PS LA 2006/2 - Administration of shortfall penalty for false or misleading statement

This cover sheet is provided for information only. It does not form part of *PS LA 2006/2 - Administration of shortfall penalty for false or misleading statement*

This document has changed over time. This version was published on *1 April 2004*

Generated on: 20 November 2026, 11:52:57 PM

Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2006/2

FOI status: may be released

This practice statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by Tax Office staff unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs, Tax Office staff must follow their business line's escalation process.

SUBJECT: **Administration of shortfall penalty for false or misleading statement**

PURPOSE: **To explain:**

- **how a statement may be false or misleading and result in a shortfall for the purposes of the uniform penalty provisions,**
- **how the Commissioner assesses the shortfall penalty, and**
- **when the assessed penalty may be remitted.**

STATEMENT

1. All legislative references in this practice statement are to Schedule 1 to the *Taxation Administration Act 1953* (TAA) unless otherwise specified.
2. The administrative penalty regime in Part 4-25 of Schedule 1 to the TAA imposes uniform penalties for certain acts or omissions which relate to matters arising under taxation laws.
3. The penalty regime consists of three distinct components:
   - penalties relating to statements and schemes
   - penalties for failing to lodge returns and other documents on time, and
   - penalties for failing to meet other tax obligations.
4. Subdivision 284-B imposes penalties relating to statements. These penalties do not apply in relation to any Excise Act (as defined in subsection 4(1) of the *Excise Act 1901*) because of the exception in subsection 2(2) of the TAA.

5. This practice statement explains how the Commissioner administers the administrative penalty on shortfall amounts (shortfall penalty) imposed under subsection 284-75(1) for statements which are false or misleading in a material particular. It provides guidance on:

   - when a statement will give rise to liability to the administrative penalty
   - how penalty amounts are assessed, and
   - when remission of the penalty under section 298-20 is warranted.

6. This practice statement applies to statements in so far as they relate to:

   - income tax matters for the 2001 and later income years
   - fringe benefits tax matters for the year commencing 1 April 2001 and later years, and
   - matters relating to other taxes for the year commencing 1 July 2000 and later years.

7. However, the parts of this practice statement which explain the remission of penalty only apply to statements made on or after 1 April 2004 in so far as they relate to the above periods. This practice statement replaces Law Administration Practice Statement PS LA 2004/5 which will no longer apply to statements made on or after 1 April 2004. Law Administration Practice Statements PS LA 2000/9 and PS LA 2002/8 continue to apply to statements made before 1 April 2004.

8. This practice statement does not deal with the administration of other types of penalties imposed under Division 284. Nor does it deal with the imposition or remission of the general interest charge (GIC) which is independent of the administrative shortfall penalty for a false or misleading statement. The Tax Office policy on the remission of GIC is set out in the *ATO Receivables Policy*.

9. An outline of the contents of this practice statement is as follows:

Topic	**Paragraphs**
Outline of Division 284 and the shortfall penalty for false or misleading statements	10 – 17
How the penalty for false or misleading statements is administered	18 – 23
Step 1: Is a penalty for a false or misleading statement imposed by law?	**24 – 94**
• Has a statement been made?	25 – 30
• Is the statement false or misleading in a material particular?	31 – 34

• Has the statement resulted in a shortfall amount?
  • What is a shortfall amount?
  • How is a shortfall amount calculated?
	35 – 45

• Has the entity exercised reasonable care?
  • Reporting tax obligations
  • Using an agent
	46 – 78

• Has the entity relied on advice or a statement from the Commissioner?	79 – 80
• Does the entity's treatment agree with a general administrative practice?	81 – 82

• Who is liable for the penalty?
  • Partnerships (other than corporate limited partnerships)
  • Trusts
	83 – 94

Step 2: Assess the amount of the penalty	**95 – 135**

• Base penalty amount
  • Failure to take reasonable care
  • Recklessness
  • Intentional disregard of a taxation law
	97 – 111

• Increase or reduction of the base penalty amount
  • Increase in base penalty amount
  • Reduction in base penalty amount
  • Unprompted voluntary disclosure
  • Prompted voluntary disclosure
  • Commissioner's discretion regarding prompted voluntary disclosure
	112 – 130

• What if more than one base penalty amount applies?	131 – 135
Step 3: Should the subsection 284-75(1) penalty be remitted in full or in part?	**136 – 158**

• What factors are considered when deciding whether or not to remit the penalty at the time it is assessed
  • The entity's particular circumstances and compliance history
  • Timing adjustments
  • Correcting GST mistakes
  • Unprompted voluntary disclosure
  • An amount disclosed or a deduction or credit claimed in another entity's return or activity statement in the same accounting period
  • The application of the special rules in respect of trustees may impose an overly burdensome penalty
  • Treating entities in the same circumstances consistently
  • Unjust result
	138 – 158

Step 4: Notify the entity of the liability to pay the penalty	**159 – 164**

EXPLANATION

Outline of Division 284 and the shortfall penalty for false or misleading statements

10. The penalty regime in Part 4-25 of Schedule 1 to the TAA sets out the uniform administrative penalties that apply to entities[1] for failing to satisfy obligations under taxation laws.[2] Uniform penalties will apply where an entity fails to satisfy the same type of obligation under different taxation laws.

11. The administrative penalty provisions consolidate and standardise the previous penalties framework, and also apply in respect of the New Tax System taxes and collection systems, including GST and PAYG withholding and instalments, being reported on the Business activity statement. Penalty provisions that were inserted at various times into the different taxation Acts are now grouped together in Schedule 1 to the TAA.

12. Division 284 imposes a penalty where an entity:

- makes a statement which is false or misleading in a material particular (subsection 284-75(1))
- takes a position under an income tax law that is not reasonably arguable (subsection 284-75(2))
- fails to provide a document to the Commissioner that is necessary to determine a tax liability, and the Commissioner determines the liability without that document (subsection 284-75(3))
- disregards a private ruling (subsection 284-75(4)),[3] or
- enters into a scheme to get a scheme benefit (section 284-145).

13. Subsection 284-75(1) imposes penalties for false or misleading statements according to an entity's behaviour and actions at the time of and leading up to the making of a statement. Where the facts demonstrate that the entity has taken reasonable care to comply with their tax obligations, no administrative penalty will be imposed under subsection 284-75(1). Although an entity will not be liable to a subsection 284-75(1) penalty where they have taken reasonable care they may still be liable to one of the other penalties listed in paragraph 12.

14. An entity's behaviour and actions following the discovery of a shortfall will also be relevant in determining whether the penalty initially imposed should be increased or reduced.

[1] Entity includes an individual.
[2] Subsection 2(2) of the *Taxation Administration Act 1953* specifies Acts which are not taxation laws for the purposes of Subdivision 284-B in Schedule 1.
[3] As a result of amendments made by *Taxation Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* the penalty for a shortfall amount arising from a failure to follow a private ruling does not apply to income tax matters for the 2004-2005 and later years; fringe benefits tax matters for the year starting 1 April 2004 and later years; and matters relating to other taxes for the year starting 1 July 2004 and later years.

15. The Commissioner will further consider the entity's behaviour, individual circumstances and compliance history in exercising his discretion to remit some or all of the penalty assessed under Division 284, in so far as those factors demonstrate the entity's efforts to comply with their tax obligations, both currently and in the past.

16. At each stage where the entity's (or agent's) behaviour is relevant, the following factors should be taken into account:

- The statements and principles in the taxpayers' charter. An entity should be presumed to have been honest unless there is information which suggests otherwise. Conclusions about what motivated the entity's behaviour should only be made where they are supported by facts or where reasonable inferences can be drawn from those facts. Other than the automated case actioning environment (that is, data matching) or where the facts clearly show that the entity is deliberately disengaging from the tax system, the entity should be contacted and given the opportunity to explain their actions before the penalty decision is made.
- The individual circumstances of the case, giving appropriate consideration to the background and experience of the entity in a self-assessment environment.
- The principles which underpin the compliance model (this includes the need for graduated responses to non-compliance).

17. The particular facts of each case will determine the liability to penalty for a false or misleading statement, and whether or not the Commissioner should exercise the discretion to remit. For this reason, the statements and examples in this practice statement should be used as a general guide only.

How the penalty for false or misleading statements is administered

18. Subsection 284-75(1) sets out the conditions for an entity to be liable to an administrative penalty for a false or misleading statement. If all the conditions are met, a penalty will apply unless one of the exceptions in section 284-215 applies.

