

Review of
Business
Taxation

A STRONG FOUNDATION

Discussion Paper

Establishing
objectives, principles
and processes

November 1998

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FOREWORD

This is the first discussion paper issued by the Review of Business Taxation to enable those interested in the necessary reform of business taxation to participate in the process. Reforming the business tax system is critical to the future wellbeing of all Australians. Thus, how well we accomplish this task is vitally important.

The Government's initiative in announcing *A New Tax System* has provided the opportunity to reform the system in a fundamental manner which we need to grasp firmly. We are at a watershed, as Australia faces the consequences of increasing globalisation of world economies with a tax system that is patently deficient, unnecessarily complex and seen to be working unfairly and inefficiently.

The Australian tax system can be likened to the leaning tower of Pisa. Adding another storey will not reduce the chance of collapse. It would only make it more certain. Like the leaning tower, the business tax system needs a sound and stable foundation before we can start the task of rebuilding.

One of the principal reasons for the widespread dissatisfaction with the current system is that it is not based on a coherent set of principles. The 1936 Act was developed in an Australian economy very different from today's. This Act has been added to and patched largely in an *ad hoc* manner until it is no longer coherent and is not easily comprehended.

If we are to avoid perpetuating this situation we need to establish a sound foundation and a framework of coherent principles capable of adaptation to meet changing needs and policies without sacrificing the integrity of the system.

This is why we have separated the discussion of the objectives and principles of taxation and the related processes of policy development, legislation and administration from the particular policy issues we are required to address. The latter will be the subject of another discussion paper that will be issued by the Review early next year.

Our objective is to join with the various stakeholders in the tax system in agreeing on the kind of foundation on which a robust system can be built —a system that enhances the growth performance of the Australian economy, is equitable and efficient, and is as transparent and as simple as it can be made.

We wish to encourage debate and discussion and will be holding a number of seminars in the various capital cities as well as inviting submissions to help the Review come to its recommendations to Government.

We invite you to participate in this critical endeavour.

J.T. Ralph AO
Chairman

Membership of the Review

Mr John Ralph AO (Chairman);
Mr Rick Allert AM; and
Mr Bob Joss.

The Secretary is Dr Alan Preston.

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SUBMISSIONS TO THE REVIEW

Invitation for submissions

The Review has published this discussion paper to facilitate widespread community debate and discussion. The Review invites members of the community to make submissions relating to all matters raised in this paper which bear on its terms of reference. In particular, it welcomes comments on its proposed strategy for building a strong foundation for the business tax system as a necessary prerequisite to policy reform.

How to make a submission

Submissions on issues canvassed in this paper should be lodged by **Thursday 31 December 1998** and addressed to:

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Telephone: (02) 6263 4325 Fax: (02) 6263 4352

Each submission should clearly indicate a contact person and contact details. If the submission is more than five pages, please include an Executive Summary.

The Review requests that two hard copies be provided and, if possible, an electronic copy on IBM Compatible 3 1/2" floppy disk in Microsoft Word or Rich Text Format. Alternatively, submissions can be emailed to the Review (rbt@treasury.gov.au).

The Review intends to treat submissions as public and may quote or publish the whole or part of your submission. **You should clearly indicate if you would like all or part of your submission to be treated as confidential.**

How to get copies of submissions

The Review intends to list all public submissions, and where possible the text of public submissions, on its website (<http://www.rbt.treasury.gov.au>).

Organisations making submissions are asked to put in place arrangements to make copies of their submission available to interested parties. In the case of submissions by individuals, the Review will make the necessary arrangements.

OVERVIEW

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Approaching the task of reform

Pursuing fundamental redesign of business taxation

1. The Review has been asked to conduct wide ranging consultations with a view to making recommendations about the fundamental redesign of business tax arrangements. The objective is a stable, simpler and more coherent business tax system. Such a system will lead to more robust investment decisions, improved competitiveness, greater productivity, higher gross domestic product growth and more jobs.
2. Recommendations of the Review are to be consistent with the aims of:
 - improving the competitiveness and efficiency of Australian business, and thereby the competitiveness of the Australian economy;
 - providing a secure source of revenue;
 - enhancing the stability of taxation arrangements;
 - improving simplicity and transparency; and
 - reducing the costs of compliance.
3. To set the scene, business income —as defined in the Government’s recent paper, *A New Tax System*, and adopted for purposes of the Review’s terms of reference —includes all investment income of whatever form and however derived. Business income is earned by a variety of entities including companies, trusts, partnerships, superannuation funds and individuals. In 1995-96 the Australian Bureau of Statistics estimated there were approximately one million businesses operating in Australia compared with around 2.3 million taxable companies, superannuation funds, partnerships, business trusts and individuals’ businesses. Business income includes dividend, interest and rental income as well as capital gains and the returns from operating a business. So defined, business income is a very broad concept. Australian taxable business income is estimated to have been around \$112 billion in 1995-96 giving rise to taxation revenue of \$28.2 billion or 22 per cent of the Commonwealth’s total tax revenue.

