

REPORT TO
AUSTRALIAN TAXATION OFFICE

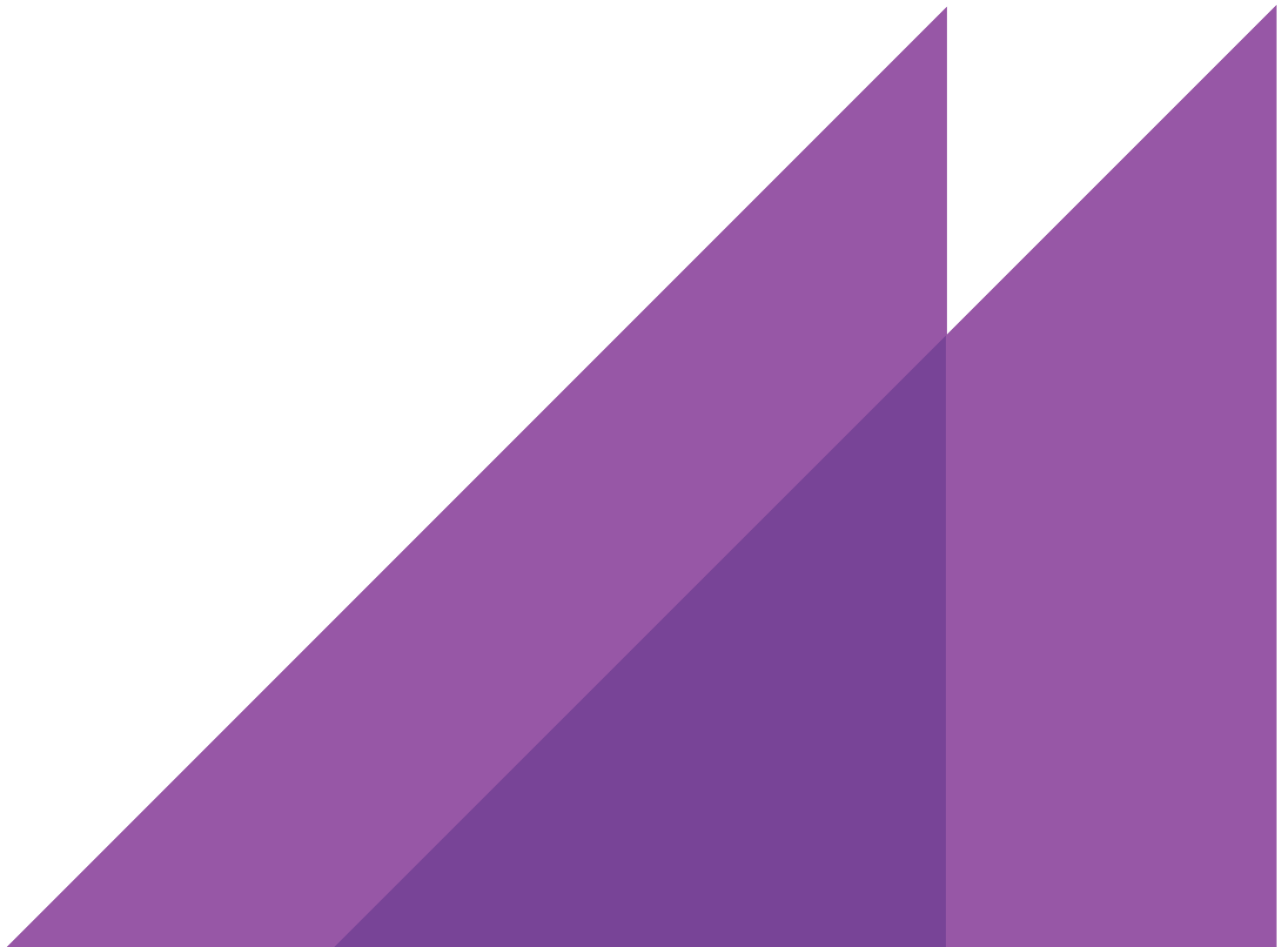
17 MAY 2016

CUTTING THE GORDIAN KNOT



ADDRESSING COMPLEXITY IN
AUSTRALIA'S TAX SYSTEM

FINAL REPORT





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GLOSSARY OF TERMS

ACIL Allen	ACIL Allen Consulting
AGD	Attorney-General's Department
ALRC	Australian Law Reform Commission
ASX	Australian Stock Exchange
ATO	Australian Taxation Office
the Board	Board of Taxation
CGA	Certified General Accountants Association (Canada)
CSO	Civil Society Organisation (UK)
FBT	Fringe Benefits Tax
FTE	Full-time equivalent
CGT	Capital Gains Tax
GDP	Gross Domestic Product
GST	Goods and Services Tax
GTPP	Generic Tax Policy Process (NZ)
IFS	Institute for Financial Studies (UK)
ITAA 1936	<i>Income Tax Assessment Act 1936 (Cth)</i>
ITAA 1997	<i>Income Tax Assessment Act 1997 (Cth)</i>
JCPAA	Joint Committee of Public Accounts and Audit
MP	Member of Parliament
MYEFO	Mid-Year Economic and Fiscal Outlook
NIC	National Insurance Contributions (UK)

NZ	New Zealand
OECD	Organisation for Economic Cooperation and Development
OPC	Office of Parliamentary Counsel
OTS	Office of Tax Simplification (UK)
PCO	Parliamentary Council Office (NZ)
PM&C	Department of Prime Minister and Cabinet
RAB	ATO Revenue Analysis Branch
RIS	Regulation Impact Statement
TAD	Treasury Tax Analysis Division
TAG	Tax Advisory Group (NZ)
TLRP	Tax Law Rewrite Project (UK)
TPCC	Tax Policy Coordination Committee
TWG	Tax Working Group
UK	United Kingdom
US	United States
WST	Wholesale Sales Tax
VAT	Value Added Tax



TEN PRINCIPLES FOR SIMPLIFYING THE TAX SYSTEM

ACIL Allen has developed ten principles for simplifying the Australian tax system. The principles should be thought of as general approaches to use when developing new tax policy and amending existing tax law. The principles should be taken as flexible principles aimed at delivering cultural and behavioural change rather than rigid rules.

Principle One

Recognise that the primary purpose of the tax system should be to raise revenue in an economically neutral and efficient manner, and that it should not be used as the primary method to address non-tax policy issues or problems.

Principle Two

Ensure tax laws (especially new laws) have a clear, stated policy intent.

Principle Three

Resist advocates who seek unreasonable special rules for themselves.

Principle Four

Write tax law in a general (ideally, principles-based) form reflecting policy intent.

Principle Five

Avoid the temptation to anticipate every possible contingency when drafting tax law and accept that it is not possible to collect every last dollar of revenue.

Principle Six

Consult widely, early and transparently on new tax policy and proposed changes to tax law, then on its implementation, and also post-implementation. Consultation processes should build a sense of mutual obligation amongst participants.

Principle Seven

Establish the architecture needed (e.g. legislation and regulations) to enable the Commissioner of Taxation to consistently administer tax law in accordance with policy intent.

Principle Eight

Build the tax system on a framework of relationships and trust, with safeguards against the abuse of trust.

Principle Nine

Restrict the use of grandfathering when changing tax law as it tends to create complexity for mostly suboptimal policy benefit.

Principle Ten

Give Treasury, the Australian Taxation Office and the Office of Parliamentary Counsel the resources, capabilities and capacities they need to deliver simplification.



EXECUTIVE SUMMARY

Context

We ask a lot of the Australian tax system. We want it to raise revenue for government, make the distribution of wealth less unequal, encourage people to work and to save, as well as influence a broad range of behaviours in respect of health and investment. In addition, we demand that the tax system is a transparent, fair, consistent, understandable and predictable instrument of government.

Most if not all of these things are worthy in themselves (although, in some cases, it might be reasonable to ask if the policy objectives we are seeking could be achieved in another way). But the result is that these demands generate a lot of complexity, and potentially unnecessary costs, for the tax system.

In November 2015 ACIL Allen Consulting (ACIL Allen) was commissioned to analyse the drivers of complexity in tax policy and law and how complexity could be addressed. The commissioning of the analysis was supported by key system stakeholders, including the Treasury.

The purpose of this report is to consider the current approach to tax policy and law design and identify ways it can be simplified. It is focused on factors influencing the policy development, drafting and implementation of tax legislation and not the Australian Taxation Office's (ATO) administration of tax legislation. Its scope is restricted to federal taxes.

The approach used in this report is underpinned by an analysis of the current literature on tax system complexity, and consultations with a broad range of stakeholder groups. The outcomes of these consultations are provided throughout the body of the report in a de-identified way to protect the confidentiality of stakeholders who participated in consultations.

The problem of complexity

Many stakeholders consulted for this report (or the Review) consider that the tax system is far too complex. But this tends to be an amorphous statement—'complexity' is usually undefined or is understood differently by different parties. Complexity is in the eye of the beholder, and dependent on where the stakeholder operates within the tax system and what level of 'pain or gain' is generated by complexity. As such, this Review has not taken complexity to have a single distinct meaning. Instead, it has acknowledged that complexity has many facets.

Also, there is likely to be an irreducible level of complexity in any hypothetical tax system—the modern commercial environment is complex and the tax system to some extent will inevitably reflect the complexity of the commercial world to which it applies. There will always be costs associated with a national tax system.

Many attempts have been made to address the issue of complexity over the past three decades. However, it appears that the tax system has become more complex over time. One key explanation for this is the piling of new tax law onto already existing complex law—whether the complexity is derived from policy or legislative drafting. Other explanations focus on the lack of incentives for key stakeholders to reduce complexity in tax policy and law design process.

The tax system also lacks a set of common design principles. ACIL Allen has become aware of considerable divergence in stakeholder views about the underlying objectives of the tax system and how it should evolve in the future. There is often little consensus about how best to tackle the problem of complexity and minimal coordinated effort to implement simplification measures. In short, the system currently lacks a policy vision and the policy mechanisms necessary to coordinate stakeholder actions around a common purpose of simplification.

Towards simplification

Stakeholders consulted for this report expressed frustration at the perceived inability of successive governments and tax administrators to simplify the tax system. However, stakeholders also identified numerous ways of reducing complexity. Some of these approaches represent a new way of designing tax policy and law, while others seek to address existing structures and processes.

To this end, ACIL Allen has developed ten principles for simplifying the tax system and shaping the behaviour of participants within the design process (see Box 4.1 of this report). The principles should be thought of as general approaches to use when developing new tax policy and amending existing tax law. They should be taken as flexible precepts for driving cultural and behavioural change rather than rigid rules.

In addition, ACIL Allen has identified a number of building blocks that are essential for changing culture and delivering lasting change. Each of building blocks tackles different aspects of the complexity problem and provides guidance to government about the potential range of investments that are necessary to deliver simplification. (See Chapter 8 for additional detail about each building block.) The building blocks are:

- *Architectural and institutional building blocks.* These building blocks focus on the structural changes that could underpin simplified tax policy and law. They typically involve significant changes to the institutional settings which support tax policy and law design.
- *Process-based building blocks.* These building blocks focus on the procedural elements of tax policy and law design which shape the actions of stakeholder in the tax system.
- *Capability and capacity-based building blocks.* These building blocks consider the ability of key decisions makers and the institutions they represent to deliver a simpler tax system. They consider the skills, experience and expertise of decision makers/institutions within the context of simplification.

It is ACIL Allen's opinion that simplification should occur over the medium-to-long term. It should be an ongoing process that deals with both the stock of existing tax law and the flow of new law.

Simplification will involve change to the structures, processes and cultures that underpin the tax system. This means that a simplification agenda will extend beyond the life of any single Parliament (and potentially any single government), and bipartisan support will be critical to its success.

Implementation should also be staged to ensure that key changes to the current arrangements are carefully designed and have the level of stakeholder acceptance necessary to deliver cultural and behavioural change. Details of the implementation phases for each building block are provided in Chapters 4 and 8 of this report.

Finally, implementation activities should be underpinned by constant monitoring and reporting to ensure they are progressing against an overall simplification implementation plan. A number of independent reviews are also recommended to ensure the highest level of accountability against an implementation plan is maintained.



This part of the report is a standalone précis of the Review's scope, findings and conclusions.



1.1 Context

We ask a lot of our tax system. We want it to raise revenue for governments to spend on services we demand, to make the distribution of wealth less unequal, and for it to ensure that everybody pays their ‘fair share’ (whatever that means). We want it to encourage people to work and to save, especially for their retirement. We want the tax system to discourage behaviours that are bad for our health (such as smoking or consuming sugary drinks) and to encourage behaviours that are healthy (such as eating fresh food). We want the tax system to encourage the growth of certain industries (such as the film industry), to encourage the growth of certain kinds of business organisation, such as small business and to facilitate efficient forms of business structure as firms expand their operations throughout the world. We want the tax system to encourage certain types of economic activity (such as research and development), and to make the economy ‘internationally competitive’ (whatever that means). We want it to help fix environmental problems (such as excessive carbon emissions or plastic bag litter), to fix traffic congestion, to encourage self-education, and to discourage activities that might or might not be harmful but which we consider ‘sinful’ (such as gambling and the consumption of alcohol). The list goes on and on, and then on some more.

As well as these objectives for the tax system, we want the processes which decide how much tax people should pay to be transparent, fair, consistent, understandable and predictable.

Most if not all of the things we ask of the tax system are worthy in themselves (though in some cases it might be reasonable to ask if the policy objectives could be achieved another way). But the result is that we have a tax system that has become extremely complex, so much so that large, important parts of our tax law are understood by only a handful of people and no one understands all of it.

Excessively complex policy and law has been a persistent problem in Australia’s tax system. The desirability of a better (less complex) tax policy and law design process was recognised by the Ralph Review in 1999, the Henry Tax Review (2008) and *Re:think, Tax discussion paper* (2015).¹ The recommendations from the Ralph Review emphasised the need for strong coordination amongst stakeholders, as well as sufficient opportunities for business and other taxpayers to participate in the design process.

Since this time, the ATO, Treasury and other government agencies have addressed these recommendations by implementing a range of integrated tax design principles and processes. These principles and processes have focused on embedding a shared understanding of tax policy intent,

¹ “Review of Business Taxation,” Ralph Review, accessed March 23, 2016, <http://www.rbt.treasury.gov.au/>; “Australia’s future tax system,” Henry Review, accessed March 23, 2016, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm>; The Treasury, *Re:think, Tax discussion paper* (Canberra: Commonwealth of Australia, 2015).

undertaking consultation with industry experts and taxpayers and developing collaborative arrangements between the various government agencies involved in tax policy and law design.

Despite these efforts complexity in tax policy and law has persisted.

In this report, ACIL Allen presents ample evidence not only to suggest why simplification is important, but also how the tax system can achieve lasting change. The report should be seen as a set of 'guide rails' for simplification. It does not however provide the definitive account on how to deliver simplification; such a report is beyond the reasonable timeframe of this report and indeed of any single report.

The difficulty and resources required to deliver simplification should not be underestimated. For example, one senior tax adviser consulted for this Review suggested that simplifying the consolidation provisions of the income tax law alone, would take 50 people working for two years to complete.

Finally, the report draws an important distinction between necessary and unnecessary complexity within the tax system. This distinction is important to note as some level of complexity in our tax system is inevitable (be it due to the evolving nature of taxpayer affairs, constantly changing company structures and ongoing technological advances that drive the way tax policy and law is administered). As such, only those approaches that tackle unnecessary complexity (that is, complexity which is driven by stakeholder interactions that could be avoided or re-shaped) are analysed in this report.

1.2 Purpose

ACIL Allen Consulting (ACIL Allen) was engaged by the Australian Taxation Office (ATO) in November 2015 to undertake a review (the Review) of integrated tax design, with a goal of understanding the drivers of complexity in tax policy and law and how the complexity they cause can be addressed.

The purpose of this Review is to consider the current approach to integrated tax design and identify ways in which the design of tax policy and law can be simplified. This includes understanding how the various tax system stakeholders contribute to complexity, and the changes required to simplify tax policy and law design.

The Review was focused primarily on factors influencing the policy development, drafting and implementation of tax legislation and not the ATO's administration of tax legislation. The Review's scope was restricted to all federal taxes. State and territory taxes and local council rates were excluded.

The terms of reference (TOR) set for the Review are outlined in **Box 1.1**.

BOX 1.1 TERMS OF REFERENCE

The requirements set out in the TOR include:

- a) maintain communication with the ATO and project stakeholders as required
- b) work with key stakeholders (both government and private sector) individually to understand:
 - i) What they feel their role is in the tax design process (the hats they wear)
 - ii) How they feel they contribute to the problem of complexity and how they could contribute to a solution
 - iii) How they feel others contribute to the problem
 - iv) How others could contribute to a solution
 - v) What improvements they think could be made (systemically, structurally, behaviourally, culturally and in the process)
- c) conduct research on what has been thought of before, and examine why previous attempts to address complexity of policy and law have not gained traction. This may include international standards comparison where relevant
- d) facilitate workshops/interviews with key stakeholders to work through the themes identified
- e) develop recommendations on potential solutions including principles that can be adopted in the tax design process
- f) develop an action plan for implementing recommendations.

SOURCE: REQUEST FOR TENDER DOCUMENT

1.3 Review governance

A Project Steering Committee was established to support the Review and to provide guidance and oversight of its direction. The Project Steering Committee included senior representatives of ATO with responsibilities for integrated tax design and a representative from the Board of Taxation (the Board).

The Project Steering Committee's role focused on the governance and oversight of the Review. All observations and analysis presented in this report are the independent professional opinion of ACIL Allen.

1.4 Methodology

The methodology used for this Review was underpinned by the following phases, which included data collection, documentary review, stakeholder consultation and analysis.

1.4.1 Desktop review

This phase involved consideration of existing documents that were identified as relevant to the Review. The documents were reviewed at two levels.

First, ACIL Allen explored the academic and official government literature to understand what the core drivers of complexity are and how they can be conceptualised. This included consideration of several Australian Government reviews (and the submissions from respected organisations to those reviews), as well as the academic literature examining complexity from economic, policy and institutional perspectives.

Second, ACIL Allen explored key reports, reviews and policy documents from a selection of countries (in particular, the UK, New Zealand and Canada) to identify how other tax systems have reduced complexity over time (see Appendix A).

1.4.2 Stakeholder consultations

As part of the project, a large number of stakeholders were asked to participate in the review process. The approach included consultation with 76 stakeholders to capture data, insights and observations for analysis.

The consultation approach was supported by an initial meeting between the ATO and ACIL Allen to identify the stakeholders who should be consulted for the Review. Once identified, ATO contacted each stakeholder to seek agreement about his/her participation in the Review.

A consultation guide was developed to provide consistency in the consultation approach and to assist stakeholder preparation for the consultations. The consultation guide also provided a working definition of tax system complexity based on a review of academic and government literature. This definition was useful in helping stakeholders to define complexity and to identify possible solutions for addressing it.

The consultations were conducted using a mixture of face-to-face and teleconference formats.

1.4.3 Development of principles and solutions (building blocks)

Following the desktop review and consultation stages, ACIL Allen developed preliminary findings and solutions. These preliminary findings and solutions were presented to the Project Steering Committee for consideration and feedback in a workshop. Refinements to the preliminary findings and solutions were made following the workshop and presented in this report.

1.4.4 Drafting, reporting and refinements

A Final Report was a key deliverable of the Review. The report (including a draft report) was prepared using the report structure that was agreed with the Project Steering Committee. The drafting process involved synthesis of the information collected and analysed throughout the Review. It also included a process of review by the Project Steering Committee prior to the report being finalised.

1.5 Report structure

This report is divided into two main parts. Part A provides a high level summary of the Review's outcomes. Part B provides the reader with a detailed account of tax system complexity as discussed in the literature and conceptualised by the broad range of stakeholders consulted for the Review. Part B also provides the evidence underpinning the Review's outcomes and suggested next steps.

Within this context the remaining sections of the report are as follows:

- **Part A – Summary Report:**
 - *Chapter 2.* This chapter defines the problem of tax system complexity and explains why many stakeholders view it as an intractable problem.
 - *Chapter 3.* This chapter presents a case study of Division 7A of the *Income Tax Assessment Act 1936 (Cth)* (ITAA 1936). Division 7A is an excellent example of how and why the tax system has become so complex, and what can be done about it.
 - *Chapter 4.* This chapter presents the main outcomes of the Review. It provides ten key principles for tax system simplification and identifies a range of possible solutions to the problem of complexity. The chapter also provides a high level discussion of the implementation considerations associated with these solutions.
- **Part B – Detailed Report:**
 - *Chapter 5.* This chapter discusses the contextual factors underpinning tax system complexity. It provides background information to the problem of tax system complexity.
 - *Chapter 6.* This chapter examines a selection of primary and secondary literature that are relevant to the study of tax system complexity. The chapter draws on Australian and overseas literature to help define and then analyse tax system complexity, culture and behaviour.
 - *Chapter 7.* This chapter presents the key themes from stakeholder consultations. It discusses the issues identified by stakeholders that relate to tax policy design and tax law individually as well as those issues which relate to both policy and law design.
 - *Chapter 8.* This chapter discusses a number of potential solutions to the problem of complexity. These solutions take the form of 'building blocks' for tax system simplification. The chapter also discusses the implementation considerations underpinning each building block.
- **Appendices:**
 - *Appendix A.* This appendix provides the results of a desktop review of New Zealand, Canada and the United Kingdom.



2

THE PROBLEM OF COMPLEXITY

Many taxpayers and stakeholders consider that the tax system is too complex. But this tends to be an amorphous statement—‘complexity’ is usually undefined or is understood differently by different parties. This Review has not taken complexity to have a single distinct meaning. Instead, it has acknowledged that stakeholders perceive complexity to have many facets. Taking complexity to reflect only particular elements of the term could exclude other understandings, and it has not been the Review’s purpose to do this.

As shown in **Box 2.1** below, complexity is clearly in the eye of the beholder.

BOX 2.1 STAKEHOLDER VIEWS ABOUT COMPLEXITY

This box outlines a divergence of stakeholder views and conceptions of complexity in the tax system.

<i>“Our culture is that there should be no losers at all from tax reform. This creates complexity.”</i>	Senior tax official
<i>“Treasury and ATO have a ‘whack a mole’ approach to tax legislation.”</i>	Industry stakeholder
<i>“The Treasury approach is to deal with every possible contingency.”</i>	Industry stakeholder
<i>“Stakeholders want their particular situation enshrined in statute.”</i>	Senior policy official
<i>“Sometimes seemingly simple tax changes in fact create complexity.”</i>	Senior policy official
<i>“The search for equity creates complexity. But too much complexity reduces equity.”</i>	Senior policy official
<i>“Technical zealots are a barrier to simplification.”</i>	Senior tax official
<i>“Under the FBT rules there are 39 different ways of valuing a meal.”</i>	Industry stakeholder
<i>“Special pleading drives complexity (e.g. Taxation of Financial Arrangements).”</i>	Senior tax adviser
<i>“Political deals done to get legislation passed are a huge cause of complexity.”</i>	Senior policy official

SOURCE: ACIL ALLEN

2.1 What does complexity mean?

While there was no consensus on the meaning of complexity, there was agreement on how it could be measured—for taxpayers and tax administrators, complexity equates to additional costs of complying with their tax system obligations. Levels of litigation, ruling requests, reliance on professional external and internal advisors, and the use of tax agents by individuals are all indicators of complexity.

It is important to note that there is likely to be an irreducible level of complexity in any hypothetical tax system—the modern commercial environment is complex and the tax system will inevitably reflect the complexity of the commercial world to which it applies. There will always be costs associated with administering a tax system.

It is also important to note the role of government institutions and key tax system stakeholders in the design of tax policy and law. These institutions and stakeholders interact in ways which shape the complexity of the tax system.

For these reasons we have adopted a blended working definition of tax system complexity, culture and behaviour as outlined below:

Unnecessary complexity in tax policy and law arises from interactions between participants (who pursue their own as well as common tax system principles) operating at different stages within the tax system. These interactions generate uncertainty in policy and law which in turn generates a gap between a taxpayer's perception of a tax obligation and the amount that is actually owed, and opportunities for tax system manipulation. To minimise this uncertainty participants frequently introduce new tax policies and laws and constantly make changes to existing tax policies and laws.

See Chapter 6 of this report.

2.2 A Gordian knot?

Many attempts have been made to address the issue of complexity. However, stakeholders consulted for this Review consider that the tax system has become more and more complex over time—and that it is too difficult to develop the system again from scratch.

Many stakeholders describe the problem as being one of piling new law onto already existing complex law—regardless of whether the complexity derives from complex policy or complex legislative drafting. This appears to be a symptom of an interlinked set of factors that create incentives for the tax system to become steadily more complex over time. While Australian taxpayers might prefer a simpler system, participants in the tax system do not have strong enough incentives to actively seek to reduce complexity. In fact, ACIL Allen has been made aware of considerable incentives to increase complexity, which can provide opportunities to maximise the financial and policy interests of key stakeholders.

The tax system also lacks a set of common design principles. ACIL Allen has witnessed considerable divergence in stakeholder views about the underlying objectives of the tax system and how it should evolve in the future. This means there is often little consensus about how best to tackle the problem of complexity and minimal coordinated effort to implement simplification measures.

In short, the system currently lacks a clear vision of what the tax system is trying to achieve. While this vision should have strong reference to the overall priorities of government, it needs to be primarily developed and supported by key stakeholders within and outside of government. The communication and promotion of this vision should not only fulfil the formal reporting requirements of government, but also provide stakeholders with the ability to have their voices heard.

2.3 Cutting the knot

Stakeholders expressed frustration at the inability of successive governments and tax administrators to simplify the tax system. However, consultations and lessons from the international experience did identify a number of potential approaches (or building blocks of a new approach) to help reduce complexity in the future.

Complexity is only intractable if nothing can be done to address it. However, even if it is impossible in practice to redesign the tax system or redraft the entire tax legislation, the application of goodwill and resources of tax system participants could help to address some causes of complexity.

The tax system will always experience a certain level of complexity. It is a matter of all participants in the tax system choosing to actively reduce the level of complexity when alternative choices could increase it. Chapter 4 and 8 identify the ways to deliver simplicity over the longer term.

2.4 How much can be gained from simplification?

According to *Re:think, Tax discussion paper*, the ATO estimated that Australian taxpayers bear costs of approximately \$40 billion annually to comply with tax system obligations.² That is a lot of money, equal to approximately 2.5 per cent of GDP. Not all of this expenditure is due to the complexity of the tax system; there is always going to be a substantial cost of tax compliance in any advanced economy like Australia's, even if the tax system is relatively simple. But it is important to ask how much of this expenditure could be plausibly reduced if the tax system was simplified.

Such an estimate is attempted in what follows. It is only a partial, back-of-the-envelope exercise, and the results should be treated with caution. It does not attempt to estimate the dynamic benefits of simplification, such as the gains in national income that could be realised if the money spent on dealing with complexity was instead invested in productive uses, or if business people did not need to think so much about the complexity of the tax system and could devote their time instead to making better products and services.

To begin, suppose that the tax system is simplified so that most individuals do not have to file a return. These would be people with relatively simple affairs, and for the sake of this exercise suppose that this means people with a taxable income below \$60,000.

According to the latest ATO data (2012-13), there are 9,656,692 people with taxable incomes below \$60,000. A large number of these people (4,728,245) receive interest, which they have to declare on their tax returns. Suppose alternatively though that, as in the UK, tax is deducted at the source—i.e. their bank or financial institution deducts interest at a standard rate and sends the tax to the ATO. These people would no longer have to lodge a return for the purpose of declaring interest.

But there are other non-salary sources of income, such as rent (received by 1,047,222 people with income under \$60,000) and franked dividends (1,668,868). Plus, there are deductions for clothing/uniforms (3,927,561), gifts/donations (2,460,410) and so on. Suppose, for the sake of this exercise, all work-related expenses are abolished and people receive a tax cut in lieu. The average donation is only \$339. The Government could abolish tax deductibility of small donations and give an equivalent amount to registered charities.

There are arguments that can be made against all of these simplification measures and any serious reform would need to weigh up all of the pros and cons. But, in any case, suppose that of these 9.7 million people, seven million have their tax affairs simplified so that they don't have to put in a return. Assume average savings of \$250, comprised of: (i) the value of people's time; (ii) cash savings from not paying tax agents; and (iii) processing savings at ATO. Total savings would be \$1.75 billion.

In terms of possible savings for businesses, the accounting industry has revenues of approximately \$18 billion per annum.³ Most of this would be for routine accounting, auditing and tax work. Suppose, though, that 10 per cent of this amount could be saved if the tax system is simplified. This would amount to reduced expenditure on accounting services of approximately \$1.8 billion per year.

² The Treasury, *Re:think*, 28.

³ Tristan Williams, *IBISWorld Industry Report M6932 Accounting Services in Australia* September 2015.

Is this a reasonable number? According to one large business consulted during the preparation of this report, the cost to them of just one recent additional complexity to the system will cost that business several million dollars per year from changing their accounting systems and ongoing fees to their tax advisors. This is just one business, albeit a large one, and so a total saving of \$1.8 billion per year for all Australian businesses does seem reasonable.

Another way of checking the reasonableness of this estimate is to note that there were 2,121,235 active businesses in Australia as of June 2015.⁴ Savings of \$1.8 billion per year amounts to \$848 per business, on average. Considering the range of tax complexities that businesses have to deal with, from the intricacies of the Fringe Benefit Tax (FBT) rules to the consolidation provisions of the tax law, this number also seems reasonable.

Adding the saving for individuals and business calculated above gives a total annual saving from simplification of \$3.55 billion. This amounts to about nine per cent of the total cost of tax compliance of \$40 billion per year. This is a modest percentage, probably underestimated, but the amount is well worth having. Simplification of the tax system can be thought of as a microeconomic reform, and there are few if any such reforms that produce such a high ongoing return.

⁴ "8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2011 to Jun 2015", Australian Bureau of Statistics, accessed May 6, 2016, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0>.



3.1 The issue

Throughout this Review, many stakeholders identified Division 7A of the ITAA (1936), which deals with *Distributions to entities connected with a private company*, as an exemplar of tax system complexity. Introduced as an integrity measure in 1998 to deal with a seemingly simple problem, Division 7A has grown to an impressive 161 pages in the statute.

It is not the purpose of this chapter to conduct a technical review of Division 7A. Such a review was recently conducted in great depth by the Board, on whose website⁵ can be found two discussion papers, 21 first round submissions (mainly from the tax advisory industry), 19 second round submissions, and the Board's report to the Government, which contained a number of substantial recommendations to reform Division 7A. (These have not—at least yet—been taken up by the Government.) Rather, the purpose of this chapter is to illustrate the flavour of complexity of one important part of the tax law. The same exercise could have been done with a range of provisions in the tax law such as the consolidation regime, where piecemeal ad hoc 'fixes' to identified problems have led to an endless spiral of amendment and growing complexity.

Stakeholders generally agreed that Division 7A has grown because its introduction created unintended consequences for business investment and efficient business structures, including interaction with other parts of the tax system that were not predicted, and that additional integrity measures within Division 7A have become necessary as some taxpayers have taken advantage of the specific wording of its provisions to create new tax avoidance opportunities, contrary to its policy intent.

Division 7A has grown by a series of patches to fix previous problems and there is no obvious end in sight. Indeed—and this observation is not confined to Division 7A—many stakeholders are of the view that complex law inevitably leads to ever more complexity, as the problems created by the previous complexity are fixed (but only temporarily) by even more complex law.

The result, according to the Board, is:⁶

In their current form, the rules in Division 7A are complex, inflexible and costly to comply with. They fail to achieve an appropriate balance between ensuring taxpayers are treated fairly, promoting voluntary compliance and discouraging non-compliance. They can also operate as an unreasonable impediment for businesses operating through a trust that wish to fund their growth by reinvesting profits back into the business.

⁵ "Post-Implementation Review of Division 7A of Part III of the Income Tax Assessment Act 1936," accessed March 24, 2016, <http://taxboard.gov.au/consultation/post-implementation-review-of-division-7a-of-part-iii-of-the-income-tax-assessment-act-1936/>.

⁶ Board of Taxation, *Post implementation review of Division 7A of Part III of the Income Tax Assessment Act 1936, A report to the Assistant Treasurer* (Canberra: Commonwealth of Australia 2014), vii.

Many, but not all, stakeholders who were consulted for the Review believe that Division 7A is ripe for a radical reform, not in terms of rewriting detail, but by recasting it in a much shortened form as a series of principles, which would then be applied by the ATO on a case by case basis. One senior policy adviser remarked during consultations, in all apparent seriousness, that he could rewrite Division 7A in less than ten pages.

3.2 The policy intent and the resulting statute

Division 7A was enacted by the *Taxation Laws Amendment Act (No 3) 1998*, following the then Treasurer's Budget night announcement in 1997:

I am announcing tonight a range of further measures to enhance tax system integrity. These are not measures to increase revenue but are designed to guard against the potential erosion of revenue in the future. Many of these measures deal with tax avoidance, unfair minimisation and evasion...

The Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1998 noted:

9.8 Section 108 of the Act is an anti-avoidance provision intended to prevent private companies distributing profits to shareholders and their associates tax free, in the form of loans or other advances. The section also operates to capture amounts paid or credited on behalf of an associated person, while transfers of property are treated as if they were payments of amounts equal to the value of the property.

The intent of the legislation was clear. Consider the simple case of a private company with a single shareholder who controls the company. If the profits are paid to the shareholder as a dividend, that dividend is taxed as personal income (perhaps with a franking credit attached). Alternatively, the company could 'lend' the same amount to the owner, at zero interest, with the loan payable on demand with no fixed term (or rolled over if repaid). The owner gets the same amount of cash as if they had been paid a dividend, but pays no tax. This is a textbook case where the actions of the company owner have no purpose other than to avoid tax.

