Australian Government
Australian Taxation Office

MR RODERICK G DOUGLASS
[redacted]

Reply to: PO Box 9977
BRISBANE QLD 4001
Our reference: [redacted]
Contact officer:
Phone:
Fax:
TFN:

30 July 2015

Proposed adjustments
For your information and action

Dear Mr Douglass

We propose that adjustments are required regarding the Personal Services Income audit for the tax periods ending 30 June 2006, 2007, 2011, 2012, 2013 and 2014.

The enclosed reasons for decision details our view on issues identified during this audit. Accordingly we propose to adjust your return and amend your assessment as per the enclosed proposed adjustments.

What you need to do

Please review the reasons for decision and proposed adjustments. If you disagree with our understanding of the facts or our interpretation of the law please write to us outlining:

- the reasons why you think our decision is not correct, and
- any additional information which may support your position.

In the absence of any response, the proposed adjustments may be made without further consultation.

You may be entitled to Interest on Overpayments (IOP) for the overpayment of tax. Where you are entitled to IOP, it will be automatically calculated and credited upon processing of the credit adjustment. IOP is generally assessable to you in the year it is received.

Please forward information by 26 August 2015 marking it for the attention of [redacted] case reference [redacted] and either:

- faxing it to **1300 136 452**, or
- emailing to [redacted]
- mailing it to:

[redacted]
Australian Taxation Office
PO Box 9977
BRISBANE, QLD 4001

What happens next

We will contact you again soon after 26 August 2015 to advise you of our decision.

Our decision will be based on your response to our reasons for decision, and any further information that becomes available.

Interest charges

If we adjust your tax return or activity statement, you may have to pay an interest charge on any extra tax you owe. This is to compensate the community for the impact of late payments. We will tell you the amount of any interest charge in the notice of amended assessment or a later interest charge notice.

The interest charge is tax deductible in the year in which it is incurred.

Your rights and obligations

We previously provided you with information explaining your rights and obligations, as well as what you could expect during this audit. If you require further information regarding your rights and obligations, please discuss this with [redacted]

More information

If you have any questions, please phone [redacted] een 8.00am and 5.00pm, Monday to Friday, and ask for [redacted] on extension [redacted]

Personal services entities affected by the alienation measure are required to make Pay As You Go withholding payments to the Commissioner. For more information visit our website at **www.ato.gov.au**

Yours faithfully

Steve Vesperman
Deputy Commissioner of Taxation

Taxpayer Name: Roderick Douglass (TFN [redacted]

Summary

The Australian Tax Office is currently undertaking reviews in relation to personal services income (PSI). This review is to assess potential risks, if any, to the tax revenue, that may arise in relation to personal services income.

Issues

1. Was any of the ordinary or statutory income received by Roderick G & Sally E Douglass during tax periods ended 30 June 2006 and 2007 considered the personal services income of yours (the main service provider) in accordance with section 86-15 of the ITAA 1997?

2. Was any of the ordinary or statutory income received by R G Douglass & M L Galvis during tax periods ended 30 June 2011, 2012, 2013 and 2014 considered the personal services income of yours (the main service provider) in accordance with section 86-15 of the ITAA 1997?

3. Did the partnership Roderick G & Sally E Douglass satisfy any of the personal services business (PSB) tests for the tax periods ended 30 June 2006 and 2007?

4. Did the partnership R G Douglass & M L Galvis satisfy any of the personal services business (PSB) tests for the tax periods ended 30 June 2011, 2012, 2013 and 2014?

5. Were the two partnerships required to attribute their net personal services income received in accordance with sections 86-15 and 86-20 of the *Income Tax Assessment Act 1997* (ITAA 1997) to you for each of the tax periods ended 30 June 2006, 2007, 2011, 2012, 2013 and 2014?

6. Can the Commissioner amend your individual income tax returns for the income tax periods ended 30 June 2006, 2007, 2011 and 2012 given there is a time limitation for amendment of income tax returns?

7. Should an administrative penalty be imposed under Section 284-75 of the *Tax Administration Act 1953 (TAA)*?

8. Should the shortfall penalty be remitted under section 298-20 of Schedule 1 to the TAA?

9. Should the shortfall interest charge that is imposed on your amended assessment be remitted in full or in part under section 280-160 of Schedule 1 to the TAA?

Income periods

Income tax years ended 30 June 2006, 2007, 2011, 2012, 2013 and 2014

Introduction to findings

Amendment to be actioned as PSI earned by the two partnerships is attributed back to you, the main service provider. The issues, facts and decision explain how this case was decided.

