

## REFORMING BUSINESS TAX PROCESSES

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The processes underlying the business tax system are in need of reform.

The Review proposes, as a basis for consultation, reform initiatives which encompass a more open approach for initiating tax policy changes, an integrated and team-based tax design process with clear accountabilities, an advisory board to support the processes and more effective consultation.

The Review also proposes a strategy for reinforcing the impact of its framework and process reforms on simplifying Australia's system of business taxation.

The Review believes that its proposed process reforms, together with the objectives and principles outlined earlier, could be consolidated and supported in a *Charter of Business Taxation*.

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# *What approach should be taken to business tax process reform?*

## Addressing key shortcomings

7.1 The discussion of policy, legislation and administration principles in Chapter 6 is novel in Australian tax policy-making in its attempt to elaborate and invite consultation on a framework of national objectives and principles before delving into the detail of how the principles may be implemented. This chapter builds on these objectives and principles by setting out some possible directions in relation to the processes of policy, legislation and administration.

7.2 Chapters 3 and 4 described the operation of these processes and highlighted several shortcomings:

- the system lacks a sound conceptual framework of objectives and principles to guide its operation;
- a largely ‘sequential’ approach is usually taken to make changes;
- overall accountability for the results the system produces is lacking;
- there is ineffective consultation with the ultimate users of the business tax system, the private sector, when changes are being developed; and
- current arrangements for the taxation of business income are excessively complex.

7.3 Chapter 6 addresses the first and last of these shortcomings by proposing a set of objectives and principles to guide changes to the business tax system. This chapter suggests potential directions for addressing the remaining shortcomings identified.

## Drawing on international experience

7.4 The Review has commissioned an examination of the process for the development of business tax policy and the implementation of legislation in 13 other countries. The results will be made available in an information paper to be released shortly. However, a number of relevant conclusions can be drawn from the initial analysis.

## The process of developing policy and legislation

7.5 There are many models throughout the world for developing taxation policy, drafting the legislation and administering the law through revenue collection and interpretation. The models involve a combination of coordination at certain stages of the process and separation of responsibilities at other stages.

7.6 The objectives that the countries reviewed are trying to achieve with these models can be summarised as follows:

- In developing policy and drafting the supporting legislation, countries are attempting to coordinate economic policy, tax technical and legislative drafting skills to ensure that the legislation achieves its policy objectives. This is a difficult task as the skills involved are diverse and success often depends on the experience and ability of a limited number of experts. At a minimum, close cooperation is required between several agencies to achieve the desired outcome.
- In some countries, processes are in place to enable independent assessment of the quality of newly-drafted tax legislation. This involves an appraisal of the legislation by bodies such as the judiciary or a specialised agency, together with a report to the legislature on the suitability of the legislation for its stated purpose.
- The administration of the tax system, including both collection and administration of the law, is usually in the hands of a single agency. However, an alternative model used in France and Sweden involves the separation of responsibility for tax collection from the responsibility for the interpretation of the law. This separation recognises the different responsibilities associated with the functions of tax collection and legal interpretation.

7.7 In the past decade, countries have increasingly undertaken public consultation on tax policy and legislation. As in Australia, such processes have tended, in most cases, to be either informal or *ad hoc*. Governments have rarely committed themselves to a process of enabling open debate on all tax issues. Instead, they have generally put forward consultative documents on major policy issues when the politics of doing so are favourable. On occasions, they may also provide draft legislation for public comment but the more common process involves the scrutiny of legislation by parliamentary committees during the parliamentary process.

7.8 New Zealand and the United States have processes which ensure a significant degree of consultation, but at different levels of executive government and the legislature.

- New Zealand has put in place a formal process known as the *Generic Taxation Policy Process*. The main aims are to improve the tax policy-making process and to ensure close public consultation.
- The United States relies on its standard process of government to ensure open scrutiny of taxation policy and legislation. This is achieved through the committee system of Congress, which involves extensive open debate on tax measures in both Houses. The process is characterised by extensive lobbying which can result in significant changes to the original policy position put forward by the Executive. Because the outcomes of the committee process can only be voted up or down, and not amended, the process is also characterised by political deals which often result in totally unrelated matters being incorporated into tax legislation.

