

ROSA'S LAST GASP: THE FINAL STEPS IN SELF ASSESSMENT'S 21 YEAR JOURNEY

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Income tax self assessment has operated in Australia for over of 21 years. The introduction of self assessment fundamentally altered the balance of power and focus of responsibilities between taxpayers and the Australian Taxation Office (ATO). It has also impacted dramatically on the triangular relationship between the ATO, taxpayers, and their tax advisers creating an often fractious relationship.

Although there had been some changes in the early 1990's, it was with the release in March 2004 of the discussion paper, Review of Aspects of Income Tax Self Assessment (ROSA) that the Government finally accepted that this imbalance needed redressing. The resultant changes to the penalty regime and interest charge provisions were enacted by Tax Laws Amendment (Improvement of Self Assessment) Act (No 1) 2005 and the Shortfall Interest Charge (Imposition) Act 2005. The changes expanding the scope of the ruling system and the shortening of the periods of review (including nil assessments) were enacted by the Tax Laws Amendment (Improvement of Self Assessment) Act (No 2) 2005.

Since these changes there has been no action on the balance of the ROSA legislative recommendations until the then Minister for Revenue and Assistant Treasurer announced:

- *on 27 March 2007 that the Board of Taxation would consult publicly on the scope to apply consistent self assessment principles across all federally administered taxes;*
- *on 26 June 2007 the release of a discussion paper examining options for reforming liability discretions in the income tax law; and*
- *on 22 August 2007 a review into unlimited amendment periods in the income tax laws and released a discussion paper.*

The focus of this paper is to review the liability discretion and unlimited amendment period Treasury papers to evaluate the effectiveness of the approach adopted in those papers and the likely impact of any reforms upon the self assessment system.

I INTRODUCTION

Income tax self assessment has been in operation in Australia for in excess of 21 years.¹ The move to self assessment was driven by the desire to improve the cost efficiency of revenue collection by liberating assessing resources within the Australian Taxation Office (ATO) to audit activities.²

However, its introduction fundamentally altered the balance of power and focus of responsibilities between taxpayers and the ATO.³ This occurred as taxpayers have had to bear virtually all, or at least a disproportional share of the burden of moving to self assessment. This included dealing with the uncertainty associated with what are often overly complex legislative provisions and the threat of significant penalties and the imposition of the General Interest Charge if their view of laws is not as likely to be correct as incorrect, or is more likely to be correct than incorrect. As a result this has also impacted dramatically on the triangular relationship between the ATO, taxpayers, and their tax advisers⁴ and has created an often fractious relationship.⁵

To redress this imbalance there were some changes in the early 1990's, and in 2005 as a result of the *Review of Aspects of Income Tax Self Assessment (ROSA)*. Some additional minor alterations could be on the horizon as the then Minister for Revenue and Assistant Treasurer announced during 2007 the establishment of three reviews aimed at finalising the ROSA review.

Firstly, this paper undertakes an historical stocktake of the changes to self-assessment since 1986. The paper then focuses on the effectiveness of the approach adopted in two recent Treasury papers and the likely impact of any reforms upon the self assessment system in the context of comments made in the Inspector-General of Taxation's Review into the Tax Office's Administration of Public Binding Advice.⁶

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¹ In September 1985 the Government first announced that traditional taxation administration arrangements were to be replaced with self assessment in National Review of Standards for the Tax Profession Report: *Tax Services for the Public* (1994). Self assessment was introduced in a piecemeal basis, with the first tranche introduced in a limited form in the 1986-87 year and full self assessment for companies and superannuation funds introduced from 1 July 1989. For a brief overview of self assessment see Inspector General of Taxation, Commonwealth, *Issues Paper Number 3: Self-assessment* (December 2003) at URL: http://www.igt.gov.au/content/Issues_Papers/Issues_Paper_3.asp located on 17 November 2007.

² Peter Costello, Treasurer, Commonwealth, *Discussion Paper: Review of Aspects of Income Tax Self Assessment* (March 2004), 3.

³ For an explanation of and background to this shift of responsibility, see *Tax Services for the Public*, above n 1 at 3-9.

⁴ Ibid at p xvii.

⁵ For example, at the ATO Tax Practitioner Forum's (ATPF's) November 2001 meeting, the Taxation Institute raised for discussion numerous practitioner concerns about the increasing volume of tax return information being required in a self assessment environment (Agenda Item 3.10).

⁶ Inspector-General of Taxation, "Inspector-General of Taxation announces terms of Reference for three new reviews", Press Release, 12 October 2007. The Review into the Tax Office's Administration of Public Binding Advice will examine the extent to which the Tax Office has met expectations by making its advice legally binding for a wider range of topics, while balancing appropriate risk management considerations with the aim of improving certainty. It will also examine the relationship between concepts such as "general administrative practice" "general guidance" and "legally binding advice". For a copy of the paper go to:

The paper will conclude by evaluating whether the power balance between taxpayers and the ATO has been or will be achieved in the context of ROSA's last gasp.

II HISTORY

A September 1985: The start of self assessment

The Government first announced in September 1985 that traditional taxation administration arrangements were to be replaced with self assessment.⁷ The decision to adopt a self assessment regime reflected the reality of the administration of the full assessment system in the mid 1980's. Under the traditional assessment system the returns lodged were supposed to be reviewed and examined by the ATO before tax was calculated and an assessment issued. This process had degenerated to lip service in many ATO branches with assessors being asked to process 1,000 individual returns in a standard seven hour, twenty one minute day.⁸ The excessive person power requirements of the system coupled with lack of quality assurance meant the old system could not last.⁹ Thus, given that under full self assessment there is, in most instances, no checking of the return prior to assessment, the cost savings by the revenue authorities alone would be enough to push a Government to adopt a self assessment system.¹⁰

Despite the economic imperatives, self assessment has been introduced in Australia on a piecemeal basis. Initially, a minimalist self assessment system was introduced on 1 July 1986.¹¹ This introduction, in the absence of a binding ruling system, created concerns about uncertainty and about the resultant penalties and interest charges that could result from a taxpayer making a mistake.¹² In order to support the self assessment system, taxpayers need a mechanism for gauging the Commissioner's view of a tax matter. They also need to be certain that if that transaction is undertaken in accordance with ATO advice, it is free from subsequent challenge by the ATO. Although the Commissioner had issued Public Rulings since 1982, these rulings were not binding and indeed the Commissioner has publicly argued against these old rulings in litigation.¹³

http://www.igt.gov.au/content/work_program/071012_Binding_advice_FINAL%20.pdf located on 17 November 2007.

⁷ *Tax Services for the Public*, above n 1.

⁸ The average salary and wage return received one minute scrutiny, the average business return four minutes – see *2004 ROSA Discussion Paper*, above n 2, 2.

⁹ See generally Michael Dirkis and Michael Payne-Mulcahy, "Time for a change: Self assessment 14 years on" (2002) 36 *Taxation in Australia* 417.

¹⁰ Under self assessment taxpayers' returns are lodged (either in a paper form or electronically), the lodging of a return is deemed to be an assessment. The ATO does not review the returns on lodgement. The taxpayer has the responsibility for calculating the amount of tax due and payable imposed and is required to calculate the tax and lodge a cheque with the return if tax is payable. A notice may be issued by the ATO confirming the amount paid (or a refund is issued where appropriate).

¹¹ See "What the Commissioner said: desk Audit – Self Assessment" (1986) 21 *Taxation in Australia* 255.

¹² See PL Williams "President's Page" (1988) 23 *Taxation in Australia* 265 and Jeff Mann "The President's Page – Looking forward to a year of challenge" (1990-91) 25 *Taxation in Australia* 523.

¹³ See *Bellinz Pty Ltd v FCT* (1998) 39 ATR 198. The limited scope of these rulings was the problem.

