
POLICY FORMULATION

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An architecture for reforming policy processes

Recommendation

1.1 Integrated taxation design process

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

A Strong Foundation put forward for discussion a number of concerns about the way changes to tax laws affecting the business sector are currently identified, designed and administered. Possible reforms in these areas were canvassed. The response from the business sector was spirited, with debate hinging not on whether such reforms were needed but rather on how far they should go.

The following recommendations respond to identified concerns and set out a new, improved architecture for the continuing reform and maintenance of business taxation in Australia.

An integrated approach

Proposed as the fundamental change is a move from a largely sequential taxation design process to one which is holistic and fully integrated. The new process should help to produce a tax system that:

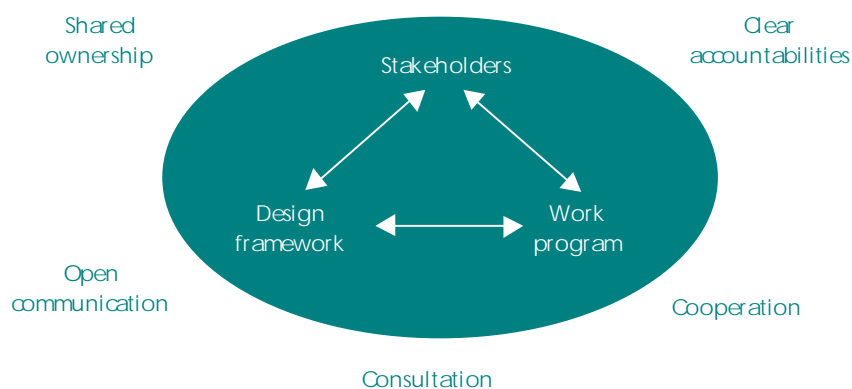
- simplifies existing law within a principle-based framework;
- fosters constructive participation by taxpayers, and their effective interaction with tax authorities;
- promotes simpler and less costly compliance; and
- is efficient and cost-effective to administer.

The starting point for an integrated approach must be the establishment of agreed national taxation objectives and, deriving from these objectives, a principle-based approach to the design of business tax policy, legislation and administration.

This concept of integration embraces not only the design process itself but also, and at least as importantly, the way the various tax-related government agencies relate with each other and with the business sector and wider community. There must be a shared sense of ownership of the issues, clear accountabilities, open communication, a commitment to consultation and

cooperation and an ability on all sides to think systemically and work across organisational boundaries. The maintenance of these consultative and cooperative relationships will be a major factor in ensuring the improved design processes are able to be sustained (Figure 1.1).

Figure 1.1 The environment for reform



It is essential that policy, legislative and administrative expertise be brought together throughout the design process, to ensure that:

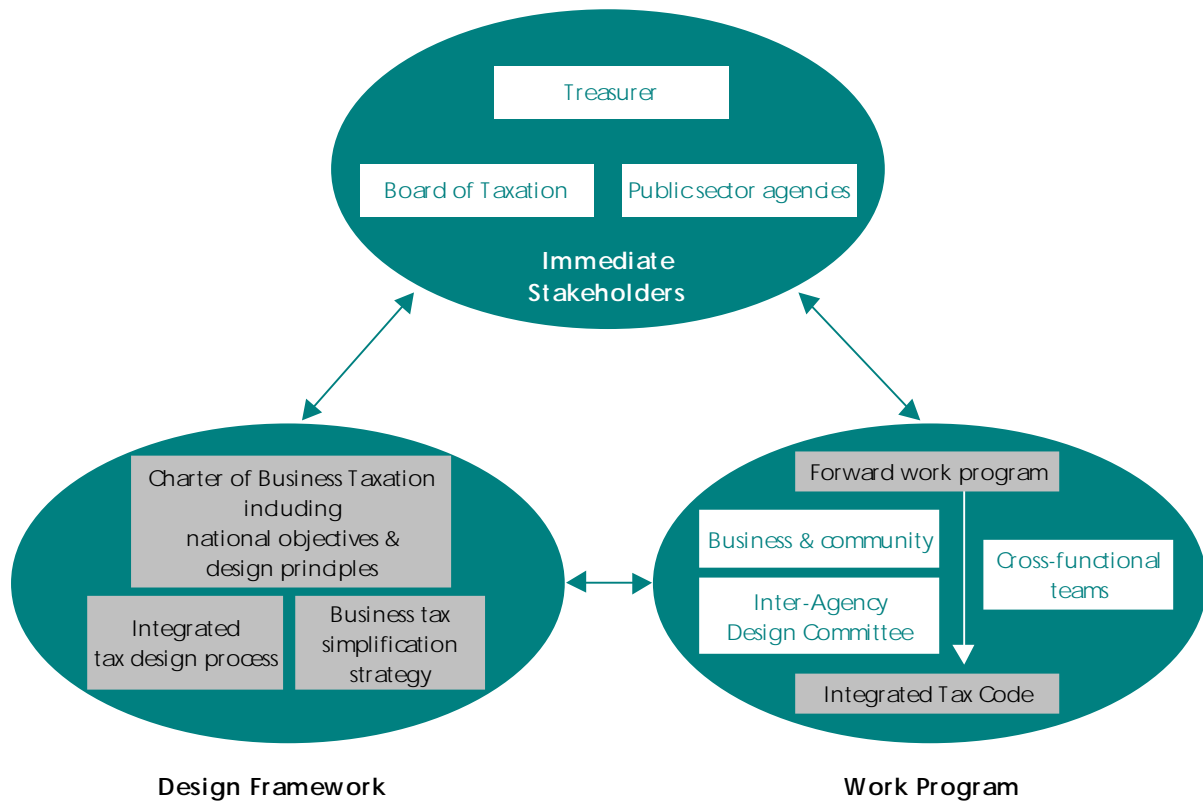
- administrative implications are at the fore when policies are formulated and consequential legislative provisions are drafted;
- reciprocally, the policy intent is reflected accurately when elaborated in legislation and the systems for its administration (recognising that legislation is the practical expression of policy); and
- more generally, ‘feedback loops’ are strengthened between policy formulation, legislative drafting and administration (including systems design).

