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# The Process for Making Tax Policy: An International Comparison

## Proceedings of a Round Table on the Tax Policy Process

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### Summary of Proceedings

Brian J. Arnold\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS

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\* Senior adviser, Canadian Tax Foundation (e-mail: barnold@execulink.com).

## INTRODUCTION

On June 20, 2013, the Canadian Tax Foundation (CTF) sponsored a one-day invitational round table in Ottawa to discuss the tax policy process in Canada and other selected countries. The round table was attended by senior Canadian tax practitioners (many of whom have previous experience with the federal Department of Finance), government officials from Canada and other countries, and representatives from the corporate sector, think tanks, and the Organisation for Economic Co-operation and Development (OECD). Larry Chapman, the CTF's executive director and chief executive officer, and I chaired the discussions.

The round table focused almost exclusively on the process for developing tax policy, rather than the tax legislative process. Although there is considerable overlap between these two processes, for present purposes it is convenient to distinguish between them. In Canada, the tax legislative process may be considered to commence with the announcement of a tax change (often on the tabling of the annual federal budget by the minister of finance) and includes the introduction, consideration, and enactment of tax bills by Parliament. The process is transparent and reasonably well understood. In contrast, the tax policy process is not well known by those outside government, and it is difficult for anyone who has not worked in the Tax Policy Branch of the Department of Finance to find detailed information about the process. Generally, the process for developing Canadian tax policy can be considered to include all of the activities carried out by the Department of Finance and others before the announcement of a legislative change and the introduction of a bill in the House of Commons.<sup>1</sup> Those activities include the generation of ideas for tax reform, research and data analysis, analysis of options for reform, design of tax reform proposals, consultation with the public, and the preparation of draft legislation.<sup>2</sup>

Although the tax policy process is widely acknowledged to be important, it has not received much attention in Canada in recent years. Accordingly, the fundamental purposes of the round table were to give government officials and tax professionals a better understanding of the process for making tax policy, both in Canada and in other countries, and to initiate a conversation on the tax policy process among members of the Canadian tax community. In order to facilitate an assessment of the Canadian tax policy process, government officials and private-sector tax experts from selected countries—Australia, New Zealand, the United Kingdom, and the United States—prepared brief papers describing the most important aspects of their tax policy processes. With the exception of the United States, these countries were selected because they have parliamentary systems and legislative processes similar

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1 Aspects of the tax policy process continue during the legislative process—for example, the review and refinement of draft legislation.

2 As noted during the discussions, tax policy considerations may be taken into account in the administration of the tax system and in court cases. Moreover, the way in which the tax system is administered and the way in which tax cases are decided by the courts may have an impact on the need for tax reform.

to Canada's and they have all recently made significant changes to their tax policy processes. In addition, the Department of Finance prepared a paper on the Canadian tax policy process. All of these papers are reproduced following this summary.

The participation of current and former government officials deserves special mention. The participating officials (or former officials) from outside Canada included Rob Heferen of the Australian Treasury; Struan Little of the New Zealand Inland Revenue; John Whiting of the UK Office of Tax Simplification, and non-executive director of the board of HM Revenue & Customs (HMRC); and Eric Solomon of Ernst and Young in Washington, DC, formerly assistant secretary (tax policy) in the US Treasury department. Representing Canada were several senior people from the Department of Finance, including Nancy Horsman, senior assistant deputy minister, and Brian Ernewein, general director of the Tax Legislation Division. Their participation and support, in particular, must be acknowledged. Without their willingness to be involved, the round table would probably not have been possible, and certainly would not have been as interesting and informative as it was.

As noted above, details of the tax policy process are best known to insiders, and without that perspective, trying to understand the process is almost impossible. In addition to preparing the papers, all of the contributors participated in the discussions openly, frankly, and with good humour, even when aspects of their tax policy process were subject to criticism.

All of the participants attended in their personal capacities, and the round table operated in accordance with the Chatham House Rule: the proceedings were not recorded and participants were told at the outset that this summary of the discussions would be published without the attribution of any comments to specific participants. As is customary, the seating for the presenters was set up in a rectangular format, in order to encourage discussion. Although the large number of participants and observers limited the opportunity for spontaneous interactions, the discussions were useful and at times lively. The tone and quality of the discussions reflected the high level of the participants' knowledge and experience. There is a tendency for meetings such as this to turn into a litany of complaints, with government officials on the receiving end, and although critical comments were directed at both officials and tax practitioners concerning their roles in the tax policy process, the discussions were invariably respectful.

The agenda for the round table was straightforward. After a brief introduction, the first session involved a discussion of the strengths and weaknesses of the tax policy process in the countries represented. The second session looked at the human resources necessary to carry out an effective tax policy process. The third session focused on what is perhaps the most controversial aspect of the tax policy process in many countries, namely, public consultation on tax reform proposals. The fourth session featured a grab bag of topics involving the tax policy process, such as the relationship between the government departments responsible for tax policy and tax administration; the need for broad, systematic forward-looking tax policy research; the role of politics and politicians; and the role of the media. The final session considered whether it would be possible or desirable to develop best practices or model

guidelines with respect to the tax policy process for countries to follow, and what, if any, further steps should be taken in Canada to continue the conversation about the tax policy process started at the round table.

## **OVERVIEW OF THE TAX POLICY PROCESS IN SELECTED COUNTRIES**

The first session of the round table consisted primarily of presentations concerning the tax policy process in Australia, Canada, New Zealand, the United Kingdom, and the United States. The background papers prepared for the round table provided basic descriptions of the process in these countries and insights about those processes that are unavailable elsewhere. Participants were expected to have read the papers in advance. As a result, the presentations focused primarily on identifying the strengths and weaknesses (or challenges and concerns, as some participants preferred to call them) of each country's tax policy process, any recent changes to the process, and the major factors causing those changes. It was noted during the discussions that the strengths of any particular country's process were also potential weaknesses.

### **Australia**

Australia is a parliamentary democracy. Like Canada, it has a bicameral legislature (the House of Representatives and the Senate). Unlike Canada, however, in Australia the Senate is rarely controlled by the political party that forms the government, and therefore it has a significant role to play in the Australian legislative process.

Significant tax reform has been a priority for successive Australian governments since the 1980s. Since then, several broad reviews of the tax system have been undertaken, the most recent of which was the Henry review, the report of which was released in May 2010.<sup>3</sup> The process for making tax policy has also been subject to serious scrutiny in the last 15 years.

Until 2002, broad tax policy was formulated by a small group in the Treasury, most of whom were economists; technical tax policy analysis (legislative design and the preparation of drafting instructions) was performed by the Australian Taxation Office (ATO), whose primary responsibility is the administration of the tax system. In 2002, the tax policy functions of the ATO (and many of the ATO officials who performed those functions) were transferred to the Treasury. The Office of Parliamentary Counsel drafts all federal legislation, including tax legislation on instructions prepared by the Treasury. Therefore, since 2002, the responsibility for tax policy has been centralized in the Treasury.

Although in general the Australian process for making tax policy works quite well, the centralization of the process in the Treasury means that there is a lack of

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<sup>3</sup> Australia, Department of the Treasury, *Australia's Future Tax System: Report to the Treasurer* (Canberra: Department of the Treasury, May 2010).

competing tax policy advice from inside or outside government. The government has attempted to compensate for this lack of contestability through consultation with the tax community on proposed tax changes. In effect, the government consults on how tax measures should be implemented, but not on why they should be adopted in the first place. The government rarely consults on fundamental tax policy issues for two main reasons:

1. the perceived desirability for political control, and
2. the desirability to avoid uncertainty for taxpayers with respect to tax policy matters.

That said, public consultation on tax reform proposals in a variety of forms is extensive, with consultations conducted by both the Treasury and the ATO. The extent of consultation is both a strength and a weakness of the Australian tax policy process. Its strength lies in the access that consultation provides to the views of the public, especially tax professionals. Its weaknesses are twofold: first, the private sector is experiencing “consultation fatigue” as a result of the need to participate in so many consultation exercises; and second, consultation sometimes produces mixed responses, with no clear direction for the government. Both weaknesses point to the necessity for tax professionals to coordinate their responses to consultations. In addition, since most input from tax professionals is provided on a voluntary, unpaid basis, there is some concern about the quality and independence of the advice.

Another strength of the Australian process is the role played by the Board of Taxation, a quasi-independent, non-statutory body consisting mostly of tax professionals. Funding for the board’s activities is provided by the Treasury. The board provides tax policy advice and conducts post-implementation reviews of recently introduced tax proposals on matters referred to it by the government. The government has also responded to the lack of competing advice on fundamental tax policy issues by recently funding a Tax and Transfer Policy Institute at the Australian National University to stimulate academic tax policy work.<sup>4</sup>

In summary, the strengths of the Australian tax policy process are

- extensive consultations with the public by both the Treasury and the ATO,
- the role of the Board of Taxation, and
- periodic comprehensive reviews of the tax system.

The weaknesses are

- a lack of competing tax policy advice for government,
- a lack of consultation on fundamental tax policy decisions, and
- a degree of consultation fatigue among tax professionals.

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<sup>4</sup> See “Tax Policy Formulation in Australia,” following this summary.

## Canada

The process for making tax policy in Canada is not generally well known to Canadians. The responsibility for making tax policy rests with the Tax Policy Branch of the Department of Finance, although the Canada Revenue Agency (CRA) is involved in aspects of the process.<sup>5</sup>

Decisions about changes to the tax system are subject to the approval and close scrutiny of the minister of finance and the prime minister. This centralized control of the process raises the issue of the need for competing tax policy advice. The motto of the Canadian public service—“Fearless advice; faithful implementation”—was raised to highlight the challenges faced by tax policy officials in the Department of Finance. They are sometimes required to give advice that may not be consistent with the government’s chosen policy direction when they believe that the government’s proposals would result in poor tax policy. However, the government has the ultimate authority to make decisions concerning tax policy, and it is the duty of the public service to implement the government’s decisions.

The following strengths of the Canadian tax policy process were identified:

- the drafting of tax legislation is an integral part of the tax policy process;<sup>6</sup>
- the centralization of the tax policy function in the Department of Finance means that accountability is clear and provides “one-stop shopping” for stakeholders;
- the relationship between the Department of Finance and the tax community is generally good; and
- the staff of the Department of Finance are both motivated and dedicated in contributing to the tax policy process.

It was also noted that having a strong minister of finance, such as the current minister, was important for the proper operation of the tax policy process.

The challenges faced by Finance officials include the fact that they are seriously outnumbered by tax professionals and that tax professionals are sometimes reluctant to disclose the existence of loopholes in the legislation that operate to the advantage of their clients. The point was made that consultation should be a two-way street, with benefits flowing to tax professionals and their clients in terms of better-targeted policy and legislation, and to the government in terms of the elimination of loopholes.

The recent Canadian experience with a minority government also proved to be challenging for the development and enactment of tax proposals, since a minority government’s control of the legislative agenda is subject to more constraints than is the case for a majority government.

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5 See “The Process for Making Tax Policy in Canada,” following this summary. See also Brian J. Arnold and Heather Kerr, “The Canadian Tax Policy Process,” in Heather Kerr, Ken McKenzie, and Jack Mintz, eds., *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012), 3:1-33.

6 As it is in New Zealand, but not in Australia or the United Kingdom.

It was also noted that the tax system has been used increasingly as a mechanism to deliver social and economic measures. As a result, the annual budget often deals with an expanding range of essentially non-fiscal matters that have complicated the tax system and the tax policy process. In addition, the growth in other priorities, such as ministerial correspondence, briefings, media requests, and access-to-information requests, detracts from the time available to deal with core tax policy analysis.

In summary, some of the weaknesses of the Canadian tax policy process are

- the difficulty for Finance officials to get unbiased and full disclosure from tax professionals about proposed tax measures,
- the extensive use of the tax system to deliver economic and social programs, and
- competing priorities that can limit the time available to do long-term thinking about the tax system.

## New Zealand

New Zealand, being a small country (with a population of about 4.5 million), has a correspondingly small community of tax professionals, government officials, and academics. New Zealand is a parliamentary democracy with a unicameral legislature. Major tax reform in New Zealand began in the mid- to late 1980s with a strong minister of finance, Roger Douglas, and a small group of dedicated and capable officials in the Treasury. Some of the major new measures adopted included a broad-based goods and services tax, an imputation system, controlled foreign corporation rules, and foreign investment fund rules.

Responsibility for tax policy advice is shared jointly by the Inland Revenue Department and the Treasury. Within Inland Revenue, responsibility for tax policy, including drafting, rests with Policy and Strategy (formerly the Policy Advice Division),<sup>7</sup> which is also responsible for the general administration of the tax system. There is also a small group in the Treasury that performs high-level tax policy analysis.

The relationship between the Treasury and Inland Revenue concerning the responsibility for tax policy became strained in the early 1990s, and in 1994 a committee chaired by Sir Ivor Richardson performed a comprehensive review of the organizational structure of Inland Revenue, including the role of the policy unit.<sup>8</sup> As a result of this review, Inland Revenue and the Treasury acquired joint primary responsibility for tax policy. Inland Revenue is responsible for tax policy analysis, including data collection and analysis, legislative design, and drafting. The government also endorsed the recommendation of the organizational review committee to adopt a

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7 See “Development of Tax Policy in New Zealand: The Generic Tax Policy Process,” following this summary.

8 New Zealand, Organisational Review Committee, *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue (and, on Tax Policy, also to the Minister of Finance) from the Organisational Review Committee* (Wellington: Inland Revenue Department, April 1994).

“generic tax policy process” (GTPP) to govern the formulation of tax policy and legislation. The GTPP has not been enacted as a statute and is not binding on the government; however, in general, successive governments have adhered to the process. It is generally agreed that the GTPP works well.

The strengths of the New Zealand process for making tax policy are

- the participation of private-sector tax professionals in the process on both a formal and an informal basis;
- the open access to Inland Revenue tax policy officials and the minister accorded to tax professionals;
- the shared responsibility for tax policy and cooperation between the Treasury and Inland Revenue;
- the integration of the broad policy, legislative design, and drafting functions, coupled with a tight legislative process, which results in a tax policy process that is fast and certain; and
- the publication each year by Inland Revenue of its work program for the next 18 months, so that the public is notified on an ongoing basis of the tax issues that the government considers to be important.

The weaknesses of the New Zealand process are the following:

- The resources devoted to tax policy are shrinking at a time when demands on tax policy officials are increasing; as a result, insufficient strategic thinking occurs with respect to tax policy and fewer foreign consultants are used.
- There is insufficient post-implementation review of tax measures.
- Consultation on proposed tax measures limited to the New Zealand tax community is increasingly inadequate in a global economy.

## United Kingdom

The United Kingdom is a parliamentary democracy with a bicameral legislature—the House of Commons and the House of Lords (though the House of Lords has no power in relation to tax legislation). It has been the model for the governments of many Commonwealth countries. The tax legislative process in the United Kingdom is an annual affair and is characterized by the speed with which tax measures can be enacted; measures announced in March, for example, can be enacted as early as July.

The process for making tax policy in the United Kingdom is centralized, with control vested in the chancellor of the exchequer.<sup>9</sup> Responsibility for the tax policy process is shared by HM Treasury (HMT) and HMRC, with HMT doing the broad tax policy work and HMRC the technical aspects. When this shared responsibility works,

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<sup>9</sup> See “Tax Policy Making in the United Kingdom,” following this summary.



it works well; however, apparently it does not always work. Drafting is done separately by the Office of Parliamentary Counsel on instructions from HMRC.

The government recently adopted a new approach to making tax policy with the publication in June 2010 of *Tax Policy Making: A New Approach*.<sup>10</sup> Under this new “TPM” approach, the government has committed to consult on all tax changes, even minor ones, and at all stages of the tax policy process. Previously, consultation was increasingly a feature of the UK landscape but the incoming government wanted to formalize the process—though consultation is a code of practice rather than a statutory requirement. This new approach appears to be working well generally, although it has not always been adhered to and some of the departures have arguably served to emphasize its importance.

The strengths of the UK tax policy process are

- centralized decision making, with HMT having primary responsibility, and
- the government’s recent commitment to extensive public consultation on tax changes.

The weaknesses of the process are the following:

- Extensive consultations are time-consuming and necessitate a serious commitment of human resources.
- HMT recruits generalists rather than tax specialists, and they lack experience in dealing with tax and tax policy issues. The structure of the process is not conducive to building such experience, since teams that work on policy issues are typically disbanded once a project is completed.
- There is seldom, if ever, a formal post-implementation review of tax legislation.
- There is a lack of long-term strategic thinking about the tax system, which makes it difficult to evaluate short-term changes.
- There is no competing tax policy advice, from outside government or from Parliament, to the advice provided by HMT, though naturally there are plenty of submissions from professional and business bodies and other interested parties.

## United States

In international comparisons, the United States is often seen as exceptional. This exceptionalism is certainly true with respect to its system of government and the tax policy process. Unlike the process in the other countries reviewed here, the US process is decentralized, and intentionally designed as a system of checks and balances.

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10 United Kingdom, HM Treasury and HM Revenue & Customs, *Tax Policy Making: A New Approach* (London: HM Treasury, June 2010), together with *The New Approach to Tax Policy Making: A Response to the Consultation* (London: HM Treasury, December 2010).

Enactment of tax legislation requires the agreement of the House of Representatives, the Senate, and the president. Since the same political party does not usually control all three branches of government, the process works best when the key players cooperate.<sup>11</sup>

The president, through the Department of the Treasury, prepares tax proposals that are sent to Congress. Both the House Ways and Means Committee and the Senate Finance Committee have important roles to play in virtually all aspects of the tax policy process. The Joint Committee on Taxation also plays an important role in developing legislative compromises on tax matters between the House and the Senate. The Treasury and the Internal Revenue Service (IRS), which is responsible for tax administration, generally work well together. Their respective roles are clearly defined, with the Treasury having no role with respect to specific taxpayers. The Office of Tax Policy in the Treasury includes both lawyers and economists, who have considerable expertise and experience that they apply in designing tax policy.

The strengths of the US process are

- transparency;
- extensive consultations (including, but not limited to, lobbying) on all tax issues; and
- the availability of considerable competing tax policy advice from within government and from taxpayers, tax professionals, think tanks, and academics outside government.

The weaknesses of the US process are generally the converse of its strengths:

- The checks and balances that are designed to ensure that diverse interests are taken into account sometimes result in polarized confrontation rather than agreement.
- Political partisanship and the role of the media and the Internet in conveying information to the public about tax proposals make political compromises difficult and sometimes impossible.
- The tax system is increasingly used to deliver economic and social programs.
- The huge US fiscal deficit makes the revenue effect of tax policy proposals critical in the current political environment; as a result, revenue forecasting about tax proposals is very important.<sup>12</sup>

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11 See “The Process for Making Tax Policy in the United States: A System Full of Friction,” following this summary.

12 In general, any proposal that is forecast to reduce taxes will be rejected unless coupled with proposals to increase taxes or reduce spending by at least an equivalent amount.

## HUMAN RESOURCES NECESSARY FOR THE TAX POLICY PROCESS

The second session focused on the human resources necessary to carry out the tax policy process effectively. The purpose of the discussion was to get information about the resources devoted to the tax policy process in the five countries studied in order to facilitate comparisons among them. It was acknowledged at the outset that the tax community would naturally think that more resources should be allocated to the tax policy function. However, a comparative study published in 2012 concluded that the tax policy process was undervalued and under-resourced in every country.<sup>13</sup>

It should be acknowledged at the outset that it is difficult to draw comparisons among the countries with respect to the human resources involved in tax policy making, for several reasons. First, the availability and allocation of resources are constantly changing. Second, the estimates of the number of people employed in the tax policy department may not be comparable because some departments perform more functions (such as data collection and analysis and drafting) than others. With respect to the United Kingdom, HMT has its permanent policy groups and HMRC has its policy teams. The issue is the continuity of individuals assigned to the particular policy groups or to specific tax policy matters within those groups. As noted above, teams are often formed to work on particular projects but are usually disbanded when the work is complete. Moreover, the level of experience and expertise of tax policy officials are arguably at least as important as their numbers, if not more so. A simple chart prepared for the round table, reproduced as an appendix to this summary, summarizes the information provided in the papers.

All of the countries indicated that the number of tax policy officials would be shrinking over the next couple of years as a result of the financial situation of their governments, and this financial situation makes it difficult for tax policy departments to obtain additional resources. In addition, the compensation of tax policy officials is not generally competitive with compensation offered by the private sector to similarly qualified individuals, especially at the more senior and experienced levels. The reduction in human resources will make it even more difficult to perform long-term strategic tax policy work. Australia appears to be the exception in this regard, with long-term strategic planning carried out on an integrated basis with economic and social policy. Moreover, Australia carries out periodic fundamental reviews of the tax system more frequently than the other countries.

The extent of public-sector resources allocated to making tax policy raises the obvious questions of whether and how they might be supplemented through access to private-sector resources. However, it was noted that even prestigious private

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13 See Christopher John Wales and Christopher Peter Wales, *Structures, Processes and Governance in Tax Policy-Making: An Initial Report* (Oxford: Oxford Centre for Business Taxation, March 2012). Further, the report of an internal audit of the Canadian Department of Finance in March 2013 questioned whether the Tax Policy Branch had sufficient resources to fulfill all its responsibilities; see Canada, Department of Finance, Internal Audit and Evaluation, *Evaluation of the Tax Policy Branch: Final Report* (Ottawa: Department of Finance, March 1, 2013).

institutions have serious difficulty raising funds for tax policy projects. In general, private-sector resources were devoted to more immediate, short-term tax concerns, including responding to government consultations on tax issues.

The discussion indicated a wide range of country practices with respect to the use of interchanges with the private sector. Canada was the only country with a regular interchange program. Although the United States does not have an interchange program, there is a strong tradition of public service that encourages leading tax professionals to spend time during their careers working for Treasury or the IRS. For some countries, interchanges with the private sector seemed like a good idea, but only at relatively junior levels. In the United Kingdom, conflicts of interest have been raised as a problem with respect to temporary secondments from the private sector.<sup>14</sup>

## CONSULTATION

The extent and the form of public consultation on tax reform proposals are among the most important and controversial aspects of the tax policy process. The papers confirm the intuitively obvious view that, in principle, consultation with the public is desirable, since it assists in avoiding unintended consequences and undue compliance burdens. Moreover, as the principal humourist in the group said, if the art of taxation consists of plucking the goose with the least amount of hissing, then probably the goose deserves a say.

However, consultation does have costs, and some of the papers raised concern about consultation fatigue, indicating that you can have too much of a good thing. As a result, it is important to ensure that public consultation on proposed tax measures is conducted in a way that maximizes the benefits and minimizes the costs to ensure that consultation is worthwhile.

In all of the countries with the exception of the United States, where public consultation takes place on everything, public consultation on technical amendments and integrity measures is typically limited to implementation issues and draft legislation.<sup>15</sup> In general, consultation takes place after the fundamental tax policy decisions—identification of the problem and the identification and evaluation of the available options for dealing with the problem—have been made.<sup>16</sup> This initial stage of the tax

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14 The concern is that tax practitioners might use the knowledge gained while on a temporary assignment with the tax policy department for private gain after returning to private practice.

15 In all of the countries, however, as noted below, periodic major consultations occur with respect to more fundamental tax policy design issues; for example, the Henry review in Australia (supra note 3), the Tax Working Group in New Zealand (*A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Wellington: Victoria University of Wellington, Centre for Accounting, Governance and Taxation Research, January 2010)), and the Technical Committee on Business Taxation in Canada (Canada, *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, April 1998)).

