice of amended assessment, section 170AA is to be amended. Subparagraph 170AA4(a)(i) will be amended to only apply to taxpayers who are not relevant entities ***[subparagraph 170AA(4)(a)(i) - Subclause 21(e)]***. For relevant entities, the Bill will insert a new subparagraph which provides that the period in respect of which interest is to be paid in relation to an amended assessment is to commence on the day on which the relevant entity is required to make a payment under section 221AZD(b), or would have been required to make such a payment but for the fact that no amount of income tax is payable or the amount of income tax specified in the return does not exceed the initial payment. ***[subparagraph 170AA(4)(a)(ia) - Subclause 21(f)]***

The existing paragraph 170AA(4)(b) and subsection 170AA(7), which specify the rate at which interest is to be calculated, are being amended so that the rate or rates of interest to be used when calculating interest under section 170AA will be ascertained in accordance with the new section 214A. ***[paragraph 170AA(4)(b) - Subclauses 21(g) and (h)]***

The existing subsection 170AA(6) contains a number of provisions which are required to enable interest to be calculated in cases where an assessment is issued to a taxpayer subsequent to an earlier notice advising the taxpayer that the taxable income of the taxpayer for the year of income was nil or that no tax was payable on the taxable income. Through the amendments being made to subsection 170AA(7), the Bill will ensure that in respect of relevant entities with nil taxable income or no tax payable for a year of income, the Commissioner is deemed to have served a notice to the effect that the taxable income of the taxpayer for the year of income is nil or that no tax is payable. In addition, the Bill also provides that in respect of such a notice for relevant entities, the due date of the notional assessment is to be the day that would have applied under subparagraph 170AA(4)(a)(ia). This change ensures that when interest is payable by a relevant entity under section 170AA, the commencement date of the period in which interest applies in respect of a particular year of income will be the same for all taxpayers, regardless of whether interest in being imposed in an original or amended assessment. ***[subsection 170AA(7) - Subclause 21(h)]***

The existing power of remission in section 170AA(11) will apply to interest payable under section 170AA.

Interest and penalty for late payment of tax

Section 207 of the ITAA currently imposes additional tax, by way of a 20% per annum late payment penalty, when any amount of tax remains unpaid after the time when it became due and payable. This section is being amended to provide for the separate imposition of penalty and interest when tax is paid late. Instead of the existing 20% per annum late payment penalty payable under section 207, a taxpayer will be required to pay both:

> a penalty for not paying an amount of tax by the prescribed or notified due date for payment; and
>
> interest at the statutory rate, to compensate the Revenue for being denied use of the funds for the period since the due date for payment.

Section 207 is being amended to reduce the late payment penalty to 8%, and a new section is being inserted requiring a taxpayer who is liable to pay the penalty to also pay interest at the rate prescribed under section 214A. ***[sections 207 and 207A - Clauses 23 and 24]***

Penalty for late payment of tax

The penalty for late payment is to be changed to 8% per annum of the amount unpaid. It will still be calculated from the time when the tax became due and payable. This penalty is due on a daily basis while any amount of tax that is due for payment remains unpaid. ***[section 207 - Subclause 23(a)]***

For taxpayers who are not on full self assessment, the late payment penalty and interest is to be payable on any amount of income tax or provisional tax paid after the due date for payment specified in a notice of assessment or other notice issued to the taxpayer by the ATO.

For taxpayers who are on full self assessment (relevant entities) the late payment penalty and interest is to be payable on any amount paid after the prescribed due date for payment. In the case of amounts payable on assessment, the late payment penalty and interest is to apply to any amount of tax paid after the due date for lodgment of the return for the relevant year of income. To give effect to this requirement, the Bill provides that for late payment purposes, tax under paragraph 221AZD(b) is to be taken to be due and payable on the due date for the furnishing of the return for the relevant year of income. ***[paragraph 207(1AA)(a) - Subclause 23(b)(a)]***

For the purposes of calculating late payment penalty and interest for relevant entities, the amount of tax that is taken to be due under section 221AZD is to be the amount of income tax specified in the tax return for the relevant income year, reduced by any credits or offsets allowed within the meaning of subsection 221AZE(6). ***[paragraph 207(1AA)(b) - Subclause 23(b)(b)]***

This change is required to avoid the situation of an amount for a relevant entity being technically overdue between the due date for lodgment of the return and the actual date of lodgment, even though no amount is ultimately payable as a result of being offset by credits, eg., deductions from prescribed payments, which do not arise until an assessment is made. In cases where a return is lodged late, the assessment is deemed to be made on the date of lodgment.