Under proposed arrangements, not only will public sector agencies involved in the tax system work cooperatively together in integrated teams throughout the design process but those outside public sector will have an active ongoing involvement in an advisory and consultative role. The integrated teams will draw on expertise external to the public sector to ensure the best possible outcome, targeted to the objectives of government and cognisant of the concerns and realities of the marketplace.

This process, along with relevant accountabilities, national objectives and associated design principles, will be set out in a *Charter of Business Taxation*. A Board of Taxation, with majority membership drawn from the private sector, will be established and have responsibility for maintaining the Charter, monitoring the implementation of the integrated taxation design process and advising the Treasurer generally on systemic matters pertaining to business taxation.

This new design architecture provides the structure for the participative development of a forward work program for changes to the business tax system and the establishment of an Integrated Tax Code to consolidate all existing tax law.

Figure 1.2 The integrated approach



The new architecture (Figure 1.2) will also give structure to the process of reforming the administrative interface between business taxpayers and the tax authorities, a reform which will be pivotal to the achievement of lasting reductions in compliance costs, and lasting reductions in the numbers of, and time taken to resolve, disputes over interpretation of the law.

Continuing refinement and review

The business taxation system, like all taxation systems, will be continually evolving. It is essential that the process of evolution be managed properly, and therefore that the integrated design process be monitored and kept under review. As lessons are learned and shared, the design process will be refined and so that in a consultative and ordered way, the tax system will develop and evolve.

Reinforcing inter-agency coordination

Recommendation

1.2 Key elements of agency coordination

That as part of the integrated taxation design process, key elements of agency coordination include the establishment of:

- (i) a standing Inter-Agency Design Committee (IADC), with each of the three agencies represented at a senior level;**
- (ii) cross-functional teams accountable to the IADC, each team having responsibility for taking a specific policy issue through all the stages of the policy development, legislation and administrative design processes; and**
- (iii) clear accountabilities for standards, product and integration at each stage of the design process along the lines proposed in the *Charter of Business Taxation* (Schedule 2).**

In *A Strong Foundation* (Chapter 4), the Review found current processes to be deficient for four major reasons:

- there is no sound conceptual underpinning for the legislative expression of policy;
- there is no integrated approach to policy change;
- there are no specific accountabilities directed at overall performance of the business tax system; and
- there are no adequate arrangements for private sector consultation.

The Review stated in *A Strong Foundation* its view that a key element in the reform of business tax processes must be the establishment of an integrated approach to tax design. This integrated process has, at its core, defined national taxation objectives and taxation design principles. These objectives and principles are to be enshrined in the Charter of Business Taxation.

The Review recognised that integration could be achieved, but not guaranteed, by concentrating all the responsibilities for tax design and administration within one agency. But the core processes (*A Strong Foundation*, Figure 4.1, page 41) are so extensive, differentiated and distributed that they will always pose a demanding challenge for coordination whether or not assigned to a single agency. The Review prefers therefore to build on existing agency roles and accountabilities, allowing each agency to bring to bear its unique functional perspective and thus to optimise its overall contribution, to achieve a quality process and a quality product.

That body, for convenience, has been given the name Inter-Agency Design Committee (IADC).

Members will bring to the IADC substantial expertise relevant to the business tax system, and have an understanding of all business tax policy changes and consultative processes taking place at any one time. Consequently, the IADC will be in a good position to ensure that interactions between those changes and the rest of the taxation system are taken fully into account.

The IADC will have responsibility for ensuring the participative forward work program for business tax policy (see Recommendation 1.8) is put into effect and that the objectives and principles set out in the Charter of Business Taxation are fully applied. To this end it will:

- establish cross-functional project teams to address specific tax policy issues;
- arrange for the teams to be resourced;
- approve the teams' project briefs;
- provide guidance to the teams;
- ensure effective project management arrangements are in place; and
- be ultimately responsible for the quality of the work produced by the teams.

Cross-functional teams

The project teams will operate on an integrated basis, with membership drawn from the Treasury, the ATO and the OPC. Where appropriate and wherever possible, the teams will contain representatives external to the public sector and may also include representatives from other parts of the public sector.

Project teams will be accountable through the team leader to the IADC. They would seek to ensure that the final product meets the policy intent and is consistent with the stipulated design principles. Where trade-offs between competing agency or systems interests are required, teams will be responsible for identifying and resolving them — including through successive escalation, as required, to the IADC, agency heads or the Treasurer.