### Lessons for Australia

7.9 Evaluation of different models for tax policy, legislation and administration depends on many environmental and cultural factors such as the structure of government, the strength of the majority party and the attitude of taxpayers to compliance with the law. As a result, the Review considers that it would be inappropriate to transfer the precise parameters of the model used in another country to Australia. Processes in Australia should be tailored to the particular features of our policy environment.

7.10 However, there are clear lessons to be learned from the objectives that other countries are trying to achieve:

- The model should aim to bring together the necessary economic policy, tax technical and legislative drafting skills in a coherent way. This may involve locating those resources in a single agency or improved coordination arrangements that ensure that the accountabilities of each of the agencies are clearly defined.
- It should aim to allow maximum public comment on major policy initiatives and draft legislation consistent with the time restrictions associated with a government's term of office.
- It should aim to ensure that draft legislation is independently scrutinised by those with appropriate expertise.

## *What are the possibilities for reform?*

7.11 Possibilities for reform which could improve the levels of community trust and confidence in business tax processes, as well as their outcomes, are:

- adopting a more open approach for initiating policy proposals;
- strengthening the effectiveness of consultation;
- applying an integrated tax design process;
- specifying accountabilities for the design process;
- establishing an advisory board to support the process;
- reinforcing business tax simplification; and
- consolidating a *Charter of Business Taxation*.

### Adopting a more open approach for initiating policy proposals

7.12 Under our Westminster system of parliamentary democracy, policy-making is the prerogative of the government of the day. In particular, executive responsibility for taxation policy falls within the ministerial responsibility of the Treasurer.

#### **Treasurer's overarching responsibility for policy agenda**

7.13 The Review, in undertaking as part of its terms of reference a fundamental re-examination of the policy, legislative and administrative processes that support the business tax system, is conscious that any reforms to those processes must continue to ensure the primacy of the Treasurer's overarching responsibility for taxation policy.

7.14 One central implication of that overarching responsibility is that the Treasurer should continue to determine the taxation policy agenda to which Commonwealth resources are to be devoted and in respect of which Commonwealth agencies are to be held accountable.

7.15 For its reforms to the policy, legislative and administrative processes of the business tax system, the Review intends to focus on reform processes under which, as the guiding principle, the Treasurer authorises the initiation of policy development. There may be scope for the Treasurer to provide standing authorisation—for example for certain types of policy development consistent with other objectives (such as the simplification strategy canvassed later in this chapter). Such standing authorisation would not be intended, however, to derogate from the Treasurer's ministerial responsibility for taxation policy.

## Forward work program for business tax policy

7.16 A more visible, and public, agenda for business tax policy would be an essential input into any proposed reforms to policy, legislative and administrative processes.

7.17 The Treasurer should ultimately approve the forward work program for business tax policy. At issue, therefore, are how that program is to be assembled and what consultations should take place in relation to it.

7.18 A draft forward work program for business tax policy could be prepared by the Treasury, in conjunction with the Australian Taxation Office (ATO), for preliminary endorsement by the Treasurer. Program items would be supported by a standard project initiation brief, setting out the objectives for policy development, resource requirements, timeframe, revenue implications and a risk assessment of not undertaking the work or not achieving acceptable outcomes.

7.19 Following initial consultation with the business community and others, as appropriate, the forward work program could then be submitted for the Treasurer's final approval. Possible consultative mechanisms are examined separately below.

## Budget nexus

7.20 The formulation of the Commonwealth Budget necessarily raises issues of revenue and consequently taxation. Currently much of the ongoing tax policy process is conducted within the budget context. This leads to a veil of secrecy and the production of highly articulated tax policy changes in short timeframes that are often driven by the immediate bottom line of the budget. The consultative processes based around a forward work program for business tax policy now being proposed by the Review should do much to dispel unnecessary and counterproductive secrecy while affording essential scope to the government of the day in handling sensitive tax policy issues. Of course, the flexibility for budget priorities to drive the development of tax changes outside that process would necessarily remain.

7.21 The success or otherwise of these reforms will depend as much on mutual trust, common sense and professional commitment amongst all participants, as on sound design.

## Limiting legislation by press release

7.22 The process of legislation by press release is a source of considerable criticism in Australia. Certainly the extent of this practice seems to be much higher than in other OECD countries. While exceptions

to complete openness of the tax policy process are necessary, a good tax design process nonetheless should categorise many fewer measures as revenue sensitive –and so requiring press releases –than is the case at the moment.

