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TAXATION INSTITUTE *of* AUSTRALIA
IT'S ESSENTIAL

22 September 2006

Mr Russell Chafer
Committee Secretary
Joint Committee of Public Accounts and Audit
Parliament House
Canberra ACT 2600

e-mail: jcpa@aph.gov.au

Dear Mr Chafer

INQUIRY INTO ASPECTS OF TAX ADMINISTRATION: ADDITIONAL INFORMATION

Following an appearance before the Joint Committee of Public Accounts and Audit's Inquiry into Taxation Matters on 28 July 2006, the Taxation Institute of Australia (Taxation Institute) is pleased to provide the Committee with the additional material requested by the Committee. I apologise for the delay.

The three areas where additional information was sought, ie:

- cases where the judiciary have been critical of the laws;
- further ideas on the quality control measure, such as a mechanism for evaluating whether a new law will "simplify" or make the system more complex; and
- the difficulties of obtaining advice;

have been addressed in the following.

Cases where the judiciary have been critical of the laws

The first area where the Committee sought additional information was in identifying cases where the judiciary have been critical of the laws that they have had to interpret. As well as the much quoted criticism of the previous CGT provisions (eg Mason CJ and Deane J in *Hepples v FCT* (1991) 22 ATR 465, at 467 and 477 (respectively), Spender J at first instance in *Cooling v FCT* (1989) 20 ATR 711 at 723, Hill J in his Full Federal Court judgment in *FCT v Cooling* (1990) 21 ATR 13 and Dr Gerber of the AAT in *Case Y53* 91 ATC 464 at 471) a quick search of Austlii case data base reveals over 2000 references to tax and complex in the same document.

Although many of those references will be because of a reference to complex facts, there are some that are critical of the Act. For example, in *Commissioner of Taxation v Ryan* [2000] HCA 4 Kirby J at paragraph 62 noted:

> "Courts nowadays are less willing than in the past to indulge in the fiction that a later legislative amendment is always designed to give effect to the presuppositions inherent in earlier judicial decisions [63]. Especially in legislation as complex as the Act under consideration here."

He added at paragraph 64 that:

> "[a]s to judicial restraint, I agree that those who walk into the minefield of the Act must show particular caution. This is not only because of the importance of its provisions both to the revenue and to taxpayers but also because of the great complexity of the Act and the occasional absence of a reflection of the fairness and rationality that may more easily be imputed to the Parliament in other statutes . . ."

At paragraph 81 Kirby again reflected that "[t]he Act under present scrutiny is large, complex and very important" and "[t]he price that will be exacted for spurning the legislative instruction to give effect to the purpose of legislation is increasingly complex and detailed statutory provisions, difficult for citizens to understand and for courts to construe." Justice Kirby also made similar comments in *FCT v Scully* [2000] HCA 6, at paragraph 62.

What is more concerning is that there is no guarantee that the legislative process will improve. The comments of Sir Anthony Mason AC KBE in his 20 April 2006 Opening Address to the Atax 7th International Conference on Tax Administration on recent legislative initiatives capture these concerns. He said

> 10. "Principles based drafting" would unquestionably result in a shortening of the Act – but, according to Tom Reid and Ian South's example, at the cost of expanding the Explanatory Memorandum and endowing it with a substantially enhanced role. The example they give in their interesting paper consists of three pages of statutory text explicated by 17 pages of Explanatory Memorandum. The Memorandum appears to contain materials that one would expect to find in the statute. The same comment applies to the Explanatory Memorandum to the Promoters legislation. I doubt that the stated outcome in one or more examples given in that Explanatory Memorandum is consistent with the statute. Perhaps the courts will be confronted with a new and daunting task – interpreting the Explanatory Memorandum.
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> 11. We need to recall that tax liability is determined by Australian judges and lawyers who are attuned to interpreting specific, detailed provisions rather than provisions formulated in more general, abstract terms. The long experience of Australian tax lawyers is that generally expressed anti-avoidance provisions are unpredictable in their application to particular transactions. The division of judicial opinion in the decided cases confirms this experience. I acknowledge that such provisions do have inherent difficulties which are not common to other provisions.
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> 12. The question is: to what extent is "principles based drafting" suited to aspects of tax legislation? A reasonable degree of certainty of application of tax laws is necessary so that taxpayers can plan their activities on the basis that the laws will have a predictable operation. They will not have a predictable operation if they are couched only in abstract and general terms which leave a very large element of leeway to the courts in applying very general principles to particular fact situations. Given time, the courts' interpretation of provisions will, hopefully, result in certainty, but it may be a long timespan.
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> 13. In his paper, Warren Cole points to the specific reservation expressed by the Renton Committee on the application of "principles based" drafting to fiscal law and the Committee's statement:

> "that it would in any event be unreasonable to draft in principles so broad that the effect of the statute could not be assessed without incurring the expense of litigation to determine an issue".

And Warren Cole, who speaks with the benefit of the New Zealand experience, agrees with the view that "principles based" drafting is not suitable for widespread use in tax laws. He provides, however, some examples where such drafting can be used advantageously. In his examples, both principles and specific rules are set out in the statute. It seems, though this aspect needs to be explored further, that New Zealand makes substantially less use of the Explanatory Memorandum than the Australian Treasury proposes.