Inviting responses to Review papers

4. The Review will be publishing three papers before its final report:
 - this discussion paper, addressing business tax framework and process elements of the Review's terms of reference;
 - an information paper in December 1998, presenting a comparison of Australia's business tax system with those of a number of other countries; and
 - a further discussion paper, planned for release in late January 1999, addressing the Government's business tax reforms announced in *A New Tax System*, along with some specific business tax issues identified in the Review's terms of reference.
5. The Review is inviting public submissions on any framework and process issues bearing on its terms of reference, including those issues canvassed in this paper, by 31 December 1998. Because of the breadth of issues raised in this paper, the Review has decided not to pose specific questions for response, but encourages the community to participate in developing a sounder framework and better processes for business tax design.
6. Submissions on the Review's second discussion paper will be invited on specific design issues raised by implementation of the Government's announced strategies for reforming business taxation. These submissions will be due by 31 March 1999.
7. The Review is required to submit its final report no later than 30 June 1999.

Dealing with three key problem areas

8. Together, *A New Tax System* and the Review's terms of reference identify three key problem areas of the business income tax system:
 - the differential taxation of different business entities;
 - the lack of a coherent framework for taxing investment income; and
 - the need to reform the framework and processes applying to the design of business tax policy, legislation and administration to provide greater certainty to taxpayers and to reduce compliance and administration costs.

Differential taxation of different business entities

9. There are many instances in the current tax law where the tax treatment of income from a particular transaction depends on the nature of the entity undertaking the transaction. This violates the tax principle that taxpayers in similar positions should be treated similarly. Taxpayers are also encouraged to adopt ownership structures that maximise their tax advantages rather than the structure best suited to their business circumstances. For example, income that is not taxable in the hands of a company because of tax preferences, past losses, or other reasons is taxable in the hands of shareholders when distributed as dividends. Similar income distributed by discretionary trusts to beneficiaries is not taxable in their hands.

Lack of a coherent framework for taxing investment income

10. In many instances transactions which are identical, or very similar in their economic substance, are taxed differently because of differences in form. For example, leasing and purchasing plant can be structured in such a way that the economic substance of the two transactions is identical. Yet the tax implications may differ between the two transactions.

11. In some circumstances double taxation of income, or multiple loss creation from the same transaction, can occur because of deficiencies in the current law arising, at least in part, from the complexities of the current system.

12. In other cases genuine business expenses are not deductible under current policy and law —giving rise to so called ‘black hole’ expenditures.

13. Various inequities and inefficiencies stem from the tax rates applied to particular forms of income. One of the most obvious examples is the taxation of all fringe benefits at the top marginal tax rate even though a number of the employees receiving those fringe benefits will be subject to lower marginal income tax rates on their other income. A further anomaly is that, unlike wages and salaries, a tax on fringe benefits is levied on the employer and not on the recipient of the benefit.

14. A number of anomalies and timing mismatches can lead to inappropriate tax outcomes for individual taxpayers and between taxpayers for similar transactions.

Reform of business tax framework and processes

15. Additionally, there is widespread dissatisfaction and frustration with the operation of the current business tax system. This extends not

only to taxpayers and private sector tax professionals but to virtually all other parties involved, including the bureaucracy, the Government and the Parliament.

16. In the opinion of the Review, an overriding cause of this dissatisfaction and frustration is the complexity and *ad hoc* nature of the current system. In turn, this reflects two important and interacting limitations:

- the absence of transparent objectives and principles underpinning design of the business tax system; and
- less than satisfactory processes for implementing tax policy design within that system.

17. These *framework* and *process* limitations have a number of consequences:

- amending the system to reflect new policy positions is an unnecessarily technically complex exercise;
- taxpayers find it hard to understand and comply with the system;
- anomalies and inconsistencies are an inevitable consequence of that complexity;
- the need for recourse to appeal mechanisms or the courts is increased; and
- appeal bodies and courts can find little guidance in the rules about how to resolve conflicts.