Under the existing subsection 207(1B), where a judgment debt carries interest, the penalty otherwise payable for late payment under section 207 is reduced by the amount of the judgment debt interest. Under the new interest arrangements, judgment debt interest is only to be offset against the interest imposed by the new section 207A(1) and not against the penalty imposed by the existing section 207. The Bill gives effect to this new requirement by changing subsection 207(1B) to delete all references to the penalty under section 207 being offset by any judgment debt interest. ***[Subclause 23(c)]***

The existing subsection 207(3) makes it clear that for the purpose of calculating late payment penalty for the late payment of tax, an outstanding amount of 'tax' includes any additional tax imposed under Part VII of the ITAA. This will continue to be the case, but given the changes being made by this Bill to separate penalties and interest, it is necessary to include interest under section 170AA and additional tax under Part VII. *[Subclause 23(d)]*

Interest for late payment of tax

Interest at the statutory rate is also to be paid on any amount of tax unpaid, calculated in the same manner as late payment penalty under section 207, from the time when the tax became due and payable. The interest will be due on a daily basis while any amount of tax that is due for payment remains unpaid. *[subsection 207A(1) - Clause 24]*

For relevant entities, as explained above, in determining the amount of tax that is to be subject to interest for late payment, the tax specified under section 221AZD in a return is to be reduced by any offsets or credits allowed within the meaning of subsection 221AZE(6). *[subsection 207A(2) - Clause 24]*

With respect to the late payment of franking deficit tax, the amendments made to subsection 160ARW(2) *[Schedule 3 - Subclause 33(3)]* provide that late payment penalty under section 207 is only to apply from 30 days after the issue of an amended assessment advising that an additional amount of franking deficit tax is payable. However, interest (under the new section 207A) for the late payment of franking deficit tax is to accrue from the day on which franking deficit tax is due and payable in accordance with the existing section 160ARU (ie., from 1 month after the end of the franking year). As the existing subsection 160ARW(2) causes section 207 penalty to accrue at a reduced rate from that date until 30 days after the amended assessment, the amended provision effectively continues the existing policy of the law. Section 207A contains a technical subsection to ensure that in those cases where subsection 160ARW(2) applies to an amount, interest under section 207A is calculated from the earlier date. *[subsection 207A(3) - Clause 24]*

Under the existing subsection 207(1A), the Commissioner has the power to remit late payment penalty where he is satisfied that there are special circumstances that contributed to the delay in payment of the tax in which, having regard to those circumstances, it would be fair and reasonable to remit all or part of the penalty.

Similarly, in respect of the interest associated with the late payment of tax, there will be a need for a provision to allow the Commissioner to remit the interest in those cases where there are special circumstances which make it fair and reasonable for the interest to be remitted.

However, as distinct from the remission of late payment penalty, interest is only to be remitted in very exceptional cases, given that it represents compensation to the Revenue for the time value of money for the period that the Revenue has been denied use of the funds. Thus in contrast to the remission provision for late payment penalty, which has regard to exceptional circumstances that contributed to the delay in payment of the tax, the remission provision in respect of interest will be more limited. The Bill provides a provision identical to the existing remission provision in respect of section 170AA interest, which allows the Commissioner to remit interest in those cases where there are special circumstances which make it fair and reasonable for the interest to be remitted. ***[subsection 207A(4) - Clause 24]***

As mentioned above, where a judgment debt carries interest, any interest payable under the new section 207A is to be offset by the amount of the judgment debt interest. ***[subsection 207A(5) - Clause 24]***

The existing subsection 207(2) makes it clear that the Commissioner may sue for recovery of any tax unpaid as soon as the tax becomes due and payable, notwithstanding that a person is liable to pay additional tax by way of penalty when an amount of tax remains unpaid. This subsection will continue to operate in respect of penalty imposed under section 207. This Bill will insert a similar subsection in respect of interest imposed under the new section 207A. ***[subsection 207A(6) - Clause 24]***

A provision similar to that contained in the existing subsection 207(3) in respect of penalty for late payment is also required in respect of interest for late payment. The Bill gives effect to this requirement by making it clear that interest for late payment can be imposed under the new section 207A on an amount of tax that can include interest or penalty imposed under section 170AA or Part VII of the ITAA. In other words, if the balance payable for an assessment, which includes interest under section170AA or penalty under Part VII, or both, is not paid in full by the due date, penalty under section 207 and interest under the new section 207A can be imposed on the total tax outstanding. ***[subsection 207A(7) - Clause 24]***

Interest rates

Where a taxpayer is required to pay interest under section 170AA or 207A, the rate at which interest is to be calculated in respect of any specific period of time is the statutory rate of interest applicable to a given period of time. Given that interest is meant to compensate the Revenue for the time value of money, the rate at which interest is to be paid by taxpayers, which is based on market rates, will be varied periodically to reflect interest rate movements in the market.

The rate of interest that is to apply for a given period of time will be published in the Gazette by the Commissioner before the rate takes effect. A new interest rate will normally be published to apply for a six month period, commencing on 1 July and 1 January each year.

