PS LA 2008/18 - Interaction between Subdivisions 284-B and 284-C of Schedule 1 to the Taxation Administration Act 1953

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SUBJECT: **Interaction between Subdivisions 284-B and 284-C of Schedule 1 to the *Taxation Administration Act 1953***

PURPOSE: **To provide guidance to officers on the assessment of penalties under Division 284 of Schedule 1 to the *Taxation Administration Act 1953* when assessments which rely on adjustment provisions (including the general anti-avoidance provisions) are issued**

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BACKGROUND

1. Unless otherwise specified, all legislative references in this practice statement are to Schedule 1 to the *Taxation Administration Act 1953* (TAA).

2. Division 284 provides an administrative penalty regime for all taxation laws to enable administrative penalties to apply to entities that fail to meet their taxation obligations in a number of circumstances.

3. Subdivision 284-B imposes administrative shortfall penalties on an entity for conduct that includes:

   - making a statement which is false or misleading in a material particular (subsection 284-75(1)), and
   - taking a position on the operation of an income tax law that is not reasonably arguable (subsection 284-75(2)).

4. Subdivision 284-C imposes administrative penalties on an entity that gets a scheme benefit under a scheme.

5. It is not the intention of this practice statement to provide comprehensive guidance on the operation of the penalty regime in Division 284. The purpose of this practice statement is to explain the interaction between Subdivisions 284-B[1] and 284-C, when either or both may apply. Law Administration Practice Statement PS LA 2006/2 (PS LA 2006/2) provides comprehensive guidance on the application of administrative penalties for making false or misleading statements pursuant to subsection 284-75(1).

6. General provisions such as sections 6-5 and 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) set out the substantive requirements for a particular tax treatment.

7. An adjustment (or scheme) provision is an anti-avoidance provision such as the general anti-avoidance rule in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936), which is applied to cancel a tax benefit otherwise obtainable under a general provision of the tax law.

8. In *Re Brown and Federal Commissioner of* Taxation [2006] AATA 1107; [2006] ATC 2573; 65 ATR 172 *(Brown)*, the Administrative Appeals Tribunal (AAT) held that a penalty cannot be imposed under Subdivision 284-C where a deduction has been disallowed otherwise than under an adjustment provision. In the decision impact statement on *Brown*, the Tax Office accepted the decision.

9. In many cases involving a tax avoidance scheme it will not be known whether an adjustment provision will apply at the time of making the primary assessment. To ensure that an appropriate amount of penalty is ultimately payable by the taxpayer it is necessary to consider the imposition of penalty under Subdivision 284-B and/or Subdivision 284-C.

STATEMENT

The imposition of penalties where no adjustment provision applies

10. If an entity has a shortfall amount that is not related to a scheme, Subdivision 284-C will not need to be considered. In these situations, the shortfall will arise from applying a general provision and penalties under Subdivision 284-B for making a false or misleading statement or not taking a reasonably arguable position on an income tax law should be considered.

[1] Note that imposition of penalties under subsection 284-75(3) of Subdivision 284-B is beyond the scope of this practice statement

The imposition of penalties when the assessment is made on alternative grounds

11. If an entity has a shortfall amount from participating in a scheme, the entity's primary tax assessment will still usually be made in reliance on a general provision (or provisions), with an adjustment provision relied on **in the alternative**. In these cases the penalty will typically be similarly assessed in reliance on Subdivision 284-B and reliance on Subdivision 284-C in the alternative.

12. Where the penalty amounts arising respectively under Subdivisions 284-B and 284-C are the same, then the final penalty payable will normally be equal to that amount (that is penalties will not be imposed cumulatively).

13. However, if the alternative penalty amounts are different, the amount payable under the penalty assessment will be the greater of the amounts calculated under Subdivisions 284-B and 284-C. The entity should be provided with an explanation of the amount payable including details of the separate penalty calculations and the circumstances in which the lesser penalty amount may apply.

