MT 2008/2 - Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable

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Miscellaneous Taxation Ruling

Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable

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Preamble

This publication (excluding appendix) is a public ruling for the purposes of Division 358 of Schedule 1 to the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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What this Ruling is about

1. This Ruling sets out the Commissioner's views on the imposition of an administrative penalty for taking a position that is not 'reasonably arguable' under subsection 284-75(2) of Schedule 1 to the *Taxation Administration Act 1953* (TAA) (this is referred to as the 'no reasonably arguable position' penalty).

2. Specifically, this Ruling outlines the:

- legislative development of the reasonably arguable position;
- differences between 'reasonably arguable' and 'reasonable care'; and
- conditions that need to be satisfied before the 'no reasonably arguable position' penalty can be imposed under subsection 284-75(2).

3. The expression 'reasonably arguable' has the meaning given by section 284-15 of Schedule 1 to the TAA. This meaning applies equally to:

- subsection 284-75(2) – penalty relating to statements;
- paragraph 284-160(1)(b) – base penalty amount for Part IVA schemes;
- paragraph 284-160(2)(b) and subsection 284-160(3) table items 1 and 2 – base penalty amount for transfer pricing schemes; and
- subparagraphs 290-65(1)(b)(i) and 290-65(1)(b)(ii), and subsection 290-65(2) – meaning of tax exploitation scheme.

4. Unlike other administrative penalties, which apply to all taxation laws, the administrative penalty under subsection 284-75(2) only applies in relation to relevant tax law, which, for the purposes of this Ruling, is an income tax, global and domestic minimum tax (minimum tax)[A1] and petroleum resource rent tax law (PRRT).

5. This Ruling does not consider the guidelines for the exercise of the Commissioner's discretion under section 298-20 of Schedule 1 to the TAA to remit the penalty otherwise attracted.

6. This Ruling also does not consider the methodology involved in calculating an administrative penalty where a shortfall amount needs to be split in order to apply different rates of penalty – see Taxation Ruling TR 94/3 which applied to former Part VII of the *Income Tax Assessment Act 1936* (ITAA 1936).

7. All legislative references in this ruling are to Schedule 1 of the TAA, unless otherwise indicated.

8. A number of expressions used in the relevant legislative provisions are referred to in this Ruling. These expressions are defined in paragraphs 74 to 84 of this Ruling.

Date of effect

9. This Ruling applies both before and after its date of issue. However, the Ruling does not apply to entities to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

[A1] The global and domestic minimum tax introduced by the *Taxation (Multinational—Global and Domestic Minimum Tax) Act 2024* and related Acts.

Previous Ruling

10. Taxation Ruling TR 94/5 was withdrawn with effect from the date of issue of draft Miscellaneous Taxation Ruling MT 2008/D2 on 14 May 2008.

Background

Legislative framework

11. The concept of a reasonably arguable position was used in former sections 226K (penalty tax where unarguable position taken) and 222C (which defined the expression 'reasonably arguable') of the former penalties regime contained in Part VII of the ITAA 1936.[1]

12. The rationale for the introduction of former sections 226K and 222C of the ITAA 1936 was outlined by Hill J in *Walstern v. Federal Commissioner of Taxation* (2003) 138 FCR 1; 2003 ATC 5076; (2003) 54 ATR 423 at paragraph 106 (*Walstern's case*) as follows:

> …It is clear from the Second Reading Speech to the Taxation Laws Amendment (Self Assessment) Bill 1992…that while all taxpayers would be penalised if they failed to exercise reasonable care, it was thought appropriate…for taxpayers who made large claims, generally in excess of $10,000 to exercise greater care…The Minister assisting the Treasurer, …said, inter alia:
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> > …The Government considers it appropriate that a more rigorous standard apply where the item at issue is very large…where the interpretation of the law for such items is in issue, we expect taxpayers to exercise more care; that is, the taxpayer must have a reasonably arguable position on the matter.

13. These provisions do not apply to statements made in relation to the 2000–01 and later income years and were replaced by Division 284, specifically by subsection 284-75(2) and section 284-15.

