



THE TAX INSTITUTE

THE MARK OF EXPERTISE

28 January 2016

Mr Tom Reid
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The Treasury
Langton Crescent
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By email: taxlawdesign@treasury.gov.au

Dear Mr Reid,

Commissioner's power to modify law

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the *Tax Laws Amendment (2016 Measures No. 1) Bill 2016: Commissioner's remedial power (Exposure Draft)*.

Summary

Our submission below addresses our main concerns in relation to the Exposure Draft, in particular:

- Whether the remedial power will be able to be utilised in practice;
- Clarification around which laws the Commissioner is able to modify as a result of exercising the remedial power;
- How the impact on the Commonwealth budget is to be determined;
- The ability to override a judicial interpretation of a provision; and
- A number of drafting issues.

Discussion

While we appreciate what providing the Commissioner with a power to modify the law in certain circumstances is intended to do, The Tax Institute queries whether the remedial power captured in the Exposure Draft will be able to be utilised by the Commissioner in practice at all.

In our view, there are limited circumstances in which the remedial power could be utilised, particularly as the impact on revenue must be negligible. Therefore, it would be useful if Treasury could include in the Explanatory Memorandum (**EM**) examples where the power could be used. Perhaps Treasury could draw on past examples where, in the absence of a power to modify the law, taxpayers suffered compliance costs disproportionate to the purpose of the provision.

For example, is it intended that the Commissioner's remedial power would have been utilised (had it been available at the time) in the following two situations?

- a) The cost base allocation rules in the scrip for scrip provisions which received Royal Assent in *Tax and Superannuation Laws Amendment (2015 Measures No. 4) Act 2015* (Cth); and
- b) The addition of section 109BC to Division 7A of the *Income Tax Assessment Act 1936* (Cth) which was contained in *Tax Laws Amendment (2010 Measures No. 2) Act 2010* (Cth).

We set out our concerns with the Exposure Draft in more detail below.

1. Relevant consideration is cost of compliance not cost of tax imposed

Draft section 370-5(1)(b) requires the Commissioner to have regard to the purpose or object of the provision **and** whether the cost of complying with the provision is disproportionate to that purpose or object. However, we understand it is not intended the Commissioner be able to modify a provision to materially affect the revenue impact of that provision.

Based on the explanation provided at paragraph 1.37 of the EM, these considerations enable the Commissioner to modify the operation of a provision so the Commissioner can either administer the law in accordance with its purpose or object **or** provide an outcome that reduces compliance costs that are otherwise out of proportion to the purpose or object of the provision.

While it is acknowledged that the word 'and' may be construed as 'or' in an appropriate context¹, it is not considered desirable in circumstances enabling the Commissioner to modify the operation of the law. A provision imparting such a power should be unambiguous and not open to different interpretations.

In our view, the wording of draft section 370-5(1)(b) should be amended to evoke the above position by either having subsections (i) and (ii) operate as alternatives (ie change 'and' at the end of subsection 370-5(1)(b)(i) to 'or') or insert the words 'either or both of the following' after the words 'having regard to' in draft section 370-5(1)(b).

2. Clarification regarding which laws the Commissioner may modify utilising this power

The Tax Institute requests that Treasury clarify which laws the Commissioner is able to modify with the remedial power.

The draft provisions provide that a 'taxation law' may be modified. 'Taxation law' is defined² in the *Income Tax Assessment Act 1997* (Cth) to include an Act or part thereof over which the Commissioner has general administration. However, we would like to clarify how this will operate in practice.

As an example, while the reference to 'taxation law' will pick up certain Parts of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) of which the Commissioner has the general administration, we query whether this reference will pick up other Parts such as Part 4 (prescribed standards) of which the Commissioner has the general administration so far as self-managed superannuation funds are concerned, but APRA otherwise has the general administration. In particular, could the modification power be used to provide a better foundation for the pension underpayments relief? Is this the intended meaning of paragraph 1.25 of the EM, so that both APRA and the Commissioner will have to agree in the case of Part 4 of the SIS Act? If so, what is the process for this to occur?

