16 October 2024

Director
Personal Deductions and Fringe Benefits Tax Unit
Treasury
Langton Cres
Parkes ACT 2600

*By email: deductions@treasury.gov.au*

Dear Director,

**Exposure draft legislation denying deductions for the general interest charge ('GIC') and the shortfall interest charge ('SIC')**

The National Tax & Accountants' Association ('NTAA') is a national member-based organisation that represents the interests of around 10,000 member firms, including tax accountants and superannuation professionals.

The NTAA is focused on representing the interests of our members and their taxpaying clients, which predominantly include individual taxpayers, small and medium-sized business taxpayers and self-managed superannuation funds.

We are grateful for the opportunity to provide feedback on Exposure Draft ('ED') *Treasury Laws Amendment Bill 2024: Denying Deductions for Interest Charges* exposure draft legislation ('ED Bill') and the accompanying explanatory material ('EM') as these measures are likely to have significant adverse implications for our members and their clients.

The NTAA has significant concerns with the amendments proposed in the ED Bill and opposes the ED Bill proceeding in its current form. In particular, we wish to highlight the following concerns.

**1. Proposed amendments create a 'double penalty'.**

GIC and SIC are daily compounding interest charges that are broadly calculated by adding an 'uplift factor' to a 'base rate', being the 90-day bank bill rate as published by the Reserve Bank of Australia.

Linking interest charges to this 'base rate' ensures the charges are commercial. The purpose of the 'uplift factor' (7% for the GIC and 3% for the SIC) is to ensure the interest charges are sufficiently high to encourage taxpayers to comply with all of their tax obligations, including the prompt payment of tax liabilities. This approach also discourages taxpayers from using tax debts as a source of business or private finance, as the GIC is generally imposed at a premium over the rate at which many taxpayers can access finance.

For example, the 90-day bank bill rate has been around 4.3%. The GIC rate for the last four quarters has been significantly higher, sitting at around 11.3%, as a result of the 7% 'uplift factor'.

However, whilst the 'uplift factor' and, by extension, the GIC and SIC serve a purpose, it was not intended to serve as a culpability penalty for having engaged in blameworthy activity. This has been acknowledged at various times by Treasury, the ATO and the Inspector-General of Taxation and Taxation Ombudsman.



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The NTAA is of the view that removing the deductibility of these interest charges increases the after-tax cost of the GIC and SIC and is tantamount to a double penalty (given that under the current rules, the high interest rates on these charges have factored in the tax deductibility of these amounts). In our view, it is not appropriate or necessary to increase the effective cost of these interest charges such that they serve as a culpability penalty, particularly as the tax system already contains a robust penalty regime to deal with culpable behaviour.

We acknowledge that taxpayers can request remission of GIC and SIC in certain circumstances. However, such remission is at the discretion of the Commissioner of Taxation under the *Taxation Administration Act 1953,* and any remission is far from guaranteed. There is also very limited scope to appeal or review a decision to not remit interest charges.

In addition, it is noted that GIC and SIC as a 'tool' is very inflexible. For example, the same charge rate applies regardless of the size of the tax debt involved, the size of the taxpayer involved and also regardless of the culpability of the taxpayer in not satisfying their tax obligations. To further increase the cost of interest charges by making them not deductible, although efficient and simplistic, is not fair and equitable.

The NTAA does not support the proposed amendments in their current form. The NTAA is of the view that any amendment in this area should be limited to the more problematic types of taxpayers, such as those with larger tax debts, those with long-term outstanding debts or those with multiple outstanding tax debts. Alternatively, the proposed amendments should be accompanied by a sufficient reduction to the 'uplift factor' for GIC and SIC to ensure interest charges remain at an appropriate level.

**2. Cost of living challenges.**

The proposed amendments in the ED Bill will increase the cost of interest charges associated with a tax debt. Some taxpayers will be in a position to effectively 'refinance' their tax debt to avoid the proposed amendments as, for some, interest expenses on 'refinanced' debt will be tax deductible.

However, in many cases, affected taxpayers will not be in a position to take this action. This may be because the taxpayer is unable to obtain alternative finance or because doing so would still result in non-deductible debt. The upshot of this will be ever-increasing non-deductible interest charges for many taxpayers.

Given this outcome, the NTAA is concerned about the timing of implementing the proposed amendments. Many taxpayers are already facing unprecedented financial challenges due to the current economic environment, and this development will exacerbate those challenges. Of note, small businesses are facing a prolonged period of high inflation and slower growth, and many are facing difficulties sourcing suitable labour. Employees continue to deal with low wage growth combined with a high cost of living.

For some taxpayers, the proposed amendment may lead to insolvency. The ATO may ultimately not recover outstanding tax liabilities at all, and the taxpayer may not be in a position to generate future tax revenue.

**3. Certain small business and individual taxpayers will be disproportionately affected.**

The proposed amendments in the ED Bill might be seen as a more equitable means by which to encourage taxpayers to comply with their tax obligations. For example, in some cases, the cost of losing a tax deduction for interest charges on a tax debt is greater for a successful business as opposed to a less successful business (e.g., compare a tax deduction denied for an individual taxpayer who is on the highest marginal tax rate as compared to the same tax deduction being denied for an individual on a lower marginal tax rate).

However, the NTAA is concerned that the effect of the proposed amendments will have a disproportionate effect on lower-income earners and small business taxpayers. These taxpayers are generally less likely to be able to absorb the increased interest costs (being the after-tax cost), given limited resources and a limited ability to deal with rising interest charges compared to larger businesses.

**4. Proposed amendments can apply to interest charges that accrued prior to 1 July 2025.**

The proposed amendments apply to SIC and GIC incurred in income years commencing on or after 1 July 2025. This approach meets the objective of simplicity as, per the EM, it is consistent with the established and familiar principle of deductibility being tied to when an expense is incurred.

However, the NTAA is concerned that linking the application of the amendments to interest charges incurred on or after 1 July 2025 means that the change is potentially, in effect, retrospective. In particular, a 'retrospective' application of the changes can arise where:

- Interest charges accrued on a tax debt prior to 1 July 2025.

  The SIC is applied to income tax shortfalls for the period before amended assessments are issued. It is applied from the due date for payment of the earlier, understated assessment until the day before the ATO issues the notice of amended assessment.

  Whilst the SIC is calculated or accrues retrospectively for each day in the SIC liability period, the SIC is incurred when the taxpayer is issued with the notice of amended assessment.

  This means that SIC arising on an amended assessment issued from 1 July 2025 will not be deductible even if the SIC accrued prior to 1 July 2025. This outcome is particularly severe where a taxpayer is unaware of the shortfall and, thus, cannot take any action to avoid generating a non-deductible interest charge.

- A tax debt arose prior to 1 July 2025.

  GIC is imposed on existing unpaid tax liabilities and is incurred on a daily basis in the year it is imposed.

  This means that GIC incurred from 1 July 2025 will not be deductible even if it arises with respect to an unpaid tax liability from an income year prior to 1 July 2025.

The NTAA is of the view that these types of outcomes should be avoided to promote the principles of certainty and fairness within the tax system. We strongly believe that it is appropriate to grandfather deductions for interest charges on existing unpaid tax liabilities and to ensure SIC accrued prior to 1 July 2025 continues to be deductible.

Yours faithfully,

Geoff Boxer
Chief Executive Officer