The rate at which interest is to be calculated in respect of any period falling within the first six months in a financial year is the weighted average yield set at the last tender for the 13 Week Treasury Note before the end of April preceding the financial year, increased by 4 percentage points. ***[subsection 214A(3) - Clause 25]***

This is best illustrated by an example. If the weighted average yield for the last weekly tender for the 13 Week Treasury Note before the end of April 1992 was 7.0%, the rate to be used in calculating interest under section 170AA or 207A in respect of the six month period commencing on 1 July 1992 would be 11%.

Similarly, the rate at which interest is to be calculated in respect of any period falling within the last six months in a financial year is the weighted average yield set at the last tender for the 13 Week Treasury Note before the end of October in that financial year, increased by 4 percentage points. ***[subsection 214A(4) - Clause 25]***

While a new rate will normally be set to apply from the commencement of the standard six month period, it is possible during lengthy periods of stable interest rates for the rate set for a particular six month period to be used for a further six month period. *[subsection 214A(5) - Clause 25]*

In situations where the interest rate in relation to a six month period would not differ by more than one percentage point from the interest rate for the preceding six month period, it is possible for the earlier rate to be used for a further period. In such cases, the Treasurer must determine that the rate for the preceding period will be the rate that will apply for the new period. *[subsection 214A(6) - Clause 25]*

For example, if the rate for the six month period commencing on 1 July 1992 was 11% and the new rate (based on the weighted average yield set at the last weekly tender for the 13 Week Treasury Note before the end of October 1992) would have been 11.8%, the Treasurer could determine that 11% should continue as the rate to be used for the six month period commencing on 1 January 1993. On the other hand, if the new rate would have been 10.2%, the Treasurer could determine that 11% should continue to be used for a further six month period.

The above provisions *[subsections 214A(5) and 214A(6)]* are designed to avoid administrative difficulties associated with changing the rate of interest too frequently. This is particularly relevant for taxpayers who are on full self assessment, as they would be expected to calculate the amount of any interest payable by them when any tax is paid late. However, while seeking to minimise the number of changes in interest rates, there is a need to protect the Revenue in situations where there are large movements in interest rates over a short period of time. In these situations, the Bill allows the Treasurer to determine that a new rate of interest is to apply for a certain period, based on the weighted average yield set at the last weekly tender for the 13 Week Treasury Note for a month other than the relevant April or October. *[subsection 214A(5) - Clause 25]*

In setting a rate of interest that is to apply to a particular period, the rate is to be limited to a maximum of one decimal place. To give effect to this requirement, the Bill provides that the rate must be rounded upwards to one decimal place. *[subsection 214A(7) - Clause 25]*

For example, if the rate based on the weighted average yield set at the last weekly tender for the 13 Week Treasury Note before the end of April was 10.95%, the rate for the next period would be set at 11%. On the other hand, if the rate was 10.94% instead of 10.95%, the rate would be set at 10.9% and not at 11.0%.

With the rate of interest to apply in different periods of time being subject to periodic review, there is a requirement that the rate to apply in respect of a given period be published before the rate can come into effect. The Bill provides that before a new rate comes into effect, the Commissioner must publish the new rate for a particular period in the Gazette. ***[subsection 214A(8) - Clause 25]***

Deduction for interest payments

Where a taxpayer is required to pay interest under section 170AA or 207A for the underpayment or late payment of tax, the taxpayer will be able to claim a deduction for the interest expenditure.

The Bill will amend subsection 51(5) of the ITAA to allow all taxpayers to claim a deduction for any interest expenditure that consists of interest under section 170AA or 207A. That is, all taxpayers, not just business taxpayers, will be able to deduct from assessable income, interest paid under these sections to the ATO. This will remove the present lack of symmetry in the tax treatment of interest paid to the ATO and interest paid by the ATO. The deduction will be able to be claimed in the income year in which the interest expenditure is incurred. ***[subsection 51(5) - Clause 16]***

Other changes

Further amendments to the ITAA are set out in ***Schedule 3*** to the Bill. These changes deal with the amendment of a number of existing provisions that extend the scope of section 207 or extend their own scope by referring to section 207.

Given the changes made by this Bill to impose interest on late payments under the new section 207A and the amendments to section 170AA to enable interest to be imposed on all underpayments (even where penalty under Part VII of the ITAA is imposed) it is necessary to amend a number of existing provisions that make reference to additional tax under section 207 or Part VII.

These amendments are necessary to ensure that interest under the new section 207A and the amended section 170AA is also included, as applicable, in the relevant existing provisions that make reference to additional tax under section 207 of Part VII. ***[Subclause 33(3)]***

Application of interest provisions

The amendments to section 51 made by this Bill will only apply to interest paid under sections 170AA or 207A in respect of assessments in respect of the 1992-93 year of income and all subsequent years of income. ***[subsection 34(1) of the Self Assessment Act - Subclause 34(1)]***

