Australian Government

Inspector-General of Taxation

Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office

A report to the Minister for Revenue and Assistant Treasurer

Inspector-General of Taxation

5 August 2004

Review of the Remission of the General Interest Charge for Groups of Taxpayers in Dispute with the Tax Office

A report to the Minister for Revenue and Assistant Treasurer

Inspector-General of Taxation

5 August 2004

ISBN 0 642 74243 X

Australian Government
Inspector-General of Taxation

Telephone: (02) 8239 2111
Facsimile: (02) 8239 2100

Level 19, 50 Bridge Street
SYDNEY NSW 2000
GPO Box 551
SYDNEY NSW 2001

5 August, 2004

The Hon Mal Brough, MP
Minister for Revenue and Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister

I am pleased to present to you my report outlining my findings in respect of the Review of the Remission of the General Interest Charge for groups of taxpayers in dispute with the Tax Office. The report has been prepared under section 10 of the *Inspector-General of Taxation Act 2003* (the Act).

In accordance with the requirements of section 25 of the Act, I have provided the Commissioner of Taxation with the opportunity to respond to the report's findings and his submissions on individual findings have been incorporated into the report. In finalising the report, I have fully considered all the Commissioner's comments.

I have also included as an appendix to the report the Commissioner's covering letter (dated 8 July 2004) to his response. The letter provides a fuller explanation of the Commissioner's position. I believe it is fair summary to state that the Commissioner has broadly responded positively to my findings relating to Tax Office policy and procedures.

Contrary to my findings, the Commissioner has maintained his previous stance in respect of situations involving his exercise of judgement relating to remission of General Interest Charge for specific groups of taxpayers, the subject of this review, although the Commissioner has foreshadowed a one-off remission concession. I fully endorse the Commissioner's proposal to offer a streamlined review mechanism to enable certain participants in Employee Benefit Arrangements to have their individual circumstances fully considered.

I also note that since my draft report was provided to the Commissioner for response, he has independently announced a further concession to investors in retirement villages, and a broad general interest charge remission opportunity for a large number of small business debtors not in dispute with the Tax Office.

This first review undertaken by my Office has provided many challenges due to the inherent complexity of the review topic and has provided many lessons which come from an initial process. No doubt, the lessons learnt will be carried forward to the conduct of future reviews.

I offer my thanks to the co-operative approach of Tax Office staff and the support and contribution of many professional bodies, business groups and individuals. The willingness of many to provide their time in preparing submissions and discussing issues with myself and my staff is greatly appreciated.

Yours sincerely

David Vos

David Vos AM
Inspector-General of Taxation

CONTENTS

APPENDICES

CHAPTER 1: TERMS OF REFERENCE, KEY FINDINGS AND HOW THE REVIEW WAS CONDUCTED

1.1 On 20 November 2003, the then Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, requested that the Inspector-General of Taxation review the Australian Taxation Office's (ATO or Tax Office) systems for remitting the General Interest Charge (GIC).

1.2 The request was made pursuant to paragraph 8(3)(a) of the *Inspector-General of Taxation Act 2003*.

1.3 The Minister asked that the review focus on disputed tax involving groups of taxpayers, with particular consideration to the situation of participants in Employee Benefit Arrangements.

1.4 The Government's concurrent review of the self assessment system and related discussion paper[1] has implications for the matter raised by the Minister. However, the matter was also one which was raised as a significant issue during the consultations which the Inspector-General undertook with stakeholder groups to determine a forward work program.

1.5 During these consultations, tax practitioners, taxpayer groups and industry representatives expressed substantial concerns at the ATO's approach to remitting GIC. They were particularly concerned that its approach, especially in the area of Mass Marketed Tax Effective Investments, is inconsistent with its practice elsewhere, such as in relation to Employee Benefit Arrangements. These consultations also indicated that that there is a view among accounting and tax practitioner bodies that the ATO is reluctant to use its power to remit the GIC.

1.6 The Minister's request was accepted as a priority for the work program of the Inspector-General.

---

1 Commonwealth Treasury, *Review of Aspects of Income Tax Self Assessment*, Discussion Paper, March 2004.

INTRODUCTORY COMMENTS

1.7 The circumstances which led to the creation of the disputed tax liabilities and associated interest charges under review have resulted in strong feelings of dissatisfaction amongst many participants in widely marketed tax planning arrangements that may also have a commercial orientation. Nevertheless, the opportunity to finalise an unanticipated and unwanted dispute with the ATO can be tolerable to many taxpayers when compared to the ongoing cost and uncertainty of litigation.

1.8 Equally, it can be good administrative practice for the ATO to minimise its own costs and reduce community angst by seeking to finalise old disputes where no significant principle of law is involved. The ATO states that it has implemented measures to reduce the likelihood of reoccurrence of similar situations, such as by introducing the Product Ruling system, Taxpayer Alerts and a more active market intelligence function.

1.9 Early resolution of disputes with groups of taxpayers has significant benefits. The longer the ATO and groups of taxpayers take to finalise outstanding disputes, the higher is the risk of deep seated attitudes on both sides of the dispute developing.

1.10 The Inspector-General has not reviewed the actual efficacy of the disputed arrangements or the ATO processes for achieving finalisation. However, in situations extending over many years, the issue of the amount of interest charged on underpaid tax can be a significant inhibitor to finalisation of a dispute.

1.11 As mentioned above, the efficacy of Employee Benefit Arrangements and other matters of dispute with the ATO have not been a consideration of this review. Such considerations are matters for the courts, and there is now available the benefit of judicial deliberation in a number of cases. The key issue for the review is the consistency of approach by the ATO in its application of its interest remission powers. However, part of the complexity of this review lies in the history and circumstances of the disputed arrangements.

1.12 For example, Employee Benefit Arrangements could be a quite legitimate human resource strategy to reward and retain key employees in a tax effective way. Such an arrangement may have attracted favourable opinion from the legal and accounting profession and from the ATO (and in this case, further complicated by the alleged corrupt

actions of a former senior ATO official). With the benefit of such favourable advice, less scrupulous or knowledgeable parties may then market such arrangements to a wider audience. At the other extreme, examples of arrangements involving small husband and wife businesses, operating as a company, setting up separate trust arrangements to hold untaxed profits to pay the 'employee' husband and wife business proprietors' retention and performance bonuses at some future time, which would be determined by themselves in their company director capacity, were provided in the review. In some situations, even the formal paperwork to create the trust entities is not formalised. Many situations fall between these extremes.

1.13 However, a key element of the overall situation is the reliance placed by taxpayers, particularly small businesses, on the advice and guidance of their professional advisers, particularly when it is backed up by opinions provided by credible legal and accounting professionals or the ATO (even if third hand or only of a general nature). The knowledge to identify the tax planning options, and the knowledge to even create and administer the required company and trust entities, is generally well beyond the competence of the normal small business or salary and wage taxpayer.

1.14 It is an unfortunate feature of the system that the instigators and marketers of inappropriate tax planning arrangements may not carry any risk should the ATO and courts respond adversely — the taxpayer participant usually bears the financial consequence even though the promoter fees may be substantial and the set-up and dismantling transaction costs significant. It is noted that, on 13 July 2004, the West Australian Supreme Court sentenced 3 advisers to a mass marketed arrangement involving fraud to jail terms of 5 years each for conspiring to defraud the Commonwealth. It is also noted that the Government has flagged the introduction of legislation proposing penalties for tax avoidance promoters in appropriate circumstances.[2]

1.15 In an environment with the identified range of circumstances leading to large groups of taxpayers having disputes over their tax affairs, the large challenge facing the ATO is maintaining overall integrity and equity in the tax system while having regard to the individual circumstances of taxpayers.

---

2 The Assistant Treasurer, Press Release C117/03 — Crackdown on Promoters of Tax Avoidance and Tax Evasion, dated 5 December 2003.

1.16 Where there are situations of disputes involving large numbers of taxpayers with varying circumstances, thus creating significant administrative workloads inhibiting individual consideration, the onus must be to err on the side of empathy with affected taxpayers if the overall circumstance warrants (rather than focus predominantly on the actual tax planning event).

1.17 Egregious game players should suffer appropriate penalty but not to the detriment of those who have allowed the benefits of a marketed plan and natural reliance on advisers to influence their normal judgment and behaviour.

1.18 There are risks associated with generalised treatments where sheer numbers prevent the normally expected individual attention associated with individual disputes. These risks need to be weighed against the broader negative reaction and ongoing compliance attitudes that can arise when the tax consequences are out of kilter with expectations of fair treatment.

1.19 While individual participants in many of the disputes under consideration had the potential to achieve attractive tax savings, the end outcome is that many are victims of circumstances which have carried social, emotional, business and financial costs going well beyond the amount of tax involved. It is noted that the ATO acknowledged and responded to this exceptional situation in respect of Mass Marketed Tax Effective Investment arrangements.

1.20 In undertaking this review, care has been taken to avoid standing in the shoes of the Commissioner in respect of making individual judgements on specific cases. That responsibility clearly rests with the Commissioner, and various review rights are available to aggrieved taxpayers. The focus of the review has been on the broader systemic approach and conduct of the ATO. The Inspector-General cannot direct the Commissioner (other than to supply documents or information in respect of a review).

TERMS OF REFERENCE FOR THE REVIEW

1.21 The terms of reference for the review were as follows.

1.22 The review will investigate the administration of GIC remission in cases of tax disputes where settlement offers involving groups of taxpayers have been made. It will especially consider the following:

- the Commissioner of Taxation's policy for remitting GIC for disputes involving groups of taxpayers;
- the distinguishing features of each group of taxpayers who are in dispute with the ATO;
- the manner in which any remission policy is applied to such groups of taxpayers in dispute with the ATO;
- the manner in which any GIC remission policy is applied to taxpayers involved in arrangements which the ATO has classified as Employee Benefit Arrangements. These arrangements are: employee benefit trust arrangements, employee share or incentive plans, offshore superannuation schemes and controlling interest superannuation arrangements; and
- the degree to which the policy applied to taxpayers involved in Employee Benefit Arrangements is appropriate and consistent with that applied to other groups of taxpayers in dispute with the ATO.

HOW THE REVIEW WAS CONDUCTED

1.23 The announcement of the review was reported both in the press[3] and in specialist accounting and legal publications. The review was also announced on the Inspector-General's website at www.igt.gov.au on 8 January 2004.

---

3 Inspector-General of Taxation, Media Release 'Inspector-General of Taxation Announces Terms of Reference for Review of Remission of General Interest Charge', dated 7 January 2004.

1.24 Written submissions on the review were taken from members of the public generally and a number of particular people and organisations. In addition, members of the review team, together with the Inspector-General (in a number of cases), met or consulted with representatives of a number of bodies relevant to the review, including the Commonwealth Ombudsman and Australian National Audit Office.

1.25 The Commissioner of Taxation was asked to provide information and documents relevant to the review. Visits were made to the Moonee Ponds and Northbridge offices of the ATO by staff of the Inspector-General to examine relevant files and interview relevant ATO officers. The Inspector-General and his staff also met with the Commissioner of Taxation to discuss aspects of the review.

1.26 The Commissioner of Taxation was also given an opportunity to make submissions to the Inspector-General in relation to the report. The Commissioner's letter in response has been attached to the report as Appendix 1. Specific responses to the key and subsidiary findings have been included in the report and the appendices to the report.

Other recent inquiries

1.27 Significantly, this review coincided with the Review of Aspects of Income Tax Self Assessment, conducted by the Australian Government Department of the Treasury. As indicated above, a discussion paper in relation to this review was released in March 2004.

1.28 The recent report on the ATO's Management of Aggressive Tax Planning by the Australian National Audit Office is also relevant.[4]

SUMMARY OF KEY FINDINGS

Key Finding 1

1.29 The legislative provisions authorising interest remission for the pre-amended assessment period provide the Commissioner with a broad power to remit the interest charge.

---

4 Australian National Audit Office, *The Australian Taxation Office's Management of Aggressive Tax Planning*, Audit Report No. 23 2003-4.

1.30 However, the Commissioner has adopted a narrow approach regarding the circumstances in which the interest remission power will be exercised.

1.31 This has meant that, particularly where interest has accrued over a period of up to four or six years, the pre-amended assessment interest charge without remission may have a far broader and punitive-like effect. The interest remission guidelines must be flexible and responsive to remove inappropriate punitive-like consequences where out of the ordinary circumstances exist.

Key Finding 2

1.32 Prior to 1992, the Commissioner had an established policy that the remission power for interest, or its equivalent, for the pre-amended assessment period would only be exercised in exceptional circumstances.

1.33 With the 1992 legislative amendments to the penalty and interest provisions, including the introduction of the interest 'uplift' factor, the Commissioner did not revise his previous policy regarding the circumstances in which the interest remission power would be exercised.

1.34 As such, there was no detailed policy framework for the remission of the pre-amended assessment interest for the years of income from 1992/93 up to and including 1999/2000.

1.35 For the years of income 2000/01 and onwards, the ATO's Receivables Policy does not provide sufficient guidance to the public on how the interest remission power is to be exercised for the pre-amended assessment period.

1.36 For this reason, tax administration would benefit if the Commissioner published a separate policy document which provides clear guidelines on his policy, covering the current and prior years, for remission of the interest charge.

1.37 The policy should include the different considerations relevant to determining whether remission of the interest charge is warranted for either or both the pre-amended and post-amended assessment periods.

Key Finding 3

1.38 Although disputes involving different groups of taxpayers may have distinguishing features including the nature, complexity and sophistication of the arrangements, at the taxpayer level there are more common features between the individuals forming part of each group than points of differentiation. These include a broad array of investors, targeted marketing techniques, prior ATO advice/advance opinions/rulings and ATO time delays.

1.39 Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.

Key Finding 4

1.40 Administrative procedures regarding the remission of the interest charge for groups of taxpayers require that an appropriate balance is achieved between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer in accordance with the Taxpayers' Charter.

1.41 To date, the approach of the Commissioner suggests more focus has been on considerations of administrative efficiency as opposed to an examination of a taxpayer's individual conduct and circumstances. In particular, considerations of the type and nature of the arrangement and the extent to which members of a group share certain further characteristics have overshadowed consideration of the conduct and circumstances for each individual.

Key Finding 5

1.42 There are a variety of factors that the ATO has considered relevant in the statutory reduction and remission of penalties. These factors may also be relevant in considering the remission of the interest charge for groups of taxpayers in dispute with the ATO.

Key Finding 6

1.43 For certain investors in Mass Marketed Tax Effective Investments (MMTEIs) the ATO set up a formal process, which also involved separate ATO internal review procedures, for the remission of interest and other elements contained in the standardised settlement arrangements. A similar process has not been established for participants in Employee Benefit Arrangements (EBAs).

1.44 The actual formal structure of this process for certain MMTEI investors, and its accompanying review procedures, were well documented within the ATO and transparent to taxpayers.

1.45 Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977*. This is a costly and lengthy process.

1.46 Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.

1.47 However, any such review process would need to operate according to the overriding principle that all individual circumstances relating to particular taxpayers are taken into account during the operation of this process.

1.48 In particular, considerations of the extent to which taxpayers who are subject to this review process are members of a particular group, or share certain other characteristics of other taxpayers who are subject to the same process, should not override consideration of the conduct and circumstances of each individual.

Key Finding 7

1.49 Taxpayers who are members of groups of taxpayers in dispute with the ATO over arrangements frequently share a range of common features. Some of these features were identified by the ATO and used to determine the final settlement offer that was made to the majority of MMTEI investors. In the ATO's view, these common features suggested

the existence of exceptional circumstances which justified applying an interest remission policy which led to the interest charge being reduced to nil.

1.50 The present ATO treatment of pre- and post-amended assessment interest charges for taxpayers involved in EBAs has focussed principally on the nature of the arrangement giving rise to the particular dispute. For taxpayers involved in three kinds of EBAs full interest has been charged while for taxpayers involved in one form of EBA a reduced interest rate has been applied.

1.51 This focus on the nature of the arrangement in EBA disputes appears to have led to taxpayers involved in EBA disputes receiving interest remission outcomes which are inconsistent with those received by other groups of taxpayers. It has also led to taxpayers involved in certain types of EBAs receiving interest remission outcomes which are not consistent with those applied to taxpayers involved in other forms of EBAs.

NATURE AND PURPOSE OF THE GENERAL INTEREST CHARGE

Imposition of interest

1.52 Interest is one of the additional amounts payable when an assessment is amended by the ATO to increase the amount of tax payable by a taxpayer. The other additional amounts that are payable in this situation are the additional tax itself (called 'primary tax' in this report) and any administrative penalty that the underpayment may attract.

1.53 Interest payable in respect of an amended assessment is automatically imposed on taxpayers, under specific legislative provisions. This interest will consist of pre-amended assessment interest (being the interest which is levied up to the time when the amended assessment is issued) and post-amended assessment interest (being the interest that is levied if the amended assessment is not paid by its due date). The ATO has always had the power to remit both these forms of interest.

Pre-amended assessment interest

1.54 Pre-amended assessment interest arises in the following circumstances. Under the self assessment system, taxpayers generally self assess their tax liability; that is, they lodge their returns on the basis of what they consider to be the correct application of the law, without the ATO actually checking the validity of the information provided by the taxpayer. The ATO only normally undertakes investigation of a taxpayer's return some time after the return has been lodged and the relevant assessment paid. If those investigations indicate that the taxpayer has incorrectly determined their tax liability the ATO will issue an amended assessment, which will require payment of the amount of the underpaid tax together with interest on that amount (termed in this report 'pre-amended assessment interest' or 'interest on underpaid tax').

1.55 While an ATO Notice of Intention to Audit may give some prior warning, the amended assessment is generally the first indication that a taxpayer will receive advising them that the ATO does not agree with their application of the law to the relevant return. The pre-amended assessment interest that is charged in this amended assessment could therefore have accrued during a period when the taxpayer remains unaware of the fact that this interest is accruing.

Post-amended assessment interest

1.56 Post-amended assessment interest or late payment interest is the interest that is levied from the date when an amended assessment is due for payment until the date it is in fact paid. In contrast to pre-amended assessment interest this interest will therefore accrue during a period when the taxpayer is aware of this interest liability.

1.57 Because taxpayers are aware of when post-amended assessment interest starts to accrue, they can take steps to minimise the amount of post-amended assessment interest. One step which they can take, provided there is a formal dispute with the ATO, is to enter into what is known as a 50-50 payment arrangement with the ATO. Under this arrangement, provided the taxpayer pays 50 per cent of the amount of tax in dispute (including any accrued interest and penalties) the ATO will permit 50 per cent of the disputed tax amount to remain in abeyance until the dispute is finally resolved. The taxpayer will be liable for only 50 per cent of the interest calculated on the 50 per cent of tax not paid (that is, the ATO will remit 50 per cent of the interest accrued).

1.58 The focus of this review is principally on the imposition and remission of pre-amended assessment interest. This is because this interest is imposed during a period when a taxpayer is generally unaware of this interest charge and is not therefore able to undertake any steps to minimise its imposition.

Development of present interest system

1.59 The basic structure of the present system for pre-amended assessment interest was first introduced in 1992. Prior to 1992, except in certain limited cases, only a penalty was payable when an amended assessment was issued. However, this pre-1992 penalty was imposed by the ATO on the basis that it consisted of a fixed amount plus a per annum charge that was essentially equivalent to what is now known as pre-amended assessment interest.

1.60 In 1992, the law was changed so that the interest and penalty elements of the penalty for underpaid tax were imposed under separate legislative provisions.

1.61 The generally accepted policy behind the new separate interest charge for pre-amended assessment interest created in 1992 was that this interest charge was designed to compensate the Revenue for the time value of money over the period in which the taxpayer had short paid their tax. This also had the effect of achieving neutrality with those taxpayers who had fully met their tax obligations. The interest was therefore not primarily meant to be used as a mechanism to penalise taxpayers but rather to compensate the Revenue for its own borrowing costs.

1.62 From 1992, the Government intended that the new separate penalty provisions were to be the mechanism that was to be used to punish taxpayers, where appropriate, for underpayments of tax. From 1992, the amount of any penalty was set, by statute, to vary according to certain actions of the taxpayer and the degree to which their tax claims were reasonably arguable.

1.63 The rate of pre-amended assessment interest in 1992 was the 13 week Treasury note yield plus a further 4 per cent. The additional 4 per cent uplift was described by the Government as reflecting administration costs and the fact that most taxpayers would not be able to borrow at the 13 week Treasury note rate.

1.64 From 1 July 1999, the rate of pre-amended assessment interest was increased by a further 4 per cent. No explanation was given for this further increase in the Explanatory Memorandum to the Bill which introduced this uplift. There is evidence from other material which suggests that this uplift was made to discourage taxpayers from using the tax system as an unsecured mechanism for borrowing. Another view is that this increase was part of a broad simplification package for interest generally.

1.65 From 1 July 2001, the 8 per cent uplift factor in the rate of pre-amended assessment interest was reduced to 7 per cent.

1.66 Further details on the nature of the law and policy for the imposition of pre- and post-amended assessment interest are contained in Appendix 2.

ATO CONDUCT IN ISSUING AMENDED ASSESSMENTS WITH AN INTEREST CHARGE

1.67 The ATO commenced issuing amended assessments to groups of taxpayers involved in mass marketed tax effective investments in 1998. In subsequent years, it extended this activity to other groups of taxpayers who had entered into certain other investment arrangements.

1.68 The ATO issued these amended assessments up to four or, in certain cases, six years after the date on which the relevant underpaid tax was originally due. In many cases, the size of the pre-amended assessment interest component in the amended assessments outweighed the size of any culpability penalties contained in the total amended tax bill. In practice, this meant that, although pre-amended assessment interest was not meant to be imposed as a penalty, taxpayers could receive amended tax bills where the amount of culpability penalties levied were less than the amount of accrued pre-amended assessment interest.

1.69 The ATO's actions in issuing amended assessments over such extended periods, thus creating large interest liabilities, may expose flaws in the manner in which the ATO has exercised its powers of remission for interest and penalties.

Meaning of terms 'General Interest Charge' and 'Interest'

1.70 Although the terms of reference for the review refer to the remission of GIC, the current GIC regime in its present form was only introduced for the years of income commencing after 1 July 2001.

1.71 For each of the two income years between 1 July 1999 and 30 June 2001, the GIC regime operated but with certain key features that are different to the present regime.

1.72 The majority of the disputes examined for the purpose of this review actually concern years of income between 1 July 1993 and 30 June 1999. For these years of income, the interest payable by a taxpayer in a situation where their assessment is amended by the ATO prior to 30 June 1999 is not GIC. Instead, it consists of 'tax shortfall penalty interest' (which is payable for the period prior to the amendment of the assessment) and 'late payment interest' (payable from the due date of the amended assessment if this assessment is not paid).

1.73 Under transitional rules, interest payable by taxpayers in respect of these years of income consisted of GIC to the extent that interest was payable for the period prior to the issue of the amended assessment and that period accrued after 1 July 1999. It also consisted of GIC to the extent that the interest was for the late payment of the relevant amended assessment and the period of late payment arose after 1 July 1999.

1.74 Both the ATO, in its communications to affected taxpayers, and taxpayers themselves use the terms 'general interest charge' and 'interest' to embrace any interest that is payable on disputed amounts of tax. This is regardless of the year of income involved or the period during which the relevant interest has accrued. For this reason, where the terms of reference for the review and this report refer to the 'general interest charge' or ' interest' these terms cover interest payable under the interest regime that preceded the GIC as well as the GIC itself.

Acknowledgements

1.75 The Inspector-General would like to acknowledge the co-operation and assistance of many staff, at all levels, in the ATO and Department of the Treasury. This review was also greatly assisted by the contribution of many interested organisations and people in the private sector.

CHAPTER 2: INSPECTOR-GENERAL'S REPORT AND FINDINGS

2.1 This chapter details the Inspector-General's major findings in relation to each of the terms of reference of the review. It also lists a number of subsidiary findings that have arisen during the course of this review.

TERM OF REFERENCE 1: ATO POLICY ON THE REMISSION OF INTEREST

2.2 The first term of reference for this review has required the Inspector-General to examine the nature of the ATO's policy approach to remitting GIC in situations where settlement offers have involved groups of taxpayers.

2.3 In examining the Commissioner's interest remission policy for the pre-amended assessment period a number of key issues arise, each of which will be considered below, with relevant references to the appendices where greater detail is available.

Self-imposed narrow remission policy

2.4 The taxation laws, as supported by the extrinsic material, provide the Commissioner with a broad power to remit interest for the pre-amended assessment period for current and previous years of income.

2.5 The Commissioner is of the view that the interest remission provisions that apply to the years of income from 1992/93 to date, for the pre-amended assessment periods, do not grant the Commissioner an unfettered discretion to remit.[5] Rather, the Commissioner is of the view that the power to remit this interest charge will only be activated in exceptional circumstances.

---

5 Appendix 3 outlines the Commissioner's view in greater detail.

Need for a comprehensive, robust interest remission framework for the pre-amended assessment period

Years of income from 1992/93 to 1999/2000

2.6 The Commissioner has no detailed policy framework for the remission of the interest charge for the pre-amended assessment period for disputes involving years of income from 1992/93 to 1999/2000.

2.7 The Commissioner's legislative power to remit the interest charge for the underpayment of tax for these years of income is contained in section 170AA of the *Income Tax Assessment Act 1936* (ITAA 1936) (or, in the case of the 1999/2000 year only subsection 8AAG(1) of the *Tax Administration Act 1953* (TAA 1953)).

2.8 The remission power granted by these sections is stated in broad terms and contains no express requirement that it is to be exercised only in special or exceptional circumstances.[6] The approach by the Commissioner would seem to unnecessarily restrict the operation of the discretionary power afforded by Parliament to remit the interest charge.

2.9 Chapter 93 of the ATO's Receivables Policy only provides guidance for the remission of interest on the underpayment of tax for the years of income 2001 and onward. The Commissioner has also confirmed that the current Receivables Policy contains no specific guidance as to how the Commissioner will remit interest for the underpayment of tax for the years of income from 1992/93 up to and including 1999/2000.[7]

2.10 The ATO's current instruction to its staff is that the principles contained in *Taxation Ruling* IT 2444, which was issued on 27 August 1987, apply to the remission of the interest charge for the pre-amended assessment period for disputes involving years of income from 1992/93 to 1999/2000.

2.11 *Taxation Ruling* IT 2444 provides that, having regard to the compensatory nature of the interest charge, it is clear that the legislature did not intend the remission power to be exercised in the general run of cases. Rather, the Ruling identified three kinds of situations in which remission in whole or in part may be warranted and included where, by

6 As discussed in Appendix 3.
7 As discussed in Appendix 3.

reason of the particular circumstances, it was considered fair and reasonable to remit the interest.[8]

2.12 *Taxation Ruling* IT 2444 continued to express the Commissioner's view on the circumstances when the remission power would be exercised after 1 July 1992. *Taxation Ruling* IT 2444 was issued prior to a number of changes to the interest and penalty regime including the introduction of an 'uplift' factor as part of the interest charge, a divergence between the pre-amended assessment interest rate under section 170AA of the ITAA 1936 and the rate used for overpayments of tax, and a new framework for the structure of penalties for underpaid tax.

2.13 The position adopted by the Commissioner in *Taxation Ruling* IT 2444 also appears to have been carried forward into Chapter 93 of the Receivables Policy.

Years of income from 2000/01 and onward

2.14 The Commissioner's policy framework for the remission of the interest charge for the pre-amended assessment period for the 2000/01 and beyond years of income is set out in Chapter 93 of the ATO's Receivables Policy.

2.15 The Commissioner's legislative power to remit the interest charge for the underpayment of tax for these years of income is contained in section 8AAG of the TAA 1953. Under this section pre-amended assessment interest may be remitted in a number of specified situations, and in addition, where it is either fair and reasonable or otherwise appropriate to do so.[9]

2.16 Chapter 93 does not clearly indicate that it applies to pre-amended assessment interest. The opening words of the chapter actually indicate that it applies to interest for the *late payment* of tax. However the chapter also applies to pre-amended assessment interest, owing to the fact that from the year of income 2000/01 onwards pre-amended and

8 As discussed in Appendix 3.
9 As discussed in Appendix 3.

post-amended assessment interest were merged into one interest charge for the late payment of tax.[10]

Key concerns

2.17 Firstly, the current ATO's Receivables Policy does not cover disputes for the years of income from 1992/93 to 1999/2000 with only *Taxation Ruling* IT 2444 applying during this period.

2.18 Secondly, this policy does not distinguish between pre- and post-amended assessment interest and does not indicate whether there may be factors that are relevant to a decision to remit one form of interest, but not the other. It is therefore necessary that the ATO interest remission policy clarify the relevant considerations for the remission of the interest charge between the pre- and post-amended assessment periods.

2.19 Thirdly, the ATO's Receivables Policy does not provide sufficient guidance to the public on how the interest remission power is to be exercised during the pre-amended assessment period and what factors are to be taken into account in determining interest remission during this period. Good tax administration requires that taxpayers are made aware of the factors that will be taken into consideration by the Commissioner in determining whether to remit the interest charge. More importantly, the interest remission policy needs to specifically set out how the remission power will be exercised in certain circumstances, similar to the approach adopted in previous ATO guidelines, such as *Taxation Ruling* IT 2517.

2.20 This would include circumstances that have been considered relevant in the statutory reduction and remission of penalties for disputes involving groups of taxpayers, such as:

1. the ATO has contributed to the delay during the pre-amended assessment period due to operational reasons or some uncertainty as to the operation of the law;

2. the taxpayer has made a voluntary disclosure to the Commissioner regarding their taxation position and there is no evidence of any prior intention to avoid the payment of tax;

---

10 As discussed in Appendix 3.

3. there is reasonable and positive co-operation by the taxpayer during the pre-amended assessment period; and

4. there is evidence of a prior general administrative practice by the Commissioner to issue favourable advices on an issue or arrangement.

2.21 Fourthly, as has been already mentioned, the Commissioner has adopted a narrow view of how the interest remission power should be exercised, especially in the pre-amended assessment period. In doing so, the interest remission policy for the post-1992 period has neglected to consider the context in which the Commissioner's views in *Taxation Ruling* IT 2444 were originally expressed and the nature of the interest rate imposed at that time.

2.22 At the time *Taxation Ruling* IT 2444 was issued, the interest rate imposed for the underpayment of tax following an amendment to an assessment was linked to the interest rate imposed for overpayments in tax.

2.23 With the amendments in 1992 and the introduction of an 'uplift' factor to the interest charge there was a change in the possible effect of the interest charge for the pre-amended assessment period. Notwithstanding these amendments, the Commissioner did not revise his previous policy regarding the circumstances in which the interest remission power would be exercised to reflect these changes.

2.24 In this context, the influence of *Taxation Ruling* IT 2444 on the Commissioner's interest remission policy in the post-1992 period has caused a distorted view of how the discretion to remit such an interest charge should be exercised, especially in the pre-amended assessment period.

2.25 As a consequence, the narrow view adopted by the Commissioner regarding the circumstances that warrant remission of pre-amended assessment interest for the years of income 1992/93 and onward has meant that, in certain cases, particularly where this interest has accrued over a period of up to four or six years, the interest charge without remission has had a far broader and punitive-like effect.

2.26 Where the circumstances of the taxpayer mean that the interest charge in the pre-amended assessment period has a punitive-like effect and given that the purpose of the interest charge is to represent the time

value of money, the interest remission policy must be flexible so as to accommodate these circumstances and remove any punitive-like effect. Definitions of what constitutes 'special circumstances making it fair and reasonable' or 'otherwise appropriate to do so' cannot be treated as static concepts, but rather need to change as the nature and effect of the interest charge changes.

2.27 It is generally accepted that the intention of Parliament in introducing the 'uplift' factor was to serve as a disincentive to taxpayers and effect compliance by discouraging taxpayers from using the tax system as an unsecured mechanism for borrowing.

2.28 However, in the pre-amended assessment period a taxpayer may not be aware that there is an underpayment of tax. In fact, a taxpayer may genuinely believe that they have complied with all their taxation obligations under the self assessment regime. In such a situation it is unclear how the imposition of the interest charge in full without remission can serve to discourage the taxpayer from using the tax system as an unsecured mechanism for borrowing. Rather, it would be assumed that such a compliance effect would be more relevant in circumstances where a taxpayer has intentionally not complied with their taxation obligations or has delayed in the payment of tax.

2.29 In this context, the imposition of the interest charge in full without remission during the pre-amended assessment period can have a punitive-like effect even though the taxpayer's circumstances do not warrant such an outcome.

2.30 In order to ensure that the policy objectives of the interest charge are satisfied, it is important that the interest remission policy should consider the intention of Parliament in introducing the interest charge and the wording of the Act, and the nature of the interest charge and its possible effects.

2.31 That approach needs to be one that is consistent with the broad discretion that Parliament has afforded the Commissioner to remit the interest charge and also consistent with other ATO policies such as the penalty remission policy, the Compliance Model and the Taxpayers' Charter. It is also important that the approach adopted by the Commissioner in the remission of the interest charge is flexible and ensures that the principles of equity and fairness in the administration of the tax system are maintained.

2.32 As is discussed later in this chapter and in appendices 4 to 6, the Commissioner appears to have acknowledged the need for a flexible approach to how the interest remission power is exercised so as to deal with situations on their merits. This is confirmed by the instances where the Commissioner has in fact remitted the interest charge in a number of disputes involving groups of taxpayers. These disputes included mass marketed tax effective investment disputes, controlling superannuation interest disputes and disputes involving securities lending arrangements. In these disputes the Commissioner has remitted the rate of pre-amended assessment interest to either nil or to a rate which approximately equals the equivalent rate of interest for the overpayment of tax payable in respect of the particular period.

2.33 The Inspector-General's key findings in relation to the first term of reference are as follows:

KEY FINDING 1

The legislative provisions authorising interest remission for the pre-amended assessment period provide the Commissioner with a broad power to remit the interest charge.

However, the Commissioner has adopted a narrow approach regarding the circumstances in which the interest remission power will be exercised.

This has meant that, particularly where this interest has accrued over a period of up to 4 or 6 years, the pre-amended assessment interest charge without remission may have a far broader and punitive-like effect. The interest remission guidelines must be flexible and responsive to remove inappropriate punitive-like consequences where out of the ordinary circumstances exist.

Tax Office response

2.34 The broad design of the current remission powers is to provide for defined circumstances relevant to the individual, with a further power of remission where there are special circumstances or where it is otherwise appropriate.

2.35 While broad, the further remission power is not unfettered. There must be reasonable grounds for exercising it.

2.36 This can be illustrated by referring to the extrinsic material in the Explanatory Memorandum (EM) to the Taxation Laws Amendment (Self Assessment) Act 1992 which is applicable to the former interest charge provisions.

2.37 The interest remission power embodied in that Act — "The Commissioner may, in his or her discretion, remit the whole or any part of the interest payable by a taxpayer under this section." - was applicable for a large part of the pre amended assessment period for Employee Benefit Arrangements.

2.38 In relation to this broad remission power EM states at page 109:

> "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]".

2.39 In practice the remission powers under that Act and the current law have been exercised in a wide range of cases where the necessary circumstances have been found to exist.

2.40 Thus we have used that power in the context of some widely marketed schemes where there are particular circumstances warranting it. Other examples include situations where there are acknowledged gaps in the law, periods between announced changes to the law and enactment of the relevant legislation, reliance on publications (e.g. Tax Pack) in the event they prove to be misleading, so called GST "wash transactions" and where the ATO has delayed in issuing an amended assessment after gathering all relevant information necessary for the assessment.

2.41 The mere fact that interest is accumulating at the legislated rate prior to an amended assessment issuing is not, of itself, grounds for

remission. As recognised in your findings "out of the ordinary" circumstances need to exist to warrant remission.

2.42 The question of the appropriateness of the rate of GIC applying during the pre-amended assessment period is subject to examination in the Review of Income Tax Self Assessment.

Inspector-General comment

2.43 The quoted Explanatory Memorandum (EM) provides some level of historical guidance. However, it is noted that there have been legislative changes since that EM and it is the view of the Inspector-General that the matter is not as clear cut as suggested by the response.

2.44 In noting the reference to out of the ordinary circumstances, the Inspector-General observes that this issue is not necessarily directly relevant to the majority of situations under focus in this review.

KEY FINDING 2

Prior to 1992, the Commissioner had an established policy that the remission power for interest, or its equivalent, for the pre amended assessment period would only be exercised in exceptional circumstances.

With the 1992 legislative amendments to the penalty and interest provisions, including the introduction of the interest 'uplift' factor, the Commissioner did not revise his previous policy regarding the circumstances in which the interest remission power would be exercised.

As such, there was no detailed policy framework for the remission of the pre-amended assessment interest charge for the years of income from 1992/93 up to and including 1999/2000.

For the years of income 2000/01 and onwards, the ATO's Receivables Policy does not provide sufficient guidance to the public on how the interest remission power is to be exercised for the pre-amended assessment period.

KEY FINDING 2 continued

For this reason, tax administration would benefit if the Commissioner published a separate policy document which provides clear guidelines on his policy, covering the current and prior years, for the remission of the interest charge.

The policy should include the different considerations relevant to determining whether remission of the interest charge is warranted for either or both the pre-amended and post-amended assessment periods.

Tax Office response

2.45 The ATO's policy on pre-amended assessment interest articulated in Taxation Rulings IT 2444 and IT 2593 for the period prior to 1992 is relevant also for the period 1992/93 to 1999/2000. As noted in the response to Key Finding 1, the general remission power introduced in 1992 was the same as that for the immediately prior years.

2.46 The ATO's receivables policy does contain an extensive chapter on remission, including specific examples embracing the pre-amended assessment period, eg misleading publications and delays in issuing amended assessments.

2.47 However it is acknowledged that there would be benefit in publishing more practical and accessible guidelines for the community.

2.48 Community representatives, including your office and that of the Ombudsman will be consulted in finalising these guidelines.

2.49 The impact of the timing and outcomes of the Review of Income Tax Self Assessment will need to be considered in that context.

Inspector-General comment

2.50 The Tax Office states that Taxation Rulings issued prior to 1992 were current because the general remission powers were the same in later years. However, the Inspector-General notes that there were legislative changes to the actual remission powers and there were changes occurring over time in the broader commercial environment. The situation was not static over the decade.

2.51 The Inspector-General endorses the Commissioner of Taxation's acknowledgement that more practical and accessible guidelines need to be published.

TERM OF REFERENCE 2: FEATURES OF EACH GROUP OF TAXPAYERS IN DISPUTE WITH THE ATO

2.52 The second term of reference of this review involves an examination of the distinguishing features of each group of taxpayers for whom the ATO has made certain standardised settlement arrangements.

2.53 This review has examined, to varying degrees, the ATO's practices for the remission of pre-amended and post-amended assessment interest for groups of taxpayers involved in the following five types of disputes:

- Mass Marketed Tax Effective Investments (MMTEIs);
- Employee Benefit Arrangements (EBAs);
- Investments in Retirement Villages;
- Investments in Equity Linked Bonds; and
- Securities Lending Arrangements.

2.54 In an attempt to finalise the above disputes and achieve payment of the outstanding tax, the ATO has progressively offered standardised settlement arrangements, involving particular terms as regards the remission of pre-amended and post-amended assessment interest to taxpayers involved in the above disputes.

2.55 Aside from a very small number of cases, these standardised settlements were offered to affected taxpayers either on the basis that they were members of a group of people who had invested in one of the above types of arrangement or on the basis that they were members of further subgroup of investors in the particular arrangement who shared certain characteristics. These taxpayers were not offered settlement terms that were tailored to their own particular set of circumstances.

2.56 Although the grouping of taxpayers may allow for administrative efficiency, it is crucial that the overarching principles of equity and fairness within tax administration are promoted. This is ensured by

integrating flexibility within any grouped categories of arrangements so as to allow the circumstances of individual taxpayers to be considered where requested.

2.57 It is recognised that the Commissioner has finite resources to allocate to the various functions carried out by the ATO. This means that how the Commissioner approaches certain issues, such as the application of interest remission for groups of taxpayers, may involve consideration of issues of administrative efficiency. However, it is incumbent upon the ATO to adapt its operating procedures to address the individual circumstances in a manner consistent with the Taxpayers' Charter. This includes acting consistently, treating the taxpayer as an individual, listening to the taxpayer and taking all relevant circumstances into account.[11] Ensuring that this obligation is adhered to is crucial in not only promoting equity and fairness but also maintaining public confidence in the administration of the tax system.

2.58 Confidence in the administration of the tax system is not promoted if taxpayers within an arrangement are treated as a homogenous group and labels are attached to that entirety that do not reflect the true nature of the individual members of that group.

2.59 Therefore, the particular type of arrangement and how it operated should be merely one consideration in determining whether a particular settlement arrangement involving particular terms in relation to the remission of interest is warranted. That is, whether a taxpayer entered into a mass marketed tax effective investment or another arrangement should not be the key determinant of whether a taxpayer is granted a certain settlement arrangement involving a certain remission of the interest charge.

2.60 Likewise, the extent to which a taxpayer shares certain characteristics of others who have also invested in the particular arrangements (such as their level of involvement in and knowledge of the relevant arrangement and of the tax system generally) should not be the only factors considered in determining whether a particular settlement offer involving particular interest terms is appropriate.

---

11 Concerns that the ATO failed to take account of relevant circumstances were raised by the Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report June 2001. See further discussion in Appendix 3.

2.61 As outlined in further detail in Appendices 4 to 6, the above five disputes that have been examined for the purposes of this review all involve marketing techniques by promoters that especially target unsophisticated investors, mixed ATO advice and opinions on the nature of those arrangements and delays in arriving at a considered view of the efficacy of the arrangements.

2.62 Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.

2.63 An examination of all the circumstances of the taxpayers involved in these arrangements would also include factors that were considered relevant by the Commissioner for the remission of penalties. Where such factors are not also considered for relevancy in determining the remission of the interest charge, then this may give rise to an inequitable and punitive-like outcome for a taxpayer. In particular, this could arise in situations where there has been delay on the part of the ATO during the pre-amended assessment period or the taxpayer has made a voluntary disclosure to the Commissioner. More importantly, transparency would be improved if the Commissioner specifically outlined such factors and how these factors would be considered for the purposes of the remission of the interest charge.

2.64 In the Inspector-General's view, the above comments lead to the following findings:

KEY FINDING 3

Although disputes involving different groups of taxpayers may have distinguishing features including the nature, complexity and sophistication of the arrangements, at the taxpayer level there are more common features between the individuals forming part of each group than points of differentiation. These include a broad array of investors, targeted marketing techniques, prior ATO advice/advance opinions/rulings and time delays.

KEY FINDING 3 continued

Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.

KEY FINDING 4

Administrative procedures regarding the remission of the interest charge for groups of taxpayers require that an appropriate balance is achieved between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer in accordance with the Taxpayers' Charter.

To date, the approach of the Commissioner suggests more focus has been on considerations of administrative efficiency as opposed to an examination of a taxpayer's individual conduct and circumstances. In particular, considerations of the type and nature of the arrangement and the extent to which members of a group share certain further characteristics have overshadowed consideration of the conduct and circumstances for each individual.

Tax Office response

2.65 The factors listed in Key Finding 3 are amongst the factors taken into account when determining whether a settlement offer is appropriate and the terms of that settlement offer.

2.66 Of course the fact that an arrangement involves a group or groups of people does not of itself mean a settlement is appropriate. Each case needs to be considered on its merits, taking account of the circumstances surrounding the arrangements and the participants in them and the impact on the health and integrity of the tax system.

2.67 The fact that the terms of particular settlements, including interest charge remissions, generally apply equally to all investors reflect that the

reasons for the settlement generally go to the nature of the arrangements and of the investor's involvement in them.

2.68 Efficient administration is one of the matters taken into account in determining the terms of any settlement offer. For example the ability to resolve large numbers of disputes and allow resources to be more effectively employed in managing the tax system is a relevant factor in determining the final terms of a settlement.

2.69 This means that where it is appropriate to settle, the terms have generally been set at a level that is more beneficial than having regard solely to the circumstances of the various participants.

2.70 Where there are significant groups within a particular arrangement that have significant distinguishing features this may result in differentiated settlement terms. This was the case for mass marketed investment schemes where promoters and accountants were offered different terms.

2.71 Applications for further remissions outside of the general settlement terms are considered on a case-by-case basis. Given the general structure of settlements outlined above, grounds for further remission of the interest charge would generally be expected to relate to an individual participant's financial and other circumstances not directly related to the nature of the arrangement and the circumstances of the person's participation in it.