16 Under the United Kingdom's TPM (supra note 10), consultation should include the policy-making decision, but this is clearly not always adhered to.

policy process is the point at which tax professionals and taxpayers would like to see more consultation. The final stage of the tax policy process—post-implementation review—appears to be rare in most countries, although there appeared to be general agreement that such post-implementation reviews were desirable.

To begin the discussion on consultation, the participants in the round table were asked to address what types of issues are suitable for public consultation and what type of consultation is appropriate for different types of tax issues.

One view was that, as long as an issue was not one that the private sector could take advantage of, the issue was acceptable for consultation. Another participant suggested that, from a practical perspective, consultation was appropriate whenever there was an opportunity to influence the proposed tax changes and the government was prepared to listen. Several participants considered that consultation on broad policy issues at an early stage of the tax policy process was important for purposes of educating the tax community and the public at large, and perhaps avoiding the necessity of more consultation later in the process. The lack of involvement at an early stage left many feeling that the real policy decisions were often presented as *faits accomplis*. However, one concern expressed with respect to consultation at an early stage in the tax policy process was that it could turn into lobbying.

Several participants raised the point that trust between tax policy officials and tax professionals was crucial for consultation to be effective. Tax professionals had to feel that their suggestions were not only listened to, but also acted on in more than just rare instances. Tax policy officials had to feel that tax professionals were acting in an objective, unbiased way in the consultation process by raising issues that were sometimes against the interests of their clients. This is a very controversial issue, and not surprisingly, tax professionals take different views about how far the interests of their clients extend. The situation in New Zealand is quite interesting in this regard. As the New Zealand paper points out, there appears to be an excellent relationship of trust between New Zealand tax practitioners and government tax policy officials, and the paper notes several instances in which professional bodies have made recommendations that were contrary to the general interests of their clients.

One participant noted that consultation was more nuanced than simply obtaining the public's views on all proposed tax changes. Different types of consultation were appropriate for different types of issues.<sup>17</sup> For example, one of the important purposes of some consultations is to educate the public or tax professionals about proposed tax changes. Also, governments sometimes consult privately with individual tax professionals or small groups of tax professionals. Most participants accepted that such private consultations were necessary and appropriate in certain circumstances, although concerns were raised about the lack of transparency. The view was expressed that experience with public consultations suggested that some people and

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17 An example of a different type of consultative exercise that proved to be very effective was the working group of tax advisers, financial institutions, and government officials set up by HM Treasury in 2000 to deal with Islamic finance in London.

organizations sent in comments just to have their names published in the list of those making submissions. Private consultations, on the other hand, could be more flexible and were especially useful for identifying tax reform options and deficiencies in proposed solutions. Most importantly, they allowed tax professionals to be candid in their dealings with tax policy officials.

Some participants suggested that, from the government's perspective, another important purpose of consultations was to help governments to change course with respect to prior tax policy decisions. Public consultation can provide the government with an opportunity to say that it is changing course in response to input from the public.

Some participants raised the most important question of all: whether public consultation was worth the effort, time, and expense. Presumably, as a matter of principle, consultation could be justified (apart from making the public feel involved) only if the outcome—tax legislation—was better as a result. Others were strongly of the view that consultation in its various forms did improve the quality of a country's tax policy and legislation. The point was made that the result of consultation was dependent on what questions the government asked and whom it asked. Some questioned whether governments were really receptive to input from tax professionals and whether tax professionals had the necessary broad tax policy expertise to be useful at early stages of the policy-making process. Consultation that consists of asking what tax professionals are thinking about, or what they think tax policy officials should be thinking about, was said to be a waste of time. Instead, specific proposals for change, often in the form of draft legislation, which has the salutary effect of focusing the mind, was said to be the more appropriate stage for tax professionals to exercise influence. Apparently, in Canada at least, the issuance of draft legislation for comment is unique to tax legislation. Others thought that consultation could also be valuable at earlier stages to deal with implementation issues and problems with existing legislation (for example, legislation to reverse the result of unacceptable court decisions).

Two important cautions to government were voiced with respect to public consultations. First, government officials should avoid going through the motions just so the government can say that it has consulted. Second, following consultation, the government needs to provide some type of feedback concerning the submissions received, including its reasons for adopting particular policy options. If these two concerns are not addressed, they have the potential to seriously undermine any attempt to conduct meaningful consultations on tax proposals.

Finally, participants mentioned that it was important to understand the many constraints on the tax policy process. One important constraint in Canada—the tradition of budget secrecy—means that advance public consultation on the nature and design of tax measures to be included in the budget is often not possible. Moreover, the budget process itself is not conducive to effective consultation because the decisions on what to include in the budget are taken in the context of other spending and fiscal decisions, and are often not made until the last minute, when it is too late for consultation. However, other participants suggested that budget secrecy was

primarily a political issue rather than a practical constraint on public consultations concerning proposed tax changes. Other countries have apparently found ways to deal with the issue of budget secrecy. For example, in New Zealand, two tax bills per year are dealt with outside the annual budget process.

Lack of time precluded any discussion of whether the role of public consultations as part of the tax policy process should be institutionalized, as it has been in Australia, New Zealand, and the United Kingdom. The role of the Board of Taxation in Australia was discussed briefly. Although the board is quasi-independent, it acts only in response to requests from the Treasury; it does not act on its own initiative. It is a business-friendly advisory body, and the Treasury uses the board to get the perspective of tax professionals on policy questions and post-implementation review of selected tax measures. In addition, as a result of concerns about inadequate disclosure of conflicts of interest, the Treasury is in the process of preparing a “Charter for Consultations on Tax Policy and Law” to govern the participation of tax professionals in the consultative process.<sup>18</sup>

The Australian Treasury also conducts semi-annual meetings with tax professionals to discuss tax policy issues in general, rather than measures under active consideration with respect to which some tax practitioners may have financial interests. The purpose of these meetings is to facilitate a shared understanding by all stakeholders, including the Treasury and the ATO, of their different perspectives.

In the United Kingdom, the recent adoption of the new process for making tax policy has been accompanied by the formation of a Tax Professionals Forum to review whether the new consultation process has been followed by the government. The forum is chaired by a Treasury minister and consists of eight members from the professional community. It issues an annual report but has no formal powers.

## **OTHER ASPECTS OF THE TAX POLICY PROCESS**

The next session of the round table dealt with other important aspects of the tax policy process, including

- the need for long-term, forward-looking tax policy research and analysis;
- the relationship between the tax administration and the tax policy department with respect to the tax policy process;
- politics and the role of politicians; and
- the role of the media.

The discussion on each of these topics is summarized below.

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18 See “Tax Policy Formulation in Australia,” and “Some Additional Comments on Australia’s Tax Policy Process,” following this summary.

## The Need for Long-Term, Forward-Looking Tax Policy Work

It is widely acknowledged that the tax policy departments in government should be conducting long-range tax policy research in addition to day-to-day tax policy work, which generally responds to more immediate concerns. Such forward-looking tax policy research is important for the purposes of establishing directions and goals for the tax system. However, it was also acknowledged that tax policy departments are often stretched in terms of resources, and long-term tax policy research was usually accorded a lower priority than more immediate problems. As a result, the question arises as to whether such work is being done, or should be done, by the private sector. The lack of resources and the absence of any obvious immediate payoff were mentioned as factors that discourage private-sector involvement in long-range tax policy work.

Several participants pointed out that meaningful tax policy research required access to government data that might not be available to researchers outside the government or might be costly to obtain, and sometimes the necessary information simply does not exist. Another problem is that it is often necessary to know what information is available in order to ask for information. Obviously, confidential information about specific taxpayers is not available to outside researchers, but ideally there should be easy outside access to information that is not taxpayer-specific. The UK Office of Tax Simplification has access to the data prepared by the data analysis group in HMRC.

Despite the difficulties, long-term tax policy research is done periodically. For example, the Mirrlees review<sup>19</sup> in the United Kingdom, the Henry review in Australia,<sup>20</sup> and the Victoria University of Wellington Tax Working Group (TWG) in New Zealand<sup>21</sup> were mentioned as exemplary in this regard. New Zealand's TWG was a joint effort of the government, academics, and tax professionals. The group was used to provide a neutral environment in which contentious issues could be discussed freely, while the government stood back until clear options were identified.<sup>22</sup> Tax officials worked closely with the chair of the TWG to design the agenda, and the government supported the work by providing analytical and other resources. In addition, the New Zealand Institute of Chartered Accountants has established a Tax Advisory Group (TAG) consisting of 12 volunteers from the major accounting firms, with 3 to 4 permanent full-time professional staff. The TAG has done some longer-range tax policy work, resulting in recommendations that occasionally conflict with

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19 James Mirrlees, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, eds., *Dimensions of Tax Design: The Mirrlees Review* (Oxford: Oxford University Press, 2010), and Mirrlees et al., *Tax by Design: The Mirrlees Review* (London: Institute for Fiscal Studies, September 2011).

20 *Supra* note 3.

21 *Supra* note 15.

22 Therefore, the government could, if necessary, distance itself from the group's recommendations.



the interests of the institute's members, although the bulk of the TAG's recent work focuses on detailed technical analysis.

The role of universities and academics in providing long-range tax policy research was also discussed. The Institute for Fiscal Studies (IFS) is the predominant tax and economic research organization in the United Kingdom and was formed in 1969 with a view to challenging government tax policy. It now has 30 to 40 economists on staff and focuses on economic policy generally. It has also established a Tax Law Review Committee with 20 to 25 members, which makes periodic recommendations concerning the tax system. Oxford University's Centre for Business Taxation is relatively new but has produced some excellent tax policy research; it is funded by the United Kingdom's 100 largest companies. Another recent initiative is the establishment of a centre for the study of tax administration at the University of Exeter, in conjunction with the IFS and with the support of HMRC.

### **The Relationship Between the Government Departments Responsible for Tax Policy and Tax Administration**

In New Zealand, Inland Revenue is responsible for both tax policy and tax administration; therefore, cooperation between officials responsible for the two functions is purely an interdepartmental matter. In the other four countries, however, tax policy and tax administration are dealt with by separate departments, although in the United Kingdom both HMT and HMRC deal with aspects of tax policy. This separation poses potential problems for the tax policy process, which (arguably at least) requires the integration of broad tax policy (economic and statistical) analysis, technical analysis, and drafting. The formulation of tax policy requires input from the tax administration with respect to the administrability of, and taxpayer compliance with, proposed tax measures. Therefore, close cooperation between the two departments is important.

In the United States, the relationship is not problematic because the roles of the Treasury and the IRS are relatively well defined and distinct. In Canada, the relationship between Finance and the CRA is also working well at present. There is daily interaction on various issues, as well as cooperation on special projects such as a joint working team on the OECD's base erosion and profit-shifting project. In addition, the CRA and the Department of Justice attend legislative drafting sessions in the Department of Finance, and Finance officials participate in meetings of the CRA's committees on adverse decisions and the general anti-avoidance rule. In the United Kingdom, the new "tax policy partnership" between HMT and HMRC (following the 2005 reorganization) has taken time to develop satisfactorily but is now thought to be working reasonably effectively, although not perfectly. In Australia, where the ATO had a significant role in tax policy until 2002, there is occasionally tension in the relationship between the Treasury and the ATO, which manifests itself in the ATO's practice of litigating some cases on a basis that is contrary to the Treasury's understanding of the tax policy underlying the legislation.

According to some participants, the key to a good working relationship between the tax policy department and the tax administration is good personal relationships

between the officials involved, but they felt that it was difficult to institutionalize these relationships.

### **Politics and the Role of Politicians**

The reality is that politicians have the ultimate decision-making authority with respect to tax policy, including the tax policy process. One of the issues raised during the discussions was the difficulty of getting politicians, other than the responsible minister, engaged in tax policy issues. Typically, individual members of Parliament are not knowledgeable about tax policy, or the tax system in general, and have few resources to call on for assistance with tax policy issues. In countries with a centralized tax policy process, one suggestion was for the private sector to help educate Opposition party members about tax issues. It was acknowledged that it was important for private institutions to provide an effective check on the centralized control of tax policy by the government. Various methods of doing this were raised, such as being proactive with the media, interacting with parliamentary committees, and educating the public generally. Some expressed hope that the good tax policy ideas expressed publicly in the media might drive out, or at least suppress, some of the inappropriate tax policy ideas that politicians come up with. Another suggestion was that government should make more frequent use of truly independent reviews of the tax system, such as those conducted through royal commissions, even though such reviews generally provide a snapshot rather than an ongoing scrutiny of the tax system.

One extraordinary fact that emerged from the discussion is that in New Zealand the tax policy advice prepared by Inland Revenue for newly elected governments (and the similar document prepared by the Treasury) becomes a public document once the responsible ministers have had sufficient time to consider the advice. This has become standard practice and works well.

One point made during the discussion was that an important role for tax policy officials was to advise against the adoption of measures contrary to good tax policy. This role can be especially problematic given that the tax system can be used as a mechanism to deliver social and economic programs. Not surprisingly, a 2010 recommendation of the TWG in New Zealand, to develop more institutionalized arrangements to ensure that tax policy is treated by the government as a long-term or quasi-constitutional exercise, garnered little support from the major political parties.

### **The Role of the Media**

The discussion concerning the role of politics and politicians in the tax policy process led seamlessly to a spirited discussion of the role of the media with respect to tax policy. The question posed was how to encourage the media to become more engaged with tax policy issues (and be more responsible when they do engage) when, in general, they do not appear to be interested unless an issue can be reduced to a short sound-bite. Some participants sounded an optimistic note, suggesting

that there were some responsible journalists, perhaps in niche media, who could be encouraged to become more engaged in tax policy issues. Others were concerned that few journalists were interested in (or perhaps capable of) becoming better informed about tax policy and prepared to deal with the issues in a responsible way. Nevertheless, despite their misgivings, many participants agreed that journalists play an important role in influencing politicians. Consequently, government, governmental organizations, and private institutions working on tax policy issues need to have a strategy for dealing with the media; otherwise, it was suggested, lobbyists would exploit the absence of objective, unbiased, and informed opinion. In the United Kingdom, HMRC has recently become more proactive with the media and holds periodic briefings on tax issues for the media.

In summary, although there appeared to be a consensus that efforts should be made to educate the media about tax policy issues, there was no consensus on how to do so or whether the media were interested in becoming better informed. If the media were better informed about tax policy issues, the public would be better informed and public confidence in the tax system would be improved.

## **BEST PRACTICES AND CONCLUSION**

Not surprisingly, given the round table's full agenda, the time available to discuss best practices with respect to the process for making tax policy was limited. This may have been just as well since some participants noted that the term "best practices" was outmoded, and perhaps the development of one or more model tax policy processes would be more appropriate. Another participant suggested that a catalogue of good ideas for tax policy making would be worthwhile and should include the collection and availability of reliable data, adequate human resources, a media strategy, and provision for post-implementation review of tax measures. Another participant thought that public consultation should be added to the list. Several participants liked the suggested distinction between "Big P" tax policy issues (broad issues of tax structure, design, incidence, distributional effects, etc.) and "Little P" issues (more technical tax issues). Tax professionals do not deal with or have expertise in the Big P issues; as a result, it is necessary have some type of external body perform this type of tax policy research, which could serve both as a supplement to the work done by government and as a check on that work. The point was made that increased consultation and transparency might come at the cost of less grandfathering and tighter effective dates for new measures, in order to prevent taxpayers from exploiting any delay in the implementation of proposed tax measures.

Some participants thought that the tax policy process was too dependent on each country's particular situation to develop a model process that would suit each country's needs. For example, New Zealand's situation is so special in many respects (and not just because of the country's small population) that its GTPP is not readily transferable to other countries. Nevertheless, it was suggested that it would be worthwhile to develop model or best practices with respect to the institutionalization of the relationships among the principal players in the tax policy process.

The round table concluded without much time for discussion of the next steps that might be taken to continue the conversation, apart from the publication of the proceedings. One suggestion was for a similar round table discussion of the tax policy process with politicians. Larry Chapman informed the group that, at the very least, the CTF would facilitate a broader discussion of the tax policy process with the membership of the Foundation.

**APPENDIX TABLE 1 Human Resources Assigned to the Tax Policy Process in Australia, Canada, New Zealand, and the United Kingdom**

	Number of professionals (excludes administrative staff)	Qualifications/ experience	Internal training	Private-sector interchanges	Consultants	Tax administration issues
Australia	190 (45 in data, 20 in law design, 6 drafters)	Tertiary qualifications in economics, law, public policy, and accounting	Extensive	Yes	Yes: ad hoc	Two-way secondments with ATO
Canada	160 <sup>a</sup>	Economists with graduate degrees; lawyers and accountants	Not available	Yes: 1-2 regularly for senior roles	Not available: ad hoc	CRA responsible for tax administration
New Zealand	51.5	Average: —Senior advisers, 11 years —policy managers, 18 years	Yes	No	Yes: ad hoc	IRD responsible for policy and administration
United Kingdom	HMT—120 HMRC—Not available (no permanent group dedicated to tax policy)	Generalists	Not available	Yes, on unpaid basis Controversial	Rarely	Supplied by HMRC

Note: No detailed human resources data were included in the US presentation at the round table.

<sup>a</sup> Includes legislative draftsmen but not staff devoted to revenue forecasting.

ATO = Australian Taxation Office.

CRA = Canada Revenue Agency.

HMRC = HM Revenue & Customs.

HMT = HM Treasury.

IRD = Inland Revenue Department.

Sources: Papers presented at the round table, reproduced herein.



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# Tax Policy Formulation in Australia

Rob Heferen, Nicole Mitchell, and Ian Amalo\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS ■ AUSTRALIA

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## INTRODUCTION

Just as Australia’s political system is a unique mix of elements, some drawn from other countries and others developed domestically, its tax system also has a unique character. Australia’s representative democratic system<sup>1</sup> is key to that character and informs the development and assessment of tax reform ideas.

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\* Of the Australian Treasury, Canberra (e-mail: Rob.Heferen@treasury.gov.au; Nicole.Mitchell@treasury.gov.au; Ian.Amalo@treasury.gov.au).

1 Australia is a federation, with three levels of government: the federal Australian government (or the commonwealth government), the governments of the six states and two territories, and

In this regard, tax policy making is different from monetary policy making in Australia. There is no tax entity independent of government that plays a role similar to that played by the Reserve Bank of Australia in setting monetary policy. In contemporary Australia, tax policy is an increasingly contested policy debate. Tax debates often concern tradeoffs between different values and priorities, and so tax policy making appropriately sits with elected officials. Successive governments have introduced a range of innovative institutions and practices aimed at improving the quality of tax policy making in Australia, including greater involvement of the private sector, extensive consultations, and accountability mechanisms.

This paper focuses solely on tax policy making by the Australian government. This is not to suggest that an examination of tax policy formulation by the Australian states and territories would be unwarranted. The Australian states, territories, and local governments levy a range of taxes in their own right (accounting for around 20 percent of total tax revenue) and have undertaken important reviews and reforms in recent years. In the interests of brevity, however, the ensuing discussion will focus on the federal (or commonwealth) level.

## **STAGES IN TAX POLICY FORMULATION**

### **Development Stage**

Under Australia's parliamentary system, the government is formed by the party with control of the House of Representatives (the lower house or "the house of government"). Ministers are appointed from both the House of Representatives and the Senate (the upper house or "the house of review") to form the executive government, with policy decisions being made by Cabinet. (The Senate's role as a house of review is discussed in a separate section below.) Ministerial responsibility for tax policy lies with the treasurer, who also has ministerial responsibility for economic, fiscal, and monetary policy (among other matters). The treasurer is supported by the other Treasury portfolio ministers. Ultimately, the power to make tax laws rests with the Parliament. It is rare in Australia for the government to have a majority in the Senate, and so legislation often needs the support of senators from the Opposition or minor parties to become law. Under Australia's system of government, the Cabinet (which is made up of senior ministers) is the key decision-making body of government. While the Cabinet's makeup and internal processes are subject to the prime minister's prerogative, and the shape and arrangements have changed over time, a core feature is that all major policy proposals are considered by Cabinet.

Tax policy development is a highly contested space. Reform, research, and policy options are generated by a multitude of sources, including electoral parties, Senate inquiries, academics, think tanks, lobby groups, tax representatives, and the media.

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around 700 local government authorities. One of two major political groups usually forms the government, federally and in the states—the Australian Labor Party (the centre-left party) and the Coalition, which is a formal grouping of the Liberal Party and its minor partner, the National Party (the centre-right parties).



Governments have recognized this increasingly contested policy environment by ensuring that the Treasury undertakes greater policy consultation, including early “non-transactional” engagement, in order to be in a position to provide more comprehensive advice.<sup>2</sup> In recent years, the then Rudd government also commissioned a comprehensive tax review (the Henry review),<sup>3</sup> and has established an independent tax studies institute at the Australian National University to improve the quality of public debate on tax reform. Governments have also made recent improvements in tax policy consultation processes (discussed later in this paper). As the department that serves the treasurer, the Treasury is the most influential public-sector advising body on tax, though its influence varies, of course, according to the precise nature of each issue.

Other processes for generating ideas, gathering information, and identifying solutions within government are discussed below, in the section describing the respective roles of the Treasury and the Australian Taxation Office (ATO) in formulating tax policy. That discussion highlights recent efforts to improve communication between the two agencies and outlines Australia’s history of tax reviews. The Australian government requires that a regulation impact analysis be undertaken by responsible departments to inform all decisions, including tax policy changes, that are likely to have a non-trivial regulatory impact on business or not-for-profit organizations. This analysis involves consideration of impacts, costs, and benefits of proposed regulatory options and is provided to the relevant decision maker (for example, Cabinet) along with the policy proposal, unless an exemption is granted by the prime minister for exceptional circumstances.

Tax proposals typically attract additional requirements, including the requirement that they be proposed by the treasurer. In practice, the great bulk of tax policy is developed and evaluated during the annual budget process, although significant policy measures are increasingly being introduced through the mid-year budget update process.

As outlined above, while the exact arrangements differ from government to government, it is fair to describe the budget process as an iterative one. Budget bids are first submitted to senior ministers (typically the prime minister, the treasurer, and the minister for finance and administration) in October, and costed proposals are considered by senior ministers between February and April through the Expenditure Review Committee, a formal subcommittee of Cabinet with delegated authority to make decisions. By tradition, the budget for the next financial year is delivered by the treasurer to Parliament on the second Tuesday of May.

It is worth noting here that while budget decisions are classified until budget night, targeted and confidential consultations with stakeholders are undertaken on

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2 See Australian Treasury, *Strategic Review of the Treasury* (Canberra: Australian Treasury, December 2011).

3 Australia, Tax Review Panel, *Australia’s Future Tax System: Report to the Treasurer* (Canberra: Australian Treasury, December 2009).

more complex proposals prior to a final decision, to ensure that the proposed policy meets its objectives. These consultation processes remain confidential following the budget process.

Once a decision requiring legislative change is made, the Treasury is responsible for instructing legislative drafters in the Office of Parliamentary Counsel on tax matters, producing explanatory materials and regulation impact statements for tabling, conducting community consultation on tax policy, managing the legislation program, and assisting the government in securing the passage of bills through Parliament. In short, the Treasury has a central role in ensuring that legislative products match their policy intent.