Agency accountabilities

Each agency will 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, rather to reinforce them.

- The Treasury is accountable 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 defined policy intention and is consistent with the national taxation objectives and taxation design principles.

- The ATO is accountable for detailed design and development of the legislative, administrative and compliance systems to give effect to the policy.
- The OPC is accountable for the design and drafting of the law.

The establishment of integrated teams and the IADC will facilitate a much greater degree of accountability for the overall design process. Specific accountabilities for agency standards, for cross-functional team product and for integrated outcomes are specified in Schedule 2 to the Charter of Business Taxation. The fact that all team members participate in all phases of the process and share mutual accountability for the ultimate effectiveness of the measure will encourage a truly integrated approach.

A need for cultural change

Changes to the structural arrangements of the three agencies will not guarantee improved integration and will not necessarily solve the problems of separation and lack of alignment between policy, legislation and administrative systems. The success of this proposal for an integrated design process will depend not only on the adoption of new integrated cross-functional working arrangements and inter-agency goodwill and collaboration but, associated with these, changes in organisational culture. Without such cultural change, any new integrated design process will be merely an administrative shell.

For this reason, attention will need to be paid to encouraging team members:

- to think systemically about the taxation system within Australia and internationally and about the wider business, social and physical environment to which it relates;
- to collaborate openly and effectively in a team environment with others who hold competing points of view, to learn from others, and to resolve differences constructively; and
- to implement the integrated design process in a flexible and collaborative manner depending on the particular project's complexity, size and timeframe.

Having a robust, well structured and effectively operating tax system for Australia requires this integrated, cooperative approach. It will need strong leadership. The alternative is to see the system fall back into disrepair over time, with the community becoming increasingly frustrated with the system as a result.

A Charter of Business Taxation

Recommendation

1.3 Charter of Business Taxation

That a *Charter of Business Taxation* be adopted in order to establish an accepted framework within which Australian taxation laws affecting business can be consistently developed and maintained.

As noted in *A Strong Foundation* (page xii), there is widespread dissatisfaction and frustration with the operation of the current business tax system. These feelings are shared not only by taxpayers and private sector tax professionals but by virtually all other parties involved, including the bureaucracy, the government and the Parliament.

The Review is of the opinion that an overriding reason for this situation is the complexity and *ad hoc* nature of the current system.

To address these systemic deficiencies, the Review recommends the adoption of an enduring and far more transparent framework for business taxation in Australia. This new framework should be expressly articulated, conceptually sound and based on agreed national objectives and framework design principles. The setting out of these objectives and design principles in a *Charter of Business Taxation* gives them lasting visibility, focus and status, and assists in making accountable those responsible for their implementation.

The proposed Charter, which would have effect from a date specified by the Treasurer, follows this discussion. It builds upon the framework for business taxation set out in *A Strong Foundation*, a framework refined in the light of submissions and consultation with the business sector.

The Charter lies at the heart of the interlocking reforms to policy, legislative and administrative processes recommended by the Review. It establishes a context within which Australian taxation laws affecting business can be consistently developed and readily maintained. The Charter serves as a benchmark against which proposed changes to taxation law, and the actions of government bodies responsible for the policy and administrative processes associated with their development and implementation, can be judged more transparently.

The Charter has at its core three national taxation objectives:

- optimising economic growth;
- promoting equity; and
- promoting simplification and certainty.

These national taxation objectives require, among other things, that the business taxation system encourage long-term economic development, treat all taxpayers fairly and be as simple, certain, and easy to comply with as possible.

The Charter sets out a regime of taxation design principles to promote achievement of these objectives and to provide a broad, robust framework for the development of business taxation policy and legislation. These principles are of three kinds: policy design, legislative design and administrative design.

The Charter provides for an integrated approach to the design of the business taxation system, and sets out the accountabilities of those responsible for it. Consistent with Recommendations 1.1 and 1.2, it specifically requires the Treasury, the ATO and the OPC to work together in integrated teams, with a shared purpose and shared ownership of outcomes. Where appropriate and wherever possible, these integrated teams would contain representatives external to the public service and may also include representatives from other parts of the public sector.

The Charter also provides for the proposed Board of Taxation (see Recommendation 1.4) to play a pivotal role:

- in fostering compliance with the defined national taxation objectives and taxation design principles; and
- in ensuring there is wide consultation with affected parties at the earliest possible stage of policy development.

The Board, for its part, would act as guardian of the Charter and advise the Treasurer on its operation and effectiveness. It also would recommend to the Treasurer any changes to the Charter it believes necessary in order to ensure the Charter remains apposite.

Charter of Business Taxation

Purpose

This *Charter of Business Taxation* sets out the framework within which Australian taxation policy affecting the business sector will be formulated. The framework will ensure legislative and administrative aspects of policy are considered at the policy formulation stage and that, reciprocally, legislation and administration reflect the policy intention. The Charter defines national taxation objectives and identifies business taxation design principles in the areas of policy, legislation and administration. It gives structure and transparency to the consultation and legislative design process and sets out the accountabilities of those responsible for it.