A high level summary of the provisions of Division 7A is in section 109B, which gives a simplified outline of the Division (as shown in **Box 3.1** below).

BOX 3.1 DIVISION 7A IN SECTION 109B

This Division treats 3 kinds of amounts as dividends paid by a private company:

- amounts paid by the company to a shareholder or shareholder's associate (see section 109C);
- amounts lent by the company to a shareholder or shareholder's associate (see sections 109D and 109E);
- amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives (see section 109F).

This treatment makes the amounts assessable income of the shareholder or associate (under section 44).

However, some payments, loans and forgiven debts are not treated as dividends. (See Subdivisions C and D.) Also, this Division does not apply to demerger dividends. (See Subdivision DA.)

An amount may be treated as a dividend even if it is paid or lent by the company to the shareholder or associate through one or more interposed entities. (See Subdivision E.)

An amount may also be included in the assessable income of a shareholder or shareholder's associate if:

- a company has an unpaid present entitlement to income of a trust; and
- the trustee makes a payment or loan to, or forgives a debt of, the shareholder or associate.

(See Subdivisions EA and EB.)

If the total of the amounts is more than the company's distributable surplus, only the part of the total equal to the distributable surplus is treated as dividends. (See section 109Y.)

This Division applies to non-share equity interests and non-share dividends in the same way it applies to shares and dividends.

SOURCE: ITAA 1936

This simplified outline, while informative, does not do justice to the details of Division 7A. The complexity of Division 7A is, perhaps, best illustrated by listing its subdivisions and sections (as recreated below).

Division 7A—Distributions to entities connected with a private company	294
Subdivision A—Overview of this Division	294
109B Simplified outline of this Division	294
Subdivision AA—Application of Division	295
109BA Application of Division to non-share dividends	295
109BB Application of Division to closely-held corporate limited partnerships	295
109BC Application of Division to non-resident companies	296
Subdivision B—Private company payments, loans and debt forgiveness are treated as dividends	297
109C Payments treated as dividends	297
109CA <i>Payment</i> includes provision of asset	299
109D Loans treated as dividends	302
109E Amalgamated loan from a previous year treated as dividend if minimum repayment not made	305
109F Forgiven debts treated as dividends	309
Subdivision C—Forgiven debts that are not treated as dividends	311
109G Debt forgiveness that does not give rise to a dividend	311
Subdivision D—Payments and loans that are not treated as dividends	313
109H Simplified outline of this Subdivision	313
109J Payments discharging pecuniary obligations not treated as dividends	314
109K Inter-company payments and loans not treated as dividends	315
109L Certain payments and loans not treated as dividends	315
109M Loans made in the ordinary course of business on arm's length terms not treated as dividends	315
109N Loans meeting criteria for minimum interest rate and maximum term not treated as dividends	316
109NA Certain liquidator's distributions and loans not treated as dividends	318
109NB Loans to purchase shares under employee share schemes not treated as dividends	318
109P Amalgamated loans not treated as dividends in the year they are made	318
109Q Commissioner may allow amalgamated loan not to be treated as dividend	319
109R Some payments relating to loans not taken into account	320
Subdivision DA—Demerger dividends not treated as dividends	322
109RA Demerger dividends not treated as dividends	322
Subdivision DB—Other exceptions	322
109RB Commissioner may disregard operation of Division or allow dividend to be franked	322
109RC Dividend may be franked if taken to be paid because of family law obligation	324

109RD	Commissioner may extend period for repayments of amalgamated loan	325
Subdivision E—Payments and loans through interposed entities		326
109S	Simplified outline of this Subdivision	326
109T	Payments and loans by a private company to an entity through one or more interposed entities	327
109U	Payments and loans through interposed entities relying on guarantees	328
109UA	Certain liabilities under guarantees treated as payments	329
109V	Amount of private company's payment to target entity through one or more interposed entities	330
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109X	Operation of Subdivision D in relation to payment or loan	332
Subdivision EA—Unpaid present entitlements		333
109XA	Payments, loans and debt forgiveness by a trustee in favour of a shareholder etc. of a private company with an unpaid present entitlement	333
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109XH	Amount and timing of payment or loan through interposed entities	344
109XI	Entitlements to trust income through interposed trusts	345
Subdivision F—General rules applying to all amounts treated as dividends		347
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09Z	Characteristics of dividends taken to be paid under this Division	350
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109ZB	Amount treated as dividend is not a fringe benefit	350
109ZC	Treatment of dividend that is reduced on account of an amount taken under this Division to be a dividend	351
109ZCA	Treatment of dividend that is reduced on account of an amount included in assessable income under Subdivision EA	352
Subdivision G—Defined terms		353
109ZD	Defined terms	353
109ZE	Interpretation rules about entities	354

3.3 A way forward

The Board in its review of Division 7A provided a detailed discussion of its operation. As indicated above, the Board was highly critical, concluding that reform of Division 7A is 'urgent', though noting that many of its problems arise because the design of the business tax system as a whole, and Division 7A's interaction with the tax treatment of trusts and the Capital Gains Tax (CGT) regime. A large part of the problem is that there are valid commercial reasons which are not motivated by a desire to avoid or defer tax (or which have that effect) for businesses to operate through a trust structure, and so not every payment by a company should be treated as a dividend to be taxed as personal income. There are genuine and mischievous payments from private companies, and the job of Division 7A is to sort them out, but the reality of modern business practices means that this a difficult task, with the real risk that genuine payments are disallowed and mischievous payments slip through.

The Board does not recommend a reformed, simplified, principles-based redrafting Division 7A as such, but it does recommend four principles for a policy that would form the basis of its reform. These are:

- it should ensure that the private use of company profits attracts tax at the user's progressive personal income tax rate
- it should remove impediments to the reinvestment of business income as working capital
- it should maximise simplicity by reducing the compliance burden on business and the administrative burden on the Commissioner of Taxation and other stakeholders
- it should not advantage the accumulation of passive investments funded by profits taxed at the company tax rate over the reinvestment of business profits in active business activities.

There is little doubt that the complexity of the current law is derived largely from the construction of anti-avoidance measures. The original measures targeted specific arrangements identified by the ATO. As new arrangements were uncovered or developed, new provisions were added, along with further provisions to modify the unintended effects of the earlier provisions.

Another reason for continuing amendment of the current law is that taxpayers and tax advisors do not rush to advise the Government when they have uncovered a new loophole. The Government can be confident, however, that it will be advised if it has missed legitimate provisions of benefits that should be excluded from the principles-based general rule.

As the law currently stands, ongoing and continual additions to the complexity are inevitable. A principles-based solution, in contrast, does not start with a list of transactions to be caught by anti-avoidance rules. Rather, it would set out a broad principle—dividends need not be paid in cash and any non-cash benefits provided by a company directly or indirectly to shareholders (or associates) are treated as the equivalent of cash dividends. The law can set out legitimate exceptions to the principle.

If Division 7A was reformed along principles-based lines, in a much less complex written form, inevitably this would mean that the Commissioner of Taxation would be given a lot of discretion to decide if particular arrangements are consistent with the relevant principles. This would most likely create anxiety among some taxpayers who: would be uncomfortable about the vagueness of the principles, and desire the apparent certainty of black letter law which clearly defines concepts like 'private use', 'reinvestment of business income' and 'passive investments'; would not trust the Commissioner of Taxation to be reasonable (as they see it); could not wait for their particular arrangement to be given the green or red light; and would think that even with the best will in the world, rulings from the Commissioner of Taxation would be inconsistent and perhaps arbitrary.

The quick response to these concerns is that these risks already exist under current law. Nonetheless, they are valid concerns. The way to address these concerns is to create, as part of the principles-based legislative architecture, regulations and guidance material that can implement the policy intent of the law, provide as much certainty as possible to taxpayers, and provide the Commissioner of Taxation and taxpayers with the flexibility needed to meet changing circumstances without amending the Act, all without the Byzantine complexity of the existing law.

Inevitably, there will be disputes and litigation—as there is now—and so there will be a common law overlay to this principles-based statute law, but that need not be a bad thing. It should be further noted that principles-based law is not something new and untried. It already exists in parts of the tax law.



ACIL Allen has developed ten principles for simplifying the Australian tax system—see **Box 4.1**. The principles should be thought of as general approaches to use when developing new tax policy and amending existing tax law. The principles should be taken as flexible precepts that support cultural and behavioural change rather than rigid rules.

BOX 4.1 TEN PRINCIPLES FOR A SIMPLER TAX SYSTEM

Principle One

Recognise that the primary purpose of the tax system should be to raise revenue in an economically neutral and efficient manner, and that it should not be used to address every non-tax policy issue or problem.

Principle Two

Ensure changes to tax laws (especially new laws) have a clear, stated policy intent.

Principle Three

Resist advocates who seek unreasonable special rules for themselves.

Principle Four

Write tax law in a general (ideally, principles-based) form reflecting policy intent.

Principle Five

Avoid the temptation to anticipate every possible contingency when drafting tax law and accept that it is not possible to collect every last dollar of revenue.

Principle Six

Consult widely, early and transparently on new tax policy and proposed changes to tax law, then on its implementation, and also post-implementation. Consultation processes should build a sense of mutual obligation amongst participants.

Principle Seven

Establish the architecture needed (e.g. legislation and regulations) to enable the Commissioner of Taxation to consistently administer tax law in accordance with policy intent.

Principle Eight

Build the tax system on a framework of relationships and trust, with safeguards against the abuse of trust.

Principle Nine

Restrict the use of grandfathering when changing tax law as it tends to create complexity for mostly suboptimal policy benefit.

Principle Ten

Give Treasury, the Australian Taxation Office and the Office of Parliamentary Counsel the resources, capabilities and capacities they need to deliver tax simplification.

SOURCE: ACIL ALLEN

While tax system simplification is a challenging proposition, the Review has identified a number of practicable and achievable approaches to reduce complexity. Consultations with a range of stakeholders have identified building blocks for delivering simplification and addressing the drivers that cause complexity.

The ten principles underpin each of the building blocks identified through this Review. **Table 8.1** in the Detailed Report demonstrates the relationship between each principle and building block.

For the purposes of this Review, the building blocks are conceptualised as:

- *Architectural and institutional building blocks.* These building blocks focus on the structural changes that could underpin simplified tax policy and law. They typically involve significant changes to the institutional settings that support tax policy and law design.
- *Process-based building blocks.* These building blocks focus on the procedural elements of tax policy and law design that shape stakeholder behaviour in the system.
- *Capability and capacity-based building blocks.* These building blocks consider the ability of key decisions makers, and the institutions they represent, to deliver simplification. They consider the skills, experience and expertise of decision makers and institutions within the context of simplification.

Each building block seeks to address an identified driver(s) associated with tax system complexity. These drivers have been identified by stakeholders and categorised using Tran-Nam and Evans' (2014) framework as discussed in Chapter 6. Broadly, the drivers can be understood from the perspective of:

- policy complexity
- legislative complexity
- operational complexity (This driver is important to acknowledge for completeness although this is not the main focus of the Review).

Table 4.1 on the next page presents an overview of the building blocks and an assessment of their merits. Additional detail about the building blocks is outlined in Chapter 8.

TABLE 4.1 OVERVIEW OF THE BUILDING BLOCKS (SOLUTIONS) IDENTIFIED DURING THE REVIEW

Description	Rationale	Assessment
Architectural and institutional building blocks		
Establish a National Compact for the tax system	To reach agreement across a broad and diverse system about the principles and behaviours that should shape the ongoing evolution of the tax system. A National Compact would seek to gain endorsement across all levels of government, with the Commonwealth Government to champion the compact in partnership with state and territory governments, industry representatives, the tax agent community and political parties	Worthwhile proposal with significant merits
Implement a principles-based legislative model which embraces the use of subordinate legislation and other administrative instruments	To fundamentally reconfigure the tax law around a hierarchical model that enshrines fundamental principles in the core legislation and transfers detail underpinning the legislation to subordinate legislation (e.g. regulation) and administrative instruments. Changes to the core legislation would occur infrequently and only if significant issues arose with the application of the core principles underpinning tax law. Changes to the subordinate legislation/instruments would require significant cross-referencing to the principles to ensure they are consistent with the core legislation (as per the United States (US) tax code)	Worthwhile proposal which requires strategic thinking and detailed implementation planning in order to be successful
Establish an independent body to advise on tax simplification	To establish an independent body that provides evidence-based advice about the ongoing evolution of the tax system and practical suggestions for delivering simplification. The body would focus on simplifying both the stock of existing tax policy, as well as the flow of future policies and laws. The body would include representation from government, the tax advisory industry and academia. The body would focus on technical aspects of the tax system as opposed the fundamental issues relating to the tax mix or policy design. The body would be given its own budget and staffing resources to ensure its independence from Treasury or other tax authorities (i.e. the resourcing model used for the Productivity Commission to ensure its ongoing independence)	Worthwhile proposal requiring further analysis of the appropriate model
Establish a Joint Standing Committee of the Commonwealth Parliament focussing on tax system simplification	To establish a Joint Standing Committee to examine (over the longer term) issues relating to excess tax system complexity and to provide findings and recommendations for simplification. A Joint Standing Committee would assist in developing bipartisan support for simplification at the highest levels of government and provide a public profile for simplification. The Committee's role would need to be clearly defined so as not to duplicate the functions of other committees such as the Economics and the Public Accounts and Audit committees	Proposal has a strong rationale, but implementation would need to be carefully managed to avoid duplication with other committees and to gain the political support needed to establish another Parliamentary committee
Process-based building blocks		
Implement much strengthened consultation process for tax policy development and post-implementation review	To implement a stronger process-based framework for consultation on tax policy and law. The process would provide minimum and maximum timeframes for consultation and guide the way consultation occurs on all new legislation, amendments to existing legislation, and post-implementation review. It would also establish consultation processes at the early stages of tax policy and law design to ensure simplification is at the core of all policies	Worthwhile proposal requiring further analysis of the appropriate model

Description	Rationale	Assessment
Introduce an annual consolidated tax amendment bill	To introduce a United Kingdom (UK)-style annual omnibus tax amendment bill that includes all legislative proposals and amendments to tax legislation. This building block would reduce the frequency of changes and provide drafters with an opportunity to consider the implications of each proposal/amendment on related aspects of the tax law. Urgent legislative changes outside the omnibus tax amendment process could still be made	Proposal has merits but requires further testing and exploration before it can be adopted
Ensure that each piece of tax legislation includes a fulsome objects clause	To clearly articulate the policy intent of each piece of tax legislation. This intent will not only cover what the section/division should do, but why it should also do it. This building block involves the inclusion of an objects clause (or several, if appropriate) in each piece of new tax legislation. It may also include amending existing tax legislation to include objects clauses	Worthwhile proposal which requires further investigation
Capability and capacity-based building blocks		
Increase the level of resources within Treasury, ATO and OPC to deliver simplification and enhanced integrated tax design outcomes	To ensure that Treasury, the ATO and Office of Parliamentary Council (OPC) have the resources and expertise necessary to deliver a long term agenda in a way that provides stakeholders with confidence that the change is being effectively managed. This building block recognises that while simplification is highly beneficial it is potentially time and resource intensive	Worthwhile proposal which requires further investigation
Build a better understanding of the costs of tax system complexity	To ask the Productivity Commission to undertake a study about the costs of tax system compliance, including the economic costs (e.g. effects on business investment) of compliance. This building block also involves identifying the parts of each law that give rise to the most complexity so they could be targeted for reform. The study would be an authoritative source on tax system complexity and be used as a platform to drive change	Worthwhile proposal which requires further investigation
Build a stronger understanding amongst Ministers, ministerial advisors and political parties about the implications of changes to the tax system	To generate a common understanding amongst Ministers, their advisors, political parties and the broader community about the implications of changes to the tax system. This understanding will extend beyond the existing Regulation Impact Statement (RIS) process which is generally seen amongst stakeholders consulted for this Review as an ineffective tool of decision making. By building a common understanding, political decision makers will be better placed to deal with the special interest considerations of individuals/institutions who unreasonably seek changes to the tax law for their own benefit	Worthwhile proposal which requires further investigation

SOURCE: ACIL ALLEN

4.1 Implementation considerations

A detailed assessment of each building block is provided in section 8.5.1. It is evident from this assessment that all of the building blocks are not created equally. For example, the architectural and institutional building blocks are intended to elicit fundamental reform of the existing framework; they are not incremental reforms. By comparison, the process-based and the capability and capacity-based building blocks can be applied to a fundamentally reformed tax system, as well as the current system.

Simplification should occur over the medium to long term. Simplification needs to be an ongoing process that deals with both the stock of existing policy and law, and the flow of new policy and law. This means that a simplification will extend beyond the life of any single Parliament (and more than likely government) and will require a bipartisan support to ensure simplification outcomes are achieved.

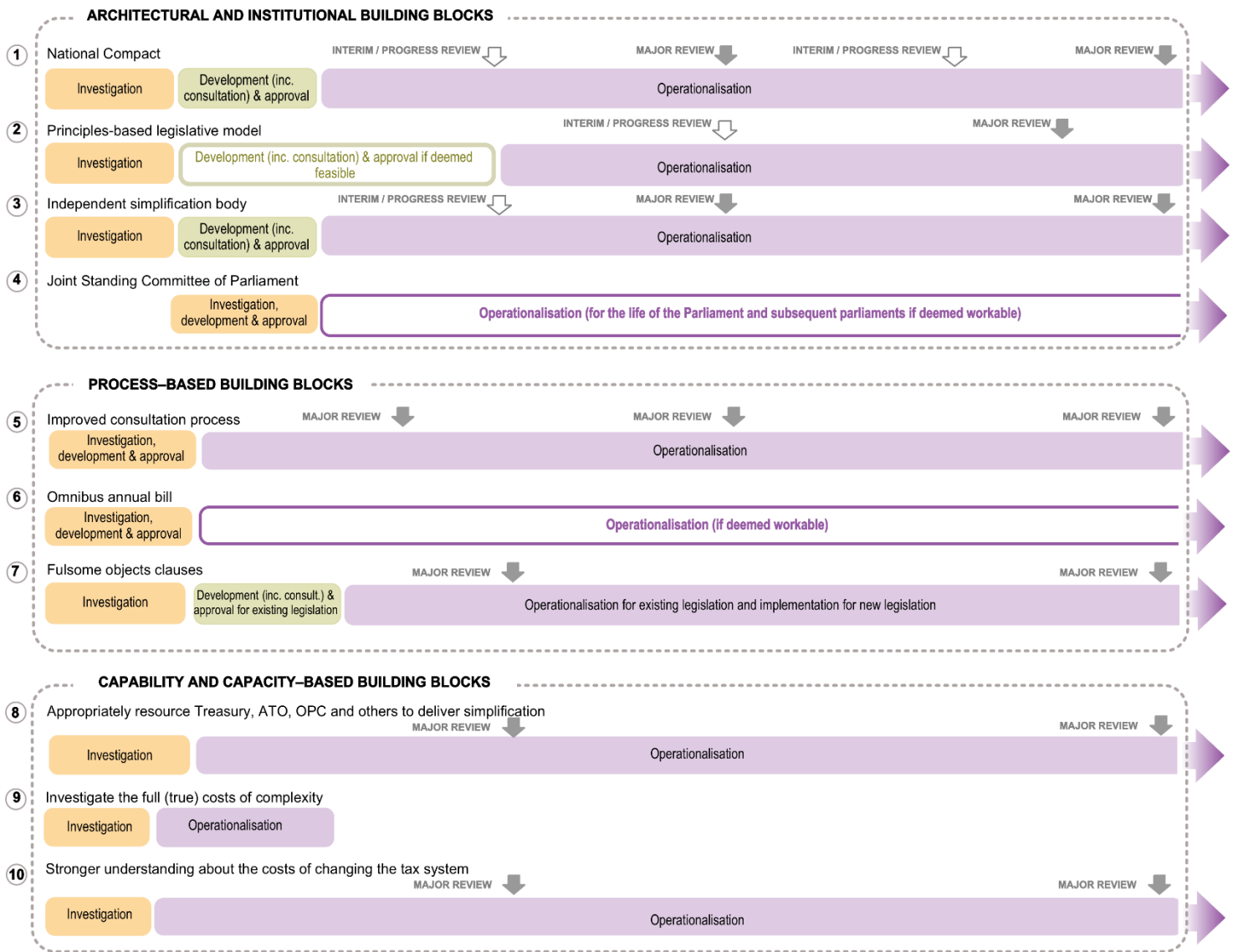
The implementation activities for each building block will generally involve three distinct phases consisting of the:

- *Investigation phase.* This phase should explore the feasibility and strategic issues associated with each building block. The phase should clearly identify the objectives, costs and benefits of pursuing each building block.
- *Development phase.* This phase should tackle all of the design issues associated with the building block and its implementation against an agreed schedule. This phase should also involve stakeholder consultation to ensure the parameters of the building block are appropriately identified and the implementation activities will deliver the outcome being sought by government.
- *Operationalisation phase.* This phase should involve the management and ongoing implementation of each building block.

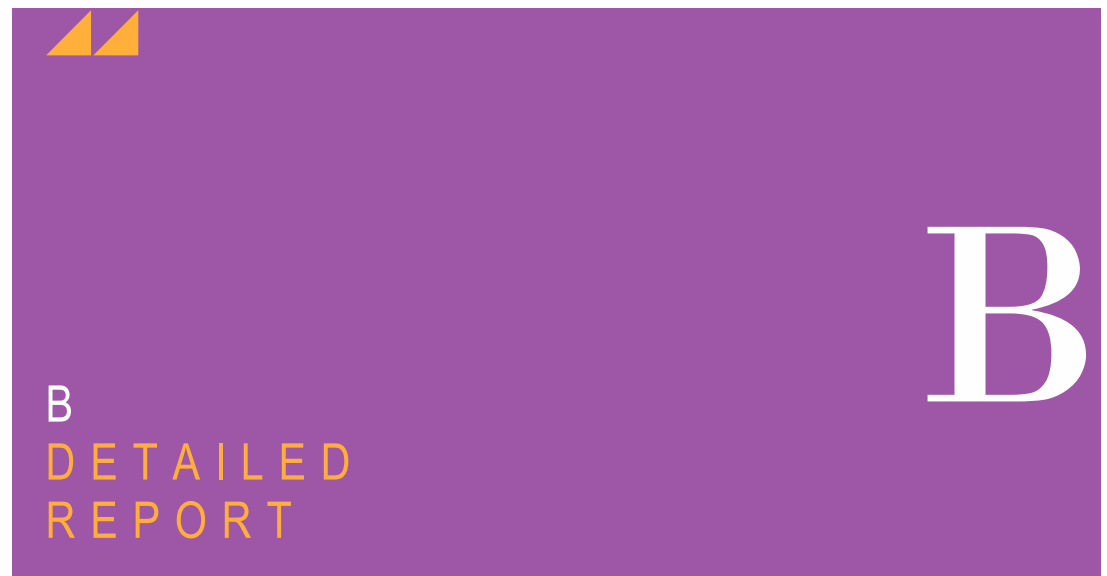
Implementation of each phase should be underpinned by a range of monitoring, reporting and evaluation activities. In particular, a number of independent reviews are recommended to ensure the highest level of accountability is maintained during the implementation phases.

An indication of the implementation considerations underpinning each building block is presented in **Figure 4.1** below.

FIGURE 4.1 IMPLEMENTATION PLAN



SOURCE: SOURCE: ACIL ALLEN BASED ON ANALYSIS UNDERTAKEN IN THIS REVIEW



This part of the report provides the detailed analysis underpinning the précis of findings and conclusions made in Part A.



This chapter discusses the context surrounding tax system complexity and why it is perceived to be a problem in Australia.

5.1 Previous analyses of the tax system

This Review has not occurred in isolation. Many reports and reviews relating to the tax system have taken place over recent decades. These reviews have often touched on issues relating to the complexity of the tax system.

Recognising that the ITAA 1936 had become complex and unwieldy, in November 1993, a parliamentary committee recommended that a task force be established to rewrite Australia's income tax law. The Tax Law Improvement Project was established one month later. Sections of the ITAA 1936 were rewritten with income tax law now found in the ITAA 1997. The aim of the rewrite was:⁷

...to make significant savings in the cost of complying with the income tax law by simplifying the law.

Only minor changes were made to policy.

The published literature suggests that while Australia's income tax law is now clearer and easier to read than it was in 1993, this has not affected the complexity of the underlying tax policy. Indeed, rewriting the tax law has made the underlying complexity more transparent. Similar observations have been made in relation to New Zealand's project to rewrite its income tax law over a period of 15 years. Since this time a number of reviews have been undertaken which explored, or in some way, touched on the issue of complexity and the need to improve tax system arrangements, processes and institutions. The most important of these are discussed below.

5.1.1 Ralph Review

In 1998, the Howard Government announced a Business Income Tax Review (the Ralph Review) to investigate issues relating to business tax reform identified in the *A New Tax System* reforms.

As part of its review, the Ralph Review focussed on the processes used for developing tax policy. The Ralph Review recommended that:⁸

...a more systemic and integrated taxation design process be formalised between the Treasury, the Australian Taxation Office and the Office of the Parliamentary Counsel—the three Commonwealth agencies with responsibilities relating to the design and administration of taxation law.

⁷ Kerry Jones. *Rewriting Australia's income tax law*. Accessed March 23, 2016. https://www.opc.gov.au/calc/docs/Loophole_papers/Jones_1998.pdf.

⁸ "Policy formulation," Ralph Review, accessed March 23, 2016, <http://www.rbt.treasury.gov.au/publications/paper4/part1/section1.htm>.

The aim of the recommended reforms were similar to the themes around simplicity of the tax system discussed with stakeholders during this (i.e. ACIL Allen's) Review:

The new process should help to produce a tax system that:

- *simplifies existing law within a principle-based framework*
- *fosters constructive participation by taxpayers, and their effective interaction with tax authorities*
- *promotes simpler and less costly compliance*
- *is efficient and cost-effective to administer.*

The Ralph Review recommended that a Board of Taxation be established, to, among other things, advise the Treasurer on 'systemic matters pertaining to business taxation.'⁹

5.1.2 Board of Taxation

In 2002, the Howard Government appointed the Board to 'advise on the design and operation of Australia's tax laws and the processes for their development, including community consultation and tax design.'¹⁰

The Board comprises members appointed in their personal capacity by the Treasurer from the business and wider community. The Treasury Secretary, Commission of Taxation and First Parliamentary Counsel are standing ex-officio Board members. The Board is supported by a secretariat of Treasury officers, and assisted by an Advisory panel comprised of leading tax professionals.

The activities of the Board have included reviewing tax policy, undertaking post-implementation reviews of tax policy (including Division 7A and aspects of the consolidation regime), and consulting on implementing new tax rules.

5.1.3 Treasury's use of principles-based drafting in the design of tax law

A number of stakeholders consulted for this Review expressed the view that Treasury already applies a principles-based approach to the drafting of tax legislation. Evidence suggests that this approach goes back at least approximately ten years with an article by Thomas Reid in the December 2005 edition of the *Australian GST Journal* indicating that the Treasury had started using the 'coherent principles' approach to drafting tax law.¹¹

The coherent principles approach to drafting law is designed to not 'pretend' that Parliament can prescribe how policy in a tax law can be applied to every single case. Instead, Parliament should enact principles that reflect the intended policy outcome.

In 2010, David Lovric, the Senior Assistant Parliamentary Counsel, gave a paper on using principles-based drafting in tax law.¹² In that paper, he defined principles-based drafting as follows.

A principles-based draft states a broad and operative principle. In many cases, such principles will be accompanied by surrounding provisions that provide examples, clarifications, add-ons and carve-outs. These surrounding provisions illustrate how the principle works in practice, or make explicit add-ons or carve-outs to its operation.

A provision states a broad principle if the principle is flexible and covers a wide range of circumstances at a high level of abstraction. Broad principles have a degree of uncertainty at their edges; they have a core of relatively clear application surrounded by a penumbra of uncertain application. Some aspects of this uncertainty may be clarified by surrounding provisions (as we will see later). Other aspects of this uncertainty may be clarified by subsequent amendments or case law. Yet even with such clarifications, the entire operation of a broad principle is never fixed in a bright-line way.

A provision is operative if it is the source of rights, duties, powers or privileges. It states the preconditions for a legal result, and provides for that result. By contrast, if a provision merely provides

⁹ "Policy formulation," Ralph Review, accessed March 23, 2016, <http://www.rbt.treasury.gov.au/publications/paper4/part1/section1.htm>.

¹⁰ Tax Design Review Panel, *Better Tax Design and Implementation, A report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs* (Canberra: Commonwealth of Australia 2008).

¹¹ Thomas Reid, "Interpreting the GST law: tax law based on coherent principles", *Australian GST Journal* (2005): 239-247.

¹² David Lovric, *Principles-based drafting: experiences from tax drafting*, accessed March 23, 2016, http://www.opc.gov.au/calcdocs/Loophole_papers/Lovric_Dec2010.pdf.

context for the operation of other provisions (as is the case with an objects clause), it is not operative, and is therefore not principles-based in the sense used in this paper.

An aim of the principles-based drafting is for Parliament to enact principles that clearly reflect the policy outcome it is seeking to legislate. By 'lifting' the level of detail in legislation, it is hoped to make the law more understandable and to avoid gaps in the law.

5.1.4 Tax Design Review Panel's report 'Better Tax Design and Implementation'

In 2008, the Tax Design Review Panel reported to the Rudd Government on ways to reduce delays in the introduction of tax legislation, improve the quality of tax law changes, and increase community input into prioritising changes to tax laws. While this report was not squarely focussed on the complexity of the tax system, the issues examined did overlap with complexity.

The Panel made 26 recommendations to the Minister which touched on issues including the approach to consulting on tax changes, the publication of a forward work program, and the monitoring and post-implementation of new laws. Panel recommendations included the following:

- The Government should generally consult on tax changes at the initial policy design stage prior to any government announcement.
- Press releases advising of tax changes should be accompanied by separate Treasury documents providing a level of detail similar to that provided in the Treasury's drafting instructions to OPC.
- Government should ensure greater priority is given to the ongoing care and maintenance of the tax system.
- Principles-based legislation was conceptually promising but had not been universally accepted, and would not make any difference to delays in tax design and the legislative process.
- The Government should consider whether the Commissioner of Taxation should be granted the power to make extra-statutory concessions for taxpayers.

In 2011, the Board reviewed the Government's implementation of these recommendations. The Board found that while there had been improvements in the tax design process, further improvements could be achieved by paying deeper and more systematic attention to the design process 'and the roles and responsibilities of stakeholders involved in that process.'¹³

5.1.5 Henry Review

In 2008, the Rudd Government commissioned Australia's Future Tax System Review (the Henry Review) to undertake a 'root and branch' review of Australian and state/territory taxes and their interactions with the social security system. The aim of the review was to 'create a tax structure that will position Australia to deal with its social, economic and environmental challenges and enhance economic, social and environmental wellbeing'.¹⁴

Complexity was one factor examined by the Henry Review. The review stated that complexity reduces transparency, impedes optimal decision making by taxpayers and their ability to respond to intended policy signals, and can cause people to pay the wrong amount of tax. Furthermore, complexity is regressive as it can affect the people with the least capacity to deal with it.

The causes of complexity identified by the Henry Review included 'the pursuit of finely calibrated equity and efficiency outcomes', 'instability in policy settings', and the incentives for business taxpayers to maximise their after-tax profits. The review also identified taxpayer choice in identifying their tax liabilities as a cause of complexity. The review referred to research suggesting an optimal level of tax system complexity and operating costs is 'one that balances administration and compliance costs with improved efficiency and distributional outcomes.'

The Henry Review made recommendations relating to the tax and transfer system that sought to address complexity as one of a number of factors. The highest level recommendations focussed on changing Australia's tax system to focus on four 'robust and efficient' broad-based taxes: personal

¹³ Board of Taxation, *Post-implementation review of the Tax Design Review Panel recommendations* (Canberra: Commonwealth of Australia, 2011), xi.

¹⁴ "Australia's future tax system," Henry Review, accessed March 23, 2016, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm>

income, business income, rents on natural resources and land, and private consumption. Personal income tax should be assessed on a more comprehensive basis and business income tax should be designed to support economic growth. Additional taxes should exist ‘only where they improve social outcomes or market efficiency through better price signals.’

The review made a number of recommendations with the aim of addressing complexity in the tax system, including the following process-related matters:

- Government should commit to using a principles-based approach to tax law design.
- The Board should be empowered to initiate its own reviews of how current tax policies and laws are operating in consultation with the Government. The Government should also ensure that the Board has adequate resources including its own permanent secretariat.
- Information or advice provided by Treasury to the ATO to assist the ATO in determining the purpose or object of law, or material used by the ATO to determine policy intent (except correspondence to or from government) should be made public.

5.1.6 Re:think, Taxation discussion paper

In March 2015, *Re:think, Tax discussion paper*, was released as a Abbott Government election promise. The aim of the discussion paper was to help support a conversation to develop ‘a better tax system to deliver taxes that are lower, simpler and fairer.’¹⁵

Re:think, Tax discussion paper stated that the Australian tax system had grown ‘increasingly complex over time’.¹⁶ The paper stated that a complex tax system can ‘divert resources away from more welfare-enhancing activities’, is less transparent, and more complex to administer.¹⁷

Re:think, Tax discussion paper sought feedback on a number of potential sources of complexity:

- The design of the tax system (which in part is a reflection of the economy and environment of the time the system was introduced, and in part a reflection of the way businesses operate today).
- Frequent ad hoc patches to gaps and problems in the law rather than addressing structural issues. Announced but un-enacted patches were also suggested as a source of complexity.
- Attempts to provide certainty for particular taxpayers or transactions by applying or excluding the application of tax law through detailed black-letter legislative drafting. Such an approach is ‘not suitable as the basis for regulating complex, dynamic systems and can obscure any underlying policy principles in the law.’¹⁸
- The use of concessions, grandfathering, multiple methodologies which allow taxpayers to calculate income or deductions.
- The uncertainty caused by the time between announcing a policy and introducing legislation.
- The complexity of legislative drafting.

