

REGULATION IMPACT STATEMENT – REMEDIAL POWER FOR THE COMMISSIONER OF TAXATION

Background

Australia's taxation (and superannuation) law is very complex. The nature and volume of taxation law and its evolution over time has, and continues to, produce unforeseen or unintended outcomes in its application. These outcomes can result in entities generating tax liabilities where this was not intended, or entities being subject to record keeping or other compliance requirements that were not intended. The impact of unforeseen or unintended outcomes can range from minor to large. Unintended outcomes that cannot be addressed administratively are resolved through primary law change, which can be a lengthy and resource intensive process.

While amendments to the primary law are appropriate for large unintended outcomes, there is a need for a timelier option to address smaller unintended outcomes that cannot be resolved administratively. This option would allow the taxation law to be remedied to apply as intended in more situations, enhancing certainty and reducing compliance costs for entities. It would also enhance the capacity of existing legislative mechanisms to consider more significant taxation law changes. This too would deliver greater certainty for entities, as contemplated taxation law changes could be considered and delivered more quickly.

This regulatory impact statement analyses options to reduce the regulatory impact and uncertainty imposed on entities, which are caused by unintended outcomes arising in the application of the taxation law.

The options considered to alleviate the uncertainty and compliance costs for entities which arise from unintended and unforeseen outcomes in the law are:

- providing the Commissioner of Taxation (the Commissioner) with greater flexibility in addressing such issues (preferred option);
- providing greater resources to manage such issues through existing mechanisms; or
- continuing with the current approach.

Public consideration of a Remedial Power

Tax professional bodies have raised whether a Remedial Power for the Commissioner could assist the Commissioner to ensure the taxation laws can be administered to give effect to the purpose or object of the law.

The idea of granting the Commissioner a discretionary power to deal with unintended outcomes in the application of the taxation law is not new. This suggestion was previously considered by both the Tax Design Review Panel (TDRP) and the Inspector-General of Taxation.

In May 2009, the Treasury released a discussion paper on an Extra-statutory concession power for the Commissioner of Taxation. The proposal received mixed external support and the previous government did not move to implement the proposal. The key concern raised by stakeholders related to potential Constitutional separation of power issues.

A working group was established in 2014 to consider the feasibility of a Remedial Power, including what such a power could achieve and how it may operate in practice. Although the working group did not formulate any recommendations, there was broad in-principle support for the proposal.

1. The problem

The existing approach towards resolving unforeseen and unintended outcomes in the taxation law is lengthy and resource intensive. This creates uncertainty and compliance costs for entities applying the law, additional costs for the Commissioner to administer the law and additional pressure on resource constrained legislative processes.

Unintended outcomes create uncertainty by delivering tax outcomes that do not make sense in their context. The Commissioner can resolve some unintended outcomes by taking a purposive approach to the interpretation of a provision or using the general powers of administration. However, the Commissioner cannot resolve unintended tax outcomes by giving effect to the purpose or intention of a provision, where such an approach would extend beyond the words of the provision. This leaves the lengthy process of law change as the remaining avenue to resolve these unintended outcomes.

The inability to address unintended outcomes in a timely manner creates compliance costs for entities, who inevitably request clarification around the application of the taxation law in these anomalous situations. This increases administration costs for the ATO, in the form of advice and clarification of the Commissioner's administrative approach provided to entities.

The inability to address unintended outcomes in a timely manner also places the onus on entities to either comply with the provision and the unintended outcome it gives effect to, thereby incurring additional tax costs or additional compliance requirements; or, comply with the provision as intended but bear the risk of being penalised.

The undesirability of these alternatives leads to calls for unintended outcomes to be addressed through change to the primary law.

For large unintended outcomes this process is appropriate. However, the process is less suitable for smaller unintended outcomes. Sometimes these may be bundled together and addressed through Bills making minor technical changes to the taxation laws. However, to be included in these Bills minor changes must compete for the same resources that cater for more significant primary law changes. This often results in minor changes being deferred or delayed, as they struggle to be prioritised ahead of more significant matters for resolution through law change. As the Financial Services Council note in their consultation submission, 'A deficiency of our current tax system is that considerable effort is put into reforms but the same level of focus is not given to legislative updates for small amendments and technical changes. Over time this increases the complexity and decreases the effectiveness of the taxation law.' At any point in time there would be a range of smaller unintended outcomes in the taxation law that could be resolved through law change, but which must wait to be prioritised before they can be addressed.

In any case, even when the decision is made to address a minor change through primary law change, this is a lengthy and resource intensive process. There are limited departmental and parliamentary resources that can be directed towards effecting law changes. These resources are spread across the full range of government legislative priorities. The legislative process is subject to necessary checks and balances that take time. It also takes time to ensure stakeholders are properly consulted on the impact of contemplated law changes. The process of effecting law change can take up to and sometimes more than two years between the identification and resolution of a problem. Minor unintended outcomes can sometimes wait several years until they are prepared to be properly considered by the public and the Parliament. Indicatively, at the time the Government was elected, there were 96 tax changes of ranging significance that had been announced by various governments but had not yet been legislated, with some of them stretching back several years.¹

¹ For example, changes to the simplified imputation system were announced on 22 March 2001, to take effect from 1 July 2002. Another example is changes to the foreign currency provisions which were announced on 5 August 2004 to take effect from 1 July 2003. Although some of these changes have been enacted, many remain outstanding.