Facts

1. You were selected for a personal services income (PSI) audit. You completed your 2006 and 2007 income tax returns to included 50% net business income distributed from Roderick G & Sally E Douglass. You completed your 2011, 2012, 2013 and 2014 income tax returns to include 50% partnership distributions from R G Douglass & M L Galvis and you answered 'N' to the question 'Did you receive any personal services income?'.
2. On 30/1/2015 a letter was sent to you advising that an audit process for the years ended 30 June 2011, 2012, 2013 and 2014 has commenced.
3. On 2/3/2015 you replied to the audit letter stating:
   - You were not aware of any obvious mistakes in the tax returns
   - The business used a labour hire firm "Adecco"
   - The business was trading under Douglass Engineering Services P/L until 30/6/2010 and commenced trading with R G Douglass & M L Galvis since 1/7/2010 and continues to trade today.
4. A letter was sent to you on 10 April 2015 advising that a PSI audit for the years ended 30 June 2011, 2012, 2013 and 2014 had commenced.
5. On 23/4/2015 you provided documentation and explanation as follows:
   - Completed PSI questionnaires for 2011, 2012, 2013 and 2014 income tax years
   - Samples of tax invoices you issued to TAD Technical Careers & Contracts during 4/4/2011 to 26/1/2014.
   - You read a High Court decision on the ATO website stating "husband and wife partnerships can legally split 50/50 regardless of the workload sharing". Based on this, you set up the partnership R G Douglass & M L Galvis to run your business to suit the income splitting arrangement.
   - R G Douglass & M L Galvis only has one source of income and it was from TAD, a labour hire firm.
   - You are the only service provider in your business
6. On 4/5/2015 and 22/6/2015, telephone conversations took place between you and the auditor and the following were discussed:
   - You used to run your business from another partnership Roderick G & Sally E Douglass T/A RG & SE Douglass Engineering up until 30 June 2007.
   - After you divorced with your ex-wife you incorporated Douglass Engineering Services Pty Ltd and you traded your business from this company from 1/7/2007 to 30/6/2010.
   - After you remarried you commenced a new partnership RG Douglass & ML Galvis and traded your business from this partnership from 1/7/2010. This partnership is still active.
   - Your business has been conducted in essentially the same manner for the past 20 years. You are the sole engineer and service provider.
   - You understood the PSI rules did not allow income splitting hence you always reported 100% of the PSI until you read a High Court decision on the ATO website in 2006 which said it was lawful to split income in a husband and wife partnership regardless of their share of contribution. Based on this, you therefore split your PSI with Sally Douglass in 2006 and 2007 income years and with Maria Galvis in 2011 to 2014 income years.
   - You did not keep a copy of the High Court decision and you did not note down the name of the case.

- You never sought any professional advice on your tax affairs and you didn't contact the Tax Office for any advice as you believed the ATO publications and website information were sufficient for you to prepare your income tax returns
- You sourced your own clients these clients generally required you to provide your services by contracting through labour hire firms.
- You could not provide past contacts with those labour hire firms you used. You said the latest ones you used included TAD, Adecco and Technical Resources.
- The amount you claimed in Label D10 of your 2011 and 2012 income tax returns were amounts of interest charged by the ATO and they were pre-filled amounts when you loaded e-Tax for those years.
- You were advised that the PSI audit would be expanded to cover the income years ended 30 June 2006 and 2007.
- You agreed the due date of this audit case and the period of review for 2013 income tax period be extended to 15/9/2015.

7. A letter detailing the expansion of audit was sent to you on 26/6/2015.
8. On 29/6/2015 you provided a copy of contract you had with Technical Resources dated 19/2/2015.
9. On 1/7/ 2015, you had a phone conversation with the auditor and provided the following:
   - The contract with Technical Resources was the only contract you could find but the terms and conditions were very similar from the contracts with the other labour hire firms you used: hourly rates, invoiced weekly or fortnightly or monthly depending on the firm.
   - When performing your work you did not necessary perform at client's premises.
   - You never subcontracted out work to others as there was never a need to, but if you did you would need to obtain the clients' permission.
10. On 9/7/2015, you wrote to us with the following:
    - You believed you followed the ATO publications as guidance in terms of splitting income. You highlighted three ATO media releases from 2005 to support your argument:
      (a) Refocus of the Income-Splitting Test Case Program (2005)
      (b) Practice Statement PS LA 2005/24: Application of general anti-avoidance rules
      (c) Part IVA: the general anti-avoidance rule for income tax (NAT 14331-12.2005)
    - You used e-Tax to complete your tax returns but those e-Tax lodgements are now on a corrupted disc. You believed you acted in good faith when reporting the cost of managing your tax affairs amount in your 2012 tax return and you remembered you had a very big interest debt with the ATO in that year.
    - You used labour hire firms in your business because your clients didn't want to deal with individual contractors and they provided a faster invoicing cycle.
    - You submitted timesheets to your clients and invoiced the labour hire firm on an hourly basis. Your service was task based. You did some of the work from home and some in the engineering companies' offices.
    - You have tried to search for earlier contracts with the labour hire firm but you could not find any. You only signed 3 or 4 contracts in your 25 years of contracting work.
    - You completed the 2006 and 2007 PSI questionnaires with limited information.
11. On 13/7/2015, you advised the auditor that the labour hire firm you used in 2006 and 2007 was TAD but you did not have the income figures with you and agreed the ATO should use the figures on the tax returns to make any decision. A penalty discussion also took place as you

agreed to have the penalty decision included in this interim decision report so that you could review your overall position.

