TR 94/6 - Income tax: tax shortfall penalties: voluntary disclosures

Taxation Ruling
Income tax: tax shortfall penalties: voluntary disclosures

other Rulings on this topic

IT 2246; IT 2527; TR 92/10

contents para

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling outlines the Australian Taxation Office (ATO) policy on voluntary disclosures for the purpose of administering sections 226Y, 226Z and 226ZA (relating to penalties in respect of tax shortfalls), sections 226D, 226E and 226F (relating to penalties in respect of tax avoidance schemes) and sections 160ARZJ, 160ARZK and 160ARZL (relating to penalties in respect of franking tax shortfalls) of the *Income Tax Assessment Act 1936* (ITAA). Specifically, it provides guidelines on:

- the circumstances under which a disclosure will be taken to qualify for an 80% reduction of the penalty otherwise attracted;
- the circumstances under which a disclosure will be taken to qualify for a 20% reduction of the penalty otherwise attracted;
- the point at which a taxpayer will be taken to have been informed that a tax audit is to be carried out;
- the circumstances under which the Commissioner will exercise his discretion to treat a disclosure as having been made before the taxpayer was informed of a tax audit.

2. The Ruling also states ATO policy on prosecution action against taxpayers who have made voluntary disclosures.

3. The Ruling is expressed in terms of tax shortfall penalties. However, as the voluntary disclosure provisions relating to scheme penalties and franking tax shortfall penalties are substantially the same as those relating to tax shortfall penalties, the guidelines provided by this Ruling apply, subject to the necessary changes, to cases where the scheme penalties or franking tax shortfall penalties are in question.

The relevant sections relating to the scheme penalties and franking tax shortfall penalties have been noted in brackets where appropriate.

4. Taxation Ruling TR 92/10, in particular paragraphs 10 and 11 of that Ruling, should be read in conjunction with this Ruling for the purpose of determining the nature of the modifications to be made to Taxation Ruling IT 2517 in respect of the remission of subsection 223(1) additional tax in relation to the 1991-92 year of income.

Legislative framework

5. The *Taxation Laws Amendment (Self Assessment) Act 1992* introduced, among other things, new penalty provisions into Part VII of the ITAA that apply where a taxpayer has a tax shortfall. Penalty is attracted at specified rates for breaches of the new penalty standards. The law also provides that the rates of penalty otherwise attracted are reduced by a set amount in certain circumstances. These are:

(a) where a taxpayer voluntarily tells the Commissioner in writing about a tax shortfall or part of a tax shortfall for a year *before* the Commissioner has informed the taxpayer that a tax audit relating to the taxpayer in respect of the year was to be carried out - section 226Z (and sections 226E and 160ARZK). In these cases the penalty is reduced:

- if the shortfall or part is less than $1,000 - to nil;
- if the shortfall or part is $1,000 or more - by 80%;

(b) where a taxpayer voluntarily tells the Commissioner in writing about a tax shortfall or part of a tax shortfall for a year *after* the Commissioner has informed the taxpayer that a tax audit was to be carried out, and it could reasonably be estimated that telling the Commissioner has saved the Commissioner a significant amount of time or significant resources in the audit - section 226Y (and sections 226D and 160ARZJ). In these cases the penalty is reduced by 20%.

6. The Commissioner has a discretion to treat a disclosure that is made by a taxpayer after the taxpayer has been informed that a tax audit is to be carried out as having been made before the taxpayer was so informed - section 226ZA (and sections 226F and 160ARZL). The Commissioner may exercise this discretion where he considers it appropriate in all of the circumstances. The effect of the Commissioner exercising this discretion is that a taxpayer would obtain an 80% reduction in the penalty otherwise attracted in respect of the tax shortfall disclosed rather than a 20% reduction.

Ruling

7. In order for a disclosure made by a taxpayer before the taxpayer is informed of a tax audit to qualify for an 80% reduction of the penalty otherwise attracted, the disclosure must be made voluntarily and must be a full and true statement of all the relevant material facts that will allow the Commissioner to make a correct adjustment of the taxpayer's assessment in respect of the matter that is disclosed.

