

CHAPTER 6: OTHER ISSUES

Chapters 2-5 have each examined topics that have potentially substantial impacts on taxpayer certainty and/or compliance costs. This Chapter collects some issues identified in discussions with the Review team and from recent publications that do not fall clearly within the main themes of those Chapters. While these issues have not been subject to extensive consideration and some may not affect many taxpayers, the team invites comments by interested parties on these issues.

6.1 Earlier examination of returns

Under self assessment, taxpayers are responsible for correctly assessing their own assessable income, deductions and tax offsets. Under the former system certain issues were finalised with the notice of assessment.

One way to give taxpayers earlier finality would be for the Tax Office to undertake more pre-assessment examinations of returns. Early examination of returns could apply to taxpayers who:

- have straightforward affairs
- have a one-off complex transaction and who place a high premium on certainty
- are covered by complex or new legislative provisions
- are involved in arrangements where there is significant revenue risk
- may be difficult to contact for audit (for example because they have moved overseas).

Pre-assessment examination could be at the request of taxpayers or at the initiative of the Tax Office. The Tax Office would only be able to re-open such assessments in limited circumstances, for example, fraud or evasion.

This approach would have costs and benefits. Taxpayers would achieve earlier closure of their tax returns and the Tax Office would receive earlier intelligence. However, more vetting would be likely to delay some assessments (and therefore refunds or tax payments). It could potentially increase Tax Office costs, as compliance checks would need to be performed in a compressed timeframe. Furthermore, the approach would be of less value if there was a shorter period of review (discussed in Chapter 3). If it applied to a large number of taxpayers, it would, in effect, be a return to the former assessment system and its attendant problems.

6.2 Taxpayer awareness of self assessment obligations

Taxpayers have considerable responsibilities under the self assessment system and are subject to sanctions if they do not meet them. These responsibilities and the self assessment framework do not appear to be well understood by sections of the taxpaying community. This lack of understanding has contributed to resentment by taxpayers who have had assessments amended by the Tax Office.

The operation of the self assessment system is often particularly problematic for taxpayers when they become subject to one of the Tax Office's post assessment verification processes. It may transpire that the taxpayers find themselves in dispute with the Tax Office, leading to their returns being amended some years after the original assessment, with penalties and/or interest also payable. Some taxpayers (particularly individuals and very small businesses) are unaware of their responsibilities for ensuring their returns are correct and the consequences of getting it wrong.

The 1993 Joint Committee of Public Accounts recommended that 'the Australian Tax Office develop and make publicly available appropriate information for taxpayers on their obligations under a self assessment system'.¹ Reviews into Mass Marketed Schemes by the Ombudsman² and Senate Economics Reference Committee³ have recommended that

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1. Commonwealth of Australia Joint Committee of Public Accounts 1993, *An Assessment of Tax, Report 326*, 1993, Commonwealth of Australia, Canberra, Recommendation 20.
 2. Commonwealth of Australia Ombudsman 2001, *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*, Commonwealth of Australia, Canberra, Recommendations 1 and 2.
 3. Commonwealth of Australia Senate Economics Reference Committee 2001, *Inquiry into mass marketed tax effective schemes and investor protection, A Recommended Resolution and Settlement, Second Report*, Commonwealth of Australia, Canberra, Recommendation 3.36: 'The Committee recommends that the ATO, in consultation with Taxation Institute of Australia, the Commonwealth Ombudsman and other relevant bodies, develop measures to educate taxpayers about their obligations and rights in the self assessment environment ...'.

the Tax Office do more to ensure greater understanding by taxpayers about the self assessment system. In making his recommendations, the Ombudsman noted 'the promoter and the overwhelming majority of complainants argue that the Commissioner had given these projects the all clear and has now changed his mind and is seeking to amend assessments retrospectively'.

For its part, the Tax Office has recognised the lack of awareness about the self assessment system by some taxpayers and is looking to adopt an approach where self assessment messages are closely aligned to key tax events. Already, additional messages have been included on the notice of assessment, in *TaxPack* and around the signature block of paper returns. However, it is not clear whether these measures have been sufficient to address the concerns identified.

