Appendix 4: International comparisons

The Review has examined the income tax assessment systems in Canada, New Zealand (NZ), the United Kingdom (UK) and the United States (US). This Appendix provides an overview of the key features of each system and the Australian system.

The Canadian system of income tax assessment

Canada's income tax self assessment system commenced in 1917. All Canadian taxpayers must complete an annual tax return and calculate their income tax liability. The income year for individual taxpayers is 1 January to 31 December, with returns due by 30 April the following year. Returns must be sent to the Canada Revenue Agency (CRA) along with payment for any outstanding income tax liabilities. If too much tax has been withheld from a taxpayer during the income year, the CRA will refund the excess amount within two to six weeks. Taxpayers can lodge returns over the internet, through a tax agent, by telephone or by ordinary mail. To receive social security benefits, individuals may need to lodge a return even if they have no taxable income.

In addition to administering the Canadian federal income tax, the CRA collects income tax for Canada's provinces. As a consequence, individuals and most corporate taxpayers only need to complete a single annual income tax return (although Alberta, Ontario and Quebec levy their own corporate income taxes).

Rulings and other advice

Interpretation bulletins and information circulars (such as newsletters and technical publications) are available electronically and provide taxpayers with a reasonable expectation of how the CRA will treat a transaction. Technical interpretations of specific provisions and written opinions on completed transactions are also provided to taxpayers on request. The CRA provides a wide range of advice to Canadian taxpayers by phone, internet and in fact sheets and other publications. However, none of this advice is binding on the CRA.

Individual taxpayers may apply for an advance income tax ruling on a proposed transaction. These rulings are provided on a user pays basis at a rate of CAN$100 (plus GST) for each of the first ten hours (or part thereof) and CAN$155 (plus GST) for each subsequent hour (or part thereof). These advance rulings are generally administratively binding on the CRA. In common with Australian PBRs, they are only valid for the taxpayer to whom they are issued.

Advance income tax rulings are made publicly available on the CRA website (once they have been edited to remove information that may identify the relevant taxpayer).

Period of review

The CRA provides each Canadian taxpayer with a Notice of Review. This is an assessment of each taxpayer's income tax liability, based on the information supplied in their return.

The CRA may review the information supplied in a taxpayer's return before it issues a Notice of Review. However, it more commonly undertakes post-assessment verification activities. This may involve matching third party information to identify under-reported income and over/under claimed credits and deductions.

Returns are chosen for post-assessment checking either randomly or based on risk profiling. The CRA identifies possible fraud and evasion through a variety of means, including post-lodgement audits, audits of refund claims, profiling high-risk taxpayers, informant leads and partnerships with other law enforcement agencies. The CRA devotes about 25% of its resources to enforcement – most of these resources are devoted to auditing taxpayers' returns. Audits focus on detecting and correcting non-compliance among high wealth individuals, corporations and taxpayers with significant opportunities for avoidance.

Individual taxpayers must retain their records for six years. If filing a paper return, all receipts substantiating claims for deductions must be provided to the CRA. However, taxpayers who file electronically need only store the records themselves.

Taxpayers may amend a return as far back as 1985, as long as they can provide sufficient evidence to substantiate the change. The CRA has three years after it issues a Notice of Review to amend the assessments of individual and certain small company taxpayer. It has four years to amend the assessments of large corporations. There is no statutory time limit in cases of fraud.

Penalties

Penalties can be applied from the final date for lodging annual returns.

The late filing penalty is 5% of the balance owing for that year, plus 1% of the balance owing for each full month that the return is late, for a maximum of 12 months. The penalty may be higher if a similar penalty was charged on a return for any of the three previous years. Penalties increase to 10% and 2% respectively (for a period not exceeding 20 months) for repeated failures. The penalty can be avoided by filing the return on time, even if the amount owed is not paid (voluntary disclosure provisions).

The penalty for false statements or omissions is the greater of $100 or 50% of the amount of tax avoided because of the false statement.

Interest

Compounding interest is charged on unpaid tax debts. The rate of interest on unpaid tax debts is set at the Canada Treasury Bill rate with an additional uplift factor of 4%. This interest is not tax deductible.

The CRA pays compound daily interest on amounts owing to taxpayers after June 15 each year. Refund interest is paid at the Canada Treasury Bill rate plus an uplift factor of 2%.