Decisions

1. Was any of the ordinary or statutory income received by Roderick G & Sally E Douglass during tax periods ended 30 June 2006 and 2007 considered the personal services income of yours (the main service provider) in accordance with section 86-15 of the ITAA 1997?

   Yes

2. Was any of the ordinary or statutory income received by R G Douglass & M L Galvis during income tax periods ended 30 June 2011, 2012, 2013 and 2014 considered the personal services income of yours (the main service provider) in accordance with section 86-15 of the ITAA 1997?

   Yes

3. Did the partnership Roderick G & Sally E Douglass satisfy any of the personal services business (PSB) tests for the tax periods ended 30 June 2006 and 2007?

   No

4. Did the partnership R G Douglass & M L Galvis satisfy any of the personal services business (PSB) tests for the tax periods ended 30 June 2011, 2012, 2013 and 2014?

   No

5. Were the two partnerships required to attribute their net personal services income received in accordance with sections 86-15 and 86-20 of the *Income Tax Assessment Act 1997* (ITAA 1997) to you for each of the tax periods ended 30 June 2006, 2007, 2011, 2012, 2013 and 2014?

   Yes

6. Can the Commissioner amend your individual income tax returns for the income tax periods ended 30 June 2006, 2007, 2011 and 2012 given there is a time limitation for amendment of income tax returns?

   Yes

7. Should an administrative penalty be imposed on you under Section 284-75 of the *Tax Administration Act 1953 (TAA)*?

   Yes

8. Should the shortfall penalty be remitted under section 298-20 of Schedule 1 to the TAA?

   Yes, partial remission will apply.

9. Should the shortfall interest charge that is imposed on your amended assessment be remitted in full or in part under section 280-160 of Schedule 1 to the TAA?

   See Reasons for decisions.

Reasons for decisions

Issue 1

The alienation measures contained in Part 2-42 of the *Income Tax Assessment Act 1997* (ITAA 1997) apply to individuals or a personal services entity (company, partnership or trust) whose income includes an individual's PSI. An income is PSI if it is mainly a reward for an individual's personal efforts or skills. The measures apply whether the income is received directly by the individual or through a personal services entity.

Based on the information you provided, during the 2006 and 2007 income tax periods, the income of Roderick G & Sally E Douglass came from one labour hire firm:-

Year	Payer	Amount	Main service provider
2006	TAD Technical Careers & Contracts	$223,318	Roderick Douglass
2007	TAD Technical Careers & Contracts	$236,821	Roderick Douglass

Section 84-5 of the ITAA 1997 defines PSI as being 'your ordinary or statutory income or the ordinary or statutory income of any other entity if the income is mainly a reward for your personal efforts or skills.

In this case, all of the payments from TAD to Roderick G & Sally E Douglass were paid as a reward for the personal efforts and skills of you as the main service provider, hence constitutes PSI for the purpose of section 84-5.

Issue 2

Based on the information you provided, during each of the 2011, 2012, 2013 and 2014 income tax periods, the income of R G Douglass & M L Galvis came from one labour hire firm:-

Year	Payer	Amount	Main service provider
2011	TAD Technical Careers & Contracts	$251,458	Roderick Douglass
2012	TAD Technical Careers & Contracts	$330,483	Roderick Douglass
2013	TAD Technical Careers & Contracts	$350,815	Roderick Douglass
2014	TAD Technical Careers & Contracts	$343,819	Roderick Douglass

Section 84-5 of the ITAA 1997 defines PSI as being your ordinary or statutory income or the ordinary or statutory income of any other entity if the income is mainly a reward for your personal efforts or skills.

In this case, all of the payments from TAD to R G Douglass & M L Galvis were paid as a reward for your personal efforts and skills as the main service provider, in providing engineering consultation services. Therefore the income constitutes PSI for the purpose of section 84-5.

Issue 3 and Issue 4

PSI rules apply to an entity that receives PSI unless it is a personal services entity conducting a personal services business (PSB). For an entity to be satisfies as a PSB it must satisfy one of the followings:

- has a PSB determination from the Commissioner (subdivision 87-B);
- passes the Results test (section 87-18);
- entity passes the 80% rule and one of the following tests:
  - Unrelated clients test prescribed by section 87-20,
  - Employment test prescribed by section 87-25, and
  - Business premises test prescribed by section 87-30

The application of the PSI rules is examined separately for each income tax year.

Roderick G & Sally E Douglass did not have a personal services business determination in force therefore it must pass the results test or one of the additional tests for it to be considered as conducting a PSB.

R G Douglass & M L Galvis did not have a personal services business determination in force therefore it must pass the results test or one of the additional tests for it to be considered as conducting a PSB.

The Results test

Under section 87-18 a personal services entity meets the result test in an income year if, in relation to at 75% of the entity's PSI during the income year:

(a) The income is for producing a result; **and**
(b) The entity is required to supply the plant, equipment or tools necessary to perform the work; **and**
(c) The entity is liable for the cost of rectifying any defective work.