8. A disclosure will generally be treated as having been made voluntarily if it is made before the taxpayer or the taxpayer's representative is notified that an audit has commenced into the taxpayer's affairs. However, certain disclosures may be treated as having been made voluntarily, notwithstanding that they are made after notification of an audit, where the disclosure is about a matter outside the scope of the audit or it could be concluded that the disclosure would have been made even if the audit had not been commenced. Whether a person is a representative of the taxpayer will depend on the arrangements that exist between the taxpayer and the other person. In the main, a representative is any person or entity which manages or acts as agent in respect of any part of the taxpayer's financial and/or taxation affairs, for example, the taxpayer's accountant, bookkeeper, financial adviser, solicitor or tax agent.

9. A disclosure by a taxpayer after the taxpayer has been informed of a tax audit will generally qualify for a 20% reduction of the penalty otherwise attracted if it is made before detailed enquiries are commenced into the matter disclosed and the disclosure enables a correct adjustment of the taxpayer's assessment to be made. The timing and nature of the disclosure should be such that it could be reasonably estimated to have saved significant time and resources in the audit. In this context a disclosure will be voluntary if it represents a level of co-operation and assistance by the taxpayer that is well above what is ordinarily expected of a taxpayer during the conduct of an audit.

10. The time at which a taxpayer is taken to have been informed of a tax audit is the time when the ATO first contacts the taxpayer or the taxpayer's representative about a tax audit for a particular year. Notification will normally be in writing or may be made orally. A tax audit includes audits to ascertain a taxpayer's proper income tax liability, record keeping audits, tax strategy reviews and monitoring or watching briefs. Audits relating to taxes other than income tax (e.g., sales tax, FBT, superannuation guarantee, training guarantee, etc) will be disregarded for the purposes of determining whether a person has acted voluntarily in making a disclosure of an income tax shortfall

unless income tax audits are being conducted concurrently with audits of other taxes.

11. The Commissioner will generally exercise his discretion to treat a disclosure as having been made before the taxpayer was informed of a tax audit where:

(i) at the time that the taxpayer was notified of the commencement of the audit, the focus of the audit as advised to the taxpayer did not cover the type of tax shortfall disclosed by the taxpayer; or

(ii) it may be reasonably concluded that the taxpayer would have made the disclosure even if the tax audit had not been commenced.

However, this Ruling does not restrict authorised officers when exercising the discretion. Each case should be decided on the merits of its own facts and circumstances.

12. It should be noted that even if a disclosure is made before the taxpayer is informed of a tax audit, the disclosure still needs to have been made voluntarily to qualify for the 80% reduction in penalty otherwise attracted.

13. The fact that a person has made a voluntary disclosure does not necessarily preclude a prosecution. The decision whether to prosecute in such cases will be taken on the advice of the DPP. In no case should a tax officer provide an undertaking to a taxpayer that the taxpayer will not be prosecuted.

14. Other Rulings dealing with the imposition of additional tax are:

- TR 94/2 Transitional arrangements for 1992-93 substituted accounting periods;
- TR 94/3 Calculation of tax shortfall and allocation of additional tax;
- TR 94/4 Reasonable care, recklessness and intentional disregard;
- TR 94/5 Reasonably arguable; and
- TR 94/7 Exercise of the Commissioner's discretion to remit penalty.

Date of effect

15. This Ruling, to the extent it is concerned with the interpretation of sections 226Y, 226Z, 226D, 226E, 160ARZJ and 160ARZK, sets out the current practice of the ATO and is not concerned with a

change in interpretation. Consequently, it applies from the date those sections commenced to operate.

16. To the extent the Ruling provides guidelines for the exercise of the discretions contained in sections 226ZA, 226F and 160ARZL it applies in respect of exercises of those discretions after the date on which this Ruling is issued.

17. To the extent that Taxation Ruling TR 92/10 should be read in conjunction with this Ruling it applies where the Commissioner's discretion to remit additional tax imposed under subsection 223(1) is exercised after the date on which this Ruling is issued.