The time between announced changes and legislation has led to an administrative approach the Commissioner applies for some yet to be legislated taxation law changes.² Although this approach enables entities to comply with the announcement in anticipation of new law, as an administrative undertaking it can only give limited protection for entities. Where the law change is not enacted for several years, this creates a high degree of uncertainty for the entity around their compliance with tax obligations. While the entity may have complied with the Commissioner's administrative approach, they have not complied with the legislation as it exists up until it is changed.

The time it takes to address unintended outcomes through law change creates pressure for the subsequent change to apply retrospectively, especially where entities have been able to apply the anticipated change since announcement. Retrospective law changes create complexity for entities in understanding their obligations and for the ATO in administering anticipated retrospective law changes.

There is the need for a timelier option to supplement law change in addressing more minor unintended tax outcomes. This would help to clarify obligations for entities more quickly, providing certainty and confining the need for complicated anticipatory administrative approaches.

Illustrative examples of the problem

Example 1 below illustrates a situation where an unintended outcome led to a policy announcement that resulted in an announced but unenacted measure of the previous government. Purposive interpretation and the Commissioner's general powers of administration were not sufficient to remedy the unintended outcome.

Example 1: Capital gains tax – relief for taxpayers affected by natural disasters

The taxation law may give rise to unintended capital gains tax (CGT) outcomes for victims of natural disasters receiving necessary assistance or compensation.

For example, when the Lockyer Valley Regional Council gave the flood devastated resident landholders of Grantham the option to move to higher ground as part of a voluntary land swap initiative, the law did not produce appropriate outcomes for resident landholders who chose to participate in the program. One of the issues was that they were not able to satisfy the requirements of the CGT rollover relief to allow them to disregard the immediate CGT consequences.

This situation created uncertainty and cost for entities in determining how the law applied to them. Applying the law also brought the cost of locating or reconstructing records under difficult circumstances.

Allowing relief in these circumstances would not be inconsistent with the purpose or the object of the CGT relief provisions for entities who have assets destroyed as a result of circumstances beyond their direct control. The purpose or the object of such relief is to allow entities to choose to defer any adverse CGT consequences on destroyed assets which are replaced. Therefore, if in the future the Commissioner had the proposed Remedial Power unintended CGT consequences for victims of natural disasters such as this may be resolved in a more timely manner.

This example is similar to an announcement made by the previous government that the law would be changed to give CGT relief to entities in such circumstances. Although the announcement was made in October 2011 the matter remained unlegislated until December 2013, when it was subsequently announced that this measure would not proceed.

Example 2 below demonstrates a situation where the taxation law gives an unintended outcome. This led to a policy announcement that resulted in an announced but unenacted measure of the previous government.

² There are occasions where, in the interests of efficient administration, the Commissioner may accept entities anticipating a proposed retrospective change to the law. Where the ATO advises entities of particular circumstances where this is appropriate, entities may be protected from any shortfall penalties and GIC or SIC. The general powers cannot go so far as to provide protection from shortfalls in primary tax (see Law Administration Practice Statement PS LA 2007/11).

Example 2 Improvements to company loss recoupment rules

Companies are able to deduct losses from earlier years if they have continuity of ownership or carry on the same business. Establishing continuity of ownership is very difficult for widely held companies with large numbers of small shareholdings. Recognising this difficulty, the taxation law provides an alternative simpler test to allow a widely-held company to aggregate all small shareholdings and treat them as if owned by a single notional person. This simpler test does not work if there is a restructure to interpose a new holding company because, due to the operation of other rules, that single notional person holding is now *treated* as being owned by the new holding company. This constitutes a change in ownership which means that the company may not be able to claim losses from earlier years even though there is no actual change in its underlying ownership.

In addition, there are instances where the taxation law may be operating as intended but imposes compliance costs that are disproportionate to achieving the purpose or object of the law. For example, after a provision is enacted, it is found that, because of developments in the practices of businesses or the Commissioner, the provision imposes compliance costs which are disproportionate to achieving the purpose or object of the relevant law.

Changes to the current approach would enable issues like these to be addressed in a more timely manner, provided any budget impact was negligible. This would alleviate entities from bearing the costs associated with unintended outcomes in the taxation laws.

2. Case for government action / Objective of reform

Taxation laws are public goods that only the government can provide. Similarly, only government action can resolve uncertainty arising where the taxation law does not achieve its purpose or object.

Absent government action to address unintended or unforeseen outcomes, entities themselves must bear the risk of being found not to have complied with their obligations, or they must bear the costs of additional tax or additional compliance costs. Entities must also bear the compliance costs of understanding how the law applies, the ATO's administrative approach and the impact of any contemplated law change.

At the moment government resolves unintended outcomes through law changes. As noted this can be a lengthy process, resulting in uncertainty and extra compliance costs for entities, difficulties in administering the law and additional pressure on legislative resources.

Government action is needed to provide for the more timely resolution of unintended outcomes, particularly smaller unintended outcomes which struggle to be prioritised for resolution under the existing approach of primary law change.

3. Policy options

The proposed options to provide for the timelier resolution of unintended or unforeseen outcomes in the taxation laws are:

- providing the Commissioner with a Remedial Power to make a disallowable legislative instrument to modify the operation of a taxation law to allow the law to be administered consistently with its intended purpose or object;
- providing greater resources to enable government to enact minor law changes to manage unintended consequences arising from the application of the current legislation; or
- continuing with the current approach.