In response to these concerns the then Treasurer announced in a "Simplification Statement" on 13 December 1990 that the Government was to make changes.¹⁴ After a consultative document of 13 December 1990¹⁵ and an information paper on 20 August 1991,¹⁶ the modifications required to improve the self assessment system were introduced in 1992. This involved the introduction of the binding rulings system, a new interest system for under payment or late payment of tax, adjustments to the amendment process¹⁷ and the objection period¹⁸ and a new penalties regime.¹⁹

*B Commonwealth Parliament's Joint Committee of Public Accounts: Report No 326
November 1993*

Following the introduction of these changes the Commonwealth Parliament's Joint Committee of Public Accounts (JCPA) conducted an inquiry into the ATO's operations. In November 1993 the JCPA handed down its *Report No 326 - An Assessment of Tax - A Report on an Inquiry into the Australian Taxation Office* (Report 326). The JCPA recommended 148 changes to various areas of taxation administration and legislation.²⁰

The JCPA saw an urgent need for a review of the responsibilities and practical obligations of the self assessment system for taxpayers and their agents. It noted a need for increased support to assist taxpayers to satisfy their obligations.²¹ It recommended both: a delay in further extension of the self assessment system (pending the development of a comprehensive supporting legislative framework); and that the ATO make taxpayers more aware of their obligations under self assessment.²²

The JCPA also saw a need to reform the rulings system to fundamentally re-evaluate the roles of the administrator and the legislator. It considered that the costs of access to judicial interpretation had effectively transferred the power to define the law to the Commissioner.²³ It noted "[i]n no circumstances should an administrator have the capacity to impose on citizens obligations which cannot be supported clearly in the law".²⁴ The JCPA in particular recommended that:

- all public Rulings should acknowledge any alternative legal interpretations, and should not be issued where varying interpretations cast serious doubt on the validity of the Ruling;
- all public Rulings go through a formal approval process;
- a notice identifying and summarizing a public Ruling should be placed in the Commonwealth Gazette in order to clarify it is a public Ruling;

¹⁴ See "Income Tax simplification the first instalment" (1990-91) 25 *Taxation in Australia* 557.

¹⁵ Paul J Keating, Treasurer, Commonwealth, *A full self assessment system of taxation: A consultative document* (13 December 1990).

¹⁶ John Kerin, Treasurer, Commonwealth, *Improvements to self assessment - Priority tasks: An Information Paper* (20 August 1991).

¹⁷ The Commissioner was permitted to rely on statements made in an amendment request.

¹⁸ The period to object to an assessment or private Ruling was set at 4 years.

¹⁹ *Taxation Laws Amendment (Self Assessment) Act 1992*.

²⁰ Joint Committee of Public Accounts, *Report No 326 - An Assessment of Tax - A Report on an Inquiry into the Australian Taxation Office* (1993). For a summary of its recommendations see Michael Dirkis, "Australia: The times they are a changing: Tax Reform in 1993/94" (1994) 48 *Bulletin for International Fiscal Documentation* 492.

²¹ *Report No 326*, *ibid*, xix.

²² *Ibid*, recommendations 19 & 20; also see paras. 6.32-6.36.

²³ *Ibid*, xx.

²⁴ *Ibid*.

- Parliament, as the only body with the power to make laws should have a supervisory role in respect of all public Rulings (i.e. public Rulings should be tabled in Parliament within five days of Gazettal, allowing the Parliament to evaluate and analyse them, and respond to unsatisfactory rulings);
- the Commissioner should review all the ATO's Determinations and public and private Rulings to determine their continued validity;
- where a taxpayer indicates in a return that they are not following a private Ruling, no penalties should be applied or where a Determination is ignored;
- hypotheticals should be ruled upon, resources permitting; and
- the ATO create a publicly available computer data base of all private Rulings and the public register consolidating all Determinations, and public and private Rulings.²⁵

In respect of administratively imposed penalties the JCPA recommended that the Commissioner's power to administratively impose culpability penalties be removed as culpability should be settled by the courts not administrators.²⁶ The JCPA conceded that if these powers are retained, penalties should be imposed by a legally qualified officer. It also recommended that the law be amended to stop the re-imposition of a penalty where a prosecution is withdrawn.²⁷

Despite the JCPA's concerns about the continuing inequity of the self assessment system the Government largely ignored its recommendations.²⁸ They accepted the JCPA's recommendations concerning the Gazettal of public Rulings and that all public Rulings should be tabled in Parliament within five days of Gazettal. However, they did not agree that Rulings would not be subject to disallowance by the Parliament. The Government also rejected the recommendations that penalties should not be imposed where a taxpayer indicates in a return that they are not following a private Ruling or where a taxpayer ignores a Determination. Also it did not support the imposition of limitations on the Commissioner's powers to impose penalties. To deal with the recommendation that Rulings should be vetted by senior staff, the Commissioner announced the formation of a panel to review major rulings, consisting of three senior ATO staff and two external members.

*C Two large tax reform initiatives:
1998 A new tax system and 1999 Review of Business Taxation*

Recommendations for the reform of the rulings and amendment period aspects of self assessment were contained in the Government's August 1998²⁹ blue print for tax reform, *Tax Reform, Not a new tax, a new tax system* (the ANTS document).³⁰ The ANTS document indicated that the Government would:

²⁵ Ibid, recommendations 28-43; also see paras. 6.15-6.98.

²⁶ Ibid, xx.

²⁷ Former s 82E(2) (and its successor s 284-90(1) item 8) of the *Taxation Administration Act 1953*.

²⁸ See Treasurer, *Response to "Report No 326 - An Assessment of Tax - A Report on an Inquiry into the Australian Taxation Office"* (9 August 1994).

²⁹ Treasurer, "A New Tax System for all Australians", Press Release No 79, 13 August 1998.

³⁰ See generally Peter Costello, Commonwealth, *Tax Reform, Not a new tax, a new tax system* (August 1998). For a summary of this reform process see John Harrison, "The GST Debate-A Chronology: Background Paper No 1 1997-98" (1997) (updated by Marilyn Stretton (1999) at URL: <http://www.aph.gov.au/library/pubs/chron/1998-99/99chr01.htm> located on 13 November 2007.

- reduce uncertainty and compliance costs by reducing from four to two years the period in which the ATO can amend assessments of wage and salary earners;³¹
- make oral advice on simple tax issues binding on the Commissioner;
- ensure that the ATO rulings system is made more comprehensive and its scope is more certain by allowing the Commissioner to give a ruling on procedural, administrative or collection matters and on a question of fact; and
- examine a system of user charges for private rulings and other binding advice given to large business taxpayers in complex cases.

None of these suggestions were implemented by 1999, when the Review of Business Taxation (RBT or Ralph Committee) released its final report, *A Tax System Redesigned*,³² which also made some recommendations in relation to self assessment. The recommendations were to:

- Expand the scope of legally binding rulings;³³
- Improve certainty and timeliness of private rulings;³⁴
- Not introduce a "class order" private rulings system;³⁵
- Have the same penalty regime for public and private rulings;³⁶
- Introduce a fee for selected rulings; and³⁷
- Have rulings remain a function of the ATO.³⁸

Initially the Government did not specifically respond to these recommendations. It did, however, rewrite the penalty regime.³⁹

31 An unlimited period would continue to apply in cases of fraud or evasion.

32 Review of Business Taxation, Commonwealth, *A Tax System Redesigned* (1999).

33 *A Tax System Redesigned*, *ibid*, recommendation 3.1. This was originally an ANTS recommendation. The Government did not directly respond to the recommendation. The initiative was finally adopted through ROSA.

34 *A Tax System Redesigned*, *ibid*, recommendation 3.2. The Recommendation consisted of four issues: default issue of private rulings; use of facts from other sources; taxpayer to bring new evidence; and public information on ATO technical decisions. Initially there was no specific response. Finally, only the last issue was put into practice by the ATO in the form of "Register of Private Binding Rulings". Edited private Rulings are in general published in the Register only if they were applied for after 31 March 2001: PS LA 2001/7 paragraph 3. For details of the new practice; see ATO's PS LA 2001/7. This change was not a direct result of the Ralph Recommendation. It came from a separate internal review of the private ruling system commissioned by the Commissioner in May 2000. For details of the review, see *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office* (commonly known as the Sherman Report), issued on 7 August 2000.