The amendments of section 170AA made by this Bill will only apply to assessments in respect of the 1992-93 year of income and all subsequent years of income. This means that for most taxpayers the new provisions will apply to the underpayment of tax in respect of the income year commencing on 1 July 1992. However, in the case of taxpayers who have adopted an accounting period which commences prior to 1 July 1992 in lieu of the year of income commencing on 1 July 1992, the new provisions will apply to any underpayment of tax in respect of the accounting period adopted in lieu of the year of income commencing on 1 July 1992. For example, for a taxpayer whose 1991-92 year of income ended on 30 April, the new provisions will first apply to the year of income commencing on 1 May 1992. ***[subsection 34(4) of the Self Assessment Act - Subclause 34(4)]***

Similarly, the amendments of section 207 and 207A made by this Bill will only apply to late payments of tax in respect of the 1992-93 year of income and all subsequent years of income. ***[subsection 34(5) of the Self Assessment Act - Subclause 34(5)]***

The amendment of section 160ARW(2) made by this Bill will only apply to the late payment of tax in respect of a franking year commencing on or after 1 July 1992. ***[subsection 34(5) of the Self Assessment Act - Subclause 34(5)]***

In the case of the late payment of provisional tax, including instalments of provisional tax, the new provisions will only apply to the late payment of provisional tax in respect of the 1993-94 year of income and all subsequent years of income. For most taxpayers, this will be provisional tax that is due after 1 July 1993. ***[subsection 34(6) of the Self Assessment Act - Subclause 34(6)]***

Amendment of Interest on Underpayments Act

The Bill inserts a new subsection into section 3 of the Interest on Underpayments Act to make it clear that any interest that is payable under the ITAA that is a tax is imposed by the Interest on Underpayments Act. Any interest that is payable under the ITAA that is not a tax is not imposed by the Interest on Underpayments Act. ***[subsection 3(2) of the Interest on Underpayments Act - Clause 38]***

Chapter 6
Elections and Notifications

Key Features

This chapter deals with how elections and options available under the law are to be made by taxpayers under a self assessment system. The key features are:

- taxpayers, in most cases, will no longer be required to prepare and lodge written notices of elections;
- elections made by agreements between taxpayers will be required in writing and need to be kept by taxpayers;
- elections and notifications affecting the taxation treatment of future transactions or events, or which cause the Commissioner to take some action in relation to an assessment, will still be required to be in writing and lodged with the Commissioner;
- the Commissioner retains the power to extend the time for making an election.

Summary of Proposed Amendments

The Bill gives effect to changes announced in section 12 of the August 1991 information paper entitled 'Improvements to Self Assessment - Priority Tasks'.

The amendments will have the effect that most elections and notifications relevant to the calculation of taxable income will no longer be required in writing.

There are a number of instances in the ITAA where taxpayers can decide, by way of an election, what law is to apply to a particular set of facts. These elections allow taxpayers to advise the Commissioner of their choice of the provision to be applied in determining taxable income. Making an election may enable the taxpayer to tell the Commissioner, for example, how much of an amount of income is assessable or how much of an item of expenditure is deductible. The present law generally requires an election to be in writing and lodged with the Commissioner before it is effective.

Following the move in 1986-87 to a self assessment system of taxation, tax returns are no longer subject to technical and other scrutiny prior to assessment. This means that the Commissioner no longer needs to consider the information provided by taxpayers in their tax returns. Instead, the Commissioner can rely on section 169A of the ITAA in making an assessment and accept, without examination, statements by taxpayers of assessable income and allowable deductions. The requirements that elections be in writing and lodged with the Commissioner are inconsistent with a system where the Commissioner will not look at the written elections. In these circumstances, there is generally no practical point in elections being lodged with the Commissioner.

Elections

The amendments proposed by the Bill will have the effect that the majority of elections will no longer be required to be made in writing and lodged with the Commissioner. The need to give certain notices to the Commissioner will also be removed. The process of making an election will involve the taxpayer deciding which provision of the ITAA is to be applied in calculating a component of taxable income and keeping a record which verifies the calculation. Whether or not a taxpayer has made an election will be evident from these records and in the calculation of taxable income as disclosed in the tax return. Taxpayers will still be required to make elections by a particular date, usually on or before the due date for lodging the relevant tax return. The Commissioner will be able to extend this period where he considers it appropriate.

In almost every case an election gives a taxpayer the option to override the ordinary operation of the law. An example of this occurs in section 26B of the ITAA. An insurance payment to a grazier for a loss of livestock is ordinarily assessable income in the year in which it is received. But subsection 26B(2) allows a taxpayer to elect instead to spread an insurance recovery over a five year period. In this way, the taxpayer can stop the application of the ordinary law and determine that the insurance payment is assessable in the manner chosen by the taxpayer. Taxpayers will no longer be required to notify the Commissioner of this type of election. ***[Schedule 1 - Clause 33]***

Some elections and notifications allow two or more taxpayers, by agreement, to decide what law is to apply in a particular case. An example is the election under paragraph 80G(6)(c). That election allows companies in the same company group to transfer losses among the group. At present, the public officers of the transferor and transferee company must give a notice to the Commissioner stating that the right to the deduction for a loss has been transferred. This requirement is to be removed from the legislation ***[Schedule 2 - Clause 33]***. Instead, it is to be a condition of the transfer that the income company and the loss company agree in writing, before lodgment of the income company's tax return for the relevant year, that the right to the allowable deduction should be transferred. These agreements will be required to be kept by the taxpayers with their taxation records.