Inspector-General comment

2.72 The Inspector-General noted that the approach of the Tax Office suggests more focus has been placed on considerations of administrative efficiency rather than consideration of individual circumstances.

2.73 The Commissioner acknowledges that administrative efficiency is one factor in determining mass dispute settlements and that therefore a key element of any such settlement requires that the terms be set at a more beneficial level than having regard solely to the circumstances of participants. The Inspector-General notes that opinions differ on whether the terms offered by the Commissioner are more beneficial. If the terms are more beneficial for most participants, cases may still exist where the relevant taxpayers should be granted more concessional treatment. For these exception cases, processes must exist to ensure that the individual circumstances of the taxpayers are considered. On the other hand, if the

terms of settlement are not more beneficial to most participants, the individual circumstances of each participant need to be fully considered.

2.74 Whether full consideration of all individual circumstances has occurred is a question of fact. The Inspector-General notes the strong community perception that individual circumstances have not been fully taken into account by the Tax Office.

KEY FINDING 5

There are a variety of factors that the ATO has considered relevant in the statutory reduction and remission of penalties. These factors may also be relevant in considering the remission of the interest charge for groups of taxpayers in dispute with the ATO.

Tax Office response

2.75 The fact that there are circumstances leading to a reduction or remission of penalties is not, of itself, conclusive of grounds for remission of the interest charge. If this was intended the legislative schema could be expected to reflect this.

2.76 On the other hand they may, in combination with other factors contribute to a decision to remit the interest charge in whole or in part, particularly in a settlement context.

Inspector-General comment

2.77 The Inspector-General notes the acknowledgement of the Commissioner that factors relevant to a reduction or remission of penalties may be relevant to interest remission consideration.

TERM OF REFERENCE 3: THE APPLICATION OF INTEREST REMISSION POLICY TO CERTAIN GROUPS OF TAXPAYERS

2.78 The third term of reference for this review relates to the manner in which the ATO has applied its interest remission policy to groups of taxpayers.

2.79 As indicated above, this review has examined, to varying degrees, the ATO's practices for the remission of pre- and post-amended assessment interest for groups of taxpayers involved in the following five types of disputes:

- Mass Marketed Tax Effective Investments (MMTEIs);
- Employee Benefit Arrangements (EBAs);
- Investments in Retirement Villages;
- Investments in Equity Linked Bonds; and
- Securities Lending Arrangements.

2.80 In all of the above disputes the ATO has offered settlement terms to affected taxpayers which are standardised. The settlement terms generally do not vary according to the individual circumstances of the relevant taxpayer.

2.81 The standardised settlement terms that were offered to each of the above groups are discussed in further detail in Appendices 4 to 6. In summary, they were as follows.

MMTEI investments

2.82 For MMTEI investments, the terms of the standardised settlement offer distinguished between three broad groups of taxpayers.

2.83 The first group of MMTEI taxpayers (the vast majority) were those who were investors who took advice from others and who had a good tax record. These taxpayers were able to settle their tax dispute on the basis of a deduction being allowed for their actual cash outlay, no interest or penalties and a two year interest free time period within which to pay any underpaid tax.

2.84 The second group of MMTEI investors were promoters, financial planners and tax advisers who derived fees from other people investing in MMTEIs. Taxpayers in this second group were able to settle their MMTEI dispute on the basis of a deduction being allowed for their cash outlay only. Full interest was charged. In addition, penalties were levied.

2.85 The third broad group of MMTEI investors included tax advisers who did not directly derive fees from placing other people into MMTEI arrangements, but derived fees from providing tax advice generally. This group also included certain financial planners such as those whose work involved placing clients into MMTEI investments but whose status was that of an employee only. These taxpayers were able to settle their MMTEI dispute on the basis of a deduction for their cash outlay, interest at the reduced rate of 4.72 per cent and some penalty, depending on the circumstances.

Employee Benefit Arrangements

2.86 Employee Benefit Arrangements, although initially referred to by the ATO as 'mass marketed schemes', were not eligible for any of the settlement terms offered to other MMTEI investors. These arrangements have, with one notable exception, received standardised offers involving terms such as no deduction, the raising of assessments to participating employees or the levy of fringe benefits tax, full interest and penalties of 5, 10 or 20 per cent of the underpaid tax.

2.87 The exception was EBAs which were in the form of controlling interest superannuation (CIS) arrangements. Taxpayers in these arrangements have, as a result of a number of court decisions, received a standardised concession consisting of a denial of the relevant deduction, no penalty and interest being levied at the reduced rate of 4.72 per cent only on any underpaid or late paid tax.

Retirement villages, equity linked bonds and securities lending arrangements

2.88 Investors in retirement villages, equity linked bonds and securities lending arrangements have, like EBA investors, been offered standardised settlement terms which generally do not vary according to the individual circumstances of taxpayers who are members of that group.

2.89 In particular, investors in equity linked bond arrangements have been required to forego the claimed deductions and pay pre-amended assessment interest at the full interest rate. Investors in retirement village arrangements have been required to forego their deductions and pay pre-amended assessment interest on the basis that the full interest rate will be suspended for a certain time period only. Investors in securities

lending arrangements have also been required to forego their deductions, but have been charged with pre-amended assessment interest at a rate which excludes any uplift factor.

2.90 Penalties have also been applied to these other arrangements in certain circumstances.

2.91 The following table summarises the standardised settlement terms that were offered to the groups of taxpayers examined during the course of this review:

Type of Dispute	Interest	Penalty	Other relevant settlement terms
Mass Marketed Tax Effective Investments	Nil (for majority of investors)	Nil (for majority of investors)	For the majority, a deduction was allowed for the cash outlay and taxpayers were offered a 2 year interest free period to pay the primary tax
Employee Benefit Arrangements	Full (4.72% for controlling interest superannuation (CIS))	5,10 or 20% (nil for CIS)	Other settlement terms depended on the particular type of EBA
Retirement villages	Full, but no pre-amended assessment interest was charged for the period up to 19 April 2001	5%	A deduction was allowed for any cash payment made by way of deposit in the year the investment was signed and for the balance of the purchases monies in the year when the retirement village was completed.
Equity Linked Bonds	Full	10%	
Securities Lending Arrangements	Pre-amended assessment interest was remitted to exclude any uplift factor	Nil	

Factors considered in remitting interest

Mass Marketed Tax Effective Investments

2.92 As discussed further in Appendix 4, in deciding to remit the interest charge for taxpayers who participated in MMTEIs, the Commissioner determined that there were special circumstances by reason of which it would be fair and reasonable to remit the interest charge for both underpaid and late paid tax.

2.93 The special circumstances the Commissioner identified for such taxpayers were as follows:

- typically, investors in these eligible schemes lacked full knowledge of the scheme arrangements and the operation of the tax system;
- investors were often subject to aggressive and sophisticated marketing techniques;
- investors had a generally good tax record and typically they took advice from people expected to have the necessary knowledge to foresee the pitfalls; and
- investors contributed real money to the schemes and most suffered a real financial loss.[12]

2.94 Promoters, financial planners, tax agents and other tax advisers who received fees in relation to the arrangements or from providing tax advice generally were not eligible for a full remission of GIC unless they could demonstrate special circumstances to justify a remission.

Controlling interest superannuation arrangements

2.95 As discussed in detail in Appendix 5 and later in this chapter, the special circumstances that applied in granting the CIS arrangements a remission of pre- and post-amended assessment interest to 4.72 per cent involve the uncertainty of the law prior to May 1999, the existence of a reasonably arguable position by the taxpayer and the fact that the ATO had, prior to March 1999, issued a number of rulings which confirmed the efficacy of these arrangements.

Range of factors applied to remit interest

2.96 It is evident that in deciding whether to exercise the discretion to remit, in whole or in part, the interest charge in the above cases, the Commissioner took into consideration a range of 'factors' so as to establish whether special circumstances existed and what was fair and reasonable. From an examination of material provided by the ATO such factors included:

---

12 Information provided by the ATO to the Inspector-General in email dated 21 January 2004.

- the existence of uncertainty in the law. This was one key factor in the decision to remit part of the interest charge in CIS arrangements;

- the taxpayer's background, experience, occupation and prior compliance history. These were factors in the decision to remit GIC in mass-marketed tax effective investment arrangements;

- whether the taxpayer had made a voluntary disclosure;

- the level of the taxpayer's co-operation;

- the contribution of ATO delay. This was a key factor in the decision to remit part of the interest charge in retirement village arrangements;

- the existence of prior correspondence, rulings or advance opinions. This was another key factor in the decision to remit part of the interest charge in CIS arrangements; and

- the payment of fees to promoters and tax advisers.

2.97 Although there is evidence of these factors being taken into consideration in these cases and for other arrangements, there is no detailed policy framework to guide ATO staff or taxpayers on what these factors should be for pre-amended assessment interest involving disputes for the years of income from 1992/93 to 1999/2000. For the 2000/01 year of income and beyond, the only factor relevant to the remission of pre-amended assessment interest which is discussed in detail in Chapter 93 of the ATO's Receivables Policy is ATO delay.

2.98 It is the Inspector-General's view that it is not expected that an interest remission policy will cover in advance all circumstances and factors to be taken into account in determining whether special or exceptional circumstances exist or what is to be considered fair and reasonable or otherwise appropriate.

2.99 However, it is appropriate that a policy should exist which clearly articulates examples of the key factors which the Commissioner considers in practice. This is to ensure that taxpayers are properly informed of the key factors the Commissioner considers relevant to the remission of the interest charge and enable a taxpayer to make an application for remission of the interest charge on the basis of that knowledge. It is important that taxpayers are provided with all the

relevant information to allow them to properly manage their tax affairs and be able to exercise their legal rights.

2.100 *Taxation Ruling* IT 2517, which dealt with the remission of a charge that was equivalent to pre-amended assessment interest for the years of income up to and including 1991/92 did contain examples of certain factors which the Commissioner would consider in setting the level of pre-amended assessment interest.

2.101 One of the Inspector-General's subsidiary findings in relation to the third term of reference for the review (Subsidiary Finding 7 discussed later in this chapter) identified the need for a policy document for the remission of interest which clearly articulated examples of the key factors the Commissioner considers relevant to the remission of pre-amended assessment interest. *Taxation Ruling* IT 2517 is a useful model in that it contains an explanation of relevant factors and worked examples.

ATO internal review processes on remission of interest

2.102 As is discussed in more detail in Appendix 4, for certain investors in MMTEIs, the ATO set up a formal internal review process for remission of interest and other elements contained in the standardised settlement arrangement. The ATO also communicated the existence of that process to affected taxpayers. A similar process has not been established for participants in other disputes such as employee benefit arrangements.

2.103 The formal review process was established for investors in MMTEI disputes who were promoters, financial planners and tax agents or advisers who were not eligible for the standardised no interest/no penalties settlement offer that was made to other investors.

2.104 The nature of the formal review process for certain MMTEI investors was as follows.

2.105 From March 2002 onwards the ATO sent a letter to these investors advising them of the opportunity to lodge a submission outlining whether they had 'special circumstances' that could lead them to receive the same nil interest and nil penalties offer which had been available to other investors. This letter did not contain detailed guidelines to these investors as to how to frame their applications, nor did it address the specific criteria which these applicants needed to address. These guidelines were only published by the ATO on its website in June 2002.

2.106 By the time these guidelines were published on the web, many of these investors had already made their applications for concessional settlement treatment. These guidelines were therefore not issued on a timely basis. In addition, by being published on the website only, they were not communicated to affected taxpayers in a way that would ensure that these taxpayers would be made aware of these guidelines.

2.107 However, the ATO did communicate the existence of these specific website guidelines in the letters which it sent to taxpayers which notified them of whether their applications for concessional settlement treatment had been wholly or partly successful. These letters also advised these investors of the existence of an internal ATO review process for considering their applications. The investors who took advantage of this review process were therefore able to utilise these website guidelines in framing their review applications.

2.108 This review found that there were very small numbers of taxpayers in employee benefit and other arrangements that were offered standardised settlement terms who actually applied for and received a variation in the level of pre-amended assessment interest based on their individual circumstances. There were four such cases for EBAs, one case involving a retirement village, five cases involving equity linked bond arrangements and three cases involving securities lending arrangements.

2.109 There is an absence of any formal process similar to that adopted for MMTEIs for the remission of interest and other elements contained in the standardised settlement arrangements for taxpayers involved in EBAs and other arrangements. This may have led many of these taxpayers and advisers to believe that there was no such process within the ATO for considering whether a particular case may involve special circumstances that would lead to different settlement terms such as for the remission of interest.

2.110 Alternatively, the absence of such a process may have led these taxpayers and their advisers to believe that, even if there was such a process, the result would be that concessional settlement treatment on the basis of special circumstances would be denied.

2.111 This review found that the actual structure of the above formal process adopted for MMTEI investors and its accompanying review procedures were well documented within the ATO and transparent to taxpayers.

2.112 However, as indicated above, this review also found that there were certain shortcomings in the manner in which this process was communicated to affected taxpayers.

2.113 This review also found that in conducting the above review process considerations of the extent to which taxpayers were members of a particular group or shared certain other characteristics overshadowed considerations of the conduct and circumstances of each individual.

2.114 Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977*. This is a costly and lengthy process.

2.115 Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.

2.116 The above comments lead to the following further key finding:

KEY FINDING 6

For certain investors in Mass Marketed Tax Effective Investments (MMTEIs) the ATO set up a formal process, which also involved separate ATO internal review procedures, for the remission of interest and other elements contained in the standardised settlement arrangements. A similar process has not been established for participants in employee benefit arrangements.

The actual formal structure of this process for certain MMTEI investors and its accompanying review procedures were well documented within the ATO and transparent to taxpayers.

Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977* (ADJR). This is a costly and lengthy process.

KEY FINDING 6 continued

Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.

However, any such review process would need to operate according to the overriding principle that all individual circumstances relating to particular taxpayers are taken into account during the operation of this process.

In particular, considerations of the extent to which taxpayers who are subject to this review process are members of a particular group, or share other certain characteristics of other taxpayers in the same process, should not override considerations of the conduct and circumstances of each individual.

Tax Office response

2.117 See the response to Key Findings 3 and 4. Special arrangements will be established to deal with applications, within the context described in that response.

Inspector-General comment

2.118 The Inspector-General notes the agreement to establish a special arrangement and looks forward to further details becoming available.

TERM OF REFERENCE 4: EMPLOYEE BENEFIT ARRANGEMENTS

2.119 The fourth term of reference for this review has required the Inspector-General to examine the manner in which any interest remission policy has been applied to taxpayers involved in Employee Benefit Arrangements (EBAs).

Definition of Employee Benefit Arrangements

2.120 The ATO has, for some time, categorised EBAs as falling into four categories: Employee Benefit Trusts (EBTs), Employee Share Plans (ESPs), Controlling Interest Superannuation (CISs), and Offshore Superannuation (OSSs.) The ATO has also advised that it has identified a fifth arrangement, being Employee Share Trusts (ESTs). A more detailed description of each of the four types of arrangements which the ATO has classified as EBAs are in Appendices 9 to 12 of this report.

Nature of EBAs

2.121 EBAs were prevalent from the mid 1980s until early 1999. They arose particularly, but not exclusively, in the small and medium sized enterprise sector. They were marketed on the basis that they met a need for employers in that sector to provide a remuneration strategy that rewarded, retained and motivated employees, especially 'key' employees, in a way that was competitive with the remuneration that could be provided by larger listed companies.

2.122 EBAs have the same essential elements. An employer (usually but not necessarily a small business proprietor) makes a contribution to a trust or to a superannuation fund for the ultimate benefit of their employees, including employee directors. The contribution is invested by the fund and generates income on which tax is paid. The contribution, together with income earned from the contribution, may be eventually paid to the intended employee beneficiary.

2.123 The perceived advantages of EBAs to participating employees were as follows. Firstly, they were flexible vehicles to use for investing as they were not subject to the investment constraints that are imposed on normal superannuation vehicles. Secondly, contributions were not subject to superannuation contributions tax. Thirdly, the money was not locked away until retirement, the age of 65, illness or death. Fourthly, investments could be made on these employees' behalf with pre-taxed funds.

2.124 For employers, these arrangements were perceived to be attractive for the following reasons. Firstly, they enabled monies to be paid to key employees in a tax deductible way. Secondly, the arrangements had no fringe benefits tax (FBT) or superannuation guarantee charge implications. Thirdly, the arrangements were able to be structured so

that ultimate payouts could be made conditional upon the employee meeting certain business requirements (for example, meeting certain performance targets).

ATO activity on EBAs

2.125 On 19 May 1999 the ATO indicated, via a press release,[13] that EBAs were contrived arrangements, intended to frustrate the clear policy intent of the law. Accordingly, it commenced action to withdraw the tax benefits claimed to be associated with these arrangements, an activity which has continued to the present.

2.126 In a speech to the Financial Planning Association on 27 April 1999,[14] the Commissioner of Taxation outlined the features of EBAs which the ATO found of particular concern. These were as follows:

- the implementation of arrangements in circumstances that had little to do with the underlying human resource policy upon which they were predicated;
- the lack of independence of the trustee or administrator of the EBA, hence leaving the funds at the total control and discretion of the controllers of the company;
- the implementation of the arrangement where there are no arm's length employees and its use as a mechanism solely to benefit and access cash from the company by the owner-controllers of the company;
- the use of 'round-robin' financing to inflate the deduction; and
- the claimed ability to pass money out of often convoluted structures tax free.

2.127 The ATO's withdrawal of tax benefits for EBAs applied to EBAs entered into prior to 19 May 1999 as well as those entered into after this date. It involved the ATO issuing single or (except, generally, in the case of CIS arrangements) multiple amended assessments to participants. The

13 Australian Taxation Office, Media Release Nat 99/16, dated 19 May 1999.

14 Commissioner of Taxation, *The Changing Landscape for Financial Planning*, Lunchtime Address to Financial Planning Association of Australia, Melbourne, 27 April 1999.

single and multiple assessments all involved amounts of primary tax, interest and penalties.

2.128 The multiple assessments were based on there being a number of possible taxing points, depending on the implementation of the particular EBA. These multiple taxing points generally included that no deduction was allowable for the contribution, or that FBT was payable on the contribution. In certain EBAs, assessments were also raised to the participating employees in that contributions on their behalf were included as assessable income in the year of contribution. Also, an employee might be assessed on the value of the ultimate benefit when and if paid. The ATO did, however, flag that although it had issued multiple assessments, it would be prepared to settle a particular EBA on the basis of a single taxing point in a manner which would not allow additional taxing points to be triggered.

Prior ATO advices on EBAs

2.129 Prior to March 1999, EBAs in the form of EBTs, ESPs and CISs all received prior advices from the ATO which confirmed the claimed broad tax benefits.

2.130 Prior ATO advice in this context consists of three forms of advice. These are advice which is in the form of a private binding ruling (PBR), advice which is in the form of an advance opinion and other forms of general advice not falling within either of these other two categories. An example of general advice is where a taxpayer's adviser receives general advice on the tax consequences of a 'typical' tax arrangement which is not client specific.

2.131 The ATO is legally bound to follow a PBR if it has been implemented in accordance with its terms. It considers that it is administratively bound to follow an advance opinion that has been properly implemented.[15] The ATO therefore considers both these forms of advice to be 'binding'. The ATO does not consider that other forms of general advice are binding, even if a taxpayer has implemented this advice in accordance with its terms.

2.132 The ATO has provided figures to this office which indicate that 24 favourable advices were issued in relation to EBT arrangements, of

15 *Taxation Ruling* IT 2500, at paragraph 14.

which 14 were binding on the ATO (that is, in the form of private binding rulings). For ESP arrangements, at least two favourable advices were issued. For CIS arrangements, 25 advices were issued, four of which were binding. The ATO has advised that no advices were issued by the ATO on OSS arrangements.

2.133 The ATO's provision of positive advices on the above arrangements halted on 26 March 1999 when the ATO placed an embargo on the issue of advices on the above arrangements.[16]

2.134 Subsequently, on 19 May 1999, the ATO stated that previous private binding rulings and advance opinions would be withdrawn, where they were not implemented according to the facts presented in the original application for ATO advice.[17]

Original ATO concession for EBAs — the 'safe harbour' offer

2.135 In its 19 May 1999 press release,[18] the ATO indicated that its broad offer to taxpayers who had already entered EBAs was as follows. If participants came forward by 30 June 1999, the ATO would reduce penalties to 5 per cent and apply only a single and 'appropriate' tax liability. Full interest would, however, be charged from the original due date for payment of the relevant underpaid tax to the date upon which the taxpayer made full disclosure of their circumstances to the ATO. In a later press release the ATO extended the deadline for taxpayers to accept this offer to 13 September 1999.[19] The ATO has since described this arrangement as its 'safe harbour' offer.

2.136 This offer was not, however, available for taxpayers engaged at the extreme end of sham and fraudulent behaviour.

ATO processes for EBA safe harbour cases

2.137 From figures provided to this office by the ATO, it appears that out of the 6,562 EBA cases which the ATO has currently identified, 1,535 taxpayers responded to the ATO's safe harbour offer. The ATO has

16 Australian Taxation Office, Media Release Nat 99/12, dated 26 March 1999.
17 Australian Taxation Office, Media Release Nat 99/16, dated 19 May 1999.
18 ibid.
19 Australian Taxation Office, Media Release Nat 99/46, dated 13 August 1999.

also indicated that in these cases interest was 'generally' remitted in full during the period from the date of voluntary disclosure until the issue of the amended assessment. This remission was made on the basis that during this period the non-payment of the relevant tax could be attributed to ATO delay.

ATO settlement arrangements after safe harbour period expired

2.138 After the expiry of the safe harbour period, the ATO settlement offers for EBT and ESP forms of EBAs, have, according to material provided to this office by the ATO[20], generally consisted of terms which have included one taxing point, a 10 per cent penalty, full interest and a waiver of all objection and appeal rights.

2.139 As indicated above, CIS arrangements have received a different offer owing to the outcome of court cases. On 14 May 2003, the ATO announced that, in the interest of providing an opportunity to clear up these CIS cases, the ATO would reduce the interest to a 'commercial' rate of 4.72 per cent in those cases where a genuine contribution was made before 19 May 1999. This interest reduction was to apply for both pre- and post-amended assessment interest. The 19 May 1999 date was selected because this was the date on which the ATO announced that these schemes did not work.

2.140 The ATO has advised that it has recently altered certain aspects of its settlement terms for EBAs involving offshore superannuation arrangements. This was as a result of the decision in the Walstern case.[21]

2.141 The ATO has requested that OSS taxpayers submit a settlement proposal and detail any material differences between their case and that which was considered in Walstern.

2.142 OSS arrangements which have been implemented in the same manner as Walstern (and which do not involve a safe harbour period) will now be subject to settlement terms which consist of one taxing point, a 20 per cent penalty, full interest and a waiver of all objection and appeal rights.

---

20 ATO Minutes No: IGT07-2004, IGT08 -2004 and IGT10-2004, all dated 30 January 2004.
21 *Walstern v FCT* [2003] FCA 1428.

2.143 OSS arrangements which are materially different to Walstern will be subject to the same settlement terms as those which have applied to OSS arrangements since the expiry of the safe harbour period. These terms have generally consisted of one taxing point, a 10 per cent penalty, full interest and a waiver of all objection and appeal rights.

2.144 The precise terms of settlement have varied between all forms of EBA, owing to their differing structures. However, the settlement options for all EBAs have been standardised in the same manner as other settlement arrangements discussed in this report, that is, whichever settlement option applied to a participants in a particular EBA that option would be applied according to its standardised terms. Apart from CIS cases, these standardised terms included no remission of pre-amended assessment or post-amended assessment interest.

How interest has been remitted to date for EBA arrangements

2.145 There are four ways in which taxpayers involved in EBAs have received a remission of the interest payable upon the multiple amended assessments that have been issued by the ATO. They are as follows:

Situation 1

2.146 The rate of interest has been reduced by the ATO as a part of a 'standardised' decision to remit the interest to 4.72 per cent for most participants in a particular form of EBA. This is what has occurred for 3,452 participants in controlling interest superannuation arrangements. In this case, the interest reduction applied to both pre- and post-amended assessment interest.

Situation 2

2.147 The rate of interest has been reduced to 4.72 per cent for participants based on their individual circumstances. This has occurred in only 3 EBA cases.

Situation 3

2.148 In some cases, the period for which interest is applied has been reduced for certain groups of taxpayers. This occurred for 1,535 EBA taxpayers who responded to an offer by the ATO to come forward with details of their arrangements by 13 September 1999.

Situation 4

2.149 In only one EBA case, the period over which the interest has been applied has been reduced because of individual circumstances affecting the particular EBA case in question.

2.150 Each of these situations is discussed in further detail below.

Situation 1: ATO's reduction of interest in CIS cases

2.151 In making a reduction of interest in CIS cases the nature of the particular types of arrangement overshadowed consideration of the individual circumstances of each affected taxpayer. The rate reduction was granted to most CIS taxpayers without an examination of the individual facts and circumstances applying to the particular taxpayer's case.

2.152 The rate reduction was also not applied to other EBAs and therefore was not consistent with the ATO treatment of those EBAs.

2.153 The ATO has indicated that there were two main factors which led to its reduction of both pre- and post-amended assessment interest for most CIS cases and not EBAs generally.

2.154 The first of these was that there was a Federal Court decision (the Prebble case[22]) which indicated that the law in relation to CISs was uncertain and that a taxpayer had a reasonably arguable position that a tax deduction would be available for a contribution made to a controlling interest superannuation fund. The ATO does not consider that this factor applies to other forms of EBAs.

2.155 The second factor was that for CISs the ATO had issued a number of advices, all of which were favourable to taxpayers. For other forms of EBAs, the ATO has noted that there were either no favourable advices that were issued (for example, for OSS arrangements) or there were both favourable and unfavourable advices issued (for example, for EBT and ESP arrangements).

2.156 Alternative views on whether these grounds also apply to other forms of EBA have been offered in submissions made to this review.

---

22 *Prebble v FCT* [2003] FCAFC 165 (Full Federal Court) and *Prebble v FCT* [2002] FCA 1424 (single judge)

2.157 Firstly, submissions have commented that, in the first announcement which the Commissioner made in relation to EBAs, he referred to the possibility that these cases might need to be taken to the High Court for a decision. According to these submissions, this indicates that the Commissioner considered that the law in relation to all forms of EBA was uncertain. These submissions note that this feature of EBA arrangements has been borne out in the history of EBA litigation to date. As covered in more detail in Appendix 5, this history illustrates that the cases decided to date have produced differing results on various tax aspects of EBAs. These submissions therefore conclude that the law in relation to other forms of EBAs is also uncertain.

2.158 Secondly, submissions made to this review have noted that the ATO has adopted a tenuous distinction between CIS arrangements and other forms of EBAs where it asserts that CISs only ever received favourable prior ATO advice. These submissions note that the fact that any favourable advices were issued by the ATO in relation to the other forms of EBAs should be a factor for these cases to receive interest remission.

2.159 The ATO has not offered to CIS cases, or to any other EBA case, the nil interest and nil penalties settlement terms that were offered to the majority of investors in MMTEIs. The ATO does not consider that any of the factors which led it to offer concessional settlement terms, including those relating to interest to most MMTEI investors apply to either CIS arrangements or EBA arrangements generally.

2.160 However, as detailed further under Term of reference 5, the Inspector-General is of the view that to a large extent the same factors which applied to mass marketed investors also applied to EBA investors, including CIS investors.

Situation 2: Individual Employee Benefit Arrangement cases where the interest rate has been reduced

2.161 According to material provided to staff of the Inspector-General of Taxation, there are three EBA cases where taxpayers have received a reduction in the rate of interest, apart from safe harbour cases. There is one EBA case (dealt with below) where the interest has been remitted for a particular period.

2.162 As discussed above, the ATO have not, unlike the case of certain MMTEI investors, set up a formal review process for EBA taxpayers to allow interest remissions for these taxpayers to be considered on a case by case basis. It has also not communicated the existence of any such process to EBA taxpayers. However, such a review process was applied in these three rate reduction cases and the period reduction case referred to below.

2.163 The absence of an internal formalised appeal process for interest remission decisions raises concerns that tax practitioners who have established access to the ATO decision makers may be able to achieve better interest rate remission outcomes for their clients.

2.164 The small number of these cases reinforces the key finding referred to earlier that an internal review process of a structure similar to that adopted for MMTEI investors should also be adopted for EBA taxpayers.

Situation 3: EBA cases where interest has been remitted for a period only for all taxpayers in a particular group.

2.165 As indicated above, there is only one situation involving EBAs where the period for which interest is applied has been reduced as part of a 'global' decision which applies for all taxpayers who meet a certain criterion. This situation is where the relevant EBA participant has responded to the offer by the ATO to come forward with details of their arrangements by 13 September 1999. In this case, the ATO has remitted the interest in full for the period between the time when the taxpayer provided all relevant material to the ATO and the date of issue of the relevant amended assessment.

2.166 During the course of the review, the principal concern which was raised on this aspect of the ATO's remission policies on interest for EBAs was that, in some cases, the ATO was unwilling to accept that the relevant taxpayer has made a full disclosure within the stipulated time period. These cases were those where taxpayers were unable to provide a relevant document because it was actually in the possession of the promoter of the arrangement. The ATO has denied that this situation ever arose in respect of such safe harbour cases.

2.167 Another concern was there is or was a lack of transparency in the methods used by the ATO to apply and then remit this interest. It was suggested that the ATO should, in this specific case and more generally,

automatically provide a detailed interest calculation whenever a payment demand notice which includes an amount of interest is sent to taxpayers.

2.168 The ATO now publishes a fact sheet which outlines the rate of interest applied for all periods since 1 July 1999 which now partly addresses this concern. However, it still does not automatically provide detailed interest calculations unless these are specifically requested.

2.169 Tax administration would therefore be improved if the ATO were to readily make available a mechanism to allow taxpayers to check how interest calculations have been made. The nature of this mechanism should be determined in consultation with appropriate parties, including taxpayers, tax agents and professional bodies representing tax agents and tax advisers.

Situation 4: Cases where interest has been remitted for a period based on individual circumstances

2.170 The ATO has provided material to this review which indicates that in only one EBT case was there a reduction in the period during which the ATO applied the interest for underpaid tax. This case was not subject to the safe harbour settlement option. The remission was based on an admission by the ATO that it had delayed in responding to the taxpayer during the relevant period.

2.171 The Inspector-General has the following concern with this case. A number of submissions made to the office indicate that there have been substantial delays, sometimes up to 18 months, from the time that the taxpayers respond to a Notice of Intention to Audit and the date of issue of the amended assessment. It appears surprising, given the above submissions and the volume of EBA cases handled by the ATO, that this form of ATO delay has given rise to interest remission in only one non safe harbour EBA case.

2.172 These comments suggest that taxpayers may not be aware that ATO delay is a ground for the remission of interest, even though this is specifically referred to in the ATO's current written policy document for the remission of interest.

2.173 These comments also support the concerns previously noted that there could be a lack of taxpayer and adviser awareness of the ability to seek interest remission based on individual circumstances.

Other settlement terms offered to EBA taxpayers

2.174 It is beyond the terms of this review to examine and comment upon the terms of the various settlement offers which the ATO have made to EBA participants since March 1999, and the methods under which the ATO has set about implementing these terms, other than to the extent that they deal with the imposition of the interest.

2.175 However, very strong concerns have been made to this office about the nature of these other terms and their method of implementation by the ATO.

2.176 One concern has related to the ATO's method of communicating to taxpayers the terms of these settlement offers. The ATO has advised, for example, that they have communicated to taxpayers that it does not expect payment of all the multiple assessments which may have issued. However, concerns have been raised that the letters conveying this message are not clear on this point. These concerns are based on the view that one part of these letters, for example, could be interpreted to mean that the ATO does require payment of all these amounts, but not all at the same time.

2.177 Examples of other concerns which have been raised include considerable ATO delays in the actual settlement process and the level of penalties charged. They also include the ATO's application of the anti-avoidance provisions, the tax treatment of adviser's fees, the tax treatment of the amount of FBT charged in a multiple assessment situation and the application of the ATO's settlement terms to situations where EBA participants have retired.

2.178 Concerns have also been raised about the conduct of ATO officers during the settlement processes and the legal form of the settlement documents themselves.

2.179 The subject of the ATO's settlement processes generally may be considered further in determining the Inspector-General's future work program.

TERM OF REFERENCE 5: CONSISTENCY OF TREATMENT OF EMPLOYEE BENEFIT ARRANGEMENTS AND OTHER GROUPS OF TAXPAYERS

2.180 The fifth term of reference for the review requires an examination of the degree to which the policy applied to taxpayers involved in Employee Benefit Arrangements is appropriate and consistent with that applied to other groups of taxpayers in dispute with the ATO.

Employee Benefit Arrangements

2.181 As indicated above, taxpayers involved in EBAs have not received the nil interest and nil penalties settlement terms that were offered to investors in MMTEIs.

2.182 The ATO has indicated that its reasons for not offering to EBA taxpayers' settlement terms that are similar to those provided to taxpayers involved in mass marketed investments are as follows.

- Firstly, the ATO considers that taxpayers involved in EBAs were more 'sophisticated' taxpayers than those which were involved in mass marketed tax effective investments. According to the ATO, EBA investors were generally business people rather than wage and salary earners.

- Secondly, the ATO considers that EBAs were not marketed using the same aggressive marketing techniques as MMTEIs, but were tailor made for each EBA participant.

- Thirdly, the ATO considers that MMTEI investors often suffered an actual economic loss in relation to the investment, while this was not the case for EBA investors.

- Fourthly, the ATO considers that taxpayers involved in MMTEIs handed over their funds to outside parties and therefore lost control of them, whereas in EBA arrangements the funds were often provided to entities related to the participating employer or employees.

2.183 The Inspector-General is of the view that to a large extent the same factors which applied to mass marketed investors also applied to EBA investors.

2.184 The Inspector-General notes that from the early days of its investigations into MMTEIs, the ATO grouped EBAs with other forms of MMTEI. This practice is confirmed in the Commissioner of Taxation's Annual Report for 1999-2000 where it categorises employee benefit arrangements as one form of mass marketed scheme.[23]

2.185 The ATO publicly de-grouped EBAs from other forms of MMTEI from at least 26 April 2001 when it announced that it would reduce the interest on tax debts for some MMTEIs, which did not include EBAs.

2.186 However, the ATO's own internal guidelines for settling MMTEIs continued to apply to EBAs after both this date and even after the date of its no penalty and no GIC offer to MMTEIs. These guidelines were only withdrawn by the ATO on 29 October 2002.

2.187 There is further evidence which supports a view that the ATO continues to regard EBAs as a form of MMTEI, even though they have indicated to this office and others that EBAs are not now part of MMTEIs. For example, in an organisational sense, the ATO staff which are responsible for EBA arrangements are also responsible for MMTEI arrangements.

Alternative views

2.188 It is possible to take an alternative perspective in respect of each of the ATO's grounds for distinguishing EBAs from MMTEIs.

2.189 Firstly, submissions made to the Inspector-General have asserted that participants in EBAs comprised the same broad array of participants that were involved in MMTEIs. One submission noted the following in this regard:

> '… a broad array of individuals entered into the EBAs ranging from 'sophisticated' investment bankers and corporate executives to the average salary and wage earner, small business operator, 'mum and dad' companies, etc. The investors in the EBAs were not exclusively 'sophisticated investors' and many were like those who invested in the mass-marketed schemes.'

23 Commissioner of Taxation's Annual Report 1999/2000, at page 70.

2.190 Secondly, submissions have asserted that EBAs were marketed in a very similar fashion to MMTEIs. These submissions state that, although EBA promoters did not market to employees directly but rather to their employers, the same kind of sophisticated marketing techniques were employed to capture this target employer market. These techniques included glossy brochures and senior barristers' opinions.

2.191 Furthermore, these submissions assert that the manner in which EBAs were implemented did not depend greatly on the individual circumstances of the EBA participant, as the essential features of these arrangements were identical in their broad outline.

2.192 Thirdly, submissions to this review have asserted that many EBA participants have actually suffered economic loss as a result of their participation in these arrangements. Submissions noted that many EBT taxpayers in particular have been forced into liquidation in order to pay the assessments they have received. Furthermore, the multiple nature of EBA assessments reportedly destroyed the creditworthiness of EBA participants, thereby causing these participants to suffer a loss to their business reputation.

2.193 Fourthly, these submissions assert that the ATO's view that the funds invested in EBAs remained under the investor's control is arguable as the very nature of EBAs is that legal entitlement to the relevant funds, together with the actual funds themselves in many cases, is passed on to other entities. Professional advisers involved in implementing settlements have commented on the difficulties on some occasions of obtaining the agreement of third parties, such as trustees, to the release of funds held in these other entities.

2.194 These submissions also point out that, in any event, in many MMTEIs the taxpayers' funds were never applied to the relevant investment, but were used to meet the promoter's fees. The issue of retaining control over the relevant invested funds is therefore not perceived to be as relevant as identified by the Commissioner.

2.195 In addition, these submissions note that EBA taxpayers incurred significant promoter and legal costs in both setting up their EBA structures and dismantling them in response to ATO audit activity, with the tax deductibility of these costs also being an issue disputed with the ATO.

2.196 The Inspector-General is in general agreement with the above comments made in submissions received regarding the ATO's grounds for distinguishing participants in EBAs from investors in MMTEIs.

2.197 This leads to the following key finding in relation to the fifth term of reference:

KEY FINDING 7

Taxpayers who are members of groups of taxpayers in dispute with the ATO over arrangements frequently share a range of common features. Some of these features were identified by the ATO and used to determine the final settlement offer that was made to the majority of MMTEI investors. In the ATO's view, these common features suggested the existence of exceptional circumstances which justified applying an interest remission policy which led to the interest charge being reduced to nil.

The present ATO treatment of pre- and post-amended assessment interest charges for taxpayers involved in EBAs has focussed principally on the nature of the arrangement giving rise to the particular dispute. For taxpayers involved in three kinds of EBAs full interest has been charged while for taxpayers involved in one form of EBA a reduced interest rate has been applied.

This focus on the nature of the arrangement in EBA disputes appears to have led to taxpayers involved in EBA disputes receiving interest remission outcomes which are inconsistent with those received by other groups of taxpayers. It has also led to taxpayers involved in certain types of EBAs receiving interest remission outcomes which are not consistent with those applied to taxpayers involved in other forms of EBAs.

2.198 The Inspector-General also notes that there is one further factor present in certain EBA disputes which may warrant specific attention in considering whether full remission of the pre-amended assessment interest charge for taxpayers involved in EBA disputes is appropriate.

2.199 This additional factor applies to EBA taxpayers who were involved in employee benefit trust, employee share plan and controlling interest superannuation arrangements. For these three types of arrangements, there is evidence of an administrative practice within the ATO of giving

favourable advices for such arrangements. Evidence of such an administrative practice is referred to at paragraph 51 of the Federal Court's decision in the Prebble case.[24] This practice appears to be evidenced by the significant number of favourable prior advices given. This factor was not present to the same degree for MMTEI investors, given that for over 43,000 taxpayers involved in MMTEIs the ATO has indicated that there were only 6 prior advices.[25]

2.200 Conduct of the ATO which has caused taxpayers to be misled is not a factor which is specifically dealt with in Chapter 93 of the ATO's Receivables Policy. It was, however, a factor which was specifically referred to by the ATO in its policy documents for the remission of the per annum interest charge for underpaid tax prior to 1 July 1992 and, more recently, for the remissions of the interest for underpaid FBT prior to 1 April 2001. The relevant rulings dealing with each of these types of interest specifically provided that this factor would lead to interest being remitted to nil.[26]

Tax Office response

2.201 The focus of Key Finding 7 is the distinction in treatment between mass marketed investment schemes and Employee Benefit Arrangements.

2.202 Without traversing in detail the views and counter views about our reasons for distinguishing between the two some brief observations are appropriate on some of those. They also help illustrate a broader consideration in making the distinction.

2.203 The particular economic loss considerations in the mass marketed investment schemes referred to the participant's own funds being invested in, and lost on, what was in many cases a poor or non-existent venture. It was not a reference to losses associated with costs of entering the arrangements, such as promoter fees, or the consequences of facing an appropriate tax liability.

2.204 Further, unlike the investments in mass marketed investment schemes, the use of the funds in employee benefit arrangements were

24 *Prebble v FCT* (2002) FCA 1434.
25 ATO Minute No: IGT 14-2004.
26 *Taxation Ruling* IT 2517, at paragraphs 37 and 41; *Taxation Ruling* TR 95/4, at paragraph 8.

generally under the effective control of and/or generally for the benefit of the participant and/or associates.

2.205 The participants set up the structures involved and directed the funds to them.

2.206 These factors have been recognised in decided cases to date. For example, in Essenbourne the court concluded that the arrangements were designed to distribute profits in a tax free form to the principals of the employer entity.

2.207 In some cases amounts contributed to employee benefit trusts were loaned back to the employer or associate of the employer. In the Spotlight case, which involved the provision of benefits for arm's length employees, the round-robin loan back arrangement was a factor leading the Court to conclude that there was a dominant purpose of gaining a tax benefit.

2.208 Paragraphs 2.198 to 2.200 state that "there is evidence of an administrative practice within the ATO of giving favourable advice" for employee benefit trust, employee share plan and controlling interest superannuation arrangements. Paragraph 2.198 notes that this factor "may warrant specific attention in considering whether full remission of the pre-amended assessment interest charge for taxpayers involved in EBA disputes is appropriate".

2.209 At paragraph 2.199 the Inspector-General cites the judgements of the Federal Court in the Prebble case as evidence of such an administrative practice.

2.210 The Prebble case involved a controlling interest superannuation arrangement and the court's decision and comments are not relevant to the other types of employee benefit arrangements. As previously pointed out, we took into account the court's decision in Prebble that the taxpayers claim was reasonably arguable and the issue of a small number of favourable advices in deciding to partially remit the interest charge for most controlling interest superannuation arrangement cases.

2.211 The circumstances which made it appropriate to partially remit interest in those cases have no relevance to other employee benefit arrangement cases.

2.212 As previously pointed out, we are of the view that the evidence does not support a conclusion that there was an administrative practice within the ATO of giving favourable advice or accepting the tax benefits claimed in respect of employee benefit trust or employee share plan arrangements which have been the subject of disputes with the ATO.

2.213 In relation to employee benefit trust arrangements, apart from both the favourable and unfavourable rulings which are the subject of a current criminal matter, the small number of favourable advices issued by the ATO did not cover the circumstances of the typical employee benefit trust scheme involving non-arm's length employees. In our view the typical employee benefit trust arrangement was not a genuine employee retention plan but rather a scheme designed to distribute profits in a tax free form to the principals of the employer entity. As indicated, this view was confirmed by the Federal Court in the Essenbourne case.

2.214 In relation to employee share plan arrangements, only two favourable advices were issued. This does not represent evidence of an administrative practice.

2.215 No advices were issued in respect of the offshore schemes.

2.216 The broader point referred to is this - the acceptance that arrangements of this kind marketed in these circumstances could at worst result in a no-penalty, no-interest outcome would significantly impact on the future health and integrity of the tax system.

Inspector-General comment

2.217 The Inspector-General has concluded that the ATO's treatment of EBAs has resulted in EBAs, and different forms of EBAs, receiving interest remission outcomes inconsistent with other groups of taxpayers.

2.218 In responding, the Tax Office has identified a range of factors which it has considered as key points of difference between MMTEIs and EBAs. It has stated that these factors have been recognised in relevant court decisions.

2.219 These comments by the Tax Office go to the efficacy of EBAs rather than the consistency of treatment of interest remission between groups of taxpayers. The Inspector-General has consistently stated that the efficacy of EBA arrangements has not been a consideration of this review.

2.220 The Inspector-General notes that the Commissioner of Taxation will be offering EBA taxpayers, as a settlement incentive, an interest cap. The total amount of pre- and post-amended assessment interest accruing to the date two months from the date of release of this report will be capped at 70 per cent of the primary tax in dispute (that is, excluding penalty and interest). The capping will apply irrespective of whether participants continue to dispute the issues in the courts. This offer will also be applied to finalised cases.

2.221 The Inspector-General is strongly of the view that the overall health and integrity of the tax system is crucial to community confidence and ongoing viability of the system. However, it is noted that the remission of interest and penalty for most MMTEI investors has not seemed to have had adverse consequences to this integrity and that the number of MMTEI taxpayers significantly exceeded the number of EBA taxpayers.

