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**Australian Government**  
**Australian Taxation Office**

# Securing Australia's revenue, securing community confidence



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# CHAPTER 1 – SECURING AUSTRALIA’S REVENUE, SECURING COMMUNITY CONFIDENCE

## Overview of the tax system

The Joint Committee of Public Accounts and Audit has, through its oversight role in relation to the Australian National Audit Office (ANAO), had significant ongoing review of the Tax Office during the course of its deliberations. This review has included reviews of the ANAO’s report into administration of taxation rulings in 2002 and the Tax Office’s management of its relationship with tax practitioners in 2003. This ongoing role has complemented the extensive review of the tax system in the JCPA report 326 *An assessment of tax* (November 1993). That report brought about significant changes, supported by the government and the Tax Office including:

- the taxpayers’ charter and its associated complaints system
- the Taxation Adviser to the Commonwealth Ombudsman, and
- the Small Claims (Taxation) Tribunal.

We have, of course, had one of the world’s largest tax reform agendas (A new Tax System, and Business Tax Reform).

What hasn’t changed is that Australia’s self-assessment tax system is still one largely based on voluntary compliance with the tax law.

We are very fortunate in this country that by and large we have a culture of doing the right thing. The reality is that all but around \$4.2 billion of total collections of \$214.9 billion is voluntarily paid – supported by systems such as pay as you go (PAYG).

We acknowledge that the right environment must support self-assessment and high levels of voluntary compliance. That environment is made up of the law, collection processes including information technology support, information, advice and service. It also includes recognition and support for other stakeholders or players in the tax system such as tax agents, advisers, employers and software providers.

Procedural fairness, courtesy and integrity underpin a world class tax administration. This is important because the success of any tax system is highly dependent on people’s propensity to voluntarily comply with their tax obligations.<sup>1</sup>

Factors that shape community attitudes and behaviour include:

- the community’s belief that the Tax Office is fair, certain and legitimate
- perceptions of fairness including:
  - the assistance people receive in relation to their responsibilities under the tax system

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<sup>1</sup>‘It’s the community’s tax system’, speech by Michael D’Ascenzo, 30 January 2006

- the ease with which people can deal with the Tax Office
- issues of respect and natural justice, and
- the perceived effectiveness of deterrence strategies.

The recurring themes of excellent service to taxpayers, efficient and effective management of risks to the tax system, making it easier for people to comply, and building community confidence in our tax administration remain our goals today as they were in the past.

We support the culture of voluntary compliance by instilling high levels of community confidence in our administration through:

- operating effectively and efficiently
- providing excellent service
- listening to the community and making the task of tax compliance as simple and convenient as possible
- dealing with people with respect, professionalism and fairness, and
- supporting honest taxpayers who want to do the right thing by having effective deterrent strategies against those who do not.

We also believe that the tax system should be acknowledged as the community's system – and we acknowledge the efforts of a range of people such as employers, tax agents, advisers, bookkeepers, software producers, banks and other intermediaries to make the system work. The notion of an 'us and them' culture between taxpayers, tax agents and the Tax Office is one that should be long gone. The Tax Office of the 21<sup>st</sup> century is open and transparent, and engaging in co-design, consultation and collaboration with stakeholders in the community's tax system.<sup>2</sup>

Taxpayers rely heavily on tax agents and advisers – some 97% of businesses and 74% of individuals choose to lodge their income tax returns through tax agents. This has been the case for some years in our tax system. Historically this has been a unique feature of the Australian system since tax agents were recognised in law introduced back in 1943.

For individuals with simple affairs the pattern may change – this year nearly 1.4 million taxpayers lodged using the e-tax product, taking electronic self-preparer lodgments higher than paper lodgers. Refunds through e-tax typically take 14 days and its edit checks, pre-population opportunities, and its associated advice material make it a comprehensive product offering a measure of simplicity for individuals. For business, accounting requirements often provide the incentive to seek specialist assistance – these requirements form the base upon which many tax obligations are derived. Businesses' shortcomings in accounting and record-keeping expertise is today mitigated by software products, including the Tax Office e-record (provided to all businesses). Nevertheless, most businesses choose for an accountant (including tax agents) and/or bookkeeper to assist them in this specialist task

In recognition of the role played by tax agents and advisers in the tax system, we dedicate considerable effort to providing support to them and we want to enhance that support. We are also taking a collaborative approach, with tax professional bodies on some of the demographic and skills issues facing the profession.<sup>3</sup>

<sup>2</sup> 'Tax administration into the 21<sup>st</sup> century', presentation by Michael D'Ascenzo, 28 April, 2000

<sup>3</sup> CEO minutes, 27 February 2006

The Tax Office vision is to be recognised domestically and internationally as a world class tax administration (we are already recognised as world class internationally<sup>4</sup>), and more importantly, that we work with the community in the care and management of the tax system. In this regard, the Uhrig *Review of Corporate Governance of Statutory Authorities and Office Holders* (June 2003) said 'It could be argued that of all statutory authorities, the ATO has the most significant and wide-ranging relationship with the community, involving people both as individuals and also where they may be participants in business or non-profit organisations or as tax professionals. To assist the community in that relationship, the ATO has established a wide range of consultative arrangements dealing with the implementation and administration of taxation legislation. These arrangements, which continue to evolve, may take many forms – national and regional liaison committees involving senior representatives of the ATO and representative of peak business bodies, working parties, task forces, discussion documents, seminars and conferences.'

Our approach to managing the tax system has evolved to meet rising community expectations and our own desire to lift the bar on excellence in tax administration. Throughout this submission, we draw the Committee's attention to the current strategies and processes we use to administer income tax laws on behalf of the community. The strategies are necessarily different recognising the need to differentiate and the limitation of one size fits all solutions for the wide spectrum of circumstances faced by individuals and businesses.

Chapter 4 of this submission deals with our relationship and support for tax agents.

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<sup>4</sup> Inspector-General of Taxation Annual Report 2004–05 'It was very interesting to note the high regard the Australian Taxation Office is held in by other revenue agencies.'

## A snap shot of then and now

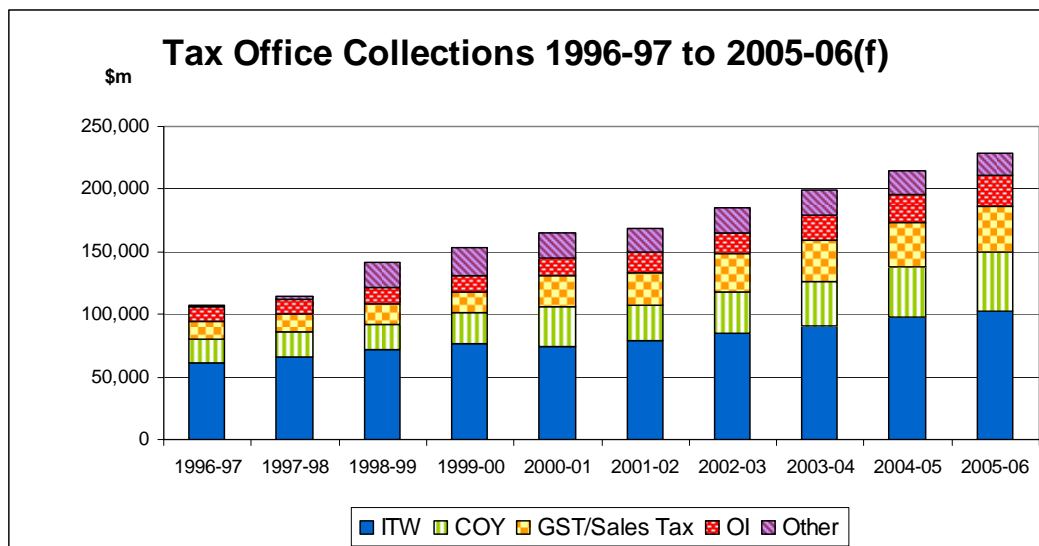
	1992-93	2004-05
Number of individual taxpayers	9.27 million	11 million
Number of income tax returns processed	10 million	13.6 million
Total revenue collected	\$74.7 billion	\$214.8 billion
Individuals	\$47.37 billion	\$98.01 billion
Total income tax collections	\$65.46 billion	\$155.76 billion
Electronic lodgments	60%	86%*
Total transfer payments	\$0.199 billion	\$6.19 billion
Total amount refunded	\$8.8 billion	\$50.6 billion
Collectable debt on hand	\$4.2 billion	\$9.6 billion
Collection cost as a percentage of revenue	1.25%	1.03% (inclusive GST)** 0.90% (exclusive GST)
Number of staff	17,700	22,294
Tax office financial budget	\$1.1 billion	\$2.4 billion

Please note that:

\*as at 26 March 2006

\*\*since the 1992-93 inquiry, several changes have been made to the tax system which may impact upon comparative analysis.

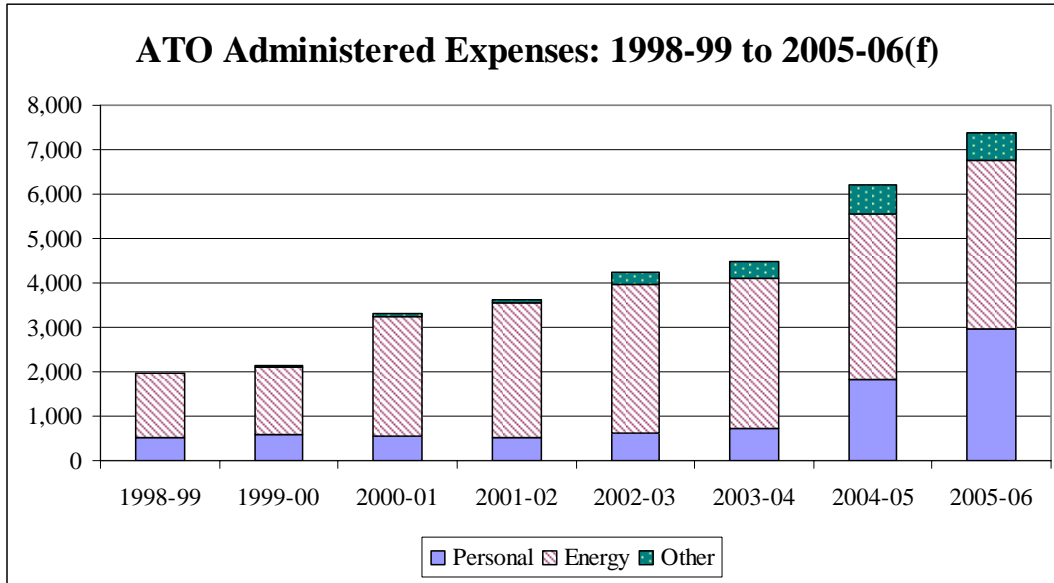
## Revenue collections



Note: For the 2005-06 year the MYEFO projections have been used

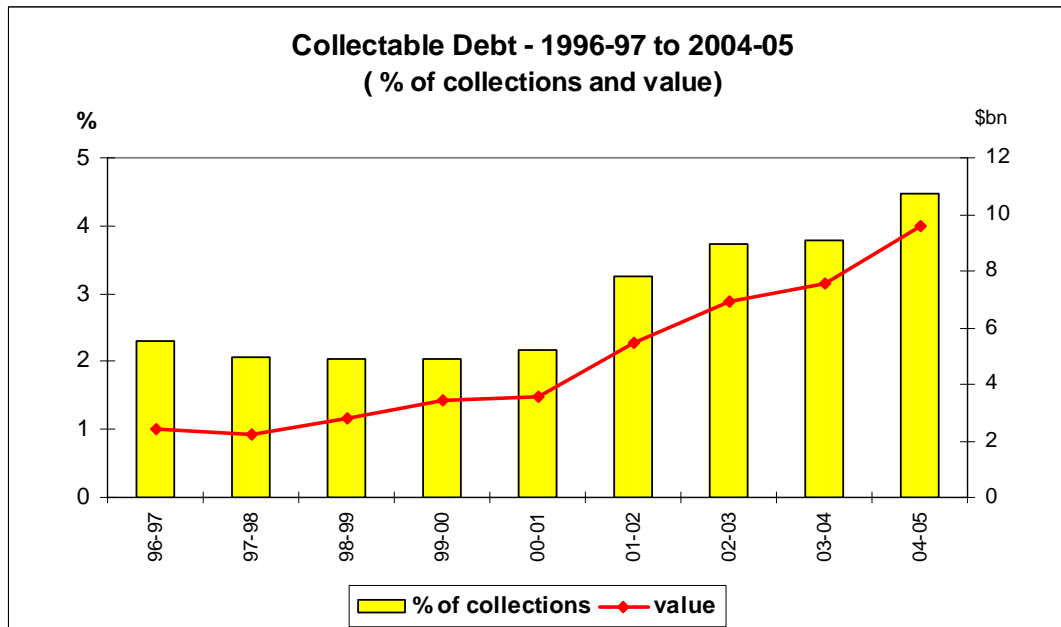


## ATO Administered Expenses

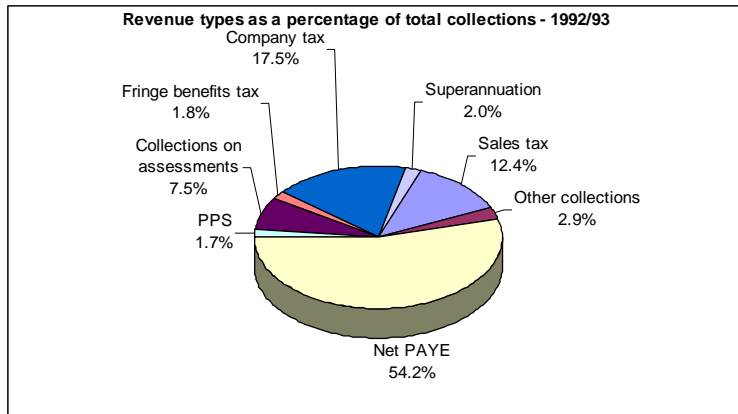


Note: The start point of the graph is 1998–99, rather than 1996–97 in the revenue graph. The later base was chosen to eliminate distortions caused by CSA transactions in 1996–97 and 1997–98. The 2005–06 numbers are MYEFO estimates.

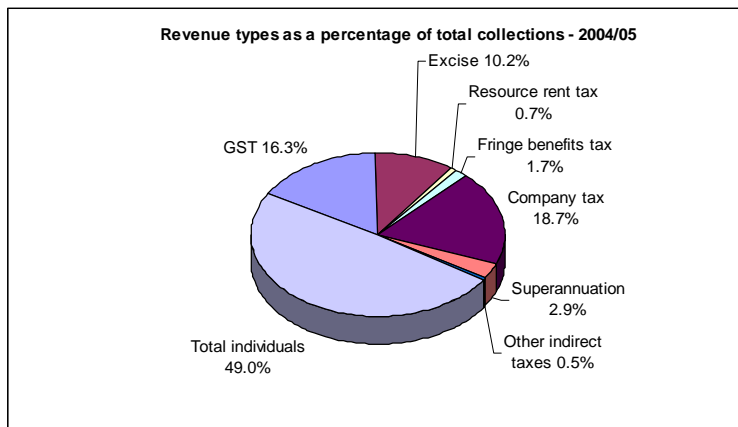
## Collectable debt levels and collectable debt as a percentage of collections over the years 1996–97 to 2004–05



## Revenue types as a percentage of total collections – 1992–93 and 2004–05



Source: Annual report 1992–93



Source: Annual report 2004–05

### The Tax Office role

The tax acts are instruments of fiscal, economic and social policy. The shape, incidence and rates of the tax system are proposed by government and agreed to by parliament. The community's input ultimately is through the ballot box.