35 *A Tax System Redesigned*, *ibid*, recommendation 3.3. No action was required.

36 *A Tax System Redesigned*, *ibid*, recommendation 3.4. The Government did not directly respond to the recommendation. As a result of ROSA, the Treasurer announced that the differential penalty for disregard of private rulings in s 284-90(1)(item 8) of the *Taxation Administration Act 1953* would be abolished (see Treasurer, "Outcome of the Review of Aspects of Income Tax Self Assessment", Press Release No 106, 16 December 2004, Recommendation 38). Section 284-90(1)(item 8) of the *Taxation Administration Act 1953* was repealed by the *Tax Laws Amendment (Improvement of Self Assessment Act (No 1) 2005* for the 2004-2005 income year.

37 *A Tax System Redesigned*, *ibid*, recommendation 3.5. This was originally an ANTS recommendation. The Government did not directly respond to the recommendation.

38 *A Tax System Redesigned*, *ibid*, recommendation 3.6. No action was required.

39 The legislation is contained in *A New Tax System (Tax Administration) Act (No 2) 2000*. However, the rewrite ignored *A Tax System Redesigned*, *ibid*, recommendation 3.4 to remove the imposition of additional penalties where a taxpayer declines to follow an adverse private Ruling or Determination by rewriting as s 284-90(1) item 8.

D Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection: 2001

Despite the Report 326, ANTS and the Review of Business Taxation recommendations little was actually done to address the taxpayer/ATO power imbalance. This imbalance was in evidence given by taxpayers to the 2001 Senate Economics Reference Committee's *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*.⁴⁰ This evidence pointed to the continuing public misconceptions of the self assessment system. On this issue the Committee recommended:

. . . that the ATO, in consultation with the Taxation Institute of Australia, the Commonwealth Ombudsman and other relevant bodies, develop measures to educate taxpayers about their obligations and rights in the self assessment environment. Particular attention should be given to ensuring that taxpayers are made aware of the period over which the ATO may review their returns and amend their assessments. Further . . . information about the ATO's power to review and amend assessments, and the time periods that apply, should be clearly stated in the *TaxPack* and on notices of assessment sent to taxpayers.⁴¹

E Review of Income Tax Self-assessment (ROSA): 2004

On 24 November 2003, the Treasurer announced a major Review of Income Tax Self-assessment (ROSA) to be conducted by a Treasury taskforce that included officers seconded from the ATO.⁴² The review of the income tax self assessment system focused on whether the right balance has been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. The Government in March 2004 released the discussion paper, *Review of Aspects of Income Tax Self Assessment (ROSA)*.⁴³ The discussion paper sought feedback on different options for addressing these issues, including:

- making more of the ATO's advice legally binding;
- shortening the period in which the ATO could amend assessments;
- introducing a time limit for the ATO to advise taxpayers that their assessments may be reviewed and therefore could ultimately be subject to amendment; and
- reducing the General Interest Charge where assessments were amended to increase tax payable.

⁴⁰ On 29 June 2000 the Senate referred to the Senate Economics Reference Committee the matter of mass marketed tax effective schemes and investor protection for inquiry and report with particular attention to:

- The adequacy of measures to promote investor understanding of the financial and taxation implications of tax effective schemes;
- The conduct of, and the adequacy of measures for controlling, tax effective scheme designers, promoters and financial advisers; and
- The ATO's approach towards and role in relation to mass marketed tax effective schemes.

For examples of the imbalance see - Taxation Institute of Australia's 27 August 2001 submission to the Senate Economics Reference Committee's *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*.

⁴¹ Senate Economics Reference Committee, Commonwealth Parliament, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection* (11 February 2002), xiii, recommendation 3.36

⁴² Treasurer, "Review of Aspects of Income Tax Self-Assessment", Press Release No 98, 24 November 2003.

⁴³ See Treasurer, "Release of discussion paper on the income tax self assessment system", Press Release No 17, 29 March 2004 and *2004 ROSA Discussion Paper*, above n 2.

After a period of consultation Treasury submitted its recommendations to the Government in August 2004.⁴⁴ A number of the recommendations can be traced to Report 326, ANTS and the Review of Business Taxation.⁴⁵ In December 2004 the Government accepted the 54 recommendations (30 requiring legislative reform and 24 that are administrative in nature).⁴⁶ Of the recommendations requiring legislation, 29 required some consequential administrative changes by the ATO as did 17 of 24 administrative recommendations.⁴⁷ The balance of the administrative recommendations was to be implemented by: Treasury (4); the Inspector-General of Taxation (2); and the Board of Taxation in conjunction with Treasury (1).

The legislative changes to the penalty regime and interest charge provisions (introduction of the Shortfall Interest Charge) were enacted by *Tax Laws Amendment (Improvement of Self Assessment Act (No 1) 2005* and the *Shortfall Interest Charge (Imposition) Act 2005*.⁴⁸ These changes were aimed at taxpayers whose assessments were amended to increase a liability. They created the Shortfall Interest Charge to replace the then existing General Interest Charge with a charge four percentage points lower than the General Interest Charge rate.

These changes impacted on entities who received an administrative penalty for a shortfall amount, given they were operating in a self assessing environment. The changes recognised that, in pre-amendment 'shortfall' cases, taxpayers are usually unaware of their debts, and so are unable to respond to the incentive premium of the General Interest Charge to pay their debts on time. The measure introduced a new, lower Shortfall Interest Charge in lieu of the General Interest Charge for the period before assessments are amended. This measure also allowed for the Commissioner to remit the Shortfall Interest Charge where the Commissioner considered it fair and reasonable to do so.

As well the measure amended the law to provide that when an administrative penalty applies and the Commissioner decides the penalty should not be remitted in full, the Commissioner must provide the taxpayer with an explanation of why the penalty applies and why it has not been remitted in full.

The changes to expand to the scope of the ruling system and the shortening of the periods of review (including nil assessments) were enacted by the *Tax Laws Amendment (Improvement of Self Assessment Act (No 2) 2005*.⁴⁹ A standard amendment period of two years for taxpayers with simple affairs, including most individuals and very small business taxpayers was implemented.

The amendment period for other taxpayers, such as taxpayers with complex affairs and large businesses, generally remained at four years. The amendment period for loss and nil liability returns was made the same as for a return incurring a positive liability. The amendment period for assessments where a taxpayer sought a scheme benefit in

⁴⁴ Treasury, *Report on Aspects of Income Tax Self Assessment*, (August 2004).

⁴⁵ For example, ROSA recommendation 4.3 adopts *Report No 326* recommendation 37 and the *A Tax System Redesigned* recommendation 3.4; ROSA recommendation 3.1 adopts ANTS recommendation for reducing from four to two years the period in which the ATO can amend assessments of wage and salary earners and ROSA recommendation 2.2 adopts ANTS recommendation for expanding the scope of legally binding rulings and the *A Tax System Redesigned* recommendation 3.1.

⁴⁶ Treasurer, "Outcome of the Review of Aspects of Income Tax Self Assessment", Press Release No 106, 16 December 2004.

⁴⁷ See Australian Taxation Office, "Review of Aspects of Income Self Assessment (ROSA): Briefing to National Tax Liaison Group" - June 2005.

⁴⁸ Received Royal Assent on 29 June 2005.

⁴⁹ Received Royal Assent on 19 December 2005.

relation to income tax (including where Part IVA of the *Income Tax Assessment Act 1936* (ITAA36) is invoked) was set at four years. The unlimited amendment period for cases of fraud or evasion was not changed.