19. The severity of the penalty depends on the Commissioner's assessment of:

- the level of care taken by the entity or the tax agent, and
- certain factors set out in the legislation that increase or reduce the penalty.

20. Assessment of penalty therefore occurs in two stages. First, the base penalty amount is determined according to the level of care taken by the entity or the entity's agent. Second, the base penalty amount will be increased where the entity does one of the things listed in section 284-220 or reduced because of voluntary disclosure under section 284-225.

21. Once the penalty has been assessed, section 298-20 gives the Commissioner the discretion to remit that penalty in part or in full.

22. Thus, the administration of penalties for false or misleading statements involves four main steps:

- Step 1 – Determine whether a penalty for false or misleading statement is imposed by law
- Step 2 – Assess the amount of the penalty
- Step 3 – Determine whether the penalty should be remitted in full or in part
- Step 4 – Notify the entity of the liability to pay the penalty.

23. Each of these steps must be followed in the order in which they appear above. For example, consideration of the discretion to remit a penalty cannot take place until the penalty amount has been assessed. Each step is discussed in detail below.

Step 1: Is a penalty for a false or misleading statement imposed by law?

24. An entity is liable for an administrative penalty if:

- the entity or their agent makes a statement to the Commissioner or another person exercising powers or performing functions under a taxation law
- the statement is false or misleading in a material particular, whether because of something in it or omitted from it, and
- the entity has a shortfall amount as a result of the statement.

Has a statement been made?

25. A statement is anything communicated to the Commissioner or to another person exercising powers or performing functions under a taxation law, including a statement made to:

- a tax officer in the course of his or her duties, or
- a Customs officer who is authorised to administer an indirect tax law under a delegation from the Commissioner, for example, administering the GST provisions on taxable importations.

26. A statement may be made or given in writing, orally or in any other way, including electronically. Statements may be made in correspondence, responses to requests for information, a notice of objection, a request for an amendment to an assessment, in answer to a questionnaire or in connection with an audit or investigation.

27. In the context of self-assessment, where entities determine their own tax liabilities and pay the amounts due by dates specified in the law, a statement will include entering an amount or other information at a label on 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.

28. Entering an amount at a label will generally be a statement of mixed fact and law in so far as it indicates that the amount returned was received, expended or withheld etc. and that the amount was the correct amount assessable, deductible or reportable etc.

Example 1

Simon entered an amount at the 'other work related expenses' deduction label on his income tax return. Simon made a statement of mixed fact and law because he claimed that he had incurred the expenditure and that he is entitled to a deduction for that expenditure in that income year.

29. A statement may be made where an entity fails to include information in a document or approved form when there is a requirement to do so. Although at first it appears that no statement was in fact made, the entity will be taken to have made a negative statement, for example, that there was no liability or that an event did not occur.

30. However, if no statement is made because of a failure to lodge an approved form (for example, an activity statement) the entity is not liable for a penalty under subsection 284-75(1). The entity may be liable to a penalty under subsection 284-75(3) for failing to provide a document necessary for determining a tax related liability and Division 286 for failure to lodge a return, statement, notice or other document on time.

Is the statement false or misleading in a material particular?

31. A statement is false if it is contrary to fact or wrong irrespective of whether or not it was made with knowledge that it was false.

Example 2

Paul, a sole trader, claimed a deduction for car expenses based on a faulty odometer. The claim is a false statement, even if he was unaware that the odometer was faulty.

32. A statement is misleading if it creates a false impression, even if the statement is true. It may be false or misleading because of something contained in the statement, or because something is omitted from the statement. Even if it is literally true it may be misleading because it is uninformative, unclear or deceptive.

Example 3

Julia requested an amendment to her income tax assessment to claim a deduction for a gift. In her request she failed to disclose that a material advantage accrued to her in return for making the gift. The taxpayer has made a false statement even though she actually made the gift. The taxpayer failed to disclose a fact which would affect her entitlement to a deduction.

33. A material particular is something that is likely to affect a decision regarding the calculation of an entity's tax liability or entitlement to a credit or refund. An inconsequential fact which does not affect an entity's tax position will not be a material particular. Most information provided in an income tax return or activity statement will be material particulars.

Example 4

Company X understated in its return the amount of gross interest it derived for the year. The omission of an amount of interest resulted in the company's taxable income being understated for the income year. The understatement of gross interest is a material particular because it reduced the amount of income tax that was assessed to be payable.

34. If a statement was correct at the time it was made but is subsequently made incorrect because of a retrospective amendment to the law, the statement is not later considered false or misleading. It is the nature of the statement at the time that it was made that is relevant.

Has the statement resulted in a shortfall amount?

35. The shortfall amount must result from the false or misleading statement. A penalty will not be imposed under subsection 284-75(1) if there is no shortfall amount resulting from a false or misleading statement or if an exception in section 284-215 applies.

What is a shortfall amount?

36. The table in section 284-80 lists the circumstances that give rise to a shortfall amount. Only the circumstances listed in Item 1 and Item 2 relate to false or misleading statements. Where one of those items applies, the shortfall amount is either the amount by which a tax-related liability is less, or a payment or credit is more than it would have been if the false or misleading statement was not made.

37. A tax-related liability is a pecuniary liability to the Commonwealth arising under a taxation law. For the purposes of determining the shortfall amount under Item 1 of subsection 284-80(1), the various tax-related liabilities are listed in section 250-10. Reportable amounts or total amounts as stated in a document will not necessarily be tax-related liabilities.

38. Item 2 of subsection 284-80(1) relates to an amount that the Commissioner must pay or credit to a taxpayer under a taxation law, that is provisions which specify that an entity is entitled to a payment or credit. An amount credited under the running balance account provisions would fall for consideration under this item.

39. In some circumstances, it is possible for both Item 1 and Item 2 to apply to the same shortfall. For example, an entity may over-claim a refundable tax offset or input tax credit and Item 2 would apply. Where the over-claimed credit also reduces the tax liability by more than it otherwise would have, then Item 1 will also apply. In such a case tax officers are to treat the shortfall amount as arising under either Item 1 or Item 2 but not both.

How is a shortfall amount calculated?

40. A shortfall amount is generally worked out for an accounting period. However, in some circumstances it is worked out on an 'events' basis, for example, taxable importations or wine tax on customs dealings.

41. For income tax purposes a shortfall amount is the amount by which the income tax for the income year, as worked out under subsection 4-10(3) of the *Income Tax Assessment Act* 1997 (ITAA 1997), is less than it would have been had the false or misleading statement not been made.

Example 5

Company Y lodged an income tax return for the 2003 income year disclosing assessable income of $35,000 and deductions of $3,000. No tax offsets were claimed. During an audit, it was discovered that rental income of $10,000 and rental outgoings of $8,000 had not been disclosed. The shortfall amount is the amount by which the tax-related liability is understated:

Actual tax liability	
($35,000 - $3,000) + ($10,000 - $8,000) = $34,000 × 30%	$10,200.00
Returned tax liability	
($35,000 - $3,000) = $32,000 × 30%	$9,600.00
Shortfall amount	$ 600.00

42. A shortfall amount may be modified by the formula in subsection 284-80(2) where the head company of a consolidated group makes errors in working out a tax cost setting amount for an asset, as mentioned in section 705-315 of the ITAA 1997.

43. There can be a number of shortfall amounts arising from different tax-related liabilities in a activity statement. This is because the activity statement is designed to report more than one tax-related liability.

Example 6

Company Z notified the following amounts in its activity statement:

GST net amount	$83,000 CR
PAYG tax withheld	$10,000 DR
PAYG income tax instalment	$50,000 DR
Deferred company instalment	$ 8,000 DR
Net amount for activity statement	$15,000 CR

During an audit, a tax officer found that the PAYG tax withheld for the period was actually $20,000. All the other amounts notified were correct. Although the correct net amount for the quarter is still a credit, there is a shortfall amount of $10,000 in the PAYG withholding liability. The penalty will be worked out on the PAYG withholding shortfall amount of $10,000.

Example 7

Company XY notified in its activity statement that the GST net amount payable for a period was $25,000. During a field verification visit, a tax officer found that GST payable on supplies by the company was understated by $5,000 and input tax credits were understated by $1,000. As the tax-related liability under the GST law is the net amount payable for the tax period, the shortfall amount is $4,000. The penalty for the false or misleading statement is worked out on that net amount (the shortfall amount), not the $5,000 understatement of GST payable on supplies.

