

IT 2565 - Income tax : substantiation of certain expenses: remission of additional tax imposed by section 223 or 223A

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TAXATION RULING NO. IT 2565

INCOME TAX : SUBSTANTIATION OF CERTAIN EXPENSES:
REMISSION OF ADDITIONAL TAX IMPOSED BY SECTION
223 OR 223A

F.O.I. EMBARGO: May be released

REF

N.O. REF: 87/4958-2

DATE OF EFFECT: Immediate

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| REFERENCE NO: | SUBJECT REFS: | LEGISLAT. REFS: |
|---------------|----------------------|-----------------|
| I 1011649 | REMISSION OF | 223 |
| | ADDITIONAL (PENALTY) | 223A |
| | TAX | 227(3) |

OTHER RULINGS ON TOPIC IT 2517

PREAMBLE

This Ruling provides guidelines for the exercise of the Commissioner's discretion under subsection 227(3) to remit the statutory penalty imposed by section 223 or 223A in cases where claims for deductions are not allowable because of Subdivision F of Division 3 of Part III of the Income Tax Assessment Act - (the substantiation provisions).

2. Under the substantiation provisions of the Income Tax Assessment Act (the Act), employment-related expenses of employees and car and travel expense claims by employees and self-employed persons, which are otherwise allowable deductions under general provisions of the Act, are precluded from deduction if the specified substantiation requirements are not satisfied. The substantiation provisions variously provide that a deduction for certain types of expenditure is not allowable unless specified records are maintained or obtained by or on behalf of the taxpayer.

Section 223

3. Section 223 automatically imposes additional tax where a taxpayer makes a false or misleading statement or omits a matter or thing from a statement which renders the statement misleading in a material particular, and as a result tax has or would have been avoided. In a substantiation context, a false or misleading statement is made where a taxpayer signs the substantiation declaration included in taxation returns stating the necessary receipts or other records are held and, upon enquiry, this is found not to be the case.

4. Where the substantiation declaration is unsigned, the statutory penalty imposed under section 223 will nonetheless apply if the taxpayer cannot substantiate the whole or any part of the claim subject to the substantiation provisions and fails

to indicate in the return that all or part of the claim cannot be substantiated in accordance with those provisions. In such cases, the taxpayer will have omitted a matter or thing without which the statement made is misleading in a material particular.

5. Penalties are an integral part of the taxation system. Taxpayers are expected to fully and accurately disclose relevant matters in their returns and this carries with it a significant duty of care. While the penalty provisions are accordingly attracted by a failure to meet that duty, those provisions can be administered in a manner to encourage voluntary compliance, on which the taxation system heavily depends.

6. It is important also that the legislation be administered having regard to the realities and practicalities of taxpayers fulfilling their income tax obligations. The complexity of the tax law, and the substantiation provisions in particular, make it difficult for some taxpayers to understand and satisfy all of the law's requirements. It is not always practicable for taxpayers to include full and complete details of deductions made in income tax returns or of records kept to substantiate those deductions. Judgements have to be made about whether particular records will satisfy the substantiation provisions. Substantiation requirements for most deductions are generally beyond doubt. However, even in the case of doubtful or contentious records, a taxpayer who omits or incorrectly states critical information runs the risk of additional tax under section 223 being imposed. The message to taxpayers is : when in doubt, give a full and accurate description of your expenses and your records.

7. Section 223 applies to each false or misleading statement. Where more than one false or misleading statement is detected and distinctions can be made in terms of the gravity of each statement, then additional tax should be remitted according to the factors present which add to or lessen the seriousness of each statement (e.g., deliberate intent to mislead vis-a-vis inadvertence).

8. The guidelines set out in this Ruling are a special application of the broader principles for the remission of subsection 223(1) additional tax set out in Taxation Ruling No. IT 2517 and, accordingly, should be read in conjunction with that Ruling. The following matters discussed in IT 2517 apply with equal force to cases involving the substantiation provisions:

- . application of section 223 (paragraphs 2 - 6 of IT 2517);
- . discretion of Deputy Commissioners and authorised officers (paragraphs 7 - 13 of IT 2517);
- . reporting requirements in audit and other relevant reports (paragraphs 16 - 17 of IT 2517);
- . explanation of terms used in the Ruling (paragraph 19 of IT 2517);
- . voluntary admission of a false or misleading statement

(paragraphs 21 - 30 of IT 2517);

- . explanation of the concepts "per annum" component and "culpability" component (paragraphs 32 - 34 of IT 2517);
- . factors likely to influence the level of the "culpability" component (paragraphs 36 - 40 of IT 2517);
- . level of taxpayer co-operation (paragraphs 46 - 52 of IT 2517); and
- . remission of the "per annum" component (paragraph 81 of IT 2517).

