Joint Committee

of

Public Accounts and Audit

Inquiry Reviewing a Range of Taxation Issues within Australia

Supplementary Submission by the Australian Treasury

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INTRODUCTION

Treasury welcomes the opportunity to further assist with the inquiry.

Treasury's main submission (No.51) outlined some key measures that the Government has taken in recent years to improve the administration of tax laws. We present below some supplementary comments, after considering submissions made to the inquiry by other parties and discussions at the public hearings.

NEW LEGISLATIVE REGIME FOR TAX AGENT SERVICES

Our submission advised that a new legislative regime providing national oversight of tax agents by a national Tax Practitioners Board (in place of the current state-based Tax Agents' Boards) was under development, which would include protection from certain penalties for taxpayers who have exercised reasonable care by using a tax agent in specified circumstances.

On 9 May 2006, the Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton, announced (press release No.016) that the Government will provide $57.5 million over four years for the implementation of the new legislative regime for tax practitioners. Treasury is currently working with the Office of Parliamentary Counsel to prepare exposure draft legislation. It is expected that public consultation on this measure will take place in early 2007.

Treasury notes views expressed by inquiry participants on the adequacy of the tax practitioner training and disciplinary arrangements — including the arrangements for BAS service providers — and on the appropriate scope of the 'safe harbour' for taxpayers who use a tax agent.

Tax Agent discipline and training

Inquiry participants have expressed concern that only half of all practising tax agents are members of a recognised professional association (RPA) — with the implication that different standards currently apply to different tax agents, as those who are RPA members are more highly regulated through the application of their associations' codes of conduct, continuing professional education and professional indemnity insurance requirements, and comprehensive investigation and disciplinary processes.

The new tax agent services regime will align closely with the requirements set by RPAs for their members. It will create a legislated Code of Professional Conduct, applicable to all registered tax agents and BAS service providers, to govern the provision of tax agent services. The Code will apply equally to RPA member practitioners and non-RPA member practitioners. The forthcoming legislation will also broaden the range of disciplinary sanctions which may be imposed by the Board for failure to comply with the Code. Such sanctions are intended to apply flexibly and progressively, ranging from a written caution for minor infringements of the Code to termination of registration for serious breaches.

The sanctions are intended to give tax practitioners who breach the Code the opportunity to improve their performance to the required standard and demonstrate their compliance, rather than simply punishing them for poor performance. For example, the sanctions available to the Board will include an order that the practitioner complete a course of training. It is anticipated that the RPAs will play an important role in this regard, as training courses provided by them may be approved by

the Board for delivery to all sanctioned tax practitioners, whether or not they are members of the RPA.

These aspects of the new regime are expected to improve the overall integrity and strength of the system, and thereby enhance the consumer protection goal of the regime.

BAS service providers

Providers of BAS services are currently exempt from regulation. They are not required to be registered, and so are not subject to prescribed educational qualification requirements, and the disciplinary and enforcement arrangements in the current legislation cannot be imposed upon them. There is widespread agreement throughout the taxation services industry that the standard of BAS services provided by bookkeepers is insufficient, and that regulation should play a role in establishing the appropriate standard.

The new tax agent services regime will widen the scope of the regulatory framework to incorporate BAS service providers. Tax practitioners who meet certain minimum criteria, including qualifications and relevant experience, will be considered competent to provide BAS services. BAS service providers will have access to assistance from the Tax Practitioners Board, from the RPAs and from educational institutions, to increase their knowledge of the tax laws and to obtain ongoing professional education and support. They will also be exposed to the requirements of the Code of Professional Conduct and associated sanctions for breaches.

Importantly, a relatively long transition period will be available to BAS service providers, to facilitate their entry into and compliance with the requirements of the new regime and to avoid undue industry disruption. This will allow BAS service providers appropriate time to increase their competency by undertaking required educational qualifications and training.

The scope of the new tax agent services regime will not extend to bookkeepers in general. The regime will only regulate the provision of BAS services for a fee.

Scope of ‘safe harbour’

The Government announced that the new tax agent services regime will include protection from tax shortfall penalties for taxpayers who have exercised reasonable care in using a tax agent. Where a taxpayer has furnished all relevant taxation information to their tax agent, the taxpayer will not be held liable for resulting ‘lack of reasonable care’ tax shortfall penalties for errors by the agent. This is in contrast to the current provisions, which impose a penalty on the taxpayer where a tax shortfall has arisen, regardless of whether it was the taxpayer or tax agent who was responsible for the shortfall.

The precise form of this measure is currently under consideration by Government. However, Treasury notes the Inspector-General of Taxation’s (IGT’s) contention that this protection should be extended to scheme penalties. This is not the Government’s policy, primarily because ‘lack of reasonable care’ is not a criterion for scheme penalties. Relieving taxpayers of the risk of scheme penalties simply because they have used an agent would raise significant integrity issues.