### **Legislative Stage**

For a tax bill to become an Act, it must be passed in the same form by the House of Representatives and the Senate and then assented to by the governor general. Section 53 of the Australian constitution<sup>4</sup> prevents bills that authorize the spending of money (appropriation bills) and bills imposing taxation from originating in the Senate, so all tax bills must originate in the House of Representatives.

Despite this constitutional restriction, the Senate's role in tax policy remains important. This is because the Senate performs a well-developed house of review function through its committees, with tax policy considered by the Senate Standing Committee on Economics. Notwithstanding some fluctuations, the number of bills referred to Senate committees has trended upward in recent decades.

### **Post-Implementation Review Stage**

As part of the regulation impact analysis described above, departments are required to provide information on how the preferred regulatory option will be implemented, monitored, and reviewed. More formal post-implementation reviews, initiated within one to two years of implementation, are required for all regulations that initially proceeded without a compliant regulation impact statement.

In addition, specific post-implementation reviews on tax policy are conducted by the Board of Taxation. The Board of Taxation, which was established following the 1999 Review of Business Taxation (the Ralph review),<sup>5</sup> is a non-statutory advisory board charged with providing advice to government, from a business and broader community perspective, on improving the design and operation of taxation laws. As part of its functions, the board also conducts post-implementation reviews of legislation to assess their quality and effectiveness. Since its establishment in 2000, the Board of Taxation has conducted 29 reviews and consultations, with 6 of those reviews covering the post-implementation phase.

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4 Commonwealth of Australia Constitution Act.

5 Australia, Review of Business Taxation, *A Tax System Redesigned—More Certain, Equitable and Durable* (Canberra: Review of Business Taxation, July 1999).

## GOVERNMENT DEPARTMENTS WITH A ROLE IN TAX POLICY FORMULATION

The Treasury's role in developing tax legislation has been outlined above. The Treasury also has primary responsibility for advising on tax policy; more specifically, the Treasury formulates and provides advice to government on policy options, produces regulation impact statements, and prepares official costings, which together with the overall revenue forecasts underpin the government's budgets. All of these activities are undertaken in close conjunction with the ATO, the statutory authority responsible for the administration of Australia's taxation and superannuation laws and the government's principal revenue collection agency.

In recognition of the importance of the relationship between the ATO and the Treasury, in September 2012 the secretary to the treasury and the former commissioner of taxation substantially redrafted the "Treasury and the Australian Taxation Office—Tax and Superannuation Protocol."<sup>6</sup> The protocol aims to improve the working arrangements between the Treasury and the ATO. It is applied in the design of new policies and laws that form part of these systems, and in the administration of the law once enacted.

### Tax Policy Reviews

Australia has a rich history of tax policy reviews. The report of the Taxation Review Committee (the Asprey review) released in 1975<sup>7</sup> was seminal and marked a watershed moment in the realm of tax policy reviews. Justice Ken Asprey's review shifted the emphasis away from tax policy motivated solely by the adequacy of revenue to fund growing public provision, to a greater focus on improving the equity, efficiency, and simplicity of the tax system.

A key theme of the Asprey review was the need to broaden the tax base. Key reforms recommended by the Asprey review were implemented over the next two decades, including capital gains tax and fringe benefits tax (in the late 1980s) and the goods and services tax (in 2000). Other reviews, including the 1999 Ralph review and the Board of Taxation's review of international taxation arrangements in 2002-3<sup>8</sup> had more immediate policy impacts, with reform packages announced alongside the review's public release or shortly thereafter.

More recently, a comprehensive review of the tax and transfer system, the Henry review,<sup>9</sup> was conducted over 18 months in 2008 and 2009. The Henry review added

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6 Australian Taxation Office, "Treasury and the Australian Taxation Office—Tax and Superannuation Protocol" ([www.ato.gov.au/General/New-legislation/In-detail/ATO---Treasury-protocols/ATO---Treasury-protocol](http://www.ato.gov.au/General/New-legislation/In-detail/ATO---Treasury-protocols/ATO---Treasury-protocol)).

7 Australia, Taxation Review Committee, *Full Report* (Canberra: Australian Government Publishing Service, 1975).

8 Australia, Board of Taxation, *Review of International Taxation Arrangements* (Canberra: Board of Taxation, February 2003).

9 *Supra* note 3.

the design principles of policy consistency and sustainability to the principles identified by the Asprey review. Essentially, the requirement for consistency ensures that tax and transfer policy are internally consistent, while the requirement for sustainability ensures that the tax system has the capacity to meet the changing revenue needs of government on a continuing basis without recourse to inefficient taxes.

Consistent with Australia's system of responsible government, tax reviews are provided to the relevant minister. The government decides how the review will be released and what policy changes (if any) it wishes to make in response to the recommendations. While review panels do not make policy decisions, they do facilitate such decisions by identifying areas of concern in the tax system and promoting public discussion about tax reform.

## **RESOURCE ALLOCATION IN THE TREASURY**

Within the Treasury, Revenue Group formulates advice to the government on taxation policy. The work of the group includes

- analysis and the provision of advice to the relevant minister on tax and superannuation policy options and their economic and social impacts;
- the provision of revenue forecasts and costings of taxation policies;
- extensive policy-based and non-transactional consultations; and
- legislative support, including providing instruction to parliamentary counsel on the design of taxation laws and support for the passage of tax legislation through Parliament.

Revenue Group accounts for over 20 percent of Treasury staff members, and nearly a sixth of the group's staff are engaged in preparing tax legislation. The group is headed by an executive director and structured into seven divisions, with almost half of the staff employed at the junior (Australian public service, or APS) level (see table 1).

Following a review in 2012 of Revenue Group's capabilities, the Law Design Practice was established to better identify legislative priorities and provide greater quality assurance of legislative products, as well as provide a clearer career pathway for specialist law design officers. Officers engaged in the Law Design Practice have legal qualifications and/or extensive experience in law design. In a similar vein, the overwhelming majority of officers engaged in the Tax Analysis Division have specialist skills and are trained in economics and/or quantitative studies (mathematics, statistics, or actuarial studies). Officers in the remaining divisions possess tertiary qualifications in law, economics, finance, and/or statistics. Thus, Revenue Group employs both specialists and generalists, reflecting a need to strike a balance between both sets of skills. A few officers also have private sector experience.

The Treasury has an active two-way secondment program with the ATO. This provides an opportunity for Treasury officers to gain direct experience of the administration of Australia's tax system and the implementation of tax policies, with the aim of enhancing an officer's overall skills in policy and legislative development.

**TABLE 1 Staffing Resources in Revenue Group, Australian Treasury<sup>a</sup>**

	Total division staff	SES	EL	APS
Tax System Division . . . . .	19.87	2.00	5.27	12.60
Corporate and International Tax Division . . . . .	30.40	5.00	11.00	14.40
Small Business Tax Division . . . . .	17.88	0.80	6.80	10.28
Indirect, Philanthropy and Resource Tax Division . . . . .	25.35	2.00	12.35	11.00
Personal and Retirement Income Division . . . . .	31.55	3.00	14.64	13.91
Tax Analysis Division . . . . .	45.47	3.60	19.87	22.00
Law Design Practice . . . . .	30.25	1.73	12.52	16.00
Executive team . . . . .	4.80	1.00	1.00	2.80
Total, Revenue Group . . . . .	<u>205.57</u>	<u>19.13</u>	<u>83.45</u>	<u>102.99</u>

<sup>a</sup> Full-time equivalent staff as at May 2013.

SES = senior executive service.

EL = executive level.

APS = Australian public service.

Source: Australian Treasury internal data.

By the same token, ATO officers are routinely seconded to the Treasury to gain experience in tax policy development.

Revenue Group employs private-sector consultants from time to time, most often to review existing processes or to provide technical assistance. The Treasury has a program of temporary secondments from the private sector and also encourages such secondments in tax policy, particularly in the secretariat that the Treasury provides to the Board of Taxation. More generally, Revenue Group taps into the expertise of private-sector tax specialists for specific projects on a paid consultancy basis.

Of course, it is not just government agencies that are devoting resources to the formulation of tax policy in Australia and, more broadly, throughout the world. The Big Four accounting firms derive between 20 and 30 percent of their global revenues from the provision of taxation services, and around 20 percent of their workforce is employed in taxation—proportions that have remained generally stable over the past few years. Information on the websites of these firms suggests that similar allocations apply to their Australian operations.

It is at least arguable that this extensive devotion of resources by the private sector results in more tax system complexity. While there is general confidence in the Australian tax system, a recent survey by Per Capita that explored the public's attitude toward taxation and government expenditure revealed that Australians find the tax system "burdensome."<sup>10</sup> This finding seems consistent with the fact that over

10 See David Hetherington, *Per Capita Tax Survey 2012: Public Attitudes Towards Taxation and Government Expenditure* (Sydney: Per Capita Australia, March 2013).

70 percent of Australian tax lodgers rely on tax agents to complete their personal tax returns—a proportion that has remained broadly unchanged over recent years. According to data published by the Organisation for Economic Co-operation and Development (OECD), Australia has the third-highest rate among 16 OECD member countries for personal tax returns filed by tax agents (see figure 1).

## CONSULTATION

Until the early 2000s, tax policy consultations in Australia were infrequent and largely confined to administrative matters. Today, consultation forms an integral part of the tax design process, with a large number of measures being subject to consultation in both the policy design and draft legislation phases.

Tax consultations serve a number of purposes and are subject to diverse influences. The major aims of consultation are

- to act as a discovery process that will provide valuable input on the most effective way to implement government policy, and to assist in minimizing compliance and administration costs, as well as to avoid (to the extent possible) unintended consequences;
- to elucidate on the policy intent of proposed changes;
- to serve as a vehicle to formulate current and future tax policy; and
- to improve situational and strategic awareness to better inform Treasury thinking.

Both the Treasury and the ATO have an active consultation program that focuses on the particular areas of responsibility of each agency. The ATO is a full participant in consultation arrangements undertaken by the Treasury.

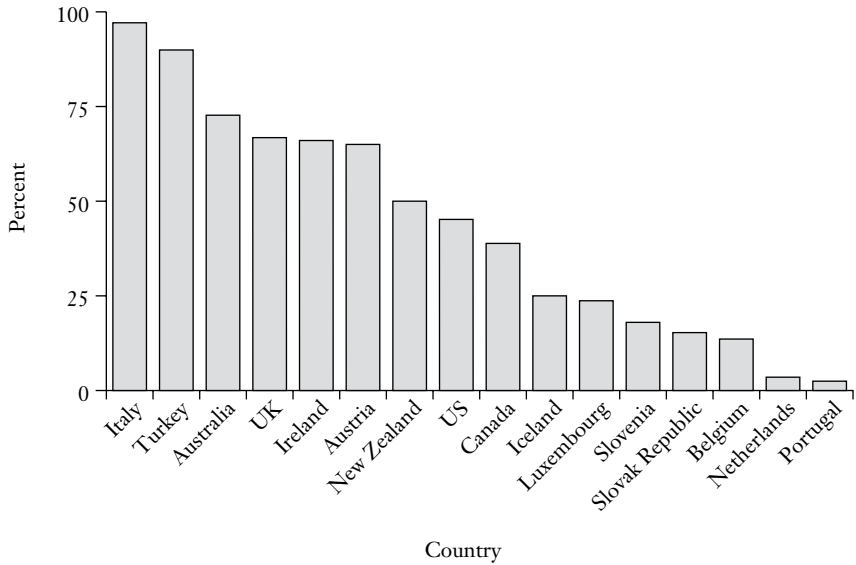
In the normal course of events, consultation involves the public release of an initial discussion paper, followed by an exposure draft of legislation or regulation. From time to time, however, consultation is more targeted, either to a public audience or to a more confidential group. Consultation on some measures may include more than one approach.

In the case of confidential consultations, participants are required to sign an undertaking not to divulge details of the consultation. However, if participants wish to discuss a confidential consultation with someone who is not a party to the consultation, they can request that this party also be given the opportunity to sign an undertaking and participate.

Participants in targeted consultations are generally chosen because they have expertise in the area or because they belong to a group that may be specifically affected by the legislation. Responses can be in the form of discussions at meetings or written submissions.

Public consultations are open to the general public, including individuals. Such consultations may be advertised in newspapers and posted on the Treasury website. For open public consultations, discussion (or policy) papers and/or exposure drafts

**FIGURE 1 Percentage of Personal Tax Returns Filed by Tax Agents in 16 OECD Countries, 2009**



Source: Organisation for Economic Co-operation and Development, Forum on Tax Administration, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)* (Paris: OECD, March 2011).

of legislation are generally prepared and made available. Submissions are sought in response to these papers, and these are also frequently made public on the website.

The nature of tax consultations can be characterized by the state of knowledge of a particular matter by the Treasury and the ATO on the one hand, and by stakeholders on the other. The  $3 \times 3$  matrix (table 2) depicts this graphically. The rows indicate the state of information that the Treasury and the ATO have about industry conditions, and the columns indicate stakeholders' understanding of policy.

Cell A represents fairly routine, basic “care and maintenance” law changes. These may arise from Treasury/ATO law fix registers or from stakeholder consultations. Cell A 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 that may well reflect more fundamental problems in tax law. Tax-avoidance issues could be present.

Cells C and D represent complex situations where the Treasury and the ATO do not have a full or sufficient 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 at the time of writing), and when policy change spans overlapping regulatory domains.

**TABLE 2 Tax Consultation Characterization Matrix**

		Stakeholders	
		Know	Don't Know
Treasury/ATO	Know	<p><b>A</b> Implementing well-understood policy in ordinary industry conditions</p> <p>e.g., basic care and maintenance; possibly deadlocked policy</p> <p><b>Basic consultation effort</b></p>	<p><b>B</b> Implementing newish policy in ordinary industry conditions</p> <p>e.g., complex care and maintenance; anti-avoidance</p> <p><b>Above basic consultation effort; policy dissemination</b></p>
	Don't know	<p><b>C</b> Implementing well-understood policy in new or changing industry conditions; overlapping regulatory domains</p> <p>e.g., tax consolidation care and maintenance</p> <p><b>Well above basic consultation effort; private-sector experts supplement Treasury's knowledge base; layered consultation ensures integrity of consultation process</b></p>	<p><b>D</b> Implementing newish policy in changing industry conditions; overlapping regulatory domains; new judicial doctrine</p> <p>e.g., resource rent tax, tax measures for carbon pricing</p> <p><b>Significant consultation effort; private-sector experts supplement Treasury's knowledge base; layered consultation ensures integrity of consultation process, including drawing on international experience</b></p>

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, the Treasury should draw on contracted private-sector expertise. The Treasury should also undertake multilayered consultations that cover a range of interests affected by the policy measure, in order to manage the risk that certain vocal and possibly influential voices might otherwise unduly distort the stakeholder experience.

Cell D represents mutual lack of information. This situation could arise with respect to new taxes, or when a judicial decision throws open an established way of thinking about a tax issue. In both situations, the Treasury and the ATO should be learning together with stakeholders and should seek to be informed through multilayered consultations and international experience, as appropriate.

In practice, tax consultations often entail multiple stages and approaches. For example, consultations on the minerals resource rent tax legislation in 2011 were conducted in two stages: first, the detailed policy design, led jointly by a government minister and a senior industry representative; and second, more detailed legislative implementation, led by the Treasury and involving a broader industry and practitioner group. This approach, in part, follows from the Treasury's role in such consultations.



While the Treasury may often lead consultations, its role is to listen to participants, advise the government on the views of stakeholders, and provide policy advice. The Treasury does not take policy decisions—that is ultimately the role of Parliament.

In addition to the well-developed program of consultations on announced measures, Revenue Group has in recent years conducted a program of semi-annual non-transactional consultations and has increased early-stage pre-policy consultations with stakeholders. The Revenue Group stakeholder consultation program aims to supplement Treasury consultations on specific tax measures and to engage the taxpayer community in a wider conversation about strategic tax policy issues.

Similarly, the early-stage consultations facilitate broader conversations about tax policy tradeoffs. In the past two years, pre-policy consultations have been undertaken on the business tax system, base erosion and profit shifting, and not-for-profit sector tax concessions. Each of these groups has been composed of a range of business, union, and community representatives. While this diversity might make it more difficult for groups to reach consensus on tax policy recommendations, it does expose sectoral interest arguments to appropriate scrutiny.

## **THE ROLE OF TAX GOVERNANCE BODIES**

The tax system in Australia operates with a number of tax governance bodies (listed in table 3), each serving a perceived need. The ATO plays a central governance role as the government's principal revenue collection agency and administrator of tax and superannuation laws.

The Parliamentary Budget Office is the latest independent governance body to become operational and will give Parliament the ability to better evaluate tax policy measures. The Parliamentary Budget Office is intended to inform Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy, and the financial implications of proposals. It is relatively well resourced (with around 25 staff employed currently and the intention of employing between 30 and 35 permanent staff), has experienced policy officers among its ranks, and has access to Treasury data and models.

The Tax and Transfer Policy Institute at the Australian National University was recently established to serve as a centre for excellence, collaborating with academics and institutions across Australia and overseas. The institute is expected to raise the quality of national debate on tax reform and the awareness of tax policy issues.

## **CONCLUSION**

The tax system is a fundamental part of Australia's social and economic infrastructure. This paper has outlined the role of key agencies, such as the Treasury and the ATO, as well as some of the more significant developments in governance and consultation arrangements in Australian tax policy formulation over the past decade. Underlying that discussion, Australia's system of responsible government remains central: All tax policy decisions are made by the democratically elected government of the day, and not by bureaucratic, academic, or other elites.

**TABLE 3 Tax Governance Bodies in Australia**

Organization	Type	Purpose
Australian Taxation Office	Independent statutory agency	The government's principal revenue collection agency, and part of the treasurer's portfolio. Administers the tax and superannuation laws.
Board of Taxation	Non-statutory advisory body	Advises the treasurer on improving the general integrity and function of the taxation system. Provides business and broader community perspectives. Established in 2000.
Inspector General of Taxation	Independent statutory agency	Identifies systemic issues in tax administration and reports to the government with recommendations for improving tax administration. Does not review tax policy. Established in 2003.
Taxation Ombudsman	Independent statutory agency	Investigates complaints from taxpayers and tax professionals about the administrative actions of the ATO. Also uses information from complaints to identify potential systemic problems in tax administration. Established in 1995.
Australian National Audit Office	Independent statutory agency	Undertakes financial statement audits and performance audits examining the economy, efficiency, and administrative effectiveness of the ATO's administration of the tax system.
Tax Practitioners Board	Independent statutory board	Responsible for the registration and regulation of tax practitioners and for ensuring compliance with the Tax Agent Services Act 2009. Replaces six state-based tax agents' boards.
Tax and Transfer Policy Institute	Independent research centre	Established in 2013 as an independent centre for excellence at the Australian National University.
Parliamentary		
Parliamentary Budget Office	Parliamentary department	Informs Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy, and the financial implications of proposals. Established in 2011.
Joint Committee of Public Accounts and Audit	Statutory committee in Parliament	Since 2007, has conducted public hearings with the ATO commissioner with respect to the administration of the tax system.
Senate Economics Committee	Statutory committee in Parliament	Investigates specific matters of policy, government administration, or performance.

## Some Additional Comments on Australia's Tax Policy Process

Graeme Cooper\*

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### INTRODUCTION

These comments refer only to income tax matters (though I have no reason to believe that consultation on other federal taxes works in a significantly different manner), and they should be read subject to the general caveat that they are based only on what is publicly visible.

### GENERAL DESCRIPTION OF THE PROCESS

It is a striking feature of the Australian tax world that, dating from about 10 years ago, consultation on every major tax announcement is expected and will occur. Just what accounts for this situation is not obvious, but it seems that our politicians have listened to years of complaints from business and tax professionals about the lack of consultation, and so there is an expectation that major policy announcements will be released for public comment prior to formal enactment. This will often take the form of a discussion paper and perhaps one or more drafts of indicative legislation.

However, while there is a lot of consultation, it almost always occurs *ex post*: day-to-day tax policy proposals almost always emerge from government as a *fait accompli* without the benefit of any transparent, prior, and external involvement. Instead of being involved in policy development, the participation of actors external to government is typically limited to policy refinement and issues of implementation. The one exception is policy announcements that have been prompted by lobbying, but that too is not conducted in public.

The usual situation is that the government will announce some measure, and then invoke a consultative process to refine and implement that measure. A typical example is the recent proposal to amend the tax secrecy rules to permit disclosure by the ATO of the tax position of corporations with taxable income over AU\$100 million. The measure was announced by the treasurer on February 4, 2013, along with the proposal to examine “advice from Treasury and views of the community . . . with a view to introducing any necessary legislative changes this year.”<sup>11</sup> In April, the Treasury released a brief paper, allowing three weeks for comment.<sup>12</sup>

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\* Of Sydney Law School, The University of Sydney (e-mail: graeme.cooper@sydney.edu.au).

11 Australian Treasury, Assistant Treasurer, “Greater Transparency of Tax Paid by Large and Multinational Businesses,” *Media Release* no. 5, February 4, 2013.

12 Australian Treasury, *Improving the Transparency of Australia's Business Tax System: Discussion Paper* (Canberra: Australian Treasury, April 2013).

There is nothing new in the observation that external public consultation is rarely conducted *ex ante*; it is a constant complaint. The 1999 Review of Business Taxation was keen to see what it described as a “participative” approach to the formulation of tax policy.<sup>13</sup> Recommendation 1.8 of its report proposed that tax policy be formulated in conjunction with the business community, and advocated “a more open and integrated approach to the initiation of policy proposals relating to business taxation.”<sup>14</sup> In a similar vein, the 2008 Tax Design Review Panel recommended that

the Government consult on new tax proposals at the initial policy design stage. This would allow the early input of private sector ideas and expertise to analyse the policy issue and find an appropriate and workable policy response.<sup>15</sup>

This *fait accompli* method of operating has drawbacks that occasionally become obvious. Proposals can be based on mistakes: the erroneous claims upon which the recent amendments to Australia’s general anti-avoidance rule (GAAR) were based were never tested. Changes can be ineffectual: the recent repeal and re-enactment of Australia’s domestic transfer-pricing rules probably does nothing to change Australian law, although it was promoted as a change. Or the change is simply unworkable: one of my favourite examples is the Treasury’s proposals in the early 1990s to allow the pooling of depreciable assets rather than asset-by-asset depreciation; it was not possible for taxpayers to pool assets because the capital gains tax rules insisted upon tracking costs asset by asset.

Australia’s more ambitious tax policy projects, which seem to occur every decade, tend to be more road-tested before implementation, and the lesson of grand projects is that many do not survive serious external scrutiny. Key elements of the Asprey review,<sup>16</sup> such as the introduction of a value-added tax, were not pursued. Many of the reforms suggested by the 1999 Review of Business Taxation were never adopted, especially key proposals such as replacing the fringe benefits tax with tax imposed directly on the employee, the proposal to tax trusts as companies, the proposed tax value method, and the proposed regime for taxing “leases and rights.” A similar story can be told about the Henry review:<sup>17</sup> almost all of its recommendations were ignored at the time the report was released; a handful have been enacted since. In some cases, the failure of a proposal has undoubtedly been due to politics and factors other than the merits of the proposal—but in many cases, a proposal was abandoned simply because it was shown to be misconceived once it was publicly scrutinized.

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13 *Supra* note 5.

14 *Ibid.*, at recommendation 1.8.

15 Australia, Tax Design Review Panel, *Better Tax Design and Implementation: A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs* (Canberra: Australian Treasury, April 2008), at paragraph 3.4.