Option 1: Providing the Commissioner with a Remedial Power

A Remedial Power would allow the Commissioner to make a disallowable legislative instrument to modify the operation of a taxation law in circumstances where:

- the application of the law produces outcomes which are inconsistent with the intended purpose or the object of the law (this may include circumstances where it is reasonably clear that particular arrangements or transactions were not contemplated at the time of the policy development or the drafting of the law); or
- the application of the law results in compliance costs for entities that are disproportionate to achieving the intended purpose or the object of the law, and those costs can be relieved in a way that is not inconsistent with that purpose or object.

The power would only be available where:

- the modification would not be inconsistent with the intended purpose or object of the provision;
- the Commissioner considered the modification to be reasonable, having regard to the intended purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the intended purpose or object; and
- the Commissioner has received advice from the Secretary of the Treasury or Secretary of the Department of Finance (or an authorised APS employee of either department) that any impact on the Commonwealth budget would be negligible.

These key thresholds limit the scope within which the Commissioner would be able to validly exercise the Remedial Power. Should an entity form the view that the Commissioner's exercise of the Remedial Power extends beyond the limitations of the power, they may be able to seek review by the courts.

The modification must not be inconsistent with the purpose or object of the provision

The exercise of the Remedial Power would only be valid where the modification in question is not inconsistent with the intended purpose or object of the provision which is sought to be modified. This limitation reflects the intention that the power would enable the Commissioner to administer taxation provisions in accordance with their intended purpose or object. The power would not allow the Commissioner to alter or extend the intended purpose or object of the law.

The Commissioner would identify the intended object or purpose of the law as part of deciding whether the Remedial Power is available. The intended purpose or object would be identified objectively. In ascertaining the intended purpose or object of a provision consideration would need to be given to the material referred to in subsection 15AB(2) of the *Acts Interpretation Act 1901* (AIA). It may also be relevant for the Commissioner to consider the full legislative history associated with a particular provision. Notably, there would be no requirement for the text of the relevant provisions of the taxation law to be considered in ascertaining the intended purpose or object. While these provisions could still be considered, they would not be given primacy, or a greater weight, in ascertaining the intended purpose or object of a provision.

The intended purpose or object ascertained for the exercise of the Remedial Power may differ from the purpose or object ascertained through statutory interpretation principles. This is because the Remedial Power would be a power of last resort for the Commissioner, and where the Commissioner sought to use it, he or she would have already established that purposive interpretation could not adequately resolve the issue.

These requirements would allow a court to scrutinize whether or not the Commissioner acted within the scope of the power and ultimately whether the use of the power was valid.

The modification must be reasonable

The Commissioner would need to be satisfied before exercising the Remedial Power that the modification would be reasonable having regard to the intended purpose and object of the relevant provision. The Commissioner would also need to consider whether the cost of complying with the provision is disproportionate to achieving that object or purpose.

Although its exercise would be subject to limitations, the Remedial Power would still be a discretionary power. The Commissioner could therefore choose to take other matters into account when determining whether it is appropriate to exercise the power. There are a range of matters the Commissioner could take into account, and weigh up against each other, before deciding whether it would be reasonable to exercise the power. These include the extent to which the modification would be favourable to an entity, any impacts on any current judicial interpretations of the provision, or whether the exercise could lead to asymmetrical outcomes.

Any impact on the Commonwealth budget must be negligible

The Remedial Power would only be intended to operate in situations where any impact on the Commonwealth budget would be negligible. This would ensure the Remedial Power would be used to resolve smaller issues that would be less likely to warrant resolution by way of primary law change. Prior to making a legislative instrument under the Remedial Power, the Commissioner would need to receive advice from the Department of The Treasury or the Department of Finance that any impact on the Commonwealth budget would be negligible. Impacts on the Commonwealth budget will be determined in accordance with ordinary processes and budget rules.

Other key features of the power include:

Only to apply where favourable

A legislative instrument made in exercise of the power must be treated by an entity (the first entity) as not applying to the first entity or any other entity where it would produce an unfavourable result for the first entity. This ensures that the modified law will only apply where it is favourable to entities. It would not apply to any group or particular entities if they would be adversely affected.

Having an application rule as opposed a ‘favourable only’ limitation for the Remedial Power would prevent a modification from being found invalid because the modification would be less favourable to one entity in a class. Were this to occur, the application rule would mean the modification would not apply to that particular entity, but the legislative instrument making the modification would be valid and would be capable of applying to the other entities.

Parliamentary scrutiny

Any exercise of the power would be by disallowable legislative instrument, giving Parliament the opportunity to scrutinise and, if necessary, disallow the instrument. To give Parliament even greater scrutiny, legislative instruments made under this power would not commence until after the full disallowance period has finished. This would ensure any modification could not apply until Parliament had a full opportunity to scrutinise the instrument. To manage concerns as to any impact from a delayed commencement date, it would still be possible for the legislative instrument to specify that it applies before the commencement date. For example, even though an instrument would commence at the end of the disallowance period it could be specified to have application from a previous date.

Constitutional validity

The Remedial Power would be a delegation of Parliament’s legislative power. The delegation of this power is not a broad delegation of power allowing the Commissioner to legislate at large. To help ensure the validity of the use of the power, the power would be framed by clear legislative limitations. The parliamentary oversight and scrutiny noted above helps to ensure this delegation would operate consistently with Constitutional requirements.

