

Treasury's approach to tax consultation

**Second submission to the Board of Taxation's Review of the Report on the
Tax Design Review Panel**

21 September 2011

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Since the bulk of recommendations relevant for Treasury in the Tax Design Review Panel's report 'Better Tax Design and Implementation' concern taxation consultations, this second submission focuses on those issues.

Tax consultations serve a number of purposes and are subject to diverse influences. In recent years, the community's demand for and expectations of government consultations in diverse policy fields has grown considerably. Treasury seeks to exercise a degree of judgment in meeting those expectations and adapts its processes to emerging situations, consistent with its own resource constraints and prevailing government processes. While most tax consultations in recent times have been satisfactory, Treasury acknowledges that some consultations have fallen short of desired outcomes. Treasury seeks to learn from successful and unsuccessful consultations.

Overview

When new policy is conceived or existing policy changed, the Government wants Treasury to reflect the underlying policy intent in the enabling legislation. It also wants the Australian Taxation Office (ATO) to be in the best position to administer legislation consistent with that underlying policy intent. And it is hopeful that judicial decisions will have regard to that policy intent.

Taxation consultations have a bearing on how enacted legislation is to be interpreted and administered by the ATO.

Consequently, Treasury is in continual dialogue with stakeholders on taxation matters. These consultations take many forms and contribute to the Government's goal of developing sound tax policy and legislation. Treasury notes that while significant resources are devoted to such consultations, it continues to adjust its approach to improve its advice to the Government.

Some consultations are aimed at 'taking the pulse' of stakeholders. Being broadly focused, such consultations improve Treasury's situational and strategic awareness. In turn, a good appreciation of the tax landscape enables appropriate 'care and maintenance' measures of the tax system, as well as preparing the ground for major structural reform. Furthermore, Treasury participates in regular meetings of the ATO's National Tax Liaison Group meetings and appears before Parliamentary committees.

Consultation for policy development takes account of economic issues relevant to particular industry circumstances and the efficacy of particular tax instruments. Generally, peak industry and practitioner representative bodies would be engaged in such consultations. In addition, Treasury engages with members of the senior judiciary and with leading members of the academic community. Such dialogue enables Treasury to position contemporary tax policy debates and discussions in the broader economic context, domestically and internationally.

Government inquiries also entail significant consultation. For example, the Australia's Future Tax System Review held public seminars and received around 720 submissions; and the Review of the National Innovation System also conducted extensive consultations and

received 674 submissions. Stakeholders' views expressed in such inquiries are available to, and used by, Treasury policy officers in formulating current and future tax policy.

Detailed policy design and legislative development are also subject to extensive consultation. For example, consultations to implement the Government's decisions arising from the Review of the National Innovation System, including a Senate Inquiry in mid 2010, yielded 414 submissions. Those formal submissions were supplemented by public and private meetings, including exclusively with tax practitioners. Navigating the legislation through Parliament involved numerous consultations, particularly with those stakeholders opposed to any refocusing of the research and development tax incentive. Consultations on the Minerals Resource Rent Tax (MRRT) legislation have been resource intensive with a relatively small number of stakeholders whereas consultations for the Not-for-Profit reforms are resource intensive with a somewhat larger and more diverse group of stakeholders. Consultations in the MRRT case were in two-stages – the detailed policy design led jointly by a Government minister and a senior industry representative, the second (more detailed legislative implementation) led by Treasury and involving a broader industry and practitioner group.

From this brief overview of Treasury's tax consultations, it would be evident that consultations are extensive, multi-layered and resource intensive. Although there is a well-established pattern to consultations, their details and intensity vary according to particular circumstances. While acknowledging that the Government accepted in-principle the Board of Taxation's recommendations on tax consultations, Treasury observes that in practice the exact nature and scope of any consultation remains a matter for government.

Tax consultation as a discovery process

At its heart, tax consultation seeks to discover and assess information not wholly within Treasury's grasp. Treasury and industry participants mutually gain from exchanging views about the economic circumstances prevailing broadly as well as those that affect the taxpaying community. In addition Treasury aims to gauge the capacity of tax professionals in absorbing and adapting to proposed tax measures.

These general benefits depend on the respective situation of stakeholders and the Treasury (and ATO). It is not always the case that Treasury is without relevant information or that stakeholders always possess complete information about how a tax measure is likely to work in practice. In a good number of cases, and perhaps even the majority, stakeholders and Treasury will possess incomplete information about how a tax measure will work. Stakeholders may have a good idea of how a measure will affect their own or similar businesses but have little appreciation of how stakeholders in aggregate are likely to be affected. Equally, Treasury may have a good idea of how a tax measure will affect businesses in aggregate over the longer term but may not always appreciate how accounting and tax policies of major businesses interact to deflect the intended objective of a tax measure. Furthermore, consultation cannot insure against stakeholders exaggerating or misrepresenting response effects. This possibility requires Treasury to carefully evaluate stakeholder claims rather than accept everything offered in consultations at face value.

