PS LA 2021/2 - The ATO's administrative approach to the extension of the Commissioner's discretion to retain tax refunds

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This document has changed over time. This version was published on *22 April 2021*

Generated on: 26 November 2026, 01:45:04 AM

Australian Government
Australian Taxation Office

PS LA 2021/2
The ATO's administrative approach to the extension of the Commissioner's discretion to retain tax refunds

This Law Administration Practice Statement sets out the ATO's administrative approach to the extension of the Commissioner's discretion to retain tax refunds.

This Practice Statement is an internal ATO document and is an instruction to ATO staff.

1. What is this Practice Statement about?

As part of the *Treasury Laws Amendment* (*Combating Illegal Phoenixing*) *Act 2020* (the Amending Act), changes were made to extend the Commissioner's discretion to retain a refund where a taxpayer has an outstanding notification (other than a notification under the business activity statement (BAS) or petroleum resource rent tax (PRRT) provisions) that:

- is required to be given to the Commissioner under a taxation law[1] (for example, an income tax return), and
- affects or may affect the amount of the refund.[2]

The law does not limit the application of the extension to the discretion. However, this Practice Statement recognises that the Commissioner's exercise of this extended discretion will not be taken lightly. In particular, the exercise of the discretion will be considered in circumstances where taxpayers are identified as engaged in high-risk behaviour (including those engaging in illegal phoenix activity).[3]

This Practice Statement provides you with guidance on when you may exercise the Commissioner's discretion to retain a taxpayer's refund. However, this Practice Statement does not apply to the exercise of the Commissioner's discretion to retain a taxpayer's running balance account (RBA) surplus or credit where:

- a notification under the BAS provisions, the PRRT provisions or Single Touch Payroll is outstanding[4], or
- the Commissioner requires verification of information contained in a notification.[5]

For guidance on exercising the discretion to retain a taxpayer's refund where a notification under the BAS and PRRT provisions is outstanding or the Commissioner requires verification of information contained in a notification, refer to Law Administration Practice Statements PS LA 2011/22 *Refunds of running balance account surpluses and credits – Commissioner's discretion to retain refunds and the discretion to pay refunds in a different way* and PS LA 2012/6 *Exercise of Commissioner's discretion to retain a refund.*

2. Who can exercise the discretion to retain the refund?

Only Executive Level 2 officers or SES officers in the Client Engagement Group are to exercise the discretion to retain the refund. Other staff should refer recommendations to exercise the discretion to an appropriate Executive Level 2 in their business line, in the first instance.

3. How will the Commissioner apply the discretion?

Having regard to the nature of the legislative change and the context in which it was introduced, the Commissioner will only consider applying this discretion to taxpayers identified as engaging in high-risk behaviour (including those engaging in what is considered to be phoenix-type activity).[6]

Recognising the particular concern with phoenix behaviour, in the first year after Schedule 4 of the Amending Act commenced (1 April 2020), the Commissioner considered exercising the discretion to retain refunds where there were reasonable grounds to believe the taxpayer is, or the controller or associates of the taxpayer were, engaged in phoenix behaviour. During this first year, the Commissioner did not dedicate resources to investigating whether there were other high-risk behaviour that justifies the exercise of the discretion.

[1] 'Taxation law' is defined under subsection 995-1(1) of the *Income Tax Assessment Act 1997*.
[2] Subparagraph 8AAZLG(1)(b)(iii) of the *Taxation Administration Act 1953* (TAA).
[3] Paragraph 5.20 of the Explanatory Memorandum to the Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019.
[4] Sections 8AAZLG and 8AAZLGB of the TAA.
[5] Section 8AAZLGA of the TAA.
[6] Paragraph 5.20 of the Explanatory Memorandum to the Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019.

4. When should you consider exercising the discretion?

You should consider exercising the discretion to retain a refund where there are reasonable grounds to believe that the:

- taxpayer has an RBA surplus or other credit that has not been applied against a tax debt of the taxpayer
- taxpayer has an outstanding notification that they are required to give under a taxation law (other than the BAS or PRRT provisions)
- outstanding notification affects or may affect the amount of the refund, and
- taxpayer (including associates or controllers) is engaged in phoenix behaviour (during the first year after commencement of the Amending Act), or the taxpayer is engaged in high-risk behaviour (including phoenix behaviour) (after the first year following commencement of the Amending Act).

5. What may be considered as 'phoenix' or high-risk behaviour?

When deciding whether a refund should be retained, you need to weigh the seriousness of that behaviour against the potentially adverse consequences for the taxpayer.