The Remedial Power would apply broadly to entities and circumstances, helping to ensure that the power properly relates to taxation and prevent it from being exercised in an arbitrary way. This ensures that the power’s use would be consistent with the requirements of the Constitution.

An instrument made under the Remedial Power would not apply where it would interfere with an order made by a court before the commencement of the instrument. This helps to ensure that the exercise of the Remedial Power would not interfere with a decision of a court in a particular matter. Ensuring that a determination would not apply in such circumstances reflects the importance of the separation of powers, and ensures that there is not an interference with federal judicial power in a manner that is inconsistent with the Constitution.

Retrospective application

Although it is generally expected that legislative instruments made under the Remedial Power would operate prospectively, there may be circumstances where the Commissioner decides a retrospective application would be appropriate and reasonable.

A legislative instrument with retrospective application would not commence until the disallowance period for Parliament has expired, and would have no effect if the instrument would disadvantage the rights of an entity.

Sunsetting periods

Legislative instruments made under the Remedial Power to modify the operation of the taxation law would be subject to ordinary sunseting arrangements in the Legislation Act 2003. This would mean legislative instruments would expire after a period of ten years. The ten year period would allow instruments to apply for a sufficient period to both address the identified unintended outcome, while also allowing more lasting solutions to be pursued where necessary.

As the sunseting date approaches it will be necessary to review whether an instrument is still required. A review will determine whether it is necessary to remake the instrument or if it is more appropriate to allow the instrument to cease. Such a review could also consider whether, for some issues, changes to the primary legislation should be made if there was capacity at that time.

Option 2: Increasing resources dedicated to taxation law development

Another option to better manage unforeseen and unintended outcomes in the taxation system would be to increase the resources directed to different contributors for the development of tax legislation. This would provide greater capacity to consider law changes, enabling more unintended tax outcomes to be resolved through corrective legislative amendments.

There are several parties involved in the development of taxation law. The Office of Parliamentary Counsel drafts new taxation law, as instructed by The Treasury, with Treasury working in conjunction with the ATO. The ATO draws on insights from entities and tax agents to identify areas where the taxation law is not operating as intended. Treasury assesses tax policy changes, consults with the community on contemplated changes, briefs ministers and develops drafting instructions and explanatory materials for new law. The Office of Parliamentary Counsel drafts new taxation law for introduction into Parliament. The Cabinet or portfolio ministers make decisions on tax policies. Portfolio ministers also guide new legislation through internal policy committees and oversee the introduction and passage of new legislation through Parliament. Both houses of Parliament consider proposed legislation. The community is involved throughout the process, providing comments on policy changes and legislative proposals.

Increasing the resources directed towards taxation law changes would involve redirecting existing resources, or increasing the overall resources directed towards taxation law development. Increasing the resources directed towards the development of taxation law would enable existing processes to be used to address a larger number of unintended outcomes more quickly. Increasing the resourcing of Treasury would enable a larger number of potential taxation law changes to be considered and put to government. Allocating further responsibility for law design and development to the ATO could enable existing expertise and resources to be redirected towards taxation law development, again allowing a larger number of potential law changes to be considered. Addressing unintended outcomes

through legislative amendments would need to be supported by increasing the resources directed towards other parts of the law making process, such as legislative drafting functions of the Office of Parliamentary Counsel.

This would have implications for each party involved in the development of taxation law. Increasing resources, or redirecting existing resources towards tax changes, both come with an opportunity cost for the other functions those resources could have been directed towards.

Irrespective of the level of resources, some elements of the law making process remain relatively fixed. There are limits on the number sitting days each year and the number of law changes the government could consider during parliamentary sitting periods. Increased resources may enable legislative solutions to be identified, consulted on and drafted for a larger number of taxation changes. However, there may be no additional space on the legislative agenda to consider those changes.

The legislative process regularly involves detailed community consultation on law changes, as well as necessary procedural checks and balances, making it a lengthy process. Increased resourcing would not change the time needed to fulfil these steps. The ability of increased resourcing to result in the timelier resolution of unintended outcomes would therefore be constrained.

The development of taxation law is just one function amongst many undertaken by the government. Increasing the resources directed towards developing taxation legislation to resolve unforeseen and unintended outcomes in the taxation system would need to be assessed in the context of overall government priorities, budget constraints and existing departmental resourcing priorities.

Option 3: Continuing the current approach

An alternative to government action would be not intervening and instead continuing to use the existing legislative process to address some unintended outcomes while leaving many issues unresolved.

While the Commissioner has general powers of administration which are used to manage and administer the taxation system, these powers have limitations. These powers are limited to assessing and collecting taxes according to the law, applying the law and acting with administrative common sense. They do not extend to creating, extinguishing or modifying the legal rights of entities. They cannot be used to change the operation of the law so that it may operate consistently with its purpose or object. Consistent with section 15AA of the AIA, the Commissioner applies purposive principles to the interpretation of the taxation laws to give effect to the purpose or object of the law. This approach also has limitations. A purposive approach gives meaning to the words of the law which best achieve the purpose or object of the law. There are some instances where an interpretation that gives effect to the purpose or object of the law is not available from the words of the law. In these circumstances, the Commissioner would continue to have a duty to apply the law, even where it may produce outcomes that are not consistent with the purpose or object of the law.

