

APPENDIX 3: UNCERTAINTY AND TAX LAW DESIGN – THE WIDER CONTEXT

It has been argued that the current scope of tax policy, the length and complexity of the tax laws and the inherent uncertainties of the self assessment system combine to prevent some taxpayers from determining their tax liability with sufficient certainty at reasonable cost. This Appendix discusses how these elements impact on taxpayers' self assessment obligations and identifies some steps that have already been taken to improve law design.

Tax policy

Tax policy has a major impact on the structure of the tax law, its administration and costs for taxpayers. As noted in Chapter 1, tax policy balances potentially conflicting objectives including revenue collection, economic efficiency, equity and other social goals, while attempting to minimise administration and compliance costs.

In general, a smaller set of tax policies with broad application will involve fewer concepts, less law and be easier to comply with than a larger set of policies, each with narrower application. However, the latter approach allows distinctions between taxpayers and/or activities to be recognised through different tax treatments, which may be important for equity or other reasons. For example, providing a tax concession for research and development requires taxpayers to determine if their transactions are eligible for the concession (and thus incur compliance costs), but the promotion of research and development can generate higher economic growth, far outweighing the increased compliance costs.

Both individual and business taxpayers will generally have higher compliance costs the more complex areas of the law they need to consider in managing their tax affairs. Individuals, unlike businesses, may not need to keep many financial records, except for tax purposes. Policies that have the effect of requiring taxpayers to create and keep records they otherwise would not need to (particularly where those records cannot be easily obtained after the event) can impose significant compliance costs. One example often cited of this kind is donations to tax deductible entities. Again, while these policy decisions may involve some compliance cost, they may also provide significant equity and other benefits.

Policy is rarely more complex than it needs to be to achieve its objectives – the difficult question is the degree to which exceptions should be accommodated and measures should be targeted. As a practical matter, simplifying *policy* to reduce the costs of

self assessment would often mean either the removal of established concessions, or altering their limitations (such as means tests).

Tax law design

Tax law design is the process of turning tax policy into legislation that can be passed by the Parliament, administered by the Tax Office and complied with by taxpayers. A key design choice relevant to self assessment is the amount of detail set out in the law.

Over the last 20 years or so, the tax legislation has set out in increasing detail how the law will apply in a variety of fact situations. This is often seen as desirable because taxpayers naturally want a high level of certainty as to whether and how the law will apply in their particular circumstances. While this approach does provide certainty where a taxpayer's circumstances are specifically addressed by a rule, laws designed in this way can never anticipate all the relevant circumstances for every taxpayer.

As factual circumstances vary greatly, covering a wide range of circumstances in detail is likely to result in law that is long and complicated. Complex circumstances are not easily clarified through elaboration in the law, at least without generating legislation of inordinate length. Indeed, by introducing more boundaries between the legal concepts, potentially there is increased scope for ambiguity and uncertainty. Long and detailed law can also make it harder to find the underlying policy intent and thus increase the risk that the courts will interpret the legislation in a way unintended by Parliament. When law is cast in a very specific way, new circumstances can generate loopholes or inequities, requiring further specific legislation and so on.

For these reasons, there has been increasing recognition in Australia and overseas of the benefits of using high level principles, rather than black-letter approaches, to draft the tax law.¹ These principles synthesise the detail that would otherwise be set out in black-letter rules, to achieve the substantive effect of the measure.

Where necessary, additional detail can be provided in the law or in subordinate legislation. Elaboration of the practical effects can occur through rulings.

Another significant advantage in using high level principles is that the volume of the law is likely to be reduced as additional detail is used only where the high level principles by themselves are insufficient. Law based on principles is less likely to need to be altered in

1. Commonwealth of Australia 1998, *Tax Reform: not a new tax, a new tax system*, August 1998, Commonwealth of Australia, Canberra recognised that the tax laws were too complex and announced that in the future the Government would endeavour to design the tax code using general principles in preference to long and detailed provisions (p. 149). See also Braithwaite, J 2003, 'Making tax law more certain: A theory', *Centre for Tax System Integrity*, Australian National University, Canberra.

the face of market innovations (for example, the development of new financial products) or to repair structural or technical defects. These effects may reduce the amount of time Parliament needs to devote to tax legislation.

With the transfer of responsibility for legislation from the Tax Office to Treasury in mid 2002, the Government signalled its determination to address issues with tax legislation.

In Press Release No 22 of 2002, the Treasurer noted:

'The transfer will bring the accountability for tax policy and legislative design more directly under Ministerial control. The change in responsibility will also reinforce the need for whole-of-Government perspectives to be taken into account in tax law design processes.

The new arrangements will see policy and legislative development brought together within the Department of the Treasury, providing maximum opportunity for legislation to be developed in a manner consistent with the policy intent set by Government. Working arrangements between the ATO and the Treasury will ensure that the administrative, compliance and interpretive experience of the ATO fully contributes to policy and legislation processes.'

The principle-based approach will be adopted for new tax law measures, except where it would require extensive rewriting of existing law.

Alignment of tax, law design and administration

It is important for tax law and administration to work together to meet the needs of taxpayers and ensure that Government policy objectives are met. The Ralph Review spoke of the need to *integrate* the development of policy, legislation and systems of administration in developing new policy initiatives.

Treasury is responsible for advising Government on the design of tax policy and tax law, while the Tax Office is responsible for tax administration. In practice, Treasury works closely with the Tax Office designing tax laws to ensure that the administrative, compliance and interpretative experience of the Tax Office contributes to the tax design process.

Consultation

Consultation is a cornerstone of the Government's approach. During the development of tax measures the Government works from an in-principle position of:

- consulting on substantive tax legislation initiatives, and announcing the consultation process to be used
- seeking input from external stakeholders in the development of policy and legislation
- road testing draft legislation and related products
- ensuring policy intent for each new measure is described by public announcement
- releasing an indicative forward program of tax legislation
- providing feedback to external participants in consultation processes.

Treasury consults as a matter of course with a wide range of taxpayers and their representatives, on tax law design to ensure all their different perspectives are brought to bear in advising Government. Treasury provides the Board of Taxation with regular updates on the progress of its consultation processes.