44. Section 284-215 sets out a number of situations which affect whether a shortfall amount exists for penalty purposes or whether a shortfall amount is reduced or eliminated. Where this provision applies and a shortfall amount is taken not to exist or is eliminated, no liability to a penalty arises under subsection 284-75(1).

45. Although an entity may make a statement that is false or misleading in a material particular, they will not have a shortfall amount for the purposes of subsection 284-75(1) to the extent that the entity (or their agent) exercised reasonable care in making the statement. This is because of the exception in subsection 284-215(2).

Has the entity exercised reasonable care?

46. Reasonable care in the context of subsection 284-215(2) means the care that a reasonable person, in the same circumstances as the entity, would be likely to exercise in making the statement. In practice, this means that all actions leading up to making the statement should be taken into account, including record keeping, reporting and using a tax agent.

47. Whether a person has exercised reasonable care is considered objectively. This means that the test is not whether the person intended or tried to exercise reasonable care, but rather whether they have in fact done so. It is generally the case though, that where a person makes a genuine effort to ensure that statements made to the Commissioner are correct, it is likely that the facts will show that reasonable care was taken.

48. The standard of care of a reasonable person in the circumstances of the entity is not meant to be overly onerous. It does not mean that an entity or their agent is required to demonstrate the highest possible level of skill or care. The standard is that of a sensible person in the circumstances of the particular person.

49. It should be noted that generally no one factor, taken in isolation, will be sufficient to determine reasonable care or the lack thereof. All the circumstances need to be considered and it is a question of degree as to the relevance of a particular factor.

50. A person may make a statement about their own tax affairs or about the tax affairs of an entity which the person represents. Determining what would amount to reasonable care in the circumstances of the entity involves recognition of that person's:

- personal circumstances (such as age, health and background)
- level of knowledge, and/or
- understanding of the tax laws.

51. The physical and mental health, and the age, of a person can be relevant in determining whether reasonable care has been exercised. For example, when a person's incapacity is serious enough that it encroaches on most aspects of their daily life, it is more likely that they will be found to have taken reasonable care for a person in that situation. By contrast, a person in full health may not be taken to have exercised reasonable care.

Example 8

Stephen is a 54 year old farmer who always prepares his own income tax return. A few months prior to lodging his last return he suffered a stroke. In the period of his rehabilitation he was unable to attend to any paperwork or correspondence. During that period he misplaced one of several interest statements sent to him by his bank. At the time of preparing his return Stephen was still catching up on the backlog of paperwork and was still not fully recovered. As a result he returned interest of $4,750 rather than the correct amount of $5,000.

Stephen's illness and incapacity are relevant factors for determining whether reasonable care was exercised. So too are the facts that one of many bank statements was misplaced and the amount of the understated interest was relatively small in comparison to the total interest derived, such that the amount actually returned did not seem unusually small. It is likely that a reasonable person in Stephen's circumstances who was making a genuine effort to comply with his tax obligations could have omitted the amount. As a result Stephen could be considered to have exercised reasonable care.

Example 9

Alistair is a 60 year old farmer who manages his own tax affairs. For the past eighteen months, he has been busy with his business and voluntary community work and has not given much attention to his own paperwork. As a result, he misplaced one of two interest statements sent to him by his bank for the last income year. At the time of preparing his income tax return, Alistair did not check his interest statements for the year. As a result he returned interest of $250 rather than the correct amount of $500.

Alistair's busy schedule is not a factor which can help to establish that reasonable care was exercised because generally a reasonable person would organise their business and private obligations so sufficient time and effort can be devoted to their tax affairs. His age is also an irrelevant factor, because it does not impede his ability to conduct his daily affairs. The fact that Alistair misplaced one of only two statements and omitted half of his interest income is relevant because it is likely that a reasonable person in Alistair's circumstances would have noticed that one statement was missing and a substantial amount of the total interest had been omitted. As a result Alistair would not be considered to have exercised reasonable care.

52. Other factors that may be relevant when determining whether reasonable care has been exercised include the person's level of tax knowledge and level of education. The higher the level of tax knowledge or education, the more likely it is that the person is able to understand what is necessary when making statements to the Commissioner. Those with a more comprehensive understanding are expected to meet a higher standard to demonstrate that reasonable care has been exercised when providing information to the Tax Office.

53. New entrants to the tax system will generally have a lower level of knowledge and understanding of the tax laws than entities who have been in the tax system for some time. New entrants will not be penalised for false or misleading statements in their first year if they have made a genuine attempt to comply with tax obligations that is they have taken reasonable care. However, the new entrant will be liable to a penalty under subsection 284-75(1) if they have used the services of a tax agent and the agent has failed to take reasonable care. New entrants do not include businesses whose principals have previously been involved in business operations.

54. Where substantial tax law changes (for example, the introduction of the consolidation regime) impact on an entity's ability to understand their entitlements or obligations under the law and as a result the entity makes a false or misleading statement, provided that they have made a genuine attempt to comply with the new statutory requirements:

- in the first 12 months from the date of application of the new law, or
- if there is an extended transitional period, during that transitional period,

the entity will have exercised reasonable care in making a statement.

55. Where an entity claims to have made a genuine attempt to comply with substantial changes in the law the objective facts or reasonable inferences should support this claim. Where there is evidence of an attempt to avoid or disregard the requirements of the law the entity will not have made a genuine attempt to comply.

56. Further circumstances to be taken into account when determining whether an entity has exercised reasonable care include:

- the relative size of the shortfall compared to the entity's tax liability
- the type of the item reported and the relative size of the discrepancy between what was reported and what should have been reported
- the complexity of the law and the transaction (the difficulty in interpreting complex legislation), and
- the difficulty and expense associated with taking action to reduce or eliminate the risk of making an error.

57. Consideration will be given not only to the nature of the shortfall but also to the relative size of the error arising from the statement. In other words, the bigger the shortfall, the greater the likelihood that reasonable care has not been exercised.

Example 10

Company XZ operates a small business. In its return for the last income year the company disclosed assessable income of $50,000. However, an administrative error resulted in $10,000 of assessable income being omitted. It is reasonable to conclude that the company should have been aware that all its income had not been returned given the relatively large amount that was omitted. This is regardless of whether or not the entity used an agent to complete the return. In the absence of other factors which indicate that reasonable care was taken (for example, adequate procedures in place which were reasonably designed to prevent such errors from occurring) the entity would not satisfy the standard of reasonable care in this case.

Example 11

Company YX returns assessable income of $50,000,000 for the last income year but omits assessable income of $10,000. Subject to consideration of the circumstances that led to the error, the relative size of the omission does not, of itself, support a conclusion that there was a lack of reasonable care. The size of the error in relation to the total assessable income may mean that the company, despite the error, still took reasonable care in the preparation of its tax return.

58. There is no hard and fast rule as to the amount or percentage of tax liability that is necessary to determine when a shortfall amount will be sufficient to show reasonable care or a lack thereof. It will always depend on an examination of all the circumstances that led to the shortfall.

59. Factors indicating that an entity has not taken reasonable care include:

- taking an interpretative position with respect to an item that is frivolous or which lacks a rational basis
- repeated errors where the entity has been advised or is otherwise aware that mistakes have previously been made
- an error which could have been avoided with relative ease, for example, systems failures the risk of which are foreseeable or for which the entity has not established adequate safeguards and monitoring, and
- an error which results from the inadequate training of staff, in particular inexperienced or temporary staff.

60. An error in adding, subtracting or transposing amounts may be the result of failing to exercise reasonable care but an error is not conclusive evidence of a lack of reasonable care. An error made by a division of a business which leads to an error in the entity's tax return may amount to a failure to take reasonable care but this will depend on factors such as the circumstances in which the error was made and the procedures in place to prevent or detect such errors.

Example 12

An employee of a small business makes an error of $10,000 in transferring figures from working papers to the activity statement. The owner of the business was aware that the same employee had made a number of similar transposition errors in previous activity statements but the owner took no action. In this case it could be concluded that a reasonable person in the business owner's circumstances would have foreseen a risk and put simple checks in place that would at least reduce the risk of obvious errors. Therefore, in respect of the shortfall which resulted from the $10,000 error, the entity would be liable for a shortfall penalty for not taking reasonable care in making a statement that was false or misleading in a material particular.

61. For an individual who prepares their own tax return, an earnest effort to follow *TaxPack* or e-tax instructions would usually be sufficient to pass the test. For example if a taxpayer claimed a deduction for work-related expenses without being able to substantiate the claim in accordance with the substantiation provisions or Law Administration Practice Statement PS LA 2005/7, then this would indicate that the taxpayer had not taken reasonable care in making the claim, since the instructions emphasise the requirement to be able to substantiate work-related expenses.