In the development of new taxation law, principles based drafting can provide more flexibility in administering the law. However, this would not deal with the large legacy of existing complexity in the system that needs to be managed.

The existing complexity in the law combined with rapidly evolving business practices will continue to create scope for intended or unforeseen consequences with the operation of the taxation laws. Use of existing processes and resources would likely mean that such issues would not be resolved in a timely manner due to competing demands on the same resources to progress legislative change. Relying on the existing approach is likely to perpetuate uncertainty and compliance costs for entities.

4. Cost benefit analysis of each option / Impact analysis

Option 1: Providing the Commissioner with a Remedial Power

The Remedial Power would apply to all Acts for which the Commissioner has the general powers of administration. The power itself would have no impact on entities, as it only enables legislative instruments to be made. When those legislative instruments are made they could impact on the full range of entities from individuals to large companies. The impacts of the Remedial Power would differ amongst entity groups, reflecting the fact that not all of the taxation laws impact on all entities. For example, individuals are unlikely to experience an impact of the power being exercised to modify the operation of the law in relation to corporate taxation rules.

Benefits and costs for business, community organisations and individuals

The Remedial Power would provide benefits for the community by enabling the resolution of unintended or unforeseen tax outcomes in a timelier and less resource intensive manner than changing the primary law.

The need for this power is acknowledged in consultation submissions. Greenwoods & Herbert Smith Freehills note, 'We have seen too many instances where it is accepted that the text of the income tax legislation has miscarried, but the ATO regards itself as unable to interpret and administer the provision in a way that produces an outcome it acknowledges would be sensible.'

As noted, impacted entities often respond to unintended tax outcomes by seeking clarification from the ATO or from external advisers on the operation of the tax provision. This is often followed by calls for law change. Where law change is contemplated to resolve an unintended outcome, administrative approaches which provide limited benefit may be required until law change is made. This uncertainty imposes compliance costs and risks associated with understanding and fulfilling tax obligations onto entities.

It can take up to two years to amend the taxation law to resolve an unintended outcome. Where amendments are particularly complex or are of a lower priority vis-à-vis other law changes on the whole of government legislative agenda, it can take even longer. Complex changes would take longer to draft, while minor changes would rarely warrant a standalone place on the legislative program. Instead, minor changes would be combined with other measures into a single Bill that gave effect to multiple different law changes. This increases the time in which minor changes can be addressed through law change, as they must await a place in a suitable Bill and wait for other changes in that Bill to be properly consulted on and prepared ready for introduction to Parliament. Any delays in enacting other measures in the Bill will also impact on the minor change. This makes the resolution of minor changes through law change lengthy and unpredictable.

The Remedial Power would allow more minor unintended outcomes to be resolved more quickly through a standalone process that would be expected to take between six and nine months. Once identified as a suitable candidate, the Commissioner could begin the process of resolving an unintended outcome using the Remedial Power. This would create certainty for entities helping to provide a level of confidence over their obligations. This could circumvent the need for entities to seek clarification in relation to the operation of a provision. Articulating the solution to an unintended outcome sooner, thereby sparing entities from the need to seek clarification to understand an unintended outcome, or complicated administrative approaches they generate, would help to reduce compliance costs for entities. It would also reduce the imposition of the risks and costs created by unintended outcomes on entities. Consultation submissions noted the significance the Remedial Power could have in improving the overall efficiency of the administration of the taxation law. The Australian Institute of Superannuation Trustees noted the Remedial Power would 'smooth the administration of superannuation and taxation law, particularly in relation to non-contentious technical issues'.

The ability to resolve unintended outcomes by using the Remedial Power would be expected to deliver significant compliance relief for impacted entities. Consultation submissions noted the

Remedial Power should allow for the efficient resolution of minor unintended consequences in the taxation law and a reduction of compliance issues for affected entities.

It is estimated that the Commissioner may use the Remedial Power to modify the operation of the law up to ten times per annum. Indicatively, had the Remedial Power been applied to Example 1 above it is estimated this would have led to regulatory savings of \$330,000 each year. The estimated savings for Example 2 would have been \$335,000 each year. Compliance cost savings will vary depending on the nature of the issue the Remedial Power addresses.

The Remedial Power would offer a less resource intensive method for addressing minor unintended outcomes. Improving the efficiency in the use of government resources to address minor unintended outcomes benefits the community by reducing the need to draw on public resources.

The Remedial Power would also produce costs for the community. The Remedial Power would create a small to negligible impact on entities initially as they and their advisers gain an understanding of how the new process to modify the operation of the taxation laws using the Remedial Power may operate.

The creation of new legislative instruments would require community input into their development. While this already takes place for new legislation, to the extent a larger number of minor unintended outcomes would be addressed through the Remedial Power than are addressed under the existing arrangements, there would be a commensurate increase in the need for community input.

As the Remedial Power was used to address unintended outcomes, potentially impacted entities would need to acquaint themselves with the instruments made and assess whether they were applicable to their circumstances. In the event the Remedial Power introduced a retrospective change, entities would experience the same compliance costs related to amending their tax returns as would be generated by retrospective change to the primary law.

Instruments made under the power would also create an additional source of complexity for entities, as they would modify the operation of taxation provisions. These modifications would increase the complexity for the community in understanding how a particular provision works. This would generate small compliance costs for impacted entities.

