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# Tax Reform: A Matter of Principle? An Integrated Framework for the Review of Australian Taxes

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*“Whoever hopes a faultless tax to see, hopes what ne'er was, is not, and ne'er shall be.”*  
Alexander Pope

## **Abstract**

In the 2008 Australian Federal Budget, Treasurer Wayne Swan announced a comprehensive ‘root and branch’ review of the Australian tax system to help create the foundation for Australia’s future tax system. This Review is now underway. This article argues that a pivotal part of the review is clarifying and outlining *how* a tax will be evaluated because this functions as the context for the evaluation and can significantly influence the overall conclusion that is reached. The central proposition advanced in this article is that a multi-staged, integrated evaluative framework should be created to evaluate tax reform measures. The first part of this article examines the criteria endorsed in the Consultation Paper for the Review as potential design principles that can be used to evaluate a taxation measure and suggests a further key criterion that should be used – the rule of law. The second part of this article examines some of the potential interactions and trade-offs between the criteria to provide the framework for prioritising each principle in establishing the framework. The third part of the article suggests an integrated evaluation framework, by defining the three stages at which a tax can be evaluated: policy, drafting and administration and specifying which of the criteria should be considered at each stage and attributing a priority to each of the criteria.

## **INTRODUCTION**

Tax reform is now firmly on Australia’s agenda. In the 2008 Australian Federal Budget, Treasurer Wayne Swan announced a ‘comprehensive review of Australia’s tax system.’<sup>1</sup> The stated aim of the review is to help create the foundation for Australia’s future tax system that will ‘deal with the demographic, social, economic, and environmental challenges of the 21st century.’<sup>2</sup> More specifically, the Treasurer stated:

We need a tax system that is fairer, that is simpler, that better rewards people for their hard work, that responds to our environmental and demographic challenges, that makes us

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<sup>1</sup> Commonwealth Government, *Terms of Reference for Australia’s Future Tax System Review* (2008) <http://www.treasury.gov.au/documents/1376/PDF/Terms%20of%20Reference%20-%20Australia's%20Future%20tax%20System.pdf> at 15 July 2008.

<sup>2</sup> *Ibid.*

internationally competitive, and that creates the incentives to invest in our productive capacity. One that supports national prosperity beyond the mining boom.<sup>3</sup>

The review designed to create Australia's future tax system (AFTS Review) is far-reaching – expressed by the Prime Minister Kevin Rudd to be a 'root-and-branch' review of the Australian tax system and is planned to cover all the following areas:

- Interactions between federal, state and local taxes;
- The interaction of the tax system with the proposed emission trading system and the welfare system;
- How to reduce inefficient taxes;
- The balance between work, investment and consumption taxes;
- Enhancing the taxation of savings, assets, property (including housing), investments, consumption (including excise but excluding GST), and other types of taxation collected by the states;
- The role and structure of company taxation;
- The role for environmental taxes; and
- The interrelationship between elements of the tax system.

The AFTS Review is now underway. An initial Discussion Paper: *The Architecture of Australia's Tax and Transfer Systems* was released on 19 August 2008.<sup>4</sup> The AFTS Review Panel<sup>5</sup> then requested public submissions guided by four consultation questions.<sup>6</sup> The public submissions received<sup>7</sup> contributed to the development of a Consultation Paper released in December 2008.<sup>8</sup> The Consultation Paper outlines key issues, sets focus questions and establishes the foundation for further public and community consultation.<sup>9</sup> The Review Panel is due to make specific recommendations to the Australian Government by the end of 2009.

Whilst most would agree that a holistic review of taxes that aims to achieve the principles of equity, efficiency, simplicity, sustainability and policy consistency is a worthy exercise, the history of tax reform in Australia has shown that it is difficult, if

<sup>3</sup> Treasurer Wayne Swan, Budget Speech 2008-2009 (Speech delivered 13 May 2008) <http://www.budget.gov.au/2008-09/content/speech/html/speech-01.htm> at 15 May 2008.

<sup>4</sup> Commonwealth Government, *Australia's Future Tax System: Architecture of Australia's tax and transfer system* (August 2008).

<sup>5</sup> The Review Panel consists of Dr Ken Henry as Chair, Dr Jeff Harmer, Professor John Piggott, Ms Heather Ridout and Mr Greg Smith.

<sup>6</sup> The consultation questions included:

- (1) What major challenges facing Australia need to be addressed through the tax transfer system?
- (2) What features should the system have in order to respond to these challenges?
- (3) What are the problems with the current system?
- (4) What reforms do we need to address these problems?

<sup>7</sup> Approximately 500 formal submissions and 260 pieces of correspondence were received.

<sup>8</sup> Commonwealth Government, *Australia's Future Tax System: Consultation Paper* (December 2008) (Consultation Paper).

<sup>9</sup> Commonwealth Government, *Summary of Australia's Future Tax System: Consultation Paper* (December 2008), 1.

not impossible, to satisfy all of these criteria simultaneously. Thus, while previous reviews such as Asprey (1975), the Tax Summit (1985) and the Review of Business Taxation (1999) have all made significant contributions to tax reform in Australia, arguably none of these reviews has managed to satisfy all of the traditional criteria used to evaluate taxes and tax reform measures.

Arguably, therefore, one of the most significant challenges for the AFTS Review is to create a more appropriate, transparent and achievable evaluative framework, which recognises that not only are there trade offs between the stated criteria, which therefore need to be prioritised, but that different criteria are relevant in relation to evaluating a taxation measure's policy, drafting and administration.

A pivotal aspect of the AFTS Review will be to critically analyse some of Australia's existing taxes, such as reviewing the income tax law, including company taxes and proposals for an environmental tax. This article argues that a necessary antecedent step to this part of the review is to establish an appropriate and comprehensive evaluative framework.

Clearly outlining *how* a tax will be evaluated is crucial, because by functioning as the context for the evaluation, such a framework can significantly influence the conclusion reached. The central proposition that is put forward in this article is that a multi-staged, integrated evaluative framework should be created to evaluate this and other tax reform measures.

The structure of this article is as follows. The first part will examine the criteria that are endorsed in the Consultation Paper as potential design principles that can be used to evaluate a taxation measure. These criteria include equity, efficiency, simplicity,<sup>10</sup> sustainability and policy consistency. It will be suggested that the further key criterion of adherence to the Rule of Law should also be included in critiquing a taxation measure. The meaning of the Rule of Law is discussed in part one below, along with suggested definitions that should be attributed to each of the criteria identified in the Consultation Paper.

The second part of the article acknowledges that, pragmatically, no tax can satisfy all of these criteria simultaneously and that trade offs between them are inevitable. Notably, this issue is recognised in the Consultation Paper and Question 8.3 of that Paper considers the extent to which policy objectives may be traded off to achieve a simpler tax/transfer system and further considers in what areas efficiency, equity or choice should be traded off for the attainment of simplicity.<sup>11</sup> Accordingly, in part two of this article some of the potential interactions and trade offs between the criteria is considered. The exploration of these interactions provides the foundations for determining where a priority is attributed to each of the criteria in establishing the framework.

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<sup>10</sup> For a further discussion of the traditional criteria see the Commonwealth Treasury *Review of Business Taxation: A Strong Foundation* (November 1998) <http://www.rbt.treasury.gov.au/> at 15 July 2008.; Skinner and Todd Campbell (ed), *Adam Smith An Inquiry into the Nature and Causes of the Wealth of Nations* (Clarendon Press Oxford, 1976); Joseph E Stiglitz, *Economics of the Public Sector* (New York: W.W.Norton & Company, 1988) 390.

<sup>11</sup> Consultation Paper, above n 8, 20.

The third part of the article puts forward an integrated evaluation framework, by defining the three stages at which a tax can be evaluated: policy, drafting and administration. The framework specifies which of the criteria should be considered at each stage and attributes a priority to each of the criteria. Notably this is only a suggested ranking and this may differ depending on the government's stated intention or policy goals in respect of each taxation measure. However it is imperative that whatever ranking is attributed to particular criteria it should be made explicit or transparent in any evaluation framework that is utilised.

The final part of the article draws conclusions and identifies areas for further possible research.

## 1. DEFINING THE CRITERIA FOR ASSESSING WHAT IS AN EFFECTIVE TAX

### 1.1 Defining the Criteria

The Consultation Paper outlines several design principles that submissions have identified which can be used to critique the "effectiveness" of a tax or tax reforms. These include equity efficiency, simplicity, sustainability and policy consistency.

For convenience, these principles will be adopted for the purposes of this article as the criteria used to evaluate a taxation measure for the purposes of the AFTS Review. However, it will be argued that the AFTS Review should also utilise a further pivotal design principle and this is adherence to the Rule of Law. The Consultation Paper appears to include one of the key elements of the Rule of Law - certainty within the criteria of simplicity. This article argues that, simplicity is not necessarily synonymous with certainty and that therefore, adherence to the Rule of Law (which includes certainty) should be included as a further fundamental design principle or criteria against which to evaluate a tax or tax reform measure.

These design principles represent characteristics that an effective tax or tax reform should display. However, a tax does not need to possess these characteristics in order for it to be constitutionally valid.<sup>12</sup> For example, in *Giris Pty. Ltd v Federal Commissioner of Taxation*<sup>13</sup> the High Court commented on the utility of Adam Smith's canons of taxation when considering the constitutional validity of section 99A of the *Income Tax Assessment Act (Cth)* (ITAA 1936). The High Court stated:

Yet anyone remembering the record of Adam Smith's four "canons" of taxation must be beset by misgivings and regrets that Parliament forgot it... However, Adam Smith's canon is a political principle, not a Rule of Law. It states a characteristic which it is generally considered that a tax **should** have, not a characteristic which is of the essence of a tax. Parliament may seem to have acted in defiance of a recognized principle of taxation, but that does not of itself mean

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<sup>12</sup> The criteria for an impost to be a constitutionally valid tax are contained in *Matthews v Chicory Marketing Board (Vic)* (1930) 60 CLR 263. This case is generally cited for the proposition that in order for an impost to be a tax it must be: 'A compulsory exaction of money by a public authority for Public Purposes, enforceable by law and not a payment for services.' For a more recent discussion of what will constitute a valid tax see *Luton v Lessells* (2002) 165 CLR 462. See also Clinton Alley and Duncan Bentley, 'A Remodelling of Adam Smith's Tax Design Principles' (2005) 20 *Australian Tax Forum* 579, 581.