For a personal services entity to satisfy the results test, **all three** conditions must be met in relation to 75% of the individual's personal services income.

Producing a result

To satisfy the first condition for the results test the PSI must be for producing a result. The meaning of the phrase 'producing a result' means the performance of a service by one party for another where the first-mentioned party is free to employ his/her own means (i.e., third party labour, plant and equipment etc) to achieve the contractually specified outcome. The essence of the contract has to be to achieve a result and not to do work.

The consideration often is a fixed sum on completion of the particular job as opposed to an amount paid by reference to hours worked.

The Explanatory Memorandum to the Alienation of Personal Service Income Act 2000 provides:

> 'The individual must actually be paid on the basis of achieving a result, rather than for example, for hours worked.'(paragraph 1.114) of the Explanatory Memorandum.

Thus the contract must specify a particular outcome or task that is to be produced i.e. the result. It is not sufficient for a contract to simply state the scope or services to be provided by a particular individual.

In contracts for a result, the method of payment may be important – whether payment is for the identified results that have been contracted for, or for time spent at work. The latter will not necessarily be determinative against a contract for a result, but it may be an important factor in that conclusion.

Application to your situation

In your response, you included a contract from Technical Resources and you explained to the auditor that you did not have records of contracts from other labour hire firms however the terms and conditions were very similar to the one for Technical Resources. You also told the auditor that you have always run your business the same way, that is, through labour hire firms. Remuneration was always based on an agreed hourly rate and you always invoiced and got paid either on weekly, fortnightly or monthly depending on the firm.

You provided samples of invoices you sent to TAD during 4 April 2011 to 26 January 2014. These invoices stated the hourly rate, you worked i.e.40 to 47 hours per week and you invoiced TAD on a weekly basis. TAD was a labour hire firm and the final recipient of the service was Fluor. You explained your service was task based. You did some of the work from home and some in the engineering companies' offices

The ATO view is that neither Roderick G & Sally E Douglass nor R G Douglass & M L Galvis pass the Results Tests. The reasons are as follows:

- No contracts or invoices have been provided to this office to demonstrate that payments were based upon achieving a specific result.
- Payment was at an hourly rate. Both partnerships were required to provide invoices on a weekly, fortnightly or monthly basis depending on the agreement with the relevant LHF at that time.
- The partnerships were not able to delegate work without the consent of the end service acquirer, this also indicates a low level of control.
- The business was paid for the work you performed on an hourly basis. Payment was not contingent on achieving specific results.

It is considered that Roderick G & Sally E Douglass did not satisfy the first condition of the results test in the 2006 and 2007 income tax years. It is not necessary to consider the other two limbs of the results test, as all three limbs need to be met to satisfy the test.

Similarly it is considered that R G Douglass & M L Galvis did not satisfy the first condition of the results test in the 2011, 2012, 2013 and 2014 income tax years. Again it is not necessary to consider the other two limbs of the results test, as all three limbs need to be met to satisfy the test.

80% rule and other PSB tests

All of PSI generated came from one source therefore the partnerships did not pass the 80% rule to access the other PSB tests.

Conclusion

The ATO has concluded that the partnership Roderick G & Sally E Douglass did not satisfy any of the PSB tests for the tax periods ended 30 June 2006 and 2007 hence PSI rules apply to the personal services income generated by you via the partnership in 2006 and 2007 income tax periods.

Similarly the ATO has concluded that the partnership R G Douglass & M L Galvis did not satisfy any of the PSB tests for the tax periods ended 30 June 2011, 2012, 2013 and 2014 hence the PSI rules apply to the personal services income generated by you via the partnership in 2011, 2012, 2013 and 2014 income tax periods.

Issue 5

The effect of not being a PSB is that the alienation measures contained in Division 86 apply to Roderick G & Sally E Douglass for the 2006 and 2007 income tax years and also to R G Douglass & M L Galvis for the 2011, 2012, 2013 and 2014 income tax years.

Section 86-15 of the ITAA 1997 requires that the personal services income of an individual earned through the personal services entity is to be included in his assessable income after reductions for any allowable deductions that relate to the earning of personal services income.

This means that the net PSI derived by the partnerships needs to be attributed to you, the main service provider. PSI is to be removed from the other partners of the partnerships for the periods under audit, and attributed to your individual tax returns. This is in accordance with sections 86-15 and 86-20 of ITAA 1997.

You referred to three documents from the Tax Office website and contented these publications supported your action of splitting income. Each of these documents is concerned in some way with the potential application of Part IVA of the *Income Tax Assessment Act 1936* to income splitting of personal services income by partnerships. In your situation, we refer to page 4 of the publication 'Part IVA: the general anti-avoidance rule for income tax' which clearly states that in employment-like arrangements, provisions in the income tax law which specifically deal with the alienation of personal services income may apply in any event. This would mean that the partner performing the main bulk of work is taxed on all of the partnership income. In such cases, Part IVA would have no application.