The ATO will help to reduce the costs by building familiarity with the Remedial Power through existing communication channels such as the ATO website and consultation groups. Strategies for communicating the changes to various entity groups would vary in accordance with the complexity of potential impacts from the use of the Remedial Power for different entity groups.

The Remedial Power would provide an avenue to effect temporary changes to the taxation provisions. This could create additional uncertainty and compliance costs if the unintended outcome an instrument addressed has not been permanently fixed before the instrument sunsets. Any uncertainty leading up to sunseting could be managed through consultation to determine whether the instrument was still needed. Where the legislative instrument was still needed it could be remade. This consultation would impose additional costs on the community.

In summary, the Remedial Power would be expected to deliver valuable benefits for entities in terms of reductions in compliance costs, as well as the reductions in the risks and costs associated with the timelier resolution of unintended outcomes. The Remedial Power would also generate a range of costs for impacted entities in terms of learning about the power, as well as contributing to and understanding instruments made under it. It would also deliver manageable risks associated with its inappropriate use.

Benefits and costs for Government

The Remedial Power would deliver benefits for government by offering a quicker and less resource intensive alternative process for addressing minor unintended outcomes. This would enable more minor unintended outcomes to be resolved, avoiding a backlog of unresolved issues, while also allowing the existing approach of changing the primary law to be focussed on more significant tax changes. Addressing minor unintended outcomes more quickly would reduce the government

resources dedicated towards managing the unintended outcome until it is resolved. This could remove the need for formal guidance on interim administrative approaches. It would also reduce the pressure for processes such as that which the Government undertook to address the backlog of announced but unenacted tax measures.

The Remedial Power would enable minor unintended outcomes to be remedied without the need for amendment to the primary law.

The administration benefits this would create are shown by comparing the process for resolving an issue by way of a legislative amendment to a primary law and the process for issuing a legislative instrument. Legislative amendments to the primary law require considerably more steps than the process for issuing a legislative instrument.

A legislative amendment requires a problem to be identified as one that requires law change, a process that usually involves Treasury canvassing views from the community and the ATO. Once identified as a problem requiring law change ministers would be briefed and policy approvals for the change sought. Instructions on the law change to be effected would be prepared and sent to the Office of Parliamentary Counsel, who would then create the draft law. The draft law would generally be consulted on, along with explanatory materials. These would be finalised, along with second reading speeches and briefing materials before the change is introduced into Parliament. Both houses of Parliament would then consider the law change and amendments could be proposed. After passing both houses of Parliament the change would await Royal Assent before it finally entered into force.

Although the process for making and tabling a legislative instrument would involve some Ministerial engagement and departmental resources, it would be at a reduced level.

The saving on administration and parliamentary resources, while difficult to quantify, would be significant. The savings would also enable Treasury, Government and parliamentary resources to be dedicated to higher priority issues.

The Remedial Power would also introduce additional costs for government. Resources from the ATO and Treasury would still be required to consult the community, prepare legislative instruments and explanatory materials, brief ministers on the problems the instruments were being used to address and lodge the instruments. Parliamentary resources would be required to oversee the instruments created to ensure they were appropriate and within power. The resources of various departments would be required to manage the sunseting of instruments created. However, these costs would be far less significant than those associated with making changes to the primary law.

The Remedial Power would also provide a discretionary means for resolving unintended outcomes, a potential cost of the power would be any inappropriate use. This concern was reflected in some consultation submissions, which pointed to the sensitivities around perceptions of an unelected official making the law. Transparent governance processes would be implemented to mitigate such risks. The requirements of the Legislation Instruments Act 2003 would apply to instruments made under the Remedial Power. In addition, instruments made using the power would be subject to Parliamentary disallowance.

Summary of benefits and costs

Benefits

- Timelier and less resource intensive resolution of unintended or unforeseen tax outcomes than changing primary law.
- An alternate option for resolving unintended outcomes, avoiding delays associated with minor measures being deprioritised or held up by other measures.
- Current law change processes could focus on more significant tax issues.

- Reduced need for entities to seek tax advice or clarification; less need for complicated administrative approaches; reduced compliance costs.
- Better allocation of government resources to resolving problems rather than managing symptoms.

Costs

- Small initial costs for entities and advisers to familiarise themselves with the Remedial Power.
- Increased need for community input on changes as more minor unintended outcomes would be addressed.
- Minor additional compliance cost for entities to understand Remedial Power modifications.
- Remedial Power instruments create an impermanent fix; may be a need for the underlying problem to be resolved before sunset period.
- Costs for government to create instruments; conduct public consultation; prepare explanatory material; brief ministers; oversee the instruments; and manage sunset arrangements. (Note: these would be significantly less than costs of making primary law changes.)

Option 2: Increasing the allocation of resources dedicated to taxation law development

Benefits and costs for business, community organisations and individuals

Increasing the resources directed towards taxation law development would benefit the community by allowing a greater number of issues to be considered and law changes prepared for introduction to Parliament.

An increase in the number of changes prepared for introduction into parliament would be expected to result in more tax changes being considered by Parliament. However, as the number of tax changes ready for introduction into Parliament increases, the potential space on the legislative agenda to consider those changes would diminish. At some point, increasing resources could simply create a backlog of prepared measures waiting for parliamentary consideration.