<sup>13</sup> (1969) 119 CLR 365.

that the law which it has made is not a law with respect to taxation... (emphasis added)<sup>14</sup>

In utilising these principles as potential measures against which to base an evaluation, one of the initial and fundamental difficulties faced by the AFTS Review is to clearly define what is meant by each of the criteria. A review of the literature in this area illustrates that the definitions attributed to these criteria can differ significantly and a discussion of these definitions is therefore instructive and will be undertaken later in the article.<sup>15</sup>

## 1.2 Equity

Uncontroversially, most would agree that a tax should be equitable. A tax that is perceived as fair or equitable should promote voluntary compliance.<sup>16</sup> In this regard, Allan states:

It is clearly a desired characteristic of taxes that they be fair. Apart from the ethical desirability of equity, there is the practical need for taxes to be acceptable to the tax-paying public. If taxes are generally believed to be inequitable the consequences may range from widespread evasion to revolution.<sup>17</sup>

The Consultation Paper recognises that whilst equity is an important design principle for the review of a tax there is: 'no consensus about exactly what equity is or how to measure it.'<sup>18</sup> The Consultation Paper discusses various perspectives on equity as advanced in the submissions including:

- That: 'all individuals should have the opportunity to participate in society and achieve the things that they value';<sup>19</sup>
- That those with greater economic means should pay more (vertical equity). It is noted however that there is little agreement about how economic means should be measured and what degree of progressivity in a tax system is appropriate;
- Minimal opportunities for tax avoidance and minimisation;
- That families or individuals with the same capacity should face the same taxation burden (horizontal equity);
- The benefit theory which specifies that people should pay in accordance with the benefit they receive from government spending; and
- Inter-temporal and inter-generational equity. Inter-temporal equity considers how the tax/transfer system affects people over their entire life not just on an annual basis. Whereas, Inter-generational equity is concerned with how the tax transfer decisions will affect future generations.

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<sup>14</sup> Ibid.

<sup>15</sup> Alley and Bentley, above n 12.

<sup>16</sup> Kristina Murphy, 'The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders' (2004) 28(2) *Law and Human Behaviour* 187-209.

<sup>17</sup> Charles M Allan, *The Theory of Taxation* (Harmondsworth: Penguin Books Ltd, 1971) 36.

<sup>18</sup> Consultation Paper, above n 8, 32.

<sup>19</sup> Above n 8, 32-34.

It is suggested that for the purposes of the AFTS Review equity should be defined as encompassing a reference to horizontal, administrative, vertical and inter-nation equity. However, further work on refining the meaning to be attributed to equity should be undertaken by the Review in establishing the evaluation framework.

Horizontal equity is said to occur when people in the same situation are treated in the same manner by the tax. For example, people with the same income should be taxed the same amount. Allan states:

...horizontal equity, describes the equal treatment of equal people. This principle is unchallengeable as an ideal and is not impracticable of operation. People of equal incomes, for example, might be required to pay the same income taxes. All people who smoke twenty cigarettes per day would be required to pay the same in specific tobacco taxes.<sup>20</sup>

Another attribute of horizontal equity is that the tax should apply equivalent treatment to transactions that achieve the same economic result. That is the tax should not apply differently to two transactions that although different in form (e.g. conducted through a company or trust) are economically equivalent.

Vertical equity refers to the proposition that people in different situations should be taxed differently. Thus, the concept of vertical equity requires a progressive tax system where those in a better position or with greater “means” should pay a greater amount of tax. However, as noted above there is little consensus regarding how economic means should be measured,

Administrative equity occurs where the administrative procedures that are adopted, in respect of a particular tax, ensure that all taxpayers are treated equally. This would include that all taxpayers had equal access to information pertaining to their tax affairs.

Inter-nation equity requires that a taxpayer should only be liable to tax in each jurisdiction or country in which they operate, in proportion to the extent of their economic involvement in that country or jurisdiction. This aspect of equity is not discussed in the Consultation Paper. However, arguably given that a key priority in the AFTS Review is designing a system that makes Australia internationally competitive, addressing increasing globalisation and the changing pattern of world economic activity, it is important that Australian domestic taxation policy remains internationally competitive by prioritising inter-nation equity as a key element of the design principle of equity.

Furthermore, there are other aspects of equity that all taxes should comply with. For example a tax law should not discriminate on the basis of race, sex or disability. However, these aspects of equity have not been discussed below as it is considered these are broader requirements of law (rather than criteria on which a taxation measure should be critiqued) and are embodied in existing Commonwealth Acts such as:

- *Disability Discrimination Act 1992*;
- *Human Rights and Equal Opportunity Commission Act 1986*;
- *Race Discrimination Act 1975*; and

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<sup>20</sup> Allan, above n 17.

- *Sex Discrimination Act 1984.*

In conclusion on this point it is recognised that it can be problematic determining what is “fair” or equitable and that further detailed work is required in refining the definition of equity. The Asprey Report recognised these difficulties when it stated that that equity is: ‘an ideal exceedingly difficult to determine and harder still to measure.’<sup>21</sup> The difficulty lies in determining the basis on which individuals should be compared. For example, when defining horizontal equity when will two taxpayers be in the same position? Should a comparison for the purposes of horizontal equity be undertaken on an individual or family unit basis? It is generally accepted that the “income” of the individual is a relevant measure to use for comparative purposes. However, there is some debate as to whether income should be the measure of an individual’s wealth and if it is, whether current or lifetime income should be used.<sup>22</sup> Despite these difficulties, this article contends that equity should be one of the principles used to evaluate an efficient tax.

### 1.3 Efficiency (Neutrality)

A key aspect of efficiency is neutrality which is said to exist where taxes minimise distortions to economic activities and do not impede genuine commercial transactions. The US Department of Treasury states:

An ideal tax system would, however, interfere with private decisions as little as possible. That is, it would not unnecessarily distort choices about how income is earned and how it is spent. It would not unduly favor leisure over work, or consumption over saving and investment. It would not needlessly cause business firms to modify their production techniques or their decisions on how to finance their activities. A neutral tax policy would not induce business to acquire other firms or to be acquired by them merely for tax considerations. It would not discourage risk-taking or the formation of new businesses...<sup>23</sup>

Similarly Allan defines neutrality to be in existence where: “the tax avoids distorting the workings of the market mechanism.”<sup>24</sup>

The history of Australian taxation has shown that the Australian government frequently uses tax expenditures to influence and further particular economic or social goals. For example, to encourage gold mining in Australia, income from gold mining was tax exempt from 1924 to 1988. Therefore where it is an **intended effect** of the tax to influence economic activity, this would not be in contravention of the principle of efficiency. On this basis the article assumes that for the purposes of the AFTS Review, a tax is neutral where it avoids **unintentionally** distorting economic activity.

### 1.4 Simplicity

Ironically, “simplicity” (sometimes referred to as administrative efficiency)<sup>25</sup> is perhaps the most difficult of the criteria to define and, consequently, it has been attributed numerous and disparate meanings. The Asprey Report states that simplicity involves a ‘complex of ideas’.<sup>26</sup> Binh Tran-Nam states: ‘If there were ever to be

<sup>21</sup> Commonwealth Taxation Review Committee *Full Report* (1975) (‘Asprey Report’).

<sup>22</sup> *Ibid* 3.11-3.15.

<sup>23</sup> Department of Treasury, *Tax Reform for Fairness Simplicity and Economic Growth, Volume 1* (1984).

<sup>24</sup> Allan, above n 17, 37.

<sup>25</sup> Robin Woellner *et al*, *Australian Taxation Law* (19<sup>th</sup> ed, 2009) 24.

<sup>26</sup> Asprey Report, above n 21, 3.19.



agreement between tax academics, it must be that tax simplicity...is itself a complicated notion.<sup>27</sup>

The difficulty in defining simplicity arises because simplicity is a subjective concept. For example, a taxation practitioner with several years of experience may find a particular tax very simple to apply, relative to a taxpayer with no specialised knowledge of the taxation law.

Simplicity is defined very broadly in the Asprey Report:

... A tax will be called simple, relative to others, if for each dollar raised by it the cost of official administration is small, and if the 'compliance costs', the costs in money and effort of all kinds to the taxpayer, are also small.<sup>28</sup>

Based on the Asprey Report and for the purposes of this article, simplicity will be viewed in the context of compliance and administration (also known as administrative efficiency).

The first element is taken to be satisfied if a taxpayer (or their adviser) can understand and apply the tax with minimal compliance costs. The meaning of compliance costs is based on the definition assigned to it in the Report on the Review of Aspects of Income Tax Self Assessment<sup>29</sup> and includes direct financial costs, opportunity costs and non-financial compliance costs.

Direct financial costs include the costs to the taxpayer of engaging tax experts for managing their tax affairs. Opportunity costs include the time spent by the taxpayer complying with their tax obligations that may have been spent doing other activities (such as leisure or work). Non-financial compliance costs include any mental stress that may result from uncertainty placed on the taxpayer about whether they have discharged their tax obligations.

The second element provides that in order for a tax to be simple it must have minimal administration costs. Administration costs include the costs of tax policy planning, resolving taxation disputes (including taxation litigation), and the costs of administering the law including taxpayer education, rulings, circulars and the provision of other types of ATO information. One factor that can affect simplicity is the number of taxpayers affected by a taxation measure. For example the fewer taxpayers from which the tax is collected the simpler the tax. The Asprey Report states that: 'The sheikhdom that can raise all the revenues it requires (and maybe much more) from a single tax on a single oil company has what is unquestionably the simplest tax of all.'<sup>30</sup>

It is important to note that a brief tax law will not necessarily be simple. This is because brevity does not necessarily translate into simplicity. The Review of Business Taxation acknowledged this and stated:

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<sup>27</sup> Binh Tran-Nam, 'Tax Reform and Tax Simplicity: A New and 'Simpler' Tax System' (2000) 23(2) *University of New South Wales Journal* 241.

<sup>28</sup> Asprey Report, above n 21, 3.20.

<sup>29</sup> Report on the Review of Aspects of Income Tax Self Assessment (2004 AGPS) <http://selfassessment.treasury.gov.au/content/report.asp> at 23 March 2009.

<sup>30</sup> Asprey Report, above n 21, 3.22.

Complexity and simplicity...are concepts lacking simple definitions. It may be anecdotally convenient, and not unduly misleading, to equate complexity to some index of the growth in volume of tax legislation ... Nevertheless, it is clear that short provisions of legislation may not be simple and long provisions may not be simple and long provisions may not be complex.<sup>31</sup>

## 1.5 Sustainability

The Review suggests that sustainability can be viewed from three perspectives: environmental, institutional and fiscal sustainability.

