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Tax Insights

Tax policy and tax law making

Better making better tax laws

Snapshot

Following the re-election of the Albanese government, there has been much talk about flatlining productivity in Australia, and what can be done to revive the almost stalled rate of economic growth.

Productivity, productivity, productivity … is the narrative: reports to be issued by the Productivity Commission, a Productivity Roundtable to be held, and the Treasurer declaring "The best way to think about the difference between our first term and the second term that we won last night, first term was primarily inflation without forgetting productivity, the second term will be primarily productivity without forgetting inflation". Tax and tax reform is starting to be elevated in the discussion as one part of the productivity initiative.

Indeed, there are many good tax policy ideas and tax reform ideas. The challenge is not the lack of good ideas: yes, there is always room for genuine debate about the right tax reform response and the right mix of responses, but the overwhelming issue for the last twenty years issue has been the absence of effective implementation – finding the political courage and effective processes to work sensibly towards a common goal of greater prosperity and fairness in our society. Incremental tax law change will only produce incremental change. Something more is required.

The purpose of this publication is not to debate the tax policy ideas, or the tax reform ideas: there has been and (hopefully) will be much such debate. Rather, this publication focusses on the process of tax policy making and tax law making. If Australia could better make, better tax laws, that of itself could give us a productivity bump.

Tax law is of course the prerogative of the government of the day, and it is complex. However, the tax law making process all too often creates uncertainty: whether in relation to policy objectives, start dates, legislative progress through the Parliament, the drafting process and in other ways. All of this uncertainty comes at a cost: to the administrator, to business, to the economy and to the tax system.

We can and should do better in our tax law making processes. How might we do this?

1. Review the much-too-long ABUM list

Australia has had a longstanding practice of legislation-by-press-release, where tax related announcements are made by the government of the day, often expressed in broad terms, with a specified start date, and often replete with a great deal of uncertainty. The relevant legislation generally emerges later, sometimes much later and sometimes, not at all. Australia has even created its own acronym for this: such matters are referred to as ABUMs, or announced but unenacted measures. Depending on how you count the ABUMS, there are currently over 40 unlegislated measures.

In 2013, the incoming government undertook a process of reviewing the more than 90 ABUMs and making decisions as to which of these measures would proceed and which would not. The outcomes of such a process did not please everyone, but it provided certainty. In the pursuit of increasing certainty and greater transparency, the government should undertake a similar process. Proceed or not proceed: and if the decision is to proceed, let's do it promptly.

2. Issue a Tax roadmap

In years past, Treasury has released a public document setting out its upcoming priorities and key contacts for particular measures. This forward work plan was of great assistance to business, advisers and taxpayers, enabling them to anticipate expected change. Such a roadmap also allows the government to provide a sense of a coherent approach to the system as a whole rather than the government delivering what may otherwise appear to be a series of disconnected measures.

In the United Kingdom, the HMRC has issued the Corporate Tax Roadmap which sets out the government's plans on Corporation Tax, which includes commitments to amend key features of the system and highlights several areas where the government will be exploring change. In New Zealand, the government issues a regular Tax and Social Policy Work Programme.

We encourage the government to issue such a forward work plan or tax roadmap.

3. Get the start date right, the first time

A reasonable objective should be that tax laws that are to take effect from a particular date are legislated before that date. This provides best certainty to business, administrators and the tax system. Unfortunately, we have seen examples of measures being passed into law after the measure has already taken effect, sometimes almost a year after. In other cases, the originally announced start date has been deferred as the measure is not yet in a sufficient state of development to be introduced into parliament to meet the intended start date. We have even seen a case where a particular measure was announced to take effect from 1 July 2023, no legislation was ever introduced and some 11 months after the "start date", the measure was abandoned. We can and should do better.

When considering what should be the appropriate start date for new legislation, the government should be considering various factors including the extent of policy development prior to the original announcement, how long the legislation may take to progress through parliament and the impact on taxpayers' systems to comply.

4. Timely guidance

Part of the lifecycle of good tax law making should be to anticipate the extent of ATO guidance that may be required to provide certainty. If a law commences from a certain date, but critical guidance is not delivered, in some cases for years, this results in costs and uncertainty.