18. In many ways the private sector and the government are both victims of a system which is in need of radical reform.

Recognising the urgency of reform

Threats to the current system will raise the stakes

19. Both business generally and the current business tax system face a rapidly changing environment, which creates threats and opportunities. A number of the threats posed by these changes highlight the inadequacy of Australia's current approach to business taxation in an increasingly complex business environment:

- the continuing globalisation of the world economy will exert increasing pressure on Australia's competitiveness, raising the premium on efficient business tax arrangements;

- globalisation will offer companies additional scope in their choice of national base so that international differences in business tax systems will play a greater role in that choice;
- the development of electronic commerce creates particular difficulties in terms of identifying transactions and the tax jurisdiction in which they take place;
- the financial markets are continually developing new financial products of increasing complexity, accentuating the existing problems of the tax system and of taxing financial arrangements consistently —particularly because of the blurring of the debt/equity distinction; and
- competition among countries for investment and taxation revenue poses a significant threat to national revenue bases.

20. The pre-eminent economic challenges for Australia remain those of lifting its sustainable growth performance and enhancing job creation. A more efficient business tax system can contribute vigorously to those goals by redirecting business energy and commitment more productively.

Addressing first things first

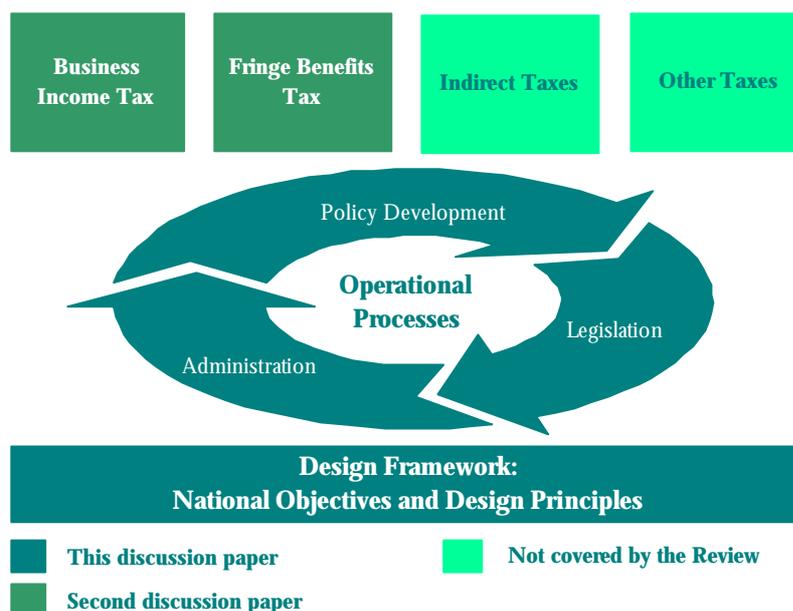
Framework and process limitations

21. The Review is deferring to its second discussion paper consultation on specific policy issues related to the taxation of entities and investments. The object of this, the first of its discussion papers, is to consult on the framework and process limitations of the business tax system with a view to recommending fundamental improvement. Figure 1 indicates the scope of and interrelationships amongst the reform strategies proposed in this paper.

22. Two related factors motivate this staged approach:

- the business tax system is a complex adaptive system: its effective redesign requires reform not only of its specific policy building blocks but also to its design infrastructure —to its framework and processes; and
- refinement of those infrastructure reforms through consultation will directly benefit the Review’s subsequent consultations on the entities and investments building blocks of the business tax system.

Figure 1: Design framework and design processes for the business tax system



Building a strong foundation

Focusing on both framework and process reform

23. To respond to these limitations, the Review proposes a reform strategy comprising:
- a suggested design framework of national objectives and supporting principles; and
 - proposed reforms to the design processes for policy, legislation and administration.

National objectives and design principles

24. Revenue raising is the key function of the business tax system. But that system must be designed and operated to support broader national aspirations for Australia’s overall economic performance and well-being.

25. Reflecting those overarching economic goals, the Review proposes, for discussion, a set of national objectives and design principles for the business tax system. As a foundation on which to build enduring reform, a national imperative must be to develop a consensus around some such set of objectives and principles. Beginning to build that consensus will be a primary aim of the Review’s consultative strategy.

26. On the basis of the suggested national objectives, the Review advances a number of design principles dealing with the policy, legislative and administrative processes of the business tax system. That system would be designed and maintained having regard to these principles.

27. Inevitably there will need to be some trade-offs amongst objectives and in the practical application of, and balancing between, particular principles. These should be explicitly recognised and would reflect the priorities and judgment of the government of the day.

28. Clearly identifying and articulating business taxation principles would foster both rational debate on and better redesign of the business tax system. Of themselves, such principles cannot avoid sensitive issues of judgment, but they can make those judgments much more transparent and easier to debate constructively.

29. In the end, tax design in a complex environment is as much art as it is science: judgment is often as important as fact and analysis. The Review proposes to use these principles as guides to tax analysis and design, seeking to identify departures from them wherever these occur.