Re:think, Tax discussion paper offered two ways in which tax system complexity could be addressed. The first involved addressing structural issues in the law instead of frequently applying patches to gaps. The second called for the use of a principles-based (as opposed to black-letter) approach to the design of tax law.

¹⁵ The Treasury, *Re:think*, iii.

¹⁶ *Ibid.*, 167.

¹⁷ *Ibid.*, 169-71.

¹⁸ *Ibid.*, 175.

5.2 Existing tax policy and law design arrangements

This section provides an overview of the existing arrangements for the development of tax policy and legislation, and its administration by the ATO.

5.2.1 Developing tax policy

Treasury has central role in the development tax policy, although ideas for tax policy can also arise from many sources in the policy ecosystem. These sources include the ATO, the Treasurer, other ministers, political parties, Parliamentarians, other government agencies, industry, lobbyists, academics, and policy think tanks.

The Revenue Group of Treasury is responsible for advising government on tax policy and instructing OPC on tax bills.

The ATO works with Treasury, OPC, other government departments and key stakeholder groups to provide, advice on the design of policy and legislation. The provision of advice and the roles and responsibilities of ATO are governed by protocols signed between ATO and Treasury. The key dimensions of these protocols are summarised in **Box 5.1** below.

BOX 5.1 PROTOCOLS BETWEEN TREASURY AND ATO FOR THE INTEGRATED TAX DESIGN PROCESS***Designing new policies and laws—the integrated tax design process***

Tax and superannuation policy, legislation and administration are integrally related and interdependent. Our approach to tax and superannuation design will endeavour to ensure that the administrative, compliance and interpretive experience of the ATO fully contributes to those policy and legislation processes and that there is a high level of integration across the policy, costings, legislative and administrative aspects of tax and superannuation changes. This approach supports the primary objectives of providing the best possible advice to Government, and implementation of new policy and law that meets user needs. An integrated tax design approach should encourage collaboration on costing process as well as a coherent approach to tax design, development and implementation. The coherence of the integrated tax design process will be reflected in both the approach to tax design and the tax policy outcomes.

Designing new policies and laws—quality assurance of new law

Quality assurance is both a framework and a process to give the Government confidence that its policy measures are being implemented and will be applied as intended.

The Treasury and the ATO will separately determine internal processes to assure the Government of the quality of tax and superannuation legislation and will institute internal mechanisms that enable senior officers in each organisation to jointly sign off on this quality dimension before legislation is referred to a Minister for introduction into Parliament. To guide internal processes, Treasury and the ATO developed a proposal for quality assuring tax and superannuation legislation and administration. This proposal was approved in April 2012.

Revenue costings

A key element of advising on policy proposals is considering the revenue impact on government and the distributional impacts on taxpayers.

The accountability of tax costings rests with Treasury. However, Treasury and the ATO share responsibility for costings and collaborate on all aspects of the costing process. Treasury's Tax Analysis Division (TAD) will allocate responsibility for the costing of a specific new proposal having regard to availability of information, capabilities and other relevant factors. Wherever feasible, costings prepared by one agency should be reviewed by the other for quality assurance purposes.

The Treasury (TAD) will provide requests for costing or data to the Tax Office through the ATO's Revenue Analysis Branch (RAB). As part of the request, the Treasury will provide contextual information and the policy intent and the timeframe for the request. The request will include information on any likely or known timeframe for consideration by Government. Where a proposal has previously been costed, the Treasury will highlight any changes to the policy since the previous costing as well as any additional information available about the proposed operation of the policy. Revenue costings provided to the Treasury by the ATO will, where agreed, include a compliance cost assessment and information on the administrative impacts of the proposal. The ATO will also advise whether it will be able to implement the measure by the proposed start date and/or details of start date preferences. The response will also incorporate any possible issue or difficulty that taxpayers, tax agents or other intermediaries are likely to have in being ready to comply with the measure by the proposed start date.

Enacted law—the law in administration

Whilst acknowledging that the Courts are the final arbiters of the laws made by Parliament, the ATO interprets and enforces enacted law that it is responsible for administering.

In forming its view on the interpretation of law, the ATO will routinely consult senior members of Treasury's Law Design Practice and the professions, and undertake community consultation and release draft views for public comment in accordance with its long standing practices.

The ATO will engage the Treasury on policy and law design issues that are identified in the administration of the law at the earliest possible juncture. In particular, where the ATO identifies that enacted law is not operating consistently with what is understood to be the policy intent of the law, the ATO will provide advice to Treasury recommending law change to ensure that the policy intent is met.

The ATO will also provide advice to Treasury in circumstances where:

- there is a significant risk that enacted law is not operating consistently with what is understood to be the policy intent of the law, or
- the enacted law is operating consistently with what is understood to be the policy intent of the law, but there have been unforeseen impacts for the revenue, the community or administration.

Communication between the Treasury and the ATO

Subject to government and legal requirements, both agencies will share information to meet the objectives outlined in this Protocol. Communications between the Treasury and the ATO on tax and superannuation policy and law are always confidential.

Tax Policy Co-ordination Committee (TPCC)

The TPCC has responsibility for the management of the relationship between the Treasury and the ATO at an institutional level. TPCC meetings are held monthly and are attended by senior officers in the Treasury's Revenue Group and the ATO.

SOURCE: "ATO—TREASURY PROTOCOL", LAST MODIFIED SEPTEMBER 17, 2012, [HTTPS://WWW.ATO.GOV.AU/GENERAL/NEW-LEGISLATION/IN-DETAIL/ATO—TREASURY-PROTOCOLS/ATO—TREASURY-PROTOCOL?ANCHOR=P58-8617#P58-8617](https://www.ato.gov.au/GENERAL/NEW-LEGISLATION/IN-DETAIL/ATO—TREASURY-PROTOCOLS/ATO—TREASURY-PROTOCOL?ANCHOR=P58-8617#P58-8617).

5.2.2 Drafting tax legislation

Once Cabinet or a Minister has agreed to a tax policy that requires legislative change, Treasury takes responsibility for developing drafting instructions to the OPC. OPC drafts bills to implement the policy. Treasury works closely with OPC during the drafting phase. ATO previously held the responsibility for developing drafting instructions until this responsibility was moved to Treasury in 2002.

Treasury is also responsible for producing RIS¹⁹ and explanatory memoranda, and consulting on exposure drafts of bills, regulations, and explanatory guides. Exposure drafts of bills and regulations can be amended through this process.

Treasury also assists government in managing its legislative program.

5.2.3 Parliamentary process

A tax bill may be amended through the parliamentary process. This process involves the consideration of the tax bill by the House of Representatives and the Senate and possible negotiations between government and members of those houses about the contents of the bills. The parliamentary process is an integral part of legislating tax policy. It is not simply a technical process to turn government tax policy into law.

All tax bills must be passed by both houses of Parliament before receiving Royal Assent.¹⁹ The need for the Senate to pass a tax bill, and the lack of a government majority in the Senate for most of the past three decades, has led to the Senate being a key factor in the development of tax legislation. An example of this was the Senate requiring in 1999 that the then-proposed GST be amended to exempt certain items including fresh food. While the Senate cannot introduce tax bills, the constitutional requirement for its approval of tax bills may make it, in effect, an equal bargaining partner to the Government over tax policy.

Parliament can pass any tax bill regardless of the policy development process that has occurred previously. This means that tax bills can be amended to produce legislation that is suboptimal and incoherent from a policy point of view, and which may reflect the results of political agreements made at short notice. The policy intent of legislation that emerges from Parliament may not be clear, and may not reflect the Government's original policy intent.

Changes can also be made to tax bills in the House of Representatives, but this is less of a factor structurally as the Government will usually hold a majority in its own right in that house.

5.3 The costs of complexity and a call for their reduction

The result of these current arrangements is that Australian taxpayers incur substantial costs in complying with their tax obligations. *Re:think, Tax discussion paper* states that the ATO estimated that Australian taxpayers bear costs of approximately \$40 billion annually to comply with tax system obligations. In 2011-12, 72.4 per cent of Australian tax filers lodged their tax return through a tax agent. One stakeholder consulted for this project commented that Australia has one of the highest rates of use of registered tax agents per taxpayer of any country operating in the Organisation for Economic Cooperation and Development (OECD) group of nations.²⁰ Statistics published by ATO (in 2013-14) show that approximately 74 per cent of personal taxpayers use registered agents in Australia.

Furthermore, according to a PricewaterhouseCoopers survey reported in 2010, the compliance costs to businesses represented a cost equivalent to an additional 1.6 per cent surcharge on their taxes.²¹

While the level of these costs appears high, conceptually, it is possible that they are simply the efficient costs of taxpayers complying with their obligations. Nor is it clear that the current level of compliance costs indicates that the tax system is *too* complex. Policy makers may seek to achieve

“Parliament is just not allocating the time required for regular amendments to the various Acts that govern the tax system. This used to be a regular occurrence. But it seems both sides of politics are allergic to the type of fine tuning that is essential to any Tax Act.”
Industry stakeholder

“I’ve been told that Australia has the highest proportion of tax agents to taxpayers in the western world. It’s hard to back this view up, but given the complexity of our system, compared to others, it seems about right.”
Tax agent

¹⁹ This ignores the potential for a bill to become an Act after a joint sitting following a double dissolution election.

²⁰ Organisation for Economic Co-operation and Development (OECD) *Survey of Trends in Taxpayer Service Delivery Using New Technologies*, Centre for Tax Policy and Administration, OECD, Paris (2005).

²¹ PricewaterhouseCoopers, *2010 Total Tax Contribution Understanding the economic contribution of business*, 9.

policy goals that require a more complex tax system, and more complex tax systems may require greater compliance costs.

Notwithstanding the above, almost all stakeholders consulted for this Review indicated that compliance costs of Australia's tax system are too high (and getting higher) and that complexity was the principle driver of these costs. These views are consistent with arguments put forward in the Ralph Review, the Henry Review and *Re:think, Tax discussion paper* which identify excess complexity as an undesirable cost that needs to be reduced over time.

Stakeholders referred to the opportunity cost associated with existing compliance costs, and the potential benefits from using compliance-related resources for other purposes. Some stakeholders considered that the compliance costs could be reduced by approximately one third to one half by addressing complexity, which would likely lead to material economic benefits especially over the medium-to-long term. Stakeholders almost universally considered that the compliance costs could be reduced by changing various elements of the tax system without changing the underpinning policy goals. One industry stakeholder reflected the views of many others:

Compliance costs are far too high, and one of the reasons for this is that when policy makers are considering new taxation measures or legislation is one vital question is too often not asked: and that is, will this measure and how it needs to be complied with, impede commerce?

Only one stakeholder identified that there were any substantive benefits accruing from a highly complex system of tax policy and design.

“There are no real benefits to complexity that I can see. Complexity just creates costs to businesses, taxpayers and government which, in my opinion, are a dead weight loss to the system.”
Senior government official



DEFINING AND ANALYSING TAX SYSTEM COMPLEXITY, CULTURE AND BEHAVIOUR

6

This chapter provides an overview of the concepts underpinning complexity, drawing on a range of primary and secondary literature that explore the cultural and behavioural dimensions of a tax system.

6.1 Definitions

Complexity, like other concepts (such as efficiency or equity) lacks a simple definition and is potentially subject to competing dimensions.

It may be anecdotally convenient to equate complexity to some index of the growth in volume of tax legislation. However, short provisions of legislation may not be simple and long provisions may not be complex. Nor is the issue of complexity solely one of legal language: no application of plain English can render intelligible a poorly defined policy.²²

To address the conceptual tensions inherent tax system complexity and offer a definition of complexity that is relevant to the scope of this Review, ACIL Allen has undertaken a review of contemporary literature and government reports. A sample of the more relevant dimensions identified in the literature are outlined below.

6.1.1 Definitions of tax system complexity discussed in the literature

Operation of the tax system

Tax complexity is a multi-dimensional concept that cannot be easily defined—as already established above. One way to define complexity is to identify where it occurs (i.e. what stage it occurs) in the operation of tax system. According to this approach, it is possible to define (describe) complexity as:

- *policy complexity*. This type of complexity is a consequence of the choices made by policy makers during the policy design process
- *legislative complexity*. This type of complexity is a consequence of the decisions taken and processes used to draft tax laws
- *administrative complexity*. This type of complexity arises from the rules, practices and processes of tax authorities
- *compliance complexity*. This type of complexity arises from the tax calculation and planning behaviour of businesses and individual taxpayers.²³

These stages have been used in numerous government reports to analyse tax system complexity.

²² "Policy formulation," Ralph Review, accessed March 23, 2016, <http://www.rbt.treasury.gov.au/publications/paper4/part1/section1.htm>.

²³ B. C. Tran-Nam and C. Evans, "Towards the development of a tax complexity index," *Fiscal Studies: the Journal of Applied Public Economics* 35 (2014): 341-370.

Certainty versus uncertainty

Another dimension of complexity focuses solely on issue of certainty. The first type of complexity occurs where the law is relatively certain but requires considerable mechanical (or administrative) work to apply the law. For example, applying the Controlled Foreign Corporation (CFC) rules can be complex.²⁴

To administer these rules, ATO is required to consider multiple levels of ownership for each company shareholder and then aggregate them together in various combinations to see if the total exceeds the tax threshold. Administration of the CFC rules require a lot of time and skill; but there is relative certainty as to what the law says about the taxation of Controlled Foreign Corporations.

The second type of complexity arises where the law is not certain. For example, individuals want to know if a gain is a revenue gain (fully taxed) or capital gain (half taxed). Companies want to know if a loss is a revenue loss they can take against ordinary business income or a capital loss that will be quarantined against capital gains.

But the legislation provides no definition of revenue or capital gains or losses and, while the case law may now somewhat do so, classifying each gain or loss on a one-by-one basis by reference to a vast pool of precedents is a complex and costly process. This type of complexity is very different from the first type where the law is certain but it's complex to determine how it applies. In this case, the complexity is figuring out what the law says because the law does not provide clear guidance.

Complexity as a reflection of good tax design

The Office of Tax Simplification (OTS) in the UK has defined tax system complexity in terms of the long standing principles of a good tax system. These principles are universally understood to be:

- *Simplicity*. It is not possible to achieve certainty unless the taxes are simple and capable of being understood and dealt with by those liable to pay. A taxpayer should be able to know the tax they are due to pay before they pay it, without this being excessively difficult.
- *Stability*. Constant change adds to complexity and damages confidence in the tax system; without stability, certainty will be undermined as further changes may be needed to achieve tax objectives.
- *Efficiency*. A simple tax system will have low compliance costs and minimal distortionary impacts on taxpayer decision making.

Necessary versus unnecessary complexity

The principles are then used by OTS to distinguish between two main types of complexity; 'necessary' and 'unnecessary' complexity. Necessary complexity is 'the bare minimum amount of complexity required to properly administer the tax according to policy objectives, recognising that there will always be some complexity in tax'.

Unnecessary complexity refers to any unwarranted or unneeded aspect of a tax system that can include: outdated provisions; requiring information not needed to calculate tax; duplicate provisions to deliver the same policy intention; not abolishing obsolete rules; using the tax system to micro-manage the economy; or when there is a feature of the tax system that creates unnecessary problems.

Frequency of change and revision

Yet another way of understanding complexity is to consider the frequency of tax law change and the layering of tax changes upon a pre-existing (often inadequate) legislative base. This understanding of complexity focuses on the duplication, overlap and ambiguity caused by the introduction of new provisions (usually one at a time) over existing tax laws.

²⁴ Controlled Foreign Corporation (CFC) rules are features of an income tax system designed to limit artificial deferral of tax by using offshore low taxed entities. The rules are needed only with respect to income of an entity that is not currently taxed to the owners of the entity.

Taxpayer understanding and impacts

The concept of tax salience has also been used to define complexity within the literature. According to Mumford (2015) tax salience is:²⁵

... the gap between a taxpayer's perception of a tax obligation and the amount that is actually owed.

Mumford (2015) explains that a high tax salience generally indicates that taxpayers have an accurate understanding of the law, whereas low tax salience refers to a significant gap between a taxpayer's impression of legal obligations and those that actually exist.

Mumford further argues that low tax salience is not always a product of poor or complex tax legislation or drafting. Errors in taxpayer understanding of obligations can arise from a number of other factors.

Mumford also poses whether complexity is actually beneficial for those agencies who manage the tax system. Here the view that there are benefits in maintaining complex systems which are less easy to manipulate because taxpayers feel uncertain about the implications of manipulation.

6.1.2 Definitions of tax culture and behaviour discussed in the literature

There is a moderately extensive literature on the issues relating to tax culture and behaviour. Avi-Yonah, Sartori and Marian (2011) provide an overview of comparative tax law approaches as a study of cultural differences.²⁶ However, some of the references cited by Avi-Yonah et al (2011) are too focused on explaining the differences between national tax systems to be of significant use to this Review.

There is little literature focused on the issues addressed in this Review. For example, Livingston's (2005 and 2006) research assumes that tax cultures are different for reasons that do not necessarily correlate with a nation's general culture.

Livingston asserts that narrow and localised factors play a more important role than broad cultural norms which are often subject to misleading or overstated stereotypes. These arguments suggest that tax cultures are best understood as narrow indicators such as: the training of tax elites; the relationship between lawyers, economists and other tax professionals; the nature of tax administration; the attitudes towards tax evasion and compliance; and the unwritten tax policy traditions of a country.²⁷ Within this context tax culture is defined as:²⁸

Tax culture is an elusive concept, but may be defined to refer to the body of beliefs and practices that are shared by tax practitioners and policy-makers in a given society and thus provide the background or context in which substantive tax decisions are made....

Tax culture is related to but distinct from a country's broader political and social culture, so that (for example) a country might have a political or social culture that favoured a progressive distribution of tax burdens, but a tax culture that somehow or another impeded it; or conceivably the other way around.

Other explanations of tax culture focus more on the institutions involved in the tax policy and law design process. One such explanation has been provided Nerré (2008) who defines tax culture within the context of parliamentary, bureaucratic and tax industry interactions that change over time. These interactions generate social ties, expectations, behaviours and dependencies which ultimately shape the culture of a tax system. According to Nerré (2008):²⁹

A country-specific tax culture is the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country's culture, including dependencies caused by their ongoing interaction.

²⁵ Ann Mumford, "Tax Complexity, Tax Salience and Tax Politics", *Social and Legal Studies: An International Journal*, 24(2) (2015).

²⁶ Reuven Avi-Yonah, Nicola Sartori and Omri Marian, *Global Perspectives on Income Tax Law* (USA: Oxford Press, 2011).

²⁷ Michael Livingston, "Law, culture, and anthropology: On the hopes and limits of comparative tax", *Canadian Journal of Comparative Law and Jurisprudence* XVIII(1) (2005).

²⁸ Michael A. Livingston, "From Milan to Mumbai, changing in Tel Aviv: Reflections in progressive taxation and progressive politics in a globalized but still local world," *American Journal of Comparative Law* 54 (2006): 555-86. See also, Michael A. Livingston, "Law, culture, and anthropology: On the hopes and limits of comparative tax," *Canadian Journal of Comparative Law and Jurisprudence* 18(1) (2005): 119-34.

²⁹ Birger Nerré, "Tax Culture: a Basic Concept of Tax Politics," *Economic and Policy Analysis*, 38(1) (2008): 153-67.

6.1.3 Working definition of tax system complexity, culture and behaviour

This chapter has considered numerous ways of defining tax system complexity, culture and behaviour. Each of these approaches have merit and go some way to defining what is a complex multi-dimensional phenomenon. However, no single definition is adequate to cover the breadth of dimensions outlined in the literature and described to ACIL Allen during the consultations undertaken from this Review.

For these reasons we have adopted a blended definition of tax system complexity, culture and behaviour as outlined below:

Unnecessary complexity in tax policy and law arises from interactions between participants (who pursue their own as well as common tax system principles) operating at different stages within the tax system. These interactions generate uncertainty in policy and law which in turn generates a gap between a taxpayer's perception of a tax obligation and the amount that is actually owed, and opportunities for tax system manipulation. To minimise this uncertainty participants frequently introduce new tax policies and laws and constantly make changes to existing tax policies and laws.

6.2 Analysing the impact of complexity

While there is general agreement amongst all stakeholders consulted for this Review that complexity delivers costs to the economy and taxpayers which should be avoided, there is less consensus (especially in the literature) on how to measure and analyse complexity. One common approach is to consider the compliance burden of complexity, while other approaches draw on metric and driver-based analytical techniques to measure complexity. Each of these approaches are discussed below.

6.2.1 Economic burden of compliance

Compliance burden is the time spent engaging with the tax system that includes completing and lodging a tax return, maintaining tax records or substantiating eligibility. *Re:think, Tax discussion paper* suggests that Australia's tax system is a major contributor to the regulatory burden faced by businesses and the broader economy.

Estimates provided by the ATO to the *Re:think, Tax discussion paper* suggest that tax system compliance costs are significant. *Re:think, Tax discussion paper* further suggests that the cost of managing an individual's tax affairs can be significant and is growing (the average cost per taxpayer has risen from \$200 to approximately \$400 per annum between 1990 and 2010). It also suggests that more than 70 per cent of taxpayers in Australia lodge their tax return through a tax agent.³⁰

6.2.2 Metrics of complexity

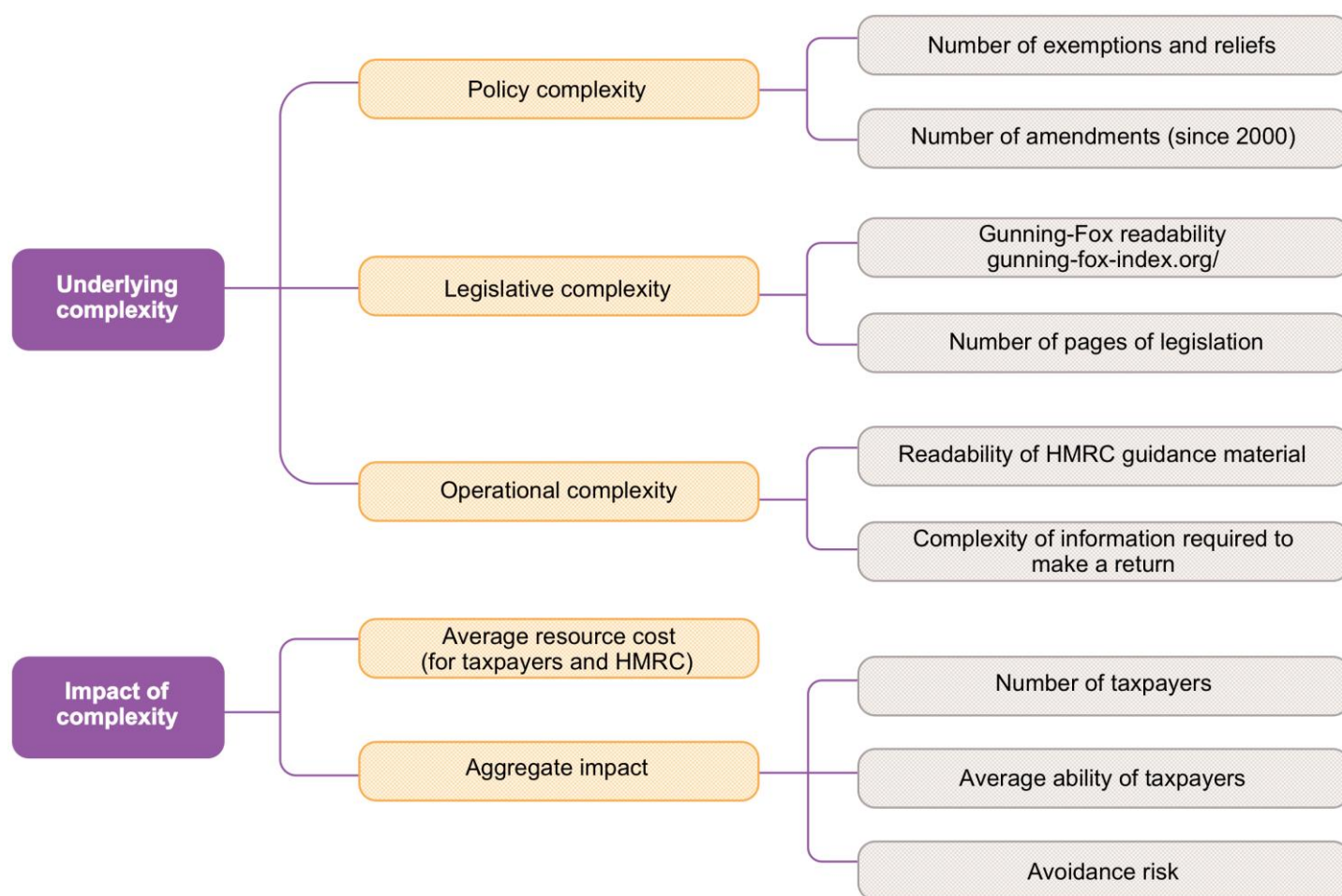
Other approaches have argued that 'compliance burden' is only one measure of complexity in the tax system and a broader set of metrics are required to identify the areas where the law is most in need of simplification. An example of a popular approach (based on considerable academic research) is the OTS' tax complexity index. The index was originally designed to give a single star rating for each area of tax. The index has been used to prioritise simplification projects, by indicating which areas of tax are most complex and why.³¹

In its paper on the index, the OTS suggests that complexity can be separated into two discrete measures: 1) a measure of underlying complexity and 2) the impact of complexity. A number of factors underpin each measure of complexity as shown in **Figure 6.1** below. These factors are weighted and then summed to arrive at an overall measure of complexity for the UK tax system.

³⁰ "Australia's future tax system," Henry Review, accessed March 23, 2016, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm>.

³¹ OTS, "The Tax Complexity Index," accessed March 16, 2016, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/438587/OTS_complexity_index_methodology_June_2015.pdf.

FIGURE 6.1 OTS TAX COMPLEXITY INDEX



SOURCE: OFFICE OF TAX SIMPLIFICATION AND HM TREASURY, DEVELOPING A TAX COMPLEXITY INDEX FOR THE UK, OFFICE OF TAX SIMPLIFICATION AND HM TREASURY, LONDON, VIEWED 9 DECEMBER 2014: WWW.GOV.UK/GOVERNMENT/UPLOADS/SYSTEM/UPLOADS/ATTACHMENT_DATA/FILE/285944/OTS_DEVELOPING_A_TAX_COMPLEXITY_INDEX_FOR_THE_UK.PDF AND RE:THINK, TAX DISCUSSION PAPER

An alternative approach has been offered by Tran-Nam and Evans. Instead of differentiating between underlying complexity and the impact of complexity, Tran-Nam and Evans have developed separate measures for business and personal tax. These measures include the number of:

- federal, state and local taxes
- requests for private rulings from the ATO
- external disputes; the use of tax agents by personal taxpayers; and frequency of reporting and payments for business taxpayers.³²

6.2.3 Drivers of complexity

An entirely different analytical approach is to consider the sources or drivers of complexity. Australian tax law professors, Binh Tran-Nam and Chris Evans have analysed complexity from the perspective of the sources which generate the complexity in the first place.³³ According to Tran-Nam and Evans there are a number of sources of tax complexity in the literature, however, what is important is whether these sources are within or outside the control of government. This approach brings out the prospect of simplification 'from government's perspective in that it does not seem to be reasonable or justifiable to simplify the tax system by working with factors that are beyond its control.'

³² Binh Tran-Nam and Chris Evans, "Towards the development of a tax complexity index," *Fiscal Studies: the Journal of Applied Public Economics* 35 (2014): 341-370.

³³ The Treasury, *Re:think, Tax discussion paper* (Canberra: Commonwealth of Australia, 2015).

For Tran-Nam and Evans complexity is derived from known sources that encompass: manipulation by advisors; poor legislative drafting; the use of tax law to achieve complex policy goals; and the greater complexity of international commercial transactions. A full description of each source is provided in **Box 6.1** below.

BOX 6.1 SOURCES OF COMPLEXITY (WITHIN AND OUTSIDE THE CONTROL OF GOVERNMENT)

Within the direct control of government

There are a number of sources of complexity that are directly within the control of government. These include:

- *Protection of tax revenue.* A certain degree of tax complexity (basic institutions, anti-avoidance measures, etc.) is necessary to ensure that a given amount of tax revenue can be collected and that the integrity of the tax base can be maintained.
- *Use of tax law for non-revenue policy objectives.* The tax system is often used to redistribute income and achieve other socio-economic objectives (e.g. tax of 'sins' or negative externalities).
- *Distinction between taxes and transfers.* The fact that transfers are not treated as negative taxes complicates the tax-transfer system.
- *Broadening of tax base.* Tax base broadening typically increases the number of taxpayers and thus raises effective complexity (e.g. replacement of the Wholesale Sales Tax (WST) by the Goods and Services Tax (GST) in Australia in 2000).
- *Frequency of tax law change.* This makes the tax system more complex because of the need to learn new legislation and the cumulative effect of legislative changes, thus giving rise to both legal and effective complexities.
- *Tax law drafting.* Poorly drafted tax laws (whether in the linguistic sense, in the organisational scheme or in the 'principles versus rules' approach) cause statutory complexity.
- *Minimisation of tax revenue losses.* Tax administrators often attempt to minimise revenue losses through a variety of practices (e.g. compulsory lodgement of tax returns or frequent reporting of business income) that can increase procedural complexity.

Partly within the direct control of government

Some sources of complexity are, however, only partly within the direct control of government. They include:

- *Tax culture.* An adversarial tax culture between tax authorities and taxpayers may increase the level of effective complexity (e.g. the high-tax-planning—high-auditing scenario).
- *The economy.* The growing complexity of the domestic and global economy (the use of complex business structures, more people owning equity investments, globalisation, etc.) contributes to effective complexity.

Outside the direct control of government

Finally, there are a number of sources of complexity that government cannot directly control, though various policy interventions may be able to 'nudge' taxpayers in more favoured directions. Sources essentially outside government control include:

- *Household and business preference for tax liability minimisation.* Taxpayers may prefer more complexity to lower their tax liabilities (e.g. the 'tax refund' culture in Australia).
- *Tax practitioner preference for complexity.* Many tax practitioners may prefer a certain degree of complexity to generate chargeable hours.
- *Aggressive tax planning.* The engagement in aggressive tax planning by a partnership between high-risk tax practitioners and high-risk taxpayers gives rise to effective complexity.

SOURCE: ADAPTED FROM TRAN-NAM AND EVANS (2014) TO MEET THE SCOPE OF THIS REVIEW

These sources accord (to some degree) with the drivers of complexity outlined in *Re:think, Tax discussion paper*. According to Treasury, the key drivers of complexity are:

- artificial boundaries and distinctions that do not reflect commercial or economic differences
- patching the law to fix particular outcomes (especially by adding specific integrity measures to address apparent weaknesses in the tax law)
- attempts to provide certainty for particular groups of taxpayers or transactions
- attempts to minimise compliance costs or adverse outcomes of reform for existing situations (otherwise known as grandfathering and the use of concessions)
- complex drafting styles.

6.2.4 Analysing the cultural and behavioural aspects of the tax system

Examination of the cultural and behaviour aspects of tax system complexity is an important focus of this Review. Culture, values and norms influence how tax policy is developed, translated into law, implemented and administered. Culture, values and norms also influence how tax practitioners and taxpayers engage with the ATO and comply with their obligations.

As part of the literature review undertaken for this project, ACIL Allen identified two models for analysing the cultural (and thus the behavioural) dimensions of tax systems. The first model draws on Richardson's (2007) adaptation of Hofstede's (1980) cultural framework, which comprises the four major cultural dimensions of: individualism; power distance (or pluralism); uncertainty avoidance; and masculinity (as defined by a focus on achievement, heroism, assertiveness and material success).³⁴ Additional detail about each dimension is provided in **Box 6.2** below.

BOX 6.2 HOFSTEDÉ'S FOUR DIMENSIONS OF CULTURE

1. Individualism vs collectivism.
2. Large vs small power distance. Power distance is the extent to which members of a society accept that power in institutions and organisations is distributed unequally. People in large power distance societies accept a hierarchical order. People in small power distance societies strive for power equalisation and demand equality. The fundamental issue is how a society handles inequality. It has consequences for the way people build their organisations and institutions to deal with inequalities.
3. Strong vs weak uncertainty avoidance. Uncertainty avoidance is the degree to which individuals feel uncomfortable with uncertainty and ambiguity.
4. Masculinity vs femininity. Masculinity stands for a preference in society for achievement, heroism, assertiveness and success. Femininity stands for a preference for relationships, modesty, trust and quality of life.

SOURCE: HOFSTEDÉ 1980

Richardson suggests that little of the research on international tax systems has considered the issue of culture. In doing so, Richardson, cites a range of well-known international scholars in the area of public policy and international finance to demonstrate his case in point.

For example, he argues that while Peters' (1991) research suggests that the political culture of a country drives government toward formulating one type of solution instead of another for its tax problems (using cluster analysis of 22 OECD countries), his research does not explain why tax systems become complex over time.³⁵

By way of further example, Richardson considers the research of Rose (1985)³⁶ and Wildavsky (1985)³⁷ which analyses the role of government in tax and expenditure decision making but dismisses the research as being too focused on national budget (especially expenditure processes), and therefore not sufficiently focused on tax culture and behaviour.

Owing to the void in the literature, Richardson builds his own model of tax culture based on Hofstede's dimensions, but adds a fifth dimension to recognise the model's application to the tax system:³⁸

Long term vs short term orientation. Long term orientation comprises values of persistence, status, thrift and having a sense of shame. Short term orientation comprises values of personal steadiness and stability, protecting your face, respect for tradition and reciprocity of greetings.