18. To the extent this Ruling relates to the possible prosecution of taxpayers who have made voluntary disclosures, it applies to both past and future years.

Explanations

19. The purpose of the provisions giving a reduction in the penalty otherwise applicable is to encourage the making of disclosures by taxpayers. This is the guiding principle to be used in applying the provisions. While each case will be governed by its own facts, the benefit of any doubt should generally be given to the taxpayer. However, a balance must be struck between encouraging voluntary disclosures and not rewarding taxpayers who, hoping to avoid detection, defer making disclosures until such time as it becomes obvious that ATO activity is about to uncover a tax shortfall. The latter refers to more serious cases, particularly cases involving fraud on the revenue, with or without some degree of criminality, which would be likely to continue indefinitely but for imminent detection.

20. Except for minor errors amounting to less than $1000 tax, sections 226Y and 226Z provide substantial incentives for taxpayers to review their taxation affairs and make a voluntary disclosure of any tax shortfall before the ATO begins an audit. The discounts are intended to leave a penalty, albeit a small penalty where an 80% discount applies, where a taxpayer has not taken reasonable care or has attracted the operation of other tax shortfall provisions. Generally, this position acknowledges that only taxpayers who take reasonable care when lodging a return should be free of tax shortfall penalties. The 80% and 20% discounts on penalty rates also acknowledge that taxpayers who voluntarily disclose a tax shortfall before the commencement of an audit should receive a substantially greater discount than those who defer the making of disclosures until the ATO has commenced audit activity.

Disclosures made before being informed of a tax audit - sections 226Z, 226E and 160ARZK

21. In order for a disclosure by a taxpayer to qualify for an 80% reduction in the penalty otherwise attracted, the disclosure must:

(i) be made before the taxpayer is informed of a tax audit;

(ii) be in writing and contain a full and true disclosure of all the relevant material facts necessary for the Commissioner to make a correct adjustment of the taxpayer's assessment in respect of the matter disclosed;

(iii) be made voluntarily; and

(iv) amount to a tax shortfall of at least $1000.

These criteria are discussed separately below.

(i) Time at which taxpayer is informed of a tax audit

22. Generally, a taxpayer will be treated as having been informed that a tax audit relating to the taxpayer for a particular year is to be carried out when the ATO first makes contact with the taxpayer or his or her representative about the audit. Notification will normally be made in writing or may be made orally. The use of the word 'audit' is not essential. Terms such as 'under examination' or 'under review' would suffice. However, it should be clear on the face or tenor of the communication that an audit has been commenced into the affairs of the taxpayer.

23. For the purposes of the tax shortfall penalty provisions, 'tax audit' is defined as n examination of a person's financial affairs by the Commissioner for the purposes of a tax law' (subsection 222A(2) of the ITAA and subsection 14ZAA(1) of the *Taxation Administration Act 1953*). The definition is a very broad one and covers the usual audits the ATO undertakes to ascertain a taxpayer's proper liability to tax as well as other examinations of a taxpayer's affairs, including record keeping audits, tax strategy reviews, monitoring or watching briefs, source deduction audits (for example, PAYE, PPS) and FBT.

24. To prevent harsh results arising because of the broad definition of a tax audit, the discretion available to the Commissioner under section 226ZA to treat a disclosure as having been made before the taxpayer was informed of a tax audit should generally be exercised in cases where, the tax shortfall disclosed was unlikely to fall within the focus of the audit notified to the taxpayer. It would assist taxpayers if notifications about an audit indicate as far as possible the type of audit being conducted and its scope unless it is apparent from the nature of the audit to be undertaken, e.g., a record keeping audit.

25. Section 226Z (and sections 226E and 160ARZK) refer to a taxpayer being informed of a tax audit in respect of a particular year of income. Tax officers should, accordingly, be explicit about the years of income that are being reviewed when informing taxpayers that they are to be audited. While it will still be open for the ATO to look at other years, the taxpayer will be able to make a disclosure about those other years, which may still qualify for the 80% reduction in any penalty attracted, until such time as the taxpayer is specifically informed that the audit will cover those years. Ultimately, whether a disclosure made by a taxpayer about a year other than the years under audit may be accepted as having been made voluntarily will depend on the facts.

