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Progressing the Integrated Tax Code

Recommendation

2.1 Establishing the Integrated Tax Code

That the integrated taxation design process (Recommendation 1.1) be adopted as the process within which to establish the Integrated Tax Code announced by the Government in *A New Tax System*.

Recommendation

2.2 Accountabilities for Code development

That the establishment of the Integrated Tax Code proceed quickly, as a joint responsibility of the Treasury, the Australian Taxation Office and the Office of the Parliamentary Counsel, with those agencies:

- (i) identifying the design architecture of the Code along the lines illustrated in the draft legislation attached to this report, the body of laws it potentially comprises and the processes by which those laws will formally be integrated into the Code;**
- (ii) determining a priority for the work involved in fully implementing the Code, including the early completion of the policy re-design of areas of the 1936 Act and other taxation legislation not considered by the Review;**
- (iii) utilising the simplification strategy recommended by the Review; and**
- (iv) seeking the assistance and advice of the Board of Taxation.**

The integrated tax design process for business tax policy and legislation is a key element of wide-ranging administrative reform recommended by the Review. This integrated process is ideally suited to the development of the Integrated Tax Code announced by the Government in *A New Tax System*. This new Code will bring together all taxation laws, and do so in a way that supports a simpler, more responsive and consistent approach to compliance and administration.

Exposure draft legislation accompanying the Review's report represents the first significant component of the new Integrated Tax Code. For the first time, fundamental policy re-design has incorporated a clear, principle-based structure with plain language drafting to achieve comprehensive improvement in draft tax law.

When fully implemented, the Code will provide a vast improvement over the structure of the current taxation laws and make them far easier to use. The Code structure will include:

- a legislative guide to the taxation laws included in the Code, explaining what the Code is, how to navigate around it, what Acts are within it, what those Acts do, and how they are linked;
- a common dictionary to ensure consistency and greater standardisation of concepts across the Code; and
- standardised provisions that have application across the various Acts included in the Code.

Inter-Agency Design Committee

The recommended standing Inter-Agency Design Committee (Recommendation 1.2), comprising senior representatives of the Treasury, the Australian Taxation Office (ATO) and Office of the Parliamentary Counsel (OPC), will be ideally placed to advise the Government on the scope of the Code and to oversee its development and its maintenance.

Architecture and scope

Advice to the Government is essential at the outset regarding which of the many revenue-related laws are to be treated as part of the Code. High level design architecture, as recommended and adopted in the draft legislation attached to this report, will be needed to ensure these laws are brought together in a coherent and logical structure. It is equally important to ensure that key connections and inter-relationships between these laws are clearly identified.

Determining work priorities

The timetable for the full implementation of the Code should be developed as part of the forward work program for business taxation policy (see Recommendation 1.8) taking into account the needs of the Code's users and priorities for policy re-design in areas of the taxation law not covered by the Review. The Review recognises the compliance difficulties that many taxpayers experience from having to deal with two Income Tax Assessment Acts. Completing the rewrite of the *Income Tax Assessment Act 1936* — not only to incorporate the outcome of the Review but more generally to establish the Integrated Tax Code — must therefore be a high priority.

Recommendation

2.3 Simplification strategy

That, consistent with the national taxation objective of promoting simplification and certainty, design of the Integrated Tax Code be directed towards achieving three key outcomes:

- (i) substantially fewer pages of legislation;**
- (ii) fewer net additions to the Code; and**
- (iii) improved taxpayer interaction — involving both a reduced need for interaction and making necessary interaction more user-friendly.**

The Review's proposals for process reforms are also driven by the simplification objective. The Charter of Business Taxation and integrated taxation design process, in particular, provide a framework for ongoing simplification of taxation policy and legislation, and are central to its achievement.

The draft legislation emanating from this Review is a first and major instalment towards ongoing simplification.

Reduction in legislation

A major reduction in the volume and complexity of tax legislation will assist profoundly in reducing the burden of compliance and administration. The Tax Law Improvement Project demonstrated conclusively that such a reduction is possible, and did so while constrained by the requirement not to alter the impact of the law, only its expression. Further evidence of the scope for substantial simplification is to be found in the Review's draft exposure legislation. Given this experience, and the benefits of the integrated approach to policy design proposed by the Review, it is reasonable to set a target to reduce the size of tax legislation to no more than half of its present volume.

Flow control

Stringent control on the making of net additions to the Code lies at the heart of sustained simplification of the tax law. Adoption of a consistent principle-based framework, definitions and terminology, along with improved adaptability in the face of continuing changes, will help to minimise net additions to the law flowing from future policy changes. Making changes within the structure, made possible by the recommended architecture, will avoid the kind of problems associated with the current legislation.

Improved taxpayer interaction

In working to simplify tax law, the fundamental purpose of simplification needs always to be kept in clear focus. This is the need to make tax law much more user-friendly — that is, easier to understand, and easier and less costly to comply with. Importantly, too, every opportunity should be taken to recast tax law in such a way as to minimise the need for taxpayers to deal directly with the law itself or those administering it.