Richardson then applies meso-level analysis to consider a tax system sub-culture which he sees is linked to but distinct from the broader political culture of a nation.³⁹ For Richardson, these dimensions drive both the overall design and day-to-day behaviour of participants within a national tax system. Importantly these dimensions identify aspects such as external influences, ecological factors, tax

³⁴ Grant Richardson, "The influence of culture on tax systems internationally: a theoretical and empirical analysis," *Journal of International Accounting Research*, 6(1) (2007): 57-79.

³⁵ Guy Peters, *The Politics of Taxation: A Comparative Perspective*, USA: Wiley.

³⁶ Richard Rose, "Maximizing Tax Revenue while Minimizing Political Costs", *Journal of Public Policy*, 5 (1985):289-320.

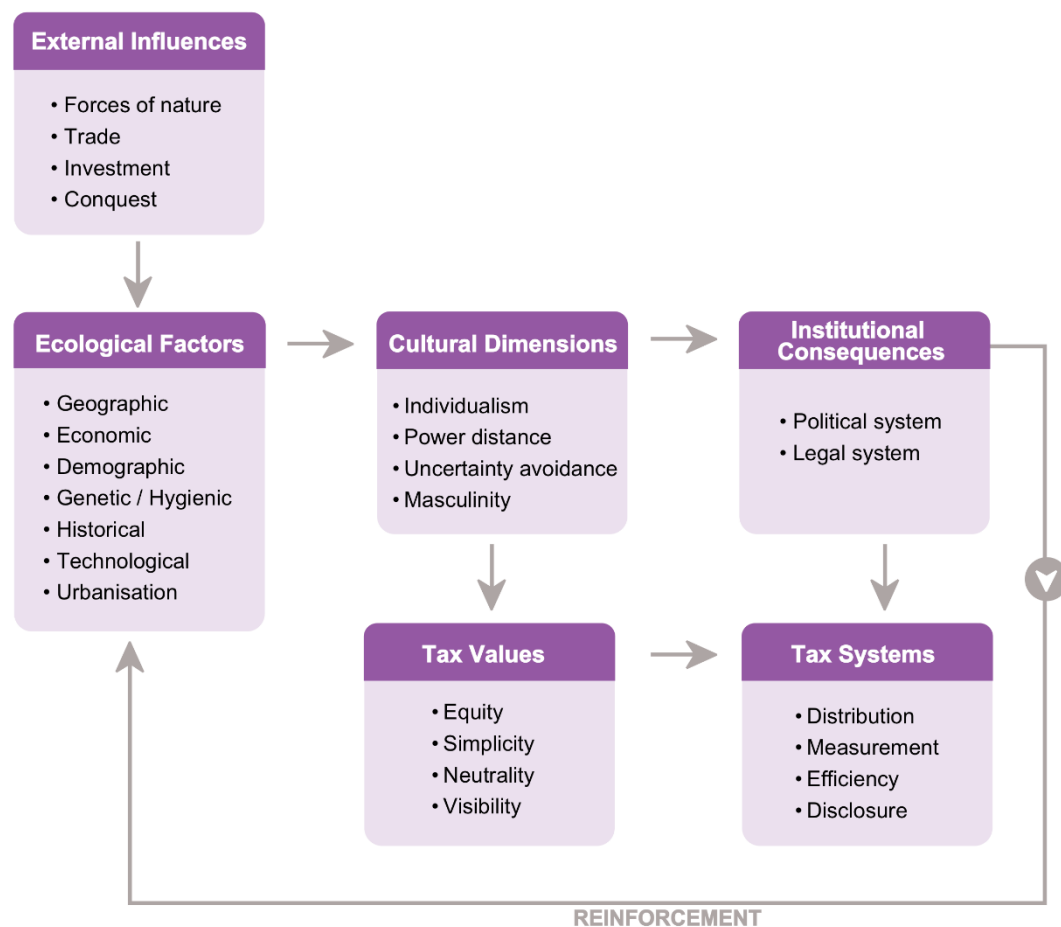
³⁷ Aaron Wildavsky, "A Cultural Theory of Expenditure Growth and (Un)Balanced Budgets", *Journal of Public Economics*, 28 (1985): 349-357.

³⁸ Grant Richardson and Roman Lanis, "The influence of culture on tax administration practices," *Australian Taxation Forum* 15 (2000): 359-386. See also Grant Richardson, "The influence of culture on tax systems internationally: a theoretical and empirical analysis," *Journal of International Accounting Research*, 6(1) (2007): 57-79.

³⁹ Michael Livingston, "Law, culture, and anthropology: On the hopes and limits of comparative tax", *Canadian Journal of Comparative Law and Jurisprudence* XVIII(1) (2005).

values, institutional activities as shown in **Figure 6.2** below. According to Richardson, these aspects are elements of the tax system that are common to many OECD nations.⁴⁰

FIGURE 6.2 RICHARDSON'S MODEL OF TAX CULTURE



SOURCE: GRANT RICHARDSON 2007

The second model considered by ACIL Allen for this Review focuses on the interactions between participants in the tax system and the affect these interactions have on tax culture. According to Nerré (2008), the culture of a nation's tax system shapes how participants interact within the tax code, which is also impacted by the broader political and social culture of a nation.

The Nerré model has the benefit of specifically focusing on the role that politics and policy decision making play within tax system design. In particular, the model suggests that a nation's tax culture is the entirety of all relevant institutions connected with the tax system and its practical execution.

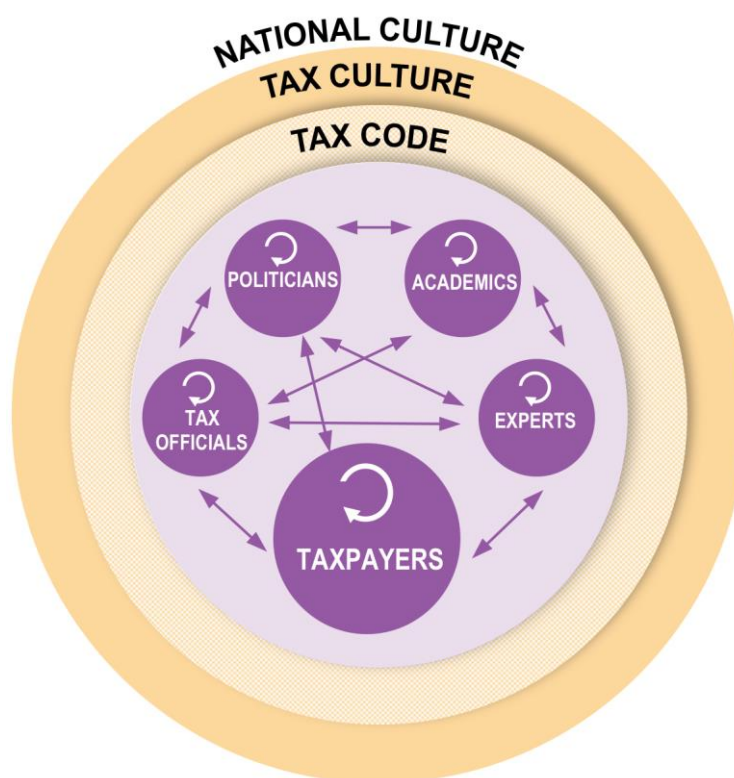
Accordingly, a nation's tax culture is underpinned by more than a 'culture of taxation' and 'taxpaying culture'. It is also determined by the broader cultural norms of a nation and the institutions which develop tax policy and law.

In short, the broader cultural norms set the environment and constraints (i.e. the rules of the game) within which taxpayers, politicians, tax officials, experts, tax advisors, and academics interact.

Under the Nerré model, institutional conflicts are an inevitable aspect of tax policy and law as participants pursue their own often competing principles/agendas.

An overview of the model is provided in **Figure 6.3**.

⁴⁰ Grant Richardson, "The influence of culture on tax systems internationally: a theoretical and empirical analysis," *Journal of International Accounting Research*, 6(1) (2007): 57-79.

FIGURE 6.3 A MODEL OF TAX CULTURE AND PARTICIPANT INTERACTIONS

SOURCE: NERRÉ (2008)

6.2.5 Which approaches withstand scrutiny?

This section has considered several approaches for measuring and analysing tax system complexity, culture and behaviour. However, in ACIL Allen's view, not all of these approaches will be relevant to the Australian context nor will they help government to deliver simplification over time.

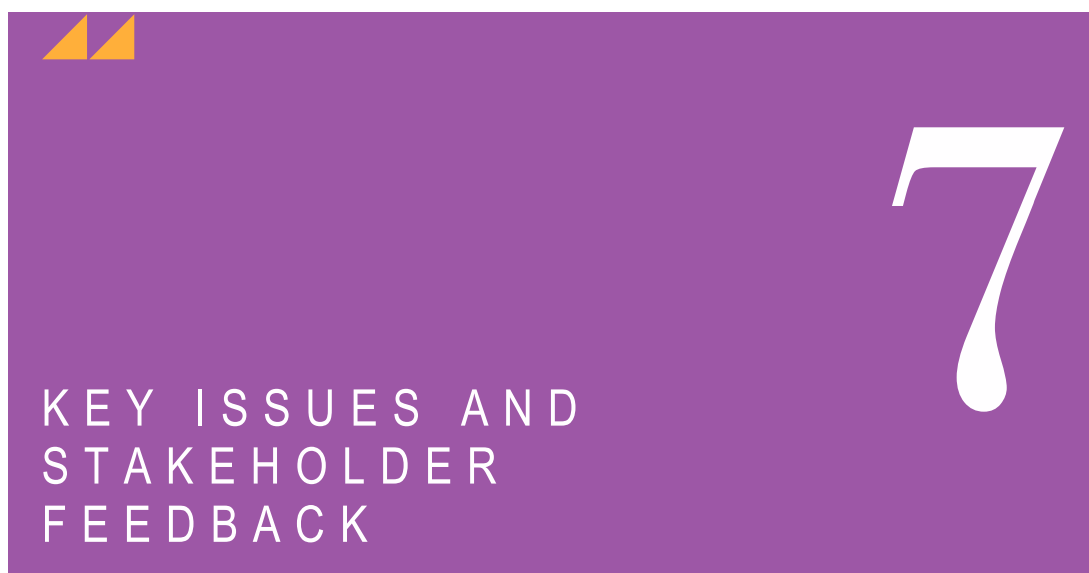
While complexity indexes have received increasing attention from academics and governments around the world, they can be potentially complex in their design and ultimately difficult to understand.

Such complexity can be at odds with the intention of the index which is to identify key aspects of complexity and provide a platform from broader community acceptance about change. As such, we suggest an approach which seeks to measure the true costs or economic burden of complexity will deliver information that is more useful to participants within the tax system.

Furthermore, in ACIL Allen's view it is perhaps more useful to focus on the drivers (or sources) of complexity for analytical purposes than it is to develop a complexity index. By focusing on the drivers, the analysis can explore dimensions of participant behaviour, cultural norms and practices and identify where there are competing tensions or discordance between participants. While it is possible to explore these dimensions through a complexity index, indexes place less emphasis on participant interaction and are therefore less useful to a Review of this nature.

Finally, this section has examined some literature related to tax system culture. It has identified two models which provide useful analytical reach into tax system complexity. The Richardson approach identifies the key values held by tax system participants and locates these values within a context that includes national and international environmental factors.

The Nerré approach focuses more heavily on participant interactions as key shapers of tax system outcomes. In ACIL Allen's view both approaches have considerable merit (due to their overall alignment with the scope of this Review and the feedback gained from stakeholders) and are subsequently drawn upon developing solutions to the problem of tax system complexity.



This chapter discusses the key issues that were identified during stakeholder consultations conducted for this Review. These issues can be characterised as relating to the:

- policy development process—i.e. the development of intrinsically complex policy
- legislative drafting process—i.e. the translation of policy into legislation
- interaction of the policy development and legislative drafting processes.

While complexity can also arise from the way tax policy is administered, issues relating to this source of complexity were outside the scope of this Review.

7.1 Overview of issues relating to policy development

Complexity in the development of tax policy was a major theme of the stakeholder feedback collected for this Review. The key issues underpinning policy complexity are discussed below.

7.1.1 A culture of distrust

Cultural factors were seen as key drivers of complexity in policy development. In particular, many stakeholders indicated that a lack of trust between the ATO and tax practitioners/industry was an underlying factor behind much of the complexity of the system.

Some stakeholders indicated that a component of the Australian political culture—a desire to avoid paying tax—drives a lot of mistrust in the system. This mistrust generates policies aimed at preventing tax avoidance amongst a small number of taxpayers, which often impacts the entire taxpaying community.

7.1.2 Australia as a bicameral federation

Many stakeholders stated that the bicameral nature of the Commonwealth Parliament is a source of policy complexity. Key elements include the need to obtain Senate approval of tax legislation and the widespread perception that the parliamentary process focusses more on equity than efficiency issues in relation to tax. Furthermore, the ability of states to levy taxes also increases the complexity of the tax system. Stakeholders recognised that these matters are an essential part of Australia's political system and that it is unrealistic or even undesirable to change them.

Some stakeholders also perceived that policy makers were too open to lobbying by interest groups. These stakeholders expressed the view that lobbying increased the complexity of policy and introduced special rules for particular interests.

Other stakeholders considered that lobbying had a small impact on the overall design of tax policy and was not a significant driver of complexity.

“In 2016, tax policy is not developed with stakeholder input at the front end, where it needs to be. The engagement more commonly at the point when the ATO has to work out how to apply the law.”
Industry stakeholder

“Political deals to get legislation passed are a huge source of complexity.”
Senior policy official

7.1.3 Lack of a strategic policy position

*“We are never given an overall strategic policy position for the tax system by government.”
Tax policy official*

A significant number of stakeholders indicated that frequent “chopping and changing” in tax policy generate significant complexity. These stakeholders identify a lack of an overall strategic policy position as the main cause of these changes.

7.1.4 Accumulation of policy changes over time

*“We keep band-aiding the system to fix the policy mistakes of the past. The problem is that we often create more issues than we resolve with each new band-aid.”
Senior government official*

A large majority of stakeholders expressed a view that the complexity of the system reflects a historical accumulation of policy changes, which have been made at different times to meet different objectives, and address different weaknesses in tax law.

Policy measures add complexity onto existing complexity.

7.1.5 Intrinsically complex policy

*“There needs to be a checklist to guide all new tax law, including the objective of each new piece of legislation or amendment. And panels of experts charged with reviewing the most egregious sections of the Act.”
Industry stakeholder*

A number of stakeholders, especially tax agents, considered that intrinsically complex policy is a source of complexity. One stakeholder gave an example of complex policy being the use of different tax rates for different business and legal structures.

These varying tax rates require the existence of a strong compliance framework. In this case, a policy decision to have a variety of legal structures with different tax rates results in an irreducible level of complexity. On the other hand, some stakeholders considered that complex policy is not an issue; instead, the issue is complex legislative drafting.

A number of stakeholders stated that the policy decision to reduce income tax for small business (as announced in the 2015-16 Commonwealth Budget) was an example of a policy decision that increased complexity. Some stakeholders stated that the definition of a small business and the way it applies to a company drove considerable complexity in the legislation.

Many stakeholders indicated that anti-avoidance tax measures were a source of complexity.

The use of grandfathering also made the tax system very complex.

*“Can’t be seen to be having any losers or rough edges in the system.”
Senior policy official*

The vast majority of industry stakeholders stated that the lack of ‘safe harbour’ provisions in the tax law made taxpayers’ compliance with their obligations more challenging. These stakeholders considered that expanding such provisions would reduce the challenge of complying with tax law. Some stakeholders indicated that the ATO is investigating the potential use of safe harbours as a way of reducing complexity in the current tax system.

7.1.6 Use of the tax system to achieve social and economic goals

Many stakeholders considered the use of tax law to influence behaviour and achieve social or economic goals to be a source of complexity in the tax system.

Stakeholders overwhelmingly stated that drawing on fairness and equity as principles of policy design system has increased the complexity of the system. The overwhelming majority of stakeholders consulted stated that it was not good to mix tax policy with social and industry policy. While individual measures may be considered to have value, collectively, they increase the complexity of the tax system substantially.

7.1.7 Consultation process

Stakeholders from the tax advisory community considered that there is a need for Treasury to strengthen the consultation process (especially at the conceptualisation stage) that underpins tax policy development.

Many stakeholders from the professional bodies cited the manner in which tax policy is developed in NZ, where there is a generally agreed period of consultation driven by public officials before a Minister makes a policy decision, as a good practice model that could be applied to the Australian context.

Stakeholders stated that the current level of consultation is insufficient and leads to materially greater complexity in the tax system than needed or desired. One key theme from consultations was that

there is insufficient conceptual clarity about the purposes of tax policies and that the current level of consultation does not allow sufficient time and consideration to develop that clarity.

These stakeholders also indicated that the policy development process does not adequately focus on understanding how new tax policy proposals interact with the existing tax system. In addition, stakeholders considered that policy makers and the general community have a low level of understanding about the efficiency and distributional impacts of existing taxes.

One industry stakeholder indicated that a source of complexity for multinational corporations is that Australia develops its own approach to policies rather than drawing on policies that exist in other countries. This increases operational costs for these firms.

7.1.8 Lack of political salience

Another key theme was that reducing complexity in the tax system does not currently have political salience, as the costs of tax complexity are distributed across many parties and there is an entire industry that may benefit from the existing complexity.

In addition, Ministers are well-known for announcing policies that require implementation through the tax system before detailed analysis of their implementation arrangements has been undertaken. This has placed considerable pressure on tax authorities to adjust the tax system to meet policy requirements and not the other way around. The result (more than often) is a high degree of complexity.

Furthermore, the complexity of a tax policy is often heightened as a result of industry lobbying.

One policy stakeholder stated that there should be regular review of tax legislation, and that all tax expenditures should be subject to sun-setting. There should be a commitment to evaluate tax legislation on an ongoing and systematic basis.

7.1.9 Tax as a cost

A small number of stakeholders, especially the academics and major tax advisors consulted for this review, noted that tax systems were much simpler in countries, such as Hong Kong, in which the rate of corporate income tax is substantially less than Australia. There is little interest in reducing the amount of tax paid in those countries as it is not a significant cost.

This insight is unlikely to be useful in relation to Australia given the substantial differences in economic models, tax, and social security models, unless there is a medium-to-long term policy agenda of reducing income tax rates.

7.2 Policy development issue 1: Build understanding about the costs of tax system complexity

7.2.1 What is the issue?

There was a commonly held view amongst many stakeholders that policy makers did not understand the costs of complexity in the existing tax system nor the potential costs of complexity associated with proposed new tax policy proposals. This knowledge gap was a key factor underpinning the perceived lack of consideration given by policy makers to the impacts that new policies could have on complexity.

While there has not been a thorough study of the costs to taxpayers of complying with their tax system obligations, many stakeholders considered that costs of compliance estimated in the *Re:think, Tax discussion paper* was consistent with their perceptions.

Re:think, Tax discussion paper also asked stakeholders for their views on the potential to have a single measure of complexity. The stakeholders consulted for this Review were lukewarm about having a single metric, but warned against reporting complexity in a way that only a small number of experts could comprehend.

“There is far too much haste. Ministers’ make announcements before stakeholders have been engaged and can flag unintended consequences on individuals and companies.”
Professional body stakeholder

“We seem to have a talent for complexity in this country that is not matched by other mature tax systems.”
Industry specialist

“The ATO and the professional bodies probably have the best helicopter view of how policy change in one area of tax will likely affect another area. Treasury needs to tap into this far more before it advises Ministers, or puts up its own policy recommendations.”
Industry stakeholder

Many stakeholders stated that a key issue was with policy makers not understanding the likely costs of complexity associated with new policies. Some stakeholders stated that it is relatively common for new policies to appear simple and straightforward but to be very complex in their implementation.

A few stakeholders gave an example of such a policy as being the 2015 budget initiative of an immediate tax deduction for all individual small business assets costing under \$20,000.

Some stakeholders stated that policy makers did not understand the opportunity cost of complexity. One senior policy stakeholder considered that the costs to taxpayers of complying with their tax system obligations could be reduced by about half without impacting the overall equity of the tax and transfer system.

Many stakeholders (especially the tax system experts consulted for this Review) commented that the benefits from reducing the costs of complexity were material and worth pursuing. In particular, they saw tax system simplification as a future microeconomic reform in Australia.

A number of stakeholders considered that Australian policy makers and other tax system participants had limited understanding of the extent to which provisions of tax policy were developed for equity and other non-efficiency goals, such as GST exemptions for fresh food, actually contributed to the attainment of those goals. This lack of background knowledge was seen to contribute to policy makers having a less than optimal background knowledge when considering policy.

Another view among key stakeholders was that Ministers were not informed of the likely costs to society of implementing and administering a proposed new tax policy, with focus instead on the fiscal impacts.

Policy makers would gain a greater understanding of the costs of complexity if Treasury presented to them the implementation and administration costs for a proposed policy (in total and across different sectors of the economy) in addition to the associated fiscal impacts. ACIL Allen has not reviewed the types of information provided to Ministers in conjunction with a proposed policy, but it would be expected that this suggestion would lead to policy makers taking the impacts on complexity more into account if stakeholders' perceptions of the information provided to Ministers is accurate.

Stakeholders also perceived that the wider community has a low level of understanding about the costs of complexity except insofar as they are personally affected. Stakeholders considered that increasing the community's knowledge about the costs of complexity would enhance overall debate on tax policy and the level of policy more widely.

Last, it should be noted that a small number of stakeholders disputed the widespread view that the tax system is complex. In the view of these stakeholders, the tax system is not complex as the market has provided solutions (i.e. tax agent services) that taxpayers can purchase to bypass complexity.

This Review does not take a view on the amount or degree of complexity in the tax system, as there is no single definition or measure of complexity. Like many things, tax complexity is difficult to define but it is recognisable when present. In any case, the important point is that the overwhelming number of stakeholders consulted *perceive* it to be excessively complex, and that excessive complexity generates costs which should be avoided if possible.

7.2.2 What are the causes?

The causes of a lack of understanding about the costs of tax system complexity are likely to include different views about the meaning of complexity, a limited level of research on the costs of complexity, and limited dissemination of those research findings.

7.2.3 What can be done?

The Review has identified a number of building blocks which may improve the community's and policy makers' understanding of the costs of tax system complexity.

A key suggestion going forward would be to improve understanding of the costs of tax system complexity amongst the broader stakeholder community. In order to improve this understanding it will be important to undertake a study of the costs to taxpayers and taxpayer cohorts of complying with their obligations, and the economic costs associated with different taxes and tax mixes.

“Treasury has stopped doing the work it should be doing to understand the impact of proposed policy on businesses in particular. This is cultural, but it's due also to it not having enough warm bodies to do the consultation it should be doing.”
Industry stakeholder

It would also involve identifying which parts of each law give rise to the most complexity so they could be targeted for reform (e.g. do concessions for cars or the concessions for in-house meals impose greater compliance costs in the FBT; do concessions for food or the rules for deposits give rise to greater compliance costs with the GST?).

This study would increase the level of information publicly available about the costs of complexity in the existing tax system. While *Re:think, Tax discussion paper* estimated the annual cost of complying with tax system, there is limited robust research about the different dimensions of complexity and how different parts of Australian society and the economy wear the costs of a complex system.

A public inquiry would provide a solid evidence base on the costs of complexity for policy makers and the Australian community. Such an inquiry could be repeated approximately every five years to provide a rolling up-to-date published brief of evidence.

It may also be necessary to improve the quality of information about new policy proposals or changes to legislation. Compliance cost impact statements are provided to Government in RIS¹ at the decision making stage, and in explanatory memoranda. However these costs cannot be assessed with great precision and this poses a significant challenge. If this challenge could be met it would help to generate a common understanding among Ministers and their advisors about the true costs of changing the tax law. Publishing accurate information about the anticipated costs of complexity for a proposed tax policy may also strengthen community understanding and appreciation of those costs.

7.3 Policy development issue 2: Highly adversarial nature of national tax debates and a lack of shared understanding about the future direction of the tax system

7.3.1 What is the issue?

Many stakeholders stated that tax debate in Australia is highly politicised and adversarial. Tax is a contested area of public policy and stakeholders perceived the Australian tax system to be subject to much greater and more frequent changes than in other countries.

Stakeholders agreed that tax is an inherently political area of policy, and that it is appropriate in the Australian democratic system for the values of voters (as expressed through elections) to impact the development of the tax system. However, while recognising this point, many stakeholders considered that it would be very useful to reduce the heat in tax debate. The tax debate in other countries was perceived as far less adversarial.

Stakeholders considered that there is a low level of general knowledge about the tax system in Australia among politicians, industry, and the general public, relative to a preferred level of knowledge. Stakeholders perceived that this low level of knowledge helps provide the conditions for a less informed debate on tax matters.

Many stakeholders also stated that one of the major issues associated with tax policy development in Australia is that there is no shared understanding among government, tax professionals, industry, and the community about a future direction for the development of the Australian tax system. There was a view in some quarters that this had led to an unanchored tax policy debate in recent years.

7.3.2 What are the causes?

Identifying and analysing the full range of causes of the highly adversarial culture of debate would require an in-depth sociological, historical and political study. Many stakeholders considered that this behaviour was engrained in Australia's political culture and would be very difficult to change without significant leadership from the major parties.

Stakeholders did mention that a low level of awareness about the objectives of a tax system may be one factor.

“Tax is a political battleground in Australia, where there is little culture of consensus or common sense.”
Senior policy official

“Tax is a political battleground in Australia, unlike New Zealand.”
Senior policy official

“One of the fundamental reasons tax is a political football in Australia is because there is no consensus on what the tax system is supposed to do. Is it a revenue tool, or an instrument of policy? Agreement about this would clarify how the system develops in the future.”
Industry stakeholder

7.3.3 What can be done?

ACIL Allen has identified a National Compact as one potential way of helping to shape and change expectations regarding the future of the tax system and debates about the tax system. This Compact would take the form of an agreement across a broad and diverse system about the principles and behaviours that should shape the ongoing evolution of the tax system.

The Compact should seek to gain endorsement across all levels of government, with the Commonwealth Government championing the Compact in partnership with state and territory governments, industry representatives, the tax agent community and political parties.

The agreement would seek to provide a common framework for debate which reduces the intensity of conflict among key decision makers within the tax system.

7.4 Policy development issue 3: Inadequate processes for developing policy and undertaking post-implementation reviews

7.4.1 What is the issue?

Many parties expressed views that there is insufficient consultation with stakeholders during the development of tax policy, leading to greater complexity in the system than is needed.

Stakeholders also expressed the view that consultation after the implementation of tax policy is inadequate. There was strong support for more robust consultation during the policy development phase, and after its initial implementation phase.

Treasury and the ATO do undertake a substantial amount of consultation on proposed tax policies. For example, Treasury had five processes open for consultation as at 10 March 2016, including on the proposed objective of superannuation. Consultation can be public or targeted:

- the public process will involve the publication of an initial discussion paper followed by an exposure draft of legislation or regulations, and
- a targeted process, which is more tightly focussed on particular stakeholders. Targeted processes can either be confidential or public.

The extent of consultation undertaken on a policy proposal is determined by factors including the knowledge that Treasury and ATO have about industry conditions and stakeholders' understanding of policy. For example, significant consultation was used in relation to consulting on the carbon price mechanism, while a basic approach to consultation is used in relation to implementing well-understood policy in ordinary industry conditions.

The Treasury Revenue Group has also undertaken a program of biannual non-transactional consultations with stakeholders and increased the extent of its early stage pre-policy consultations.⁴¹

The ATO has a consultation framework which comprises:⁴²

- a number of consultation groups that provide forums for consultation in specific areas and stewardship of the broader tax and super systems
- a Consultation Hub within the ATO to coordinate matters raised for consultation⁴³
- other types of consultation
- the consultation process (see **Box 7.1** below).

This framework is supported by the policy and consultation processes of other government agencies who interact with the tax system (such as the departments of Health and Education).

“There is no reason why there cannot be an agreed process of engaging stakeholder before a tax policy or measure is decided, including a minimum timeframe. This would go a great distance to getting better and less complex outcomes.”
Industry stakeholder

⁴¹ Rob Heferen, Nicole Mitchell and Ian Amalo, “Tax Policy Formulation in Australia,” *Economic Roundup 2* (2013), accessed March 10, 2016, <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/Economic-Roundup-Issue-2/Economic-Roundup/Tax-policy-formulation-in-Australia>.

⁴² See <https://www.ato.gov.au/General/Consultation/About-consultation/ATO-consultation-framework/#Consultationprocess>.

⁴³ Matters discussed at stewardship groups or special purpose groups are captured and forwarded to the ATO Consultation Hub.

BOX 7.1 CURRENT ATO CONSULTATION FRAMEWORK



ATO Consultation Hub

The hub coordinates all consultation between the ATO and the community, enhancing the ATO's decision-making and increasing transparency of the process through a broader and more informed understanding of community views. Where consultation is required, the hub is responsible for ensuring the ATO:

- is clear about the reason and intent of the consultation
- identifies the right people to consult
- advises on the best method of conducting the consultation
- undertakes the process in a timely way.

The hub enables ATO to:

- capture matters raised by the community for consultation
- develop a systemic view of consultation and understand the benefits and opportunities it provides
- deliver more effective consultation engagements through a system-wide perspective, greater efficiency and the use of best-practice methods when engaging with the community
- harness the wide variety of expertise and willingness in the community to make the tax and superannuation systems better for all Australians.

Other types of consultation

ATO uses a variety of formats to ensure that its consultation model remains dynamic and flexible, and that, whatever format used—such as working parties or online forums—it is 'fit for purpose'.

The Commissioner of Taxation has asked his senior leaders to seek opportunities to consult with community and industry leaders and the tax profession about their issues.

Consultation process

If a matter requires consultation ATO will:

- identify the right people to consult—industry or professional associations, experts
- publish the topic in Matters under consultation
- decide how the consultation will be conducted
- undertake the consultation
- communicate the outcome of the consultation to all interested parties
- act on the outcome
- update matters under consultation once the consultation is completed.

SOURCE: "ATO CONSULTATION FRAMEWORK," LAST MODIFIED JUNE 25, 2015, [HTTPS://WWW.ATO.GOV.AU/GENERAL/CONSULTATION/ABOUT-CONSULTATION/ATO-CONSULTATION-FRAMEWORK/#CONSULTATIONPROCESS](https://www.ato.gov.au/GENERAL/CONSULTATION/ABOUT-CONSULTATION/ATO-CONSULTATION-FRAMEWORK/#CONSULTATIONPROCESS).

Noting the level of consultation that Treasury and ATO undertake, stakeholders raised a number of issues relating to the development of tax policy. They stated that it was relatively common for government to announce a policy by media release before government agencies were given the opportunity to develop the policy in detail.

While stakeholders did not indicate how frequently this occurred, they stated that it was relatively common for the media release to be the only source of information they could draw on, and for the media release to provide only limited clarity and detail about the policy.

Stakeholders also perceived it was common for government to announce both a policy and its implementation mechanism simultaneously, which resulted in more complicated implementation mechanisms than needed. Many stakeholders considered that there should be much more consultation on the implementation mechanism and that this should take place after government announces a preferred policy direction.

One policy official stated that it was relatively common for complexity to emerge through the following processes:

- a draft policy and/or exposure draft bill is announced
- it becomes clear, through consultation, that particular circumstances are not covered by the draft policy/bill
- the policy/draft bill is amended, following lobbying, to cater for those particular circumstances.

"Ministers on all sides of politics have increasingly made announcements without considering how policies will be actually applied. Treasury needs to be more active and have the resources to fully consider policy implications before such an announcements are made."
Professional body stakeholder

A number of stakeholders considered that Treasury needed to have a greater understanding of the commercial situation facing firms and markets when developing better policy. This may have the impact of reducing the complexity of a tax policy or tax legislation.

One official questioned how much of a “real world view” was taken by Treasury into consideration during consultation. This official referred to an example of the need for individuals to include the income of their de facto partner or spouse in their personal tax return. This official stated that determining the level of a partner’s income could be challenging in reality and added to the complexity of the system for individuals.

A number of stakeholders also stated that there was no systemic post-implementation review of tax policy, although this was less remarked on than the perceived need for more consultation during policy development.

It should be noted that arrangements for post-implementation review form part of regulatory impact analyses, which are needed for policy changes likely to have a material regulatory impact on business or not-for-profit organisations.

A formal post-implementation review is required for all regulation that initially proceeded without a compliant regulation impact statement. Furthermore, the Board can undertake post-implementation reviews of legislation to assess their quality and effectiveness.⁴⁴ However, the fact that stakeholders raised this as an issue indicates that post-implementation review is perceived to be inadequate.

A further issue that can lessen predictability for businesses is governments announcing tax changes but enacting different policies. The Review was told of a firm making a transaction on the basis of a government media release but where the draft law ended up being radically different to the media release. While policy can change in the course of the policy development process, the uncertainty generated by enacted policy being materially different to announced policy can heighten costs for businesses.

7.4.2 What are the causes?

The principal causes appear to be a disjunction between the adequacy of the consultation process as perceived by stakeholders and by Treasury.

7.4.3 What can be done?

ACIL Allen has not assessed whether the consultation government agencies undertake is adequate. Instead, the important point is that many industry stakeholders, policy makers and experts consulted perceive it to be inadequate. Drawing together stakeholder views and the experience in NZ and the UK suggests that undertaking consultation from the policy development phase to post-implementation review can be beneficial for policy coherence and stakeholder buy-in. It can also help identify where a policy and its implementation can be strengthened.

Adopting a more structured generic consultation process on tax policy and the development of this as a norm would be desirable.

The process would provide minimum and maximum timeframes for consultation and guide the way consultation occurs on all new legislation, amendments to existing legislation, and post-implementation review. It would implement a stronger process-based framework to shape the way consultation on tax policy and law occurs in Australia, while allowing flexibility to take the particular circumstances of each policy proposal into account. This building block may involve, in practice, a greater emphasis on consulting stakeholders at the very early stage of policy design than is currently used by government.