(ii) Full and true disclosure

26. The requirement that the disclosure be in writing is self explanatory. In terms of the extent of the disclosure required, if the disclosure is incomplete, but the degree of incompleteness is insignificant and has no or little material effect on the processing of the disclosure, the case may still be treated as a disclosure which qualifies for the reduced rates of penalty.

27. A taxpayer may disclose one part of a tax shortfall, but not other parts of the tax shortfall. This may be because the taxpayer is only aware of one part of the shortfall. Provided the disclosure on the particular part of the shortfall is full and true, the taxpayer is entitled to the benefit of the reduced penalty rates in respect of the part of the shortfall disclosed. The part or parts of the shortfall not disclosed would continue, if appropriate, to attract penalty at the normal (non-reduced) rates. On the other hand, if a taxpayer's disclosure in respect of a part of a tax shortfall is not sufficiently complete then the disclosure will not qualify for a reduction in penalty.

28. A taxpayer need not admit liability in respect of the shortfall disclosed. A taxpayer is eligible for the reduced penalty rates whether or not the taxpayer maintains an opinion contrary to that of the Commissioner, or disputes the adjustment the Commissioner makes to the taxpayer's assessment.

(iii) Voluntary

29. The term 'voluntary' is not defined in the legislation. Its normal meaning implies an act done without prompting, persuasion or compulsion. A disclosure will be treated as having been made voluntarily if it is made without having been prompted by ATO action. That is, the disclosure generally must be made before the ATO first makes contact with the taxpayer or his or her representative

where that contact may have indicated to the taxpayer that his or her affairs are being audited.

30. Contact with the taxpayer will normally be by letter or telephone advising the taxpayer of the commencement of an audit, including a letter advising a taxpayer of information that suggests a tax shortfall. The meaning of 'contact with the taxpayer' may vary between cases but normally the term should be read narrowly to ensure that most taxpayers will get the maximum benefit from the reduced penalties for disclosures.

31. Under normal circumstances, a disclosure may be treated as having been made before any contact with the taxpayer even though enquiries by the ATO have commenced and the taxpayer could reasonably expect to be subject to an audit. An example would be where an employee of a company comes forward to declare omitted income from work done for a company after the ATO has begun issuing query letters progressively to other employees who are believed to have omitted income for work performed for that company. The employee would be accepted as having come forward voluntarily because the taxpayer had not been contacted by letter or otherwise by the ATO.

32. A further example of voluntary behaviour would be where a taxpayer discloses an income tax shortfall after the taxpayer is notified of a record keeping audit, tax strategy review, monitoring or watching brief, source deduction audit, case selection enquiries, FBT and sales tax audits or any other non-income tax activity. Moreover, disclosures of a tax shortfall relating to a year not under audit may be accepted as voluntary unless there are special circumstances bearing out involuntary behaviour.

33. Similarly, an ATO project or review on an industry-wide or geographic basis would not of itself preclude a taxpayer who is engaged in one or more of these industries or who lives in a certain geographic region from making a voluntary disclosure. Also, the mere listing of a taxpayer's name for future audit does not preclude the taxpayer from making a voluntary disclosure, provided first contact has not been made by the ATO.

34. In the case of a partnership, however, a disclosure made by a partner in relation to partnership matters after the ATO has first made contact with the representatives of the partnership of which he or she is a member is not regarded as voluntary. Similarly, a disclosure made by a taxpayer after first contact with a trust or private company in which the taxpayer is a principal beneficiary, shareholder or director should not be treated as voluntary if the disclosure relates to the taxpayer's interest in the trust or private company.

35. Also, a disclosure would not be regarded as 'voluntary' where it is made in relation to a year outside the scope of an audit but is made after realising from, say, a discussion with an auditor, that an existing audit would be extended to cover the year and subject matter to which the disclosure relates, even though formal notification of commencement of an audit for that year had not been given.