62. For an entity conducting a business, the reasonable care test could be satisfied by the entity putting in place an appropriate record keeping system and other procedures to ensure that the income and expenditure of the business are properly recorded and classified for tax purposes. The fact that an employee of the business makes an error would not necessarily mean that the entity is subject to a penalty. For example, a penalty would not apply where the taxpayer can show that its procedures are designed to prevent such errors from occurring. What is reasonable will depend, among other things, on the nature and size of the business, but could include, for example, internal audits, sample checks of claims made, adequate training of accounting staff and instruction manuals for staff.

63. An entity that relies on a third party (excluding a tax agent) for advice of a fact that is relevant to the preparation of a return or other tax document will be taken to have exercised reasonable care unless the entity knew or could reasonably be expected to know that the information was wrong. For example, if a bank provides an interest statement and understates the amount of interest earned, as long as the entity has no reason to believe that the statement is wrong, the entity would not be liable for a subsection 284-75(1) shortfall penalty on the understatement.

Reporting tax obligations

64. An individual who prepares their own tax return, statement or other document will generally be taken to have exercised reasonable care if they have followed up-to-date, freely available material such as *TaxPack* and Tax Office fact sheets.

65. A number of provisions in the taxation law require an entity to make an estimate of a particular matter. Examples are the number of business kilometres travelled by a car during a period in an FBT year, or the average turnover during an income year under the Simplified Tax System (STS). Where an entity makes reasonable efforts to identify and consider the matters that are relevant to making that estimate, they will have taken reasonable care.

66. Where an entity makes a statement based on a conclusion reached as a result of interpreting the law in a particular way, reasonable care requires that the conclusion must be reasonable for an ordinary person to come to in the same circumstances.

Example 13

Mr and Mrs Hitchman are both public servants who earn $77,000 and $30,000 respectively. They own a rental property as joint tenants and are not carrying on a rental property business. For the year of income ended 30 June 2005 the property returned a rental loss of $2,000. This loss was claimed in full by Mr Hitchman who prepared his own return but did not read the *TaxPack Supplement 2005* or the *Rental Properties 2005 instructions*. His only reason for claiming the whole of the loss was that he was not aware that he could not personally claim the entire loss, and that the overall tax outcome was more favourable if the loss was claimed by the person in the higher tax bracket.

Mr Hitchman has not exercised reasonable care because a reasonable person in his circumstances would have read the *TaxPack Supplement 2005* and the *Rental Properties 2005 instructions*.

67. If an entity is uncertain about the tax treatment of an item, reasonable care requires the entity to make reasonable enquiries to resolve the issue. Reasonable enquiries would generally include consulting a tax agent, contacting the Tax Office or consulting a Tax Office publication or other authoritative reference in an effort to satisfy the entity about the appropriate tax treatment of the item. However, a failure to provide adequate information when seeking advice, a failure to provide reasonable instructions to a tax adviser, or unreasonable reliance on a tax adviser or on wrong advice may still expose the entity to a penalty for lack of reasonable care.

68. The reading of what a person believes to be the relevant provision of a taxation law might not constitute a reasonable enquiry unless the person had reasonable grounds for believing that they had understood the requirements of the law.

69. Unlike the reasonably arguable position test which focuses solely on the merits of the position taken, the reasonable care test focuses on the efforts taken by the entity or their agent in resolving the tax treatment of a particular item. Thorough research may be enough to satisfy the requirement of reasonable care but may not be enough to satisfy the reasonably arguable position test. Conversely, where reasonable care is not taken in considering the tax treatment of a particular item this will usually, but not necessarily, result in the entity's position not being reasonably arguable. Although possible, it would be unusual to arrive at a reasonably arguable position without having properly researched the issue.

70. Where an entity or their agent adopts a tax treatment that is not consistent with the Commissioner's view, reasonable care will have been exercised where they have made a genuine effort to research the issue and there is some basis for the position adopted.

71. However, if an entity obtains a private ruling on the application of a taxation law and disregards the ruling, this may constitute failure to take reasonable care where a genuine effort was not made to research the issue. Alternatively, where the statement relates to an income tax law, the entity will be liable to a penalty under subsection 284-75(2) if the approach taken is not reasonably arguable.

72. If the position is reasonably arguable and a genuine effort was made to arrive at that position then reasonable care will have been exercised irrespective of the amount of the shortfall. The Tax Office view on the concept of a reasonably arguable position is explained in Taxation Ruling TR 94/5.

73. Deciding whether the entity or tax agent has exercised reasonable care will depend on whether the process taken to reach the position was reasonable in the circumstances. The more substantial the amount of the shortfall, the greater the degree of care which should be taken prior to adopting a position.

74. Entities are responsible for the acts of their employees provided the acts are within the acts authorised for that employee. Therefore, if an employee fails to meet the reasonable care standard, the employer entity is liable for the failure. This is so whether the entity is a natural person or not. The only difference is that a non-natural person must act through agents and employees as it is incapable of acting otherwise.

Using an agent

75. If an entity has used the services of a tax agent, both the entity and the agent must take reasonable care. Where the entity's agent does not exercise reasonable care, the entity will be held liable for any penalty imposed.

76. An entity that uses an agent must provide the agent with all necessary information. To be taken to have exercised reasonable care, the entity is expected to:

- properly record matters relating to tax affairs
- provide honest, accurate and complete information in response to questions asked by the agent, and
- bring to the attention of the agent information the entity could be reasonably expected to have known was relevant to the preparation of the return, activity statement or other document.

77. An entity's failure to meet these expectations would generally indicate a lack of reasonable care on the entity's part. If there is nothing to alert the agent, the agent will not be taken to have failed to exercise reasonable care solely because of the entity's failure to do so. However, if the agent has reasonable grounds for suspecting that an inquiry could elicit further information that is necessary to complete an accurate return or document the agent must take that step if the agent is to exercise reasonable care.

Example 14

Sarah who owned an investment unit engaged an agent to prepare her income tax return for the previous income year. Sarah provided paperwork to the agent evidencing that during the income year the external walls of the unit block were rendered and that her share of the cost was $7,000. She informed the agent that the external walls of the building had previously been plain brick. The agent claimed the $7,000 as a repair. An agent taking reasonable care would have characterised the expense as a capital improvement.

Example 15

John engaged an agent to prepare his income tax return for the previous income year. In discussions prior to preparing the return John informed the agent that his house had been sold during the year of income. The house had been John's principal residence for the last 5 years but prior to this time he had let it to tenants. The agent does not ask John whether the residence had ever been used for income producing purposes and does not include a proportion of the capital gain realised on the sale of the dwelling in John's assessable income. An agent taking reasonable care would have asked for this additional information.

78. The standard of care required by a tax agent is higher than that expected of an ordinary person due to the knowledge, education, skill and experience of the practitioner obtained from continual exposure to the operation of the financial system and similar transactions for numerous clients. When examining an entity's affairs a tax agent would be expected to apply this experience to the entity's situation and to ask the questions necessary to correctly prepare the client's return. However, this does not mean that a tax agent will always be expected to display the highest level of skill or foresight of which anyone is capable. The standard is that of a prudent professional of normal intelligence in the circumstances of the tax agent.

Has the entity relied on advice or a statement from the Commissioner?

79. Where a shortfall amount arises because an entity has treated a taxation law as applying in a particular way, and that way agrees with advice given by the Commissioner or a statement in a Tax Office publication, it is highly likely that the entity will have exercised reasonable care and the exemption in subsection 284-215(2) will apply. However, even if reasonable care has not been taken and the entity relies on advice or a statement from the Commissioner the shortfall amount will be reduced to the extent that the treatment agrees with that advice or statement (subsection 284-215(1)).

80. Advice given by the Commissioner may be given in writing, electronically or orally. Statements in approved publications would include the various return form instructions and guides published by the Tax Office to assist entities with their tax affairs. If, for example, *TaxPack* or the various activity statement instructions contained an error, and an entity's liability was disclosed as less than it should have been, because the entity followed the instruction, subsection 284-215(1) reduces that shortfall amount to the extent that it was caused by following the instructions.

Does the entity's treatment agree with a general administrative practice?