Scope and function of business taxation

The business taxation system comprises those taxes which are collected directly from business as well as other taxes where the collection mechanism impacts to a significant degree on business. The major tax applied directly to business is income tax but other bases can be applicable. Business also plays an important role in collecting other taxes such as indirect taxes and withholding taxes remitted by business. The Charter also applies to these taxes.

The key function of taxation generally, and therefore of business taxation, is to raise revenue to fund the outlays of government. In addition, the taxation system provides government with an essential tool in its management of the economy and its pursuit of wider policy objectives.

National taxation objectives

Consistent with the function of revenue-raising, three major objectives guide the development of the business taxation system:

- optimising economic growth;
- promoting equity; and
- promoting simplification and certainty.

The three national taxation objectives are interdependent and must be pursued jointly. Proposed changes to tax law, or to taxation administration, should take

account of all three. Any decision to trade off one objective against another should be taken explicitly, after consideration of the anticipated advantages and disadvantages of the various options. In such instances the course which, on balance, delivers the best social outcome should be adopted. The Board of Taxation has the role of monitoring compliance with these objectives.

Optimising economic growth

In raising revenue for the government, the business tax system should interfere to the least possible extent with, and indeed should promote, the best use of existing national resources, efficient allocation of risk, and long-term economic growth. Ideally, the business tax system should be neutral in its impacts and thus not be a consideration in business decision making. Poorly designed tax systems can inhibit economic growth by distorting business decisions. In cases where existing market forces and institutional structures do not produce an optimal outcome, the tax system may sometimes be the best instrument to correct the deficiency. In all such cases it must be established that changes to the tax system will be likely to increase economic growth.

Promoting equity

Equity, or fairness, is a basic criterion for community acceptance of the tax system. The concept of equitable taxation is usually directed at the way in which individuals are taxed but this also has implications for the business tax system. There is widespread community support for the idea that individuals in similar circumstances should be taxed in similar ways (referred to as horizontal equity). It is also accepted that taxation should be based on ability to pay and that those with a greater capacity to pay should pay relatively more tax (referred to as vertical equity). Transitional and administrative arrangements under the law must also be equitable.

The concept of equity in the business tax system relates principally to horizontal equity. This concept implies that business income earned in similar circumstances should be taxed in similar ways. This means that, in principle, all entities carrying on business activities should be taxed in a similar manner. The concept of vertical equity is relevant to the business tax system in two ways. First, the taxation of distributions by entities in the hands of individuals and the way in which this interacts with taxation applied at the entity level. Secondly, the direct taxation of income from investments by individuals. Thus, where business is carried on by a sole proprietor or a partnership, the income of the sole proprietor or the partners is received directly by individuals and is subject to considerations of both horizontal and vertical equity.

Promoting simplification and certainty

Complexity is one consequence of continually building the business tax system upon a foundation deficient in policy design principle. Complexity has a technical dimension but is more than a matter of statutory volume or opaque language. Its structural dimension is reflected in unintended or inconsistent statutory interactions, as well as excessively specialised provisions which lack general application and adaptability. Such structural complexity fuels a dynamic process of exploitation and anti-avoidance response that generates escalating complexity. Complexity also has a compliance dimension for taxpayers, tax administrators, the judiciary, policymakers and other stakeholders.

A separate issue, although one related to the complexity of tax law, is that of administrative complexity. Complexities in administrative arrangements add to business (and government) costs, and do little to promote voluntary compliance.

Because of the inherent complexity in many business transactions, the business tax system will always contain complex provisions. The objective of simplification should be applied in two ways.

- The business tax system should be designed in as simple a manner as possible recognising economic substance in preference to legal form.
- Where the tax treatment of particular transactions is likely to be complex, such additional complexity in the tax law should be justified by the improvement in equity or economic growth that may be achieved.

Complexity should be kept to a minimum by the adoption of a principles-based approach to policy development and its legislative expression and administration. Simplification of business tax law and its administration will be an ongoing task, one which will require a sustained commitment from government, business, key agencies and the Board.

The collection of business tax revenue relies fundamentally on the principle of voluntary taxpayer compliance. Such compliance should be fostered by making the business tax system as simple, inexpensive and certain in its application as possible.

Tax laws should be designed from the perspective of those who must comply with and administer them. Taxation laws should be as clear and concise, and provide as much certainty, as possible. They should be framed in plain English and based upon a consistent set of stated design principles. Their structure should be able to accommodate continuing change.

Further, the objective of equity cannot be realised if some sectors of business, or of the community generally, bear disproportionately the costs of complying with the nation's tax laws. Compliance costs should be minimised in total and distributed fairly.

Business taxation design principles

The business taxation design principles established under this Charter are set out in Schedule 1. They promote achievement of the national taxation objectives and provide a broad, robust framework for the development of business taxation policy and legislation.

The principles provide broad guidance to those involved in designing, administering or interpreting Australia's business tax system. There may, however, be circumstances where:

- one or more of the principles conflicts with others, and a choice has to be made between them; or
- it is otherwise deemed in the public interest to depart from one or more of them.

Most of the principles are universal in their application in that they are relevant to any form of business taxation. Several relate specifically to the taxation of business income, reflecting the fact that income taxation is the major form of taxation applied directly to the activities of business.