Tax agents also play an integral role in informing taxpayers of their obligations under the system, especially since virtually all business taxpayers and around 75% of individuals use them.

Through his early consultations, the Inspector-General of Taxation identified 'a lack of understanding among taxpayers that their "notice of assessment" is not a final account... and that the Commissioner has not given his "tacit" approval to their tax affairs but may, in fact, review their assessment years later'.⁴

Internal Tax Office research has also found that some small business and individual taxpayers believe that once they receive their notice of assessment that is the end of the matter and their tax affairs for that year are finalised.

Other commentators⁵ have noted '... the word "assessment" has an idea of finality and legally it cannot be conditional. Thus, the issue of a "notice of assessment" sits uncomfortably with the concept of self assessment.' They go on to suggest that the word assessment should only be used when a taxpayer's liability has been finalised (such as after an audit) and the current notice of assessment should be renamed to convey the message that the notice is merely a confirmation of information supplied by the taxpayer, not a final statement of liability.

4. Inspector-General of Taxation 2003, Issues Paper Number 3: Self-Assessment: <<http://www.igt.gov.au/content/submissions.asp?NavID=7>>, point 74, p.16 and point 91, p.19.

5. Dirkis, M and Payne-Mulcahy, M 2002, 'Self assessment 14 years on: Time for a change', *Taxation Institute of Australia*, vol 36, 2002, pp. 417-421.

6.3 Balance of power

Another issue is the perception of a power imbalance between the Tax Office and the taxpayer when it comes to formal disputation. From the point of view of many taxpayers, the Tax Office appears to be a powerful adversary with virtually unlimited resources and finances. As a result, there may be many instances where a taxpayer's case has some merit, but is not ultimately heard because of the cost and difficulty of presenting the case. This phenomenon is not simply a tax matter, but can arise whenever an individual disputes issues with government.

In other situations where such an imbalance of resources exists, mechanisms such as alternative dispute resolution (ADR) have proven successful. This non-adversarial approach could improve relations between individual and small business taxpayers and the Tax Office and remove the perception of the Tax Office aligning its resources against a single taxpayer in a court setting. Access to an inexpensive dispute resolution mechanism may also encourage taxpayers to become more aware of their rights and to query an adverse assessment. The Tax Office itself may benefit, in terms of costs, public image and ease of administration. Of course, this approach would not help clarify areas of the law.

The governance system for taxation in Australia already includes roles for an Ombudsman (to consider and investigate complaints from people who believe they have been treated unfairly or unreasonably), an Inspector-General (to review systemic issues of tax administration) and scrutiny by the ANAO. Furthermore, there are processes to streamline litigation, including the Small Taxation Claims Tribunal and the structured mediation of the Administrative Appeals Tribunal. The question arises whether there is a gap to be filled, perhaps by greater use of ADR processes or whether a new element is required in the governance structure, such as a publicly funded taxation advocate similar to that of the United States.⁶

6.4 Review of tax agents' systems by the Tax Office

Tax agents play a particularly important role in the self assessment system by advising clients and preparing income tax returns using information provided by clients. In collecting and collating this information, agents would usually carry out some checks or ask questions to ensure the information is correct and consistent. Accordingly, the Tax Office places heavy emphasis on assisting tax agents and advisers as part of their overall compliance strategy.

6. See explanation of the US system in Appendix 4.

The Tax Office has undertaken recent initiatives to improve services to tax agents, for example, through the establishment of the tax agent portal. Nevertheless, tax agents have expressed concerns in submissions to the Inspector-General of Taxation about reviews by the Tax Office of the agents' systems to verify information provided by clients. These reviews, which are not audits, are time consuming for agents and they assert that their cost is difficult to recoup from clients. Two flow-on issues are that such compliance work is supposedly discouraging new entrants to the profession and displacing time an agent could be spending on providing other services to clients, such as advice about cash flow or general business operation/structure.