The imposition of penalties where an adjustment provision applies

14. Where an entity enters into a scheme and obtains a scheme benefit that is cancelled pursuant to an adjustment provision (that is, where the scheme benefit is allowable under general provisions and the adjustment provision applies to cancel the scheme benefit), penalties will be imposed under Subdivision 284-C. However, Subdivision 284-B penalty should also be considered where the conditions for its imposition are or may be satisfied. It does not necessarily follow that because Subdivision 284-C does apply Subdivision 284-B does not apply.

15. Penalties may be imposed cumulatively under both Subdivisions. That is, where an entity has entered into a scheme and has made a false or misleading statement in relation to the scheme, penalties can be imposed under *both* Subdivisions 284-B and 284-C.

16. However, depending on the circumstances, the Commissioner may exercise his discretion to remit the resulting cumulative penalty amount to a reduced penalty amount. For example, the **total** penalty may be remitted to either the Subdivision 284-B or Subdivision 284-C amount if they are the same or to the greater of the Subdivision 284-B and Subdivision 284-C amounts if they are different. However, the cumulative bases for the penalty imposition are maintained and the penalty notice **should not** purport to remit the excess penalty under any specific Subdivision.

17. The Commissioner is entitled to rely upon both Subdivision 284-B and Subdivision 284-C to support an assessment of the amount of penalty which the Commissioner considers to be appropriate. By making an assessment, the Commissioner fixes the amount of penalty which is payable. In fixing that amount, the Commissioner may rely on cumulative or alternative grounds of liability (which may be inconsistent). On review or appeal, the onus will be on the entity to show that the amount of penalty made payable under the assessment is excessive.

18. To explain the imposition (and subsequent remission, where appropriate) of cumulative penalties to the entity, it is recommended that the decision maker use the following standard wording to advise the entity:

> You are liable for a penalty of $X under item … (to be inserted) of subsection 284-90(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) for (failure to take reasonable care/recklessness/intentional disregard) as to the operation of a tax law. A further $Y penalty applies under section 284-160 of Schedule 1 to the TAA 1953 in relation to the tax benefit you obtained from participating in a scheme. This results in a cumulative penalty of $(X+Y). However, by the exercise of the Commissioner's discretion under section 298-20 of Schedule 1 to the TAA 1953, your overall penalty amount has been remitted to Z.
>
> The reasons for the imposition of both penalties and the remission decision are set out below.

19. The principles discussed in this practice statement are illustrated in the examples in paragraphs 38 to 48 of this practice statement.

EXPLANATION

Statutory framework

20. An entity has a shortfall amount for the purposes of Subdivision 284-B of Schedule 1 to the TAA if one of the items in the table in subsection 284-80(1) of Schedule 1 to the TAA applies. The shortfall amount is the amount by which the relevant tax-related liability is less than, or relevant payment or credit is more than, it would have been if the false or misleading statement had not been made. In this context the expression 'tax-related liability' as used in Subdivision 284-B of Schedule 1 to the TAA and as defined in subsection 995-1(1) of the ITAA 1997 includes a liability worked out under an adjustment provision.

21. The base penalty amount under Subdivision 284-B is calculated as a percentage of that shortfall amount.[2]

22. The base penalty amount under Subdivision 284-C is always calculated as a percentage of the relevant entity's scheme shortfall amount.

23. A scheme shortfall amount is the amount by which the entity's liability is less than or payment or credit is more than it would have been but for the application of an adjustment provision (section 284-150).

The imposition of penalties under Subdivision 284-B

24. Tax officers should refer to PS LA 2006/2 for detailed guidance on the imposition of penalties under subsection 284-75(1) for making a false or misleading statement.

25. Penalties are imposed under Subdivision 284-B for:

- making a statement that is false or misleading in a material particular, which results in a shortfall amount;
- taking a position on the operation of an income tax law that is not reasonably arguable, which results in a shortfall amount; and

[2] This applies to shortfall amounts under subsections 284-75(1) and 284-75(2). Note that different rules apply to calculating the shortfall amount under subsection 284-75(3), however this is beyond the scope of this practice statement

- failing to provide the Commissioner with the necessary documents, thereby requiring the Commissioner to determine tax liability without those documents (not discussed in this practice statement).