2.222 The Inspector-General is supportive of the proposal outlined in the Commissioner of Taxation's covering letter (Appendix 1) to implement an arrangement of a senior panel, supported by transparent guidelines, to consider future widely based settlement activities.

SUBSIDIARY FINDINGS

2.223 The following is a listing of subsidiary findings that have arisen during the course of the review. These findings are discussed in further` detail in the appendices to this report.

Subsidiary Finding 1

2.224 The current ATO Receivables Policy only deals with the remission of the interest charge due to ATO delay in the issuing of an amended assessment once all information and evidence has been gathered and the ATO has formed a view.

2.225 Tax administration could be improved if the interest remission policy also specifically set out how the remission power would be exercised where the ATO has contributed to the delay during the pre amended assessment period due to operational reasons or some uncertainty as to the operation of the law

2.226 This could be similar to the approach adopted in previous ATO guidelines, such as *Taxation Ruling* IT 2517.

Tax Office response

2.227 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

2.228 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 2

2.229 Taxpayers would benefit if the Commissioner produced a simple guide to the remission of the interest charge, similar to an ATO Fact Sheet, outlining the process for requesting remission of the interest charge and the supporting information that the ATO requires.

Tax Office response

2.230 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

2.231 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 3

2.232 Taxpayers would benefit from the Commissioner publishing more supplementary information dealing with the remission of the interest charge. For example, greater guidance could be provided in the form of more ATO Interpretative Decisions being released and referred to in the ATO interest charge remission guidelines.

Tax Office response

2.233 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

2.234 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 4

2.235 Taxpayers would benefit if, in relation to pre-amended assessment interest, the Commissioner provided upon request the factors considered relevant to the decision to maintain, remit or reduce the statutory interest charge.

Tax Office response

2.236 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

2.237 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 5

2.238 Tax administration could be improved if the interest remission policy specifically set out how the remission power would be exercised for pre-amended assessment interest in instances where:

- no penalty is imposed due to the taxpayer's previous good compliance record in accordance with the ATO Compliance Model;
- the taxpayer has made a voluntary disclosure to the Commissioner regarding their taxation position and there is no evidence of any prior intention to avoid the payment of tax;

- there is reasonable and positive co operation by the taxpayer; and
- there is evidence of a general administrative practice by the Commissioner supporting the approach taken by the taxpayer.

2.239 Such an approach would be similar to that adopted in previous ATO rulings and would serve to promote and encourage voluntary compliance by taxpayers.

Tax Office response

2.240 The proposed remission guidelines will outline factors to be taken into account in deciding whether the interest charge should be remitted. As noted in the response to Key Finding 5, the fact that there are circumstances leading to a reduction in penalties is not, of itself, conclusive of grounds for remission of GIC under the current law.

Inspector-General comment

2.241 The Inspector-General endorses the Tax Office's proposal to publish clearer guidelines addressing the issues identified and notes that the Commission of Taxation acknowledges that circumstances leading to a reduction in penalties may also be relevant considerations for the remission of GIC.

Subsidiary Finding 6

2.242 Taxpayers would benefit if the ATO adopted a case management arrangement for finalising the total amount, including interest, which taxpayers must pay to finalise their dispute.

Tax Office response

2.243 The audit and debt collection staff do work together. However the ATO will examine how to improve ways for taxpayers and their representatives to interact with the Office.

Inspector-General comment

2.244 The Inspector-General endorses the Tax Office agreement to address the issues identified and looks forward to further detail becoming available.

Subsidiary Finding 7

2.245 The ATO policy document dealing with the remission of interest should clearly articulate the type of key factors the Commissioner considers relevant to the remission of pre-amended assessment interest. *Taxation Ruling* IT 2517 is a useful model in that it contains an explanation of relevant factors and worked examples.

Tax Office response

2.246 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

2.247 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines.

Subsidiary Finding 8

2.248 Tax administration would be improved if the ATO, as a matter of fairness, communicated to all EBA participants that the existence of prior non-binding ATO advice, including advice provided to an adviser in respect of unnamed clients, may entitle them to receive a partial reduction in the rate of interest.

Tax Office response

2.249 Where a taxpayer received advice from the ATO in respect of an employee benefit arrangement which was subsequently implemented, that factor was taken into account in deciding whether the interest charge should be remitted. Taxpayers and their representatives have been given opportunities to advise the ATO of the receipt of any advice letters. To date there have been only a very small number of cases in which an arrangement has been implemented materially in accordance with the circumstances outlined in an advice letter.

Inspector-General comment

2.250 The Inspector-General notes the Tax Office response to this finding. However, a key issue is whether EBA participants or their advisers are aware of this possible ground of interest remission.

Subsidiary Finding 9

2.251 Tax administration would be improved if the ATO ensured that in all cases where interest remission decisions are made the reasons for these decisions are appropriately recorded on the file at the relevant time. This procedure would more readily allow these decisions to be the subject of internal ATO review (as recommended above) and also any external ATO review.

Tax Office response

2.252 The ATO agrees with this finding.

Inspector-General comment

2.253 Noted.

Subsidiary Finding 10

2.254 Tax administration would be improved if the ATO communicated directly to taxpayers who are involved in EBAs the extent to which the presence of arm's length employees in their EBA arrangements will lead to different settlement terms. This communication should clearly define the term 'arm's length employees' so that taxpayers who read this ATO communication understand how it might apply to their circumstances.

Tax Office response

2.255 The information generally available to the ATO does not allow identification of cases involving benefits primarily for arms length employees.

2.256 As recognised by the Inspector-General, the ATO has publicly communicated that settlement of employee benefit trust arrangements involving primarily arm's length employees will be considered on a case

by case basis. Where taxpayers or their representatives consider that their arrangements fall into this category they should contact the ATO.

Inspector-General comment

2.257 The Inspector-General notes the Tax Office response to this finding. However, a key issue is whether EBA participants or their advisers are aware of this possible ground of interest remission.

Subsidiary Finding 11

2.258 Tax administration would be improved if the ATO were to readily make available a mechanism to allow taxpayers to check how interest calculations have been made. The nature of this mechanism should be determined in consultation with appropriate parties, including taxpayers, tax agents and professional bodies representing tax agents and tax advisers.

Tax Office response

2.259 The ATO will consider such mechanisms as part of the improvements under the easier, cheaper and more personalised change program.

Inspector-General comment

2.260 The Inspector-General endorses the Tax Office agreement to address the issues identified and looks forward to further detail becoming available.

Subsidiary Finding 12

2.261 Tax administration would be improved if ATO communications to EBA taxpayers specifically made reference to the fact that ATO delay is a ground for interest remission.

Tax Office response

2.262 Contrary to paragraph A5.113, the ATO has partially remitted the interest charge in a number of cases due to acceptance that the ATO contributed to an undue delay in issuing amended assessments.

2.263 Further, after publication of the report we will be communicating with all tax agents explaining the implications, consistent with our response. This will cover remission issues.

Inspector-General comment

2.264 The Inspector-General notes the Tax Office response, although the ATO was only able to provide documentary evidence in respect of one case.

2.265 The Inspector-General supports a direct communication process to all tax agents, to assist their communication with their clients, covering interest remission and other matters associated with this report.

APPENDIX 1: COMMISSIONER OF TAXATION'S LETTER IN RESPONSE TO REPORT

Australian Government
Australian Taxation Office

COMMISSIONER OF TAXATION

Mr David Vos AM
Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

Dear David

REVIEW OF THE REMISSION OF THE GENERAL INTEREST CHARGE

The following are my comments on the Review.

Introductory Comments

At times views on our administration of the law in the areas covered by the report are based on a premise that the operation of the current law is inappropriate and that we should compensate for that.

In this category I put views as to the appropriateness of the General Interest Charge rate, particularly in the period prior to an amended assessment issuing, and the fact that our tax system generally places ultimate responsibility on taxpayers, even where they rely on the advice and opinion of others.

Ultimately these are matters for Parliament. I note in this regard that the Review of Income Tax Self Assessment initiated by Government is examining the operation of the General Interest Charge and issues of certainty for taxpayers.

Individual Circumstances

The broad design of the current remission powers is to provide for defined circumstances relevant to the individual, with a further power of remission where there are special circumstances or where it is otherwise appropriate.

While broad, the further remission power is not unfettered. There must be reasonable grounds for exercising it.

In practice the further remission power has been exercised in a wide range of cases where the necessary circumstances have been found to exist.

PO BOX 900 CIVIC SQUARE ACT 2608 AUSTRALIA
ADDRESS
+61 (0)2 6216 1111
TELEPHONE
+61 (0)2 6216 2743
FACSIMILE

Thus we have used that power in the context of some widely marketed schemes where there are particular circumstances warranting it. Other examples include situations where there are acknowledged gaps in the law, periods between announced changes to the law and enactment of the relevant legislation, reliance on publications (e.g. Tax Pack) in the event they prove to be misleading, so called GST "wash transactions" and where the ATO has delayed in issuing an amended assessment after gathering all relevant information necessary for the assessment. More recently we have exercised this power in addressing small business debt accumulated over the period of the transition to the new tax system.

The fact that the terms of settlements, including interest charge remissions, generally apply equally to all investors reflect that the reasons for the settlement generally go to the nature of the arrangements and of the investor's involvement in them. Similarly the reasons for other initiatives such as the small business debt initiative mean that the terms apply to participants generally.

Efficient administration is one of the matters taken into account in determining the terms of any settlement offer. For example the ability to resolve large numbers of disputes and allow resources to be more effectively employed in managing the tax system is a relevant factor in determining the final terms of a settlement.

This means that where it is appropriate to settle, the terms have generally been set at a level that is more beneficial than having regard solely to the circumstances of the various participants.

As a result grounds for further remission of the interest charge would generally be expected to relate to an individual participant's financial and other circumstances not directly related to the nature of the arrangement and the circumstances of the person's participation in it.

Consistency

Balancing the objectives of settlements in these areas is difficult and ultimately comes down to a matter of judgement. It is always possible that someone reviewing a particular settlement offer could form a different judgement. That does not make the original decision maker's decision wrong or inappropriate.

Given the inherent difficulties in these judgements I have, however, decided that the opportunity for consistency would be enhanced if all future widely based settlements are considered by a single panel of suitably senior officers. This will be supported by guidelines specifically tailored to these types of settlements, derived from our experience to date. The guidelines will be open for public consultation and will be kept under review.

Retirement Village Settlement

While not disturbing the judgement made on the level of remission of the interest charge in these cases, I have decided that participants should not be required to forego their

rights of objection and appeal to gain the benefit of the reduction in penalties and interest.

While developed in a settlement context, the reduction in penalties to 5% (in response to a voluntary disclosure) and the reduced interest charge through its application from 20 April 2001 only (having regard to the date of the relevant Media Release and any delays by us in acting on the matter) operate by virtue of the law and our policies. Individual participants have been advised of this decision.

Employee Benefit Arrangements

Settlements in widely marketed arrangements must be determined on the merits of the circumstances involved. The mere fact that an arrangement has been marketed to a group of people is not, of itself, grounds for settlement. An important consideration in this is the impact of any settlement on the future health and integrity of the tax system.

The fact of lobbying in the media or at a political level is not a reason to prevent a settlement in a particular case.

However it is important for the health and integrity of our tax system that lobbying alone is not seen as a successful technique for achieving a favourable settlement that is not otherwise justified.

Exceptional circumstances were involved in the case of the mass marketed investment schemes, as recognised by the Senate Economics References Committee following extensive hearings and consideration.

The settlement offer reflected that.

In announcing that settlement we also stated that we viewed Employee Benefit Arrangements as inherently different.

The factors noted in your report have been considered previously, as have the countervailing factors referred to in your report and in our comments on the findings.

While noting some individual factors may be arguable one way or the other, in balancing the factors, we remain of the view that Employee Benefit Arrangements are inherently different to the mass marketed investment schemes and that a different response is required.

Perhaps reflecting urgings that the arrangements would be successful in court or more particularly that lobbying would deliver a highly concessional settlement many investors have refrained from paying the taxes raised on their participation in the arrangements.

The release of this report and our response should put paid to any prospect of a highly concessional settlement. Equally on the legal front the Courts have now found that the arrangements brought before it in the six cases heard to date are ineffective in delivering the claimed tax benefits.

Stepping back from the detail about treatment of the interest charge and settlement, what is now clear given the period they have been in dispute is that these participants now face interest charges reaching extraordinary levels, often in excess of 100% of the primary tax in dispute. Most of this has accrued since the issue of amended assessments.

While noting that lobbying should not be seen to gain a result not otherwise justified, the situation now reached requires a response in the interest of those involved and of appropriate administration.

The level of the interest charge is such that it may of itself present a barrier to participants resolving their debts.

In balancing the various matters in this issue I have therefore decided that greater weight should be given to this interest charge outcome at this time.

Given that, I have further decided that the combination of factors, with this increased weighting for the accumulation of General Interest Charge, warrants a partial remission of the Charge. As a result the total amount of the pre and post amendment interest charge accruing to the date two months from the release of this report will be capped at 70% of the primary tax in dispute (ie. excluding penalty and interest). Where we have issued both income tax and fringe benefits tax assessments, we will only be seeking to recover tax in respect of one of those assessments which will usually be income tax.

General Interest Charge will continue to apply at the normal rate from that date.

The capping of the interest charge will apply irrespective of whether participants continue to pursue their disputes through the normal review processes.

However, these participants who wish to continue to pursue their disputes can limit their exposure to further General Interest Charge under our current arrangements for amounts in dispute.

Under these, in return for paying 50% of the tax in dispute (excluding penalty and interest) the General Interest Charge on the remaining amount is reduced by 50% for the period up until the dispute is finalised.

Participants not pursuing their rights of review and appeal who enter into a payment arrangement will be given a 50% reduction in the General Interest Charge for the period of the repayment. They will be required to enter into direct debit arrangements as part of this.

A payment arrangement of up to 12 months will be generally granted.

People will be entitled to seek a longer period based on their individual circumstances.

Participants will also be entitled to make individual applications for remission of penalties, further General Interest Charge remission or hardship relief having regard to their individual financial and personal circumstances. Special arrangements, including for internal review of decisions, will be put in place to consider these applications.

A large number of participants have already settled their position and paid the amounts outstanding. As necessary they will benefit from the capping of the General Interest Charge.

Consistent with our practice to date we will continue to offer formal settlements in appropriate cases. In practice this would mean a reduction in the penalty imposed for some cases.

Participants with outstanding debts who do not pursue any of the above options to resolve their case will face firm collection action.

The Attachments provide specific comments on the report's key findings (Attachment A) and subsidiary findings (Attachment B).

Yours sincerely

Michael Carmody
COMMISSIONER OF TAXATION

8 July 2004

APPENDIX 2: LAW AND POLICY FOR IMPOSITION OF INTEREST AND PENALTIES

A2.1 This appendix sets out how interest for underpaid tax and late payment of tax has been imposed during recent years. It also sets out the policy which has underlined the imposition of this interest during this time period.

A2.2 Particular concentration has been given to how these interest charges have been imposed in years of income prior to and including 1999/00 as the majority of the disputes examined during the course of this review relate to these earlier income years.

A2.3 While focusing on interest imposed by the law, at appropriate points the history of how the ATO has imposed penalties for underpaid tax during recent years is also described.

A2.4 This appendix deals with interest and penalties for underpayments and late payments of income tax. However, as some of the disputes referred to in later appendices of this report also concern underpayments and late payments of fringe benefits tax, a brief section is also included on the interest and penalties which apply for underpayment and late payment of this form of tax.

IMPOSITION OF INTEREST FOR UNDERPAID TAX AND FOR LATE PAYMENT OF TAX

A2.5 Interest for underpaid tax (pre-amended assessment interest) is the interest payable from the date when an original assessment is due for payment for a particular income year up to the date upon which the ATO issues an amended assessment for that year.

A2.6 Interest for late payment of tax (post-amended assessment interest) is the interest that is levied from the date when an amended assessment is due for payment until the date it is in fact paid.

A2.7 Since 1992, both interest for underpaid tax and the late payment of tax have been automatically imposed on taxpayers, under specific legislative provisions.

A2.8 The ATO has, however, always had power to remit both these forms of interest. This remission power and how it has been exercised during this period is the subject of the next appendix of this report.

HISTORY OF INTEREST CHARGES

A2.9 The history of interest charges for underpaid tax and late payment of tax over recent years falls into three main phases — a pre-1992 phase, a 1992-99 phase and a post-1999 phase.

Pre-1992 phase

Interest for underpaid tax

A2.10 Prior to 1992, the regime for interest on underpaid tax operated as follows. Generally, an interest charge for underpaid tax was not automatically imposed. Instead, a penalty of up to 200 per cent of the relevant underpaid tax was applied when an assessment was amended.[1] The ATO had a general power to remit this penalty in whole or in part.[2]

A2.11 In *Taxation Ruling* IT 2517 the ATO indicated that it would normally levy this penalty for underpaid tax on the basis that it consisted of two components — a per annum interest-like charge (which was set at the rate of 14.026 per cent) and a separate flat penalty component.

A2.12 The per annum component was set at the same rate of interest which was paid on overpayments of tax. However, the per annum charge on underpaid tax was not tax deductible, while any interest received on an overpayment of tax was assessable. This meant that, from a taxpayer's perspective, the after tax cost of interest on underpaid tax was greater than the after tax benefit of interest received from the ATO for overpaid tax.

---

1 Section 223 of the *Income Tax Assessment Act 1936* (ITAA 1936).
2 Section 227 of the ITAA 1936.

A2.13 The penalty component of the charge for underpaid tax was also not tax deductible.

Interest for late payment of tax

A2.14 For years of income up to and including 1991/92, if an amended assessment was not paid, a late payment penalty was charged (on a simple interest basis) at the rate of 20 per cent per annum.[3] This charge was not tax deductible.

1992-1999 phase

Interest for underpaid tax

A2.15 In 1992, after a review by Treasury, the Government decided to split the previous penalty for underpayment of tax into its interest and penalty elements. This split was achieved as follows. Firstly, new sections were introduced into the income tax law to levy penalties for underpaid tax.[4] Secondly, an existing provision, which up until 30 June 1992 had only operated to impose interest for underpaid tax in limited circumstances,[5] was amended so that it was now the principal section which imposed interest for underpaid tax.[6]

A2.16 The explanatory memorandum to the Bill which introduced the new separate interest charge described this charge as being 'compensation to the Revenue for the time value of money'.[7] The rate of interest was set at the 13 week Treasury note yield plus four percentage points.

A2.17 In the Second Reading Speech to this Bill, the Minister assisting the Treasurer described the extra 4 per cent as reflecting administration costs and the fact that most taxpayers would not be able to borrow at the

---

3 Section 207 of the ITAA 1936.
4 Sections 222 to 227 of the ITAA 1936.
5 These circumstances largely involved cases involving requests made by taxpayers under section 169A of the ITAA 1936 for the ATO's view of the law to be applied to a particular item shown in a lodged income tax return or other cases where the relevant item in dispute had been disclosed in the taxpayer's return.
6 This was section 170AA of the ITAA 1936.
7 Explanatory Memorandum accompanying the Taxation Laws Amendment (Self Assessment) Bill 1992, Chapter 8.

13 week Treasury note rate.[8] He also stated that the rate set for the new separate interest charge would make most taxpayers indifferent to borrowing from a bank or being liable to the interest at that rate.

A2.18 The new basis for calculating interest was not explained in the explanatory material accompanying the change, although some details of the principles that were applied were provided in an earlier Information Paper.[9] In 1994, the reasons for the change in calculation were more clearly explained as follows:

> 'The old benchmark was the weighted average yield of certain long term Treasury Bonds. However, this rate was not considered to be an accurate reflection of short term market rates of interest. For that reason it was decided to move to a new benchmark that is the 13 Week Treasury Note rate. It was also decided that the rate of interest payable by taxpayers for underpayments should be higher than that paid to taxpayers for overpayments. This reflects the commercial reality that a person has to pay a higher rate of interest to borrow funds than the rate they will receive for investing funds. '[10]

A2.19 According to the Department of the Treasury, the new basis for calculating pre-amended assessment interest also had the effect of achieving neutrality between taxpayers who met their tax liabilities by the due date and those who did not.[11]

A2.20 The above reasons were referred to in an Explanatory Statement connected with changes made to the rate of interest payable on overpayments of tax. For the 1992/93 and 1993/94 years of income this rate of interest was set at 10 per cent. From the 1994/95 year onwards, it became equal to the 13 week Treasury Note yield. As a result of these changes, from the 1994/95 year of income the rate of interest for overpayments of tax became 4 per cent less than the rate of interest for underpaid tax.

---

8 Second Reading Speech to Taxation Laws Amendment (Self Assessment) Bill 1992.

9 Commonwealth of Australia, *Improvements to Self Assessment – Priority Tasks – An Information Paper,* August 1991, at paragraphs 7.66 to 7.69.

10 Explanatory Statement accompanying the Taxation (Interest on Overpayments) Regulations 1994.

11 Commonwealth Treasury, *Review of Aspects of Income Tax Self Assessment*, Discussion Paper, March 2004 at page 64.

Penalties for underpayment of tax post 1992

A2.21 In the post 1992 regime, penalties were to be used as the main administrative mechanism under which taxpayers were to be penalised in respect of any culpable behaviour they had exhibited as regards the underpayment of tax. Specifically, in designing the post 1992 penalties regime, the ATO and Treasury worked on the basis that such penalties served two complementary purposes:

- they helped define a 'correct' tax return by setting standards to be met; and

- they punished taxpayers who committed an unexcused breach of the prescribed standards.[12]

A2.22 The level of penalties payable in various situations was specifically set by statute. Penalties could be increased or decreased according to whether there were specific aggravating or ameliorating circumstances surrounding a particular taxpayer's behaviour. The ATO also had a general power to remit the level of penalty otherwise set by statute.[13]

A2.23 The manner in which the ATO has exercised its broad remission power in relation to penalties is discussed in the next appendix of this report.

A2.24 The basic levels of penalties which applied for each year of income from 1992/93 until 1999/2000 were as follows:

(a) Reasonable Care or Reasonably Arguable Position

If a taxpayer took reasonable care in preparing their tax return and the tax underpaid was less than $10,000 or 1 per cent of the tax that would have been payable on the basis of the taxpayer's return, no penalty was payable.

If the underpaid tax exceeded $10,000 or the 1 per cent threshold, the taxpayer took reasonable care and also had a reasonable arguable position, no penalty was payable.

---

12 Commonwealth of Australia, *Improvements to Self Assessment – Priority Tasks – An Information Paper,* August 1991 at page 5.

13 The relevant provisions were contained in sections 222 to 227 of the ITAA 1936.

(b) Lack of Reasonable Care

If the taxpayer failed to take reasonable care, a 25 per cent penalty of the underpaid tax was levied.

(c) Lack of a Reasonably Arguable Position

If the underpaid tax exceeded $10,000 or the 1 per cent threshold, and the taxpayer took reasonable care, but did not have a reasonably arguable position, a penalty of 25 per cent was payable.

(d) Failure to follow a private ruling

A penalty of 25 per cent of the underpaid tax was automatically imposed if a taxpayer failed to follow a private ruling they had obtained from the ATO.

(e) Recklessness or intentional disregard of the law

Reckless behaviour by the taxpayer, their tax agent or both attracted a 50 per cent penalty, while intentional disregard of the law attracted a 75 per cent penalty.

(f) Tax avoidance schemes

If the taxpayer had entered into a tax avoidance scheme, for example, one which attracted the general anti avoidance provision, Part IVA of the ITAA 1936, a 50 per cent penalty was attracted. This was reduced to a 25 per cent penalty if there was a reasonably arguable position that Part IVA did not apply.

Aggravating and ameliorating circumstances

A2.25 The aggravating circumstances which, under statute, could increase the above penalties were as follows:

- hindrance of the ATO;
- a failure to notify the ATO within a reasonable time after becoming aware of the underpayment; and
- prior year penalties for carelessness, recklessness or intentional disregard of the law.

A2.26 In all the above cases the aggravating circumstance would increase the basic penalty levied by 20 per cent (for example, a 25 per cent penalty became 30 per cent).

A2.27 The ameliorating circumstances which could reduce the level of basic penalty fell into two categories.

A2.28 The first category was where these ameliorating circumstances would operate to reduce the level of penalty to nil. These circumstances were:

- where the taxpayer's approach was consistent with advice they had received from a taxation officer; or
- where the taxpayer's approach was consistent with a general administrative practice of the ATO; or
- where the taxpayer was at the time of lodging their return awaiting a response to a private ruling request on the matter.

A2.29 The second category of ameliorating circumstances was where the circumstances would lead to some reduction in the level of the penalty. The two circumstances which fall into this category both relate to the situation where the taxpayer made a voluntary disclosure of the underpayment to the ATO. If the voluntary disclosure was made after a tax audit had commenced, the basic penalty was reduced by 20 per cent (for example, a 25 per cent penalty became 20 per cent), while if the disclosure occurred before any audit activity had commenced the penalty was reduced by 80 per cent (for example, a 25 per cent penalty became 5 per cent) or by 100 per cent (if the tax shortfall was less than $1000).

Late payment interest

A2.30 For the 1992/93 to 1998/99 income years, the interest charge for late payment of tax was made up of two elements.

A2.31 The first element was an interest charge levied at the same rate as interest for underpaid tax.[14] This interest charge was tax deductible.

14 This charge was levied under the newly introduced section 207A of the ITAA 1936.

A2.32 The second element was an 8 per cent per annum penalty on the amount of tax paid late.[15] This penalty was not tax deductible.

Rates of interest charged for underpaid and late paid tax from 1992/93 to 1998/99

A2.33 Appendix 7 shows the rates of interest for underpaid and late paid tax for each of the periods from 1992/93 to 1998/99.

Post 1999 phase for imposition of interest

A2.34 On 1 July 1999, the General Interest Charge (GIC) regime was introduced. The GIC created a single common rate of interest payable to the ATO where a correct payment was not received by the due date. It applied to most tax types administered by the ATO.[16]

A2.35 The new GIC system resulted in a number of major changes to the previous regime for underpaid tax and late payment of tax.

Increase in uplift factor for interest on underpaid tax to 8 per cent

A2.36 The first change introduced by the new GIC regime was that the rate of interest for underpaid tax was increased by four percentage points. This was achieved by raising the relevant uplift factor applied to the Treasury note rate from 4 per cent to 8 per cent. This increase was set out in the explanatory memorandum to the Bill which introduced the GIC.[17] However, no justification was provided for the increase in this explanatory memorandum, nor in any of the announcements accompanying the introduction of the Bill.

A2.37 At least one commentator has suggested that this change was not subject to any prior consultation with professional bodies which form part of the National Tax Liaison Group.[18]

A2.38 The ATO did release a consultative paper 'Review of Late Payment and Late Lodgement Penalties' in June 1997 to members of this

---

15 This charge was levied under section 207 of the ITAA 1936.

16 GIC is not applied to excise and diesel fuel rebates.

17 Explanatory Memorandum accompanying the Taxation Laws Amendment Bill (No. 5) 1998, at paragraph 1.46.

18 Van, Den Broek, '*General Interest Charge – a wolf in sheep's clothing*', ATP Weekly Tax Bulletin No 18, 3 May 1999.

group. However, this consultation paper makes no specific mention of interest on underpaid tax.[19]

A2.39 The absence of any consultation on this matter with members of the National Tax Liaison Group would appear to be confirmed by the minutes of the National Tax Liaison Group meeting of 3 December 1998, where the change in the rate of pre-amended assessment interest is described as a 'surprising inclusion' in the Bill which introduced the GIC.

Change in rate of interest on late paid tax

A2.40 The second major change introduced by the new GIC regime resulted in an approximate 3.3 per cent reduction in the previous nominal rate of interest applied for late payment interest.[20]

Change from simple to compounding calculation

A2.41 The third major change was that the interest rate for both underpaid tax interest and late payment interest was changed from a simple interest rate to a compounding interest rate. For administrative purposes, the simple rate was, however, maintained for the 1999/2000 year only.

Transitional provisions

A2.42 The fourth major set of changes made by the new GIC regime related to the transitional provisions that were to apply for interest relating to prior year assessments.

A2.43 Firstly, under these transitional provisions, the new GIC regime replaced the previous charge for interest on underpaid tax where this interest was levied in relation to amended assessments for years of income prior to and including 1998/99. This meant that interest at GIC rates would be applied where a 1998/99 or earlier assessment was

---

19 A copy of this paper is available as an Attachment I to the National Tax Liaison Group minutes of June 1997.

20 The nominal interest for late payment of tax for the period from July 1998 to June 1999 was 16.8 per cent (that is, 8.8 per cent interest and 8 per cent penalty). The new GIC interest rate for late payment of tax was 13.5 per cent. As a special transitional measure to the introduction of the new system for interest on late paid tax the ATO in fact exercised its discretion to reduce the interest for late payment for the 1998-99 year to 13.5 per cent.

amended, but only to the extent that the period of the relevant underpayment occurred after 1 July 1999.[21]

A2.44 Secondly, again under transitional rules, where a 1998/99 or prior year amended assessment had not been paid by 1 July 1999, interest at GIC rates, rather than late payment interest under the previous regime, was payable on that amount from 1 July 1999.

Interest on overpaid tax

A2.45 The final change which the GIC regime introduced was a wider divergence between the rate of interest on overpaid tax and the rate of interest for underpaid or late paid tax. From 1 July 1999, interest on overpaid tax continued to be calculated on the basis of the 13 week Treasury note rate with no uplift. The only major change to this calculation occurred in 2001 when the reference base was changed to the 90 day bank bill rate, owing to the cessation of the Treasury note tender system. This has mean that, in contrast to the 1994 to 1999 position where the divergence between the ATO's interest rates for underpaid and overpaid tax was 4 per cent, the divergence in these rates became 8 per cent.

Policy basis for increasing the rate of pre-amended assessment interest

A2.46 As indicated above, neither the explanatory memorandum to the Bill which introduced the new GIC, nor any of the announcements accompanying the introduction of the Bill provide an explanation of the policy basis for the increased rate of pre-amended assessment interest that was to apply from 1 July 1999.

A2.47 However, an article published in the ATP Weekly Tax Bulletin No 18 and dated 3 May 1999 refers to a letter from the Assistant Treasurer to the author of the article which provides some insight as to the policy basis for increasing the rate of pre-amended assessment interest from 1 July 1999.

A2.48 The letter states that the increase in the rate for pre-amended assessment interest was made so that the rate was now slightly above

---

21 See section 399 of the *Taxation Laws Amendment Act (No. 3) 1999*, as amended by *A New Tax System (Pay as You Go) Act 1999*, items 90 and 91.

commercial rates for business and slightly below the rates that apply to personal borrowings. It also states that the new rate was set to discourage taxpayers from using the tax system as an unsecured mechanism for borrowing.

A2.49 These comments suggest that the new rate for underpaid tax was set at least partly to discourage certain behaviour by taxpayers, that is, it contained an element designed to influence taxpayer's behaviour.

Policy basis for the new post 1 July 1999 rate for post-amended assessment interest

A2.50 The explanatory memorandum to the Bill which introduced the new GIC is clearer on the policy basis for the new rate of post-amended assessment interest that was to apply from 1 July 1999. This memorandum indicates that the new interest rates for late payment of tax were to be 'transparent, consistent, commercially based and easy to administer'.[22] The memorandum further states that the new interest rate reflects 'market interest rates'.[23] It also states that the new rate would be more easily understood by taxpayers.[24]

A2.51 The term 'market interest rate' is not defined in the explanatory memorandum. This term can give a wide range of different interest rates, according to whether the term means the high alternative borrowing rates (in the form of personal loan or credit card rates) that are available to individuals or, at the other end of the scale, the much lower alternative financing rates that can be obtained by large companies. Judged from the perspective of individual non-business taxpayers, however, the initial new rate of interest, being a tax deductible rate of 12.72 per cent, compared favourably with the rate which individual taxpayers could obtain via a personal loan or credit card.

Alternative views as to the policy basis for the new rate of interest for pre- and post-amended assessment interest

A2.52 The explanatory memorandum to another Bill introduced in 1999, associated with the introduction of GST, provides an alternative

---

22 Explanatory Memorandum accompanying the Taxation Laws Amendment Bill (No. 5) 1998, at page 2.
23 ibid, at page 13.
24 ibid, at page 3.

view of the manner in which the new GIC interest rate was set.[25] This other explanatory memorandum states that the GIC was:

> '… based on a commercially realistic rate **together with a fixed culpability component** [emphasis added].'

A2.53 It is not clear whether this statement in this other Bill explaining the basis for the new GIC applied to GIC generally (that is, to both pre- and post-amended assessment interest) or only to post-amended assessment interest (that is, interest on late paid tax). The context of the statement suggests that it may have applied to post-amended assessment interest only. However, the actual statement only refers to 'GIC' without any reference to whether this term covers either pre- or post-amended assessment interest, or both.

A2.54 This statement suggests that the new interest rate, at least for late paid tax, was set at least partly to discourage certain behaviour by taxpayers, that is, it contained an element designed to influence taxpayer's behaviour.

A2.55 An alternative view is that no weight should be placed on the above statement as the Bill in question did not enact or amend the operative provisions which give effect to the GIC. The statement could be viewed as an attempt to outline some features of the then recently enacted GIC with a view to elaborating on the impact of placing certain indirect tax measures within the scope of the GIC.

A2.56 A further view of the policy basis for the new rates for both pre- and post-amended assessment interest is that these rates were made the same as part of a broad simplification process of the interest regime.

History of imposition of interest post 1 July 1999

A2.57 The history of the imposition of interest for underpaid and late paid tax since 1999 can be divided into two separate time periods: a 1999/2000 phase, and a 2000/01 and beyond phase. Slightly different rules for the imposition of both forms of interest have applied for these time periods.

---

25 A New Tax System (Indirect Tax Administration) Bill 1999.

1999/2000 phase

A2.58 When an assessment for the 1999/2000 year of income was amended, interest for underpaid tax would still be levied,[26] but at the GIC rate.

A2.59 If a 1999/2000 year amended assessment was not paid, a separate interest charge for late payment would arise. This was also be levied at the GIC rate.[27]

A2.60 These rules mean that when a 1999/2000 assessment was amended, the same rate of interest would be charged for both the period prior to that amended assessment being issued and for the period after that assessment was due for payment. However, there would be a 'gap' period when no interest was payable. This was the period between the date of issue of the amended assessment and the due date for payment of this assessment.

A2.61 Appendix 8 shows the rates of GIC payable for each quarter from 1 July 1999 to 30 June 2000.

2000/2001 and beyond phase

A2.62 For the 2000/01 and later income years, interest for underpaid tax and late payment of tax were merged into a single GIC.[28] This meant that, when an assessment for the 2000/01 year of income was amended, GIC would be levied for the entire period starting from the due date of the original notice of assessment for the relevant year of income up to the time when the relevant tax was paid.

A2.63 From 1 July 2001, two further changes were made to the GIC rules.

A2.64 Firstly, the uplift factor contained in the GIC rate was reduced from 8 per cent to 7 per cent.

A2.65 Secondly, the reference base for the levy of GIC was changed from the 13 week Treasury note rate to the 90 day bank bill rate.

---

26 Section 170AA of the ITAA 1936.
27 This interest is levied under subsection 204(3) of the ITAA 1936.
28 This charge is levied under subsection 204(3) of the ITAA 1936.

A2.66 Appendix 8 shows the rates of GIC payable for each quarter from 1 July 2000 to 30 June 2004.

A2.67 From 1 July 2000, the previous penalties regime for underpayment of tax was also changed. The changes mainly represented a rationalisation of the penalties system so that uniform penalties were to be applied across different tax types administered by the ATO. However, the underlying rationale for these penalties, and the basis of their imposition and remission, remained largely the same as prior to 1 July 2000. The ATO has stated that the rulings which were issued on the previous 1992-2000 penalties regime still apply to the post-2000 penalties regime.[29]

Assessability and deductibility of interest and penalties

A2.68 The net cost to taxpayers of any interest or penalties imposed in connection with an amended assessment will be affected by the extent to which those interest or penalties are tax deductible. The rules in this area have also changed over recent years.

Prior to 1992/93

A2.69 Prior to the 1992/93 year of income, interest for underpaid tax, the penalty for late payment of tax and the penalty for underpaid tax were all non tax deductible. Interest received on overpayments of tax was, however, assessable.

1992/93 to 1998/99

A2.70 For the years of income from 1992/3 to 1998/99 interest on underpaid tax was tax deductible. The interest component of the late payment charge for these years was also tax deductible, but the 8 per cent penalty aspect of this charge was not. Interest on overpaid tax remained assessable.

A2.71 For the 1992/3 to 1998/99 years of income, interest on underpaid tax was deductible in the year when the relevant amended assessment was received, not when it was paid.

A2.72 For these years, interest for late payment of an amended assessment accrued on a daily basis from the date when the amended tax

29 ATO *Practice Statement* PS LA 2004/5.

was payable. Accordingly, this interest was deductible on an accruals basis from the date the interest was due for payment, that is, it could be deducted prior to its actual payment.

A2.73 For the 1992/93 to 1998/99 years of income, penalties for tax shortfalls remained non-deductible.

Post 1 July 1999

A2.74 From 1 July 1999, the GIC was fully tax deductible. Penalties for tax shortfalls, however, remained non-deductible.

A2.75 For the 1999/2000 year there were still separate interest charges for underpaid and late paid tax. For this year, interest on underpaid tax was deductible during the year in which the amended assessment was received. Interest on late paid tax was deductible on an accruals basis from the date when the amended tax was due for payment.

A2.76 From the 2000/01 income year onwards, interest for underpaid tax and late payment of tax were merged into a single GIC charge for late payment. From this date, GIC has been deductible on an accruals basis from the date when the original assessment was due for payment. However, penalties for tax shortfalls have remained non deductible.

Review of imposition or remission of interest and penalties

A2.77 For all of the years of income from 1992/93 to date, the ATO's decision to impose or remit interest cannot be reviewed by the Administrative Appeals Tribunal (AAT). Any decision by the ATO to impose or remit interest can only be judicially reviewed in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977*.

A2.78 By contrast, for all of these years of income the ATO's imposition or remission of penalties can be reviewed by the AAT provided the amount of the penalty exceeds a certain minimum threshold. The AAT can also exercise the Commissioner's power of remission. An appeal relating to a remission of a penalty may also be taken to the Federal Court, but the Court is restricted to examining whether the ATO has acted in accordance with correct legal principles.

Fringe Benefits Tax

Interest and penalties for underpaid tax

A2.79 Prior to 1 July 1999, interest for underpaid fringe benefits tax (FBT) was imposed in a similar manner to the pre 1992 regime for income tax. Interest for underpaid FBT was not generally automatically imposed. Instead, a penalty of up to 200 per cent of the relevant underpaid FBT tax could be applied when an assessment was amended. In *Taxation Ruling* TR 95/4, the ATO indicated that it would levy this penalty for underpaid FBT on the basis that it consisted of two components — a per annum like interest charge (generally levied at the same rate as applied during this time period for interest on underpaid income tax) and a separate flat penalty component.

A2.80 When the GIC regime was introduced from 1 July 1999, the per annum component of this penalty charge was replaced by the GIC.

A2.81 Prior to 1 April 2001, the penalty imposed for underpaid FBT was imposed on a similar basis to that for underpaid income tax, except that penalty levels were set administratively (under *Taxation Ruling* TR 95/4) rather than by legislation. From 1 April 2001, this administratively based FBT regime for penalties was replaced by the uniform administrative penalty regime which now applies for all taxation laws.

Interest and penalties for late paid tax

A2.82 Prior to 1 July 1999, interest for late paid FBT was imposed under a specific legislative provision.[30] From 1 July 1999, this interest continued to be levied by a separate legislative provision,[31] but the rate of interest applied was calculated at GIC rates.

Review of imposition of interest for FBT

A2.83 The AAT had the power to review the ATO's decision to impose a per annum charge for underpaid FBT when this was charged by way of a penalty. The AAT has not been able to review the imposition of interest for underpaid FBT since this charge has been imposed as part of the GIC

30 This was under the former section 93 of the *Fringe Benefits Tax Assessment Act 1986* (the 'FBTAct').

31 This was under the new section 93 of the FBT Act which applies from 1 July 1999.

regime. Both before and after 1 July 1999, the AAT has not had the power to review the imposition of interest for late payment of FBT.

Conclusions and observations

A2.84 The main points to arise from this examination of the history of the imposition of GIC and penalties for income tax in recent years are as follows.

A2.85 The first observation is that the imposition of interest for underpaid income tax has undergone significant legislative change throughout the period from before 1 July 1992 to the present. The main changes have been as follows.

A2.86 In 1992, the penalty that applied for underpaid tax was separated into two components: an interest component and a penalty component. The interest component contained a 4 per cent uplift element. From 1 July 1994, the separate interest charge for underpaid tax was four percentage points less than the interest payable on overpayments of tax.

A2.87 The original 4 per cent uplift contained in the calculation for interest on underpaid tax was increased to 8 per cent in 1999. The 8 per cent uplift factor was reduced to 7 per cent in 2001.

A2.88 The separation into interest and penalty components also saw the introduction of income tax deductibility for the interest imposed on underpayments of tax.

A2.89 The second observation is that the imposition of interest for late payment of tax has also undergone significant legislative change throughout the period from before 1 July 1992 to the present. In contrast to the situation involving interest for underpaid tax, the net effect of these changes has been that the nominal rate of interest for the late payment of tax has actually decreased over this period — the major change having occurred on 1 July 1999 when the nominal rate was reduced by 3.3 percentage points.

A2.90 The third observation is that whilst the imposition of penalties has undergone some changes during the period from 1 July 1992 to the present, these changes have not been as extensive as those referred to above which have affected the imposition of interest for underpaid and late paid tax.

A2.91 The fourth observation is that the 1992 separation of interest from penalties in an underpaid tax situation indicates a different policy basis for each component. Interest would be levied to compensate the Revenue for the time value of money. Penalties would be levied to influence taxpayer's behaviour.

A2.92 The fifth observation is that from 1992 to the present, the ATO's power to remit interest has been subject to external review only in accordance with the provisions of the *Administrative Decisions (Judicial Review) Act 1977*. Perhaps reflecting its underlying purpose and the nature of the judgment exercised by the Commissioner, the ATO's power to impose and remit penalties has been, throughout this period, subject to review by both the AAT and the Federal Court.

A2.93 The sixth observation relates to the different rules which apply for the imposition of interest and penalties for FBT and income tax. For interest, different rules operated for each type of tax for the period prior to 1 July 1999. For penalties, different rules operated for the period prior to 1 April 2001.

A2.94 The ATO has indicated that, as a matter of administrative practice, it generally applied the same principles for imposing and remitting interest and penalties for these two types of taxes.

A2.95 Nevertheless, the existence of these different rules means that, where a transaction gives rise to either a disputed income tax liability or a disputed FBT liability (as in the case of employee benefit arrangements discussed in detail in Appendix 5), the interest and penalties calculations may be different.

APPENDIX 3: LAW AND ATO POLICY FOR REMISSION OF INTEREST AND PENALTIES

INTRODUCTION

A3.1 Part A of this appendix sets out the legislative history of the remission of the interest charge and details the ATO's interest remission policy.

A3.2 Part B traces the historical development of the ATO interest remission policy against the backdrop of legislative amendments to the interest provisions. It considers the nature and purpose of the interest charge and the effect of the interest charge given the ATO's interest remission policy.

A3.3 Part C of this appendix outlines the factors that have been considered by the Commissioner in exercising the discretion to remit the interest charge in certain arrangements and how the Commissioner exercised this discretion when dealing with groups of taxpayers. It also examines the concerns raised with the Inspector-General regarding the treatment by the ATO of groups of taxpayers, including the type of relevant 'factors' considered by the Commissioner and the approach adopted by the Commissioner in settling disputes with groups of taxpayers.

A3.4 Part D specifically addresses particular concerns raised with the Inspector-General regarding the ATO's interest remission policy, including instances where there is ATO delay during the pre-amended assessment period and a lack of taxpayer and community awareness of the ATO's interest remission policy.

A3.5 Part E of the appendix briefly examines the ATO policy for the remission of penalties for both income tax and fringe benefit tax purposes. It refers to some of the concerns raised with the Inspector-General regarding the significance of factors considered relevant to remission of penalties when considering the remission of the pre-amended assessment interest.