36. There may be cases where there is evidence that a disclosure, made after first contact by the ATO with the taxpayer, has nevertheless been made voluntarily. This may be the case, for example, where the taxpayer was undertaking its own review of its tax affairs (often called a 'prudential' audit) at the time contact was first made by the ATO, with a view to making a disclosure of any discrepancies it discovered. Where the evidence clearly supports that this is the case (including that the taxpayer intended to make disclosures), the disclosures made by the taxpayer may be accepted as voluntary, and so may qualify for the 80% reduction under section 226Z (and sections 226D and 160ARZK) by the exercise of the discretion under section 226ZA.

(iv) Threshold

37. Where the amount of a tax shortfall or a part of a tax shortfall voluntarily disclosed before the taxpayer is informed of a tax audit is equal to or greater than $1,000, the penalty otherwise payable in respect of that shortfall or part is reduced by 80%. If the amount of the shortfall or part of the shortfall disclosed is less than $1,000 the penalty otherwise payable is reduced to nil - section 226Z (and section 160ARZK). Note that under section 226E, relating to scheme cases, the reduction in penalty is 80% in all cases, irrespective of the amount of the disclosure.

38. Where a taxpayer makes more than one disclosure in respect of a particular year of income the disclosures should be added together to determine whether the $1,000 threshold has been exceeded for that year. Thus, if a debit amendment has issued in respect of an initial disclosure of part of a shortfall of less than $1,000, and another disclosure is subsequently made in respect of the same year of income so that the sum of the parts of the shortfall disclosed is equal to or greater than $1,000, the penalty reduction provided in respect of the first disclosure would need to be revised.

Disclosures made after being informed of a tax audit - sections 226Y, 226D and 160ARZJ

39. Notwithstanding that a tax audit has commenced a taxpayer may still volunteer information to the Commissioner that will materially

assist in the completion of the audit. Such a disclosure will qualify for a 20% reduction in the penalty otherwise attracted if:

(i) it is made after the taxpayer has been informed that a tax audit was to be carried out;

(ii) it is in writing and brings all the relevant facts and other information to the attention of the Commissioner that will allow the Commissioner to readily identify the amount and nature of the shortfall;

(iii) it is made voluntarily; and

(iv) it could reasonably be estimated to have saved the Commissioner a significant amount of time or resources in the audit.

40. The time at which a taxpayer is notified of an audit and the matter dealt with in (ii) above have already been discussed separately in respect of disclosures before audit (see paragraphs 22 - 28).

(iii) Voluntary

41. In relation to (iii) above, in addition to what has already been discussed separately in respect of disclosures before audit (see paragraphs 29 - 36), it is clear that the word 'voluntary' in the context of a disclosure made after notification of an audit includes a disclosure by a taxpayer that may have been prompted in an indirect way by the audit. For example, disclosures outside the scope of an audit**.** 'Voluntary' in this context presupposes a level of co-operation and assistance by the taxpayer that is well above that ordinarily expected of taxpayers during the conduct of an audit. The requirement that the disclosure be voluntary is closely related to the requirement that the disclosure could reasonably be estimated to result in a significant saving in the time or resources taken to conduct the audit.

42. However, a taxpayer who merely 'comes clean' when caught should not be accepted as having made the disclosure voluntarily, for example, where the tax shortfall disclosed is the same kind of subject matter that is within the scope of an audit.

(iv) A significant amount of time or resources

43. In relation to (iv) above, a disclosure made early during an audit is more likely to result in a significant saving of time and resources than a disclosure made later, especially where the disclosure relates to a matter that will clearly be examined during the course of the audit. It should be noted that the actual time or resources spent on the audit does not in fact need to be less than was planned because of the

disclosure that was made. It may be that the time saved is used in looking into other matters. What is required is that the disclosure made could be reasonably estimated to have saved a significant amount of time or resources in looking into the matter disclosed.