Similar changes will be made to other provisions in the law where two or more taxpayers may enter into an agreement which allows an election to be made that effects the calculation of taxable income. In these cases taxpayers will no longer be required to lodge the notices of election with the Commissioner. A written agreement will be required which taxpayers will have to keep with their taxation records.

Notices other than elections

There is an instance, not involving an election, where a taxpayer must provide a certificate to the Commissioner, in support of a claim for a rebate. The instance is where a taxpayer wants to make a claim for a rebate in respect of a dependant invalid relative (under section 159J). A taxpayer making such a claim must provide the Commissioner with a certificate issued by an authorised medical practitioner, confirming the invalidity of the dependant. The requirement for the certificate is to be provided to the Commissioner is being removed *[Schedule 4 - Clause 33]*. In future a taxpayer claiming an invalid relative rebate will be required to obtain a certificate but not to notify the Commissioner.

Some elections still to be in writing

The nature of some elections and notifications is that they will still be required to be in writing and lodged with the Commissioner. Many of these elections affect the taxation treatment of a future transaction or event. Others are necessary for the Commissioner to be able to process assessments.

The elections which provide for miscellaneous roll-over relief from capital gains tax on disposal of certain assets are examples of elections which do not have any tax effect in the year of election but will have an effect in a later year. An example is section 160ZZN, where the taxpayer elects for roll-over relief on the transfer of an asset to a wholly owned company. The effect of this election is to delay any taxation consequence of the initial disposal until the asset is disposed of by the wholly owned company, possibly many years after the election is made. If the election preserves the pre-20 September 1985 status of the asset (ie., capital gains tax free), any subsequent gain on the disposal would be tax free. On the other hand, any subsequent loss on disposal would not be deductible against other capital gains.

If a taxpayer did not give the Commissioner notice of the election made under section 160ZZN, it would be possible to wait for the consequence of a subsequent disposal and choose the best result for the taxpayer. If a capital loss was made, the taxpayer could deny the existence of an election. If a capital gain was made, the taxpayer could say that there had been an election. For this reason, elections like this will still have to be made in writing and lodged with the Commissioner.

There are also two instances where the Commissioner needs to be notified of a particular event before an assessment can be made.

The first instance is where a primary producer elects under section 158A, to opt out of the averaging system. Unless the Commissioner is told about such an election, assessments would continue to be made on the basis that the taxpayer is entitled to income averaging.

The other instance is where a taxpayer wants to be given the benefit of having a lower effective tax rate applied to taxable income under section 59AB. This provision of the law provides relief to a taxpayer whose business has ceased because depreciable plant has been disposed of, lost or destroyed, eg., because of a fire, and where there is an amount included in the taxpayer's assessable income because of the disposal, eg., where there was an insurance recovery. In this case, the Commissioner needs to be told about the taxpayer's election so that the ordinary rates of tax are not applied to taxable income.

These types of elections will still have to be given to the Commissioner in writing.

Any notification that would cause the Commissioner to exercise a discretion will not be removed at this stage. It would not make sense to remove the need to make these notifications while the ascertainment of a component of taxable income was dependent on the Commissioner being advised to exercise a discretion. An example of this type of notice is the notice that may be given under subsection 31(3), where taxpayers can notify the Commissioner that, for reasons of obsolescence or any other special circumstances, they wish to adopt a value of trading stock which is lower than the lowest value applicable under subsection 31(1). Such a value is not available unless the Commissioner determines that the value is fair and reasonable. Other examples of these types of notice are in subsections 63A(3), 63A(7), 80A(2), 102AAZD and 300B(1).

Explanation of Proposed Amendments

Elections

The amendments that will remove the requirement to lodge written elections are set out in ***Schedule 1*** of the Bill. ***[Subclause 33(1)]***

The amendments in ***Schedule 1*** apply to elections made on or after the date of Royal Assent ***[Clause 2].*** However, if Royal Assent occurs before 1 July 1992 the amendments will only apply to elections made on or after 1 July 1992. ***[Subclause 34(9)]***

The following provisions will be amended to remove any reference to elections being in writing and lodged with the Commissioner.

subsection 26AAC(4E)	subsection 26AAC(8B)
subsection 26AAC(15B)	subsection 26B(5)
subsection 26BA(8)	subsection 34(2A)
subsection 36AA(6)	subsection 51AE(9)
subsection 56(1AB)	subsection 57AK(9)
subsection 57AM(32)	subsection 79E(7)
subsection 80(2D)	subsection 82KY(1)
subsection 88(6)	subsection 102AAX(4)
subsection 116D(1)	subsection 122M
subsection 123BB(2)	subsection 124ADH(2)
subsection 124AG(3)	subsection 124AH(4AB)
subsection 124UA(3)	subsection 124ZAE(2)
subsection 275B(5)	subsection 279(6)
subsection 290A(3)	subsection 401(4)