PART A: BACKGROUND TO THE INTEREST REMISSION POWER

Legislative basis

Years of income up to and including 1991/1992

Interest for underpaid tax

A3.6 Prior to 30 June 1992, no separate provision generally operated to impose or remit interest on underpayment of tax. Rather, this interest was imposed administratively as part of the per annum component of the penalty for unpaid tax.[32] The Commissioner had a wide discretion to remit in whole or in part the imposed penalty tax.[33]

Interest for late payment of tax

A3.7 Interest for late payment of tax was imposed as a late payment penalty (LPP).[34] This was calculated on a simple interest basis at the rate of 20 per cent per annum.[35] The Commissioner was given the discretion to remit this penalty, but on certain conditions. These conditions were similar to those that applied for the 1999/2000 year of income, as discussed below.

Years of income from 1992/1993 up to and including 1998/1999

Interest for underpaid tax

A3.8 For the years of income from 1992/93 to 1998/99, the previous penalty for underpaid tax was split into separate interest and penalty elements. The Commissioner was given wide discretions to remit both these elements.[36]

---

32 Penalty for unpaid tax was imposed pursuant to section 223 of the *Income Tax Assessment Act 1936* (ITAA 1936). Section 170AA of the ITAA 1936 had limited application.

33 Section 227 of the ITAA 1936.

34 Late Payment Penalty rates are detailed in Appendix 7 of this report.

35 Section 207 of the ITAA 1936.

36 The remission power for the interest element was contained in subsection 170AA(11) of the ITAA 1936, while the remission power for the new separate penalty was contained in subsection 227(3) of the ITAA 1936.

Interest on late payment of tax

A3.9 Following amendments to the law, taxpayers became liable for two separate charges on any amount of tax left unpaid after the due date, with each provision having its separate remission power.[37]

A3.10 A penalty was imposed by way of a per annum charge for tax that remained unpaid after the date of payment.[38] The Commissioner's power to remit this charge was subject to similar limitations to those that applied for the year of income 1999/2000, as discussed below.[39]

A3.11 A per annum interest charge was also levied for late paid tax.[40] The Commissioner was provided with a wide discretion to remit the whole or any part of the interest payable by a taxpayer under this section.[41]

1999/2000 year of income

A3.12 As discussed in Appendix 2, for the 1999/2000 income year separate charges for interest on late paid tax and interest on underpaid tax were levied. Both forms of interest were charged at the new uniform GIC rate.

Interest on underpayment of tax

A3.13 For this year, interest on unpaid tax continued to be imposed as a separate charge.[42] The power to remit this form of interest was expressed in wide terms without specifying any conditions.[43]

Interest for late payment of tax

A3.14 Specific provisions allowed the Commissioner to remit interest that arose from the late payment of tax.[44]

A3.15 These provisions allowed the Commissioner to remit the interest if one of the following conditions applied:

---

37 Amendments introduced by the *Taxation Laws Amendment (Self-Assessment) Act 1992*.
38 Section 207 of the ITAA 1936.
39 Subsection 201(1A) of the ITAA 1936.
40 Section 207A of the ITAA 1936.
41 Subsection 207A(4) of the ITAA 1936.
42 Section 170AA of the ITAA 1936.
43 Subsection 8AAG(1) of the *Taxation Administration Act 1953* (TAA 1953).
44 Subsections 8AAG(1)-(5) of the TAA 1953.

- the delay in payment was not due to, or caused directly or indirectly by an act or omission of the person and the person has taken reasonable steps to mitigate those circumstances;

- the delay in payment was due to, or caused directly or indirectly by an act or omission of the person, the person has taken reasonable action to mitigate those circumstances and having regard to those circumstances it would be fair and reasonable to remit all or part of the charge; or

- there are special circumstances making it fair and reasonable to remit all or part of the charge.

Years of income 2000/01 and beyond

A3.16 For the years of income 2000/01 and beyond, interest for underpayment of tax was merged with interest for the late payment of tax and calculated pursuant to section 8AAC of the *Taxation Administration Act 1953* (TAA 1953).[45] The Commissioner's power to remit this interest charge was subject to the same limitations that applied to interest for late payment of tax during the 1999/2000 income year (see above) but effective from 1 July 2000, the Commissioner was also granted the power to remit the interest charge if it was 'otherwise appropriate to do so'.[46]

ATO policy for remission of interest

A3.17 This part of the appendix specifically examines the Commissioner's policy for the remission of interest arising where there is an underpayment of tax.

Years of income up to and including 1991/92

A3.18 *Taxation Ruling* IT 2517 provided some guidance as to the factors to be considered in the imposition and remission of the per annum component of the penalty for underpaid tax. This was the administratively imposed interest for underpaid tax that applied during this period in most circumstances.

---

45 The interest charge was imposed pursuant to section 204 of the ITAA 1936.
46 Paragraph 8AAG(5)(b) of the TAA 1953.

A3.19 *Taxation Ruling* IT 2517 also provided that the per annum component was intended to compensate the Revenue for the full amount of tax not having been paid by the due date. The rate of this interest charge was set at 14.026 per cent per annum, which was the same rate at which interest on overpayments of tax was imposed.[47]

A3.20 The ruling provided that any remission of this component should be made in only exceptional circumstances.[48] Generally, reduction of the per annum component would only be warranted where:

- a taxpayer makes a voluntary disclosure (the per annum component should generally be reduced to 10 per cent);
- a taxpayer did not know and could not be expected to know that a statement in his or her return was false or misleading or that income had been omitted (the per annum component should be reduced to nil);
- a taxpayer has been genuinely misled by actions of the ATO (the per annum component should be reduced to nil);
- a taxpayer made an understatement of taxable income which resulted from an interpretation of the law adopted by him or her for which there was judicial or quasi-judicial authority at the time of lodgement of the return — and the statement made in the return is misleading in only a minor particular. In this case the principles contained in another ruling, *Taxation Ruling* IT 2444, were to be followed when determining whether, and to what extent, the per annum component should be reduced.

A3.21 During this period another provision also operated in certain limited circumstances to impose interest for underpaid tax.[49] *Taxation Ruling* IT 2444 provided guidance on the manner in which the Commissioner would exercise any discretion to remit interest for underpaid tax during this period in these limited circumstances.[50]

---

47 *Taxation Ruling* IT 2517, paragraph 33.
48 *Taxation Ruling* IT 2517, paragraph 81.
49 Section 170AA of the ITAA 1936.
50 These circumstances largely involved cases involving requests made by taxpayers under section 169A of the ITAA 1936 for the ATO's view of the law to be applied to a particular item shown in a lodged income tax return or other cases where the relevant item in dispute has been disclosed in the taxpayer's return.

Years of income from 1992/93 up to and including 1999/2000

Interest for underpaid tax

A3.22 Chapter 93 of the current ATO Receivables Policy appears, at first glance, to set out how the Commissioner will remit interest for underpayment of tax for these years of income. However, a close reading of the opening paragraphs of Chapter 93 indicates that it applies to the remission of interest '*in particular, general interest charge imposed as a result of late payment*.'[51] As discussed in Appendix 2, interest for the underpayment of tax was merged with interest for late payment of tax from the years of income 2000/01 and onward. Chapter 93 therefore only provides guidance for the remission of interest on the underpayment of tax for the years of income 2000/01 and onward. Chapter 93 also appears to be focused on the remission of interest in the post-amendment assessment period.

A3.23 The ATO has confirmed with the Inspector-General that the current ATO Receivables Policy contains no specific guidance as to how the Commissioner will remit interest for the underpayment of tax for the years of income from 1992/93 up to and including 1999/2000.[52]

A3.24 The ATO has informed the Inspector-General that the reason for this omission is that the remission of interest on the underpayment of tax during these years was considered to be an assessing function, and therefore part of the understatement regime for underpayment of tax. The ATO has also recognised that the principles contained within the ATO Receivables Policy have in practice probably been used to consider remission of interest for the underpayment of tax for this period. The ATO has indicated that they intend to make the ATO Receivables Policy clearer on this point in future.[53]

A3.25 Leaving aside Chapter 93 of the ATO Receivables Policy, the ATO has indicated that *Taxation Ruling* IT 2444, issued on 27 August 1987, also provides some guidance as to how the

---

51 Commissioner of Taxation, *ATO Receivables Policy*, April 2003, accessed from http://www.ato.gov.au on 13 April 2004, Chapter 93. The preamble to the Chapter 93 provides that 'this Chapter takes effect from 1 July 1999 and relates to remission of the General Interest Charge (in particular, general interest charge imposed as a result of late payment)'.

52 Attachment to ATO Minute No: IGT02-2003, dated 8 January 2004.

53 ibid.

Commissioner will exercise the power to remit interest on underpayment of tax for the years of income 1992/93 up to and including 1999/2000.[54]

A3.26 Paragraph 14 of that ruling provides that having regard to the compensatory nature of the interest charge, it is clear that the legislature did not intend the remission power to be exercised in the general run of cases. In broad terms, the ruling identified three kinds of situations in which remission in whole or in part may be warranted:

- where a taxpayer voluntarily advises of an underpayment;
- where an understatement of taxable income resulted from an interpretation of the law adopted by a taxpayer for which there was a judicial or quasi-judicial authority at the time of lodgement of the taxpayer's return; or
- where, by reason of the particular circumstances, it is considered fair and reasonable to remit the interest.

A3.27 As will be further discussed below, concerns have been raised with the Inspector-General with the manner in which the Commissioner exercises his discretion to remit the interest charge.

A3.28 In the absence of specific guidelines, the manner in which interest for the underpayment of tax has been remitted by the ATO in practice for the years of income from 1992/93 up to and including 1999/2000 can only be ascertained from examining actual situations involving those years of income. The next three appendices of this review examine five such situations.

Interest on late payment of tax

A3.29 Chapter 92 of the ATO Receivables Policy deals with the Commissioner's powers to remit additional charges for late payment and the circumstances when those additional charges will be remitted. Chapter 92 has application before 1 July 1999.

A3.30 The policy provides that taxpayers have a responsibility to meet their payment obligations as and when their taxation debts fall due for payment. The various taxation laws provide for the automatic imposition

54 ATO Minute No: IGT015-2004, dated 23 February 2004, and email to the Inspector-General from ATO dated 16 April 2004.

of additional charges when a debt is paid late. The automatic imposition of additional charges for late payment is a response, by way of legislation, aimed at encouraging payment by the due date and compliance with future liabilities.[55]

A3.31 The ATO Receivables Policy notes that the legislation that applies for this period acknowledges that situations exist where it would be fair and reasonable for the additional charges to be remitted. The Commissioner has the discretion to remit the additional charges in part or in full depending on the circumstances that lead to the late payment.

A3.32 It also notes that the law identifies three specific circumstances when the Commissioner may exercise the discretion to remit the additional charges. These three circumstances have been listed earlier in this appendix.[56]

A3.33 Paragraphs 92.4.5 and 92.4.6 of the ATO Receivables Policy deal specifically with the per annum interest charge that was applied during this period. This interest is termed 'penalty interest' and the ATO Receivables Policy provides that:

> 'Penalty interest is by its nature a compensatory amount and is imposed where the Commonwealth has been denied the use of funds because amounts were not paid by the due date. Penalty interest may be remitted, but will only be remitted in limited and exceptional circumstances (for example, natural disasters such as fire, flood, or drought which directly caused serious financial difficulty).
>
> Each request for remission of the penalty interest will be considered on its merits and a decision made in light of the particular circumstances of the case. The debtor will need to demonstrate that exceptional circumstances apply for remission of this component of the additional charges.'

A3.34 Penalty interest does not necessarily imply culpability, but merely that, technically at law, the interest is imposed as a penalty (rather than imposed, for example, under contract).

---

55 Commissioner of Taxation, *ATO Receivables Policy*, April 2003, accessed from http://www.ato.gov.au on 13 April 2004, at paragraphs 92.3.1 and 92.3.2.

56 The specific set of circumstances have been listed at paragraph A3.15 of this appendix.

A3.35 The ATO Receivables Policy also deals with the remission of the separate penalty for late paid tax that applied during this period. Paragraph 92.4.8 of the policy provides that:

> 'The Commissioner will consider all of the factors put forward by a debtor in the request for remission, their effect upon late payment and the steps taken to alleviate the delay in payment. Remission will not be considered if the debtor were to rely on general grounds for the request, nor would it be considered if the debtor were to rely on factors that could only be remotely linked to the late payment.'

A3.36 The policy then goes on to list particular circumstances relevant to the remission power for this penalty component and provides some commentary on the Commissioner's view on what each entails. Relevant circumstances are:

- factors beyond the control of the debtor;
- acts or omissions of the debtor;
- relieving the circumstances or effects of circumstances;
- what is considered to be 'fair and reasonable';
- the taxpayer's good history payment;
- the bankruptcy or liquidation of the taxpayer;
- interest arising as a result of a court judgment;
- special circumstances; and
- situations involving disputed debt and amended assessments.

Years of income 2000/01 and onward

A3.37 The major publicly available ATO policies and guidelines associated with remission practices for the interest for the years of income 2000/01 and onward are:

- the ATO Receivables Policy — particularly Chapter 93; and
- the ATO's Code of Settlement Practice.

A3.38 As was previously discussed for the years of income 2000/01 and onwards, interest for the underpayment of tax and interest for the late payment of tax were merged into one interest charge, the GIC.[57]

A3.39 The current remission policy for GIC is contained in Chapter 93 of the ATO Receivables Policy.

A3.40 Although the comments made here concerning Chapter 93 and its approach to the remission of interest for the underpayment of tax are not directly relevant to the majority of the disputes examined for the purpose of this review, the comments are pertinent to the future application of the interest remission power in the pre-amended assessment period. The comments are also directly relevant to the application of the remission power for late payment interest in the disputes examined during this review.

Commissioner's current view as to the application of the interest remission power

A3.41 The Commissioner has stated that taxpayers have a responsibility to meet their payment obligations as and when their taxation debts fall due for payment. The various taxation laws provide for the automatic imposition of the GIC when a debt is paid late. The GIC automatically imposed by legislation is intended to encourage compliance with future liabilities. It denies late payers an advantage over those who do pay on time and the knowledge that the GIC is accruing should encourage debtors to organise their affairs in such a way as to enable them to pay on time.[58]

A3.42 The Commissioner acknowledges that situations may exist where it would be fair and reasonable for the GIC to be remitted. In such circumstances, a debtor has a right to request a remission of GIC and the onus is placed by the Commissioner on the debtor to demonstrate that remission is warranted. However, it is important to note that there is no legislative prohibition upon the Commissioner exercising the discretion to remit GIC on his own accord where the Commissioner decides that the circumstances warrant remission.

---

57 Section 204 of the ITAA 1936 imposes the liability to pay the GIC in income tax matters. The provisions in Division 1 of Part IIA of the TAA 1953 deal with the calculation of the GIC, imposition of GIC on Running Balance Accounts (RBA) and remission of the GIC.

58 Commissioner of Taxation, *ATO Receivables Policy*, April 2003, accessed from http://www.ato.gov.au on 13 April 2004, at paragraphs 93.3.1 and 93.3.2.

A3.43 Where a request is made by a taxpayer for the remission of GIC, the ATO Receivables Policy requires that a request be considered having regard to the following:[59]

- the facts of each individual case;
- the chapter titled 'Principles Underlying the Receivables Policy of the ATO'; and
- the policy guidelines contained in Chapter 93 of the ATO Receivables Policy.

A3.44 Paragraph 93.4.4 of the ATO Receivables Policy provides that it would be inappropriate for the Commissioner to exercise the discretion to remit GIC for the following reasons:

- as an inducement to encourage payment of debts;
- as an inducement to finalise a disputed assessment; or
- to finalise a case where the ATO has not attempted to collect the GIC.

A3.45 The ATO Receivables Policy also specifies that the Commissioner will consider all of the factors put forward by a debtor in the request for remission, their effect upon late payment and the steps taken to alleviate the delay in payment.[60]

A3.46 In considering the circumstances under which remission of GIC is appropriate, both the relevant legislation and the ATO Receivables Policy distinguish different classes of taxpayers dependent upon the circumstances causing the delay and whether there was reasonable action to mitigate those circumstances.

'Fair and reasonable' circumstances

A3.47 Apart from instances of hardship occasioned by natural disasters such as fire, flood and drought, the ATO Receivables Policy provides that the Commissioner may remit the GIC in circumstances where it is fair and reasonable to do so.

---

59 Commissioner of Taxation, *ATO Receivables Policy*, April 2003, accessed from http://www.ato.gov.au on 13 April 2004, at paragraph 93.4.3.

60 Commissioner of Taxation, *ATO Receivables Policy*, April 2003, accessed from http://www.ato.gov.au on 13 April 2004, at paragraph 93.5.5.

A3.48 Paragraphs 93.5.13 and 93.5.14 of the ATO Receivables Policy outline the Commissioner's views on what is meant by the term 'fair and reasonable'. They provide that:

> 'A decision by the Commissioner to remit GIC because it is fair and reasonable must be considered in view of the legislative policy that debtors should be liable to additional charges if they pay late. Not only must the exercise of the power to remit be fair to the debtor concerned, it must be fair to the whole community. In other words a debtor who pays late should not be given any advantage over those taxpayers who organise their affairs to ensure they can pay on time. Debtors will need to demonstrate that it is fair and reasonable to remit the GIC, having regard to the nature of the specific event or decision.
>
> Partial remission should be considered where the debtor has experienced the types of factors outlined in this chapter, and would otherwise qualify for full remission; however, their recent payment record has been unsatisfactory. It may be unfair to taxpayers who consistently do the right thing if those who choose not to comply are given the same level of remission. Partial remission may also be the appropriate in cases where the circumstances that led to the non payment were caused directly or indirectly by an act or omission of the debtor, and the debtor meets the other criteria for remission.'

A3.49 The ATO Receivables Policy provides no further information on how the discretion to partially remit the interest charge will be exercised. For instance, no specific guidelines are provided to indicate what proportion of the interest should be remitted, what specific circumstances will be considered and how partial remission will be calculated. This position may be contrasted to that taken by the Commissioner for the remission of penalties. For example, in relation to the Failure to Lodge on Time penalties the policy lists specific factors to be considered by the Commissioner in exercising the power to partially remit the penalty.[61]

A3.50 Paragraphs 93.5.22 and 93.5.23 of the ATO Receivables Policy outline particular examples of special circumstances where remission may be granted and deal with instances of hardship and release from payment of tax.

---

61 Paragraph 98.5.21 of the ATO Receivables Policy.

'Otherwise appropriate' circumstances for remission

A3.51 The discretion to remit the GIC was broadened, effective from 1 July 2000, with the inclusion of the words 'or it is otherwise appropriate to do so'.[62] The Explanatory Memorandum for the Bill that proposed the amendment stated that:

> '3.62 This amendment to the TAA 1953 allows the Commissioner to remit the GIC in a wide range of circumstances.
>
> 3.63 The effect of the amendment is to give the Commissioner a broader discretion to remit the GIC than under the current provision.'

A3.52 The current ATO Receivables Policy states, at paragraph 93.5.24, that:

> '… this provision gives the Commissioner a degree of flexibility. It means that the Commissioner can adapt to changing circumstances, and consider unusual circumstances, or future issues, on their merits and make decisions accordingly. Such decisions will not usually be concerned with the circumstances of a particular taxpayer, but may extend to a particular group of tax debtors, or to the general body of tax debtors, and may involve consideration of issues of administrative efficiency and fairness. Decisions to grant remission under this provision will be restricted to senior Tax Office officers. An example of this type of decision is the announcement by the Commissioner of a settlement offer made to some taxpayers who have invested in mass marketed schemes, subject to those taxpayers being eligible for, and agreeing to enter into, specified settlement arrangements.'

A3.53 The ATO has expressed the view that paragraph 8AAG(5)(b) of the TAA 1953 does not grant the Commissioner an unfettered discretion to remit. However, the ATO has acknowledged that the ATO's policy guidelines may need to more fully discuss the scope and practical application of this limb of the remission power.[63]

Inspector-General's view

A3.54 It is important to acknowledge that in performing his duties, the Commissioner only has limited resources to allocate to particular

---

62 Amendment to subsection 8AAG(5) of the TAA 1953 by the *A New Tax System (Tax administration) Act (No. 2) 2000.*

63 Attachment to ATO Minute IGT30-2004, dated 27 May 2004, at page 8.

functions. This means that in carrying out his statutory functions considerations of administrative efficiency will be relevant. However, it is important that such limitations and considerations are balanced with the Commissioner's obligations under the Taxpayers' Charter. In particular, relevant to this discussion are the Commissioner's obligations under the Taxpayers' Charter to:

- act impartially and use his powers in a fair and professional manner; and

- make fair and equitable decisions in accordance with the law. This includes acting consistently, treating the taxpayer as an individual, listening to the taxpayer and taking all relevant circumstances into account.

A3.55 The Senate Economics Reference Committee in their Interim Report on MMTEIs raised the concern that the ATO had failed to take full account of relevant circumstances when dealing with interest remission and other decisions for MMTEI investors. Submissions to the Committee complained that taxpayers' efforts to have individual circumstances addressed were met with standardised pro-forma ATO correspondence that glossed over or simply ignored personal factors. The Committee noted that this style indicated a process-driven 'broad brush' approach to dealing with MMTEI investors and stated that:

> '… it was hard to reconcile, on the face of it, the claim that the ATO 'always' considers individual circumstances with the evidence presented to the inquiry. It seems to the Committee that the ATO's overall handling of many scheme participants is more influenced by the view that variations are 'relatively minor' across schemes and participants than the requirement to treat taxpayers on an individual basis. This view tends towards prejudging scheme participants and appears to have introduced a bias in the ATO's approach that marginalises individual circumstances.'[64]

A3.56 To address these concerns, the Committee considered that:

> '… it is incumbent upon the ATO to adapt its operating procedures to address individual circumstances in a manner consistent with the

64 Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report, June 2001, at page 40.

> Taxpayers' Charter. This is necessary for the ATO to meet its obligations under the Charter and Income Tax Assessment Act.'[65]

A3.57 Submissions to the Inspector-General also expressed a concern with how the Commissioner has applied the remission policy in a global manner regardless of individual circumstances.

A3.58 Such concerns seem well founded given the Commissioner's interpretation of paragraph 8AAG(5)(b) of the TAA 1953, particularly his view that the remission power would not usually be concerned with the circumstances of individual taxpayers. In the Inspector-General's view, the adoption of such a position marks a narrowing of the broad discretion afforded by Parliament to the Commissioner.

A3.59 It is important that the remission power be applied in a manner consistent with the broad effect intended by Parliament. There is no limitation placed by Parliament on this remission provision applying to the circumstances of a particular taxpayer or that it should only extend to a particular group of taxpayers. To do so, in the Inspector-General's view, unnecessarily restricts the operation of the discretionary power afforded by Parliament to the Commissioner to remit the interest charge.

A3.60 The ATO has expressed the view that an inference a reader may draw from the above discussion is that the ATO view of paragraph 8AAG(5)(b) of the TAA 1953 is that it applies only to groups of taxpayers. Rather, the ATO has indicated that the paragraph 93.5.24 of the ATO Receivables Policy does not preclude the application of the provision to an individual case, but reflects its administrative experience that the sort of situations where it would expect to use this wider power would generally be those relating to a group or groups of taxpayers. The ATO is of the view that, in practice, most individual cases would be dealt with under the other limbs of section 8AAG of the TAA 1953.[66]

---

65 Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report, June 2001, at page 41.

66 Attachment to ATO Minute IGT30-2004, dated 27 May 2004 at page 8.

PART B: HISTORY OF THE INTEREST REMISSION POWER AND ITS APPLICATION

Submissions to the Inspector-General

A3.61 Evidence and submissions to the Inspector-General have raised concerns with the impact of the interest charge and the Commissioner's approach to interest remission. In particular, submissions to the Inspector-General noted that the need for an appropriate and equitable remission policy was amplified by the current interest charge rate.

A3.62 Regarding the effect of the interest charge, a submission to the Inspector-General commented that GIC rate was, at least in part, penal in nature and made the following comments:

> 'It is difficult to see how the current method of application of the GIC and the current rate at which it prevails is a commercially realistic one, given the addition of the 7 percentage points. Nor is it possible to see how it could be labelled compensatory in nature. So much was acknowledged by the Commissioner when he stated that eligible investors in mass marketed schemes 'will be entitled to an interest reduction from the full general interest charge, currently 11.89 per cent, to a rate reflecting the time value of money.'

A3.63 In a similar vein, another submission to the Inspector-General expressed the view that:

> 'It is difficult to see how the GIC can reflect 'market interest rates' in regard to many taxpayers, as the 7 per cent premium on the 90-day Bank Bill rate will often result in a greater GIC rate than the equivalent market rate of debt funding available to a taxpayer and the Government (particularly in the current, low interest environment). Whilst the GIC may be deductible, it nonetheless requires significant cash outlay from a taxpayer to pay the amount to the ATO. As a result, the GIC effectively serves as an additional penalty on a taxpayer.'

A3.64 The submission goes on to conclude that:

> 'On the basis that the GIC rate does not 'reflect market interest rates' it is submitted that the current rate of GIC and its full application in addition to the other administrative penalties is not serving the original policy intent of the provisions.'

A3.65 Some submissions concede that the GIC is apparently intended to serve as a disincentive to taxpayer's to 'use the Treasury as a bank' and delay payment of tax. However, they point out when this is coupled with the ATO's reluctance to remit the GIC in all but exceptional circumstances the policy intent seems:

> '… inappropriate in situations where the taxpayer has genuinely intended to pay the correct amount of tax and the tax shortfall arose, for example, due to uncertainty and lack of ATO guidance as to how the law properly applied.'

A3.66 The ATO confirms that it will only remit the GIC in 'exceptional circumstances'. It states:

> 'The introduction of the GIC from 1 July 1999 also did not change the circumstances in which remission of interest (GIC) for the pre-amended assessment period would be warranted. It is true that the rate of interest increased by adding 8 percentage points to the base interest rate (section 170AA was previously determined by adding 4 percentage points to the same base rate). In the EM accompanying the amendment it was recognised that there would be an increase in the interest rate in cases where an amended assessment increased the amount of tax payable (refer to paragraphs 1.45 and 1.46 of the EM to the Taxation Laws Amendment Act (No.3) 1999). However, there is nothing in the legislation or the EM suggesting that the Parliament intended the remission power should be exercised any differently. The general remission power in subsection 8AAG(1) of the TAA which applied in the 1999-2000 year was essentially the same as subsection 170AA(11) which applied in earlier years.'[67]

A3.67 In support of that view the ATO refers to the Explanatory Memorandum to the *Taxation Laws Amendment (Self-Assessment) Act 1992*, which stated the following in respect of the penalty interest for late payment:

> '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

67 ATO Minute No. IGT015-2004, dated 23 February 2004.

> 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*.'[68] (emphasis added by the ATO)

A3.68 In critically evaluating the views expressed in the submissions as to the nature of the interest charge and the position taken by the Commissioner in his current interest remission policy, it is important to have regard to the amendments made to the interest provisions discussed in Appendix 2. It is also necessary to examine the underlying policy behind the legislative changes and the development of the remission policy in that context.

Nature and purpose of the interest charge and consistency of the ATO interest remission policy with that purpose

Position for the years of income up to and including 1991/92

A3.69 During the years of income up to and including 1991/92, there were no separate general provisions operating to impose or remit interest on the underpayment of tax. Instead a penalty of up to 200 per cent of the underpaid tax could be applied. However, the ATO stated in *Taxation Ruling* IT 2517 that this penalty would actually be levied on the basis that it consisted of a per annum interest-like charge and a separate flat penalty.

A3.70 *Taxation Ruling* IT 2517 set out the remission guidelines to be followed in exercising the remission power in respect of both the penalty and per annum interest components of this penalty. This ruling made clear the purpose of each separate charge in paragraphs 33 and 34 of *Taxation Ruling* IT 2517. These provided that:

> 'The 'per annum' component is intended to compensate the Revenue for the full amount of tax not having been paid by the due date. In certain circumstances, the 'per annum' component may warrant further remission.

68 ibid.

> The 'culpability' component is separate from the 'per annum' component and reflects the gravity of the offence or the wrong doing of the taxpayer. It operates primarily in terms of the principle that the culpability of the taxpayer's actions is a function of the reason for or motivation of his or her actions. It will also account for the extent to which a taxpayer has assisted or facilitated ATO enquiries.'

A3.71 The rate imposed for this per annum component was equivalent to the rate that applied to overpayments of tax. Unlike the former policy that imposed a rate of 20 per cent per annum, it did not contain a penal or culpability component. The culpability of the taxpayer for the underpayment of tax was treated separately through the culpability penalty component.

A3.72 The ATO outlines its views on the policy objectives of the penalty regime in *Taxation Ruling* IT 2517. Paragraph 11 provided that:

> 'Although subsection 223(1) [of the ITAA 1936] is clearly intended to penalize heavily taxpayers who seek to evade their correct liability to tax, it is equally obvious that this legislation is not to be administered so as to be seen as oppressive by those taxpayers who, although caught by subsection 223(1), have made an honest attempt to fulfil their obligations under the income tax law. Subsection 227(3) recognizes that, in the context of subsection 223(1), there are degrees of culpability. Some situations will require substantial additional tax, others less substantial. Some, although these will be exceptional, may not warrant any additional tax at all.
>
> Penalties are an integral part of our taxation system. Taxpayers are expected to fully and accurately disclose relevant matters in their returns and this carries with it a significant duty of care. While the penalty provisions are accordingly attracted by a failure to meet that duty, those provisions also help to encourage voluntary compliance, on which our taxation system heavily depends. The administration of those provisions for which this ruling provides guidance should bear those principles in mind.'

A3.73 The guidelines clearly set out relevant factors that would be considered in determining the remission of the per annum component. These factors have already been mentioned in this appendix.

A3.74 Importantly, the ruling acknowledged the inherent difference between an interest charge and a penalty charge and the underlying purpose of each component.

Inspector-General's view

A3.75 In the Inspector-General's view, such an approach promoted transparency and ensured that taxpayers were better able to understand what each element represented. This ruling was important in ensuring that the administration of each element was not seen as oppressive by those taxpayers who made an honest attempt to fulfil their obligations under the income tax law.

A3.76 It is also important to note that the guidelines set out in *Taxation Ruling* TR 95/4 for the remission of penalty taxes arising from fringe benefit tax audit action are similar in application to the approach set out in *Taxation Ruling* IT 2517.

Section 170AA of the ITAA 1936

A3.77 During the period up to year of income 1991/92, section 170AA of the ITAA 1936 was a separate provision that imposed interest for underpaid tax in certain limited circumstances.[69] This provision had been inserted into the ITAA 1936 in 1986. The interest rate that applied under this section was also linked to the interest rate paid by the Commissioner on overpayments of tax.[70] On 27 August 1987, the Commissioner released *Taxation Ruling* IT 2444 to provide guidelines concerning the Commissioner's discretion to remit interest imposed under section 170AA in the limited circumstances where it applied.

A3.78 Paragraphs 13 and 14 of the ruling provided that:

> 'In considering whether, or to what extent, interest should be remitted, it is necessary to bear in mind the purpose for which the interest charge was introduced. Broadly, the interest charge on underpayments of tax is designed to compensate the revenue for the full amount of tax not having been paid by the due date.
>
> Having regard to the compensatory nature of the interest charge, it is clear that the legislation did not intend the remission power to be exercised in the general run of cases. This is specifically noted at page 70

69 Section 170AA did not operate where the underpayment of tax was subject to a penalty under section 223 of the ITAA 1936.

70 Paragraph 170AA(4)(b) of the ITAA 1936 provided that interest was to be imposed:
'… at such rate of interest as is, or such rates of interest as are, applicable under regulations made for the purposes of paragraph 10(1)(b) of the *Taxation (Interest on Overpayments) Act 1983*'.

> of explanatory memorandum, which accompanied the Taxation Laws Amendment Bill 1986. Against this background, factors such as ignorance or misinterpretation of the law and tax agent error will not normally be considered as circumstances warranting remission.'

A3.79 The ruling then went on to describe three kinds of situations in which remission of interest in whole or in part may be warranted where an amendment results in an underpayment of tax. These factors have previously been mentioned in this appendix.[71]

Amendments in 1992 to the interest regime

A3.80 In 1992, the Government decided to formally divide the previous penalty for underpayment of tax into its interest and penalty elements. This division was achieved by expanding the coverage of section 170AA of the ITAA 1936, so that it applied in all circumstances where there was an underpayment in tax.[72] In addition, the relevant rate of interest was set at the last weekly tender for the 13 week Treasury Note before the end of that month plus four percentage points. This rate of interest no longer matched the rate of interest paid in instances of overpayment of tax.

A3.81 Following these amendments to section 170AA, *Taxation Ruling* IT 2444 was not revised to reflect the changes to the nature of the interest charge under section 170AA with the introduction of the uplift factor. The Commissioner continued to apply the principles contained in the ruling, in particular the principle that remission of interest was not to be exercised in the general run of cases.

A3.82 The ATO accepts that it may have been appropriate to reconsider *Taxation Ruling* IT 2444 after the passage of the 1992 legislation. The ATO has also indicated that it does not necessarily follow that they would have come to a different conclusion regarding the scope for remission of the interest charge.

---

71 The specific set of circumstances have been listed at paragraph A3.26 of this Appendix.

72 The previous penalty provision under which the Commissioner imposed an interest charge, namely section 223 of the ITAA 1936, was also repealed at this time.

Amendments in 1999 to the interest regime

A3.83 The regime for interest on underpaid tax was again significantly amended on 1 July 1999 with the introduction of the GIC regime.

A3.84 The GIC was originally set in accordance with the weighted average yield of the 13 week Treasury Note rate plus eight percentage points. The basis of calculating the rate was later changed with the 90 day Bank Accepted Bill rate replacing the 13 week Treasury Note yield rate and the uplift factor being reduced from eight to seven percentage points. The Explanatory Memorandum to the *Taxation Laws Amendment Act (No. 3) 2001*, which effected the change, noted that:

> 'The Government considers that a 7 percentage point margin is sufficient to support the policy objectives that taxpayers should pay their tax liabilities on time and not use the Commonwealth as a lending authority.'

A3.85 In Appendix 2, there is reference to an article published in the ATP Weekly Tax Bulletin No 18 quoting a letter from the Assistant Treasurer to the author of the article. This letter also indicates that the uplift factor reflects an average borrowing rate which should discourage taxpayers from using the tax system as an unsecured mechanism for borrowing. It further states specifically that the uplift factor does not represent a culpability component.

A3.86 A submission to the Inspector-General expressed the view that in light of the introduction of an 8 per cent uplift factor as part of the interest charge, the approach taken by the ATO in relation to the remission of the GIC should ensure that it is only used in situations where it will encourage timely payment of liabilities and discourage the use of the Commonwealth as a lending authority.

Inspector-General's view

A3.87 Firstly, the current ATO Receivables Policy does not cover disputes for the years of income from 1992/93 up to and including 1999/2000. Only *Taxation Ruling* IT 2444 applied during this period.

A3.88 At the time *Taxation Ruling* IT 2444 was issued, the interest rate imposed for the underpayment of tax following an amendment to an assessment was linked to the interest rate imposed for overpayments in tax.

A3.89 With the amendments in 1992 and the introduction of an uplift factor to the interest charge, there was a change in the possible effect of the interest charge for the pre-amended assessment period.

A3.90 Notwithstanding these amendments, *Taxation Ruling* IT 2444 continued to express the Commissioner's view on the circumstances when the remission power would be exercised after 1 July 1992. This is despite the fact that *Taxation Ruling* IT 2444 was issued prior to the introduction of the uplift factor as part of the interest charge. Also, the position adopted by the Commissioner in *Taxation Ruling* IT 2444 appears to have been carried forward into the Chapter 93 of the ATO Receivables Policy.

A3.91 In doing so, the administrative policy documents dealing with the remission of the interest charge for the post-1992 period have neglected to consider the context in which the Commissioner's views in *Taxation Ruling* IT 2444 were originally expressed and the nature of the interest rate imposed at that time. In particular, the influence of *Taxation Ruling* IT 2444 on the Commissioner's interest remission policy has created a limited view of how the discretion to remit such an interest charge should be exercised, especially in the pre-amended assessment period.

A3.92 As a consequence, the narrow view adopted by the Commissioner regarding the circumstances that warrant the remission of the pre-amended assessment interest for the years of income 1992/93 and onward has meant that, in certain cases, the interest charge without remission has had a far broader and punitive-like effect. This is particularly so where the interest has accrued over a period of up to four or six years and the taxpayer was unaware of the liability.

A3.93 Where the circumstances of the taxpayer mean that the interest charge in the pre-amended assessment period has a punitive-like effect, and given that the primary purpose of the interest charge is to represent the time value of money, then the interest remission policy must be flexible so as to accommodate these circumstances and remove any punitive-like effect. Definitions of what constitutes 'special circumstances making it fair and reasonable' or 'otherwise appropriate to do so' cannot be treated as static concepts, but rather need to change as the nature and effect of the interest charge changes.

A3.94 This approach seems to have been adopted by the Commissioner when announcing the concessions to be made to investors

in Mass Marketed Tax Effective Investments (MMTEIs) where he stated that:

> '… eligible investors will be entitled to an interest reduction from the full general interest charge, currently 11.89 per cent, to a rate reflecting the time value of money. This rate will be 4.72 per cent which is the rate applicable to tax before 1 July 1999 but for administrative simplicity it will be used for all years.'[73]

A3.95 It is generally accepted that the intention of Parliament in introducing this uplift factor was to serve as a disincentive to taxpayers and effect compliance by discouraging taxpayers from using the tax system as an unsecured mechanism for borrowing.

A3.96 However, in the pre-amended assessment period a taxpayer may not be aware that there is an underpayment of tax. In fact, a taxpayer may genuinely believe that they have complied with all their taxation obligations under the self-assessment regime. In such a situation it is unclear how the imposition of the interest charge in full without remission can serve to discourage the taxpayer from using the tax system as an unsecured mechanism for borrowing. Rather, it would be assumed that such a compliance effect would be more relevant in circumstances where a taxpayer has intentionally not complied with their taxation obligations or has delayed the payment of tax.

A3.97 In this context, the imposition of the interest charge in full without remission during the pre-amended assessment period can have a punitive-like effect even though the taxpayer's circumstances do not warrant such an outcome.

A3.98 In order to ensure that the policy objectives of the interest charge are satisfied, it is important that the Commissioner's interest remission policy should look at the intention of Parliament in introducing the interest charge and the wording of the Act, the nature of the interest charge and its possible effects.

A3.99 The approach needs to be one that is consistent with the broad discretion that Parliament has afforded the Commissioner to remit the interest charge and also consistent with other ATO policies such as the

---

73 Australian Taxation Office, 'Most Mass Marketed Scheme Investors Set to Benefit from Interest Reduction', Media Release-Nat 01-58, 23 July 2001.

penalty remission policy, the Compliance Model and the Taxpayers' Charter. It is also important that the approach adopted by the Commissioner in the remission of the interest charge ensures that the principles of equity and fairness in the administration of the tax system are maintained.

A3.100 As is discussed later in this appendix and in Appendices 4 to 6 in more detail, the Commissioner appears to have acknowledged the need for a flexible approach to how the interest remission power is exercised so as to deal with situations on their merits. This is confirmed by the instances where the Commissioner has in fact remitted the interest charge in a number of disputes involving groups of taxpayers. These disputes included MMTEI disputes, Controlling Interest Superannuation (CIS) disputes and disputes involving securities lending arrangements. In these disputes the Commissioner has remitted the rate of pre-amended assessment interest to either nil or to a rate which approximately equals the equivalent rate of interest for the overpayment of tax payable in respect of the particular period.

A3.101 The above comments lead to the following key finding:

KEY FINDING 1

The legislative provisions authorising interest remission for the pre-amended assessment period provide the Commissioner with a broad power to remit the interest charge.

However, the Commissioner has adopted a narrow approach regarding the circumstances in which the interest remission power will be exercised.

This has meant that, particularly where interest has accrued over a period of up to four or six years, the pre amended assessment interest charge without remission may have a far broader and punitive like effect. The interest remission guidelines must be flexible and responsive to remove inappropriate punitive-like consequences where out of the ordinary circumstances exist.

Tax Office response

A3.102 The broad design of the current remission powers is to provide for defined circumstances relevant to the individual, with a further power of remission where there are special circumstances or where it is otherwise appropriate.

A3.103 While broad, the further remission power is not unfettered. There must be reasonable grounds for exercising it.

A3.104 This can be illustrated by referring to the extrinsic material in the Explanatory Memorandum (EM) to the Taxation Laws Amendment (Self Assessment) Act 1992 which is applicable to the former interest charge provisions.

A3.105 The interest remission power embodied in that Act – "The Commissioner may, in his or her discretion, remit the whole or any part of the interest payable by a taxpayer under this section." - was applicable for a large part of the pre amended assessment period for Employee Benefit Arrangements.

A3.106 In relation to this broad remission power EM states at page 109:

> "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]".

A3.107 In practice the remission powers under that Act and the current law have been exercised in a wide range of cases where the necessary circumstances have been found to exist.

A3.108 Thus we have used that power in the context of some widely marketed schemes where there are particular circumstances warranting it. Other examples include situations where there are acknowledged gaps

in the law, periods between announced changes to the law and enactment of the relevant legislation, reliance on publications (e.g. Tax Pack) in the event they prove to be misleading, so called GST "wash transactions" and where the ATO has delayed in issuing an amended assessment after gathering all relevant information necessary for the assessment.

A3.109 The mere fact that interest is accumulating at the legislated rate prior to an amended assessment issuing is not, of itself, grounds for remission. As recognised in your findings "out of the ordinary" circumstances need to exist to warrant remission.

A3.110 The question of the appropriateness of the rate of GIC applying during the pre-amended assessment period is subject to examination in the Review of Income Tax Self Assessment.

Inspector-General comment

A3.111 The quoted Explanatory Memorandum (EM) provides some level of historical guidance. However, it is noted that there have been legislative changes since that EM and it is the view of the Inspector-General that the matter is not as clear cut as suggested by the response.

A3.112 In noting the reference to out of the ordinary circumstances, the Inspector-General observes that this issue is not necessarily directly relevant to the majority of situations under focus in this review.

KEY FINDING 2

Prior to 1992, the Commissioner had an established policy that the remission power for interest, or its equivalent, for the pre-amended assessment period would only be exercised in exceptional circumstances.

With the 1992 legislative amendments to the penalty and interest provisions, including the introduction of the interest 'uplift' factor, the Commissioner did not revise his previous policy regarding the circumstances in which the interest remission power would be exercised.

As such, there was no detailed policy framework for the remission of the pre-amended assessment interest for the years of income from 1992/93 up to and including 1999/2000.

For the years of income 2000/01 and onwards, the ATO's Receivables Policy does not provide sufficient guidance to the public on how the interest remission power is to be exercised for the pre-amended assessment period.

For this reason, tax administration would benefit if the Commissioner published a separate policy document which provides clear guidelines on his policy, covering the current and prior years, for remission of the interest charge.

The policy should include the different considerations relevant to determining whether remission of the interest charge is warranted for either or both the pre-amended and post-amended assessment periods.

Tax Office response

A3.113 The ATO's policy on pre-amended assessment interest articulated in *Taxation Rulings* IT 2444 and IT 2593 for the period prior to 1992 is relevant also for the period 1992/93 to 1999/2000. As noted in the response to Key Finding 1, the general remission power introduced in 1992 was the same as that for the immediately prior years.

A3.114 The ATO's receivables policy does contain an extensive chapter on remission, including specific examples embracing the pre-amended

assessment period, eg misleading publications and delays in issuing amended assessments.

A3.115 However it is acknowledged that there would be benefit in publishing more practical and accessible guidelines for the community.

A3.116 Community representatives, including your office and that of the Ombudsman will be consulted in finalising these guidelines.

A3.117 The impact of the timing and outcomes of the Review of Income Tax Self Assessment will need to be considered in that context.

Inspector-General comment

A3.118 The Tax Office states that Taxation Rulings issued prior to 1992 were current because the general remission powers were the same in later years. However, the Inspector-General notes that there were legislative changes to the actual remission powers and there were changes occurring over time in the broader commercial environment. The situation was not static over the decade.

A3.119 The Inspector-General endorses the Commissioner of Taxation's acknowledgement that more practical and accessible guidelines need to be published.

