



THE TAX INSTITUTE

20 July 2018

Mr David Thodey AO
Chair
Independent Review of the Australian Public Service
C/- Department of the Prime Minister and Cabinet
PO Box 6500
CANBERRA ACT 2600

By email: apsreview@pmc.gov.au

Dear Mr Thodey,

Independent Review of the Australian Public Service

The Tax Institute welcomes the opportunity to make a submission to the Department of the Prime Minister and Cabinet in relation to the *Independent Review of the Australian Public Service (APS Review)*.

Through its work in relation to tax policy and administration, The Tax Institute liaises with a number of Departments of State and government entities that engage staff under the *Public Service Act 1999* (Cth) including:

- The Treasury;
- The Australian Taxation Office;
- The Inspector General of Taxation; and
- The Board of Taxation.

The focus of our submission is on the two key agencies involved in policy, law design and administration in the Australian tax and superannuation systems – being the Treasury and the Australian Taxation Office (**ATO**). The matters raised in our submission are directly relevant to these aspects of the APS review:

- delivering high quality policy advice, regulatory oversight, programs and services;
- tackling complex, multi-sectoral challenges in collaboration with the community, business and citizens;
- improving citizens' experience of government and delivering fair outcomes for them; and
- acquiring and maintaining the necessary skills and expertise to fulfil its responsibilities.

Summary

The Tax Institute considers that improvements to the policy development and consultation phases of tax and superannuation law formation would result in better law. For Treasury and the ATO to properly fulfil their policy and regulatory roles respectively, they need sufficient resources, including both the requisite skill sets and experience and time to properly consider issues arising upon formation and interpretation of tax and superannuation law. This also includes addressing deficiencies in the consultation process. In the absence of this, policy advice and regulatory oversight will be of a lesser standard than what is demanded of such a complex area of law to develop and administer. Another concern of members is when the ATO changes a longstanding view on how it interprets a particular area of the law and the uncertainty, cost and inconvenience this means for taxpayers.

Discussion

1. Overview

One of the greatest challenges facing the Australian Public Service (**APS**) in the tax and superannuation policy and law space is providing sound tax and superannuation policy to support well designed law. The better the tax and superannuation policy and law design, the easier the ensuing law is to administer. Necessary skills are required in the APS to ensure that 'good law' is formulated and put in place. The skills required include not only solid technical expertise in the areas of taxation and superannuation, but also a practical and commercial understanding of how tax and superannuation laws impact on a variety of taxpayers and participants in the system.

In the absence of these necessary skills, poor quality law may be designed and implemented. Where policy is rushed and not properly consulted on, poor law can also arise creating uncertainty and unintended results. This makes it difficult for a regulator, such as the ATO, to administer given that the ATO can only interpret the law as enacted.

2. Formation of Tax Policy and Law Design

a) Improving policy development and law design

Many of the issues that give rise to complexity in the tax and superannuation system could be resolved at the early stages of policy development and law design. The Tax Institute is of the view that a framework to involve the relevant parties as part of the policy development stage should be developed.

The 'relevant parties' include the policy arm of Treasury, the administrator (ATO), the drafters, and relevant tax practitioner and business representatives. Each of these stakeholders has a valuable contribution to make at the embryonic stage of policy development.

While steps have been taken over the last few years to improve consultation in the development of tax policy and the design of the law, the Institute is of the view that more needs to be done to reduce complexity in the tax and superannuation system and improve the quality of the tax and superannuation law being developed. Complexity will be reduced through having better resourced teams with relevant skills and knowledge and sufficient capacity to properly focus on issues during the policy development and law design stage and gain an understanding of the pragmatic implications of new policies. These issues include interactions between different parts of the law, the need for concessions and exemptions to the main rules and the need for integrity rules.

A change to policy development and law design of this nature would reduce complexity and improve the quality of new law as a lot of the issues that traditionally come up at later stages of consultation would be addressed much earlier in the process within the context of the broader scheme of the law change.

b) Improving the consultation process

The Government should develop an agreed procedure around consultation with all relevant stakeholders on matters of significant tax and superannuation policy change to be followed in all cases but extremely rare situations.

A major contributing factor to complexity in Australia's tax system is the recent history of developing tax policy 'on the run' where a media announcement is made about a new tax policy, with a relatively short timeframe to enact it or a Budget announcement is made and the scope of the announcement has not been fully developed¹. In the case of tax law measures, often they are announced to address specific issues only² and are not necessarily thoroughly considered, particularly in terms of the context of the whole system. There is a sense that law change is constant, and it is difficult to keep up with all potential changes. The tax legislation continues to grow and there does not appear to be time or appetite for whether a reduction or simplification of certain tax measures can occur.