The following provisions will be amended to remove the words requiring elections to be in writing.

subsection 36(7)	subsection 36AAA(14)
paragraph 148(6)(a)	paragraph 148(6)(b)
subsection 160M(11C)	subsection 461(4)

The following provisions will be amended to remove words referring to written elections.

subsection 26AAC(15A)	paragraph 34(2)(a)
subsection 36AAA(4)	subsection 79E(6)
subsection 80(2C)	subsection 122D(4)
subsection 122DB(4)	subsection 122DD(4)
subsection 122DF(4)	subsection 122DG(6A)
subsection 122H(1)	subsection 122H(2)
subsection 122J(4BA)	subsection 122JE(6)
subsection 122JF(3)	subsection 124ADH(1)
subsection 124AG(1)	subsection 124AG(2)
subsection 124AH(4AA)	subparagraph 401(3)(d)(i)
subparagraph 461(3)(c)(i)	

The following provisions will be amended to remove the words requiring elections to be lodged with the Commissioner.

paragraph 36A(2)(d)	subsection 116D(2)
paragraph 148(6)(c)	subsection 159GZS(5)
subsection 159GZT(7)	subsection 159GZU(5)
subsection 159GZV(5)	subsection 159GZW(5)
subsection 160ZSA(2)	subsection 160ZZQ(5A)
subsection 160ZZQ(5B)	subsection 160ZZQ(11A)

Notifications and requests

Further amendments relating to notices and requests are set out in ***Schedule 2*** of the Bill. ***[Subclause 33(2)]***

The amendments made by ***Schedule 2*** apply to agreements and elections made on or after the later of 1 July 1992 or the date of Royal Assent. The amendments do not affect the operation of notices or requests given or made by taxpayers before whichever of those commencement dates is relevant. Any notice or request given to the Commissioner prior to the actual commencement date will be effective in respect of the assessment for the year to which it relates.

This ensures that the amendments will not have a retrospective effect. The various amendments made by ***Schedule 2*** are explained in the following notes.

Property disposal on change of ownership

Where there is a disposal of property on change of ownership or interests in a partnership, taxpayers will no longer be required to notify the Commissioner of an election that the value of property at the date of disposal is to be the subsection 36A(2) value, being the amount that would have been the year end value had the disposal not taken place. Instead, each person who owned the property before and after the change in ownership or interest must agree in writing that the subsection 36A(2) value is to apply. The agreement is to be made by the prescribed date and signed by all parties. ***[subsection 36A(3)]***

Devolution of property on death of a taxpayer

Subsection 37(2), which relates to the devolution of property on the death of a taxpayer, is to be amended to exclude the requirement of giving notice to the Commissioner that the trustee and beneficiaries unanimously agree on the value of the property. ***[subsection 37(2)]***

Disposal of depreciated property

Subsection 59(2A) allows a taxpayer to elect that the assessable profit on disposal of depreciated property is not to be included in assessable income. Instead, the taxpayer can request that the Commissioner offset the assessable profit against the cost, for depreciation purposes, of any replacement property or other depreciable property of the taxpayer. This provision will be amended so that the written request need no longer be made. The offsetting deduction will become a matter of choice for the taxpayer. ***[subsection 59(2A)]***

Replacement of depreciable asset

Subsection 59(2D), which applies where a replacement asset is acquired within 2 years of the year in which there was a disposal of the depreciable item, is amended in a similar manner to subsection 59(2A). ***[subsection 59(2D)]***

Transfer of company losses

Subsection 80G(6) allows companies in the same group to transfer losses among the group companies. The requirement for public officers of the transferor and transferee company to give the Commissioner a notice stating that the deduction for the loss has been transferred is to be removed *[paragraph 80G(6)(c)]*. Instead, the agreement to transfer the deduction must be in writing, signed and kept by the public officers of both companies *[subsection 80G(6A)]*. Consequential amendments are to be made to other provisions in section 80G removing the references to notices and replacing them with references to agreements. *[subsections 80G(7), 80G(8), 80G(13) and 80G(16)]*

Premium for goodwill or licence

Section 83A concerns the notification of a premium paid for goodwill or licence where there has been a grant, surrender or assignment of a lease of land upon which a business has been carried on. As with section 80G, the requirement to notify the Commissioner is to be removed and replaced by a requirement for a written agreement signed by the parties to the agreement that the amount be treated as a premium. *[subsections 83A(2) and 83A(3)]*

Purchasing of mining or prospecting rights or information

Subsection 122B provides for the purchaser of a mining or prospecting right or information to be entitled to a transfer of deductions for certain capital expenditure incurred by the vendor in respect of the right or information. This deduction is limited to the extent of the purchaser's expenditure on the acquisition of the right or information and is contingent on the purchaser and the vendor having agreed to the amount of the transfer and notifying the Commissioner accordingly.