Government's departmental adviser on tax policy is the Department of the Treasury. Community input is encouraged through consultative processes.<sup>5</sup> The Tax Office's primary role is to administer tax laws. Taxpayers who disagree with the Commissioner's decisions are able to have the matters decided by the Administrative Appeals Tribunal – including the Small Claims (Taxation) Tribunal – or the courts who are the umpires in such disputes. The Tax Office also plays an advisory role to government (through Treasury) in providing input on the interpretive aspects and the administrative and community impact of proposals, or in informing government (usually through Treasury) of areas where the laws are not operating in accordance with their policy intent

<sup>5</sup> Treasurer's press release no. 22, May 2002

(irrespective of whether the current operation of those laws benefits the revenue or taxpayers).

### **Our business intent**

As the administrative role of the Tax Office is thus to manage and shape tax, excise and superannuation systems that fund services for Australians, giving effect to social and economic policy,<sup>6</sup> our business intent is:

‘To optimise collections and make payments under the law in a way that instils community confidence that the system is operating effectively.’

We started with 12 employees in 1910 in the Department of the Treasury, initially collecting land taxes to fund Commonwealth pensions. Since then we have grown to an organisation with 22,294 employees (as at 30 June 2005) and undertake the complex task of administering Australia’s revenue system as well as being the second largest payer of benefits to the community. In 2004–05 we collected around \$215 billion in tax and paid over \$6 billion in transfer payments to the community.

The main areas we administer are:

- income tax including pay as you go (PAYG) withholding and instalments, capital gains tax and fringe benefits tax
- goods and services tax (GST)
- excise duty
- fuel grants and benefits schemes
- superannuation
- higher education funding (on a joint basis), and
- the Australian business number (ABN) and Australian Business Register (ABR).

We also support the delivery of community benefits, with roles in other areas such as private health insurance, family assistance and cross-agency support.

In 2004–05 we:

- collected 89% of Australian Government receipts and over \$35 billion in GST for state and territory governments
- administered Australia’s direct tax systems (income tax, capital gains tax and fringe benefits tax) and most of Australia’s indirect tax systems (GST and excise)
- administered and collected the superannuation guarantee and superannuation surcharge and regulated self managed superannuation funds, and
- paid over \$3.7 billion in industry grants, such as through fuel and energy grants schemes.

In administering the Australia’s revenue system in 2004–05, we:

- processed over 3.2 million activity statements and 13.6 million income tax returns
- regulated over 300,000 self managed superannuation funds
- handled just under 11 million telephone calls, and
- maintained 17.4 million individual and business accounts.

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<sup>6</sup> Our excise role excludes customs duty

## How do we go about it – securing community confidence

### Our business model – our approach to self-assessment

Our business model sets out how we go about managing the revenue system.



Self-assessment is, in essence, a risk management approach to revenue administration, an approach that is commonly employed around the world. Australia has one of the world's most developed systems.

It recognises that tax administrators are not going to be resourced to review all transactions or events that may have a tax consequence. Such an approach would also be rejected by the community as too burdensome and intrusive. We agree with that.

Self-assessment is based on the reasoning that voluntary compliance is best achieved by employing the available resources to:

- support people in doing the right thing, and
- focus on areas where there is a greater risk of people not doing the right thing, whether intentionally or not.

### Approach

This reasoning leads to the key elements of the approach identified in our business model. That is, our approach is framed around the objectives of:

- helping taxpayers and their advisers understand their rights and obligations
- making it as easy as possible to comply, and
- verifying compliance using a risk management approach.

Recognising that there are many different participants in the revenue system and that different taxpayers have different circumstances and needs and that many take different postures in meeting their obligations, these key approaches are overlaid with the need to 'manage relationships and differentiate accordingly'.

In giving effect to these approaches we are guided by our taxpayers' charter and compliance model.

The combination of these elements of our business model mean that we are required to operate variously as:

- a trusted authority on the law
- a professional advisor and educator, helping people understand their rights and obligations under the law
- a fair but firm enforcer of the law, and

- a fair administrator who recognises people's circumstances in meeting their obligations.

### **Capabilities**

The final element of the business model recognises that delivery ultimately relies on the capabilities of human beings and their systems and that building that capability is a key element of effective revenue administration.

This is true of staff of the Tax Office where proper skilling and systems support are imperatives. Our strategies to build the capabilities of our staff are complemented by a \$493 million change program which provides the potential to reduce taxpayer compliance costs, and to allow the Tax Office to better differentiate in the way it deals with taxpayers by helping those that are trying to do the right thing, and taking firm action against those who are not.

It is also true of others. As such, the business model acknowledges our role in supporting people and businesses that contribute to the effective operation of the tax system, including employers, tax agents, accountants, advisers and software developers. Our advice to government (through Treasury) on new measures includes a consideration of the readiness and ability of taxpayers to carry out their responsibilities.

## **A snap shot of developments – securing community confidence**

### **A national business approach**

One of the key shifts we have made since the last general review of the Tax Office by this Committee is a national approach to our management. In the mid-1990s we shifted from a branch and regional management approach in our business operations to a national one, focused on programs largely based on tax products.

This approach has resulted in an improvement in our consistency in decision-making, and enabled us to build clearer governance and accountabilities in our planning and risk management approaches. In doing this, we have continued to grow our experience in differentiating between market segments. We now also have national sets of instructions for staff in corporate and tax administration processes. These include our corporate management and law administration practice statements as well as our precedent data base. Taking account of other agencies' experiences, we are continuing to develop our practices.

We are also using technology to enhance our decision-making practices, such as our precedent database and the proposed implementation of our new case management system which will support added rigour in administrative decision-making, and better time and project management in our casework. Our newly implemented client relationship management system provides to our staff a history of the taxpayer's interaction with us, enabling better decision-making and improving the experience for the taxpayer.

The shift to national management and technological enhancements has also given rise to a range of new strategies to provide taxpayer support and advice. We have now developed more deliberate and innovative approaches to telephony, web services, face-to-face and paper interactions.

The size of the implementation of tax reform in the late 1990s/early 2000s provided impetus for smarter interactions with taxpayers, particularly those in business who are now subject to business registration, activity statement reporting and payment. Tax reform gave us an opportunity to take more taxpayers on-line.

Most recently, in the past three years we have embarked on a major program to make interaction with the tax system easier, cheaper and more personalised. A copy of our publication *Making it easier to comply* is included with this submission. This has been heavily based on a program of listening to the community and, in particular, has seen a strong focus on support for tax practitioners, who play a key role in supporting taxpayers, and facilitating on-line dealings with the Tax Office.

One of the key themes that came from our 2002 listening to the community program was the desire of taxpayers from a number of market segments to see tax as a by-product from the way they go about their business – in other words, a challenge to the Tax Office to try to build tax transactions and requirements into the taxpayers' own systems.

Much work has been done to link record keeping systems with activity statements – that is, to have record keeping software create and lodge activity statements. Pre-population of e-tax income tax returns for individuals has been successfully trialed enabling the pre-population of Centrelink payment summary information and medical expenses recorded by Medicare Australia for use in the medical expenses offset. The pre-population approach is not only easier, but also builds in a sense of further confidence for taxpayers who use products such as e-tax.

Likewise, far greater use has been made of data matching in recent years, ensuring for taxpayers a much less intrusive approach to compliance, but also giving the Tax Office the ability to better target its compliance activities and assess risks. Attachment 1 provides an outline of our data matching programs.

Having moved to national management, we have also divided the management of the Tax Office into six sub-plans to ensure we give the right focus and balance to our efforts. Details about the sub-plans are set out in booklet *Managing the revenue system* provided with this submission and our annual report. It is worth noting that just over 50% of Tax Office resources are dedicated to compliance activities encompassing help and enforcement.

The other significant development in our administration is our continuing quest for openness, transparency and accountability in our operations. This value manifests itself in many ways. We demonstrate our openness and willingness to consult with an invitation to the public to provide feedback by publishing our strategies, such as our annual *Compliance program* and our plans to make the tax system easier, cheaper and more personalised in the publication, *Making it easier to comply*.

We also publish a number of our staff guidelines (after consultation on their development) such as our access manual, settlement guidelines, and our prosecution guidelines.

We welcome consultation, collaboration and co-design with community, industry and tax professional representative bodies through our many stakeholder forums.

We also include external representatives in a number of key decision-making forums such as our public rulings panels, our general anti-avoidance provisions panel, and governance forums, such as our Audit Committee and Integrity Advisory Committee.

We are accountable and publish our performance against our service standards, and the results of many of our external surveys such as our professionalism and business perceptions surveys.

### **Reducing risks to taxpayers**

The first step in reducing risks to taxpayers of making a mistake is good law design. In line with the Treasurer's announcement of May 2002, the Tax Office works closely with the Treasury to support good law design, bringing to the table its administrative and interpretative experience, and the voice of taxpayers and others in the tax system.

As a rule of thumb we hope that the common case and the bulk of situations intended to be covered by a new measure can intuitively be guided by the law, further explained in associated explanatory material where necessary.

It would be disappointing if every measure needed a vast range of binding products behind it to support voluntary compliance. Our strategy is to target our binding products to the areas of genuine uncertainty, working with industry and professional groups on issues emerging after the enactment of the law. Sometimes clarification or confirmation of the policy intent will need to come through legislation by way of amendment or regulations.

The legislative scheme for shortfall penalties, now complemented by the shortfall interest charge, reduces the risk to taxpayers of making a mistake<sup>7</sup>. In addition, we have a well-managed public rulings program which deals with a range of issues of interest to a wide range of groups in the community. These are predominantly prepared for use by tax professionals, although they are translated into material for taxpayers through guides, publications and fact sheets.

The process for developing public rulings involves input from our most senior tax officers and extensive consultation with industry partnerships and respected tax experts in the community. This is in addition to our rigorous rulings panel processes whereby experienced practitioners and academics inject technical expertise as well as business experience into our deliberations. The ANAO determined that public rulings were recognised in the market as having 'high integrity'.

In 2004–05, we issued 432 public rulings, including 147 class rulings, 138 product rulings, and 147 rulings and determinations dealing with a range of income tax, international, GST and product grant and benefit issues. We also issued 136 draft rulings and determinations. The JCPAA reviewed the taxation rulings system and said that it was pleased with the focus of the Tax Office on getting the rulings system working as it should and on the priority the issue appears to have within the Tax Office.

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<sup>7</sup> 'Consolidation: making choices – risk management in action', speech by Michael D'Ascenzo, May 2004

Public rulings are the Commissioner's view of the law and are binding on the Commissioner but not the taxpayer. In other words, they offer taxpayers protection but do not impose any obligation on taxpayers

Our public rulings system is complemented by our private rulings system that allows a taxpayer to be 'assessed' in relation to a matter or prospective matter. In other words, a taxpayer can provide a full and true disclosure of the facts (or prospective facts) and the Commissioner will (usually in 28 days) provide the Commissioner's view of the tax effect of the transaction or arrangement. If dissatisfied with the decision the taxpayer has rights of objection and appeal.

The private rulings system replicates the old 'assessment system' for taxpayers in genuine uncertainty. It goes further than the old system by allowing the taxpayer to get a ruling on a proposed transaction.

The private rulings system provides a mechanism for taxpayers to get certainty about tax treatment of particular transactions. Individual taxpayers can obtain the Commissioner's view of how the law applies to their specific circumstances. The Commissioner is legally bound to the view expressed in a private ruling and cannot assess a taxpayer to any more tax than is payable by applying the private ruling. In 2004–05, we issued 14,387 private rulings.

To obtain a private ruling taxpayers can download the *Private ruling application* form from [www.ato.gov.au](http://www.ato.gov.au) or phone 1300 720 092 to have one sent to them. Private ruling requests can also be lodged via the Tax Agent Portal or Business Portal for security and timeliness.

We are also transparent in our technical decision-making and maintain a precedent database, which is made publicly available on our website.

The precedent database includes ATO Interpretative Decisions (ATO IDs) which are based on an edited and summarised version of a decision on an interpretative issue on law that is administered by the Commissioner. A current ATO ID sets out the Commissioner's indicative view on a particular interpretative issue. ATO IDs are based on interpretative decisions arising from private rulings, audits, correspondence, disputes, etc.

An ATO ID is created to provide a precedent that can be applied by other tax officers dealing with similar interpretative issues. However, as they are summarised versions of what may have been complex legal argument applied to complex facts, a general similarity of a taxpayer's situation to the circumstances in an ATO ID will not necessarily lead to the same result.

The purpose for establishing precedential views in ATO IDs is to ensure that tax officers are providing consistent advice to taxpayers where the factual circumstances of particular cases are not materially different. Where a tax officer considers that the tax precedent is wrong, they are required to escalate the matter for review. Our Centres of Expertise also conduct regular review and maintenance of ATO IDs and other precedential material for the purposes of identifying precedents which are incorrect or require clarification..



ATO IDs are made public for transparency purposes only and are not legally binding on the Commissioner. However, they do provide protection to taxpayers in respect of penalties and interest. Where a taxpayer reasonably relies on an ATO ID in good faith and the ATO ID is subsequently found to be incorrect, taxpayers would only be asked to pay the primary tax that they would otherwise have owed to the community and would not be subject to penalties or interest. In such cases, payment arrangements can be entered into if that is more convenient for the taxpayer.

The number of ATO IDs being added to our precedent data base has levelled off and in consultation with the tax profession we are rationalising the database. This includes activities such as incorporating the principles stated in ATO IDs into binding products such as public rulings.

We also provide publications, guides and other products to help taxpayers. They are not legally binding on the Commissioner, unless stated otherwise. However, taxpayers who rely on the advice provided in these products generally are protected from having to pay administrative penalties and they also may not be required to pay interest charges, for example, the Commissioner's guarantee in *TaxPack* and e-Tax (see chapter 2 on individuals).

# CHAPTER 2 – SELF-ASSESSMENT FOR INDIVIDUALS

## Overview

There are almost 11 million individual taxpayers who account for around 45% of our net revenue collection – increasing over the past three years from \$82.6 billion in 2002–03 to \$95.7 billion in 2004–05.

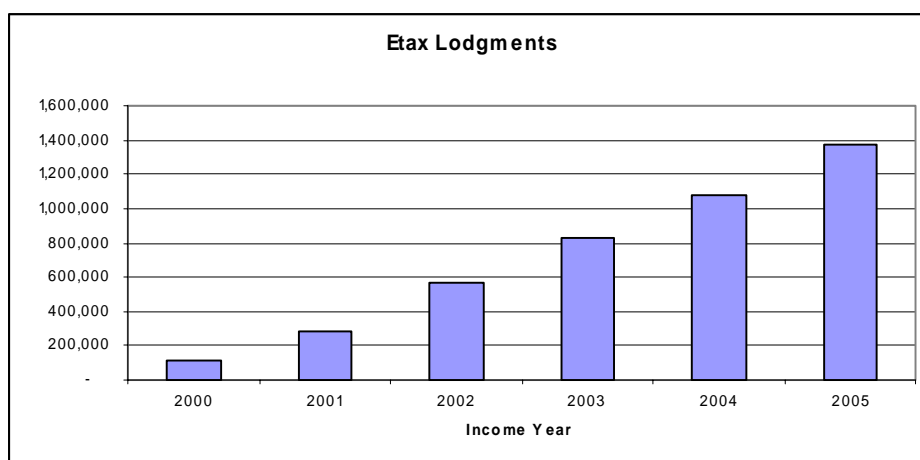
These individuals are mainly wage and salary earners and private investors, paying income tax through the pay as you go (PAYG) system. In fact, 90% of PAYG amounts withheld by employers are remitted on behalf of individuals. The percentage of PAYG withholding collected is:

- 35% in the large market
- 21% in the small to medium enterprises market
- 16% in the micro-business market
- 7% in the non-profit market, and
- 21% in the government market.

The number of 'individuals' includes approximately 2.9 million people who are also involved in operating a business, though this side of their affairs we manage mostly as part of the micro-business market segment (see chapter 3).

The affairs of taxpayers in the 'individuals' market segment range from the simple, such as simple salary or wages, to the more complex, such as individuals who invest in property, earn dividends from shares and interest from bank accounts, and who receive a wage and salary as well or operate as a sole trader or in partnership with others, or receive trust distributions.