81. Subparagraph 284-215(1)(b)(ii) provides that a shortfall amount will be reduced to the extent that an entity's treatment agrees with a general administrative practice under a taxation law. 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. An example is Law Administration Practice Statement PS LA 2003/8 which sets out rules which have been developed to lessen the cost of accounting for low cost assets for taxpayers carrying on a business. A general administrative practice is usually adopted for the efficient administration of the tax system and will generally be documented.

82. A general administrative practice is not established merely because the Commissioner has issued several private rulings dealing with the same issue. Although, if there are a significant number of uncontradicted private rulings dealing with the same issue that are provided by the Commissioner over a long period, this would tend to support a conclusion that they evidence a general administrative practice. A simple failure by the Commissioner to take some action within his power does not establish a general administrative practice. Similarly, mere silence or failure to issue a public ruling on a matter does not evidence a general administrative practice.

Who is liable for the penalty?

83. Generally, where a statement is made by an entity's authorised representative the entity will be liable for the penalty. For example, a company will be liable for false or misleading statements made by an employee, public officer or director.

84. However, special rules apply to partnerships and trusts in determining the liability for shortfall penalties.

Partnerships (other than corporate limited partnerships)

85. A partnership can have a tax-related liability in relation to GST, PAYG withholding, or FBT. A partnership cannot however have an income tax liability or PAYG instalment liability.

86. For matters relating to the net income of the partnership or the partnership loss, each partner is liable to a penalty on the shortfall amount reflected in the partner's income tax return. That is, an incorrect statement made in the partnership return will result in a shortfall amount in each partner's return. Where a partnership's net income is understated, or loss is overstated, each partner's share of the misstated amount is in proportion to the partner's share of the partnership net income or loss. Each partner is liable to a penalty calculated on the shortfall amount in their income tax return.

Example 16

A partnership is made up of two partners who are entitled to share in profits equally. In the partnership return for the last income year, the net partnership income was understated by $25,000. Each partner will be liable for a penalty on a shortfall amount of the tax on the understated $12,500.

87. However, for shortfall amounts relating to tax-related liabilities of the partnership, for example, PAYG withholding, GST and FBT amounts, section 444-30 applies. That provision makes each partner jointly and severally liable for the penalty imposed on the partnership shortfall amount. If one partner is not at fault for the partnership having a shortfall amount that partner will still be liable to pay the penalty amount.

Trusts

88. Where a trustee of a trust makes a false or misleading statement that causes a beneficiary of the trust to have a shortfall amount, section 284-30 treats the shortfall amount as that of the trustee. This provision will mainly apply where a false or misleading statement is made by the trustee about the net income of the trust as this will affect the amount that a beneficiary has to include in their assessable income.

89. Where a beneficiary has relied on the trustee's advice as to their share of the net income of the trust, the beneficiary will generally be taken to have exercised reasonable care unless they knew or could reasonably be expected to have known that the information was wrong. Where the beneficiary has exercised reasonable care they will not have a shortfall amount for the purpose of determining whether they are liable to an administrative penalty.

90. Although they do not have a shortfall amount for the purpose of their own liability they still have a shortfall amount for all other purposes including the trustee's liability.

91. It is anticipated that in most cases it will be appropriate to impose a penalty on the trustee in respect of the shortfall amounts of all the beneficiaries. However, there may be some situations where it is appropriate to consider the liability to penalty of both the trustee and one or more beneficiaries.

92. Section 284-30 operates with subsection 284-75(1) to impose a penalty on the trustee in addition to a penalty that may be imposed on the beneficiary in respect of the beneficiary's shortfall amount. For example, where the trustee and beneficiary have not exercised reasonable care (and none of the other exceptions in section 284-215 apply), the trustee and beneficiary will both be liable for penalty tax. However, as a matter of policy the Commissioner will exercise his discretion to remit all or part of the penalty of the trustee and/or beneficiary in order to avoid duplicating the penalty.

93. Where a beneficiary has knowledge of the trustee's behaviour and is in a position to control the trustee then generally the Commissioner would exercise his discretion to remit the part of the trustee's penalty which relates to that beneficiary's shortfall amount. In addition, the Commissioner generally would not exercise his discretion to remit the penalty which applies to the beneficiary who controlled the trust.

94. In cases where a superannuation fund does not have a trustee, the person who manages the fund is treated as a trustee of the fund for the purposes of Schedule 1 (see section 444-15). Consequently, if the person who manages a superannuation fund makes a false or misleading statement in relation to the fund and the fund has a shortfall amount as a result that person is liable, in the capacity of the manager of the fund, for any penalty.

Step 2: Assess the amount of the penalty

95. If an entity is liable under subsection 284-75(1), then under subsection 298-30(1) the Commissioner must make an assessment of the amount of penalty. The assessment is made in accordance with section 284-85.

96. There are two stages in the assessment of the penalty:

- calculating the base penalty amount, then
- increasing or reducing the base penalty amount if certain conditions are satisfied.

The formula for modifying the base penalty amount is set out in paragraph 112.

Base penalty amount

97. The base penalty amounts set out in section 284-90 are formulated as percentages of the shortfall amount. The percentage will depend on the level of care taken by the entity (or agent) which resulted in the shortfall amount. The relevant levels of care are:

- failure to take reasonable care (Item 3)
- recklessness (Item 2), and
- intentional disregard (Item 1).

Failure to take reasonable care

98. An entity should be presumed to have taken reasonable care unless the facts or reasonable inferences suggest otherwise. Where there is some doubt as to whether the entity exercised the appropriate level of care they should be contacted and given the opportunity to explain prior to making the penalty decision. Conclusions about the level of care an entity has exercised should only be made where supported by evidence. Paragraphs 46 to 78 discuss reasonable care.

99. If the entity and their agent have demonstrated that they took reasonable care in making the false or misleading statement, then no penalty is imposed under subsection 284-75(1) because of the exception in subsection 284-215(2).

100. Where the Commissioner has already determined that for the purpose of subsection 284-215(2) the entity did not exercise reasonable care in making the false or misleading statement, it follows that for the purpose of Item 3 of subsection 284-90(1) the entity has not exercised reasonable care to comply with a taxation law. Thus, the minimum base penalty amount imposed for a false or misleading statement is 25% of the shortfall amount.

101. If a higher level of base penalty amount is to be imposed, the facts must show that an entity has either been reckless or shown intentional disregard of a taxation law.

Recklessness

102. Subsection 284-90(1) states that a base penalty amount of 50% of the shortfall amount is imposed if the shortfall resulted from recklessness as to the operation of a taxation law.

103. The courts have long recognised that the ordinary meaning of recklessness involves something more than mere inadvertence or carelessness. An entity will have behaved recklessly if their conduct clearly shows disregard of, or indifference to, consequences or risks that are reasonably foreseeable as being a likely result of the entity's actions. In other words, recklessness involves the running of what a reasonable person would regard as an unjustifiable risk.

104. More recently, in the context of the old income tax penalty provisions in Part VII of the ITAA 1936, Cooper J in *BRK (Bris) Pty Ltd v. Federal Commissioner of Taxation*[4] observed that recklessness means:

> *to include in a tax statement material upon which the Act or regulations are to operate, knowing that there is a real, as opposed to a fanciful, risk that the material may be incorrect, or be grossly indifferent as to whether or not the material is true and correct, and that a reasonable person in the position of the statement-maker would see there was a real risk that the ITAA 1936 and regulations may not operate correctly to lead to the assessment of the proper tax payable because of the content of the tax statement.*

[4] 2001 ATC 4111 at 4129

105. A person would be acting recklessly if:

(a) the person did an act which created a risk of a particular consequence occurring (for example, a tax shortfall), and

(b) a reasonable person who, having regard to the particular circumstances of the person, knew or ought to have known the facts and circumstances surrounding the act would have or ought to have been able to foresee the probable consequences of the act, and

(c) the risk would have been foreseen by a reasonable person as being great, having regard to the likelihood that the consequences would occur, and the likely extent of those consequences (for example, the size of the tax shortfall), or

(d) when the person did the act, he or she either was indifferent to the possibility of there being any such risk, or recognised that there was such risk involved and had, nonetheless, gone on to do it. That is, the person's conduct clearly shows disregard of, or indifference to, consequences foreseeable by a reasonable person.

106. A finding of dishonesty is not necessary to a finding of recklessness. It is sufficient that the person's behaviour objectively displayed a high degree of carelessness and indifference to the consequences.