Moreover, an increase in the resources for taxation law development may not end up in those resources being directed towards addressing minor unintended outcomes. The resources may simply be directed towards higher priority law changes. In this case there may be little or no improvement in the timeliness with which minor unintended outcomes were addressed.

Nonetheless, to the extent increased resources result in more unintended outcomes being considered and addressed by Parliament, entities would have more certainty over the operation of tax provisions. This would reduce compliance costs associated with entities seeking clarification around the operation of provisions, or trying to understand complex administrative approaches.

Increased resources should also lead to an improvement in the timeliness with which unintended outcomes were resolved through law change. With more resources the potential wait for contemplated changes to be prepared ready for Parliament would be reduced. However, improvements in timeliness would be tempered by the time constraints inherent in the legislative process.

There would be clear costs associated with increasing the resources directed towards taxation law development. These resources would require funding, which would need to come from additional tax revenue or reductions in other government spending.

There would be indirect costs associated with having more tax measures considered more quickly, in terms of increased demands for community input into taxation law development.

Benefits and costs for government

Increasing the resources directed towards the development of taxation law would benefit the government by providing the capacity to consider more taxation law fixes. This would result in an increase in the number of taxation law changes considered by Parliament, which would help to improve the taxation law. In turn, this would help to reduce the amount of guidance the government would need to provide around uncertain areas of the taxation law.

Increasing resources would also be expected to result in more timely consideration of taxation law changes. This would help to reduce the need for the government to undertake stocktakes of unenacted measures.

This approach would also generate costs for the government. Increasing the resourcing of taxation law development would result in the government undertaking more taxation law changes. This could lead to a disproportionate focus on taxation law, at the opportunity cost of other policy priorities.

Summary of benefits and costs

Benefits

- More changes assessed for consideration by Parliament.
- Greater certainty over the operation of the tax provision, reducing the need for entities to seek clarification.
- Less need for guidance on uncertain areas of the taxation law; reducing costs for government.

Costs

- Increased need for community input, as more unintended outcomes would be considered.
- Additional resources may result in the identification of additional solutions; if the solutions remained unenacted the underlying problem persists.
- May lead to a backlog of measures waiting for parliamentary consideration.
- Funding would be required for the additional government resources required; this would need to come from additional tax revenue or cuts to government spending.
- Additional resources directed to taxation law change could create a disproportionate focus on taxation law at the expense of wider government policy priorities.

Option 3: Continuing the current approach

Continuing the current approach would mean addressing unintended outcomes through existing measures, including purposive interpretation of provisions, while attempting to limit the growth in unintended outcomes through principles based drafting.

This approach would be unlikely to address unintended outcomes. The existing legislative approach has struggled to adequately address unintended outcomes in a timely manner. Principles based drafting would be unable to resolve unintended outcomes which arise as a result of interactions with the stock of existing law. Purposive interpretation would be insufficient to remedy defects or omissions in the law where the words of the law do not support its purpose or object.

Continuing with the current approach would be expected to result in a build-up of unresolved unintended tax outcomes and the compliance costs they generate.

Benefits and costs for business, community organisations and individuals

The benefits of continuing with the current approach would be that no additional resources would be required, so there would be no need for additional funding of taxation law development. Moreover, as there would be no increase in the consideration or resolution of unintended tax outcomes, there would be no increase in the need for the community to contribute to the development of new law, or to learn about how law changes would apply.

Continuing with the current approach would also deliver costs from unintended outcomes not being addressed in a timely manner. Entities would still be confronted by uncertainty over tax obligations where unintended outcomes persist. Entities would still need to seek advice and clarification around the operation of the law. There would continue to be a diversion of resources away from other legislative priorities where minor unintended outcomes were addressed through law change.

Benefits and costs for Government

Continuing with the current approach has the benefit of requiring no additional resources.

However, this would deliver a variety of costs. Smaller unintended outcomes would continue not to be addressed in a timely manner, which would be expected to continue to result in calls for law change. Over time there may be a growth in unaddressed unintended outcomes, which would require resources to manage. Resources would continue to be allocated towards managing the collection of unaddressed unintended outcomes, rather than resolving individual unintended outcomes themselves.

Continuing to rely on the existing approach of changing the primary law to address unintended outcomes would continue to be resource intensive. Where primary law change was used to address unintended outcomes, this would continue to place pressure on the legislative agenda.

Over time the continued growth in unintended outcomes in the law and the inability to address these in a timely manner could reduce people's confidence in the tax system and willingness to voluntarily comply with tax obligations. This could also draw resources away from resolving unintended outcomes and towards managing downstream impacts from the growth in unintended outcomes.

Summary of benefits and costs

Benefits

- No redirection in resources towards taxation law development.

Costs

- Risk of having to keep dealing with build-up in unaddressed unintended outcomes.
- Resources would continue to be directed towards managing the problem presented by a collection of unintended outcomes, rather than resolving particular unintended outcomes.
- Resolving unintended outcomes would continue to be resource intensive, demanding the same resources as solutions for more substantial problems requiring law change. There would be no tailoring of resources to the size of the problem.
- Over time an erosion of confidence in the system.

5. Consultation plan

As discussed above, prior to the decision by government to establish a Remedial Power, some consultation occurred around the possible operation of the Remedial Power and its merits, including a targeted consultation process with representatives from the Department of the Treasury, the ATO, the Australian Government Solicitor and key industry and professional associations.