Keeping the taxation law up-to-date

Recommendation

2.4 Maintaining the integrity of the taxation law

Structural flaws, unintended consequences and technical corrections

- (a) That given the critical role the taxation system fulfils in the economic and social well-being of Australia, priority be given in the annual parliamentary process to the introduction of legislation designed to ensure:**
 - (i) structural flaws in the taxation system that might permit tax avoidance are promptly addressed (see also Recommendation 6.2);**
 - (ii) perceived unintended consequences of taxation legislation are resolved so that the intent of the law is clear to all; and**
 - (iii) technical corrections to taxation legislation are made regularly.**

Annual Bill

- (b) That provision be made in the legislative program for an annual Bill to ensure that these matters are considered by the Parliament, with urgent or significant matters being accommodated in business-as-usual taxation legislation introduced into the Parliament.**

Addressing structural flaws

The Review has adopted the approach of recommending structural reform of the taxation system based on a strong foundation to meet national objectives in accordance with a set of policy, legislation and administrative design principles.

The application of these principles (set out Schedule 1 of the *Charter of Business Taxation* in Section 1) is designed to ensure the integrity of the taxation system.

Embodied in the structural reforms proposed by the Review is the principle that business transactions with a similar economic substance should be taxed in the same manner. This structural reform, by reducing significantly existing disparities and flaws in the taxation law, will reduce the reward which can be gained by undertaking activities purely for taxation purposes.

The taxation system is both large and complex, and fundamentally interlinked with the systems of business, finance and the economy. These systems in turn operate in a global environment and are subject to continual development and innovation. Despite the best efforts of all concerned, structural flaws are likely to emerge in the taxation system as it evolves, opening up opportunities for tax avoidance. Such opportunities are particularly likely in the processes of transition to new arrangements. It would therefore be realistic to plan on the need for some further reform to be considered by the Parliament at least annually.

While the general anti-avoidance rule — as modified by Recommendations 6.1 to 6.5 — may be invoked to counteract avoidance opportunities, the Review is convinced that the most satisfactory solution is for sound structural reform to be put in place. This is the only way of maintaining the integrity of the taxation system.

Ideally, within twelve months of identification of a particular tax avoidance arrangement which relies on a structural flaw, that underlying flaw would be addressed. Consideration of such matters will be undertaken as part of the forward work program (see Recommendation 1.8). Prompt action will ensure that the taxation system remains structurally sound and that the general anti-avoidance rule does not have to be used indefinitely as a substitute for reform.

In order to ensure that this outcome can be achieved, the Review believes the requisite priority must be given in the annual legislative program and Parliamentary process to further or emerging structural reform.

A place must be reserved at least annually in the legislative process for structural reforms to the taxation system that need to be considered by the Parliament. Urgent or significant matters should be addressed as soon as possible. Where practicable, these matters should be included in business-as-usual taxation legislation if appropriate legislation is being prepared for introduction into the Parliament.

Corrections for unintended consequences

In concert, the Review's proposed reforms to policy processes are intended to reduce substantially the incidence of unintended consequences — particularly as experience develops with the application of the integrated tax design process.

Nevertheless, the complexity both of the business environment and of the taxation system make it inevitable that on occasion new taxation laws affecting business will have consequences that are perceived not to have been fully intended by the law-makers and/or were not fully anticipated by those impacted by them.

These 'unintended' consequences may involve, for example, perceptions of:

- unnecessary complexity and uncertainty in the law's application;
- inconsistency with commercial practice or taxpayer behaviour;
- difficulties in compliance and/or administration; and
- inconsistency with the policy the legislation was intended to implement.

In each such instance the complaint is that the law operates inappropriately.

There would be advantage in maintaining a list of such issues, outlining in each instance the perceived unintended consequence, the scale of the effect, possible solutions and action under way to address the matter. This will be undertaken as part of the development of the forward work program.

The Review acknowledges all such proposals for policy change to correct perceived unintended consequences must be considered in the context of the overall legislative program, with the government allocating priorities. A process should be developed for urgent or significant matters to be accorded high priority. These matters might be addressed either in a separate annual Bill or as part of the business-as-usual taxation legislative program. Where the issues are truly uncontroversial, they may be included in an annual Taxation Laws Technical Corrections Bill. In all circumstances the matter should be addressed at least annually.

Technical corrections

'Technical' corrections, in this context, are simply amendments to taxation legislation required to correct obvious drafting errors of a formal nature (for example, references to incorrect sections, failure to asterisk defined terms). Amendments of this kind are of an uncontroversial nature and should be routinely undertaken as part of the housekeeping of the taxation laws.

The Review favours the concept of a separate Taxation Laws Technical Corrections Bill. The Review believes that the legislative program should be planned so that priority is given to such a Bill at least annually. This

arrangement will ensure no technical correction remains outstanding for more than twelve months from the time the need for a correction is identified. In so doing the Review recognises there will be a need to take positive measures to ensure a Bill of this nature receives sufficient priority, in a crowded legislative drafting and parliamentary program, to pass into law.