44. In some audit cases the general level of access granted to the taxpayer's records and the general level of assistance and co-operation provided by the taxpayer during the audit will result in a significant saving in the time and resources spent on the audit. In such cases an across the board discounting of penalties otherwise attracted may be appropriate on the basis of the 'disclosures' made. Wherever possible, however, the reduced rates of penalty should be directly related to specific disclosures made in respect of specific matters.

45. The reduced rates of penalty for disclosures made during an audit are not attracted where a taxpayer is simply courteous or co-operative in responding to specific requests for information. To attract the reduced rates a taxpayer must make, voluntarily, disclosures of information not otherwise known to the auditor that lead to a significant saving in time or resources.

Commissioner's discretion to treat disclosure as having been made before taxpayer informed of a tax audit

46. If a taxpayer voluntary makes a disclosure after being informed of a tax audit then the Commissioner may, if he considers it appropriate in all of the circumstances, determine that for the purposes of sections 226Y and 226Z (and sections 226D and 226E and sections 160ARZJ and 160ARZK), the taxpayer is taken to have made the disclosure before being informed of the audit - section 226ZA (and sections 226F and 160ARZL). The effect of the exercise of the discretion is that the disclosure will qualify for the 80% reduction in the penalty otherwise attracted unless the $1000 tax threshold applies.

46. As a general rule, the discretion should be exercised in the following kinds of cases:

(a) where, because the tax audit being undertaken has only a limited or narrow focus (such as a record keeping audit, a tax strategy review or a monitoring or watching brief, or an audit of a group of companies where a member of the group which is not the focus of the audit makes a disclosure), the tax shortfall disclosed was not within the scope of the audit as notified to the taxpayer and no detailed enquiries had been commenced into the matter; or

(b) where it may reasonably be concluded that the taxpayer would have made the disclosure even if the tax audit had not been commenced (such as where a company is

undertaking a prudential audit at the time the ATO commences its audit and it could be reasonably concluded that the taxpayer was going to disclose the outcome of the prudential audit irrespective of the tax audit).

47. The purpose of the discretion is to ensure that a taxpayer is not improperly denied the benefit of the 80% reduction in penalty rates because of a literal application of the law. In the end, authorised officers must make a decision in each case based on all of the facts. While this Ruling provides guidelines on how the discretion should be exercised, it is not intended to restrict officers in the exercise of the discretion in appropriate cases.

Penalties in 'self amendment' cases

48. The *Taxation Laws Amendment (Self Assessment) Act 1992* amended section 169A of the ITAA so that the Commissioner may accept statements made by taxpayers in amendment requests for the purposes of making an assessment. A 'self amendment' is any request for an amendment which the Commissioner accepts without scrutiny. Such statements must be made in writing.

49. A request for an amendment, whether on the special tax agent amendment form or otherwise, will usually be a voluntary disclosure, subject to the considerations covered by this Ruling about whether it is made voluntarily and the time at which it is made. Accordingly, where the Commissioner, following a request from a taxpayer, amends an assessment to increase the tax payable by the taxpayer, and the increase in tax is less than $1,000, no penalty is attracted.

50. Where the increase in tax is $1,000 or greater, a penalty of 5% (being a penalty of 25% reduced by 80%) will be imposed, on the basis that the amount of the tax shortfall disclosed is a prima facie indication that the shortfall was caused by the taxpayer failing to take reasonable care. The rate of penalty imposed may be reviewed if information becomes available which indicates that either no penalty, or a higher rate of penalty, is warranted.

Prosecution of taxpayers who have made voluntary disclosures

51. The fact that a person has made a voluntary disclosure does not necessarily preclude a prosecution. However, it is a factor to be taken into account in deciding whether the public interest requires criminal proceedings. The Director of Public Prosecutions (DPP) has advised that, as a general rule, it is unlikely that a person who has genuinely made a voluntary disclosure will be prosecuted, unless the offence exhibits a significant degree of criminality.

52. The decision whether to prosecute in such cases will be made on the advice of the DPP. In no case should a tax officer provide an undertaking to a taxpayer that the taxpayer will not be prosecuted.