Around 74% of individuals use tax agents to prepare their income tax returns. Of the remainder who prepare their own returns, increasing numbers are lodging online, with nearly 1.4 million individuals using e-tax to lodge their 2004–05 returns.



As is indicated by our compliance model, most individuals attempt to meet their tax obligations and gain their entitlements. Our compliance model and the *Compliance program* we publish each year, also indicate how we manage the full range of taxpayers – from those who willingly comply, to those who make mistakes, to those who deliberately avoid paying tax.

Our compliance approach is heavily aimed at providing individuals with advice and assistance as they need to meet their obligations. We provide a range of products that recognise the diverse needs of individual taxpayers. They include:

- e-tax software, available at [www.ato.gov.au](http://www.ato.gov.au) from July to February, which allows people to prepare and lodge their income tax return quickly and securely online
- *TaxPack* and the *TaxPack supplement* for people with more complex tax affairs
- two shorter forms for people with simpler tax affairs
- [www.ato.gov.au](http://www.ato.gov.au) for information, publications, interactive self-help tools and calculators, as well as administrative and legal decisions about tax obligations – so far this year (to 30 March) the number of requests to the individuals' section of the website is almost 37 million
- a self-help telephone service (13 28 65) for access to 24-hour information and a range of services
- a general advice helpline (13 28 61), and
- outreach education programs, including the schools education program, workforce education program and TaxHelp.

We are also developing a range of targeted help and education products. For example, this year we introduced a range of new products to help people comply with their capital gains tax obligations for real estate. This includes a range of fact sheets, an electronic record keeping tool, and more electronic calculators and decision support tools.

Another example of how we are making it easier, cheaper and more personalised for taxpayers who are interacting with the revenue system is the progressive roll-out of the client relationship management system into call centres which began in the first half of 2005–06. This gives contact staff a single consolidated view of a taxpayer's information and taxpayer contact history (including phone calls and letters). It means progressively that staff will have easier access to all of a taxpayer's details and this will minimise the need for taxpayers to bring our staff up to speed on their situation when they call. Following a further release scheduled for next month (April) 2006, when taxpayers need to be transferred to another tax officer during the phone call, the details of their inquiry will be automatically transferred with the call.

At all stages of their interaction with us, taxpayers can access help from tax officers through our shopfronts, by email, mail or telephone.

We also help individuals meet their tax obligations by providing written and oral advice on the laws we administer, including public, private and oral rulings that are legally binding on the Commissioner, and a wide range of other advice products and services such as telephone services, fact sheets and guidelines.

An example of our service to individuals is the phone lodgment service we provide for individuals with simple tax affairs who use the short form. From 1 July 2005 to 30 March 2006, 52,360 people had lodged their 2004–05 returns using phone lodgment.

Individuals using this lodgment service lodge within 12 minutes and returns are issued to them within 14 days.

Another example of our responsiveness to the needs of different individuals within this segment, is the *Retirees TaxPack* – for those who have retired from the workforce and have straight-forward tax affairs. This is a shortened form of *TaxPack* for individuals generally. Approximately 60,260 (as at 30 March) people used the *Retirees TaxPack 2005* to lodge their 2004–05 income tax return.

As for many of the products we provide to taxpayers, *Retirees TaxPack* carries the 'Commissioner's guarantee'. The guarantee is contained in the following statement in *Retirees TaxPack 2005*:

'The Commissioner offers the following protections if you use *Retirees' TaxPack 2005* properly.

- As a *Retirees TaxPack* user you will not be expected to know more than we have presented to you in *Retirees TaxPack 2005* and its related publications.
- We have made every effort, including consultation with community groups and tax professionals outside the Tax Office, to make sure that *Retirees TaxPack* is accurate. Nevertheless, if something is misleading and you make a mistake as a result, we will not charge you a penalty or interest on any missing tax.
- If you use *Retirees TaxPack* properly and make an honest mistake, my staff, including my auditors, will accept that you have honestly described your tax affairs. We will not charge you a penalty, although we may ask you to pay interest on any missing tax.'

This protection gives certainty to taxpayers that, if they make an honest mistake, they will not be penalised. A similar guarantee is given to users of *TaxPack*. Further certainty is also being achieved through further improvements, such as those we are implementing in response to the *Report on Aspects of Income Tax Self Assessment* (ROSA).

### **A fair system**

The changes to the self-assessment system in 1992 were considered by the JCPA as: making the system fairer and more certain for taxpayers. The more recent review of self-assessment by Treasury (ROSA) provided a further shift in favour of taxpayers. This review made a total of 54 recommendations, most of which are expected to be implemented in 2005–06. The majority of these recommendations required legislative change with the remainder requiring administrative or regulatory change. The key changes include:

- shorter periods of review – the period of review in which the Tax Office can come back and adjust assessments is reduced to two years for more than eight million individual taxpayers, as well as for small business taxpayers who opt into the simplified tax system
- interest and penalties – interest on income tax shortfalls (where an amendment has increased the tax owing) is reduced for the period between the due date for the original assessment and the due date for the additional tax payable; penalties will be imposed in a narrower range of circumstances and the process for imposing penalties will be more transparent, and

- Tax Office advice – taxpayers are able to seek private rulings on a greater range of matters.

## **Key interactions with the tax system**

In administering the tax system, our goal is to make it as easy as possible for people to comply with their obligations. This means that at key points of contact with us, we offer taxpayers the relevant services and products to help them understand what they need to do, to help them get it right and which support them through the process. We also have mechanisms in place which protect the revenue for government by ensuring that taxpayers pay their fair share of tax.

The obligations individual taxpayers must meet generally occur around the following interactions.

### **Registering for a tax file number**

Most people obtain their tax file number as they begin to enter the workforce<sup>8</sup>. A tax file number is needed to identify the taxpayer in the tax system to us, to employers and to others who may need to withhold tax from the taxpayer, such as where they are contractors, or investors in listed companies and are receiving dividends. Where no tax file number is given, tax is withheld at the highest marginal tax rate.

Applying for a tax file number is a process which requires robust identification of the individual (using agreed Commonwealth evidence of identify documents such as birth certificates). We have a standard turn-around time of 28 days for applications for a tax file number.

More than 546,000 individuals entered the revenue system in 2004–05 by registering for a tax file number.

### **Keeping proper records**

Most individuals only need to focus on their tax obligations once a year, at TaxTime, as most people's employers have been withholding and regularly remitting to us the income tax these individuals owe. Individuals receive a payment summary from their employers at the end of the financial year, which they need to keep as part of their own personal records on income earned.

Individuals must also maintain records of other income earned (such as from dividends, capital gains, interest, rent, royalties and so on) and of expenses they had in earning their income (such as work-related expenses and capital losses).

There are many services and products available to individuals to help them understand what records they need to keep, in what format and how they will need to report them. For example, the personal tax record keeper, available at [www.ato.gov.au](http://www.ato.gov.au) is a free software product available to help taxpayers keep their tax records. Taxpayers can

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<sup>8</sup> Either through our schools program or our partnership with DIMA. Through the venture with DIMA a person can obtain a TFN when they arrive in Australia which provides an individual automatic registration process (online) building on their migration documents.

record information during the year and download this to e-tax to complete their tax return at the end of the year.

### **Lodging their tax returns on time**

We make a major effort to help those people who chose to complete their own tax returns accurately and lodge them on time. This effort is generally focused during TaxTime when we have services such as TaxHelp volunteers working in the community and products such as *TaxPack* and fact sheets on expenses for different occupations, widely available in the community. We also run a significant publicity campaign at this time to alert people to their obligations.

Around 74% of individuals use tax agents to prepare their income tax returns. Of the remainder who prepare their own returns, increasing numbers are lodging online.

Lodging is made more accurate by our online and electronic lodgment service (used by tax agents) doing automatic checks for omitted information or by doing some calculations.

We also help by pre-populating information electronically where we can. For example, we involved approximately 650 individuals in a trial last year that allowed them to have their medical expense information downloaded from the Health Insurance Commission into their income tax returns when they used e-tax to lodge.

When taxpayers lodge their tax return, we accept what they say at face value though we do a number of automatic checks before issuing a tax assessment notice, for example, in relation to high risk refunds.

### **Reporting correct information and claiming valid entitlements**

The taxpayer is in the best position to report how much income they earned (such as from salary, wages, dividends, capital gains, interest, royalties and so on) and to claim deductions (such as capital losses and work-related expenses).

We are responsible for calculating the amount of tax they owe, or the refund they are due. We then send them a notice of assessment based on the information they supply to us unless we know it to be incorrect – for example, all income has not been disclosed because third parties such as financial institutions tell us.

Where individuals use e-tax they can expect their tax assessment notice in 14 days or 42 days if lodging by paper. If lodging through a tax agent, they can expect an assessment notice within 14 days, and have the benefit of the tax agent's lodgment program.

After we have issued a notice of assessment we may further review a return to:

- look for errors that could not be checked for during processing because it would cause an unacceptable delay, and
- check identified areas of risk.

We run data-matching programs to verify information while minimising our demands on the individual for substantiation of their claims. Our data matching programs obtain information on investment and employment income, dividends and government benefits. We then match this with tax return information to identify discrepancies, follow up with letters to taxpayers to confirm any apparent omitted income, and make appropriate amendments.

Where there has been an avoidance of tax due to fraud or evasion, there is no time limit to the period in which we can review tax returns. In other cases, an amendment must be completed within four years after the day on which tax became due and payable under the assessment, unless the taxpayer is eligible for a shorter period of review, in which case a two-year limit applies. The four-year limit can be exceeded if the review has already begun, but only with the permission of the taxpayer or the Federal Court.

We may also amend a taxpayer's assessment outside of the four-year period where the taxpayer applies for an amendment and supplies all information necessary for the Commissioner to decide the application within the four-year period.

The two-year shorter period of review automatically applies to eligible taxpayers.

## **Paying tax obligations on time**

### **PAYG withholding**

The vast majority of taxpayers pay their tax regularly through the amounts withheld by their employers from their salary or wages. Approximately 20% of individuals, however, have a tax shortfall to make up, and most pay on time.

Seventy-eight per cent of individuals receive a refund at the end of the year (average amount is \$1,550). This amount may consist of overpaid PAYG withholding amounts and the work-related and other expenses individuals can claim. But refunds can also include amounts arising from the family tax benefit, private health insurance offset and medical expenses offset.

Most taxpayers prefer receiving a refund rather than finding themselves in debt to the Tax Office.<sup>9</sup> This reduces the administrative costs which would be needed to pursue and recover small debts. Taxpayers can of course apply for a variation of the amount their employer withholds from their pay (see chapter 6).

### **PAYG instalments**

Generally, if a taxpayer earns over \$2,000 of income that is not subject to withholding at source – typically investment income – they may have to pay tax in advance towards the next year's assessment. We issue them an *Instalment activity statement (IAS)*, requiring the payment. This amount is credited at the end of the year.

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<sup>9</sup> A community study undertaken for the Tax Office in 2000 found that the majority of taxpayers enjoyed receiving a refund, regarding it as a form of enforced saving. In most households, refunds were used to pay bills or to have a 'splurge' or a special treat. The report observed that 'Most participants therefore looked forward to tax time because they expected either a small or a large refund', and concluded that 'a personal tax system without refunds would be unpopular'.

We are responsible for calculating the amount of tax they owe, or the refund they are due. We then send them a notice of assessment based on the information they supply to us unless we know it to be incorrect – for example, all income has not been disclosed because that is what third parties such as financial institutions tell us.

### **What happens when individuals don't meet their obligations?**

As the majority of individuals try to do the right thing, our compliance strategies focus heavily on help and education, especially during the key contact times.

However, some people make mistakes and a small proportion intentionally ignore their obligations or try to dishonestly obtain a benefit.

#### **Not lodging on time**

The vast majority of taxpayers lodge their tax returns on time. If they fail to lodge, we send people a letter alerting them to the problem and giving them an opportunity to lodge before further action is taken. Last year, only 750,000 individuals lodged late, with more than 60,000 individuals lodging them only after we contacted them.

The law imposes penalties for late lodgment and failure to lodge if returns are not lodged by the due date. However, the due date varies depending on whether taxpayers use a tax agent, lodge electronically (e-tax) or a paper return. Non-lodgment may result in prosecution. We usually remit the penalty for returns generating a refund.

#### **Failing to report correct information and claim valid entitlements**

Our key focus areas include work-related expense claims, capital gains tax, rental income and expenses and significantly increasing our data matching capability.

Work-related expenses are the largest claim deduction category for individuals and remain a priority in our compliance activities. Last year around 6.8 million taxpayers claimed \$10.7 billion, an increase of around 9.1% on the previous year.

The amount of net capital gains tax included in the 2003–04 year increased by 53% to around \$9.5 billion. Similarly the number of individuals declaring capital gains tax in their return has increased from around 765,000 in the 2002–03 year to approximately 930,000 in the 2003–04 year.

Rental income was up by about 12% on the previous year, while rental deductions claimed were up by 19.5%. Last year around 1.4 million taxpayers declared total rental income of \$15.2 billion and claimed rental deductions of \$17.8 billion.

Our compliance strategy is complemented by our data matching program focused on interest, dividend and employment income. Last year data matching of third-party information against returns identified 373,983 potential omissions of income, resulting in revenue adjustments totalling \$178.6 million.



A breakthrough for the Tax Office is the ability to significantly increase our data matching capabilities in capital gains tax by improving the way we use real estate property data to identify property and vacant land sales that involved large capital gains.

Last year we identified over 71,000 property transactions involving over 68,000 taxpayers where a capital gain may have occurred. With access now available to data held by states and territories, we expect to significantly increase our identification of the number of property transactions where a capital gain may have occurred.

Tax agents lodge around 74% of income tax returns for individuals and remain a key intermediary to the self-assessment system. We take a risk assessment approach based on profiles of taxpayer and tax agent compliance behaviour. We look at behaviour patterns and reported information to detect risks and identify variations from norms, such as industry and occupation performance.

There are almost 11 million individual taxpayers and last year we amended around 372,000 of those returns, while individuals self-amended around 409,000 returns.

In dealing with this population we have determined that the best strategy is to contact taxpayers or their tax agents by letter or telephone when we detect a problem or an issue that requires clarification. Our approach comprises:

- sending out letters to provide education and advice on areas of concern, for example, to 100,000 taxpayers who entered the rental market last year to ensure they understand how to declare rental income and claim deductions correctly
- sending out letters where our data matching detects a potential understatement of income or where we require more information to check the validity of a claim, and
- phoning taxpayers to check on the accuracy of information in returns lodged.

Depending on the explanation provided, we may reach agreement on an amendment to the return or need to escalate the issue to an audit.

### **Failing to pay tax obligations on time**

Our overall revenue and compliance performance is underpinned by taxpayers paying liabilities that are established when they lodge statements and returns.

While many taxpayers pay their tax on time, we have to actively collect debt from some taxpayers. Our debt collection work is based on recognising payment obligations early, minimising ongoing debt holdings, and improving timeliness and efficiency. We take into account a taxpayer's compliance history, and the cost-effectiveness of our actions and opportunities to influence behaviour. Where taxpayers fail to respond to our approaches, we take firmer action, which can include legal proceedings or recovering a debt from a taxpayer's bank accounts or other income sources.

Where taxpayers have failed to pay their tax obligations on time, the law imposes a penalty and general interest charge and/or shortfall interest charge may be applied to the underpaid amount for the time it was owing.

## **Penalties and interest charges**

The application of penalties and interest charges was reviewed by Treasury in their *Report on Aspects of Income Tax Self Assessment* (ROSA). We have been implementing the ROSA recommendations to ensure that our administration is in line with government requirements and to ensure we continue to meet taxpayers' needs.

Where a penalty is imposed, we now explain why it has been imposed and how it has been calculated. This helps taxpayers to understand the behaviour that attracts a penalty.

We will provide information on how to seek remission and where appropriate reasons for rejecting remission requests to help taxpayers understand why a penalty or interest charge has not been remitted in full.