14. The administrative penalty regime, which includes Division 284, applies from 1 July 2000 in relation to:

- income tax matters for the years commencing on or after 1 July 2000;
- fringe benefits tax (FBT) matters for the years commencing on or after 1 April 2001;
- PRRT matters for the years commencing on or after 1 July 2012;

[1] Part VII of the ITAA 1936 does not apply to statements made in relation to the 2000-01 and later income years. It was repealed by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*.

- withholding tax for transfer pricing scheme penalties for the years commencing on or after 29 June 2013;
- minimum tax matters relating to fiscal years commencing on or after 1 January 2024; and
- matters relating to other taxes for the years commencing 1 July 2000.

15. The regime sets out uniform administrative penalties that apply to entities that fail to satisfy certain obligations under different taxations laws.

16. The administrative penalty provisions consolidate and standardise the different penalty regimes that previously existed. In addition, the provisions apply in respect of various taxes and collection systems including income tax, FBT, goods and services tax, minimum tax, PRRT and pay as you go withholding and instalments.

17. Division 284 imposes penalties where an entity:

- makes a statement that is false or misleading in a material particular to:
  - the Commissioner or to an entity that is exercising powers or performing functions under a taxation law – subsection 284-75(1); or
  - to an entity other than the Commissioner and an entity that is exercising powers or performing functions under a taxation law and the statement is one required or permitted to be made by a taxation law – subsection 284-75(4).
- takes a position under a relevant tax law that is not reasonably arguable – subsection 284-75(2);
- fails to provide a return, notice or other document to the Commissioner that is necessary to determine a tax-related liability accurately, and the Commissioner determines the liability without the assistance of the document – subsection 284-75(3);
- disregards a private ruling;[2] or
- enters into a scheme to get a scheme benefit or a transfer pricing benefit – section 284-145.

18. This Ruling focuses on the penalty imposed under subsection 284-75(2) where an entity takes a position that is not reasonably arguable.

[2] This penalty does not apply in relation to income tax matters for the 2004-05 and later income years, FBT matters for the year beginning on 1 April 2004 and later years, and matters relating to other taxes for the year beginning 1 July 2004 and later years.

19. Subsection 284-75(2) and subsection 284-90(1) impose a penalty where:

- a statement is made by an entity or its agent, which treats a relevant tax law as applying to a matter in a particular way that is not reasonably arguable; and
- a shortfall amount resulting from the statement exceeds the reasonably arguable threshold set out in subsections 284-90(3) and (3A) in relation to item 4, 5, 6 or 6A of the table in subsection 284-90(1), as applicable.

20. An entity's agent, in this context, means someone who is authorised to represent the entity in making a statement to the Commissioner.

21. It is important to note that unlike other administrative penalties, which apply to all taxation laws, the administrative penalty under subsection 284-75(2) only applies in relation to relevant tax law.

22. Due to the operation of items 4, 5, 6 and 6A of subsection 284-90(1), a base penalty amount can only apply if the statement results in a shortfall amount. Exceptions under section 284-224 may also apply to reduce the amount of the penalty.[3] A statement can be made by way of omission, for example, where an entity fails to include information in a document or approved form when there is a requirement to do so. An example of this could be where an entity completes an income tax return but omits to return relevant amounts of income.

23. If an entity is liable to an administrative penalty under subsection 284-75(2), then under subsection 298-30(1) the Commissioner must make an assessment of the amount of penalty. This assessment is made in accordance with the formula described in section 284-85 as follows:

- calculate the base penalty amount under subsection 284-90(1);
- increase (section 284-220) or decrease (section 284-225) the base penalty amount if certain conditions are satisfied; and
- consider remission.

24. The base penalty amount under subsection 284-90(1) for a penalty imposed under subsection 284-75(2) is 25% of the shortfall amount, or the part of it, that resulted from taking a position on the law that was not reasonably arguable.

25. The Commissioner is required under section 298-10 to provide an entity with written notice of any liability for an

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[3] Section 284-224 sets out a number of situations which affect whether a base penalty amount is reduced. For guidance on the periods before 4 June 2010, see Miscellaneous Tax Ruling MT 2008/1 issued 12 November 2008.
[4] [Omitted].

administrative penalty and the reasons why the entity is liable to pay the penalty. However, the Commissioner is not required to provide reasons where a decision is made to remit all of the penalty.