Environmental sustainability demands that a taxation reform measure should be compatible with environmental policies. The Report states that:

An important theme in submissions from environmental groups is that, given its central importance to economic decision making, the tax transfer system needs to be consistent with achieving sustainable economic growth...

Many submissions argue that tax transfer setting should be consistent with the objective of reducing carbon emissions.<sup>32</sup>

Institutional sustainability requires that the legal and administrative frameworks of the tax reform are robust and community attitudes “maintain the legitimacy” of the system.

Fiscal sustainability requires that the tax system is sufficient to meet the revenue needs of Australia and that these needs are met without recourse to inefficient taxes. This further entails determining whether the policy underlying the taxation measure contribute to a fair and equitable society and are “affordable” over a long term basis. Fiscal sustainability advocates relying on a stable revenue stream by decreasing reliance upon more volatile taxes. Furthermore, it advocates flexible taxation measures that are able to apply appropriately to changing economic conditions, schemes or innovative structures.

## 1.6 Policy Consistency

The Consultation Paper suggests that a taxation measure should have policy consistency both internally (consistency between taxation measures within the taxation act under review) as well as being externally consistent with the Australian government’s broader policy objectives (for example, environmental climate change policies).

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<sup>31</sup> Review of Business Taxation (1998), above n 10.

<sup>32</sup> Consultation Paper, above n 8, 27. It is generally accepted by the literature that regulation to encourage a change in the economic impact of business will cause a distortion to economic activity. For example, the Garnaut Report (Garnaut R 2008, *The Garnaut climate change review*, Cambridge University Press, Port Melbourne) looks at the ways that certain tax and transfer policies can address global warming by impacting the way business is conducted to encourage more desirable and sustainable activities. See also the Report by the NSW Business Chamber, *The challenge of green tape: growth of environmental law and its impact on small and medium enterprises across Australia* available at [http://www.nswbusinesschamber.com.au/reference/influence\\_government/green\\_tape\\_report.pdf](http://www.nswbusinesschamber.com.au/reference/influence_government/green_tape_report.pdf). This report considers the growing burden of environmental regulation on small and medium enterprises.

## 1.7 Rule of Law

Like simplicity, an exact or uniform definition of the Rule of Law is elusive. The exact characteristics of the Rule of Law are the subject of extensive debate which is beyond the scope of this article. Nevertheless the Rule of Law according to the most common attributes assigned to it by the literature will be discussed. This article advocates that the AFTS Review should adopt the Rule of Law as a further criteria to measure the effectiveness of any taxation measure.

The first attribute of the Rule of Law is the requirement that the law (in this context, the terms of the tax itself) must govern the rights of the individual. These rights should not be determined through the exercise of broad, discretionary powers vested in the administrative. In fact broad discretionary powers are the antithesis of the Rule of Law. In this regard, Professor Cooper notes that: ‘The excessive use of discretions, and even the delegation of legislative authority to bureaucrats, can contradict this notion since the bureaucrat may be empowered effectively to decide what the law is.’<sup>33</sup>

Similarly, in relation to the relationship between the Rule of Law and broad discretionary powers, Heydon observed: ‘The Rule of Law operates as a bar to untrammelled discretionary power.’<sup>34</sup>

In this regard, certainty underpins the Rule of Law. The Rule of Law requires taxpayers (or their advisers) to be able to ascertain from the legislation what their rights and obligations are. In order to do this the tax must be certain. Lord Diplock stated in *Merkur Island Corpn v Laughton*<sup>35</sup> ‘Absence of clarity is destructive of the Rule of Law; it is unfair to those who wish to preserve the Rule of Law; it encourages those who wish to undermine it.’<sup>36</sup>

Adam Smith noted the following about the maxim of certainty (in respect of a tax):

The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person...The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.<sup>37</sup>

For the purposes of this article, a tax will be regarded as satisfying the Rule of Law when a taxpayer or their adviser is able to reasonably establish from the terms of the taxation measure itself when it will apply. Furthermore, a “certain” tax would generally not vest broad discretions in the administrator as the existence of such

<sup>33</sup>Graeme Cooper, ‘Conflicts, Challenges and Choices - The Rule of Law and Anti- Avoidance Rules’ in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (The Netherlands: IBDF Publications 1997) 13.

<sup>34</sup>Dyson Heydon, ‘Judicial Activism and the Death of the Rule of Law’ (2003) XLVII(1-2) *Quadrant Magazine*.

<sup>35</sup>[1983] 2 AC 570.

<sup>36</sup>Nabil Orow, *General Anti-Avoidance Rules - A Comparative International Analysis* (Bristol: Jordans Publishing Limited, 2000) states that: ‘certainty of the law constitutes the essence of the Rule of Law’. Geoffrey De Q. Walker, ‘The Tax Wilderness: How to Restore the Rule of Law’ (2004) Winter *National Observer* 15-27 likewise, states: ‘Uncertainty in the law is a major factor in undermining the Rule of Law, and tax is riddled with it.’

<sup>37</sup>Skinner and Todd Campbell (ed), above n 10.

discretions would make it difficult for a taxpayer (or their adviser) to predict when the tax will apply.

The attainment of certainty, used for the purposes of this article, alters the traditional definition of certainty. The traditional definition (as outlined by Smith above) requires that the taxpayer is able to apply the tax law with certainty. In this article, it will be assumed that, certainty will be obtained where the taxpayer or *their adviser* is able to understand or apply the tax. The modification is made to the traditional definition because, given the point to which the tax law in Australia has evolved, it must be accepted that taxpayers may not be able to apply the taxation law themselves with certainty. Indeed, the complexity of the tax law and large number of discrete provisions within the ITAA 1936 and *Income Tax Assessment Act (Cth)* 1997 (ITAA 1997) has led many taxpayers (well over 70% of Australian individual taxpayers) to seek the assistance of a specialist or adviser to help them understand and apply the law.<sup>38</sup>

The second widely accepted attribute of the Rule of Law is that government and the bureaucracy should comply with the laws that are passed.<sup>39</sup>

Two other commonly accepted requirements of the Rule of Law are that people in similar circumstances should be treated alike.

Furthermore, the Rule of Law requires that the law is stable, certain and predictable. Thus the Court stated in *Black-Clawson International Ltd v Papierwerke Waldhof Aschaffenburg AG*:

The acceptance of the Rule of Law as a constitutional principle requires that a citizen before committing himself to any course of action should be able to know in advance what the legal consequences that will flow from it are. Where those consequences are regulated by a statute the source of that knowledge is what the statute says. In construing it the court must give effect to what the words of the statute would be reasonably understood to mean by those whose conduct it regulates.<sup>40</sup>

The Australian Taxation Office (ATO) also acknowledges that the Rule of Law is an important value in Australia.<sup>41</sup> Commissioner D'Ascenzo however outlines the difficulties of adhering to such a principle in Australia:

The Rule of Law provides an anchor for legislative regimes such as taxation and superannuation operating as they do in this choppy sea of change. Whilst this constancy safeguards rights and obligations, its ambulatory restrictions, the inherent vagaries of words, and the infinite variety of personal circumstances impose daunting difficulties on policy makers, legislators and administrators. Where the law blurs into indeterminacy

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<sup>38</sup> Review of Aspects of Income Tax Self Assessment, above n 29. The Report suggests that 76% of people engage tax agents.

<sup>39</sup> Ronald Sackville, 'Avoiding tax avoidance: The primacy of Part IVA' (2004/2005) 39(6) *Taxation in Australia* 295.

<sup>40</sup> *Black-Cawson International Ltd v Papierwerke Waldhof Aschaffenburg AG* [1975] AC 591, 638.

<sup>41</sup> Michael D'Ascenzo, Commissioner of Taxation 'Living Our Values' (a speech delivered at the 7th International Tax Administration Conference, Sydney Australia, 20 April 2006.)

there are difficulties also for taxpayers and their advisors and the potential for disputation increases.<sup>42</sup>

## 2. RELATIONSHIPS BETWEEN THE CRITERIA

A tax or tax reform measure that exhibited all of the above attributes could only be achievable in 'Fiscal Utopia', as many of the criteria discussed above are conflicting or mutually exclusive. The corollary of this is that trade offs between the attainment of individual criterion are inevitable. Accordingly, part three of this article discusses the priorities to be assigned to the criteria defined above. However, to do this the relationships between the criteria must first be examined. This examination enables a ranking to be attributed to the criteria and assists in determining, where there is a conflict, which criteria should take precedence.

### 2.1 Equity and Efficiency

Traditionally, it is well recognised that there can be trade offs between achieving equity and efficiency. Vertical equity requires that those on higher incomes pay a higher amount of tax. This can impact efficiency as it may reduce incentives to enter into business transactions or invest, work, save or consume. As the Organisation for Economic Co-operation and Development (OECD) states in its Booklet on the Comparative Assessment of OECD Countries:

Governments are often faced with trade offs between equity and efficiency goals of tax policy. There is an abundance of examples of conflicts between equity and efficient inherent in the taxation of income generating activity... Specifically the choice of progressive tax rate structures reduces vertical inequality but increases inefficiency by reducing incentives to utilise labour and capital resources and prompt avoidance and evasion. Indeed this conflict between equity and efficiency lies at the heart of many differences between OECD countries in their choices of tax rate.<sup>43</sup>

### 2.2 Equity and Simplicity

Equity and simplicity have a mixed relationship. In order to achieve equity, a taxation measure may need to be drafted in such a manner as to capture people's individual circumstances and attributes, which may result in voluminous and complicated legislation. In this respect, equity may conflict with simplicity. The Review of Business Taxation states:

Equity and complexity... certainly interact. Complexity in the tax legislation is created, for example, by the capture of individual taxpayer circumstances or by the provision of transitional provisions in meeting equity objectives.<sup>44</sup>

However, legislation that is simple may not require a taxpayer to engage expert advice. Indeed it is recognised by the Consultation Paper that complexity tends to be regressive in its impact.

<sup>42</sup> Michael D'Ascenzo, Commissioner of Taxation, 'The Rule of law: a corporate value' (a speech delivered to the Law Council of Australia, Rule of Law conference, Brisbane, 1 September 2007.)