16 *Supra* note 7.

17 *Supra* note 3.

## GOVERNMENT DEPARTMENTS WITH A ROLE IN TAX POLICY FORMULATION

While the Treasury has formal responsibility for formulating income tax policy, it is inevitable that administrative agencies will make policy, and the ATO is definitely a key player in deciding the shape of Australia's tax settings.

There have been many examples over the years of occasions when the ATO, by administrative edict, has unilaterally added refinements, imposed restrictions, or simply rejected policy settings. These are just a few such cases:

- Non-portfolio dividends from foreign subsidiaries would be tax-exempt only if received directly by the parent company, and not if the dividend flowed to the company via a wholly owned trust.
- Interest incurred to earn foreign (exempt) dividends would be deductible only for dividends earned in the same tax year.
- Company tax treatment would be denied to a trust in the face of legislation that treated the trust as a company “for all the purposes of the Act.”<sup>18</sup>
- An instrument could not be classified as debt despite an economic compulsion to repay (contradicting the explanatory memorandum, which referred to this very example three times).<sup>19</sup>
- GAAR could be used to deny tax credits to holders of instruments classified as equity under Australia's debt-to-equity tests.
- Loans by in-house finance companies would be treated as akin to equity investments.
- The key building blocks of tax law relating to trusts are viewed as being unresolved, despite 70 years of jurisprudence.

While it may not be obvious to outside observers, these are not simply instances of an administrator taking a position because of a lack of clarity, or acting to remedy a perceived weakness in the drafting, or trying to give effect to what the ATO presumes would be the policy. To my mind, they contradict policy settings. As one judge recently put it,

the real problem for the Commissioner [of Taxation] in the present case is that he seeks to cancel, in reliance on the [GAAR], tax consequences intended by Parliament to be conferred on a company . . . joining a consolidated group.<sup>20</sup>

These ATO policy decisions are not subject to any external and formal review process; it is not possible to say whether they are subject to any formal internal ATO review. The lore in the profession is that they are unilateral decisions taken individually by powerful, apparently unchecked, senior ATO officials.

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18 Income Tax Assessment Act 1997, section 713-135.

19 The ATO eventually abandoned its resistance in Taxation Ruling TR 2008/3.

20 *Macquarie Bank Limited v. Commissioner of Taxation*, [2011] FCA 1076, at paragraph 43.

On the other hand, the ATO has put in place an extensive set of committees that consult with the tax profession. (I have heard that there are more than 100 such committees.) Indeed, the ATO conducts far more consultations each year than the Treasury does on tax matters. The discussions of these bodies are not limited to matters of administration and technical detail. Whether and how the deliberations of these ATO-sponsored committees are fed into the Treasury's formal processes is not obvious, but—at least sometimes—they definitely are. For example, the many revisions of Australia's taxation of financial arrangements regime appear to have been driven largely by the issues raised by the non-governmental members of the Finance and Investment Subcommittee operated by the ATO.

The newly appointed commissioner of taxation is understood to be keen to reduce the current level of consultation, which he views as excessive and inefficient.

## CONSULTATION

### Formal Processes for Consultation with External Actors

Consultation on implementing policy is conducted in an ad hoc manner despite the existence of formal institutions for this process. Different models can be seen in practice:

- Sometimes policy proposals will be referred to the Board of Taxation, a standing committee (drawn from the tax profession, the private sector, and administrative agencies) charged with contributing “a business and broader community perspective to improving the design of taxation laws and their operation.”<sup>21</sup> Several recent reform projects (consolidation, collective investment vehicles, private company dividends, controlled foreign corporation rules, charities, share redemptions, etc.) were referred to the board.
- Sometimes a special ad hoc committee will be struck to assist with the refinement and implementation of policy. Special committees were struck, for example, for the minerals resource rent tax, reductions to the corporate tax rate, the project on reducing delays and improving tax law, the GAAR review, and the base erosion project.
- There are instances of selective secret consultations, where the Treasury will conduct informal discussions with a handful of experts of its own choosing, or with organizations representing particular industries, prior to releasing its legislation. This is understood to have occurred for some of the recent projects affecting the funds management industry.
- Sometimes a proposal is simply revealed to the general tax community, and interested observers are invited to comment. This has occurred, for example, with respect to the trust-law reform project, the minimum income tax regime,

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21 The board's charter is available at [www.taxboard.gov.au](http://www.taxboard.gov.au).

the limited recourse debt rewrite, the special regime for losses suffered on infrastructure projects, the corporate loss carryback regime, and so on. This consultation usually occurs around a draft bill and before a formal bill is introduced in Parliament.

- There are still instances where there is no precommencement consultation. A measure is announced and a bill enacted without external review.

These models are not necessarily discrete (for example, in the review of Australia's GAAR, there was both a publicly announced ad hoc panel and secret consultations), but in many instances they are (sometimes the Board of Taxation will be approached; sometimes it will be ignored in favour of an ad hoc committee). There is no apparent logic that drives this decision.

The only consistent pattern is that public post-implementation reviews—and there have only ever been a handful of these—appear to be solely allocated to the Board of Taxation.

### **Those Consulted**

Another significant dimension of this part of the topic is, who is consulted and why. The Treasury and the ATO rely to varying degrees on experts they have selected, individuals invited from a leading private-sector player, individuals nominated by the industry bodies, and individuals nominated by professional organizations, all volunteers. There is clearly a temptation (and it is probably also the practice) for private-sector actors to inveigle their way onto panels in order to advocate for their firms, their industry, or clients.

The resulting tension is inevitable: the very people who will best foresee the problems are the people with the greatest potential conflicts of interest. The Treasury is trying to manage this tension by introducing its proposed “Charter for Consultations on Tax Policy and Law” (in addition to the oath of secrecy, enforceable by criminal sanctions, which is routinely sought from experts). The same charter will apparently apply both to partisan players (the Treasury's own experts, and people who represent an affected industry or group) and to those who might be disinterested—professionals with technical expertise in tax.

The problem is difficult. The role expected of those being consulted is rarely made clear to them. In the case of industry experts, for example, have they been invited to represent and advocate for the industry, or have they been invited to explain the industry's position so that its concerns can be understood? The Treasury appears to have a notion of “key stakeholders” who must be involved in consultations. If people are selected because they are “stakeholders,” they are not being selected for their disinterested expertise. Tax professionals might be expected to be disinterested, though many will be invited precisely because of their client base.

The Treasury's draft charter attempts to deal with the problem by requiring that conflicts of interest be made transparent and by asking participants to advance the national interest. It is not clear what is meant to happen when everyone declares a conflict. It seems to me inevitable that anyone in the room who is an expert will

have some conflicting interest, and few delegates, even those acting from the best of motives, are likely to see as a “national interest” a position that is inconsistent with their own/their clients’ pecuniary interests.

Moreover, this approach mismatches roles and responsibilities. Everyone expects the ultimate decision maker (the minister or board member) to be impartial and disinterested, while everyone expects a lobbyist to be entirely partial. Those being consulted on tax matters are not decision makers, so it is implausible to insist that they accept strictures appropriate for those with real authority.

Perhaps what this really shows is that the Treasury lacks the skills and judgment to be able to differentiate the partisan from the disinterested, and it is trying a work-around to change the dynamic of the consultation process. From my observation, the Treasury and the ATO are not good at distinguishing the zealot from the sage or the expert from the charlatan (though admittedly sometimes these people are foisted upon them).

### **Effectiveness of Consultation**

The professional bodies and some of the individuals who participate in consultation routinely ponder whether consultation exercises are worthwhile. The professional accounting and tax bodies have staff devoted more or less full-time to attending consultation meetings or answering requests for submissions on the latest legislation or topic. Much of this effort is devoted to negotiating with the ATO, which has by far the largest number of consultation events.

The consensus seems to be that consultation is not worthwhile—announced policies rarely change unless there is a single, coordinated, “over-my-dead-body” response. There have been a few notable instances where the professional bodies have combined to defeat major reforms. Examples are the proposal to tax trusts as companies, the tax value method, the leases and rights project, the first iteration of the tax-preferred leasing rules, the ATO’s paper on section 974-80, and the ATO’s position against streaming income classes via trusts. A common feature of these examples is that the proposals did not emerge from the government as announced policy and so could be disowned by the government without political damage.

But even consultation just on refinement and implementation seems often to be ineffective in modifying errors or removing the impractical elements of proposals. The professional bodies have decided to pool resources and offer joint comments to the ATO, prepared on a rotating basis; evidently they have come to the conclusion there is little to be gained from investing separate time and effort.

To be fair to the government agencies, it is not common to receive consistent responses from external consultants. Except in cases where there is only one industry representative, they are unlikely to be presented with a single set of clear recommendations.

Regardless of its effectiveness in improving legislative outcomes, consultation will probably continue in much the same vein as currently. No single professional body will abandon the field to its rivals, and individual practitioners like it to be known that they are heavily involved in matters of great moment, even if they “can’t



really talk about it”; the major firms clearly see a benefit in demonstrating their connection with government.

It is significant that, as part of the negotiation surrounding the Treasury’s Charter for Consultations on Tax Policy and Law, the quid pro quo sought by the profession was a promise by the Treasury to explain its decisions on submissions made during consultation. This may not change the profession’s perception that “we invested all this time and effort and nothing changed,” but at least the profession hopes that it will now know why.



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# The Process for Making Tax Policy in Canada

Brian Ernewein and Nancy Horsman\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS ■ CANADA

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\* Of the Department of Finance, Ottawa (e-mail: Brian.Ernewein@fin.gc.ca; Nancy.Horsman@fin.gc.ca). The authors would like to acknowledge the contributions of Ted Cook and Michael McGonnell in the preparation of this paper.

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## OVERVIEW

Canada has a federal system of government. The federal government and each of the 10 provincial and 3 territorial governments develop and enact tax legislation. The federal and provincial governments do so under their own constitutional authority; the territorial governments do so under power delegated by the federal government.

At the federal level, legislation is enacted by the Parliament of Canada. Each province or territory has its own legislature that enacts provincial or territorial laws. Federal laws apply across the country. Provincial and territorial laws apply within the boundaries of the province or territory.

The federal and provincial governments each have jurisdiction to levy taxes on personal and corporate income and to impose sales taxes. However, the constitution of Canada<sup>1</sup> restricts provincial taxing powers to direct taxation within a province. Only the federal government can impose indirect taxes (such as import duties).

The description below outlines the federal tax policy process.

## GENERAL DESCRIPTION OF THE PROCESS

### Development Stage

#### *Generation of Ideas for Tax Changes, Including Identification of Problems in the Existing Tax System*

The Tax Policy Branch (TPB) of Canada's Department of Finance is responsible for the development of tax policy at the federal level. TPB personnel conduct internal research and analysis (for example, conducting economic analysis and reviewing case law) to generate ideas for tax initiatives and to analyze ideas for tax changes from other sources. The Canada Revenue Agency (CRA), which administers most federal taxes, is an important source of ideas for tax initiatives. In addition, TPB personnel are in regular contact with other branches of the Department of Finance, other federal departments, and representatives of provincial and territorial governments. Other sources of policy initiatives include

- elected officials (either individually or by way of recommendations of a parliamentary committee);

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1 Constitution Act, 1867, 30 & 31 Vict., c. 3, section 92.

- submissions from individual taxpayers, tax advisers, industry groups, and tax practitioner groups (for example, the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada [“the CBA-CPA joint committee”] and the Tax Executives Institute);
- expert panels appointed by government (for example, the Expert Panel on Financial Security for Children with Severe Disabilities and the Independent Panel on Federal Support to Research and Development);
- studies and research by private groups (for example, the C.D. Howe Institute and the Canadian Tax Foundation);
- international bodies (such as the Organisation for Economic Co-operation and Development [OECD] and the G8/G20); and
- academic research and advisers from the academic community.

### ***Research, Information Gathering, and Study***

The TPB is made up of five divisions: Personal Income Tax; Sales & Excise Tax; Business Income Tax; Tax Legislation; and Intergovernmental Tax Policy, Evaluation and Research. All except the Tax Legislation Division carry out quantitative and qualitative economic research and analysis regarding contemplated policy options. Members of the Tax Legislation Division and the Sales & Excise Tax Division review case law and commentary published by practitioners and academics. TPB staff review submissions by taxpayers, practitioners, and expert committees such as the CBA-CPA joint committee. The research undertaken depends on the nature of the issue.

The CRA has developed a large database using data from taxpayers’ return information. Department of Finance staff have access to this database for research and analytical purposes. It is a major source of information for the quantitative portion of the TPB’s policy analysis and allows TPB staff to model the projected outcomes of policy proposals.

### ***Identification and Evaluation of Solutions***

The annual federal budget is normally the major vehicle for the introduction of new tax policy initiatives; accordingly, the policy options analysis process normally tracks the annual budget cycle. Options are analyzed in anticipation of their potential acceptance as measures to be adopted in the budget.

For measures considered for inclusion in the budget, the legislative feasibility of various policy options, their consistency with the government’s priorities and with tax policy objectives (fairness, neutrality, simplicity, etc.), the economic and distributional impacts, the cost/revenue impact, potential provincial/territorial impacts, and other considerations are all reviewed. In addition, all tax measures are reviewed for their gender and environmental impacts. This is done by way of preparation of a briefing package for consideration for ministerial approval.

Similar analysis is conducted for potential tax changes considered outside the budget cycle.

### ***Drafting of Legislation***

Federal income tax legislation is drafted by members of the Tax Legislation Division in consultation with the Department of Justice and the CRA. Federal sales and excise tax legislation is drafted by members of the Sales & Excise Tax Division in consultation with the Department of Justice and the CRA (and the Canada Border Services Agency [CBSA] in some instances). Department of Justice lawyers are assigned to the Tax Counsel Division, which works within the TPB but is part of the Department of Justice. TPB staff also prepare the associated explanatory notes for use by parliamentarians and taxpayers.

Tax legislation is normally released in draft form and the public has the opportunity to submit comments, usually for a period of 60-120 days. Comments received on the draft legislative proposals are considered in finalizing the legislation before its introduction in Parliament.

### **Legislative Phase**

The Department of Justice prepares government bills for introduction in Parliament. Tax legislation is normally tabled in Parliament by the minister of finance. Federal legislation must be passed by both chambers of Parliament (the House of Commons and the Senate). The House and the Senate will generally study proposed legislation in committee before passing it. Legislation becomes law upon receiving royal assent (received from the governor general).

### **Post-Enactment Review Stage**

Administration of tax legislation is the responsibility of the CRA. If the CRA identifies issues with the application of the legislation, it will advise the TPB accordingly. TPB staff also have ongoing contact with stakeholders and review court decisions to identify issues in existing legislation.

Individual taxpayers may find that legislation has an impact that they believe is not within the policy intent of the legislation. In such circumstances, taxpayers (or their advisers) may contact the TPB. If, upon review, TPB officials consider that the technical application of a particular provision is not in accord with its underlying policy intent, a senior TPB representative may issue a comfort letter advising of their intention to recommend to the minister of finance an appropriate technical amendment to the legislation. Taxpayers (and their advisers) generally rely on comfort letters issued by the Department of Finance in proceeding with transactions and in preparing tax returns—although accounting standards may require certain firms to identify in their financial reports that a legislative amendment is required to support the tax position that the firm has taken. The CRA will also rely on these comfort letters, either to assess tax in accordance with the policy articulated by the Department of Finance or, in certain cases, to suspend an assessment of tax pending enactment of the particular change.

## **GOVERNMENT DEPARTMENTS AND ADVISORY BODIES WITH A ROLE IN OR RESPONSIBILITY FOR TAX POLICY FORMULATION**

### **Primary Responsibility for Formulating Tax Policy**

The Department of Finance is responsible for formulating federal tax policy. The department develops policies and provides advice to the government with the goal of creating a healthy economy for all Canadians. Activities include the following:

- analyzing and designing tax policy and carrying out the related research and evaluation;
- recommending policy and legislative changes to the minister of finance;
- planning and preparing the tax portion of the federal government's budget;
- drafting amendments to the tax statutes and related regulations;
- consulting provincial governments regarding tax policy and legislation;
- negotiating tax treaties and tax information exchange agreements with foreign governments;
- consulting with stakeholders; and
- negotiating tax administration agreements with aboriginal governments, and tax collection and sales tax harmonization agreements with provincial governments, as well as making payments pursuant to these agreements.

### **Responsibility for the Administration of the Tax System**

The CRA is the agency responsible for the administration of the federal income tax. In addition, the CRA administers

- the personal income tax of the territories and all provinces except Quebec;
- the corporate income tax systems of the territories and all provinces except Quebec and Alberta;
- the federal goods and services tax (GST) in all provinces except Quebec; and
- the provincial sales taxes of the five provinces that have adopted the harmonized sales tax (HST), which combines the 5 percent federal GST with a provincial component whose rate is set by the province.

In general, Quebec administers the Quebec sales tax (the QST, its value-added tax) as well as the GST/HST in Quebec. Quebec entered into a sales tax harmonization agreement with Canada in March 2012, the terms of which require that the QST be harmonized with the GST on a going-forward basis. British Columbia, Manitoba, and Saskatchewan administer their own retail sales taxes. (Alberta does not impose a provincial sales tax.) The CBSA collects applicable federal and provincial sales tax at the border.

Taxpayers are generally required to self-assess their income taxes payable (if any) and to report them in annual returns (signed declarations) filed with the CRA.

The CRA reviews these returns and may reassess taxes payable. The tax law contains authority for the CRA to review the records of taxpayers that are relevant to the determination of their taxes payable, and also provides certain collection powers not available to ordinary creditors. Taxpayers are entitled to an internal review within the CRA of the amount of tax assessed and have a further right of appeal to the courts (in the first instance to the Tax Court of Canada, then to the Federal Court of Appeal, and finally, with leave, to the Supreme Court of Canada).

### **The Role of Advisory Bodies and Parliamentary Committees**

From time to time, expert committees and advisory panels are appointed to advise the government on specific issues or in respect of specific areas of tax. Examples in recent years include

- the Advisory Panel on Canada's System of International Taxation,
- the Expert Panel for the Children's Fitness Tax Credit,
- the Expert Panel on Financial Security for Children with Severe Disabilities,
- the Technical Advisory Committee on Tax Measures for Persons with Disabilities, and
- the Technical Committee on Business Taxation.<sup>2</sup>

In addition, parliamentary committees issue reports that may provide input for ongoing policy development. Recent examples include reports of the House of Commons Standing Committee on Finance on tax evasion and the use of tax havens,<sup>3</sup> and on the use of tax incentives to encourage charitable giving by Canadians.<sup>4</sup>

Recommendations of these committees and advisory panels are seriously considered and in some cases implemented by the government. For example, a number of recommendations of the Advisory Panel on Canada's System of International Taxation have been implemented.

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2 The findings and recommendations of these various panels and committees can be found in the following reports: respectively, Advisory Panel on Canada's System of International Taxation, *Final Report: Enhancing Canada's International Tax Advantage* (Ottawa: Department of Finance, December 2008); Canada, *Report of the Expert Panel for the Children's Fitness Tax Credit* (Ottawa: Department of Finance, October 2006); Canada, *A New Beginning: The Report of the Minister of Finance's Expert Panel on Financial Security for Children with Severe Disabilities* (Ottawa: Department of Finance, December 2006); Canada, *Disability Tax Fairness: Report of the Technical Advisory Committee on Tax Measures for Persons with Disabilities* (Ottawa: Department of Finance, December 2004); and Canada, *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, April 1998).

3 Canada, House of Commons, *Tax Evasion and the Use of Tax Havens: Report of the Standing Committee on Finance*, 41st Parl., 1st sess., May 2013.

4 Canada, House of Commons, *Tax Incentives for Charitable Giving in Canada: Report of the Standing Committee on Finance*, 41st Parl., 1st sess., February 2013.



## RESOURCES DEVOTED TO THE FORMULATION OF TAX POLICY

### Professional and Other Staff

The TPB currently has approximately 160 staff, including both professional and support staff. As of April 1, 2013, the active staffing complement for the TPB was as follows:

Senior Assistant Deputy Minister's Office .....	7
Personal Income Tax Division .....	32
Tax Legislation Division .....	27
Sales & Excise Tax Division .....	44
Business Income Tax Division .....	29
Intergovernmental Tax Policy, Evaluation and Research Division .....	17

The majority of the professional staff of the TPB are economists and other social policy professionals. The Tax Legislation Division and parts of the Sales & Excise Tax Division are staffed primarily by lawyers and accountants. Most of the economists on staff have a graduate degree, and a number of the professionals in the TPB have graduate degrees in tax, business, or public policy.

Typically, new staff are hired through university recruitment or from other branches of the Department of Finance or other federal departments, rather than as experienced hires from the private sector. New staff are trained as tax policy professionals within the TPB.

### Private Sector Consultants

Depending on the nature and complexity of the issue, advice from the private sector may be sought to ensure that all possible considerations associated with the contemplated policy change are looked at. This is particularly relevant when the contemplated policy change has the potential to significantly affect market transactions or stakeholders in a particular segment of the economy.

### Temporary Secondments from the Private Sector

The TPB arranges for the secondment of private practitioners to fill senior roles within the branch on an as-needed basis. For example:

- A senior tax partner with a major accounting firm recently joined the Department of Finance under the federal government's executive interchange program and acted as director of the Tax Legislation Division for almost two years.
- A partner from another major national accounting firm has joined the Tax Legislation Division under the same program, to work on foreign affiliate issues.
- On the sales tax side, accountants and a lawyer from major national firms have assisted with the examination of the GST/HST treatment of financial services.

## CONSULTATIONS WITH THE PUBLIC AND TAX PROFESSIONALS

### Consultation Process

The minister of finance engages in a series of consultations with members of the public prior to each budget. The House of Commons Standing Committee on Finance also holds pre-budget hearings and presents a report on these hearings.

In addition, the government engages in public consultations on specific issues. Examples of recent public consultations on tax issues include the following:

- *Scientific research and experimental development (SR & ED) tax incentive program.* In October 2007, the Department of Finance and the CRA issued a consultation paper and invited submissions on how the SR & ED tax incentive program could be made more effective for Canadian businesses and how it could be designed to play an even greater role in fostering a more competitive and prosperous Canadian economy.<sup>5</sup>
- *Non-resident trusts.* A consultation was completed in 2010 pursuant to revised proposals for the taxation of non-resident trusts and foreign investment entities outlined in the 2010 federal budget.<sup>6</sup> The consultation consisted of a panel of experts commenting on detailed proposals.
- *Reporting of tax-avoidance transactions.* The 2010 budget released for consultation a proposal that avoidance transactions that met certain benchmarks be required to be reported to the CRA.<sup>7</sup>
- *Taxation of corporate groups.* The 2010 budget announced that Canada was exploring new rules for the taxation of corporate groups, such as a more formalized system of loss transfers or a form of consolidated reporting.<sup>8</sup> A discussion paper was released in November 2010 and comments were invited.<sup>9</sup>
- *Employee profit-sharing plans (EPSPs).* As announced in the 2011 federal budget,<sup>10</sup> the government undertook consultations for the purpose of reviewing the existing rules for EPSPs. As part of these consultations, the Department of Finance invited comments on the rules that apply to EPSPs.<sup>11</sup>

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5 See Canada, Department of Finance, *Tax Incentives for Scientific Research and Experimental Development: Consultation Paper* (Ottawa: Department of Finance, October 2007).

6 Canada, Department of Finance, 2010 Budget, Budget Plan, March 4, 2010, at 371-78.

7 *Ibid.*, at 382-84.