The rulings system changes were intended to improve ways for taxpayers to access timely determinations on how certain laws apply, so that the risks of uncertainty when self assessing, or working out their tax obligations or entitlements, were reduced. The changes were to:

- make rulings available to many taxpayers on a wide range of matters;
- ensure that the Commissioner provides rulings in a timely manner;
- enable the Commissioner to obtain, and make rulings based on, relevant information;
- protect taxpayers from increases in tax and from penalties and interest where they rely on rulings;
- limit the ways the Commissioner can alter rulings to a taxpayer's detriment; and
- give protection from interest charges where a taxpayer relies on other advice from the Commissioner, or on the Commissioner's general administrative practice.⁵⁰

The ATO claims to have implemented 10 of the administrative changes with further recommendations scheduled for finalisation by the end of March 2008.⁵¹ ATO follow-up on recommendations requiring a legislative response has been completed for 23 recommendations with work relating to the remaining six recommendations scheduled for finalisation by the end of May 2008.⁵²

The recommendation to the Board of Taxation for a review of consultation has been finalised with the Government accepting the recommendations of the Board set out in February 2007 in *Improving Australia's Tax Consultation System — A Report to the Treasurer*⁵³ on 16 August 2007.⁵⁴ The Inspector General of Taxation has also completed his two ROSA reviews, i.e. in respect of the ATO's Test Case Litigation Program⁵⁵ and whether there is a pro-revenue bias in Private Binding Rulings.⁵⁶

⁵⁰ Explanatory Memorandum *Tax Laws Amendment (Improvement of Self Assessment Bill (No 2) 2005*, Summary of Regulation Impact Statement.

⁵¹ "ROSA NTLG Briefing as 29 May 2007", in NTLG Draft Minutes for the meeting of 28 June 2007.

⁵² "ROSA NTLG Briefing as 15 August 2007", in NTLG Draft Minutes for the meeting of 5 September 2007. Update: There has not been official advice of the status of these six matters but informal advice indicates they are considered as being achieved through administrative action.

⁵³ Board of Taxation, *Improving Australia's Tax Consultation System — A Report to the Treasurer* (February 2007).

⁵⁴ Treasurer, "Improving Australia's Tax Consultation System: Report by the Board of Taxation", Press Release No 76, 16 August 2007.

⁵⁵ The review was part of Inspector General of Taxation, *Review of Tax Office Management of Part IVC litigation* (28 April 2006). The report was publicly released on 7 August 2006.

⁵⁶ Inspector General of Taxation, *Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters* (16 December 2007). The Review commenced on 25 August 2005.

F Current initiatives

On the matters referred to Treasury, since the 2005 legislative changes, there had been no action until the then Minister for Revenue and Assistant Treasurer announced:

- on 27 March 2007 that the Board of Taxation would consult publicly on the scope to apply consistent self assessment principles across all federally administered taxes;⁵⁷
- on 26 June 2007 the release of a discussion paper examining options for reforming liability discretions in the income tax law;⁵⁸ and
- on 22 August 2007 a review into unlimited amendment periods in the income tax laws and released a discussion paper.⁵⁹

It is the scope of these reviews which is the focus of the next section of the paper.

III EVALUATING THE 2007 REVIEWS

The Board of Taxation's terms of reference in respect of its consultation on the scope to apply consistent self assessment principles across all federally administered taxes will be considered. Then the paper evaluates the Treasury discussion papers that examine options for reforming liability discretions in the income tax law and review unlimited amendment periods in the income tax laws respectively.

A Board of Taxation review of consistent self assessment principles across all federally administered taxes

The Board of Taxation has commenced a process of public consultation on the scope to apply consistent self assessment principles across all federally administered taxes (including the Goods and Services Tax [GST]).⁶⁰

The Board's terms of reference are:

- Extending the framework for legally binding rulings that currently applies to income tax and numerous other taxes to the GST and other taxes for which the Commissioner of Taxation has administrative responsibility. The goal of a single regime for rulings is considered worth pursuing for the potential benefits for practitioners and taxpayers who interact with several aspects of the tax system;

⁵⁷ Minister for Revenue and Assistant Treasurer, "Board of Taxation to Consult on Opportunities to Apply Consistent Self Assessment Principles Across All Taxes", Press Release No 26, 27 March 2007.

⁵⁸ Minister for Revenue and Assistant Treasurer, "Review of Discretions in the Income Tax Law", Press Release No 76, 26 June 2007 and Treasury, *Review of Discretions in the Income Tax Laws - Discussion Paper* (June 2007). Following ROSA recommendation 6.3, the discussion paper proposes a methodology to replace the discretions with objective tests that a taxpayer can apply when they lodge their tax return.

⁵⁹ Minister for Revenue and Assistant Treasurer, "Review of unlimited amendment periods in the income tax laws", Press Release No 103, 22 August 2007 and Treasury, *Review of Unlimited Amendment Periods in the Income Tax Laws - Discussion Paper* (August 2007).

⁶⁰ Board of Taxation "Consultation on the Application of Consistent Self Assessment Principles" at URL: http://www.taxboard.gov.au/content/self_assessment_principles.asp accessed on 7 December. As at this date this is the only detailed material on the Board's website regarding this matter.

- Applying the principle that amendment periods should approach the minimum required for the Tax Office to identify incorrect assessments and take action to correct them. Recent changes to income tax legislation reduced amendment periods for individuals and small businesses to two years.
- Applying the Shortfall Interest Charge, rather than the General Interest Charge, to cases where there is a shortfall of tax (in taxes other than income tax).⁶¹

In considering these terms of reference the Board has been asked to consider issues of symmetry between taxpayers. However, in respect of symmetry between the ATO and the taxpayer, the second point of the terms of reference simply refers to consistent and minimised amendment periods. This approach merely reinforces a view (which is discussed in more detail in respect of the Treasury discussion paper on unlimited amendment periods in the income tax laws at point C following) that the ATO/Taxpayer symmetry is too often viewed through a compliance-integrity prism. This viewpoint seems to focus on certainty for the taxpayer by giving the ATO limited but sufficient time to discover non-compliance. This is to be contrasted with giving the taxpayer ample time to discover 'non-compliance' that has resulted in too much tax being paid.

It is important to note that the Board of Taxation is seeking a consistent approach in all laws administered by the ATO. Concern has been expressed for many years of inconsistencies in the self assessment model as it operates for different taxes, in particular the *Fringe Benefits Tax Assessment Act 1986*.⁶²

Moreover there has been a consistent view expressed by peak tax professional bodies of the need to move to a single rulings model across Commonwealth taxes. This view has been consistently expressed for nearly a decade.⁶³ This need for consistency in the rulings process is all the more important because the ATO has an expanded remit with a responsibility for the administration of superannuation.

⁶¹ Ibid.

⁶² The self assessment system was applied in respect of Fringe Benefits Tax (FBT) at the same time as income tax and, unlike income tax, it was not subjected to subsequent review. As a result the self assessment process in respect of FBT still contains some crucial legislative defects. For example, there are inconsistencies between s 74(3) and s 72 of the *Fringe Benefits Tax Assessment Act 1986*. While s 74(3) still embodies the concept of "full and true disclosure" in the making of an assessment, s 72 deems the making of an assessment when the taxpayer lodges his return. This inconsistency raises the issue as to how can a full and true disclosure can be made when returns are in the main lodged electronically. The effect of this inconsistency is that the period for amendment is effectively always six years rather than the intended three year period.

⁶³ The Taxation Institute has been concerned since 1999 about the inconsistency between the ruling processes between income tax and the GST. To this end the Taxation Institute wrote to the then Treasurer on 26 August 1999 in support of the creation of a single statutory rulings system and on 14 October 1999 to the then Assistant Treasurer, Senator Rod Kemp addressing a number of issues and problems arising from GST rulings. These concerns were also expressed in a February 2000 confidential joint Taxation Institute, ICAA, CPA and Law Council submission to the ATO as well as providing comments on the recommendations on rulings contained in *A Tax System Redesigned*. The submission followed a meeting on 18 January 2000 between the ATO and these professional bodies, in which a case was made for the incorporation of GST into one formal rulings system. The Taxation Institute reinforced its view in its 28 May 2004 submission to the Treasury in response to the discussion paper - *Review of aspects of Income Tax Self Assessment* - in which the covering letter addresses the need to consider a standardised ruling system for both income tax and indirect taxes.