26. Under subsection 298-30(2) an entity that is dissatisfied with an assessment of penalty may object to it in the manner set out in Part IVC of the TAA.

Differences between reasonably arguable and reasonable care

27. Under a self assessment system all entities are expected to exercise reasonable care in the conduct of their tax affairs.[5]

28. The reasonable care test requires entities to take the same care in fulfilling their tax obligations that could be expected of a reasonable person in the position of the entity. This means that even though the standard of care is measured objectively, it takes into account factors such as the entity's knowledge, education, experience and skill.[6]

29. In contrast there is no personal aspect to the reasonably arguable position test as it applies an objective standard involving an analysis of the law and application of the law to the relevant facts. It is not a question of whether an entity *thinks* or *believes* that its position is reasonably arguable, but simply whether it *is* reasonably arguable. Having a reasonably arguable position is a further requirement that must be satisfied where the shortfall amount is above a specified amount for the tax year. This approach is taken because the reasonable care standard on its own is seen as inadequate in large adjustment cases because of the personal considerations relevant to that test.[7]

30. In this sense, a higher standard is imposed than that required to demonstrate reasonable care. Because of these differences, an entity may not have a reasonably arguable position despite having satisfied the reasonable care test.

31. Although demonstrating a reasonably arguable position involves the application of a purely objective test, an entity will usually reach their position (at the time of making the statement) as a result of researching and considering the relevant authorities. In these circumstances, the efforts made by the entity to arrive at the correct taxation treatment will also demonstrate that reasonable care has been shown.

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[5] *Improvements to self assessment – Priority Tasks, An Information Paper August 1991*, circulated by the Honourable John Kerin, MP, Treasurer (the information paper) at paragraph 2.7 which were given effect to by the *Taxation Laws Amendment (Self Assessment) Act 1992* (repealed).

[6] See the proposals made in the information paper at paragraphs 2.7 to 2.12.

[7] See the proposals made in the information paper at paragraph 2.19.

Ruling

Administrative penalty under subsection 284-75(2)

32. An entity will be subject to an administrative penalty under subsection 284-75(2) where the entity or their agent makes a statement to the Commissioner which treats a relevant tax law as applying to a matter (or identical matters) in a particular way that, when having regard to the relevant authorities, is not reasonably arguable and there is a shortfall amount that exceeds the reasonably arguable threshold in subsection 284-90(3).

33. An amount is above the reasonably arguable threshold:

- where the shortfall amount exceeds the greater of $10,000 or 1% of the tax payable for the tax year on the basis of the entity's tax return (in relation to item 4 in the table in subsection 284-90(1)); or
- where the statement was made by a trustee of a trust under section 284-30, the effect of the treatment of the law on the net income or tax loss of the trust exceeds the greater of $20,000 or 2% of the net income (in relation to item 5 in the table in subsection 284-90(1)); or
- where a partner in a partnership makes such a statement under section 284-35, the effect of the treatment of the law on the net income or loss of the partnership exceeds the greater of $20,000 or 2% of the partnership net income (in relation to item 6 in the table in subsection 284-90(1)); or
- in relation to item 6A in the table in subsection 284-90(1), an entity's threshold for a fiscal year is the greater of:
  - $10,000; and
  - 1% of whichever of the following applies
    - the amount of Australian Income Inclusion Rule and Undertaxed Profits Rule (IIR/UTPR) tax payable[7A] by the entity for the fiscal year, worked out on the basis of the entity's Australian IIR/UTPR tax return for the fiscal year;
    - the amount of Australian domestic minimum tax (DMT) payable by the entity for the fiscal year, worked out on the basis of the entity's Australian DMT tax return for the fiscal year.

[7A] For definitions of 'Australian IIR/UTPR tax', 'Australian IIR/UTPR tax return', 'Australian DMT tax' and 'Australian DMT tax return', see section 995-1 of the *Income Tax Assessment Act 1997*.

34. The question whether the position taken by the entity is reasonably arguable is determined at the time the statement[8] is made by the entity.

