



## OFFICE OF REGULATION REVIEW

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### **Tax Law Improvement Project**

**These comments are in response to the general invitation by the “Tax Law Improvement Project” (TLIP) for input from interested persons and organisations.**

**The Office of Regulation Review (ORR) — located within the Industry Commission — provides advice on the Commonwealth Government’s regulation review policy: it reviews new regulations; and monitors the progress and participates in programs for the reform of existing regulations. The ORR also advises Cabinet on regulatory proposals affecting business, liaises with departments and agencies in the development of regulations, and comments publicly on regulatory issues. Reflecting these roles, these comments focus on the compliance costs of taxation. The ORR intends to monitor and contribute, where possible, to the important work of the TLIP.**

**The ORR functions also include advising agencies on the use of the Cabinet endorsed ‘Revised Guidelines for Regulation Impact Statements’ (RIS) (Attached). Whilst RIS Guidelines have to date applied only when agencies seek Cabinet approval for new or amended regulations, it is anticipated that their essential elements will apply more broadly in the future. For example, the Legislative Instruments Bill currently before Parliament provides for similar tests which agencies must apply to a wide range of legislation including subordinate regulation. Such guidelines and tests also provide a useful indication of ‘best practice’ for all public sector organisations seeking to introduce new or amended regulations.**

**As outlined in the following discussion, the approach taken to date by the Australian Taxation Office (ATO) to the TLIP conforms — in broad terms — to Cabinet endorsed RIS Guidelines.**



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## *Objectives and necessity*

**The RIS Guidelines highlight the importance of clearly defining the need for regulation and identification of the goals of regulation. The need to improve the tax system to reduce compliance and administrative costs — and improve overall compliance — was outlined by the Assistant Treasurer, the Hon. George Gear, MP. who stated:**

The (tax) law is often very complex, sometimes to the point of being impenetrable for all but the most dedicated expert. The result is that tax law is more costly to comply with than should be the case.

**The TLIP project also has clear goals: to rewrite income tax law to make it simpler and to reduce compliance costs.<sup>1</sup> Such costs are incurred by taxpayers through: acquisition of in-house and/or external administrative and legal infrastructure to meet taxation obligations; training of staff; communication with the ATO; resolution of disputes with the ATO etc. The ATO also incurs substantial costs in administering tax law.**

**In the TLIP compliance costs are separated into those costs necessary to meet effective requirements of the law and those “extra costs” created by poorly expressed laws or laws that go beyond what is necessary.<sup>2</sup>**

**We understand that, within the ATO — in projects separate to the TLIP — research is being undertaken into compliance costs, ways of reducing such costs, and factors contributing to such costs. Indeed, draft guidelines and explanatory memoranda are to be prepared which provide estimates of the financial costs of compliance with taxation obligations.**

**These ATO projects seek to enhance information provided by, and the transparency of, the ATO’s existing Compliance Cost Impact Statement. This statement — which was developed and implemented following a recommendation by the Joint Committee of Public Accounts — is used by the ATO when assessing new or amended taxation proposals.<sup>3</sup> It provides only very general information as to the types of taxpayers affected and ATO administration costs which are likely to be incurred, where new or amended taxation proposals are implemented. However, this ATO Statement does not provide estimates of the financial costs of compliance to new or amended tax law. Nor does it provide estimates of compliance costs generated by existing taxation law.**

**ATO research into compliance costs is likely to provide additional information about measuring such costs. Indeed, such research could be developed to include a methodology to estimate compliance costs of**

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<sup>1</sup> ATO 1994, ‘Tax Law Improvement Project: The Broad Framework’, *Information Paper No. 1*, August.

<sup>2</sup> ATO 1994, ‘Tax Law Improvement Project: The Broad Framework’, *Information Paper No. 1*, August, p. 15.

<sup>3</sup> Joint Committee of Public Accounts 1993, ‘An Assessment of Tax: A Report of an Inquiry into the Australian Taxation Office’, *Report No. 326*, AGPS, Canberra, p. 91.

existing as well as revised tax law. It could also assist the TLIP measure compliance costs and changes in such costs that might result from simplification of tax law.

Further research about the nature and extent of such compliance and administrative costs has been undertaken by a number of organisations and individuals. For example, the journal "Australian Tax Forum" has published a number of papers dealing with such costs.<sup>4</sup> The Australian Tax Research Foundation has also published a number of papers dealing with compliance costs.

Several Industry Commission inquiries have also assessed costs and distortions created by the taxation system. For example, broader issues relating to the efficiency and equity of State tax regimes were considered in the Commission's 1993-94 *Annual Report*. The Commission's *Regional Impediments Report* and another on *Urban Settlement* considered the impact of State based taxes as well as some Commonwealth taxes, including the fringe benefits tax, superannuation guarantee charge and capital gains tax.<sup>5</sup> The forward work program of the Industry Commission includes a reference on firms locating off-shore. The compliance and administrative costs of taxation may be considered in greater detail in this inquiry.