Therefore, the PSI previously attributed to Sally Douglass in 2006 and 2007 income tax periods will be removed from her tax returns for those tax periods. The PSI will also be removed from the tax returns of Maria Galvis for each of the tax periods ended 30 June 2011, 2012, 2013 and 2014.

You must declare the PSI in your individual income tax returns and pay the relevant amount of tax on that income for each of the tax periods under audit.

Cost of managing your tax affairs in your 2012 income tax return

During the PSI audit, we identified that you claimed $25,098 at Label D10 "Cost of managing your tax affairs". You explained that this was the ATO interest imposed on and paid by you. You said this was a pre-filled figure when you were reporting your 2012 income tax return through e-Tax. According to our pre-filling report, you downloaded the 2012 e-Tax prefill function once on 27/10/2012 at 13:08:21, in the downloaded ATO related interest page the "Total net deductible interest expenses" was only $9,162. You were not able to provide any proof or creditable explanation of your action to support your overstatement of the expense. Based on this, we will reduce the amount at label D10 in your 2012 income tax return to $9,162.

Summary of adjustments

Tax amendments required for you are:

Income tax period ending 30 June	Description	Label	Amount
2006	Increase Attributed Personal Services Income	8O	$111,659
2007	Increase Attributed Personal Services Income	8O	$118,410
2011	Increase Attributed Personal Services Income	9O	$125,729
2012	Increase Attributed Personal Services Income	9O	$165,242

2012	Decrease Cost of Managing Your Tax Affairs	D10	$15,936
2013	Increase Attributed Personal Services Income	9O	$175,408
2014	Increase Attributed Personal Services Income	9O	$171,910

Issue 6

For the 2006, 2007, 2011 and 2012 income tax years, there is a requirement to amend. The issue dates of the original notice of assessments and the expiration dates of amendment period are as follows:-

Income year	Issue date	Due and payable date	Expiration date of amendment period
2006	12/12/2006	Credit assessment	12/12/2008
2007	13/11/2007	Credit assessment	13/11/2007
2011	3/11/2011	28/11/2011	4/11/2013
2012	5/11/2012	29/11/2012	5/11/2014

Subsection 170(1) items 1-5 of the *Income Tax Assessment Act 1936* (ITAA 1936) for the 2005 and later income years restricts the time the Commissioner may amend an assessment to two or four years after the day on which he or she gives the notice of assessment. However under item 5 of that subsection that restriction is not applicable if the Commissioner formed the opinion that there has been fraud or evasion.

The Commissioner has formed the opinion that there was a blameworthy act or omission made on the part of you and that the avoidance of tax was due to fraud or evasion in relation to the 2006, 2007, 2011 and 2012 income tax years.

Blameworthy act or omission by you
The way you behaved showed you omitted PSI from the returns without a credible explanation and there was a lack of care amounting to indifference.

In reaching to our decision, we considered that:

1. You were running the business for more than 20 years and it is reasonable to expect you to have taken reasonable care when reporting business income. This included seeking professional advice or contacting the ATO regarding the taxation issues surrounding the nature of your business income.

2. You demonstrated an understanding of the application and the intent of the PSI rules by previously correctly completing your tax returns and the PSI schedules with correct attributions.

3. You changed your business structure twice into partnerships with the intention of splitting your personal services income and obtaining a tax benefit. The tax consequences of these changes would have been significant as you paid tax at higher rate. The character of the business essentially remained the same and in all that time you were the sole service provider undertaking the principle work.

4. You said your decision to set up a partnership and split income because you relied on a High Court decision that husband and wife partnerships could legally split income regardless of workload sharing, yet you were unable to provide any details of the

information of the court case. You knew the reference to income splitting contradicted to how the PSI rule was explained in all other ATO publications however you did not seek further professional advice for clarification.

5. A reasonable person would expect you to seek professional advice to clarify any uncertainty or conflicting information to your previous understanding. Your failure to seek professional or ATO advice on the correct treatment of your personal services income in 2006, 2007, 2011, 2012, 2013 and 2014 is blameworthy. You chose to split the PSI without any proof or creditable explanation of your action. You were reporting the PSI on your income tax returns with a lack of care that amounted to indifference to their correctness.

6. The attribution rule of the PSI is not an overly complex area of the relevant law. There was readily available information on the operation of the PSI rules set out on the ATO website. It was also explained in the Partnership tax return instruction and in the Personal services income schedule instruction that accompanied the tax return guide for companies, partnerships and trusts. You were able to report correctly in 2005 and again in 2008 to 2010 however you chose to omit 50% of the PSI from your 2006, 2007, 2011 and 2012 income tax returns.

7. The number of years over which the income was omitted was also extensive. You first split income with your ex-wife in 2006 and 2007 and then repeated the same acts in 2011 to 2014. When you were prompted by the ATO in 2014 to review your PSI and lodgement obligations you failed to make further inquiry to clarify and rectify the omission.