The New Zealand system of income tax assessment

Since the mid 1980s, New Zealand's tax policy and administrative arrangements including assessments, rulings, dispute resolution and penalties, have changed significantly. These changes often followed extensive public consultation.

Throughout the 1980s, New Zealand reformed its tax policy by broadening its tax base with a GST and a fringe benefits tax and lowering company and individual tax rates. It also abolished deductions for work related expenses, superannuation and various business concessions, including accelerated depreciation and most individual tax rebates.

Unlike Australia, New Zealand operates a full self assessment system for income tax. Taxpayers assess their own liabilities, then claim a refund or pay the amount owing. The Inland Revenue Department (IRD) does not issue assessment notices as a matter of course, however, it does issue Personal Tax Summaries or Statements of Earnings when requested by a taxpayer.

In practice, around 75% of New Zealand wage and salary earners do not lodge income tax returns. Instead, to pay the correct amount of tax during the year they rely on the extensive tax withholding system for wages, salary, interest and dividends. In addition, taxpayers do not need to contact the IRD if they have less than NZ$200 of under or over-taxed income.

Significant numbers of other individual taxpayers must confirm the details of an IRD generated Personal Tax Summary including wage, salary and interest details; they do this instead of lodging a return. Once taxpayers confirm these details, they receive a refund or pay the amount outstanding.

Businesses, and individual taxpayers with income outside the withholding tax system (such as from rent), must lodge returns.

Rulings and other advice

The IRD issues non-binding information to taxpayers and tax agents through its monthly Tax Information Bulletin, a telephone service, fact/information sheets and a tax return guide (like Australia's *TaxPack*).

The IRD also issues four types of legally binding rulings: public, private, product, and status. Taxpayers do not have to follow a ruling nor can they appeal or dispute a ruling, however they must disclose in their tax return if they follow a ruling.

The IRD publishes public rulings, giving its interpretation of how certain tax laws apply in a given situation.

Private rulings indicate how the law applies to a particular taxpayer and other taxpayers cannot rely on them. The IRD does not publish private rulings. Taxpayers pay application fees and preparation fees for them.

Product rulings state how the law applies to a particular transaction, rather than to a particular taxpayer. The IRD publishes product rulings in the Tax Information Bulletin and taxpayers seeking them pay fees on the same basis as for private rulings.

Status rulings clarify if changes in the law affect a private or product ruling a taxpayer has received previously.

Period of review

Taxpayers have two months to amend their own tax assessments, although the IRD is canvassing an extension to four months.

The IRD has four years (from the end of the income year in which a return is lodged) to amend taxpayer assessments. When it considers a tax return is fraudulent, wilfully misleading or omits income, the period to amend the assessment is unlimited.

The IRD also has four years to amend the assessments of taxpayers who do not lodge returns.

The IRD conducts audits of selected taxpayers. Audits can range from an examination of one particular issue to a full examination of business records. The IRD selects audit cases in a variety of ways, including analysis of business records or tax returns, matching with other information sources, taxpayer compliance or payment histories or random selection.

Penalties

Penalties can apply for late lodgement of returns. These are flat dollar amounts and depend on the taxpayer's net income. Penalties also apply for late payment of tax, generally an automatic 5% initially, then 1% per month.

In some circumstances taxpayers can request the IRD to remit late lodgement and late payment penalties. For example, taxpayers must demonstrate reasonable justification, genuine oversight, a one-off situation or incorrect IRD advice. Late payment penalties do not apply when the total tax outstanding is under NZ$100.

Penalties can apply where taxpayers have a tax shortfall and depend on taxpayer culpability. Tax shortfall penalties range from 20% for lack of reasonable care or unreasonable interpretation to 40% for gross carelessness, to 100% for abusive tax positions and 150% for evasion. They may be lower if taxpayers voluntarily disclose shortfall details.

If the IRD successfully prosecutes or penalises taxpayers for an abusive tax position or evasion, it can publish taxpayer details in the New Zealand Gazette.

Interest payments and charges

When taxpayers have NZ$100 or more in unpaid tax, the IRD charges 'use of money' interest at the Reserve Bank of New Zealand business base lending rate[1] plus 200 basis points. When taxpayers have NZ$100 or more in overpaid tax, the IRD pays taxpayers interest at the Reserve Bank of New Zealand 90 day bank bill rate less 100 basis points.