<sup>43</sup> OECD, *Comparative Assessment of OECD Countries* (2001) [http://books.google.com.au/books?id=zjXl6TmdvIAC&pg=PT23&lpg=PT23&dq=equity+and+neutrality+AND+taxation+AND+relationship&source=bl&ots=BIPQRIFL7U&sig=843u9rYGYGhMz2z7hWmiZ2Lh3wc&hl=en&ei=Bce9SfqKMNK1kAWYkPSKCA&sa=X&oi=book\\_result&resnum=5&ct=result#PPP1\\_M1](http://books.google.com.au/books?id=zjXl6TmdvIAC&pg=PT23&lpg=PT23&dq=equity+and+neutrality+AND+taxation+AND+relationship&source=bl&ots=BIPQRIFL7U&sig=843u9rYGYGhMz2z7hWmiZ2Lh3wc&hl=en&ei=Bce9SfqKMNK1kAWYkPSKCA&sa=X&oi=book_result&resnum=5&ct=result#PPP1_M1) at 22 March 2009.

<sup>44</sup> Review of Business Taxation, above n 10.

The impact of complexity in the tax-transfer system tends to be regressive, falling most heavily on those with the least capacity to deal with it and the least means to get professional help. These people may make less advantageous decisions or be unaware of the transfers to which they are entitled.<sup>45</sup>

That is that lower income taxpayers may be more significantly impacted by complexity within a revenue statute. The corollary of this is that if legislation is simple, the accessibility of the legislation is not governed by the financial means of the taxpayer and will assist in maintaining equity. Consequently, equity and simplicity have a mixed relationship.

### **2.3 Equity and Sustainability**

Equity and sustainability would appear to have a largely complementary relationship. In order to achieve fiscal sustainability the review requires that the policy underlying the taxation measure is equitable. Furthermore, institutional sustainability requires that the tax measure is robust and that community attitudes towards the measure maintain the legitimacy of the system. Arguably to ensure that this legitimacy is maintained the system must be equitable.

### **2.4 Equity and Policy Consistency**

Equity and policy consistency would appear to have a mixed relationship. The Consultation Paper states:

Consistency in policy settings within the tax-transfer system can help people to understand the system and helps to reduce complexity, cost and uncertainty for taxpayers. This can reduce the costs of the system and increase equity by improving levels of voluntary compliance. If taxpayers cannot understand the system, or if the system is clearly inconsistent in the way it treats different taxpayers, transactions or activities, then taxpayers are less likely to comply with their obligations.<sup>46</sup>

Furthermore equity would be enhanced as individuals would be treated consistently within the same Act between statutes/Acts and state jurisdictions.

However in order to achieve equity in each individual statute, there may be a need to recognise different taxpayer attributes or activities which could create policy inconsistency between different external statutes. The Report on Aspects of Income Tax Self Assessment states:

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.<sup>47</sup>

### **2.5 Equity and Rule of Law**

The Rule of Law requires certainty from the taxation measure. Certainty and equity appear to have a mixed relationship.

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<sup>45</sup> Consultation Paper, above n 8, 33.

<sup>46</sup> Ibid 36.

<sup>47</sup> Report on the Review of Aspects of Income Tax Self Assessment, above n 29, Appendix 3.

A certain tax measure should not contain broad discretions. Broad discretions may compromise equity by vesting in the administrator the discretion to determine the treatment of individual taxpayers. This may result in individuals, in the same situation, being treated differently as the discretion may be exercised by different people (eg delegates of the Commissioner). The accessibility of a tax that is uncertain would also be differentiated on the basis of training or income. This is because, in respect of an uncertain tax, taxpayers would be inclined to seek expert advice in order to ascertain the likely operation of the tax. Consequently, only those taxpayers who have the financial means to engage experts or who possess the relevant knowledge themselves will be able to predict the operation of the tax.

In order to achieve certainty, however, a tax conveying complex policy goals may need to be drafted in a lengthy and prescriptive manner. This may lead to complexity, which may compromise equity, as only those taxpayers with the requisite financial means to engage experts, or who possess the relevant knowledge themselves, will be able to apply the tax correctly. The Review Business Taxation recognised this issue:

Equity and complexity... certainly interact. Complexity in the tax legislation is created, for example, by the capture of individual taxpayer circumstances or by the provision of transitional provisions in meeting equity objectives. Conversely, increased complexity diminishes equity where the relative accessibility of the business tax law is differentiated by taxpayer training, experience or income, or where taxpayer capacity to exploit the opportunities created by an increasingly complex code is similarly differentiated.<sup>48</sup>

Whilst the Rule of Law may satisfy horizontal equity it will not necessarily satisfy vertical equity. The Rule of Law requires that all individuals are treated equally, whilst vertical equity requires that individuals in different positions should be treated differently.

Furthermore, there are examples of where a certain tax may be equitable in the administrative sense but not necessarily in the horizontal or vertical equity sense. A poll tax for example satisfies the criteria of certainty but does not rank well when considered in terms of the criteria of vertical equity, as it fails to take into account the financial means of each person taxed.

## 2.6 Efficiency and Simplicity

Efficiency and simplicity have a mixed relationship. A simple tax will minimise the time spent on tax planning, which can divert resources away from their most productive use. The Consultation Paper states:

complexity may also reduce economic efficiency by increasing the level of uncertainty about the expected payoffs to long-term investment decisions, such as: investment in education; retirement products; long-lived productive assets; or the choice of business structure.<sup>49</sup>

Another complementary aspect of the relationship between efficiency and simplicity is that a simple tax will reduce the time spent on “unproductive activities” like tax planning, tax litigation and in some cases tax administration. *Report 410 on Tax Administration* by the Joint Committee of Public Accounts and Audit Report states

<sup>48</sup> Review of Business Taxation, above n 10, 6.23.

<sup>49</sup> See Consultation Paper, above n 8, 34.

(Report 410):' A simpler system will deliver savings to both taxpayers and government and allows entrepreneurs to focus on growing their business, rather than complying with arbitrary tax rules.<sup>50</sup>

However, there are also notable examples of where an efficient tax can be more costly to administer. For example the GST is a more neutral or efficient tax than a wholesale sales tax. For example according to the Asprey Committee in Australia:

A broad based tax serves horizontal equity by not discriminating between savings and consumption, but by itself it cannot be adopted to the varying situations of individuals. Nor is it, by itself, suitable for vertical equity. It is essentially a proportionate consumption tax and actually regressive as a tax on income since the proportion of consumption to income normally fall as income increases. It stands high by the test of simplicity, certainly far higher than personal income tax when both are compared as major revenue raisers.<sup>51</sup>

However given it is collected at multiple stages it is a significantly more complex and costly tax for the ATO to administer.

## 2.7 Efficiency and Sustainability

Efficiency and Sustainability have a mixed relationship.

For example, it may be argued that tax policies that are environmentally sustainable may impact economic decision making and therefore efficiency. This was recognised in the Consultation Paper where it is stated that: “ number of submissions arguing taxes relating to the Carbon Pollution Reduction Scheme should be designed to minimise the costs imposed on business.”<sup>52</sup> Furthermore the Consultation Paper recognises that whilst taxes are a way of “improving environmental amenity” they can also “detract from environmental outcomes” through creating inappropriate incentives. Taxes impact economic activity and help to mitigate environmental damages by either imposing: “a cost on some products or activities that are environmentally damaging, or give a benefit to some products or activities that are environmentally beneficial”.<sup>53</sup>

A report by Fullerton, Leicester and Smith for the UK Mirrlees Review recognises that tax policies designed to impact sustainable economic growth can distort and impact economic activity.

Barriers to implementing a domestic carbon tax could also come from concerns over international competitiveness and distribution. It would be undesirable for production to move abroad as a result of a unilateral carbon tax, reducing any net environmental gain, and widespread sectoral exemptions from any tax would significantly blunt its environmental impact.<sup>54</sup>

However, fiscal sustainability demands that the tax system or tax measure should be certain and provide a stable revenue base. Indeed instability will reduce efficiency and

<sup>50</sup> Joint Committee of Public Accounts and Audit, *Report 410 Tax Administration (June 2008)* ('Report 410') <http://www.aph.gov.au/House/committee/jpaa/reports.htm> at 23 March 2009, Executive Summary xxviii.

<sup>51</sup> Asprey Report, above n 21, 3.43.

<sup>52</sup> Consultation Paper, above n 8, 27.

<sup>53</sup> Consultation Paper, above n 8, 245-246.

<sup>54</sup> D Fullerton, A Leicester, S Smith 2008, 'Environmental Taxes' in *Reforming the Tax System for the 21<sup>st</sup> Century : The Mirrlees Review*, *Institute for Fiscal Studies*, London, [www.ifs.org.uk/mirrleesreview](http://www.ifs.org.uk/mirrleesreview).



in this regard the two criteria have a complementary relationship. The Consultation Paper states:

Instability in tax-transfer settings...may also reduce economic efficiency by increasing the level of uncertainty about the expected payoffs to long-term investment decisions.<sup>55</sup>

## 2.8 Efficiency and Policy Consistency

Efficiency and Policy Consistency have a largely complementary relationship.

If a taxation measure has an internally consistent policy with other provisions in the same taxation act it will provide the basis for a more stable revenue act and will overall ensure the act is easier to apply and less likely to negatively impact economic activity. Conversely, where policies are inconsistent it may result in multiple provisions having to be drafted to counter-act the effect of one another and as Braithwaite has observed: 'A smorgasbord of rules engenders a cat and mouse legal drafting culture of loophole closing and reopening by creative compliance.'<sup>56</sup>

Furthermore, if a taxation measure has a policy that is externally consistent with other Australian Acts and broader government objectives– it will be simpler, easier to comply with and more effective to apply, as entities will only need to consider consistent policies, rather than a patchwork of different legislative policies. This will reduce the time spent by entities on complying with the tax laws giving them more time to focus on productive economic activities.

## 2.9 Efficiency and Rule of Law

The Rule of Law and efficiency have a mixed relationship.

A certain tax may be less likely to cause unintended distortions to economic activity. When a tax is uncertain it may distort economic activity because taxpayers (and their advisers) will be unable to predict the consequences of their business decisions and this may discourage the entry into genuine commercial activities.

However, a certain tax may nonetheless contravene efficiency. For example, a tax such as a wholesale sales tax may be drafted in a very precise and certain manner, but may cause unexpected distortions to economic activity by changing the relative prices of products.

Furthermore in order to be efficient and minimise distortions to economic activity, it is imperative that the bureaucracy complies with the laws that are passed. Transparency in the actions of the bureaucracy will promote a climate of legislative certainty and stability which arguably would be less likely to distort economic activity.

Similarly, the rule of law requires equality of treatment between individuals and entities in similar situations. Consistent treatment of individuals and entities would be less likely to distort economic activity.

## 2.10 Simplicity and Sustainability

Simplicity and sustainability have a mixed relationship.

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<sup>55</sup> Consultation Paper above n 8 27.