Reform to design processes for policy, legislation and administration

30. The Treasury, the Office of Parliamentary Counsel (OPC) and the Australian Taxation Office (ATO) are the three main agencies involved in serving the government in the fields of policy development, legislation and administrative processes. The Treasury is primarily responsible for policy development, the ATO for developing drafting instructions which the OPC translates into legislation, and the ATO for administration.

31. The Review sees the development of tax policy and legislation in Australia over recent years as generally having been a step-by-step process. Each step has been performed as a separate and distinct function by the responsible government agency, with little or no opportunity for community input during the process. Although considerable interaction occurs between the three agencies, there is a lack of integration and inadequate specification of agency accountabilities. In the Review's opinion, substantial gains would attend much tighter integration across, and specification of accountabilities for, the three elements of policy, legislation and administration.

32. During policy development, policy considerations should have regard to their legislative and administrative implications. Legislation should implement the policy intent while being easily understood and giving appropriate weight to the ease of administration and compliance. Administration should be in accordance with both the legislation and the

policy intent. It should minimise compliance costs and provide processes for ongoing feedback from both the administrators and the taxpayers on the effectiveness of the system.

33. As well as an integrated approach to policy, legislation and administration, the Review is also proposing much more open and systematic processes intended to facilitate wider community involvement in all phases of business tax design.

Proposing a design framework: the national objectives

34. National taxation objectives provide high level guidance for the design and operation of the business tax system. The Review is proposing three national objectives around which to structure debate towards formation of a national consensus on the required design principles:

- optimising economic growth;
- ensuring equity; and
- facilitating simplification.

Economic growth

35. In raising revenue for the Commonwealth the business tax system should interfere to the least extent possible with the best use of existing national resources, with the efficient allocation of risk and with economic growth in the longer term.

36. An internationally competitive economy will require, and be sustained by, efficient economic use of its resources. To that end, a vital precondition for international competitiveness will be to ensure that the business tax system does not influence business decisions unnecessarily. In particular, the business tax system should not make Australia an unattractive location for inbound investment, nor drive existing domestic investment offshore purely on the basis of tax considerations.

37. The rationale for this objective springs from broader social goals. Irrespective of taxation arrangements, Australia's economy —its market structures as well as its complementary institutional arrangements —needs to be marshalled with the objective of ensuring that investment funds are allocated in such a way as to optimise economic growth. Design of our business tax arrangements should not be allowed to affect this allocation any more than necessary to achieve the other national objectives.

38. Of course, there are examples where existing market forces and institutional structures do not produce an optimum outcome and others where such an outcome is not well represented by standard economic

measures. In some of those cases it may be that the tax system is the best instrument to seek to correct that.

Equity

39. Equity, or fairness, is an objective that directly reflects community concerns. The idea that individuals in similar circumstances should be taxed in similar ways (referred to as *horizontal equity*) commands broad support within the Australian community. Equally, the idea that tax burdens should depend upon ability to pay and that those more able to pay should pay more tax (termed *vertical equity*) also appears to be widely accepted.

40. Because of the business tax focus of the Review, horizontal equity is the dominant dimension of the equity objective —with the personal tax system, together with the social security and related payments systems, reflecting decisions on vertical equity. In designing business taxation, concerns about the fairness of transitional and administrative arrangements must also be considered.

Simplification

41. Simplification poses fundamental questions about optimum design of the business tax system —in particular, how to ensure in the tax legislation:

- much needed clarity via expressed principles and their structured application;
- far greater simplicity, certainty, uniformity and consistency of application;
- improved adaptability in the face of continuing change; and
- significantly increased ease of compliance and administration.

42. Simplification of administration, as well as of the tax legislation, is also essential for promoting voluntary taxpayer compliance.

43. Complexity, as the other side of the simplification coin, is not something identifiable that has been grafted onto the business tax system. It derives from multiple sources such as tax legislation that encourages highly technical interpretation by courts; importation of external legal concepts into tax legislation; a wide range of tax preferences; equity concerns; and complex business arrangements, to name but a few. Because of that, complexity cannot easily be excised from the business tax system; the simplification objective will accordingly demand an effective strategy and process for its realisation.

Proposing a design framework: the supporting principles

44. Design principles directed to achieving the national objectives are essential to support a robust framework for policy development, legislation and administration. They sketch a broad, rather than precise, road map for moving more efficiently towards and maintaining desired outcomes on the national objectives.

45. Corresponding to each of the policy, legislative and administrative processes, the Review is suggesting a set of principles supporting:

- policy design;
- legislative design; and
- administrative design.

46. Policy design principles are primarily directed to the achievement of the economic growth objective, but will also have consequences for the equity objective. Thus measuring income comprehensively ensures resources are utilised efficiently, but also has equity benefits in taxing all forms of income comparably. Various principles directly address the equity objective, referring to horizontal, transitional or administrative equity. The application of the principles collectively and consistently can be expected to facilitate simplification. In certain cases, the pursuit of one objective (such as equity) may have offsetting impacts on another objective (such as simplification).