26. Where a shortfall amount arises from the operation of a general or non-scheme provision of the tax law, the Commissioner must consider the imposition of penalties under Subdivision 284-B.

27. Base penalty amounts under Subdivision 284-B may be 25%, 50% or 75% of the shortfall amount, depending on the grounds for the imposition of the penalty. The base penalty amount may be reduced or increased (under sections 284-220 and/or 284-225) depending on the individual circumstances of the case.

The imposition of penalties under Subdivision 284-C

28. Subdivision 284-C applies to scheme shortfall amounts resulting from participating in a scheme to which an adjustment provision applies.

29. Subdivision 284-C imposes a base penalty amount of 50% of the scheme shortfall amount, or 25% if it is reasonably arguable that the adjustment provision does not apply to the scheme.[3]

The imposition of penalties when the primary tax assessment is made on alternative grounds

30. The AAT decision in *Brown* has confirmed that penalty under Subdivision 284-C cannot apply to a scheme to which an adjustment provision **does not** apply, that is, a failed scheme.

31. In a typical case involving a tax avoidance scheme it will not be known whether an adjustment provision applies at the time of making the primary assessment. To ensure that an appropriate amount of penalty is ultimately payable the penalty assessment will typically need to be raised on alternative grounds (that is, Subdivision 284-B and Subdivision 284-C in the alternative). Thus, the penalty assessment will be made pursuant to the penalty provision relating to the primary ground of assessment, with the penalty provision corresponding to the alternative ground similarly relied on in the alternative.

The imposition of cumulative penalties

32. Where an entity has been involved in a scheme (penalised under Subdivision 284-C) and makes a false or misleading statement in relation to the scheme (penalised under Subdivision 284-B), the entity may be subject to cumulative penalties, as Division 284 allows for the concurrent application of administrative penalties under both Subdivisions.

33. If a tax benefit has been obtained under the general provisions and an adjustment provision is relied on to cancel the tax benefit, Subdivision 284-C penalty would be applicable. The application of penalties for making a false or misleading statement under Subdivision 284-B should also be considered where appropriate.

34. In practice, cumulative penalties will only be imposed in exceptional cases. What will constitute an exceptional case is a matter of fact to be determined by considering an entity's particular circumstances.

[3] Subdivision 284-C also provides for base penalty amounts of 25% and 10% in respect of certain situations involving international agreements, however consideration of this is beyond the scope of this practice statement

35. If cumulative penalties are imposed and the resulting amount is considered excessive for the particular circumstances, the Commissioner may exercise his discretion to remit so much of the penalty as he considers appropriate. The remission decision should not purport to remit the penalty under any specific provision but rather reduce the overall penalty to an amount considered reasonable in the circumstances. That is, the remission should not be attributed to any particular penalty type.

36. In determining whether a penalty amount is excessive, tax officers should only consider the total base penalty amount of penalty and not any subsequent penalty loading pursuant to sections 284-220 and 284-225 resulting from the entity's conduct.

Examples

37. Paragraphs 38 to 48 of this practice statement provide examples of situations where penalties are imposed. Note that Examples 1 and 2 do not have a scheme component and are intended to exemplify the grounds for imposing Subdivision 284-B penalty, in order to provide the context for the imposition of such penalty where Subdivision 284-C may also have application.

Example 1: false or misleading statement

38. When filling out her income tax return, Marina does not include the income she received from her managed fund. This results in a shortfall amount, which occurred as a result of a failure to take reasonable care. Therefore, Marina will be subject to a base penalty amount of 25% under Subdivision 284-B.

Example 2: not taking a reasonably arguably position

39. Marina claims a deduction for margin payments made in respect of exchange-traded option contracts. These fees are disallowed under section 8-1 of the ITAA 1997 as outlined in Taxation Determination TD 2006/25. Marina disagreed with the Commissioner's interpretation of the relevant laws and treated the tax law as applying to her in a different way. However, her position was not reasonably arguable. Therefore, she will be subject to a penalty of 25% of the shortfall amount under Subdivision 284-B of Schedule 1 to the TAA.