The IRD can remit interest if taxpayers substantiate that payments were late due to incorrect IRD advice and that they corrected the failure to comply as soon as practicable.

'Use of money' interest does not compound. It is taxable when paid by the IRD and tax deductible under New Zealand's deductibility provisions (that is, if a taxpayer deriving income in carrying on a business, or a company, incurred the interest charge).

1. This is the base interest rate offered to new business borrowers, weighted by each surveyed institution's total NZ dollar borrowings.

The United Kingdom's system of income tax assessment

The United Kingdom taxes a variety of individual and corporate incomes including employment income, dividends, capital gains, benefits provided in kind, royalties and property income. The components of each variety of income, and all deductions against income, are outlined in schedules in the tax laws. These schedules effectively quarantine deductions, as they can only be offset against income in the same schedule.

For corporations, a full self assessment system has operated in the United Kingdom since 1999 and under this system, all corporations effectively have to complete tax returns.

For individuals, a partial self assessment system was introduced in 1996. Under this system, most individuals do not have to lodge tax returns as their tax liabilities are withheld at source. In practice, the Inland Revenue sends tax returns to those who must lodge a return, which are only those with complicated tax affairs, those in the top income tax bracket and the self-employed.[2] Where individuals are not sent a tax return, they are still required to declare taxable income not subject to withholding to the Inland Revenue. Where an individual is sent a tax return, they have the option to calculate their tax liability themselves or have Inland Revenue calculate it for them.

Rulings and other advice

'Statements of Practice' explain the Inland Revenue's interpretation of the revenue legislation and how it applies the law in practice. While these statements are not legally binding, the Inland Revenue considers that taxpayers who correctly apply such Statements to their circumstances binds the Inland Revenue as a matter of administrative practice.

In general, the Inland Revenue does not provide advance rulings on the tax effect of proposed transactions. The Inland Revenue does provide taxpayers with post-transaction rulings on income and capital gains taxes in certain circumstances. The Inland Revenue will usually consider itself bound by post-transaction rulings, unless information provided to obtain the ruling was incorrect or incomplete. Taxpayers seeking post-transaction rulings are not charged for them.

The Inland Revenue also produces extra-statutory concessions (ESCs), which are relaxations of the strict interpretation of the UK's tax laws for the purposes of making administration of the tax laws easier or to provide taxpayers with relief from hardship at

2. The UK Inland Revenue has announced it will publish new criteria for who has to complete a self assessment tax return, in April 2004. Under these new criteria, the Inland Revenue has stated the number of people needing to fill in tax returns, will be reduced.

the margins of the tax law. For example, where a new tax law produces unintended consequences which could be resolved with a lengthy statutory remedy, the Inland Revenue can instead grant an ESC which produced the same administrative effect, whilst avoiding the time delays and cost associated with a statutory change. These concessions are published by the Inland Revenue and can be relied on by taxpayers to bind the Inland Revenue, provided they are not used for tax avoidance.

The Inland Revenue also issues non-legally binding information to taxpayers and tax agents through its telephone services, fact and information sheets, and tax return guides.

Period of review

The Inland Revenue must inform taxpayers within 12 months of the statutory filing date that it will begin auditing them. Where a tax return is lodged late, the period of review is extended.

In certain circumstances, the Inland Revenue can also open investigations into taxpayers' returns after the normal period of review. Where taxpayers have made incomplete disclosures in their tax returns without fraudulent or negligent conduct, the Inland Revenue has five years after the statutory filing date. In cases involving fraudulent or negligent conduct, Inland Revenue has 20 years after the statutory filing date to open a review of the return.

Penalties

A number of late lodgement penalties apply to individuals. These penalties include an automatic late lodgement penalty of £100 where an individual fails to lodge their tax return by the due date of 31 January, a further £100 penalty if the tax return is six months late, a penalty not exceeding the tax liability owing for that year if the return is 12 months late, and daily penalties of up to £60 per day. Daily penalties may be imposed at any time after the return is due and are not subject to capping.

