

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

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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

A handwritten signature in cursive script that reads 'David Vos'.

David Vos AM
Inspector-General of Taxation

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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 paper¹ 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 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.

Review of the Remission of the General Interest Charge

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 press³ 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.

Review of the Remission of the General Interest Charge

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.

Review of the Remission of the General Interest Charge

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 ATO²⁰, 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* case²²) 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.

Review of the Remission of the General Interest Charge

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.

Review of the Remission of the General Interest Charge

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.

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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.

Appendix 1 to Review of the Remission of the General Interest Charge

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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