B Review of Discretions in the Income Tax Laws – Discussion Paper

The intention of the Review of Discretions Discussion Paper⁶⁴ is to simplify the nature and number of discretions that are available to the Commissioner under the taxation law. The Treasury paper takes a principles based approach by trying to identify overarching concerns and policy considerations to be taken into account when assessing the appropriate response to an identified discretion.⁶⁵ The paper undertakes a considerable exercise of identification and classification, as well as providing a useful working definition of discretions and their effect as:⁶⁶

[P]rovisions in the law that are not self-operating, so that the outcome depends on the Commissioner forming an opinion, attaining a state of mind, making a determination, exercising a power or refusing to do any of the above. The potential for uncertainty caused by discretions was first identified in 1991 in the government information paper, *Improvements to Self Assessment — Priority Tasks*. This paper noted that some discretions made it difficult for ‘taxpayers [to] know the consequences of transactions at the time they are undertaken.’⁶⁷

The thrust of the Discussion Paper is to circumscribe and minimise the role of discretion. The major stated benefit of doing so is to increase taxpayer certainty. It is argued that the taxpayer will be in a position to determine their liability because there is less scope for the Commissioner to ‘subjectively’ decide matters that will impact on that liability. It must be kept in mind that this is a self selected goal of the reduction of discretion. As will be argued later, certainty is not the same thing as fairness. Less discretion, of whatever sort, may make for a more rigid system incapable of responding fairly to individual circumstances.

The Discussion Paper notes that this reduction and/or circumscribing of discretions has been a consistent theme across federal governments. As far back as 1991 it was said that:⁶⁸

Where possible, Commissioner discretions used when ascertaining assessable income will be removed from the Act. In most cases the discretion will be replaced with specific criteria or objective tests to which the taxpayer can refer in determining the relevant amount, apportionment, etc. If a discretion cannot be removed, the Commissioner will make a Taxation Ruling on how he would exercise the discretion, or the taxpayer can seek a Private Ruling on the matter, thereby allowing the taxpayer to self assess on that basis.

The Discussion Paper also notes that, even if discretions are not reduced in number, “it might be possible to reduce the volume of tax law considerably by presenting them in a different way.”⁶⁹

The Discussion Paper classifies the 825 discretions it identifies as:⁷⁰

- 114 liability discretions (24 relating to superannuation);
- 499 discretions relating to administrative matters (administrative discretions) (30 relating to superannuation); and

⁶⁴ *Review of Discretions Discussion Paper*, above n 58.

⁶⁵ See Appendix one for a diagrammatical representation of the policy approach.

⁶⁶ *Review of Discretions Discussion Paper*, above n 58 at 1-2.

⁶⁷ *1991 Self Assessment information paper*, above n 16 at 10.

⁶⁸ *Ibid* at 58.

⁶⁹ *Review of Discretions Discussion Paper*, above n 58 at 4.

⁷⁰ *Ibid*. The liability discretions are listed in Appendix A. The administrative discretions (grouped into sub-categories) appear in Appendix B. The superannuation-related discretions are listed in Appendix C. A complete list of all the discretions in the income tax laws (classified by type), including anti-avoidance discretions, appears at Appendix D.

- 212 discretions to prevent tax avoidance (anti-avoidance discretions) (11 relating to superannuation).

As will be discussed later the typologies of these discretions do not provide for clear boundaries. For example, although s 99A of the ITAA36 is in nature an anti avoidance provision, the discretion in s 99A(2) could be classified as a liability discretion. Although Appendix A of the Discussion Paper seems to contain most of the key liability discretions, there are omissions from the administrative discretions such as s 319(2) of the ITAA36.

This classification conundrum is to be expected and raises some concerns as to just how principled the review approach can be in practice. The discretion targeted for eradication is the so called liability discretion. It is asserted that, from the 1991 Paper, liability discretions have been avoided wherever possible. The Tax Law Improvement Project (which rewrote many of the tax laws and ultimately resulted in the *Income Tax Assessment Act 1997* (ITAA97)) is credited with reducing these discretions. However, a number of liability discretions still exist in the ITAA36.

The Discussion Paper takes the expression ‘liability discretions’ to mean those that authorise the Commissioner to make decisions affecting assessable income, taxable income and/or tax payable on taxable income.⁷¹ It is considered that these are to be contrasted with the ‘good’ administrative discretions, such as the Commissioner’s power to vary the time or specify the form in which information should be presented. These ‘administrative discretions’ are generally touted in the Discussion Paper as necessary for the effective operation of the tax system, allowing the Commissioner to focus on practical compliance rather than the letter of the law.⁷² Similarly, some discretions are considered necessary to prevent tax avoidance. Why this classification of liability discretion versus the rest is put in terms of constrain versus accept seems spurious. It is obvious that tax avoidance discretions will determine the quantum of tax a taxpayer is liable to pay. Less directly administrative discretions will do the same, for example the waiving of a lodgment deadline may mean a penalty is avoided or a concession accessed.

It is asserted that the potential operation of liability discretions is a serious flaw in our self assessment system. Tax liabilities may remain uncertain for years after lodgment of a tax return because of the pending (or possible) exercise of a discretion by a Commissioner that affects liability. Taxpayers need to be able to exercise objective reasonableness to determine their liability and not be penalised if that is subsequently disputed. The passage of time between lodgment of a return and the final exercise by the Commissioner is not limited by a test of reasonableness. Also, by the time a discretion is exercised, it may not be possible for the Commissioner to reasonably take into account circumstances that might have existed at the time of lodgment of the tax return. It is not fair for a discretion to be exercised with hindsight. Therefore, any proposal to introduce a greater test of reasonableness, and objectivity is supported.

There can be no basic objection to replacing liability discretions with objective tests. But there is the risk, particularly where there is rewriting of long standing discretion provisions, that an objective test will not be consistent with its original policy. This could result in a narrowing of the practical scope of the discretion without a review of the validity of the original policy position. This can occur where the Commissioner applies a discretion in circumstances not expressly contemplated at the time the

⁷¹ Ibid at 10.

⁷² Ibid at 8.

discretion was enacted. This variation may have occurred due to the courts having adopted an alternative interpretation. For example, the scope of discretion in the domicile test in s 6(1) of the ITAA36 definition of a “resident” or “resident of Australia” has been widened due to the Federal Court’s interpretation of “permanent place of abode” in *Applegate v Federal Commissioner of Taxation*.⁷³ As a result the domicile test also fails to meet its legislative intention of capturing government workers (i.e., the purpose of the domicile test was to extend the scope of the Act to ensure that “. . . Agent-Generals for the Australian States together with members of their staffs, to be treated as residents”⁷⁴).

In a self assessment environment there is also value in seeking to standardise administrative discretions.⁷⁵ Although there may be good small “p” policy for a number of variations to what are similar compliance requirements, such variations create confusion and add to compliance costs. For example the system could be simplified either by using only one form for all elections or an election is deemed to be made on the basis of disclosures in the tax return. Instead of having a specific process for making that election, notification or choice there are confusing multiple alternatives for notifying the Commissioner of an election, transaction or event. It is arguable that this confusion has origins in the adoption of self assessment, which resulted in elections that were lodged with returns being retained. Subsequently, under new tax policy developments decisions were made to require the receipt of information on lodgment. In fact many elections, notices etc:

- are not required in writing (e.g. the choices under the Capital Gains Tax rules do not have to be lodged with the Commissioner);
- have to be lodged and kept by the taxpayer;
- have to be in a prescribed form and others do not; and
- have to be in writing separately from an income tax return and others can be lodged with, or triggered by, the lodging of a tax return.

Any combination of these requirements can apply to an election, notification or choice. For example, the range of elections that have to be in writing and lodged include:

- elections by primary producers under s 392-25 of the ITAA97 that averaging not apply;
- elections by companies under s 319(2) of the ITAA36 of a new statutory accounting period under the Controlled Foreign Company rules; and
- requests by a trustee under s 99A(2) of the ITAA36 for the Commissioner not to apply s 99A of the ITAA36 to income of a trust, to which no beneficiary is entitled.