The law is to be amended so that the Commissioner does not have to be notified of the agreement to include in the allowable capital expenditure of the purchaser an amount representing all or part of the expenditure incurred in acquiring the right or information *[subsections 122B(1) and 122B(2)]*. The agreement must be in writing and signed by or on behalf of the purchaser and the vendor and must be made not later than 2 months after the end of the relevant year of income. *[subsection 122B(5)]*

An agreement under this section has no effect if the expenditure incurred by the purchaser relates to the grant, assignment or surrender of a mining lease that is the subject of an election under subsection 88B(5). ***[subsection 122B(4)]***

Acquiring petroleum prospecting or mining rights

Section 124AB allows for the inclusion in the allowable capital expenditure of the purchaser, of an amount of expenditure incurred in acquiring petroleum prospecting or mining rights or information. Similar amendments to those in section 122B above are being made to section 124AB. The requirement that the taxpayer notify the Commissioner will be replaced by a requirement that there be a written and signed agreement specifying the amount of the allowable capital expenditure. ***[subsections 124AB(1), 124AB(3) and 124AB(5)]***

Payments for exploration permits and production licences

Section 124ABA allows for the transfer of entitlements to deductions for capital expenditure in respect of cash bidding payments for exploration permits and production licences. Where the original bidder sells part or all of the interest in the bid the deductions can be transferred to the purchaser. Similar amendments to those in section 124AB above are being made to remove the requirement that a notice be lodged with the Commissioner. ***[subsections 124ABA(2) and 124ABA(3) and paragraphs 124ABA(3)(a), 124ABA(3)(b) and 124ABA(3)(c)]***

Transfer of foreign tax credits

Section 160AFE allows for the carrying forward of excess foreign tax credits and their transfer between group companies. Notifying the Commissioner of the transfer of the excess credit will no longer be necessary. The companies will be required to have a signed written agreement which gives effect to the transfer. ***[paragraph 160AFE(1D)(c), subsections 160AFE(1D) and 160AFE(1DA)]***

Transfer of capital losses

Section 160ZP allows for the transfer of net capital losses to resident companies in the same group. It will no longer be necessary for the companies to give the Commissioner notice of the transfer. The companies will be required to have a signed written agreement of the transfer. *[paragraph 160ZP(7)(c), subsections 160ZP(7AA), 160ZP(7A), 160ZP(7B), 160ZP(8), 160ZP(9), 160ZP(10) and paragraph 160ZP(13)(a)]*

Superannuation fund - non-taxable contributions

Subsection 274(7) allows a trustee of a complying superannuation fund with the consent of a contributor to notify the Commissioner, in a prescribed manner, that certain contributions are not to be taxable contributions. This notification is to be replaced by an election which the taxpayer makes in determining the amount of taxable income. The taxpayer is not required to advise the Commissioner of the election but should keep appropriate records. *[subsections 274(7), 274(8) and 274(9)]*

Other notices

Further amendments are set out in *Schedule 4* to the Bill. *[Subclause 33(4)]*

Rebate for invalid relative

A medical certificate will no longer have to be produced to the Commissioner for a taxpayer to claim a rebate for the maintenance of an invalid relative. To be entitled to the rebate it will be necessary for the taxpayer to obtain the medical certificate and keep it with other taxation records *[Subclause 34(11)]*. This amendment will apply to rebate claims in returns lodged on or after the date of Royal Assent to the Bill or 1 July 1992, whichever is later. *[paragraph 159J(6)(c)]*

Foreign tax credits

In relation to claims for certain foreign tax credits made on or after the later of Royal Assent or 1 July 1992 *[Subclause 34(12)]*, information relating to the determination of those credits will no longer have to be furnished to the Commissioner but must be able to be produced upon request. *[section 160AM]*

Superannuation fund - transfer of liability

Section 275 allows the trustee of a complying superannuation fund or a complying approved deposit fund (the transferor) to transfer a liability in respect of taxable contributions to a life assurance company, registered organisation or pooled superannuation trust (the transferee). For the transfer to be effective, the transferor must obtain the consent of the transferee to the transfer. At present this consent does not have to be evidenced in writing. At present the trustee of the transferor fund is required to give the Commissioner a notice of the transferred amount. This requirement is to be replaced by a requirement for a written agreement signed by or on behalf of the transferor and the transferee and made on or before the date of lodgment of the transferor's tax return for the year in which the transfer takes place. The taxpayers do not have to inform the Commissioner of the agreement but should keep appropriate records. *[subsections 275(1), 275(2), 275(4), 275(6) and 275(7)]*

The Bill provides that the amendments to section 275 only apply to transfers of taxable contributions made in the year of income of the transferor in which 1 July 1992 falls and all later years of income. That is, for most taxpayers it will have effect for the income year ending on 30 June 1993. For those funds with an early balancing date, it will apply to transfers in the substituted accounting period in which 1 July 1992 falls. This will allow sufficient time for transferors and transferees to comply with the new requirement that consent to a transfer of taxable contributions be in writing. *[Subclause 34(13)]*

Glossary of Commonly Used Terms

Glossary of Commonly Used Terms

Set out below are brief descriptions of commonly used terms in the Bill and explanatory memorandum. Where terms are explained in detail in chapters of this document, a reference is given to the chapter where the term is explained.