The interest charge on income tax amendments for 2004–05 onwards (where taxpayers are required to pay more tax) will now be four percentage points lower than the current general interest charge rate. This lower charge is called the shortfall interest charge and will apply from the date of the original assessment to the day before any shortfall is corrected. If this shortfall is not paid by the due date, the higher general interest charge will then apply to the outstanding amount.

The Commissioner has a broad discretion to remit the new shortfall interest charge, where he considers it fair and reasonable.

Taxpayers will be able to object to a decision not to remit the shortfall interest charge where the remaining shortfall interest exceeds a certain percentage of the tax shortfall.

Taxpayers will have access to rulings and practice statements relevant to our administration of penalties and interest charges including:

- a new practice statement providing clarity and guidance on tax shortfall penalties and materiality, and
- a new practice statement providing guidance on remission of the shortfall interest charge.

## **Taxpayers' rights of review**

The *Taxpayers' Charter* and supplementary brochures available on our website help the community understand:

- their rights as taxpayers under the law
- the service and other standards they can expect from us
- their important tax obligations, and
- what they can do if they're dissatisfied with our decisions, actions or service, or they want to make a complaint.

## **How individual taxpayers view their interaction with us**

As part of our listening to the community program, we regularly conduct research into the market segments to find out what taxpayers think of our approaches.

In our community perceptions survey in June 2005, 46% of individuals surveyed agreed or strongly agreed that the effort involved in completing their tax return is less now than in previous years (this is trending upwards from 36% in June 2002, 37% in June 2003 and 38% in June 2004).

When asked whether the Tax Office looks for new ways of doing things to help taxpayers, 51% of individuals agreed (up from 43%, 44% and 46% in 2002, 2003 and 2004).

Forty six per cent of individuals agreed that the Tax Office takes into account their circumstances when making decisions.

# CHAPTER 3 – SELF-ASSESSMENT FOR MICRO-BUSINESS

## Overview of the micro-business segment

There are around 2.4 million micro-businesses in Australia. Micro-businesses are those with annual turnover of less than \$2 million. They account for 96% of all businesses in the revenue system. They include around 300,000 small superannuation funds and 200,000 trusts. Eighty-one per cent of micro-businesses have a turnover of less than \$500,000. Over 60% are in property and business services, finance, construction services, primary production and the retail trade. Around 60% of micro-businesses operate as sole traders or partnerships and have a high level of interaction with the personal tax and entitlement system. About 28% have employees.

There is a high turnover of businesses in the micro-business segment but the overall net growth is relatively small. There are approximately 10% new businesses each year, that is, taxpayers who have never operated a business before.

Most micro-businesses try to meet their tax obligations, and generally succeed in doing so. However, they are often hampered by lack of time and resources, the pressure of running a business, their understanding of accounting and tax requirements, and meeting the requirements of various government agencies.

These businesses pay around 12% of net Tax Office collections, including:

- 14% of income tax from companies
- 71% of other income tax
- 25% of goods and services tax (GST)
- 3% of wine equalisation tax and luxury car tax
- 2% of fringe benefits tax, and
- less than 1% of excise.

They collect a further 7% of net Tax Office collections on behalf of their employees.

Ninety-five per cent of micro-businesses lodge their annual income tax return through a tax agent.

Recent surveys indicate that 72% of micro-businesses lodge their own activity statements and that 60% have not sought the assistance of their tax agent to do so.

Many micro-businesses have problems coping with tax changes or dealing correctly with more complex, less frequently encountered aspects of the revenue system, such as the sale of an asset, international dealings and capital gains tax. Some business operators who are new to business also struggle to maintain adequate accounts and to correctly report their income, claim their entitlements and accurately complete their activity statements. A minority of micro-businesses ignore some or all of their tax obligations.

We provide written and oral advice to help micro-businesses meet their tax obligations.

Many of our products are tiered, ranging from an overview through to complex explanatory rulings. The business operator can self-select the level of information required. Many of our products are also co-designed with micro-businesses and tailored for particular industry use.

We provide a range of help and support products to support micro-businesses including:

- a business tax telephone information line which operates from 8.00am to 6.00pm, Monday to Friday – there were 3.4 million calls to this line in 2004–05
- automated business self-help telephone services available 24 hours a day seven days a week, and
- [www.ato.gov.au](http://www.ato.gov.au) for most publications, rulings, self-help calculators, and decision support tool for the simplified tax system. We bundle our online services to meet specific industry needs including new businesses, home-based businesses and primary production. So far this year (to 30 March) the number of requests to the business section is 11.47 million.

Our written advice takes the form of public and private rulings as well as a wide range of other products and services including fact sheets, guidelines, practice statements, and specialist industry and topic publications.

We introduced the Business Portal in March 2004. It is a secure online service that allows businesses to lodge activity statements, check tax accounts, update business registration details and much more. Accessed from our website, it is a fast, convenient and secure way for business operators to comply with their tax obligations and can save businesses time. Businesses can use the Business Portal to:

- lodge an activity statement and receive instant confirmation of success
- revise activity statements online
- view details of previously lodged activity statements
- view activity statements online, and
- view business registration details.

There has been steady growth in the use of the Business Portal – at the end of March 2006 there were 121,703 registered users of the portal – though at this stage, the majority of users appear to be larger businesses.

We have been progressively improving the portal and in 2004–05 improvements included:

- introducing real time processing of activity statements for businesses via the Business Portal, and
- enabling portal users to lodge activity statements directly from a commercial accounting software package.

We are also looking at strategies to enable micro-businesses to lodge more forms online. In June 2005 we developed the *More time for business: a guide to our online services* mini CD-ROM to promote and encourage take-up of our online services for business. It contains links to all of our online services for business and instructions on how to use them. The CD has been sent to around 2.1 million businesses that lodge paper activity statements.

We continue to help businesses understand and meet their tax obligations, as well as supporting taxpayers in specific areas, such as the building industry and businesses

operating at home. New initiatives include the development of an electronic decision tool for employers in the building industry to determine if someone is an employee.

One of our priorities this year has been to begin the progressive roll-out of a client relationship management system. Small businesses dealing with us over the phone will notice that our staff can provide them with more personalised, faster and more comprehensive service. Contact staff now have a consolidated view of a taxpayer's information and taxpayer's contact history. It means progressively that staff will have easier access to all of a taxpayer's details and this will minimise the need for taxpayers to bring our staff up to speed on their situation. A further release is scheduled for later this month when taxpayers needing to be transferred to another tax officer during a phone call will have the details of the enquiry automatically transferred with the call.

Continuing the work started in 2005–06, the future will see further enhancements to support the client relationship management approach. Inbound correspondence will be imaged, tracked and made available electronically to all front-line staff. As well as providing a complete view of a taxpayer's contact history for contact staff, this will help ensure that taxpayer correspondence gets to the right tax officer in the first place.

Contact staff will also be able to advise taxpayers of the progress of enquiries and requests they have previously made as we progressively introduce an organisation-wide case management system which will enhance our ability to ensure consistent treatment and recording of the taxpayer's dealings with us.

Beyond 2006–07 will see real time processing of more forms lodged electronically. For example, users will be able to receive real time assessments for lodgments including income tax returns and fringe benefits tax returns, in addition to activity statements. This will mean that many taxpayers will get an immediate response when lodging these forms online, with refunds deposited directly into their bank accounts.

Online forms will be increasingly pre-populated with information held by us and other government and non-government organisations. Forms will also be tailored to the taxpayer's circumstances. For example, where a taxpayer does not have a GST obligation their activity statement will not include GST fields.

Taxpayers will be able to register, view and update their details online for most obligations and benefits, including elections they have made, such as variations to instalment rates.

We also provide advice to tax agents who support micro-businesses through a range of other channels, such as the tax agent relationship management program and the Tax Agent Portal, and support for new legislative measures.

## **Key interactions with the tax system**

The key interactions which micro-businesses have with the tax system broadly cover four areas – registering in the system, lodging, reporting correct information and making payments.

### **Registering in the system**

The most common tax registrations micro-businesses need to obtain are:

- a tax file number

- an Australian business number (ABN)
- goods and services tax, and
- pay as you go (PAYG) withholding.

If the business operates as a sole trader, the taxpayer uses their individual tax file number for both business and personal dealings with the Tax Office. If the taxpayer chooses to operate their business through a partnership, company or trust, they will need a separate tax file number. They can apply for a tax file number when they register for an ABN.

A business needs an ABN to:

- register for GST and other business tax registrations such as PAYG withholding
- deal with other businesses, for example, they must quote their ABN on any tax invoices they issue, and
- avoid having tax withheld from payments. Businesses will be required to withhold 48.5% of any payments they make to a micro-business unless it quotes an ABN.

Once a micro-business registers for an ABN, the business details from their application are added to the Australian Business Register, which we administer. The register is the central collection, storage and verification system for basic identity information about all business entities with an ABN. Businesses can log onto the register to update their details, or to check the bona fides of an ABN quoted to them to ensure they comply with no ABN withholding rules.

A business needs to register for PAYG withholding if it:

- employs people (including the business owner if the business is operated through a company or trust)
- makes payments to the business owner as a director, or payments to contractors under a voluntary agreement, or
- withholds 48.5% from payments to suppliers because they have not quoted their ABN or shown they do not have to quote it.

Other business tax registrations micro-businesses may need could include:

- fringe benefits tax – if they provide fringe benefits to employees
- wine equalisation tax – if they are a wine manufacturer, wholesaler or importer
- luxury car tax – if they are a retailer, wholesaler or manufacturer of luxury cars, and
- fuel tax credits – if they use eligible fuel in their business.

In 2004–05 improvements under the making it easier to comply initiative included:

- enabling businesses to register, view and update details for GST and withholding tax on the Business Portal, and
- the redesign of a number of business registration forms, in consultation with users.

### **Keeping proper records**

Keeping appropriate and adequate records is the foundation of good tax compliance for micro-businesses.

Under tax law, taxpayers must keep records that:

- specify and explain all transactions. This includes any documents that are relevant for the purpose of working out their tax liabilities. Taxpayers should make records of transactions as soon as they occur or as soon as possible afterwards, and

- relate to all taxes for which taxpayers are liable. This may include income tax, goods and services tax, pay as you go obligations, capital gains tax, and fringe benefits tax.

Taxation ruling TR96/7 *Income tax: record keeping – section 262A – general principles* provides details about types of records taxpayers need to keep in relation to income tax and other taxes relating to any election, choice, determination or calculation made under a tax law, including the basis on which any were made.

These records must generally be kept for a minimum of five years.

Over the years, we have put a lot of effort into supporting micro-businesses with their record keeping. We:

- produce fact sheets on record keeping tailored to specific industries such as retail, wholesale, services and primary production
- provide products and services to help small business operators meet their record-keeping obligations, including the *Record keeping for small business* booklet, the free *e-Record* record-keeping software, our registered software facility and free record-keeping workshops
- work with industry bodies to develop best practices, codes of conduct and incentives to encourage self-regulation of record keeping and other requirements, and
- we recently developed a record keeping evaluation tool available on our website which allows taxpayers to self-assess whether they are meeting their record-keeping obligations

The introduction of the record-keeping evaluation tool for our field officers has supported our focus on identifying micro-businesses that do not keep proper records and ensuring that, with our assistance, they take steps to achieve an adequate standard of record keeping.

During 2004–05 we used the tool to review 11,800 businesses and found that 30% of them had inadequate records. When revisiting 1,447 of these businesses later in the year, we found that the majority are now keeping good records.

We are maintaining our revisit program over 2005–06 and will impose penalties where businesses fail to improve their record keeping based on our previous advice to them. Penalties will apply on a graduated approach, based on the level of effort made to improve record keeping, up to a maximum penalty of \$2,200.

### **Lodging activity statements and tax returns on time**

The type of income tax return a micro-business needs to lodge depends on their entity type. If they have employees they may also have to lodge an FBT return.

The due dates for income tax returns depend on the legal structure of the micro-business and on whether the business is a self-preparer or uses a tax agent. The dates for those using an agent depend on the agent's lodgment program which is settled by us with the assistance of tax agent representatives.

The majority of micro-businesses lodge their annual income tax return on time.

The turnover of the micro-business generally determines the regularity of business activity statement reporting. It can be either monthly, quarterly or annually. Again the majority lodge on time.



We run quarterly radio and press advertising to increase awareness of due dates for *Business activity statements* to remind small businesses of their obligations.

In 2004–05 we introduced a service for new micro-businesses, with products tailored specifically for them, and we are continuing the support this year. Through our early contact and assistance program, we contact people who plan to prepare their own activity statements soon after they register for an Australian business number and goods and services tax to offer the following services:

- tax checklists and basic tax information for new businesses
- access to free tax basics seminars
- free record-keeping software to make completing activity statements easier, and
- access to trained staff in our business call centres.

The information supplied to us by a micro-business taxpayer forms the basis of their tax assessment for the year, unless we know it to be incorrect. This financial year we are examining high-risk unusual claims, large claims and multiple claims over time. In addition to verifying high-risk claims before issuing refunds, we are also reviewing lower risk cases after refunds have been issued. We also undertake pre-assessment checks for some non-commercial loss cases.

### **Reporting correct income and claiming valid entitlements**

The self-assessment system is based on taxpayers providing complete and accurate information. This includes providing correct information in returns and activity statements.

### **Paying tax obligations on time**

Taxpayers have an obligation to ensure the taxes and other amounts they are liable for are paid by the due date. Interest is normally payable on late payments, as discussed in chapter 5.

Dealing effectively with debt is an important part of maintaining and growing the confidence of the community in the tax system.

In collecting tax debts we need to make judgments about the circumstances people face. We do not want to send a viable business into liquidation, but out of fairness to other businesses and taxpayers who regularly meet their tax responsibilities, we are taking firmer action against those not willing to pay their taxes.<sup>10</sup>

Micro-businesses often fail to provide for their tax liabilities and cannot pay them as they fall due.

To address this, in June 2004 the Commissioner announced that the Tax Office would offer general interest charge concessions and the option of extended payment periods for about half a million small businesses with outstanding tax debts of less than \$25,000. This initiative was developed with input from both the accounting profession and small business representatives.

This provided a one-off opportunity for businesses to clear up their outstanding debt on favourable terms.

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<sup>10</sup> In 2004 we commissioned KPMG Financial, Accounting and Business Services to undertake an independent review of a random sample of 97 recovery cases. The review concluded that the Tax Office had, to a great extent, provided the taxpayer with ample opportunity and time to settle the outstanding debts.

Nearly 300,000 letters were issued, representing debt of about \$1.5 billion (as at 31 December 2005).

Between 1 July 2004 and 31 December 2005, nearly 100,000 payment arrangements were entered into, representing \$846 million in outstanding debt. This is in addition to more than 100,000 taxpayers who have paid in full, with payments of \$620 million received to 31 December.

To reach outstanding debtors who had not contacted us with a view to entering into a payment arrangement, we have needed to take a more proactive approach.

For example, between 31 January and 15 March 2006, we undertook a pilot contact program aimed at small business. The pilot used accelerated calling patterns extending into evenings through existing telephony systems. The project operated until 8.30pm three nights a week.

Of course, no-one likes getting business-related calls at home in the evening and we followed our strict protocols to protect people's privacy. We offered the opportunity to either nominate a time for us to call them back, or to call us back at a time that was convenient for them. However, these were taxpayers that we tried to contact through all the usual channels – including letters and calls to their business.

At completion of the pilot, 8,700 calls had been made resulting in 2,900 taxpayer contacts. To date, we have negotiated promises to pay in full or by instalments to the value of \$44.5 million.

Ten complaints were received; three of these related to the time of the call.

Evaluation of the trial, which will take around four weeks to complete, has now begun.

This approach can bring benefits for both the Tax Office and the business.

By encouraging small businesses to work with us, we may reduce the number of cases where we need to take firmer, and more difficult and expensive, action.

From the business's point of view, early intervention can keep them from getting into higher and untenable levels of debt.