8 *Ibid.*, at 386.

9 Canada, Department of Finance, *The Taxation of Corporate Groups: Consultation Paper* (Ottawa: Department of Finance, November 2010).

10 Canada, Department of Finance, 2011 Budget, Budget Plan, June 6, 2011, at 291.

11 Canada, Department of Finance, "Consultations on the Tax Rules for Employee Profit Sharing Plans," August 30, 2011 ([www.fin.gc.ca/activty/consult/epsp-rpeb-eng.asp#a1](http://www.fin.gc.ca/activty/consult/epsp-rpeb-eng.asp#a1)).

- *Registered disability savings plans (RDSPs)*. In October 2011, the Department of Finance announced that it was undertaking a review of RDSPs, to ensure that such plans are meeting the needs of Canadians with severe disabilities and their families.<sup>12</sup> The review sought public input on a number of matters that are crucial to the success of RDSPs, including access to plan savings, plan termination, and the administration of the RDSP program.
- *Life insurance policyholder taxation*. The 2012 federal budget proposed changes to the life insurance policyholder taxation rules and announced a related consultation with key stakeholders.<sup>13</sup> A consultation paper was released to an industry working group on May 31, 2012. TPB officials discussed the proposals outlined in the paper extensively with industry representatives.
- *Contingency fees related to the SR & ED tax incentive program*. As announced in the 2012 federal budget,<sup>14</sup> the government undertook consultations on contingency fees charged by SR & ED tax preparers to determine whether these fees diminish the benefits of the SR & ED tax incentive program to Canadian businesses and the economy.

As noted earlier, tax legislation is generally released in draft form for public comment before it is introduced in Parliament. Written comments are solicited, and may be provided by either mail or e-mail. Meetings are also often held with stakeholders, either in relation to particular measures that affect a particular taxpayer or group, or, in the case of input provided by organizations such as the CBA-CPA joint committee or the Tax Executives Institute, on most or all of the measures put forward in the particular package of draft legislative proposals.

Parliamentary committees, of both the House of Commons and the Senate, hold hearings on proposed tax legislation as part of its passage by Parliament.

TPB staff have regular meetings with stakeholder groups such as the commodity tax committees of the Canadian Bar Association and the Chartered Professional Accountants of Canada, and the Tax Executives Institute.

### **Issues Considered Suitable for Public Consultation**

Public consultation can be particularly useful in the following circumstances:

- Where new policies are proposed, consultations may reveal unintended consequences or, alternatively, may reveal a gap in the policy.
- With policies that may be sensitive or controversial, consultations may provide an opportunity to explain concerns that might be addressed in the legislation.

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12 Canada, Department of Finance, “Consultation on Ensuring the Effectiveness of Registered Disability Savings Plans,” October 2, 2011 ([www.fin.gc.ca/activty/consult/rdsp-reeci-eng.asp#Ensuring](http://www.fin.gc.ca/activty/consult/rdsp-reeci-eng.asp#Ensuring)).

13 Canada, Department of Finance, 2012 Budget, Budget Plan, March 29, 2012, at 400-2.

14 *Ibid.*, at 71.

- Often, changes that are required to tighten existing legislation take effect at the time they are announced, in order to prevent revenue losses. In these cases, consultations occur after the announcement, and generally relate to technical issues rather than the policy aspects of the tightening change.
- Consultations may be used to review the effectiveness of existing tax measures.
- Through the release of draft legislation, the tax practitioner community is given an opportunity to comment on proposed amendments addressing technical issues identified by the TPB, the CRA, or taxpayers and their advisers.

### **Timing and Form of Public Consultation**

The stage at which consultation is carried out varies with the purpose of the consultation. For example, the consultation process

- may occur at an early stage and provide the impetus for a tax change (such as when a parliamentary committee studies a particular issue or the minister of finance engages in pre-budget consultations);
- may be carried out to elicit views on a range of options, or on one particular option, to address an issue;
- may be carried out with respect to the implementation of a tax change that has been announced by the government; or
- may occur on the release of draft legislation for comment.

The Department of Finance's main approach to formal consultation involves a news release and the posting of a consultation paper or draft legislation on the department's website inviting comments from interested stakeholders.

Consultations may also be in the form of informal meetings between TPB staff and taxpayers, industry groups, tax practitioners, or the other stakeholders.

### **Effectiveness of the Consultation Process**

Consultations are useful for learning about new policy ideas, for identifying issues associated with new tax policies, and for identifying technical issues with proposed legislation. Consultations are also useful for identifying sensitive aspects of policies and for explaining government positions on policy issues.

## **OTHER ISSUES**

### **Academic Research**

The tax policy community would benefit from more academic scholarship in the area of tax law. Canada has a limited number of academics at universities and other organizations who focus their research on tax policy issues.

### **Transparency**

The budget process and the development of legislation are generally secret. Consequently, there are important limits to the extent that information is shared with

respect to the development of tax initiatives. However, comfort letters issued by the Department of Finance are made public, as are advance tax rulings and technical interpretations issued by the CRA.

The Department of Finance and the CRA are both subject to the Access to Information Act,<sup>15</sup> which may require the release of information in certain circumstances.

### **The Role of Politics and Politicians**

In the field of taxation, only the government can introduce a measure that would impose a new or additional tax. However, measures to reduce taxes may be introduced either by the government, or by parliamentarians as private members' bills.<sup>16</sup>

In addition to the House of Commons Standing Committee on Finance, the Senate's Standing Committee on Banking, Trade and Commerce and the Senate's Committee on National Finance study tax legislation, and tax issues more generally, as part of their respective mandates.

### **The Role of International Organizations**

The Department of Finance and the CRA are actively involved with the OECD at the working-party level and with the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes. As well, a senior representative of the Department of Finance sits on the OECD Committee on Fiscal Affairs. The Department of Finance actively supports the work of the International Monetary Fund and the World Bank. The OECD model tax convention<sup>17</sup> generally serves as a model for Canada's tax treaties.

### **The Role of Independent Tax Reform Bodies**

There are several non-governmental organizations in Canada that play an important role in the development of tax policy and the advancement of tax reform:

- The Canadian Tax Foundation promotes and facilitates the study of, and discussion about, Canada's tax system. Drawing its members from all branches of the tax community, in Canada and abroad, the Foundation is the predominant Canadian organization in this area. Its publications include the *Canadian Tax Journal*, conference reports, regular tax updates, and monographs on a range of tax topics.
- The CBA-CPA joint committee acts as a nexus for the tax practitioner community to present concerns to the Department of Finance.

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15 RSC 1985, c. A-1, as amended.

16 Audrey O'Brien and Marc Bosc, eds., *House of Commons Procedure and Practice*, 2d ed., 2009 (Ottawa: House of Commons, 2009), 1114.

17 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, July 2010).

- The Tax Executives Institute represents corporate in-house tax professionals.
- A number of independent think tanks, other research institutions, and professional bodies (for example, the C.D. Howe Institute, the Fraser Institute, the Association de planification fiscale et financière, and the University of Calgary's School of Public Policy) publish work relating to the economics of taxation and other aspects of tax policy.

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# Development of Tax Policy in New Zealand: The Generic Tax Policy Process

Struan Little, Geof D. Nightingale, and Ainslie Fenwick\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS ■ NEW ZEALAND

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\* Struan Little and Ainslie Fenwick are of the Inland Revenue Department, Wellington (e-mail: [struan.little@ird.govt.nz](mailto:struan.little@ird.govt.nz); [ainslie.fenwick@ird.govt.nz](mailto:ainslie.fenwick@ird.govt.nz)). Geof D. Nightingale is of PricewaterhouseCoopers, Auckland (e-mail: [geof.d.nightingale@nz.pwc.com](mailto:geof.d.nightingale@nz.pwc.com)). We would like to acknowledge the work of Matt Bengé and Robin Oliver in the preparation of this paper.

## INTRODUCTION

New Zealand has a tax policy process that is widely seen to work relatively well. There is a degree of cooperation between the private and public sectors that is quite rare internationally. There is a large element of working together to provide a tax system that is best for “New Zealand Inc.” (New Zealand as a whole).

In understanding the tax policy process and why it works well, it is helpful to consider some important facts about New Zealand. New Zealand is a small country, where the key players involved in tax policy in the government and the private sector all know one another. There are repeated interactions. While these could potentially either build or destroy trust, there are strong incentives to cooperate and build trust. Private-sector tax professionals also are known by and have good access to government ministers, particularly through conferences and the work of the New Zealand Institute of Chartered Accountants and the International Fiscal Association. Open channels exist for expressing concerns to ministers if those in the private sector think that tax policy officials are getting things badly wrong.

New Zealand has a formalized generic tax policy process (GTPP), which importantly includes a strong consultative component. The GTPP has a high degree of support from the private sector, tax officials, and government ministers. The private sector voices strong concerns when important tax policy changes are not put through the full GTPP.

## GENESIS OF THE GTPP

In 1984, New Zealand elected a reformist Labour government. Policy moved quickly in the direction of a “broad-base, low-rate” (BBLR) tax system. By lowering rates and broadening tax bases, the reforms were aimed at reducing the distorting impact of taxation, making things fairer, and ensuring the tax system’s ability to raise the revenue necessary to fund government spending. In many ways, this policy shift paralleled tax changes that were taking place in other countries, including the United States and Australia, but in New Zealand the reforms arguably went further. With some chopping and changing, this BBLR framework has, for the most part, continued until today.

Not only was there a radical change in tax policy in the mid-1980s; there was also a fundamental shift in willingness to consult. The government established consultative committees to review and better implement proposed tax policy reforms.

The first of these committees was set up to consider the goods and services tax (GST). It worked spectacularly well and allowed a well-designed GST to be brought in very quickly. The original framework of the GST (which came into effect in 1985) continues to this day. There was a wealth of goodwill in making tax policy changes, and now a very open and consultative environment in which to do so.

It was clear that by the end of the 1980s, much had been achieved. There was, however, less consensus on the direction of future policy changes.

Concerns about the tax policy process were among the reasons for the government’s decision, in 1993, to ask a review committee (chaired by Sir Ivor Richardson)



to carry out a fundamental strategic review of the Inland Revenue Department and its activities. The scope of this review was broader than just tax policy, but tax policy was an important element in the review.

The Organisational Review Committee reported in April 1994.<sup>1</sup> On the policy side, the committee identified the following key concerns:

- Things were working much less well than they had during the early 1990s.
- It was difficult to see how tax policy fitted into the government's broader economic objectives.
- There was not a strong enough tax policy group within the Inland Revenue. The review expressed concern that while both Inland Revenue and Treasury were involved in tax policy, there was anecdotal evidence that "[Inland Revenue] tax policy advice [was] often overpowered by the advice from Treasury and the private sector."<sup>2</sup>

The committee suggested the establishment of a major policy arm in Inland Revenue able to match the intellectual capability of the Treasury and the private sector. The reasons for this recommendation are not made explicit. But there may have been a concern that practical tax problems were not being addressed in the legislation. There may have also been a concern that real compliance costs of tax legislation did not have a sufficient focus and that this focus might increase with a greater Inland Revenue presence on tax policy.

There was also a concern that policy and legislation were not sufficiently linked, leading to unnecessarily complex legislation. The Organisational Review Committee also suggested the establishment of a legislative function in Inland Revenue and a fundamental rewrite of the Income Tax Act.<sup>3</sup>

## THE GTPP

Before the Organisational Review Committee had reported, the government had signed on to the committee's recommendation of a formalized GTPP. The main objectives of the GTPP were

- to encourage early consideration of key policy elements and tradeoffs,
- to provide an opportunity for substantial external input into the policy formation process, and
- to clarify the responsibilities and accountability of participants in the process.

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1 New Zealand, Organisational Review Committee, *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue (and on Tax Policy, also to the Minister of Finance) from the Organisational Review Committee* (Wellington: Inland Revenue Department, April 1994).

2 *Ibid.*, at 79.

3 All other government legislation is drafted by the Parliamentary Counsel Office (PCO). Inland Revenue is unique in this respect.

The committee suggested a multiphase formalized GTPP that included the following:

1. *Strategic phases*: economic strategy; fiscal strategy; three-year revenue strategy
2. *Tactical phases*: rolling three-year work program; annual work and resource plan
3. *Operational phases*: detailed policy design; formal detailed consultation and communication; ministerial and Cabinet signoff of detailed policy
4. *Legislative phases*: drafting of legislation; ministerial and Cabinet signoff of legislation; introduction of bill; select committee phase; passage of legislation
5. *Implementation and review phases*: implementation of legislation; post-implementation review; identification of remedial issues

Subject to a few minor amendments, these original suggestions continue to provide the basis for today's GTPP, which is illustrated in figure 1.

Another key legacy of the organisational review is that Inland Revenue and the Treasury are jointly responsible for developing tax policy—through the Policy Advice Division (now referred to as Policy and Strategy) within Inland Revenue and through a smaller policy group within the Treasury. This joint provision of tax policy advice is not common internationally. It does, however, create safeguards for the government by increasing the extent to which tax policy advice is tested internally before issues are put to ministers or released for public consultation.

### **Strategic Phases**

The strategic phases of the GTPP involve the development of an economic strategy, a fiscal strategy, and a revenue strategy. Broad policy proposals may be publicized through channels such as budget documentation.

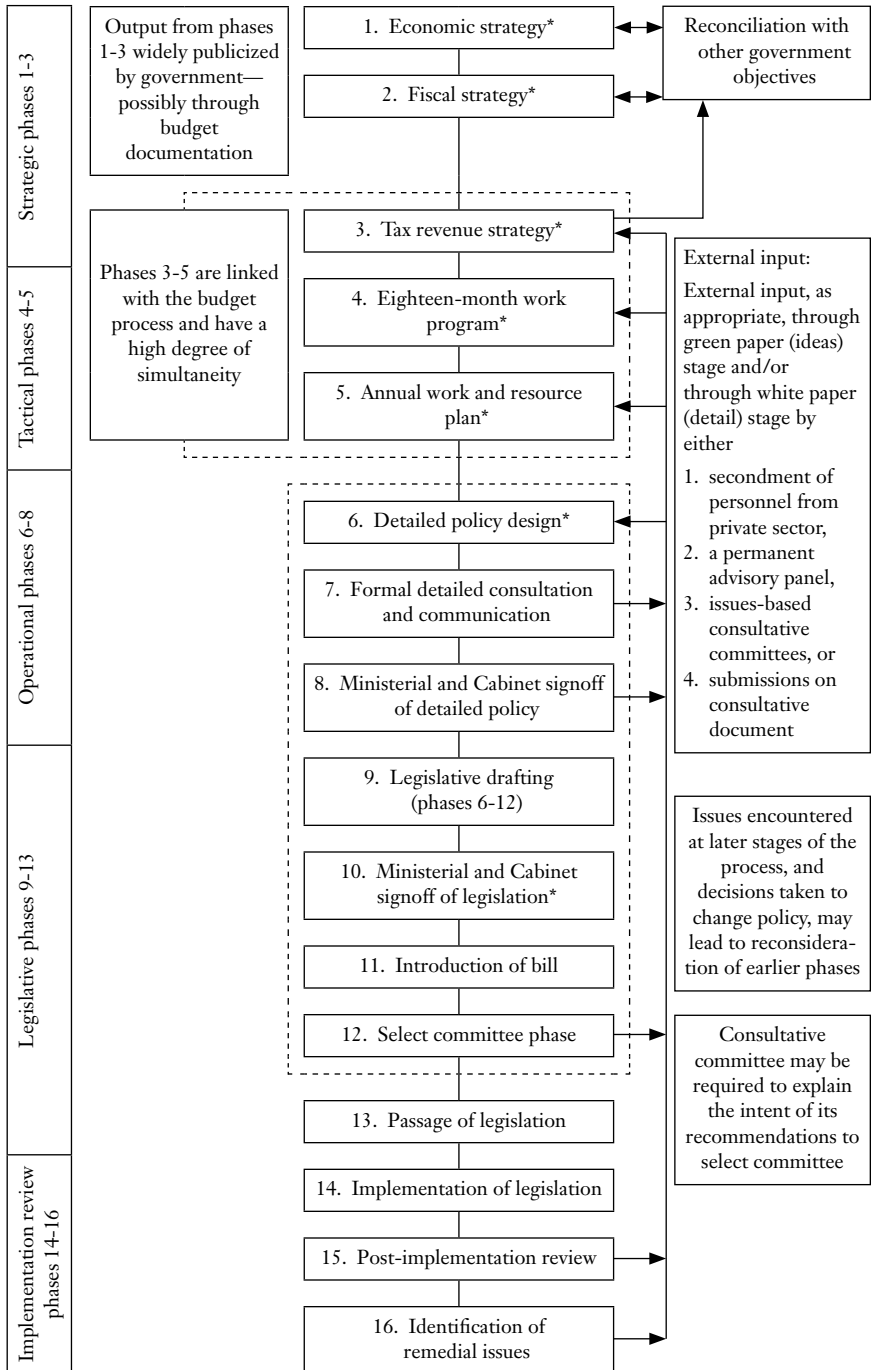
### **Tactical Phases**

The tactical phases of the GTPP involve planning and form the basis for policy delivery for the following 18 months. An 18-month work program is developed jointly with the Treasury, consulted on, approved by ministers and Cabinet, and published. This published work program is consistent with the government's economic objectives.

In developing the work program, the international environment within which New Zealand operates is a key consideration. This includes identifying emerging trends in tax policy both internationally and politically. The role of the chief economist (a position within Policy and Strategy) is to provide expertise and leadership on the development of the economic and strategic direction of tax policy. In addition, the chief economist provides leadership for the forecasting function and economic advice across all tax and strategy matters.

A core aspect of the GTPP is research, including data analysis, and Policy and Strategy has a Forecasting and Analysis Unit. Data from this unit are used regularly in the development of tax policy. Another source of information is the specialist

**FIGURE 1 New Zealand’s Current Generic Tax Policy Process (2013)**



research, evaluation, and analysis undertaken by the National Research and Evaluation Unit within Inland Revenue.

As noted above, monitoring international trends in tax policy is an important element of good tax policy design. New Zealand has strong links with international organizations. Staff within the policy unit are active members of a number of the Organisation for Economic Co-operation and Development (OECD) working parties.

### **Operational Phases**

The operational phases consist of detailed policy design, detailed consultation, and gaining ministerial and Cabinet approval of recommendations. This phase culminates in government approval of practical tax policy initiatives that are ready to be introduced in Parliament and implemented.

On major reforms, consultation will often involve the release of a government discussion document. This gives people something specific to react to. It is critical for the language of the document to cater for its intended audience and especially to take into account whether or not readers are likely to be tax specialists. Normally, about six weeks are allowed for submissions, and during the submission period officials have intensive face-to-face meetings with affected taxpayers. After the submissions have been received and considered, officials will report to the government on them. The government may either decide to proceed to legislation taking into account what has been learned from submissions, or ask for further consultation on certain issues. This may involve direct consultation on specific points or the release of an officials' issues paper and subsequent consultation.

A good tax policy process cannot be just written down in a set of rules of engagement. There needs to be considerable goodwill. The public and private sectors need to be willing to engage and listen to each other (not talk at each other). Consultation needs to be real, with the government being willing to pick up valid suggestions put forward by the private sector.

Not every proposed reform requires a government discussion document. For smaller issues, consultation may involve discussions or correspondence with a much smaller group of people or even just a telephone call. Often remedial issues are dealt with as raised rather than through a large-scale review.

During these phases, an Inland Revenue design area (outside Policy and Strategy) supports the development of policy, such as exploring the administrative impacts of various policy options. This design area has responsibility for engaging the wider Inland Revenue. This also allows for the consideration and suggestion of practical options to ensure a sustainable and reliable outcome that still meets the policy intent. The result is that the design area directly contributes to robust policy design, ensuring that the resulting law can be properly administered, that it is suited to its intended purpose, and that costs and impacts for both the government and taxpayers are minimized.

### **Legislative Phases**

In the legislative phases, the detailed policy recommendation is translated into legislation. This occurs in parallel with the operational phases described above, which

speeds up the process by ensuring that legislation is ready for introduction in Parliament once all policy issues have been resolved. It also ensures that the proposed reforms can be expressed clearly in legislation.

Once a bill has been introduced, it is publicized on Inland Revenue's website (as well as Parliament's website), along with a specially prepared commentary that explains the rationale for the proposed policy changes. External consultation takes place through public submissions to the select committee considering the bill. A benefit of the GTPP is that by the time legislation comes before a select committee, the private sector should be thoroughly familiar with the reasons for change.

### **Implementation and Review Phases**

The implementation and review phases include the post-implementation review of new legislation, after it has had time to "bed in," and the identification of any remedial issues that need to be addressed for the new legislation to have its intended effect. Opportunities for external consultation are also built into this stage.

### **HOW THE GTPP OPERATES IN PRACTICE**

There have been a number of major reviews in recent years. One example is the 2006 Business Tax Review. An initial discussion document was released in July 2006,<sup>4</sup> seeking consultation on proposals to reduce the company tax rate, along with the tax rate on certain widely held savings vehicles, from 33 percent to 30 percent, and to introduce targeted tax credits for research and development (R & D), export market development, and skills training. Three officials' issues papers followed, in November 2006, which refined the original policy proposals and initiated further consultation.<sup>5</sup>

Interestingly, not all business-friendly options proposed by the Business Tax Review were supported by business groups. In particular, there was little public support for export market development and skills training tax credits. These were dropped. However, there was support, on balance, for an R & D tax credit and strong support for rate cuts.

Legislation introducing tax rate cuts for companies and savings vehicles was introduced, went through the select committee process, and was ultimately passed. The company tax rate and tax rates for widely held savings vehicles were cut from 33 percent to 30 percent for the 2008-9 income year. A 15 percent R & D tax credit was also introduced, starting that year.

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4 New Zealand, Inland Revenue Department, *Business Tax Review: A Discussion Document* (Wellington: Inland Revenue Department, Policy Advice Division, July 2006).

5 New Zealand, Inland Revenue Department, Policy Advice Division and New Zealand Treasury, *R&D Tax Credits: Definition, Eligibility Criteria, Eligible Expenditure—An Officials' Issues Paper on Matters Arising from the Business Tax Review* (Wellington: Inland Revenue Department, November 2006); *Market Development Tax Credits: Definition, Eligibility Criteria, Eligible Expenditure—An Officials' Issues Paper on Matters Arising from the Business Tax Review* (Wellington: Inland Revenue Department, November 2006); and *Skills Training Tax Credits: Definition, Eligibility Criteria, Eligible Expenditure—An Officials' Issues Paper on Matters Arising from the Business Tax Review* (Wellington: Inland Revenue Department, November 2006).

An interesting aspect of the tax environment in New Zealand is the extent to which private-sector practitioners are prepared to push for tax changes that are not in their own direct financial interest. The R & D tax credit provided strong business benefits to major accounting firms; there was a considerable amount of financially rewarding work in helping firms to identify which expenditures could reasonably be considered to be R & D. Nevertheless, these firms strongly opposed the R & D credit, on the ground that it was not in New Zealand's best interests. In their view, it would be better to abandon the credit in favour of a non-incentivized BBLR framework. The R & D tax credit lasted only a year and was dropped by the new National Government elected in November 2008.

### **The Role of the Private Sector**

Key participants in the private sector that are engaged in the tax policy process include professional bodies, sector-specific groups, and the large accounting and advisory firms.