PART C: OTHER FACTORS CONSIDERED BY THE ATO

Recent concessions and settlement arrangements

Mass Marketed Tax Effective Investments

A3.120 As discussed further in Appendix 4, in deciding to remit the interest charge for taxpayers who had participated in the MMTEIs, the Commissioner determined that there were special circumstances by reason of which it would be fair and reasonable to remit the interest charge for both underpaid and late paid tax.

A3.121 The special circumstances the Commissioner identified for such taxpayers were as follows:

- typically, investors in these eligible schemes lacked full knowledge of the scheme arrangements and the operation of the tax system;
- investors were often subject to aggressive and sophisticated marketing techniques;
- investors had a generally good tax record and typically they took advice from people expected to have the necessary knowledge to foresee the pitfalls;
- investors contributed real money to the schemes and most suffered a real financial loss.[74]

A3.122 Promoters, tax agents and other tax advisers were not eligible for a full remission of GIC unless an investor could demonstrate special circumstances to justify a remission.

Controlling interest superannuation arrangements

A3.123 As discussed in further detail in Appendix 5, on 14 March 2003, the Commissioner announced that for Controlling Interest Superannuation (CIS) arrangements the interest charge would be reduced to the commercial rate of 4.72 per cent where a contribution was made to a superannuation fund before 19 May 1999.

A3.124 The special circumstances that applied in the CIS arrangements involved the uncertainty of the law prior to May 1999, and the existence of a reasonably arguable position by the taxpayer.

Inspector-General's view

A3.125 It is evident that in deciding whether to exercise the discretion to remit the interest charge in the above cases in whole or in part, the Commissioner took into consideration a range of 'factors' so as to establish whether special circumstances existed and what was fair and reasonable. From an examination of material provided by the ATO such factors included:

74 Information provided by the ATO to the Inspector-General in email dated 21 January 2004.

- the existence of a reasonably arguable position (this was a key factor in the decision to remit part of the interest charge in CIS arrangements);

- the taxpayer's background, experience, occupation and prior compliance history (these were factors in the decision to remit GIC in eligible MMTEI arrangements);

- whether the taxpayer made a voluntary disclosure and the level of the taxpayer's co-operation;

- the existence of prior correspondence, rulings or advance opinions; and

- the payment of fees to promoters and tax advisers.

A3.126 Although there is evidence of these factors being taken into consideration in these cases and for other arrangements, there is an absence of any detail in Chapter 93 of the ATO Receivables Policy, or any other supplementary interest remission guidelines, clearly articulating these factors and what the Commissioner requires when taxpayers make requests for remission of GIC.

A3.127 Excluding remission requests based upon delay in issuing amended assessments, there is little guidance in Chapter 93 of the ATO Receivables Policy as to the factors the Commissioner will consider in determining whether special circumstances exist that warrant the remission of GIC. In particular, there is little guidance as to the factors the Commissioner will look at in determining whether it is fair and reasonable to remit the GIC having regard to the nature of the specific event or decision.

A3.128 It is the Inspector-General's view that it is not expected that a policy will cover in advance all circumstances and factors to be taken into account in determining whether special circumstances exist and what is to be considered fair and reasonable.

A3.129 However, it is appropriate that any policy dealing with the remission of the GIC clearly articulate factors the Commissioner considers in practice. This is to ensure that taxpayers are properly informed of the factors the Commissioner considers relevant to the remission of the interest charge and to enable taxpayers to apply for remission of the interest charge on the basis of that knowledge. It is

important that taxpayers are provided with all the relevant information to allow them to properly manage their tax affairs and be able to exercise their legal rights.

Groups of taxpayers

A3.130 In the English case *IRC v National Federation of Self Employed & Small Businesses Ltd* [1982] AC 617, Lord Scarman said:

> 'I am persuaded that the modern case law recognises the legal duty owed by the revenue to the general body of the taxpayers to treat taxpayers fairly; to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise; to ensure that there are no favourites and no sacrificial victims.'

A3.131 This decision has been cited with approval in Australia in a number of Federal Court decisions including *Bellinz Pty Ltd v Federal Commissioner of Taxation* (1998) 615 FCA, and *Pickering & Ors v Deputy Commissioner of Taxation* (1997) 37 ATR 41. In the latter case, Cooper J expressed the view that:

> '… there is a growing body of academic and judicial opinion that persons in like situations are entitled at law to receive like treatment.' (article references and citations omitted)

A3.132 A number of submissions have expressed concern with the ATO's consistency in its application of the law relating to the remission of the interest charge as it applies to groups of taxpayers. In particular, concerns have been raised as to the approach adopted by the Commissioner for the remission of the interest charge amongst groups of taxpayers that had effectively entered into similar tax arrangements.

Background

A3.133 From 1 July 2000, the Commissioner could exercise his discretionary power to remit the GIC for late payment in circumstances 'where it is otherwise appropriate to do so'.

A3.134 In paragraph 93.5.24 of the ATO Receivables Policy the Commissioner has indicated that the power to remit under this provision:

> '… will not usually be concerned with the circumstances of a particular taxpayer, but may extend to a particular group of tax debtors, or to the general body of tax debtors, and may involve consideration of issues of administrative efficiency and fairness.'

A3.135 This approach was adopted by the Commissioner in determining how the remission power should be exercised in a number of arrangements. Apart from those taxpayers that had participated in the MMTEIs, other taxpayers were broadly grouped into categories based upon the type of arrangement. For some arrangements, a general offer of partial GIC remission was then made as part of the settlement offer.

Submissions to the Inspector-General

A3.136 The Inspector-General received a number of submissions outlining their circumstances and detailing the experience of taxpayers and advisers with the ATO's approach to remitting the interest charge for various arrangements including EBAs and retirement village investments.

A3.137 One submission noted that it had been their experience that:

> '… taxpayers who entered into EBAs were subject to tax shortfall penalties of 10 per cent and GIC calculated from the due date of the original assessment until the date the taxpayer entered into a settlement. Any requests that were made to the ATO for the remission of the GIC were denied.
>
> However, taxpayers who had invested in a mass-marketed scheme and settled with the ATO were offered full remission of GIC and penalties. We believe that this represents an inconsistent approach in the application of the law and the use of the Commissioner's discretion.
>
> The ATO has justified the inconsistent approach by drawing a distinction between the type of taxpayer who invested in the EBAs and those taxpayers who invested in the mass-marketed schemes. We do not agree that such a distinction can be drawn, or applied to all taxpayers involved in the employee benefit arrangements.'

A3.138 The submission went on to state that in their experience:

> '… a broad array of individuals entered into the EBAs ranging from 'sophisticated' investment bankers and corporate executives to the

> average salary and wage earner, small business operator, 'mum and dad' companies, etc. The investors in the EBAs were not exclusively 'sophisticated investors' and many were like those who invested in the mass-marketed schemes.'

A3.139 In a similar vein, another submission expressed the following concerns with the ATO's procedures and approach for groups of taxpayers:

- There was a divergence in the ATO's approach as to how groups of taxpayers were treated in the lead up to the settlement of a dispute;
- The ATO is reluctant to recognise a taxpayer's reasonably arguable position when remitting or reducing penalties. Taxpayers who have sought an advance opinion from a tax practitioner or who have been sophisticated enough to take advice are being poorly treated. This has been particularly prevalent in the ATO's handling of employee benefit trust arrangements.

A3.140 The submission raised the above concerns in the context that the Commissioner had failed to consider the individual taxpayer's circumstances in determining how the remission power was to be exercised.

A3.141 Another submission to the Inspector-General expressed concerns that there was a perception amongst the taxpayer community that the ATO is offering generous GIC remission in certain high profile situations but not in others. In doing so, the submission made the following comments:

- Various arrangements that are very similar to (and in some cases modelled on) the mass marketed schemes, but are not strictly 'mass-marketed', have not been able to access the same generous GIC remission;[75]

---

75 For example, the submission refers to the refusal by the Commissioner to grant GIC remission on similar terms in arrangements involving retirement villages and research and development (R&D) syndicates. These arrangements had either a private ruling (R&D syndicates) or were based on a public ruling (retirement villages) whereas almost all of the mass-marketed arrangements did not have such confirmation from the ATO. In the case of retirement villages, the investments were sold to the same types of investors and often had the same benefits as the mass-marketed arrangements.

- It is not clear why the ATO has adopted three different approaches in relation to the remission of the GIC in these situations (Mass-Marketed Schemes, Controlling Interest Superannuation Arrangements and the other Employee Benefit Arrangements). The lack of explanation for the different approaches may be interpreted as a lack of consistency;

- The features identified by the ATO, which were said to distinguish the mass-marketed investment scheme participants, are true of many taxpayers who are subject to the GIC;

- The unfair treatment of tax agents who themselves have entered into mass-marketed schemes, but were in no way involved in their promotion;[76]

- It appears that GIC remission is handed out to participants in mass-marketed arrangements due to public outcry and political exposure, while others whose circumstances are much the same (or indeed more worthy of remission), but who have not had the same success in using the media and lobbying politicians, have had their applications for GIC remission refused. This leads to the perception of inequity and discrimination.

A3.142 The submission concluded that the actions of the ATO have resulted in participants feeling that:

> '… there is discrimination between taxpayers who have entered into fundamentally similar transactions with the same knowledge. In essence, the only difference is that enough people entered into one of these arrangements that the ATO labels the arrangement a mass-marketed arrangement and/or an artificial distinction between 'the innocent public' and people who 'should have known better'.

Inspector-General's view

A3.143 In an attempt to finalise disputes involving certain groups of taxpayers and achieve payment of the outstanding tax, the ATO has progressively offered standardised settlement arrangements, involving particular terms as regards the remission of pre-amended and

76 Such tax agents have been denied access to the settlement offers made available to other participants in the same schemes — they are denied 'eligible taxpayer' status.

post-amended assessment interest to taxpayers involved in these disputes.

A3.144 Aside from a very small number of cases, these standardised settlements were offered to affected taxpayers either on the basis that they were members of a group of people who had invested in one of the relevant types of arrangement or on the basis that they were members of a further subgroup of investors in the particular arrangement who shared certain characteristics. The relevant taxpayers were not offered settlement terms that were tailored to their own particular set of circumstances.

A3.145 Although the grouping of taxpayers may allow for administrative efficiency, it is crucial that the overarching principles of equity and fairness within tax administration are promoted. This is ensured by integrating flexibility within the grouped categories of arrangements so as to allow the circumstances of individual taxpayers to be considered where requested and maintaining a consistent approach to remitting the interest charge for different classes of taxpayers.

A3.146 It is recognised that the Commissioner has finite resources to allocate to the various functions carried out by the ATO. This means that how the Commissioner approaches certain issues, such as the application of interest remission for groups of taxpayers, may involve consideration of issues of administrative efficiency. However, as was made clear by the Senate Economics Reference Committee, it is incumbent upon the ATO to adapt its operating procedures to address the individual circumstances in a manner consistent with the Taxpayers' Charter.[77] Ensuring that this obligation is adhered to is crucial in not only promoting equity and fairness but also maintaining public confidence in the administration of the tax system.

A3.147 Confidence in the administration of the tax system is not promoted if taxpayers within an arrangement are treated as a homogenous group and broad distinguishing labels are attached to the entirety that do not reflect the true nature of the members of that group.

A3.148 Therefore, the particular type of arrangement and how it operated would be merely one consideration in determining whether

77 Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report, June 2001, at page 41.

remission of interest is warranted. That is, whether a taxpayer entered into a MMTEI or another arrangement should not be the key determinant of whether a taxpayer is granted remission of the interest charge. Nor should the sophistication of an arrangement be attributed to a taxpayer for the purposes of classing them as a 'sophisticated' participant.

A3.149 Likewise, the extent to which a taxpayer shares certain characteristics of others who have also invested in the particular arrangements (such as their level of involvement in and knowledge of the relevant arrangement and of the tax system generally) should not be the only factors considered in determining whether a particular settlement offer involving particular interest terms is appropriate.

A3.150 As outlined in further detail in Appendices 4 to 6, the disputes that have been examined for the purposes of this review all involve marketing techniques by promoters that especially target unsophisticated investors, mixed ATO advice and opinions on the nature of those arrangements and delays in arriving at a considered view of the efficacy of the arrangements.

A3.151 Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of which particular arrangement is involved.

A3.152 In the Inspector-General's view, the above comments lead to the following key findings.

KEY FINDING 3

Although disputes involving groups of taxpayers may have distinguishing features including the nature, complexity and sophistication of the arrangements, at the taxpayer level there are more common features between the individuals forming part of each group than points of differentiation. These include a broad array of investors, targeted marketing techniques, prior ATO advice/advance opinions/rulings and time delays.

KEY FINDING 3 continued

Against this background, an examination of all the circumstances of the taxpayers involved in these arrangements may indicate that it is more appropriate for a similar interest remission outcome to arise for taxpayers who share similar individual circumstances regardless of the particular arrangement involved.

KEY FINDING 4

Administrative procedures regarding the remission of the interest charge for groups of taxpayers require that an appropriate balance is achieved between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer in accordance with the Taxpayers' Charter.

To date, the approach of the Commissioner suggests more focus has been on considerations of administrative efficiency as opposed to an examination of a taxpayer's individual conduct and circumstances. In particular, considerations of the type and nature of the arrangement and the extent to which members of a group share certain further characteristics have overshadowed consideration of the conduct and circumstances for each individual.

Tax Office response

A3.153 The factors listed in Key Finding 3 are amongst the factors taken into account when determining whether a settlement offer is appropriate and the terms of that settlement offer.

A3.154 Of course the fact that an arrangement involves a group or groups of people does not of itself mean a settlement is appropriate. Each case needs to be considered on its merits, taking account of the circumstances surrounding the arrangements and the participants in them and the impact on the health and integrity of the tax system.

A3.155 The fact that the terms of particular settlements, including interest charge remissions, generally apply equally to all investors reflect that the reasons for the settlement generally go to the nature of the arrangements and of the investor's involvement in them.

A3.156 Efficient administration is one of the matters taken into account in determining the terms of any settlement offer. For example the ability to resolve large numbers of disputes and allow resources to be more effectively employed in managing the tax system is a relevant factor in determining the final terms of a settlement.

A3.157 This means that where it is appropriate to settle, the terms have generally been set at a level that is more beneficial than having regard solely to the circumstances of the various participants.

A3.158 Where there are significant groups within a particular arrangement that have significant distinguishing features this may result in differentiated settlement terms. This was the case for mass marketed investment schemes where promoters and accountants were offered different terms.

A3.159 Applications for further remissions outside of the general settlement terms are considered on a case-by-case basis. Given the general structure of settlements outlined above, grounds for further remission of the interest charge would generally be expected to relate to an individual participant's financial and other circumstances not directly related to the nature of the arrangement and the circumstances of the person's participation in it.

Inspector-General comment

A3.160 The Inspector-General noted that the approach of the Tax Office suggests more focus has been placed on considerations of administrative efficiency rather than consideration of individual circumstances.

A3.161 The Commissioner acknowledges that administrative efficiency is one factor in determining mass dispute settlements and that therefore a key element of any such settlement requires that the terms be set at a more beneficial level than having regard solely to the circumstances of participants. The Inspector-General notes that opinions differ on whether the terms offered by the Commissioner are more beneficial. If the terms are more beneficial for most participants, cases may still exist where the relevant taxpayers should be granted more concessional treatment. For these exception cases, processes must exist to ensure that the individual circumstances of the taxpayers are considered. On the other hand, if the terms of settlement are not more beneficial to most participants, the individual circumstances of each participant need to be fully considered.

A3.162 Whether full consideration of all individual circumstances has occurred is a question of fact. The Inspector-General notes the strong community perception that individual circumstances have not been fully taken into account by the Tax Office.

PART D: PRE-AMENDED ASSESSMENT PERIOD, ATO DELAY AND TAXPAYER AND COMMUNITY AWARENESS OF THE ATO INTEREST REMISSION POLICY

ATO delay in the pre-amended assessment period

A3.163 Evidence and submissions to the Inspector-General raised concerns with the inconsistency of the ATO in remitting interest for periods of delay caused by the ATO during the audit process. In particular, specific mention was made of the ATO's inconsistent remission of the interest charge in circumstances where both the taxpayer community and the ATO are uncertain of the application of the law.

A3.164 One submission noted that:

> '… in many cases, the period of time between a taxpayer responding in full to a Notice of Intention to Audit of an EBA and the ATO issuing assessments-amended assessments has been up to 18 months. The period of time between a taxpayer's contribution to an EBA and the date of issue of the assessments-amended assessments is considerably longer — in some cases up to six years.'

A3.165 In a similar vein, another submission raised concerns with the retrospective application of the interest charge, noting:

> 'Due to the nature of the tax law, there are frequently instances where taxpayers may interpret the law, and its application to their particular factual circumstances, differently to that of the ATO. The taxpayer should be able to request a stay in the imposition of the GIC so that it is not effectively retrospective in instances where there is a review process being undertaken, the necessity for which has arisen due to the complexity of the tax law.'

A3.166 Paragraphs 93.5.32 and 93.5.33 of the ATO Receivables Policy discuss the remission of the interest charge where there has been a delay in issuing amended assessments. They provide that:

> 'The Commissioner may partly remit GIC for late payment based on significant delay. This may occur where the Commissioner has by a particular date gathered all the information and evidence that is necessary for the issue of the amended assessment, but the issuing of the amendments is delayed for a significant period of time beyond that date. However, a decision about any such remission will be affected by many factors. These may include:
>
> - the complexity of the issues involved in making a determination of the amended amount;
>
> - whether the taxpayer requested that the issuing of the amended assessment be delayed; or
>
> - whether the taxpayer did, or was in a position to, self-amend, that is, determine and pay the amended amount themselves.
>
> Remission in such circumstances would normally consist of a reduction to the prevailing base interest rate (which is the prevailing monthly yield of 90 day Bank Accepted Bills) from whatever date the Commissioner deems appropriate in the circumstances.'

A3.167 The Inspector-General notes that paragraphs 93.5.32 and 93.5.33 of the ATO Receivables Policy only seem to deal with the remission of the interest charge due to ATO delay in the issuing of an amended assessment once all the relevant information and evidence has been gathered and the ATO has formed a view. In some instances there may be a lengthy period of time taken by the ATO in gathering the relevant

information and evidence and arriving at a position on a particular arrangement, especially where there is some uncertainty as to the operation of the law.

Subsidiary Finding 1

The current ATO Receivables Policy only deals with the remission of the interest charge due to ATO delay in the issuing of an amended assessment once all information and evidence has been gathered and the ATO has formed a view.

Tax administration could be improved if the interest remission policy also specifically set out how the remission power would be exercised where the ATO has contributed to the delay during the pre-amended assessment period due to operational reasons or some uncertainty as to the operation of the law.

This could be similar to the approach in previous ATO guidelines, such as *Taxation Ruling* IT 2517.

Tax Office response

A3.168 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

A3.169 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Taxpayer and community awareness of the ATO interest remission policy

A3.170 Evidence and submissions to the Inspector-General raised concerns with the adequacy and availability of publicly available information detailing how the Commissioner will exercise his discretion to remit interest for underpayment of tax or late payment of tax.

A3.171 A submission to the Inspector-General expressed the view that:

> 'Chapter 93 does not include any comments on specific circumstances where the Commissioner may choose to remit the GIC. Instead, the Commissioner has issued a series of Interpretative Decisions (IDs) and Rulings in relation to specific issues that may affect taxpayers. This approach has resulted in no specific public guidance being issued by the Commissioner for many contemporary issues about which taxpayers may be in dispute with the ATO.'

A3.172 The submission proceeds to suggest that:

> '…a more transparent and holistic approach should be adopted by the Commissioner in respect of the publication of guidance on the remission of GIC. This should involve the issue of public guidance about the remission of GIC for a broader range of taxation issues than is currently available. To ensure the integrity of the tax system and protect against inconsistent GIC outcomes between taxpayers, it would also be desirable, where possible, for guidance issued by the Commissioner to be in a form that is binding (for example, public rulings).'

A3.173 Another submission expressed concern over the adequacy of publicly available ATO interest guidelines in three key areas. Each of these is set out below with a summary of the main concerns.

ATO Receivables Policy

- Chapter 93 of the Receivables Policy is flawed because it is not clear from this information exactly when and how the Commissioner will exercise his discretion to remit or reduce the GIC.

- The information in Chapter 93 is complex and difficult to follow, with some reasons having a general application, and others are specific to a transaction.

ATO supplementary information on its GIC remission policy

- Limited supplementary ATO information is available to the public about the GIC in general.

- There is specific supplementary information about the ATO's GIC remission policy but in its current form this information is not helpful as a guide to the ATO's GIC remission policy.[78]

- Settlement guidelines are not always clear about how remission should apply and other supplementary information focuses more on the calculation and levying of GIC, rather than its remission.

Accessibility and public awareness

- The [ATO] Receivables Policy is not readily accessible to the public. Access to this policy document is principally via the ATO's website. It is a large and complex document which is difficult to search unless you know exactly what you are looking for.

- It is not clear when and how the remission policy will be applied in practice.

- It is questionable whether the public at large are as aware of the existence of the ATO Receivables Policy as they should be, let alone the ATO's specific policy on GIC remission. Cross-referencing to Chapter 93 in supplementary information is at best poor and in most instances non-existent. This only serves to reinforce public ignorance about the existence and application of the ATO's GIC remission policy.

A3.174 In a similar vein, another submission to the Inspector-General expressed the following concerns:

- Many practitioners are unaware that the interest remission policy exists and the fact that the interest remission policy for pre-amendment periods is embedded in the [ATO] Receivables Policy makes it difficult to locate.

- Many practitioners do not know where it is located on the ATO website and when searching on the ATO website encounter great difficulties in locating the ATO policy.

---

78 For example, the GIC remission guidelines issued as part of a settlement are not always clear or equitable in their application and some general GIC information focuses primarily on the calculation of the GIC, with only passing reference to the remission of GIC. Also, some GIC information makes no reference to the remission of GIC (for example, the ATO's General Interest Charge (GIC) rates fact sheet that sets out what GIC is, how it is calculated and the rates used).

- The content of the policy is unwieldy and difficult to assimilate. It lacks examples of situations in which interest has been remitted or would be remitted and an explanation of the factors which were relevant in the decision to remit interest.

- The policy should include comments in relation to common factors that often arise in the context of penalty remission and would be relevant considerations for interest remission. For example, concepts such as honest mistake, voluntary disclosure and reasonably arguable position.

Inspector-General's view

A3.175 The Inspector-General notes that the Rulings issued at the introduction of the self-assessment regime, namely *Taxation Ruling* IT 2444 and *Taxation Ruling* IT 2517, provided far greater guidance to taxpayers and their advisers than the current ATO policies. In particular, these rulings clearly set out the circumstances of remission of the interest charge, the factors to be considered by the ATO and what the actual rate of remission would be in particular circumstances. Much of that material was not incorporated by the Commissioner in later guidelines and no mention is made of the factors set out in *Taxation Ruling* IT 2517 and *Taxation Ruling* IT 2444 as relevant to the remission of interest.

A3.176 The Inspector-General further notes that no guidance is provided to the public by the Commissioner on how the remission power is to be exercised during the pre-amended assessment period, how partial remission of the interest charge is to determined and what factors are to be taken into account in determining remission in this assessing stage.

A3.177 This contrasts to the guidance provided to taxpayers in the imposition and remission of penalties. The ATO has issued a number of rulings, such as *Taxation Ruling* TR 94/7 and practice statements, including *Practice Statement* PS LA 2004/5, on how the Commissioner will remit penalties. The Administrative Appeals Tribunal (AAT) is also able to review the exercise of the Commissioner's power to remit any penalty for the underpayment of tax. As such, a body of law has also developed regarding the circumstances when this discretion should be exercised.

A3.178 Taken together, the Commissioner's views expressed in *Taxation Ruling* TR 94/7, *Practice Statement* PS LA 2004/5 and the relevant AAT

decisions provide greater guidance to the taxpayer community as to how and when the Commissioner will exercise his discretion to remit tax shortfall penalties than does the interest remission policy.

A3.179 The Inspector-General agrees with the views expressed by a number of the submissions and the various suggestions made in those submissions. Good tax administration requires that taxpayers are made aware of the factors that will be taken into consideration by the Commissioner in determining whether to remit the interest charge. These views also reiterate Key Finding 2 which states that tax administration would benefit if the Commissioner published a separate policy document that provides clear guidelines on the current policy for the remission of the interest charge.

A3.180 The Inspector-General makes the following additional findings with the view that they would lead to an improvement in the adequacy and availability of publicly available information dealing with the remission of the interest charge for all taxpayers.

A3.181 These additional findings are consistent with the Commissioner's obligations under the Taxpayers' Charter to explain to taxpayers his decisions regarding their tax affairs and provide further assistance to taxpayers in understanding why the interest charge has been imposed at a particular rate and why remission is not warranted. This concern was raised in a number of submissions to the Inspector-General. They called for the Commissioner to provide greater information to taxpayers as to why remission of the interest charge in the pre-amended assessment period is not warranted.

A3.182 Importantly, such an approach will also provide taxpayers with more information to allow them to make informed decisions concerning remission applications and as to their legal rights under the *Administrative Decisions (Judicial Review) Act 1977*.

A3.183 This is particularly important where taxpayers do not have recourse to a merit review in respect of remission decisions.

Subsidiary Finding 2

Taxpayers would benefit if the Commissioner produced a simple guide to the remission of the interest charge, similar to an ATO Fact Sheet, outlining the process for requesting remission of the interest charge and the supporting information that the ATO requires.

Tax Office response

A3.184 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

A3.185 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 3

Taxpayers would benefit from the Commissioner publishing more supplementary information dealing with the remission of the interest charge. For example, greater guidance could be provided in the form of more ATO Interpretative Decisions being released and referred to in the ATO interest charge remission guidelines.

Tax Office response

A3.186 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

A3.187 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Subsidiary Finding 4

Taxpayers would benefit if, in relation to pre-amended assessment interest, the Commissioner provided upon request the factors considered relevant to the decision to maintain, remit or reduce the statutory interest charge.

Tax Office response

A3.188 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

A3.189 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines addressing the issues identified.

Other ATO comments

A3.190 In response to the above findings, the ATO has expressed the view that many of the above findings are based around the remission of pre-amended assessment interest, and the perception that it is not clear how Chapter 93 applies to such cases.[79]

A3.191 The ATO agrees that Chapter 93 of the ATO Receivables Policy was written primarily to focus on 'late payment' GIC. As such, the ATO has stated that it will give further consideration to the question of whether different guidelines should apply to 'pre-amended' and 'late payment' GIC and what form these guidelines should take.

A3.192 The ATO has also indicated that the ATO Receivables Policy was intended as a centralised and cohesive policy document addressing a taxpayer's lodgement and payment obligations. It may be possible to improve the policy guidelines without preparing a separate document relating to interest remission.

A3.193 The ATO has also expressed the view that it is essential for the Commissioner to retain the flexibility to deal with situations on their

79 Attachment to ATO Minute 30/2004, dated 27 May 2004, at page 9.

merits. Therefore, careful consideration needs to be given to what might be termed the 'precedent value' of examples of past situations where GIC has been remitted.

A3.194 The ATO has noted that it has in the past set out in detail, as a separate document, the factors taken into account in deciding that special circumstances existed for many taxpayers who participated in MMTEIs.[80]

A3.195 However the ATO is of the view that it now takes a more proactive approach to advising taxpayers of its view of many 'tax effective investments'. This includes issuing ATO Taxpayer Alerts. Along with other factors, the ATO has indicated that this may change the landscape such that it may not make the same decisions on remission if similar circumstances occurred in the future.[81]

PART E: CONSIDERATION OF FACTORS RELEVANT TO THE REMISSION OF PENALTIES

A3.196 A number of submissions to the Inspector-General have raised the concern that there is a lack of consistency between the factors relevant to the remission of penalties and the remission of the interest charge.

A3.197 This part of the appendix will firstly examine the legislative and policy background to the Commissioner's power to remit penalties.

A3.198 The policy underlying the application of a penalty will be briefly analysed and any disparity between factors considered relevant for the remission of penalties and the remission of the interest charge, that could give rise to a punitive-like effect in certain circumstances, will be examined.

80 ibid.
81 ibid.

Legislative and policy background to the penalty remission power

Overview — Pre-1 July 2000

A3.199 The general powers of the Commissioner to impose and remit penalties were previously contained in Part VII of the ITAA 1936. The Commissioner was given a general discretion to remit additional tax imposed by way of penalty.[82]

A3.200 Prior to 1 July 1992, *Taxation Ruling* IT 2517 outlined the remission guidelines applicable to cases involving the imposition of additional tax by way of a penalty. It specifically outlined the factors likely to influence the level of the culpability component and provided a schedule of typical base criteria and 'culpability' component ranges.[83] It also provided a series of examples of how the remission power was to be exercised in a variety of cases involving different levels of culpability.

A3.201 For the years of income 1992/93 up to and including 1999/2000, *Taxation Ruling* TR 94/7 set out guidelines on the manner in which the Commissioner would exercise the discretion to remit a penalty otherwise payable under the shortfall sections.

A3.202 Paragraph 2 of *Taxation Ruling* TR 94/7 provides that:

> 'The discretion to remit penalty otherwise attracted under a shortfall section should be exercised in only those exceptional cases where, having regard to all of the circumstances, the application of a particular shortfall section and/or rate of penalty prescribed under that section would provide a clearly unreasonable or unjust result. However, the guidelines provided by this Ruling do not fetter authorised officers when exercising the discretion to remit. Each case should be decided on the basis of its facts and circumstances.'

A3.203 In providing an explanation of the ruling and the context in which the Commissioner intends that the discretion be exercised, paragraphs 15 to 17 of *Taxation Ruling* TR 94/7 provide:

---

82 Pursuant to section 227 of the ITAA 1936. This applies to penalties otherwise payable under sections 226G, 226H, 226J, 226K, 226L and 226M of the ITAA 1936.

83 *Taxation Ruling* IT 2517, at paragraphs 36 to 38.

> 'The new tax system specifies the penalties attracted for specific kinds of behaviour, and does not contemplate for most cases a further reduction from the rates set in the legislation. A major objective of the new penalties is to promote certainty in respect of the rates of penalty attracted and that objective would be compromised if the specified rates were regularly remitted.
>
> However, the new system does recognise, through the remission power, that there will be certain exceptional cases where the penalty standards or the rates of penalty prescribed, if applied rigidly, may provide an unintended or unjust result. The discretion to remit penalties otherwise attracted should accordingly be administered in a fashion that ensures that the objectives of the new penalty system are achieved, but without oppressive results. For example, penalty otherwise attracted under a shortfall section in respect of a year of income will generally be remitted in full if the law is changed retrospectively after the taxpayer has lodged a return for the year(s) affected by the retrospective changes.
>
> While this Ruling provides guidelines as to when the discretion to remit penalties should be exercised, officers should treat each case individually and make a decision based on the merits of the particular case.'

A3.204 It is made quite clear by *Taxation Ruling* TR 94/7 that it will only be in exceptional cases that remission of the prescribed penalties will be warranted. However, the ruling does list a number of factors to be considered, namely whether:

- the underpaid tax represents a tax deferral rather than permanent avoidance;
- the income has been incorrectly included in another taxpayer's return and no tax has been avoided because the taxpayers' rates of tax are the same;
- the authority supporting the ATO's view of the law is published just before the taxpayer lodges their return and the taxpayer could not reasonably be expected to have been aware of it; or
- the taxpayer only just exceeds the $10,000 — 1 per cent threshold requiring that they have a reasonable arguable position as well as having taken reasonable care because of an extraordinary transaction and it would be unjust to penalise the taxpayer.

Overview — Post-1 July 2000

A3.205 A new administrative penalty regime was introduced with effect from 1 July 2000. The uniform administrative penalty regime imposes penalties on taxpayers for failing to satisfy obligations under the taxation laws. The uniform regime applies in relation to statements, schemes or failure to lodge penalties and the imposition of such penalties are in addition to GIC.[84]

A3.206 Previously, Chapter 94 of the ATO Receivables Policy set out the factors to be taken into account when deciding whether to remit a shortfall penalty. However, Chapter 94 of the ATO Receivables Policy was withdrawn and replaced with a series of Practice Statements including PS LA 2000/9, PS LA 2002/8 and recently PS LA 2004/5. Each of these Law Administration Practice Statements outlines the Commissioner's position on the remission of penalties following the introduction of the new tax system.

A3.207 The ATO has indicated that, despite the introduction of the new uniform administrative penalty regime, the broad principles for penalty remission set out in the previous *Taxation Ruling* TR 94/7 will continue to apply.[85] This is made explicitly clear in paragraph 55 of *Practice Statement* PS LA 2004/5.

Fringe benefits tax

A3.208 *Taxation Ruling* TR 95/4 sets out the guidelines for the remission of penalty taxes arising from a fringe benefit tax (FBT) audit. Similar to the approach set out in *Taxation Ruling* IT 2517, it provides that in determining remission of an additional tax by way of penalty, there are two components to be considered:

- a 'per annum component' that acts to compensate the revenue for the full amount of tax not having been paid by the due date; and
- a 'culpability component' based on the person's blameworthiness.

---

84 Pursuant to section 298-20 of Schedule 1 of the TAA 1953 the Commissioner has the discretion to remit all or part of an administrative penalty.

85 *Taxation Ruling* TR 2000/3, which deals with the remission of penalty and GIC for failure to make deductions from RPS, PAYE and PPS payments, also indicates that the factors to be taken into account in deciding whether to remit the GIC will be similar to those taken into account under the pre-1 July 1999 regime.

A3.209 The ruling also provides a list of circumstances where each of the components will be remitted. In respect of the per annum component, the ruling provides that:

> 'a partial or full remission may be appropriate where:
>
> - the statement or omission has been made as a result of being genuinely misled by the actions of the ATO (full remission); or
>
> - the particular circumstances make it fair and reasonable to remit all or part of the interest. The degree of the remission, if any, is dependent on the facts of the case.'[86]

A3.210 *Taxation Ruling* TR 95/4 also sets out the factors to be considered in determining the culpability component and outlines the range of the penalty to be applied for each culpability type.[87]

Relevant factors for the purposes of penalty and interest remission

Analysis of penalty remission policy

A3.211 According to the ATO, culpability penalty reflects the level of accountability to be assigned to the taxpayer for non-compliance with their tax obligations. The culpability penalty represents the sum of the typical culpability rate component, the mitigating or aggravating factors component and the repeat offence component.[88]

A3.212 The typical culpability rate is dependent upon the cause of the shortfall amount. A number of the culpability rates deal with particular taxpayer behaviours including intentional disregard of a taxation law, recklessness as to the operation of a taxation law and failing to take reasonable care to comply with a taxation law. Alternatively, a penalty is imposed in circumstances where a taxpayer takes a position that is not reasonably arguable and the shortfall amount is above a reasonably arguable position threshold.

---

86 *Taxation Ruling* TR 95/4, at paragraph 18.
87 *Taxation Ruling* TR 95/4, at paragraph 20.
88 *Taxation Ruling* TR 2000/3, at paragraph 6.

A3.213 In certain circumstances, the legislature has provided for an automatic remission in the level of the culpability penalty. One such instance is where a taxpayer has made a voluntary disclosure.[89] Another is where the taxpayer's approach was consistent with a general administrative practice of the ATO.

A3.214 Paragraph 6 of *Taxation Ruling* TR 94/7 provides that it will be in only exceptional cases that remission of the prescribed penalties will be warranted.

A3.215 Paragraph 91.3.4 of the ATO Receivables Policy provides that:

> '… the imposition of penalties will be cognisant of the taxpayer's compliance history and a consequential evaluation of compliance risk, as well as being focused on the longer-term goal of ensuring both current and future compliance. Some penalties, particularly the GIC, are designed to include compensation to the Government for the delay in paying the correct liability. In circumstances where a taxpayer has an impeccable compliance history, an error may not attract any penalty other than the GIC, while taxpayers with poor compliance history may be prosecuted rather than have administrative penalties imposed.'

Inspector-General's view

A3.216 The Inspector-General notes the reference to the GIC as 'a penalty' by the ATO Receivables Policy. Such a reference is contrary to the intention of the interest charge as a means to compensate the Revenue for the time value of money.

A3.217 It would be inappropriate for the ATO to be treating the interest charge as a penalty, especially given that the uniform administrative penalties regime is intended to govern the punitive consequences for taxpayers that fail to meet their obligations. More importantly, to treat the GIC as a penalty where there is an absence of review rights similar to those under the uniform administrative penalty regime means that taxpayers are denied appropriate legal redress. Such an outcome is

---

89 Where a taxpayer voluntary discloses a shortfall amount to the Commissioner before notification that a tax audit will be conducted, the base penalty amount is reduced by 80 per cent where the shortfall amount is $1,000 or more or to nil where the shortfall amount is less than $1,000. Where a taxpayer voluntarily discloses a shortfall amount to the Commissioner after the taxpayer has been notified that a tax audit will be conducted, the base penalty amount will be reduced by 20 per cent.

unlikely to be one intended by Parliament when introducing the current GIC regime and therefore it is important that the interest charge is imposed, and remitted, consistent with its purpose.

A3.218 In the Inspector-General's view, paragraph 91.3.4 of the ATO Receivables Policy should be revised so that it clearly articulates the purpose of the interest charge, namely to compensate the Revenue for the time value of money, rather than expressing the interest charge as a penalty.

A3.219 In response, the ATO has indicated that whilst Chapter 91 does fall under the section of the ATO Receivables Policy dealing with penalties, the term is perhaps being used in a wider sense that GIC is the impost or 'penalty' one faces when tax is not paid on time. However, as part of the wider review of the remission policy, the ATO has stated that they will consider revision to the passages in Chapter 91 as well as the placement of the remission policy.[90]

Consideration of relevant factors

A3.220 As has been previously discussed, it is important that the Commissioner's policy regarding the remission of interest achieves an appropriate balance between considerations of administrative efficiency in dealing with groups of taxpayers and examining the conduct and circumstances of a taxpayer.

A3.221 An examination of all the circumstances of the taxpayers involved in group disputes would include factors that were considered relevant by the Commissioner for the remission of penalties. Where such factors are not considered for the purposes of determining the remission of the interest charge, then this may give rise to an inequitable and punitive-like outcome for a taxpayer. This could arise where the taxpayer has a good tax compliance record, the taxpayer has made a voluntary disclosure to the Commissioner regarding their tax affairs, where there has been reasonable and positive co-operation by the taxpayer or where the taxpayer's approach is consistent with a general administrative practice of the ATO. Such scenarios will be discussed in further detail below.

90 Attachment to ATO Minute 30/2004, dated 27 May 2004, at page 10.

Taxpayer has a good tax compliance record

A3.222 The first situation considers the circumstances identified in paragraph 91.3.4 of the ATO Receivables Policy, which is extracted above, of a taxpayer that has an impeccable compliance history. The policy provides that an error by the taxpayer would not attract any penalty other than the GIC. This means that under the ATO Compliance Model there are relevant factors that warrant the remission of penalties.

A3.223 In the Inspector-General's view, in the above scenario, the factors considered relevant for the remission of penalties may also provide strong grounds for the remission of the interest charge. However, if the Commissioner takes a narrow view in terms of what factors will be relevant for the remission of the interest charge, then the imposition of the interest charge in full without remission for the pre-amended assessment period could have a punitive-like effect.

Voluntary disclosure by a taxpayer

A3.224 Where a taxpayer voluntarily discloses a shortfall amount to the Commissioner before notification of a tax audit there is an automatic remission of penalty.

A3.225 Previously, *Taxation Ruling* IT 2517 made specific provision for the remission of the interest charge where a taxpayer made a voluntary disclosure of an underpayment of tax.[91]

A3.226 In contrast to the position taken by the Commissioner in *Taxation Ruling* IT 2517, voluntary disclosure is not specified as a situation where remission of the interest charge is warranted in the current remission interest policy. However, voluntary disclosure is a factor that the ATO has applied in practice to remit the interest charge, as is evident in the disputes examined later in Appendices 4 to 6.

A3.227 If voluntary disclosure is not specified as a factor warranting the remission of the interest charge under the current policy, then it raises the possibility of inequity and unfairness being introduced into the administration of the tax system.

---

91 Paragraph 16 of *Taxation Ruling* IT 2444 also provided that interest payable under section 170AA of the ITAA 1936 was remitted to an amount equal to the lesser of interest calculated at the rate of 10 per cent per annum, or 75 per cent of interest otherwise payable.

A3.228 The Commissioner should specifically set out how the remission power will be exercised in circumstances involving voluntary disclosure for pre-amended assessment interest. Such an approach would be similar to that adopted in *Taxation Ruling* IT 2517 and would serve to promote and encourage voluntary compliance by taxpayers.

Reasonable and positive co-operation by the taxpayer

A3.229 Under the penalty remission policy which applied pre 1 July 1992, a relevant factor in the remission of penalties was whether a taxpayer's conduct has actually assisted the task of the auditor. According to the ATO, reasonable co-operation required the timely provision of information. This could either be by answering all relevant and reasonable questions truthfully and to the best of his or her ability and the timely provision of books and records.[92]

A3.230 Under *Taxation Ruling* IT 2517 positive co-operation was considered to be present where, after commencement of an audit, a taxpayer voluntarily admitted to an omission of income or an incorrect claim for a deduction. This disclosure needed to bring to light additional information to enable the ATO to make a judgment that the admission was reasonably complete.[93]

A3.231 The current interest remission policy makes no specific allowance for the co-operation of a taxpayer in determining the remission of the interest charge. In such circumstances, although the conduct of the taxpayer has resulted in a relatively significant saving in time and resources, the imposition of the interest rate in full without remission could have a punitive-like effect upon the taxpayer.

A3.232 Under the ATO Compliance Model, it is not appropriate for a taxpayer making a genuine effort to achieve the correct tax position by advising the ATO of an honest mistake to be penalised. For this reason, it is important that where factors are relevant in the remission of penalties that these same factors are part of the decision-making process in determining whether remission of the interest charge is warranted.

---

92 *Taxation Ruling* IT 2517, at paragraph 48.
93 *Taxation Ruling* IT 2517, at paragraph 51.

General administrative practice under taxation laws

A3.233 It is also important that the ATO's administrative policy dealing with the remission of the interest charge specifically provide for instances where there is evidence of a general administrative practice of the Commissioner to give favourable advice on a particular issue or arrangement.

A3.234 Previously, the Commissioner in *Taxation Ruling* IT 2517 broadly adopted such an approach. The Ruling provided that any remission of the 'per annum' component should be made in only exceptional circumstances. One instance where the remission of this per annum component was warranted was where a taxpayer had been genuinely misled by the actions of the ATO and the ruling provided for the remission of the per annum component to nil.

A3.235 More recently, the Federal Court in *Prebble v FCT* (2002) raised the possibility that the conduct of the Commissioner in issuing favourable advices for particular arrangements may amount to a general administrative practice.[94] Although making it clear that a taxpayer is not entitled in any way to rely upon a private ruling or advance opinion to which he or she was not a party to, the Court did state that:

> 'Rather, the rulings and advance opinions were referred to merely to demonstrate that other reasonable minds construing the sections in question came to the same conclusion as to their proper construction and operation with respect to controlling shareholder contributions as that contended for by the Doctor [the taxpayer].
>
> Although there is some evidence of a general administrative practice of the Commissioner to assess all claims for deductions to a superannuation fund by persons in the circumstances of the Doctor [the taxpayer] on the basis of the reasoning in those private rulings and advance opinions, that practice ended prior to September 1999.[95]

A3.236 Taxpayers who were involved in EBAs in the form of Employee Benefit Trusts, Employee Share Plans and Controlling Interest Superannuation arrangements have submitted that they believed, from the existence of prior favourable ATO advices on similar arrangements,

---

94 *Prebble v FCT* [2003] FCAFC 165 (Full Federal Court) and *Prebble v FCT* [2002] FCA 1424 (single judge).

95 *Prebble v FCT* [2002] FCA 1424 at paragraph 51.

that the arrangements they were entering into had received the endorsement of the ATO.

A3.237 In such circumstances, it is reasonable to assume that these taxpayers were not aware of the fine legal technical distinctions between advices that bind the Commissioner and those that do not. It is also reasonable to assume that, in any event, these taxpayers would have relied on the promoters of these schemes and their advisers to warn them of these distinctions, if those promoters and advisers had considered them to be relevant at the time.

A3.238 Therefore, the administration of the tax system could be improved by specifically providing, as one of the factors to be considered in determining remission of the interest charge, whether there was any evidence of a general administrative practice of the Commissioner to give favourable advice on a particular issue or arrangements.