Law companion rulings (LCRs) were first developed as an ATO guidance product in 2015. The purpose of an LCR is to provide an insight into the practical implications or detail of recently enacted law in ways that may go beyond mere questions of interpretation. An initial burst of enthusiasm saw more than a dozen LCRs issued in 2015 and 2016, but more recently, the flow has slowed to a trickle.

We encourage the government to start with realistic start dates and navigate a predictable Parliamentary process which also factors in sufficient time to produce LCRs and other guidance on key legal and practical issues associated with new law.

5. Making the right choices with scarce resources

Making new tax law is complicated! With resource limitations, a menu of policy options, and having regard to the expected budgetary impact, consideration should be given to what is the highest and best use of available resources. Consider the capital raising and franking credits measure which passed in the last Parliament: it pursued arrangements that the ATO had stated "are no longer prevalent" and which the government stated had an AUD 10 million per annum revenue benefit. The legislative process and Parliamentary scrutiny of this measure had more than the usual "twists and turns".

The process consumed great amounts of time and resources: Parliament, Senate Economics Legislation Committee, Treasury, ATO, taxpayers, advisers, industry groups and more. At the end, taxpayers were left grappling with law changes that contain many uncertainties, and which in many cases will require an ATO ruling. Again, we acknowledge that new laws are the prerogative of the government of the day, but it leaves one wondering if that was the best use of scarce resources?

6. Consultation: Finding the Goldilocks' tax law development process

We are fortunate in Australia to have longstanding and well established tax consultation processes. Despite recent events, in our experience participants in those processes do so in a manner that is overwhelmingly in the best interests of the tax system.

A consultation process that produces no change between the Exposure Draft consultation bill and the Bill introduced into Parliament is unlikely a good process (we have had consultation processes like that). Similarly, a tax law development process that results in almost 100 government amendments to its own Bill is also unlikely to reflect a good process (and yes, we have had a recent process like that too).

The Goldilocks' or just-right consultation process variously involves starting with well-developed policy objectives, well-articulated consultation papers or comprehensive exposure draft bills, followed by meaningful and considered input from consultees and a willingness for all parties to not only listen but to comprehend what is being said, and compromise when compromise is needed.

Consultation is not a cost-free exercise: it comes at a cost and for the sake of all, we need to be getting the best value out of the collective investment in that process.

There have, over the years, been many well intended reviews seeking to improve the quality of future consultation, but this work can sometimes be an exercise in the generality, and even with such processes and newly designed roadmaps, consultation processes do not always hit the mark.

We suggest a short, sharp review of tax related consultations and associated law development processes over the last two Parliaments. Based on real world experiences and outcomes, what can we learn about what was done well, what was not done well, and hence, what learnings should be embedded in future consultations.

7. Policy twists and surprises

A strong business investment environment is aided by tax certainty. The recent thin capitalisation reforms contained a number of policy surprises as the process evolved. Unexpectedly given the scope of the original announcement, changes were proposed to the longstanding interest deduction rules (referred to as section 25-90). This led to a re-running of the technical and policy arguments that had been had a decade earlier. And after much debate, the proposal was abandoned, or at least deferred. Even more unexpectedly, this led to a greater policy surprise as the debt deduction creation rules (DDCR) were released.

It is fair to say that this particular process did not reflect the Goldilocks' tax law development process.

8. Mismatches between policy, the law and the Explanatory Memorandum

There have recently been a number of mismatches between the law as passed on a particular measure and the accompanying Explanatory Memorandum (EM).

The law as it applies to all parties is of course the law that was passed by the Parliament. A well drafted EM can add helpful colour to clarify the operation of the law. At the other end of the spectrum, EMs are sometimes disconnected from the law and in our view, there have been cases where the EM does not reflect the law.

This produces a risk that parties operate in a way that reflects the EM but may be on a basis that is ultimately inconsistent with a Court if the Court takes the view that the law is to be interpreted without reference to the EM, or that the EM does not reflect the law.