Many stakeholders positively remarked on the level of consultation used in NZ on tax policy, referring positively to that country’s Generic Tax Policy Process (GTPP). The literature review suggests that the NZ Government has usually consulted on proposed tax policy in accordance with the GTPP, with the one major policy not consulted on using the GTPP criticised by tax agents for its poor design.

⁴⁴ Rob Heferen, Nicole Mitchell and Ian Amalo, “Tax Policy Formulation in Australia,” *Economic Roundup 2* (2013), accessed March 10, 2016, <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/Economic-Roundup-Issue-2/Economic-Roundup/Tax-policy-formulation-in-Australia>.

*“There should be more consultation at the early design stage.”
Industry stakeholder*

Stakeholders indicated that a particularly useful element of the GTPP was that consultation occurs throughout the tax development process—from initial development through to post-implementation. Stakeholders indicated that the process of consultation on tax policy that occurs in Australia does not appear to be as in-depth at all points in the policy process as in NZ.

It should be noted that the GTPP is simply one element of the NZ tax policy development culture; one that supports ongoing consultation. Introducing a similar policy in Australia would not necessarily lead to a corresponding culture or practice of consultation alone, and would need to be adapted for local conditions.

Stakeholders indicated that while consultation occurs on some tax policy proposals in Australia, it does not occur on all proposals, and many stakeholders stated that this was a weakness. Having some kind of generic consultation process, which could be adapted to each circumstance, would strengthen stakeholder confidence in the overall approach to consultation as well as enhance the predictability of the process.

7.5 Policy development issue 4: Limited focus on simplifying the tax system

7.5.1 What is the issue?

*“There is no political commitment to getting rid of complexity.”
Senior policy official*

Stakeholders indicated that there is limited focus and energy put into simplifying the tax system. In particular, they perceived that there is no individual or organisation with a primary role of addressing complexity in the existing tax system or in proposed tax policies.

7.5.2 What are the causes?

Stakeholders indicated that while there are incentives for the tax system to become increasingly complex, there are few incentives for parties to advocate for simplification. In particular, while there are many parties, such as the tax industry, who benefit from the tax system being complex, the benefits of simplification would be spread across many people, and hence a simpler tax system has few concerted advocates.

*“The tax industry is very strong. The private sector, ATO and Treasury have a co-dependency.”
Senior policy official*

A complex system requires administrators, policy officials, and tax advisors. One tax advisor perceived that while most tax professionals had previously been generalists, there are now many specialists in different areas of tax law. The existence of specialists could be a barrier to simplifying tax law.

Stakeholders also identified that resource limitations in Treasury and other agencies resulted in issues other than complexity being seen as more important and urgent. Lack of political salience was also mentioned as a factor.

*“Failure by a Minister to simplify tax policy is worse than not trying.”
Senior policy official*

A number of stakeholders considered the lack of “political will” to be a factor underpinning the poor progress to date in delivering simplification. Stakeholders referred to failed attempts following the Ralph Review to reform corporate tax for trusts.

7.5.3 What can be done?

Stakeholders suggested that simplification required a ‘champion’ in order for it to gain focus and salience. A suggested role for the champion was to help drive a change in mindset across the tax system and help parties adjust to the fact that there would likely be some losers from simplifying the tax system. Stakeholders indicated that the champion needed to become a part of “politics as usual” in order to be successful.

ACIL Allen has identified two approaches to create a champion to simplify the tax system. The first involves the establishment of an independent body to provide advice about simplification.

This could involve an independent body responsible for developing evidence-based about the ongoing evolution of the tax system, as well as practical suggestions and solutions to drive simplification over time. The body would not have the role of providing advice to government on tax policy, but instead would provide advice about how existing and proposed policy can be implemented in a less complex way. Tax policy is rightly a matter for government and Parliament as it is intrinsically political.

Some stakeholders considered that political risk was a factor potentially mitigating against the establishment of an independent body. This was because it would be hard to predict or quantify the benefits of simplification and provide government assurance that rewriting existing legislation would not come at the cost of revenue collection.

“There needs to be some political will to make legislation less complex going forward, and to review the most complex and confusing sections of the Act. A Parliamentary Committee would fulfil this role.”
Industry stakeholder

This Review is not setting out any particular model for an independent model. Consultations with stakeholders indicate some support for an expanded Board of Taxation to head such a body.

The second involves the establishment of a parliamentary committee with a dedicated focus on simplification. The role of this committee would need to be clearly defined so as not to duplicate the functions of other committees such as the Economics, Finance and Public Administration, and the Public Accounts and Audit committees. The committee would also require sufficient resources in order to commission research and generate evidence-based findings which support a simplification agenda.

Parliamentary committees can be fora to draw public attention and investigate matters of public interest. While the efficacy of parliamentary committees can depend on the interest of their members, the robustness of their reports depends in large part on the work of committee staff.

This approach would be useful in exposing parliamentarians to the impacts of complexity of the tax system and provide an institutional voice within Parliament to reduce complexity and ameliorate its impacts. ACIL Allen expects that politicians aspiring to economic portfolios and/or leadership positions may seek roles on this committee.

7.6 Overview of issues relating to legislative drafting

“The OPC are the best people I’ve worked with.”
Industry stakeholder

“Barwick judgements have continued to influence the ATO in particular, long after the courts stopped thinking like this.”
Senior policy official

Stakeholders identified that there were issues of complexity arising from the legislative drafting process. In discussions, stakeholders strongly supported the professionalism of the OPC, which drafts all bills for the Parliament. The issues of complexity they identified arise, in part, from structural issues.

Almost all stakeholders indicated that the detailed drafting of the tax legislation was a major source of complexity. Approximately one-quarter of the stakeholders indicated that a historical reason for this approach to drafting were decisions of the High Court under Chief Justice Barwick, which emphasised the importance of black letter law in determining the tax obligations of taxpayers. Stakeholders considered that these decisions helped create a culture of incorporating greater amounts of detail in tax legislation.

7.7 Legislative drafting issue 1: Highly-detailed provisions in tax legislation

7.7.1 What is the issue?

“Law is complex if a practitioner can’t read the law and understand it.”
Policy official

“Amendments to tax law are never wired in 100% correctly.”
Senior tax official

“I am regularly asked to give advice on parts of the Act that I haven’t heard of.”
Senior tax adviser

“Less than 10 people understand the Consolidation provisions.”
Industry stakeholder
“There wouldn’t even be that many (i.e. 10) who understand the Consolidation provisions.”
Senior policy adviser

Many stakeholders stated that the prescriptive level of detail in tax legislation presents challenges to the ATO, tax practitioners and taxpayers to interpret legislation; the level of detail can obscure the intent of legislation. Some stakeholders considered that the level of detail in tax legislation results in highly complicated legislation with many interacting provisions. They stated that it can be difficult to determine the cause of an issue “when something goes wrong.”

The highly detailed drafting raises issues when amendments to tax law are being drafted. One stakeholder considered that the level of detail and complication in the law means that amendments to tax law are never properly incorporated into existing tax law.

Industry considered that patching gaps or problems in the law (e.g. to close a loophole or change eligibility of a concession) can lead to complexity. These amendments do not address the underlying systemic cause of the issue, meaning that further amendments will be needed in the future.

Stakeholders indicated that the detail in tax legislation was at such a level that it did not have the flexibility to cover changes in technology and practice. For example, stakeholders indicated that many rules are explicitly based on having a paper-based system while many firms and individuals have adopted electronic records and communication systems. Stakeholders also indicated that tax law has a focus on mechanism, as opposed to principle.

Many stakeholders commented that the detail in many existing provisions of the law made it very challenging for tax professionals to understand the provisions. An industry stakeholder stated that

large corporations used an inappropriate amount of time to decipher complex legislation. Stakeholders referred to the costs of complying with the FBT, indicating that some large corporations employ staff whose sole role is to deal with FBT compliance issues.

“The Office of Parliamentary Counsel is very good, badly understaffed, needs better and more precise briefing from Treasury, and also needs some expert tax drafters, which it does not have at the moment. Professional body stakeholder

Industry stated that FBT was one of the most complex taxes it had to comply with, due to the highly prescriptive rules covering every possible fringe benefit provided to an employee. Stakeholders stated that small businesses, in particular, have difficulty in interpreting the minor benefits exemption, as its subjectivity causes confusion and uncertainty. A number of senior policy officials stated that part of the complexity for FBT was the way it is conceptualised as covering everything but having carve outs.

The introduction of concessions for small business can lead to additional transitional and compliance burdens, and create incentives for sophisticated taxpayers to organise their affairs in ways to minimise their tax obligations. Industry also indicated that the depreciation rules were complex.

Stakeholders indicated that recent tax legislation had been drafted using a principles-based approach and that the intention was to use such an approach in future drafting. Stakeholders also indicated that there was no program to rewrite existing tax legislation using a principles-based approach.

Box 7.2 provides a case example which compares a provision of tax law in Australia and the US to demonstrate the tendency in Australia towards complexity.

BOX 7.2 CASE EXAMPLE

In Australia, the capital allowance regime has moved from the ITAA 1936 to the ITAA 1997 but remains a complex and large body of law. The law attempts to detail every aspect of the recognition of an expense if the expense is used to acquire a benefit that lasts longer than one year. In addition to the capital allowance regime, there are other sections in the law dealing with prepayments. Having multiple regimes for something that is similar in a conceptual perspective means there is additional complexity from borderline delineation.

The contrast that illustrates an alternative approach is the US Internal Revenue Code section 167:

There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
(1) of property used in the trade or business, or (2) of property held for the production of income.

Property here means property in the legal sense—any tangible asset, intangible right; anything that is of value and can be assigned—a machine, a patent, contractual rights, a cause of action, etc. The "reasonable allowance" terms open the door for the Treasury (in the US, each Department can issue regulations while in Australia they are all issued centrally) to issue regulations that set out what's a reasonable allowance. When can you use straight line depreciation? When do you use declining balance? How do you calculate what is a reasonable decline in value each year?

The Treasury has issued extensive regulations, the same size as the Australian law, to be sure. But because they all fall under one overarching principle, the one set out in the law, there's relatively little dispute and it's easy to modify the regulations every time someone comes up with a new type of property, which of course happens daily now with the technology.

SOURCE: PROF RICK KREVER, BASED ON PUBLISHED WORK

7.7.2 What are the causes?

Consultations indicated that a complex web of factors underpin the use of detailed black letter law in tax legislation.

Many industry and policy stakeholders considered that a desire to ensure that all taxpayers meet all of their tax obligations drove a culture of attempting to block every potential loop hole. This has added substantially to the detail and complexity of legislation. Many stakeholders considered that it would be useful for the level of regulation and compliance activities to be proportionate to the risk of non-compliance; this theme was raised across many stakeholder groups. A tax official stated that the ATO is developing risk-based models for compliance, which may go some way to addressing these concerns of stakeholders.

“Don't focus on the 1% of taxpayers who are trying to avoid paying tax.” Industry stakeholder

“There is no layering of regulation according to need.”

Senior tax official

One senior tax official stated that while 80 per cent of taxpayers have simple affairs, they are subject to the same complex arrangements that are intended to apply to the 20 per cent of taxpayers with complex affairs. This stakeholder suggested that regulation should be layered according to need.

Trust between industry and the ATO

Many stakeholders considered that the prescriptive and detailed nature of tax legislation was a symptom of a much broader cultural factor—a low level of trust between the ATO and industry/tax professionals.

The relationship between the ATO and industry was a key theme arising in many consultations. Taxpayers and tax professionals desire greater predictability of their tax liabilities as they do not necessarily trust the ATO to act reasonably. While industry considered that the relationship had improved under the current the leadership of the ATO, stakeholders commented that there was still some distance to travel. Consultees expect trust will continue to improve given current relationship-building activities being undertaken by the ATO.

Some taxpayers had a perception that the ATO interested more in compliance than having a partnership with the tax profession and taxpayers.

A desire for prescriptive legislation arises from the desire of some tax professionals and taxpayers for certainty or greater predictability. This may be a particular concern where a party is undertaking a complex transaction and it prefers to understand the tax liabilities associated with that transaction. Industry seeks certainty by the inclusion of legislative provisions covering many different potential situations in the tax law. Industry stakeholders would seek less so-called certainty if they had greater trust in the ATO.

Perceived complexities include the CGT. Stakeholders stated that they thought CGT was complex because of a perceived need (of the ATO) to collect all the tax that owed rather than focussing on the 95 per cent of tax owed that would be easily collected.

While some industry and tax professionals considered that prescriptive legislation provides certainty, most policy officials and other industry stakeholders indicated that it can be a source of uncertainty, as the legislation does not keep up with market developments and changes in industry practice.

Industry indicated that legislation can become out-of-date quickly, which can ironically be a source of uncertainty and a cost to industry. Further, amendments are then made to legislation to cover the changed environment and situations.

Tax professionals also indicated that the cultural characteristics of the legal and accounting professions may be a factor underpinning complexity. These stakeholders suggest that professions are generally more comfortable with detailed legislative provisions, and often advocate for such detail during the drafting and design process. It is plausible that this preference may impact the advice they provide to their clients regarding the preferred nature of tax legislation.

7.7.3 What can be done?

The Review has identified two substantive ways of addressing this issue: increasing trust between the ATO and industry/tax professionals, and using principles-based drafting for tax legislation. While Treasury intends on using the latter approach to drafting future legislation, it could be used to recraft existing tax legislation.

Increasing trust between the ATO and industry/tax professionals

The need to improve trust between the ATO and industry/tax professionals was a key theme of consultations. Stakeholders suggested that there were two potential equilibria in the relationship between the ATO and industry—the current one of low (but increasing) trust, and an ideal relationship of high mutual trust. There was a perception that the low trust relationship was the default in Australia. A low trust environment promotes a detailed legislative regime and a litigious culture, while a high trust environment supports a principles-based regime, and a culture of understanding and mutual respect.

Stakeholders had the view, almost universally, that the relationship between industry and the ATO had improved in recent years. This was put down, in part, to the current Commissioner of Taxation

“Why is tax law particularly complex? Because it involves paying and receiving money.”

Senior policy official

“Need to find a way of separately dealing with the 99% of taxpayers who are trying to do the right thing.”

Industry stakeholder

“A lot of complexity results from going after 100% of tax payable rather than 90%.”

Tax advisor

“Every new word of legislation creates uncertainty.”

Senior tax official

“It’s perfectly ok to run dual systems: one for reasonable taxpayers and another for the others.”

Industry stakeholder

“What’s we’re seeing at the moment [in terms of trust] bodes well for the future.”

Tax advisor

“There has been a huge improvement in the relationship the ATO has had with business and the professional bodies since

Chris Jordan took the helm.”

Industry stakeholder

having had a career in industry before joining the ATO. Stakeholders also considered that the relationship had been strengthened as a result of concerted efforts to improve it by other senior leaders in the ATO.

Industry considered that the ATO would need to take the first steps before industry had a higher level of trust in the ATO. Industry mentioned that consistent ATO decision making and improved transparency in decision making would improve trust with industry. Industry considered that one way ongoing trust could be built would be for ATO decisions and guidance to be focussed on collecting “the right amount of tax rather than seeking to always collect more revenue.”

A small number of stakeholders addressed the question of whether the improved relationship between the ATO and industry would survive the appointment of the next Commissioner of Taxation.

Stakeholders considered that the new culture would stay in place after the next Commissioner of Taxation is appointed as it takes time for a culture to change—the changes would be embedded into the ATO by that time.

Using principles-based drafting

One of the strongest suggestions made to the Review during consultations was the use of principles-based drafting to craft new tax legislation and recraft existing legislation. The consultations and research undertaken for this Review have identified two competing views of what constitutes principal-based design and drafting.

One involves inherent uncertainty. This is the interpretation of the OPC as articulated by David Lovric, the Senior Assistant Parliamentary Counsel in research published by Tax Law Professor, Rick Krever: ‘Broad principles have a degree of uncertainty at their edges; they have a core of relatively clear application surrounded by a penumbra of uncertain application.’

This view was largely rejected by Treasury (about 10 years ago) as being unsuitable for tax law given the ambiguity and uncertainty it involves—inevitably the penumbra is far bigger than the core. The view of Treasury and the profession was that the significant uncertainty this approach entails adds greatly to the complexity of the law.

The second view of principal-based design and drafting poses almost the opposite goal—setting out principles that eliminate the penumbra and uncertainty entirely. It is most often contrasted with the current system of design and drafting income tax law—addressing fundamental questions by way of piecemeal ad hoc rule that overlap sometimes and give rise to lacunae at other times. The CGT is a classic example—rather than set out a decisive fall-back rule, the law uses ‘capital gains events’ trying to identify every type of receipt that should be taxed.

The second view of principles-based drafting was explained by a Treasury official, Greg Pinder, in a Treasury publication.⁴⁵ Under this approach, absolute and complete certainty can be established by using a ‘fall-back’ position that applies 100 per cent of the time unless there is an explicit and clearly defined exemption from the fall-back rule. A good example of this, albeit in a badly drafted law, is the fringe benefit law. A fringe benefit is any benefit of any sort, apart from salaries, provided by a former, current or future employee to a past, present or future employee or anyone related or connected to the employee. There is no room for ambiguity (e.g. if an employee receives something from his/her employer he/she get taxed), unless it’s specifically carved out as a concession.

Under this second understanding, there is always a fall-back position. Once the law is drafted in this way, amendments or changes are rare. In particular, there is limited need for amendment to deal with the unintended loopholes or opportunities for arbitrage and schemes.

Using principles-based drafting (which ever view is adopted) involves fundamentally reconfiguring the tax law around a hierarchical model which enshrines fundamental principles in the core legislation and transfers explanatory detail to subordinate legislation (e.g. regulations) and administrative instruments. Changes to the core legislation would occur infrequently and only if significant issues arose with the application of core principles. Changes could be made to regulations and administrative instrument

“The culture is changing at the ATO, but there is still too much focus on spending 60% of the time focusing on compliance that addresses 2% of the revenue.”

Industry stakeholder

⁴⁵ Greg Pinder, “The coherent principles approach to tax law design,” *Economic Roundup* Autumn (2005): 75-90, http://archive.treasury.gov.au/documents/987/PDF/roundup_autumn2005_full.pdf.

more easily than changes can be made to legislation, with amendments to regulations still subject to Parliamentary oversight.

The model is underpinned by high levels of trust amongst key system stakeholders: trust that taxpayers and their advisors will meet the intent of core legislation, and trust that tax authorities and courts will ensure consistency is maintained in the interpretation of core legislation and subordinate instruments (see **Figure 8.1** for an outline of the proposed model).

*“You can cut through complexity if you are prepared to it pass through to administration.”
Senior government official*

Many ATO and Treasury stakeholders supported the removal of prescriptive provisions from primary legislation. They considered that matters of process—the how—should not be included in legislation, but instead included in regulations or other materials. Stakeholders supported increasing the flexibility with which the ATO could administer tax legislation by placing a great deal of the detail into regulations and also providing guidance to taxpayers through Explanatory Memoranda and other guidance documents. Over time, the greater amounts of detail could be moved to the regulations and the legislation could become more focussed on principles. Regulations could also be subject to review through sun-setting.

This view of moving detail to the regulations, while supported by many stakeholders, was not universal. A small number of ATO stakeholders supported the inclusion of detail in legislation as this provided (the perception of) clarity. This argument regarding clarity was contested by most stakeholders.

Numerous government stakeholders and tax professionals referred to the potential utility of including detail in explanatory memoranda to tax bills. One tax official stated that it was important for explanatory memoranda to be drafted very carefully and patiently to ensure it was clear.

*“You can’t have a tax system based on the vibe of the thing.”
Senior tax official*

One argument made against moving detail from legislation into regulations or into other documents was that a court can find a regulation to be inoperable if it is inconsistent with legislation, and a court may not consider other documents (e.g. guidance material) when interpreting legislation. While these risks exist, it is easier to amend regulations and guidance material than legislation if needed. In addition, the substantive question is: what is the appropriate balance of risks in any set of revised arrangements?

One issue brought up related to the question of rough justice under a principles-based regime. This relates to the concept that providing less certainty through legislation and thereby potentially giving the Commissioner of Taxation and courts more discretion might result in less just outcomes for taxpayers.

Over time, such decisions might or might not average out. While a small number of stakeholders were opposed to taxpayers being subject to rough justice, most considered this would not be a serious problem.

*“Be careful about [giving] too much discretion to [the] ATO. It could lead to inconsistent treatment of similar cases.”
Industry stakeholder*

Some stakeholders questioned whether people were receiving justice under the current arrangements, and considered that there would always be a bit of rough justice under any arrangements.

Stakeholders indicated that the Treasury has used a principles-based approach in its drafting instructions to OPC over recent years. An article by Thomas Reid in the December 2005 edition of the *Australian GST Journal* indicated that the Treasury had started using the ‘coherent principles’ approach to drafting.⁴⁶ Reid indicated that more work needed to be done at that time to ensure that objects clauses in tax legislation indicated the policy intent of a provision and were not just summaries of clauses. Stakeholders raised this issue during consultations for this Review.

*“Rough justice? No, that’s polemic. Who says decisions are right currently?”
Policy official*

While influential segments of Treasury are favourably disposed to principles-based drafting, it has not taken traction with the legal and accounting professions. This is partly because the professions see merit in having greater specificity. In addition, industry indicated that a lack of trust with the ATO had resulted in not many successful attempts at using principles-based drafting. Industry disagreed with the view of government stakeholders that a principles-based approach had been used for drafting tax legislation for a number of years.

A tax advisor considered that while government has repeatedly committed to moving to principles-based drafting, this approach has never properly been implemented. Another tax advisor indicated

⁴⁶ Thomas Reid, “Interpreting the GST law: tax law based on coherent principles”, *Australian GST Journal* (2005): 239-247.

that Part IVA (Schemes to reduce income tax) of the ITAA 1936 had been written using principles-based drafting, but that “even then there are words to interpret.” Industry mostly supported considering using a principles-based drafting approach for all future amendments to the consolidation provisions of the ITAA1997.

*“I could rewrite Division 7A in 10 pages.”
Senior policy adviser*

Many stakeholders—including tax legal advisors, industry, and senior policy officials—expressed strong support for pilot projects to rewrite standalone sections of existing tax law. Potential projects included rewriting the following areas:

- Division 7A (Distributions to entities connected with a private company) of the ITAA 1936.
- the Consolidation provisions of the ITAA 1997
- CGT provisions.

*“Division 7A has been expanded to deal with tax avoidance by high net worth individuals.”
Senior policy adviser*

Many stakeholders stated that they considered that Division 7A was small enough that it could be rewritten using principles-based drafting as a pilot project. Some industry stakeholders considered, however, that the rewritten law would have to be very clearly worded and that there would need to be checks and balances on the Commissioner of Taxation’s discretion and a rigorous appeals system. A tax advisory stakeholder had a contrary view to the above. They considered that rewriting Division 7A would not give certainty and that everyone would ask for a ruling from the Commissioner of Taxation. The case law generated would simply create different kinds of uncertainty, and the ATO would need more resources.

ACIL Allen recognises the considerable effort has been made in the past to re-write divisions, like 7A. We note from previous work undertaken by the Board that a number of perfectly sensible suggestions/recommendations have been published which could be re-visited in any evaluation of this Division. A summary of the complexities underpinning Division 7A and the Board’s previous work on this Division is provided as a case example in **Box 7.3** below.

BOX 7.3

DIVISION 7A: POST IMPLEMENTATION REVIEW BY THE BOARD OF TAXATION



In 2014 the Board examined the broader framework in which Division 7A operates, including its interaction with other areas of tax law. Under Division 7, income of a company not distributed in accordance with the requirements was subject to an 'undistributed profits tax' at a rate of 50 per cent, which was higher than the then company tax rate. However, a significant proportion of active business income could be retained without attracting undistributed profits tax. This assisted businesses that needed to retain profits for working capital purposes. Division 7 also included section 108, a provision that sought to ensure profits retained by a company without being subject to the undistributed profits tax could not be distributed to shareholders or their associates in a tax-free form. Division 7's restriction to private companies reflected the fact that shareholders in closely held private companies were more able, due to their limited numbers and greater control of the company, to adopt restrictive dividend distribution policies, potentially granting themselves (or their associates) inappropriate access to company profits.

The Board noted two relevant and significant changes made to the company and personal income tax systems, both of which took effect from 1 July 1986. The first was the replacement of the classical double tax system with an imputation system, under which resident shareholders were entitled to a credit for tax paid by the company against their personal tax liability on dividend income. The second change was the alignment of the company tax rate and the top marginal tax rate. The combined effect of these changes was to remove the potential for tax deferral benefits that might have been achieved by accumulating amounts in a private company (rather than distributing to individuals). As a result of the 1 July 1986 changes, there was no longer any practical consequence arising from the undistributed profits tax, and Division 7 was repealed (subject to transitional arrangements). However, the company tax rate and the top marginal tax rate were only aligned for the 1987 and 1988 years of income. The company tax rate was cut to 39 per cent with effect from 1 July 1988 and, since that time, has generally declined to its current rate of 30 per cent.

The greater the gap between the lower company tax rate and the higher individual marginal tax rates, the greater the incentives to accumulate profits in private companies rather than distribute them to shareholders as dividends. The effect of the accumulation is to postpone the levying of the appropriate top-up tax (that is, the difference between the individual shareholder's marginal tax rate and the company tax rate). In summary, after-tax profits currently can be retained within companies and reinvested without being subject to the progressive tax system. The widening gap between the company tax rate and the top marginal rate for individuals, coupled with the lack of a sufficient distribution regime, represents a challenge for tax system progressivity.

The decision in 2000 to allow franking credits to be refunded to individuals has increased the incentives for corporate profits to be retained in private companies and paid out to shareholders as dividends when it is tax-effective to do so. A decision to operate a business using a particular structure or entity is generally driven by a range of considerations. Personal, family or commercial considerations relating to protecting assets, maintaining privacy, or limiting personal liability, are all relevant.

However, tax considerations are also important. The Board noted two key aspects of the tax system that influence the way small businesses are structured. The first of these was the rules governing the availability of the 50 per cent CGT discount. The CGT discount is available to individuals on capital gains made directly. The second key tax factor influencing small business structures is the tax treatment of accumulations. While a company is taxed at a fixed rate irrespective of whether income is accumulated, where there is trust income to which no beneficiary is 'presently entitled', a flat rate of tax equal to the highest personal marginal tax rate is imposed (currently 49 per cent, including the 2 per cent Medicare levy and the 2 per cent Temporary Budget Repair levy). By contrast, distributed income (that is, income to which a beneficiary is presently entitled) is generally taxed at the entitled beneficiary's marginal tax rate. Accordingly, in private group structures that operate through trusts, the trustee will generally ensure that all income is distributed annually.

The Board noted that these factors contributed to the emergence of more complex structures designed to provide businesses with access to the lower company tax rate while preserving access to the 50 per cent CGT discount. In particular, it noted the increasing prevalence since 1990 of so-called 'bucket company' arrangements, trust distributions referable to capital gains. However, it is not available to companies.

While the Board welcomed a longer-term commitment to redesigning the tax system, the potential for such reform does not reduce the urgent need for improvements to Division 7A. The Board believes there is significant scope for improving the Division in a way that would be complemented by longer-term reforms.

The first step in the process of improving Division 7A is to develop a coherent set of policy principles. The Board proposed four guiding principles for the policy that could be incorporated into its framework. The principles provide a coherent, workable framework to guide future reform of the Division.

To give effect to these principles, the Board has developed a reform model called the 'Amortisation Model'. Under this model, loans would be repayable over a 10-year period, have reduced documentation requirements, and have greater flexibility in repaying interest and the principal.

SOURCE: SOURCED DIRECTLY FROM POST IMPLEMENTATION REVIEW, OF DIVISION 7A OF PART III OF THE INCOME TAX ASSESSMENT ACT 1936, NOVEMBER 2014, FINAL REPORT AND ADAPTED WHERE NECESSARY

There was support for Treasury to engage with the tax profession and academia in undertaking any pilot project. Tax advisors considered that it would be important for their experience to be considered.

“There is merit in getting four or five small groups of specialists to focus on the most complex sections of the Act over a defined period and redraft them.

And at the same time ensure all new tax law is drafted against a simple framework.”

Professional body stakeholder

“If you have clarity over policy, you get clearer drafting.”
Industry stakeholder

“Principles-based drafting is a good idea only if you have clarity over policy.”
Industry stakeholder

While many stakeholders supported the undertaking of pilot projects to rewrite existing sections of the tax law, some considered that there were many practical constraints. Such a project would involve substantial Treasury resources that would probably not be available as it was not a political priority.

One influential stakeholder held the view that rewriting projects would involve substantial resources for no additional revenue (e.g. it would take 50 people two years to rewrite the consolidation rules). Some industry stakeholders however, suggested that industry would be happy to be involved in pilot projects, provided the demands on them were reasonable.

One stakeholder considered that, while pilot projects to rewrite sections of the tax law would be useful, the projects would need political support in order to succeed.

7.8 Legislative drafting issue 2: Lack of clarity about the policy intent of tax law

7.8.1 What is the issue?

Many stakeholders indicated that there were many sections of tax law for which they perceived the government’s policy intent to be unclear. This made interpreting some sections challenging as elements of the legislation had a greater focus on process than identifying intention.

As an example of this concern, some stakeholders considered that economic concepts are not always effectively translated into tax legislation. This can make it difficult for policy makers and courts to determine the economic rationale of tax legislation. It also generates considerable caution amongst tax authorities who seek to use principles-based drafting techniques to deal with complex policy issues which have unclear objectives.

7.8.2 What are the causes of complexity?

Many stakeholders considered that the absence of objects clauses in tax legislation could make it challenging for parties to interpret that legislation. These stakeholders considered that the inclusion of such clauses would be helpful for tax professionals, the ATO, the courts, and others.

Translating economic concepts into legislation has been a challenge in many areas of policy. This may be due, in part, to the lack of guidance material underpinning the drafting of an Act or statutory rules.

7.8.3 What can be done to reduce complexity?

The significant majority of stakeholders considered that it would be useful to include objects clauses in all new and amending tax legislation, as this would assist the ATO, tax professionals, taxpayers and courts in interpreting complex legislation or apparent gaps in legislation. Including objects clauses would help parties understand the policy intent of legislation.

Many stakeholders considered that including objects clauses in tax legislation would enhance the ability of the ATO and the courts to interpret legislation and strengthen the predictability to taxpayers and tax professionals about how the courts and the ATO might interpret legislation.

The Australian Law Reform Commission (ALRC) describes an objects clause as a provision “...that outlines the underlying purposes of the legislation and can be used to resolve uncertainty and ambiguity.” They can be used by courts and others to interpret legislation.⁴⁷

Objects clauses would articulate the policy intent of each relevant part of tax legislation. They would set out the principle on which a measure is based or, if the measure is a deliberate deviation from the principle, the goal of the deviation. For example, they would make clear who qualifies for a subsidy or concession and who does not. This may help avoid complex anti-avoidance measures resulting from rent seekers trying to re-characterise arrangements to qualify for a subsidy or concession.

⁴⁷ “5. The Privacy Act: Name, Structure and Objects,” ALRC, accessed March 3, 2016, https://www.alrc.gov.au/publications/5.%20The%20Privacy%20Act%3A%20Name%2C%20Structure%20and%20Objects/objects-act#_ftn147.

The use of objects clauses is common in legislation—many non-tax Acts have such provisions. The nature of objects clauses can vary in terms of clarity and the level of detail.

A high level review of the ITAA 1936 and ITAA 1997 indicates that while many sections of the legislation have object clauses, there are many parts of those acts lacking such clauses. In addition, there are complexities as clauses other than object clauses may provide information potentially useful in interpreting legislation. For example, the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 (Cth)* does not include objects clauses, but does include clauses entitled “What this Subdivision is about”.

ACIL Allen has not reviewed tax legislation for its need for object clauses and it is not for the Review to determine whether there is enough guidance in tax law through the existence or non-existence of objects clauses and similar provisions. However, the box below includes some information on some of the objects clauses that are included in the ITAA 1936.

BOX 7.4 EXAMPLES OF OBJECTS CLAUSES IN THE ITAA 1936

There are objects clauses scattered throughout the ITAA 1936. Examples include:

- section 23AH (Foreign branch income of Australian companies not assessable)
- 82C (relating to Subdivision CB that pertains to approved companies establishing a regional headquarters in Australia)
- 94A (Division 5A – income of certain limited partnerships)
- 102AAA (Division 6AAA- Special provisions relating to non-resident trust estates etc)
- 102AAS (Subdivision D – Accruals system of taxation of certain non-resident trust estates)
- 121A (Division 91 – Offshore banking units).

SOURCE: ITAA 1936

Including objects clauses in legislation would require government to specify the policy intent of legislation in writing. Some parties stated that policy analysts only had a government media release to draw on in development policy and that the intent of the policy and legislation was not clear. Including objects clauses would require government to provide a statement of policy intent, even if this was only at a high level.

Implementing this building block would first involve first ensuring that objects clauses are included in all future tax legislation, and second involve reviewing existing legislation to identify where objects clauses are missing. Treasury, the ATO and industry could work together to identify where it would be useful to add objects clauses in existing tax law, and conduct a process of consulting on potential objects clauses.

7.9 Legislative drafting issue 3: Frequency of changes to tax law

7.9.1 What is the issue?

Many stakeholders perceived that complexity, in part, from the frequency in which tax law changes. One stakeholder described the changes as “constant and significant”, especially to the rules regarding superannuation. Stakeholders perceived that many changes are made for fiscal reasons.

A related point is that a number of stakeholders considered that there has been insufficient maintenance of the tax system. The degree of detail in tax legislation mitigates against this maintenance. One stakeholder considered that the lack of maintenance of the tax system was one of the major failings of tax policy development. The stated reason for this is that insufficient parliamentary time has been allocated to considering tax law amendments, as they have low priority. Some stakeholders considered there is a need to maintain the tax system—things get rusted on: reform needs to be done subtly and continuously.