A3.239 In the Inspector-General's view, the above comments lead to the following findings.

KEY FINDING 5

There are a variety of factors that the ATO has considered relevant in the statutory reduction and remission of penalties. These factors may also be relevant in considering the remission of the interest charge for groups of taxpayers in dispute with the ATO.

Tax Office response

A3.240 The fact that there are circumstances leading to a reduction or remission of penalties is not, of itself, conclusive of grounds for remission of the interest charge. It this was intended the legislative schema could be expected to reflect this.

A3.241 On the other hand they may, in combination with other factors contribute to a decision to remit the interest charge in whole or in part, particularly in a settlement context.

Inspector-General comment

A3.242 The Inspector-General notes the acknowledgement of the Commissioner that factors relevant to a reduction or remission of penalties may be relevant to interest remission consideration.

Subsidiary Finding 5

Tax administration could be improved if the interest remission policy specifically set out how the remission power would be exercised for pre-amended assessment interest in instances where:

- no penalty is imposed due to the taxpayer's previous good compliance record in accordance with the Compliance Model;
- the taxpayer has made a voluntary disclosure to the Commissioner regarding their taxation position and there is no evidence of any prior intention to avoid the payment of tax;
- there is reasonable and positive co-operation by the taxpayer; and
- there is evidence of a general administrative practice by the Commissioner supporting the approach taken by the taxpayer.

Such an approach would be similar to that adopted in previous ATO rulings and would serve to promote and encourage voluntary compliance by taxpayers.[96]

Tax Office response

A3.243 The proposed remission guidelines will outline factors to be taken into account in deciding whether the interest charge should be remitted. As noted in the response to Key Finding 5, the fact that there are circumstances leading to a reduction in penalties is not, of itself, conclusive of grounds for remission of GIC under the current law.

Inspector-General comment

A3.244 The Inspector-General endorses the Tax Office's proposal to publish clearer guidelines addressing the issues identified and notes that the Commission of Taxation acknowledges that circumstances leading to

96 For example, *Taxation Ruling* IT 2517 and *Taxation Ruling* 95/4.

a reduction in penalties may also be relevant considerations for the remission of GIC.

APPENDIX 4: MASS MARKETED TAX EFFECTIVE INVESTMENTS

A4.1 This appendix sets out details of the ATO's policy and practices for remitting interest in relation to settlement offers made to taxpayers involved in Mass Marketed Tax Effective Investments (MMTEIs). It also sets out some findings and conclusions in relation to both this policy and its application in practice.

A4.2 The ATO's settlement processes for MMTEIs have been the subject of prior review by the Commonwealth Ombudsman[97], the Senate Economics Reference Committee[98] and, more recently, by the Australian National Audit Office.[99] The purpose of this appendix is not to restate any of the matters or the findings on these settlement processes that are referred to in these prior reviews. Instead, the purpose of this appendix is to examine these settlement processes to see what they reveal about the ATO's policy and practices for remitting interest in relation to tax disputes involving groups of taxpayers.

BACKGROUND

A4.3 The ATO currently describes MMTEIs as schemes sold through a prospectus and, in some cases, information memoranda, in respect of 1998/99 and earlier income years. They include schemes involving agricultural development and films. The ATO does not currently include

---

97 Commonwealth Ombudsman, *The ATO and Budplan: Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a tax effective financing scheme known as Budplan*, Report under section 35A of the *Ombudsman Act 1976*, June 1999; *The ATO and Main Camp: Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp*, Report under section 35A of the *Ombudsman Act 1976,* January 2001; and *Report on investigation of a complaint by a promoter of a series of films about ATO decisions,* Report under section 35A of the *Ombudsman Act 1976*, February 2001.

98 Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report (June 2001); A Recommended Resolution and Settlement, Second Report (September 2001) and Final Report (February 2002).

99 Australian National Audit Office, *The Australian Taxation Office's Management of Aggressive Tax Planning,* Audit Report No. 23, 2003-4.

Employee Benefit Arrangements (EBAs), retirement village investments, equity linked bond arrangements or securities lending arrangements within its current definition of MMTEIs.[100]

A4.4 MMTEIs involved large number of taxpayers and large amounts of disputed tax. The ATO has advised that there were 184 MMTEI arrangements involving over 43,000 taxpayers and $1.8 billion in tax, including penalties and interest.[101]

A4.5 MMTEIs can broadly be separated into two main categories based on the structure of the schemes and their tax effect: film investments and agricultural and other arrangements. However, some film schemes were structured in the same manner as agricultural and other arrangements.[102]

Film arrangements

A4.6 Film arrangements involved the investor paying a prescribed amount either directly or through borrowings on which interest was paid. The investment was to be used in the making of a film. The investor claimed a tax deduction for the amount invested[103] and any interest paid on related borrowings. The investment guaranteed a return of the amount invested plus a small margin. The amount returned was assessable income and taxable in the year of receipt, which was generally up to seven years from the date of the investment. The advantage to the investor was up to a seven year deferral of tax on the amount invested.

Other arrangements

A4.7 Other MMTEIs include agricultural and franchise arrangements. The basic structure involved a payment of a cash amount and an agreement to borrow an amount ranging from three to four times the cash amount. The investor paid interest on the borrowings, which were either non-recourse or indemnified, so that ultimately the investor was

100 ibid, at para 5.2.

101 ATO Minute No: IGT022-2004, dated 10 March 2004.

102 The following descriptions are based on those contained in the following papers: Searle, Peter and Gordon, Robert *'Mass Marketed Tax Effective Schemes'*, paper presented for LAAMs Seminars, 24 and 25 October 2001 and Resolution Group Holdings Limited, *Submission to the Inspector-General of Taxation on ATO's remission of GIC for Groups of taxpayers in dispute with the ATO*, dated 30 January 2004.

103 This deduction was claimed under Division 10BA of the ITAA 1936.

not responsible for repaying the amount borrowed. The investor claimed a deduction for the total amount invested, being both the cash and borrowed amounts. The tax refund claimed for the investment funded the investor's cash outlay with some additional profit. The net claimed tax effect was that the investor permanently reduced tax in the year of the investment without having to outlay the full amount of that investment.

ATO action against MMTEIs

A4.8 The ATO's initial action against MMTEI film arrangements was to disallow the deduction claimed for the outlay in the first year and interest expense in subsequent years. The return of the investment was not considered to be assessable income.

A4.9 The ATO's initial actions against agricultural and franchise type arrangements was to disallow the deductions claimed for the outlays in the first year and interest expenses in subsequent years.

HISTORY OF ATO'S SETTLEMENT PROCESSES FOR MMTEIS

A4.10 The history of the ATO's interest remission practices for settling MMTEI disputes falls into two distinct phases: a pre-February 2002 phase and a post-February 2002 phase.

Phase 1: Period prior to February 2002

A4.11 As part of trying to resolve the emerging issues relating to MMTEIs, the ATO developed a specific settlement code for MMTEIs in July 2000. This took the form of an Addendum to its existing Code of Settlement Practice.

A4.12 This Addendum, when released, also applied to EBAs which are considered in detail in the next appendix. This is because, at the time of the Addendum's release, the ATO still considered that EBAs were a form of MMTEI.

A4.13 The Addendum instructed ATO officers who were settling MMTEI disputes that there was normally no question of settling such a dispute for an amount which was less than the full amount of primary

tax in dispute. However, the level of penalties and interest was negotiable.[104]

A4.14 The Addendum also instructed ATO officers that different settlement arrangements would apply to taxpayers who were promoters (and associated entities) and those who were simply participants in these schemes.

A4.15 For participants, the Addendum divided settlement arrangements according to whether the particular MMTEI involved a Level 1, Level 2 or Level 3 form of tax mischief. A Level 1 MMTEI scheme exhibited most of the following eight characteristics:

1. the arrangements were contrived and artificial;

2. the arrangements lacked commerciality;

3. the arrangements involved fraud on the Revenue;

4. the arrangements involved round-robin financing or non-recourse loans;

5. the arrangements were not implemented as specified in any relevant contractual or other legal documentation;

6. the scheme involved abuse of a specific legislative concession or anti-avoidance provision;

7. the scheme involved a permanent non-payment of tax, as opposed to a deferral of the payment of tax to a later period; and

8. the scheme involved a high risk to the Revenue.

A4.16 A Level 2 MMTEI scheme involved some of the above eight characteristics, while a Level 3 scheme did not involve characteristics 1, 3, 5 and 6 (that is, artificiality, fraud, non-implementation according to contractual terms and abuse of a specific concession or anti-avoidance provision).

---

104 Australian Taxation Office, *Addendum to Code of Settlement Practice*, July 2000, at paragraph 1.1.7.

A4.17 The Addendum then instructed ATO staff that the following settlement offers should apply according to the level of tax mischief in the relevant scheme, unless there were special circumstances that might allow a departure from these offers. The offers were as follows.

Level 1 scheme: payment of full amount of primary tax, a 25-50 per cent penalty and full GIC.

Level 2 scheme: payment of primary tax, a 10 per cent penalty and full GIC.

Level 3 scheme: settlement may include a deduction for the cash outlay only, a 10 per cent penalty and full GIC.

A4.18 The Addendum then stated that the following factors may operate to reduce any penalty charged to scheme participants:

- the participant's awareness of the nature of the scheme;
- the participant has been defrauded by the promoter;
- the participant has made a voluntary disclosure to the ATO; and
- the participant has co-operated with the ATO.

A4.19 There is one factor alone that is mentioned in the Addendum as giving rise to a reduction in the amount of GIC. This is the age of the relevant dispute.[105]

A4.20 The Addendum referred to special circumstances (which included the issue of rulings or advance opinions in relation to the scheme) in a manner which suggests that these may operate to reduce either the GIC or the penalty. However, this point was not clear in the Addendum itself.

A4.21 For promoters and associated entities, the Addendum stated that there would be very limited circumstances where these would be offered a settlement on any basis other than payment of the full amount of primary tax, a 50 per cent or higher penalty and full GIC. According to the Addendum, this was because of the promoters' level of knowledge of the tax mischief of the scheme. The Addendum noted that the extent of

105 ibid, at paragraph 6.3.3.

the promoters' co-operation with the ATO, including the extent to which they have encouraged other participants to co-operate with the ATO and their role in terminating the tax mischief in the scheme, might be factors justifying a reduction in the amount of any penalty.

26 April 2001 and 23 July 2001 announcements

A4.22 On 26 April 2001, the ATO announced that it would reduce the interest on tax debts for some MMTEIs from the full applicable rate (then 13.86 per cent) to an interest rate which reflected the time value of money (then 5.86 per cent).[106] The ATO announced that it would, after consultation with relevant stakeholders, develop guidelines for determining who should be entitled to this interest rate reduction. EBAs and financial products such as linked bonds would not be eligible for this interest rate reduction.

A4.23 On 23 July 2001, the promised guidelines were released. On this date, the ATO also announced that the relevant reduced interest rate would be 4.72 per cent.[107] The persons to be excluded from the rate reduction were scheme promoters, tax advisers, financial planners and investors who had bad tax records (for example, outstanding tax debts). Investors who were involved in three different MMTEIs or other tax avoidance schemes in three or more years since 1990 were not automatically eligible for the interest rate reduction, but would be considered on a case by case basis.

A4.24 The July 2001 interest rate reduction was offered to MMTEI investors who either paid the disputed tax in full, who entered into a settlement arrangement in relation to this tax or who entered into a payment arrangement for the outstanding tax.

A4.25 The July 2001 interest reduction applied to all investors other than those who were specifically ineligible. The individual circumstances of all eligible investors were not to be reviewed to determine their entitlement to the reduction. This decision not to consider taxpayers on an individual basis was stated to be in 'the interests of fairness or efficiency in administration'.

---

106 Australian Taxation Office, Media Release Nat 01/30, dated 26 April 2001.
107 Australian Taxation Office, Media Release Nat 01/58, dated 23 July 2001.

A4.26 The factors which the ATO stated that it had considered in reaching this global interest rate reduction decision were as follows:

- many investors in the relevant schemes lacked full knowledge of the scheme arrangements and the operation of the tax system;
- these investors were subject to aggressive and sophisticated marketing techniques in relation to the arrangement;
- these investors had a generally good tax record;
- these investors took advice from people expected to have the necessary knowledge; and
- many of these investors suffered a real financial loss.

A4.27 Investors who were eligible for this reduced interest offer were required to make an application to the ATO for this interest rate reduction. A special ATO form was created for taxpayers to use in this regard.

A4.28 Taxpayers who had already entered into a settlement arrangement with the ATO were eligible for the interest rate reduction. The reduction was also extended to taxpayers who chose to wait for the outcome of court cases before entering into a settlement or payment arrangement with the ATO.

A4.29 Submissions have noted that the above ATO settlement offer for MMTEI investors is couched in terms which suggest that the reduction in the rate of interest is being used as an inducement to settle. Both the ATO's Code of Settlement Practice and Receivables Policy specifically provide that ATO staff may not use the level of interest that is charged as an inducement to settle.[108]

July 2001 settlement offer for certain MMTEI agricultural arrangements

A4.30 At around the time of this global interest reduction offer, the ATO also announced, via a newsletter sent to MMTEI investors, that, for

108 Australian Taxation Office, *ATO Receivables Policy* at paragraph 93.4.4 and 93.5.31; and Australian Taxation Office, *Code of Settlement Practice (in respect of taxation liabilities)* at paragraph 5.1.7.

certain agricultural arrangements involving an underlying agricultural activity, the ATO would be prepared to settle on the basis of the following terms:

- a full deduction being allowed for the investor's actual cash outlay;
- full remission of any interest before 1 January 1998; and
- a 5 per cent penalty for schemes relating to the 1996/97 and previous income years and a 10 per cent penalty for schemes entered into in later years.

Phase 2: Period after 14 February 2002

A4.31 On 14 February 2002, the ATO decided to accept most of the recommendations relating to settlement guidelines for MMTEIs contained in an interim report that was handed down by Senate Economics Reference Committee (SERC)[109]. This report was one of three reports handed down by SERC as a result of an investigation which it commenced in July 2000 into the ATO's handling of MMTEI disputes.

A4.32 The settlement offer announced by the ATO on 14 February 2002 allowed certain investors (termed 'eligible investors') to receive a tax deduction for any cash outlay, no penalties or interest on the tax owed and a two year interest free period for debt repayment, subject to an acceptable payment arrangement being made. This offer again did not apply to EBAs or other forms of financing products.

A4.33 Investors who accepted this settlement offer were required by the ATO to forego their objection and appeal rights in relation to their amended assessments.

A4.34 Promoters, financial planners, tax agents and others who gave tax advice for a fee on a regular basis were not automatically entitled to a full remission of penalties or interest or the two year interest free period to repay any tax debt, unless they could demonstrate to the ATO that special circumstances justified that they were entitled to these terms. These investors were termed 'ineligible investors' by the ATO.

---

109 Senate Economics Reference Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, A Recommended Resolution and Settlement, Second Report (September 2001).

A4.35 'Ineligible investors' were specifically defined by the ATO as falling into the following four categories:

- scheme promoters who designed, prepared, managed, sold or implemented the investment scheme (including the directors and office bearers of an entity who managed the investment);
- tax advisers or financial planners who received a fee for another investor's scheme participation;
- tax agents and others who give tax advice for a fee on a regular basis, and who could be expected to be aware of the taxation issues associated with investments (including the self-assessment system); and
- members of a professional firm which has a tax practice.[110]

A4.36 The ATO indicated that the factors (which the ATO called 'special circumstances') which had led it to make this offer to eligible investors consisted of the five factors which it had referred to in its July 2001 announcement. However, the following additional factor was added in the February 2002 announcement.

- The investors contributed some real money to the schemes and suffered some real financial loss after the tax deduction was disallowed.

A4.37 Submissions have noted that, as with the April and July 2001 interest rate reduction, the February 2002 offer is couched in terms which suggest that this rate reduction is being used as an inducement to settle.

A4.38 The February 2002 settlement offer was described by the ATO as its final settlement offer for MMTEIs and gave a deadline of 21 June 2002 for MMTEI investors to accept this offer. According to the ATO, by this date over 38,300 of the 41,700 eligible taxpayers had accepted this offer.

---

110 Australian Taxation Office, *Settlement Offer for Mass Marketed Schemes – Eligibility for remission of penalties and interest*, Fact Sheet, dated 13 June 2002, available at www.ato.gov.au. Note that the last category of ineligible investors is not referred to in the ATO's application for a concessional rate of interest form which the ATO has made available for use by eligible investors since July 2001.

Of these, 1,400 participants were identified as investors who were not eligible for the full terms of the offer.[111]

A4.39 After 21 June 2002, the ATO wrote to 4300 participants who had not responded to the settlement offer. The letter alerted any investors who missed out on the opportunity to settle to apply for consideration for exceptional circumstances. Of these, 907 were accepted.

A4.40 As the ATO's February 2002 settlement offer was inconsistent with its previous Addendum to its Code of Settlement Practice, this Addendum was withdrawn, although this withdrawal did not formally take place until 29 October 2002.

ATO processes for handling MMTEI investors after February 2002

A4.41 From March 2002 onwards, MMTEI investors were sent a settlement deed accompanied by a letter explaining the settlement offer. The letter asked the relevant investor to identify whether or not they were an eligible investor. If they were an eligible investor they could choose to accept the settlement by signing and returning the settlement deed. If they were not an eligible investor, the ATO letter advised them to lodge a submission outlining the extent to which they satisfied the special circumstances (see above) which led to the ATO making the settlement offer for eligible investors. These submissions were considered by teams in the ATO's Perth and Brisbane offices.

MMTEI investors who did not accept the February 2002 settlement offer

A4.42 According to the ATO, MMTEI investors who did not accept the ATO's February 2002 settlement offer before or after its expiry date fall into two broad categories.

A4.43 The first category consists of investors who meet the criteria for the general February 2002 settlement offer for eligible investors. These taxpayers, if they choose to settle, are not entitled to the nil interest or nil penalties aspects of the February 2002 offer. However, these taxpayers will still receive the 4.72 per cent concessional interest terms contained in the ATO's previous announcements of April and July 2001. These terms are only available, in accordance with these ATO announcements, up to

111 ATO Briefing Paper to the Inspector-General of Taxation, dated 21 January 2004.

the time when the ATO has judicial clarification of the issues involved in the relevant arrangement. Once that has occurred, the ATO has indicated it will levy interest at full rates on any unpaid tax.

A4.44 The second category of MMTEI investors who have not settled are, according to the ATO, those who would be treated as 'ineligible' investors if they had accepted the February 2002 offer. These taxpayers continue to be levied with the same level of interest and penalties which the ATO applied in the amended assessment first issued to these taxpayers.

A4.45 The ATO has advised that as at January 2004 there are approximately 3300 taxpayers who have not accepted the February 2002 offer.[112]

ATO processes for ineligible MMTEI investors who accepted the February 2002 settlement offer

A4.46 The ATO's letter to MMTEI investors did not contain detailed guidelines to ineligible investors as to how to frame their applications for eligible treatment, nor did it list the specific criteria which these applicants needed to address. These guidelines were only published by the ATO on its website in June 2002.

A4.47 The guidelines indicated that the following factors might help investors structure their application:

- what the taxpayer knew about the scheme;
- the taxpayer's knowledge of the tax system at the time of investing and claiming the deduction;
- whether the taxpayer was subject to aggressive and sophisticated marketing techniques;
- whether the taxpayer had a generally good tax record;
- whether the taxpayer took advice from people expected to have the necessary knowledge;

112 ibid.

- whether the taxpayer has suffered a real loss by paying cash into the scheme; and

- the taxpayer's role in relation to the investment.

A4.48 By the time these guidelines were published on the ATO website, many ineligible investors had already made their applications for concessional settlement treatment. These guidelines were therefore not issued on a timely basis. In addition, by being published on the ATO website only, they were not communicated to affected taxpayers in a way that would ensure that these taxpayers would be made aware of these guidelines.

A4.49 However, the ATO did communicate the existence of these specific website guidelines in the letters which it sent to ineligible taxpayers which notified them of whether their applications for concessional treatment had been wholly or partly successful. These letters also advised these investors of the existence of an internal ATO review process for considering their applications. The investors who took advantage of this review process were therefore able to utilise these website guidelines in framing their review applications.

ATO's internal review process for ineligible MMTEI investors

A4.50 The ATO's internal review process for ineligible MMTEI investors operated as follows. The review took place in the ATO's Canberra office. Taxpayers would address their review applications directly to the relevant ATO officers in Canberra. The taxpayer's file was then sent to the Canberra reviewing officer who conducted the review using an internal checklist. Once the review decision was made the taxpayer was advised of the results of this review and of their rights to seek a review of this decision by the Ombudsman.

A4.51 As at 31 January 2004, 15 out of 213 original ATO decisions relating to ineligible MMTEI investors had been overturned as a result of this review process. These altered decisions arose mainly because of additional information which the investor provided to the reviewing officer.

Possible settlement outcomes for ineligible investors

A4.52 The ATO has advised that there were three settlement outcomes which ineligible investors were offered in response to their applications for concessional treatment. These three outcomes were as follows.

1. The investors were eligible for the full terms of the settlement offer.

2. The investors would be allowed a deduction for their cash outlay and subject to a small penalty, depending on the circumstances. They would also be entitled to a remission of the interest charge for underpaid tax to 4.72 per cent and a remission of the interest charge for late payment of the amended assessment to 4.72 per cent. The latter interest rate remission was to apply for a two year period only.

3. The investors would be eligible for a cash outlay deduction, but otherwise subject to full interest and relevant penalties.

Actual settlement outcomes for ineligible investors

A4.53 When the ATO published its guidelines for ineligible investors on its website in June 2002, it indicated that, based on the cases considered by the ATO up to that time, the ATO did not expect that many investors would be eligible for the full remission of penalties and interest.

A4.54 However, the ATO stated that there would be a distinction between promoters and others who received a fee for another investor's participation (categories 1 and 2) and other investors (categories 3 and 4). Those in the latter two categories were, according to the ATO, likely to be in small to medium sized practices and were likely to have relied on the advice of unrelated and independent advisers. For this category of taxpayer, the ATO indicated that partial remission of interest along the lines of settlement outcome 2 above was appropriate.

A4.55 The ATO has subsequently indicated that as of January 2004, of the 1400 ineligible taxpayer cases, over 1100 have been finalised. Of these, 20 per cent have been granted the full terms of the settlement and 51 per cent have been given terms involving a 4.72 per cent concessional rate of interest. The remaining 29 per cent have received a settlement outcome involving full GIC, some penalties and a deduction for their cash outlay only.

Specific factors applied in granting interest reductions to ineligible MMTEI investors

Financial Planners

A4.56 Material provided for the purposes of this review indicates that, in applying its review processes for ineligible MMTEI investors, the ATO considered that the receipt of a fee for placing clients into MMTEI investments was a crucial consideration for taxpayers who were financial planners. If such a fee was received (and it exceeded a certain minimum amount) the planner would generally receive no concessional settlement (that is, settlement outcome 3 above would apply). If no fee was received, the planner would generally be treated in the same way as an eligible investor.

A4.57 The ATO considered that the term 'fee' in this context included a fee received by way of salary only. However, if the relevant financial planner investor was an employee and their work involved marketing MMTEIs, according to the ATO this might have resulted in the employee receiving the more concessional settlement outcome 2 above (that is, the 4.72 per cent interest reduction).

Tax agents or advisers

A4.58 For taxpayers who were tax agents or advisers, the ATO considered that the two key criteria which would determine the ultimate settlement outcome were the receipt of significant fees and knowledge of the tax system. The relevant fee could be either for placing others into the MMTEI arrangement or from providing tax advice generally on a regular basis.

A4.59 A tax agent who received more than a negligible fee for placing a client into a MMTEI arrangement would generally be required to pay full interest and penalties (that is, they will receive settlement outcome 3 referred to above). A tax agent who was a partner in a tax practice and who therefore received fees from the provision by that partnership of tax advice would generally receive the 4.72 per cent reduced interest settlement (that is, settlement outcome 2).

A4.60 Again, the ATO considered that, in this context, the term 'fees' included a fee received by way of salary only.

A4.61 A tax adviser's status as an employee might have had the result that they were considered a fully eligible investor (that is, entitled to

receive settlement outcome 1). An example of this was where the relevant tax agent received a fee in the form of a salary only from acting as a tax adviser to a large company.

ATO processes for issuing amended assessments to ineligible investors

A4.62 Three different areas of the ATO were responsible for the calculations of the interest, penalty and primary tax amounts which ineligible MMTEI investors had to pay. Submissions to this review have pointed out that this meant that, when finalising their MMTEI dispute, taxpayers may have had to deal with up to three or more different ATO staff. This process lengthened the time taken to finalise the dispute. The ATO should consider streamlining such processes so that in future a total case management arrangement is implemented for finalising all three aspects of a dispute of this nature.

A4.63 The above comments lead to the following subsidiary finding:

Subsidiary Finding 6

Taxpayers would benefit if the ATO adopted a case management arrangement for finalising the total amount, including interest, which taxpayers must pay to finalise their dispute.

Tax Office response

A4.64 The audit and debt collection staff do work together. However the ATO will examine how to improve ways for taxpayers and their representatives to interact with the Office.

Inspector-General comment

A4.65 The Inspector-General endorses the Tax Office agreement to address the issues identified and looks forward to further detail becoming available.

Interest concessions and settlement offers made to most MMTEI investors

A4.66 The Inspector-General is of the view that, for the majority of MMTEI investors, the ATO has allowed considerations of the type of the

arrangement that a particular taxpayer has entered into to overshadow considerations of the individual conduct and circumstances of that taxpayer. The settlement offer only applies to taxpayers who had entered one of the 184 arrangements which the ATO categorised as a MMTEI scheme.

A4.67 Certain features of the ATO's interest concessions and settlement offers to the majority of MMTEI investors are indicators of this overshadowing. For example, in the press release which referred to the July 2001 interest reduction the Commissioner specifically stated that the individual circumstances of investors were not to be reviewed to determine their entitlement to the reduction. This decision not to consider taxpayers on an individual basis was stated to be in 'the interests of fairness or efficiency in administration'.

Interest and other outcomes for ineligible MMTEI investors

A4.68 For MMTEI taxpayers who were promoters, financial planners, tax agents or tax advisers, the ATO has determined interest and other outcomes in their settlement arrangements according to two broad sets of criteria.

A4.69 Firstly, the ATO has determined interest remission and other settlement outcomes for these investors according to whether they are members of a particular subgroup within the broad overall group of MMTEI investors.

A4.70 Secondly, the ATO has determined interest remission and other settlement outcomes for these investors according to the degree to which these investors share some of the characteristics of those MMTEI investors to whom it is willing to grant a nil interest outcome.

A4.71 Both the above broad sets of criteria have overshadowed considerations of the conduct and circumstances of relevant individuals.

A4.72 One factor which indicates this overshadowing in determining the overall settlement outcome is as follows. The list of factors which the ATO advised ineligible taxpayers to refer to in their applications for concessional treatment did not include the particular MMTEI arrangement entered into, nor the nature of its particular tax mischief. These factors would be relevant if all the individual circumstances of these taxpayers were to be taken into account. They are also factors

which, according to the ATO's Code of Settlement Practice, should be taken into account in setting the terms of any settlement.

A4.73 The ATO has justified the approach it has adopted for all MMTEI taxpayers on the basis that the MMTEI dispute was extraordinary in nature, both in terms of the level of tax involved and the number of taxpayers affected. It has also indicated that on this occasion its approach was justified in the interests of good administration.

ATO internal review processes for ineligible MMTEI investors

A4.74 As discussed above, for ineligible MMTEI investors, the ATO set up a formal internal review process for remission of interest and other elements contained in the standardised settlement arrangement. The ATO also communicated the existence of that process to affected taxpayers. A similar process has not been established for participants in other disputes examined during this review, such as EBAs.

A4.75 This review found that there were very small numbers of taxpayers in EBAs and other arrangements that were offered standardised settlement terms who actually applied for and received a variation in the level of pre-amended assessment interest based on their individual circumstances. As discussed in more detail in Appendices 5 and 6, there were four such cases for EBAs, one case involving a retirement village, five cases involving equity linked bond arrangements and three cases involving securities lending arrangements.

A4.76 There is an absence of any formal ATO process similar to that adopted for MMTEIs for the remission of interest and other elements contained in the standardised settlement arrangements for taxpayers involved in EBAs and other arrangements. This may have led many of these taxpayers and advisers to believe that there was no process within the ATO for considering whether a particular case may involve special circumstances that would lead to different settlement terms such as for the remission of interest.

A4.77 Alternatively, the absence of such a process may have led these taxpayers and their advisers to believe that, if there was such a process, the result would be that concessional settlement treatment on the basis of special circumstances would be denied.

A4.78 This review found that the actual structure of the above formal process adopted for MMTEI investors and its accompanying review

procedures were well documented within the ATO and transparent to taxpayers.

A4.79 However, as indicated above, this review also found that there were certain shortcomings in the manner in which this process was communicated to affected taxpayers.

A4.80 This review also found that, in conducting the above ATO processes, considerations of the extent to which taxpayers were members of a particular group or shared certain other characteristics overshadowed considerations of the conduct and circumstances of each individual.

A4.81 Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977* (ADJR). This is a costly and lengthy process.

A4.82 Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.

A4.83 The above comments lead to the following key finding.

KEY FINDING 6

For investors in mass marketed tax effective investments (MMTEIs) the ATO set up a formal process, which also involved separate ATO internal review procedures, for the remission of interest and other elements contained in a standardised settlement arrangement. A similar process has not been established for participants in EBAs.

The actual formal structure of this process for MMTEI investors and its accompanying review procedures were well documented within the ATO and transparent to taxpayers.

KEY FINDING 6 continued

Currently, taxpayers who are seeking a review of the level of interest charged by the ATO can only do so by making an application for judicial review in accordance with the terms of the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act). This is a costly and lengthy process.

Tax administration would therefore be improved if an internal review process of a structure similar to that adopted for MMTEI investors was adopted for EBA taxpayers. Such a process would be a quicker, less expensive and more transparent review mechanism for the remission of interest than that which currently exists for such taxpayers.

However, any such review process would need to operate according to the overriding principle that all individual circumstances relating to particular taxpayers are taken into account during the operation of this process.

In particular, considerations of the extent to which taxpayers who are subject to this review process are members of a particular group, or share certain characteristics of other taxpayers in the same process, should not override considerations of the conduct and circumstances of each individual.

Tax Office response

A4.84 See the response to Key Findings 3 and 4. Special arrangements will be established to deal with applications, within the context described in that response.

Inspector-General comment

A4.85 The Inspector-General notes the agreement to establish a special arrangement and looks forward to further details becoming available.

MMTEI litigation

A4.86 There are five MMTEI cases which have been considered by the Federal Court (although the ATO has recently stated that it does not regard one of these cases as a MMTEI). Of these, four have been appealed to the Full Federal Court. In three of these appealed cases

(Sleight,[113] Vincent[114] and Puzey[115]), the Court held that the deductions in dispute were not allowable. In the other appealed case, which the ATO recently stated was not a MMTEI situation, (Cooke and Jamieson[116]) the Court held that the deduction was allowable. In the case considered by a single judge, the Federal Court confirmed that the deduction was not allowable (Howland-Rose[117] — 'the Budplan Case'). Puzey's case is currently on appeal.

A4.87 The law in relation to MMTEIs is therefore considered by some parties to still be uncertain. However, the ATO has not stated in any of its MMTEI settlement offers, that uncertainty in the law is a ground for applying a reduced rate of interest. As will be seen in the next appendix, uncertainty in the relevant law has been one factor leading to an interest rate reduction for one form of EBA. MMTEIs and EBAs have therefore received different treatment in this regard.

A4.88 While not the focus of this review, the Inspector-General notes that there are significant difficulties in concurrently conducting settlement and litigation processes in respect of the same matters. In most situations involving a settlement, there is a genuine uncertainty in the application of the law to the facts of a case and each side to the dispute accepts a compromise as an alternative to expensive litigation. In some of the MMTEI situations, the ATO allowed taxpayers to await the outcome of litigation prior to accepting the settlement offer — reflecting the desire of the ATO to finalise these bulk disputes in an administratively efficient manner.

A4.89 The relative status of those who settle and those who litigate where ongoing litigation occurs is unclear for many. Similarly, the ATO's litigation strategy when compared with participants' expectations around 'test case' processes is a matter of significant misunderstanding. The reality that many cases, particularly those involving the general anti-avoidance provisions of the ITAA 1936, can turn on their own facts is not always appreciated by participants in similar arrangements. The Inspector-General observes that the ATO could usefully improve communication processes in this area.

---

113 *FC of T v Sleight* [2004] FCAFC 94.
114 *Vincent v FC of T* (2002) ATC 4490, (2002) ATC 4742.
115 *Puzey v FC of T* (2003) ATC 4782.
116 *Cooke & anor v FC of T* (2002) ATC 4937; {2004] FCAFC 75.
117 *Howland-Rose v FC of T* (2002) ATC 4200.

Other observations, conclusions and findings

A4.90 The other observations and conclusions relevant to this review which arise from the above examination of the history of the ATO's settlement practices for MMTEI disputes are as follows.

Range of factors applied to remit interest

A4.91 The ATO has, either in MMTEI disputes or its Code of Settlement Practice, indicated that the following criteria will be applied as grounds for remitting the interest charge for underpaid or late paid tax in tax disputes involving large groups of taxpayers:

- the age of the relevant dispute;
- the taxpayer's knowledge of the arrangement giving rise to the dispute and the operation of the tax system;
- whether the taxpayer had a good tax record;
- whether the taxpayer was subject to aggressive and sophisticated marketing techniques to enter into the relevant arrangements;
- whether the taxpayers took advice from people expected to have the necessary knowledge of the tax system;
- whether the taxpayers suffered a real financial loss from entering into the relevant arrangements;
- whether the taxpayers contributed real money to the arrangement;
- whether the taxpayer derived fees (including fees in the form of a salary) from placing other taxpayers into the relevant arrangements;
- whether the taxpayer was a tax agent or adviser who received fees for providing tax advice on a regular basis;
- whether the taxpayer was an employee of a professional firm which had a tax practice; and possibly
- whether there was a ruling or advance opinion in relation to the scheme.

A4.92 In its application of the above criteria to MMTEI disputes, the ATO has not publicly stated that uncertainty in the relevant law is a factor for consideration in respect of interest remission. As discussed in the next appendix, the ATO has indicated that this factor was taken into consideration in its decision to grant an interest rate reduction to investors in controlling interest superannuation arrangements.

A4.93 As discussed in appendix 3, only some of the above factors are referred to in Chapter 93 of the ATO's Receivables Policy which is the ATO's current policy document for the remission of interest. In addition, where these factors are referred to, it is in the context of interest on the late payment of tax rather than interest on underpaid tax.

A4.94 *Taxation Ruling* IT 2517, which dealt with the remission of a charge that was equivalent to pre-amended assessment interest for the years of income up to and including 1991/92 contained more discussion of the types of factors which the Commissioner would consider in remitting pre-amended assessment interest. This ruling also contained worked examples.

A4.95 The above comments lead to the following subsidiary finding.

Subsidiary Finding 7

The ATO policy document dealing with remission of interest should clearly articulate the type of key factors the Commissioner considers relevant to the remission of pre-amended assessment interest. *Taxation Ruling* IT 2517 is a useful model in that it contains an explanation of relevant factors and worked examples.

Tax Office response

A4.96 As stated in response to Key Finding 2, the ATO will publish clearer guidelines on the remission of the pre-amended assessment interest charge.

Inspector-General comment

A4.97 The Inspector-General endorses the Tax Office proposal to publish clearer guidelines.

APPENDIX 5: EMPLOYEE BENEFIT ARRANGEMENTS

INTRODUCTION

A5.1 This appendix sets out details of the ATO's policy and practices for imposing or remitting interest in relation to settlement offers and other concessions made to taxpayers involved in Employee Benefit Arrangements (EBAs). It also sets out some findings and conclusions in relation to both this policy and its application in practice.

A5.2 Part A of this appendix describes the nature of EBAs and a brief history of the ATO's activities on EBAs.

A5.3 Part B describes the four ways in which taxpayers participating in EBAs have received a remission of interest.

A5.4 Part C discusses the ATO's reasons for not granting to EBA taxpayers generally the nil interest and nil penalties approach which it has applied to most MMTEI investors.

PART A: NATURE OF EBAS AND HISTORY OF ATO ACTIVITY ON EMPLOYEE BENEFIT ARRANGEMENTS

Definition of Employee Benefit Arrangements

A5.5 The ATO has, for some time, categorised Employee Benefit Arrangements (EBAs) as falling into four groups: Employee Benefit Trusts (EBTs), Employee Share Plans (ESPs), Controlling Interest Superannuation (CISs), and Offshore Superannuation (OSSs). The ATO has also advised that it has identified a fifth arrangement, being Employee Share Trusts (ESTs).

Nature of EBAs

A5.6 EBAs were prevalent from the mid 1980s until early 1999. They arose particularly, but not exclusively, in the small and medium sized

enterprise sector. They were marketed on the basis that they met a need for employers in that sector to provide a remuneration strategy that rewarded, retained and motivated employees, especially 'key' employees, in a way that was competitive with the remuneration that could be provided by larger listed companies.

A5.7 EBAs have the same essential elements. An employer (usually, but not necessarily, a small business proprietor) makes a contribution to a trust or to a superannuation fund for the ultimate benefit of their employees, including employee directors. The contribution is invested by the fund and generates income on which tax is paid. The contribution, together with income earned from the contribution, may be eventually paid to the intended employee beneficiary.

A5.8 A more detailed description, consisting of ATO Fact Sheets, of each of the four types of arrangements which the ATO has classified as EBAs are attached as Appendices 9 to 12.

A5.9 The perceived advantages of EBAs to participating employees were as follows. Firstly, they were flexible vehicles to use for investing as they were not subject to the investment constraints that are imposed on normal superannuation vehicles. Secondly, the contributions were not subject to superannuation contributions tax. Thirdly, the money was not locked away until retirement, the age of 65, illness or death. Fourthly, investments could be made on these employees' behalf with pre-taxed funds.

A5.10 For employers, these arrangements were perceived to be attractive for the following reasons. Firstly, they enabled monies to be paid to key employees in a tax deductible way. Secondly, the arrangements had no fringe benefits tax (FBT) or superannuation guarantee charge implications. Thirdly, the arrangements were able to be structured so that ultimate payouts could be made conditional upon the employee meeting certain business requirements (for example, meeting certain performance targets).

ATO audit activity on EBAs

A5.11 On 19 May 1999 the ATO indicated, via a press release[118], that EBAs were contrived arrangements, intended to frustrate the clear policy

118 Australian Taxation Office, Media Release Nat 99/16, dated 19 May 1999.

intent of the law. Accordingly, it commenced action to withdraw the tax benefits claimed to be associated with these arrangements, an activity which has continued to the present.

A5.12 In a speech to the Financial Planning Association on 27 April 1999[119], the Commissioner of Taxation outlined the features of EBAs which the ATO found of particular concern. These were as follows:

- the implementation of arrangements in circumstances that had little to do with the underlying human resource policy upon which they were predicated;
- the lack of independence of the trustee or administrator of the EBA, hence leaving the funds at the total control and discretion of the controllers of the company;
- the implementation of the arrangement where there are no arm's length employees and its use as a mechanism solely to benefit and access cash from the company by the owner-controllers of the company;
- the use of 'round-robin' financing to inflate the deduction; and
- the claimed ability to pass money out of often convoluted structures tax free.

A5.13 The ATO's withdrawal of tax benefits for EBAs applied to EBAs entered into prior to 19 May 1999 as well as those entered into after this date. It involved the ATO issuing single or (except in the cases of CIS arrangements) multiple amended assessments to participants. The single and multiple assessments all involved amounts of primary tax, interest and penalties.

A5.14 The multiple assessments were based on there being a number of possible taxing points, depending on the implementation of the particular EBA. These multiple taxing points generally included that no deduction was allowable for the contribution, or that FBT was payable on the contribution. In certain EBAs, assessments were also raised to the participating employees in that contributions on their behalf were included as assessable income in the year of contribution. Also, an

119 Commissioner of Taxation, *'The Changing Landscape for Financial Planning'*, Lunchtime Address to Financial Planning Association of Australia, Melbourne, 27 April 1999.

employee might be assessed on the value of the ultimate benefit when and if paid. However, the ATO did flag that although it had issued multiple assessments, it would be prepared to settle a particular EBA on the basis of a single taxing point in a manner which would not allow additional taxing points to be triggered.

Tax features of EBAs

A5.15 The purpose of this review is not to make any comments on the technical merits of EBAs. The soundness of the ATO's position on EBAs is a matter for the courts.

A5.16 However, this review does set out below the alleged tax consequences of EBAs from both the participants' and ATO's perspectives. This is because these alleged tax consequences underpin the ATO's approach to the remission of the interest for certain types of EBAs. They also underpin the submissions that have been made to this review that the ATO's approach is inappropriate and inconsistent with the approaches that the ATO has adopted in other situations of tax disputes involving groups of taxpayers.

A5.17 These alleged tax consequences depend on the particular way in which the EBA is structured.

A5.18 Most EBAs are structured so that the employer receives a tax deduction for the initial contribution. No tax is paid by the trust or fund on receipt of this contribution. No FBT is payable on this contribution, either when paid to the trust or fund or when paid out to the employee. Tax is only payable, if at all, when the contribution is paid out of the trust or fund to the employee.

A5.19 EBAs can therefore have tax consequences which can range from a deferral of the tax payable by the employee on what they would otherwise receive as a salary, through to no tax, or a reduced amount of tax, being payable on the remuneration amount.

ATO advices on EBAs prior to March 1999

A5.20 Prior to March 1999, EBAs in the form of EBTs, ESPs and CISs all received advices from the ATO which confirmed the claimed broad tax consequences.

A5.21 Prior ATO advice in this context consists of 3 forms of advice. These are advice which is in the form of a private binding ruling (PBR), advice which is in the form of an advance opinion and other forms of general advice not falling within either of these other two categories. An example of general advice is where a taxpayer's adviser receives general advice on the tax consequences of a 'typical' tax arrangement which is not client specific.

A5.22 The ATO is legally bound to follow a PBR if it has been implemented in accordance with its terms. It considers that it is administratively bound to follow an advance opinion that has been properly implemented.[120] The ATO therefore considers both these forms of advice to be 'binding'. The ATO does not consider that other forms of general advice are binding, even if a taxpayer has implemented this advice in accordance with its terms.

A5.23 The ATO has provided figures to this office which indicate that 24 favourable advices were issued in relation to EBT arrangements, of which 14 were binding on the ATO (that is, in the form of PBRs). For ESP arrangements, at least two favourable advices were issued. For CIS arrangements, 25 advices were issued, four of which were binding. The ATO has advised that no advices were issued on OSS arrangements.

A5.24 The ATO's provision of positive advices halted on 26 March 1999 when the ATO placed an embargo on the issue of advices on the above arrangements.[121]

A5.25 Subsequently, on 19 May 1999, the ATO stated that previous PBRs and advance opinions would be withdrawn, where they were not implemented according to the facts presented in the original application for ATO advice.[122] On the same date, the ATO released *Taxation Ruling* TR 99/5 which stated that the contributions made in EBT arrangements were subject to FBT. This final ruling had been preceded by the release of an earlier draft ruling (TR 98/D12) which had raised the likelihood of FBT applying to these arrangements.

A5.26 The ATO indicated that its reason for the withdrawal of previous advices was that many of these schemes were contrived

120 *Taxation Ruling* IT 2500, at paragraph 14.
121 Australian Taxation Office, Media Release Nat 99/12, dated 26 March 1999.
122 Australian Taxation Office, Media Release Nat 99/16, dated 19 May 1999.

arrangements, intended to frustrate the clear policy intent of the law. In the ATO's view, the arrangements, far from securing the claimed tax benefits, exposed participants to multiple taxing points and penalties.

Original ATO concession for EBAs — the 'safe harbour' offer

A5.27 In its 19 May 1999 press release,[123] the ATO indicated that its broad offer to taxpayers that had already been entered into EBAs was as follows. If participants came forward by 30 June 1999, the ATO would reduce penalties to 5 per cent and apply only a single and 'appropriate' tax liability. However, full interest would be charged from the original due date for payment of the relevant underpaid tax to the date upon which the taxpayer made full disclosure of their circumstances to the ATO. The ATO has since described this arrangement as its 'safe harbour' offer.

A5.28 This offer was not available for taxpayers engaged at the extreme end of sham and fraudulent behaviour.