Another innovative approach we are developing is to work with commercial debt collection agencies to collect outstanding tax. In looking at this, we recognise that it is extremely important that we maintain our high standards of privacy and security, so we are currently developing a pilot with an experienced agency which provides a similar service to Centrelink. We expect a three-month trial to be finished by the end of June.

Most importantly, however, this approach to debt helps create a level playing field for businesses. It means that some cannot gain a competitive advantage by not paying their taxes or continually deferring payment.

We are also helping businesses prepare for tax debts through initiatives such as voluntary payment cards and the early contact and assistance program for new businesses, and building on the small business debt assistance initiative to collect outstanding debt.

## **What happens when micro-businesses don't meet their obligations?**

If taxpayers don't meet their obligations under the law they may be subject to penalties and interest, as outlined below. Self-assessment necessarily requires us to carry out post-assessment reviews and audits to verify compliance.

### **Failing to register correctly or at all**

We are continuing to monitor registrations. Our strategies include:

- undertaking unannounced face-to-face visits to confirm registration details of high-risk businesses
- examining tax invoices to identify entities that may be trading but are not correctly registered, and contacting them to arrange correct registration
- matching our information with that held by other agencies, companies and industry bodies to identify enterprises that are not registered, and contacting them to arrange registration
- conducting enterprise tests to ensure registered entities are actually carrying on a business, and
- identifying businesses that are no longer trading, and contacting them to cancel registration where it is no longer required.

### **Failing to meet lodgment obligations**

We are pursuing micro-businesses with outstanding lodgments, based on the risk they pose. This particularly involves businesses that have persistently and deliberately failed to meet their lodgment obligations.

We are also enforcing lodgment obligations where outstanding lodgments may be related to other non-complying or high-risk behaviour, such as cash transactions.

In determining risk, we consider such things as the size of a business, the expected balance of the assessment, the business's lodgment history, impact on community confidence in the revenue system, information received from the community and industry characteristics, including factors such as the opportunity for cash payments (as in the building and construction industry).

This year we are:

- using external information from financial institutions and other bodies to identify and pursue lodgment obligations of businesses that are operating partly or completely outside the revenue system, including those in cash economy industries
- monitoring businesses with significant turnover or high levels of tax payable
- identifying payers who fail to lodge their pay as you go (PAYG) withholding annual reports
- telephoning or making personal visits to selected new businesses that fail to meet their lodgment obligations to ensure they understand and comply with their obligations, and
- using differentiated, risk-based responses to businesses that do not lodge returns or do not lodge them on time, including letter or telephone contact, personal visits, penalties for lodging late or failing to lodge, or default assessments in the most serious cases.

In 2004–05 we issued 1.2 million demand notices to micro-businesses that had not lodged activity statements and 573,900 demands and final notices were issued to micro-businesses that had not lodged income tax returns.

### **Failing to keep proper records**

We are continuing to check the record keeping of micro-businesses as part of our cash economy and general compliance activities.

Where we revisit a taxpayer business and find their record keeping remains unsatisfactory, we follow a graduated approach to imposing penalties, with the penalty reflecting the efforts of the business to improve the standard of their records, as follows.

<b>Record keeping behaviour</b>	<b>Remission level</b>	<b>Penalty amount</b>
Genuine attempt made to improve record keeping practices	100% remission	\$0
Some effort made but tax liability still not readily ascertainable	75%	\$550
Very little effort made to improve record keeping practices	50%	\$1,100
No effort made to improve record keeping practices	No remission	\$2,200

In cases of deliberate non-compliance – for example, where a business has very few or no records – we may apply a penalty on our initial visit.

Serious cases of non-compliance can be referred to the Director of Public Prosecution which may result in a fine of up to \$10,000.

If taxpayers are penalised for failing to meet their record keeping obligations, we will send them a written notice of the penalty. The notice will specify when the penalty is due, which must be at least 14 days after we have given the taxpayer the notice.

We may remit the penalty (partially or fully) if taxpayers are trying to do the right thing. Where the amount of penalty is more than \$220, taxpayers may seek a formal review by objecting to our decision not to remit more of the penalty.

### **Failing to report correct information and claim valid entitlements**

We have an ongoing program that scrutinises key industries where we are detecting and addressing businesses operating either partially or wholly outside the system.

This includes:

- motor vehicle retailing and wholesaling
- tourism and hospitality
- property, building and construction, and
- licensed hotels and registered clubs.

We verify compliance by reviewing high-risk cases and businesses with more complex arrangements. Our interactions with businesses range from checking claims by telephone and written requests through to intensive audits. Identifying high-risk cases involves matching large volumes of data to identify omitted transactions and businesses operating outside industry or economic norms.

We use the same techniques to identify businesses that represent little or no risk to the revenue system so that we avoid intruding on their affairs unnecessarily. We continue to work with federal, state, territory and local government agencies to identify sources of information so we can better target our compliance activities and minimise our demands for information where the risk is low.

Last year we increased our telephone verification activity – because it is faster for both us and businesses – and focused our field contact more on higher risk, more complex cases. We are continuing this approach this year, with more telephone contacts about registration integrity. This is a result of redirecting more field activity away from non-lodgment and registration integrity work to audits of activity statements, returns and compliance with other obligations.

Other areas of focus this year include:

- monitoring micro-businesses that are currently registered to ensure they continue to comply
- maintaining our record keeping review and revisit program, with a focus on record keeping in cash economy industries
- checking unusual claims, especially those resulting in refunds
- targeting high-risk cash economy taxpayers wherever they are, as well as working with high-risk industries
- matching information about asset sales with income reported in tax returns to ensure businesses pay the correct capital gains tax, and
- providing timely, high-quality advice, with special emphasis on providing certainty to businesses when they are making significant commercial decisions.

In 2004–05 our activities included:

- undertaking 7,982 income tax reviews and 399 income tax audits, resulting in additional revenue of \$10.4 million and \$17.2 million respectively
- reviewing 34,361 income tax refunds, resulting in 13.9% being adjusted and an additional \$121.8 million in revenue, and
- undertaking 18 highly targeted reviews of micro-business income tax refunds, resulting in revenue adjustments of \$656,000.

### **Failing to pay tax obligations on time**

When a taxpayer cannot pay their tax debt on time, they may contact our Client Account Management helpline and explain their reasons. In some circumstances taxpayers will need to provide written details of their financial position, including a statement of their assets and liabilities and details of their income and expenditure.

We will also want to know what steps the taxpayers have taken to obtain funds to pay their tax debt, as well as what they have done to make sure they meet future tax debts on time. Taxpayers may be given extra time to pay, depending on their particular circumstances.

If we allow taxpayers to pay their tax debt late, they are required by law to pay the general interest charge (GIC). The general interest charge is tax deductible in the income year in which it is incurred. However, the law also provides for remission of all or part of the general interest charge in appropriate circumstances.

If the payment will cause serious hardship the taxpayer can apply to us for a release from payment of their tax debt. Serious hardship is when taxpayers are unable to provide food, accommodation, clothing, medical treatment, education, or other

necessities for themselves or their family, or other people for whom they are responsible.

### **Taxpayers' rights of review**

The *Taxpayers Charter* booklet number 8 provides detailed information on what taxpayers can do if they believe their legal rights or our service and other standards have not been met. These include:

- seeking an internal review of a decision
- making a complaint
- seeking review by the Commonwealth Ombudsman, and
- seeking a review by the courts.

### **How micro-businesses view their interaction with us**

We regularly conduct research to find out what taxpayers think about our administration and to inform our remedial strategies.

In the call centre satisfaction survey of September 2005 small business clients were least satisfied – one in five (18%) said they had been transferred three to four times. In addition small business clients wanted to deal with someone who has the knowledge and ability to resolve a query on the spot.

Results of the November 2005 business perceptions survey found that 77% of businesses thought that we were doing a good job whilst 82% of businesses were satisfied with the level of service overall. Eighty-three per cent feel staff were professional and 89% agreed we treat them in a fair and impartial way. Overall 32% described meeting their business tax obligations as 'hard'.

# CHAPTER 4 – TAX AGENTS

## **Tax agents' role in the system**

We continue to recognise the critical role and importance of tax agents in the efficient operation of the revenue system. Tax agents make a crucial contribution to the operation of the tax system by:

- influencing compliance behaviour
- acting as intermediaries in their client's interaction with the Tax Office
- increasing efficiency through high usage of electronic communication and online channels, and
- providing information, advice, education and representational services to their clients.

There are currently 26,169 registered tax agents with more than 21,654 agents interacting with the Tax Office. Tax agents lodge approximately 74% of the 10 million individual returns, and over 97% of the two million business-related income tax returns.

The proportion of taxpayers using tax agents has now marginally trended down after peaking in the 1999 income year. Seventy-one per cent of individuals used tax agents for the 1993–94 year increasing to 77% for the 1998–99 year. An important factor in this later trend is the improved self-help products offered by the Tax Office together with electronic take-up in the community. Electronic lodgments through e-tax jumped 27% in the last year to nearly 1.4 million returns, substantially involving a shift from *TaxPack* users but also a small shift from tax agent users.

Research conducted for us has found that many taxpayers want to rely on the professional expertise of tax agents when they perceive their affairs as complex, but there are other reasons – including access to the tax agent lodgment program, faster access to refunds and a trend to outsourcing specialist services.

To support tax agents, we have in place extensive consultative processes including forums and advisory groups. A dedicated relationship manager program includes field visits and case management services. The tax practitioner research program carried out in partnership with the tax professional bodies continues to provide valuable data and input from a broad representative group of tax agents.

We are continuing to work closely with the tax profession to design and prioritise improvements to administrative arrangements and are committed to co-designing our products and services with tax agents.

Over the past few years we have made considerable improvements to assist tax agents in their interactions with the Tax Office, most notably through the Tax Agent Portal, premium phone services and improvement to our correspondence. Research and consultations show increasing tax agent satisfaction with these products.

## **Tax agent regulation**

Under the existing system, taxpayers are liable for any penalty where the tax agent does not take reasonable care in preparing the tax return but they do have rights to

sue the tax agent under s251M of the *Income Tax Assessment Act 1936*. Also under the existing system there is no regulation for bookkeepers.<sup>11</sup>

Tax agents are regulated by Tax Agent Boards which are independent statutory bodies constituted by legislation. There is a board in each state and each board acts autonomously in the execution of its duties. Each board consists of three members who are appointed by the Minister for Revenue and Assistant Treasurer. One member is an officer of the Tax Office and the other two members traditionally come from the legal and accounting professions. One of the non-Tax Office members is appointed as chairperson of the board.

The role of the board is to administer the tax agents' registration requirements contained in the legislation. The board is responsible for determining the suitability of applicants to be registered as tax agents, dealing with complaints about tax agents and ensuring that proper standards are maintained across the tax agent profession.

The regulation of tax agents is aimed at protecting the public by ensuring that persons who charge a fee for providing tax-related services have appropriate knowledge of the Australian income tax law, relevant accounting principles, and are otherwise fit and proper persons to be registered as tax agents.

Although there is a tax officer on the Board and the Tax Office is entitled to place submissions before it, the deliberations of the board are completely independent and the Commissioner of Taxation has no control over the proceedings of the board.

There are stringent rules regarding registration as a tax agent, requiring a mix of academic qualifications and actual hands-on experience in the workplace. A higher academic qualification results in a shorter work experience requirement however, all criteria include a course of study in Australian income tax law acceptable to the board.

An application fee applies for all new and continuing registrations. Registration lasts for three years whereupon agents need to re-register with a requirement to show the board they have maintained the same level of relevant employment experience as needed to obtain the original registration.

Most tax agents are members of one or more of the professional associations. The associations have a role in bringing about significant improvements to the tax system by:

- providing expertise and information about the tax system, and playing a constructive role in the care and management of the tax system
- shaping and leading debate on issues affecting the profession and the wider community, through advocacy and lobbying
- participating in consultation and co-design and providing submissions on technical and administrative issues, and
- providing a vehicle for two-way communication with the Tax Office.

### **The tax agent relationships**

Recognising the critical role played by tax agents we have developed collaboratively with their tax professional bodies a strategic framework for the Tax Office relationship with tax agents. This framework clarifies the expectations of our relationship and will assist us in building a relationship that is:

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<sup>11</sup> We have established a Bookkeeper Industry Working Group which examines issues such as industry standards, accreditation, training and qualifications.



- open, constructive, transparent and supportive
- courteous and respectful, and
- recognises our obligations under the law.

The strategic framework aims to address agents' desire to develop a more personalised relationship with the Tax Office. It is supported by the professional associations and is seen as a key to strengthening our relationships.

The 'State of the industry' research we conducted jointly with the tax agents' professional associations showed that agents are now significantly more optimistic about the profession's future than they were in 2002, with the proportion satisfied with the Tax Office service almost doubling from 2003 to 2005.

We are continuing to use a balanced scorecard to measure how well we are managing our relationship with tax agents. The scorecard was developed through consultation, including workshops with agents and other key stakeholders.

The scorecard identifies the core elements and factors critical to the success of our relationship with agents, including the different interests we need to balance.

### **What we have learnt from the scorecard results**

Key indicators that reflect our success in managing the relationship are as follows.

- Our comprehensive research program continued to contribute to a well-developed view of the agent's world.
- Research and intelligence findings indicate increased satisfaction by tax agents with Tax Office people, products and services and a continuing strong uptake of the Tax Agent Portal.
- There has been improvement in the quality of tailored advice, products and services, as evaluated through technical quality reviews, issues resolution processes and surveys.
- We continue to recognise the critical role and importance of agents in the efficient operation of the revenue system. As a matter of course, we now engage agents through advisory groups, forums and consultations when developing products and services.
- Agents' level of satisfaction with our professionalism improved significantly over the year. The relationship manager program continues to be well received by agents and an ongoing evaluation of the program's resolution process indicates high levels of satisfaction.

### **Consultation with tax agents**

A focus on involving tax agents, other practitioners and taxpayers in the design of products and services, in the improvement of administrative systems and in the shaping of strategic activities has greatly improved the relationship between tax agents, taxpayers and the Tax Office.

Our collaborative approach includes:

- focus groups to generate initial ideas and concepts for possible product or service improvements
- user-centred design where tax agents provide input into the design of products and services which they or their clients will use, and

- forums which give tax agents the opportunity to comment and give feedback on various Tax Office projects or programs.

These forums provide an opportunity for a candid exchange of views and for all parties to gain a mutual understanding of their respective situations. This understanding provides a sound basis to identify, discuss and co-design approaches to resolve significant tax administrative issues and commission work in relation to initiatives to support tax agents.

We work closely with the tax practitioner industry to produce products and services tailored to the role that tax agents' play. There are currently more than 50 forums, advisory groups, expert panels and industry partnerships that have tax agent or professional association representation.

The peak consultative forum is the National Tax Liaison Group, which has been operating for 20 years and has representatives from tax, legal and accounting professional associations, Treasury and the Tax Office.

The ATO Tax Practitioner Forum reports to the National Tax Liaison Group and deals with the day-to-day administrative and operational issues affecting tax practitioners. Membership includes tax agents and representatives from the major tax and accounting professional associations. The forum meets quarterly and usually holds one meeting in a regional location.

The forum sponsors working parties which concentrate on specific areas of administration, for example, accounting, lodgment and tax reform.

There are also state-based regional tax practitioner forums across Australia in Adelaide, Brisbane, Canberra, Hobart, Melbourne, Perth, Sydney and Townsville.

### **Tax agent integrity and compliance**

We recognise that tax agents have a commercial relationship with their clients; however we expect them to act in a professional manner, competently having regard to the law and to comply with their personal tax obligations.

In terms of their role as agents for their clients we risk assess tax agent client bases to identify situations where there is a high potential for making common mistakes or inaccurate claims that are outside occupational or industry norms.

We also have an on-going focus on tax agents' compliance with their personal tax obligations.