<sup>56</sup> John Braithwaite, 'Making Tax Law More Certain: A Theory' (The Australian National University Australian Taxation Office, 2002).

To ensure environmental sustainability a revenue act may need to embrace non-revenue raising goals which may compromise the simplicity of the act.

However, in order to obtain institutional sustainability and a positive community attitude towards the taxation system arguably it is fundamental that the system is not overly burdensome on taxpayers. Furthermore in order for a tax system to be fiscally sustainable the costs of raising revenue must be minimised (administrative simplicity) to ensure that the tax system is able to meet the revenue of Australian governments.

### 2.11 Simplicity and Policy Consistency

Simplicity and policy consistency would appear to have a largely complementary relationship. One of the sources of complexity, as acknowledged by the Report is where there is a large number of different taxes, with little harmonisation of Acts across jurisdictions. By trying to align the policies underlying different taxation measures this would make it easier for a taxpayer to apply the multiple taxation measures thereby enhance simplicity, making it easier for a taxpayer to understand the policy underlying all taxation measures. The Report on Aspects of Income Tax Self Assessment states:

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.<sup>57</sup>

Thus by having a smaller number of policies to comply with (or policies that are consistent) it will enhance simplicity.

### 2.12 Simplicity and the Rule of Law

The Rule of Law and simplicity have a mixed relationship.

A tax seeking to give effect to complex policy goals may not be simple to apply (for example it may be highly prescriptive and detailed) however, its application may be certain. In fact, a tax that is conveying a difficult concept may need to be drafted in a complex and lengthy manner, in order to attain certainty. This will likely increase compliance costs, thereby compromising simplicity. Alley and Bentley noted the following regarding the relationship between certainty and simplicity:

It is appropriate to consider certainty and simplicity together because so often there is a conflict between them, both in terms of legislative drafting and taxpayer compliance. The more certain are the rules, the less simple they usually are to understand. The simpler the rules the less simple they usually are to either comply with or administer.<sup>58</sup>

Equally, however, an uncertain tax would commonly require the taxpayer to consult with an expert to ascertain its likely operation, which would most likely again increase compliance costs and compromise simplicity. Thus certainty can operate to both increase and minimise compliance costs and therefore can have dual effects on simplicity. The Asprey Report recognised this when it discussed the two aspects of simplicity:

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<sup>57</sup> Report on the Review of Aspects of Income Tax Self Assessment, above n 29, 87.

<sup>58</sup> Alley and Bentley, above n 12, 59.

These two ideals are of course connected, and add up to much the same as the ancient canon of certainty. Both costs will be the less if assessor and assessed can each establish with certainty what is due: uncertainty entails costs of consultation with experts and sometimes the yet greater costs of litigation. Both kinds of cost are increased, and certainty is endangered, when a tax, whether in the interests of equity or efficiency, requires the drawing of fine distinctions between what is and what is not liable, and when these distinctions involve such uncertain ideas as 'purpose' or 'value to the recipient'. Then the legal definitions get longer and longer and beyond the comprehension of those untrained in the law, and the relevant facts in particular cases become more and more disputable.<sup>59</sup>

Furthermore, another complementary aspect of the relationship with simplicity involves the use of discretions. Broad discretions are the antithesis of the Rule of Law. The existence of these discretions in a tax would normally compel a taxpayer to seek expert advice on the likely operation of the tax, which would increase compliance costs and conflict with simplicity.

### **2.13 Sustainability and Policy Consistency**

Sustainability and policy consistency are complementary criteria. Environmental sustainability demands that tax reform measures are compatible with Australia's broader environmental policies and this creates consistency between Commonwealth statutes.

Further, for a taxation measure to be institutionally sustainable and command community support arguably it would need to have a consistent policy base with other statutes, this would make the measure less susceptible to amendment and hence, more stable.

One aspect of fiscal sustainability looks at whether the taxation measure will be stable over the longer term. Arguably, only a policy that is consistent with other broader government goals and across taxes will be a stable law and less susceptible to frequent amendment.

### **2.14 Sustainability and Rule of Law**

The Rule of Law and sustainability are complementary criteria. The Rule of Law requires that the law must be certain and stable. Whilst institutional sustainability requires that the law have the support of the community – in order to do this arguably the community would demand that their obligations be certain.

Fiscal sustainability, like the Rule of Law, also requires that the law is certain, predictable and stable.

### **2.15 Policy Consistency and Rule of Law**

The Rule of Law and policy consistency are complementary criteria. The Rule of Law requires that the law must be certain and stable. Policy consistency enhances stability in the law by ensuring a consistent policy underlying each of the various statutes. Where all statutes reflect a consistent policy base the law would appear they would be less likely to require frequent amendment and would therefore be more stable.

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<sup>59</sup> Asprey Report, above n 21, 3.20.

### 2.16 Summary –Relationship Matrix

The table below indicates the relationships between the various criteria and the number reference where they are discussed, in this chapter, above.

**TABLE 1: RELATIONSHIP MATRIX**

	Equity	Efficiency	Simplicity	Sustainability	Policy Consistency	Rule of Law
Equity		X (2.1)	X/√ (2.2)	X/√ (2.3)	√ (2.4)	X/√ (2.5)
Efficiency			X/√ (2.6)	X/√ (2.7)	√ (2.8)	X/√ (2.9)
Simplicity			(	X/√ (2.10)	√ (2.11)	X/√ (2.12)
Sustainability					√ (2.13)	√ (2.14)
Policy Consistency						√ (2.15)

Key	
√	Complementary Relationship
X	Conflicting Relationship
X/√	Both Conflicting and Complementary (Mixed Relationship)

The above matrix shows that inter-relationships exist between all of the criteria. In trying to satisfy one criterion, therefore, the effect on the other criteria must be considered. In cases where a conflicting or mixed relationship exists choices must be made between the criteria. Therefore, in order to have a meaningful evaluation framework the criteria must be ranked and prioritised.

### 3. AN INTEGRATED EVALUATION FRAMEWORK – A THREE-STAGED INQUIRY

Having identified and defined the criteria for evaluating a tax or tax reform measure in the previous part of this article, this part of the article addresses the next step which is the development of an integrated three staged evaluative framework. This article argues that the development of this new framework needs to be undertaken in three stages. These three stages follow the development of a tax from its conception at the policy level to its translation into legislation and finally to its practical administration of the taxation measure by the ATO. This may be depicted diagrammatically as follows:

**FIGURE 1: A THREE STAGED EVALUATION**



The first stage should review the tax at the policy level – this will involve evaluating the policy underlying the tax. The second stage involves reviewing the drafting of the tax. This will entail an examination of the actual legislation or mechanics of the tax. The third stage encompasses a review the administration of the tax. This trichotomy is

based on the delineation made of the three “core processes” outlined in the Review of Business Taxation Report.

The distinction between these three stages is not merely semantics and is in fact pivotal because as will be seen the criteria used at each stage of the evaluation are different.

Furthermore, the conclusion reached when critiquing a tax may differ with respect to each stage. For example, whilst the policy behind the tax may be desirable and appropriate, the ability of the English language to convey or give effect to such a measure, at the drafting stage, may be limited. Furthermore a taxation measure must rank well at each stage because a defect in drafting policy may impact administration.

For example in Report 410, it was recognised that complexity in the policy and drafting of a taxation measure had a direct impact on the quality and effectiveness of administration:

The main challenge in Australian tax administration is the complexity of the tax system. Under self assessment, this has imposed significant compliance costs on taxpayers and pushed large numbers of taxpayers into using tax agents. In effect, complexity has increased the tax burden. A simpler system will deliver savings to both taxpayers and government and allow entrepreneurs to focus on growing their business, rather than complying with arbitrary tax rules.<sup>60</sup>

Furthermore the Report on Aspects of Income Tax Self Assessment notes the impact that tax policy has upon drafting and administration

Tax policy can have a major impact on the structure of the tax law, its administration and compliance costs for taxpayers.<sup>61</sup>

In fact a significant factor in moving the task of drafting legislation from the ATO to the Department of Treasury was to ensure that those who formulated tax policy should be involved in its implementation into the drafting stage.<sup>62</sup>

Another defining factor in constructing the evaluation framework is to consider the impact the self assessment system in Australia has on the desirability and consequent priority attributed to the criteria discussed above. Many of Australia’s taxes are subject to self assessment. For example self assessment was introduced into Australia

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<sup>60</sup> Report 410, above n 50.

<sup>61</sup> Report on Aspects of Income Tax Self Assessment, above n 29.

<sup>62</sup> Notably, two recent 2008 reports by the Inspector General of Taxation identify a need for greater transparency in the interactions between the Tax Office and Treasury. These reports are: Review of the Tax Office’s administration of GST audits for large taxpayers (June 2008) [http://www.igt.gov.au/content/reports/GST\\_audits/default.asp](http://www.igt.gov.au/content/reports/GST_audits/default.asp) at 4 May 2008. (“GST Audit Report”) and Report on Improvements to tax administration arising from the Inspector-General’s case study reviews of the Tax Office’s management of major, complex issues (October 2008). Specifically Recommendation 2.20 to the GST Audit Report states that there is a need for clarification regarding the ATO’s and Treasury’s expectations of one another in relation to interpreting the legislation. Treasury states that the discussions regarding the ‘policy’ of enacted legislation are not relevant to interpreting the legislation. This further confirms the need for the policy intent of the legislation to be clearly enunciated through the terms of the legislation and supports the proposition that this legislation must be efficiently and consistently administered by the taxation office. This supports a three pronged approach to evaluating a taxation measure as advocated in this article.

from 1986/1987 in relation to income tax. Under this system the onus is upon the taxpayer to calculate their tax liability. The ATO will usually accept the tax return upon lodgement; however, they retain specific rights of amendment for errors of calculation and mistakes of fact or law.<sup>63</sup> The self assessment system is supported by a rigorous penalty regime imposed on taxpayers for errors and non-compliance. Indeed, this system places an onerous burden on taxpayers to digest and apply accurately the voluminous and complicated body of income tax legislation apparent in Australia. As Dirkis and Payne Mulcahy observed:

The introduction of self assessment fundamentally altered the balance of power and focus of responsibilities between taxpayers and the Australian Taxation Office. It has also impacted dramatically on the triangular relationship between the ATO, taxpayers and their tax advisers creating an often fractious relationship.<sup>64</sup>

### 3.2 Stage One – Evaluating the Policy of the tax

Underlying every piece of tax legislation is a “policy” objective that Parliament is seeking to achieve. An effective taxation policy should be equitable. The taxation policy should also be efficient, compliant with the Rule of Law, sustainable and consistent with other policies. The importance of these criteria to critiquing a tax policy is discussed below. Notably the Consultation Paper recognises the need to target and reform the process of developing tax policy. The Consultation Paper states that:

A common theme in submissions is the need for the tax policy process to be more open and transparent, particularly around the trade offs between efficiency, equity and simplicity.<sup>65</sup>

By establishing the criteria that are relevant in evaluating taxation policy and giving a ranking to the criteria as we have below, the need for openness and transparency in policy processes is being enhanced.