7.23 The factors which could be taken into account when considering any abridgement of the consultation process, including legislation by press release, could include the following:

- the amount of annual revenue at stake makes timing a major consideration;
- revenue losses would increase unacceptably if a prospective examination into the problem were made public;
- the change relates to a very narrow area in the system;
- the problem can be solved by reference to established policy settings and does not require change in policy direction; or
- the Bill to implement the proposal can be completed and made public within a short timeframe (say three months).

## Strengthening the effectiveness of consultation

### Categories of policy

7.24 The Review believes that one aim of the reformed processes should be to ensure the maximum possible extension to the scope for public consultation in the development of business taxation policy. As a general principle, the bulk of business tax policy development should be subject to consultation.

7.25 *Public review measures* would define the expected normal mode of consultation, entailing full consultation and review from the outset of policy development through the legislative processes and the administrative arrangements.

7.26 Some exceptions to this general principle are likely to be necessary. At one extreme, *sensitive policy issues* would be reserved by the Treasurer for purely internal development, as now, and subsequent formal announcement. Included in this category of policy would be all sensitive rate changes, other measures where risks to the revenue from public consultation outweigh the possible benefits of that consultation and measures designated by the Treasurer as sensitive. Where such policy measures would benefit from consultation after announcement, the suggested processes could ensure that such consultation occurs.

7.27 In some cases, concerns about sensitive policy issues could be balanced against the need for consultation by the Treasurer seeking private sector input, but on a *confidential* basis.

7.28 Finally, *minor policy measures* may not warrant consultation beyond the normal oversight exercised by Parliament at the legislative stage.

7.29 In many respects consultation graded in this way can already occur at the discretion of the Treasurer of the day. What the Review is proposing should be seen as a formalisation of such arrangements, with a particular emphasis on the development of, and customary reliance on, consultative processes and a limitation on the practice of legislation by press release. Effective management of such an overall consultation program would be critical to achieving better outcomes on policy design.

### Discussion papers

7.30 In respect of significant *public review measures* the government could explain the problem it has identified, or the outcome it wishes to achieve and the proposed solutions through issuing a discussion paper seeking public responses. The nature of that paper would depend on the degree of commitment by the government to the course of action proposed. In a broad discussion paper (sometimes called a Green Paper), the government would not be declaring a firm preference for any particular option. In contrast, a discussion paper (sometimes called a White Paper) may set out a proposed course of action by the government, with consultation being sought only on particular aspects of the proposals.

### Periodic independent review

7.31 Another mechanism used in the past partly for consultation and feedback on the tax system and its processes is an independent review appointed by and reporting to the Government. From the 1920s to the 1970s there was a number of independent reviews of the tax system. Since the Asprey Committee reported in 1975 the tax policy and legislation process has been largely a bureaucratic and political concern.

7.32 A number of considerations argue in favour of such independent review. Major changes to the systems take about 5-10 years to bed down in the sense that major policy U-turns are uncommon and repair and maintenance is the policy goal after the major reform is in place. An independent review allows the necessary distance from the immediacy of the tax design process. The financial system has had three major independent reviews in the last 15 years.

7.33 In about the same 5-10 year period, economic and social shifts may be significant. Moreover, taxpayers become familiar with the new system and its weaknesses so that tax avoidance goes in waves. An overall review provides the opportunity to examine whether the original policy settings are still appropriate in a rapidly changing world and whether tax avoidance requires systemic change as opposed to repair.

7.34 An independent review also allows evaluation of the tax design process and tax administration. It can consider questions such as: Are the current objectives and principles for them still appropriate? Are the processes meeting the objectives and principles? and How can they be further improved?