In addition, where there is evidence that an agent has breached the requirements for registration, we will refer the matter to the Tax Agents' Board. In 2004–05 the Tax Agent Integrity Unit reviewed the practices of 254 registered tax agents, with 138 being identified as having serious issues warranting referral to the Tax Agents' Boards (131) or for fraud investigation or prosecution (seven). Fifty-eight of the referrals to Tax Agents' Boards resulted in formal action, including seven agents being suspended, eight receiving a formal warning, 14 deregistered and 19 refused re-registration. A further 10 agents provided a written undertaking that they had modified their work practices.

During 2004–05, prosecutions of tax agents resulted in 197 fines, 19 good behaviour bonds and six custodial sentences, ranging from 30 months to nine years.

Additionally, 161 unregistered tax agent cases were reviewed, with 21 people referred for prosecution. Three of the cases were successfully prosecuted, with other prosecutions still pending. Fifteen people involved in these cases provided an undertaking that they will comply with the law.

## **Making it easier for tax agents**

To make it as easy as possible for tax agents we have developed a range of products and services including the following.

### **Lodgment program**

We recognise the significant role tax agents play in helping their clients meet lodgment obligations. For this reason, the tax agent lodgment program allows returns, forms and statements to be progressively lodged by tax agents. It takes into consideration agent workloads, revenue obligations and government and community expectations.

We also provide information about lodgment obligations, including the various forms and returns and the required lodgment dates, in the annual lodgment program calendar and in the 'Key dates for tax agents', *TAXAGENT* and other newsletters. This information is also communicated through eLink and is available on our website and through other electronic products such as the portal and electronic lodgment service.

### **The Tax Office website – [www.ato.gov.au](http://www.ato.gov.au)**

Our website is segmented according to audience. The 'Tax Professional's' segment gives tax agents and other intermediaries direct access to facilities and information that enable them to interact effectively with us on behalf of their clients. This includes information on technical topics, administrative processes, forms, questions and answers, and minutes from consultative forums. Tax Office broadcasts, eLinks, *TAXAGENT* newsletters and seminar guides are also published on our website.

Electronic tools are available to help tax agents determine whether their clients qualify for offsets, calculate the claimable amount, and complete tax returns.

A recent addition to our website is a single point of entry for all new legislative information. This includes links to Bills and explanatory memorandums, media releases and the Treasury and Australian Parliament House websites. This enables tax agents and other practitioners to track the progress of legislation from announcements through to Royal Assent, as well as any retrospective administrative treatment.

### **Electronic lodgment service**

Electronic lodgment service (ELS) allows participating tax agents to lodge their clients' tax returns and many other tax forms with us electronically. Lodging via ELS has a number of advantages, including:

- immediate acknowledgment of receipt of returns
- 24 hour/365 days a year access
- ability to lodge documents in bulk via a single transaction
- faster turnaround – most assessments are processed within 14 days
- electronic means to nominate themselves as a client's representative and update client details, and
- access to a range of electronic reports from our business systems.

Approximately 98% of registered tax agents now use ELS to lodge over 50 different return and form types and request a variety of client reports. We receive more than 19,000 ELS transmissions from agents each week, and an average of 3,500 changes of address/detail transactions daily. Approximately 16.5 million transactions are received each year, including tax returns, activity statements and a range of forms and schedules with 95% of original individual assessments lodged via ELS being processed within 14 days.

ELS software is produced commercially by software providers, who are required to comply with Tax Office specifications. We liaise with software developers through the Software Developers Consultative Group which provides the Tax Office and the software industry with a consultative forum to facilitate the development of compliant software.

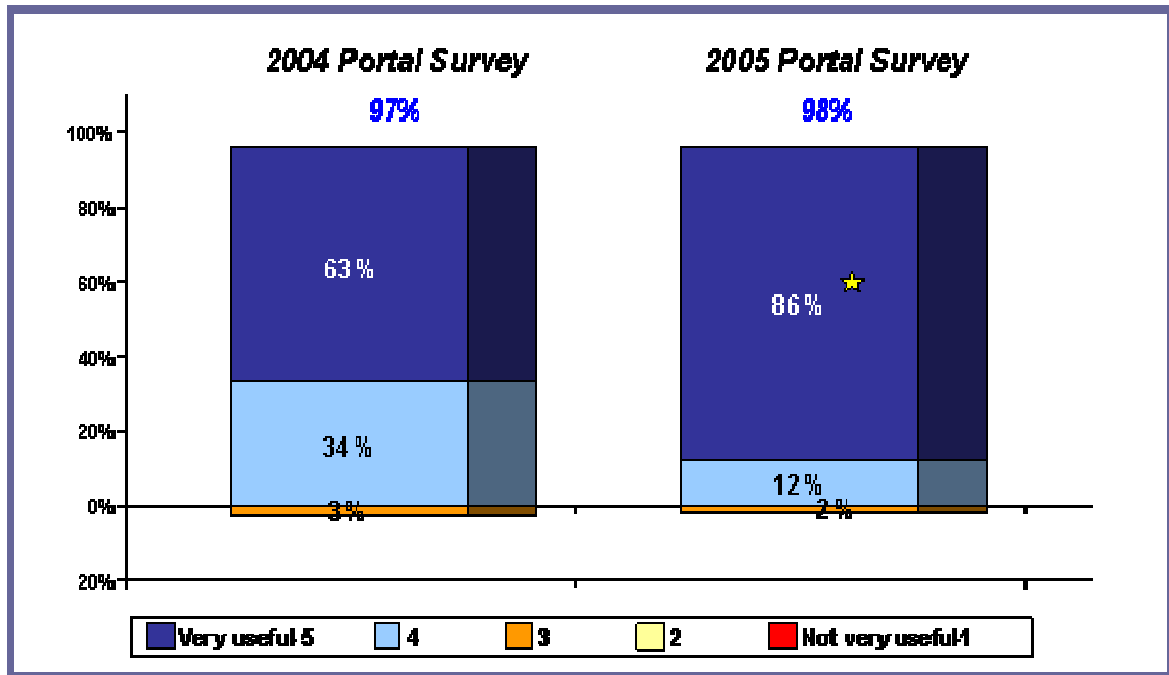
### **Tax Agent Portal**

The Tax Agent Portal is a secure website giving tax agents access to a range of information and services online. Since its launch in October 2002 it has been a tremendous success, with tax agents using it on a regular basis. In the last week of February this year there were 246,000 logins to the portal that supported 2.7 million transactions.

The site was developed and tested via a co-design process with tax professionals and was recognised with the 2003 Certified Practising Accountants Australia (CPA) Public Sector (QLD) award for excellence in innovation. It allows agents to:

- have convenient access to client information
- download reports
- submit online forms, and
- easily communicate with us.

Feedback from tax agents indicates that the Tax Agent Portal meets most of their requirements, with a recent *Tax Agent Portal evaluation* survey indicating that 98% of agents finding the portal useful or very useful. In this survey, 86% of tax agents gave the portal a score of '5 out of 5' as being very useful to their practice which is a significant increase on the results for the same survey in 2004 – refer to the figure below for comparisons between results for 2004 and 2005 portal surveys.



★ Denotes a statistically significant difference (at a 95% level) to the previous wave's result

Given this high level of use, we continue to improve the portal service by expanding its range of features and level of functionality, in response to world best practice, emerging industry needs and ongoing feedback from tax professionals. We have established an Electronic Advisory Group to assist in the identification and consideration of enhancements for the portal and other areas of technology.

Over the past 18 months improvements to the portal include the ability to:

- lodge and amend activity statements in real time
- manage client lists
- view and update more registration and obligation details, and
- lodge provision of written advice requests online, including the ability to attach documents.

In July this year the updated portal will provide tax agents with an enhanced secure message facility that will support attachments to messages sent to us. Agents will be able to view the status of message requests and paper correspondence for their clients.

Agents will also be able to access information on their clients such as Centrelink payments, child care rebate details, and family tax benefit information, without having to bother their clients.

We are also exploring the possibility of providing other information through the portal in the future such as bank interest and share dividends.

Essentially, tax agents will have greater access to our systems and information. They will be able to update more client information and lodge more forms and returns online – with fewer interactions with us and less need to contact their clients.

One of the impacts of providing more electronic information and online transactions is the increase in exposure to the security threats that exist in an electronic environment. We are working with tax agents to introduce digital certificates as the approved means of accessing the portal to mitigate the security risks.

### **Compliance program**

Each year we publish the *Compliance program* in which we identify the risks to the revenue system and the steps we are taking to address them. A copy is sent to all registered tax agents and is also available on our website.

### **Compliance toolkit**

The 'Compliance toolkit' is an electronic guide that complements the *Compliance program* and enables tax agents to assess the impacts of our compliance activities on their clients. The toolkit contains detailed information about compliance activities outlined in each year's program, including outcomes such as industry trends, compliance results and common errors. It also includes information to assist tax agents and clients in understanding how the various audits and reviews are conducted.

The 'Compliance toolkit' has been recognised as a key communication product for tax agents outlining planned compliance activities on a profession, industry or product basis. This approach to leverage has the probability of covering the widest possible number of tax practitioners and their clients on specific compliance activities we are focusing on.

### **Induction package**

The induction package introduces newly registered tax agents to the information they need to interact with us effectively and to conduct their practices efficiently. It also helps existing tax practitioners as it provides an overview of their role within the tax system and access to the procedural and administrative information they require to act on behalf of their clients.

### **Broadcast system**

We have developed a broadcast system to enable us to send urgent messages to tax agents as quickly as possible. Broadcasts are delivered by email, fax or post depending on the capability of each practitioner. Most broadcasts are published on our website after issue and a link to recent broadcasts is included through the eLink facility which is a regular email bulletin containing the most recent updates to the website.

### **Speakers and seminars**

Satellite seminars play a key role in communicating vital information to tax agents and other intermediaries across Australia. Using this technology allows accessible and consistent messages to be delivered to all tax agents. Seminars are held in locations around Australia including regional and remote areas. Approximately 17,000 tax agents attended the June seminar.

During 2004–05, 357 education sessions were delivered to tax practitioners by our speakers.

We have also begun partnering with the professional associations to deliver educational seminars to agents.

### **Telephone**

Telephone is another key channel of interaction with tax agents and taxpayers. We provide registered tax agents with a premium telephone service through dedicated agent contact numbers, with fast key codes to obtain quick and direct access. As part of our commitment to providing a premium service to help agents manage their

workloads, we aim to answer 90% of enquiries within two minutes, with an average waiting time of less than 30 seconds.

This phone service is supported by a published phone card and proof of identity procedures, both of which are sent to all registered tax agents, and are also available on our website.

### **Proof of identity procedures**

Tax agents and taxpayers must comply with proof of identity procedures whenever they contact us to access, or update, information held on their clients' accounts. These procedures are followed in order to maintain the security of taxpayers' information as required by legislation. New systems mean tax agents need to do this only once.

### **Legal database**

The 'Legal database', available on our website, is a collection of legal and policy information which provides access to much of the material we use when making decisions. The database includes:

- legislation and supporting material
- public rulings, legislative determinations and bulletins
- ATO interpretation precedents
- practice statements
- taxpayer alerts
- tax related case law
- Tax Office policy papers
- Tax Office superannuation circulars
- freedom of information index, and
- schedule of sources of precedential ATO view.

# CHAPTER 5 – PENALTIES AND INTEREST CHARGES

Taxation legislation imposes penalties and or interest charges for taxpayers who fail to fulfil their obligations.

Our approach to the administration of these laws is to gain an understanding of how and why the taxpayer did not meet the obligation. This enables the selection of the appropriate compliance strategy. Strategies range from education and assistance for taxpayers who are making a reasonable attempt to fulfil their obligations, the imposition of penalties and charges when education and assistance has not been effective or the taxpayer is not making a reasonable attempt to comply, through to prosecution for the most severe circumstances.

## Penalties

### Penalties relating to statements

If a taxpayer lodges a return (for example an income tax return or an activity statement), or requests an amendment to the assessment of a previously lodged return, this action is making a statement to the Commissioner of Taxation. If this statement results in an assessment of a tax-related liability that is less than the correct amount or a credit that is greater than the actual entitlement the taxpayer is liable to a tax shortfall penalty.

The penalty is a percentage of the tax shortfall determined by the behaviour that gave rise to the tax shortfall. The different behaviours and the penalty percentages are set out below.

**Reasonable care** – if the taxpayer has taken reasonable care in making the statement there is no penalty. Reasonable care for a taxpayer is determined by the individual circumstances of that taxpayer taking into account age, health, education, culture and other individual factors. It is not intended to be difficult for the taxpayer to exercise reasonable care.

**Failure to take reasonable care** – if the taxpayer has failed to take reasonable care the penalty is 25% of the tax shortfall. Generally a taxpayer has failed to take reasonable care if they have not done what a reasonable person in similar circumstance would do.

**Reckless** – if the taxpayer has acted recklessly the penalty is 50% of the tax shortfall. A taxpayer is reckless if they are aware, or a reasonable person in the circumstances of the taxpayer would be aware, a risk of treating a tax matter exists but has displayed an indifference to the consequences of the risk by not taking any action to minimise the risk or the consequences.

**Intentional disregard** – if the taxpayer has intentionally disregarded the law the penalty is 75% of the tax shortfall. A taxpayer has displayed intentional disregard if, when they are fully aware of their tax obligations, they disregard those obligations with the intention of bringing about certain results (underpayment of tax).

**Treatment not reasonably arguable** – if the taxpayer has treated an income tax law as applying in a manner that is not reasonably arguable the penalty is 25% of the tax shortfall where the shortfall is more than the greater of \$10,000, or 1% of the tax payable by the taxpayer for the income year. The treatment of the application of a law is reasonably arguable if, having regard to the relevant authorities and the matter in relation to which the law is



applied, it would be concluded that what is argued for is about as likely as not correct.

### **Increase in penalty amount**

A penalty for making a statement that results in a tax shortfall is increased by 20% if the taxpayer:

- took steps to prevent or obstruct the Commissioner from finding out about the shortfall
- became aware of the shortfall but did not inform the Commissioner in a reasonable time, or
- was previously liable to a penalty for having a tax shortfall.

### **Decrease in penalty amount**

A penalty for making a statement that results in a tax shortfall may be reduced if the taxpayer voluntarily discloses the shortfall to the Commissioner. The amount of the reduction depends on whether the taxpayer made the disclosure to the Commissioner before or after the start of an audit into the taxpayer's tax affairs.

If the disclosure is made before an audit has begun the penalty is reduced by either 80% (if the shortfall is \$1,000 or greater) or by 100% (if the shortfall is less than \$1,000).

If the disclosure is made after an audit has begun the penalty is reduced by 20% if the disclosure can reasonably be estimated to have saved the Commissioner a significant amount of time or resources.

### **Penalty for failing to lodge a document on time**

When a taxpayer fails to lodge a return by the day it is due they are liable to a penalty of one penalty unit (currently \$110) for each 28 day period, or part thereof, that the return remains un-lodged. The maximum number of periods for which the liability arises is five. That is, if the return remains un-lodged after 140 days the maximum amount of the penalty is five penalty units.

The amount of the penalty is multiplied depending on the size of the taxpayer's enterprise. If the taxpayer is a medium enterprise the amount is multiplied by two. If the taxpayer is a large enterprise the amount is multiplied by five.

We recognise that even with the best intentions events will arise that mean people will not always meet their lodgment obligations on time. Consequently, penalties will not generally be applied in isolated cases of late lodgment unless we have already contacted taxpayers because the document was not lodged and issued them with a warning.

In most circumstances, the penalty will be remitted where the liability arose due to late lodged income tax returns, fringe benefits tax returns, annual goods and services tax returns or activity statements where the lodgment results in:

- a refund, or
- a nil result, that is, neither a debt nor a refund.

However, where failure to lodge (FTL) penalty has been manually applied (because the document remains outstanding after requests for lodgment) the fact that the subsequent lodgment of the document gives rise to a refund or nil result, will not in itself be sufficient reason for the penalty to be remitted.

All taxpayer requests for remission are considered on their individual merits.