The taxation design process

Initiation

The Treasurer has ministerial responsibility for Australia's business tax system. Accordingly, detailed proposals for changes to this system are normally developed within the Treasury and the Australian Taxation Office in consultation with the Office of the Parliamentary Counsel, in accordance with the policies and decisions of government.

Consultation

Consistent with the Treasurer's ministerial responsibility for taxation policy, business taxation policy will be developed in accordance with a forward work program formulated within the Treasury portfolio in consultation with the business community.

It is in everyone's interests for Australia's business tax system to be accepted by all affected parties, including business, the broader public and those who must administer the system. To this end, changes to the system should be proposed, wherever possible, only after wide consultation. Such consultation should commence at the earliest possible stage of the policy development process and continue throughout implementation.

The Board of Taxation has a key role in this respect. It provides a forum where issues of business tax reform may be discussed at a detailed and expert level. It may also facilitate wider consultation between affected parties. Further, as the body which oversees this Charter, it monitors the overall consultation process, and may provide advice to the Treasurer if it considers in any instance that this process is unsatisfactory.

Integration

Functional boundaries between the three Commonwealth agencies most involved in the tax design process provide focus and clarity as to roles, but should not be barriers to co-operation. Shared purpose and shared ownership of outcomes are essential in this regard. This will be achieved in two ways:

- the Inter-Agency Design Committee will manage and be accountable for the integrated taxation design process; and
- specialist staff from the three agencies will work side-by-side in integrated cross-functional project teams throughout the tax design process.

To facilitate constructive engagement with key stakeholders and to minimise unintended consequences, these integrated teams will contain representatives external to the public sector, except where that is impracticable, and may also include representatives from other parts of the public sector. Beyond that, consultation with the private sector should occur at all stages in the design process.

This integrated arrangement enables the involvement of policy, legislative, administrative and external expertise throughout the design process. Such arrangements should ensure that:

- administrative and compliance implications are at the fore when policies and consequential legislative provisions are drafted;
- reciprocally, the policy intent is reflected accurately in the legislation and its administration (recognising that legislation is the practical expression of policy); and

- more generally, the essential ‘feedback loops’ are strengthened between policy formulation, legislative drafting and administration.

The Board of Taxation will monitor the effectiveness of this integrated process, and report on it annually to the Treasurer.

Key accountabilities

Consistent with the integrated team approach, each agency should remain accountable for ensuring standards are maintained in its particular area of responsibility.

- The Treasury has primary responsibility for policy development.
- The Australian Taxation Office has primary responsibility for:
 - detailed design and development of the legislative, administrative and compliance systems to give practical effect to policy; and
 - the implementation and ongoing administration of these systems.
- The Office of the Parliamentary Counsel has responsibility for the design and drafting of legislation.

The three agencies should be jointly responsible for ensuring the effective operation of the integrated design process and for the outcomes of that process.

Details of agency accountabilities, and those of the Inter-Agency Design Committee and the integrated cross-functional project teams established to address specific issues, are set out in Schedule 2.

Role of the Board of Taxation

The Board of Taxation has a key role in regard to the Charter. The Board’s responsibilities are to:

- monitor, and advise the Treasurer on, the process of developing and implementing business taxation policy, taking into account the objectives, principles and accountabilities set out in the Charter;
- advise the Treasurer on the development of a program of work (including consultation) on business taxation policy;
- undertake studies and research on matters referred by the Treasurer;
- advise the Treasurer on adherence to the terms of the Charter and report annually on its application;

- advise the Treasurer of any changes to the Charter needed to ensure that it adequately deals with contemporary conditions; and
- conduct an annual review of the application of the policy framework and processes relating to the general and specific anti-avoidance rules.

Relationship with *Taxpayers' Charter*

The administration of the business tax system should engender taxpayer confidence and trust. To this end the *Taxpayers' Charter* issued by the Australian Taxation Office sets out service standards which taxpayers, including business taxpayers, may expect of the Office. The *Taxpayers' Charter* also provides taxpayers with guidance as to their own rights and obligations under the law. The principles in this Charter of Business Taxation complement those in the *Taxpayers' Charter*.

Consistent with its statutory role, the Board may raise with the Treasury, the Australian Taxation Office or the Office of Parliamentary Counsel concerns about compliance with the Charter.

Amendment

The Charter may be amended by the Treasurer, acting either independently or with the advice of the Board. Amendments to the Charter will be published in the *Commonwealth Gazette* and advertised widely.

Schedule 1

Business taxation design principles

Policy design principles

Affecting economic growth

P1. Investment neutrality

In order not to distort the cost of capital used to evaluate alternative investments, business tax arrangements should avoid differentially taxing:

- types of investment;
- types of taxpayer (companies, trusts, partners, direct investors);
- entity financing alternatives (retentions, capital issues, debt issues, dividend reinvestment, reductions in share buy-backs);
- types 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.

P2. 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.

P3. 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.

P4. Provision of tax incentives Business tax incentives should be provided only after 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.

Taxing business income

P5. Taxation of comprehensive income Taxation of business income should be based on comprehensive income, defined as the sum, over an annual period, of a taxpayer's current revenue less current costs, and the net change in value of the taxpayer's assets and liabilities.

