

9th November 2007

Mr Paul McCullough
The General Manager
Tax System Review Division
The Treasury
Langton Crescent
PARKES ACT 2600

email: uap@treasury.gov.au

Dear Mr McCullough

Review of Unlimited Amendment Periods in the Income Tax Laws

The Taxation Institute of Australia (Taxation Institute) is pleased to provide the attached submission in response to the Treasury's *Review of Unlimited Amendment Periods in the Income Tax Laws* (the Discussion Paper). Our submission addresses the Questions for Consultation set out in the Discussion Paper.

We support the announcement by the Minister for Revenue and Assistant Treasurer, Mr Dutton, for a review to examine unlimited amendment periods (Minister for Revenue and Assistant Treasurer's Press Release PR 2007/103 22 August 2007) and welcome the release by the Treasury of the Discussion Paper following the Minister's announcement.

Before dealing with the specific consultation questions raised in the Discussion Paper it must be noted that the Taxation Institute does not support the rationale behind matching review periods for the Commissioner and taxpayers. As expressed previously in the Taxation Institute's 28 May 2004 submission to the Treasury on the original Review of Self Assessment (ROSA) proposals, the Institute is of the view that the Treasury rationale for symmetry is flawed because it assumes that the Commissioner and taxpayers are on an equal footing. The reality is that the Commissioner retains a dominant position under self assessment. Therefore longer periods of review are needed to give taxpayers the time to vary returns where they have made a mistake or where there is an ATO error.

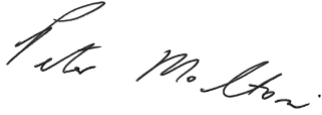
Consequently, we submit that the periods for review do not need to match and the time period for credit assessment should be unlimited.

Subject to our position on the issue of symmetry, the Taxation Institute endorses overall the seven Principles identified in the Discussion Paper to be applied in reforming this area. However, as detailed in our submission, we have identified areas of concern with the proposed implementation of these principles that require further clarification because they have the potential to undermine the effectiveness of the proposed reforms. In particular, the Taxation Institute is concerned that the application of the proposed two year contingent amendment period (Principle 3) fails

to achieve finality for all taxpayers in over 70% of the unlimited amendment periods identified in the Discussion Paper.

If you would like to discuss any of the issues raised in our submission or require further assistance or information, please contact the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours faithfully

A handwritten signature in cursive script that reads "Peter Moltoni".

Peter Moltoni
President

Taxation Institute of Australia

Review of Unlimited Amendment Periods in the Income Tax Laws

Set out below are the Taxation Institute's responses to the Questions for Consultation set out in the Treasury Discussion Paper *Review of Unlimited Amendment Periods in the Income Tax Laws* (at p 20).

1. Do you support/agree with the following principles discussed in this paper?

Subject to the comments below and our position that we do not support the underlying rationale behind matching review periods for the Commissioner and taxpayers (as outlined in the covering letter to this submission), the Taxation Institute generally endorses the seven Principles identified in the Discussion Paper.

Principle 1: Unlimited Amendment Periods for circumstances that can be dealt with within the general rules should be removed.

The Discussion Paper proposes that a four year limit should apply to certain anti-avoidance transactions "even if the taxpayer would otherwise qualify for the two year amendment period".

Care needs to be taken to ensure that an amendment to this effect does not recreate the situation in *Vincent v Commissioner of Taxation* [2002] 2002 ATC 4742. We recommend the amending legislation should limit the availability of the four year amendment period to circumstances where the ATO would have won on the avoidance argument.

Principle 2: Unlimited Amendment Periods for circumstances that will take more than four years to verify because of unusual complexity or other factors should have a longer fixed amendment period.

Section 1.3 of the Discussion Paper observes that longer time periods may be required for the ATO to investigate more complex transactions. This proposition is not accepted as:

- taxpayers are required to review and understand the tax effect of transactions to prepare tax returns within a much short timeframe. There is no apparent reason why the same onus should not be placed on the Commissioner; and
- the effective introduction of such an extension will require a definition as to what is meant by *unusual complexity or other factors*. It is difficult to contemplate what such a definition would be if it does not have the effect of opening up all assessments for amendment for the extended period.

As support for the proposition in the Paper the example of transfer pricing is given. It is stated that a longer period than the 2 or 4 year amendment period is required due to complexity and difficulty in obtaining verification information. Taxpayers face the same complexity and difficulty in making decisions about the amount to be returned. It is submitted that there is no justification for introducing unlimited amendment periods to deal with these circumstances.