Process for determining whether a position is reasonably arguable

35. Subsection 284-15(1) sets out the test to determine whether a particular way of applying the law is reasonably arguable. Essentially, the test is whether, having regard to the relevant authorities, it would be concluded that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.

35A. There is an additional requirement for transfer pricing scheme penalties. Where an entity does not have a documented transfer pricing treatment under Subdivision 284-E, Division 284 will apply as though a matter were not reasonably arguable. Paragraphs 67 to 87 of Law Administration Practice Statement PS LA 2014/2 *Administration of transfer pricing penalties for income years starting on or after 29 June 2013* provide guidance on the process for considering whether an entity has a documented transfer pricing treatment as part of deciding whether the entity has a reasonably arguable position for a particular treatment.

36. The section 284-15(1) standard required to meet this test is addressed in paragraph 1.23 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000:

> The test does not require the taxpayer's position to be the 'better view'; … However, the reasonably arguable position standard would not be satisfied if a taxpayer takes a position which is not defensible, or that is fairly unlikely to prevail in court. On the contrary, the strength of the taxpayer's argument should be sufficient to support a reasonable expectation that the taxpayer could win in court. The taxpayer's argument should be cogent, well-grounded and considerable in its persuasiveness.

37. The Full Federal Court in *Pridecraft Pty Ltd v. Federal Commissioner of Taxation* [2004] FCAFC 339; 2005 ATC 4001; (2004) 58 ATR 210 at paragraph 108 agreed that Hill J in *Walstern's case* had outlined the correct approach to the imposition of additional tax by way of penalty under the former subsection 226C(1) of the ITAA 1936:

[8] In the context of self assessment, where entities determine their own tax liabilities, a statement will include entering an amount or other information at a label or an application, approved form, business activity statement, instalment activity statement, certificate, declaration, notice notification, return or other document prepared or given under a taxation law. A statement by way of omission can also be a statement.

1. The test to be applied is objective, not subjective. This is clear from the use of the words 'it would be concluded' in paragraph (1)(b) of the section.[9]

2. The decision maker considering the penalty must first determine what the argument is which supports the taxpayer's claim.

3. That person will already have formed the view that the claim is wrong, otherwise the issue of penalty could not have arisen. Hence the decision maker at this point will need to compare the taxpayer's argument.

4. The decision maker must then determine whether the taxpayer's argument, although considered wrong, **is about as likely as not correct, when regard is had to 'the authorities'**.`

5. It is not necessary that the decision maker form the view that the taxpayer's argument in an objective sense is more likely to be right than wrong. That this is so follows from the fact that tax has already been short paid, that is to say the premise against which the question is raised for decision is that the taxpayer's argument has already been found to be wrong. Nor can it be necessary that the decision maker form the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision maker considers to be the correct argument for the decision maker has already formed the view that the taxpayer's argument is wrong. The standard is not as high as that. **The word 'about' indicated the need for balancing the two arguments, with the consequence that there must be room for it to be argued which of the two positions is correct so that on balance the taxpayer's argument can objectively be said to be one that while wrong could be argued on rational grounds to be right.**

6. An argument could not be as likely as not correct if there is a failure on the part of the taxpayer to take reasonable care. Hence the argument must clearly be one where, in making it, the taxpayer has exercised reasonable care. However, mere reasonable [care] will not be enough for the argument of the taxpayer must be such as, objectively, to be 'about as likely as not correct' when regard is to be had to the material constituting 'the authorities'.

[9] See subsection 284-15(1) of Schedule 1 to the *Taxation Administration Act 1953* which uses the same words.

> 7. Subject to what has been said the view advanced by the taxpayer must be one where objectively it would be concluded that having regard to the material included with the definition of 'authority' a reasoned argument can be made which argument when contrasted with the argument which is accepted as correct is about as likely as not correct. That is to say the two arguments, namely, that which is advanced by the taxpayer and that which reflects the correct view will be finely balanced. The case must thus be one where reasonable minds could differ as to which view, that of the taxpayer or that ultimately adopted by the Commissioner was correct. There must, in other words, be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless 'about' as likely to be correct as the correct view. A question of judgment is involved.
>
> *(Emphasis added)*

38. The approach outlined by Hill J[10] demonstrates that the reasonably arguable position standard is an objective standard involving an analysis of the law and application of the law to the relevant facts. All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether an entity has a reasonably arguable position.