14. Purposive drafting, which is a common feature of modern legislation, should not be confused with "principles based" drafting. The "principles based" drafting is well-suited to the drafting of international treaties and regulatory legislation where there is a need and a capacity for courts and tribunals to spell out the detailed application of generally expressed standards. But it is a form of drafting which, on its own, is often unsuited to aspects of tax legislation and the precise ascertainment of the rights and liabilities of taxpayers. Where it is used, its efficacy will depend upon choice of subject matter, clear identification of policy and careful expression of principle, as well as transparent consultation.

15. "Plain English" drafting will not achieve simplification if content complexity is not eliminated. The New Zealand experience indicates that "plain language" on its own is a passport to nowhere. Plain language linked to coherent, informed and principled content reform is a different matter altogether."

In summary, the comments of Sir Anthony Mason at paragraph 18 captures the Taxation Institute view, ie:

> "That there is a massive need for simplification in Australia is a self-evident truth. The existing complexity is a cause of unnecessary expense and inconvenience to both government and taxpayers."

Further ideas on the quality control measure, such as a mechanism for evaluating whether a new law will "simplify" or make the system more complex

In respect of quality control solutions, the Taxation Institute does not believe that there is one solution, rather, that the solution lies in a series of changes which in turn would enable the legislature to evaluate the complexity of measures imposed. Sir Anthony Mason in his paper at paragraph 16 notes that the New Zealand success has been achieved through a range of methods such as:

> ". . . by coherent and consistent policy formation, transparent consultation, drafting by a drafting unit within the Policy and Advice Division of the Tax Office (not by Parliamentary Counsel or Treasury), purposive clauses and extra-statutory references, general rules to overarch more specific rules and a commitment to modern drafting techniques and to plain language."

A possible series of changes would be:

- To ensure in the early design stage of policy development that there is consultation with tax experts;
- That the design process should involve compliance cost comparisons of the different approaches that could be adopted. The adoption of systematic "road" testing the various policy proposals should assist in this process. To ensure that the compliance cost

comparisons can occur, the Treasury, in consultation with the Australian Taxation Office, should develop an enhanced ability to monitor and model the taxpayers' compliance costs in the tax system. This should be supported by technological infrastructure that allows for a timely and methodologically robust monitoring capacity;

- That there is involvement of the Board of Taxation or other body (eg a joint Parliamentary Committee) to review proposed legislation before it is introduced to ensure that it is not leading to further complexity. The body would conduct timely, transparent and independent pre-implementation reviews of all tax law and policy changes. Such an inquiry would enable briefing by both the Treasury and private sector on the merits of the bill to be introduced;
- That, in order for the party rooms and ultimately the Parliament to be fully informed about the cost of compliance of a measure, a more publicly accountable Regulation Impact Statement (RIS) process needs to be established which sets out taxpayer compliance costs arising from the proposed change so that they can weight up the public good against the compliance costs imposed; and
- To focus Parliament's attention on the actual complexity and resultant community cost of a measure, particularly where the public good is deemed to be more important than the additional compliance costs imposed, the bill needs to contain compensation measures (via a direct concession, via rebate (tax offset), a cash grant (based upon a percentage of turnover or the actual level of cost to the business) or a lower tax rate for business income of small businesses.

A combination of the above measures would ensure that the Parliament, in passing laws, would be fully aware of the level of complexity and both the costs to administration and the costs of compliance arising from that law. As Sir Anthony Mason noted at paragraph 17 of his paper:

> ". . . simplification is achievable so long as there is a will to achieve it and clear thought processes are directed to identifying the relevant policies and the means by which they are to be implemented and expressed."

The difficulties of obtaining advice

As discussed at the hearing, the area of obtaining technical advice from the ATO, although subjected to improvement remains problematic. In many cases, when phoning, taxpayers and tax professionals are likely to be faced with scripted answers that are drawn from material on the ATO website. If the script does not cover the problem, then the issues is "escalated" and referred to the appropriate area. However, often the base information is not captured and taxpayers are required to restate their issues. Ultimately, if the question is too complex then the taxpayer is required to make a private binding ruling (PBR) request. This result is often frustrating as taxpayers have followed the call centre option as it is a cheaper and easier mechanism than a PBR.

This cost is evidenced by the fact that the number of private binding ruling applications is low (about 14,000 per year) when compared to the number of taxpayers (13 million personal tax returns and 2.5 million business returns). The reasons for this low uptake are:

- the cost of obtaining a PBR is in many case prohibitive for taxpayers; and
- the time taken is too long given that many business or investment decisions which may be best served by obtaining a PBR have a shortish lead time (eg it is uncommercial for a taxpayer acquiring an asset or a business to have to wait two months for a ruling on the proposed arrangement).

Time for resolution can be extended if the matter is complex or additional information is required.

The ATO has made some advances in speeding up the timing for complex rulings, although clearly there is room for continuous improvement, and is in the process of exploring advice options for small business and individuals. We would recommend that the Committee acknowledge the problem but recognise that reform of the process is being undertaken.

Should you have any queries in relation to any of the supplementary matters raised, please contact at first instance the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on (02) 8223 0011.

Yours faithfully

Andrew Mills
President