



## THE TAX INSTITUTE

1 March 2013

Mr Ali Noroozi  
Inspector-General of Taxation  
GPO Box 551  
SYDNEY NSW 2001

By email: [penalties@igt.gov.au](mailto:penalties@igt.gov.au)

Dear Ali

### **Review into the ATO's administration of penalties**

The Tax Institute is pleased to have the opportunity to make a submission to you in relation to the "*Review into the ATO's administration of penalties*" (**Review**).

#### **General**

The penalty regime is a necessary part of the Australian tax system to ensure that taxpayers who are subject to the tax laws comply with the requirements of the law and may be penalised where they do not. In this regard, the role of the ATO is to appropriately administer the penalty regime and to apply it in the relevant circumstances (such as where a taxpayer has not complied with the tax law).

However, where the ATO is perceived to inappropriately apply the penalty regime, a perception is created that the regime is weighted in favour of the ATO and against the taxpayer.

The role of the penalty regime is two-pronged. Firstly, it applies at the 'front-end' of the self-assessment system where tax law is first being applied by a taxpayer. The potential of a penalty applying is designed to encourage compliance with the tax law in the first instance. Where laws are unclear and a taxpayer has to take a 'reasonably arguable position', in the event the taxpayer is incorrect, the taxpayer's rationale is taken into account to mitigate any penalties that might later apply.

Secondly, the penalty regime applies at the 'back-end' where a taxpayer has applied the tax law incorrectly and the Commissioner makes an assessment to adjust the tax payable/refund position determined by the taxpayer according to the way the Commissioner interprets and administers the tax law.

Three issues can arise with the application of the penalty regime:

- 1) where taxpayers decide to dispute assessments, they risk increasing the penalty (for example, a shortfall penalty) that may have already been applied according to their level of culpability (usually reduced if a 'reasonably arguable position' has been taken);
- 2) depending on how many stages the dispute moves through (for example, request for amended assessment, objection etc), this extends the timeframe over which time-sensitive penalties (such as the general interest charge (**GIC**)) might apply; and
- 3) the cost to taxpayers (in time spent disputing the assessment, advisers' fees, etc) where the Commissioner may rightly or wrongly have disputed the original position of the taxpayer.

## **1. Culpability**

The main concerns of the profession around taxpayer culpability have been discussed and covered in the recommendations contained in Chapter Four of the *Review into improving the self-assessment system (ROSA Review)* report. These issues apply equally in the context of this current Review and should also be referred to here, particularly the issues with respect to the penalty thresholds.

## **2. Timeframe**

One of the main issues that arises is the potential for an extended amount of time to pass before resolution of a dispute and application of a final penalty. Time-sensitive penalties, such as the GIC, which is calculated on a compounding daily basis, increases exponentially for as long as a dispute remains on foot and an amount of tax remains unpaid.

There is concern about the absence of a mandated service standard that the ATO adheres to in the context of applying penalties. Often, extended time delays in dealing with the ATO, for example delays in a taxpayer receiving a response from the ATO as to whether sufficient information has been provided to satisfy the ATO's query during a dispute or whether further information is required, can contribute to higher than necessary time-sensitive penalties (such as GIC) being imposed. Extensive delays in determining whether a taxpayer has underpaid their tax liability could also lead to a higher shortfall interest charge being applied than had the issue been resolved earlier.

Other factors contributing to delays include the assignment of matters to part-time ATO staff or an ATO staff member responsible for the matter being reassigned to another area or the matter being referred to another area while the matter is still on foot. This disrupts the processing of the matter.

Similarly, delays on the part of a taxpayer in responding to requests from the ATO, such as requests for further information, also contribute to delays in resolving disputes leading to potential increases in the penalties that might apply if the dispute is not resolved in the taxpayer's favour. There is also a general fear among tax professionals that if they follow up a matter with the ATO rather than letting the reviewing officer take time to review the matter, this might cause the officer to err on the side of issuing an

unfavourable amended assessment or disallowing an objection, imposing penalties and not properly considering the matter. The costs associated with then dealing with the matter substantially increase. However, leaving the matter with the ATO for an extended period of time runs the risk that higher than necessary penalties might be applied (if determined to be applicable). In this regard, the ATO, taxpayers and tax professionals can all be responsible for higher than necessary penalties applying as a result of extensive delays.

Given the time sensitivity of certain penalties, guidelines should be issued by the ATO setting out the time period in which certain disputes will be resolved. A cap should also be put on the number of days interest can be charged in line with the service standard, unless there is clear evidence that a taxpayer has intentionally caused delays in the process<sup>1</sup>. This would give taxpayers an indication of the timeframes in which they can expect to receive a response from the ATO in circumstances where penalties are being applied, allowing them to hold the ATO to account. This will also provide a uniform service standard to which ATO officers are required to adhere.

There are already guiding documents, such as the *Taxpayers' Charter* and *Service Standards*, which are issued by the ATO and published on its website. These documents indicate reasonable time limits in which the ATO will correspond with taxpayers in certain circumstances. The ATO could consider updating these documents for the reasonable timeframes that should apply in situations where the ATO is imposing penalties.

However, the ATO should consult with the tax profession to agree the reasonable timeframes in which both the ATO and the profession agree to resolve matters where penalties might apply.

Should the IGOT consider making such a recommendation to the ATO, we suggest as part of the recommendation, the ATO be required to consult with the tax profession in forming the guidelines that will apply for the reasons set out above.

We note the issue of delays was referred to in the ROSA Review.

### **3. Cost and Process**

Having to engage in an audit or objection process with the ATO will always have high costs associated with it.

As part of the consultation process recommended above, the information gathering processes the ATO uses (such as in the audit or objection process) could also be reviewed to see whether these processes are also unnecessarily contributing to time delays. These processes may be able to be improved to ensure the ATO's enquiries are targeted and do not cause taxpayers to expend time gathering information that is not essential to the audit or objection process. If the information gathering processes can be streamlined and perhaps shortened, this will also assist in shortening the timeframes in which penalties may be applied.

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<sup>1</sup> It should be the ATO's responsibility to determine this.


It would also be useful if statistical information was made available to indicate what other factors may be contributing to the application of penalties or excessive penalties due to time delays. Statistical information around the following issues would be useful:

- the number of amended assessments issued;
- the reasons for the amendments (are there common errors being made?);
- whether the adjustments being made are in favour of the taxpayer or ATO;
- the dollar values of both the adjustment amounts originally issued by the ATO and the adjustments finally made when the matter is settled;
- the dollar values of proposed amended and actual amended assessments as a proportion of the final amended assessments; and
- the amount of the culpability penalties imposed as a proportion of the final assessments issued.

The availability of this information across all types of taxpayers would provide key indicators of deficiencies in the process relating to the application of penalties. Consideration of these factors may also assist to identify areas where mistakes are being made by taxpayers, tax professionals or the ATO in administering the law, which are contributing to the ATO being required to make adjustments to assessments and impose penalties in the first place. Education around these common mistakes may assist to prevent the ATO from having to make these adjustments in the first place and taxpayers incurring unnecessary penalties.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Westaway', with a stylized flourish at the end.

Steve Westaway  
President