Debts under £2,000 are recoverable under the pay as you earn system. Otherwise, individual taxpayers usually have to repay their tax debt by 31 January each year. Individuals are liable for a late payment penalty, called a surcharge, if payment is not made on time. If any tax is still unpaid 28 days after that date, a late payment surcharge of 5% of the amount of tax outstanding is charged. Where tax remains unpaid six months after its due date, a further 5% surcharge is also chargeable.

A number of late tax return lodgement penalties can apply to corporations. These include an automatic £100 penalty if a corporation files its return up to three months late, a £1,000 penalty if a corporation lodges its tax return more than three months late three times in a row, and tax-related penalties of 10% and 20% of the unpaid tax, where a corporation has not filed a return within 18 months or two years after the end of its accounting period. There are no daily penalties, surcharges nor capping of automatic penalties for corporations who file late.

Both individuals and corporations who fraudulently or negligently file an incorrect return, or fail to remedy an error in the return in a reasonable time, are liable to a penalty of up to the amount of the understated tax. These taxpayers can have their returns audited up to 20 years after the lodgement date.

All penalties for individuals and corporations can be remitted or reduced at the discretion of the Inland Revenue, though it only does so in limited circumstances which include where paying the penalty would produce hardship for the taxpayer or the taxpayer relied on Inland Revenue advice. If dissatisfied with the response of the Inland Revenue, taxpayers may also appeal to an independent Tax Appeals Commissioner to have their penalty, including any late payment penalties, reviewed. Lodgement and payment penalties can also be reduced to nil by the Inland Revenue where the taxpayer has a 'reasonable excuse' for incurring the penalty. 'Reasonable excuse' includes circumstances such as being too seriously ill to complete a tax return, but does not include the inability to pay the tax due.

Interest payments and charges

Individuals with outstanding tax balances and unpaid surcharges are charged interest at 6.5%. The late payment interest incurred by individuals is not tax deductible.

Corporations which pay quarterly company tax instalments are charged an interest rate of 4.75% on unpaid tax balances. Other corporations are charged 6.5%. The interest rate charged on outstanding tax balances is linked to the average of bank base lending rates. Late payment interest is tax deductible.

The Inland Revenue has no specific power to remit late payment interest but can do so under its general discretionary power in limited circumstances. Usually this is where an error or delay by the Inland Revenue has led to tax being unpaid by the due date.

The United States' system of income tax assessment

Federal income tax was imposed in the United States (US) after the 16th amendment to the US constitution in 1913.[3] Income tax was imposed on a full self assessment basis, that is, taxpayers assess their own liability then pay the amount outstanding or receive a refund. The system is termed 'voluntary compliance'.

Many, but not all, states in the US still impose income taxes. In addition, some cities/municipalities in the US also impose income tax.

The US *federal* income tax is administered by the Internal Revenue Service (IRS) as a progressive tax with the rates (and a number of other features) determined by the taxpayer's 'filing status'. If a taxpayer satisfies more than one filing status, they may choose which one they will use. There are five different filing statuses:

- single
- married filing joint return
- married filing a separate return
- head of household
- qualifying widow(er) with dependent child.

Federal income taxes are collected by the IRS through a system where tax is withheld by employers. Self employed individuals and businesses must pay their taxes in regular instalments, known as estimated tax payments. At the end of the tax year, the individual must fill out certain forms (determined by their filing status, their taxable income, and all other tax affairs). The taxpayers must also calculate their tax payable, using either tax tables or a tax rate schedule.

Most US taxpayers may either claim a standard deduction or itemise their deductions. The option a taxpayer chooses will typically depend on which will result in the higher deduction. The amount of standard deduction available to a taxpayer is determined by the taxpayer's filing status, however, the option is not available to all taxpayers.

Another characteristic of the US tax system is that the taxpayer must declare any involvement in tax shelters. A series of tax laws have been implemented in the US to

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3. Before this time, the constitution only allowed for the imposition of direct federal taxes if they were levied in proportion to each state's population. The constitutional amendment allowed for the federal government to impose tax on income.

limit the use of potentially abusive tax shelters. These laws require organisers of tax shelters to register the shelter, advisors to maintain a list of investors and investors to report the tax shelter registration number and disclose the tax shelter on their tax return. This disclosure is required for a reportable tax shelter transaction that is a 'listed transaction' as identified in a notice, regulation, or other published guidance by the IRS.