## Applying an integrated tax design process

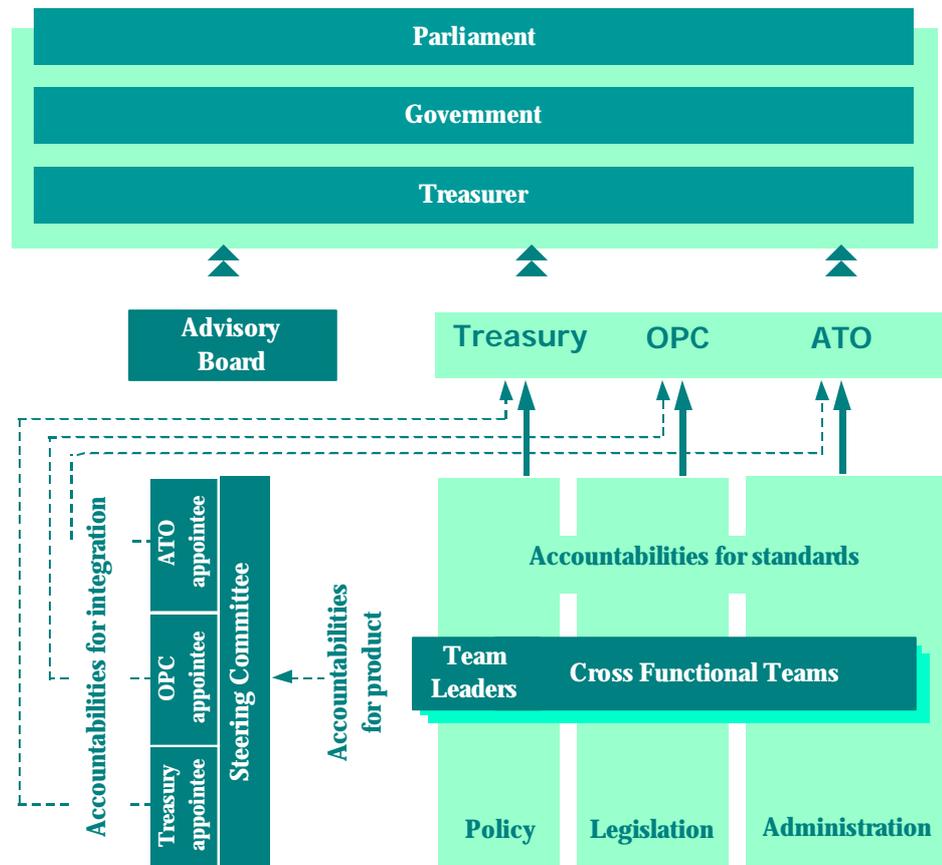
7.35 The Review believes that a key element in the reform of business tax processes is the establishment of an integrated approach to tax design. This could be achieved by concentrating all the responsibilities for tax design and administration within one agency. By itself such an approach would not guarantee integration. The approach outlined below could be modified to operate within a single agency but, in the form presented, builds on existing agency roles and accountabilities. It also allows each agency to optimise its unique functional perspective and overall contribution.

7.36 The key elements of this integrated approach are shown in Figure 7.1, with each of the components discussed in detail in this chapter.

7.37 Figure 7.1 shows the lines of accountability flowing from integrated project teams through team leaders to a joint steering committee. This committee is, in turn, accountable to the three agencies, whose responsibilities in respect of tax issues are to the Treasurer, Government and Parliament. The proposed advisory board would report to the Treasurer.

7.38 Figure 7.1 illustrates that, while the project teams established to progress the forward work program would be accountable to the steering committee for delivery of the product, individual team members would remain accountable to their own agencies for ensuring that their standards and requirements are met. The details of these accountabilities are discussed below.

**Figure 7.1: Key elements of integrated business tax design**



## Specifying accountabilities for design processes

7.39 The establishment of integrated teams and the cross-agency steering committee would facilitate a much greater degree of accountability for the overall design process. The fact that all team members participate in all phases of the process and share mutual accountability for the ultimate effectiveness of the measure would encourage a truly integrated approach.

### Agency accountabilities

7.40 Each agency would continue to be accountable for ensuring standards are maintained in its particular area of responsibility. The new arrangements are not intended to detract from these accountabilities, but rather to reinforce them:

- the Treasury for policy development and, except in cases of purely technical amendments to the law, general oversight to ensure delivery of an outcome that reflects the policy intention and is consistent with the national objectives and design principles;

- the ATO for detailed design and development of the legislative, administrative and compliance systems for, and implementation of, the policy; and
- the OPC for design and drafting of the law.

7.41 Complementing those specific agency accountabilities, the integrated teams and the cross-agency steering committee would result in the agencies being jointly responsible for the overall process and outcomes.

7.42 Each agency would be responsible for providing suitably skilled resources to undertake projects. They would also be responsible for the performance of their representatives in meeting specified accountabilities in relation to the project teams, the team leaders and as members of the steering committee. Robust project management arrangements would be employed to ensure that accountabilities for results are maintained and that the interdependencies between agencies and projects are recognised and accommodated.