39. In other words, the position must be a contentious area of law, where the relevant law is unsettled or where, although the principles of the law are settled, there is a serious question about the application of those principles to the circumstances of the particular case.[11]

Having regard to 'relevant authorities'

40. The question of whether the position taken by the entity is reasonably arguable is determined by reference to the law as it stood at the time the statement is made by the entity.

41. Under subsection 284-15(3), the following authorities are relevant in determining whether an entity has a reasonably arguable position:

- a taxation law;
- material for the purposes of subsection 15AB(1) of the *Acts Interpretation Act 1901* which covers any material not forming part of the Act which is capable of assisting in the ascertainment of the meaning of the provision

[10] *Walters v. Federal Commissioner of Taxation* (2007) 162 FCR 421; 2007 ATC 4973; (2007) 67 ATR 156 and *Federal Commissioner of Taxation v. R & D Holdings Pty Ltd* (2007) 160 FCR 248; 2007 ATC 4731; (2007) 67 ATR 790 have also followed the principles outlined by Hill J in *Walstern's case*.

[11] Paragraph 1.22 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.

such as explanatory memoranda and second reading speeches;

- a decision of a court (whether or not an Australian court), the Administrative Appeals Tribunal, the Administrative Review Tribunal or a Taxation Board of Review;
- a public ruling.[12]

42. The relevance of any authority is a matter to be weighed against other authorities, including the applicable statutory provisions and the facts of the case.[13] The relevant authorities will be weighed according to their:

- persuasiveness (an authority that has extensive reasoning, relating relevant law and facts, would be more persuasive than one that simply states a conclusion);
- relevance (an authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is inapplicable to the tax treatment at issue);[14] and
- source (a High Court decision on all fours with the tax treatment in question will be accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the Administrative Appeals Tribunal).[15]

43. The absence of authority for a particular position, other than the legislation itself, will not be detrimental to an entity seeking to establish a reasonably arguable position. What is required in such cases is that the entity has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation.[16]

44. The majority (Stone and Allsop JJ) in *Cameron Brae Pty Ltd v. Federal Commissioner of Taxation* (2007) 161 FCR 468; 2007 ATC 4936; (2007) 67 ATR 178 at paragraph 70 ruled that the taxpayer had a reasonably arguable position despite there being no authority on the issue:

> In our view, the question of construction and interpretation of section 82AAE [*Income Tax Assessment Act 1936*] was reasonably open and arguable. No authority squarely covered it. The proper interpretation depended upon the construction of section 82AAE informed by a full

[12] Public Ruling has the meaning given by section 358-5 of Schedule 1 to the TAA 1953.
[13] Paragraph 1.28 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.
[14] Paragraph 1.28 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.
[15] Paragraph 1.28 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.
[16] Paragraph 1.26 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.

> appreciation of the statutory history. The argument about the applicability or satisfaction of section 82AAE was arguable…If it be necessary to decide, we are also prepared to conclude that the issue as to the characterisation of the outgoing as capital or revenue was arguable. Whilst in our view it is clear that it was payment of a capital nature, the question is open to debate in the sense of being arguable.

45. As the reasonably arguable position standard is an objective standard, all authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into consideration in determining whether an entity has a reasonably arguable position.

46. While a public ruling issued by the Commissioner under Division 358 is a relevant authority, the mere fact that a public ruling has issued does not necessarily mean that alternative treatments to that suggested by the public ruling cannot be reasonably arguable.

47. In other words, entities should take particular note of the Commissioner's views on the correct operation of the law as expressed in a public ruling, but may adopt alternative treatments provided there are sound reasons for doing so.

48. Where there are significant alternative views in relation to the interpretation or application of the law adopted in a public ruling, the ruling will usually acknowledge the existence of those alternative views. Alternative views expressed in public rulings are not necessarily equivalent to having a reasonably arguable position. However, the relevant authorities used to support the alternative view may assist the entity in formulating a reasonably arguable position.