A further issue from this complexity is that tax professionals may find it challenging to be aware of all changes to tax law given their frequency.

*“Ongoing and minor tweaks [to the tax system] creates a background of complexity.”
Senior policy official*

*“For 90% of the people for 90% of the time the tax system is ok. We keep changing it for the 10% cent of people who experience issues 10% cent of the time.”
Senior policy official*

7.9.2 What are the causes?

The number of tax amendment bills put to Parliament each year is the main cause of this complexity.

7.9.3 What can be done?

A number of stakeholders identified merit in the adoption of a UK-style annual omnibus tax law amendment bill in Australia. This bill would include all minor (non-urgent) proposals to change tax legislation for that year to be tabled in Parliament at a single point in time.

However, stakeholders expressed mixed views about this approach. On the one hand, they suggested that a single bill would assist Treasury and OPC to adopt a “whole-of-tax code” approach to change. On the other hand, some stakeholders indicated that the parliamentary sitting schedule presents challenges to having an annual bill of this kind.

As an alternative, it may be possible to have a single annual tax simplification bill. This could be used to address identified ways to simplify the tax system. If Parliament establishes a Joint Parliamentary Committee focussing on tax simplification, this bill would naturally fall within the purview of such a committee.

7.10 Legislative drafting issue 4: Highly complicated nature of tax law

7.10.1 What is the issue?

Stakeholders indicated that they perceived the drafting of tax law to be extremely complicated. Many stakeholders referred to complicated definitions, such as that relating to debt, and perceptions that amendments can use new definitions rather than use existing definitions.

Some senior policy stakeholders considered that the timing of budget announcements and tax system changes does not provide enough time for adequate public debate and consideration of the unintended consequences of changes. For example, the ATO sometimes becomes aware of budget matters approximately one month before the budget is due to be delivered. They also perceived that drafters are challenged to manage the consequences of legislative changes resulting from the volume of amendments being made to tax law.

*“Always run out of time for drafting legislation.”
Tax official*

7.10.2 What are the causes?

Proposals to amend the tax code and introduce new provisions are highly complex due to the interrelated nature of divisions/sections and the complexity of existing provisions. OPC typically has 3-4 drafters working on tax issues at any one time, but can draw on 6-7 drafters if needed.

While stakeholders agreed that the OPC is highly professional, some stakeholders considered that the drafting process is too rushed and that it would be beneficial for OPC to be given more time to draft bills. One stakeholder considered that OPC did not have sufficient time to consider implications of legislation, stating that draft bills should not be released in those situations. On the other hand, some stakeholders considered that time was not a big driver of complexity.

Similar arguments were put forward for Treasury and the other tax authorities involved in the instructing process. In particular, there are significant resource constraints (including time constraints) that inhibit the careful conceptualisation and consideration of issues.

Stakeholders commented that creating simple (or less complicated) law can require substantial time and resources. There was a view that the additional resources required during legislative drafting would be recovered in the much reduced cost to tax agents and taxpayers.

Another perceived factor underpinning complexity was that amendments to tax law may be drafted by individuals with a technical focus who “try to make it perfect.”

7.10.3 What can be done?

Simplification requires sufficient resources that currently do not exist. The resourcing of Treasury, ATO and OPC needs to be increased to effectively simplify the tax system in a timely way.

*“This is tax not Medicare, no one dies if the drafting is delayed.”
Tax advisor*

7.11 Overview of issues relating to both policy and law design

There are a number of issues that relate to the interaction of the policy and legislative drafting processes and cannot be neatly separated into one or the other categories. These issues may intersect with a number of other issues.

A number of stakeholders considered that complexity can come about from providing flexibility and choice in the tax system. This can drive highly complex legislation as the legislation needs to be tailored to a broad range of taxpayers.

Some stakeholders considered that a factor mitigating against simplifying the tax system is a political culture of “no real losers”. This is a label for the perception that no person or interest group can be negatively impacted by reforms to the tax or welfare system. Policy decisions to grandfather existing beneficiaries of the tax system may increase the policy and legislative complexity of the tax system.

Other stakeholders, especially within government, raised concerns about the capability and capacity of the bureaucracy to effectively minimise unnecessary complexity. In particular, they indicated that government, over the past decade, has lost many experienced technical officers through retirement or redundancy. Concern about these losses goes to the heart of government’s ability to manage the tax policy and law design process.

“A large number of very experienced tax people have left the public service over the past two decades, either by choice or through redundancies. This has left a gaping hole in our ability to deal with the complexities of the system.”
Senior public servant

7.11.1 Capability and capacity of government to manage tax complexity

What is the issue?

Some senior stakeholders considered that one factor leading to greater complexity in the tax system was the result of relatively low levels of resourcing, and the lack of economic and legal knowledge, among officials working in Treasury, the ATO, and other parts of the public sector who have a strong influence on the design of tax policy and law.

What are the causes?


There was a view among many stakeholders that the legislative drafting roles in Treasury’s Revenue Group have a low status—a much lower status than when the corresponding roles were housed within the ATO.

Many stakeholders, including in industry, considered that Treasury simply does not have the resources to deal with complexity in tax legislation. Some stakeholders considered that existing Treasury resources are wasted on unimportant matters like “red tape repeal day” and “pointlessly” rewriting sun-setting regulations.

“Treasury simply doesn’t have the resources to deal with the complexity of the tax legislation.”
Industry stakeholders

What can be done?

Simplification can be a complex task, which has been made more difficult through two decades of retirements and redundancies in the areas responsible for tax policy and law design. The public service must have the technical skills and experience in all tax policy and tax law design areas in order to deliver simplification outcomes.



8

BUILDING BLOCKS AND IMPLEMENTATION

This chapter discusses a number of potential solutions to the problem of complexity. These solutions take the form of ‘building blocks’ which are foundational to a simplification agenda. These building blocks have undergone preliminary testing with some project stakeholders, however they have not been formally endorsed by any stakeholder consulted for this Review.

This chapter outlines the building blocks, then assesses them against a framework, and finally discusses the implementation considerations for each building block.

8.1 The building blocks of a simplification agenda

Consultations with a broad range of stakeholders have identified three building blocks for simplifying tax policy and law design. The building blocks are:

- *Architectural and institutional building blocks.* These building blocks focus on the structural changes that could underpin simplified tax policy and law. They typically involve significant changes to the institutional settings which support tax policy and law design.
- *Process-based building blocks.* These building blocks focus on the procedural elements of tax policy and law design which shape stakeholder activities in the system.
- *Capability and capacity-based building blocks.* These building blocks consider the ability of key decisions makers and the institutions they represent to deliver simplification of the tax system. They consider the skills, experience and expertise of decision makers/institutions within the context of simplification.

These blocks are complementary; they support each other. The building blocks are, in a sense, the broad framework from which investment decisions can be derived and a consistent set of improvements to the current tax policy and law design approach can be implemented by government.

Each building block seeks to address an identified driver(s) associated with tax system complexity. These drivers have been identified by stakeholders and categorised using Tran-Nam and Evans’ (2014) framework as discussed in Chapter 6. Broadly, the drivers can be understood from the perspective of:

- policy complexity
- legislative complexity
- operational complexity (although it is important to note that this type of complexity is not a key focus of the Review).

Each building block also seeks to meet one or more of the complexity principles developed for this Review, as shown in **Table 8.1** below. A key feature of the building blocks is that the architectural and institutional building blocks meet more dimensions of the principles than the other categories identified in this Review.

TABLE 8.1 RELATIONSHIP BETWEEN BUILDING BLOCKS AND THE PRINCIPLES OF SIMPLIFICATION

Building block	Principle									
	P1	P2	P3	P4	P5	P6	P7	P8	P9	P10
Architectural and institutional										
National compact	✓		✓	✓	✓	✓	✓	✓	✓	✓
Principles-based legislative model	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Independent simplification body		✓	✓	✓	✓	✓	✓	✓	✓	✓
Joint Standing Committee of Parliament	✓			✓		✓		✓		
Process-based										
Improved consultation	✓		✓	✓	✓	✓	✓	✓	✓	✓
Omnibus annual bill	✓	✓	✓		✓					✓
Fulsome objects clauses	✓	✓		✓				✓		
Capability and capacity										
Appropriately resource Treasury, ATO, OPC and others							✓			✓
Publish the true costs of tax system complexity	✓		✓		✓			✓	✓	
Implications of new proposal	✓		✓		✓			✓	✓	

✓=PRINCIPLE ADDRESSED IN THE BUILDING BLOCK
SOURCE: ACIL ALLEN

8.2 Architectural and institutional building blocks

This section outlines the key investments which could be considered under the architectural and institutional building block. The section identifies the rationale for investment in the building block, what driver(s) of complexity the investment will address and considers what could be required to implement the investment.

It is important to note that some of the investments outlined below have been suggested by stakeholders during consultations, while others are a direct result of ACIL Allen’s own research and analysis.

8.2.1 Building block: Establish a national compact for the tax system

Rationale

Formal agreements between governments and industries have been a part of the Australian policy landscape since Federation. Agreements or compacts have been used to deliver a range of policy outcomes including the settlement of industrial disputes in the 1980s, the delivery certainty to the charitable sectors during the 1990s and the recognition of university missions during the 2000s. Each of these agreements have provided a framework for signatories (to the agreements) to pursue their own missions, strategic goals and objectives, while also contributing to national policy objectives for the industry or sector in which they operate. Examples of compacts between government and industries are provided in **Table 8.2** below.

*“We need a culture where we are interested in the health of the tax system as a whole, not particular cases.”
Senior treasury official*

TABLE 8.2 EXAMPLES OF COMPACTS USED IN OTHER SECTORS INDUSTRIES IN AUSTRALIA

Compact	Who is involved?	Details
Engage: A new relationship between the Australian Government and the Third Sector (2010)	Commonwealth Government and the Australian charitable sector	The National Compact agrees that the Commonwealth Government and the Third Sector will work together to improve social, cultural, civic, economic and environmental outcomes, building on the strengths of individuals and communities. The collaboration contributes to improved community wellbeing and a more inclusive Australian society with better quality of life for all. The National Compact represents a commitment by the Government and the Third Sector to genuinely collaborate to achieve this shared vision. The Compact's shared principles provide a foundation for action to improve working relationships, strengthen Sector viability and develop and deliver better policy and programs. Compact signatories from the Sector agree to work with all Australian Government agencies to achieve these goals. The signing coincided with the launch of the National Compact website where organisations can sign on to the Compact ⁴⁸
The Compact: The Government and civil society organisations working effectively in partnership for the benefit of communities and citizens in England (2010)	The UK Government and major representatives of community organisations operating in the UK	The Compact is an agreement between the Coalition Government, and their associated Non-Departmental Public Bodies, Arms-Length Bodies and Executive Agencies, and civil society organisations (CSOs) in England. The agreement aims to ensure that the Government and CSOs work effectively in partnership to achieve common goals and outcomes for the benefit of communities and citizens in England ⁴⁹
Mission-based compacts (2011-13)	Commonwealth Government and Australian universities	Compacts are a key vehicle for the achievement of the Government's goals for higher education. Following the Bradley Review of Higher Education, the Government announced its goal to increase the educational attainment of the population so that by 2025, 40 per cent of all 25-34 year olds will have a qualification at bachelor level or above. The Government also announced its ambition that by 2020, 20 per cent of higher education enrolments at undergraduate level will be people from a low socio-economic status background. Compacts have provided an opportunity for universities to articulate how they will position themselves to assist in the achievement of these goals. This in turn has provided the Government with a national picture of progress being made in these areas. Compacts include specific performance targets for universities and are the mechanism through which reward funding will be provided to universities that achieve their specific goals for participation and social inclusion ⁵⁰
National Regulatory and Competition Reform Compact (2012)	COAG	In December 2012, Council of Australian Governments announced the first National Regulatory and Competition Reform Compact, which was signed by First Ministers, Australian Local Government Association and representatives from key business groups at the Prime Minister's Business Advisory Forum. The Compact sets out for the first time how governments and business will work together and their commitments to one another. The Compact will be reviewed every three years, with the first review in 2015-16 ⁵¹

SOURCE: VARIOUS SOURCES

*“Tax is a political battleground in Australia. It is just so hard to gain consensus on anything.”
Senior government official*

The reason for implementing a National Compact is two-fold. First, it is important for all participants operating within the tax system to conduct their activities within the context of a commonly understood framework or set of principles. A National Compact is an instrument which allows government to reach agreement with stakeholders about what actions should shape the ongoing evolution of the tax system. A National Compact should gain endorsement across all levels of government, with the Commonwealth Government to champion the agreement in partnership with state and territory governments, industry representatives, the tax agent community and political parties. Second, a National Compact acknowledges the highly adversarial nature of Australia's current tax system (which

⁴⁸ “PM signs national compact with Third Sector”, Pro Bono Australia, last modified March 17, 2010, <http://probonoaustralia.com.au/news/2010/03/pm-signs-national-compact-with-third-sector/>.

⁴⁹ UK Government, *The Compact*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/61169/The_20Compact.pdf.

⁵⁰ Department of Industry, Innovation, Science, Research and Tertiary Education, *Summary Report on Mission-based Compacts 2011-13*, <http://www.industry.gov.au/research/MissionBasedCompacts/Documents/SummaryReportMissionBasedCompacts2011-13.pdf>.

⁵¹ “National regulatory and competition reform compact”, Council of Australian Governments, last modified December 7, 2012, <https://www.coag.gov.au/node/486>.

is relatively rare amongst OECD countries) and seeks to establish an agreement that reduces the intensity of conflict amongst key tax system decision makers.

What drivers of complexity does the building block address?

Drivers addressed:

- *Adversarial culture*
- *Preferences for complexity*
- *Minimisation of losses by tax authorities*
- *Legal drafting*
- *Aggressive planning*
- *Use of law for non-revenue purposes*
- *Frequency of change*

A National Compact seeks to address fundamental issues associated with the culture of Australia's tax system, as a primary objective. In particular, it seeks to reduce the level of adversarialism present during discussions between government and industry about design of tax policy and law. This adversarialism is, according to the academic experts who have been consulted for the Review, relatively unique amongst OECD nations and an important reason why simplification can be difficult to achieve, even when simplification measures are seemingly innocuous.

By reducing the adversarial nature of the tax system, and the tensions associated with that adversarialism, a National Compact can assist stakeholders to have a balanced discussion about simplification. It is ACIL Allen's view that a balanced (and impartial discussion about simplification) will help to reduce tax practitioner preferences for aggressive tax planning and industry group preferences for special concessions (grandfathering) as they will be at odds with the general principles of a National Compact. It will also likely reduce the goal of minimising revenue losses by tax administrators (based on a fixed view about tax avoidance) that leads to increased procedural complexity and frequent changes to the tax system.

Under a National Compact, parliamentary drafts people will have a strong set of guiding principles within which to develop tax law. The presence of these principles will overtime minimise the need for legislation to be re-drafted as the intent of the legislation will be more clearly articulated at the outset.

Under a compact, tax authorities (especially the Treasury) will also have a stronger foundation upon which to advise governments about policy proposals especially where policy proposals which pursue non-revenue policy objectives are at odds with the National Compact principles.

What is required to implement the building block?

In order to progress this building block it will be necessary to undertake three distinct, yet related activities. These activities will need to be initiated by government before implementation support can be sought from other stakeholders.

First, government will need to establish the processes and bodies that will develop, implement, monitor and then report on the National Compact. This will require the establishment of an oversight body, committee, or joint taskforce which represents the major interests who will sign the National Compact. A number of models for this body have been identified and discussed with the ACIL Allen Review Team throughout this Review.

One such model, which we believe has merit because it leverages existing structures and expertise, is to link the governance arrangements of a National Compact to the Board. These linkages could be in the form of a Board sub-committee which reports directly to the full Board, or an independent body which reports directly to a Board with an expanded remit.

Whatever model is chosen the body will have responsibility for identifying an appropriate terms of reference for the National Compact's development and management, as well as identify and plan for a national consultation process.

Second, government will need to support the development of a National Compact which attracts a high degree of stakeholder support. Most, if not all, of the compacts reviewed for this report were underpinned by a stakeholder engagement survey which identifies the issues that stakeholders would like to see addressed in the National Compact document and how the document should be structured/presented. (Based on the compacts reviewed for this project, the potential contents of a National Compact are provided in **Box 8.1** below.)

It will also be important for government to engage a range of independent experts to scope and draft the compact, and to undertake a relatively extensive pre and post-drafting consultation process. The National Compact development process will also require a process for gaining key stakeholder approval and signatures to the final document.

Given the policy significance of a National Compact, the public release and promotion of a final document will also need to be considered as part of the design process.

BOX 8.1 SUGGESTED CONTENTS AND LOGIC OF A TAX SYSTEM COMPACT

Ministerial (i.e. Prime Minister, Treasurer, Assistant Treasurer or Revenue Minister) forward

This section would demonstrate high level political support for the compact and the desire to simplify the tax system to everyone's benefit. It could also include endorsements by the Commissioner of Taxation and other key signatories to the National Compact.

Compact principles

This section would provide the broad principles which determine actions and investments under the National Compact. The principles could be derived from this report or from previous reviews of the national tax system (such as the principles outlined in Schedule 1 of the Ralph Review 1999).

Compact undertakings and actions

This section would provide an outline of the major issues that the National Compact is seeking to address and identify investment areas for delivering outcomes against each issue. It also highlights the commitments that key signatories to the compact will endeavour to undertake.

Compact governance and implementation

This section would outline the governance arrangements of the compact. These could include a board or committee with the distinct terms of reference and the nomination and appointment processes associated with key decision making roles under the National Compact. It would also include information about how compact initiatives are rolled out across the entire system. The section should focus on more the role of government during implementation and cover the activities of other signatories to the agreement.

Compact measurement and reporting

This section would detail how the National Compact's effectiveness should be measured and reported to parliaments, other stakeholders and the broader community.

SOURCE: BASED ON ANALYSIS UNDERTAKEN BY ACIL ALLEN

The final task will involve the ongoing monitoring, reporting and review of the National Compact once it has been established. In order to undertake these activities it will be important to:

- empower and resource a body to monitor activity of signatories to ensure compliance against its provisions. This will extend to the collection of data which allows for the regular reporting (either annually or biannually) against the National Compact's targets, goals or objectives
- agree on protocols for sanctioning signatories to the National Compact who do not meet its core principles – transparency would be a key way of holding signatories to account
- review and where necessary refresh the National Compact to ensure it is relevant to stakeholders and appropriately targeted towards simplification. Compacts used in the education, community and health sectors are reviewed on a three to five year cycle depending on the needs of the sectors in which they operate.

8.2.2 Building block: Implement a principles-based legislative model that embraces the use of subordinate legislation and other administrative instruments

Rationale

This building block seeks to reconfigure the tax law around a model that enshrines fundamental principles in the core legislation and transfers all of the detail underpinning the legislation to subordinate legislation (e.g. regulation) and administrative instruments. By detail, ACIL Allen refers to the elements of the current legislation that describe how the law works in detail. Changes to the core legislation would occur infrequently and only if significant issues arose with the application of core principles. Changes to the subordinate legislation/instruments would require significant cross-referencing to the principles to ensure they are consistent with the core legislation (as per the US tax code).

*"We over complicate things because we try to anticipate every scenario in the core of the tax law."
Senior tax adviser*

The advantage of moving the detail out of the core legislation and into the subordinate and guidance material is that the core legislation, which would embody the principles of the law, would be relatively stable and less in need of frequent amendment by Parliament. Subordinate and guidance material could be amended as and when needed relatively easily, with detail taken out if it becomes unnecessary, thus reducing the tendency of tax law to accumulate.

*“Tax authorities often want to use thermonuclear devices to address every possible scenario for non-compliance. This is just crazy.”
Professional body stakeholder*

The basic premise of the model is provided in **Figure 8.1** below. The model is underpinned by high levels of trust amongst key system stakeholders: trust that tax payers and their advisors will meet the intent of core legislation, and trust that tax authorities and courts will ensure consistency is maintained in the interpretation of core legislation and subordinate instruments.

At the top of pyramid is core, or primary, legislation, which sets out the principles on which tax law is based.

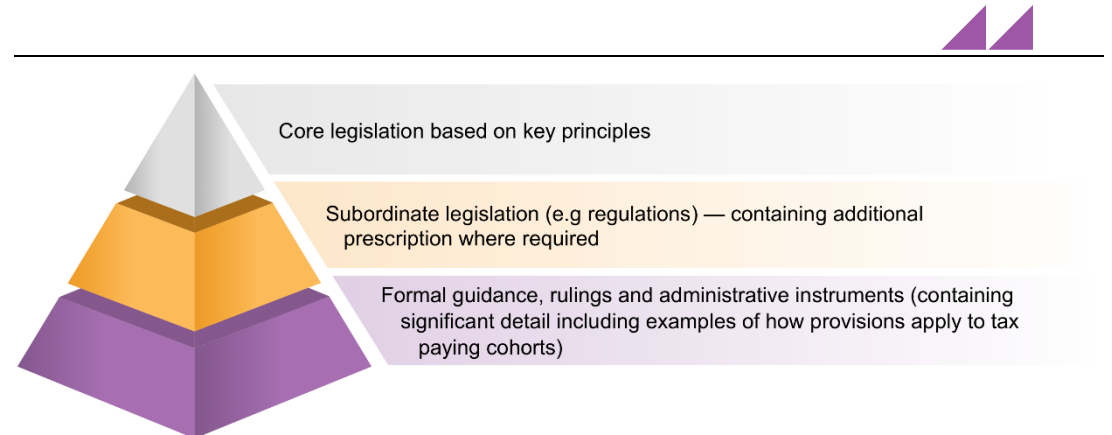
In the middle of pyramid is subordinate legislation, such as regulations, which would be based on the core legislation. This subordinate legislation would add the necessary detail to the principles. It would be able to deal with special cases. An advantage of regulations is that, since they are legislative instruments, they ‘sunset’ ten years after commencement.

The bottom layer of the pyramid would comprise formal guidance, rulings and administrative guidance by the ATO, based the core and subordinate legislation. Here, all the necessary detail for particular cases could be dealt with; without any need to change core or subordinate legislation.

*“Regulations are easier to draft, easier to review, and don’t need a spot in the Parliamentary calendar
Senior treasury official*

The point of the model is not that it eliminates complexity. Rather, the complexity is placed where it needs to be. However, by re-organising the level of detail in the three parts of the pyramid, the model could be expected to reduce (though not eliminate) the interaction between different parts of the tax laws, and so reduce the overall level of complexity.

FIGURE 8.1 HIERARCHICAL MODEL OF TAX LAW AND SUPPORTING INSTRUMENTS



SOURCE: BASED ON DISCUSSIONS WITH TREASURY OFFICIALS AND A RECONFIGURATION OF THE AYRES AND BRAITHWAITE MODEL OF RESPONSIVE REGULATION

What drivers of complexity does the building block address?

Drivers addressed:
– All drivers identified in this Review

This building block would fundamentally reform the current legislative and compliance framework. Implementation of this building block would therefore address all drivers identified in this report.

What is required to implement the building block?

Reform activities will need to be tightly scoped and carefully managed. It will require a dedicated project to review all of the current legislation, regulation and guidance material and re-draft the entire suite of documents. This will require input from national and international independent experts as well as the most experienced officials within government.

Ideally this re-draft would occur as a dedicated multi-year reform project as undertaken during the 1990s. The project should include a considerable level of consultation to ensure buy-in from stakeholders.

To be clear, what is being proposed here is not to rewrite the entire body of Australian tax law along these lines. Rather, the proposal is that this hierarchical model be used as the basis for new tax law, as well as for re-writing selected parts of existing law, for example Division 7A of the ITAA, as discussed in Section 3.3.

Owing to the complex nature of the re-draft it will be necessary to undertake the reforms while the current legislative framework is in operation. Once the re-draft has been finalised the entire framework should be introduced at a point in time, with transitional arrangements to support its implementation. Given that the detail of the model will be included in sub-ordinate instruments (as distinct from the core legislation) it will be possible to phase in a proportion of the regulations and detailed guidance supporting the new model over time.

8.2.3 Building block: Establish an independent body to advise on tax simplification

Rationale

This building block establishes an independent body to provide evidence-based and authoritative advice about complexity and the ongoing evolution of the tax system. A key focus of the body should be on the provision of advice which aims to simplify existing laws as well as make proposals to implement new provisions.

The body should include representation from government, industry and the advisory industry, as well as expertise from the commercial and community sectors. The body would focus on technical aspects of the tax system as opposed the fundamental issues relating to the tax mix or policy design. The body would be given its own budget and staffing resources to ensure its independence from Treasury and other tax authorities (i.e. the resourcing model used for the Productivity Commission to ensure its ongoing independence from executive government).

During the course of this project ACIL Allen has identified a number of potential models for the body. These include:

- a body reporting directly to the Board (which would be given governance and accountability responsibilities for the body). The body would be staffed by its own officers to ensure independence from the Treasury and ATO however, be given an expanded remit and additional resources to work through a an agreed simplification agenda
- a Productivity Commission or Law Reform Commission-style body. This model would draw on technical expertise (including in economics and law) to deliver robust analysis of the full cost of complexity (existing tax system), and the costs associated with any new (significant) policy proposals
- an OTS-style body. This model would establish an independent permanent body to be the face of tax system simplification. The role of the body would include significant interface with Members of Parliament to ensure a focus on simplification is maintained on an ongoing basis.

What drivers of complexity does the building block address?

This building block would potentially address all drivers identified in this Review.

What is required to implement the building block?

In order to progress this building block it will be important for government to agree on the most suitable model. This decision making should be underpinned by a feasibility study that explores the comparative merits of the different models (identified above) and undertakes some form of cost benefit analysis (which includes indirect costs and benefits). As part of the feasibility study the appropriate scope and constitution of the body should be identified and tested with stakeholders.

A key aspect of the testing will need to be the level of resilience each option has to the pressure associated with advising and commenting on tax reform. A body with low levels of resilience will not deliver the simplification outcomes required by the tax system.

Following the assessment process, it will be important to establish a framework for nominating, appointing and renewing members to the governing board of the body. Ideally nomination should be based on the skills required to advise government and deliver large scale reforms to the tax system.

Drivers addressed:

- *All drivers identified in this Review*

Such an approach is consistent with best practice corporate governance as recommended by the Australian Stock Exchange's (ASX's) Corporate Governance Council 3rd Edition.⁵² There may be a case to appoint a small number of members to the governing board of this body on a representative basis, however, only a minority of members should be appointed on this basis to ensure alignment with good practice.

Once the framework for nomination and appointment has been established it will be necessary to operationalise the body. This will require the body to have a charter of operation and the resources, staffing arrangements and operating procedures in place to deliver an agreed simplification agenda.

The body will need to ensure it is accountable for its use of public funding and appropriate reporting requirements will also need to be established prior to its operationalisation.

8.2.4 Building block: Establish a Joint Standing Committee of the Commonwealth Parliament focussing on tax system simplification

Rationale

This building block establishes a joint standing committee to examine (over the longer term) excessive complexity and to identify remedies which address the problem. A joint committee would assist in developing bipartisan support for simplification at the highest levels of government and provide a public profile for issues related to simplification.

The committee's role would need to be clearly defined so as not to duplicate the functions of other committees such as the House of Representatives Standing Committee on Economics, the House of Representatives Standing Committee on Tax and Revenue, the Joint Committee of Public Accounts and Audit (JCPAA) committee (a joint committee of the House and the Senate), and the Senate Standing legislation and reference Committees on Economics. The roles of each committee are provided in **Box 8.2** below to illustrate what areas of investigation are already covered by the committees.

*"There is no political commitment to get rid of complexity, something which has a Parliamentary focus is required."
Senior government official*

⁵² ASX Corporate Governance Council, *Corporate governance principles and recommendations*, (ASX Corporate Governance Council, 2014), <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>.



Role of the House of Representatives Standing Committee on Economics

The House of Representatives Standing Committee on Economics is appointed under Standing Order 215. The Committee may inquire into and report on any matter referred to it by either the House or a Minister, including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or document.

Appointed under Standing Order 215d, the Committee consists of six government members and four non-government members. Each House committee may have its membership supplemented by up to four members for a particular inquiry, with a maximum of two extra Government and two extra Opposition or non-aligned Members. Supplementary members shall have the same participatory rights as other members, but may not vote.

Role of the House of Representatives Standing Committee on Tax and Revenue

The Committee may inquire into and report on any matter referred to it by either the House or a Minister, including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or document.

The Committee reported, in 2014 and 2015, on annual reports of the ATO, tax disputes, and the Tax Expenditures Statement.

For the 44th Parliament, the Committee comprises six Government members and four non-Government members.

Role of the Joint Committee of Public Accounts and Audit

The JCPAA owes its existence and authority to the Public Accounts and Audit Committee Act 1951 (the PAAC Act). The JCPAA is also one of the oldest committees in the Parliament, having first been established in 1913.

The purpose of the JCPAA is essentially to hold Commonwealth agencies to account for the lawfulness, efficiency and effectiveness with which they use public monies.

Role of the Senate Standing legislation and reference committees on Economics

The Senate Standing Legislation Committee on Economics deals with bills referred by the Senate, the Estimates process, and oversees the performance of departments including their annual reports. This Committee comprises six Senators; three nominated by the Leader of the Government in the Senate, two nominated by the Leader of the Opposition in the Senate, and one nominated by minority groups and independent senators. The Economics portfolio coverage includes the Treasury and the Department of Industry, Innovation and Science.

The Senate Standing References Committee on Economics deals with all other matters referred by the Senate. This Committee comprises six Senators; two nominated by the Leader of the Government in the Senate, three nominated by the Leader of the Opposition in the Senate, and one nominated by minority groups and independent senators.

SOURCE: "WELCOME TO THE PARLIAMENT OF AUSTRALIA," PARLIAMENT OF AUSTRALIA, 2016, WWW.APH.GOV.AU.

What drivers of complexity does the building block address?

Drivers addressed:

– All drivers within the control government that have been identified in this Review

This building block will address all drivers within the control of government that have been identified in this report. The drivers include:

- *Protection of tax revenue.* A certain degree of tax complexity (basic institutions, anti-avoidance measures, etc.) is necessary to ensure that a given amount of tax revenue can be collected and that the integrity of the tax base can be maintained.
- *Use of tax law for non-revenue policy objectives.* The tax system is often used to redistribute income and achieve other non-progressivity socio-economic objectives (for example, tax of 'sins' or negative externalities).
- *Distinction between taxes and transfers.* The fact that transfers are not treated as negative taxes complicates the tax-transfer system.
- *Broadening of tax base.* Tax base broadening typically increases the number of taxpayers and thus raises effective complexity (for example, replacement of the Wholesale Sales Tax (WST) by the GST in Australia in 2000).

- *Frequency of tax law change.* This makes the tax system more complex because of the need to learn new legislation and the cumulative effect of legislative changes, thus giving rise to both legal and effective complexities.
- *Tax law drafting.* Poorly drafted tax laws (whether in the linguistic sense, in the organisational scheme or in the ‘principles versus rules’ approach) cause statutory complexity.
- *Minimisation of tax revenue losses.* Tax administrators often attempt to minimise revenue losses through a variety of practices (e.g. compulsory lodgement of tax returns or frequent reporting of business income) that can increase procedural complexity.

What is required to implement the building block?

In order to progress this building block it will be important to gain government and then broader parliamentary support for a new joint standing committee. ACIL Allen recognises that while the establishment of a joint committee is possible it can only be sustained with the broader support of the Parliament, and Parliament as a whole (not just government members) will need to be convinced the idea has merit. A communication process will need to be established to support the case for this building block, which could include some indication of the inquiries and studies the committee could undertake.

As part of the establishment process the role or scope of the committee will need to be identified and enshrined in legislation.

8.3 Process-based building block

This section outlines a range of investments or actions that could support improvements to the processes and procedures underpinning current tax policy and law design. These building blocks have also been identified by stakeholders as important to achieving simplification outcomes for the tax system.

8.3.1 Building block: Implement much strengthened consultation process for tax policy development and post-implementation review

Rationale

This building block seeks to revise the framework underpinning consultation processes. As discussed in Section 7.4.1, Treasury and the ATO currently undertake a substantial amount of consultation on proposed tax policies.

While there is nothing inherently wrong with the Treasury and ATO consultation frameworks, there is a commonly held view that consultation occurs too late in the policy and law design process, and that this consultation does not give stakeholders adequate time to review and comment on the raft of proposals often put to the community for consultation.

The revised process would provide minimum and maximum timeframes for consultation and guide the way consultation occurs on all new legislation, amendments to existing legislation, and post-implementation reviews.

The new processes would also seek to increase the level of consultation that occurs on policy proposals and policy reform options before they are presented in draft legislation for public consultation. This building block seeks to increase the level of transparency around the consultation process and seeks input (in particular) from trusted stakeholders much earlier in the tax policy and law design process than typically now occurs. Such an approach would mirror NZ’s common policy process (as discussed in Appendix A to this report), by providing higher levels of transparency during the consultation process and thus giving stakeholders improved certainty as to when and how the consultation will occur.

What drivers of complexity does the building block address?

This building block is designed to address a broad number of complexity drivers identified during the Review. By improving the transparency of consultation and delivering greater certainty to participants

*“No one knows whether consultation outcomes have been passed up the line in the ATO or in the Treasury.”
Industry stakeholder*

Drivers addressed:

- *Adversarial culture*
- *Tax law drafting*
- *Frequency of tax law change*
- *Clarity of policy intent*

of the consultation process, the building block is intended to gradually improve the culture of tax policy debate. This will be achieved through greater transparency in decision making which is one mechanism that can reduce the level of adversarialism between tax authorities and taxpayers.

By improving the transparency of consultation processes, governments will be required to more clearly articulate the policy intent of any proposed changes to the tax law, which should in turn reduce the need likelihood of complex wording in the drafting and the need to amend tax provisions over time.