New Zealand could serve as a good model for Australia. Since the 1990s, New Zealand has operated a tax policy process called the 'generic tax policy process' that applies to tax law changes. This process sets a clear expectation around, and provides a sufficient amount of time for, thorough consultation. It ensures that well-considered tax legislation is introduced into the New Zealand parliament and that New Zealand tax policy is well-developed, and has involved the right stakeholders, prior to reaching the draft law stage.

The result is a positive and increased level of engagement in the policy process, and a greater level of understanding of tax policy intent. Retrospective law changes are also extremely rare, and this reduces uncertainty and complexity.

¹ For example, the 2017-18 Budget measure 'Tax Integrity Package – improving the small business capital gains tax concessions' (announced in May 2017) where the scope and effect (of a policy change) was not apparent until the exposure draft was released in the following February 2018.

² For example, the diverted profits tax measure (which has since been implemented).

In its review of the tax consultation process³ the Board of Taxation made a number of recommendations to improve Australia's tax consultation processes based on the New Zealand experience.

Subsequently, a further review was conducted by the Tax Design Review Panel. In its report⁴, the Panel also recommended a number of changes to Australia's tax law design. Those changes were in broad terms consistent with the generic tax policy process advocated by the Board of Taxation, although not completely. This was noted by the Board of Taxation in its subsequent report in 2011⁵.

A number of changes have been implemented following the Tax Design Review Panel report which have improved the system (such as the publication of a forward tax policy program for a period of time though this has since ceased). However, as the Board of Taxation noted in 2011, there is still an inconsistent process of consultation and a lack of quality in consultation⁶, a degree of lack of engagement from taxpayers, and there are still problems in the system. The Board of Taxation recommended a clear and consistent generic tax policy process be adopted and announced openly.

Other problems that have arisen include situations where the Government has rushed to move from policy development stage to tabling the measure in a Bill in Parliament and not allowing Treasury sufficient time to prepare (and consult on) draft law and Explanatory Memoranda explaining the Government's intention on how the measure should apply.

Consequently, interpretation of the law is left to the administrator/regulator, the ATO, and in a number of cases has resulted in a disconnect between the Government's intention and the interpretation and application of the measure. However, this is problematic as a court is only able to consider extraneous material such as the explanatory memorandum relevant to a Bill to assist with interpreting a provision of an Act⁷. Guidance material issued by the administrator, the ATO, is not acceptable for this purpose. In the absence of sufficiently prepared explanatory memoranda, there is little other relevant guidance available to a Court to consider from which to source the Government's or Parliament's intended application of a particular provision.

c) Changes in views

There are instances that members have identified where the ATO has changed its longstanding view on how it is interpreting the law. These changes have a far-reaching impact on taxpayers, particularly where taxpayers have acted consistently with the ATO's

³ Board of Taxation *Improving Australia's Tax Consultation System Report*, February 2007

⁴ Better Tax Design and Implementation: *A Report To The Assistant Treasurer And Minister For Competition Policy And Consumer Affairs*, 30 April 2008

⁵ Board of Taxation *Post-Implementation Review of the Tax Design Review Panel Recommendations* December 2011.

⁶ For example, the Superannuation Reform Package announced in the 2016-17 Federal Budget was announced largely by media release. Following that, industry was given two weeks to consult on over 600 pages of draft legislation. This made for very rushed consultation on a significant suite of measures.

⁷ Section 15AB(2)(e) of the *Acts Interpretation Act 1901* (Cth)

previous position. It can be quite costly for taxpayers to unwind arrangements they have in place to comply with the new ATO view. It also creates uncertainty as to whether further changes will occur.

While the ATO may provide concessional relief in the form of a Practical Compliance Guideline, this does not provide a long-term solution.

d) Recent examples

The issues described above have arisen in a number and variety of situations. The following examples are included for illustration purposes.

Examples of issues arising from the consultation process

- i) Corporate and international taxation – the hybrid rules – during the consultation process, stakeholders sought comfort from Treasury on the extent to which Part IVA of the *Income Tax Assessment Act 1936* (Cth) would apply if taxpayers were to restructure to remove the Australian impact of the anti-hybrid rules. Stakeholders had asked for more broad ranging and helpful comments to be inserted into the Explanatory Memorandum (**EM**) as they did not feel the example included was sufficient for this purpose (even though Treasury sought to improve the example during the consultation process in response to stakeholder comments). Stakeholders were advised by Treasury that the EM would not contain extensive guidance as the ATO would release guidance on this issue when the legislation was enacted. While the ATO have since released draft *Practical Compliance Guideline PCG 2018/D4: Part IVA of the Income Tax Assessment Act 1936 and restructures of hybrid mismatch arrangements*, such guidance does not have the same value as guidance in an EM for interpreting the law (as noted above).
- ii) GST – 2017-18 Budget measure ‘GST withholding on property transactions’ – numerous issues were raised with Treasury during the consultation process. As Treasury was required to have the measure ready for tabling in Parliament within a certain time, members felt it was then left to the ATO to deal with a number of these issues after the measure was enacted. This included some issues that cannot be addressed administratively, thus making the role of the ATO even more difficult. The draft guidance that the ATO has issued (Law Companion Ruling LCR 2018/D1) is not able to resolve the outstanding issues with the legislation.
- iii) Superannuation – whether a ‘transition to retirement income stream’ (**TRIS**) can be converted into an account-based pension (**ABP**) – there is a significant difference between the understanding (and long-standing practice) of industry that a TRIS can be converted to an ABP (subject to the governing rules of the relevant superannuation fund) and Treasury and the ATO’s interpretation of the law which suggests this is not possible. There is no express provision in the legislation that precludes the effective conversion of a TRIS to an ABP and