49. The list in subsection 284-15(3) is not intended to be exhaustive, and a wider range of authorities may be taken into account in weighing up the merits of the competing arguments. For example, authorities relating to other areas of law, such as contract law may provide support for a particular treatment of an item.[17]

50. Other authorities could also include statements in texts recognised by professionals as being authoritative about how the law operates, particularly in cases where there are few authorities on the correct treatment of a matter apart from the legislation itself. The relative weight to be given to each authority would depend on the circumstances.

51. In comparison, an entity having an opinion expressed by an accountant, lawyer or other adviser is not of itself a relevant authority. Rather, the authorities used to support or reach the views expressed by the adviser, including a reasonable construction of the relevant statutory provisions, may support the position taken by a taxpayer.[18] Accordingly, the Commissioner will consider the authorities referred to in any opinion submitted by a taxpayer.

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[17] Paragraph 1.25 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.

[18] Paragraph 1.27 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.

Documenting a transfer pricing treatment for eligibility to take a reasonably arguable position

51A. The requirements for documenting a reasonably arguable position differ depending on whether the penalty is a transfer pricing scheme penalty or any other type of penalty.

Transfer Pricing Scheme Penalties: Documenting a transfer pricing treatment for eligibility to take a reasonably arguable position

51B. Section 284-250 states that if, an entity does not have records explaining the particular way in which the transfer pricing rules apply (or do not apply) to a matter (or identical matters) (referred to as 'transfer pricing treatment'), then that treatment will not be a reasonably arguable position for administrative penalty purposes. The specific requirements for documenting a transfer pricing treatment in a way so that the treatment is eligible to be taken as reasonably arguable are set out in section 284-255 ('documentation requirements').

51C. If an entity has not met the requirements for documenting a transfer pricing treatment (referred to as an 'undocumented transfer pricing treatment'), the entity cannot take a reasonably arguable position concerning that undocumented treatment. If an entity has met the requirements for having a 'documented transfer pricing treatment', that entity is eligible to take a reasonably arguable position, for the purposes of Division 284, for that treatment.

51D. Guidance on the documentation requirements can be found in paragraphs 72 to 79 of Law Administration Practice Statement Law Administration PS LA 2014/2 *Administration of transfer pricing penalties for income years starting on or after 29 June 2013*. PS LA 2014/2 sets out the process for determining whether an entity will have a documented or undocumented transfer pricing treatment when assessing transfer pricing scheme penalties.

51E. Further guidance on the documentation requirements is contained in Taxation Ruling TR 2014/8 *Income tax: transfer pricing documentation and Subdivision 284-E*. This ruling sets out the ATO's view on documenting a transfer pricing treatment contemporaneously.

Documenting a reasonably arguable position in all other cases

52. The general administrative penalty provisions do not require an entity to document their reasonably arguable position at the time that the statement is made. The Commissioner considers that, whilst the reasonably arguable position is determined at the time the statement is made, an entity has the opportunity to demonstrate their position when a shortfall amount in terms of subsection 284-80(1) is identified, which may be a number of years later.

53. When an entity provides their cogent reasons for taking a particular position, this will assist the Tax Office to objectively and expeditiously determine whether a reasonably arguable position was

taken at the time the statement was made. When providing these reasons, a discussion as to why the alternative arguments do not apply would be useful.

54. Although it is common practice for an entity to provide supporting reasons for the position they have taken, the failure to do so does not by itself mean that the entity does not have a reasonably arguable position. This is because the test is objective. Accordingly, in determining whether an entity has a reasonably arguable position, the Tax Office will consider all authorities relevant to the tax treatment of an item, including contrary authorities.

Is the shortfall amount above the requisite threshold?

55. An entity is only required to have a reasonably arguable position for the purposes of the administrative penalty provisions where their statement results in a shortfall amount which exceeds the relevant threshold outlined in paragraph 33 of this Ruling.

56. The method for working out whether an entity has a shortfall amount is provided for in the table in subsection 284-80(1).