Rulings and other advice

The IRS provides taxpayers with a number of advice products to guide them in interpreting and applying the tax law. The IRS mails forms to taxpayers along with relevant advice products (similar to *TaxPack*). The IRS establishes which forms and publications to send based on the taxpayer's previous tax return. The taxpayer needs to contact the IRS if any other forms or publications are required.

Other mechanisms through which the IRS gives advice and guidance are regulations, rulings (including private letter rulings that are administratively binding between the individual taxpayer and the IRS), internal revenue bulletins, the Taxpayer Advocate Service[4] and other forms of free (but not binding) advice (including telephone, fax, walk-ins, email etc).

Periods of review

In the US, the various periods for amending returns are as follows:

- For assessing the tax a taxpayer owes and for filing a credit or refund, generally three years from the filing date.
- Where the taxpayer did not report income of more than 25% of the income shown on the return, six years after the taxpayer filed.
- For false or fraudulent returns with an intent to evade tax, there is no limitation period.
- If no return is filed, there is no limitation period.

A related element of the US system is the burden of proof when the IRS is involved in a court proceeding. Prior to the Internal Revenue Service Restructuring and Reform Act of 1998, the burden of proof in a court proceeding was on the taxpayer. The shift of burden

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4. The Taxpayer Advocate Service is an independent organisation within the IRS that helps taxpayers resolve problems with the IRS and recommends changes that will help prevent the problems. It does this through advocating on behalf of both individual aggrieved taxpayers and taxpayers generally (regarding systematic flaws in the administration of the tax system).

to the IRS to prove an item on the taxpayer's tax return is incorrect occurs only in a court proceeding if the following criteria are satisfied: the taxpayer must comply with all substantiation requirements of the tax law; maintain all the records required by the tax law; cooperate with the IRS's reasonable requests for information; and, if the taxpayer is a corporation, partnership or trust, meet certain net worth qualifications.

Penalties

A wide variety of penalties potentially apply to the US taxpayer. Penalties may be waived if the taxpayer can show they acted reasonably and in good faith, or relied on the incorrect advice of an IRS employee.

- There are three penalties for unpaid taxes (called delinquency penalties): failure to file, failure to pay, and failure to make timely deposits of tax. These penalties vary in amount from 0.5% per month of the unpaid amount to 25% of the amount unpaid.

- Accuracy related penalties apply where a return has been filed and are imposed for negligence, a substantial understatement of income tax, a substantial valuation overstatement, a substantial overstatement of pension liabilities, a substantial estate or gift tax valuation understatement, and gross valuation mis-statements. These penalties vary in amount from 20% of the portion of any under payment to 40% of the under payment. (The penalty is increased to 75% if any under payment is attributable to fraud.)

- Other administrative penalties include information reporting penalties (the amount of which varies depending on the length of time within which the taxpayer corrects the failure), failure to file correct information returns, failure to furnish correct payee statements, and failure to comply with other information reporting requirements.

- Preparer, promoter and protestor penalties include return preparer penalties, penalties for promoting abusive tax shelters, penalties for aiding and abetting the understatement of tax liability and frivolous income tax return penalties. There is no taxpayer immunity from penalties when using an agent, therefore if an agent is penalised it will usually be in addition to the taxpayer concerned.

Criminal penalties also exist for a number of offences including fraud, evasion and wilful failure to file a return, supply information or pay tax due.

Interest payments and charges

Interest is levied on amounts owing to the IRS. The IRS will also pay taxpayers interest where they have overpaid their tax and the processing grace period of 45 days from the receipt of the return is exceeded. The interest rate is adjusted quarterly and compounds daily. The interest rate for each quarter is calculated on the following basis:

Taxpayer		Interest: federal short-term rate plus:
Anyone other than companies	Underpayment	3%
	Overpayment	3%
Companies	Underpayment	3%
	Overpayment	2%
	Underpayment >US$100,000	5%
	Overpayment >US$10,000	0.5%

All or part of any interest charged can be forgiven if the interest is due to an unreasonable error or delay by the IRS in performing ministerial or managerial acts. In addition, the Secretary of the Treasury may abate the interest if the administration and collection costs involved do not warrant collection of the amount due.

In contrast to Australia, the interest paid by an individual is not deductible.