As the Tax Office relies on the information provided in tax returns, it is appropriate that it attempts to gauge how much quality assurance of the information the agent has undertaken. While this kind of review is less intrusive than an audit, and will ultimately reduce costs by minimising the need for some audits, nonetheless it imposes up-front compliance costs.

Some options for reducing these initial costs include streamlining the review process, or establishing guidelines on the type of verification activity the Tax Office expects.

6.5 Obligations to provide information

The Tax Office needs to collect certain information to identify revenue risks. Taxpayers primarily provide this information in tax returns. Third parties, including employers, financial institutions, companies and Government agencies such as Centrelink and Veterans' Affairs, also provide it directly. Practitioners have raised concerns that the Tax Office does not need or use some information provided.

A related issue is the extent to which the Tax Office gives advance notice of the types of information it will potentially require from taxpayers and their advisers. Taxpayer representatives have noted that it is sometimes time consuming or difficult for taxpayers, especially large business, to extract additional information since their systems are designed to produce accounting, rather than taxation, information. They suggest that the Tax Office should flag its information requirements earlier, making it possible to design systems where information is easier to extract.

The Tax Office often publicly states before the end of the financial year the areas of tax returns that it will pay particular attention to, such as work related or rental income expenses. This puts taxpayers on notice that additional information may be required after lodgement. In addition, the Tax Office sometimes writes to individual taxpayers prior to lodgement noting the areas to which it is paying particular attention.

Providing more guidance to taxpayers on areas of interest to the Tax Office and advance notice of the exact information required post lodgement may assist them in gathering information more efficiently. However, the Tax Office needs to be able to respond to issues which emerge from lodged income tax returns.

6.6 Obligations to keep records

In addition to providing certain information in a tax return, businesses must maintain proper records and explanations of their business transactions. Individuals are also required to keep records relevant to their tax affairs.

Good records will assist in the accurate and timely completion of a tax return and may lead to better business management.

From a Tax Office audit perspective, good records are needed to determine the appropriate tax position more easily. However, it is also important to allow businesses the scope to keep records in a way that suits their needs. Submissions to the Inspector-General of Taxation have raised concerns that the current record keeping requirements are onerous.

Some of the possible approaches discussed in Chapter 3 regarding the period of time allowed for Tax Office examination of returns would, if adopted, allow for commensurate reductions in the period of time that records would need to be kept.

6.7 Lodgement deadlines

Individuals who prepare their own tax returns are generally required to be lodged by 31 October following the year of income. However, agents can lodge returns throughout the year under the Tax Office lodgement program. This program attempts to take into account a tax agent's overall workloads and their lodgement obligations across different taxes, while facilitating the collection of revenue within the financial year.

While the lodgement program assists tax agents, some say they are overworked in meeting lodgement deadlines and that extensions are not sufficiently readily available. In addition, some agents have raised concerns regarding the application of late lodgement penalties, for example, claiming the Tax Office does not sufficiently consider good lodgement histories.

Any significant changes to the lodgement program or penalties would need to consider the impact on the timing of revenue collection (and associated interest costs) and taxpayer compliance.

6.8 Discretions and elections

Most provisions of the law dealing with a taxpayer's liability are self operating, in that they require no decision of the Tax Office to have legal effect. However, the law also includes many provisions that give the Tax Office a power to make a decision (discretions), or allow the taxpayer to make a choice (elections) affecting their liability.

6.8.1 Discretions

Practitioner and industry groups have expressed concern that self assessment cannot work properly where the calculation of a taxpayer's liability depends on a decision or determination by the Tax Office. The reason that discretions are problematic is that taxpayers cannot exercise the powers themselves and, under self assessment, the Tax Office will not normally consider the issue at the assessment stage.

One factor that reduces this impact is that the Tax Office makes public rulings about how it will exercise a discretion and taxpayers can request private rulings on their particular circumstances.⁷

The 1991 paper 'Improvements to self assessment - priority tasks'⁸ said that discretions can be grouped under the following three broad categories:

- administrative discretions – which allow the Tax Office to carry out its administrative duties (for example, to issue forms, grant extensions of time, approve schemes and organizations)
- anti-avoidance discretions – which give the Tax Office the power to ensure that the revenue is protected

7. For example, Australian Taxation Office 1997, *Taxation Ruling TR 97/24*, Australian Taxation Office, Canberra explains how the Tax Office exercises the discretion (in section 900-195 of the *Income Tax Assessment Act 1997*) to grant relief where a taxpayer fails to substantiate expenses.