Example 3: scheme participation with a reasonably arguable position

40. Marina enters into a managed investment scheme and claims a deduction under section 8-1 for a management fee

41. Part IVA of the ITAA 1936 applies and the Commissioner makes a determination to cancel the tax benefit obtained by way of the section 8-1 of the ITAA 1997 deduction. It is reasonably arguable that Part IVA of the ITAA 1936 does not apply. Marina will be subject to a 25% penalty under Subdivision 284-C of Schedule 1 to the TAA.

Example 4: assessment supported on alternative grounds

42. Marina enters into a managed investment scheme and claims a deduction for a management fee. The management fee is capital in nature and is not an allowable deduction under section 8-1 of the ITAA 1997. This is reflected in the primary assessment that is issued to Marina. The resulting shortfall

amount occurs as a result of failure to take reasonable care on Marina's part. Therefore, penalty under Subdivision 284-B of Schedule 1 to the TAA will be imposed at a rate of 25%.

43. Alternatively, if the fees are allowable under section 8-1 of the ITAA 1997, there is a tax benefit that is cancelled under Part IVA of the ITAA 1936. It is not reasonably arguable that Part IVA of the ITAA 1936 will not apply, so a 50% penalty will be payable under Subdivision 284-C of Schedule 1 to the TAA. As Marina's primary assessment is made on alternative grounds her penalty assessment is similarly made on alternative grounds.

44. As the alternative penalty amounts differ, Marina's penalty assessment will be for the greater amount, that is, 50%. A letter explaining how the lesser penalty may apply should accompany the penalty notice.

Example 5: cumulative penalties

45. Marina, a resident taxpayer, and her employer enter into a scheme to convert Marina's assessable income into exempt income. On 30 April 2008, the Full Federal Court decides that another entity who participated in an identical scheme had obtained a tax benefit under Part IVA of the ITAA 1936 equal to that entity's exempt income under the scheme. Marina lodges her return for the 2008 year on 31 October 2008 and does not disclose her purportedly exempt income.

46. On the basis of the applicable judicial authority, Marina will not have a reasonably arguable position in relation to Part IVA of the ITAA 1936. Therefore, she will be subject to 50% penalty under Subdivision 284-C of Schedule 1 to the TAA.

47. Subdivision 284-B penalty may also be applicable as Marina has made a false or misleading statement in her income tax return by omitting from it her purportedly exempt income. In the circumstances, which include Marina's disregard of applicable judicial authority, Marina's shortfall has occurred as a result of recklessness with regard to the operation of the law. Therefore, Marina will be liable to Subdivision 284-B administrative penalty of 50%.

48. Marina is liable to a cumulative penalty on her shortfall amount of 100%. However, with regard to circumstances, the resulting penalty is considered unreasonably high and the Commissioner exercises his discretion to remit the total amount to 75%. The penalty notice that issues does not purport to remit the penalty under a specific penalty provision, but rather reduces the overall total penalty to 75%.

Subject references	Anti avoidance penalties Income tax penalties Penalties Remission of penalties Underestimation penalties
Legislative references	ITAA 1997 6-5 ITAA 1997 8-1 ITAA 1997 995-1(1) ITAA 1936 Pt IVA TAA 1953 Sch 1 TAA 1953 Sch 1 Div 284 TAA 1953 Sch 1 Subdiv 284-B TAA 1953 Sch 1 284-75(1) TAA 1953 Sch 1 284-75(2) TAA 1953 Sch 1 284-75(3) TAA 1953 Sch 1 284-80(1) TAA 1953 Sch 1 284-90(1) TAA 1953 Sch 1 Subdiv 284-C TAA 1953 Sch 1 284-150 TAA 1953 Sch 1 284-160 TAA 1953 Sch 1 284-220 TAA 1953 Sch 1 284-225 TAA 1953 Sch 1 298-20
Related public rulings	TD 2006/25
Related practice statements	PS LA 1998/1 PS LA 2006/2
Case references	Re Brown and Federal Commissioner of Taxation [2006] AATA 1107; [2006] ATC 2573; 65 ATR 172
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