We will also allow for any unexpected delays that may occur when taxpayers send a document to us. This would include postal or electronic transmission delays that they could not reasonably be expected to foresee.

If taxpayers consider that the circumstances which led to their late lodgment warrant a remission in the amount of penalty applied, they need to make a request in writing outlining fully the circumstances that led to the delay in lodgment.

Our penalty policy discusses when a remission in the amount of FTL penalty applied may be granted and requires us to consider the circumstances that affected the taxpayer's ability to lodge on time.

### **Penalty for failing to withhold as required**

If a pay as you go withholding (PAYGW) provision requires a taxpayer to withhold an amount from a payment made and the taxpayer fails to withhold the required amount from the payment made the taxpayer is liable to a penalty equal to the amount that should have been withheld.

This provision applies to payments made to employees, directors, office holders or other individuals in various capacities as well as to enterprises that do not quote an Australian business number in relation to the supply.

### **Penalties for failure to comply with other tax obligations**

There are other obligations for taxpayers contained in the various tax laws. The penalties for failing to comply with these obligations are generally multiples of penalty units.

Other obligations include:

- keep or retain records
- register as a PAYGW withholder
- apply for GST registration when required
- cancel a GST registration when required
- issue a tax invoice or adjustment note when required
- both principle and agent issue tax invoices or adjustment notes in relation to the same taxable supply or adjustment event
- provide reasonable access
- lodge an activity statement electronically
- pay an amount electronically
- retain or produce declarations
- retain a copy of a voluntary agreement, and
- retain a copy of a payment summary.

### **Remission of penalties**

The Commissioner has the authority to remit a penalty in whole or in part. The Commissioner has published guidelines to assist tax officers in the appropriate use of the remission powers. The most recent of these is Law Administration Practice Statement PS LA 2006/2.

If the Commissioner decides to not remit the penalty in full, written notification of the decision and the reasons for the decision must be given to the taxpayer liable to pay the penalty.

## Interest charges

### General interest charge

Taxpayers have a responsibility to meet their payment obligations as and when their tax debts fall due for payment. The various tax laws provide for the automatic imposition of the general interest charge (GIC) when a debt is paid late. The GIC is calculated daily from the beginning of the day by which tax is due to be paid, until the end of the last day on which, at the end of the day, any tax and accrued GIC remains unpaid.

The GIC automatically imposed by legislation is intended to encourage compliance. It denies late payers an advantage over those who do pay on time. The knowledge that GIC is accruing should encourage debtors to organise their affairs in such a way as to enable them to pay on time.

### Shortfall interest charge

For the period prior to 2004–05, when a tax liability with a due date which has passed is amended or revised at a later time, GIC applies from the original due date for payment on any further tax that needs to be paid. It follows that GIC for late payment of a shortfall liability can accrue from a date prior to the date of notification of the tax shortfall.

This aspect of the GIC regime was considered in Treasury's 2004 *Report on Aspects of Income Tax Self Assessment*. The law has been changed so that an interest charge at a lower rate than GIC has been introduced for the shortfall period. This lower interest charge, known as the shortfall interest charge (SIC), only applies to shortfalls arising from amended income tax assessments for the 2004–05 and later income years.

Shortfalls for other income years or other tax obligations will continue to attract GIC from the original due date for payment. In most cases this will be a date prior to notification of the shortfall.

### Variation of instalment amounts

In certain circumstances the Commissioner provides taxpayers with an instalment amount or an instalment rate. The taxpayer lodges a single return for the financial year to report the activity and pays any additional amount owing or receives a refund or credit of any amount overpaid.

For goods and services tax (GST) the taxpayer receives an instalment amount<sup>12</sup>. For pay as you go (instalments) the taxpayer receives an instalment amount or an instalment rate<sup>13</sup>.

The taxpayer may vary the instalment amount or the instalment rate to reflect any changes in activity that may occur. If the taxpayer makes a variation that results in less than 85% of the underlying tax being paid they are liable to the GIC on the underpaid amount. For GST the liability is established in Subdivision 162-D of the GST Act. For PAYG(I) the liability is established in Subdivision 45-G of Schedule 1 to the Taxation Administration Act (TAA).

### Remission of general interest charge

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<sup>12</sup> Section 162-135 of *A New Tax System (Goods and Services Tax) Act 1999 (GST Act)*

<sup>13</sup> Division 45 of Schedule 1 of the TAA

The Commissioner may remit all or part of the GIC (section 8AAG of the TAA). However remission can only be made if circumstances set out in the law are met (subsections 8AAG(2) to (5) of the TAA).

### **Remission of general interest charge on established debts**

The following extract from chapter 93 of the *ATO Receivables Policy* provides guidelines for the remission of the GIC.

93.4.1 The Commissioner may remit part or all of the GIC for late payment (Section 8AAG TAA 1953).

93.4.2 Basically, the law identifies three sets of circumstances when the Commissioner may exercise a discretion to remit the GIC for late payment. He/she may remit if he/she is satisfied:

- (a) the circumstances that contributed to the delay in payment of the debt were not due to, or caused directly or indirectly by, an act or omission of the debtor; and  
the debtor has taken reasonable action to relieve, or relieve the effects of, those circumstances; or
- (b) the circumstances that contributed to the delay in payment of the debt were due to, or caused directly or indirectly, by an act or omission of the debtor; and  
the debtor has taken reasonable action to relieve, or relieve the effects of, those circumstances; and  
having regard to the nature of those circumstances, it would be fair and reasonable to remit the GIC or part of the GIC; or
- (c) there are special circumstances by reason of which it would be fair and reasonable to remit the GIC or part of the GIC; **or**  
it is otherwise appropriate to do so.

93.4.3 Where debtors seek a remission of GIC, the debtor's request should be considered having regard to:

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

93.4.4 It would be inappropriate to exercise the discretion to remit GIC for the following reasons:

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

93.5.1 The law imposes GIC in all cases and the Commissioner will take steps to recover those charges, even after a primary debt is finalised. However, the legislation acknowledges that situations exist where it would be fair and reasonable for the GIC to be remitted. The Commissioner has the discretion to remit the GIC in part or in full depending on the circumstances that led to the late payment.

93.5.2 A debtor has a right to request a remission of general interest charges. Where the Commissioner is satisfied that a remission of the GIC is warranted, it will be remitted, either in full or in part. The onus is on the debtor to demonstrate remission is warranted.

93.5.3 A decision on the request for remission will be made based upon information provided by the debtor as part of the request for remission and from any other information available to the Commissioner, including information on any other tax debt types owed and other amounts paid after the due date. The Commissioner will not remit any GIC if there is insufficient relevant information to make a decision.

93.5.4 The Commissioner will consider a request in accordance with the relevant remission provision.

### **Reasons for remission of general interest charge**

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

#### **A. factors beyond the control of the debtor**

93.5.6 A debtor may be able to demonstrate that the cash flow difficulties they are experiencing were due to factors beyond their control and clearly could not be predicted. In considering any remission of GIC, it is also necessary to consider what steps were taken, if any, to relieve the effects of the circumstances causing the late payment. Such circumstances may include (but are not limited to) natural disasters such as fire, flood or drought; industrial action; the unforeseen collapse of a major debtor or the sudden ill health of key personnel in sole trader or small business situations.

93.5.7 General statements such as adverse business conditions affecting an industry, general economic downturn or fluctuations of currency exchange rates would not be an acceptable basis for remission under this heading as these factors are more likely to prevail across the whole community. Debtors would need to demonstrate that such factors had specific impacts on their ability to pay before they could be considered as reasons for remission.

#### **B. acts or omissions of the debtor**

93.5.8 Acts or omissions of the debtor which prevent payment by the due date will vary. In considering remission of GIC, it is necessary to determine whether the delay in payment was caused by the debtor's direct involvement or otherwise and what steps were taken, if any, to relieve the effects of the circumstances causing the late payment.

93.5.9 Debtors who have an extended credit policy to maintain business, which will adversely affect their cash flow and impact the ability to pay on time, will not qualify for remission. To remit the GIC in these situations would, in effect, be financing the business at the expense of revenue.

93.5.10 A soundly advised or well considered decision which results in unforeseen severe consequences affecting a debtor's ability to pay might otherwise gain some remission. This would assume that the debtor could demonstrate that plans were in place to ensure the payment of tax on time, but that as a result of the unforeseen circumstances, payment on time was not possible.

93.5.11 In contrast, debtors who choose not to pay a taxation liability or use available funds to acquire assets or to pay other creditors basically delay payment of the tax debt by their own action. Steps a debtor has, or could have, taken to realise assets, seek finance to meet taxation debts or to direct funds from income or cash flow are all relevant considerations in deciding whether a debtor deserves remission of GIC.

### **C. relieving the circumstances or effects of circumstances**

93.5.12 The Commissioner must consider the debtor's efforts to relieve all of the circumstances that led to late payment or the effect of those circumstances causing the delay, irrespective of whether the circumstances were subject to, or beyond, the debtor's control. To be eligible for remission, the debtor would be expected to have taken all reasonable action possible, promptly, in an attempt to lessen the severity of the circumstances as they affected the inability to pay by the due date and beyond.

### **D. fair and reasonable**

93.5.13 A decision by the Commissioner to remit GIC because it is fair and reasonable must be considered in view of the legislative policy that debtors should be liable to additional charges if they pay late. Not only must the exercise of the power to remit be fair to the debtor concerned, it must be fair to the whole community. In other words a debtor who pays late should not be given any advantage over those taxpayers who organise their affairs to ensure they can pay on time. Debtors will need to demonstrate that it is fair and reasonable to remit the GIC, having regard to the nature of the specific event or decision.

93.5.14 Partial remission should be considered when the debtor has experienced the types of factors outlined in this chapter, and would otherwise qualify for full remission, however their recent payment record has been unsatisfactory. It may be unfair to taxpayers who consistently do the right thing if those who choose not to comply are given the same level of remission. Partial remission may also be the appropriate response in cases where the circumstances that led to the non payment were caused directly or indirectly by an act or omission of the debtor, and the debtor meets the other criteria for remission.

### **E. good payment history**

93.5.15 A debtor with a good payment record may be late in making a payment. In deciding whether to remit the GIC in whole or in part, the Commissioner will take the good payment history and any other relevant factors of the debtor into account when making such a decision.

### **F. bankruptcy/liquidation**

93.5.16 The Commissioner may include claims for GIC in proofs of debt. Requests may be received from a trustee or liquidator for remission of GIC, on the basis that these charges ought to be directed at debtors who fail to pay their tax debts on time, and not to adversely affect other creditors in insolvency situations. In this situation, the Commissioner will not remit the GIC as a general rule. However, if all other creditors (ie secured and unsecured) are prepared to forego all their claims to interest on amounts owed to them (for the same length of time the taxation debts have been outstanding, if applicable), the Commissioner will consider remitting the GIC.

## **G. judgment**

93.5.17 The question of whether court allowed interest, judgment interest or GIC can be claimed depends on the court rules and practices in each jurisdiction. In general, where GIC can be claimed in lieu of court allowed interest, the GIC should be claimed.

93.5.18 The Commissioner's practice in this regard is as follows:

- (i) with one exception (see 93.5.21 below), the Commissioner will claim GIC for the period from the due date to the date of issue of the proceeding.
- (ii) with one exception the Commissioner will claim GIC for the period from the date of issue of a proceeding to the date of judgment or earlier payment.
- (iii) the Commissioner will claim judgment interest for the period from the date of judgment to the date of bankruptcy or liquidation, or earlier payment. The Commissioner will also in most circumstances claim the so called "top up amount" of GIC.

93.5.19 It should be noted that the general interest charges payable under taxation legislation are considered to be sufficient to compensate the Commonwealth for the loss of use of the funds. In some jurisdictions, the rules of the relevant court may permit court allowed interest to accrue at the same time GIC under taxation legislation is accruing (eg section 58, *Supreme Court Act (Victoria) 1986*). The Commissioner will claim only the GIC.

93.5.20 The Commissioner's policy of claiming the "top up amount" of GIC is based on the fact that judgment interest rates can vary considerably between the state jurisdictions. The Commissioner's practice is generally to seek judgment interest and then to also claim the "top up amount" of GIC. This approach is considered appropriate because it means that there will be equitable treatment of judgment debtors regardless of where that judgment is obtained.

93.5.21 The exception mentioned above concerns directors' liabilities under Division 9 of Part VI of the ITAA 1936. These liabilities are not subject to GIC under taxation law. It is therefore appropriate that interest be sought from the court when pursuing judgment for these claims.

## **H. particular examples of special circumstances where remission may be granted**

93.5.22 Hardship

- where the recovery of GIC would cause serious hardship, remission may be granted. This would include offers that approximate the limit of the financial capacity which the debtor controls or has access to. Debtors who may satisfy this criteria could include social security recipients who have no recourse to assets and who do not have the means to pay the GIC by way of instalments over time.

#### 93.5.23 Release

- where partial release from payment of tax is granted by a Board constituted under section 265 ITAA 1936 or an equivalent provision and the balance of tax is paid within a reasonable period after the decision is notified to the debtor, consideration will be given to remitting all or part of the GIC.
- where the debtor's application for release is refused, GIC will be remitted from the date of lodgment of the completed application to 14 days after notification of the decision by the Board. This is to avoid penalising the debtor for any delays that may occur in dealing with the application. However, GIC will continue to apply if an application is considered to be frivolous or without merit (these applications will be referred for consideration as a matter of urgency). Further, if an application for release is lodged in respect of a debt which is subject to dispute (objection, appeal, or reference to the AAT), or a debt which is subject to the outcome of a test case, then this full remission of GIC will only apply from the date of determination of the relevant dispute or test case.

#### 93.5.24 Other appropriate circumstances

As stated previously, GIC is imposed in all cases of late payment and is only to be remitted where the circumstances of the case warrant such remission. However, in addition to all the circumstances set out above, the law gives the Commissioner a discretion to remit the GIC for late payment in circumstances "where it is otherwise appropriate to do so". It is obviously not possible to lay down an exhaustive list of those circumstances which might warrant remission under this provision. However, this provision gives the Commissioner a degree of flexibility. It means that the Commissioner can adapt to changing circumstances, and consider unusual factors, or future issues, on their merits and make decisions accordingly. Such decisions will not usually be concerned with the circumstances of a particular taxpayer, but may extend to a particular group of tax debtors, or to the general body of tax debtors, and may involve consideration of issues of administrative efficiency and fairness. Decisions to grant remission under this provision will be restricted to senior Tax Office officers. An example of this type of decision is the announcement by the Commissioner of a settlement offer made to some taxpayers who have invested in mass marketed schemes, subject to those taxpayers being eligible for, and agreeing to enter into, specified settlement arrangements. This offer broadly includes remission of the GIC accrued to date and further remission for the first two years of any repayment arrangement.

### **I. disputed debt and amended assessments**

93.5.25 The legislative regime provides that tax is both payable and recoverable notwithstanding that there is a formal review under Part IVC of the TAA 1953. Accordingly, as a general rule, if the review does not result in a reduction of a liability, any GIC that applies will accrue from the original due date until payment. Where a liability is reduced by way of amendment, any GIC that applies will be calculated on



the amended balance from the original due date of the liability until the date of payment.

93.5.26 However, in certain circumstances where a dispute exists, the Commissioner may remit part of the GIC.

If the debtor pays all tax not in dispute and a minimum of 50% of the disputed tax, the Commissioner will generally (subject to para 93.5.27 below) partly remit the relevant GIC so the debtor will be liable for the GIC as follows:

- (i) On any debts not in dispute, GIC will accrue at the full rate from the due date(s) until the date of payment;
- (ii) On the full amount of the debts in dispute, GIC will accrue at the full rate from the due date(s) for payment until the date the debtor pays a minimum of 50% of the tax in dispute;
- (iii) On the remaining balance of the debts in dispute, the debtor will be liable for 50% of the applicable GIC calculated from the date of payment of a minimum of 50% of the tax in dispute until fourteen days after the date of the decision. (ie the Commissioner will remit 50% of the GIC accrued during this period); and
- (iv) from fourteen days after the decision, the full amount of GIC will be applied on the remaining balance finally found to be payable until that balance is paid in full.