53. Taxation Ruling IT 2246 is varied by this Ruling to the extent that the two are inconsistent.

Examples

Example 1

Facts

54. The taxpayer, a sole trader, was advised that the records of business relating to the 1993 year of income were to be audited to ensure they were in order and complied with the requirements of the ITAA. When the auditor arrived to conduct the audit the taxpayer provided a written statement that a capital expense had been incorrectly claimed as a repair in her 1992 return. The statement outlined all the relevant details to correct the 1992 assessment.

Penalty

55. The disclosure by the taxpayer would qualify for an 80% reduction of any penalty otherwise attracted. The disclosure was made before the taxpayer was informed of a tax audit for the year to which the disclosure related, as the record keeping audit related to the 1993 year of income. While the disclosure was made after the taxpayer was first contacted by the ATO, it may be accepted as having been made voluntarily, since the examination of the taxpayer's affairs was confined to the 1993 year.

56 Note that if the disclosure related to the same year as the record keeping audit it may still qualify for the 80% reduction in penalty otherwise attracted if the tax shortfall disclosed was unlikely to have been detected by the record keeping audit. In such a case, because the disclosure would have been made after the taxpayer had been informed of a tax audit for the relevant year, the Commissioner would have to exercise the discretion under section 226ZA to treat the disclosure as having been made before the taxpayer was so informed.

Example 2

Facts

57 The taxpayer, a manufacturing company, was notified by the ATO that it intended undertaking an audit of the taxpayer's income tax affairs for the 1994 and 1995 years of income. The taxpayer immediately wrote to the Commissioner advising that it had recently contracted with an accounting firm to conduct a prudential audit of its 1995 return. Documents held by the taxpayer confirm that the contract was entered into before the taxpayer was notified of the ATO audit. The taxpayer had previously made voluntary disclosures in respect of prior year returns. The taxpayer subsequently makes disclosures in respect of the 1995 year of income.

Penalty

58. The disclosures were made after the taxpayer had been informed of a tax audit, but the evidence suggests that the disclosures would have been made even if the ATO audit had not been commenced. Accordingly, the Commissioner would exercise his discretion under section 226ZA to treat the disclosure as having been made before the taxpayer was so informed.

59. For a similar reason the disclosures would also be accepted as having been made voluntarily, notwithstanding that they were made after the ATO first made contact with the taxpayer.

60. The disclosures would, therefore, qualify for an 80% reduction in any penalty attracted. This reduction in penalty would also be available to individual and small business taxpayers in similar circumstances.

61. As no disclosures were made for the 1994 year, any tax shortfall would attract normal penalty rates. However, if the taxpayer did make a disclosure for the 1994 year at the same time as the 1995 disclosure (and as a result of the 1995 prudential audit) the taxpayer would be entitled to a 20% reduction in any penalty otherwise attracted.

Example 3

Facts

62. The taxpayer, a builder, was selected for audit for the 1993 and 1994 years of income. After the first six weeks of the audit the taxpayer disclosed that, for the past three years (1992 - 1994), $300 a month of business receipts had not been recorded and were used for private purposes. The taxpayer is able to demonstrate that this is all of the business receipts that had not been returned by reference to a job

book and other notes made which had not previously been disclosed to the auditor.

Penalty

63. The disclosures for the 1993 and 1994 years would qualify for a 20% reduction of any penalty attracted as they were made after the taxpayer had been informed of a tax audit, but represented a significant degree of assistance by the taxpayer which would have led to a significant saving in time and resources in conducting the audit.

64. For the 1992 year the taxpayer had not been informed of a tax audit. Accordingly, the disclosures for that year would qualify for a 80% reduction in any penalty attracted as having been made prior to being notified of an audit.

Example 4

Facts

65. As part of a routine dividend and interest check conducted by the ATO, a taxpayer was identified as having omitted interest of $2500 for the 1993 income year. The taxpayer was informed of the omitted interest and the commencement of an audit of the 1993 year. The taxpayer was asked to review the 1993 return and also the 1994 return which had been lodged. No inference could be made from the communication between the ATO and the taxpayer that the audit would extend to other than the 1993 year.