The New Zealand Institute of Chartered Accountants has a national Tax Advisory Group (TAG) with a long history of engaging with government on tax policy development. The members of the TAG are volunteers and include two tax partners from each of the Big Four firms along with four to six other tax experts drawn from corporate, academic, and public practice. The TAG is supported by a secretariat provided by the institute, consisting of three to four full-time equivalent tax professionals. The TAG makes submissions on all tax legislation and policy changes, and engages frequently with officials and government during policy formation, legislation, and implementation.

The TAG operates with a stated objective of achieving tax policy outcomes that are in the public interest. Where the commercial interests of the institute's members seem in conflict with the public interest, the TAG's view of the public interest prevails. This is evident in the R & D example outlined above, and in recent policy proposals developed by the TAG to radically simplify tax compliance for small and medium-sized enterprises (SMEs). (Simplification would reduce the tax compliance fees earned by members from clients but may improve the economic performance of SMEs.)

The New Zealand Law Society operates a Tax Committee that also engages in tax policy development. It is not as well resourced as the TAG and tends to focus more on the legal position of the policy, but it too is a respected participant in the GTPP. It also operates with the public interest as its key framework.

Another important participant is the Corporate Taxpayers' Group (CTG), comprising 39 of New Zealand's major corporate taxpayers. The CTG's model includes a subscription basis (with corporate members funding through shared costs), secretarial support, submissions, and advice provided by major law and accounting firms. Unlike the TAG and the Law Society's Tax Committee, the CTG's primary focus is the interests of its 39 corporate members. However, it also pursues those interests within a wider public interest framework, recognizing that New Zealand is a highly interdependent and small economy.

The Big Four accounting and advisory firms in New Zealand also devote considerable senior resource and research capability to tax policy development. Partly this arises from the desire to be involved in the process, in order to remain in touch and retain professional credibility with their clients. But it also arises from a strongly held belief and tradition in these firms that contributing resources to tax policy development is in the best interests of New Zealand and the wider economy. Because the firms themselves are significant NZ businesses, they see this as an appropriate contribution to make.

Contributing to tax policy development in the public interest is not always an easy path for the private sector. Private firms must balance the (at times) competing interests of their clients (which themselves are often in conflict as between clients) and their own commercial interests (with respect to the expenditure of non-billable time on policy engagement), and competitive tensions between the various firms. Managing these conflicts while making a meaningful contribution with New Zealand's best interests as the focus is, at times, a delicate task.

Having a shared understanding of what is in the best interests of New Zealand in the long run makes it possible to navigate a path through these conflicts. This shared understanding has been established and is maintained by extensive interaction between the private sector, government, and officials through forums such as conferences and working groups, and through open and constructive engagement. This climate of cooperation was further enhanced by direct and open access to the previous, long-serving minister of revenue (the Honourable Peter Dunne), who devoted considerable time and effort to meeting with and speaking to those working in the private sector. The Honourable Peter Dunne resigned as minister of revenue in June 2013. The new minister of revenue, the Honourable Todd McClay, has continued the previous minister's high level of engagement with the private sector.

Because of the willingness of private firms to argue for what they believe is in New Zealand's best interests, the private sector has a very important role in initiating policy changes as well as modifying proposals and making them work better. The process only works, however, if there is a willingness by officials and the government to engage and listen, and to accept good suggestions. As noted earlier, a key factor that makes the GTPP work well is the high level of buy-in by the private sector to the government's BBLR framework.

## **Consultation**

Much has been said about the importance of consultation. But what is consultation? Useful consultation will depend on the subject. In many cases, tax consultation works through the publication of consultative documents, and much of the consultation is with tax practitioners. This is often but not always appropriate. For example, for consultation on the taxation of charities, it was useful to run things in a much less formal way and have large informal meetings to discuss issues, including town hall meetings. This ended up involving people that the government might not otherwise have reached. For consultation on student loan arrangements, it was useful to have a blog and to release discussion documents through an online forum. For consultation

on the tax treatment of indigenous authorities, regional hui (meetings) were organized using indigenous networks.

Full-scale consultation is not required on everything, and is not always possible. At times, consultation may just involve discussions with key affected parties. With respect to base maintenance provisions, it is understood that often there cannot be full consultation, especially if tax changes are closing some loophole. This base maintenance exception to the GTPP is acknowledged and accepted by the private sector as being appropriate (although at times there are different views as to what qualifies as base maintenance).

## **THE ROLE OF INDEPENDENT TAX REFORM BODIES—THE VICTORIA UNIVERSITY OF WELLINGTON TAX WORKING GROUP**

While the GTPP has led to very good links and considerable collaboration with private-sector tax practitioners, there have in the past been fewer links with the academic community. There has also been a limited pool of academics doing research on tax policy in New Zealand.

Concerns about New Zealand's tax system had been voiced in Inland Revenue and Treasury briefings to incoming ministers following the election of a national government in November 2008. Both Inland Revenue and the Treasury were concerned about the integrity of the tax system, but the Treasury was also concerned about whether or not New Zealand's tax structure, and in particular its reliance on personal and company income tax, was having an adverse impact on growth. There was a general concern about the fairness, efficiency, and effectiveness of current tax settings.

One approach to these concerns has been to consciously build a role for academic institutions into the policy process. In 2009, a Tax Working Group (TWG) was set up by the Centre for Accounting, Governance and Taxation Research at the Victoria University of Wellington, in conjunction with Inland Revenue and the Treasury. Although an independent group, the TWG was formed with the support of both the minister of finance and the minister of revenue. It was chaired by Professor Bob Buckle of Victoria University and brought together expert tax practitioners, academics, business people, and officials to consider key problems with the current tax system and options for reform.

The TWG proved to be a considerable success. It was a good forum for debate of the pros and cons of various tax changes. The TWG provided an open discussion process, with papers from the meetings and a record of debates being published on the Internet. This helped to inform the wider public on key tax policy issues.

The TWG reported in January 2010.<sup>6</sup> It expressed concerns about the structure of the tax system and its reliance on tax bases that impeded growth; about the coherence,

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6 Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington's Tax Working Group* (Wellington: Victoria University of Wellington, Centre for Accounting, Governance and Taxation Research, January 2010).



integrity, and fairness of the system; and about the system's revenue-raising capabilities. The TWG recommended a number of tax changes, including a reduction in personal tax rates and alignment between the company, trustee, and top personal marginal tax rates (or, failing that, at least between the trustee and top personal marginal tax rates). The TWG also recommended that a number of base-broadening reforms should be considered. In addition, it canvassed the possibility of a capital gains tax, while noting that most members of the TWG had significant concerns about the practical challenges of such a tax, and indicated that there was majority support for a land tax.

The government quickly announced that it would not introduce either a capital gains tax or a land tax, but the other measures recommended by the TWG were largely reflected in tax policy changes announced in the government's budget in May 2010.<sup>7</sup> In particular, the budget announced cuts in all personal tax rates, with the top rate falling from 38 percent to 33 percent. This aligned the top personal marginal tax rate with the trustee tax rate. There was also a reduction in the company tax rate from 30 percent to 28 percent, along with the base-broadening measures (including raising the GST to 15 percent) that had been canvassed by the TWG.

The TWG worked well from the government's perspective. It allowed possible tax changes to be aired publicly and debated openly, and it brought the academic community into important tax policy debates. However, a large element in its success was the cooperation and engagement of key tax practitioners. This was built on the engagement and cooperation that had been built up through many years of working with the GTPP.

## THE ROLE OF THE MEDIA

Tax policy matters are widely debated in the NZ media. This has been a phenomenon for many years, but it gained further traction with the wide public discussion on the work of the TWG. The media report tax changes and seek a wide range of commentary from private-sector experts, and they are prepared to give space to opinion pieces on tax matters. While this does not always result in consistently balanced reporting, it does raise the level of public consciousness with respect to tax policy matters and engages with the public on the tradeoffs in decision making.

For example, the introduction of a broad-based capital gains tax in New Zealand has for many years had little support. However, in recent years the issue has been canvassed extensively from all perspectives in the media, such that there is a vigorous public debate about the desirability or otherwise of such a tax.

The higher level of public sophistication around tax policy choices achieved by media coverage has helped governments to largely resist sector-specific pressure for a departure from the BBLR framework in several areas, such as the introduction of tax incentives targeted at particular industries or exemptions from the GST.

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<sup>7</sup> New Zealand, Budget 2010 Minister's Executive Summary, May 20, 2010, at 6-9.

## COSTS AND BENEFITS OF THE GTPP

The GTPP provides a number of important benefits. It affords an explicit focus on how tax policy fits in with the government's broader economic objectives. Consultation with the private sector on the development of the work program, combined with published information about the current work program, means that the private sector has a high degree of awareness of changes being contemplated. Because there is extensive public and private-sector consultation, by the time legislation is drafted officials normally have a very clear understanding of potential concerns. Private-sector views will often lead to changes in and improvements to proposed tax policies before legislation is introduced.

The more transparent the economic framework, the better the process works. As described above, there are constant interactions between officials and the private sector. This not only improves the particular policies being consulted on, but also creates a climate in which the government, officials, and the private sector are working together to do what is best for New Zealand as a whole. In addition, taxpayers can participate and raise issues of policy concern. Among tax practitioners, the GTPP is very well accepted. If practitioners feel that the GTPP is not being honoured, they will complain.

There are inevitably some costs associated with the GTPP. The process involves considerable time and resources for both the private sector and policy officials. It also means that tax policy reforms take longer to enact than would otherwise be the case, possibly resulting in the loss of certain strategic advantages for New Zealand.

As noted above, consultation can result in the improvement of policy proposals before legislation is introduced. However, this is not always the case. The willingness to consult and address every concern can also result in compromises being made to the detriment of good tax policy design, for both the government and the private sector. There is a risk that, in the process, the original policy intent may be lost. Compromise does require tradeoffs to be made, but are those tradeoffs the right ones?

Also, consultation is based on the premise that interested parties will engage at the appropriate stage of the GTPP. A recent scenario highlighted the fragile nature of the GTPP. Although a full consultative process was undertaken, the depth of private-sector concern was not truly evident (at least from the perspective of government officials) until the bill was before a select committee. This resulted in a solid policy proposal being overturned at the 11th hour. In this case, perhaps officials and private-sector representatives were only talking past each other, and a degree of "consultation fatigue" set in.<sup>8</sup>

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8 New Zealand, Inland Revenue Department, Policy Advice Division and New Zealand Treasury, *Recognising Salary Trade-Offs as Income—An Officials' Issues Paper* (Wellington: Inland Revenue Department, April 2012). Also see [www.stuff.co.nz/national/politics/8440084/government-ditches-controversial-car-park-tax-plan](http://www.stuff.co.nz/national/politics/8440084/government-ditches-controversial-car-park-tax-plan).

Frequent and sometimes informal interaction raises the danger that officials may be “captured” by key people in the private sector. There is no perfect way of guarding against this. The process requires both officials and private-sector stakeholders to operate with high levels of integrity.

## **TRANSPORTABILITY OF THE GTPP**

When considering the transportability of the GTPP, it is important to recognize that because New Zealand’s relatively small size facilitates interactions between key tax practitioners and officials, it is easier for the GTPP to work in New Zealand than would likely be the case in a much larger economy. The GTPP also works well in New Zealand because there is a clear and coherent policy paradigm that is well understood, and the private sector has bought into the process. To that extent, policy settings that are amenable to the GTPP will be less flexible than would otherwise be the case. For example, New Zealand’s BBLR framework requires reasonable alignment between the company tax rate and the top personal marginal tax rate. This is a reasonably inflexible paradigm if a government wishes to push up the top personal marginal rate or reduce the company rate.

## **RESOURCES DEVOTED TO THE FORMULATION OF TAX POLICY**

For the year ended June 30, 2012, Inland Revenue’s Policy Advice Division had 43.5 full-time equivalent staff devoted to the formulation of policy advice. This figure includes policy analysts, managers, forecasting staff, and analysts seconded to ministerial offices. The Treasury has 8 full-time equivalent staff devoted to the formulation of policy advice, including manager time.

Inland Revenue policy analysts have a range of qualifications, mainly in the fields of law, economics, and accounting; some analysts also have an arts or science degree.

Professional development is encouraged, and analysts and managers regularly provide or participate in training in a number of areas. A professional development session occurs every week, with attendance encouraged for analyst staff. This session is led by policy managers or analysts and covers a range of topics, including current tax policy issues, current economic research, or the fundamentals of the NZ tax system (entity taxation, residence, fringe benefit tax, etc.).

Graduate analysts attend a “Principles of Taxation” course, which is a five-day residential course. All analysts attend a Tax and Policy course repeated on an 18- to 24-month cycle, with new case studies being presented in each cycle. (The current case study, for example, is a GST issue.)

Optional training includes courses covering the following:

- machinery of government
- microeconomics
- presentation/writing skills

- New Zealand Institute of Chartered Accountants and Law Society one-day courses on a range of tax and/or legal issues
- a senior leaders technical conference (internal)
- regimes training (a four-day course)
- managing policy costs
- courses provided by the New Zealand Association of Economists
- select committee training
- OECD outreach (by nomination)

For the first seven years of an analyst's career (from entry at the graduate analyst level to the level of senior analyst), salaries are aligned to market rates for similar roles.

For the year ended June 30, 2012, a small number of private-sector consultants were engaged at a cost of \$135,641. However, regular input on a confidential basis is provided by interested parties in the private sector on an informal basis, as policy matters are developed and move through the GTPP.

Policy and Strategy does not regularly use temporary secondments from the private sector.

## **CONCLUSION**

Tax policy works fairly well in New Zealand. An important reason is the formalized GTPP process, which encourages consultation early and often in the development of tax policy.

However, a good tax policy process goes beyond formalized consultation. For the GTPP to work well, there need to be coherent policy settings that the private sector can buy into. Moreover, a good tax policy process is not something that can be captured in a written road-map. It requires willingness between the government, officials, and the private sector to truly listen and engage. It is critical that the government be open to acting on good suggestions put forward by the private sector.

While the GTPP has led to a very open and collaborative approach to tax policy reform between tax professionals and the government, New Zealand has been less successful, until recently, in engaging with the academic community. The Victoria University TWG provided a good forum for such engagement, allowing major policy changes to be debated openly and leading to some major tax policy changes. Further work on collaborating on tax research is under way.

There will never be a finalized point with the GTPP. Tax reforms will continue, and so will consultation. Mistakes will be made. A strong benefit of the GTPP, however, is that by maximizing consultation and engagement with the private sector, the process ensures that tax policy development is as good as it can be, barring occasional mistakes. It also ensures that when mistakes are made, the framework for correcting them is already in place.

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# Tax Policy Making in the United Kingdom

John Whiting and Malcolm Gammie\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS ■ UNITED KINGDOM

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\* John Whiting is of the Office of Tax Simplification, London, UK (e-mail: john.whiting@ots.gsi.gov.uk). Malcolm Gammie is of One Essex Court, London, UK (e-mail: mgammie@oeclaw.co.uk). These notes are written in a personal capacity and are not to be taken as the views of any organizations with which the authors have connections.

## INTRODUCTION

On December 3, 1798, the British prime minister and chancellor of the exchequer, William Pitt, rose in the House of Commons to deliver a budget speech that lasted only an hour but contained a key proposal for “a general tax [to be] imposed on all leading branches of income.”<sup>1</sup> Pitt said he was a “late convert” to the idea of an income tax, but now he argued for it vigorously. Ultimately the proposal was adopted, but the debate in Parliament was fierce, as it was over the coming years as this new fiscal burden was refined and eventually (though temporarily) repealed.<sup>2</sup>

Two policy-making threads can be discerned from Pitt’s epoch-making move, which have affected all the countries represented at this conference. First, behind Pitt there were clearly some nameless officials who did a good deal of preparatory work. Second, genuine political debate ensued in Parliament that analyzed and tested this tax idea, and continued to do so over the years. No doubt the latter at least was influenced, to a degree, by what we would now call the media.

The point is that a huge shift in tax policy was effected within Parliament and officialdom. Over the succeeding 200 years or so, arguably not a lot changed. But in the last 20 years or so, that picture of tax policy being brewed and hatched centrally, usually behind closed doors, has changed a good deal in the United Kingdom. We now have a generally more open, consultative approach to tax policy making—though that is never guaranteed, and (as if to remind us that Parliament, and more particularly the government, is in charge of tax policy making) at times policies emerge through a process that Pitt might recognize.

## THE UNITED KINGDOM’S PARLIAMENTARY PROCESS

Before examining the United Kingdom’s tax policy-making process, it is necessary to consider the parliamentary procedures that apply to tax changes. The reason is that these procedures have a huge influence (as they must in other parliamentary democracies) on how tax policies are developed. The path of tax legislation through Parliament in the United Kingdom is swift (in legislative terms) and relatively painless (for the tax authority).<sup>3</sup>

The normal procedure is that the budget speech is delivered in mid-March.<sup>4</sup> That speech may announce changes to take effect almost immediately, at the start

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1 Hansard, quoted in B.E.V. Sabine, *A Short History of Taxation* (Butterworths: London, 1980), at 115-16.

2 The income tax was repealed in 1816 but reintroduced, in substantially the same form, by Robert Peel in 1842.

3 The United Kingdom has an almost entirely centralized tax system, with Westminster controlling almost everything. Some devolution of taxing powers to Scotland and the Scottish Parliament in Holyrood is taking place, and calls have been made for Wales and Northern Ireland to have similar limited fiscal autonomy.

4 There was a relatively brief experiment in the 1990s with the budget speech taking place in November/December. That swept in the “autumn statement”—the mid-year economic

of the coming tax year,<sup>5</sup> or at a later date. The speech is followed by some days of political debate and a formal order for the finance bill to be printed.<sup>6</sup> A few clauses in the finance bill are considered by a Committee of the Whole House (the full House of Commons). But the bulk of the bill is sent off to a standing committee of around 25 to 30 members of Parliament (MPs) who, in principle, work through it line by line.<sup>7</sup> That process takes place in May and June; around the end of June or early July, there is the report stage and third reading of the finance bill in the House of Commons. By this time the bill is substantively enacted.

But what, you may ask, is the House of Lords doing? The answer is, virtually nothing.<sup>8</sup> The Lords have a single day to debate the bill (under two hours in 2013!) and are not able to either alter it or delay it.<sup>9</sup> Their part in the process normally takes place in July, and royal assent will be given before the end of the month.<sup>10</sup>

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report. When Labour came to power in 1997, the budget reverted to March (normally), and a “pre-budget report” (PBR) was delivered toward the end of the calendar year. Under the current coalition government, the PBR has reverted to an autumn statement, though still with overtones of a mini-budget with tax content.

- 5 Bear in mind that the United Kingdom continues to use the eccentric April 6 as the start of the tax year.
- 6 The “budget resolutions” proposed by the chancellor of the exchequer provide the necessary authority for certain tax changes to take effect on budget day (usually changes in excise or stamp duties) and are voted on at the end of the debate on the budget speech. The resolutions also provide the authority needed for measures to be included in the finance bill.
- 7 There is no provision for the committee to take evidence or input in any form from outside experts, though some professional and trade bodies do try to influence the debate by sending in briefing papers to committee members.
- 8 The House of Lords Economic Affairs Committee has, on its own initiative, established a finance bill subcommittee. In recent years, the subcommittee has selected a small number of finance bill measures (usually politically uncontroversial ones) for examination and report following the budget. The subcommittee employs two former senior policy officials (retired from HM Revenue & Customs [HMRC]) as part of its secretariat and has taken evidence from outside individuals (including both authors of this paper) and interested bodies. In 2013, the timing of the subcommittee’s work moved to January, following the government’s publication of draft finance bill legislation with the autumn statement in the previous December. It is too early to say whether the subcommittee’s work will have any influence on the eventual content of the bill, although in 2013 an important change was made to the draft general anti-abuse rule after an issue was raised in evidence to the subcommittee and the subcommittee subsequently raised the issue with HMRC.
- 9 Legislative authority to determine the content of a “money bill”—essentially, a tax revenue-raising bill—is reserved to the House of Commons, with the Lords having no power to alter or delay it.
- 10 The pace of the bill’s passage through Parliament has been dictated by the Provisional Collection of Taxes Act, which preserves the right to levy the main direct taxes for the current tax year provided that a bill renewing those taxes is enacted within a specified period (originally one expiring in early August but now extended to October).

The result is that the government of the day can all but guarantee that a tax change is on the statute book within four months from the first announcement.<sup>11</sup> Amendments to the government’s draft will be few and normally only what the government wants; the built-in majority on the committee ensures this. More subtly, since there is a guaranteed finance bill every year, an almost limitless number of tax changes can be pushed through in short order.<sup>12</sup>

Some observers may also reflect that, through acceptance of this procedure, the United Kingdom’s parliamentary system becomes unicameral in what is arguably its most important function, namely, raising tax revenues. The remainder of this paper will examine how the policy-making approach puts some better mechanisms—checks and balances perhaps—around the powerful legislative process that the government of the day has at its command.

## GENERAL DESCRIPTION OF THE TAX POLICY PROCESS

### Developing Ideas

Where do ideas for changes to the tax system come from? The trite answer might be, “Everywhere.” Certainly, in the United Kingdom many people have an interest in changing the tax system, and views are widely expressed. But that means of influencing public policy is essentially informal; there is no formal process for those outside government to contribute ideas to generate changes in the tax system.<sup>13</sup>

Most ideas for change are generated by HM Treasury (HMT), HM Revenue & Customs (HMRC—the UK tax authority), and, of course, Treasury ministers. The creation of HMRC in 2005 (merging the previous Inland Revenue and Customs & Excise) also introduced “the tax policy partnership.” This links HMT and HMRC: both are supposed to have a role in policy making. In broad terms, HMT is concerned with overall policy (for example, “Should we have corporation tax?”) while HMRC is concerned with operational aspects (for example, “How should the controlled foreign company [CFC] rules operate from day to day?”). Inevitably there are a lot of overlaps: basically, both sides will be involved to a degree in everything and will certainly be involved in broader operations (such as “Should we have CFC rules?”), or minor policy concerns. We will return to the issue of the overlap between HMT and HMRC later in this paper.

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11 There is one major exception to this speedy process: national insurance contributions (NICs—the United Kingdom’s social security tax and the second biggest revenue raiser for the government). NICs are not officially a tax, and changes have to go through the normal parliamentary bill process, usually as part of a social security bill. Perhaps that is why much of NICs is governed by secondary legislation.

12 Suggestions for tax changes are sometimes met with the excuse that “there is no space in the finance bill for such things.” Since the bill currently before Parliament is some 615 pages—a length beaten only by 2012’s 680 pages—that excuse appears a little hollow at times.

13 Though the Treasury did recently experiment with inviting comments via its website prior to the autumn statement. As yet, there has been no report back on the results.



The two departments have the focus that might be imagined, and that does accord with the tax policy partnership. It is HMT's job to consider major tax changes—perhaps driven by the simple need to raise money. HMT will also be the department that considers how to use the tax system to address shortcomings in business behaviour.

HMRC will see the need for changes because of shortcomings in the existing rules. That perception by HMRC can in turn come from a number of sources, including

- front-line staff—difficulties with running the system;
- avoidance—seeing avoidance take place; and
- representations—submissions from taxpayers, agents, business and professional bodies, etc.

Those representations may also go to HMT; indeed, many will be initially addressed to the chancellor of the exchequer. But most will end up with HMRC at some stage.