93.5.27 It should be carefully noted that such remission may not be available, even where the above conditions are met, in a case where the objection is determined to be frivolous, or where the Commissioner considers that there is a risk to the revenue. In such cases, the Commissioner may proceed to recover all tax outstanding, including GIC, notwithstanding the presence of a dispute. The circumstances in which the Commissioner may take such action are set out in more detail in the chapter 'Recovering Disputed Debt'.

93.5.28 In a particular income year, the Commissioner may validly issue two or more assessments relating to the same transaction against different taxpayers, or against the same taxpayer under different taxing provisions. In those cases, the payment by one of these entities of 50% of its disputed liability relating to that transaction, may provide benefits to all entities which have been assessed in relation to that transaction.

93.5.29 The benefits available to the other entity(ies) would be a remission of the GIC imposed on its disputed debt relating to that transaction. The amount of the benefit would be limited to a maximum of :

- the amount of GIC that would be remitted as a result of the payment if the payment had been made by the entity itself and not the paying entity, plus
- an amount equal to the GIC remitted on the paying entity's debt as a result of its 50/50 arrangement.

93.5.30 The income of a discretionary trust or similar entity could be adjusted as one of the adjustments or assessments resulting from the transaction. The benefits

outlined in 93.5.28 and 93.5.29 are only available to the other entities assessed (excluding the other beneficiaries) if **all** of the beneficiaries of the trust pay 50 % of the disputed debt relating to the transaction. Despite any non-payment by other beneficiaries, any beneficiary that pays 50 % of its disputed debt will be entitled to the benefits normally available other than those outlined in 93.5.28 and 93.5.29.

93.5.31 The prospect of remission of GIC is not to be used as an inducement to achieve settlement of a disputed assessment.’

### **Remission of shortfall interest charge**

The Commissioner may remit all, or part of, an amount of the SIC if the Commissioner considers it fair and reasonable to do so (subsection 280-160(1) of Schedule 1 to the TAA).

Without limiting the general remission power, in deciding whether to remit the Commissioner must have regard to:

- (i) the principle that remission should not occur just because the benefit received from the temporary use of the shortfall amount is less than the SIC; and
- (ii) the principle that remission should occur where the circumstances justify the Commonwealth bearing part or all of the cost of delayed payments (subsection 280-160(2) of Schedule 1 to the TAA).

We will soon be releasing a practice statement outlining the Commissioner’s policy on remission of the SIC and the GIC accrued during the period prior to the issue of an amended assessment.

# CHAPTER 6 – PAY AS YOU GO WITHHOLDING

## Getting started

An employer who employs workers may be required to withhold an amount from payments they make to them. They may also have to withhold an amount from payments they make to other workers such as contractors and to other businesses that do not quote their Australian business number (ABN).

### What a PAYG employer needs to do

- Register for PAYG withholding.
- Determine the status of workers (that is, whether they are employees or contractors).
- Work out the types of payments to withhold from.
- Work out how much to withhold from payments.
- Report and pay withheld amounts to the Tax Office.
- Give each payee a payment summary and report annually to the Tax Office.
- Keep the necessary PAYG withholding records.

### Register for withholding

An employer must register before withholding amounts from payments they make to their employees. They can do this at the same time as applying for ABN, over the phone, download a form from our website or via the Business Portal.

### Determine the status of the worker

Different obligations apply depending on whether a worker is:

- an employee – a worker employed in the business, or
- a contractor – a worker who is self-employed and has a contract to provide services.

### Work out what types of payments to withhold from

The most common payments are:

- payments to employees
- payments to directors, and
- payments to a business that does not quote its ABN to the employer.

Depending on the circumstances, a business may also need to withhold amounts from:

- payments to contractors who have a voluntary agreement
- payments to individuals under labour hire arrangements, and
- payments of dividends, interest and royalties to non-residents.

### How much to withhold

Employers will determine how much to withhold from payments they make to employees using PAYG withholding tax tables (also known as withholding schedules). They also use the information provided by employees on their tax file number (TFN) declaration and, if applicable, withholding declaration.

Approved payroll packages used by employers will calculate withholding amounts based on information input by the employer from the TFN declaration and, if applicable, withholding declaration.

### TFN declaration

Employees should provide their employer with a TFN declaration. The employer completes the payer section and sends the original to us within 14 days.

If the employee does not provide a TFN declaration, the employer must complete the payee section with all the information they can and send it to us within 14 days.

### Report and pay withheld amounts to the Tax Office

Generally, employers report and pay amounts withheld to us using an activity statement. Activity statements are sent to employers either monthly or quarterly, depending on their PAYG withholding cycle (that is, monthly for medium withholders and quarterly for small withholders). Employees report their withholding details by completing the relevant 'W' labels of the activity statement.

Note: there are special rules requiring more frequent payments for large withholders.

Employers may pay the amounts withheld using any of the following methods:

- electronically, using direct credit, BPAY or direct debit
- by sending a cheque or money order to the Tax Office with their activity statement, or
- by taking their pre-printed payment advice to any post office and paying by cash (up to \$3,000), cheque or EFTPOS (excluding credit cards).

### Give each employee a payment summary and report annually to the Tax Office

Worker payment summaries – generally, employers are required to provide their employees with a payment summary by 14 July each year.

Annual reporting – at the end of each financial year, employers have to report their PAYG withholding information to us. For payments they make to employees, they must send in a payment summary annual report.

The payment summary annual report may be lodged electronically or on paper.

### Keep the necessary PAYG withholding records

Employers must keep all records that explain their withholding transactions. For example, they must keep wages and payment records, copies of payment summaries, and copies of payment summary statements (where they report to us on paper). Records must be kept for five years.

## Employer profiles

### Number of small, medium and large withholders

As at 31 December 2005

Remitter cycle <sup>14</sup>	Large withholder	Monthly withholder	Quarterly withholder	Total
<b>Total</b>	9,252	213,144	649,326	871,722
<b>% of taxpayers by cycle</b>	1%	24%	74%	100%

<sup>14</sup> Large withholder refers to annual withholding greater than \$1million  
Monthly withholder refers to annual withholding between \$25,000 and \$1million  
Quarterly withholder refers to annual withholding less than \$25,000

A withholder's status is determined by the amounts withheld in past years.

- A large withholder is one who withholds more than \$1 million. They are required to pay amounts to us each Monday and Thursday.
- A medium withholder withholds between \$25,000 and \$1 million per annum and is required to pay on a monthly basis.
- A small withholder withholds less than \$25,000 per annum and is required to pay on a quarterly basis.

## **Key dates**

### **PAYG withholding cycle review**

Each year we review the PAYG withholding cycle of payers to ensure they are reporting and paying according to their correct cycle.

## **Administration of PAYG withholding**

### **Tax tables (withholding schedules)**

Generally speaking, employers use the basic weekly or fortnightly tax tables to obtain the amount required to be withheld from payments to their employees without needing to refer to any of the other tables. However, an employer will require a specific tax table when they make payments such as bonuses, commissions or termination payments, as these payments have markedly different withholding requirements.

We generally provide tax tables to employers by direct mail.

Copies of the most widely used schedules (weekly and fortnightly tables) are made available from most newsagents around Australia. All tables can be downloaded from our website and paper copies of most can be ordered by phone from our distribution service.

## **Withholding variations**

Employers must withhold amounts from withholding payments in accordance with the tax tables we publish. The rate of withholding can be varied.

### **Why would an employee want to vary the amount withheld?**

The rates of withholding provided in the tax tables provide a general approximation of an employees' final end of year tax liability. However, because each employee's circumstances are different, some employees may find that the amount withheld using the tax tables is either too much or too little when compared to their actual end of year tax liability.

An employee may apply to vary their rate of withholding upwards or downwards. The application is made using a form available on the web or on paper. Common reasons for variations are:

- high levels of deductible expenditure to be claimed against an allowance which would normally be taxed
- losses from rental properties or other ventures, and
- preference for end of year refund.

## **Class variation**

In some cases a group of employees may want an identical variation. In those circumstances the employer may apply for a class variation on behalf of all relevant employees.

## **Withholding declarations**

There are four forms in the suite of withholding declarations.

- NAT 3093 – Withholding declaration – full version
- NAT 5072 – Withholding declaration – Abridged version for senior Australians
- NAT 5367 – Withholding declaration – Upwards variation
- NAT 7089 – Withholding declaration – Family tax benefit worksheet.

They allow an employee to advise their employer of any special circumstances which have to be taken into account in working out the amount to withhold.

## **Payment summary mail out**

### **When payment summary and annual report information is mailed**

Each year, we send a package to all employers containing annual reporting stationery that enables them to meet their end of year reporting obligations.

### **Payment summary and annual reporting forms availability**

All payment summaries and annual reporting forms may be obtained by:

- phoning one of our help lines
- phoning our IVR ordering service (available 24/7)
- ordering via a web ordering service, or
- by visiting one of our shopfronts.

### **Reporting methods available to employers**

There are three ways employers may lodge their PAYG withholding payment summary annual report:

- on paper (using Tax Office forms)
- on physical media (such as CD Rom, DVD, disc, etc), or
- electronically via the internet (using electronic commerce interface or ECI)..

### **How many employers report on paper, ECI or via magnetic media?**

In the most recently conducted PAYG withholding payment summary annual report mail out, the numbers that used each method of reporting was as follows:

- Electronic commerce interface (ECI): 12,940
- Magnetic media (MIPS): 145,077
- Paper: 752,569

# CHAPTER 7 – PAY AS YOU GO INSTALMENTS

## Overview of PAYG instalments

The pay as you go (PAYG) system requires some taxpayers to meet their annual income tax liability by making payments at regular intervals throughout the year.

PAYG instalments (PAYGI) paid during the income year count towards the taxpayers expected tax liability in respect to business and investment income.

The actual tax liability is worked out at the end of the income year when the taxpayer's annual income tax return is assessed. PAYG instalments for the year are credited against the taxpayers' assessment to determine whether they owe more tax or are owed a refund.

## Entering the PAYGI system

Resident individuals (and certain trusts) who have shown gross business or investment income of \$2,000 or more in their most recent income tax return, will be notified of their obligation to pay PAYG instalments and given an instalment rate unless:

- the tax payable on the most recent notice of assessment is less than \$500
- the notional tax is less than \$250, or
- they are entitled to the senior Australians tax offset.

We write to the taxpayer if they are required to pay PAYG instalments. There are nine introduction letters – four of these are for consolidated entities and the remainder outline different options the taxpayer is eligible for.

What the PAYG letter tells the taxpayer.

- The assessment year used in calculations – this is the latest year for which the income tax has been assessed. The PAYG details are calculated from information in this assessment.
- The PAYG instalment rate – if a taxpayer chooses to work out their own PAYG instalment amounts then they apply the instalment rate. We calculate the instalment rate from the information provided in the taxpayer's most recent income tax assessment.
- The tax on business and investment income – if the taxpayer has to pay one (annual) instalment per year, we will advise an amount that needs to be paid – the notional tax.
- Amount of notional tax – this is the tax that would have been payable on the business and investment income, excluding net capital gains, in the latest year for which the income tax has been assessed. The amount of notional tax is adjusted by the gross domestic product rate. For 2005–06 the gross domestic product rate was set at 7%.
- The instalment amounts calculated by the Tax Office – these are the amounts the client will be required to pay each period if the taxpayer chooses to pay instalment amounts calculated by us. These amounts are based on the taxpayer's most recent income tax assessment. If the client lodges a new tax

return or amends their latest return, these amounts may be different to the amounts printed on their activity statement. The amount the taxpayer actually pays will also depend on how often they pay instalments.

- How often to pay – PAYG instalments are generally paid four times a year (quarterly). Some taxpayers pay two instalments a year and some have an annual instalment option. The PAYG letter sent to the taxpayer tells them how often they will need to pay – either quarterly or two instalments a year.

The taxpayer may be eligible to pay one annual instalment per year. The PAYG letter will tell the taxpayer if they are eligible for this option.

### **Key dates**

Most taxpayer's balance their accounts on 30 June. Below are details of the lodgment cycles available to PAYGI clients depending on their circumstances.

### **Quarterly instalments**

If the taxpayer is a business paying GST monthly, their PAYG instalments are due on:

- 21 October
- 21 January
- 21 April, and
- 21 July.

PAYGI rate payers are usually small to large businesses that chose to apply their instalment rate against their current period income.

PAYGI amount payers are generally a mix of small business and individual taxpayers with investment income.

### **Two instalments**

Some primary producers and special professionals (such as sports professionals and authors) can pay two instalments a year. Under this arrangement, the taxpayer pays 75% of their annual PAYG liability by 28 April and the remainder by 28 July.

If the taxpayer chooses to pay four instalments a year, they are required to work out their own PAYG instalments based on their income and instalment rate.

A fact sheet is available for more information: *PAYG instalments for primary producers and special professionals* (Nat 4352).

### **Annual instalment option**

The annual instalment is a single, lump sum payment of PAYG liability for the year.

A PAYG letter is sent to the taxpayer if they are eligible for the annual option. The letter also provides the taxpayer with information on electing and paying annually.

The taxpayer must advise us that they wish to be annual, if the taxpayer chooses not to do this, they will have to pay quarterly instalments for the rest of the income year.

### **Exiting the PAYGI system**

A taxpayer will be exited from the PAYG system, and notified of this by letter, when:

- a final return is lodged



- a non-lodgment advice is received
- we are notified that the taxpayer is deceased
- we are notified that the company is liquidated, or
- their latest assessment for the most recent income year does not meet the entry criteria.

## Profile of the sector

### Size of PAYGI market

Entity	Annual payers	Quarterly payers			Sub-total
		Rate	Four instalment payers (amount)	Two instalment payers (amount)	
Companies	7,152	210,845	389,617	0	607,614
Individuals	210,217	241,246	937,586	81,823	1,470,872
Trusts	1,430	523	4,886	368	7,207
Superannuation funds	41,399	30,401	114,242	0	186,042
<b>Sub-total</b>	<b>260,198</b>	<b>483,015</b>	<b>1,446,331</b>	<b>82,191</b>	<b>2,271,735</b>
Change from 2004	down 16.20%	down 5.15%	up 10.05%	up 0.77%	up 2.54%

### Segments and major players

Segment	Annual payers	Quarterly payers			Sub-total	Change from 2004
		Rate	Four instalment payers (amount)	Two instalment payers (amount)		
Large business <sup>15</sup>	309	17,211	7,019	19	24,558	down 22.70%
Small business <sup>16</sup>	111,915	430,639	1,006,366	81,799	1,630,719	up 1.32%
Individuals <sup>17</sup>	147,974	35,165	432,946	373	616,458	up 7.31%
<b>Sub-total</b>	<b>260,198</b>	<b>483,015</b>	<b>1,446,331</b>	<b>82,191</b>	<b>2,271,735</b>	<b>up 2.54%</b>

## PAYGI profiles – other information

### Letters issued from PAYGI system

Financial year	Total letters issued
2006 – YTD	659,532
2005	3,001,759
2004	2,943,942
2003	2,982,028
2002	3,734,574
2001	5,127,134

<sup>15</sup> Large business refers to businesses with an annual turnover > \$20 million

<sup>16</sup> Small business refers to businesses with an annual turnover < \$20 million

<sup>17</sup> Individuals refers to individuals not in business

**PAYGI reports downloaded from the Tax Agent Portal**

<b>2005</b>		<b>2004</b>		<b>2003</b>	
2005 – YTD	104,450				
2004	570,214	2004			
2003	76,718	2003	391,883	2003	0
2002	16,004	2002	66,345	2002	5,507
2001	9,003	2001	19,605	2001	1,256
<b>Total</b>	<b>776,389</b>	<b>Total</b>	<b>477,833</b>	<b>Total</b>	<b>6,763</b>

\* Note: these figures do not include downloads from the PAYGI Business Portal.