The Australian system of income tax assessment

Australia has a partial self assessment system for individual taxpayers, and a full self assessment system for other taxpayers.

Individuals in Australia must lodge a tax return to report their assessable income and claim deductions. This return also collects information relating to various social security payments and offsets and the Higher Education Contributions Scheme. Once a return is lodged, the taxpayer's liability is calculated by the Tax Office and they receive a notice of assessment along with either a refund or a tax bill. Because a broad range of tax deductions and other benefits are allowed in Australia, a significant proportion of taxpayers receive a refund.

Company taxpayers complete a tax return, but take an additional step of actually calculating their liability and, if they owe money, paying this to the Tax Office when they submit their return.

Australia has a pay as you go (PAYG) withholding system for salary and wage earners. Employers withhold tax from their employees and remit this to the Tax Office on at least a quarterly basis. Financial institutions and companies do not generally withhold tax from interest and shares.

Rulings and other advice

The Tax Office provides taxpayers and practitioners with a range of advice on how to apply the income tax law, from general advice that applies to a large number of taxpayers to specific advice about how the law applies to an arrangement being contemplated or undertaken by a particular taxpayer. All rulings and other advice are provided free of charge.

There are three types of formal income tax rulings: public rulings, private binding rulings (PBRs) and oral rulings. The advice contained in these formal rulings is legally binding on the Tax Office; the Tax Office cannot apply the income tax law in a way that is less favourable than that contained in the ruling. A taxpayer covered by a formal ruling is protected even if the Tax Office subsequently changes its interpretation of the relevant provisions of the income tax law in relation to other taxpayers. PBRs are used by the Tax Office to provide specific written advice to a particular taxpayer on how the law applies to that taxpayer. They only apply to a specified arrangement for a specified income year. They are not legally binding on the Tax Office in relation to other taxpayers.

Public rulings provide general written guidance on matters relevant to a wide range of taxpayers.

Oral rulings are used to provide specific advice on a limited range of income tax matters to taxpayers with simple tax affairs.

The Tax Office also publishes interpretative decisions (known as ATOIDs) on its website to allow taxpayers and practitioners to gain insights into how the Tax Office may interpret particular provisions of the law (although this material is not legally binding on the Tax Office).

The Tax Office also publishes a wide range of non-legally binding advice. *TaxPack* is the most important source of advice for individual taxpayers. It is intended to provide these taxpayers with the information needed to complete their annual returns. The Tax Office also publishes a wide range of manuals, booklets, schedules, fact sheets, policy statements, press releases, ATOIDs, and taxpayer alerts.

Period of review

The standard period for the Tax Office to amend an assessment, either to increase or reduce a taxpayer's liability, is four years. For taxpayers with simple affairs the period is two years. For individual taxpayers, the amendment period is calculated from the day on which tax became due and payable under an assessment.

There is an extended period for amendment where Part IVA (the general anti-avoidance provision) is invoked. The Tax Office has up to six years (from the date on which tax became due and payable under an assessment) to amend an assessment to cancel a tax benefit under Part IVA.

There is no time limit in cases of fraud or evasion.

Penalties

A 'tax shortfall' penalty may apply, depending on the degree of blameworthiness on the taxpayer's part, if a taxpayer has a tax shortfall resulting from any of the following:

- making a false or misleading statement
- failing to provide a document that the Tax Office needs to work out their liability
- applying an income tax law in a way that is not reasonably arguable (but only if the tax shortfall amount exceeds the greater of $10,000 or 1% of the income tax payable by the taxpayer)
- disregarding a PBR
- entering into a tax avoidance scheme or having a transfer pricing adjustment.

The term 'false and misleading statement' will generally cover omitting income, over-claiming deductions or claiming deductions or benefits that are not allowable.

The Commissioner can remit the whole or part of the penalty. The objection and review procedures can apply to the remission decision if the amount of the penalty not remitted exceeds two penalty units (currently $220).

Interest payments and charges

Interest at a uniform rate is applied to late payments of any type of tax — this is known as the General Interest Charge (GIC). The GIC is calculated by adding 7% to the Reserve Bank's bank bill rate series. The interest applies whenever a tax debt is overdue, whether or not a taxpayer has acted knowingly to create a debt.

Any GIC incurred by a taxpayer is tax deductible.