47. Accordingly, there is no simple (or indisputable) relationship, particularly of the policy design principles, to each of the national objectives or to subsets of those objectives. Business tax policy design is inherently an exercise in determining an optimal design for the business tax system subject to the government's revenue targets and to the constraints on performance represented by the national taxation objectives. Despite those necessary practical qualifications, the process of design can be expected to be facilitated and improved where a more systematic attempt is made to define objectives as well as a configuration of principles that will deliver outcomes compatible with those objectives.

Policy design principles

48. Policy design principles provide important operational guidance on how to achieve the national taxation objectives. They offer sound conceptual benchmarks, with each principle having a continuum of possible operational settings. Actual settings will depart from benchmark settings, with each such setting representing a different degree of departure from the relevant principle.

49. For example, the comprehensive income base provides a conceptual anchor for the tax base underlying Australia’s business tax system. Its practical use is less to insist on its uniform adoption and much more to guide informed and transparent judgments about relative compromises in its implementation. Without the benchmark concept, there is no sound basis against which such judgments can be evaluated.

50. Different configurations of settings across the policy principles will reflect differing community preferences and affect the overall performance of the business tax system. As such, the policy principles proposed by the Review are likely to stimulate more debate than the national objectives themselves.

51. Suggested policy principles are listed in Box 1.

BOX 1: POLICY DESIGN PRINCIPLES

Principle		See page
<i>Defining tax base</i>		
1. Income tax base	Business tax arrangements reflect an income tax base.	71
2. Taxation of comprehensive income	Comprehensive income is defined as the sum, over an annual period, of the taxpayer’s current revenue less current costs, plus the net change in the value of the taxpayer’s assets and liabilities.	72
3. Real or nominal taxation	Comprehensive income is conceptually measured as real income (i.e. income comprehensively adjusted for uniform inflation) but for practical reasons comprehensive nominal income (i.e. income not comprehensively adjusted for inflation) may be an unavoidable compromise.	73
<i>Determining tax liability</i>		
4. Integration of ownership interests	For business tax —as distinguished from commercial or legal —purposes, entities should be considered as extensions of their ultimate owners.	74
5. Single layer of domestic taxation	Business income should not bear more than a single layer of Australian taxation.	74
<i>Promoting equity</i>		
6. Horizontal and transitional equity	Under the integration principle, ability to bear tax ultimately refers only to natural persons, not entities, so that for tax purposes all income —e .g. entity profits, interest, royalties, rental and wage income —should be taxed comparably.	75

Changes affecting existing taxpayer arrangements should also be designed and implemented fairly.

Affecting economic growth

7. Investment neutrality	In order not to distort the cost of capital used to evaluate alternative investments, business tax arrangements should avoid differentially taxing: <ul style="list-style-type: none">▪ the type of investment;▪ the type of entity (companies, trusts, partnerships, direct investment etc);▪ entity financing alternatives (retentions, capital issues, debt issue, dividend reinvestment, reductions in share buy-backs);▪ the type of income distribution (dividends and the income component of share buy-backs or liquidations); or▪ distributions relative to retentions. To achieve neutrality, the tax base adopted should be as close as possible to comprehensive income.	75
8. Risk neutrality	Since capital markets must compensate investors for bearing undiversifiable risk, business tax arrangements should seek to minimise distortions to the pattern of such risk bearing by adopting a tax base as close as possible to comprehensive income.	76
9. Balanced taxation of international investment	Taxation of inbound and outbound investment and other cross-border business activities should be consistent with Australia's national interests, including its competitiveness, while respecting Australia's international obligations.	77
10. Tax incentive provision	Business tax incentives should be provided only following a formal assessment of their net impact on the national taxation objectives, and only where assessed to be an essential or superior form of government intervention.	77
<i>Reflecting incidence and substance</i>		
11. Effective tax incidence	Business taxation measures should be designed on the basis of an assessment of their actual behavioural impacts –not simply their formal or legal impacts.	78
12. Economic substance over form	Economic transactions having the same economic substance should be taxed similarly, irrespective of their form.	78

Legislative design principles

52. The focus of the legislative design principles principles is mainly on the user end of the system —p roducing a tax system that works better for taxpayers and administrators as well as achieving the desired objectives. Proposed principles are set out in Box 2.