Arrangement	explained in Chapter 1. Includes a transaction
Assessment	the ascertainment of the taxable income and tax payable for a year of income for a taxpayer
Binding ruling	a ruling that limits the amount of tax payable by the taxpayer to that which would be payable on the basis of the ruling
Commissioner assessment	an assessment where the Commissioner considers the application of the law to a taxpayer and does not merely rely on statements made by the taxpayer
Debit amendment	the amendment of an assessment for a year of income to increase the tax liability of the taxpayer for the given year of income
Election	the exercise by the taxpayer of a choice provided under the Income Tax Assessment Act (ITAA)
Full self assessment	the term used to describe the calculation by a taxpayer, of the taxable income and the tax payable for the taxpayer for a year of income
Interest	an amount of money that is paid to compensate a taxpayer or the Revenue when the correct amount of tax in respect of a year of income has not been paid at the due date for payment of the tax for that year of income
Private Ruling	explained in Chapter 1. A ruling that applies to one taxpayer only
Public Ruling	explained in Chapter 1. A ruling that can apply to any taxpayer with circumstances that match those described in the ruling

Reasonably arguable position	explained in Chapter 4. A position on a question of interpretation that is arguably about as likely as not correct
Reasonable care	explained in Chapter 4. The care that a reasonable ordinary person would exercise in the circumstances of the taxpayer
Relevant entities	a term used to describe taxpayers who are currently on full self assessment
Review rights	a taxpayer's right to object to a taxation decision and to have the Commisssioner's decision on the objection considered by the AAT or Federal Court
Rulee	a taxpayer to whom a Private Ruling relates
Scheme penalties	penalties applicable where an anti-tax avoidance provision applies
Self amendment	the issue of an amended assessment on the basis of details provided by a taxpayer in a request for amendment, without detailed scrutiny of the amendment details by the ATO
Self assessment	the term used to describe the calculation by a taxpayer of the taxable income for the taxpayer for a year of income
Statutory rate	the rate of interest published by the Commissioner as the rate to be used when calculating interest payments in respect of a specific period of time
Tax shortfall	the term used to describe the amount by which the tax payable by a taxpayer for a year of income, as calculated by the taxpayer, is less than the amount of tax that is properly payable by the taxpayer for the year of income
Tax shortfall penalties	explained in Chapter 4. The penalties that apply where there is a tax shortfall
Taxation decision	the assessment, determination, notice or decision against which a taxpayer may object
Taxation statement	explained in Chapter 4. A statement made to a taxation officer

Understatement penalties	tax shortfall penalties and scheme penalties
13 Week Treasury note rate	the term used to describe the weighted average yield of a tender for short term (13 Week) Treasury Notes

Index

TAXATION LAWS AMENDMENT (SELF ASSESSMENT) BILL 1992

INDEX

Clause No.	Section No.	Subject	Page No.
21	-	Payment of interest by taxpayer where assessment amended	17, 21, 103-106
22	170BA	Effect of public ruling on tax other than withholding tax	12, 28, 48, 49, 50
	170BB	Effect of private ruling on tax other than withholding tax	15, 28, 48, 49, 50, 55
	170BC	Assessment of tax other than withholding tax where conflicting rulings	12, 15, 28, 30, 31, 48, 49, 52, 55
	170BD	Effect of public ruling on withholding tax	12, 28, 53
	170BE	Effect of private ruling on withholding tax	15, 28
	170BF	Withholding tax where conflicting rulings	12, 15, 30, 31, 53
	170BG	Final Tribunal decision about private ruling conclusive	54
	170BH	Final court order about private ruling conclusive	54
	170BI	Final court order about Commissioner discretion	15, 55
23	-	Penalty for unpaid tax	22, 106-108
24	207A	Penalty interest on unpaid tax	22, 106, 108-110
25	214A	Interest rates	23, 110-112
26	222A	Interpretation	19, 74, 76, 77, 93
	222B	Taxation statements	19, 77
	222C	Reasonably arguable	13, 19, 83, 84, 85, 90
	222D	Treating law as not applying	19, 87
	222E	Taxation statement can apply to different years	19, 78
	222F	Omission of assessable income from return	79
27	-	Penalty for false or misleading statements	17, 104
28		Penalty tax where certain anti-avoidance provisions apply	18, 89
29		Penalty tax where Division 13 of Part 111 applies	19, 89, 90
30		Penalty tax where Part IVA applies	18, 89, 90
31	226A	Certain penalty tax under scheme sections not payable because of application of private ruling	19, 79, 80