Issue 7

Section 284-75 of Schedule 1 to the TAA imposes an administrative penalty if a taxpayer makes a statement to the Commissioner which is false or misleading.

In this case, you made a statement to the Commissioner by lodging your 2006, 2007, 2011, 2012, 2013 and 2014 income tax returns. These statements were false or misleading as they did not include the personal services income that should have been attributed to you. You also made a false or misleading statement in your 2012 income tax return when you overstated an interest deduction at Label D10 without proof or a creditable explanation. These statements led to a total tax shortfall amount of $422,030.64:

Income tax period	Tax shortfall amount
2006	$54,154.62
2007	$53,481.61
2011	$53,074.31
2012	$82,872.91
2013	$81,155.52
2014	$79,291.67
Total	**$422,030.64**

Level of penalty

Where a taxpayer makes a false or misleading statement the base penalty amount is worked out according to the level of care taken in making that statement and whether that statement resulted in a shortfall amount.

Section 284-90 of the TAA sets out the base penalty amounts to be applied in relation to statements. This section stipulates that the following penalty regime applies:

The shortfall amount or part of it resulted from intentional disregard of a taxation law by you or your agent	75% of the shortfall amount or part thereof
The shortfall amount or part of it resulted from recklessness by the taxpayer or tax agent as to the operation of a taxation law	50% of the shortfall amount or part thereof
The shortfall amount or part of it resulted from a failure by the taxpayer or tax agent to take reasonable care to comply with a taxation law	25% of the shortfall amount or part thereof

However, a taxpayer is not liable for a penalty under section 284-75 if they took reasonable care in connection with the making of the statement (subsection 284-75(5)). Miscellaneous Taxation Ruling, MT 2008/1 sets out what is meant by the term 'reasonable care', simply put means that you are required to take the same level of care to fulfil your tax obligations that could be expected of a reasonable person in your circumstances with your knowledge, experience, education and skill.

MT 2008/1 also provides guidance on the interpretation of the concepts of 'recklessness' and 'intentional disregard' as used in Subdivision 284-B.

We have considered the following facts, your compliance history and your behaviours in contributing to the tax shortfall:-

1. You were able to report PSI correctly in your income tax returns and PSI schedules in 2005 and again in 2008 to 2010 which demonstrated you had an understanding of the application and intent of the PSI rules, the consequence of income splitting and potential tax ramifications.
2. The character of the business essentially remained the same for the past 20 years and in all that time you were the sole service provider undertaking the principle work.
3. You omitted 50% of the PSI from your 2006, 2007, 2011, 2012, 2013 and 2014 income tax returns. The size of the shortfall was significant.
4. You said you understood splitting PSI income was not appropriate until you read a High Court decision which made you form the view that splitting PSI from a husband and wife partnership was lawful. You cannot provide further detail of the High Court case nor identify it by name.
5. Despite the decision in the unidentified High Court case contradicted to your previous understanding of the PSI attribution rules and other ATO publications on PSI, you failed to make any effort to clarify with the ATO or consult a tax specialist or other authoritative reference.

We consider that your behaviour fulfils the requirements associated with that of recklessness. The term recklessness is one that suggests conduct that is more culpable than a failure to take reasonable care to comply with a taxation law but less culpable than an intentional disregard of a taxation law.

In this case, there is a lack of substance and evidence to support your argument of splitting your PSI with your partners. You have been running a business structure for over 20 years, and the income was clearly PSI as it was a reward for services you provided. It is reasonable to expect you to have taken extra care and sought clarification from a tax professional or the Tax Office when completing your tax returns.

The alienation measures is a piece of legislation that is most significant to your situation because it largely impacts on your tax position. In situations where you receive conflicting information about PSI attribution rule, one would expect you seek further professional advice for clarification; in this case, you failed to do so. You prepared your 2006, 2007, 2011, 2012, 2013 and 2014 income tax returns with a lack of care that amounted to indifference to their correctness. All these actions fall significantly short of the standard of care expected of a reasonable person in the same circumstances as you.

As stated in Shawinigan Ltd v. Vokins & Co Ltd[1], recklessness is gross carelessness – the doing of something which in fact involves a risk, whether the doer realises it or not; and the risk being such having regard to all the circumstances, that the taking of that risk would be described as 'reckless'. Megaw J in this case noted further that the degree of the risk and the gravity of the consequences need to be weighed in forming a conclusion about whether conduct is reckless. In this case, we see that you took a risk to follow one piece of information you read and neglected all the other ATO publications on PSI. When reporting your PSI you showed disregard of or indifference to a risk of non-compliance with the PSI rules that is foreseeable by a reasonable person. Such risk is great, and the probable damage great, such conduct is considered unjustified and unreasonable and is amount to gross carelessness.

We have also looked at the application of 'intentional disregard' in your case, in doing so, we need to consider whether or not we feel that the behaviour was such that it showed that you had actual knowledge that the statements made were false and that you made a deliberate choice to ignore the law. Dishonesty is a requisite feature of behaviour that shows an intentional disregard for the operation of the law.