BOX 2: LEGISLATIVE DESIGN PRINCIPLES

Principle		See page
<i>Ensuring consistency</i>		
1. Limited policy differentiation	Tax legislation should ensure minimal and consistent differentiation in the policy treatment of similar or related economic transactions, by permitting such differentiation only where there is an expressly stated intention.	81
2. Integration across policy areas	Tax design should seek to ensure that the tax system is as consistent as possible with wider government policy.	81
<i>Integrating user needs</i>		
3. Integrated compliance	To the maximum possible extent, the same activity should fulfil or support a range of compliance obligations.	82
4. User-based design	Tax legislation should be designed from the perspective of those who must comply with it.	83
<i>Imposing drafting standards</i>		
5. Policy transparency	Tax legislation should disclose the policy intention and design purpose underlying the rules and be consistent with the national objectives and policy design principles.	84
6. Standardisation	Tax legislation should use standard rules, concepts and terminology.	84
7. Clarity of rules	Tax rules should be clear, certain and consistent.	85
<i>Ensuring dynamic robustness</i>		
8. Durability/ sustainability	The tax system should accommodate successive programs of change over a long period without disturbance to its basic design and operation.	86
9. Timeliness	The tax system should keep pace with economic and social change.	86
10. Anti-avoidance provisions	Tax legislation could retain general anti-avoidance provisions but should be sufficiently robust to do without specific anti-avoidance provisions.	87

Administrative design principles

53. Tax administration is the final link in the tax system chain. The full implementation of the preceding policy and legislative design principles will benefit tax administration, but further principles are necessary to ensure that the system works successfully on a daily basis, particularly through promoting voluntary compliance.

54. The administrative design principles set out in Box 3 are grouped around a number of themes.

- Firstly, a group of principles is designed to engender taxpayer trust in the tax administration system, given its necessarily pervasive and intrusive nature for the whole community.
- Secondly, there are principles directed to making relationships between administrator and taxpayer as painless and efficacious as possible (which also reinforces trust).
- Thirdly, two principles address the capacity to enforce compliance when it is not otherwise forthcoming. Such powers are necessary to reinforce the elements of trust and relationship in the tax system by bringing delinquent taxpayers to book but need to be exercised with restraint and a due sense of proportionality.
- Finally, there is the need to cope with rapid change in a proactive rather than reactive mode.

BOX 3: ADMINISTRATIVE DESIGN PRINCIPLES

Principle		See page
<i>Engendering taxpayer trust</i>		
1. Independence	The operation of day to day tax administration should be free of external influence in relation to particular taxpayers.	89
2. Privacy/confidentiality	An effective administrator must ensure that taxpayer information is collected, used and kept in accordance with privacy and confidentiality laws and guidelines.	89
3. Fairness	Taxpayers should receive fair and consistent treatment in their dealings with the ATO.	89
4. Review mechanisms	Internal and external review mechanisms should promote taxpayer confidence in the equity and accountability of the system's administrators.	90

<i>Facilitating taxpayer compliance</i>		
5. User friendly relationship	The tax administration should facilitate its dealings with taxpayers by service-oriented and simple-to-use approaches.	90
6. Certainty/reliability	Consistent decision making and coordinated administration should help ensure that taxpayers have certainty with regard to their income tax liability.	90
7. Cost effective administration and compliance	Compliance costs should be minimised to assist taxpayers to comply voluntarily with their tax obligations. Collection costs should be minimised to enable administrators to allocate limited resources to best effect.	91
<i>Enforcing taxpayer compliance</i>		
8. Enforceability	To enable evasion to be detected and deterred, administrators must have a range of enforcement powers.	92
9. Proportionality	Administrators should exercise enforcement powers proportionally to the circumstances of the case.	92
<i>Ensuring responsive administration</i>		
10. Flexibility and responsiveness	Administrative practices should be reviewed, monitored and modified regularly so as to maintain relevance. These changes should be communicated effectively to taxpayers so as not to compromise certainty.	93

Reforming the business tax processes

Process reform elements

55. The main elements of the Review's proposals for reforming business tax processes are:

- adopting a more open approach to planning the business tax policy agenda, subject to the Treasurer's direction;
- strengthening the effectiveness of consultation in designing and implementing business tax arrangements;
- applying an integrated, team-based, design process;
- specifying accountabilities for design;

- establishing an advisory board with a focus on the overall performance of the business tax system and significant private sector representation to support the reformed framework and processes;
- reinforcing business tax simplification as an ongoing requirement; and
- consolidating a *Charter of Business Taxation* as a consensus statement on design framework and process.

56. The Review will be seeking submissions on all aspects of its proposals for reforming business tax design processes.

Policy initiation and planning

57. The ultimate responsibility for the initiation of policy proposals on taxation, within our system of government, must remain with the Federal Treasurer.

58. Consistent with the Treasurer's policy prerogatives, the Review is proposing an approach that would include the preparation of a forward work program for business tax policy by the Treasury, with ATO input, for approval by the Treasurer. This process would allow for consultation and public input into that program.