Example 17

Company YZ which carries on a small business, was subject to a record keeping audit. At the end of the audit the tax officer advised the company about the areas where the records were inadequate and what was required to remedy the situation. The company was advised that it was unlikely that the correct amount of taxable income would be returned if the suggested improvements to their record keeping practices were not implemented in full. Rather than following the advice the entity made minor changes to their record keeping system which did not improve the adequacy of their records.

Two years later the entity was subject to an income tax audit. A shortfall amount was detected which was caused by inadequate record keeping. The facts indicate that the shortfall amount was caused by the entity's recklessness.

107. In some circumstances, an incorrect estimate may be due to reckless behaviour of the entity. For example, in the context of making a reasonable estimate of Simplified Tax System (STS) group turnover, an estimate will be considered to have been made recklessly where the entity fails to consider most of the relevant factors that are likely to materially affect its estimate of STS group turnover.

Intentional disregard of a taxation law

108. Subsection 284-90(1) states that a base penalty amount of 75% of the shortfall amount will be imposed if the shortfall resulted from intentional disregard of a taxation law.

109. Intentional disregard is more than just disregard for the consequences or reckless disregard. The facts must show that an entity consciously decided to disregard clear obligations under a taxation law, of which the entity was aware. For example, the production of false records will amount to intentional disregard of a taxation law.

Example 18

Company XYZ, in preparing its tax return, failed to include interest earned on funds held in an account that was opened in a false name. It can be inferred that the entity acted intentionally in omitting the interest from its return.

Example 19

Pauline is not certain whether an amount she received during the year is assessable income and therefore chose not to include that amount in her income tax return. In failing to include the amount, she has not intentionally disregarded a taxation law. However, the action may constitute failure to exercise reasonable care or recklessness.

110. An entity does not intentionally disregard an obligation by taking a view that differs from the Commissioner's view, provided the view is not frivolous or unfounded. If an entity obtains an unfavourable ruling on a settled area of a law and they disregard the ruling without having an alternative view that is reasonably arguable, this may constitute intentional disregard because the law which formed the basis of the ruling is clear and has been explained to the entity.

111. Intentional disregard of a taxation law or regulations may be determined on the basis of direct evidence, or by inference from the surrounding circumstances.

Example 20

Peter, a sole trader who runs a small business receives payment for his taxable supplies by way of cash, cheque and credit. In his activity statement, Peter reports a GST net amount on the basis that the GST payable is calculated on the credit card and cheque receipts only, and not the cash transactions. In the absence of a reasonable explanation for the omission it can be inferred that Peter has acted intentionally in omitting the GST on supplies for which cash was received.

Increase or reduction of the base penalty amount

112. The base penalty amount (BPA) may be increased or reduced depending on the individual circumstances of the case. Where the base penalty amount is increased or decreased, the formula in subsection 284-85(2) must be used to calculate the assessed penalty:

BPA + [BPA × (increase % - reduction %)]

Increase in base penalty amount

113. The base penalty amount imposed for a false or misleading statement is increased by 20% where the entity:

- prevents or obstructs the Commissioner from finding out about the shortfall
- becomes aware of the shortfall amount after the statement is made and does not tell the Commissioner about it within a reasonable time, or
- has had a prior imposition of subsection 284-75(1) shortfall penalty.

114. It is implicit that knowledge or awareness of the shortfall amount in a previous accounting period is a prerequisite to increasing the base penalty amount under paragraph 284-220(1)(c). This means that, except in cases where an entity was aware of a previous shortfall amount (for example, intentional disregard), the prior imposition of subsection 284-75(1) penalty must have been brought to the attention of the entity (for example, by the issue of written notice) before the base penalty amount may be increased for a subsequent accounting period.

115. The increase in base penalty is not cumulative that is, the base penalty amount can only be increased by a flat 20% irrespective of how many of the paragraphs in subsection 284-220(1) are satisfied.

116. The Commissioner expects that in the majority of cases, tax officers will receive reasonable co-operation from entities and their representatives. However, where an entity has made a false or misleading statement, and seeks to hide this from the Tax Office by, for example, withholding, altering or destroying records, or deliberately making further false or misleading statements, a higher penalty will apply.

117. It is not expected that entities should continually review their tax affairs to detect possible errors. However, where an entity becomes aware of a shortfall amount, and does not take steps to rectify the matter within a reasonable time, this will be taken into account in deciding the final penalty (paragraph 284-220(1)(b)).

Reduction in base penalty amount

118. The base penalty amount imposed for a false or misleading statement can be reduced in certain circumstances where an entity voluntarily discloses the shortfall amount or part of it. The amount of the reduction will depend on whether the entity makes a voluntary disclosure before or after the days specified in section 284-225.

119. Voluntary disclosures may be given to the Commissioner orally or in writing. The disclosure must identify the shortfall amount and include relevant facts and sufficient information to enable the Commissioner to correctly determine the tax-related liability.

Unprompted voluntary disclosure

120. The penalty on a shortfall amount for an accounting period will be reduced by at least 80% under subsection 284-225(2) where an entity voluntarily tells the Commissioner about a shortfall amount before the earlier of:

- the day the Commissioner tells the entity that a tax audit of their financial affairs for that accounting period is to be conducted, or
- the day by which the Commissioner has publicly requested voluntary disclosure from entities about a transaction that applies to the financial affairs of that entity.

121. A tax audit is defined in subsection 995-1(1) of the ITAA 1997 to be an examination of the entity's financial affairs for the purposes of a taxation law. This includes an audit of an entity's financial affairs to ascertain the correct amount of a tax liability or credit entitlement for an accounting period, a record keeping, tax invoice or substantiation review or a deduction verification inquiry.

122. Where voluntary disclosure is made before the earlier of the days described above, the base penalty amount in respect of the tax shortfall amount is:

- reduced by 80% if the shortfall amount is $1,000 or more, or
- reduced to nil where the shortfall amount is less than $1,000.

123. Any disclosure made after the earliest of these two days will not qualify for a reduction under this provision unless the Commissioner exercises his discretion to treat a disclosure as having been made before being advised of an audit – see paragraphs 126 to 130.

124. It is important to remember that the increase and/or reduction is provided for by the legislation and forms part of the assessment process. It is only after the necessary adjustments have been made and the assessment is complete that the liability for the penalty assessed can be further reduced by the exercise of the discretion to remit either in full or in part. Paragraphs 136 to 158 discuss remission.

Example 21

Company ZYX failed to take reasonable care and made an error in calculations for its activity statement. As a result the company made a false statement in its activity statement causing the relevant liability to be $2,000 less than it would otherwise have been. The base penalty amount is 25% of $2,000 that is, $500. The entity discloses the shortfall amount without being prompted by any action by the Commissioner. In a previous accounting period a shortfall penalty for false or misleading statement had been imposed.

The penalty is assessed as follows:

$500 + [$500 $\times$ (20%- 80%)] = $500 -$300 = $200

(Note that in these circumstances the assessed penalty should be remitted in full if the entity has made an honest mistake. See paragraph 148 to 150).

Prompted voluntary disclosure

125. The penalty on a shortfall amount may be reduced by 20% where an entity voluntarily tells the Commissioner about a shortfall amount after the Commissioner has advised the entity that a tax audit is to be conducted. However, to qualify for the reduction it must be reasonable to estimate that the disclosure saved the Commissioner a significant amount of time or significant resources in the audit. Whether the disclosure can reasonably be estimated to have saved the Commissioner significant time or resources will depend on the circumstances of the case. Generally a disclosure made soon after the audit commences is more likely to save time and resources than one made weeks or months after an audit has commenced.

Commissioner's discretion regarding prompted voluntary disclosure

126. If the Commissioner considers that the circumstances are appropriate, he has the discretion under subsection 284-225(5) to treat an entity as having made a voluntary disclosure before being told of an audit, even though the disclosure was actually made on or after that day.

127. An example of where the Commissioner may exercise this discretion is where the head company of a consolidated group has been told that an audit will be conducted in respect of certain transactions undertaken by members of the group, and another company in the group which is not the focus of the audit, voluntarily discloses a matter which is unlikely to have been detected during the audit. Another example is where the head company makes a disclosure in relation to a period which is not part of the scope of the audit.

128. Where an entity has been advised that an audit will be conducted, the discretion may also be exercised when the entity makes a full disclosure before the formal date of commencement of the audit. The Commissioner may advise of this date orally or in writing. For example, the discretion may be exercised where a voluntary disclosure is made at an initial interview which explains the general scope of the audit.

129. However, this discretion should generally not be exercised where the facts or reasonable inferences indicate that the entity was aware of the shortfall amount, prior to notification of the audit, and would not have made the disclosure if notification had not been given (this includes where an entity intentionally disregarded a taxation law).