It is considered that you had not crossed the line from acting recklessly into intentional disregard.

Therefore, in this case a shortfall penalty for recklessness is applicable and the base penalty rate is 50% of the shortfall amount as set out in section 284-90.

Penalty for not having a reasonably arguable position

Where, as a result of a false or misleading statement by an entity, a shortfall arises that is more than the greater of $10,000 or 1% of the income tax payable for the income year, we must consider whether you have taken a position that is reasonably arguable.

Miscellaneous Taxation Ruling MT 2008/2 Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable explains that where you make a statement which treats an income tax law as applying to a matter in a particular way that is not reasonably arguable and the resulting shortfall amount exceeds the applicable threshold, you will be subject to an administrative penalty under subsection 284-75(2) of Schedule 1 to the TAA. Reasonably arguable position imposes a higher standard than that required to demonstrate reasonable care.

For there to be a reasonably arguable position, the position must be on a contentious area of the law where the relevant law is unsettled or where the principles of the law are settled, but there is a serious question about the application of those principles to the circumstances of the particular case. Generally, where the shortfall amount was caused by a primary error of fact or error of calculation, penalty for not having a reasonably arguable position will not apply.

We consider that you did not have a reasonably arguable position in failing to apply the Personal Services Income (PSI) Rules when having regard to the relevant authorities; the position you have taken in preparing your income tax return was likely to be incorrect and therefore not defensible. We have made this decision based on the following factors:

- You have not demonstrated you have consulted 'relevant authorities' in failing to correctly apply the PSI rules.
- The PSI rules is not a contentious area of the law. The ATO has a number of publications and videos available on it's website, including the *PSI basic information you need to know (NAT 72468), PSI avoiding common mistakes (NAT 71560), PSI for sole traders (NAT 72511) and PSI for companies, partnerships and trusts (NAT72510)* that provide guidance on the

[1] [1960] 2 Lloyd's Rep 153 at 162; [1961] 1WLR 1206 at 1214; [1961] 3 All ER 396 at 403

application of the PSI rules which you have failed to take notice of. You have not followed this information or considered the alienation measures contained in Part2-42 of the *Income Tax Assessment Act* (ITAA 1997) which applies to individuals or personal service entities (company, partnership or trust) whose income includes an individual's PSI.

- The reasonably arguable position test applies to shortfall amounts caused by an entity treating an income tax law in a particular way. Where there is an error of fact you were unaware of, or could not have been reasonably expected to know the true facts which resulted in an application of law in a certain way the reasonably arguable test may be satisfied. We consider there were no errors of primary fact in your case, rather an incorrect conclusion of facts has been made.

Therefore you have both failed to take reasonable care and have not taken a reasonably arguable position.

Section 284-90 sets the base penalty amount of not reasonably arguable is 25% of your shortfall amount or part thereof.

Where two or more penalties apply, under subsection 284-90(2) TAA you are liable to pay only one of the penalties. In such cases, the highest applicable rate of penalty applies.

In your case the shortfall is attributable to both recklessness as to the operation of a taxation law and no reasonably arguable position and therefore the greater base penalty of 50% penalty applies.

Issue 8

Under section 298-20 of Schedule 1 to the TAA 1953, the Commissioner of Taxation may remit all or part of a penalty for a false or misleading statement imposed on a shortfall amount.

Law Administration Practice Statement 2012/5 (PSLA 2012/5) - *Administration of shortfall penalty for false or misleading statements* gives specific examples of grounds for remission.

PSLA 2012/5 Paragraph 179 States '...if an amount of tax was avoided in overall terms, due to differing tax rates between the two entities, then any shortfall penalty attracted by the entity should be remitted so that it is effectively only liable for a penalty on the net amount of tax avoided in overall terms.'

The amendments resulted in amounts refundable to Sally Douglass for the income tax periods ended 30 June 2006 and 2007 and Maria Galvis for the income tax periods ended 30 June 2011, 2012, 2013 and 2014. In accordance with PSLA 2012/5 your tax shortfall should be reduced by the following amounts when calculating the shortfall penalty:

- For the year 2006 reduced by $37,704.61
- For the year 2007 reduced by $36,990.15
- For the year 2011 reduced by $36,355.66
- For the year 2012 reduced by $52,480.86
- For the year 2013 reduced by $56,732.69
- For the year 2014 reduced by $54,700.96

No other exceptional circumstances have been identified to warrant a full remission of the penalty imposed. Therefore the penalty imposed on your shortfall amount remains at 50% but will be applied to the net tax shortfall amount only.

Base penalty amount – Should the base penalty rate be increased?

Section 284-220 of Schedule 1 of the TAA 1953 provides provisions for the base penalty amount to be increased by 20% where:

- The individual or entity obstructs the Commissioner from finding out about the shortfall.
- Becomes aware of the shortfall amount after the statement is made, and does not tell the Commissioner about it within a reasonable time, or
- Has had a prior imposition of subsection 284-75(1) shortfall penalty

We received reasonable co-operation from you during the course of the audit. In addition, there is no evidence that you were aware of the shortfall after the statement was made. There was no prior imposition of shortfall penalties under Subsection 284-75(1). As a result, no increase to the base penalty amount will apply.