In our view, more clarity is required around which laws the Commissioner is able to modify.

3. Impact of modification on Commonwealth budget to be negligible

By operation of draft section 370-5(1)(c), the Commissioner may only modify the operation of a provision if the impact of the modification on the Commonwealth budget is negligible as advised by a relevant person referred to in subsections (i) or (ii).

¹ Lend Lease Corporation Ltd v FC of Taxation, 90 ATC 4401 per Hill J at 4413.

² The definition of 'taxation law' in the *Taxation Administration Act 1953* (Cth) takes its meaning from the *Income Tax Assessment Act 1997* (Cth).

We query how the advice that the impact of the modification on the Commonwealth budget being negligible would work where the remedial power is being invoked to overcome excessive tax being imposed by operation of a particular provision.

The EM suggests at paragraph 1.47 that the impacts on the Commonwealth budget will be determined through ordinary processes and budget rules.

However, it is unclear what outcomes are being compared. For example, is it that the comparison for determining whether an impact on the budget is negligible is between the budget revenue forecast based on the policy of the provision (forecast collections) and the impact of exercising the remedial power, or is the budget impact measured between what would be collected under the provision (actual collections) as it operates and the impact of exercising the remedial power? If the latter is intended, it appears that the remedial power could not be invoked where a provision operates in an unintended way to collect excess tax even if its operation in that way was not consistent with the purpose or object (ie the policy) of the provision. We are not certain that this is the right outcome.

It would be useful if this point could be clarified, perhaps by way of inclusion of a note in the legislation outlining what are the points of comparison.

We also consider that it may take a long time for a legislative instrument to be made if the process of determining the budgetary implications of a modification to a law must pass through the ordinary budget processes and budget rules. This raises the question whether an exercise of the remedial power to modify a tax law will in fact offer a 'more timely resolution of certain unforeseen or unintended outcomes³' as is intended than would arise following the ordinary legislative amendment process to amend a tax law that gives rise to such outcomes.

4. Drafting issues

The Draft Bill and EM refer in a number of places to the *Legislation Act 2003*. It is assumed this should refer to the *Legislative Instruments Act 2003* (Cth) (**LIA**).

The Exposure Draft has been drafted at a very high 'principle-based' level. We consider the draft could benefit from more 'guideposts' to assist the reader, particularly where an operative provision is not contained in the tax laws but rather in the LIA.

A number of consequences flow from the Commissioner's determination to modify the operation of a taxation law being a legislative instrument. For example, it is unclear on the face of the legislation whether the remedial power can operate retrospectively,

³ Refer to paragraph 1.1 of the EM

even though there is commentary in the EM supporting this outcome⁴. We assume the ability for retrospectivity comes from section 12 of the LIA.

We suggest Treasury make it clear in the legislation that the remedial power could be exercised to have retrospective effect (eg a note could be included in the legislation to this effect). Notes should also be included in the legislation in other circumstances where the power emanates from the LIA, such as the requirement for reasonable consultation provided for in section 17 of the LIA.

Clause 1 of the draft Bill will insert definitions for 'Finance Department' and 'Finance Secretary' into section 995-1(1) of the *Income Tax Assessment Act 1997* (Cth). Should definitions also be inserted for 'Department' and 'Secretary of the Department'?

5. Ability to override judicial authorities

There is a suggestion in the EM at paragraph 1.42 that there may be rare circumstances where the Commissioner could consider modifying the operation of a particular provision contrary to the judicial interpretation of that provision.

It would be useful if Treasury could expand on the type of circumstances that might justify the exercise of the remedial power to override a judicial interpretation of a provision, having regard to 'any perceived conflict with the separation of powers'. It is also unclear how exercising the remedial power to overcome a judicial authority could be justified based on the consistent and fair treatment of taxpayers if the taxpayer who was a party to the particular case has a right or liability under an order of the court that cannot be overridden under draft section 370-5(5). This would mean the remedial power could be exercised in a way that could potentially benefit all taxpayers (particularly if it were exercised retrospectively) except the one that was a party to the case. We would appreciate Treasury clarifying the above matters for us.