The chart on page [6] depicts a stylised schema and the associated character of tax consultation. The rows indicate the state of information Treasury and ATO have about industry conditions and columns indicate stakeholders' understanding of policy.

- Cell A represents fairly routine, basic 'care and maintenance' law changes. These may arise from Treasury's/ATO's law fix registers or from stakeholders either through TIES or NTLG consultations. It could also represent situations of policy deadlock; progress is possible only by compromise and not necessarily through further consultation.
- Cell B reflects complex 'care and maintenance' law changes which may well reflect more fundamental problems in tax law. Tax avoidance issues could be present.
- Cells C and D represent complex situations where Treasury and the ATO do not have a good enough appreciation of industry conditions. This will tend to occur at turning points in the economic cycle, during periods of structural change (as is the case now) and when policy change spans overlapping regulatory domains. Examples are intersecting, and possibly conflicting, changes in financial regulation, corporate governance or accounting standards. Clearly, consultation effort and resource intensity would need to be somewhat higher and additional Treasury resources have to be devoted to evaluate information tendered in consultations. Accompanying these additional resources needs to be a continuing improvement in the way Treasury engages with others and continues to develop its 'listening skills'.

For some projects Treasury believes its processes are very good. It acknowledges, however, that this is not uniform and more work needs to be done to entrench in the organisation a fuller understanding of the benefits of increased and better engagement, and nurture the skill set to do it properly.

- Cell C represents situations where stakeholders are better informed about certain tax practices, including those that seek to undermine the policy intent of a measure. In such situations Treasury should draw on contracted private sector expertise. Treasury should also undertake multi-layered consultations that cover a range of interests affected by the policy measure to manage the risk that certain vocal and possibly influential voices did not unduly distort the stakeholder experience.
- Cell D represents mutual lack of information. This situation would apply particularly to new taxes or when a judicial decision throws open an established way of thinking about a tax issue. In both situations, Treasury and the ATO should be learning together with stakeholders and should seek to be informed through multi-layered consultations and international experience, as appropriate.

		STAKEHOLDERS	
		KNOW	DON'T KNOW
TREASURY/ATO	KNOW	<p>A Implementing well-understood policy in ordinary industry conditions</p> <p>Eg. Basic care and maintenance; possibly deadlocked policy</p> <p>Basic consultation effort</p>	<p>B Implementing newish policy in ordinary industry conditions</p> <p>Eg. Complex care and maintenance; anti-avoidance</p> <p>Above basic consultation effort; policy dissemination</p>
	DON'T KNOW	<p>C Implementing well-understood policy in new or changing industry conditions; overlapping regulatory domains</p> <p>Eg. Tax Consolidation care and maintenance</p> <p>Well above basic consultation effort; private sector experts supplement Treasury's knowledge base; layered consultation ensure integrity of consultation process</p>	<p>D Implementing newish policy in changing industry conditions; overlapping regulatory domains; new judicial doctrine</p> <p>Eg. Resource rent tax, tax measures for carbon pricing</p> <p>Significant consultation effort; private sector experts supplement Treasury's knowledge base; layered consultation ensure integrity of consultation process, including drawing on international experience</p>

In discussions, the Board's working group has suggested that consultations should incorporate an expert drawn from the Tax Design Advisory Panel from the start of a project through to its legislative implementation. It is argued that such a paid expert or experts would be able to make a substantial contribution to tax law development compared to situations where expertise is contracted for portions of a project. This situation appears to correspond to Cell C in the schema which includes the use of experts. Additionally, Treasury notes that:

- such bought-in expertise cannot substitute for public consultations and may well undermine them if it encourages a view that feedback being sought in consultations can be withheld strategically for later commercial reward;
- it cannot secure full revelation of industry practices because the contracted experts cannot adequately be compensated by Treasury for not subsequently exploiting the knowledge gained directly or indirectly; and
- there is not adequate budget funding since some projects can run for years (the Taxation of Financial Arrangements is a prime example).

As a project develops, it should be converging towards Cell A with uncertainties as to workability of policy and law being resolved successively. Consequently, the character and intensity of consultation would be altered to reflect the evolving state of knowledge.