Treasury also notes the IGT’s suggestion that perhaps the ‘safe harbour’ protection should extend beyond shortfall penalties to the shortfall interest charge (SIC) (which applies to the period between when a shortfall arose and when it was notified to the taxpayer). As outlined in our submission, the

SIC is intended to ensure that taxpayers with shortfalls do not receive an advantage — in the form of a 'free loan' — over those who paid their tax liabilities in full by the due date.

COMMISSIONER DISCRETIONS

Our submission advised that, as a follow-on from the RoSA Review, Treasury is examining the discretions given to the Commissioner in the income tax law, to determine an aspect of a taxpayer's liability (liability discretions), in order to develop replacement tests that a taxpayer can apply at the time of lodgement. Treasury notes concerns that eliminating discretions will result in the Tax Office losing flexibility to address potentially unjust outcomes.

Discretions in taxation laws allow the Commissioner to be flexible in the administration of the law to assist taxpayer compliance. Flexibility is also important for tax system integrity in the face of innovative avoidance practices. However, flexibility can unintentionally create uncertainty for taxpayers, and it is this concern that gave rise to the current discretions review.

The specific discretions currently included in taxation laws can be classified broadly into three categories: administrative discretions, anti-avoidance discretions and liability discretions. Administrative discretions are generally appropriate and necessary in the law because they provide the Commissioner with the flexibility needed to carry out his administrative duties fairly and effectively. Similarly, anti-avoidance discretions are usually appropriate and necessary because they enable the Commissioner to protect the revenue against aggressive tax planning. *Liability discretions* are those that require the Commissioner to determine some element of a taxpayer's actual tax liability (and do not have an anti-avoidance motive). Where taxpayers are unable to self assess because the calculation of their liability depends on a decision by the Commissioner, liability discretions can be problematic, particularly where (as is common) the Commissioner has not made that decision by the time the taxpayer lodges their return.

The Treasury review of discretions will only propose replacement of liability discretions, and then only if it is practical to do so. In each case, Treasury will take into account whether replacing the liability discretion may have adverse consequences for any taxpayers.

Treasury intends to release a discussion paper for public consultation in early 2007.

TAXATION RULINGS

Our submission outlined the RoSA reforms to the income tax rulings system, which were aimed at improving the timeliness and reliability of Tax Office advice. The new framework allows Tax Office advice to be more timely, accessible and binding in a wider range of cases. Our submission also briefly outlined the history of the rulings system and its role in the self assessment system.

On this occasion we would like to emphasise that the rulings system is intended to be an integral part of the self assessment system. It is designed to provide certainty to taxpayers on the Commissioner's view about how certain laws apply to them, when self assessing tax obligations or entitlements or anticipating the tax implications of a planned course of action.

The advice contained in Rulings is binding by law on the Tax Office. This means that a taxpayer covered by a formal Ruling is protected, even if the Tax Office subsequently changes its interpretation of the law.

Public Rulings

Public Rulings allow the Commissioner to provide written advice on the way in which, *in the Commissioner's opinion*, a particular tax law would apply to a person or class of persons in relation to an arrangement or class of arrangements. Public Rulings can deal with matters of administration, procedure, collection and ultimate conclusions of fact.

Public Rulings are labelled as such, published and gazetted.

As Rulings are merely a statement of how the Commissioner intends to apply or interpret parts of the tax law, taxpayers are not obliged to follow Public Rulings. Rulings do not have the force of law, being only the opinion of the Commissioner on how the income tax law applies.

However, if taxpayers do follow Public Rulings, then the advice contained in them is binding by law on the Tax Office. Public Rulings remain valid until they are either withdrawn or replaced. But, if the law is more favourable than the Ruling, then the law applies. In this sense, Rulings present a 'one-way bet' in the taxpayer's favour.

It is neither feasible nor desirable for lawmakers to attempt to express how a law will apply in every possible scenario, given the inherent limitations of foresight and the desirability of keeping the law to a manageable size. Consequently, Rulings on how the tax law should be interpreted in specific circumstances will necessarily form part of the taxation administration system on an ongoing basis. Ultimately, if Parliament does not think a Public Ruling reflects the way the law should be interpreted, Parliament can amend the law to make its intention clear.

Treasury notes discussions in the course of the inquiry over whether the Commissioner's Public Rulings should become legislative instruments, subject to disallowance by Parliament. Such an approach would not obviate the need for the Commissioner to interpret and apply a law — which he still does in the absence of a Ruling — or provide a basis for the Commissioner to alter his view on the meaning of a law. Disallowance would, however, remove the protection that taxpayers would have enjoyed from the Ruling being binding on the Commissioner. Subjecting Public Rulings to disallowance would also delay the process of making Rulings, introduce further uncertainty for taxpayers (to some extent reversing the effect of the Government's recent amendments) and could politicise the administration of the tax laws.