### Project teams

7.43 As noted above, the Review has identified the current essentially sequential approach to policy development, legislation and administration as one of the major shortcomings of the current processes.

7.44 The Review is proposing an integrated process built around cross-agency teams drawing upon the staff of the three main agencies involved: the Treasury, the ATO and the OPC. The Review recognises that in particular cases there may be advantages in including officers from other Government agencies or experts from the private sector on these teams.

7.45 The major advantage of an integrated approach is that it would allow the involvement of policy, legislative and administrative expertise throughout the design process. In turn, this would ensure that administrative implications are fully considered at both the policy development and legislation phases. Equally well, it would help ensure that the policy intent is accurately reflected in the legislation and administration of the law. Such an approach would allow work on the drafting of legislation to begin earlier in the process and so facilitate feedback of legislative issues into policy design as necessary.

7.46 The basic concept is to have one cross-functional project team per issue, employing a project management approach. However, depending on the size of the issue, some teams may have more than one issue, or some officers may be involved only on a part-time basis. Where issues are related

there would need to be coordination across teams to be achieved by establishment of an appropriate project management structure.

7.47 The first task of each project team would be to develop a project brief including specification of deliverables and a timeline. As a general rule the project team would be responsible for taking an initial policy issue through all stages of the policy development, legislation and administrative design processes (including working with others to ensure that all aspects of administration are delivered consistently with the policy design).

### *Accountabilities*

7.48 Teams would be accountable to the steering committee, under accountabilities specified by the committee, for ensuring the final product met the policy intent and was consistent with the legislation and administration design principles. Where trade-offs between competing agency or system interests were required, teams would be responsible for identifying and resolving them –including through successive escalation, as required, to the steering committee, agency heads or the Treasurer.

7.49 Project teams would undertake necessary consultation processes during the course of the project. They would be responsible, subject to the guidance of the steering committee, for presenting the outcomes of those consultations to the Treasurer and the government in the context of their recommendations at each decision point in the process. Major decision points would be approval of the detailed policy proposals and the draft legislation to be submitted to Parliament.

7.50 Team members would be accountable to the team leader for their day-to-day work on the project but would also remain accountable to their agency for maintaining appropriate standards in their area of expertise and for the final outcome of the project.

7.51 The team members would have more specific accountabilities in keeping with their areas of expertise, in particular to:

- carry out their agency responsibilities in relation to the project;
- ensure that the project meets specific agency standards;
- ensure that the project meets general standards so far as relevant to them;
- work with team members from other agencies to ensure an integrated, iterative and parallel process; and
- ensure that their home agency is kept informed on the impact and achievability of design proposals.

7.52 The team leader would be responsible to the steering committee for the performance of the team on a day-to-day basis and for the project outcomes.

7.53 Project team leaders would have overall accountability for the delivery of their projects, as well as ensuring that the necessary coordination with related projects and across functions occurred. They would be required to:

- manage and complete each project within general and specific standards and the budget and time requirements set for it;
- report to the steering committee on general and agency specific matters;
- ensure that the project proceeds in an integrated, iterative and parallel way; and
- cooperate and liaise with other project leaders.

### Cross-agency steering committee

7.54 A second measure to strengthen accountability and improve integration is the establishment of a steering committee to which the cross-agency teams would report.

7.55 This steering committee would be a permanent body. Its membership would comprise a senior representative from each of Treasury, the ATO, and the OPC. Individuals on the steering committee would bring substantial expertise relevant to the business tax system, commensurate with the committee's role.

7.56 The steering committee would have an understanding of all business tax policy changes and consultative processes taking place at any one time. Consequently, it would be in a good position to ensure that interactions between those changes and the rest of the system were taken into account.

7.57 The steering committee would establish teams, arrange for those teams to be resourced, provide guidance to the teams in their work and ensure that effective project management arrangements operate across all teams. The steering committee would approve the project brief and be ultimately responsible for the quality of the work produced by the teams.

### Accountabilities

7.58 Each member of the steering committee would be accountable to the head of his or her agency, representing the interests of that agency while seeking to achieve an outcome that is in the interests of the system overall. Inevitably, some compromises would be needed and members would need

to use judgment, consulting with their agency head, to achieve an outcome which balances competing agency or system interests. The existence of overarching objectives and principles for the business tax system would assist the steering committee in making these trade-offs explicit.