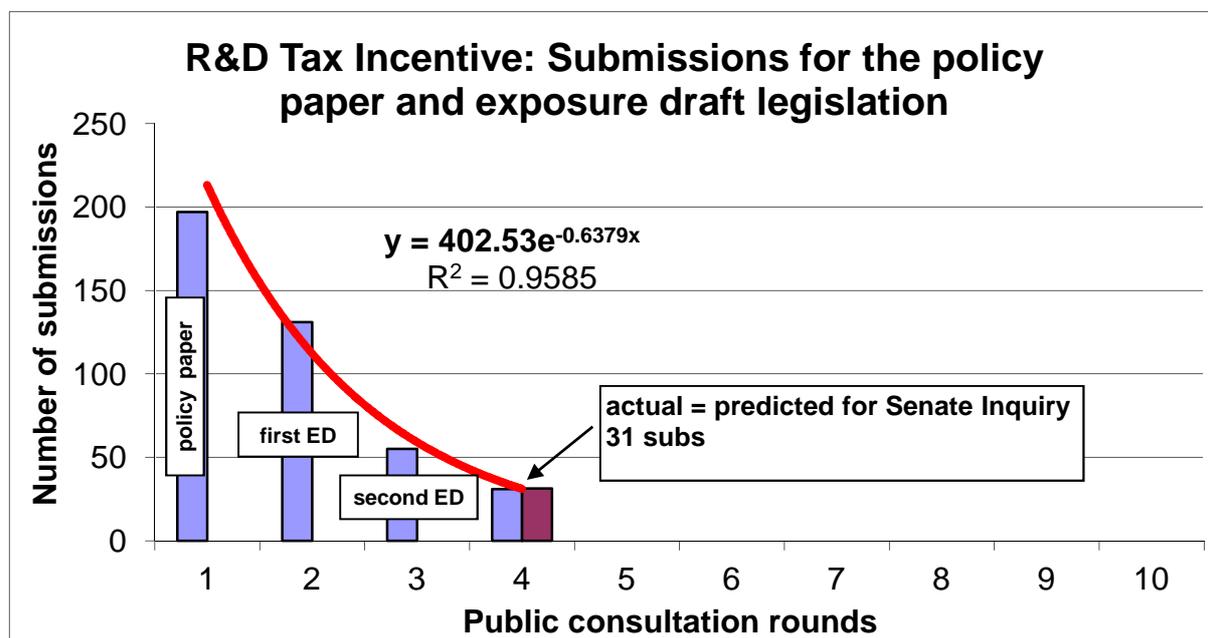
Tax consultation as process of policy dissemination

Public consultations serve a purpose beyond equipping Treasury with the requisite information and expertise. Frequently it is a process of disseminating major shifts in policy direction. Without a clear explanation of policy intent, stakeholders are unable to squarely address the draft legislation in their submissions and may be contesting the policy intent through apparent 'technical' suggestions. In some cases when those technical suggestions are not accepted, stakeholders can feel that they were not listened to.

For example, detailed policy design of the recently enacted Research and Development Tax Incentive followed a public inquiry (the Review of the National Innovation System) and extensive consultation on a policy discussion paper outlining the general flavour of legislative provisions. Those consultations were followed with two exposure drafts of legislation, with a substantial re-write of certain provisions that took account of stakeholder concerns, albeit not always in the way advocated directly by stakeholders.

Those stakeholders who opposed the policy change were successful in obtaining a Senate Inquiry in the 42nd Parliament. The draft legislation was re-introduced in the current Parliament and was again subject to intense lobbying and scrutiny. Throughout this process Treasury (and the Department of Innovation, Industry and Science) undertook extensive explanations of the policy rationale and the supporting legislative provisions.

Only with the second exposure draft, stakeholders began to address the workability of the draft legislation. The intensity of consultation from policy issues to legislative expression can be seen from the following chart.



A current example would be consultations on the Not-For-Profit reforms where a good part of the effort is being devoted to explaining how the new regulator would work.

In an important sense, this aspect of consultation represents the Executive’s efforts to facilitate the Legislature’s consent to proposed policy and legislative changes, by ensuring they are fully understood.

Tax consultation as a process of relationship management

Aside from consultations related to the October Tax Forum and myriad consultations in various stages of progression, Treasury has reached out to a handful of peak professional bodies to inform them of consultations underway and in prospect. It is hoped that periodic high level discussion of this kind will enable peak bodies to better respond to their members’ needs as well as engage in dialogue with Treasury that can go beyond particular tax measures and into broader tax-system-wide risks and stresses.

A version of the document that was shared with those peak bodies in August is at [Appendix 1](#).