Private Binding Rulings

Private Rulings are a written expression of the Commissioner's opinion on the way in which the Commissioner considers a relevant provision applies, or would apply, to a particular taxpayer who has sought that opinion. Private Rulings can deal with matters of administration, procedure, collection and ultimate conclusions of fact.

Any taxpayer, their agent or their legal personal representative may apply for a Private Ruling. There is no charge associated with the Tax Office providing a Private Ruling.

Changes to the rulings system which came into effect at the start of this year were designed to increase the speed of processing Private Binding Ruling requests, and to introduce objection, review and appeal rights for Private Rulings. More time is required before the impact of these changes on the efficacy of the system can be assessed.

Treasury notes discussions in the course of the inquiry over moving away from self-assessment to a type of 'hybrid', where taxpayers could seek to have the Commissioner assess areas of their tax return where they were uncertain about the application of the law.

It is unclear that such a system would provide a substantial increase in taxpayer certainty, compared with the Private Binding Ruling system, while having the clear potential to generate significant additional processing and administrative costs for the Tax Office (with implications for all taxpayers).

Unlike Private Binding Rulings, which can be obtained before a transaction occurs, taxpayers using this proposed system would not be able to determine the Commissioner's view on the correct taxation treatment for a particular transaction prior to entering into the transaction.

PRINCIPLE-BASED DRAFTING

Our submission outlined how Treasury has been developing a principle-based approach to drafting new taxation measures, in support of a broader objective of avoiding unnecessary complexity and reducing the likelihood of unintended outcomes. A much more detailed discussion from Treasury's Economic Roundup was attached.

Treasury notes concerns raised in the course of the inquiry that principle-based drafting could rather *increase* complexity. However, there is no evidence to support this fear.

Treasury also notes that some Committee members may be concerned that principle-based drafting has been a significant cause of complexity in taxation laws. However, the tax law made only limited use of principle-based approaches in the past, and there have been few recent uses, the most notable being this year's fuel tax legislation (principally, the *Fuel Tax Act 2006*), parts of which made significant use of legislative principles.

In some cases, a principle-based approach will not be the best choice. Typically, this will be when amending existing law that is not principle-based. Unless the existing law is rewritten in a principle-based way, it is usually better to amend the existing details using the existing legislative style. Even when the existing law is wholly rewritten, concerns can be raised about whether the established interpretations of the old law will be upset by a new approach. That can be an issue and may lead to key parts of a rewrite using existing phrasing and terminology.

Concerns have also been raised that a principle-based approach may lead to an increased need for Rulings — and that this is tantamount to delegating Parliamentary authority to the Commissioner. However, the Commissioner's Rulings are simply interpretations of the law. While Rulings needed for principle-based law might differ from those typical today (giving more prominence to the policy intention stated in the legislation and less to a technical analysis of words) there is nothing to suggest more Rulings would be required.

Nor is there anything to suggest that law developed using a principle-based approach will be less clear than law developed with the more usual black letter approach. On the contrary, the intention, effect and scope of well designed principle-based law can be clearer than the same law designed in the traditional black letter way. While principle-based law does not attempt to itemise the results for each case, its clearer intent should make it easy to apply to new cases that emerge without the need to seek a Ruling.

TAX LAW DESIGN AND CONSULTATION

Our submission outlined the important role that consultation now plays in the development of most taxation law and, in particular, the Government's commitment to a strongly consultative approach to tax law design. In this respect, the proposition discussed in the course of the inquiry for tax

legislation to be subject to thorough 'road testing' through exposure drafts is consistent with current Government policy.

However, as explained in our submission, although development of tax measures works from an in-principle position of thorough consultation, consultation cannot be mandated for every change to the tax system.

Treasury also notes that the inquiry has discussed the tradeoffs for taxpayers (and the practitioners who assist them) between more thorough road testing and more speedy implementation of changes.

Treasury also notes that the inquiry's discussions have acknowledged that a consultative approach works best where all parties act in 'good faith'.

TEST CASE FUNDING REVIEW PANEL

The Government established the Taxation Test Case Funding Review Panel (the Review Panel) in August 2006, in response to a recommendation by the IGT for increased independence in the test case funding process, made in his report *Review of Tax Office management of Part IVC litigation*. Where requested by unsuccessful applicants, the Review Panel will review decisions made by the Tax Office Test Case Litigation Panel. The Review Panel will be chaired by the Treasury, with three external members who are independent of Treasury and the Tax Office.

FBT EXEMPTION FOR ON-PREMISES CHILDCARE

When Treasury appeared before the Committee at its Canberra hearings, it was asked to provide information on the present cost to revenue of the FBT exemption for on-premises childcare. The 2005 Tax Expenditures Statement (p.119) estimates the value of the exemption for recreational or childcare facilities on an employer's business premises to be in the order of $10 to $100 million. (A figure for childcare facilities alone is not available.)

Treasury was also asked what the cost would be were the FBT exemption to be available and taken up by all employers. The Government does not publish an estimate for this.