59. The Review is also proposing the adoption of a scheme of classification of policy issues to ensure an appropriate balance between confidentiality and public involvement. This would also retain the necessary flexibility enabling the Treasurer of the day, for budgetary or other reasons, to bring taxation matters forward independently of the proposed consultative procedures, where that was judged essential. This classification scheme would also limit unnecessary reliance on legislation by press release.

Improved consultation

60. Opportunities for the private sector to contribute to the formulation of tax policy and legislation are clearly limited. The Review believes the private sector could bring perspectives and information to the process which are essential if Australia is to have a world class business tax system.

61. In particular, major benefits would be obtained by ensuring private sector involvement in the early stages of taxation policy development. The current practice limits such involvement because of the risk that public knowledge of possible policy changes may enable taxpayers to reduce

current or future tax liabilities, or because of other sensitivities. While the Review acknowledges these considerations, it believes that they are outweighed by the benefits of more effective consultation and the resulting better legislation.

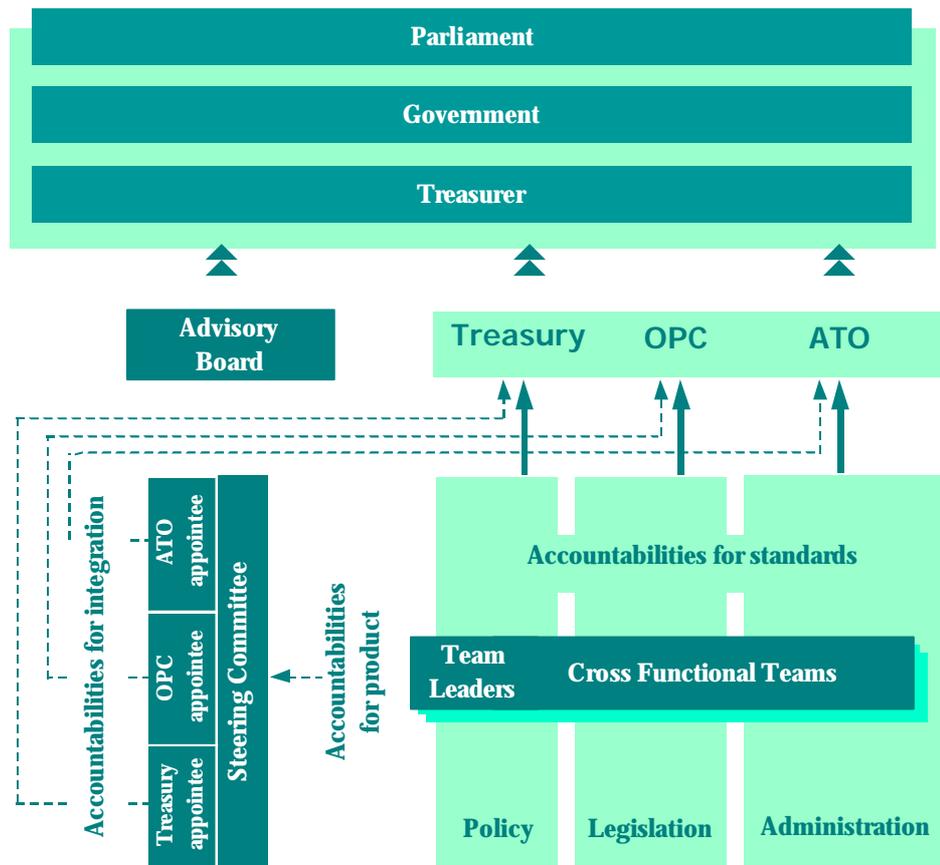
62. Only in rare cases should risks to revenue or other sensitivities pre-empt the consultation process. Were the Review's proposals for consultative development of a forward work plan to be adopted, a significant increase in consultative participation could be expected.

Integrated and team-based development with specified accountabilities

63. The Review is proposing that the development of new policy and the related legislation and administrative processes be carried out by integrated teams drawing on the Treasury, the ATO, and the OPC. In particular circumstances the teams may include representatives of the private sector or other parts of the bureaucracy.

64. Figure 2 illustrates some key elements of the Review's proposals for process reforms.

Figure 2: Key elements of integrated business tax design



65. The cross-functional teams would be headed by team leaders to whom team members would be accountable for the development and implementation of policy initiatives. Team members would remain accountable to their agency in respect of specified agency accountabilities for standards. Such agency accountabilities would contribute to ensuring that the design outcome complied with the government's intentions and took account of national taxation objectives and supporting principles.