57. Where a shortfall amount results from the entity treating the tax law as applying in a particular way that was not reasonably arguable, the base penalty amount under subsection 284-90(1) is 25% of the shortfall amount.

Example 1 – shortfall amount is less than the threshold

58. *AJ Co is liable to pay $50,000 based on its tax return in respect of a year of income and has claimed a deduction which is not properly allowable, leading to a shortfall amount of $7,000. Before consideration can be given to imposing an administrative penalty under subsection 284-75(2) the shortfall amount must exceed the greater of $10,000 or 1% of the income tax payable which is $500.*

59. *In this case, AJ Co has a shortfall amount of $7,000 which is less than $10,000 and so the requisite threshold has not been met.*

Example 2 – shortfall amount greater than the threshold

60. *Hill Co is liable to pay $20 million based on its tax return in respect of a year of income. The company has omitted income from the sale of a property resulting in a shortfall amount of $500,000. Before consideration can be given to imposing an administrative penalty under subsection 284-75(2), the shortfall amount must exceed the greater of $10,000 or 1% of the income tax payable. In these circumstances, 1% of the income tax payable by Hill Co is $200,000.*

61. *Hill Co has a shortfall amount of $500,000 which is greater than $200,000 and so the requisite threshold has been met.*

Identical matters

62. The threshold is applied separately to each non-identical situation in which the entity did not take a reasonably arguable position. If however, the matters were identical then paragraph 284-75(2)(b) ensures that they are treated as a single matter. This rule is designed to prevent single matters being split into smaller components to avoid the operation of the section. This provision should not be used to treat, as a single matter, numerous similar but distinct items of adjustment.

Example 3 – identical matters are treated as a single matter

63. *Trevor fails to include interest. If there are statements about two matters, each causing a shortfall amount of $7,500, and those matters are identical, their values are combined, resulting in a total shortfall amount of $15,000. This exceeds the $10,000 threshold and if that is higher than the 1% alternative threshold, Trevor is potentially subject to the administrative penalty under subsection 284-75(2).*

Circumstances where the shortfall amount is reduced

64. Subsection 284-224(1) sets out a number of situations which reduce an entity's base penalty amount under section 284-90.[18A] The base penalty amount is reduced to the extent that it was caused by the entity or its agent treating a taxation law as applying in a way that is consistent with any of the following:

- advice given to the entity or its agent by or on behalf of the Commissioner (paragraph 284-224(1)(a);[19]
- general administrative practice under that law (paragraph 284-224(1)(b)[20] or
- a statement in a publication approved in writing by the Commissioner paragraph 284-224(1)(c), for example, a statement made in *TaxPack*.

65. [Omitted].

[18A] For guidance on the periods before 4 June 2010, see Miscellaneous Tax Ruling MT 2008/1 issued 12 November 2008.
[19] Generally, 'advice' would include correspondence from the Tax Office on a matter relating to a taxation law, a private ruling, an oral ruling and statements made in public rulings.
[20] A general administrative practice under a taxation law is a practice adopted by the Commissioner which applies to all entities, to a class of entities or to a specified group within a class.

Reasonable care exception does not apply

66. Under subsection 284-75(5) an entity is not liable to an administrative penalty as a result of a false or misleading statement if the entity or its agent took reasonable care in making the statement. In these circumstances, an administrative penalty will not arise under subsection 284-75(1) or (4).[21]

67. However, at paragraph 1.110 of the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000 it is pointed out that taking reasonable care in making such a statement will not provide protection against the 'no reasonably arguable position' penalty under subsection 284-75(2). This is because the 'no reasonably arguable position' penalty operates as a stand alone provision.

Errors of fact

68. The reasonably arguable position test only applies to shortfall amounts caused by an entity treating a relevant tax law as applying in a particular way. This occurs where the entity concludes that, on the basis of the facts and the way the law applies to those facts, a particular consequence follows.

69. However, an entity's conclusions on a particular matter may have been based on incorrect primary facts which the entity did not know and could not reasonably be expected to have known were not the true facts. An example is where an entity relies on a bank to provide details of the amount of interest earned on a deposit. In other cases, the statements in an entity's return may not represent conclusions of the entity, but might reflect errors in calculation or transposition errors.