One major factor that currently affects UK policy development is the existence of a coalition government with a formal coalition agreement. That agreement has some major policy shifts (for example, “[w]e will increase the proportion of tax revenue accounted for by environmental taxes”)<sup>14</sup> but also includes some quite detailed provisions (such as reforming the taxation of holiday rentals in line with EU requirements). This has given the United Kingdom some long-term planning frameworks in some areas—an approach that is relatively unusual in tax terms. A development has been a commitment by the chancellor to a competitive business tax system (indeed, to make it the most competitive in the Group of Twenty), leading to a clear direction of development for the corporation tax system, at least as far as rates are concerned. This framework has had useful benefits and has led to calls for more use of similar overrides.

We must also not ignore the European Union. Overriding rules emanating from Brussels may force some changes to the UK tax system, but in the direct tax field,<sup>15</sup> the main impact comes from cases before the Court of Justice of the European Union that show that the United Kingdom's tax rules are in breach of EU treaty principles in some way. The changes to holiday rentals referred to above are one example; another is the changes being made in the Finance Act 2013 (FA 2013) to the system of exit charges.<sup>16</sup> Typically, the UK rule is found to discriminate in favour of the United Kingdom in some way (for example, the tax privileges for furnished

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14 See United Kingdom, HM Government, *The Coalition: Our Programme for Government* (London: Cabinet Office, May 2010) ([www.gov.uk/government/publications/the-coalition-documentation](http://www.gov.uk/government/publications/the-coalition-documentation)), at 31. A subsidiary agreement led to the creation of the Office of Tax Simplification (OTS)—a significant decision for at least one of the authors of this paper.

15 The European Union has greater competence in the field of indirect taxes, in particular customs duties and value-added tax (VAT).

16 United Kingdom, Finance Act 2013 section 229 and schedule 49.

holiday rentals were for UK properties only) or to breach freedom of establishment rules (for example, the exit charges for companies moving businesses to other states within the European Union or the European Economic Area).

### **Research, Information Gathering, and Study**

Much tax research, information gathering, and study is carried out through consultation (discussed below). Apart from consultation, this type of work tends to be internal. The policy teams in HMRC and HMT will do their own research and study, and gather information from their own systems. The amount of information contained within those systems must not be underestimated—and, naturally, that information is not available to those working on policy outside HMRC and HMT.

One key contributor to this process is the Knowledge Analysis and Information (KAI) team in HMRC. This is a significant unit of economists and analysts who essentially “do the numbers”—work out estimates for tax yield/cost on proposals. They will have input at various stages of the policy process: again, with their access to HMRC data, they are able to do far more than external groups.<sup>17</sup>

HMT and HMRC will occasionally carry out research projects to gather further information, but this seems to be unusual at the early policy-making stage. One recent example is a joint project carried out with the Office of Tax Simplification (OTS) when the OTS was working on a simpler system for the smallest businesses. That led to proposals for a cash basis for the smallest businesses, a revised form of which is in the FA 2013. Research seems to be more frequent in terms of gathering data to input into operational matters, and therefore tends to be carried out by HMRC rather than HMT.

### **Identification and Evaluation of Solutions**

HMT and HMRC share responsibility for identifying and evaluating solutions. Recommendations are made to ministers, who make the final decision as to which route to follow. If the consultation process has worked properly, by now there should be a good deal of input to draw on.

### **Drafting Legislation**

Legislative drafting is carried out by the Office of Parliamentary Counsel (OPC). This is a separate unit of legal draftsmen (now based in the same building as HMRC/HMT) who work on all government legislation. There is a certain amount of specialization, but tax law is not drafted by a tax lawyer as a matter of course.

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<sup>17</sup> An interesting sidelight on this is the debate in the United Kingdom about the “tax gap”—the difference between the projected and the actual yield of taxes. The KAI estimate is currently about £35 billion—approximately 6 percent—with avoidance costing around £5 billion. Some campaigners have suggested that the figure should be many times greater, but one cannot help feeling that with its access to all the HMRC data, KAI is likely to be closer to the real figure.

The OPC works from instructions provided by HMRC.<sup>18</sup> Those instructions (which are not published) are intended to set out the purpose of the new provision and how it is to be effected, providing as full a picture as possible. That is turned into legal language by the OPC team.<sup>19</sup> It is often said that any problems with the eventual result are down to shortcomings in the instructions, which do have to be totally clear and comprehensive. However, a bigger problem is often time pressure. As described above, the legislative process is tight as far as time is concerned; often decisions to proceed are taken at the last minute. If problems are identified during the actual passage of the bill, there is considerable pressure on the draftsman to come up with the answer in almost real time.

There have been some experiments with using private-sector assistance to draft material. Broadly speaking, we believe that HMRC has not regarded these experiments as offering significant improvement or, indeed, as being especially successful.

### **The Legislative Stage**

The legislative process has been described above.

### **Post-Enactment Review Stage**

Post-enactment review of tax policy is largely lacking in the UK process. It is rare that a provision is passed with any formal commitment to a post-implementation review. Sunset clauses are almost unheard of.<sup>20</sup> The OTS identified the lack of proper review of tax law after implementation as a contributor to complexity in its report on tax reliefs; specifically, too many relief provisions seemed to have just been left on the statute book without any attempt to see if they still served a useful purpose or had a continuing application. As a result, relief provisions remained that had drifted away from their original policy aim, and in some cases were simply not doing the job that they were supposed to be doing.<sup>21</sup>

Professional and trade bodies have often made the point that in the business world, new projects are invariably reviewed for effectiveness after implementation.

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18 HMRC is unique in that policy officials (and not HMRC's lawyers) brief parliamentary counsel. In all other government departments, the departmental lawyers brief parliamentary counsel.

19 From the late 1990s until 2010, the United Kingdom pursued a "tax-law rewrite" under which all income tax and corporation tax legislation was rewritten in a new, "simpler" style. The rewrite team was organized and run from within HMRC and included draftsmen seconded from the OPC. Generally speaking, the change in drafting style established by the rewrite has been maintained in subsequent finance acts.

20 There have been examples of changes made by secondary legislation that have been required to be enacted in primary legislation within a specified time.

21 Sticking to its principles, the OTS recommended that its proposed disincorporation relief should be time-limited. That is being carried through in the FA 2013, with the relief having a five-year life.

Apart from making sure that projects are working as intended, there is an interest in learning lessons from the process. Why should a similar process not be used, as a matter of routine, for tax changes of significance? Partly this may be a result of the way that policy is staffed: typically, a team is built up in HMT/HMRC to develop a new policy and carry it through to legislation. Once the legislation is on the statute book—or even before then—the policy team is usually disbanded, and the ownership of the new matter is handed over to the operational side. Operational staff may have had limited involvement in the development of the policy; their job is to make it work. It may be that making the legislation work reveals issues that need to be attended to through legislative change, but there is nobody with an interest in standing back, taking stock of the new provision, and asking the question: Is it working as intended? And, more pertinently, is it raising/costing the money envisaged?

It would be wrong to say that such reviews do not happen. Some do: but they seem to be haphazard and may be driven by political considerations as much as anything. Two recent examples can be cited:

1. The introduction of the 50 percent top rate of income tax in 2010 was inevitably a source of much debate and political argument. The yield of the measure was always going to be studied, and figures have been produced to show that it had a negligible (or even negative) yield. That paved the way for a cut in the rate to 45 percent from April 2013.
2. At the smaller end of the market, the new government introduced relief from national insurance contributions (NICs, the social security tax) for a small business taking on extra staff. This was targeted at areas outside London and the South East. However, data came in to suggest that the relief was ineffective and little used. The government took the sensible decision to scrap it and introduce a much simpler cut in pay-as-you-earn (PAYE)/NIC bills.

## **GOVERNMENT DEPARTMENTS AND OTHERS WITH A ROLE IN OR RESPONSIBILITY FOR TAX POLICY FORMULATION**

### **Government Departments**

HMT and HMRC are the main departments involved in tax policy formulation. As noted earlier, they have a joint responsibility, with HMRC having responsibility for administration of the tax system.

At least two other government departments have an interest in tax matters and may promote changes:

1. The Department for Work & Pensions (DWP) is responsible for many benefits, some of which are taxable (such as the state pension). A major reorganization of the UK benefits system is under way, which will see the emergence of universal credits (under the DWP) and the demise of child and working tax credits (under the control of HMRC).

2. The Department for Business, Innovation & Skills is involved in projects around general business promotion, and particularly the promotion of employee share ownership.

HMT continues to have overall responsibility for tax policy formulation and will make sure that it is involved in projects of other departments that affect tax.

### **Independent Advisory Bodies**

Royal commissions seem to be a thing of the past. Review committees likewise seem rarely to be used.<sup>22</sup> One recent example of the use of an independent body to review an aspect of the tax system has been the working group set up under Graham Aaronson, QC, to consider the case for a general anti-avoidance rule (GAAR) in the United Kingdom. That approach seems to have been successful in many ways, and it is clearly possible that it will be emulated for some future projects where there is a probable need for a solution but a genuine uncertainty about whether and how to proceed.

Another interesting case study in the use of differing mechanisms has been the evolution of a statutory residence test (SRT). The SRT has its origins in submissions to the government from a number of professional and trade bodies arguing that there was a need for such a test. The minister concerned effectively challenged the bodies to work together (and with other groups) to make the case for an SRT and formulate a basic outline for one. Over five years later, the SRT has now been enacted in the FA 2103.

### **Politics and the Role of Politicians**

As in every country, politics is a factor in tax policy making in the United Kingdom. The coalition agreement has already been noted. Ministers have the ultimate role in tax policy making; any initiative will have to be signed off by a Treasury minister.<sup>23</sup>

Individual politicians take varying amounts of interest in the tax system. Some will pursue issues raised by constituents, often business-linked. Realistically, their chances of achieving change are limited, but there will be occasions when ideas are taken up by ministers and the Treasury.

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22 The Keith committee was a group that considered the powers of the taxman in the 1980s and produced seminal reports that were largely implemented. When it was decided, sensibly, to carry out a thorough review of the taxman's powers following the creation of HMRC (not least to try and harmonize them across the newly merged department) many called for "Keith Mk 2," that is, a full review by an independent group. This was not heeded: instead HMRC set up their own project team to carry out the work. This was carried through well, but lacked the objective independence of the original.

23 Note that HMRC is a "non-ministerial" department—that is, it is not under direct ministerial control, in order to avoid any suggestion of political interference in the administration of the tax system.

Politicians have the most impact on the tax system through parliamentary committees. There are two key House of Commons committees:

1. The Treasury Select Committee (TSC) has formal responsibility for oversight of the Treasury's functions and the tax system generally. Committee reports are influential, but the TSC cannot initiate change as such.
2. The Public Accounts Committee (PAC) has the role of overseeing the government's spending but of late has increasingly concerned itself with the running of the tax system. A particular interest is corporate tax avoidance. The PAC cannot directly affect tax policy, but its findings and reports have influence (particularly, at the moment, through media coverage).

There are all-party parliamentary groups that focus on specific issues and will promote changes to help their particular interest area.<sup>24</sup> There is an all-party tax group, but it is (perhaps surprisingly) small and focuses on operational issues rather than tax policy. (This may demonstrate how political an issue tax is, in that it is difficult to get a mixed group of politicians together to develop common ideas.) Occasionally an MP will secure a debate on a particular tax issue, to which a Treasury minister will respond. Backbench MPs on the Finance Bill Committee will raise points and propose amendments, but hardly any of the latter are taken up by the government. The (subliminal?) message is that the finance bill is going through as HMT/HMRC/the government intended.<sup>25</sup>

One important point to make in the context of politicians is the lack of tax expertise for them to draw on. While Treasury ministers draw on HMT and HMRC, the average MP of any party has no such access. MPs can develop information through the use of parliamentary questions, and they can do their own research. But there is a distinct lack of technical support on tax matters—there is no equivalent of the US Congressional Budget Office for MPs to draw on. Firms and professional bodies will contribute some resources to help, particularly to the Opposition party/parties and particularly around the finance bill process. That enables more challenges to legislation to be mounted than might otherwise be the case. But the lack of available

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24 For example, one on “micro businesses,” which has been active in arguing for simpler tax systems for such businesses.

25 Backbench successes against government opposition are memorable because they are so rare. In the 1970s the “Rooker-Wise” amendment required annual indexation of personal allowances (the annual exempt band of income and gains), and in 1995 a backbench amendment required HMRC to produce a report on tax simplification, which eventually led to the tax-law rewrite program. More general political pressure in Parliament may well lead a government to change tack on particular legislation before any risk of defeat on a backbench amendment materializes. As a general matter, however, the government always commands a majority, and its backbench MPs will not want to be seen to inflict a parliamentary defeat on the government with such an important bill as the finance bill.

technical (and practical) tax expertise for politicians is something of a handicap—though it does result in policy being developed solely through HMT/HMRC.

## **RESOURCES DEVOTED TO THE FORMULATION OF TAX POLICY**

HMT's tax policy-making group is around 120 strong. Some have a tax background (mainly from HMRC), but most do not. They tend to be relatively young; few will have worked outside Whitehall. There is a developed tradition in the UK civil service of the generalist, often moving from post to post in different departments to gain experience. Tenure can be short—two years is a long period. Those formulating policy may be experts in policy development and the workings of the “government system”; they will usually lack the in-depth tax knowledge that might be expected.

This, of course, is where HMRC comes in. That organization has some 67,000 staff (around 17,000 tax professionals). It can contribute knowledge of the tax system; it should also be able to contribute relevant tax technical expertise. But even with the combination of HMT and HMRC there can be a lack of understanding of the real potential impact on taxpayers, both individual and (especially) business—which is where consultation enters the picture (or should do).

Private-sector consultants are used occasionally, though these are likely to be specialists in areas such as systems or environmental matters rather than tax experts. Both HMT and HMRC are readier to hire people who have private-sector experience<sup>26</sup> than they used to be, though these would be staff hirings rather than contracting a consultant for a project. The advice of outside specialist tax counsel, on both existing and proposed tax legislation, may on occasion be sought as part of the policy development process.

The issue of temporary secondees is a very live matter. Both HMT and HMRC have for some years taken in a small number of secondees from the private sector, mostly unpaid. This is sensible: HMT and HMRC gain practical insights from secondees, who in turn develop an understanding of the policy-making process. Secondees will no doubt return to the private sector with a good knowledge of the area they have been working on. What has made this a political hot potato is the claim by the PAC that (in effect) secondees are able to ensure that there are loopholes in the legislation that they have been involved with, and they are then able to return to their firms and exploit the loopholes for the benefit of their clients. It remains to be seen how this issue will be resolved, but it would surely be to the detriment of all if the secondment into tax policy making of a few people from the side of the taxpayers were no longer possible.

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26 As an example, the recently appointed head of the HMT tax group is from a civil service background but spent a good portion of her recent career with Accenture.

## CONSULTATION<sup>27</sup>

Consultation is a major feature of the UK tax system. Over the last 20 years or so, the amount of consultation has increased markedly, to the point that it is the norm. Given the speed of the finance bill process, it will be observed that good prior consultation is a very necessary balance. The fact that measures have been subject to consultation is having an influence on that process, though this does not—yet?—extend to a certification that the legislation has been reviewed through consultation,<sup>28</sup> or to any requirement for government to respond to issues raised by consultee bodies.<sup>29</sup>

The United Kingdom has no formal private-sector body involved in tax policy development or consultation in the manner of the Australian Tax Practitioners Board or (for economic policy) the UK Office for Budgetary Responsibility. Various bodies do get involved—professional bodies such as the Chartered Institute of Taxation (CIOT), trade bodies such as the Confederation of British Industry (CBI), specialist groups such as the Low Incomes Tax Reform Group, and think tanks such as the Institute for Fiscal Studies (IFS)—and they do liaise and at times coordinate efforts. But most are essentially volunteer-led.

Though consultation is neither compulsory nor formalized, it is now enshrined as normal practice thanks to the current government's new approach to tax policy making (TPM) introduced in 2010.<sup>30</sup>

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27 Most of the comments in this paper are made with reference to the processes for primary legislation. The United Kingdom makes significant use of secondary legislation (statutory instruments or SIs), normally for the mechanical or administrative aspects of rules that have been laid down in primary tax law. There is no hard-and-fast rule as to when law is laid down wholly in primary legislation or when secondary legislation is used. Sometimes it seems to simply come down to expediency, though all sides prefer all the real rules to be in primary tax law. The policy issues discussed in this paper do not really apply to SIs. Some will be consulted on through drafts being exposed, normally informally to professional bodies and often on a short time scale. HMRC also produces a large amount of guidance material that will be non-statutory but naturally persuasive. In recent years, HMRC has started to send drafts of such material to professional bodies for comment—a change in practice that is surely constructive.

28 But see *infra* note 30 regarding the role of the Tax Professionals Forum established by the coalition government.

29 HMRC does now publish, in certain cases, consultation response documents that record the main points made in consultation and include some explanation of why the government has or has not chosen to accept particular points.

30 See the initial document, United Kingdom, HM Treasury and HM Revenue & Customs, *Tax Policy Making: A New Approach* (London: HM Treasury, June 2010) and the response document, United Kingdom, HM Treasury and HM Revenue and Customs, *The New Approach to Tax Policy Making: A Response to the Consultation* (London: HM Treasury, December 2010). The government has appointed a Tax Professionals Forum (of which one of the authors of this paper is a member) to monitor TPM and to report annually on its success or otherwise. For further information, see [www.gov.uk/government/policy-advisory-groups/tax-professionals-forum](http://www.gov.uk/government/policy-advisory-groups/tax-professionals-forum).



## Issues Considered Suitable for Public Consultation

TPM commits to consulting on everything but naturally makes some exceptions:

- *Tax rates.* This is basically (and understandably) a decision for politicians.<sup>31</sup>
- *Avoidance.* Consultation on whether to block an apparent loophole seems unlikely, but consultation on the actual blocking changes is sensible and increasingly done unless revenue is put at risk.<sup>32</sup>

## Stages of the Policy Process for Consultation

Consultation is something that needs to take place in proper stages and over a sensible time scale. TPM recognizes this and sets out three main stages in the development of tax policy:

- *Stage 1:* set out objectives and clarify options.
- *Stage 2:* determine the best option and develop a framework for implementation.
- *Stage 3:* draft legislation to effect the proposed change.

The expectation is that there would be consultation at each stage. The norm for the consultation process is set at 12 weeks, though inevitably this is not always met.

The TPM document identified the need for the following improvements in the process:

- Consultation should be provided for at each identifiable stage, where it is proportionate and practical to do so, and where revenue is not at risk.
- Where there is no consultation at a particular stage, explain why.
- Set out the stages of the policy cycle.

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31 Though some might argue that there is plenty of scope for consulting about the impact of rate changes. Examples might be the recent UK experiment with a 50 percent top rate of income tax and a previous sudden increase in oil taxation rates.

32 The point being that consultation can help to ensure that the measure is properly targeted. However, such consultation can be frustrating: a current UK example is capping of income tax relief. In the 2012 budget, a plan to cap the amount of relief for individuals was announced in the wake of some publicity about “nil bills” for some very high net worth individuals. Consultation produced some changes, including dropping charitable donations from the ambit of the provision. But the result, in the FA 2013, risks affecting valid diversification of enterprises, and has led to a feeling that consultation should have taken place on how best to tackle the mischief, instead of simply focusing on the details of a chosen method. The failure to consult on this measure is unclear, given that we believe that it was preceded by detailed work within HMRC and was not a last-minute policy announcement. Possibly it was judged that prior consultation might offer too great an opportunity for the measure to be frustrated by opposition to it (as the exclusion of charitable relief illustrated).

- Set out the clear policy objectives, assumptions, and impact analysis.
- State who is leading on each consultation and set out a strategy for stakeholder engagement.

This translates to the following ideal cycle:

- March, year 1: budget speech announcing that the government plans to change the tax treatment of something and setting out the reasons
- May-August: consultation on how the change might be effected
- September-November: response document and announcement of the route to be followed; consultation on mechanics
- December: publication of draft legislation, with explanation of proposed route and method; comments invited, normally until late February
- March, year 2: budget speech confirming that the change will take place and how it is to be effected
- End of March: Finance bill published
- May/June: Finance bill debated; possibility of final amendments following submissions to HMT/HMRC and politicians
- End of July: royal assent

The new provisions may be effective from a variety of dates—sometimes April of year 2 (often quite reasonable, since the draft legislation will have been available for some months); sometimes from royal assent; sometimes from a later date (possibly even April of year 3).

One important feature of consultation is feedback—an explanation of why a particular route has or has not been chosen. In a sense, those who contribute to the process deserve evidence that their input has been received and considered. The stages and timetable set out above encourage such feedback, and it is increasingly a feature of the consultation process, often in the form of a “response document” that summarizes the responses to the questions posed and the government’s decisions on the way forward.

### **The Process for Public Consultation**

The main method of initiating the process is the publication of a consultation document that invites responses (paper or electronic) by a set date. As noted above, the target is to allow 12 weeks for the consultation period; this is not always kept to, but the record in recent years is generally good. Bodies such as the CIOT will often make the point that a proper consultation period will allow better information gathering from members (for example, via a member survey on an important issue, or at least proper time to have technical committee meetings to consider the matter), and thus produce a better-founded response.

HMT/HMRC will, on occasion, set up special meetings to publicize the issue under consideration and to solicit views from a wider group, or at least target a particular group or sector from which input is clearly needed. These meetings may take

place during the consultation period—emphasizing that the policy development process is continuous.

### **Private Consultation**

HMRC will also on occasion, arrange for private consultations (“soundings” may be a better term) regarding an idea that is under development. This seems a sensible use of trusted contacts, provided that it is only a “sense check” before the open consultation process.

### **Politics and the Role of Politicians**

Consultations have to be signed off by ministers. The current government is seen to be supportive of proper consultation and keen to ensure that open consultation is properly carried out. At the same time, political considerations can force decisions in advance of proper consideration of alternatives<sup>33</sup> or simply truncate the time available for consultation. At times, consultees are told that “ministers have decided” on a particular route. While that is a demonstration of what ministers are there to do, it can be very frustrating when evidence seems to be mounting that there may be a better route. Officials will only very rarely go back to the minister to ask for reconsideration.

### **Effectiveness of the Consultation Process**

Consultation is effective—if it is allowed to be. Consultation is now well established as part of the process of tax policy making in the United Kingdom. Tax professional bodies and business groups are well geared to consider and respond to consultations.<sup>34</sup> HMT and HMRC in turn are used to develop new ideas through consultation, against a proper time scale.

The acid test is really whether proposals are modified in the light of well-informed and sensible input during consultation. One of the most frustrating features of consultation is feeling that participants on the government side are only going through the motions in what might be termed a “tick-the-box” exercise. That complaint has been made strongly in the past, and seems to have been absorbed; today it is less of an issue, but there are still frustrations when consultation only starts partway

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33 A decision in 2011 to withdraw the child benefit—a universal payment, historically tax-free—from the “higher-paid” was clearly, and probably understandably, made on a political need basis. The problem was that there was no opportunity to discuss how best to achieve the broad objective; the resulting mechanism is complex, to say the least.

34 There is, though, arguably a distinct danger of “consultation fatigue” setting in. The full process now being followed requires three stages of input, whereas in the past only one response would be required. That does not necessarily mean three times as much effort, but it does mean much more work for representative bodies. The payback for the increased number of stages is more chance to influence, but the burden on volunteers and the limited number of paid staff is beginning to be a problem. Of course it is all worthwhile if consultation input is listened to.

through the process, so that there is no chance to influence the actual design of the change. Perhaps that is always going to be the case—though if consultation were a requirement rather than “best practice,” it might help.

