PS LA 2011/26 - Administration of penalties and interest charges in relation to the notional liabilities of the States

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This Practice Statement is under review following changes made by the *Treasury Legislation Amendment (Repeal Day) Act 2015* to insert new section 2B into the *Taxation Administration Act 1953*. Section 2B states that "This Act binds the Crown in each of its capacities. However, it does not make the Crown liable to a pecuniary penalty or to be prosecuted for an offence." For any queries about the amendment or proposed Ruling review please email: OperationalPolicyAssuranceandLawWorkManagement@ato.gov.au.

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Practice Statement Law Administration

PS LA 2011/26

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This law administration 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. ATO personnel, including non ongoing staff and relevant contractors, must comply with this law administration practice statement, unless doing so creates unintended consequences or is considered incorrect. Where this occurs, ATO personnel must follow their business line's escalation process.

Taxpayers can rely on this law administration practice statement to provide them with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this law administration practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

SUBJECT: **Administration of penalties and interest charges in relation to the notional liabilities of the States**

PURPOSE: **To provide guidance on the administrative aspects of Miscellaneous Taxation Ruling MT 2011/1**

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BACKGROUND

1. The Commissioner's view on whether and how the uniform penalty regime in Part 4-25 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) and interest charges apply to the Commonwealth, States and Territories is contained in MT 2011/1.

2. For a period before the Commissioner's view was expressed in MT 2011/1, the Commissioner placed a moratorium on the application of penalties and interest charges in relation to net amounts[1] of State and Territory entities that share the immunities of the Crown. The moratorium ceases from the date of publication of this practice statement.

3. Before the moratorium, the Commissioner did not apply penalties on State and Territory entities that shared the immunity of the Crown. However, interest charges were applied in accordance with normal practice and policy.

4. In summary, the Commissioner's view in MT 2011/1 is:

   - The Crown in right of the Commonwealth and untaxable Commonwealth entities:[2]
     - (i) can only have notional liabilities[3]
     - (ii) cannot be liable to penalties in relation to its notional liabilities, and
     - (iii) cannot be liable to interest charges due to the specific exemptions in subsection 8AAB(3) of the TAA (for the general interest charge (GIC) and subsection 280-103(2) of Schedule 1 to the TAA (for shortfall interest charge (SIC)).
   - The Crown in right of the States and State government bodies:
     - (i) can have both legal and notional liabilities[4]
     - (ii) can be liable to penalties and interest charges in relation to legal liabilities, and
     - (iii) cannot be liable to penalties and interest charges in relation to notional liabilities.[5]

[1] 'Net amount' is defined in section 195-1 of *A New Tax System (Goods and Services Tax) Act 1999*.
[2] 'Untaxable Commonwealth entity' has the meaning given by section 177-1(5) of the *A New Tax System (Goods and Services Tax) Act 1999*.
[3] Generally Commonwealth bodies are not liable to pay tax under the taxation laws. Refer to paragraph 37 of MT 2011/1.
[4] Commonwealth taxation on property of a State is prohibited under section 114 of the *Commonwealth of Australia Constitution Act 1901* (the Constitution). However, under various agreements, there is an intention that the States will be notionally liable to pay an amount equivalent to the tax that otherwise would have been payable on property of a State.
[5] Refer to paragraphs 41 to 43 of MT 2011/1.

- The Crown in right of the Australian Capital Territory (ACT) and Northern Territory (NT) and government bodies of the ACT and NT:
  - (i) have and can have only legal liabilities,[6] and
  - (ii) can be liable to penalties and interest charges in relation to legal liabilities.

DATE OF EFFECT

5. This practice statement applies:
   - to returns, activity statements or other documents in an approved form under a taxation law that are lodged on or after the date of issue of this practice statement, in relation to tax periods to which the views in MT 2011/1 apply.[7]
   - to amendments, revisions and voluntary disclosures that are made or lodged on or after the date of issue of this practice statement in respect of those returns, activity statements or other documents which relate to tax periods to which the views in MT 2011/1 apply.