9. Predictable Parliamentary process

In 2012, a Treasury official who would later become the Commissioner of Taxation described tax as "intensely political" (refer Rob Heferen, F.H Gruen Lecture, ANU, Wednesday 1 August 2012). Indeed, it is! A tax debate bears many, many objectives, including being a means by which the government can speak to the electorate, and a means by which the government can interact with the Opposition and cross benchers. The intersection of government Parliamentary strategy and the art of politics can at times collide with the much desired objective of certainty. Much of the "intensely political" activity cannot be observed by those of us who are not in the room where it happens. The interests of a taxpayer wanting certainty can sometimes get lost.

A Bill when introduced should be expected to proceed through the Parliament with some degree of speed and predictability. All parties have a responsibility to the people of Australia to progress bills and work constructively on their resolution.

A failure to do this, resulted in a less than optimal process in the last Parliament, described by Sen Lambie as the "mother of all guillotines". This resulted in minimal if any Parliamentary scrutiny of Bills and unfolded with an unseemly process on the last sitting day of 2024 with the Senate ramming through almost 40 Bills, many of which were tax related, and which had languished in the Parliament for some time. We can and should do better.

10. Think about compliance (and retrospectivity) up front

Part of a well-designed tax law is that it should be readily able to be complied with by taxpayers, and readily administrable by the ATO.

In our view, this balance has been lost for example, in the DDCR provisions. A key aspect of tax law disputes is that the burden of proof effectively sits with the taxpayer to show that an assessment of tax is excessive. The DDCR laws, applicable from 1 July 2024, will often require an examination of prior year facts, such as facts relating to when certain loans were made, when certain acquisitions were made and when certain payments were made. Indeed, it can be necessary to search for those relevant prior year facts in records and memories from many years ago.

The ATO says that the "onus is on the taxpayer to prove that the DDCR does not apply and you can prove this through the provision of information and documentation to us". The upshot is that in the absence of being able to locate documentation – documentation that was not required to be brought into existence at the time, and for which the relevant record keeping laws no longer require any documents to be retained – and in the absence of the persons with the relevant knowledge, who may have left the organisation or died, the ATO can assess the taxpayer to deny interest deductions. The relevant facts may be unknown or uncertain to all parties, but the blunt instrument of the law effectively assumes the worst case for the taxpayer and the best case for the revenue.

Where we legislate tax laws that involve elements of retrospectivity (whether in respect of application and/or record keeping), that legislation should undergo additional scrutiny as part of a formal parliamentary process.

11. Post implementation reviews

In the last Parliamentary term, two pieces of tax legislation were formally flagged for post implementation reviews, being the thin capitalisation amendments (including the DDCR) and the FBT exemption on electric vehicles. In both cases, the relevant legislative amendments to lock in these post implementation reviews were proposed by cross bench Senators.

Post implementation reviews should be a standard part of the legislative process. It is not required in all cases, but the indicia could include contentious Parliamentary scrutiny including Parliamentary committees, differences between forecast revenue impacts and actual revenue impacts, and other agreed factors.

In particular, we encourage the government to commence the post implementation of the thin capitalisation and DDCR amendments as a matter of priority.

12. Tax reform

And a last word … on tax reform. Consistent with the approach of this paper, we are not arguing the merits of various tax reform policy options. It is however critical that we develop a process around tax reform that creates the best prospects of success. The Henry Tax Review process which commenced in 2008 and the 2015 Re:think process stand as examples of incomplete or failed processes. On the other hand, the long-go Asprey Review influenced the tax system over a lengthy period, and the Review of Business Taxation Review (Ralph Review) of the 1990s is an example of a process that produced meaningful change. Again, it is worth examining the features of good tax reform processes and the weaknesses of poor tax reform processes.

Conclusion

Tax law changes should follow the core principles of good tax law design – equity and fairness, simplicity and certainty. In terms of process and law design we can do better.

Many of the tax law changes last term have resulted in significant uncertainty and a greater compliance burden and costs. This position can be improved with:

- Clarity around priorities in respect of existing announced but unenacted measures.
- Detailed planning before government announcements are made (and consideration of start dates, revenue effects, etc.)
- Attention to constraints post legislation such as time needed for implementation and for essential ATO guidance.
- Best practice consultation and parliamentary process.
- Post implementation reviews of contentious legislation or legislation that results in greatly different collections over the forward estimates.

These steps can create better certainty, reduce complexity and foster greater investment in Australia.

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