6. Sunset of the Legislative Instrument

Draft section 370-15(2) provides that a determination made by the Commissioner as a result of exercising the remedial power should end 5 years after the legislative instrument takes effect.

In our view, we do not see any reason why the sunset for legislative instruments made pursuant to an exercise of the remedial power should differ from the 10 year sunset for other legislative instruments. Paragraph 1.65 of the EM does not satisfactorily explain the reasoning behind why a 5 year sunset period has been chosen.

⁴ See for example paragraph 1.45 in the EM.

7. Practical considerations

- a) Raising a tax law for the Commissioner to consider applying the remedial power

We are aware that an appropriate level of consultation should be undertaken prior to a legislative instrument to modify a law being issued⁵.

However, it is not clear how a certain tax law may be brought to the attention of the Commissioner to consider whether the power to modify the law could (or should) be applied to it in the first place. For example, a number of taxpayers may be adversely impacted by the current application of a particular law and may wish to bring this to the Commissioner's attention. In other instances, only a single taxpayer may be affected.

The ATO should consider implementing a system where a taxpayer or group of taxpayers could bring to the Commissioner's attention a tax law to which the Commissioner could consider exercising the remedial power. We suggest these types of taxpayer requests may be actioned through the ATO Consultation Hub.

We recommend there also be an internal ATO process put in place to identify tax laws that may be ripe for modification. For example, where a number of private ruling applications have been made in relation to the same law and the same issue arises, this may suggest that there is a difficulty or uncertainty with the application of the law and that the law may be appropriate for modification.

- b) Procedural matters

Should taxpayers be provided with the ability to raise a tax law for consideration for modification by the Commissioner, a procedure will need to be put in place to notify taxpayers of the progress of their request.

We have already noted above a concern in relation to the time it may take to make a legislative instrument due to the budgetary considerations that are required to be taken into account. The Commissioner will also need sufficient time to consider whether a particular tax law should be modified and if so, in what way.

How will a taxpayer be notified whether the matter they have raised even passes the threshold to be considered that the Commissioner may be able to modify the law? How long can a taxpayer reasonably expect to await the outcome of their request? Will there be a public record of tax laws to which the Commissioner has considered applying the

⁵ Refer to paragraph 1.12 of the EM

remedial power (together with his reasons why or why not the power has been applied)?

In this regard, we see a number of procedural issues that will need to be resolved.

c) Challenging an exercise of the remedial power

Per paragraph 1.28 of the EM, an entity that considers that the Commissioner's exercise of the remedial power extends beyond the limitations of the power provided in the law is able to seek review through the court system. However, we query which party will bear the cost of such a review. Is this an expense the entity challenging the exercise of the Commissioner's remedial power should bear or should provision be made for the Commissioner to bear such costs (perhaps through or similar to the test case litigation process)?

We would appreciate consideration being given to these practical matters.

8. Examples in the EM

As noted above, it would be useful if Treasury could include in the EM examples where the power could be used.

We note that some examples have already been included in the EM, however we have a concern with one of the examples. We refer to Example 1.2 (at paragraph 1.52) and consider that the relevant tax law which applies in the example is clear. It appears to us that in the example, the Commissioner is exercising his discretion in relation to contractual arrangements between two entities, rather than making a necessary modification to a tax law. This is somewhat confusing. We query whether this is really the policy intent behind the remedial power. If not, Example 1.2 should be appropriately amended to properly demonstrate the policy intent or be removed from the EM.

9. Other

We anticipate that all legislative instruments made pursuant to this power will be published on the Federal Register of Legislative Instruments as well as the ATO 'Legal Database' website and that taxpayers will be advised of their creation via the usual means.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Arthur Athanasiou', with a stylized flourish at the end.

Arthur Athanasiou
President