7.59 The steering committee would have accountability for general matters relating to projects, including to:

- agree time lines, parameters, budgets and other general matters for projects;
- assemble teams and appoint team leaders;
- ensure consultation in accordance with agreed rules (subject to the potential role of the board, as discussed below);
- ensure that appropriate infrastructure is provided to support projects; and
- monitor general progress, resolve problems where necessary and bring projects to completion.

7.60 Members would also be accountable for specific matters in relation to the areas of expertise of each of the agencies. As members of the steering committee they would:

- set specific standards for each agency's part in the process (for example conformity with framework principles, consistency with government decisions);
- ensure that standards are met for a particular project;
- check coordination of related projects and of functions (for example, policy or legislation);
- provide advice to teams on request; and
- review and develop standards, knowledge and skills with regard to practice elsewhere.

## Establishing an advisory board to support the framework and processes

7.61 One suggestion that is often made in relation to improving the tax system is for an advisory board, including a majority of members from the private sector, to play a role in the tax process. The membership and functions of such a board depend on its possible roles.

- One possibility is for the board to be focused exclusively on reviewing and reporting on the integrity and operation of the overall business tax system and highlighting opportunities for improvement. That is, it would stay at arm's length from the

operation of the processes and perform an independent assessment function.

- Alternatively, the board could be involved in the processes themselves —in the sense of progressing work on policy approved for the forward work program by the Treasurer — to a greater or lesser degree. Some possibilities are discussed below.

## Review and report on performance

7.62 The joint project teams and steering committee described above would be responsible for ensuring the integrity of the tax system in relation to the projects they undertake. However, there would be value in having an ongoing independent assessment of how well these arrangements were working. Such assessments would help to build taxpayer confidence in the system as well as improving general understanding of the system. An advisory board —with responsibility for reviewing the overall health of the business tax system and reporting to the Treasurer (and possibly Parliament) on how well the system is delivering and being maintained — could perform this role.

7.63 In carrying out this function, the board would focus on answering the following questions, principally through an annual report:

- Did the system deliver the outcomes which were intended?
- Were the objectives and principles applied?
- Were the proper processes followed?
- Did adequate and effective consultation occur?

7.64 In terms of the process of implementing new policy initiatives, approved by the Treasurer, the board could consider matters which currently are not reviewed systematically. This might therefore represent a significant focus of such a board's activities. As well, the board would be responsible for reviewing the performance of the system against the national objectives and design principles.

7.65 The board could be empowered to appoint specialist committees to advise it on specific aspects of its responsibilities. At least some of these committees might be drawn from existing ATO consultative or advisory arrangements (see Appendix D), with a view to effecting a substantial rationalisation and streamlining of those arrangements.

## Options for stronger involvement in processes

7.66 Additional to a basic review and report function, a number of variants could be envisaged for an advisory board which involve it more

and more closely in the design of the business tax system. The Review is seeking submissions on the appropriate role for the suggested board along this continuum of options.

### *Recommendatory*

7.67 At the first stage the board could perform a recommendatory role. Thus the board could be a source of advice from time to time on the tax system, particularly in relation to the need for and nature of consultation during the development and implementation of particular policy measures approved by the Treasurer, or in relation to tax administration. Within such a recommendatory role, the board would not contribute to the development of views on the appropriateness of a particular policy or aspect of administration, but rather would stay focused on the way the system is meeting its objectives. It could also be used as a sounding board on policy issues.

### *Consultative*

7.68 As a further stage of involvement, the board could actually conduct or supervise consultation on particular tax measures from the approved work program, or on the administration of the tax system.

7.69 Active involvement in policy consultations might be seen as compromising the board's role as an independent assessor of the system. But since it is proposed that the board would consist of a majority of senior private sector representatives, who would develop a good knowledge of the tax system, those members would represent a valuable resource in terms of such policy consultations. The Review is seeking submissions on the appropriate scope of the board's activities.

7.70 For public review measures where timing precluded the publication of a discussion paper, or the issue was not of sufficient substance, the government could simply bring it to the attention of the board. For issues which required confidential consultations a similar process would be used but all parties would have to abide by confidentiality requirements.