The purpose of the consultation was to consider the feasibility of a Remedial Power and what factors would be relevant to the operation of such a power. Following the Government's announcement to establish a Remedial Power, the Government has undertaken public consultation on the proposed legislation to implement the Remedial Power. This consultation resulted in 12 written submissions, including submissions from major representative groups and industry participants. Public consultation was supported by targeted consultation with a representative group of tax advisers and industry.

The objective of such consultation was to test the design of the proposed legislation and to seek feedback on any aspect of the proposal from the community. Many submissions supported the Remedial Power and noted it struck a good balance between providing the Commissioner with a discretion, while including suitable safeguards and limitations to ensure the discretion was appropriately used.

Submissions raised a range of more specific issues:

- Submissions queried the rationale for a five year sunset period and although views were mixed, the balance of submissions favoured the usual ten year period. As a result, a ten year sunset period will be proposed for instruments made under the Remedial Power.
- Submissions stressed the need for the power to operate to complement, rather than substitute, ordinary law change processes. This reflects how the Remedial Power would be expected to operate.
- Submissions noted the need for the Remedial Power to be transparent and regularly reported upon. This is reflected in a requirement for the Commissioner to include information in the ATO Annual Report on the exercise of the Remedial Power during the relevant year. The use of the Remedial Power would be expected to be accompanied by community consultation.
- Some submissions asked for further guidance on when the operation of an instrument made under the Remedial Power would be less favourable for an entity. Submissions noted the difficulty of assessing whether a result was less favourable for an entity and queried how the Commissioner would establish this. In practical terms, under the self assessment regime it would be up to entities themselves to assess whether the application of an instrument made under the Remedial Power would be less favourable for them.
- Submissions noted it would be beneficial to have more examples of instances in which the Remedial Power could have been used.
- While most submissions praised the limitations on the exercise of the Remedial Power, others raised concerns regarding the appropriateness of allowing the Commissioner, a non elected official, to modify the operation of legislation. There are intentional limits and safeguards on the operation of the power to address this concern. Parliament would have oversight of all instruments made under the power and instruments would not take effect until after the parliamentary disallowance period has finished. The limitations in the Legislative Instruments Act 2003 will apply to the exercise of the power. Instruments made under the power would not only apply where they would produce a less favourable result for the entity applying the instrument. Further, it is expected any exercise of the power would be accompanied by public consultation.

6. Option selection / Conclusion

The best option to address the problem is the Remedial Power option (Option 1 in Section 4). This provides the greatest net benefit to entities with manageable risk and cost to government.

Option 1 uses fewer resources than Options 2 and 3 to resolve unintended outcomes in a timelier manner creating greater certainty for entities. This option does not require the same resources from the Treasury or the same amount of parliamentary time. Overall, Option 1 provides a net compliance benefit to entities in the form of greater certainty and reduced risks associated with tax obligations, while also promoting greater confidence in administration of the taxation system.

Compliance cost benefit

There would be some initial compliance costs as entities familiarise themselves with the new process during the early stages of the Remedial Power implementation. However, this cost is expected to be small and would generally decrease as entities gain a better understanding of the process.

There will be ongoing small compliance costs as entities may spend time preparing and submitting issues to the ATO that might be addressed by the Remedial Power. However, this would be no different to any other entity initiating contact with the ATO or the Treasury to raise an issue for legislative amendment.

There would be some increased complexity as entities would need to consider legislative instruments in addition to the primary legislation. This cost would be expected to diminish as entities become familiar with the Remedial Power process. However the reduction in compliance costs from the use of the Remedial Power by resolving unintended consequences (particularly those that increase compliance costs) would significantly outweigh the costs of having to consider the legislative instruments in addition to the primary law.

Government cost benefit

Exercising the Remedial Power may have some minimal cost on the budget. However, this impact would be limited because the power would only be available where any budget impact would be negligible. The government would be subject to fewer demands to enact minor law changes and resources could be focussed on more significant issues requiring law change.

Other risks

There could be the risk of adverse public perception that the Commissioner, being an unelected official, has the power to change taxation laws. Such a perception may undermine confidence in the taxation system. Another risk could be public perception that lobby groups influence issues which are considered. To mitigate this risk, the Commissioner must be satisfied that any appropriate and reasonably practicable consultation has been undertaken before exercising the power and therefore it is expected that the Commissioner would be expected to consult with the public to ensure transparency before exercising the Remedial Power.

This proposal could also be perceived to be in conflict with the Government's deregulation policy as it creates an additional body of law for entities to become familiar with.

7. Implementation and evaluation / review

Legislation is required to implement the proposal. The Commissioner would then exercise the power by making legislative instruments, which would be subject to parliamentary scrutiny and the scrutiny of the Senate Standing Committee on Regulations and Ordinances. The legislation providing the Commissioner with the power would be simple to implement. The Commissioner would establish governance arrangements to assist in managing the process for consideration of issues and to ensure the proper and transparent exercise of the Remedial Power. The Commissioner would also conduct any appropriate and reasonably practicable public consultation prior to exercising the power.

The Minister would have the discretion to seek a review of the operation of the Remedial Power provisions within three to five years of the provisions commencing. A review of the operation of the provisions might include a review of the consultation undertaken prior to exercising the power, how issues were raised with the Commissioner and how long it took to resolve issues using the power. The person conducting the review would be required to give the Minister a written report. The Minister would be required to table the report before each House of Parliament within 15 sitting days of receiving the report.