Indicators of phoenix behaviour by the taxpayer, and its associates or controllers, include (but are not limited to):

- cyclically establishing, abandoning or deregistering companies to avoid paying taxes, creditors or employee entitlements
- assets being dissipated with the intention to defeat creditors, or other action being taken to defeat creditors (which may be a precursor to phoenixing)
- a director associated with prior liquidations and/or deregistrations
- a director associated with prior instances of insolvency
- stripping or transfer of assets from a company, ahead of its abandonment, winding-up or deregistration
- transfer of company assets at an undervaluation (often to a related party) to defeat creditors
- the transfer of employees to a new company under the same effective control as the previous company to defeat tax obligations and employee entitlements
- backdating of the resignation of a director, appointment of 'straw' directors, or abandonment of a company without a resident director
- the concealment of the role of a shadow or de facto director
- the concealment or destruction of company records.

These factors, either alone or in combination, may not point to phoenix behaviour. It is the totality of the circumstances that must be considered in deciding whether to exercise the discretion to retain a refund.

Indicators of high-risk behaviour include but are not limited to:

- poor past and current compliance with taxation and superannuation obligations, including registration, lodgment, accuracy of reporting, record keeping and making on-time payments
- poor behaviours and governance in managing tax and superannuation risks
- the number of, and the circumstances around, any bankruptcies or insolvencies
- tax-related penalties and sanctions imposed, such as a taxpayer being subject to director penalty notices or having committed an offence in failing to give security as required by us
- connection with advisers who are subject to disciplinary actions or sanctions relating to taxation and superannuation laws, such as penalties relating to promoting or implementing schemes
- past information provided which reasonably indicated
  - fraud or evasion
  - intentional disregard of a taxation law
  - recklessness as to the operation of a taxation law
- the likelihood of participation in or promotion of
  - aggressive tax planning arrangements
  - schemes to obtain a tax benefit (tax avoidance schemes)
  - fraud or evasion
  - criminal activity.

6. How long can the Commissioner retain a refund?

The refund can be retained under this discretion until the taxpayer has given the outstanding notification or

an assessment of the amount is made, whichever happens first.

Where a new tax liability arises before the outstanding notification is provided or an assessment of an amount is made, the amount that would otherwise have been refunded can be applied against the new liability. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund.

Delayed refund interest will not apply on any RBA surplus or credit retained under this measure.[7] Once the notification has been provided, delayed refund interest will be payable on the RBA surplus if more than 14 days is taken to refund the amount.

However, interest on overpayments is payable where an income tax credit is retained[8] under this discretion and the Commissioner takes 30 days or more to refund an amount of that credit.[9]

7. Will the taxpayer be advised that their refund is retained for an outstanding notification?

Although not required by law, it is expected that case officers will send written communication to the taxpayer explaining:

- that the refund has been retained
- the amount retained
- why the refund was retained
- the outstanding notification(s) required to be lodged, and
- how the taxpayer can prevent refunds being retained in the future.

8. When can the Commissioner consider refunding the amount?

Where a notification is outstanding, you may refund an amount if the taxpayer can demonstrate (or you can confirm based on available information):

- **for an individual** – that the retention of the refund will cause serious financial hardship, that is the individual will not be able to afford the basic necessities of life
- **for non-individuals** – the inability to give the outstanding notification by the original due date is directly caused by circumstances beyond the taxpayer's control.

This decision must be approved by the Executive Level 2 officer (or higher) who approved the decision to retain the refund.[10]

9. Does a taxpayer have review rights to the decision to exercise the discretion?

Yes, a decision to exercise this discretion to retain a refund is externally reviewable.[11]

If the Commissioner makes an assessment of the underlying amount, the taxpayer may object to the assessment.[12]

10. Examples

Example 1 – high-risk behaviour and phoenix behaviour indicated; refund retained

Michelle is a director of a construction company that employs 15 individuals.

This company has not lodged their 2017 and 2018 income tax returns. The company has also not complied with its superannuation obligations.

The company has also recently transferred assets to another entity, indicating a reduction in available assets to meet liabilities.

Michelle was a director of three other construction companies, each of which employed some of the same staff as her current company, and each of which was liquidated with unpaid tax liabilities.

The company lodges their 2019 income tax return which results in a $120,000 refund while their other lodgments remain outstanding.

The Commissioner exercises the discretion to retain the $120,000 refund because Michelle is in control of the company and is engaged in behaviours that present a phoenix risk.