#### 3.2.1 Rule of Law

The Rule of Law requires that a taxation measure is certain for a taxpayer to apply. Therefore, it should be considered at the policy level, whether the tax’s policy is certain.<sup>66</sup> To ascertain whether the policy of a tax is sufficiently certain it should be clear:

- who the tax is intended to apply to (“the targets”); and
- why the tax is being (or has been) enacted (“the intention”)?

At this stage policymakers should also consider whether this policy certainty can translate to certain drafting. In this regard, when designing a tax policymakers should always be aiming for certainty and in the words of Sir John Donaldson in *Merkur Island Corporation v Laughton*:

<sup>63</sup>Ibid.

<sup>64</sup>M Dirkis, and M Payne Mulcahy, ‘Self assessment 14 years on: Time for a change’ (2002) 36(8) *Taxation in Australia* 412-416.

<sup>65</sup> Consultation Paper, above n 8, 30.

<sup>66</sup> Alley and Bentley, above n 12.

Ministers when formulating policy, should at all times be asking themselves and asking parliamentary counsel ‘Is this concept too refined to be expressed in basic English? If so, is there some way in which we can modify the policy so it can be expressed?’<sup>67</sup>

Uncertainty will inevitably flow through to the drafting stage and will make it extremely difficult, if not impossible, for the drafters to implement the tax in a certain way.<sup>68</sup> In this regard, the Review of Business Taxation states: ‘Nor is the issue of complexity solely one of legal language: no application of plain English may be able to render intelligible a poorly defined policy.’<sup>69</sup>

Certainty should be paramount in critiquing a tax at the policy (and also at the drafting and administration levels as discussed below). A major factor influencing the primacy that should be assigned to certainty arises because many Australian taxes rely on a self assessment system. The self assessment system is built on the presumption that a taxpayer or their adviser can calculate and ascertain their taxable liability. If a tax is uncertain then a taxpayer or their adviser will be unable to determine when the tax will apply and would not be able to self assess.<sup>70</sup>

However, the importance of certainty transcends self assessment. Certainty can potentially enhance the attainment of many of the other criteria such as efficiency, equity, sustainability and policy consistency, as discussed above.<sup>71</sup>

A further reason to require certainty in the policy of tax legislation is that there is some evidence to suggest that uncertainty in the taxation law can result in an increase in tax evasion because taxpayers lose respect for the taxation law and are therefore, more likely to evade it.<sup>72</sup> Orow suggests, in this regard, that uncertain law is “retroactive law”. He states: ‘Further uncertain law is retroactive law because the effect of the law is known only after the event. It also penalises those anxious to obey it and eventually creates contempt for the law.’<sup>73</sup>

<sup>67</sup> [1983] 2 AC 570.

<sup>68</sup> House of Representatives Standing Committee on Legal and Constitutional Affairs Clearer Commonwealth Law (September 1993).

<sup>69</sup> Review of Business Taxation, above n 10.

<sup>70</sup> Graeme Cooper, ‘Incentives and Strategic Choices Facing Taxpayers Under the Tax Self-Assessment System’ (1995) 12 *Australian Tax Forum* 99.

<sup>71</sup> Orow, above n 36, states:

It is submitted that the criterion of certainty in relation to the terms and operation of GAAR is the most significant because it underpins all the other standards including the institution of law and the legitimacy of the power of the state to exact taxation from its subjects. Uncertainty in taxation law can significantly undermine the equity and efficiency of the taxation systems and have serious consequences on the Rule of Law and the right of taxpayers to organise their financial affairs within the law.

...Further, policy consideration that militate against uncertainty include the proposition that uncertainty in the relevant sense is contrary to generally recognised and accepted principles of sound taxation such as equity, efficiency and the Rule of Law. The OECD Committee on Fiscal Affairs identified certainty as a “right” and said that taxpayers have a right to a high degree of certainty as to the taxation consequences of their actions.

<sup>72</sup> Neil Brooks, ‘Key Issues in Income Tax: Challenges of Tax Administration and Compliance’ (Paper presented at the Asian Development Bank 2001 Tax Conference, 8 September 2001).

<sup>73</sup> Orow, above n 36.

### 3.2.2 Equity

The importance of the policy underlying a tax being equitable cannot be overstated. Equity is pivotal because it encourages the perception of fairness by taxpayers, which supports voluntary compliance with the taxation law.<sup>74</sup> The Review of Business Taxation states: ‘Multifaceted though it is, no acceptable system of taxation can proceed without due weight being given to equity considerations — the history of democracy has many object lessons in that regard.’<sup>75</sup> Furthermore, in order to achieve the AFTS Review’s aim of enhancing international competitiveness any taxation policy should maintain inter-nation equity, by ensuring Australia is only claiming its share of profits from multinational entities.

### 3.2.3 Efficiency

In order to maximise the revenue raised by the government, a tax should not impede economic growth.<sup>76</sup> A tax which adversely effects economic growth by unintentionally distorting economic activity will diminish the revenue base as a whole. Therefore, in critiquing a tax or tax reform measure, one must determine: will the tax protect or raise revenue or will it have unintended economic effects that will impede economic growth and, therefore, diminish the revenue base?

Where a tax is not neutral the unintended economic distortions may compromise the benefit of the extra revenue raised.

### 3.2.4 Sustainability

The fiscal sustainability of the tax should be considered. If the tax is likely to cost more to administer than will be collected by implementing it, the tax may not be viable. An obvious difficulty in ascertaining the likely revenue benefits from administering a tax is that the amount of revenue that the tax protects from avoidance activities may not be included in the revenue collection forecast. Thus, in this respect, the tax may be acting as a barrier to tax avoidance and, protecting the integrity of the revenue base. This consideration must also be recognised in measuring the revenue benefits, although it would appear to be extremely difficult to quantify.

The environmental impact the tax measure may have should also be considered.

Furthermore, through extensive community consultation the communities attitude towards the taxation measure should be improved and institutional sustainability achieved, particularly if the results of the consultation are incorporated into the taxation measures operation. Recommendation 5 of Report 410 emphasises the need for Government to improve its community consultation on taxation measures. In particular, recommendation 5 suggests increasing consultation at the initial stages of policy development, before the policy intent of the legislation is announced.

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<sup>74</sup> Brooks, above n 71.

<sup>75</sup> Review of Business Taxation, above n 10, 6.1.

<sup>76</sup> The Review of Business Taxation (above n 10) in Chapter 6 states that optimizing economic growth means:

‘Imposition of the smallest possible impediment to economic growth, including jobs growth, thereby reducing the resource allocation and risk-taking distortions necessarily associated with revenue raising from business taxation.’



### 3.2.5 Policy Consistency

A critical criterion at this stage is to ascertain if the taxation measure is consistent with the policy underlying other taxation measures within the same Act and whether it is consistent with broader policy goals. This will enhance the stability of the taxation measure and make it easier to draft at the drafting stage as consistent terminology and structures can be utilised.

### 3.2.6 Summary of the Criteria Relevant for Evaluating Taxation Policy

It is important, at the policy stage, that a taxation measure adheres to the requirements of the Rule of Law and is equitable, efficient, has policy consistency and is sustainable. Whilst there may not necessarily be a trade off between these criteria for certain taxation measures, if trade offs do occur it is suggested that priority should be given to the design principles of adherence to the Rule of Law, equity, efficiency and sustainability. As a subsidiary goal it is desirable that the taxation policy should be policy consistent. Policy consistency is made a subsidiary goal as sometimes trying to utilise the tax system to pursue non-revenue raising goals and achieve external policy consistency, can jeopardise the efficiency and certainty of the Act and given the primacy of these goals (as discussed above) arguably this criteria should be given a subsidiary ranking.

**FIGURE 2: STAGE ONE - POLICY**



### 3.3 Stage Two – Evaluating Drafting

The second stage of the evaluation framework, critiques the legislative words or the “drafting” of a taxation measure. When critiquing drafting, the Rule of Law, equity and simplicity should be considered.<sup>77</sup>

#### 3.3.1 Rule of Law

There is mixed opinion on the importance of the Rule of Law in the context of the self assessment system. Professor Cooper observed:

...the Rule of Law might be a value that should be given absolute primacy in cases where the curtailment of personal freedoms or the expropriation of property without some attempts at lawful justification is threatened. But might be appropriate to modify or

<sup>77</sup> Note the composition of these can also differ. See for example the differing formulations of what constitutes a good tax by Adam Smith and Joseph Stiglitz.

circumscribe its application in a tax context, especially one characterised by, say, a high degree of artificiality and a motive which taints the taxpayers position.<sup>78</sup>

This article argues that the Rule of Law should be attributed high importance in assessing the drafting of a tax. Certainty of application should be contained in the words of the tax. Furthermore, as taxpayers operate in the self assessment system have a right for their obligations to be contained in the text of the Act that also assesses (and can penalise) them.

Thus, in critiquing a tax at the drafting level it is important to consider if the tax is certain. There is some debate surrounding how certainty can be achieved in the drafting of a tax. Some scholars argue that “broad-based principled” drafting can result in shorter taxes that are still capable of certain application. Broad based-principled taxes utilise drafting that seeks to convey the intended result of the legislation, rather than set out the mechanics to achieve it. Certain application, however, will only be obtained by the tax being supplemented with extraneous materials such as rulings, guidance papers and binding ATO advice which clarifies the application of the tax. The Review of Business Taxation, for example, states:

- 6.133 It is administratively desirable that taxpayers have certainty with regard to their income tax liability and how the law operates. As noted above, certainty can be achieved through other means apart from ever more complex legislation (which often can produce the opposite result). As is now done, the tax administration can provide mechanisms like rulings to clarify the operation of the law in particular cases. Reliability also requires consistency in decision making and is assisted by a more cohesive administration that has increased coordination across its functions and over time.
- 6.134 There are, however, some tensions in trying to achieve certainty or reliability in tax administration. Certainty and reliability are enhanced by a stable system that is not subject to constant change, leading to a recurring need to re-educate taxpayers. Yet it is also important that an administration be flexible and responsive where necessary. Additionally, while it is desirable that taxpayers receive consistent treatment, decision makers must still have sufficient discretion to be able to respond to taxpayers’ individual circumstances within the general policy principles of the tax system.<sup>79</sup>

The converse of this argument is that certainty can only be achieved by the drafting of sometimes lengthy and highly prescriptive taxes, particularly where the policy, that the tax seeks to convey, is itself, complicated. This argument will not be addressed in this article. However it is acknowledged that achieving certainty is an extremely important goal at the drafting level. Taxpayers should have the law available to them to undertake an assessment of their tax affairs and this can only occur where the legislation is certain. Previously, the judiciary was one of the strongest proponents of the need for taxation legislation to be certain and overtly clear in its operation. For example in *Westraders v FCT*<sup>80</sup> Chief Justice Barwick stated: “It is for the Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax.”