Similarly, examples where elections must be in writing but not lodged include:

- a notice of a nominated replacement car under s 28-130 of the ITAA97 for the purposes of the substantiation rules;
- elections under s 139B(2) of the ITAA36 for the discount on shares to be assessed in year of acquisition; and

⁷³ *Applegate v Federal Commissioner of Taxation* (1979) 9 ATR 899; 79 ATC 4307.

⁷⁴ *Explanatory Notes, Bill to Amend the Income Tax Assessment Act 1922-1929 (Cth)*, 10.

⁷⁵ The following discussion in this section has been in part sourced from Michael Dirkis “Exposing the forgotten stepchild: The poor execution in compliance and administration” (paper presented at the Australian Tax Research Foundation’s Executing Australia’s Income Tax conference, Sydney, 20 October 2006).

- elections to rollover part of an eligible termination payment (ETP) under s 27D of the ITAA36.

A second area of concern in respect of administrative discretions is the use throughout the tax laws of the requirement that, in providing information to the Commissioner, it must be "in the approved form". Drafters have often included as a matter of practice the requirement to supply information "in the approved form". The problem is that in many cases there is no prescribed form. This causes confusion and additional compliance costs as taxpayers search for non-existent forms. One example is s 284-225(1) of the *Taxation Administration Act 1953* (the TAA), which provides for the reduction of the base penalty amount by 20 percent if certain criteria are satisfied. In order to take advantage of s 284-225(1), s 284-225(2) requires the taxpayer to voluntarily tell the Commissioner "in the approved form" about any shortfall, but there is no such form. Subsection 388-50(1) of the TAA stipulates that a statement or other document under a taxation law is in an approved form if, and only, if it is in the form approved in writing by the Commissioner for that kind of statement or other document.

In a self assessment world it can be argued that the Commissioner should have an additional power to waive certain requirements and formalities in the tax law in order to reduce compliance costs for taxpayers. This may overcome the difficulties that arise from over prescriptive law (e.g. the recent problem areas of substantiation, Family Trust Elections and ITAA36 Division 7A). A possible starting point would be the criteria setting out the circumstances where a Commissioner will apply the general administrative power i.e.:

- be consistent with the policy intent of the legislation;
- achieve substantive compliance at reduced cost;
- as far as practical reflect industry practice;
- ensure that any resulting risks to the revenue are appropriately managed;
- avoid material adverse impacts on third parties; and
- retain taxpayer choice as to whether to adopt the approach or not.⁷⁶

However, as this process operates only where the solution is consistent with the policy intent of the legislation, it will offer little relief where the legislation does not allow the Commissioner any flexibility. This limitation could be removed and replaced with a form of public benefit based test. Such a test would respond to this identified inflexibility. Though defining what is the 'public benefit' in a given situation would be subject to its own vagaries. This would be tempered by the Commissioner being accountable to articulate why the use of the general administrative power was in the public interest and over time the operation of a discretion so worded would become more certain.

Finally, certainty through brevity or excision is not the only focus when dealing with liability discretions. The Discussion Paper notes that there are approximately 70 public rulings and 45 Law Administrative Practice Statements that discuss liability

⁷⁶ Michael Carmody (Commissioner of Taxation) 'The art of tax administration -Two years on' (Paper presented on 15 April 2004 to the 6th International Conference on Tax Administration: Challenges of Globalising Tax Systems, Sydney), 4. At URL: <http://www.ato.gov.au/corporate/content.asp?doc=/content/00123108.htm> accessed 16 December 2007.

discretions.⁷⁷ As well taxpayers can request private rulings. In this way the paper notes that taxpayers can get certainty in their tax affairs. Though there is no reason that the same argument can not be advanced for administrative and anti-avoidance discretions.⁷⁸

Again it needs to be borne in mind that certainty of outcome does not necessarily equate to fairness of outcome. In a self assessment environment the need for certainty is obvious. Without it the taxpayer is at risk with respect to decisions they must make in determining their tax liability should the Commissioner unexpectedly exercise the relevant discretion in a manner adverse to the taxpayer. However, a rigid, yet certain, pro-revenue, set of 'objective' tests replacing discretions may not be a fair replacement for the taxpayer.

C Review of Unlimited Amendment Periods in the Income Tax Laws

The ability to amend assessments is central to the operation of self assessment in the Australian tax system. By exploring some of the themes running through the *Review of Unlimited Amendment Periods in the Income Tax Laws – Discussion Paper* (the Discussion Paper)⁷⁹ it is proposed to provide insight into the power balance between the taxpayer and the ATO. More importantly it can demonstrate where the Treasury sees that balance being struck into the future.

In summary the Discussion Paper seeks to advance ROSA recommendation 3.7 by examining unlimited amendment periods and proposing to replace most of them with either standard amendment periods, fixed amendment periods, or amendment periods based on a contingent event. The provisions considered in the paper include the superannuation and income dependent levies such as the Medicare levy. The GST and other indirect taxes are not within its scope, but should be examined as part of the Board of Taxation's inquiry into applying consistent self assessment principles across all federally administered taxes. Despite the changes in 2005 to limit amendment periods, there are still over 100 situations where the period in which an amendment to an assessment can be made remains indefinite.⁸⁰

The following extracts from the Discussion Paper are instructive of the viewpoint from which the review is being advanced. Firstly, the Discussion Paper clearly acknowledges the interests of the taxpayer in having certainty in their tax affairs and the tension between this and system integrity. It points out that:

Unlimited amendment periods represent an extreme case of uncertainty, as the time to amend extends indefinitely. If that time can be limited without prejudicing the integrity and function of the system overall, the 'costs' of risk and uncertainty would be reduced.⁸¹

⁷⁷ *Review of Discretions Discussion Paper*, above n 58 at 2 and at footnote 3 it gives the example: *Taxation Ruling TR 97/24 Income tax: relief from the effects of failing to substantiate* that explains how the Tax Office exercises the discretion (in s 900-195 of the ITAA97) to grant relief where a taxpayer fails to substantiate expenses.

⁷⁸ *Ibid* at 10 notes that a project to examine certain aspects of the use of anti-avoidance provisions, including the possible redundancy of some provisions, is being considered separately by Treasury.

⁷⁹ *Review of Unlimited Amendment Periods Discussion Paper*, above n 59.

⁸⁰ *Ibid*, Appendix A. These provisions are located within the ITAA1936, the ITAA1997, the *Superannuation Industry (Supervision) Act 1993* and the *International Tax Agreements Act 1953*.

⁸¹ *Ibid*, at 7.

The Discussion Paper also acknowledges the need for symmetry between the taxpayer and tax administrator.

Unlimited amendment periods are not used exclusively to enable the Commissioner to increase taxpayer liability. Most provisions are symmetrical in that they also enable taxpayers to review their assessments to reduce their tax liability. Both cases should be treated equally when determining whether an unlimited amendment period remains appropriate for that provision.⁸²

But this call to formal equality does not address or discuss the power imbalance between the ATO and a taxpayer in respect of resources and knowledge. In fact the footnote extracted above is about the only direct statement acknowledging that taxpayers may wish to revise their assessments where they have paid too much tax. The Discussion Paper then focuses through system integrity as the prism to discuss the merits of amendment periods. Only lip service is paid to power balances and the interests of the taxpayer outside of their need for certainty. That certainty is seemingly easy to subvert in the interests of revenue collection. For example just having complex tax affairs is a reason for substantial amendment periods:

... in some instances a longer than standard amendment period is warranted to ensure that the Commissioner can apply the tax laws equitably and ensure compliance, particularly for more complex transactions. ... Verifying the details of transactions for taxpayers with complex tax affairs involving substantial amounts of money requires more comprehensive examination and thus takes longer. Delays in the verification process may be due to limited access to facts or evidence, claims of legal professional privilege that need to be resolved, administrative law remedies, delays in obtaining information or time to comment on the Commissioner's statements of facts or position papers.⁸³

If it takes so long to check matters maybe it would be better to reassess the substantive law so the events giving rise to the tax liability are more concrete or, just allocate more resources to that verification task if it is such a priority. But as can be inferred from the quote above the preferred model seems to be that the risk is left with the taxpayer over a long amendment period.