therefore the interpretation provided by Treasury and the ATO is, in our opinion, not consistent with the law. Later amendments were required to be made to the legislation for issues that were raised in consultation prior to when the provisions were first enacted. These issues could have been resolved during the initial consultation phase. A detailed explanation of this issue is contained in submissions we have made to Treasury⁸ and the ATO⁹.

Examples of changes in views

- i) Corporate and international taxation – revised guidance on the corporate residency test relying on the place of central management and control – there were differing views between the ATO and stakeholders regarding the decision in the *Bywater*¹⁰ case and whether the case had enough impact to cause the ATO to revise its long-held views in relation to this residency test. The ATO has relied on the *Bywater* case to support revising its views on the central management and control test.
- ii) Superannuation - The ATO has taken a couple of differing views on when a self-managed superannuation fund (**SMSF**) is required to obtain an Actuarial Certificate in order to determine the exempt pension income (**ECPI**) percentage in an income year in accordance with section 295-385 and section 295-390 of the 1997 Act.

On 9 April 2014, the ATO issued Taxation Determination TD 2014/7 to provide its interpretation of what constitutes *segregated pension assets* for the purposes of calculating the ECPI for a SMSF. An Addendum was then issued 21 October 2015 that relaxed the view somewhat and brought it into line with industry practice.

In 2017, the ATO again reversed its position with regard to the requirements for claiming ECPI by a SMSF with effect from 1 July 2018. The ATO stated that it has been incorrectly interpreting the law and will now administer this provision in line with the revised view.

The last change necessitated a major change to the support systems the Actuarial industry use to produce SMSF Actuarial Certificates. In addition, the industry has been left with the nonsensical position that, even if an SMSF is 100% in the retirement phase (this results in an ECPI of 100%), but is excluded from segregating fund assets for tax purposes in accordance with section 295-385(7) of the 1997 Act, they must still obtain an Actuarial Certificate. This is an unnecessary cost and administrative burden that is caused by strict legislative interpretation.

⁸ <https://www.taxinstitute.com.au/tisubmission/reversionary-transition-to-retirement-income-streams>

⁹ <https://www.taxinstitute.com.au/tisubmission/superannuation-treatment-of-a-reversionary-tris>

¹⁰ *Bywater Investments Ltd v Commissioner of Taxation and Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

3. Possible directions

a) Policy development, law design and consultation

We recommend that the Government revisit the recommendations made by the Board of Taxation and the Tax Design Review Panel, and in particular draw on the New Zealand experience, to design a similar tax and superannuation consultation framework for Australia to apply when tax and superannuation policy changes are being considered. Such a framework should include an agreed timeframe for consultation applied in *all* but extremely rare situations and set procedures for thorough development of tax and superannuation policy.

There should be a commitment to avoid retrospective law change. This framework should alleviate some of the issues that add complexity to the tax and superannuation law, such as making multiple amendments to new laws subsequent to their enactment to address unintended consequences that are not considered prior to enactment, or resulting in situations where the ATO is required to try to administratively manage flaws in the law.

b) Ensuring the requisite skill sets are available in Treasury and ATO

The Treasury, the ATO and the Office of Parliamentary Counsel (**OPC**) will always benefit from drawing on the technical expertise and practical experience of members of the tax and superannuation professions to ensure sound policy and well-designed laws are formed. We note there continues to be a shortage of skills, particularly within Treasury, of industry experience and suggest Treasury be provided with further funding to acquire the skills it needs to ensure it can deliver the highest quality tax and superannuation policy advice and law design and fulfil its responsibilities in the future. OPC would also require additional resources to enable them to participate in the consultation process prior to drafting new law.

We note the ATO has recently been given funding (in the 2018-19 Federal Budget) to gain additional resources in the areas of enforcement against the Black Economy, increase debt collections (including their timeliness) and to ensure individual taxpayers meet their tax obligations. This funding will support the ATO to fulfil its responsibilities as the tax and superannuation regulator. However, this does not address the upfront challenge of contributing to the tax policy and design process.

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours faithfully,



Tracey Rens
President

APPENDIX

ABOUT THE TAX INSTITUTE

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of almost 12,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.