Further, the application of Principle 2 is flawed in the context of transfer pricing. Given the information requirement imposed under the schedule 25A disclosure

statement and the heavy transfer pricing documentation requirements, this argument is difficult to sustain, as the information is available to the ATO.

If the proposal is adopted, the extended amendment period should only apply if the relevant investigation has been entered into within the time limit that would otherwise have applied and if the ATO has identified timing difficulties given the volume of documents or need to refer the matter to other authorities (not simply to deal with the technical issues, to deal with factual issues only).

On this basis, the Taxation Institute suggests:

- a standard two or four year period of review, with a mechanism to extend this four year period;
- any extension should be conditional on the ATO proving it has undertaken audit action in some meaningful way and identified difficulties in collecting information due to circumstances other than ATO failure to provide adequate resources or understand issues;
- the application for extension of time should be subject to Court review (similar to section 170(7)).

Principle 3: Unlimited Amendment Periods for circumstances that arise because of a future event should be based upon a set time after the Commissioner is notified that the event has occurred.

This is the most contentious of all the principles as its application in practice seems to reverse self assessment principles by imposing additional notification obligations on taxpayers. Further, as the Discussion Paper recommends the application of this Principle 3 in over 70% of identified cases of unlimited amendment periods of amendment in Appendix A to the Discussion Paper (80 provisions out of a total of 119), there is still considerable scope for taxpayers to be subject to unlimited amendment periods. In this context, we make the following comments related to Principle 3:

Consistency with self-assessment principles

The Discussion Paper describes contingent periods starting on notification to the ATO of a particular event. In principle that may be reasonable in certain circumstances. However, care needs to be taken that it does not become inconsistent with self-assessment principles.

For example, in relation to section 82SA, where a change in terms of a convertible note retrospectively precludes certain deductions, should the time limit for giving effect to a retrospective amendment depend upon giving notice to the ATO, or should it just run until the end of the normal assessment period after the year in which the change of terms actually takes place?

This may be even more acute in relation to CGT, for which as the Discussion Paper notes it might be difficult to identify individually each type of contingent event. The paper suggests a generic amendment period commencing from “when the Commissioner has the information to determine a taxpayer’s final liability”. That may well prove to be inconsistent with self-assessment.

For example, if entry into a contract, and completion of the contract, happen in the same year there are no notification requirements to start the limitation periods running for a reassessment of the CGT Event A1. Why should a notification period

be required just because they happen in different years? In this situation, the requirement should simply be that the amendment period runs from the year completion occurs. Overall, therefore, we recommend that the primary rule should be only that the period commences to run from the year the relevant event occurs.

Industry Research Development Board

The Discussion Paper gives as an example of a contingent period which hinges off a decision of the Industry Research and Development Board (IRDB). This suggestion has raised concerns in a number of areas. As the IRDB is a wing of Government, it is felt that a defined period of review is required covering *both* the IRDB and the ATO. Industry believes many of the delays in issuing certification are due to slowness in the IRDB's operations and industry should not be subjected to this ongoing uncertainty. This area is complex, and there might need to be different treatment for different circumstances. For example:

- such a certificate can relate to whether the relevant research and development activities did not contain sufficient Australia content or were not for the benefit of the Australian economy (section 39M(1)(b)(1a) or (ii) of the Industry Research and Development Act 1986 ("IRDA"));
- however, among other cases, a certificate might result from a finding that the results of the research and development activities have been exploited otherwise than on normal commercial terms (section 39M(a)(b)(i)IRDA).

In either case, there is no time limit on the IRDB issuing a certificate – and for the reasons outlined above it is therefore inappropriate for an amendment period to hinge on the issue of that certificate. In the first case, a judgement on the Australia specific issues could *prima facie* be made at the relevant time, so a time limit running from the time of the deduction seems appropriate. However, it is understood that, for example, where a deduction is claimed in year one, and exploitation otherwise than on normal commercial terms occurs in year six or seven, a time limit based on the year in which the deduction is incurred may be inappropriate.

It is submitted that in this area the general principle should be that a set period from the incurring of the deduction applies. It is understood that in special cases the period may need to run from a specific event – eg, possibly, for years from the time at which exploitation otherwise than on normal commercial terms occurs.

It should be noted that if a taxpayer takes steps to conceal matters which might lead to the denial of a deduction, that should normally attract the "fraud or evasion" exception, so such a set period should not facilitate evasion.

Principle 4: Unlimited Amendment Periods (other than for fraud or evasion) should only be retained in exceptional circumstances.