The refund will be retained until the company lodges the remaining outstanding income tax returns or an assessment of an amount in relation to the outstanding returns is made.

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[7] Subparagraph 12AF(b)(i) of the *Taxation (Interest on Overpayments and Early Payments) Act 1983* (T(IOEP) Act).
[8] Part IIB of the T(IOEP) Act.
[9] T(IOEP) Act.
[10] Where that Executive Level 2 officer (or higher) who made the decision is not available to make the decision, an officer in their position or in a similar role can make the decision.
[11] Under the *Administrative Decision (Judicial Review) Act 1977* and the *Judiciary Act 1903.*
[12] In the manner set out in Part IVC of the TAA.

Example 2 – high-risk behaviour indicated; refund retained

Daniel is the sole director of Daily Dollars, a financial services company. As a result of Daniel's actions, Daily Dollars has poor past and current compliance with its taxation and superannuation obligations. This has resulted in multiple penalties for false and misleading statements and director penalties for both pay as you go withholding and superannuation guarantee charge.

Daily Dollars has an outstanding income tax return that is anticipated to result in an income tax liability of $250,000.

Daniel lodges Daily Dollars' BAS for the June quarter in 2021 which results in an $80,000 credit. Daniel does not lodge Daily Dollars' outstanding income tax return.

Rather than refunding the credit, the Commissioner exercises the discretion to retain the $80,000.

The refund will be retained until Daniel lodges Daily Dollars' outstanding income tax return or an assessment of an amount in relation to the outstanding income tax return is made.

Example 3 – no high-risk indicators; refund not retained

Carl is a sole trader carpenter. Carl self-prepares his BAS but has a tax agent prepare his income tax return. He has a good compliance history, generally lodging on time and paying any tax-related liabilities as they are due.

As Carl has not visited his tax agent recently, his income tax return has not been lodged and is now overdue. Carl lodges a BAS resulting in a $10,000 credit. Despite the outstanding income tax return, there are no indicators of phoenix or high-risk behaviour and therefore the discretion to retain the $10,000 refund is not exercised.

Example 4 – no high-risk or phoenix indicators; refund not retained

Angus and his wife, Cherie, have been running a successful specialty coffee shop for the last six years. They decided to incorporate their business in 2016 and became directors. Their company, BeanOne Pty Ltd, had no employees until late-2018 when a new tram stop built near their shop caused their business to thrive. The company had to employ two people on a casual basis as a result. Until 2018, the company had never missed a BAS lodgment or an income tax return lodgment.

In 2018, Angus suffered a long-term illness and could no longer be involved in the business. Cherie continued to operate the business but struggled to keep on top of the company's records. As a result, the company's quarterly BAS for the 2018 financial year were outstanding. Cherie engaged a BAS agent to complete the outstanding BAS which resulted in a $55,000 refund. In focusing on keeping the business operating, Cherie forgot to lodge the company's income tax return.

Despite having previously missed BAS lodgments (which were eventually lodged), there is no indication of high-risk or phoenix behaviour from Cherie and Angus, or of assets being dissipated with the intention to defeat creditors. Therefore, the discretion to retain the $55,000 refund is not exercised despite the company having an outstanding income tax return.

11. More information

For more information, see:

- Law Administration Practice Statement PS LA 2011/16 *Insolvency – collection, recovery and enforcement issues for entities under external administration*
- Law Administration Practice Statement PS LA 2011/22 *Refunds of running balance account surpluses and credits – Commissioner's discretion to retain refunds and the discretion to pay refunds in a different way*
- Law Administration Practice Statement PS LA 2012/6 *Exercise of Commissioner's discretion to retain a refund*
- The economic impacts of potential illegal phoenix activity report

Date issued	22 April 2021
Date of effect	22 April 2021

References

Legislative references	ITAA 1997 995-1(1) TAA 1953 Pt IVC TAA 1953 8AAZLF TAA 1953 8AAZLG TAA 1953 8AAZLG(1)(b)(iii) TAA 1953 8AAZLGA TAA 1953 8AAZLGB ADJR Act 1977 Judiciary Act 1903 T(IOEP)A 1983 Pt IIB T(IOEP)A 1983 12AF(b)(i) Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020
Other references	Explanatory Memorandum to the Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019
File references	1-MN40UPS
Related Practice Statements	PS LA 2011/16 PS LA 2011/22 PS LA 2012/6

ATO references

ISSN	2651-9526
ATOlaw topic	Goods and services tax ~~ Taxation Administration Act 1953 ~~ Retention of refunds – section 8AAZLGA

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