Less controversial is the position where evasion or avoidance is alleged. Even here there is the blurred and subjective boundary between tax planning and avoidance.

[V]ery long or unlimited amendment periods can be justified where taxpayers deliberately seek to evade their responsibilities or to defraud the revenue. A number of countries, including Canada, New Zealand and the United States, have legislation placing taxpayers permanently at risk if they have deliberately sought to evade their tax liabilities.⁸⁴

The Discussion Paper concludes that:

... while short amendment periods provide greater certainty for taxpayers, setting periods too short may jeopardise the capacity of the Commissioner to detect non-compliance. A balance needs to be reached between the two competing objectives.⁸⁵

That balance in the Discussion Paper seems too easily struck in favour of the revenue, leaving the taxpayer at risk for the length of the amendment periods. This debate will always be a feature of a self assessment model. A fair reading of the

⁸² Ibid.

⁸³ Ibid.

⁸⁴ The 2004 *ROSA Discussion Paper*, above n 2 at 32 Table 3.1; notes that all comparable countries have an unlimited amendment period for fraud and evasion, except for the United Kingdom where the period is 20 years and 10 months.

⁸⁵ *Review of Unlimited Amendment Periods Discussion Paper*, above n 59 at 7.

paper will recognise a stated concern for the taxpayer's position and their need for certainty. Yet, the examples used are all where that runs second (at best) to system integrity and compliance. From the extracts above it seems that being wealthy and having complex tax affairs is reason enough for certainty to be in second place to the revenue. Further, the power imbalance between the taxpayer and the ATO once mentioned barely rates serious exploration in the paper.

These issues are further considered in the context of the Discussion Paper's seven reform principles.

Principle 1: Unlimited Amendment Periods for circumstances that can be dealt with within the general rules should be removed

Unobjectionably, if there is sufficient time for the Commissioner to examine the claim and make any necessary amendments to the relevant assessment and there is no continuing compelling reason for having a special amendment period, the unlimited amendment period will be repealed.⁸⁶ As we will see under the following principles the Discussion Paper finds space for extended, if not unlimited, amendment periods to protect system integrity at the cost of taxpayer certainty.

Principle 2: Unlimited Amendment Periods for circumstances that will take more than four years to verify because of unusual complexity or other factors should have a longer fixed amendment period.

Transfer pricing is the key area the Discussion Paper identifies where Principle 2 could apply.⁸⁷ The Discussion Paper argues that general rules which allow for a two-year or four-year amendment period may not be sufficient to examine cases such as transfer pricing, due to the complexity of those transactions and the difficulty in obtaining verification information.⁸⁸ Nevertheless it argues that, even for these cases, a finite amendment period may be more appropriate than an unlimited amendment period. It suggests that the timeframe for a longer amendment period should be sufficient for the Commissioner to ensure compliance, but not so long as to create unwarranted risk and uncertainty for taxpayers involved. It suggests a compromise of eight years, from the time the Commissioner gives the taxpayer the notice of assessment as being the more appropriate amendment period.

However, in the context of transfer pricing this argument is flawed. Given the information requirement imposed under the Schedule 25A Disclosure Statement and the significant transfer pricing documentation requirements (costing between \$50,000 and \$100,000 for simple cases), this argument is difficult to sustain as the information is available to the ATO. Rather, we see the revenue being protected at the cost of certainty in a self assessment environment. By and large it is the taxpayer that is bearing the cost.

Principle 3: Unlimited Amendment Periods for circumstances that arise because of a future event should be based upon a set time after the Commissioner is notified that the event has occurred.

This is the most contentious of all the principles as it seems to reverse self assessment by imposing further notification obligations on taxpayers. Further, as the Discussion Paper recommends the application of this principle in over 70% of

⁸⁶ Ibid. The Discussion Paper identifies 36 situations that require repeal.

⁸⁷ Ibid at 11.

⁸⁸ Ibid.

identified cases of unlimited amendment periods listed in Appendix A to the Discussion Paper (80 provisions out of a total of 119), so there is still considerable scope for taxpayers to be subject to unlimited amendment periods.⁸⁹

The Discussion Paper provides a number of examples of provisions that currently have unlimited amendment periods to enable the amendment of assessments to be based on an event that may occur at an unknown time in the future, usually outside the general amendment periods of two or four years. Examples cited include ss 51AH (which denies deductions where expenses incurred by an employee are reimbursed) and 82KL (which denies deductions in respect of certain recouped expenditure) of the ITAA36. The Discussion Paper argues that the standard amendment period would often render the Commissioner unable to amend assessments to prevent taxpayers retaining deductions where they have ultimately not incurred the expense themselves.⁹⁰

However, an unlimited amendment period that leaves taxpayers at risk indefinitely is unnecessary. Any amendment should occur within a reasonable time after the relevant contingent event occurs. In the above case the contingent event would be when the Commissioner is notified of the recoupment of the expense. If no notification occurs, the timeframe for amendment would remain open.

Despite all this, as acknowledged in the Discussion Paper, the bottom line is that this principle will not achieve finality for all taxpayers.⁹¹ The taxpayer carries the onus of notifying the Commissioner that the prescribed contingent event has occurred. Without this notification, the benefit of a limited review period will not be triggered and the amendment period for matters related to the contingent event will remain indefinite. From the perspective of this paper it is not an answer to this point to assume that taxpayers in this position would generally have the services of tax adviser. The onus has been placed on the taxpayer rather than the ATO and that is the focus of this paper, not the compliance costs imposed by this onus.

Principle 4: Unlimited Amendment Periods (other than for fraud or evasion) should only be retained in exceptional circumstances.

The Discussion Paper argues fairly and logically that unlimited amendment periods will remain in cases where:

- the basis for the amendment power is that the Commissioner is of the opinion there has been fraud or evasion;
- where there is a need to give effect to a decision on a review or appeal, or as a result of an objection made by a taxpayer; or
- where absolutely necessary to give reasonable effect to the provision.⁹²

Principle 5: Amendments to prior year assessments to give effect to changes in the law brought about by amending Acts should be made within 2 years of Royal Assent of the amending Act.

This recommendation applies to 80 Acts amending tax legislation passed between 1991 and 2005 where unlimited amendment periods are included as a standard

⁸⁹ Ibid.

⁹⁰ Ibid at 13.

⁹¹ Ibid at 12.

⁹² Ibid at 14-15.

feature.⁹³ This clause was often inserted due to uncertainty surrounding the timing of the passage of an amending Act. The clause effectively disables the time limits imposed by the tax legislation to allow the Commissioner to amend assessments in line with the new law regardless of whether the legislation is delayed in Parliament or whether the legislation was to apply retrospectively. It places no time restriction on the Commissioner's power to give effect to the amended law.

To close off existing unlimited amendment period provisions of this type, the Discussion Paper suggests amendments could be made so that these periods of review expire two years after a nominated date (e.g. the date of Royal Assent of the Act amending other unlimited amendment periods as the outcome of this Review). The Commissioner would therefore retain the capacity to amend assessments as a result of these Acts, but would be limited to doing so within a specified time.

This does not require further discussion as it is an appropriate response to over zealous drafting which was aimed at revenue protection and made in the context of an avalanche of legislative change.

Principle 6: *A finite period of review should apply even though taxpayers who have lodged a return do not receive a notice of assessment.*

This issue is probably not strictly speaking one where the legislation imposes an unlimited period of review. Rather it is illustrative of a processing failure arising from the impact of the ROSA.⁹⁴ The effect of the *Tax Laws Amendment (Improvements to Self Assessment) Act (No 2) 2005*, which arises from ROSA, is to:

- amend the definition of assessment in s 6(1) of the ITAA 1936 to include the fact that an assessment exists where there is an ascertainment that there is no tax payable; and
- amend s 170(1) of the ITAA36, Item 4, such that the period for amendment of a trust is limited to four years from the day the Commissioner gives the taxpayer notice of the assessment.