8. Commonwealth of Australia 1991, *Improvements to self assessment – priority tasks*, 20 August 1991, Commonwealth of Australia, Canberra.

- discretions used in calculating elements of taxable income – which authorise the Tax Office to make decisions that affect the calculation of taxable income (for example, to determine a reasonable amount).

The paper said that, where possible, discretions in the third category would be removed, but the other two categories would be retained. The paper explained that administrative discretions do not contribute to uncertainty and anti-avoidance discretions are needed to make sure the Tax Office has the power to protect the revenue.

The Tax Law Improvement Project of the mid 1990s, rewrote parts of the *Income Tax Assessment Act 1936*, replacing discretions used in calculating elements of taxable income with objective tests. For example, where the old law required the Tax Office to be satisfied that something had happened, the new law simply required the thing to have happened. In 1998, the Government subsumed that project into the implementation of the Government's tax reform measures. Legislation implementing recent measures (such as the consolidation reform) has generally avoided discretions in calculating elements of taxable income.

Despite these actions, the law still includes some discretions in calculating taxable income. The replacement of all these, some of which are rarely used, would require substantial legislative resources. An alternative would be to identify discretions that are causing the greatest practical difficulties and address those.

6.8.2 Elections

Before the introduction of self assessment, taxpayers were required to make various elections and lodge written notifications with the Tax Office with their returns. However, under self assessment, the Tax Office normally did not look at elections at the time of assessment. Consequently, there was no practical point in taxpayers lodging most elections with the Tax Office and they are now held by taxpayers. In 1992, the law relating to elections was amended to reflect this position.

To make most elections now, the taxpayer simply decides which provision of the income tax law is to apply in calculating a component of taxable income and keeps a record that verifies the calculation. Whether the taxpayer has made the election is evident from the taxpayer's records and in the calculation of taxable income as disclosed in the tax return.

Taxpayers are still required to make elections by a particular date, usually on or before the due date of lodgement of a return. The Tax Office can extend the date for lodgement of the return and the time for making some elections.

Occasionally there is controversy about aspects of a particular election, such as the implications of making it, the time allowed for it, and whether the Tax Office has a

power to extend that time. For example, tax practitioners have argued for changes to the rules about family trust elections.

A small number of elections, because of their nature, must be in writing and/or lodged with the Tax Office. For example, a primary producer who elects to opt out of the averaging system must advise the Tax Office in writing so that the Tax Office, in issuing an assessment, can calculate the taxpayer's liability correctly. If an election affects the tax treatment of two or more taxpayers, usually those taxpayers must make the election jointly in writing. This prevents difficulties that might arise if taxpayers making joint elections claim to have made different elections.

6.9 Questions for consultation

- 6.A Should the Tax Office undertake earlier examination of any categories of return (or specific items)? If so, what taxpayers or specific items and why?
- 6.B What further steps would promote taxpayer awareness of their obligations under self assessment? Could, for example, notices of assessment be better labelled?
- 6.C In what circumstances is there a need for a Public Tax Advocate or greater use of alternative dispute resolution?
- 6.D What is the impact of the Tax Office reviewing tax agent systems? Could these reviews be improved, and if so, how?
- 6.E What particular information could the Tax Office collect more efficiently? What is the optimal balance between the Tax Office giving early warning of information requirements and the need to be able to respond to issues emerging from tax returns?
- 6.F What particular record keeping requirements are regarded as onerous?
- 6.G What specific income tax lodgement deadlines are difficult to meet? Are there other circumstances in which penalties should be remitted for late lodgement?
- 6.H What are the most important discretions as to liability that should be removed/re-written?
- 6.I Are there any general problems that are affecting the operation of elections under the self assessment system?