130. Where the discretion is exercised, the base penalty amount is reduced by 80%, instead of the 20%, and if the shortfall amount is less than $1,000, the penalty is reduced to nil (subsection 284-225(3)).

What if more than one base penalty amount applies?

131. It is possible for more than one BPA to apply to a shortfall amount. For example, if a false or misleading statement has been made recklessly or with intentional disregard it will also have been made without taking reasonable care. It may also be possible for equivalent base penalty amounts to apply to the same shortfall amount. For example, an entity may not have had a reasonably arguable position and also not taken reasonable care. In such cases an entity is liable for only one BPA. Under subsection 284-90(2), the higher base penalty amount will be used in working out the penalty.

132. It should also be noted that an entity may make a number of false or misleading statements in one document which result in a number of parts of a shortfall amount. For example, an entity may recklessly understate interest income and not exercise reasonable care in claiming a rental property deduction. In this case there will be one shortfall amount and a separate penalty calculation will be required for each part of the shortfall amount.

133. In addition, an activity statement may have shortfall amounts relating to GST, PAYG and FBT. An entity may recklessly understate a PAYG instalment, and over-claim input tax credits due to a lack of reasonable care. Again, penalties in respect of each shortfall amount would be calculated separately.

134. Similarly, an entity's net amount of GST for the tax period may be made up of over-claimed input tax credits caused by a lack of reasonable care, and understated GST on taxable supplies caused by intentional disregard of the law. In this situation the penalty payable on the shortfall amount for the tax period will be made up of these two components.

Example 22

Company YXZ notified in its activity statement that the GST net amount payable for a period was $25,000. During a field verification visit, the tax officer found that the company intentionally disregarded a taxation law and taxable supplies were understated by $55,000. This resulted in an underpayment of GST of $5000. Input tax credits were overstated by $1,000 because of a failure to take reasonable care. The shortfall amount in GST for the tax period is made up of those two parts. The penalty is calculated as follows:

$5,000 × 75% =	$3,750
$1,000 × 25% =	$ 250
	$4,000

Provided no percentage increase or reduction applies, the total penalty on the $6,000 shortfall amount is $4,000.

135. Where an entity understates a liability or overstates the entitlement to a payment or credit, and at the same time overstates another liability or understates another entitlement to a payment or credit, the penalty calculation may need to be adjusted to apportion the credit.

Example 23

Company ZXY recklessly understated sales by $55,000 (the value of taxable supplies was $50,000) and this has resulted in an underpayment of GST of $5,000. The understatement of sales was also not included in the company's PAYG instalment income that was subject to a 2% instalment rate. There was also a misclassification of $22,000 worth of goods sold as GST-free due to a lack of reasonable care. This resulted in a further underpayment of $2,000. The company also made an arithmetic error that has resulted in an under-claim of input tax credits by $2,500. In this case the total of the two GST underpayments is $7,000 ($5,000 underpayment of GST plus $2,000 misclassification). However this is not the amount on which the penalty will be calculated because a reduction is required for the under-claimed input tax credits. The penalty will be calculated as follows:

Shortfall amount for understated sales (as adjusted for proportion of under-claimed input tax credits):		
$5,000 - ($2,500 × 5000/7000) =	$3,214.00	
Penalty for recklessness:		
$3,214 × 50% =		$1,607.00
Shortfall amount for misclassification (as adjusted for proportion of under-claimed input tax credits):		
$2,000 - ($2,500 × 2000/7000) =	$1,286.00	

Penalty for lack of reasonable care: $1,286 × 25% =	$321.50
Total GST penalty:	$1,928.50
Calculation of penalty on PAYG instalment shortfall amount:	
Understated income[5] (recklessness):	
($50,000 × 2%) × 50% =	$500.00
Total penalty for activity statement:	$2,428.50

A subsequent review showed that when the company lodged its income tax return for the relevant period it did not include $130,000 of assessable income (comprising $80,000 in GST-free sales and the $50,000 value of taxable supplies). As the company was advised in the course of the activity statement audit about including such amounts in the income tax return and there are no other extenuating circumstances, the behaviour is considered to be intentional disregard of the law. There were no grounds for an increase or reduction to the base penalty amount.

Calculation of penalty on income tax shortfall amount:	
Shortfall amount: $130,000 × 30%	= $39,000.00
Penalty for intentional disregard: $ 39,000 × 75%	= $29,250.00

Step 3: Should the subsection 284-75(1) penalty be remitted in full or in part?

136. Under the uniform penalty regime, penalties are attracted for specific kinds of behaviour predominantly associated with the level of care exhibited by the entity. The legislation imposes the penalty, however, the Commissioner has the discretion under section 298-20 to remit all or part of that penalty. Therefore once Step 2 is complete, the base penalty amount or adjusted base penalty amount may be remitted in full or in part.

137. In exercising the discretion regard should be had to the following objectives of the penalty regime:

- The purpose of the penalty regime is to encourage entities to take reasonable care in complying with their tax obligations. What is reasonable will depend on the circumstances of each case. However, as a general rule, the larger the item, the greater the level of care required.

[5] Any GST on taxable supplies is not instalment income

- A major objective of the penalty regime is to promote consistent treatment in respect of the rates of penalty imposed. That objective would be compromised if the penalties imposed at the specified rates were remitted without just cause, arbitrarily or as a matter of course. The Commissioner must ensure that the decision to remit in part or full or not to remit at all is made in good faith and is reasonable. All relevant matters and no irrelevant matters must be taken into consideration in making the decision.
- Entities with a good compliance history[6] should be encouraged to remain compliant by treating them more leniently than entities which do not have a good compliance history.
- An entity without a good compliance history bears a heavier burden of proof in justifying why remission is warranted. A penalty should not be remitted if the only reason given by the entity is that the understatement or over-claim was the result of carelessness, ignorance as to liability to tax or the fault of their agent.
- The discretion to remit penalties should be administered in a fashion which ensures that the objectives of the penalty regime (for example, to effect improvements in future compliance by taxpayers and to provide certainty for those taxpayers) are achieved without causing unintended or unjust results.

What factors are considered when deciding whether or not to remit the penalty at the time it is assessed?

The entity's particular circumstances and compliance history

138. An important principle contained in the taxpayers' charter and the compliance model is that the Commissioner will adopt a fair and reasonable approach in his administration of the tax system, and in doing so, will take into consideration the issues faced by entities in meeting their obligations. This principle applies to decisions on penalties, in the same way as it applies to any other decision that the Commissioner may make which affects an entity.

139. It is reasonable to expect that occasionally mistakes will be made by entities while attempting to comply with the tax laws. In many cases where there has been an honest mistake or inadvertent error the facts will show that reasonable care has been taken. In such cases, no subsection 284-75(1) penalty applies. However, occasionally the facts or reasonable inferences will show that an entity has made an isolated, honest and unintended mistake which a reasonable person in the same circumstances would not have made. As intention is not an element of the reasonable care test the entity would still be liable to a penalty under the law. Where it is clear that:

    - an isolated book-keeping or record keeping mistake was made
    - the mistake is not associated with an event or transaction which is extraordinary for the entity during the accounting period[7]
    - the mistake was honest and unintended, and

[6] A good compliance history is generally one where all lodgment obligations including lodging activity statements and income tax returns have been met, all non-disputed debt has been paid or is the subject of a payment arrangement and there is no recent history of the entity being liable to shortfall penalty.
[7] An event or transaction may be extra-ordinary because of its size or infrequency.

- the entity has a good compliance history

tax officers may remit the subsection 284-75(1) penalty. Tax officers will still need to consider the application of the other penalties listed in paragraph 12.

140. The following principles from the taxpayers' charter and the compliance model which recognise the above should be considered when making remission decisions:

- Most entities want to comply with tax laws if they are helped to understand them and they are treated fairly.
- An entity should be treated as honest unless there is reason to conclude otherwise.
- Account should be taken of the entity's relevant individual circumstances and their attitude towards complying with the tax laws.
- The more reluctant an entity is to comply with their obligations under the law, the more severe will be the penalty.
- An improvement in an entity's attitude to compliance should result in the Tax Office implementing a correspondingly less severe compliance strategy.

141. Where an entity has a history of non-compliance clear evidence that the imposition of a penalty would be unfair or unjust will be necessary before any remission is considered.