SCOPE

6. This practice statement provides guidance on:
   - (i) how the Commissioner will administer shortfall penalties in circumstances where the underlying liability of a State may be notional or legal, and
   - (ii) how the Commissioner will administer the interest charges in those same circumstances.

7. This practice statement does not apply to:
   - the NT, the ACT or their bodies because, apart from National Tax Equivalent Regime (NTER) liabilities, the liabilities of the NT and the ACT will always be legal liabilities[8]
   - government related entities that are not part of a State for the purposes of section 114 of the Constitution[9] because the liabilities of those entities are always legal liabilities
   - the Commonwealth or untaxable Commonwealth entities because all of the Commonwealth's liabilities are notional liabilities,[10] and
   - liabilities arising under the NTER because all NTER liabilities are notional liabilities.

8. This practice statement does not address notional penalties and notional interest charges which may be payable by a State body pursuant to State law.

9. This practice statement does not address the remission practices for the penalty regime. The ATO remission practices for various sections of the penalty regime are set out in Law Administration Practice Statements including PS LA 2000/9, PS LA 2002/8, PS LA 2005/2, PS LA 2007/3, PS LA 2007/4, PS LA 2011/2, PS LA 2011/19 and PS LA 2012/5.

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[6] This is because the prohibition against Commonwealth taxation on property under section 114 of the Constitution does not extend to the Territories and hence the Territories cannot have a notional liability. Refer to paragraph 44 of MT 2011/1.
[7] Refer to paragraphs 47 to 48 of MT 2011/1.
[8] Refer to paragraphs 44 to 45 of MT 2011/1.
[9] Refer to paragraphs 81 to 82 of MT 2011/1 for discussion of when an entity is part of a State for the purposes of section 114 of the Constitution.
[10] Refer to paragraph 37 of MT 2011/1.

10. This practice statement does not address the remission practices for GIC imposed under section 8AAG of the TAA and SIC under section 280-160 of Schedule 1 to the TAA. The ATO policy on the remission of these interest charges is set out in PS LA 2006/8 and PS LA 2011/12.

DEFINITIONS

11. In this practice statement, unless otherwise stated:

- all legislative references are to Schedule 1 to the TAA
- a reference to a 'State' is a reference to entities which form part of the State for the purpose of section 114 of the Constitution
- 'legal liability' refers to a liability that arises under a 'taxation law' and is imposed under the relevant imposition Act
- 'shortfall penalty' refers to the provisions in Part 4-25 of Schedule 1 to the TAA where a liability to a statement penalty arises where there is a shortfall amount. Penalties imposed where there is no shortfall amount are not within the scope of this practice statement[11]
- 'notional liability', refers to any amounts that are the notional equivalent of tax that would have arisen under a taxation law and imposed under the relevant imposition Act, and
- 'uniform penalty regime' refers to the scheme of uniform administrative penalties in Part 4-25 of Schedule 1 to the TAA.

STATEMENT

12. The shortfall penalty provisions apply in relation to the legal liabilities of a State. The shortfall penalty provisions cannot apply to a State to the extent that the underlying tax liability is a notional liability.[12]

13. Similarly, a State is liable to interest charges to the extent that its underlying tax liability is a legal liability and not to the extent that the underlying tax liability is a notional liability.

14. If there is a question whether a particular liability is notional to some extent, and the circumstances give rise to consideration of the shortfall penalty provisions and interest charges, the State may tell the Commissioner the amounts which it considers are the notional and the legal liabilities. This may occur at any time including at the time of lodgment or revision.

15. The Commissioner will consider any such information consistently with the general principles of self-assessment. So, if an entity states that it has determined that it is part of the State for the purposes of section 114 of the Constitution and that a specified amount is in respect of a notional liability, the Commissioner will ordinarily accept this statement. It would ordinarily not be necessary for the Commissioner to inquire further.