P6. Tax values for assets and liabilities In practice, the annual change in value of a taxpayer's assets and liabilities will be determined by the difference between the opening and closing tax values for each class of assets or liabilities. Assets and liabilities subject, respectively, to mark-to-market, accruals, amortisation or realisation treatments will have tax values given respectively by market value, accrued value, written-down value or cost.

P7. Real or nominal taxation Comprehensive income is conceptually measured as real income (that is income comprehensively adjusted for uniform inflation) but for practical reasons comprehensive nominal income (income not comprehensively adjusted for inflation) may be an unavoidable compromise.

P8. Integration of ownership interests For business tax purposes — as distinguished from commercial or legal purposes — entities should be considered as extensions of their ultimate owners.

P9. Single layer of domestic taxation

Business income should not have to bear more than a single layer of Australian taxation.

Promoting equity

P10. Horizontal and transitional equity

All business income should be taxed comparably.

Changes affecting existing taxpayer arrangements should also be designed and implemented fairly according to the law.

Reflecting incidence and substance

P11. Effective tax incidence

Business taxation measures should be designed on the basis of an assessment of their actual behavioural impact — not simply their formal or legal impact.

P12. Economic substance over form

Economic transactions having the same economic substance should be taxed similarly, irrespective of their legal form.

P13. Timing of changes

Changes to business taxation should normally take effect no earlier than the date of passage of legislation. An earlier date of effect should only apply if there would be a serious risk to tax revenue or the prospect of significant behavioural effects.

Legislative design principles

Ensuring transparency and consistency

L1. Transparent policy differentiation

Tax legislation should ensure transparent differentiation in the policy treatment of similar or related economic transactions, by permitting such differentiation only where there is an expressly stated intention.

- L2. *Integration across policy areas* Tax design should seek to ensure that the tax system is as consistent as possible with wider government policy.

Integrating user needs

- L3. *Integrated compliance* To the maximum possible extent, the same compliance activity should fulfil or support a range of compliance obligations.

- L4. *User-based design* Tax legislation should be designed from the perspective of those who must comply with and administer it.

Imposing drafting standards

- L5. *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.

- L6. *Standardisation* Tax legislation should use standard rules, concepts and terminology.

- L7. *Clarity of rules* Tax rules should be clear, certain and consistent.

Ensuring dynamic robustness

- L8. *Durability/sustainability* The tax system should accommodate successive programs of change over a long period without disturbance to its basic design and operation.

- L9. *Timeliness* The tax system should keep pace with economic and social change.

- L10. *Anti-avoidance provisions* Tax legislation could retain general anti-avoidance provisions but should be sufficiently robust to do without specific anti-avoidance provisions. Specific provisions should only be used where the particular problem cannot be dealt with by structural improvements to policy and legislative design or by application of the general anti-avoidance rule.

Administrative design principles

Engendering taxpayer trust

- A1. Taxpayers' Charter** The Australian Taxation Office should maintain the service standards in the *Taxpayers' Charter*, and continue to publish statistics detailing its performance against these standards.
- A2. Independence** The operation of day-to-day tax administration should be free of external influence in relation to particular taxpayers.
- A3. Privacy/confidentiality** Effective tax administration requires that taxpayer information is collected, used and kept in accordance with privacy and confidentiality laws and guidelines.
- A4. Fairness** Taxpayers should receive fair and consistent treatment in their dealings with the Australian Taxation Office.
- A5. Review mechanisms** Internal and external review mechanisms should promote taxpayer confidence in the equity and accountability of the system's administrators.

Facilitating taxpayer compliance

- A6. User friendly relationship** The tax administration should facilitate its dealings with taxpayers by service-oriented and easy-to-use approaches.
- A7. Certainty/reliability** Consistent decision making and coordinated administration should help ensure that taxpayers have certainty with regard to their income tax liability.
- A8. Cost effective administration and compliance** Compliance costs should be minimised to help taxpayers comply voluntarily with their tax obligations. Collection costs should be minimised thus enabling administrators to allocate limited resources to best effect.

Enforcing taxpayer compliance

A9. Enforceability

To enable avoidance and evasion to be detected and deterred, the taxation laws need to include a range of enforcement powers.

A10. Proportionality

Enforcement powers should be exercised proportionally to the circumstances of the case.

Ensuring responsive administration

A11. 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.

Schedule 2

Accountabilities

For standards

The Treasury, Australian Taxation Office and Office of the Parliamentary Counsel each have separate accountability for ensuring standards are maintained in their own particular areas of responsibility while sharing collectively accountability for the overall success of the integrated taxation design process.

- The Treasury has primary accountability for tax policy development and in particular for ensuring that the final products of the integrated design process achieve their stated policy objectives.
- The Australian Taxation Office has primary accountability for:
 - the detailed design and development of the legislative, administrative and compliance systems developed to give practical effect to stated tax policy; and
 - the implementation and ongoing administration of these systems.
- The Office of the Parliamentary Counsel has primary accountability for the detailed design and drafting of tax legislation.

For integration

The Inter-Agency Design Committee (IADC) is a standing committee staffed at a senior level with representatives from each of the three agencies. It is accountable for the degree of integration achieved by the integrated taxation design process. To that end, its role is to:

- establish cross-functional project teams to address specific tax policy issues;
- arrange for the teams to be resourced;
- approve the teams' project briefs;
- provide guidance to the teams;
- ensure effective project management arrangements are in place; and
- be ultimately responsible for the quality of the work produced by the teams.