Base penalty amount – Should the base penalty rate be reduced?

The base penalty amount imposed for a false or misleading statement can be reduced in certain circumstances where an entity/individual voluntarily discloses the shortfall amount or part of it. The amount of the reduction will depend on whether the entity/individual makes a voluntary disclosure before or after the days specified in Section 284-225.

As you did not make a voluntary disclosure, no reduction to the base penalty amount will apply.

Calculation of shortfall penalty amount

The net penalty amount is therefore calculated as follows:

	2006	2007	2011	2012	2013	2014
Your tax shortfall amount	$54,145.62	$53,481.61	$53,074.31	$82,872.91	$81,155.52	$79,291.67
Tax shortfall reduced by	$37,704.61	$36,990.15	$36,355.66	$52,480.86	$56,732.69	$54,700.96
Net tax shortfall amount	**$16,450.01**	**$16,491.46**	**$16,718.65**	**$30,392.05**	**$24,422.83**	**$24,590.71**
Net penalty amount (net tax shortfall x 50%)	**$8,225.01**	**$8,245.73**	**$8,359.33**	**$15,196.03**	**$12,211.42**	**$12,295.36**

Issue 9

When we adjust your tax return, you may have to pay a shortfall interest charge (SIC) on any extra tax you owe. SIC is imposed under section 280-100 of Schedule 1 to the TAA on the additional amount of income tax payable as a result of the taxpayer's assessment being amended. This is to compensate the community for the impact of late payments.

The Commissioner of Taxation may remit all or part of an interest charge where the Commissioner considers it fair and reasonable to do so (section 280-160 of Schedule 1 to the TAA).

For example, shortfall interest charge may be remitted where:

- the taxpayers assessment is amended to include an additional amount of income tax, but this additional tax is offset by a credit or overpayment; or

- the Tax Office contributed to the accruing of the shortfall interest charge either through advice it provided or through its actions. This could include delays by the Tax Office in commencing or completing an audit.

In accordance with PS LA 2006/8 where the tax shortfall on which the SIC was imposed is offset by a related credit or overpayment, for example on an associated taxpayer's account, it may be fair and reasonable to remit SIC to the base rate.

Where a taxpayer makes a voluntary disclosure and the Tax Office has all information needed to process the amendment, the Commissioner will generally remit in full the interest charges from the date of voluntary disclosure. In this case, you did not make a voluntary disclosure.

Paragraphs 57-59 of Practice Statement PS LA 2006/8 provide for remission when there has been more than 30 days of case inactivity when the case could have been actioned. There were no periods of inactivity on this case.

We will tell you the amount of any interest charge in the notice of amended assessment or a later interest charge notice.

The interest charge is tax deductible in the year in which it is incurred.

ATO Reference

Section 84-5 of the Income Tax Assessment Act 1997
Section 86-15 of the Income Tax Assessment Act 1997
Section 86-20 of the Income Tax Assessment Act 1997
Section 86-60 of the Income Tax Assessment Act 1997
Section 86-65 of the Income Tax Assessment Act 1997
Section 87-1 of the Income Tax Assessment Act 1997
Section 87-15 of the Income Tax Assessment Act 1997
Section 87-18 of the Income Tax Assessment Act 1997
Section 87-20 of the Income Tax Assessment Act 1997
Section 87-25 of the Income Tax Assessment Act 1997
Section 87-30 of the Income Tax Assessment Act 1997
Section 87-40 of the Income Tax Assessment Act 1997
Part 2-42 of the Income Tax Assessment Act 1997

Subsection 170(1) items 1-5 of the Income Tax Assessment Act 1936

Taxation Administration Act 1953, schedule 1
Section 16-30 and section 16-40 the Tax Administration Act 1953
Section 16-45 Income Tax Assessment Act 1997
Section 280-100 schedule 1 the Tax Administration Act 1953
Section 280-160 of Schedule 1 the Tax Administration Act 1953
Section 284-75 of the Tax Administration Act 1953
Section 284-90 of the Tax Administration Act 1953
Section 284-220 of Schedule 1 the Tax Administration Act 1953
Section 284-225 of Schedule 1 the Tax Administration Act 1953
Section 298-20 of Schedule 1 the Tax Administration Act 1953

Practice Statement PS LA 2012/5
Practice Statement PS LA 2006/8
Practice Statement PS LA 2008/6

Taxation Ruling TR 2001/7
Taxation Ruling TR 2001/8
Taxation Ruling TR 2003/10
Taxation Ruling TR 94/7
Miscellaneous Taxation Ruling MT 2008/1
Miscellaneous Taxation Ruling MT 2008/2

Shawinigan Ltd v. Vokins & Co Ltd [1960] 2 Lloyd's Rep 153 at 162; [1961] 1WLR 1206 at 1214; [1961] 3 All ER 396 at 403