Nevertheless, despite the availability of some limited information about compliance and administrative costs — and ongoing research by the ATO and other organisations — detailed data about the nature, extent and sources of such costs are currently not available. Until such data become available, the success of the TLIP in reducing compliance and administrative costs could be difficult to quantify and measure.

#### *Consultation processes*

RIS Guidelines highlight the importance of considering existing government policy, legislative considerations and consultation. The approach of the TLIP to date conforms in broad terms with these objectives. For instance, the review process has included the release of two information papers and creation of consultation mechanisms with interest groups and agencies.

Nevertheless, such consultation could be enhanced by the TLIP providing more information — through information papers etc — about the characteristics and extent of compliance costs. In addition, the steps

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<sup>4</sup> See for example: Pope, J. 1994, "Compliance Costs of Taxation: Policy Implications", *Australian Tax Forum: a journal of taxation policy, law and reform*, 11, pp. 85-121. & Sandford, C. 1994, "International Comparisons of Administrative and Compliance Costs of Taxation", *Australian Tax Forum: a journal of taxation policy, law and reform*, 11, pp. 292-309.

<sup>5</sup> See: Industry Commission 1994, *1993-94 Annual Report*, AGPS, Canberra; 1993, *Impediments to Regional Industry Adjustment*, Report No. 35; & 1993 *Taxation and Financial Policy Impacts on Patterns of Urban Settlement*, Report No. 30.

taken to simplify tax laws should be directly linked to reductions in such costs, in a manner similar to the approach outlined in RIS Guidelines. For example, this could involve consideration of the impact on compliance costs of each stage of the TLIP.

*Alternative approaches to improvement of tax law*

In response to specific options for simplifying tax — as mooted in the 1995 ATO Information Paper titled “Building the New Tax Law” — the ORR provides the following comments and suggestions.

Three different approaches to improvement of taxation law have been considered by the TLIP (the New Zealand approach, specialist approach and modular approach). According to the TLIP *Information Paper No. 2*, the preferred approach adopts features of all three approaches, via a “pyramid” approach which becomes more specific as it works down, starting with core provisions, then general provisions, and then specialist groupings. In addition, provision has been made for improved numbering, a toolbox of key terms and other design improvements.<sup>6</sup>

The preferred approach of the TLIP was developed after considering a number of factors, such as maximising benefits to users, administrative ease and efficiency, impact of rewritten laws on Parliament and the community, and whether the process can be completed in a staged or progressive manner. In essence, it involves rewriting income tax legislation according to the “pyramid” approach.

However, as noted above, the nature, extent and sources of compliance and administrative costs are still unclear. We know that tax legislation imposes such costs on taxpayers and that these costs are “significant”. However, it is difficult to obtain reliable measures of such costs or identify their sources.

The ORR considers that it could be difficult for the TLIP to choose the best approach to achieving the goal of reducing these costs, until better information is available about their extent and sources. For example, without more information about such costs the TLIP — in re-writing all income tax law — could allocate insufficient resources to reviewing the main sources of compliance costs. In addition, there is a possibility that the TLIP could allocate too much time and resources on those areas of tax legislation that impose little, if any, compliance costs. Notwithstanding the administrative and time benefits of the “pyramid” approach chosen by the TLIP, without better cost information there is a risk that the preferred approach of the TLIP will not be the most effective method of reducing compliance costs.

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<sup>6</sup> ATO 1995, ‘Tax Law Improvement Project: Building the New Tax Law’, *Information Paper No. 2*, April.

**Therefore, the ORR suggests — at this early stage in the review — that the TLIP give some attention to measuring compliance and administrative costs, and identifying the sources of such costs. Once these costs and their sources have been better identified, the most effective approaches to achieving the key goal of reducing these costs can be adopted by the TLIP.**

**This ORR suggestion would also assist the TLIP in implementing the recommendation of the Joint Committee of Public Accounts that:**

all future taxation legislation be supported by a Taxation Impact Statement which details the impact on taxpayers of the legislation, including the total compliance cost and the extent to which simplification objectives have been achieved.<sup>7</sup>

*Review of impact of regulations*

**Whilst the TLIP is currently considering broad approaches to simplification of tax laws, it might be worthwhile at this stage also considering mechanisms for review of the revised tax law. As outlined in the RIS Guidelines, such mechanisms can include on-going arrangements for consultation and review, and regular reporting of the impact of changes in tax law.**

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**The contact officer in relation to these comments is Dr. Stephen Rimmer whose telephone number is 264 5897.**

**Paul Coghlan  
Assistant Commissioner  
3 August 1995.**

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<sup>7</sup> Joint Committee of Public Accounts 1993, “An Assessment of Tax: A Report of an Inquiry into the Australian Taxation Office”, *Report No. 326*, AGPS, Canberra, p. 91.