7.71 Consultation is an expensive process for both the public and private sectors. As a general rule it is up to those espousing a particular view to make a decision as to what resources they will devote to it. However, on occasions the board may identify a need for further research or information. In such cases the board could consult with relevant public sector agencies and others on the best way to proceed. They would then need to make a case to the Treasurer for public sector funding of any work. Of course the board would need to have a budget for administrative costs associated with its activities. This would need to include some allowance for the administrative costs of any committees appointed by the board.

7.72 If it was decided that the board would not have a consultative role there would be a need for the government to appoint *ad hoc* committees to facilitate and conduct an improved consultation process.

### Membership options

7.73 In respect of board membership, the Review would support having at least a majority of senior private sector members. An issue is the range of community interests that should be represented on the board. The board would not be determining the broader taxation policy agenda; that would remain the prerogative of the Treasurer and the government. Even in its widest formulation, the role of the board would not extend beyond consultation on, and implementation of, policy issues nominated by the Treasurer.

7.74 A further issue is whether the board should include senior representatives of Treasury, ATO and OPC, and possibly other public sector agencies.

7.75 The arguments for public sector representation are probably strongest if the board's activities were confined to the independent assessment and oversight role. The public sector representatives would mean that the board was fully representative of all the participants in the system, apart from the government and the Parliament. On the other hand, public sector members of the board assessing the performance of the system would also be responsible for major aspects of that performance in their day-to-day work. This could create some conflict of interest.

7.76 If the board were to be an active participant in the policy consultation process, public sector representatives may find themselves in the position of being members of a board supporting a position at odds with that of the Treasurer and the government. Nevertheless, their expertise would be a valuable input to the consultation process.

7.77 The Review is seeking community reactions on membership options.

### A constructive approach by the private sector

7.78 Establishment of an advisory board would give the private sector an enhanced and more formal role in the development and maintenance of the business tax system. Most of the other reforms proposed in this area require changes to the roles and performance of the public sector agencies.

7.79 The full benefit from these reforms would be achieved only if the private sector also adopted a constructive and open approach to taxation

issues. While taxpayers are entitled to pursue their self interest subject to the existing law, the establishment of relationships between taxation authorities and taxpayers based on good faith and trust, as well as professional commitment, would be intended to reduce both compliance and administration costs and to remove one driver for complexity in the system. Individual taxpayers would need to weigh up the benefits of such an outcome against any short term benefits obtainable from pursuit of their own individual interests. Successful and sustainable operation of the proposed participative arrangements would require, accordingly, a national interest perspective from all those involved.

## Reinforcing business tax simplification

7.80 Together, the suggested framework principles and tax process reforms can be expected to produce a better functioning business tax system and higher quality implementation of announced policy.

7.81 The Review has separately canvassed, in Chapter 3, sources and illustrations of complexity as a general property of the business tax system. Simplification is one of the three suggested national objectives for business taxation, but it has been systematically undervalued as a national objective. The Review believes the framework principles and tax process reforms proposed in this paper will support concerted simplification in the emerging design of the tax system.

7.82 However, a wider strategy is needed to ensure that simplicity is given adequate weighting in the ongoing design of the system and to support its translation into legislation. Central to this are the Review's proposals that involve a thorough revision of the objectives and principles for business taxation —which should ensure significantly improved certainty, consistency, stability and adaptability that can then be reflected in the tax legislation.

## Objectives of law simplification

7.83 The Review believes that business tax law simplification ought to be based on the revised framework and include three paramount objectives:

- a substantial reduction in the volume of tax legislation (*stock reduction*);
- much more stringent control on net additions to the legislation (*flow control*); and
- making the tax legislation more accessible to taxpayers, reducing their interaction with it where possible, and making their

necessary interaction with it more user-friendly (*improved taxpayer interaction*).

7.84 These three simplification objectives are, of course, mutually supportive. Making the tax law more accessible to taxpayers and the tax system easier to use is, of course, a major benefit of simplification. At the same time, as a fail safe measure, stock reduction and flow control would ensure a high degree of focus on the simplification objective.

### **Guidelines for development of a simplification strategy**

7.85 The development and implementation of a business tax simplification strategy could be an ongoing responsibility of the Treasury, the ATO and the OPC. It should be carried out by an integrated team and be subject to the same accountabilities in respect of the cross-agency steering committee and the individual agencies as any other tax initiative.

7.86 The proposed board could provide independent assessment and oversight of the process. This would help to ensure the process was ongoing and is not 'pigeon-holed' because of the urgent driving out the important. The main difference compared with other initiatives is the size of the initial task and the need for continuing work once that task is completed.