Section 223A

9. Where a taxpayer bases a claim for a deduction for car expenses on an inaccurate business use percentage for the purposes of the log book provisions, subsection 223A(1) may apply. Subsection 223A(1) imposes additional tax where a taxpayer specifies in car records maintained by him or her a deductible percentage for car expenses under the log book provisions which exceeds the percentage properly allowable under those provisions. The statutory additional tax imposed under subsection 223A(1) is double the difference between the correct tax payable and the amount payable if the taxpayer's percentage had been accepted.

RULING

10. In considering the remission of statutory additional tax imposed under either section 223 or subsection 223A(1), an important question to ask is: - DID THE TAXPAYER INCUR THE EXPENDITURE ?

11. In arriving at the answer, the auditor should take into account any relevant evidence (documentary or oral) provided by the taxpayer which would support a conclusion that the expenditure has been incurred even though the form of that evidence does not satisfy the requirements of the substantiation provisions.

Expenditure not incurred

12. Where the answer to the above question is "no", i.e., the auditor is of the opinion the expenditure claimed has not been incurred, the general guidelines set out in IT 2517 should be followed in determining the extent to which the statutory penalty should be remitted. The guidelines set out in IT 2517 should also be followed, where appropriate, in remitting additional tax imposed under subsection 223A(1).

Expenditure incurred

13. If the expenditure has been incurred (and is allowable under a general provision of the Act) but the evidence provided by the taxpayer fails to satisfy the substantiation requirements, the statutory additional tax imposed under section 223 or 223A should be substantially remitted or remitted in full (see below).

14. The following guidelines address the question of the remission of penalty where the taxpayer is able to satisfy an auditor on the balance of probabilities that he or she has incurred expenditure which would be allowable under a general provision of the Act. However, in the circumstances, the taxpayer is not able to substantiate the claim as required by the substantiation provisions.

15. Except for the situations outlined in paragraphs 17 and 21 below, the statutory penalty in these cases should normally be remitted to a "culpability" component in the range of 0 - 10% of the tax avoided, plus the "per annum" component. The imposition of a higher "culpability" penalty in a case where a claim would have been allowable but for the operation of the substantiation provisions is, in general, unwarranted.

16. In determining where the "culpability" component should fall within the suggested range (0 -10%), authorised officers should consider the reason(s) for the false or misleading statement or omission and give the taxpayer the opportunity to bring to attention any factual elements considered to be relevant.

17. The statutory additional tax should be fully remitted in the following situations:

- . taxpayer genuinely misled by actions of the ATO;
- . taxpayer did not know and could not be expected to know of the relevant substantiation requirements.

18. Where a high proportion of the expenses that are subject to a substantiation audit, e.g., 75% or more, are in fact substantiated, and the auditor is able to conclude that, on the balance of probabilities, the remainder of the expenses claimed was incurred, no "culpability" component should be imposed. The statutory additional tax should be remitted to the extent that a "per annum" component only is imposed.

19. Similarly, the statutory additional tax should be remitted to the extent that a "per annum" component only is imposed in the following situation:

- . genuine misunderstanding of the requirements of the legislation."

20. The lower end of the range of the "culpability" component (0 - 4%) should be reserved for the following situations:

- . inadvertent error/honest mistake;
- . carelessness.

21. The upper end of the range of the "culpability" component (5 - 10%) should be reserved for cases involving recklessness and cases in which the taxpayer knew that he/she was unable to substantiate claims made in accordance with the substantiation provisions.

22. Where more serious matters are involved (e.g., falsification of receipts or invoices) an increase above a "culpability" component of 10% would be warranted. Depending on the particular circumstances, the "culpability" component may warrant an increase of 5 - 30% of the tax avoided.

23. However, if the circumstances of a particular case involve the factors listed in paragraphs 15 - 21, or other factors not specifically referred to which warrant the remission of penalty outside the range suggested (including remission of statutory additional tax in full), officers should not feel constrained in acting accordingly. Reasons for the decision should, of course, be adequately documented in an audit or other relevant report.

COMMISSIONER OF TAXATION
2 November 1989