Prospect of litigation on EBAs

A5.29 In its press release of 19 May 1999, the ATO acknowledged that there were fine technical distinctions and arguments associated with these arrangements and that taxpayers had the right to contest the ATO's views in the courts. However, the Commissioner flagged that the ATO was prepared to argue its views on these arrangements all the way to the High Court.

A5.30 The ATO's original concessions were premised on the basis that participants would need to forgo their objection and amendment rights. The ATO subsequently withdrew this aspect of their proposal and announced it was prepared to let these matters be tested in the courts if necessary. It also extended the time during which participants could take up the ATO's offer from 30 June 1999 to 13 September 1999.[124]

A5.31 In the 19 May 1999 press release, the ATO also announced that it would work with promoters of these arrangements to litigate representative cases and that objections of other participants would not

123 ibid.
124 Australian Taxation Office, Media Release Nat 99/46, dated 13 August 1999.

be determined until court decisions had been made. However, the ATO did say that it would, to protect the community's position, raise alternative assessments to cover possible alternative taxing points. These alternative assessments included determinations that the anti-avoidance provisions of either the *Income Tax Assessment Act 1936* (ITAA 1936) or the *Fringe Benefits Tax Assessment Act 1986* (FBT Act) applied to the arrangements.

ATO processes for EBA safe harbour cases

A5.32 From figures provided to this office by the ATO, it appears that out of the 6562 EBA cases which the ATO has currently identified, 1535 taxpayers responded to the ATO's safe harbour offer. The ATO has also indicated that in these cases interest was 'generally' remitted in full during the period from the date of voluntary disclosure until the issue of the amended assessment. This remission was made on the basis that during this period the non-payment of the relevant tax could be attributed to ATO delay.

ATO settlement arrangements after safe harbour period expired

A5.33 After the expiry of the safe harbour period, the ATO settlement offers for EBT and ESP forms of EBAs, have, according to material provided to this office by the ATO[125], generally consisted of terms which have included one taxing point, a 10 per cent penalty, full interest and a waiver of all objection and appeal rights.

A5.34 CIS arrangements have received a different arrangement owing to the outcome of court cases. This is discussed in further detail below.

A5.35 The ATO has advised that it has recently altered certain aspects of its settlement terms for EBAs involving offshore superannuation arrangements. This was as a result of the decision in the Walstern case[126], also discussed below.

A5.36 The ATO has requested that OSS taxpayers submit a settlement proposal and detail any material differences between their case and that which was considered in Walstern.

---

125 ATO Minutes No: IGT07-2004, IGT08 -2004 and IGT10-2004, all dated 30 January 2004.
126 *Walstern v FCT* [2003] FCA 1428.

A5.37 OSS arrangements which have been implemented in the same manner as Walstern (and which do not involve a safe harbour period) will now be subject to settlement terms which consist of one taxing point, a 20 per cent penalty, full interest and a waiver of all objection and appeal rights.

A5.38 OSS arrangements which are materially different to Walstern will be subject to the same settlement terms as those which have applied to OSS arrangements since the expiry of the safe harbour period. These terms have generally consisted of one taxing point, a 10 per cent penalty, full interest and a waiver of all objection and appeal rights.

A5.39 The precise terms of settlement have varied between all forms of EBA, owing to their differing structures. However, the settlement options for all EBAs have been standardised in the same manner as other settlement arrangements discussed in this report. That is, whichever settlement option applied to a participants in a particular EBA, that option would be applied according to its standardised terms. Apart from CIS cases, these standardised terms included no remission of pre-amended assessment or post-amended assessment interest.

ATO conduct in entering into settlements

A5.40 It is beyond the terms of this review to examine and comment upon the terms of the various settlement offers which the ATO have made to EBA participants since March 1999, and the methods under which the ATO has set about implementing these terms, other than to the extent that they deal with the imposition of the interest.

A5.41 However, very strong concerns have been made to this office about the nature of these other terms and their method of implementation by the ATO.

A5.42 One concern has related to the ATO's method of communicating to taxpayers the terms of these settlement offers. The ATO has advised, for example, that they have communicated to taxpayers that it does not expect payment of all the multiple assessments which may have issued. However, submissions have been made that the letters conveying this message are not clear on this point. These submissions point out that one part of these letters, for example, could be interpreted to mean that the ATO does require payment of all these amounts, but not all at the same time.

A5.43 Examples of other concerns which have been raised include considerable ATO delays in the actual settlement process and the level of penalties charged. They also include the ATO's application of the anti-avoidance provisions, the tax treatment of advisers' fees, the tax treatment of the amount of FBT charged in a multiple assessment situation and the application of the ATO's settlement terms to situations where EBA participants have retired.

A5.44 Concerns have also been raised about the conduct of ATO officers during the settlement processes and the legal form of the settlement documents themselves.

A5.45 The subject of the ATO's settlement processes generally may be considered further in determining the Inspector-General's future work program.

Revenue currently at risk in respect of EBAs

A5.46 After the expiry of the safe harbour period, a significant further number of EBA cases were identified by the ATO, through audit activity, giving rise to 6562 identified cases by 30 November 2003. The total amount of tax, penalties and interest on these cases, before any settlement, has been estimated by the ATO to be around $1.4 billion. The ATO has not been able to disaggregate this figure to show either the amount of interest included in this figure or how this figure is split between the different EBA categories. However, it has advised that this figure is based on the application of multiple taxing points on all EBAs.

EBA Litigation

A5.47 As foreshadowed by the Commissioner in 1999, there has been a substantial amount of litigation in respect of EBAs.

A5.48 To date, there have been six decided court cases involving the tax treatment of EBAs. Three of these have involved EBTs (Spotlight,[127] Kajewski[128] and Essenbourne[129]), two have involved CISs (Harris[130] and

127 *Spotlight Stores Pty Ltd v Commissioner of Taxation* [2004] FCA 650.
128 *Kajewski v FCT* (2003) ATC 4375.
129 *Essenbourne v FCT* (2002) ATC 5021.
130 *Harris v FCT* (2002) ATC 4569 (Full Federal Court), and (2002) ATC 4017 (single judge).

Prebble[131]) and one has involved an OSS (Walstern[132]). There have been no cases on ESPs.

A5.49 These cases have offered different views on the tax aspects of an EBA arrangement.

A5.50 In Essenbourne, decided on 17 December 2002, the Federal Court found that the original contribution to the trust was not an allowable tax deduction under the general deduction provisions of the ITAA 1936. It also stated that the particular EBA did not give rise to any FBT liability. The judge also commented, without making a binding decision on this point, that, if the deduction had been allowable, the anti-tax avoidance provisions of the ITAA 1936 would not have operated.

A5.51 In Kajewski, decided on 26 March 2003, the Federal Court found that the original contribution to the trust was not an allowable deduction under the general deduction provisions of the ITAA 1936 and that, in the circumstances of the case, the taxpayers were not entitled to a reduction in the tax penalty imposed.

A5.52 In Prebble, decided on 22 August 2003, the Full Federal Court held that a tax deduction was not available for a superannuation contribution made under a controlling interest superannuation scheme. This decision was consistent with the earlier decision of the Full Federal Court in the Harris case. In Prebble, the court also held that the taxpayer should not be subject to a culpability tax penalty for the claim he had made. This was because his case for deductibility was reasonably arguable. The court made this finding about reasonable arguability despite also noting that the taxpayer's claim had not been in accordance with the policy intention of the relevant law.

A5.53 In Walstern, decided on 8 December 2003, the Federal Court held that a deduction was not allowable for superannuation contributions made to an offshore superannuation fund. It also held that, on the facts of that case, FBT applied on these contributions at the time the amounts contributed were allocated by the fund to the relevant employees. The court then raised some doubts about the ATO's practice

131 *Prebble v FCT* [2003] FCAFC 165 (Full Federal Court) and *Prebble v FCT* [2002] FCA 1424 (single judge).

132 *Walstern v FCT* [2003] FCA 1428.

of applying only one taxing point in EBA cases where multiple potential taxing points exist. However, it noted that this matter was not one that it needed to make a final decision on, the ATO having already indicated that it was not its intention to pursue both income tax and FBT amendments against the relevant taxpayer.

A5.54 In Spotlight, decided on 25 May 2004, the Federal Court found that the original contribution to the trust was an allowable tax deduction, under the general deduction provisions of the ITAA 1936. However, the anti-avoidance provisions of the ITAA 1936 ultimately operated to deny this deduction. The Court also held that it was reasonably arguable that these anti-avoidance provisions did not apply and that therefore the taxpayer was entitled to a reduction in the level of penalty tax that had been imposed by the ATO. The Court also found that the EBA did not give rise to any FBT liability. The taxpayer has appealed this decision to the Full Federal Court.

ATO responses to decided court cases on EBAs

A5.55 The ATO has made two significant responses as a result of the court cases on EBAs decided to date. Both were announced in an ATO Media Release dated 14 March 2003.[133]

A5.56 The first response related to the decision in Essenbourne. After this case, the ATO announced that it did not accept the decision in so far as it applied to FBT. It stated it would not appeal the actual decision because the denial of a tax deduction for the contribution was sufficient to make the scheme ineffective. It therefore stated it would be looking to test the FBT aspect of EBAs in future court cases.

A5.57 The second response came as a result of the decision in Prebble. After this case, the ATO withdrew all culpability penalties it had imposed in respect of participants in CIS arrangements, provided a genuine contribution was made to the fund. In addition, the Commissioner announced that, in the interests of providing an opportunity to clear up these CIS cases, the ATO would reduce the interest to a 'commercial' rate of 4.72 per cent in those cases where a contribution was made before 19 May 1999. This interest reduction was to apply for both pre- and post-amended assessment interest. The

133 Australian Taxation Office, Media Release Nat 03/30, dated 14 March 2003.

19 May 1999 date was selected because this was the date on which the ATO announced that these schemes did not work.

Taxpayer and tax practitioner responses to the reduction in interest for all CIS cases

A5.58 After the ATO's announcement of 14 March 2003, the Taxation Committee of the Business Law Section of the Law Council of Australia released a statement[134] which raised several concerns about the above two responses of the ATO to decided court cases.

A5.59 These concerns were as follows. Firstly, the Law Council objected to the ATO ignoring the FBT aspects of the decisions, noting that this was inconsistent with the ATO's undertakings in the Taxpayers' Charter and also its overall duty to apply the law to collect only the correct amount of tax.

A5.60 Secondly, the Law Council argued that the ATO should withdraw penalties levied for EBT type arrangements, because the basis for application of penalties in these cases was 'symmetrical' with that which applied to CIS cases.

A5.61 Thirdly, as regards interest, which is the focus of this review, the Law Council specifically stated that interest for all EBAs in the form of EBTs should now be treated in the same way as CIS arrangements, that is, the interest for these cases should also be reduced to a rate of 4.72 per cent.

A5.62 All of the above concerns expressed by the Law Council have been echoed in other submissions that have been made to this office. However, most of these other submissions have gone further than the Law Council's suggestion of a reduction in the interest rate to 4.72 per cent. These submissions have argued that that the ATO should apply no interest to any form of EBA as to apply interest is inconsistent with the approach that has been adopted for other forms of mass marketed investments.

134 A copy of this statement was provided to the Inspector-General by the Law Council on 6 January 2004.

PART B: HOW INTEREST HAS BEEN REMITTED TO DATE FOR EBA ARRANGEMENTS

A5.63 There are four ways in which taxpayers involved in EBAs have received a remission of the interest payable upon the multiple amended assessments that have been issued by the ATO. They are as follows.

Situation 1

A5.64 The rate of interest has been reduced by the ATO as a part of a 'global' decision to remit the interest for most participants in a particular form of EBA. This is what has occurred for 3452 participants in CIS arrangements. In this case, the interest reduction applied to both pre- and post-amended assessment interest.

Situation 2

A5.65 The rate of interest has been reduced for participants based on their individual circumstances. This has occurred in only 3 EBA cases.

Situation 3

A5.66 In some cases, the period for which interest is applied has been reduced for certain groups of taxpayers. This occurred for 1,535 EBA participants who responded to an offer by the ATO to come forward with details of their arrangements by 13 September 1999.

Situation 4

A5.67 In only one case, the period over which the interest has been applied has been reduced because of individual circumstances affecting the particular EBA case in question.

A5.68 Each of these four situations is discussed in detail below.

Situation 1: ATO's reduction of interest in CIS cases

A5.69 In making a reduction of interest in CIS cases the nature of the particular types of arrangement overshadowed consideration of the individual circumstances of each affected taxpayer. The rate reduction was granted to most CIS taxpayers without an examination of the

individual facts and circumstances applying to the particular taxpayer's case.

A5.70 The rate reduction was also not applied to other EBAs and therefore was not consistent with the ATO treatment of those EBAs.

Basis for ATO's reduction of interest in CIS cases

A5.71 In material provided to this office and oral statements provided for the purposes of this review, the ATO has indicated that there were two main factors which led to its announced reduction of interest for most CIS cases and not EBAs generally.

A5.72 The first of these was that the Prebble decision indicated that the law in relation to CISs was uncertain. The ATO does not consider that this factor applies to other forms of EBAs.

A5.73 The second factor was that for CISs the ATO had issued a number of advices, all of which were favourable to taxpayers. For other forms of EBA, the ATO has noted that there were either no favourable advices that were issued (for example, for OSS arrangements) or there were both favourable and unfavourable advices issued (for example, for EBT and ESP arrangements).

A5.74 Alternative views on whether these grounds also apply to other forms of EBA have been offered in submissions made to this review.

A5.75 Firstly, submissions have commented that, in the first announcement which the Commissioner made in relation to EBAs, he referred to the possibility that these cases might need to be taken to the High Court for a decision. According to these submissions, this indicates that the Commissioner considered that the law in relation to all forms of EBA was uncertain. These submissions note that this feature of EBAs has been borne out in the history of EBA litigation to date. This history illustrates that the cases decided to date have produced differing results on various tax aspects of EBAs. These submissions therefore conclude that the law in relation to other forms of EBA is also uncertain.

A5.76 Secondly, submissions have noted that the ATO has adopted a tenuous distinction between CIS arrangements and other forms of EBAs where it asserts that CISs only ever received favourable prior ATO advice. These submissions note that the fact that any favourable advices

were issued by the ATO in relation to the other forms of EBAs should be a factor for these cases to receive interest remission.

A5.77 The ATO has not offered to CIS cases, or to any other EBA case, the nil interest and nil penalties settlement terms that were offered to the majority of investors in MMTEIs. The ATO does not consider that any of the factors which led it to offer concessional settlement terms, including those relating to interest, to most MMTEI investors apply to either CIS arrangements or EBAs generally.

A5.78 However, as detailed further below, the Inspector-General is of the view that to a large extent the same factors which applied to MMTEI investors also applied to EBA investors, including CIS investors.

Situation 2: Individual EBA cases where the interest rate has been reduced

A5.79 According to material provided to staff of the Inspector-General of Taxation, there are three EBA cases where taxpayers have received a reduction in the rate of interest, apart from the safe harbour cases. There is one EBA case (dealt with below) where the ATO has remitted the interest for a particular period.

A5.80 A number of parties who made submissions to the review have indicated that they would be surprised to learn that there have been any cases where interest has been remitted by the ATO. This is because, in their view, there was a general understanding that the ATO applied a 'no interest remission' policy across all EBAs.

A5.81 The ATO have not, unlike the case of certain MMTEI investors, set up a formal review process for EBA taxpayers to allow interest remissions and other settlement terms for these taxpayers to be considered on a case by case basis. It has also not communicated the existence of any such process to EBA taxpayers. However, such a review process was applied in these three rate reduction cases and the period reduction case referred to below.

A5.82 The absence of an internal formalised appeal process for interest remission decisions also raises concerns that tax practitioners who have established access to the ATO decision makers may be able to achieve better interest rate remission outcomes for their clients.

A5.83 The small number of these cases reinforces the key finding referred to earlier that an internal review process of a structure similar to that adopted for MMTEI investors should also be adopted for EBA taxpayers.

Other comments on interest rate reduction remission processes for individual taxpayers

A5.84 All three cases involving a reduction in the rate of interest involve non-binding ATO advice being given to the taxpayers or their representatives in the form of general correspondence. All of these three cases also involve what the ATO has termed 'arm's length employees'.

Prior advice which the taxpayer has implemented

A5.85 The ATO, in both material provided to the Inspector-General and discussions with staff of the Inspector-General, has indicated that the ATO has considered a remission in the rate of interest applied to an EBA where the taxpayer has received prior advice from the ATO.

A5.86 Such advice could be either in a form which was legally binding on the ATO (that is, a private binding ruling), in a form which the ATO will consider is usually administratively binding (that is, an advance opinion) or in a form which the ATO does not consider to be binding (that is, advice in the form of general correspondence).

A5.87 The ATO's process for dealing with such prior advice was to consider firstly whether taxpayers affected by this advice implemented it in accordance with its terms.

A5.88 Based on a review of the actual files of the cases affected by prior advice, it appears that if any of the following factors were not mentioned in the original ATO advice, but were present in the actual implementation arrangements, the ATO would conclude that the advice has not been implemented in accordance with its terms:

- over 90 per cent of the contributions were made for non arm's length employees associated with the employer;
- the contribution was loaned back to the employer;

- the contribution was lent to entities associated with the recipient employees or to the 'employee' business principals in incorporated 'mum and dad' business arrangements; or

- the contribution represented a salary sacrifice.

A5.89 The three interest remission cases all involved general correspondence. The ATO concluded in all three cases that the manner in which this advice was implemented was in accordance with the terms of the original advice. These cases also all involved arm's length employees.

A5.90 In none of the three cases did the ATO record on its files the actual reasons for the interest remission decision. These reasons had to be gleaned from discussions between staff of the Inspector-General and the relevant ATO decision maker.

A5.91 Based on these three cases, the ATO's current practice for reducing the interest rate to 4.72 per cent in EBT cases of prior non-binding advice is as follows. This reduction will occur where at least the following two factors are present:

- there is prior non-binding advice that has been given to the taxpayer or their representative which has been properly implemented; and

- the relevant employees involved in the EBT are at arm's length.

A5.92 It could be argued that the ATO cannot justify its position of only a partial interest remission being allowable in this kind of case, given that the ATO has admitted that it gave the relevant taxpayers previous advice with which the taxpayers have fully complied. It has been commented that these taxpayers would be justified in thinking that the ATO has applied one standard to them (that is, that they must abide by what they have said they will do) and another to itself (that is, that it does not have to abide by what it has previously said it will do).

A5.93 This observation leads to the following subsidiary findings.

Subsidiary Finding 8

Tax administration would be improved if the ATO, as a matter of fairness, communicated to all EBA participants the existence of prior non-binding ATO advice, including advice provided to an adviser in respect of unnamed clients, may entitle them to receive a partial reduction in the rate of interest.

Tax Office response

A5.94 Where a taxpayer received advice from the ATO in respect of an employee benefit arrangement which was subsequently implemented, that factor was taken into account in deciding whether the interest charge should be remitted. Taxpayers and their representatives have been given opportunities to advise the ATO of the receipt of any advice letters. To date there have been only a very small number of cases in which an arrangement has been implemented materially in accordance with the circumstances outlined in an advice letter.

Inspector-General comment

A5.95 The Inspector-General notes the Tax Office response to this finding. However, a key issue is whether EBA participants or their advisers are aware of this possible ground of interest remission.

Subsidiary Finding 9

Tax administration would be improved if the ATO ensured that in all cases where interest remission decisions are made the reasons for these decisions are appropriately recorded on the file at the relevant time. This procedure would more readily allow these decisions to be the subject of internal ATO review (as recommended above) and also any external ATO review.

Tax Office response

A5.96 The ATO agrees with this finding.

Inspector-General comment

A5.97 Noted

Arm's Length employees

A5.98 The ATO has publicly communicated, by way of a fact sheet issued on 14 March 2003[135] that EBAs involving arm's length employees will be considered on a case by case basis. However, this fact sheet does not indicate whether this criterion alone will give rise to any interest rate reduction when it is not coupled with prior ATO non-binding advice.

A5.99 The definition which the ATO uses for the term 'arm's length employee' situation is not clear. The ATO appears to define this situation by reference to what is not an arm's length employee situation. In discussions with staff from the Inspector-General, ATO officers have indicated that a non-arm's length employee situation is one where 90 per cent or more of the proceeds of the relevant trust or fund are ultimately paid out to persons who are associated with the employer who has made the original contribution.

A5.100 Submissions made to this review have indicated that neither taxpayers nor advisers understand how the presence of arm's length employees in an EBA will affect any settlement terms which the ATO may offer for that EBA. The exact meaning of the term, 'arm's length employees' and the possible relevance of this factor has not been clearly set out in correspondence sent to EBA taxpayers.

A5.101 These observations lead to the following finding.

Subsidiary Finding 10

Tax administration would be improved if the ATO communicated directly to taxpayers who are involved in EBAs the extent to which the presence of arm's length employees in their EBAs will lead to different settlement terms. This communication should clearly define the term 'arm's length employees' so that taxpayers who read this ATO communication understand how it might apply to their circumstances.

135 Australian Taxation Office, Fact Sheet 'Employee Benefit Arrangements' (EBAs) Nat 8097-3.2003.

Tax Office response

A5.102 The information generally available to the ATO does not allow identification of cases involving benefits primarily for arms length employees.

A5.103 As recognised by the Inspector-General, the ATO has publicly communicated that settlement of employee benefit trust arrangements involving primarily arm's length employees will be considered on a case by case basis. Where taxpayers or their representatives consider that their arrangements fall into this category they should contact the ATO.

Inspector-General comment

A5.104 The Inspector-General notes the Tax Office response to this finding. However, a key issue is whether EBA participants or their advisers are aware of this possible ground of interest remission.

Situation 3: EBA cases where interest has been remitted for a period only for all taxpayers in a particular group.

A5.105 As indicated above, there is only one situation involving EBAs where the period for which interest is applied has been reduced as part of a 'global' decision which applies for all taxpayers who meet a certain criterion. This situation is where the relevant EBA participant has responded to the offer by the ATO to come forward with details of their arrangements by 13 September 1999. In this case, the ATO has remitted the interest in full for the period between the time when the taxpayer provided all relevant material to the ATO and the date of issue of the relevant amended assessment.

A5.106 During the course of the review, the principal concern which was raised on this aspect of the ATO's remission policies on interest for EBAs was that, in some cases, the ATO was unwilling to accept that the relevant taxpayer had made a full disclosure within the stipulated time period. These cases were those where taxpayers were unable to provide a relevant document because it was actually in the possession of the promoter of the arrangement. The ATO has denied that this situation ever arose in respect of such safe harbour cases.

A5.107 Another concern was there is or was a lack of transparency in the methods used by the ATO to calculate and then remit this interest. It

was suggested that the ATO should, in this specific case and more generally, automatically provide a detailed interest calculation whenever a payment demand notice which includes an amount of interest is sent to taxpayers.

A5.108 The ATO now publishes a fact sheet which outlines the rate of interest applied for all periods since 1 July 1999 which now partly addresses this concern. However, it still does not automatically provide detailed interest calculations unless these are specifically requested. This leads to the following subsidiary finding.

Subsidiary Finding 11

Tax administration would be improved if the ATO were to readily make available a mechanism to allow taxpayers to check how interest calculations have been made. The nature of this mechanism should be determined in consultation with appropriate parties, including taxpayers, tax agents and professional bodies representing tax agents and tax advisers.

Tax Office response

A5.109 The ATO will consider such mechanisms as part of the improvements under the easier, cheaper and more personalised change program.

Inspector-General comment

A5.110 The Inspector-General endorses the Tax Office agreement to address the issues identified and looks forward to further detail becoming available.

Situation 4: Cases where interest has been remitted for a period based on individual circumstances

A5.111 The ATO has provided material to this review which indicates that in only one EBT case was there a reduction in the period during which the ATO applied the interest for underpaid tax. This case was not subject to the safe harbour settlement option. The remission was based on an admission by the ATO that it had delayed in responding to the taxpayer during the relevant period.

A5.112 The Inspector-General has the following concern with this case. A number of submissions made to the office indicate that there have been substantial delays, sometimes up to 18 months, from the time that the taxpayers respond to a Notice of Intention to Audit and the date of issue of the amended assessment.

A5.113 It appears surprising, given the above submissions and the volume of EBA cases handled by the ATO, that this form of ATO delay has given rise to interest remission in only one non safe harbour EBA case.

A5.114 These comments suggest that taxpayers may not be aware that ATO delay is a ground for the remission of interest, even though this is specifically referred to in the ATO's current policy document for the remission of interest.

A5.115 These comments also support the concerns previously noted that there could be a lack of taxpayer and adviser awareness of the ability to seek interest remission based on individual circumstances.

Subsidiary Finding 12

Tax administration would be improved if ATO communications to EBA taxpayers specifically made reference to the fact that ATO delay is a ground for interest remission.

Tax Office response

A5.116 Contrary to paragraph A5.113, the ATO has partially remitted the interest charge in a number of cases due to acceptance that the ATO contributed to an undue delay in issuing amended assessments.

A5.117 Further, after publication of the report we will be communicating with all tax agents explaining the implications, consistent with our response. This will cover remission issues.

Inspector-General comment

A5.118 The Inspector-General notes the Tax Office response, although the ATO was only able to provide documentary evidence in respect of one case.

A5.119 The Inspector-General supports a direct communication process to all tax agents, to assist their communication with their clients, covering interest remission and other matters associated with this report.

PART C: HOW ATO APPROACHES TO EBAS COMPARE WITH ATO APPROACHES TO OTHER GROUPS OF TAXPAYERS

A5.120 The ATO considers that EBA disputes generally do not warrant the settlement treatment that was granted to MMTEI investors.

A5.121 Details of how the ATO initially grouped EBAs with MMTEIs, but then subsequently distinguished EBAs from MMTEIs are set out below. Also set out below are comments on the ATO's current treatment of EBAs.

ATO's initial characterisation of EBAs as mass marketed disputes

A5.122 The Inspector-General notes that, from the early days of its investigations into MMTEIs, the ATO grouped EBAs with other forms of MMTEI. This practice is confirmed in the Commissioner of Taxation's Annual Report for 1999/2000 where it categorises EBAs as one form of mass marketed scheme.[136]

A5.123 The ATO publicly de-grouped EBAs from other forms of MMTEI from at least 26 April 2001 when it announced that it would reduce the interest on tax debts for some MMTEIs, which did not include EBAs.

A5.124 However, the ATO's own internal guidelines for settling MMTEIs continued to apply to EBAs after both this date and the date of its no penalty and no GIC offer to MMTEIs. These guidelines were only withdrawn by the ATO on 29 October 2002.

A5.125 There is further evidence which supports a view that the ATO continues to regard EBAs as a form of MMTEI, even though ATO staff have indicated to this office and others that EBAs are not now part of

136 Commissioner of Taxation's Annual Report 1999-2000, at page 70.

MMTEIs. For example, in an organisational sense, the ATO staff which are responsible for EBAs are also responsible for MMTEI arrangements.

ATO reasons for not applying MMTEI settlement offers to EBAs

A5.126 In the opinion of some parties, the ATO's reasons for not applying its concessional interest rate offer given to MMTEIs to EBAs were not comprehensively stated. What was stated was that these arrangements involved very different circumstances, for example, a high level of investor control.

A5.127 From material gathered during this review, it appears that the ATO's list of grounds for excluding EBAs from MMTEI treatment is as follows.

A5.128 The first ground was that the ATO considered that EBAs generally involved participants who were more sophisticated taxpayers, being people in business rather than wage and salary earners. According to the ATO, these business people generally had a higher level of knowledge of the details of the tax planning arrangements than participants in MMTEIs.

A5.129 The second ground was that, EBAs were not marketed using the same aggressive marketing techniques as MMTEIs, but were tailor made for each EBA participant.

A5.130 The third ground for the ATO's different treatment of EBAs was that MMTEI investors often suffered an actual economic loss in relation to the investment, while this was not the case for EBA investors.

A5.131 The fourth ground offered by the ATO for the distinction is that the taxpayers involved in MMTEIs handed over their funds to outside parties and therefore lost control of them, whereas in EBAs the funds were often provided to entities related to the participating employer or employees.

Alternative views

A5.132 It is possible to take an alternative perspective in respect of each of the ATO's grounds for distinguishing EBAs from MMTEIs.

A5.133 Firstly, submissions made to the Inspector-General have asserted that participants in EBAs comprised the same broad array of participants that were involved in MMTEIs. One submission noted the following in this regard:

> '… a broad array of individuals entered into the EBAs ranging from 'sophisticated' investment bankers and corporate executives to the average salary and wage earner, small business operator, 'mum and dad' companies, etc. The investors in the EBAs were not exclusively 'sophisticated investors' and many were like those who invested in the mass marketed schemes.'

A5.134 Secondly, submissions have asserted that EBAs were marketed in a very similar fashion to MMTEIs. These submissions state that, although EBA promoters did not market to employees directly, but rather to their employers, the same kind of sophisticated marketing techniques were utilised to capture this target employer market. These techniques included glossy brochures and senior barrister's opinions.

A5.135 Furthermore, these submissions assert that the manner in which EBAs were implemented did not depend greatly on the individual circumstances of the EBA participant, as the essential features of these arrangements were identical in their broad outline.

A5.136 Thirdly, submissions to this review have asserted that many EBA participants have actually suffered economic loss as a result of their participation in these arrangements. Submissions noted that many EBT taxpayers in particular have been forced into liquidation in order to pay the assessments they have received. Furthermore, the multiple nature of EBA assessments has destroyed the creditworthiness of EBA participants, thereby causing these participants to suffer a loss to their business reputation.

A5.137 Fourthly, these submissions assert that the ATO's view that the funds invested in EBAs remained under the investor's control is arguable as the very nature of EBAs is that legal entitlement to the relevant funds, together with the actual funds themselves in many cases, is passed on to other entities. Professional advisers involved in implementing settlements have commented on the difficulties on some occasions of obtaining the agreement of third parties, such as trustees, to the release of funds held in these other entities.

A5.138 These submissions also point out that, in any event, in many MMTEIs the taxpayers' funds were never applied to the relevant investment, but were used to meet the promoter's fees. The issue of retaining control over the relevant invested funds is therefore not perceived to be as relevant as identified by the Commissioner.

A5.139 In addition, these submissions note that EBA taxpayers incurred significant promoter and legal costs in both setting up their EBA structures and dismantling them in response to ATO audit activity, with the tax deductibility of these costs also being an issue disputed with the ATO.

A5.140 The Inspector-General is in general agreement with the above comments made in submissions received regarding the ATO's grounds for distinguishing participants in EBAs from MMTEI investors.

A5.141 This leads to the following key finding.

KEY FINDING 7

Taxpayers who are members of groups of taxpayers in dispute with the ATO over arrangements frequently share a range of common features. Some of these features were identified by the ATO and used to determine the final settlement offer that was made to the majority of MMTEI investors. In the ATO's view, these common features suggested the existence of exceptional circumstances which justified applying an interest remission policy which led to the interest charge being reduced to nil.

The present ATO treatment of pre- and post-amended assessment interest charges for taxpayers involved in EBAs has focussed principally on the nature of the arrangement giving rise to the particular dispute. For taxpayers involved in three kinds of EBAs full interest has been charged while for taxpayers involved in one form of EBA a reduced interest rate has been applied.

This focus on the nature of the arrangement in EBA disputes appears to have led to taxpayers involved in EBA disputes receiving interest remission outcomes which are inconsistent with those received by other groups of taxpayers. It has also led to taxpayers involved in certain types of EBA receiving interest remission outcomes which are not consistent with those applied to taxpayers involved in other forms of EBA.

A5.142 The Inspector-General also notes that there is one further factor present in certain EBA disputes which may warrant specific attention in considering whether full remission of the pre-amended assessment interest charge for taxpayers involved in EBA disputes is appropriate.

A5.143 This additional factor applies to EBA taxpayers who were involved in employee benefit trusts, employee share plans and controlling interest superannuation arrangements.

A5.144 For these three types of arrangements, there is evidence of an administrative practice within the ATO of giving favourable advices for such arrangements. Evidence of such an administrative practice is referred to at paragraph 51 of the Federal Court decision in the Prebble case.[137] This practice appears to be evidenced by the significant number of favourable prior advices given. This factor was not present to the same degree for MMTEI investors, given that for the over 43000 taxpayers involved in MMTEIs the ATO has indicated that there were only six prior advices.[138]

A5.145 Conduct of the ATO which has caused taxpayers to be misled is not a factor which is specifically dealt with in Chapter 93 of the ATO's Receivables Policy. However, it was a factor which was specifically referred to by the ATO in its policy documents for the remission of the per annum interest charge for underpaid tax prior to 1 July 1992 and, more recently, for the remissions of the interest for underpaid FBT prior to 1 April 2001. The relevant rulings dealing with each of these types of interest specifically provided that this factor would lead to interest being remitted to nil.[139]

Tax Office response

A5.146 The focus of Key Finding 7 is the distinction in treatment between mass marketed investment schemes and Employee Benefit Arrangements.

A5.147 Without traversing in detail the views and counter views about our reasons for distinguishing between the two some brief observations

137 *Prebble v FCT* (2002) FCA 1434.
138 ATO Minute No: IGT 14-2004.
139 *Taxation Ruling* IT 2517 at paragraphs 37 and 41; *Taxation Ruling* TR 95/4 at paragraph 18.

are appropriate on some of those. They also help illustrate a broader consideration in making the distinction.

A5.148 The particular economic loss considerations in the mass marketed investment schemes referred to the participant's own funds being invested in, and lost on, what was in many cases a poor or non-existent venture. It was not a reference to losses associated with costs of entering the arrangements, such as promoter fees, or the consequences of facing an appropriate tax liability.

A5.149 Further, unlike the investments in mass marketed investment schemes, the use of the funds in employee benefit arrangements were generally under the effective control of and/or generally for the benefit of the participant and/or associates.

A5.150 The participants set up the structures involved and directed the funds to them.

A5.151 These factors have been recognised in decided cases to date. For example, in Essenbourne the court concluded that the arrangements were designed to distribute profits in a tax free form to the principals of the employer entity.

A5.152 In some cases amounts contributed to employee benefit trusts were loaned back to the employer or associate of the employer. In the Spotlight case, which involved the provision of benefits for arm's length employees, the round-robin loan back arrangement was a factor leading the Court to conclude that there was a dominant purpose of gaining a tax benefit.

A5.153 The Inspector-General states that "there is evidence of an administrative practice within the ATO of giving favourable advice" for employee benefit trust, employee share plan and controlling interest superannuation arrangements. The Inspector-General notes that this factor "may warrant specific attention in considering whether full remission of the pre-amended assessment interest charge for taxpayers involved in EBA disputes is appropriate".

A5.154 The Inspector-General cites the judgements of the Federal Court in the Prebble case as evidence of such an administrative practice.

A5.155 The Prebble case involved a controlling interest superannuation arrangement and the court's decision and comments are not relevant to

the other types of employee benefit arrangements. As previously pointed out, we took into account the court's decision in Prebble that the taxpayers claim was reasonably arguable and the issue of a small number of favourable advices in deciding to partially remit the interest charge for most controlling interest superannuation arrangement cases.

A5.156 The circumstances which made it appropriate to partially remit interest in those cases have no relevance to other employee benefit arrangement cases.

A5.157 As previously pointed out, we are of the view that the evidence does not support a conclusion that there was an administrative practice within the ATO of giving favourable advice or accepting the tax benefits claimed in respect of employee benefit trust or employee share plan arrangements which have been the subject of disputes with the ATO.

A5.158 In relation to employee benefit trust arrangements, apart from both the favourable and unfavourable rulings which are the subject of a current criminal matter, the small number of favourable advices issued by the ATO did not cover the circumstances of the typical employee benefit trust scheme involving non-arm's length employees. In our view the typical employee benefit trust arrangement was not a genuine employee retention plan but rather a scheme designed to distribute profits in a tax free form to the principals of the employer entity. As indicated, this view was confirmed by the Federal Court in the Essenbourne case.

A5.159 In relation to employee share plan arrangements, only two favourable advices were issued. This does not represent evidence of an administrative practice.

A5.160 No advices were issued in respect of the offshore schemes.

A5.161 The broader point referred to is this - the acceptance that arrangements of this kind marketed in these circumstances could at worst result in a no-penalty, no-interest outcome would significantly impact on the future health and integrity of the tax system.

Inspector-General comment

A5.162 The Inspector-General has concluded that the ATO's treatment of EBAs has resulted in EBAs, and different forms of EBAs, receiving interest remission outcomes inconsistent with other groups of taxpayers.

A5.163 In responding, the Tax Office has identified a range of factors which it has considered as key points of difference between MMTEIs and EBAs. It has stated that these factors have been recognised in relevant court decisions.

A5.164 These comments by the Tax Office go to the efficacy of EBAs rather than the consistency of treatment of interest remission between groups of taxpayers. The Inspector-General has consistently stated that the efficacy of EBA arrangements has not been a consideration of this review.

A5.165 The Inspector-General notes that the Commissioner of Taxation will be offering EBA taxpayers, as a settlement incentive, an interest cap. The total amount of pre- and post-amended assessment interest accruing to the date two months from the date of release of this report will be capped at 70 per cent of the primary tax in dispute (that is, excluding penalty and interest). The capping will apply irrespective of whether participants continue to dispute the issues in the courts. This offer will also be applied to finalised cases.

A5.166 The Inspector-General is strongly of the view that the overall health and integrity of the tax system is crucial to community confidence and ongoing viability of the system. However, it is noted that the remission of interest and penalty for most MMTEI investors has not seemed to have had adverse consequences to this integrity and that the number of MMTEI taxpayers significantly exceeded the number of EBA taxpayers.

A5.167 The Inspector-General is supportive of the proposal outlined in the Commissioner of Taxation's covering letter (Appendix 1) to implement an arrangement of a senior panel, supported by transparent guidelines, to consider future widely based settlement activities.

Case law — Elias vs Commissioner of Taxation

A5.168 The ATO has, in discussions with the Inspector-General indicated that the Federal Court decision in the Elias Case[140] provides judicial support for its current treatment of interest charged to EBA taxpayers. In this case the taxpayer sought judicial review of the

140 *Elias v Commissioner of Taxation* (2002) FCA 1132.

Commissioner's refusal to remit the GIC pursuant to the *Administrative Decisions (Judicial Review) Act 1977* (the 'ADJR Act').

Facts of Elias' Case

A5.169 In the proceedings, the taxpayer, who had entered into an EBA in the form of a CIS, alleged a number of grounds upon which he claimed the Commissioner had erred in refusing to remit the GIC. Most relevant to the current discussion was the submission to the Court that the Commissioner had treated the taxpayer unfairly because he treated him differently as compared to other types of taxpayers involved in MMTEIs, who received concessions by way of a remission of the GIC.

A5.170 The taxpayer submitted that the failure of the Commissioner to consider whether it was fair that he should be treated in a different way from the participants in those other arrangements meant that the Commissioner breached the principles of natural justice as:

- the Commissioner failed to take relevant considerations into account; and

- the Commissioner acted in accordance with a rule or policy without regard to the merits of the applicant's case.

A5.171 Justice Hely held that the taxpayer had not established that there was any irrationality in treating participants in mass marketed schemes more benignly than participants in EBAs. The Court stated that:

> 'The media release refers to the two groups, and to the fact that one group will receive more favourable treatment than the other, and explains why there is to be differential treatment between the two. In the view of those who published the media release, the two groups are to be treated differently because members of one may be expected to be more financially sophisticated than the members of the other. It has not been shown that the reason assigned for the differential treatment is without foundations.'

A5.172 The Court concluded that the taxpayer had not established that there was any reviewable error on the part of the decision maker in failing to consider this question. Also, the Court held that the taxpayer had not established that the decision refusing to remit the GIC in the case of the taxpayer was irrational having regard to the terms of the media

release. Rather, all the taxpayer had established was that the Commissioner had announced that cases, which in the opinion of the Commissioner are different, would be treated differently.

A5.173 The ATO responded to the handing down of this decision by releasing a summary as part of its information sheet outlining the decisions supporting the views taken by the Commissioner. In respect of the Elias case, the information sheet provided that:

> 'The Court held that the decision was reasonable and was made within the Commissioner's discretion.
>
> The Court also held that there were good reasons put forward for discriminating between taxpayers involved in mass marketed schemes and those involved in employee benefit arrangements.' [141]

Inspector General's view

A5.174 The following general comments are offered in respect of the Elias case.

A5.175 Firstly, the Elias case deals with the remission of post-amended assessment interest and the judicial review of the Commissioner's refusal to remit that interest. The Court made no specific comments regarding the remission of interest for the pre-amended assessment period, which is the focus of this review.

A5.176 Secondly, the Court in Elias was only examining whether the conduct of the Commissioner amounted to a reviewable error in accordance with the ADJR Act. Such a review does not examine the merits of the decision made by the Commissioner or the merits of the opinion held by Commissioner.

A5.177 There will be instances where a taxpayer is not able to establish that there was a reviewable error on the part of the decision maker. However, this does not necessarily mean that the merits of the decision are in accordance with good administrative practice and consistent with the principles of equity and fairness.

---

141 Australian Taxation Office, 'Court decisions in scheme cases, which weren't mass marketed', Information Sheet, 8 December 2003.

A5.178 In analysing this decision and the views expressed by the Court the distinction between judicial review pursuant to the ADJR Act and a merits review is important.

A5.179 The description by the ATO in the information sheet on its website that the Court 'held there were good reasons put forward for discriminating between taxpayers involved in mass marketed schemes and those involved in employee benefit arrangements' appears to blur that distinction and may cause some confusion as to view taken by the Court. At no time did the Court make any comment as to merits of the opinion held by the Commissioner in differentiating between these groups of taxpayers. In fact, a consideration of the merits would be outside of the powers of the Court under the ADJR Act.

APPENDIX 6: RETIREMENT VILLAGES, EQUITY-LINKED BONDS AND SECURITY-LENDING ARRANGEMENTS

A6.1 The purpose of this appendix is to record the nature and current status of disputes between the ATO and groups of taxpayers involved in retirement village investments, equity linked bond investments and security lending arrangements. Taxpayers involved in these arrangements have also received standardised settlement terms from the ATO.

A6.2 The Inspector-General has not examined in detail the ATO's remission practice for the interest charge in relation to these three disputes. The following material is therefore descriptive in nature and is largely based on material provided to the Inspector-General by the ATO and in submissions during the course of this review.

A6.3 Unlike Employee Benefit Arrangements (EBAs), the ATO has, from an early stage, distinguished these investments from other forms of Mass-Marketed Tax Effective Investments (MMTEIs). For example, the Commissioner of Taxation's Annual Report for 1999/2000 indicates that these investments were not a form of 'mass-marketed arrangement' but were often tailor-made for higher income taxpayers.

RETIREMENT VILLAGE ARRANGEMENTS

Background

A6.4 In 1994, the ATO issued *Taxation Ruling* TR 94/24. This ruling dealt with the taxation treatment of commercial retirement village operators who recovered the costs of developing or acquiring a retirement village by granting long-term occupancy rights to incoming residents.[142] Under this ruling, expenditure incurred by the owner in

142 Australian Taxation Office, 'Tax Office Releases New Draft Ruling on Retirement Villages', Media Release — Nat 2000/35, 19 April 2000.

acquiring or developing the village, though normally treated as capital expenditure, was considered to be expenditure of a revenue nature. Accordingly, a deduction would be allowed for that expenditure in the year in which it was incurred.

A6.5 On 19 April 2000, following investigations by the ATO into these arrangements, the ATO issued a media release announcing the release of a draft ruling on the income tax treatment of investments in retirement villages, replacing *Taxation Ruling* TR 94/24.[143] This draft was released as a final ruling, *Taxation Ruling* TR 2002/14, on 28 June 2002.

A6.6 In the media release the ATO stated that the review of *Taxation Ruling* TR 94/24 was caused by evidence of aggressive tax planning arrangements that sought to exploit the ruling. In particular, the ATO indicated that it would be challenging some of these more aggressive planning arrangements, including:

- investments with highly leveraged non-recourse funding involving artificial prepayments to bring forward deductions ahead of construction of the retirement village; and

- investments involving payment of a deposit for purchase of a land and retirement village package, where a deduction for the full purchase price is claimed immediately, even though settlement will not occur until construction of the retirement village is completed.