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<sup>78</sup> Cooper, above n 33.

<sup>79</sup> Review of Business Taxation, above n 10, 6.133 - 6.134.

<sup>80</sup> (1980) 144 CLR 55.

In more recent times, however, the judiciary has been more amenable to give effect to legislation by interpreting it in a purposive manner.<sup>81</sup> This approach has been formalised by the enactment of section 15AA of the *Acts Interpretation Act (1901)* (Cth).<sup>82</sup> Section 15AB of the *Acts Interpretation Act (1901)* (Cth) also advocates the use of extrinsic material to assist in the interpretation of a provision of an Act.<sup>83</sup>

Despite this change in statutory interpretation and the recognition, by the *Acts Interpretation Act (1901)* (Cth), that regard can be had to extraneous materials; it is argued that this does not diminish the importance of aiming for certainty in drafting of the tax to begin with. Therefore, in this regard and for the reasons discussed under stage one, adherence to the principle of the Rule of Law that legislation be certain is held to be paramount in evaluating drafting of a tax. This involves ascertaining whether the taxpayer can determine when and to what extent the legislation applies to any transaction they enter into.

### 3.3.2 Equity

Just as it is important that the overall policy of the tax is equitable, it is equally important that the drafting of the tax maintains this equity. In this regard it must be ensured that the drafting of the taxation measure captures all the attributes of a taxpayer that are necessary to ensure a fair basis of comparison and that equity is achieved by the practical operation of the Act. Equity aids voluntary compliance and encourages the perception of fairness by taxpayers. This is pivotal for any system of taxation but particularly a taxation system that relies upon self assessment.

### 3.3.3 Simplicity

At an Australasian Tax Teachers Conference when asked about complexity in the tax laws, Michael D'Ascenzo the Commissioner of Taxation stated: '...in a sense, who cares?'<sup>84</sup> He then went on to explain that 73 percent of people engage tax agents and the tax profession and ninety-five percent of companies utilise the tax profession. He stated that if you live a complex society it must be expected that the laws may also be complex. The Consultation Paper for the AFTS review recognises that the tax/transfer system is extremely complex and acknowledges that to some degree this reflects a system that has equity and efficiency objectives. However, it states that complexity adds cost and risk to business and personal activities and that complexity has an impact on choices to work, save and consume.

<sup>81</sup> *Cooper Brooks (Woolongong) Pty Ltd v FCT* (1980) 147 CLR 297.

<sup>82</sup> Section 15AA(1) states:

In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

<sup>83</sup> Section 15AB states:

(a) confirm that the meaning of the provision is the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act; or  
(b) determine the meaning of the provision when:  
(i) the provision is ambiguous or obscure; or  
(ii) the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act leads to a result that is manifestly absurd or is unreasonable.

<sup>84</sup> Michael D'Ascenzo, Commissioner of Taxation, 'It is the community's tax system' (Speech delivered at the 18<sup>th</sup> Annual Conference, Australasian Tax Teachers Association, Melbourne, 2006).

In short, simplicity is not always desirable or possible. In some cases simplicity may only be possible where the policy underlying the tax is not complex. Realistically, in many respects, much of the Australian tax legislation is seeking to serve and convey desirable complex policy goals and, therefore cannot be conveyed simply.

Binh Tran-Nam argues that the goal of simplicity should not be overstated, as a complicated tax law can be a necessary consequence of a developed economy:

In a more mature economy where market structures, business organizations and commercial transactions have grown continuously and rapidly in complexity, tax laws have to evolve accordingly. The tax system of an economy is analogous to the dress of a person. As a person grows taller, a well-fitted dress should become accordingly longer and wider. A complex economy must have more complicated tax laws.

In sum, it must be recognised that the tax system cannot remain simple in the absolute or static sense while the economy continues to evolve. Tax simplification at the expense of other objectives of the tax system may not be a desirable thing. Instead of scoring political points, the government should be open and frank about the inherent difficulties in trying to simplify the tax system. It is not productive for the government to exaggerate the true simplification prospects of its tax reforms in order to pursue other hidden agenda.<sup>85</sup>

Furthermore, as the decision matrix above illustrates, simplicity may arguably compromise more important goals like equity and adherence to the Rule of Law.

Another reason for not overstating the importance of trying to achieve simplicity is that it may be “inefficient” to pursue the goal of simplification. Professor Cooper states that it may be “highly inefficient” to pursue the goal that ordinary citizens should understand all of the laws with which they are to comply:

...It is also likely that the level of understanding of the audience – the ordinary citizen - depends upon educational levels and achievements, so that at some point investing greater resources in better drafting may show lower returns than investing greater resources in educating readers.<sup>86</sup>

An extension of this is that most taxpayers “interact selectively”<sup>87</sup> with the tax system. Most individual taxpayers would not, for example, have to apply the consolidation regime in the ITAA 1997. Accordingly, the degree of simplicity that is appropriate for tax that apply to corporations or business would differ to that appropriate for a tax more frequently applied by individual taxpayers.

Therefore, applying the criteria of simplicity to a tax that is seeking to convey a complex policy goal is, in many respects, redundant. A greater degree of simplicity is optimal and should be aimed for where possible; however, it should not be aimed for at the expense of more important goals such as equity and certainty. Furthermore, the degree of simplicity differs depending on the taxpayers targeted by the tax. Where businesses or corporations are the targets of a particular tax a higher degree of complexity may be acceptable.

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<sup>85</sup> Binh Tran-Nam, above n 27.

<sup>86</sup> Professor Graeme Cooper, ‘Themes and Issues in Tax Simplification’ (1993) 10 *Australian Tax Forum* 417.

<sup>87</sup> Review of Business Taxation, above n 10.

For these reasons, simplicity is seen as a desirable principle and not one that should be aimed for at the expense of other essential design principles.

### 3.3.4 Summary of the Criteria Relevant for evaluating Drafting at Stage Two

The most important criteria in stage two is that a tax be implemented with certainty (thereby satisfying the Rule of Law) and maintains equity. Whilst an ideal tax would also satisfy the criterion of simplicity to the extent that this means the taxation measure conflicts with the attainment of certainty or equity arguably this should be attributed lower (desirable) importance when critiquing a tax under stage two.

**FIGURE 3: STAGE TWO - DRAFTING**



### 3.4 Step Three – Evaluating the Administration of the Tax

Stage three involves evaluating the administration of the tax. The three criteria that are relevant under the administration stage are adherence to the Rule of Law, administrative equity, efficiency and simplicity.

#### 3.4.1 Adherence to the Rule of Law

The main consideration here is whether the tax is being administered in a way that provides the taxpayer with certainty. Pivotal to achieving certainty in tax administration is transparency. For a taxpayer to understand how the system of taxation administration works – the information and process must be made transparent and open, furthermore the bureaucracy must comply with the law that has been passed. In considering this it is relevant to consider the following questions:

- Is it clear from the terms of the tax how it is to be administered?
- Do the rulings (private, public etc) on the tax provide consistent decisions on the application of the tax?
- Has the administrator made its view clear (via tax rulings, booklets and other guidelines ) as to when it considers the tax will apply? Does its view accord with the stated intention of how the taxation measure is to apply (obtained from the Explanatory Memorandum);
- Has the tax been administered in a timely manner or have there been significant delays in the administrator’s view being clarified?
- Has the tax been widely litigated? Does the case law provide consistent decisions on the application of the tax in question? In such decisions has the Court had to

refer to extrinsic materials to determine in what circumstances the tax is designed to apply?

- Does the tax contain a discretion? If it does contain a discretion has the administrator indicated when it would exercise this discretion? Is it clear what considerations will be relevant and irrelevant in the exercise of the discretion?
- Are the avenues of review open to the taxpayer transparent and easily accessible? Does the tax allow for independent review of its application?
- Has the Commissioner followed any Court decisions regarding the particular provision? Recommendation 11 in *Report 410: Tax Administration* suggests that if the ATO has concerns about a decision of the Court it should publicly announce these concerns in the decision impact statement and commit to resolving the issue within 12 months.

### 3.4.2 Administrative Equity

In looking at whether the tax has been administered equitably the overall question is has horizontal equity been maintained in the administration of the tax?

In this regard some anecdotal evidence regarding administration of the tax may be relevant. It will again be relevant to consider whether like cases have been treated alike, have economically equivalent transactions been afforded the same taxation treatment. Again it is relevant to determine whether the tax contains broad discretions, which have the potential to be exercised inequitably? If the tax does contain broad discretions are there sufficient safeguards to ensure that the tax will be administered equitably and fairly? Such safeguards may include the existence of opportunities for independent review, guidelines as to how the tax will be administered or the opportunity to obtain a private ruling in a timely manner.

### 3.4.3 Simplicity

At this stage it is relevant to consider whether the administrator has or is likely to incur significant administrative costs in enforcing and collecting the tax. Is it likely that the costs of administration will diminish overtime?

Where the tax has been enacted again it is relevant to consider the following questions:

- Has the tax been extensively litigated? Do the Courts decisions reveal a consistent basis for applying the tax?
- Has the administrator needed to incur significant costs providing responses to requests for private rulings?
- Has the ATO issued significant rulings, taxpayer alerts, booklets or advice on the tax?
- Has there been a review of the administration tax by an independent Board of Review such as the Ombudsman, Inspector General or Board of Taxation?

These questions address the amount of administrative resources that have been dedicated to clarifying or enforcing the particular legislative provision. For example where there has been the need to litigate a number of times in relation to a particular

legislative provision, it is arguable that the provision is uncertain or has been administered in a way that has not enhanced transparency or taxpayer certainty. Furthermore, where there have been a large number of private ruling requests or the need to issue a number of public rulings in relation to a particular provision this would appear to indicate that a particular provision is ambiguous or unclear and is resulting in administrative complexity.