The members of this Committee are accountable, each to their own agency, for the overall management of the integrated tax design process and therefore for ensuring:

- the forward work program for business tax policy is put into effect; and
- the national taxation objectives and design principles are applied consistently with the requirements of this Charter.

For product

The cross-functional project teams will contain representatives from each of the three agencies and, where appropriate and practicable, from outside the public sector. The cross-functional teams are accountable to the IADC for ensuring:

- their final product meets policy intentions and is consistent with the stipulated design principles;
- trade-offs between competing agency or system interests have been identified and resolved;
- effective consultation has been conducted in relation to their product; and
- draft legislation, explanatory notes, worksheets and administrative and compliance systems conform with stipulated standards.

Annual assessment of performance

The Board of Taxation will assess, and report annually to the Treasurer on the performance of the business tax system in terms of the requirements of this Charter, including performance in relation to these accountabilities.

A Board of Taxation

Recommendation

1.4 Board of Taxation — establishment and functions

That a Board of Taxation be established, with the role and functions set out in the exposure draft bill and explanatory notes accompanying this report.

In an *A Strong Foundation* (page 96), the Review identified key shortcomings in existing processes for developing tax policy, drafting tax legislation and administering tax law. Concerns in regard to these matters have since been echoed in submissions and at consultative forums.

One particular concern has been the largely piecemeal approach which has evolved in relation to the development of business tax policy and, associated with this, the lack of adequate overall accountability for the result. The dissatisfaction and frustration of business taxpayers in this regard have been heightened by the ineffective and inadequate consultation which has taken place when changes to business tax have been under development.

In these circumstances, it is not surprising that the suggestion in *A Strong Foundation* (page 108) that there be created an advisory taxation board, with a majority of members from the private sector, has been received positively by the business sector. Accordingly, the Review now recommends such a Board of Taxation be established. The Board will:

- draw on the knowledge and expertise of the business sector, including from professionals and advisers, and provide government with a source of independent and timely advice on the development and implementation of sound business taxation policies;
- be the guardian of the proposed Charter of Business Taxation containing the national taxation objectives and taxation design principles, and recommend changes necessary to ensure the Charter remains contemporary;
- be a source of informed advice on appropriate consultative processes in relation to ongoing business taxation issues;
- monitor and report on the performance of the business taxation system — and, in this regard, of the Treasury, the ATO and the OPC — against the objectives and principles set out in the Charter; and
- conduct an annual review of the application of the policy framework and processes relating to the general and specific anti-avoidance rules, to be published as part of the Board’s annual report (see Recommendation 6.2).

At present there is little opportunity for the private sector to engage in formal consultations with government agencies responsible for the development of business taxation policy and legislation. This is a primary source of frustration. The establishment of the Board will be a major step forward. It will reinforce the consultation with the private sector that is a necessary part of the integrated design process. This will give the private sector greatly enhanced opportunity to consult with these agencies — and thereby have earlier, more effective input into the policy development process. The government and its agencies will also benefit, as has been demonstrated very clearly during the current review.

For all these reasons the Board will play an important role in achieving a more open, consultative, accountable and systematic approach to business taxation and in maintaining integrity in the business taxation design process. In this way the Board will ensure that the improved methods of developing business taxation policy and legislation established and recommended by the Review continue to be a feature of the operations of relevant government agencies.

Advisory vs Oversight Board

The Review received submissions seeking the establishment of a board of directors to oversee the administration of the ATO. Such a board could not, however, function effectively as an advisory body to government on the operation and development of tax policy processes. That is because the key role in this area lies not with the ATO but with Treasury; the role of the Commissioner of Taxation is mainly to administer the taxation laws. Any advisory role for an ATO board of directors would therefore largely be limited to advice on administration and the implementation of policy decisions which have already been made.

The Review does not believe the establishment of a policy-constrained board of directors would be helpful to either government or the business community. The concept of a Board responsible for administration of the ATO, which was suggested in several submissions, is not favoured. It would also diminish the statutory accountability of the Commissioner of Taxation. Rather, the Review sees a need to have an independent and business-focused advisory Board of Taxation to assist up front in the development of clear and improved business taxation policy processes and in monitoring the performance of the administrative functions against the Charter. Such an approach offers the prospect of greater certainty and less conflict in the downstream administration of business tax laws and therefore of minimising the problems which have given rise to the requests for external control over the administration of the ATO.

Recommendation

1.5 Board of Taxation — membership

That the Board of Taxation comprise:

- (i) seven members external to the public service, serving in a personal capacity and chosen on the basis of their expertise and experience, one of whom shall be appointed to chair the Board;**
- (ii) the Secretary to the Treasury;**
- (iii) the Commissioner of Taxation; and**
- (iv) one senior representative of another government agency.**

Under the recommended structure, members of the Board will be senior members of the Australian community and the chief executives of the government agencies with primary responsibility in taxation matters. The majority of members will be external — chosen by the Treasurer on the basis of their expertise and experience. These members would be appointed in a personal rather than a representative capacity, as independent members, not subject to direction from any others.