A6.7 As a result of these rulings, the Commissioner adopted an alternative position in respect of the taxation consequences for retirement village investments. Importantly, the ATO indicated that the costs of developing or acquiring a retirement village to operate an ongoing business were outgoings of capital or of a capital nature and hence not deductible on revenue account.

A6.8 The ATO has indicated that there was ongoing dialogue between the ATO and industry representatives following the media release being issued in 19 April 2000. According to the ATO, the purpose of this ongoing dialogue and consultation with industry and their representatives was to arrive at a position that might be acceptable for

143 ibid.

investors in order to meet their tax obligations in relation to their investment in retirement village arrangements.[144]

A6.9 Following this dialogue with industry representatives, the ATO advised that in October 2003 it issued the 'Offer of Closure' letters to taxpayers who had invested in the retirement village arrangements. This offer indicated that the ATO would settle its dispute with these taxpayers on the following basis:

- a deduction would be allowed for the deposit paid on signing the contract in the year of income in which it was paid;
- a deduction would be disallowed for the balance of purchase monies in respect of the retirement village claimed in the year the contract of sale was signed;
- a deduction would be allowed equal to the cash payment contributed by way of the balance of purchase monies in the year of income that Certificates of Completion and Occupancy were/are issued in respect of the retirement village;
- a tax shortfall penalty of 5 per cent would apply; and
- the pre-amended assessment interest charge would be remitted for the period up to 19 April 2001.

A6.10 Along with the Offer of Closure the ATO provided investors with an ATO position paper outlining its general view on the tax deductions that may have been claimed by investors.

ATO position in relation to tax consequences of retirement village arrangements

A6.11 The ATO view on retirement village arrangements, as described in the settlement offers made to investors in retirement villages, was as follows:

- Investors were not entitled to an income tax deduction for the full amount of the purchase price in the year in which the contract was signed. This is because the amount is not considered to have been incurred for the purpose of the ruling.

144 ATO Minute No: IGT 26-2004, dated 11 May 2004.

- The deposit paid by investors on signing their investment contract was incurred and therefore considered deductible in the income year in which it was paid (subject to the village not including rental or certain hostel arrangements).

- The balance of the purchase price was only incurred and consequently was only considered deductible in the income year in which payment of the balance was required by the developer (subject to the village not including rental or certain hostel arrangements). The reason for this position was that the amount was not incurred until it became due and payable. The due and payable position was usually reflected by the issuing of the certificates of completion and occupancy together with the transfer of ownership of the retirement village to the investors.

- In some cases, where the retirement village was not developed the deposits paid would be refunded to the investors. These refunds would be considered as assessable income in the income year in which they were refunded.

ATO position in relation to tax shortfall penalty and interest

Penalties

A6.12 As discussed, the ATO took the view that the purchase price of the retirement village, claimed in the year of signing the purchase contract, was not an allowable deduction for taxation purposes except for the deposit paid. In its settlement offer to investors in the retirement village arrangements, the ATO view on penalties was that investors failed to take reasonable care to ensure that, in accordance with *Taxation Ruling* TR 94/24:

- the amount invested had been actually incurred for tax purposes; and

- the ruling covered the accommodation arrangements.

A6.13 As such, the ATO indicated that a tax shortfall penalty of 25 per cent arising out of the disallowance of the deduction would ordinarily be imposed. The penalty actually applied on settlement therefore represents an 80 per cent reduction with the acceptance of the settlement offer being treated as a voluntary disclosure by the ATO.

Interest charge

A6.14 In its settlement offer to investors in the retirement village arrangements, the ATO view was that in a typical case of this nature, the full rate of interest would be payable on the tax shortfall for the period from the due date of the original assessment to the date of the issue of the amended assessment.

A6.15 However, subject to the settlement deed being signed, the ATO indicated that it would take into account the time elapsed before taxpayers were advised of the ATO's concerns in relation to these arrangements and a period of time elapsed thereon. Accordingly, pre-amended assessment interest was remitted up to 19 April 2001 and interest was imposed in full from 20 April 2001 to the date of acceptance of the Offer of Closure. If the tax liability was not paid when it was due then GIC was imposed in full up to the date of payment of the liability.

Concerns raised with ATO action in relation to retirement village arrangements

A6.16 The Inspector-General has not requested detailed information from the ATO specifically in respect to ATO actions and settlements for retirement village arrangements.

A6.17 However, a number of investors and representatives acting for investors in the retirement village arrangements have raised with the Inspector-General the following concerns.

- The Offer of Closure was sent to all investors in various projects regardless of the individual circumstances of a particular retirement investment. Some projects had been completed and were operational whereas other arrangements appeared to be aggressive tax planning arrangements. The blanket approach by ATO in dealing with participants regardless of their circumstances was raised as a concern by a number of participants.

- The time taken between the Commissioner announcing his initial and general view on *Taxation Ruling* TR 94/24, on 19 April 2000, and when the final Offer of Closure was sent to investors in October 2003. According to the offer of closure, the interest charge was imposed in full rate from 20 April 2001 to the date of acceptance of the Offer of Closure.

- Participants relied upon *Taxation Ruling* TR 94/24 to claim deductions associated with their investment. In these circumstances, and given the change and clarification by the ATO of their view in respect to taxation consequences arising from investment, the imposition of GIC at full rates from 20 April 2001 to the date of payment is not fair and equitable.

- The ATO have refused to countenance that taxpayers' exercised reasonable care or adopted a reasonably arguable position in relying on a public ruling.

- In the Offer of Closure the ATO did not provide taxpayers with an opportunity to provide additional information pertaining to their individual circumstances, such as legal and accounting advice, so as to demonstrate that they had in fact taken reasonable care.

- The fact that the ATO only provided investors 45 days (extended to 66 days) to understand the Offer of Closure, consider its implications in respect of their position and communicate their acceptance of the offer.

- Participants do not understand why the date of 19 April 2001 was selected by the ATO as the date up to which the interest charge would be remitted. This date appears to have been chosen because it is one year after *Taxation Ruling* TR 94/24 was withdrawn.

- The ATO has taken an inconsistent approach between the Offer of Closure made to participants in retirement villages as compared to the offer made in relation to MMTEIs. These submissions state that in many cases retirement village investments were marketed to unsophisticated investors in the same way as in MMTEIs. They assert that there is a need to look at the circumstances of each individual participant and the characteristics of each arrangement and how it was marketed and implemented in determining the remission of penalties and interest charge.

- Differential tax treatment was not applied according to whether the retirement villages were partly constructed or not and whether the participants invested as a going concern.

ATO response to concerns raised by Inspector-General in relation to retirement village arrangements

A6.18 The ATO considers that the representations received from external stakeholders do not accurately reflect the extent to which the ATO undertook to consult with relevant stakeholders representing the investors. For example, the ATO indicates that it undertook negotiations with an accounting firm that represented twenty-four of twenty-eight retirement village syndicates and many investors. These discussions included the impact of the GIC and the submissions received from stakeholders that had been considered at very high levels in the ATO.

A6.19 In addition, in its response to the concerns raised by stakeholders, the ATO emphasised the extent of consultation with taxpayers and industry representatives prior to the Offer of Closure being provided to investors. The ATO indicated that the Offer of Closure was very carefully constructed after lengthy discussions and input from external taxpayer representatives. Also, the ATO has advised that it was their understanding that there was constant contact between particular representatives acting for the investors and the syndicate members.

A6.20 The ATO noted the concerns raised by external stakeholders with the ATO's differentiation of retirement villages from the MMTEIs settlement offer. In response, the ATO has stated that they differentiated the retirement village investments from the MMTEIs settlement offer as:

> '… taxpayers did not suffer a real financial loss of the full deduction claimed and they were generally considered to be sophisticated investors who were not subject to the same marketing techniques as the typical investor in the mass marketed investment schemes.'

Current status of ATO action in relation to retirement village arrangements

A6.21 The ATO has identified 1900 participants in the retirement village arrangements. This number does not include the beneficiaries of trusts where the trust was the actual participant. Of those, 558 adverse assessments have been raised so far, which include identified beneficiaries of trusts and those who were about to fall outside the statutory time limit for amendment purposes. The ATO has also noted that investigations into other retirement village arrangements are on-going.

A6.22 As at May 2004, there were 1,060 cases in which taxpayers have entered into a settlement arrangement and 447 (including trust beneficiaries) have been issued with amended assessments. Current ATO estimates on the total primary tax, GIC and penalty amounts imposed on taxpayers who have settled and whose assessments have been amended are as follows:

Primary tax	$43,154,496
GIC	$14,621,189
Penalty tax	$2,350,012

A6.23 Due to the recent processing of settlements, the ATO is unable to provide information relating to the payment of primary tax, GIC and penalties raised in these amended assessments.

A6.24 The ATO has also noted that there is only one instance where a retirement village arrangement had settled on terms different to the general offer, with a later GIC 'start date'. The ATO has stated that this was due to delays in participants receiving the ATO letter of settlement.[145]

A6.25 The ATO has indicated that there are currently 574 cases in which taxpayers have not entered into a settlement offer. They have noted that settlements are still being received. Of the 574 cases, 111 amended assessments have been issued so far with the remainder to issue shortly. The ATO has estimated that, to date, the total primary tax, GIC and penalty amounts imposed on taxpayers who have not settled and amended assessments have issued are as follows:

Primary tax	$11,367,461
GIC	$6,416,132
Penalty tax	$2,767,045

A6.26 In relation to the 574 cases mentioned above, the ATO has indicated that there are some participants who have requested extensions of time to settle, due to factors outside of their control.

145 ibid.

A6.27 Finally, the ATO has identified eight unfinalised dispute cases, with the disputed tax comprising the following amounts:

Primary tax	$744,137
GIC	$468,818
Penalty tax	$159,372

Inspector-General's view

A6.28 The ATO, as part of the settlement offer to investors in the retirement village arrangements, has imposed the interest charge in full for underpaid tax after 19 April 2001, but only a 5 per cent penalty.

A6.29 The fact that the taxpayers made a voluntary disclosure in respect of their conduct in claiming a deduction for the purchase price of the retirement village is recognised by statute as a factor warranting the remission of penalty from 25 per cent to 5 per cent.

A6.30 Key Finding 1 of the report provides that in certain circumstances the pre-amended assessment interest charge without remission may have a far broader and punitive-like effect. Where out of the ordinary circumstances exist then the interest remission guidelines must be flexible and responsive to remove inappropriate punitive-like consequences.

A6.31 The imposition of the interest charge in full without remission from 20 April 2001 to the date of acceptance of the Offer of Closure that was issued by the ATO to investors in October 2003, could have such an effect notwithstanding the voluntary disclosure made by taxpayers.

A6.32 Consistent with Key Findings 1 and 5 of the report, to the extent that factors were considered relevant by either statute or the ATO to reduce or remit penalties imposed in the above arrangements, these same factors may also be relevant considerations for the remission of the interest charge for this group of taxpayers.

Changes to ATO position on retirement village arrangements

A6.33 Since the Inspector-General's draft report was sent to the Tax Office, it has made certain changes to its previous offer regarding retirement village arrangements. These changes were conveyed to investors in the retirement village syndicates by way of letter.

A6.34 The ATO has now stated that investors in the retirement village syndicates will not have to forgo their rights of objection and appeal if they wish to take advantage of reduced penalties where they make a voluntary disclosure.

A6.35 In addition, the ATO has indicated that they propose to remit the GIC payable up to 19 April 2001 for all participants, whether or not they make a voluntary disclosure and/or exercise their review rights.

A6.36 For investors who have already accepted the original 'Offer of Closure', which included an undertaking not to lodge an objection or appeal, the ATO has indicated that they will now provide them with an opportunity to lodge an objection or appeal into this matter. An extension of time will also be granted to lodge objections, should this be required.

A6.37 For those investors who have not yet made a voluntary disclosure, the ATO has stated that they will extend the time that investors can lodge a voluntary disclosure schedule to 31 August 2004. For those taxpayers that take up the offer, the relevant letter provides that the tax shortfall penalty which applies will be reduced from 25 per cent to 5 per cent and investors will still be able to exercise their review rights, that is, be able to object or appeal against their amended assessment.

A6.38 The Commissioner has also announced that he proposes to run a test case to provide judicial finality on the issue of whether the balance of the purchase price (which is payable when the terms of the contract are met) is only deductible at that time. The Commissioner has indicated that taxpayers who want to be considered as a test case can lodge an application to a specified address for consideration.

EQUITY-LINKED BONDS ARRANGEMENTS

Background

A6.39 The ATO announced that tax deductions claimed by taxpayers participating in linked bond, or note, arrangements were to be disallowed.[146] Such bonds combined the features of a bond paying fixed

146 Australian Taxation Office, Media Release Nat 99/21, dated 15 June 1999.

interest on maturity with potential bonus for a return. This return was linked to the performance of a pre-selected equity, interest rate or exchange rate.

A6.40 According to the ATO, the usual features of such equity-linked bonds, as outlined in Media Release 99/21, were:

- the investor borrows 100 per cent of the face value of the bond and pre-pays the interest, of which a significant portion is borrowed from the issuer in the first year of the arrangement;
- the investor returns the fixed interest on maturity of the bond in the second year of the arrangement; and
- the bond offers potential for a bonus return linked to the movement of a share price, exchange rate or other contingent event.

A6.41 According to the ATO, depending on the amount borrowed, these arrangements had the effect of allowing the deferral of income from the current year to the next year with the potential for a bonus return linked to the movement in share price, exchange rate or other contingent event.

A6.42 The ATO also outlined the terms of settlement to be made to taxpayers who had invested in equity-linked bonds.[147] Essentially, the terms of settlement allowed note holders an income tax deduction for the amount of their actual cash outlay for interest charged on the notes. Money borrowed from the note issuer to prepay the balance of interest charged was not deductible.

ATO position in relation to pre-amended assessment interest

A6.43 In its settlement offer to investors in the equity-linked bond arrangements, tax shortfall penalty was imposed at the rate of 10 per cent. Interest was imposed at the full rate from the due date of the original assessment for each year until the date the taxpayer originally disclosed their involvement in the equity-linked arrangements to the ATO. Alternatively, if no voluntary disclosure was made, then the full rate of GIC applied until the date of the ATO's settlement offer.

147 Australian Taxation Office, Media Release Nat 99/84, dated 30 November 1999.

A6.44 The ATO's decision to remit the interest in cases of voluntary disclosure was based on the view outlined in the ATO Receivables Policy. It provided that where there is sufficient information to issue an amended assessment and the ATO contributes to the delay in actioning the cases, then there are grounds for the remission of the GIC.

A6.45 Accordingly, in these circumstances the ATO decided that the GIC would be remitted from the date the taxpayer made a voluntary disclosure until the date the amended assessment was issued.

A6.46 The ATO has advised that the penalty rate that would otherwise be applied to these arrangements was 50 per cent.[148] The penalty actually applied by the ATO on settlement therefore represents an 80 per cent reduction of the amount of penalty that would normally apply. This accords with the statutory position where there has been a voluntary disclosure by a taxpayer.

Current status of ATO action in relation to equity-linked bond arrangements

A6.47 In information provided to the Inspector-General, the ATO has identified 5510 participants in the equity-linked bond arrangements, which includes the beneficiaries of trusts where the trust was the actual participant. Of that number, 4920 adverse assessments have been raised with 590 outstanding pending the finalisation of the audit project. Current ATO estimates place the tax outstanding after the disallowance of the total year-one interest deductions at $668 million with an estimated tax recoupment in year-one of $324 million.

A6.48 There are 4266 cases in which taxpayers have entered into a settlement with the ATO. Within this group, there are the following categories of amounts outstanding.

148 Information provided to the Inspector-General of Taxation by the ATO in an email dated 1 April 2004.

A6.49 There are 681 cases where settlement offers have not been accepted with the primary tax, tax shortfall penalty and GIC outstanding as follows:

Primary tax	$35,649,350
GIC (pre-amendment)	$5,765,242
Penalty tax	$5,084,149

A6.50 There are nine disallowed objections in which the participants have not subsequently settled. However they have yet to lodge appeals to either the Administrative Appeals Tribunal or the Federal Court. There are also 249 unfinalised dispute cases, with the amounts in dispute as follows:

Primary tax	$17,992,064
GIC (pre-amendment)	$2,341,373
Penalty tax	$2,041,197

A6.51 In information provided to the Inspector-General, the ATO identified six cases that were settlements outside the general settlement offer to participants. Of these, there were five cases where there was remission in whole or in part of the GIC.

Inspector-General's view

A6.52 The ATO, as part of the settlement offer to investors in the equity-linked bonds arrangements, has imposed the interest charge in full for underpaid tax from the due date of the original assessment for each year until the date the taxpayer originally disclosed their involvement in the arrangement to the ATO. However, as part of the settlement offer, only a 10 per cent penalty was imposed with the acceptance of the settlement offer being treated as a voluntary disclosure.

A6.53 The fact that the taxpayers made a voluntary disclosure in respect of their conduct in claiming a deduction in respect of the bonds is recognised by statute as a factor warranting the remission of penalty from 50 per cent to 10 per cent.

A6.54 Key Finding 1 of the report provides that in certain circumstances the pre-amended assessment interest charge without remission may have a far broader and punitive-like effect. Where out of the ordinary circumstances exist then the interest remission guidelines

must be flexible and responsive to remove inappropriate punitive-like consequences.

A6.55 In particular, the imposition of the interest charge in full without remission from the due date of the original assessment for each year until the date the taxpayer originally disclosed their involvement in the arrangements to the ATO, could have such an effect. In these instances the rate of the interest charge exceeded the penalty rate, notwithstanding that investors had made a voluntary disclosure.

A6.56 Consistent with Key Findings 1 and 5 of the report, to the extent that factors were considered relevant by either statute or the ATO to reduce or remit penalties imposed in these arrangements, these same factors may also be relevant considerations for the remission of the interest charge for this group of taxpayers.

SECURITY LENDING ARRANGEMENTS

Background

A6.57 Security lending arrangements occur when a holder of securities agrees to transfer them for a period to a borrower for an additional return on the securities by way of fees. These arrangements are entered into because of the margin and settlement requirements of the securities markets.

A6.58 The ATO undertook an audit into a security lending arrangement entered into by an individual taxpayer. As a result of the audit, an amended assessment was issued to the individual taxpayer and further action was undertaken by the ATO to identify other participants in the arrangement.[149] Other participants in this arrangement were contacted by the ATO and after receiving responses from those identified, the ATO commenced issuing amended assessments to these participants.

A6.59 Following representations on behalf of an individual participant, the ATO offered a settlement on standard terms to all taxpayers who had received an amended assessment in relation to pre-13 May 1997 security lending arrangements.

---

149 ATO Minute No: IGT5-2004, dated 27 January 2004.

ATO terms of settlement

A6.60 The terms of the ATO's settlement offer were as follows:

- the dividends received under the arrangement were to be included in assessable income;
- the franking rebate on those dividends would be disallowed;
- a deduction would be allowed for so much of the compensatory fee and other fees incurred under the arrangement that did not exceed the amount of the dividend received under the arrangement; and
- the penalty tax otherwise payable for the tax shortfall would be remitted to nil.

A6.61 The ATO has advised that the penalty rate that would otherwise be applied to these investments was 50 per cent.[150] The penalty actually applied on settlement, namely nil, therefore represents a 100 per cent reduction in the amount of penalty that would apply under the statutory rules for penalties.

A6.62 The settlement offer also provided for the remission of interest on the tax shortfall:

- for the period from the due date for payment shown on the original notice of assessment to 30 June 1999, to the 13 week Treasury Note rate;
- for the period 1 July 1999 to 30 June 2001, to the Treasury note yield rate; and
- for the period 1 July 2001 and onwards, to the 90 day bank bill rate.

A6.63 Also, the interest rate was remitted to nil for the period from the date a participant made a voluntary disclosure until the date the amended assessment issued. The settlement offer also provided that the interest charge for late payment would be imposed in full if the tax outstanding after settlement was not paid within 28 days of the date of issue of the amended assessment reflecting the settlement.

---

150 Information provided to the Inspector-General of Taxation by the ATO in an email dated 1 April 2004.

Current status of ATO action in relation to security lending arrangements

A6.64 The ATO identified 247 taxpayers who had entered into a security lending arrangement. Of those, there have been 206 adverse amended assessments issued. No adverse assessment was issued in 41 cases either due to a lapse of the four year amendment period or because the taxpayers had been subject to an audit on their dividend and interest deduction prior to the audit project.

A6.65 For the 206 taxpayers who received an adverse amended assessment, information provided by the ATO lists the amount of tax outstanding prior to settlement as follows:

Primary tax	$28,507,677
Tax shortfall penalty and GIC	$13,403,292

A6.66 The above figure representing tax shortfall penalty and GIC was provided by the ATO. The Inspector-General has been informed that a break-up of the amount into the individual components is not available.

A6.67 Of those 206 taxpayers who had received an adverse amended assessment, 196 have entered into settlement agreements. Following settlement, the total tax outstanding prior to any payment being received was a follows:

Primary tax	$10,821,570
GIC (pre-amendment interest)	$1,722,293
Penalty tax	Nil

A6.68 Whilst all participants were offered settlement on the same terms, there were three cases that were settled on the basis that exceptional individual circumstances existed that warranted further concessions by the ATO.[151]

151 Information provided to the Inspector-General of Taxation by the ATO in an email dated 10 March 2004.

A6.69 Finally, there are 10 disputed cases that have not yet settled and the amount of tax is still in dispute, with the amount of outstanding disputed tax as follows:

Primary tax	$1,133,358
GIC (pre-amendment interest)	$423,762
Penalty tax	$107,620

Inspector-General's view

A6.70 As part of the settlement offer, the Commissioner remitted the penalties from 50 per cent to nil. The penalty remission policy states that in order for the Commissioner to exercise his remission powers, he will look at the facts and circumstances of the taxpayer. With the security lending arrangement cases, the Commissioner has taken the view, as demonstrated by the actual exercise of the remission power, that there were factors that warranted the remission of penalties in full.

A6.71 The Commissioner also remitted the interest charge to the 13 week Treasury note rate and the 90 day bank bill rate between the due date of payment and the date of voluntary disclosure. The interest rate was remitted to nil for the period from the date a participant made a voluntary disclosure until the date the amended assessment issued.

A6.72 Consistent with Key Finding 1, the flexible approach adopted by the Commissioner alleviated any punitive-like effect in the application of the interest charge for the pre-amended assessment period.

APPENDIX 7

RATES — ADDITIONAL CHARGES FOR UNDERPAID TAX (UNDER SECTION 170AA) AND LATE PAYMENT ('ATLP') — PREVIOUS REGIMES

For 1992 and prior Income Tax Assessments, 1992 and prior Income Tax Instalments, and 1993 and prior Quarterly Provisional Tax (QPT) Instalments, the following ATLP rates apply:

Period	Penalty per cent
Up to and including 13-2-83	10
14-2-83 to 30-9-92	20
1-10-92 to 30-6-98	16
1-7-98 to 30-6-99	13.5
1-7-99 onwards	GIC applies

For 1993 and later Income Tax Assessments, 1993 and later Income Tax Instalments, and 1994 and later QPT Instalments, the following ATLP rates apply:

Period	Penalty per cent	Interest per cent	Total per cent
1-7-92 - 31-12-92	8	10.6	18.6
1-1-93 - 30-6-93	8	9.6	17.6
1-7-93 - 31-12-93	8	9	17
1-1-94 - 30-6-94	8	8.7	16.7
1-7-94 - 31-12-94	8	8.7	16.7
1-1-95 - 30-6-95	8	10.8	18.8
1-7-95 - 31-12-95	8	12	20
1-1-96 - 30-6-96	8	11.5	19.5
1-7-96 - 31-12-96	8	11.5	19.5
1-1-97 - 30-6-97	8	10.5	18.5
1-7-97 - 31-12-97	8	9.8	17.8
1-1-98 - 30-6-98	8	8.8	16.8

ATLP rates (continued)

Period	Penalty per cent	Interest per cent	Total per cent
1-7-98 - 31-12-98 (*)	4.7 (8)	8.8 (8.8)	13.5 (16.8)
1-1-99 - 30-6-99 (*)	4.7 (8)	8.8 (8.8)	13.5 (16.8)
1-7-99 onwards	GIC applies	GIC applies	GIC applies

(*) Rate in brackets is the legislated rate.

The rate outside the brackets is the rate set by the ATO Commissioner's discretion.

The rates in the 'Interest' column include those prescribed by section 214A until the GIC was introduced. Therefore, this column also represents the rates at which interest under section 170AA would apply in respect of the 1993-2000 years of income.

APPENDIX 8

General Interest Charge (GIC) rates

On 1 July 1999, the penalty arrangements for late payment and other obligations were rationalised and simplified pursuant to *Taxation Laws Amendment Act (No 3) 1999*.

This has been done by the introduction of a uniform tax deductible general interest charge (GIC). The GIC applies to a range of penalties, including late payment penalty on outstanding amounts due to the Tax Office.

Section 8AAD of the *Taxation Administration Act – 1953,* determines the rate of the charge. The daily rate can be calculated by dividing this rate by the number of the days in a calendar year. The GIC when first introduced was based on the relevant 13 week Treasury Note rate plus 8 percentage points. But from 1 July 2001, the GIC is based on the 90 day Bank Accepted Bill plus 7 percentage points.

In the 2000 financial year, the GIC daily compounding rate only applied to PAYE, PPS, RPS & Sales Tax. A simple interest rate applied to other taxes.

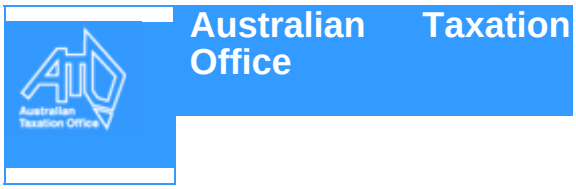
The GIC compounding rate now extends to most other taxes, including income tax, fringe benefits tax and the new tax system taxes such as GST and PAYG (including IRW — Interest & Royalty Withholdings).

For some taxes Petroleum Resource Rent Tax, the Commissioner will exercise his discretion to apply a simple interest rate. The GIC is updated quarterly (refer table below), the figure for the March - May quarter should be available mid February.

Quarter	GIC annual rate (simple interest)	GIC daily rate (compounding)
July - September 1999	12.72%	0.03484931%
October – December 1999	12.73%	0.03487671%
January - March 2000	13.08%	0.0357377%
April – June 2000	13.65%	0.03729508%
July - September 2000	14.00%	0.03825137%
October – December 2000	13.86%	0.03786885%
January - March 001	13.86%	0.0379726%
April – June 2001	13.86%	0.0379726%
July – September 2001	11.89%	0.03257534%
October - December 2001	11.95%	0.03273973%
January - March 2002	11.28%	0.03090411%
April – June 2002	11.31%	0.0309863%
July – September 2002	11.84%	0.03243835%
October – December 2002	11.96%	0.03276712%
January – March 2003	11.84%	0.03243835%
April – June 2003	11.75%	0.03219178%
July – September 2003	11.78%	0.03227397%
October – December 2003	11.82%	0.03238357%
January – March 2004	12.31%	0.03363388%
April – June 2004	12.57%	0.03434426%

Last Modified: Tuesday, 9 March 2004

APPENDIX 9



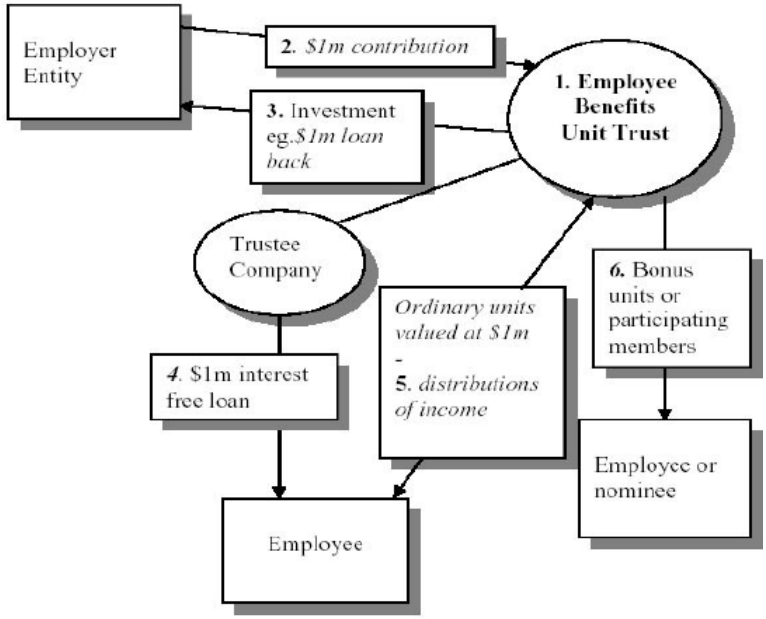
Employee Benefit Trust arrangements

THE SCHEME

A typical employee benefits trust arrangement has the following features:

- An employer entity sets up an Employee Benefits Trust.
- The entity contributes to the trust for employees or other people nominated by the employees. Often this contribution is financed through a loan or overdraft.
- The trust invests these contributions on behalf of the employees or their nominees, often by loaning an amount equal to the contributions back to the employer entity or an associate of the employer entity.
- A selected employee or person may be invited to acquire an interest (for example, by taking up ordinary units) in the trust. This is generally financed by money borrowed from the trust. Where the trust is not a unit trust, selected employees or persons may be nominated as beneficiaries. The selected employees are predominantly directors or shareholders of both the employer and trustee companies.
- The holders of ordinary units are entitled to distributions of income in proportion to their holding.
- Bonus units may be issued to selected employees or selected employees may become participating members. Corpus may be distributed, at the trustee's discretion, among the holders of bonus units in proportion to their holding and then to participating members. There is no consideration provided by employees to become bonus unit holders or participating members.

The flow of funds



The tax mischief

The taxpayer's legal perspective:

The arrangements are designed to defer or avoid tax on the employer company's profits but are structured to purportedly provide a large tax deduction to the employer and avoid a fringe benefits tax liability.

Our legal perspective:

The Tax Office has a number of concerns relating to employee benefits trust arrangements including:

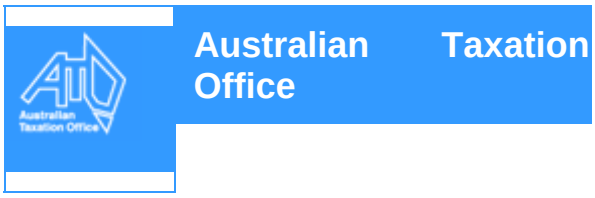
- the application of the *Fringe Benefits Tax Assessment Act 1986* to the employer's contribution to the employee benefits trust, and
- the employer's contribution not being included in the aggregate fringe benefit amount resulting in the provision of a tax benefit for the purposes of section 67 of the *Fringe Benefits Tax Assessment Act 1986*.

What you can do.

If you are a member of an employee benefit trust you should contact the Tax Office on **1800 001 111** for further advice.

If you are considering establishing an employee benefit trust you may wish to seek a ruling from the Tax Office on the taxation impacts for participants in the arrangement. For further information, contact the Tax Office on **1800 001 111**.

APPENDIX 10



Employee share or incentive plans

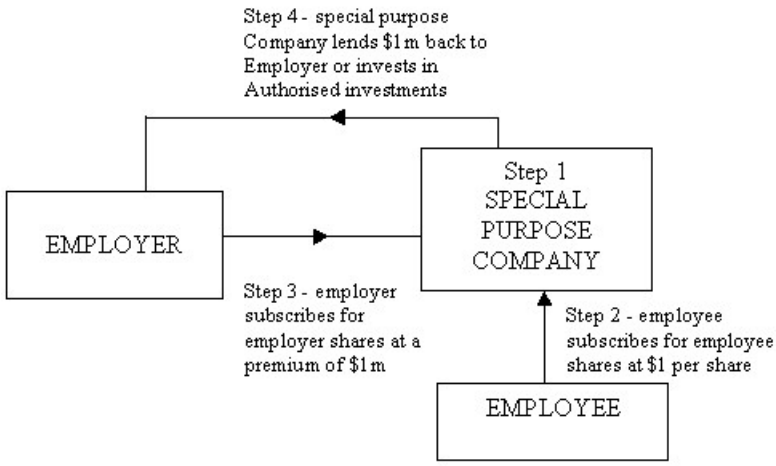
THE SCHEME

An employee share or incentive plan scheme has the following characteristics:

- The employer entity establishes a special purpose company.
- Shares or membership interests are allocated to selected employees for a nominal amount in the special purpose company.
- The employer contributes a sum of money to the special purpose company, greatly increasing the value of the employees' shares or membership interests.
- The special purpose company invests the contribution amounts on behalf of the employees, often lending the contribution back to the employer entity or their associate.

The flow of funds

An example where employees are issued with shares in the special purpose company.



The tax mischief

Employee share or incentive arrangements are designed to provide the employer with an effective incentive plan for employees. However, the only employees who generally participate in such plans are the controllers of the employer business.

The taxpayer's legal perspective:

The advantages to the employer are:

- a deduction is allowable under section 51(1) or section 8-1 to the value of the employer contribution into the special purpose company
- the contribution will not be subject to fringe benefits tax
- the contribution will not be subject to the superannuation guarantee charge, and
- the contribution will not be subject to payroll tax or workcover.
- The advantages to the employee are:
- no tax payable on the amount of the contribution credited into the employees' account at the date of deposit
- the contribution is not taken into account in determining the income of an employee for the purpose of the superannuation contributions surcharge
- contributions to the special purpose company are not subject to 15% tax as are super contributions
- there are no retention restrictions with the special purpose company contributions as there are with superannuation contributions

- subject to certain limitations, an employee can withdraw funds from an ESP at any time, and
- contributions to the special purpose company are not subject to the age based Reasonable Benefits Limits.

What we think the legal effect is:

The Tax Office has a number of concerns including (where applicable):

- calculating the discount for the purposes of Division 13A of the *Income Tax Assessment Act 1936;*
- applying the *Fringe Benefits Tax Assessment Act 1986* to the contributions made by the employer to the special purpose company, and
- providing a tax benefit, being the deduction claimed for the employer's contribution to the special purpose company, for the purposes of the potential application of Part IVA of the *Income Tax Assessment Act 1936*.

In our view contributions for employees made by way of premium or otherwise, may be assessable income of the employee under Division 13A, and-or paragraph 26(e), and-or subsection 25(1) of the *Income Tax Assessment Act 1936*. Also:

- part IVA may apply to include the amount of the contribution in the assessable income of the employee
- as a property fringe benefit or a residual fringe benefit taxable to the employer
- section 67 of the *Fringe Benefits Tax Assessment Act 1986* may apply to increase or adjust the aggregate fringe benefit to include the premium contribution amount
- the deduction claimed under section 51(1) of the *Income Tax Assessment Act 1936* or 8-1 of the *Income Tax Assessment Act 1997* in respect of the value of the employer entity's contribution to the special purpose company may be disallowed, and
- part IVA may apply to cancel the deduction that has, or may be claimed by the employer in respect of each contribution.

Furthermore, deductions under section 69 or subsection 51(1) of *Income Tax Assessment Act 1936*, or section 8-1 of *Income Tax Assessment Act 1997* for advisers' fees may not be allowable.

What you can do.

If you are a member of an employee share or incentive plan you should contact the Tax Office on **1800 001 111** for further advice.

If you are considering establishing an employee share or incentive plan you may wish to seek a ruling from the Tax Office on the taxation impacts for participants in the arrangement. For further information contact the Tax Office on **1800 001 111**.

Last Modified: Monday, 26 May 2003

APPENDIX 11

Australian Taxation Office

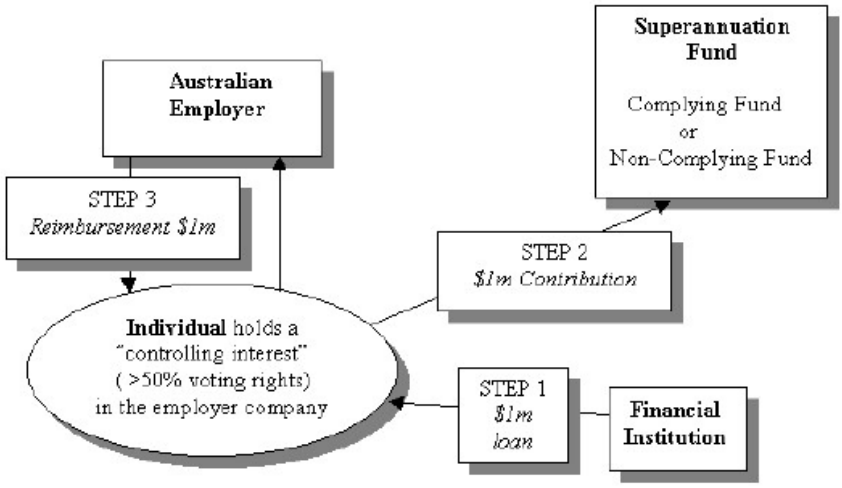
Controlling interest superannuation scheme

THE SCHEME

A controlling interest superannuation scheme has the following characteristics:

- A taxpayer is a director or employee at common law engaged in producing assessable income of a company in which they have a greater that 50% voting interest. As a result the individual is regarded as both an eligible employee and a taxpayer who has a controlling interest in that company. The taxpayer may take out a loan to finance a superannuation contribution.
- The taxpayer makes the contribution for themselves to a complying or non-complying superannuation fund.
- The taxpayer's contribution may be reimbursed by the employer company.
- Often the complying or non-complying fund invests the contribution in an entity associated with the controlled entity or in term deposits with the company that lent the funds to the taxpayer to make the contribution.

The flow of funds



The tax mischief

No tax obligations are purported to arise from the scheme, so a tax mischief stems from a legislative weakness in section 82AAA.

The taxpayer's legal perspective:

- The taxpayer claims deductions under sections 82AAC or 82AAE for the contributions made to the fund (unless they are reimbursed by the employer) as they are an eligible employee.
- They claim deductions under subsection 51(1) of the *Income Tax Assessment Act 1936,* or section 8-1 of the *Income Tax Assessment Act 1997* for any interest expense incurred on any loan to finance the contribution.
- They claim that the contribution does not constitute a fringe benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986 (Cth)* where it is made to a complying superannuation fund or non-complying superannuation fund. Where the contribution is reimbursed by the employer any such fringe benefit has no (or minimal) fringe benefits taxable value.
- It is asserted that the contribution to the superannuation fund is not a taxable contribution as defined in section 274 of the *Income Tax Assessment Act 1936 (Cth)*. This is because the contribution is not made for the purpose of making provision for superannuation benefits for

another person. The contribution is made for the purpose of making superannuation benefits for the individuals themselves.
- It is asserted that the contribution does not constitute a surchargeable contribution under section 8 of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*.

Our legal perspective:

The Commissioner's view is that, depending on the facts, one or more of the following applies:

- deductions under sections 82AAC or 82AAE for a contribution are not allowable, either because the contributions were not made for the purpose of providing superannuation benefits or because the controlling individual is not an eligible employee deductions under subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)* or section 8-1 of the *Income Tax Assessment Act 1997 (Cth)* for the interest expense (if any) incurred by the taxpayer in relation to a loan to finance a contribution are not allowable.

What you can do

The legislation was amended in 2000 so that there could be no doubt that controlling interest superannuation schemes are no longer effective. On 14 March 2003 we announced changes to our position on certain Employee Benefit Arrangements including some types of controlling interest superannuation schemes. For more information please refer to our Media Release.

For more information contact the Tax Office on **1800 001 111**.

Last Modified: Thursday, 13 November 2003

APPENDIX 12

Australian Taxation Office

Offshore superannuation scheme

THE SCHEME

Offshore superannuation schemes had the following characteristics:

- The fund is a non-resident and non-complying fund with central management and control maintained overseas. It has no branches or permanent establishments in Australia and has no intention of establishing any.
- Participating employer maintains portfolios. Contributions are made by an employer (or an associate) to the fund in respect of employees who are nominated by the employer for membership.
- Membership is typically obtained only after a series of transactions. For example, the trustee invites the employee to make an application for membership, the employee applies and the trustee accepts the application.
- Employee member entitlements under the terms of the fund may either be fixed or discretionary. Where the employee's entitlement is fixed, employer contributions are not allocated to an individual employee's account until the employee becomes a member of the fund. Where the employee's entitlement is discretionary, the contribution remains unallocated until the employee is entitled to receive it. Where employee membership is contingent upon the employee making a contribution to the fund, that contribution is usually financed by a limited recourse loan from the fund and both the contribution and the loan is offset against each other when they become repayable. Any interest on the contribution and loan (which is typically charged at the fringe benefits tax rate) is also offset against each other.

Example: offshore superannuation arrangement with fixed class members

1. The fund is a non-resident non-complying superannuation fund.

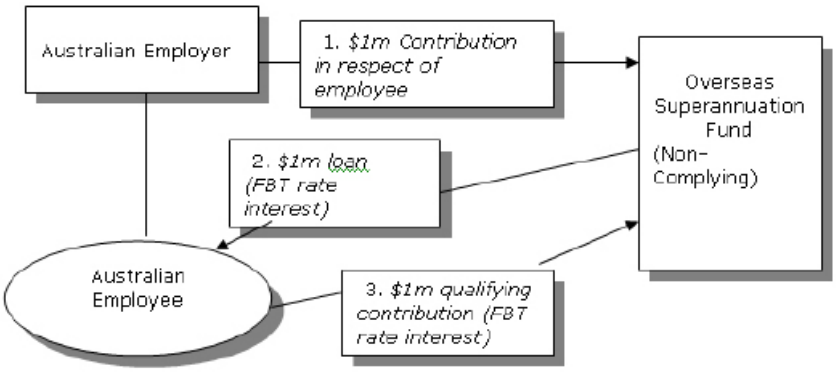
2. The employer (or associate) makes contributions to the fund, and a deduction is claimed for that contribution under section 82AAE.

3. Employer contributions are not allocated to individual employees is admitted as a member of the fund.

4. Employees become members only after the trustee invites them to apply for membership, the employee applies, the trustee accepts the application and the employee makes a contribution to the fund.

5. The employee's contribution is financed by a limited recourse loan from the fund, and both the contribution and the loan will be offset against each other at the time of repayment. Any interest on the contribution (charged at the FBT rate) and the loan will also be offset against each other.

The flow of funds



The tax mischief

Non-complying funds that generate tax concessions even greater than those provided to complying funds by Parliament create a tax mischief as these funds avoid contributions tax and surcharge even though there is a clear policy intent on what must be paid.

The taxpayer's legal perspective:

The concessions claimed include deductibility of the contributions, no tax or surcharge in the hands of the fund, no age-based limits, no impact from reasonable benefits limits and no FBT liability. The end benefit is said to be tax free on withdrawal at any time. In extreme examples, any amount of income can be completely washed of tax.

Our legal perspective:

The Commissioner's view is that, depending on the facts, one or more of the following applies:

- deductions under section 82AAE for an employer's contribution is not allowed
- deductions under subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)* or section 8-1 of the *Income Tax Assessment Ac 1997 (Cth)* for the interest expense (if any) incurred by the employer in relation to a loan to finance a contribution is not allowed
- deductions under section 69 or subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)*, or section 25-5 or section 8-1 of the *Income Tax Assessment Act 1997 (Cth)* for advisors' fees in relation to the offshore superannuation scheme are not allowable
- fringe benefits tax applies to a contribution with the taxable value of the fringe benefit to the trustee equal to the amount of the contribution
- the trustee will not be exempt from Australian tax on a contribution, and the contribution to the superannuation fund will constitute a taxable contribution, as defined in section 274 of the *Income Tax Assessment Act 1936 (Cth)*
- section 108, section 109 and-or Division 7A applies to deem a contribution or loan a dividend from the employer if the employee is a shareholder (or an associate of a shareholder)
- part X of the controlled foreign companies provisions applies to fund members
- the foreign investment fund provisions of Part XI will apply to fund members
- The foreign investment fund provisions of Part XI will apply to fund members
- The non-resident trust provisions of Subdivision D of Division 6AAA of Part III will apply to participating employers and-or fund members to include the attributable income of the fund in their assessable income
- There will be application of the trust accrual provisions

- Part IVA may be applied to the arrangement, and
- Section 67 of the *Fringe Benefits Tax Assessment Act 1986 (Cth)* may be applied to the arrangement.

What you can do.

The legislation was amended in 2000 so that there is no doubt that offshore superannuation schemes are no longer effective. If you were a participant in an offshore superannuation scheme you should contact the Tax Office on 1800 001 111 for advice about entering a settlement agreement.

Last Modified: Tuesday, 30 September 2003