

Government, penalties and interest charges: the ATO finally releases its position

4 July 2011

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Introduction

The Australian Taxation Office (ATO) has finally released its long anticipated public ruling and practice statement on how administrative penalties and interest charges apply to tax liabilities of government entities – MT 2011/1 and PSLA 2011/26.

The ATO's approach goes way beyond entities complying with their tax reporting and liability obligations. Entities will now also need to be very clear about what status they hold in the context of the Constitution and have an in depth understanding of the legal nature of the supplies they make.

Background to the changes

There has long been confusion on whether, and to what extent, Government entities are subject to the general penalty and interest regime.

The confusion stemmed from the fact that the many Government entities formed part of the Crown and, as a result, were entitled to the privileges enjoyed by the Crown. This includes immunity from the imposition of penalties and interest.

The ATO has had a long running moratorium on the imposition of penalties and interest charges for revisions of activity statements and late payment of tax liabilities by Government entities, especially in a GST context.

The Ruling: MT 2011/1

The ATO's view on when penalties and interest charges can be imposed stems from section 114 of the Constitution.

Section 114 provides, amongst other things, that the Commonwealth cannot impose any tax on property of any kind belonging to a State.

Following on from section 114, penalty and interest charges will be imposed when there is a 'legal liability' (that is, where section 114 does not apply so tax can be imposed) but will not be imposed where there is a 'notional' liability.

A notional liability arises where section 114 does apply – and therefore legally no tax is payable – but the entity makes a tax payment nonetheless. The most notable notional tax is the GST equivalent paid by States under the Intergovernmental Agreement struck with the Commonwealth in 1999. The Commonwealth also notionally pays a number of federally imposed taxes.

As a result, under the new ruling, a number of important issues must be resolved in order to determine whether penalties and interest will be applicable for government entities including

1. *Whether the government entity forms part of the "State"*

In this context, the ruling states that Territories are not States for these purposes.

2. *Whether the tax liabilities of the entity are legal or notional.*

Broadly, the ATO's view is that:

- The Commonwealth's tax liabilities will, with very few exceptions, be notional and, as a result, will never be subject to penalties and interest charges

- The NT's and ACT's tax liabilities will always be legal and, as a result, will always be subject to penalties and interest charges, and
- The State's tax liabilities may be legal or notional in nature. Only the legal tax liabilities of the State will be subject to penalties and interest charges.

The supporting Practice Statement PS 2011/26 provides guidance as to the ATO's proposed administration of this legal and notional distinction. The practice statement makes it clear that the onus is on the taxpayer to provide documents which substantiate:

- that it forms part of the State, and
- what part of its taxation liabilities are notional in situations involving upward revisions of tax liabilities or late payment of tax liabilities.

Where a taxpayer does not make this clear, the ATO will assume that it does not form part of the State and all of its liabilities are legal! As a result, it will not be afforded any protections available under the Crown.

Given the technical and legal intricacies of the meaning of what is the 'State', let alone the meaning of 'property of any kind', this could be a daunting task for Government taxpayers.

Transitional period

The new regime will apply to tax liabilities in relation to tax periods which commence on or after 1 July 2011.

Significantly, no retrospective action will be taken for decisions concerning penalties and interest charges made prior to the release of the ruling.

What you should be doing now?

These changes are effective now. To understand the true impact of these changes, Government entities will need an in depth understanding of – and documentary evidence supporting - a number of important and technically difficult issues:

Ask yourself:

- Does your entity form part of the ‘State’? Are there parts of your entity that does not form of the State? e.g. companies, trusts, funds.
- Does your entity have dealings with ‘property of any kind’ and can these be reported separately? e.g. real estate, intellectual property, trademarks.

To have a deeper discussion about what the above means for your government organisation, please contact your usual PwC contact or:

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