70. As a broad rule, where a shortfall amount was caused by an error of fact or calculation, the 'no reasonably arguable position' penalty will not apply since the entity has not treated a relevant tax law as applying to a matter in a particular way.

71. In this context, errors of fact are errors of primary fact and not wrong conclusions of fact which an entity may make which bear on the correct application of a tax law, such as whether the entity is carrying on a business. Whether the statements in an entity's return represent conclusions of the entity or were caused by errors of fact or calculation should be determined on the basis of all the available evidence. Note that where there is an error of fact it may be necessary to consider whether the entity has taken reasonable care.

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[21] For guidance on the periods before 4 June 2010, see Miscellaneous Tax Ruling MT 2008/1 issued 12 November 2008.

Example 4 – error of fact – income tax matter

72. *Bill when looking up the effective life of a particular asset mistakenly selects the wrong effective life. Bill knows the relevant asset category but accidentally selects the effective life for the asset category listed next to the correct one. Although Bill has claimed a deduction for decline in value using the incorrect effective life as a result of this error, it does not involve treating an income tax law as applying in a particular way.*

73. *In these circumstances, the 'no reasonably arguable position' penalty will not apply because Bill has not treated an income tax law as applying to a matter in a particular way.*

Definitions

Base penalty amount

74. In the context of Division 284, subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) states that the base penalty amount for calculating the amount of an administrative penalty is worked out under:

- section 284-90, where the penalty is for a false or misleading statement, or a position that is not reasonably arguable; and
- section 284-160, where the penalty relates to a scheme.

75. The base penalty amount is the starting point for the calculation of an administrative penalty.

Income tax law

76. Income tax law under subsection 995-1(1) of the ITAA 1997 means a provision of an Act or regulations under which is worked out the extent of liability for:

(a) tax; or

(b) Medicare levy; or

(c) franking tax; or

(d) withholding tax; or

(e) mining withholding tax.

MRRT law

76A. [Omitted.]

PRRT law

76B. PRRT law under subsection 995-1(1) of the ITAA 1997 means:

(a) the *Petroleum Resource Rent Tax Assessment Act 1987*;

(b) any Act that imposes PRRT;

(c) the TAA, so far as it relates to any Act covered by paragraphs (a) and (b);

(d) any other Act, so far as it relates to any Act covered by paragraphs (a) to (c) (or to so much of that Act as is covered); and

(e) regulations under an Act, so far as they relate to any Act covered by paragraphs (a) to (d) (or to so much of that Act as is covered).

Scheme

77. 'Scheme' is very widely defined in subsection 995-1(1) of the ITAA 1997. It means any arrangement, scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

78. An arrangement is further defined in subsection 995-1(1) of the ITAA 1997 as any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

Shortfall amount

79. 'Shortfall amount' is defined in subsection 995-1(1) of the ITAA 1997 as having the meaning given by section 284-80.

80. Item 3 and 4 of the table in subsection 284-80(1) provide that a shortfall amount is the amount by which the relevant tax-related liability, or the payment or credit, is less than or more than it would otherwise have been if the statement did not treat a relevant tax law as applying in a way that was not reasonably arguable.

Taxation law

81. 'Taxation law' is defined in subsection 2(1) of the TAA as having the meaning given by the ITAA 1997. Subsection 995-1(1) of the ITAA 1997 defines 'taxation law' as an Act of which the Commissioner has the general administration and any regulations under such an Act. It also includes part of an Act (and associated regulations) to the extent that the Commissioner has the general administration of the Act.

82. However subsection 2(2) of the TAA provides that an Excise Act (as defined in subsection 4(1) of the *Excise Act 1901*) is not a taxation law for the purposes of Subdivision 284-B (administrative penalties relating to statements).

Tax-related liability

83. 'Tax-related liability' is defined in subsection 995-1(1) of the ITAA 1997 as having the meaning given by section 255-1.

84. Section 255-1 provides that a tax-related liability is a pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is not yet due and payable).

Commissioner of Taxation
12 November 2008

Appendix 1 – Detailed contents list

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