66. The Review also proposes formation of a steering committee consisting of senior representatives of the three agencies through which team leaders would discharge their accountability for achieving a seamless design of business tax product. In turn, steering committee members would be required to meet higher level accountabilities for supporting the integrated design process.

67. These proposals are designed to ensure that policy, legislation and administration concerns and design principles are taken account of all the way through the development process. This should lead to more effective implementation of policy with less complexity and lower compliance and administration costs than at present.

An advisory board to support the framework strategy

68. The Review believes that an advisory board could support the operation of the business tax system. The paper discusses some options for the precise role of the board and also its membership.

69. The board could provide advice, but not direction, in regard to the business tax framework and processes. It could also report annually to the government of the day on the operation of the system and these reports could be tabled in Parliament. These reports could focus on the extent to which the operation of the system reflects framework objectives and principles and optimal processes along the lines proposed by the Review in this paper.

70. An issue for determination would be the appropriate role of this board in the consultation processes, particularly as they relate to policy development.

71. Given the board's role in reviewing the operation of the system there would appear to be some advantages in having it provide a channel for feedback on administrative and legislative issues within the existing system. This could be achieved by having specialist consultative committees or task forces which reported to the board and which the board could appoint on an *ad hoc* basis to deal with specific issues as the need arose.

72. A broader issue is whether the board itself would be involved in the implementation of new policy proposals, and the related legislative and administrative processes, where these have been approved by the Treasurer as part of the forward work program for business taxation. As noted earlier, the Treasurer would retain the essential flexibility, for budgetary or other reasons, to bring forward taxation measures outside the proposed customary consultative arrangements.

73. A range of possible variants extends from basic advice to the agencies involved at one end, to full scale involvement in consultation at the other. Whatever the form of its involvement, it would be essential for the board to have a supportive, rather than adversarial, focus on the framework and processes of the business tax system.

74. The membership of the board could be entirely drawn from the private sector or could include a minority of public sector members, particularly senior representatives from the Treasury, the ATO and the OPC.

75. The argument in favour of public sector membership is that it would bring to the board the full range of perspectives and expertise on the tax system, and would provide assistance to the board in its interaction with the bureaucracy.

76. An argument against public sector membership is that the board's role in reviewing and commenting on the operation of the system, including through public reports, may conflict to some extent with the responsibility of the public sector members for operating the system and reporting to government and the Parliament.

A constructive approach by the private sector

77. 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.

78. 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.

A strategy for business tax simplification

79. Simplification is being proposed by the Review as one of three national objectives for the business income tax system. In the Review's opinion acceptable performance on simplification would require:

- the adoption, as the Review proposes, of national objectives and supporting principles, which would enable the tax law to be written in a more consistent and readily understood manner;
- a significant reduction in the volume and growth of tax law, which should be facilitated by the adoption of the proposed framework;
- a much greater emphasis on achieving simplification including an increased willingness to trade-off achievement of other objectives; and
- a much greater focus on taxpayer requirements.

80. The Tax Law Improvement Project (TLIP) has been the subject of considerable criticism on the grounds that it did not address policy issues. This reflects a misunderstanding of its task, which was to simplify the drafting of the legislation. It was specifically constrained from addressing policy issues.

81. The Review accepts that simplification cannot proceed effectively without being integrated into the policy process. Consistent with the proposals in *A New Tax System* for an integrated tax code and consideration of successor arrangements for TLIP, the Review is considering the case for a business tax simplification strategy. It would be directed at ensuring a rewrite of the existing taxation legislation and establishing mechanisms to ensure that simplicity remains a prime consideration in future legislative changes.

Charter of Business Taxation

82. After refinement through the consultative process, much of the framework for reform put forward by the Review could usefully be encompassed in a *Charter of Business Taxation*.

83. The Charter would address the functions of the business tax system, the national objectives for the system, the supporting principles at the policy, legislative and administrative levels and statements of strategic principles and process requirements.

84. Amongst its purposes, the Charter could:
- provide a summary and consensual statement of the business tax framework and operation of related policy processes;
 - afford authoritative guidance to all participants in the process of integrated design of business tax policy;
 - underline improved consultative arrangements for business tax policy;
 - set out key accountabilities and a transparent performance review mechanism for the business tax system; and
 - reinforce an enhanced and sustained commitment to a simplification strategy for the business tax system.

Addressing specific issues in tax administration

Considering various operational issues

85. Operational issues in tax administration have the potential to cause taxpayer discontent and may impact seriously on compliance, administration and the overall effectiveness of the system. The major reforms to processes suggested by the Review could be expected to result in less pressure on administration and compliance.

86. Nevertheless, the Review has identified some operational issues which are of concern—for example, relating to assessments, dispute resolution and rulings—and is seeking submissions on possible reforms to administrative processes and practices.