What is required to implement the building block?

In order to progress this building block it will be important to critically examine current consultation processes with a view to identifying opportunities to address its current weaknesses. This should include closer inspection of the NZ model to identify lessons that are relevant to Australia.

Following the examination it will be important to develop a revised consultation framework for tax policy and law design. This framework will require the approval of government ministers, industry and major stakeholders to ensure high level of acceptance for the new framework. Revised accountability arrangements may also be required to ensure key processes are being followed under the new framework.

“Some tax law is complex. But that does not mean it needs to be drafted in a manner that is confusing and unreadable. Treasury and the OPC could address this quite easily.”
Professional body stakeholder

8.3.2 Building block: Introduce an annual consolidated tax amendment bill

Rationale

This building block introduces a UK-style annual omnibus tax bill which would include all legislative proposals and amendments to the tax legislation. The building block seeks to reduce the frequency of changes put to Parliament and provide drafters with an opportunity to consider the implications of each proposal/amendment on related aspects of the tax law within the context of a consolidated tax amendment bill. Legislative changes outside the omnibus tax amendment process could still be made, however, these would be the exception rather than the norm.

As an alternative, there could be an annual tax simplification bill where redundant legislation was repealed or unnecessary detail relating to the primary tax law was moved—to guidance material, for example.

“When laws are complex, they inevitably have to be changed all the time”
Senior tax official

What drivers of complexity does the building block address?

This building block will address the drivers associated with the frequency of tax law changes and those related to the drafting process.

Drivers addressed:

- Tax law drafting
- Frequency of tax law change

What is required to implement the building block?

Omnibus annual bills are not currently part of Australia’s legislative process. The reasons for this are cultural. Governments have traditionally sought the flexibility and strategic benefits of introducing bills at a point in the parliamentary calendar when it best meets their political priorities.

The reasons are also procedural, as the parliamentary calendar is broken into three sitting periods (Autumn, Winter and Spring) and these periods do not naturally lend themselves to the introduction of an annual bill.

That being said, it would be possible to introduce a bill during one of these sitting periods for approval by both houses. This would require significant discipline within government to ensure a consolidated set of amendments are tabled in Parliament and coordination support within the Prime Minister’s Office, the Treasury, ATO and OPC to ensure the bill is ready to be tabled at the agreed time.

8.3.3 Building block: Ensure that each piece of tax legislation includes a fulsome objects clause

Rationale

*“Even now, the ATO and Treasury have different views of policy intent at the early stages of policy development.”
Industry stakeholder*

This building block seeks to clearly articulate the policy intent of all tax legislation. This intent will not only cover *what* the section/division should do, but *why* it should also do it. This building block involves the inclusion of an objects clause (or several, if appropriate) in each piece of new tax legislation. It may also include amending existing tax legislation to include objects clauses which explain why the legislation was enacted in the first place in instances where objects clauses only address what the section/division is intended to do.

By including the overarching goal in each major section or division of the tax law, government may assist in binding together the various pieces of legislation that cover the tax code in Australia with a common purpose. In Australia, the foundations for such a goal are provided for by legislation in other areas (such as the *Environment Protection and Biodiversity Conservation Act 1999 (Cth)*, which in turn has been informed by the Convention on Biological Diversity to which Australia is a signatory). Ideally these common purpose statements should be underpinned by international precedents in law where it makes sense to do so. By way of example, the OECD provides the basic principles and parameters from which many objective statements can be developed which directly address fundamental questions about why the legislation has been enacted by Parliament.⁵³

Moreover, the objects clauses should set out the principle on which a measure is based or, if the measure is a deliberate deviation from a principle, the goal of the deviation. For example, this would make the rationale clear about why certain subsidies or concessions are given.

While this building block could be implemented as a standalone measure, it would be supported by the principles-based legislative model building block. Implementing the latter building block would support the development of objectives clauses through the identification of principles in the legislative drafting process.

What drivers of complexity does the building block address?

Drivers addressed:

- *Clarity of policy intent*

This building block addresses issues relating to the lack of policy intent present in many laws and complex rules often implemented by government to protect the integrity of measures where the purpose is unclear.

What is required to implement the building block?

In order to progress this building block, it will be important to apply different considerations for new and existing tax legislation. For new legislation, a clear government decision about policy intent would be required. Objects clauses would need to be carefully drafted to reflect the intent and why the intent is important. This may prove to be a challenge for government initially, but will become easier over time as the expectations on government increase and the policy culture subsequently changes.

For existing legislation, government would need to develop discussion papers and consult with industry on retrofitting objectives clauses onto existing legislation or redrafting existing objects clauses. It is acknowledged that this will be a difficult and potentially resource intensive exercise, but is a worthy objective to pursue within government.

The final version of objects clauses would be subject to amendment through the Parliamentary process.

⁵³ The Law Society of NSW Young Lawyers, *Submission on the Independent Biodiversity Legislation Review Panel: Issues Paper*, September 12, 2014, <https://www.lawsociety.com.au/cs/groups/public/documents/internetyounglawyers/905697.pdf>.

8.4 Capability and capacity-based building blocks

This section outlines the capability and capacity-based investments that are necessary to support a focused and ongoing simplification agenda.

8.4.1 Building block: Increase the level of resources within Treasury, ATO and OPC to deliver simplification and enhanced integrated tax design outcomes

Rationale

ACIL Allen recognises that simplification and enhanced tax system integration are important but resource intensive activities. It will be important to ensure that Treasury, the ATO and OPC have the resources and expertise necessary to deliver a long term agenda in a way that provides stakeholders with confidence that the change is being effectively managed.

ACIL Allen notes from this Review that considerable tax system design expertise has retired or left the public service over recent years. This expertise will need to be replaced (or grown in-house) to ensure effective tax design advice is delivered to government on an ongoing basis.

Additional secondments between government agencies (where required) or secondments from private sector tax accounting firms could be one way of addressing these resourcing issues any others associated with simplification.

The building block could also include enhanced professional development for tax policy makers and legal drafters (who, for example, are asked to work on a single issue, but the issue has significant implications for other aspects of the tax law) where skills gaps are identified as inhibiting the simplification process.

What drivers of complexity does the building block address?

This building block would potentially address all complexity drivers within the control of government, as shown below:

- *Protection of tax revenue.* A certain degree of tax complexity (basic institutions, anti-avoidance measures, etc.) is necessary to ensure that a given amount of tax revenue can be collected and that the integrity of the tax base can be maintained.
- *Use of tax law for non-revenue policy objectives.* The tax system is often used to redistribute income and achieve other non-progressivity socio-economic objectives (e.g. tax of 'sins' or negative externalities).
- *Broadening of tax base.* Tax base broadening typically removes special concessions, reducing the effective complexity (e.g. replacement of the Wholesale Sales Tax (WST) by the Goods and Services Tax (GST) in Australia in 2000).
- *Frequency of tax law change.* This makes the tax system more complex because of the need to learn new legislation and the cumulative effect of legislative changes, thus giving rise to both legal and effective complexities.
- *Tax law drafting.* Poorly drafted tax laws (whether in the linguistic sense, in the organisational scheme or in the 'principles versus rules' approach) cause statutory complexity.
- *Minimisation of tax revenue losses.* Tax administrators often attempt to minimise revenue losses through a variety of practices (e.g. compulsory lodgement of tax returns or frequent reporting of business income) that can increase procedural complexity.

What is required to implement the building block?

In order to progress this building block it will be important to consider the following investments:

- Provide Treasury, ATO and OPC with additional resources (time and staffing resources) to ensure effective consideration of the linkages between tax changes and other parts of the tax code. This could include the establishment of OPC-style capability within Treasury (as per the Canadian model) to provide a concentration of expertise that can deal with the complexities on an ongoing basis

*"Fixing the problem of complexity is an expensive business, it's going to take some time and quite a bit of money. Although, if you ask me, it's worth every cent."
Government official*

*"Treasury is grossly under-resourced to deal with complexity."
Senior tax adviser*

Drivers addressed:

- *All drivers within the control government that have been identified in this Review*

- Support the agencies to arrange additional secondments within government and between government and the tax profession. It is noted that these secondments already occur, but they could be expanded significantly to assist in delivering a complex and time consuming simplification agenda.
- Training and professional development programs where skills gaps or areas of inexperience are identified and are deemed to impede the progress of simplification.

The resource costs associated with this building block would only be a fraction of the benefit which could be derived if the burden of complexity was reduced by government.

8.4.2 Building block: Build a better understanding of the costs of tax system complexity

Rationale

This building block generates a greater understanding of the costs of complexity in the existing tax system which is estimated to be a proportion of cost of compliance estimated in *Re:think, Tax discussion paper*. This building block involves the Productivity Commission (or other body) undertaking a detailed study about the compliance costs of the tax system, and the economic costs associated with different taxes and tax mixes. The building block also involves identifying which parts of each law give rise to the most complexity so they could be targeted for reform.

The study would be an authoritative source on tax system complexity and be used as a platform to drive change.

What drivers of complexity does this building block address?

This building block generates a deep understanding the full costs of compliance and therefore provides evidence to address all of the complexity drivers identified in this Review.

What is required to implement the building block?

This building block requires government support for an inquiry, and agreement with the Productivity Commission or other body to undertake an inquiry into tax system simplification. A terms of reference, timeframe and inquiry budget will also need to be set as part of the implementation process.

8.4.3 Building block: Build a stronger understanding amongst Ministers, ministerial advisors and political parties about the implications of changes to the tax system

Rationale

This building block generates a common understanding amongst Ministers, their advisors, political parties and the broader community about the implications of changes to the tax system. This understanding will extend beyond the existing RIS process which is generally seen amongst stakeholders consulted for this Review as an ineffective tool of decision making.

By building a common understanding, political decision makers will be better prepared to resist the pleading and special interest considerations of lobbyists who unreasonably seek changes to the tax law for their own benefit.

This building block requires Treasury to cost the proposed changes in terms of revenue (which it does now) and document all the potential material implications (in terms of complexity, compliance and administration costs) of a legislative change or proposal. This way all of the impacts associated with the change, including the costs of complexity, would be presented to the relevant Minister and other political decision makers for consideration. While compliance cost impact statements are provided to Government in RIS at the decision-making stage, and in explanatory memoranda, these costs cannot be assessed with great precision and this poses a significant challenge.

This building block may require the development of stronger tools to identify potential costs at an earlier stage in the policy development process.

Drivers addressed:

- All drivers identified in this Review

*“Political deals done to get legislation passed are a huge cause of complexity.”
Senior government official*

*“Sometimes seemingly simple tax changes in fact create complexity.”
Senior government official*

Drivers addressed:

- Tax law drafting
- Frequency of tax law change
- Use of tax law for non-revenue policy objectives.

What drivers of complexity does this building block address?

This building block addresses the drivers associated with using tax law for non-tax purposes. It also assists in developing tax law that is simple and requires less modification over time.

What is required to implement the building block?

In order to progress this building block it will be important to support Treasury (or another body) to undertake earlier and stronger assessments of the potential compliance costs associated with the proposed changes. It will also require a communication strategy to ensure stakeholders to government are cognisant of the outcomes of these assessments.

8.5 Implementation considerations

8.5.1 Which building blocks withstand scrutiny?

As part of this Review, ACIL Allen assessed the pros and cons of each building block. Pros and cons were considered from the perspective of the outcomes they would deliver (i.e. increased simplification, trust, predictability), the ease of their implementation and the level of stakeholder acceptance they would attract following the completion of this Review and further testing with the stakeholder group.

The results of this analysis are provided in **Table 8.3** below. The results should only be viewed in a general sense to give an overall impression of the desirability of each building block and its suitability to deliver simplification outcomes.

TABLE 8.3 ASSESSMENT OF THE BUILDING BLOCKS PRESENTED IN THIS REPORT

Building block	Outcome being sought	Implementation considerations	Stakeholder acceptance	Overall conclusion
National Compact				
Pros	<ul style="list-style-type: none"> – Focused solely on developing trust, a common understanding, and mutual responsibility among tax system stakeholders – Provides a formal mechanism for shaping policy advice Treasury and ATO give to Ministers and government – Successfully used in other sectors where common goals need to be identified to deliver national policy outcomes that transcend the interests of selected stakeholders 	<ul style="list-style-type: none"> – It is a good time to establish a National Compact (i.e. a number of government stakeholders consulted for this project have already provided in principle support for this idea) – Champion within Government (ATO) already identified during this Review 	High within Government – especially ATO	Worthwhile proposal with significant merits
Cons	<ul style="list-style-type: none"> – National Compact may not generate behavioural change – Risk amongst signatories that the National Compact will be full of motherhood statements, real change may not actually occur 	<ul style="list-style-type: none"> – Difficult to develop an accountability system under a National Compact 	Potentially low acceptance amongst industry and tax profession, but this has not been tested with stakeholders	
Principles-based legislative model				
Pros	<ul style="list-style-type: none"> – Subordinate instruments can be amended quickly and as required. Changes could be made in the first instance to formal guidance, rulings and administrative instruments, then in the second instance to regulations, and, only if needed, to the legislation 	<ul style="list-style-type: none"> – None identified 	Strong support from a selection of Treasury officials consulted for this Review for the model	Worthwhile proposal which requires strategic thinking and detailed implementation planning in order to be successful

Building block	Outcome being sought	Implementation considerations	Stakeholder acceptance	Overall conclusion
	<ul style="list-style-type: none"> – Could fundamentally re-shape the dynamic of consultation around tax system change. Consultation about changes to the core legislation would be extensive, timetabled and detailed. Consultation about the other changes could be more dynamic, issue-based and pitched at the level where the changes occur 			
Cons	<ul style="list-style-type: none"> – Will need to demonstrate that revenue is not significantly at risk under the model – Potentially shifts the issue of complexity to lower order instruments, and unnecessary complexity continues to undermine the performance of the tax system – Will need to gain high level political support for the reforms – Accountability will be an issue if administration is used in place of legislation 	<ul style="list-style-type: none"> – Difficult to implement. Wholesale change would be required over incremental reform 	Tax agents would need to be provided assurance that a level of certainty and consistency can be delivered by the reforms	
Independent simplification body				
Pros	Pros differ depending on the model chosen		High level of acceptance amongst most Government stakeholders consulted for this project	Worthwhile proposal requiring further analysis of the appropriate model
Cons	Cons differ depending on the model chosen		Some industry stakeholders expressed scepticism about the benefits of another tax body	
Joint Standing Committee of Parliament				
Pros	<ul style="list-style-type: none"> – Standing committees endure the life of the Parliament and governments – Joint committees are a sound mechanism for gaining bipartisan support over simplification – Elevates simplification to the highest levels of government and potentially the national media – which assists in building political and community support 	None identified	Proposal has support from some parts of the tax profession	Proposal has a strong rationale, but implementation will be difficult without bipartisan support
Cons	<ul style="list-style-type: none"> – Potential overlap with the current Standing Committee of Economics – Committee may lose political salience over time and government may ignore committee reports – Committee may find it challenging to source staff with the required expertise – Obtaining the bipartisan support that is needed for success may be a significant ongoing challenge for the committee 	Potentially difficult to gain Parliament's agreement to establish these types of committees	Parliament may not be interested in establishing another committee, however this has not been tested with Parliamentarians	

Building block	Outcome being sought	Implementation considerations	Stakeholder acceptance	Overall conclusion
Improved consultation				
Pros	<ul style="list-style-type: none"> Provides consistent and transparent process for tax policy and law design Provides consistent framework and processes for consultation Stakeholders understand processes and routines and engage in a meaningful relationship-based way (i.e. not in a one-off transactional approach) Australia model could draw on existing NZ model 		Proposal welcomed by tax agents and a number of government stakeholders consulted for this project	Worthwhile proposal requiring further analysis of the appropriate model
Cons	<ul style="list-style-type: none"> Potentially difficult to gain political support for the establishment and operation of the process Difficult to include all stakeholders in the process all of the time (i.e. in a larger system such as Australia this will be logistically problematic) Risk that the new process is captured by special interest groups or partisan stakeholders 	Potentially costly to include a large number of participants in the preliminary design phase of all new tax policies and laws	None identified – all stakeholders consulted for this Review support enhanced consultation processes	
Omnibus annual bill				
Pros	<ul style="list-style-type: none"> Assists drafters and instructors to adopt a whole-of-tax-code approach to changes Reduces the number of changes that are offered during the year Provides a structured approach to drafting which allows OPC to better plan for the year and to ensure sufficient resources are attached to complex drafting exercises 		Acceptance amongst some tax advisors and government officials consulted for this Review	Proposal has merits but requires further testing and exploration before it can be adopted
Cons	<ul style="list-style-type: none"> Parliamentary sitting schedule is not aligned with an annual bill of this nature Tax bills are commonly referred to a standing committee and it could be impossible to fit a single bill into the standing committee timetable 	Different starting dates for different changes will mean that a single bill will include some retrospective provisions. This may be unworkable in reality	<ul style="list-style-type: none"> Proposal has not been tested with Parliamentarians Senior government officials are sceptical about the merits of this proposal due to competing and constantly changing drafting priorities 	Note: this analysis does not extend to the identified alternative of an annual simplification Bill
Fulsome objects clauses				
Pros	<ul style="list-style-type: none"> Requires policy makers to clarify the intent of tax policy Better clarifies the policy intent of tax legislation for the ATO, tax practitioners and taxpayers The ATO and courts would have recourse to objects clauses when interpreting legislation 	Rules and guidelines relating to clauses could be easily introduced for new legislation	Universally acknowledged by all stakeholders consulted for this Review as a highly valuable proposal	Worthwhile proposal which requires further investigation

Building block	Outcome being sought	Implementation considerations	Stakeholder acceptance	Overall conclusion
Cons	May change the understood policy intent of existing legislation. This may increase uncertainty in the interpretation of legislation until case law settles any change to the interpretation	Will be difficult and time consuming to introduce clauses for existing legislation	May be difficult to gain political acceptance about the need for such clauses	
Appropriately resource Treasury, ATO, OPC and others				
Pros	<ul style="list-style-type: none"> Builds on existing expertise, practices and processes within Treasury Increases the likelihood that drafting instructions will be clear and more easily translatable into draft legislation 	Relatively easy to implement providing resources can be made available or re-allocated to meet this proposal	Strong support within government officials and other stakeholders for this proposal	Worthwhile proposal if resources can be allocated to simplification
Cons	<ul style="list-style-type: none"> Cost and budget pressure Skills and experience related to instructing take many years to build 	Finding additional resources in a budget-constrained environment	Proposal not tested with Parliamentarians	
Costs of tax system complexity				
Pros	<ul style="list-style-type: none"> Better informed policy debate May build community, industry, policy community and political support for reduced complexity in the tax system 	Review outcomes will be accepted by decision makers if undertaken by an authoritative and independent body	High amongst government stakeholders, academic experts and a selection of tax agents consulted for this review	Worthwhile proposal which requires further investigation
Cons	Cost of undertaking the review	The cost and mechanics of running a large review process	Proposal not tested with the Productivity Commission nor Ministers	
Implications of new proposal				
Pros	<ul style="list-style-type: none"> Targets key decision makers responsible for policy development Builds understanding at the right levels within the tax system Useful for helping to generate future champions of tax system simplification 	Would provide a time series data set suitable for policy development and planning	Some appetite for this option amongst the non-Treasury central agencies consulted for this Review	Worthwhile proposal which requires further investigation
Cons	<ul style="list-style-type: none"> Potentially costly: Treasury would need to updates the costings regularly to ensure they are accurate and credible sources of information Tax simplification may have low salience (relative to other goals) to the stakeholders the information is attempting to impact 	Cost of regularly producing the analysis could be considerable and impact on other requirements such as MYEFO and other budget reporting	Proposal not tested with Treasury nor Ministers	

SOURCE: ACIL ALLEN

8.5.2 Sequencing of implementation activities

The section above identified that there are merits in pursuing (or at least investigating) all of the building blocks discussed in this chapter. However, not all of the building blocks discussed in this chapter are created equally. For example, the architectural and institutional building blocks are intended to elicit fundamental reform of the existing tax policy and law design framework. These proposals seek to institute a new way of designing tax policy and law that delivers simplification.

By comparison, the process-based and capability and capacity-based building blocks seek change to both the current and future arrangements underpinning tax policy and law design. That is, they are equally applicable to a fundamentally reformed tax policy and law design framework, as they are to the current system.

In ACIL Allen's view, simplification should occur over a medium-to-long term timeframe. This timeframe will provide governments with the breathing space to trial new approaches and to see the benefits of cultural change rollout. This time frame is also consistent with the timeframes that other countries (such as the UK) have used to plan for and deliver simplification outcomes. This means that a simplification agenda will extend beyond the life of any single Parliament (and more than likely government) and will require a bipartisan support to ensure progression of an ongoing simplification agenda.

The implementation activities will generally involve three distinct phases, however, it is important to note that there may be some consolidation of these phases where it makes sense to do so. These phases are the:

- *Investigation phase.* In this phase government should explore the feasibility and the high level design issues associated with each building block. The outcome of this phase should provide a clear indication of government's intention to progress the building block and plan for progressing it.
- *Development phase.* In this phase government should tackle all of the design issues associated with the building block and its implementation against an agreed schedule. This phase should also involve detailed consultation (where required) to ensure the parameters of the building block are appropriately identified and the implementation steps/actions will deliver the outcome being sought by government.
- *Operationalisation phase.* In this phase government will be involved in managing the ongoing implementation of each building block.

The implementation activities should be underpinned by constant monitoring and reporting to ensure they are progressing against any overall strategies or implementation plans developed to achieve long term simplification. A number of independent reviews will also be necessary to provide assurance that sufficient progress against any implementation plans set for simplification. These reviews could happen at a high level (progress or interim reviews) or at a detailed level (detailed reviews which include some form of impact analysis) to ensure implementation activities are contributing to the problems as they emerge and support remedial action when it is required.

A high level implementation plan for each building block is presented in **Figure 8.2** below. The figure illustrates the sequencing of each building block and the timeframes associated with different aspects of the implementation process. The figure also indicates when an independent review of each building block is desirable.

8.5.3 Next steps

Stakeholders consulted for this Review recognise ATO's hard work (in recent years) to establish better relationships with tax practitioners. These stakeholders considered that the ATO should continue this relationship building, as one way of addressing complexity.

In terms of this Review, the next steps are as follows:

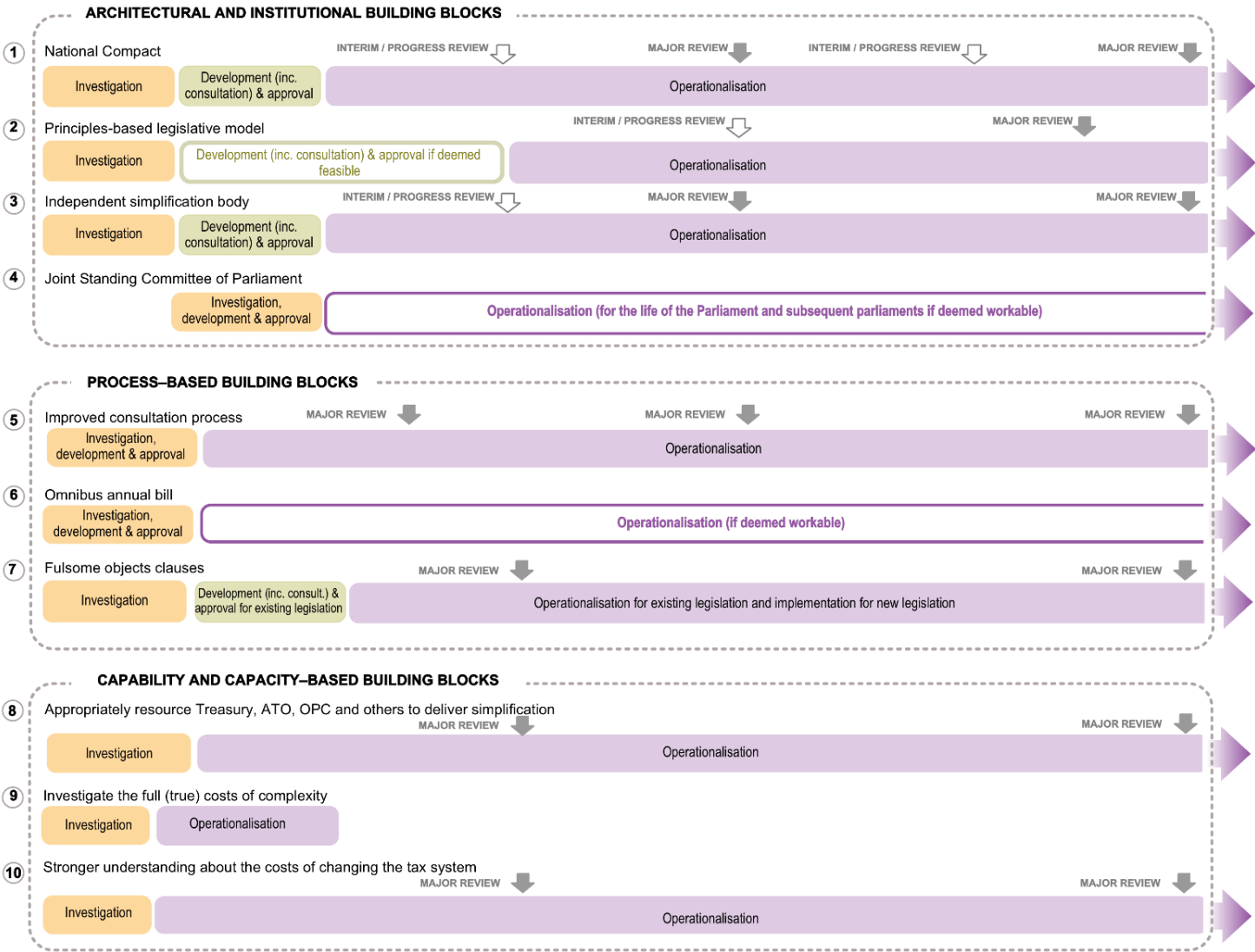
- ATO to circulate this report among government agencies if it considers this appropriate
- ATO to provide a copy of this report to all stakeholders consulted during the project
- ATO to publish this report on its website
- ATO and Treasury to jointly scope out each of the building blocks and discuss them with tax system stakeholders

-
- ATO to consider a detailed plan for implementing each building block. This will involve the sequencing of concurrent investment activities (as outlined in **Figure 8.2**) and developing business cases and new policy proposals where resources are required to fund the activities outlined in this Review. It is assumed that the financial benefits of simplification will, over time, exceed the upfront costs associated with each building block and the overall investment by government will be a fraction of the total resources saved by delivering simplification.

Support from various tax system stakeholders would assist with the implementation of each building block, in part by strengthening government confidence that key stakeholders would support their implementation. Historically, strong stakeholder support has underpinned changes in how Australian tax policy is developed. The rancour of tax debate in Australia makes stakeholder support crucial.

Stakeholders could support the implementation of these building blocks through public statements such as speeches and reports, or private discussions with decision makers. Public statements that support the building blocks, would provide comfort to important constituencies that government is committed to simplification and will invest the effort needed to reduce complexity in tax policy and law design.

FIGURE 8.2 IMPLEMENTATION PLAN



SOURCE: ACIL ALLEN BASED ON ANALYSIS UNDERTAKEN IN THIS REVIEW



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APPENDICES



This appendix provides an overview of selected approaches used to simplify NZ, the UK, and Canada's tax systems. The overview draws on literature which explores: (1) complexity in policy; and (2) complexity in legislative drafting.

A.1 New Zealand

The program of tax simplification in NZ has focussed on both reforming income tax policy since the mid-1980s and rewriting the associated legislation over a fifteen year period.

Policy reform

While the NZ Government has implemented substantial tax reforms since the mid-1980s, this section focusses on processes used to support policy reform over the last two decades.

The NZ Government has used strong consultation processes since at least 1995 and independent groups more recently to support policy reform. The support for reform is underpinned by a culture in which influential elements of NZ society have a shared understanding of the future direction of the NZ tax system, and debate on tax issues over recent decades has lifted the population's understanding of tax issues, allowing government to better resist lobbying by special interest groups.

Since 1995, the NZ Government has used a common consultative process to gain stakeholder input to new tax policies. This consultation process, entitled the Generic Tax Policy Process (GTPP), appears to be well regarded by NZ stakeholders.

The NZ Government has also drawn on independent groups to provide advice on tax reform. The Tax Working Group (TWG), comprising experts from academia, revenue, treasury and tax practice, was created in 2009 to review the NZ tax system from a policy perspective. TWG, crucially, had political support: from both the Minister of Finance and Minister of Revenue. The TWG reported to the NZ Government in 2010 and the government subsequently implemented a number of its recommendations in the 2010 budget.

Rewriting income tax legislation

The NZ income tax legislation was rewritten in a number of tranches over a period of 15 years. The literature indicates that, as in Australia and the UK, the rewriting project has both improved the readability of the legislation and made the complexity of the underlying policy more transparent.

A.1.1 Drivers of complexity

The literature points to a number of specific drivers of complexity in the NZ tax system.

Complexity of concepts

Notwithstanding the reform of tax policy over the last few decades, the complexity of some concepts is one driver of tax system complexity. For example, the distinction between capital and revenue for the purposes of income tax is a source of complexity.⁵⁴

Lack of clarity in legislative drafting

The NZ Government identified over time that many major changes to tax law had increased the length and complexity of income tax legislation.⁵⁵ In 1990, the Valabh Committee highlighted structural and drafting weaknesses in the Income Tax Act 1976 including:⁵⁶

The core provisions not being properly integrated with each other and the rest of the Act;
- the scheme and purpose being difficult to discern;
- the structure of the Act and the ordering of its sections not being logical;
- the organisation not adequately reflecting the Act's role, that role being to quantify taxable income, to -
- impose the tax liability on that income and to set out the process of assessment and collection; and
inconsistent drafting styles, redundant wording, cumbersome sections, and repetitive provisions.

Saw and Sawyer's (2010) research found that long average sentence lengths and use of passive voice contributed to tax complexity.⁵⁷

Frequency of changes to tax law

Freudenberg et al (2012) found that tax advisers of small business perceived there to be a high frequency of tax law changes and changes to guidance documents. These advisers considered that, of 35 aspects around the NZ tax system, the perceived high frequency of tax law changes and changes to guidance documents was the third most complex.⁵⁸ Other aspects with a high ranking of complexity included court decisions changing or clarifying previously accepted practices and government announcements of proposed future changes.

Failure to follow consultation processes

While Freudenberg et al (2012) state that while New Zealand has a 'sophisticated consultative process' for developing tax policy through the GTPP,⁵⁹ this process has not always been followed. Failure to follow the GTPP consultation processes has led to increased complexity in the tax system.

A.1.2 Consequences of complexity

Compliance costs

The complexity of tax laws has been identified as a potential factor in non-compliance in NZ. Studies have suggested that the estimated tax gap for NZ, or difference between what should be paid in tax and what is actually paid, increased from NZ\$82 million in 1969 to NZ\$3.2 billion in 1994.⁶⁰

Added complexity for tax advisers

Freudenberg et al (2012) stated that frequent changes to tax law added complexity for advisers. They stated that this could be due to having to learn new rules and how they might apply to clients. They also stated that the NZ Inland Revenue Policy Division's failure to follow the GTPP for policy

⁵⁴ Andrew J. Maples, "Tax complexity and the capital-revenue distinction – lessons from two recent New Zealand cases," *Bulletin for International Taxation*, 61 (2007): 293-307.

⁵⁵ Caroline Pau, Adrian Sawyer, and Andrew Maples, "Complexity of New Zealand's tax laws: An empirical study," *Australian Tax Forum*, 22 (2007): 59-92.

⁵⁶ Policy Advice Division, Inland Revenue Department, *Rewriting the Income Tax Act: Exposure Draft General commentary* (Inland Revenue Department: Wellington, 2001) <http://taxpolicy.ird.govt.nz/sites/default/files/2001-dd-rewrite-exposure-draft-vol-1-commentary.pdf>.

⁵⁷ Kathryn Saw and Adrian Sawyer, "Complexity of New Zealand's income tax legislation: The final instalment," *Australian Tax Forum*, 25 (2010): 213-244.

⁵⁸ Brett Freudenberg, Binh Tran-Nam, Stewart Karlinsky, and Ranjana Gupta, "A comparative analysis of tax advisers' perception of small business tax law complexity: United States, Australia and New Zealand," *Australian Tax Forum*, 27 (2012): 677-718.

⁵⁹ Inland Revenue, "Tax Policy," accessed January 13, 2016, <http://taxpolicy.ird.govt.nz/publications/2011-other-bim/1-policy-development-process>.

⁶⁰ Caroline Pau, Adrian Sawyer, and Andrew Maples, "Complexity of New Zealand's tax laws: An empirical study," *Australian Tax Forum*, 22 (2007): 59-92.

development while drafting 'look through company' provisions caused many difficulties for tax practitioners.

A.1.3 Solutions

The NZ Government has used a number of approaches to address complexity in the NZ tax system.