66. The taxpayer confirmed the ATO findings of $2500 omitted interest for the 1993 year and also disclosed a further $150 omitted interest from a different financial institution and an overclaimed deduction of $400 in that year. The taxpayer also made disclosures of omitted interest for the 1992 and 1994 years.

Penalty

67. The disclosure for the 1992 year could be accepted as having been made voluntarily before an audit. This disclosure would attract an 80% reduction in the penalty rate applicable.

68. The 1994 year was not under audit and there was no inference that the audit would be extended to the 1994 year at that time. The disclosure would, therefore, be voluntary even though it was possible that a future interest check would detect the omission. An 80% reduction in the penalty rate would apply, unless the disclosure was for an amount of less than $1,000 where no penalty would be imposed due to the operation of paragraph 226Z(d).

69. The omitted interest of $2500 for the 1993 year would attract penalty at the normal rates. The penalty rate on the $150 omitted interest would be reduced by 20% as the disclosure during the audit would have saved significant time and resources. The penalty rate on the overclaimed deduction of $400 would be reduced by 80% by the exercise of the discretion under section 226ZA because of the narrow focus of the audit on interest only.

Example 5

Facts

70. An AUSTRAC report identified suspect transactions on a bank account believed to be in a false name. An ATO officer went to the bank and obtained details of cheques written on the account. All the cheques examined were made payable to one individual. The following day, the ATO officer called at the office of the recipient of the cheques to confirm the identity of the person who had written the cheques. The identity of the drawer of the cheques was also confirmed from other information held by the ATO. Later that same day, the drawer of the cheques made a voluntary disclosure, through an accountant, of omitted interest earned by the account since it was opened, which consisted of $2,000 each year over a three year period.

Penalty

71. The disclosure would attract an 80% reduction in any penalty rate applicable because the taxpayer had not yet been notified of an audit. The ATO investigation was still in its initial phase and no formal contact had been made with the taxpayer.

Example 6

Facts

72. An ATO officer, as part of an investigation into potential fraud, made telephone contact with a representative of the taxpayer under investigation to request some information about the taxpayer's financial affairs. Three days after this telephone call was made the taxpayer made a disclosure of income. The disclosure concerned a serious fraud on the revenue - some $60,000 tax per year for several years - and involved a serious degree of criminality.

Penalty

73. What might constitute a 'voluntary' disclosure would depend on the facts of a case, and the extent of any fraud or criminality involved

would be relevant factors. Where a taxpayer perpetrates a substantial fraud, a disclosure is not voluntary if the taxpayer is aware of an impending investigation.

74. In this case, it would have been patently obvious to the taxpayer that the ATO's initial enquiry was directly related to the fraud as the amount of income omitted represented a significant proportion of the taxpayer's gross income over the relevant period and that the enquiry had alerted the taxpayer that an audit was under way (see *Morris' Case*, 92 ATC 4618; (1992) 24 ATR 1). It was probable that the tax fraud would have continued indefinitely but for the likelihood of imminent detection raised by the telephone call to the taxpayer's representative.

75. The ATO contact with the taxpayer's representative amounted to a notification of commencement of an audit. The disclosure would, therefore, attract a 20% discount on any penalty imposed because it was made after 'notification' of an audit and the disclosure saved substantial time and resources. Although the discretion under section 226ZA could also be applied, the discretion would not be exercised in this case given the nature of the omissions.

76. If the tenor of the communication between the ATO and the taxpayer's representative did not clearly indicate that an audit had commenced, the disclosure could not attract any discount because it was not made voluntarily in that the making of the disclosure by the taxpayer was an inevitable outcome on the facts of the case.

Commissioner of Taxation

6 January 1994

ISSN 1039 - 0731

ATO references
NO 93/2071-7
BO

Previously released in draft form as
TR 93/D22

Price $1.80

FOI index detail
reference number
I 1014146

subject references
- additional tax
- prosecution
- self assessment
- tax shortfall
- voluntary disclosures

legislative references
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- ITAA 222A(2)
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- ITAA 226D
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case references
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