142. Where an entity has been more culpable and has behaved recklessly or with intentional disregard it is difficult to envisage a situation where the Commissioner would exercise the discretion to remit. It would be exceptional if the discretion was exercised when an entity had behaved recklessly or with intentional disregard.

Timing adjustments

143. In some cases a shortfall amount may represent an amount of tax deferred rather than an amount of tax permanently avoided. In such cases there may be scope to remit the penalty in whole or in part.

144. The case for remission is strongest where there is only a short period of deferral of tax, for example, where an amount of assessable income is included by a taxpayer in a year later than the year in which it was correctly assessable. Assuming that penalty is otherwise imposed, a partial remission of the prescribed penalty may be warranted in these kinds of cases depending on the circumstances and where the shortfall amount did not result from recklessness or intentional disregard by the entity.

145. A factor that would influence the level of remission in cases where there is only a short period of deferral would be if, in addition to the deferral of tax, there has been an amount of tax avoided because of a reduction in the rates of the tax between the two years in question. In general, a remission of the prescribed penalty in respect of that part of a tax shortfall that represents the amounts of tax that would have been permanently avoided because of the change of rates would generally not be warranted.

Correcting GST mistakes

146. The Tax Office guide *Correcting GST mistakes – 07/2004* contains examples of when an entity who makes a mistake on an activity statement may correct that mistake on a subsequent activity statement without incurring a penalty.

147. Where a registered tax agent prepares an income tax return and has difficulties in reconciling the GST details in activity statements prepared by the client or their bookkeeper, the GST may be corrected by including the adjustment in the next activity statement to be lodged after the preparation of the income tax return. This concession to registered tax agents only applies to client entities which have a turnover of less than $20 million. There is no threshold on the value of the reconciliation adjustment. The registered tax agent is expected to advise the client or bookkeeper of the mistake and discuss possible causes of the error in the activity statement to prevent it from happening again.

Unprompted voluntary disclosure

148. Where an entity has taken reasonable care no subsection 284-75(1) penalty applies. In those circumstances if an entity voluntarily discloses an error or if subsequent action by the Tax Office leads to a correction of the error this will not give rise to a penalty under subsection 284-75(1).

149. Even if the facts show that reasonable care was not taken, the penalty imposed by the legislation is still reduced if a voluntary disclosure is made. As discussed at paragraphs 120 to 124 where an entity makes an unprompted voluntary disclosure the penalty on a shortfall amount will be reduced by at least 80% because subsection 284-225(2) applies. Any penalty which remains after the statutory reduction will be remitted in full unless there is information to indicate that the entity did not make an honest mistake or it can be reasonably inferred that it was not an honest mistake.

150. For the purposes of remission under these circumstances, an unprompted voluntary disclosure does not include the situation where the Commissioner exercises his discretion under subsection 284-225(5) to treat an entity as having made a voluntary disclosure.

An amount disclosed or a deduction or credit claimed in another entity's return or activity statement in the same accounting period

151. Where, in the same accounting period, an amount omitted by an entity is mistakenly included by another entity in their return or activity statement, subsection 284-75(1) penalty may be fully remitted if, after the relevant amendments, there was no shortfall amount in overall terms and neither party has any losses or other tax deductions or offsets.

152. Equally where a deduction or credit is claimed in the wrong entity's return or activity statement and there was no shortfall amount in overall terms subsection 284-75(1) penalty may be remitted in full.

153. In similar circumstances, but where there was a shortfall amount in overall terms, for example, because of differing tax rates between the two entities, then any subsection 284-75(1) penalty attracted by the entity that made the false or misleading statement should be remitted so that it is effectively only liable for a penalty on the net shortfall amount in overall terms.

154. However, if an entity has been reckless or has intentionally disregarded a taxation law when completing the relevant return or activity statement remission will not generally be granted.

The application of the special rules in respect of trustees may impose an overly burdensome penalty

155. Where both the trustee and beneficiary are liable under the legislation, that is both have made a false or misleading statement, the decision as to whether a penalty should be remitted for the trustee only, or the beneficiary only or both parties, depends upon the facts and circumstances of each particular case.

Treating entities in the same circumstances consistently

156. This ground is relevant in relation to audits undertaken by the Tax Office where a number of entities are involved in, for example, the same arrangement. However this is not a justification for making an erroneous penalty decision based on a previous incorrect penalty decision.

Unjust result

157. There will inevitably be exceptional cases where the prescribed rate of penalty may not provide a just result to the entity. In such cases, the Commissioner may remit, in whole or in part, the subsection 284-75(1) penalty imposed by the law. It is envisaged that any such remission would be infrequent ie on the facts of the particular case the result is patently unjust.

158. There may also be some circumstances where the entity's behaviour results in more than one type of penalty applying under the law. For example, an entity may have failed to retain records and be liable for a penalty under section 288-25. The lack of records and the entity's failure to otherwise try to report the correct amounts may result in a shortfall amount and a penalty under subsection 284-75(1). Generally, in those circumstances only one penalty should apply and the lower penalty should be remitted.

Step 4: Notify the entity of the liability to pay the penalty

159. The Commissioner must issue a written notice to the entity of the entity's liability to pay the penalty (section 298-10). This notice will advise of the amount of the liability that remains after any remission of the penalty.

160. As a result of amendments made by *Taxation Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* where a penalty applies and has not been remitted in full, the Tax Office must provide an explanation of why the penalty was imposed and why the penalty has not been remitted in full.

161. The requirement to provide reasons applies to notices given and decisions made after 29 June 2005 in relation to income tax matters for the 2004-2005 income year and later years; fringe benefits tax matters for the year starting 1 April 2004 and later years; and matters relating to other taxes for the year starting 1 July 2004 and later years.

162. The law does not specify when the explanation must be supplied. However, tax officers should ensure that reasons are supplied at the same time as, or as soon as possible after, the entity has been notified of the penalty.

163. It is important to remember that in order to influence behaviour positively the basis of a penalty decision should be explained to an entity. It is highly unlikely that compliance behaviour will be improved if the entity does not understand the basis of assessment and remission (if any).

164. The entity has the right to object, under Part IVC of the TAA, against an assessment of the penalty (subsection 298-30(2)). The entity can also object against the remission decision, if the amount of the penalty remaining after any remission is more than $220 (subsection 298-20(3)).

Subject references	administrative penalty assessment of penalty false or misleading statement remission of penalty
Legislative references	TAA 1953 2(2) TAA 1953 Sch 1 250-10 TAA 1953 Sch 1 Div 284 TAA 1953 Sch 1 284-75(1) TAA 1953 Sch 1 284-75(2) TAA 1953 Sch 1 284-75(3) TAA 1953 Sch 1 284-75(4) TAA 1953 Sch 1 284-80(1) TAA 1953 Sch 1 284-80(2) TAA 1953 Sch 1 284-90 TAA 1953 Sch 1 284-90(1) TAA 1953 Sch 1 284-145 TAA 1953 Sch 1 284-215 TAA 1953 Sch 1 284-215(2) TAA 1953 Sch 1 284-215(1)(b)(ii) TAA 1953 Sch 1 284-220 TAA 1953 Sch 1 284-220(1) TAA 1953 Sch 1 284-220(1)(b) TAA 1953 Sch 1 284-220(1)(c) TAA 1953 Sch 1 284-225 TAA 1953 Sch 1 284-225(3) TAA 1953 Sch 1 284-225(5) TAA 1953 Sch 1 288-25 TAA 1953 Sch 1 298-10 TAA 1953 Sch 1 298-20 TAA 1953 Sch 1 298-30 TAA 1953 Sch 1 444-15 TAA 1953 Sch 1 444-30 ITAA 1997 4-10(3) ITAA 1997 705-315 ITAA 1997 995-1 Excise Act 1901 4(1)
Related public rulings	TR 94/4; TR 94/5
Related Practice Statements	PSLA 2000/9; PSLA 2002/8
Case references	BRK (Bris) Pty Ltd v. Federal Commissioner of Taxation 2001 ATC 4111
File reference	04/16898
Date issued:	**6 March 2006**
Date of effect:	1 April 2004

Amendment history	14 April 2006: to correct the calculation in Example 23 and to insert new footnote 5 25 August 2006: Paragraph 4: Remove reference to the *Fuel (Penalty Surcharges) Administration Act 1997* Paragraph 87: Change reference to section 444-5 of Schedule 1 to the TAA to section 444-30 of Schedule 1 to the TAA, following the passage of the *Fuel Tax (Consequential and Transitional Provisions) Act 2006*
Other Business Lines consulted	All