It is also imperative that the tax has been administered in a manner to minimise compliance costs and so that economic activity is impacted as little as possible. This will involve a consideration of many of the factors listed under 3.4.1 in deciding whether the ATO acted in a transparent and timely manner or whether there has been a considerable delay in providing advice to taxpayers. One particularly important aspect of efficient administration is the timeliness in which the ATO provides private rulings. Report 410 comments on the pivotal role that rulings play in the self-assessment system. Therefore an assessment on how quickly private rulings that concern the operation of a particular taxation measure have been issued will be relevant in determining administrative efficiency.

#### 3.4.4 Criteria Relevant for critiquing the administration of a taxation measure at Stage Three

Under stage three, it is very important that a tax is able to be administered equitably, in compliance with the Rule of Law. The goal of administrative simplicity is of secondary importance. This is because, arguably, administrative costs are already minimised significantly under a self assessment system and, therefore, it is more important in such a system to pursue the goals of certainty and equity. However, where the tax is certain it is likely to also be capable of being administered cost effectively and therefore, where certainty is pursued it is likely that administrative costs will be minimised.

**FIGURE 4: STAGE 3 - ADMINISTRATION**



#### 4. CONCLUSIONS

In order for the AFTS Review to be effective, this article has argued a comprehensive and more appropriate evaluative framework for the review of Australia's existing taxes than currently exists must be constructed. The Review Panel needs to be transparent in defining the criteria it will use in its evaluation for the AFTS Review, detail the priorities given to each of these objectives and the structure of the framework that it plans to use. This article advocates a three staged evaluation framework and suggests an essential/desirable ranking that should be attributed to these criteria.

The first stage evaluates the policy underlying the tax. At this stage, five criteria are relevant. The policy of the tax should comply with the Rule of Law, be equitable, efficient, and sustainable and it is also desirable that it is policy consistent.

The second stage evaluates the drafting of the tax. Three criteria are used to evaluate drafting and should be given the following ranking. It is crucial that the tax does not detract from the Rule of Law and is equitable. Optimally the tax will also be simple. However, in some circumstances simplicity will conflict with equity and the Rule of Law and to the extent of any conflict this criteria should be treated as a merely desirable, subsidiary criterion.

The final stage critiques the ability of the tax to be administered effectively. Four criteria are relevant at this stage and should be assigned the following ranking. At this stage (as at the policy level) it is most important that the tax can be administered in a certain, efficient and equitable manner. It is also desirable that the administrative costs of the tax are minimal or in other words the tax satisfies the criteria of simplicity. However, this should be a subsidiary goal to the extent that it conflicts with certainty and equity. This is particularly the case because many of Australia's taxes are administered on a self assessment basis and these costs are already minimised. Importantly where a tax does not rank well in relation to the administration stage it should be considered whether this highlights a flaw in the drafting of the tax that enables the defective administration.

The integrated evaluation framework advanced in this article highlights the utility for the Review Panel of using a multi-staged evaluation framework to conduct the AFTS Review because it:

1. Recognises that a tax or tax reform measure has three elements (policy, drafting and administration) that need to be critiqued. To be "effective" the tax should function well at **all** three levels. It is not enough that the policy behind the tax is effective, that policy must also be capable of transformation into effectively drafted law and have the ability to be administered in a certain, equitable and simple or administratively efficient manner.
2. Illustrates that any defects in the tax will flow through from policy to drafting to administration. In order to be effective the tax must rank well at the policy stage. Where the policy is uncertain, for example, this will necessarily flow through to the drafting and the administration of the tax.
3. Acknowledges that each level has a different set of criteria, which are relevant.
4. Assists in identifying at what "level" problems with a tax should be dealt with. For example, identifying whether a problem with a tax is a result of the drafting or administration, or whether it arises from a more entrenched "foundational" flaw in the policy underlying the tax.
5. Acknowledges that no tax can be perfect and that trade offs between the criteria are inevitable. Where one design principle is given precedence this ranking should be explicit. Therefore, the most desirable criteria (as discussed in the article) should be given precedence, in evaluating the tax.
6. Recognises that "Rule of Law" is an important criteria and should be included in any evaluation framework adopted by the AFTS Review.

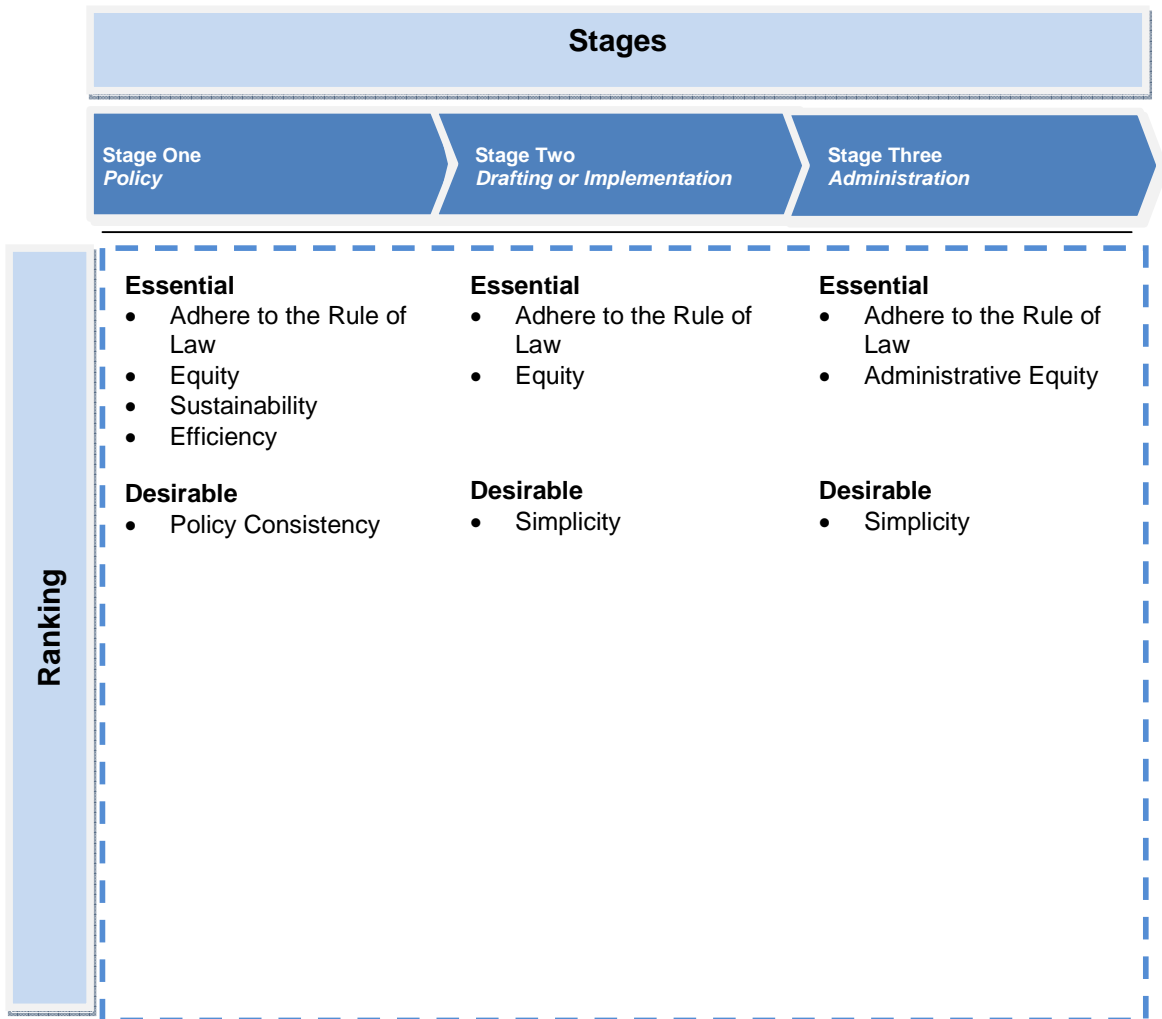


7. Recognises that there are several different views as to the meaning of each criterion and therefore, that the meaning attributed to each criterion must be explicitly set out in the AFTS Review evaluation framework.

It is accepted that further work could usefully be undertaken on the suggested integrated evaluation framework put forward in this article. For example, significant work needs to be conducted into how to measure each of the criteria and on mapping the relationships between the criteria. However, it is suggested that by adopting the methodology outlined in this article, the framework advocated in this Article could help the effectiveness of the AFTS Review because it:

- (a) Explicitly explores the interactions and relationships between each of the traditional criteria for evaluating a tax or tax reform measure and recognises that conflicts or trade offs exist between many of them;
- (b) Recognises the importance of evaluating a new tax or tax reform measure in three stages at a policy level, at an drafting level and at an administration level; and finally
- (c) Analyses the value and ranking that should be attributed to these criteria at each level identified in point (b) and advocates the use of a transparent framework in undertaking an evaluation of a taxation measure.

**APPENDIX 1: STRUCTURE OF THE PROPOSED THREE STAGE EVALUATION FRAMEWORK**



**APPENDIX 2: REPORT CARD FORMAT FOR THE INTEGRATED EVALUATION FRAMEWORK**

<b>Stage One – Policy</b>	
Criteria	Relevant Considerations
Rule of Law	Is it clear who the tax is intended to target?  Is it clear what mischief the tax is designed to curb?
Equity	Does the policy of the legislation apply to all entities consistently?
Sustainability	Is the policy of the legislation environmentally, fiscally and institutionally sustainable?
Efficiency	Does the policy of the legislation impede economic growth or hinder legitimate economic activity?
Policy Consistency	Does the policy of the legislation complement other policies within the relevant tax legislation?
<b>Stage Two – Drafting</b>	
Rule of Law	Can the taxpayer or their adviser able ascertain whether the legislation applies to them? Is it clear to the taxpayer what transactions may trigger the operation of the legislation?  Can the taxpayer ascertain the application of the legislation from the legislation itself (eg without recourse to the Explanatory Memorandum or ATO Rulings/Booklets/Guidance etc)?
Equity	Does the legislation promote horizontal, vertical or inter-nation equity?
Simplicity	Can the taxpayer understand the legislation easily or do they have to incur significance compliance costs to understand the legislation?
<b>Stage Three – Administration</b>	
Rule of Law	Is the tax administered in a way that promotes and maintains certainty regarding the tax? Is the tax administrated in a way that preserves transparency?
Equity	Is the tax administered in a way that preserves equity?
Simplicity Administrative Efficiency	Has the administrator incurred significant costs in administering the tax? Has the tax been administered in a timely, open and transparent manner?