[11] Refer to items 3A, 3B and 3C of the table in subsection 284-90(1) of Schedule 1 to the TAA, that were inserted into the table by *Tax Laws Amendment (2010 Measures No. 1) Act 2010.*

[12] For a State body, notional liabilities arise because section 114 of the Constitution prohibits the imposition of Commonwealth tax on property of a State. Refer to paragraphs 14 and 41 to 43 of MT 2011/1.

16. However, as for any other matter that is subject to self-assessment, the Commissioner may inquire further in relation to whether the entity is part of the State for the purposes of section 114 of the Constitution or whether a liability has been correctly determined to be a notional liability. The Commissioner will seek to resolve any such issue co-operatively with the State entity.

17. In considering whether a particular transaction is a 'tax on property' of a State for the purpose of section 114 of the Constitution, if the transaction does not clearly fall within a category of transactions identified one way or the other in MT 2011/1,[13] case officers must escalate the issue to the Interpretative Advice area within their business line for consideration and further escalation as required.

EXPLANATION

Shortfall penalty

18. Taxpayers may be liable to a penalty for failing to satisfy certain obligations under different taxation laws for which the Commissioner has general administration.

19. More specifically, Division 284 provides for liability to penalty in certain situations where a taxpayer makes a statement which results in a 'shortfall amount'. The table in subsection 284-80(1) sets out the situations in which an entity has a 'shortfall amount'. For an entity to have a 'shortfall amount', subsection 284-80(1) requires the entity to have a tax-related liability. A 'tax-related liability' is defined in section 255-1 as:

> a pecuniary liability to the Commonwealth arising directly under a taxation law (including a liability the amount of which is not due and payable)

20. Section 114 of the Constitution prevents the Commonwealth from imposing tax on the property of a State.[14] However, a State entity may, under a State law or from other directions, pay to the Commissioner the notional equivalent of what would have been payable under a taxation law but for the operation of section 114 of the Constitution. This amount is a notional liability and is not a 'tax-related liability' for the purposes of section 255-1 of Schedule 1 to the TAA.

21. However, a State entity is legally liable to pay a liability that is assessed under a taxation law, and that is imposed under the relevant imposition Act because section 114 of the Constitution does not preclude its imposition. These liabilities are legal liabilities and are 'tax-related' liabilities for the purposes of section 255-1 of Schedule 1 to the TAA. Hence, a State entity can have both legal liabilities which are tax-related liabilities and notional liabilities which are not tax-related liabilities.

22. It follows that certain penalties under Division 284 cannot apply to any shortfall amount of a notional liability as it is not a 'tax-related liability'. A State entity is only liable to penalty on a shortfall amount relating to their legal liability. The penalty amount is determined in accordance with the relevant section in Division 284.

[13] Refer to paragraphs 72 to 82 of MT 2011/1.
[14] Refer to paragraphs 68 to 71 of MT 2011/1 for discussion on what is a 'tax on property' of a State.

Interest charges

23. The GIC and SIC are imposed automatically by operation of the law.[15] However, GIC and SIC only apply in respect of a legal liability of a State entity and not in respect of a notional liability.

Administrative practice

24. To enable the Commissioner to efficiently administer the position outlined above, where shortfall penalty and interest charges may apply, the State entity may provide additional information advising:

    (a) the entity's status as part of the State for the purposes of section 114 of the Constitution, and

    (b) a statement detailing the legal and notional liabilities that make up the total liability for the relevant reporting period.

25. This information should be provided in circumstances including, but not limited to:

    (a) an activity statement or return being revised (including self revision, request for revision lodged with the ATO, and revision as a result of compliance activity), or

    (b) the State entity failing to pay the tax liability as it falls due.

26. The State entity may provide this information at any time, for example, when lodging an original or revised activity statement or return, lodging a revision request or when they are advised that interest charges have been applied.

27. The Commissioner will consider any such information consistently with the general principles of self-assessment. So, if an entity states that it has determined that it is part of the State for the purposes of section 114 of the Constitution and that a specified amount is in respect of a notional liability, the Commissioner will ordinarily accept this statement. It would ordinarily not be necessary for the Commissioner to inquire further.