The Taxation Institute agrees that unlimited periods should apply only in "exceptional circumstances". Ideally the legislation should have the effect that unlimited amendment periods can arise only by express specific legislation (eg a default rule covering situations like those referred to in our response to consultation question 2, such that a particular period applies where there is not some other express limit), at least where the amendment is adverse to a taxpayer. Ideally all situations would be listed in one location (see our response to consultation question 6), and a new one would be added only by express specific legislation clearly identifying any prerequisites to its exercise by the ATO, and with explanatory material clearly justifying its introduction.

The Taxation Institute also accepts that fraud or evasion should be a special case. However, a problem arises where, after the expiry of normal amendment periods and of periods for which retention of records is required (and beyond which, commercially, records will generally not be retained), the ATO makes an accusation of fraud or evasion. The onus of proof as to there not being fraud or evasion lies on the taxpayer (*SLBBB v FCT* 2001 ATC 2194). As assertions of evasion do not seem to require a very high threshold, we suggest that there should be some point beyond which at least an initial burden of proof lies on the ATO to raise a prima facie case of fraud or evasion. However, even in cases of fraud or evasion, arguably there should be some long stop date for amending an assessment (noting that in extreme cases, it should be possible for the Government to prosecute for a relevant offence under the criminal laws, and then get an order under section 21B of the Crimes Act, so a fixed time limit would not mean a total escape from potential liability).

Principle 5: Amendments to prior year assessments to give effect to changes in the law brought about by amending Acts should be made within 2 years of Royal Assent of the amending Act.

The Discussion Paper rightly suggests that there needs to be an amendment period giving effect to retrospective legislation. This should be accompanied by amendments to the objection provisions, so that a taxpayer can ensure that (if the ATO is unable to process an amendment within the relevant time) the taxpayer's rights are protected.

Principle 6: A finite period of review should apply even though taxpayers who have lodged a return do not receive a notice of assessment.

Agreed.

Principle 7: Transitional arrangements should close off amendments to assessments from previous years, after allowing the Tax Office sufficient time to review past assessments.

Agreed.

2. Are you aware of any other provisions that are subject to an unlimited amendment period and should be considered in this Review?

The Taxation Institute has identified the following provisions that we believe should be considered by this Review. However, this is not a definitive list and there may well be other provisions that need to be considered:

- The review should look at the position of payers and payees of amounts that are subject to dividend, interest or royalty withholding tax. It ought ideally to consider other withholding obligations like TFN/ABN withholding, and PAYG withholding.
- It appears that section 169, in conjunction with other provisions in the Tax Act, can have the effect of authorising assessments that are not subject to section 170 (refer *Cadbury-Fry-Pascall Pty Ltd v FCT* (1944) 70 CLR 362). It seems that if the relevant assessment is not "an assessment...for a year of income..." or similar, section 170(1) does not apply to it. CCH Federal Tax Reporter lists sections 104, 126, 132, 133 and 148 as being sections as to which section 169 might apply. It seems from (1954) 5 TBRD Case 5 that section 102(1)(b) may be another one.

3. Are you aware of any other Acts affecting income tax that give effect to unlimited amendment periods? Could they be replaced or removed?

The Taxation Institute has not identified any at present.

4. Are there other alternatives that should be used to replace particular unlimited amendment periods?

In addition to the alternative outlined in our response to consultation question 1, the Taxation Institute also draws your attention to section 1.2 of the Discussion Paper that notes where an amendment is made on the basis of an unlimited amendment period "...consequential amendments may also then occur...". The Taxation Institute believes that consideration should be given to a general provision with the effect that, whenever an assessment is increased by an amended assessment (at least where a longer than normal amendment period has been used), there is an opportunity for that taxpayer or other taxpayers to lodge objections seeking compensating adjustment-style consequential amendments.

5. Are the suggested amendment periods, as listed in the Appendices, appropriate for each provision?

Please see our general comments – we have not reiterated them here in respect of each relevant provision.

These comments are not intended to be exhaustive. Lack of comment on a provision in this clause does not imply that the Taxation Institute may not suggest an alternative at some later point (eg if exposure draft legislation is released).

Section 51AD operates from time to time (section 51AD (10)), so it is inappropriate for circumstances during a year of income to be at risk until after the property is disposed of just because the section may start to apply with effect from some later time. In the case of long term projects, such an approach would be similar to an unlimited period.

Division 250 is likewise applicable from time to time (section 250-100 and for the same reason as for section 51AD the disposal of the property is not an appropriate benchmark.

6. Should the tax assessment and amendment provisions be consolidated into a single location in the tax laws, and if so, where?

The proposal that all tax assessment and amendment provisions be consolidated into a single location is a good one. The Taxation Administration Act seems the appropriate place.