However, in December 2005, prior to the royal assent and in the middle of an income year, the ATO stopped issuing non-tax notices to trustees of trusts. This effectively means that where a trust has no taxable income its period for review is unlimited.⁹⁵ There appears to be both legislative and administrative concerns underlying the decision.

On the legislative side the ATO argues that:

Whilst it may be possible to issue nil assessments from information included in a trust return, this would not cover all potential trustee assessments which could arise from a trust return, for example section 98 default beneficiary assessments - such default beneficiaries would not have been included in the distribution statement for nil assessment purposes (because they would not be considered to have a present entitlement). Any assessment subsequently issued to them (or rather to the trustee) would be a nil assessment for which the Commissioner would have unlimited time to issue.⁹⁶

⁹³ Ibid; a list of the 80 Acts with the generic unlimited amendment period is in Table B.

⁹⁴ ROSA Discussion Paper above n 2.

⁹⁵ At the NTLG meeting of 5 September 2006 the ATO confirmed that "Under existing practices, a notice of assessment is not issued to a trustee unless there is a positive amount of tax to which the trustee is to be assessed. This means that for the various types of trustee assessment provided for in Division 6 of the ITAA36, where no tax is payable for the year of income, no period of review would commence under current legislative arrangements" - see NTLG Draft Minutes for the meeting of 5 September 2006 - Item 14.

⁹⁶ See NTLG Agenda for the meeting of 7 December 2006 - Item 23.

Similarly, where there is nil income, it is difficult to satisfy the present entitlement under the various assessing rules.

On the administrative side the ATO advised:

Issuing notices for the full range of non-taxable circumstances for each trustee would create significant administrative difficulties for the Commissioner, as there are over 450,000 non-taxable trusts. Compliance costs would also be increased as the Tax Office does not currently collect the required information to identify the range of nil assessments for which the trustee may potentially be liable. A redesign of the trust return form would be required to capture this information to facilitate the generation of the required assessment notices.⁹⁷

In the context of the current major rebuild of the ATO's processing systems (the so-called "Change Program") it is understandable that the ATO is reluctant to commit the resources to redesign systems that will become redundant in 12 months.

The ATO also argues that to proceed down this line would also create additional reverse work flows for tax agents as the ATO currently accepts and processes these tax returns where tax agents have not completed the beneficiary details in the 'Statement of distribution' section of the Trust tax return. The ATO warns that should it ". . . be required to issue notices of assessment to trustees, those returns that do not disclose the beneficiary details and the relevant assessment calculation code would be considered incomplete."⁹⁸

Thus, the ATO proposes to adopt an interim administrative solution which:

. . . would involve a binding undertaking by the Commissioner not to issue an original assessment (of a positive amount) to the trustee beyond the usual review period, except where there has been fraud or evasion. This would give comfort to trustees wanting certainty for a particular income year. It would ensure fairness and equity of treatment for trustees with nil liability or loss returns.⁹⁹

Also, the ATO has adopted an administrative practice not to issue an original assessment (of a positive amount) to the trustee beyond the usual review period, except where there has been fraud or evasion. The ATO has foreshadowed that an amendment to the law might be required to clarify this area. This illustrates poor tax policy implementation. The ATO neither considered the difficulties of implementing these ROSA changes, nor did it upgrade its information requirements in light of a perceived risk. As a result the potential compliance costs and risks are increased for taxpayers.

The proposed solution in the Discussion Paper is to only allow the Commissioner to raise an assessment within four years from the later of the due date for lodgement of the return or the actual lodgement of the return would effectively provide an amendment period for trustees who had not received an assessment.¹⁰⁰ Whether this legislative change is necessary remains an open question.

Principle 7: Transitional arrangements should close off amendments to assessments from previous years, after allowing the Tax Office sufficient time to review past assessments.

This is a procedural matter and the Discussion Paper sets out the scope of possible transitional arrangements.¹⁰¹ It argues that the transitional arrangements should close

97 See NTLG Draft Minutes for the meeting of 5 September 2006 – Item 14.

98 Above, n 96.

99 Above, n 97.

¹⁰⁰ *Review of Unlimited Amendment Periods Discussion Paper*, above n 59 at 17.

¹⁰¹ *Ibid* at 18.

off assessments from previous years, after giving the ATO time to complete reviews of past assessments. Transitional arrangements need to ensure the Commissioner has no less time than the proposed new amendment periods to finalise prior year returns.

IV HAS THE IMBALANCE BEEN ADDRESSED?

It is essential that for any tax system to operate effectively it should be *perceived* as equitable, both in the way tax is levied and in the administration of the system. Therefore the focus on any reform should be on the objectives of self assessment and how the costs and burdens of achieving these objectives ought to be shared more equitably. It will be remembered that the Asprey Committee, in considering the essential aims of efficiency, fairness and simplicity in a tax system, said:

Thus, the Committee is to consider the effects of the system upon the 'economic and efficient use of the resources of Australia', the desirability that there should be a 'fair distribution of the burden of taxation', and that revenue-raising be 'by means that are not unduly complex and do not involve the public or the administration in undue difficulty, inconvenience or expense.'¹⁰²

In the Taxation Institute's 28 May 2004 submission on the original ROSA proposals it was stressed that, although it supported a reduction in the ATO's periods of time to amend, it did not support the rationale behind matching review periods for the ATO and taxpayers. Underlying the Taxation Institute's position is that the Treasury rationale for symmetry is flawed as it proceeds on the basis that the Commissioner and taxpayers are on an equal footing. As the Commissioner still retains a dominant position longer periods of review are needed to give taxpayers the time to vary returns where they have made a mistake or where there is an ATO error.¹⁰³ Here the role of tax advisers in the tax system is of course important. However, in the context of an exploration of the principles underlying the self assessment system their role is outside the direct scope of this paper which is an analysis of the bilateral relationship of taxpayer and ATO.

Given ATO dominance in the relationship, there is little reason to continue the matching principle in respect of the taxpayer's review period. Consequently, the periods for review no longer need to match and the time period for credit assessment should be unlimited. Alternatively, an overarching provision should be introduced to extend amendment periods in such circumstances.

V CONCLUSION

It must not be forgotten in any review in this area that self assessment was the direct result of a desire to reduce the overheads of the tax administrator. What was lost in that 1986 decision making process was the adverse and inequitable impacts of placing the responsibility for determining taxpayers' tax liability on those taxpayers without giving them the tools to do so. These impacts are further compounded by the fact that over the same period the law has become more voluminous and complex (the Income Tax Acts alone growing from about 4,000 pages in 1998 to over 9,000 in 2007).

¹⁰² Preliminary Report of the Taxation Review Committee (Asprey Committee) June 1974 at para 3.6. See also *A Tax System Redesigned* above, n 32 at 15-17.

¹⁰³ Deductions for self-education expenses were handled incorrectly in *TaxPack* for a number of years. When the error was discovered, many taxpayers were unable to access refunds because the 4 year period for amendment had elapsed. Thus, an ATO error resulted in a significant windfall gain for the ATO.

The legislative changes in 1992 and 2005 and the implementation of (or progress towards) the majority of the administrative recommendations of ROSA do suggest some major steps have been taken in redressing those fundamental policy failures. Yet the Treasury discussion papers still reveal a fundamental failure to recognise the continuing power imbalance between the majority of taxpayers and the ATO. The papers focus on compliance not equity. Therefore, it is not surprising that the Inspector General of Taxation has been compelled to review progress made in respect of binding advice.

In conclusion, despite self assessment reaching the historic age of majority, it is premature to declare that the self assessment reform is complete. There has been more of an asthma attack than one last gasp in the process of balanced reform.

Appendix 1:

The Policy approach set out in Treasury, *Review of Discretions in the Income Tax Laws - Discussion Paper* (June 2007), at 14.

Figure 1: Process for review of liability discretions