28. If the State entity does not provide information as detailed in paragraph 25 of this practice statement, it is ordinarily reasonable for the Commissioner to conclude that the State entity has turned their mind to the nature of the tax liability and the State entity has determined that the entire amount reported for the period relates to a legal liability.

29. Similarly, where the State entity provides information in respect of a notional liability only, it is also ordinarily reasonable for the Commissioner to conclude that the State entity has turned their mind to the nature of the total tax liability and the State entity has determined that any remaining portion of the total liability remaining after the notional liability is deducted relates to legal liabilities. The Commissioner will apply the usual practices to determine the penalty amount and interest charges to those legal liabilities.

30. However in any of the circumstances covered in paragraphs 26 to 29 of this practice statement, as for any other matter which is the subject of self-assessment, the Commissioner may inquire further in relation to whether the entity is part of the State for the purposes of section 114 of the Constitution or a liability has been incorrectly determined to be a notional liability. The Commissioner will seek to resolve any such issue co-operatively with the entity.

[15] Refer to paragraphs 63 to 67 of MT 2011/1 for further discussion on GIC and SIC.

31. Where both the Commissioner and the State entity are not able to accurately establish the amounts of the liabilities that are legal and notional respectively, the Commissioner may agree with the State entity on a reasonable estimate of the parts of the liabilities that are legal and notional liabilities.

32. In considering whether a particular transaction is a tax on property of a State for the purpose of section 114 of the Constitution, if the transaction does not clearly fall within a category of transactions identified one way or the other in MT 2011/1,[16] case officers must escalate the issue to the Interpretative Advice area within their business line for consideration and further escalation as required.

Examples that outline how the Commissioner applies the ATO view in MT 2011/1

Example 1 – General interest charge applies to legal liability only

33. On 15 September 2010, State entity A lodged an activity statement for the monthly tax period ended 31 August 2010 reporting an amount payable of $175,000. The amount payable consists of the following:

GST payable on taxable supplies (legal liability)	$ 80,000
GST payable on taxable supplies (notional liability)	120,000
Input tax credits	(25,000)
Amount payable	$175,000

34. State entity A paid $175,000 on 25 November 2010.

35. As a monthly taxpayer, the amount payable for the tax period ended 31 August 2010 was due on 21 September 2010. As State entity A paid its net amount after the due date, it is liable to pay GIC but only to the extent of its legal liability. The GIC is payable on the amount of $55,000 which is the amount payable for the period excluding its notional liability.

Example 2 – Activity statement revised and net amount increased

36. State entity B lodged an activity statement for the tax period ended 30 September 2010 reporting an amount payable of $70,000 which consists of the following:

GST payable on taxable supplies (legal liability)	$ 20,000
GST payable on taxable supplies (notional liability)	100,000
Input tax credits	(50,000)
Amount payable	$ 70,000

37. Subsequently, State entity B revised its activity statement and increased the amount payable to $80,000 as follows:

GST payable on taxable supplies (legal liability)	$ 30,000
GST payable on taxable supplies (notional liability)	100,000
Input tax credits	(50,000)
Amount payable	$ 80,000

[16] Refer to paragraphs 72 to 80 of MT 2011/1.

38. State entity B may be liable to a penalty under section 284-75 and GIC. The amount of notional GST payable on taxable supplies is disregarded for the purposes of determining whether there is a shortfall amount. This is because a notional liability is not a tax-related liability which forms the basis for working out a shortfall amount under subsection 284-80(1).