Elements of a good consultation process

Across different policy fields the community’s demand for and expectations of consultation has grown considerably. Tax consultations are still relatively new and are evolving. Consultations are as much a challenge for ministers as they are for stakeholders and for Treasury. The Government side has to learn to hold things less tightly. That is happening gradually, demonstrated by the progression from almost exclusively confidential consultation (in the early 2000s), to a position of almost exclusively open public consultation

within less than 10 years. Stakeholders, particularly those 'in the know', also need to work out how to engage in a more open consultation process. Treasury is learning and benefiting from stakeholder attitudes and views and will adapt its consultation processes accordingly.

Most consultations have been successful and have proven to be of enduring value. Others have been testing and perhaps frustrating, with questionable mutual benefit.

Reflecting on the experience so far, Treasury has found the following elements useful.

- Explanation of policy by Treasury in consultative forums, making consultation and submissions more efficient and effective than otherwise (e.g. clarifying where a submission would be inconsistent with the policy framework – which sometimes led to no submission being made);
- Appropriate mix of resources (number, level and experience) from Treasury and ATO;
- Treasury participation in ATO consultative processes, enabling issues on minor policy gaps to be addressed in a timely way;
- After legislation takes effect, Treasury monitoring developments through its own consultations and NTLG processes;
- Good working relationships among Stakeholders, Treasury and ATO with skill gaps being filled quickly through discussion, consultation, secondments or contracted experts.

Resource constraints are binding

As with the non-tax consultations Treasury undertakes, a balance has to be struck between available resources and tax consultation requirements.

Available resources are constrained by budget allocations. In recent times Treasury's budget allocation has been reduced in line with the Government's broader objectives. At the same time, the consultation task has grown with the volume of new tax measures.

Consequently more intensive consultation on any particular issue draws resources away from other issues and potentially slows down the program of tax law development and implementation.

Summary

Properly viewed, consultations tend to be fluid and multi-faceted. At each stage Treasury is seeking to exercise care and judgment and to adapt its processes to emerging situations, consistent with its own resource constraints and prevailing government processes. The

alternative view imagines consultations as proceeding in determinative steps somewhat at arm's length from prevailing needs of government and without resource constraints.

To recast the opening line of a well known literary work, successful consultations tend to have common attributes whereas unsuccessful consultations are unsuccessful in their own way. Idiosyncratic factors are often present, and may even be decisive, in disappointing consultation events.

Treasury encourages institutional learning with staff sharing what worked well and what did not, at the conclusion of major tax projects.

The Treasury
21 September 2011

The Treasury

Revenue Group Consultation — Stakeholders – as at 18 August 2011

Currently open for consultation	Contact Details	Status
Discussion papers		
Improvements to the company loss recoupment rules	Contact: Tess Bostle (BTD) Phone: 6263 3005	Consultation closes on 26 August 2011.
Exposure drafts of legislation		
TOFA related amendments to ease transition and to ensure appropriate interaction with the pay as you go instalments provisions	Contact: Nan Wang (BTD) Phone: 6263 2768	Consultation closed on 15 August 2011.
Greater consistency in the for scrip roll-over and the small business entity provisions	Contact: Clare Hyden (BTD) Phone: 6263 3870	Consultation closes on 19 August 2011.
Legislative framework for public ancillary funds	Contact: Chris Legget (BTD) Phone: 6263 3357	Consultation on the exposure draft closed on 1 August 2011. Consultation on the draft guidelines closes on 31 August 2011.
'In Australia' special conditions for tax concession entities	Contact: Chris Leggett (PRID) Phone: 6263 3357	Consultation closes 12 August 2011.
Removal of income tax impediments affecting special disability trusts	Contact: Casey Elliott (BTD) Phone: 6263 3025	Consultation closes 12 August 2011.
'Clean energy future' including fuel tax, GST and income tax components (DCCEE consultation)	Contact: Rachel Thompson (BTD) Phone: 6263 3832 Contact: John Gallagher (ITD) Phone: 6263 2865	Consultation closes 22 August 2011.
Farm Management Deposits	Contact: Ly Mai (BTD) Phone: 6263 3919	Consultation closes 19 August 2011
Awaiting approval/release	Contact Details	Status
Discussion papers		
Tax treatment of securities lending/repurchase agreements	Contact: Nan Wang (BTD) Phone: 6263 2768	Expected to release by September 2011.
Various issues with the TOFA tax hedging rules	Contact: Nan Wang (BTD) Phone: 6263 2768	Expected release late September 2011.
Exposure drafts of legislation		
Monthly Deferrals	Contact: John Gallagher (ITD) Phone: 2865	Expected released in August 2011.
GST treatment of new residential premises	Contact: Michael Harms (ITD) Phone: 3308	Expected release in August 2011.
Off-market share buy-backs	Contact: Tony Regan (BTD) Phone: 3334	Expected release in second half of 2011.