7.87 The Review intends that the integrated design team concurrently preparing draft exposure legislation in conjunction with the Review's examination of the Government's business tax reforms announced in *A New Tax System* will provide valuable lessons for an ongoing simplification strategy.

7.88 Some initial guidelines for the simplification strategy would include the following:

- It should be based on the policy framework revision and incorporate the three simplification objectives outlined above: stock reduction, flow control and improved taxpayer interaction.
- An important part of the strategy would be to educate participants in the system, including policy advisers, legislative drafters, tax administrators and taxpayers about the costs and causes of complexity. This will require research into the sources and consequences of complexity and wide dissemination of the results.
- The strategy should consider all possible options for simplification but of course would be subject to guidance from the Government concerning appropriate trade-offs with other objectives.

- It should be developed within the business tax framework proposed by this Review. The revised *Income Tax Assessment Act 1997* reflects work done by the Tax Law Improvement Project (TLIP) in pursuit of simplification. It is likely that a substantial amount of that work would be consistent with the framework proposed by the Review and would be able to be used by the integrated design teams mentioned above.
- The business tax simplification strategy would need to have regard to the transition costs involved in proposed changes aimed at simplifying the law.
- Its related processes should involve effective participation by all stakeholders, and would, ideally, retain continuing bipartisan support at the political level.
- The strategy would need to be applied consistently over time to ensure that the tax system remains as simple as possible.

7.89 With the majority of the tax legislation not yet revised by the TLIP being in the business tax area, adoption of this law simplification strategy would also be consistent with the announcement in *A New Tax System* that TLIP work would be subsumed in the implementation of the Government's reform package.

#### *Stock reduction strategy*

7.90 It is impossible to say with any accuracy what is the appropriate volume of tax legislation. But even a casual examination of the tax legislation would convince most people that the current volume is excessive. The Review believes there is an advantage in nominating a challenging, but essentially arbitrary, target at the beginning of the process. The TLIP has approximately halved the size of most areas of the *Income Tax Assessment Act 1936* that it has rewritten, without the benefit of an integrated approach to policy design and the proposed framework objectives and principles. An initial target of legislation at most half of the existing size would therefore seem to be appropriate. It is better to be too ambitious than too cautious when pursuing an objective such as simplification.

#### *Flow control strategy*

7.91 Flow control is the nub of any strategy for sustaining a successful simplification strategy. Adoption of a consistent framework, definitions and terminology, along with improved adaptability in the face of continuing change, would help to minimise additions to the law flowing from policy changes. Further to that, there would need to be increased recognition of the costs of adding to the volume of law when considering the design and implementation of new initiatives.

### **Reporting requirement**

7.92 The board could be required to report on progress with simplification of the tax law in the context of the overall performance of the tax system against the agreed framework and principles.

## **Consolidating a *Charter of Business Taxation***

7.93 When suitably refined after consultation, much of the framework for business taxation being suggested by the Review might usefully be encompassed in a *Charter of Business Taxation*.

7.94 Adoption of such a Charter would serve to reinforce the durability of the framework and process-related reforms to the business tax system ultimately to be recommended by the Review following its consultations. With that underpinning, the Review would expect that the quality of future business taxation policy would be further supported and improved.

### **Elements of Charter**

7.95 The Charter would need to address at least the following elements:

- the functions of the business tax system;
- the national objectives for that system;
- the framework principles at the policy, tax design and administrative levels; and
- statements of strategic principles and process requirements addressing business tax policy initiation, integrated team-based design, consultation, oversight, accountabilities and simplification.

### **Role of Charter**

7.96 The Charter could have the following interrelated purposes:

- it would provide a summary and consensual statement of the intended business tax framework and operation of its related policy processes;
- it would afford authoritative guidance to all participants in the process of integrated design of business tax policy;
- it would underline improved consultative arrangements for business tax policy;

- it would set out key accountabilities and a transparent performance review mechanism for building and maintaining the business tax system; and
- it would reinforce an enhanced and sustained commitment to a simplification strategy for the business tax system.

### Process for finalising Charter

7.97 It would be desirable that the Charter represent a consensus expression of national aspirations for Australia's business tax system. To that end, the finalisation of the Charter could be one of the first topics to be addressed under the reformed consultative and oversight arrangements being proposed by the Review.