	GST payable (legal liability)	Input tax credit	Net amount
Original statement	20,000	50,000	(30,000)
Revised amounts	30,000	50,000	(20,000)
Shortfall amount			10,000

Example 3 – Activity statement revised and net amount increased but revision does not result in shortfall amount

39. State entity C lodged an activity statement for the tax period ended 30 June 2010 reporting an amount payable of $85,000 which consists of the following:

GST payable on taxable supplies (legal liability)	$65,000
GST payable on taxable supplies (notional liability)	50,000
Input tax credits	(30,000)
Amount payable	$85,000

40. Subsequently, State entity C revised the activity statement and increased the amount payable to $95,000 as follows:

GST payable on taxable supplies (legal liability)	$35,000
GST payable on taxable supplies (notional liability)	80,000
Input tax credits	(20,000)
Amount payable	$95,000

41. State entity C is not liable to a penalty under section 284-75(1) and GIC because it does not have a shortfall amount. This is because a notional liability is not a tax-related liability and the notional liability component is disregarded in determining whether there is a shortfall amount.

	GST payable (legal liability)	Input tax credit	Net amount
Original statement	65,000	30,000	35,000
Revised amounts	35,000	20,000	15,000
Shortfall amount			nil

Example 4 – Activity statement revised but revision is to notional liability only

42. State entity D lodged an activity statement for the tax period ended 31 March 2010 reporting an amount payable of $225,000 which consists of the following:

GST payable on taxable supplies (legal liability)	$200,000
GST payable on taxable supplies (notional liability)	55,000
Input tax credits	(30,000)
Amount payable	$225,000

43. Subsequently, State entity D revised the activity statement and increased the amount payable to $295,000 as follows:

GST payable on taxable supplies (legal liability)	$200,000
GST payable on taxable supplies (notional liability)	125,000
Input tax credits	(30,000)
Amount payable	$295,000

44. State entity D is not liable to a penalty under section 284-75 because the amount of the revision relates to its notional liability only.

Example 5 – Activity statement revised but revision is to input tax credit only

45. State entity E lodged an activity statement for the tax period ended 30 June 2010 reporting a net refund of $35,000 which consists of the following:

GST payable on taxable supplies (legal liability)	$ 10,000
GST payable on taxable supplies (notional liability)	55,000
Input tax credits	(100,000)
Amount payable	($ 35,000)

46. Subsequently, State entity E revised the activity statement and decreases its net refund to $5,000 as follows:

GST payable on taxable supplies (legal liability)	$ 10,000
GST payable on taxable supplies (notional liability)	55,000
Input tax credits	(70,000)
Amount payable	($ 5,000)

47. State entity E may be liable to a penalty under section 284-75 and GIC on the shortfall amount that resulted from its claim for input tax credit that is more than it was entitled to. The notional amount is disregarded for the purposes of determining whether or not there is a shortfall amount.

	GST payable (legal liability)	Input tax credit	Net amount
Original statement	10,000	100,000	(90,000)
Revised amounts	10,000	70,000	(60,000)
Shortfall amount			$30,000

Amendment history

Date of amendment	Part	Comment
7 May 2014	Paragraph 9 & related practice statements	'PS LA 2006/2' replaced by 'PS LA 2012/5'.

Subject references	crown privilege general interest charge input tax credits interest charges notional tax penalties shortfall interest charge shortfalls
Legislative references	ANTS(GST)A 1999 177-1(5) ANTS(GST)A 1999 195-1 TAA 1953 8AAB(3) TAA 1953 8AAG TAA 1953 Sch 1 TAA 1953 Sch 1 255-1 TAA 1953 Sch 1 Part 4-25 TAA 1953 Sch 1 280-103(2) TAA 1953 Sch 1 280-160 TAA 1953 Sch 1 Div 284 TAA 1953 Sch 1 284-75 TAA 1953 Sch 1 284-75(1) TAA 1953 Sch 1 284-80(1) TAA 1953 Sch 1 284-90(1) Commonwealth of Australia Constitution Act 1901 114 Tax Laws Amendment (2010 Measures No. 1) Act 2010
Related public rulings	MT 2011/1
Related practice statements	PS LA 2000/9 PS LA 2002/8 PS LA 2005/2 PS LA 2006/8 PS LA 2007/3 PS LA 2007/4 PS LA 2011/2 PS LA 2011/12 PS LA 2011/19 PS LA 2012/5
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