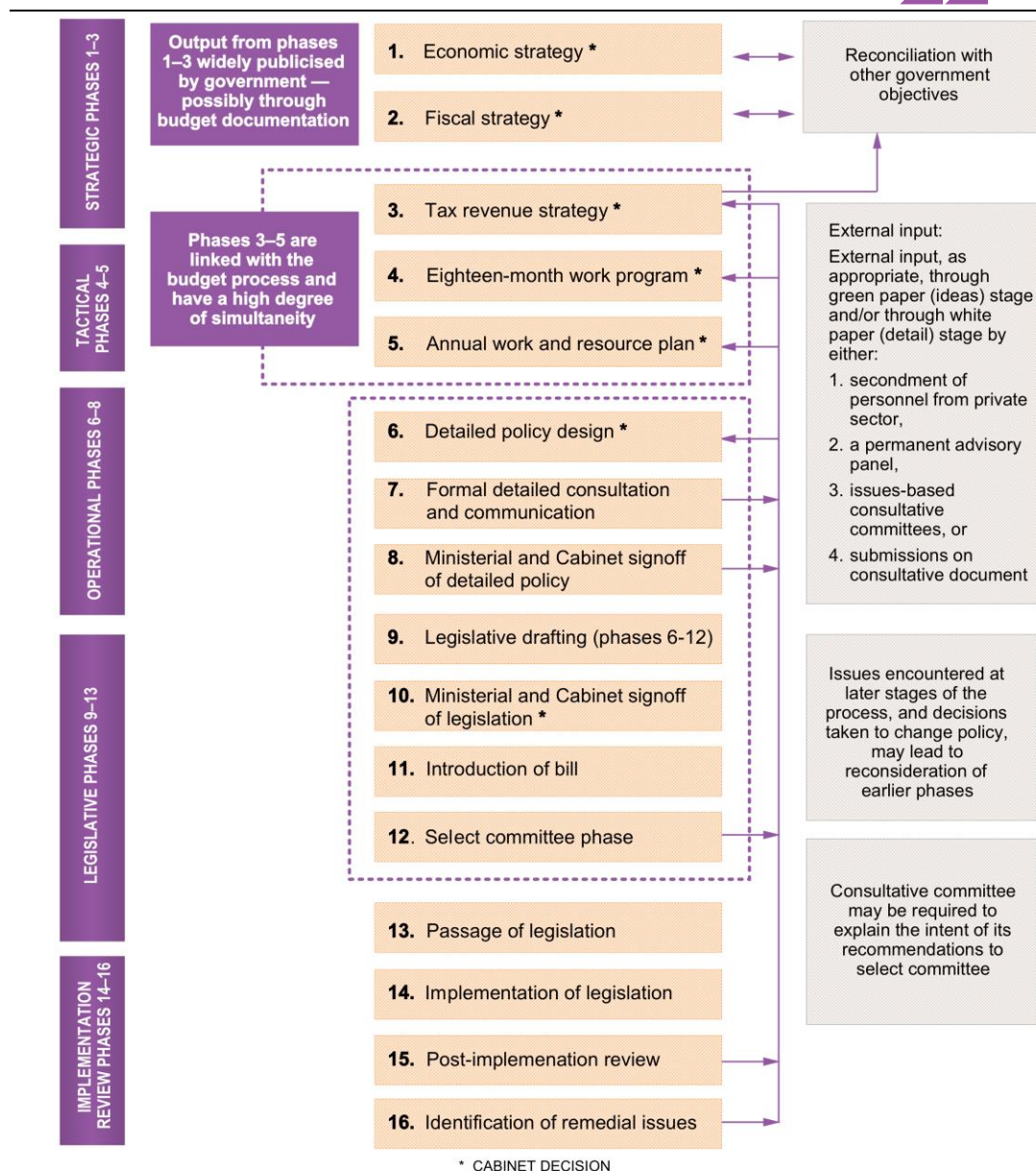
Generic Tax Policy Process

The GTPP is a formal policy for the development of tax policy in NZ. The NZ Government agreed to introduce a GTPP policy in the early 1990s after appointing a review committee to undertake a fundamental strategic review of the Inland Revenue Department. The main objectives of the GTPP were to:

- encourage early consideration of key policy elements and trade-offs
- provide an opportunity for substantial external input into the policy formation process
- clarify the responsibilities and accountability of participants in the process.

The GTPP is detailed in **Figure A.1**.

FIGURE A.1 GENERIC TAX POLICY PROCESS



SOURCE: STRAUN LITTLE, GEOFF D. NIGHTINGALE, AND AINSLIE FENWICK. DEVELOPMENT OF TAX POLICY IN NEW ZEALAND: THE GENERIC TAX POLICY PROCESS, P.5

A key element in the GTPP is the involvement of many stakeholders, including professional bodies, sector-specific groups, and large accounting and advisory firms. The private sector has played an important role in initiating policy changes as well as modifying proposals and making them work more effectively.

There has been a climate of cooperation between the private sector and government, strengthened by a shared understanding of 'what is in the best interests of New Zealand in the long run'. This shared understanding has been established and is maintained by extensive interaction between the private sector, government, and officials through forums such as conferences and working groups, and through open and constructive engagement. 'This climate of cooperation was further enhanced by direct and open access' to a previous, long serving Minister of Revenue, 'who devoted considerable time and effort to meeting with and speaking to those working in the private sector.'⁶¹

⁶¹ Straun Little, Geof D. Nightingale, and Ainslie Fenwick, *Development of Tax Policy in New Zealand: The Generic Tax Policy Process*, <http://www.ctf.ca/ctfweb/CMDownload.aspx?ContentKey=1e6b7151-5986-4b7f-9f8a-29ed1057c41b&ContentItemKey=5fa365e4-cc8f-4643-a359-70cd5864cee2>, p.9.

The involvement of the private sector in tax policy development is discussed in **Box A.1**.

BOX A.1 PRIVATE SECTOR INVOLVEMENT IN TAX POLICY DEVELOPMENT

The NZ Institute of Chartered Accountants has a national Tax Advisory Group (TAG) with a long history of engaging with government on tax policy development. The TAG is a volunteer group comprising two tax partners from each of the big four accounting firms together with four to six other tax experts drawn from corporate, academic, and public practice. The TAG is supported by a secretariat from the Institute of Chartered Accountants. The TAG makes submissions on all tax legislation and policy changes. It also engages frequently with policy makers during the development of policy, legislation, and implementation.

The stated objective of the TAG is 'achieving tax policy outcomes that are in the public interest.' The TAG's view of the public interest prevails where the commercial interests of the Institute's members are seen to conflict with the public interest.

The NZ Law Society has a Tax Committee that engages in tax policy development, focussing more on the legal position of policy. Its key framework is 'the public interest'. The Tax Commission is a 'respected participant in the GTPP.'

The Corporate Taxpayers' Group is a group of 39 of NZ's major corporate taxpayers; its primary focus is the interests of its 39 corporate members. It also pursues those interests within a wider public interest framework.

The big four accounting and advisory firms devote senior resources and research capability to the development of tax policy. In part, they do this from 'a strongly held belief and tradition in these firms that contributing resources to tax policy development is in the best interests of New Zealand and the wider economy.'

SOURCE: LITTLE, DEVELOPMENT OF TAX POLICY IN NEW ZEALAND: THE GENERIC TAX POLICY PROCESS

Box A.2 below shows information published about the GTPP as published by the NZ Inland Revenue Department.

BOX A.2 GENERIC TAX POLICY PROCESS: ELEMENTS

From broad option to detailed proposal

A major reform may pass through the five distinct phases of the policy process, moving from the conceptual to the concrete. The stages are:

- *Strategic*, which involves the development of an economic strategy, fiscal strategy and three-year revenue strategy. Broad policy proposals may be publicised through channels such as budget documentation.
- *Tactical*, which involves the development of a three-year work programme and an annual resource plan to implement the revenue strategy. The process allows the initial scoping and development of broad policy options, and may involve external consultation at this point, often by means of a high-level 'green' paper, or discussion document.
- *Operational*, which consists of detailed policy design, detailed consultation, and gaining Ministerial and Cabinet approval of recommendations. Again, discussion documents, or 'white' papers in this case, may be used for purposes of consultation. Proposed reforms may be revised in light of the submissions received. This phase culminates in government approval of practical tax policy initiatives that are ready to be introduced into Parliament and implemented.
- *Legislative*, in which the detailed policy recommendation is translated into legislation. This occurs in parallel with the operational phases described above, which speeds up the process by ensuring legislation is ready for introduction into Parliament once all policy issues have been resolved. It also ensures the proposed reforms can be expressed clearly in legislation. External consultation takes place through public submissions to the select committee considering the bill.
- *Implementation and review*, which include the post-implementation review of new legislation, after it has had time to 'bed in', and identification of remedial issues that need correcting for the new legislation to have its intended effect. Opportunities for external consultation are also built into this stage.

Who's responsible for what

The GTPP does not specify the precise roles to be played by Inland Revenue and the Treasury in developing tax policy. Rather, it allows these roles to be determined in accordance with the comparative advantage of each department.

Inland Revenue is primarily responsible for the detailed design, implementation and review of tax policy—in other words, for the operational, legislative, and implementation and review phases of the process. We do, however, also take part in the strategic and tactical phases of the process, along with the Treasury.

Role of Inland Revenue

The Policy and Strategy group within Inland Revenue strengths lies in its ability to strategically manage tax and related social policy issues from identification through to implementation. This involves a variety of activities, including:

- identifying tax and related social policy issues through our links with the rest of Inland Revenue, other government departments and the private sector
- developing detailed policy proposals to deal with those issues, and planning how the proposed reforms will be managed through to implementation and review
- managing the process of consultation
- managing the process of obtaining Ministerial and Cabinet approval of the proposed reforms
- drafting legislation to give effect to them, and managing the passage of legislation from introduction into Parliament through to enactment
- reviewing the effectiveness of the reform after it is implemented.

The policy result

The GTPP means that major tax initiatives are subject to public scrutiny at all stages of their development. As a result, we have the opportunity to develop more practical options for reform by drawing on information provided by the private sector and the people who will be affected. The process also gives us greater opportunity to explain to interested parties the rationale underlying proposed reforms, thus improving their long-term sustainability.

SOURCE: INLAND REVENUE, "HOW WE DEVELOP TAX POLICY," ACCESSED FEBRUARY 10, 2016, [HTTP://TAXPOLICY.IRD.GOV.TZ/HOW-WE-DEVELOP-TAX-POLICY](http://taxpolicy.ird.govt.nz/how-we-develop-tax-policy).

Independent Working Group on Tax Reform

Government has consciously sought to build a role for academics in the tax policy process. In 2013, Sawyer discussed the impact of the 2009-2010 independent TWG on tax reform.⁶²

Following a 2009 conference held at Victoria University of Wellington, it was decided to establish an independent group—the TWG—comprising experts from academia, revenue, Treasury, and tax practice to review the NZ tax system from a policy perspective. The TWG was formed with the support of the Minister of Finance and Minister of Revenue.

The TWG sought to:

- identify concerns with the current tax system
- describe what a good tax system should be like
- consider options for reform
- evaluate the pros and cons of these options.

The TWG established six principles for reform to the tax system and made a number of significant recommendations for reform including changes to tax rates, structures and bases.

The NZ Government announced a major overhaul of the NZ tax system in its 2010 budget, adopting many recommendations of the TWG. The changes included lowering income tax rates, increasing the rate of the GST, and broadening bases.

Professor John Creedy, in commenting on the work of the TWG, emphasised:⁶³

...the strength of the report is in its attempt to contribute to rational policy debate by rehearsing the various arguments in a clear and dispassionate manner, so that those on different sides of the debate can come to understand just why they differ. That a disparate group of individuals from a range of backgrounds have established some common ground in a way of thinking about taxes is itself sufficient cause for praise. The Report can be read with interest and profit by all those interested in tax policy.

Norman Gemmell, an advisor to TWG, stated that a phased approach assists with building the case for reform, and that this:⁶⁴

...must involve real-time engagement and public debate. While a co-operative and multi-disciplinary process is important, this will not succeed unless the body is "independent" of the government. A major constraining factor with most reviews was the revenue neutral constraint. Focussing on 'fairness', especially horizontal equity, was also crucial to the TWG's success.

The Chair of the TWG, Professor Bob Buckle, stated in an opening address to a symposium on tax policy reform that:⁶⁵

The road to New Zealand's recent tax reform has been an interesting one. It has underscored the importance of well-informed policy advisors, and it also reflects the courage of Ministers prepared to risk new approaches to public policy development.

Professor Buckle suggested there are a number of elements of making effective tax policy in NZ that other countries may find useful. These include using experts, employing rational policy analysis, consulting with stakeholders, and drawing on reports to support reform.

As reported by Buckle, Associate Professor David White observed that:⁶⁶

Much of the success of the mid-1980s NZ tax reform must be attributed to innovative consultation and policy review procedures featuring close and effective interdisciplinary collaboration between lawyers, accountants and economists from the public and private sectors.

Sawyer (2013) argues that the GTPP and the TWG, in conjunction with the unique political environment in NZ, has facilitated a surprisingly high level of tax policy review that has led to legislative reform.

⁶² Adrian Sawyer, "Moving on from the tax legislation rewrite projects: a comparison of the New Zealand tax working group/generic tax policy process and the United Kingdom Office of Tax Simplification," *British Tax Review*, 3 (2013): 321-344.

⁶³ *Ibid.*, 325.

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*, 326.

⁶⁶ *Ibid.*

Little et al (n.d.) claim that the TWG was a 'considerable success':⁶⁷

It was a good forum for debate of the pros and cons of various tax changes. The TWG provided an open discussion process, with papers from the meetings and a record of debates being published on the Internet. This helped to inform the wider public on key tax policy issues.

The TWG worked well from the government's perspective. It allowed possible tax changes to be aired publicly and debated openly, and it brought the academic community into important tax policy debates. However, a large element in its success was the cooperation and engagement of key tax practitioners. This was built on the engagement and cooperation that had been built up through many years of working with the GTPP.

Role of the media

Little et al (n.d.) state that tax policy has been debated in the NZ media for many years and that this was enhanced with wide public discussion on the work of the TWG. Public consciousness about tax has been raised through the debate and commentary from private sector experts.⁶⁸ The authors claim that the 'higher level of public sophistication around tax policy choices achieved by media coverage has helped governments to largely resist sector-specific pressure' for departure from the overall approach to tax policy.⁶⁹

Rewriting income tax legislation in plain language

Since the late 1980s, the NZ Government has had a focus on reducing the complexity of income tax legislation to reduce compliance costs on taxpayers and administrative costs on Inland Revenue. It has sought to rewrite income tax legislation in plain language without changing the underlying policy basis.

The rewrite project involved a number of processes:

- a limited rewrite of administrative provisions in the early 1990s
- Phase One of a larger rewriting process: enactment of the *Income Tax Act 1994*, the *Tax Administration Act 1994*, and the *Taxation Review Authorities Act 1994*
- Phase Two: enactment of core provisions in 1996
- Phase Three: enactment of the *Income Tax Act 2004*
- Phase Four: enactment of the *Income Tax Act 2007*.

Research indicates that, up to the end of Phase Two, the average length of sentences in tax legislation had reduced from 324 words to 53 words, However, the readability of the tax legislation, indicated by the Flesch Reading Ease Score, 'had not improved dramatically'.⁷⁰

Pau et al (2007) observed that the rewrite to the end of Phase Three had 'been successful in improving the overall readability of the income tax legislation'.⁷¹ The average sentence length had reduced from over 300 words in the *Income Tax Act 1976* to 34 words in the *Income Tax Act 2004*.

Saw and Sawyer (2010) observed that, to the end of Phase Four, the readability of income tax legislation had increased with the average sentence length decreasing.⁷²

Rewrite Advisory Panel

The Rewrite Advisory Panel was established in 1995 to consider and advise on issues arising during the rewriting of the *Income Tax Act 1994*. The Panel consisted of a chairman and representatives from Inland Revenue, The Treasury, the NZ Institute of Chartered Accountants and the NZ Law Society.

⁶⁷ Little, 10.

⁶⁸ Ibid., 11.

⁶⁹ Ibid.

⁷⁰ Pau, 66.

⁷¹ Ibid., 83.

⁷² Saw and Sawyer, 237.

In 2004, the Panel was invited to take on the role of considering whether the rewrite process had resulted in any unintended legislative changes. The Panel was to consider issues submitted and make recommendations to government on how unintended changes should be dealt with.⁷³

The Inland Revenue Technical Standards unit was to take on the secretariat role to support the Panel. The unit comprised solicitors, technical advisors, business analysts and process design specialists.

In 2007 the Panel was invited to consider potential unintended changes arising under the Income Tax Act 2007. In 2007 the Panel was further invited to monitor and report back to Ministers on the Income Tax Act 2007 and its continuing consistency with the objectives of the Rewrite project.⁷⁴

In March 2010, the Minister of Revenue announced that the role of the Panel was being expanded to include remedial matters that did not arise from the Income Tax Act Rewrite project. The Panel was only able to deal with particular issues on which the Minister of Revenue calls for submissions. These issues did not include matters that have already been accepted for the tax policy work programme.

The Advisory Panel was disestablished in late 2014.

Parliamentary Counsel Office commitment to clear legislative drafting

The NZ Parliamentary Counsel Office (PCO) has responsibility for drafting Bills and Legislative Instruments and makes reports to the Attorney-General and relevant select committee on other Bills. The PCO is a separate statutory office reporting to the Attorney-General.⁷⁵

The PCO states it has a commitment to drafting clear statutory provisions in plain language. The Attorney-General is required to prepare a three-yearly programme for revising statutes in each Parliament. The purpose of the revisions are to re-enact bills in a 'more accessible form that does not change their legal effect.'

The PCO has published Chapter 3 (Principles of clear drafting) of its in-house Drafting Manual to guide other agencies in preparing subordinate legislation. This chapter states that the PCO 'is committed to improving access to legislation by ensuring that legislation is drafted as clearly and simply as possible.'⁷⁶

A.2 United Kingdom

This section examines issues regarding tax complexity in the United Kingdom (UK) as a case study.

Evidence suggests that while the UK has undertaken a substantial rewriting of tax legislation in order to improve taxpayer and tax advisor comprehension and understanding of their obligations, it has not undertaken a substantive simplification of tax policy.

The government worked on simplifying UK tax law between 1997 and 2009 through the Tax Law Rewrite Project (TLRP). This involved a large scale effort to redraft tax legislation so that it was more understandable.

The UK Government has also had an institutional approach to simplify tax with the establishment of the OTS in 2010. The OTS's role is to make recommendations to government to simplify the tax regime.

While the UK Government published a *Tax Consultation Framework* in 2011 laying out a consultative process for potential tax changes, stakeholders have commented negatively on how the government has actually consulted.⁷⁷ Stakeholders have commented that the OTS is more consultative than other section of the UK Government that develop tax policy.

⁷³ Rewrite Advisory Panel, "Process for resolving potential unintended legislative changes in the Income Tax Act 2004," accessed January 14, 2016. <https://www.rewriteadvisory.govt.nz/sites/default/files/rap001.doc>.

⁷⁴ Rewrite Advisory Panel, "Rewrite Advisory Panel," accessed January 14, 2016, <https://www.rewriteadvisory.govt.nz/>.

⁷⁵ Parliamentary Counsel Office, "Role of the Attorney-General in relation to the PCO," accessed July 14, 2016, <http://www.pco.parliament.govt.nz/role-of-attorney-general/>.

⁷⁶ Parliament Counsel Office, "Chapter 3-Principles of clear drafting," excerpt from PCO Drafting Manual, accessed January 13, 2016, <http://www.pco.parliament.govt.nz/clear-drafting/>.

⁷⁷ HM Treasury and HM Revenue and Customs, *Tax Consultation Framework*, accessed January 15, 2016, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89261/tax-consultation-framework.pdf.

One stakeholder, commenting on the first four years of the OTS, stated that:⁷⁸

...the response or lack of response by government to many of the substantive changes recommended by the OTS has left an impression that the OTS is focused on administrative changes and that there is insufficient appetite in government for more radical changes to simplify the system. At the same time, administrative recommendations have also been dismissed by government with too little explanation.

The literature suggests that many of the factors and consequences of tax complexity in UK are similar to that in NZ and Canada. This section focusses on a number of matters particular to the UK.

A.2.1 Drivers of complexity

Complexity of concepts

One driver of complexity in tax legislation are the concepts underpinning policies. Malcolm Gammie, of the Institute for Financial Studies (IFS) Tax Law Review Committee, wrote in 2008:⁷⁹

The majority of complexity, however, surrounds the concepts upon which the legislation is built, the structure the system adopts in terms of tax rates and taxable units, and the extent to which the government chooses to use the tax system to achieve particular policy objectives.

Gammie further argued that some taxes are conceptually difficult (such as buildings allowances, capital gains and financial avoidance); some taxes are conceptually simple but have features that may make them administratively difficult, and that:⁸⁰

...simplification requires some compromise with what would be ideal because what is ideal is likely to be more complex rather than simpler.

Gammie also argues that the choice of tax rates and the taxable unit (e.g. the individual or family) 'can have a profound effect on the relative complexity of any tax'. In particular, Gammie argues a:⁸¹

- value-added tax that distinguishes many different products and services and taxes them at different rates is likely to be more complex than one that adopts a single rate.
- tax system that taxes individuals but pays tax credits to families is liable to be more complex than one where both elements of the system are based on the same unit of assessment.

Gammie further argues that solving the issue of complexity requires recognising what is complex and why and concentrate on what can sensibly be done about it. Furthermore, government must be clear as to what its policy goals are, and it will then be clear whether its goals or methods are potentially too complicated.

Poor policy design

Stakeholders identify poor policy design as a factor behind the complexity of the tax system. Examples identified by Paul Johnson, an IFS director, in 2014 included the following:⁸²

There is a basic rate of income tax of 20%, a higher rate of 40% and a top rate now of 45%. What is less well known is that the last government introduced a rate of 60% on a band of income starting at £100,000. This government has maintained it and effectively increased its range considerably. There is now a 60% rate of income tax on income between £100,000 and £121,000 (where it drops back to 40%). It's hard to make much sense of that.

Governments of all stripes have continually cut income tax whilst increasing National Insurance Contributions (NICs) – a tax on earned income. The only reason for this is that income tax seems to be more salient and therefore increases to NIC rates are politically easier.

The last government and this one raised rates of Stamp Duty Land Tax time and time again. This is one of the worst designed and most damaging of all taxes, yet revenues from it are due to hit £15 billion

⁷⁸ Tracey Bowler, *The Office of Tax Simplification: Looking Back and Looking Forward*. (London: Institute for Fiscal Studies, 2014), accessed January 14, 2016, <http://www.ifs.org.uk/publications/7476>.

⁷⁹ Robert Chote, Carl Emmerson, David Miles, and Jonathan Shaw (eds), *The IFS Green Budget 2008*, accessed January 18, 2016, <http://www.ifs.org.uk/budgets/gb2008/08chap13.pdf>, p. 266.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Paul Johnson, "Tax without design," accessed January 18, 2016, <http://www.ifs.org.uk/publications/7204>.

within just a few years. At the extreme a £1 increase in sale price can now trigger an additional £40,000 tax bill. The tax helps to gum up the entire property market.

The introduction and subsequent abolition of a 0% rate of corporation tax for the lowest profit companies. It seemed to surprise the government that this led to a wholly predictable upturn in the number of self employed people deciding to incorporate and hence a loss of revenue to no good purpose.

Devolution

Devolution is a factor particular to the UK that has similarities with complexities in a federation (noting that the UK Parliament ultimately has legal power over any devolution settlement). The devolution of taxing powers to the Scottish Parliament may increase the complexity of the tax system in the UK as tax agents and taxpayers have to understand different tax regimes across the UK, especially if they operate across different parts of the UK with different tax systems.

A.2.2 Consequences of complexity

Tax advisers and taxpayers raise similar complaints regarding the complexity of the UK tax system as in other countries. These complaints include the size of legislation, inequity, and impacts of country economic output and welfare.

A.2.3 Solutions

The UK Government has used two approaches to address tax complexity:

- rewriting tax legislation without changing policy—the Tax Law Rewrite Project (TLRP)
- establishing an internal organisation—the OTS—to help institutionalise simplification.

Tax Law Rewrite Project

The TLRP commenced after the Chancellor's 1996 Budget speech.⁸³ The project involved rewriting UK tax legislation over a period extending to 2009. The TLRP sought to consolidate different tax provisions so that provisions covering the same area were brought into the one act. The final two Bills resulting from the project were introduced into the House of Commons in November 2009.

As at 2002, the project comprised 30 individuals including five tax professionals from the private sector (a solicitor, two chartered accountants, and two chartered tax advisers). Two committees oversee the project's work—the Consultative Committee and the Steering Committee.

- The Consultative Committee was comprised of representatives from the tax professions as well as business and industry. The Consultative Committee was able to advise for restructuring provisions and proposed policy changes.
- The Steering Committee was made up of members from the House of Commons and the House of Lords, the legal and accountancy professions, business and consumer interests and chaired by Lord Howe, a former Conservative Chancellor. The committee provided strategic guidance to the project as well as ensuring the project met the objectives of clarity and user-friendliness, and that it took full account of private sector concerns.

The project consulted widely on draft legislation and minutes of the committee meetings were published on the website of Inland Revenue.

Sawyer, writing in the *British Tax Review* in 2013, stated that commentators and practitioners indicated that provisions in the rewritten tax legislation was easier to understand and apply, and that it was easier to educate students and others without a legal background. However, Sawyer stated that 'an overwhelming majority of commentators' saw no additional benefits, as rewriting the legislation 'did not tackle the underlying issues of policy and conceptual complexity, it was only playing around at the edges.'⁸⁴

⁸³ Technical Department, Chartered Institute for Taxation, "Tax Law Rewrite," accessed January 15, 2016, <http://old.tax.org.uk/showarticle.pl?id=659&n=379>.

⁸⁴ Sawyer, 342.

Office of Tax Simplification

The OTS was created in July 2010 as an independent Office of the Treasury to provide advice to the Chancellor on simplifying the UK tax system.⁸⁵ The UK Government has published a draft Finance Bill 2016 to establish OTS on a statutory basis.

The OTS is led by a Chair and Tax Director, and is under the overall control of the OTS Board on which the Chair and Tax Director sit as does a senior person from each of Revenue and Customs and Treasury.

The Chancellor is required to lay the OTS's reports before Parliament, and the Chair or Tax Director may be required to give evidence before the relevant parliamentary committees.

The OTS sets of Consultative Committees for each project. The work of the OTS is undertaken by a small team of people including a number of full-time secondees from Revenue and Customs and/or Treasury. Tax profession individuals are brought in specifically for their expertise, generally working one or two days per week. There are the equivalent of five or six full-time people working on different projects.⁸⁶

Bowler, writing in 2014 for the IFS Tax Law Review Committee, made the following comments.

- The OTS has adopted a bottom-up consultative approach to simplification. This is seen as a great strength. After initially analysing the issue of tax reliefs, which revealed itself to be a very substantial issue, the OTS has focussed on particular groups of taxpayers to identify where simplification is possible.
- The OTS' achievements has been primarily about the administration of the tax system—how taxpayers find information, complete returns and the guidance given by Revenue and Customs. However, not all OTS administrative proposals have been taken forward, nor have reasons always been given for them as to why they are not taken forward.
- The OTS has also identified significant substantive changes which have the potential to simplify the system. However, the government has chosen not to pursue them in many cases. Bowler states:

...government has kept the impact of the OTS's recommendations to the edges. The OTS is given some influence on tackling the symptoms of the problems, particularly when they concern administrative matters, but is kept back from tackling the root causes.
- The OTS is only permitted to consider the existing law when it is considering an area—it cannot consider any proposed changes or changes legislated during the project.
- The OTS also has no formal role after it puts recommendations forward, apart from potentially making a submission itself.
- Government needs to attach greater status to OTS recommendations. It needs to give explanations whenever it does not take forward OTS recommendations. The OTS also needs more resourcing to enable it to do more, more quickly.

A.3 Canada

This section examines issues regarding tax complexity in Canada.

The literature suggests that Canadian governments at both federal and provincial levels have focussed on simplifying tax at the policy level since the mid-1980s. However, there has not been as great a focus on simplifying the implementation of policy (e.g. through clearer legislative drafting).

Factors behind the simplification of tax policy have included:

- an view among policy elites that Canadian business taxes were too high and undermining economic growth
- a desire to be competitive against US in light of tax reforms introduced by the Reagan administration in 1986

⁸⁵ OTS, "About the OTS," accessed January 14, 2016, <https://taxsimplificationblog.wordpress.com/about/>.

⁸⁶ Bowler.

- the haphazard and unsatisfactory nature of then-existing sales taxes (replaced with a federal GST and provincial harmonised sales taxes that tops up the federal GST in most provinces).

Income tax rates have been reduced and its base broadened since the mid-1980s. Income tax continues to be complex as it is used to implement economic and social policy. Some literature analysed for this Review suggests the size and complexity of income tax legislation has continued to increase due to:

- the political difficulty of removing existing special rules for particular groups
- the desire by tax advisers for greater certainty regarding their tax obligations, particular given the greater complexity of transactions
- policy makers introducing new rules to seek to address the increasing complexity of tax planning strategies they consider to be outside the spirit and letter of the law.

The Certified General Accountants Association of Canada (CGA) has been one of the prime advocates for simplifying the Canadian tax system. Another source of advocacy for policy simplification has been think tanks including the Fraser Institute—a ‘conservative/libertarian’ organisation.

A.3.1 Drivers of complexity

A review of the literature has revealed the following perceived drivers of complexity in the Canadian tax system.

Increased complexity of issues

Clark and Farber state that one driver of increased complexity is policy makers seeking to address issues with the global economy and the ‘increased complexity of transactions’. The speed with which developments occurred have led to ‘a sense of urgency, if not panic’ for policy makers.⁸⁷

Use of tax system to carry out economic and social policies

The Canadian Government has sought to use tax policy to help implement economic and social policies. This is perceived as tending to increase the complexity of tax legislation at the policy and implementation levels.

Political constituency support

Clark and Farber (2011) state that the Canadian income tax legislation includes numerous special tax rules ‘designed for very specific groups and purposes’. One driver for retaining them is that constituencies have ‘grown used to seeing the tax system as the delivery vehicle for the indirect government spending that benefits them’. It is difficult to remove special tax rules, especially where they have existed for a while and have strong constituencies.

Desire for certainty relating to complex transactions

Clark and Farber (2011) state that one of the drivers for tax legislation complexity is the desire for certainty regarding the tax implications of complex transactions.

Tax advisers also seek greater detail and certainty from treasury departments. Further, legislative drafters aim to increase certainty and reduce the scope for interpretation by the courts.

Proposals that linger for lengthy periods

The CGA states that complexity is increased by uncertainty associated with proposals that can linger for years without being passed.⁸⁸

⁸⁷ C. Scott Clark and Len Farber, *Issue in Focus: the need for tax simplification – a challenge and an opportunity* (Ottawa: Certified General Accountants Association of Canada, 2011), accessed January 13, 2016, http://www.cga-canada.org/en-ca/researchreports/ca_rep_2011-08_tax_simplification.pdf

⁸⁸ CGA, *Tax simplification: Benefits and political challenges in a Canadian context* (Ottawa: CGA-Canada, 2013), accessed January 15, 2016, http://www.cga-canada.org/en-ca/ResearchReports/ca_rep_2012-12_tax_summit.pdf.

Complexity of filing tax returns

Clark and Farber (2011) state that tax practitioners and professionals believe that tax filing requirements are ‘unnecessarily complicated’ and that it is difficult to obtain decisions and interpretations on a timely basis.

A.3.2 Consequences

Increased complexity of issues

Clark and Farber (2011) state that the Income Tax Act has grown ‘from a few pages of general principles’ in 1917 to an ‘exhaustive and intricate’ system.

Thomas O’Brien, a PwC Tax Partner, stated that Canadian federal and provincial tax authorities have become ‘increasingly vigorous’ in combatting domestic and international tax planning strategies they consider to be outside the spirit and letter of the law.⁸⁹ This has resulted in complex changes to Canadian tax law.

Ongoing additions to legislation

Clark and Farber (2011) state that one reason the Income Tax Act has increased from 11 pages in length (including regulations) at its beginning in 1917 to about 2,800 pages, including regulations and commentary, is that many special measures have been introduced while almost nothing has been removed from the Act.

Need for rulings from the Canada Revenue Agency

The CGA states that Canadian businesses ‘lament’ the growing compliance costs and ‘the need for advance rulings from the Canada Revenue Agency’ as tax-related mistakes can be ‘prohibitive’.

Increasing challenge to Parliamentarians to oversee the tax system

The CGA states that the complex language in the Income Tax Act can result in Parliamentarians having difficulty overseeing the tax system and interpreting legislative provisions. The courts can also have challenges interpreting provisions in the Income Tax Act.

A.3.3 Solution

The Review found no evidence of a commitment by the Canadian Government to undertake a comprehensive reform of the Canadian tax system at either policy or legislative drafting levels. Nonetheless, Canadian governments have undertaken policy reforms over recent decades.

Policy reform

Canadian governments made a number of major changes to the country’s tax system in recent decades. In the mid-1980s the Canadian Federal Government reduced the federal corporate income tax rate and reduced tax breaks. It also lowered personal income tax rates and broadened the base.⁹⁰

These reforms came about following a growing view among policy makers and politicians that the then-existing Canadian tax system was undermining economic growth. ‘The idea of lowering rates and moving to a new more neutral corporate tax base was consistent with the philosophy adopted by the new Mulroney Government elected in 1994.’⁹¹

The Canadian Government made reforms to corporate income tax in the 1985 budget. Following the Reagan administration’s reforms to tax in the US in 1986, the Canadian Government decided to undertake out additional reforms.

⁸⁹ PricewaterhouseCoopers, *Total Tax Contribution, Canada’s tax regime: complexity and competitiveness* (2008), <https://www.pwc.com/ca/en/tax/publications/ttc-0508-en.pdf>, p.9.

⁹⁰ Robert D. Brown and Jack Mintz, “Chapter 1, The Big Picture,” in *Tax Policy in Canada*, accessed January 13, 2016, http://www.ctf.ca/CTFWEB/Documents/PDF/2012/TaxPolicy_Chapter1.pdf.

⁹¹ *Ibid.*, 1:18.

Federal and provincial governments reduced rates of corporate tax after the 1997 Report of the Technical Committee on Business Taxation advocated lower corporate tax rates and a more neutral corporate tax base.

Indirect taxation has been an area of major reform in Canada. In 1991, the federal sales tax was replaced by a value-added tax (the GST), and most provinces moved to replace their sales taxes with a harmonised sales tax. The tax burden was reduced on business investments and made the tax base more neutral.

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