Currently in preparation	Contact Details	Status
Discussion papers		
Refund of excess concessional contributions	Contact: Ruth Gabbitas (PRID) Phone: 4154	Expected release in mid August 2011.
A statutory definition of 'charity'	Contact: Chris Leggett (PRID) Phone: 3357	Expected release in September/October 2011.
Governance arrangements for NFP entities	Contact: Chris Leggett (PRID) Phone: 3357	Expected release in September/October 2011.
Currently in preparation	Contact Details	Status
Exposure drafts of legislation		
Preliminary Investment Manager Regime (Consultation on amendments to (a) limit the ATO from issuing assessments against certain income of foreign managed funds for the 2009-10 and prior years; and (b) exempt certain income of a foreign fund to the extent it is taxed solely because the fund has a permanent establishment in Australia for 2010-11 and later income years)	Contact: Dominic Shore (ITTD) Phone: 2081	Expected release in August 2011.
Tax Breaks for Green Buildings – Bonus tax deduction	Contact: Courtney Cleary (BTD) Phone: 3122	Expected release in late 2011.
Income Tax Treatment of Instalment Warrants	Contact: Clare Hyden (BTD) Phone: 3870	Possible release in late 2011.
GST - Assessment of indirect taxes	Contact: Sue Piper (ITD) Phone: 4310	Expected release in late August/early September 2011.
GST – Financial supplies	Contact: Rob Dalla-Costa (ITD) Phone: 3328	Expected release later in August 2011.
Capital Gains Tax Treatment of Earnout Arrangements	Contact: Nicholas Backhouse (BTD) Phone: 3241	Expected release in second half of 2011.
Some of the announced forex amendments	Contact: Michael Pols (BTD) Phone: 3841	Expected release in August 2011. Expected forex amendments in second half of 2011.
Announced amendments to TOFA relating to accrual/realisation method, foreign bank branches and transitional balancing adjustments	Contact: Michelle Rueckert (BTD) Phone: 2983	Expected release in second half of 2011.
Minor amendments – tranche two	Contact: Barbara Anderson (TSD) Phone: 4431	Public consultation expected September 2011.
Minerals Resource Rent Tax	Contact: Patrick Sedgley (BTD) Phone 3115	
Petroleum Resource Rent Tax	Contact: James O'Toole (BTD) Phone: 3112	Expected release in late August 2011
Small business legislation package: Increase instant asset write-off to \$6,500; simplified pooling arrangements; depreciation of motor vehicles for small businesses; abolish ETO	Contact: Haydn Daw (BTD) Phone: 2789	Expected release in late August 2011.

Currently in preparation	Contact Details	Status
Exposure drafts of legislation (cont)		
Tax Compliance: Reporting Taxable Payments	Contact: Haydn Daw (BTD) Phone: 2789	Expected release in late August/early September 2011.
New Tax System for managed investment trusts	Contact: Michael Bradshaw (BTD) Phone: 3323	Expected release in August/September 2011
GST grouping	Contact: Michael Harms (ITD) Phone: 3308	Expected release in late 2011.
GST – general / tax law partnerships	Contact: Michael Harms (ITD) Phone: 3308	Expected release in late 2011.
GST – restrictions on GST refunds	Contact: Michael Harms (ITD) Phone: 3308	Expected release in late 2011.
GST – treatment of appropriations	Contact: Michael Harms (ITD) Phone: 3308	Expected release in late 2011.
GST — certain supplies to health insurers	Contact: Michael Harms (ITD) Phone: 3308	Expected release in late 2011.
Stronger Super – SMSFs	Contact: Louise Lilley (PRID)) Phone: 3327	Expected release in 2011.
Stronger Super – Super Stream	Contact: Nigel Murray (PRID) Phone: 4426	Expected release in 2011.
Minor amendment – prescribed period for provision of audit report to SMSF trustees	Contact: Sarah Alland (PRID) Phone: 3202	Expected release in August 2011.
Amendment to portability on Australian Superfunds and NZ Kiwi Saver	Contact: Frances McGee (PRID) Phone: 4011	Expected release in late 2011.
Tax treatment of sustainable rural water use and infrastructure payments	Contact: Ly Mai (BTD) Phone: 3919	Expected release in August or September 2011.
Better targeting of NFP tax concessions	Contact: Chris Leggett (PRID) Phone: 3919	Expected release in late August 2011.
Australian Charities and NFP Commission	Contact: Chris Leggett (PRID) Phone: 3357	Expected release in October/November 2011.