The external members should come from a range of backgrounds and collectively will bring to the Board:

- a broad community perspective and commitment to the national interest;
- expertise and experience in the world of business and commerce; and
- a strong capacity for assessing tax policy, law and administration as well as their associated processes.

The interaction on the Board of external and public sector members will be beneficial to all parties: the ATO and the Treasury will gain a better understanding of the way business operates in Australia and internationally and of business concerns and issues, whilst the private sector members will gain a better appreciation of the administrative and policy dimensions of the tax system.

By working together in an atmosphere of goodwill, trust and shared professional commitment, the members will assist greatly in relieving tensions and building good working relationships between business and tax administration and also in reducing the costs of both taxation compliance and taxation administration.

Recommendation

1.6 Board of Taxation — study program

That the Board of Taxation:

- (i) present annually to the Treasurer for approval a proposed Board work program of studies and research; and**
- (ii) be able also to seek from the Treasurer specific references to undertake studies or research.**

In addition to contributing to the development within the Treasury portfolio of the proposed forward work program for business tax policy (Recommendation 1.8), the Board will have the capacity to undertake its own program of studies and research. In this regard it is essential that it focus its energies on work that addresses the concerns and priorities of government — particularly as reflected in the Charter. The Board will be in a position to advise the Treasurer on matters it believes should be addressed, having regard to the concerns of business, but the decision on these matters is properly one for government.

It is sensible therefore to provide for the Board to recommend an annual work program for itself and, where appropriate, to request of the Treasurer specific references, and for the Treasurer to make the final determination on these matters.

Recommendation

1.7 Board of Taxation — support arrangements

That the Board of Taxation be:

- (i) provided with an independent secretariat to give it technical and administrative support;**
- (ii) given the capacity to commission private sector research; and**
- (iii) fully funded by the Australian government.**

The Board must have the capability to undertake and/or commission research on the economic and technical development of Australia's business taxation system in accordance with its approved work program or with a specific reference from the Treasurer.

In its primary role of monitoring the performance of business tax processes, the Board also needs to be seen to be independent of the Treasury and the ATO, with its own direct access to the Treasurer.

For these reasons the Board needs to be supported — at both a professional and an administrative level — by an adequately-resourced independent secretariat. Preliminary costings suggest that annual government funding in the order of \$4-5 million would be required for this purpose. This level of funding would:

- provide remuneration on a part-time basis for the Board’s external members;
- support a professional secretariat of around 10 people;
- cover the Board’s administrative costs, including those of separate accommodation and travel; and
- provide for the engagement of consultants and the commissioning of research.

The Treasury and the ATO may also require some small amount of additional funding to provide for their interaction with the Board.

Establishing a participative forward work program

Recommendation

1.8 Development of a forward work program

That business taxation policy be developed in accordance with a forward work program formulated within the Treasury portfolio in consultation with the Board of Taxation and the business community, and endorsed by the Treasurer.

At present much of the ongoing tax policy process is conducted within the budget context. This circumstance 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. There needs to be a more open and integrated approach to the initiation of policy proposals relating to business taxation.

The development of a defined forward work program for business taxation policy, with appropriate consultation, approved by the Treasurer, is a sensible way to address these difficulties. It will ensure there is a visible, and public, agenda for business taxation policy.

Initially, a draft forward work program for business tax policy will be prepared by the Treasury, in conjunction with the ATO, for preliminary endorsement by the Treasurer. Program items will be supported by a project brief setting out policy objectives, resource requirements, timeframe and revenue implications. Project briefs will also include a risk assessment, addressing firstly the risks should the work not be undertaken and secondly those of not achieving satisfactory outcomes.

The Board of Taxation, with a majority of members drawn from outside the public sector, will provide assistance to the Treasury portfolio and advice to the Treasurer on the development of the forward work program and on the need for further consultation in respect of new policies for business taxation (see Recommendations 1.4 and 1.5). The Board will also be able to offer advice on the relative priorities given to various proposals in the work program and suggest areas of policy that have not been raised that need to be addressed.

Where a structural flaw in the law that gives rise to the application of the general anti-avoidance rule requires attention (see Recommendation 6.2) that work will be included in the forward work program for attention. The forward work program will be ongoing, with sufficient flexibility to meet urgent needs in this area.

Following initial consultation with the Board and others in the business community and elsewhere, as appropriate, the forward work program will be submitted by Treasury to the Treasurer for final approval.

The consultative processes provided for here should do much to dispel unnecessary and counter-productive 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 trigger the development of tax changes outside that process necessarily also would remain.

An additional attraction of this proposal is that it requires inevitable trade-offs between competing priorities and objectives to be made more explicit, thereby adding greater accountability and transparency to the policy development process. It should also increase the likelihood that changes to business taxation will be properly conceived, designed and implemented and not *ad hoc* as sometimes has been the case in the past.

Funding will need to be provided to the Treasury to cover the cost of developing the forward work program.

There is no doubt, in the minds of the members of the Review, that bringing together the users of the system with the designers and the administrators of the system leads to better outcomes. This has been demonstrated during the period of the Review and is a conclusion endorsed by those who have been involved with it both within and outside the public sector.

In sum, this proposal for a forward work program provides an opportunity for the private sector to add valuable input to the policy development process. Opening up the policy process to public input at an early stage provides an opportunity to build confidence and trust between taxpayers and the revenue authorities.