Consultation also requires good engagement from consultees. UK policy makers seem to have that available.<sup>35</sup> But the opportunity must not be abused. Consultees do not, of course, expect to be paid for their trouble, and some are undoubtedly lobbying for an advantage to their sector. But most are participating in a genuine attempt to make the system operate better and, in particular, to make it less burdensome on those who will have to comply with the new rules. The need for proper response documents to give feedback has already been noted. Fundamentally, consultation should result in sensible points being taken into account, especially on practical aspects. The United Kingdom’s process scores reasonably well in all of this, though occasions when the wheels come off serve to show that a satisfactory outcome is not guaranteed (and perhaps also serve as a useful reminder for the authorities).<sup>36</sup>

## OTHER ISSUES

### Data Collection and Analysis

The work of the HMRC KAI unit has already been mentioned, and the KAI team does provide high-quality data on proposals. The problem is that KAI’s expertise is not available to taxpayers and their representatives, nor is there a comparable organization in the private sector that is able to help develop responses to proposals. Thus, private-sector responses to proposals usually lack costing data; or what seem like sensible contributions can turn out to be based on a misunderstanding of a proposal’s effect. It would undoubtedly be useful to have a KAI-style organization available outside HMRC/HMT to improve the quality of responses.

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35 For example, the GAAR consultation document of June 2012 (United Kingdom, HM Revenue & Customs, *A General Anti-Abuse Rule: Consultation Document* (London: HM Revenue & Customs, June 2012)) attracted over 14,000 responses, with 169 substantive ones that replied to the questions posed.

36 The 2012 budget launched a number of changes, including some seemingly minor technical amendments to VAT (goods and services tax) that were to take effect in October. Some of the changes set out in the budget were clearly planned to reverse losses by HMRC in tax cases. However, several were widely attacked as having a much bigger impact than had been anticipated. An example was the changes around the taxation of hot takeaway food, which led to “pastygate” (when the tax treatment of meat pasties became a particular cause célèbre). A better route would surely have been to announce a plan to consult on certain areas of difficulty that were clearly giving rise to contentious boundary issues in practice, and go into things with an open mind. The process would have taken six months longer but would have got to a better—and probably smoother—result.

## Transparency

Inevitably the process of tax policy making is not fully transparent. The consultations that take place are a major contribution to transparency, and parliamentary debates are, of course, public. But many decisions are taken on the basis of “advice to ministers,” which is not published. External groups that have contributed to the policy development process through consultation have to trust that the advice is given fairly. But such advice has the potential to override a lot of preceding work and expert input.

## International Organizations

As noted earlier, the European Union has an influence on UK tax policy making, given the need to consider EU rules around such matters as competition and non-discrimination, and prohibitions on support for particular sectors.

## Independent Tax Reform Bodies

Professional bodies such as the CIOT have a certain influence, as do business bodies such as the CBI and the Federation of Small Business. There are a good number of think tanks, such as Reform, with the IFS at the top of that sector. The Oxford Centre for Business Taxation has built a good reputation and is increasing its influence.

The IFS has an outstanding reputation for input to debates on overall policy matters, backed by their analysts. Exeter University and the IFS are responsible for the operation of the Tax Administration Research Centre, which was launched on January 1, 2013 with the benefit of substantial funding from the Economic and Social Research Council, HMRC, and HMT. The centre has been set up to undertake research on tax administration, with a view to strengthening the theoretical and empirical understanding of tax operations and policies. Its research is multidisciplinary, and the research team involves economists, accountants, experimentalists, and psychologists. An important role of the centre is to build capacity for future tax research.

We must also mention the Mirrlees report,<sup>37</sup> which was produced by a group coordinated by the IFS, and which set out a major analysis of the UK tax system and how it might be reformed.

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37 James Mirrlees, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, *Tax by Design: The Mirrlees Review* (Oxford: Oxford University Press, 2011).



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# The Process for Making Tax Policy in the United States: A System Full of Friction

Eric Solomon\*

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**KEYWORDS:** TAX POLICY ■ POLICY MAKING ■ TAX LEGISLATION ■ PROCESS ■ UNITED STATES

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## INTRODUCTION

The American Revolution (1775-1783) resulted in the independence of 13 of Great Britain's North American colonies. In the 1780s, leaders of the new American nation realized that the national government, formed under the articles of confederation, was too weak. In 1787, representatives of the new states met in Philadelphia to consider ways to strengthen the national government, although many of them feared that a national government with enhanced authority had the potential to usurp power from the states and oppress the people.<sup>1</sup> The result of the Philadelphia convention was the US constitution. The constitution gave many additional powers to the national government. At the same time, the constitution addressed the fear of

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\* Of Ernst & Young LLP, Washington, DC (e-mail: eric.solomon@ey.com).

1 The Declaration of Independence (1776) asserted that the reason for severing ties with Great Britain was the abusive exercise of power by the British government: "The history of the present King of Great Britain is a history of repeated injuries and usurpations, all having in direct object the establishment of an absolute Tyranny over these States." A long list of alleged oppressions follows this statement, including "imposing Taxes on us without our Consent."

governmental abuse by creating a structure with checks and balances, including a bicameral legislature, an independent executive, and an independent judiciary.<sup>2</sup>

This system of checks and balances fundamentally affects the formation of policy in the United States today, including the formation of tax policy. Ultimately, federal tax legislation in the United States must be approved by both houses of Congress (the House of Representatives and the Senate) and signed by the president (or, if the president vetoes the bill, Congress must override the veto). This legislative structure creates the framework for the development and enactment of US federal tax laws. This structure is quite different from the structure in many other countries, including, for example, countries with a parliamentary system of government.

Legislation is not the only vehicle by which US federal tax policy is made. It is made in various additional ways, including

- Treasury department regulations,
- other published guidance by the Treasury department that is generally applicable to all taxpayers,<sup>3</sup>
- guidance by the Internal Revenue Service (IRS) relating to particular taxpayers,<sup>4</sup>
- IRS administrative initiatives<sup>5</sup> and IRS internal guidance,<sup>6</sup>
- tax treaties and other intergovernmental agreements,<sup>7</sup> and
- court opinions in litigated cases.

This paper will focus on the development of US federal tax policy through legislation, followed by a brief discussion of regulations.

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2 In Federalist Paper no. 51 (1788), James Madison explained, “If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.” Consequently, it is necessary to “contriv[e] the interior structure of the government as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places” (James Madison, “The Structure of the Government Must Furnish the Proper Checks and Balances Between the Different Departments,” *New York Packet*, February 8, 1788). See also John M. Blum, Bruce Catton, Edmund S. Morgan, Arthur Schlesinger Jr., Kenneth M. Stampp, and C. Vann Woodward, *The National Experience: A History of the United States*, 2d ed. (New York: Harcourt Brace & World, 1968), at 131-38.

3 For example, Revenue rulings, Revenue procedures, and notices.

4 For example, a private letter ruling that can be relied upon only by the taxpayer who received the ruling.

5 For example, efforts to find offshore bank accounts.

6 For example, IRS procedures contained in the *Internal Revenue Manual*, infra note 23.

7 For example, tax information exchange agreements and agreements under the Foreign Account Tax Compliance Act (FATCA), subtitle A of title V of the Hiring Incentives To Restore Employment Act of 2010, Pub. L. no. 111-147, enacted on March 18, 2010.



As a preliminary matter, it is helpful to describe the tax function in the executive branch of the federal government. The executive branch consists of the president, the White House, and various departments (such as the Treasury department) and agencies. The tax function has two primary parts. The Treasury department's Office of Tax Policy, which has approximately 100 lawyers, economists, and accountants, advises and represents the administration regarding tax legislation. It also participates in the preparation of regulations and other generally applicable published guidance, negotiates tax treaties, represents the United States in meetings of multi-lateral organizations dealing with tax policy matters, and prepares revenue estimates for the administration. The IRS, which has more than 90,000 employees, administers the tax law and deals with all matters involving particular taxpayers, such as the filing of returns, collections, audits, and litigation. The Justice department also conducts tax litigation. The responsibilities of the Office of Tax Policy and the IRS are generally separate and distinct, but they do work together on published guidance generally applicable to all taxpayers, such as regulations.<sup>8</sup>

One other important observation is that during the 1600s and 1700s, the 13 American colonies developed as 13 separate sovereignties under the rule of England. The constitution was drafted by representatives of the new states and ratified by the states, which intended to retain most of their original sovereignty. The constitution grants various enumerated powers to the federal government, including the power to “lay and collect Taxes.”<sup>9</sup> However, the federal government is the product of a federation of the states and, as articulated in the 10th amendment to the US constitution, the “powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”<sup>10</sup> Among the powers retained by the states is the power to levy taxes. Consequently, the states (and local governments) have their own tax systems and develop their own tax policy.<sup>11</sup>

## FEDERAL TAX LEGISLATION

### Sources of Legislative Ideas

In the United States, there are many sources of legislative ideas. First and foremost, members of Congress (with the assistance of their staff) develop tax policy ideas and introduce tax legislation (in the form of bills). Tax proposals can either be broad reform proposals or focus more narrowly on particular areas or specific issues.

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8 This separation of duties is a consequence, in part, of the Watergate era in the early 1970s, when the White House attempted to use the IRS to harass President Nixon's enemies.

9 US constitution, article I, section 8.

10 Tenth amendment to the US constitution (1791).

11 For example, unlike the federal government, state and local governments impose franchise taxes, sales and use taxes, and property taxes.

In the House of Representatives, primary jurisdiction over tax matters is exercised by the Ways and Means Committee. For example, since 2011, this committee and the Senate Finance Committee have held numerous hearings about many aspects of tax reform. Congressman Dave Camp, the chair of the Ways and Means Committee, has issued discussion drafts about reform of international taxation (October 2011), financial products taxation (January 2013), and small business taxation (March 2013). He has indicated that he will introduce a comprehensive tax reform package that will be considered by the full Ways and Means Committee.

In the Senate, primary jurisdiction over tax matters is exercised by the Senate Finance Committee. In 2012-13, the committee issued numerous papers listing options for reform of various areas of US tax law. In September 2012, Senator Michael Enzi, a member of the committee, introduced a bill to reform international taxation. In November 2013, Senator Max Baucus, the chair of the Senate Finance Committee, issued discussion drafts about reform of international taxation, tax administration, and cost recovery and accounting.

In addition, members of Congress who are not on the House Ways and Means Committee or the Senate Finance Committee develop tax policy ideas and introduce legislation. For example, Senator Carl Levin has introduced the Stop Tax Haven Abuse Act to address concerns about the use of offshore entities to avoid or evade US tax.<sup>12</sup> He has also chaired hearings of the Senate Permanent Subcommittee on Investigations examining offshore profit shifting by US corporations.

An important office serving Congress in tax matters is the Joint Committee on Taxation. The staff of this committee consists of lawyers, economists, and accountants who assist committees and members of the House and Senate on tax legislative matters. The staff publish numerous documents on all aspects of federal tax law, and prepare the official congressional revenue estimates for tax legislation.

The president and his administration also play an important role in the development of tax policy. Every year, normally in early February, the administration issues its proposal for the government's budget for the coming fiscal year (starting on October 1). Included in the budget proposal are tax legislative proposals prepared by the Treasury's Office of Tax Policy, with input from White House staff, such as the National Economic Council. The administration puts forth other tax policy documents as well. For example, in February 2012, the Obama administration issued "The President's Framework for Business Tax Reform," a joint report by the White House and the Treasury department that set forth five principal elements for business tax reform. The administration also creates commissions. President George W. Bush created the President's Advisory Panel on Federal Tax Reform, which in November 2005 put forth two different reform proposals. One proposal would have reformed the income tax system; the other would have blended elements of both an income tax and a consumption tax. In December 2010, a majority of President

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12 S. 1533, introduced on September 19, 2013.

Obama's National Commission on Fiscal Responsibility and Reform recommended substantial federal spending reductions coupled with tax reform that would eliminate many deductions, reduce tax rates, and reduce budget deficits.

The IRS, which administers the tax law, also contributes ideas to improve tax administration. These ideas are often reflected in the administration's annual proposal for the government's budget. In addition, the IRS Taxpayer Advocate, an independent organization within the IRS that helps taxpayers resolve problems arising from their interactions with the federal tax authority, recommends law changes to prevent future taxpayer difficulties, including changes to protect taxpayer rights.

Other governments and governmental organizations contribute to the development of US federal tax policy. For example, formalized groups of countries, such as the Group of Eight (G8) and the Group of Twenty (G20), both of which include the United States, meet periodically about common issues. The G8 and the G20 have focused on tax issues, including exchange of information among countries, tax avoidance and tax evasion, and base erosion and profit shifting. Both groups have also expressed their support for the work of the Organisation for Economic Co-operation and Development (OECD) in the area of base erosion and profit shifting. The OECD (of which the United States is a member, along with 33 other countries) has undertaken a project on this subject. In February 2013, it published a report on the issue, including discussion of possible solutions, which was followed by the publication of an action plan in July 2013.<sup>13</sup> Although the findings and recommendations of the OECD are not binding on the United States, they do influence the US debate on tax policy and may lead to US actions, such as actions within the authority of the executive branch or proposed legislation.

Non-governmental organizations also contribute significantly to the development of tax policy in the United States. There are numerous policy organizations across the entire political spectrum, including think tanks such as the Urban Institute, the Center on Budget and Policy Priorities, the Tax Foundation, and the Heritage Foundation. These organizations employ public-policy experts who publish papers, make proposals, and otherwise play an active role in the tax policy debate.

In addition, professional organizations make an important contribution to the US tax policy discussion. For example, the American Bar Association Section of Taxation has prepared papers discussing options for tax reform in various areas of the tax law. As another example, the New York State Bar Association Tax Section has submitted technical comments on Chairman Camp's international tax reform discussion draft.

Finally, constituents, including businesses, organizations, and individuals, contribute to the development of tax policy. Discussions with members of Congress, the administration, and the White House are a common and accepted part of the

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13 Organisation for Economic Co-operation and Development, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013) and *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013).

US policy-making process. A substantial industry has developed, particularly in Washington, DC, in which lobbyists provide information and advocate on behalf of their clients to members of Congress and the administration.<sup>14</sup>

### **The Federal Tax Legislative Process**

The US federal tax legislative process starts with the introduction of a bill by a member of Congress. The constitution requires that all bills for raising revenue shall originate in the House of Representatives.<sup>15</sup> Tax bills introduced in the House are referred to the House Ways and Means Committee. The House Ways and Means Committee considers the bill and can process it, often in a public setting called a “markup.” If the Ways and Means and Committee approves the bill (by majority vote), the bill is sent to the full House (the House floor) for consideration. The House can then approve the bill by majority vote.

In the Senate, tax legislation is referred to the Senate Finance Committee. The Senate Finance Committee considers the bill and can process it, again often in a markup. Sometimes the Senate Finance Committee has a conceptual markup, in which it does not have specific statutory language before it. If the Senate Finance Committee approves the bill (by majority vote), the bill is sent to the full Senate (the Senate floor) for consideration. The rules of the Senate allow filibusters, a parliamentary tactic used to delay or prevent a bill’s passage.<sup>16</sup> Under Senate rules, a filibuster can be stopped only by invoking “cloture” and obtaining the vote of 60 of the 100 senators to proceed. Thus, in practice, in the Senate a bill needs 60 votes to be approved. Because filibusters can have the effect of preventing Senate action on many matters, there have been recent debates about changing the rules to prevent filibusters in certain situations.<sup>17</sup> Nevertheless, today the ability to filibuster legislation continues. If there is no filibuster on a bill or the filibuster is overcome, the entire Senate can approve a bill by majority vote, with the vice-president breaking a tie.

The bills passed by the House and Senate might not be identical. In fact, as the result of negotiations and amendments in the House and Senate proceedings, the bills passed by the two houses of Congress might be quite different. Consequently, if the bills are different, a conference committee made up of leading members of the House Ways and Means Committee and the Senate Finance Committee negotiate

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14 There is a legend that the term “lobbyist” was first used by President Grant (1869-1877) to describe people who approached him for favours while he was enjoying brandy and a cigar in the lobby of the Willard Hotel in Washington, DC, although in fact the word originated before Grant’s time in office.

15 US constitution, article I, section 7.

16 The Senate rules do not allow filibusters on reconciliation bills, which deal with budget issues.

17 On November 21, 2013, in a highly controversial action, the Senate voted to end the ability to filibuster presidential nominations for executive-branch and most judicial positions.

to achieve a compromise bill. If the negotiations are successful, the compromise bill is sent back to the House and Senate for passage.

Finally, an identical bill passed by the House of Representatives and the Senate is then sent to the president for his signature. If the president signs the bill, it becomes law. However, if the president vetoes it, it is sent back to Congress and does not become law unless both the House and the Senate override the veto by a two-thirds majority vote in both houses.

A primary purpose of this discussion summarizing the US federal tax legislative process is to emphasize the diffusion of responsibility for tax policy and the effect of the checks and balances created by the constitution, requiring passage by both houses of the legislative branch and approval by the executive branch. The US federal system is quite different from the systems in many other countries, including, for example, the parliamentary systems in the United Kingdom, Australia, Canada, and New Zealand, where the ruling party can achieve the enactment of tax legislation in a much quicker and more efficient manner. Some would argue that the checks and balances of the US federal tax system are an obstacle to action. Others would argue that the system operates as the framers of the constitution intended, to promote debate and ensure consensus. The Tax Reform Act of 1986<sup>18</sup> is cited as an example where, despite challenges along the way, the system ultimately produced a successful outcome.

### **Government Officials Involved in the Tax Legislative Process**

Consistent with the diffusion of responsibility described above, there are numerous government officials involved in the development and enactment of US federal tax policy. Of course, members of Congress, in particular members of the House Ways and Means Committee and the Senate Finance Committee, are primary participants. Because members of Congress have so many responsibilities besides tax, and because the tax law is so complicated, staff members play a critical role, especially the staffs for the House Ways and Means Committee, the Senate Finance Committee, and the Joint Committee on Taxation.

In the executive branch, the Treasury's Office of Tax Policy and White House staff play a role in the tax legislative process. Their participation varies depending on the bill and the political environment. For example, during the period leading up to the enactment of the Tax Reform Act of 1986, President Reagan was a vocal supporter of tax reform and the Treasury department played a critical role in the process, by (among other things) issuing two comprehensive studies with legislative proposals. In contrast, more recently, the role of the administration in tax legislation has varied, in part because of increased political partisanship. The level of the administration's involvement can depend on which party controls the houses of Congress and the presidency.

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18 Pub. L. no. 99-514, enacted on October 22, 1986.

There are many people, both inside and outside the US federal government, who have extensive experience in tax policy issues. Leaders of the House Ways and Means Committee and the Senate Finance Committee have worked on tax matters for many years. Various other government participants, such as congressional staff members and employees of the Treasury's Office of Tax Policy, usually have extensive private-sector business, legal, or academic experience. After their government experience, they generally return to the private sector and often interact with current government officials. Some even return to the government at a later time. This interchange between the public and private sectors is beneficial because it enables government policy makers to understand current trends and issues. On the other hand, it contributes to the perception of a revolving door, whereby former government officials have special access to current government officials and personally profit from this access.

### **Some Observations About the Current Legislative Scene**

As previously discussed, in the US system there is a diffusion of responsibility that has a profound effect on the formation of tax policy. The checks and balances created by the constitution, combined with the existence of two distinct political parties, have created many points of friction, including, for example, Democrats versus Republicans, the House of Representatives versus the Senate, and Congress versus the administration. These frictions make it difficult to reach agreement. Adding to the difficulty is intense political partisanship, which has created an environment of mistrust with standoffs and brinkmanship. For example, Congress and the Obama administration faced a "fiscal cliff" at the end of 2012 when 2001/2003 tax relief was scheduled to expire. The United States faced other crises when the federal debt limit was reached in the summer of 2011 and the fall of 2013.

In the current environment, it is difficult to reach political compromises. Contributing to the challenging atmosphere is the role of the media and electronic communications. The media, through television, radio, and the Internet, heavily influence public opinion and the views of members of Congress, the administration, and other government officials. Instant electronic communication, whether by the media or by interested organizations and individuals, provides helpful transparency, but at the same time concerns about disclosure can discourage politicians and other government officials from engaging in sensitive discussions that can be helpful in finding a middle ground.

The inability to resolve problems results in continuing uncertainty, which hampers planning for individuals and businesses. In the near term, it will be difficult for Congress and the administration to reach agreement on two of the most pressing domestic issues, spending and taxes, including tax reform. Some have expressed the fear that only as a result of a crisis can the obstacles to compromise be overcome.

The US federal budget deficits also have a substantial impact on the tax legislative process. The annual US federal budget deficit has exceeded US\$1 trillion in several recent years. Because of concerns about revenue impact, revenue estimates prepared by the staff of the Joint Committee on Taxation play a major role in all tax

legislation. Furthermore, to minimize the revenue impact of revenue-losing provisions, such as tax incentives, Congress has enacted dozens of temporary provisions that expire after a year or two. Upon expiration, Congress is compelled to revisit the provisions, which are usually reenacted for another temporary period. In addition, sometimes Congress enacts tax increases to offset the costs of non-tax programs. For example, in 2010, Congress included various taxes in the Patient Protection and Affordable Care Act<sup>19</sup> and the Health Care and Education Reconciliation Act<sup>20</sup> (“the health-care acts”) to offset the cost of health-care measures.

A final observation about the US federal legislative process is that the Internal Revenue Code<sup>21</sup> is used for purposes besides raising revenue to fund the government. In particular, it is used to achieve social and economic policy objectives. For example, the health-care acts impose taxes on employers who decline to provide, and employees who decline to obtain, health-care coverage. Tax provisions can also serve as an alternative to direct spending. For example, there are numerous tax incentives to effectuate energy policy and refundable tax credits to assist disadvantaged individuals and families. Because of the use of the Internal Revenue Code for social and economic policy purposes, it is very complex and a political battleground.

## REGULATIONS

The Internal Revenue Code is the foundation of the US federal tax system. However, it does not answer all the tax questions that arise in a complex society and economy. Accordingly, in section 7805 of the Code, Congress has given general authority to the secretary of the treasury (or his delegate) to “prescribe all needful rules and regulations for the enforcement of [the tax laws].” Furthermore, various sections of the Code give additional authority to the Treasury department to issue regulations in particular areas.<sup>22</sup>

Because there are so many unanswered questions in the Internal Revenue Code, the Treasury department has issued thousands of pages of regulations. Consequently, in addition to the enactment of legislation included in the Internal Revenue Code, the promulgation of regulations is a fundamental part of the articulation of tax policy in the United States. For this reason, a brief discussion of the regulatory process is appropriate.

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19 Pub. L. no. 111-148, enacted on March 23, 2010.

20 Pub. L. no. 111-152, enacted on March 30, 2010.

21 Internal Revenue Code of 1986, as amended (herein referred to as “the Code”).

22 For example, section 1502 of the Code states that the “Secretary [of the treasury (or his delegate)] shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group . . . may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability [of the group and its members], and in order to prevent avoidance of such tax liability.”

The preparation and issuance of regulations is a joint effort of the Treasury's Office of Tax Policy and the IRS. Participants in the process generally include lawyers (and sometimes economists on projects such as transfer pricing) in the Office of Tax Policy and lawyers in the IRS Office of Chief Counsel. The development and drafting of regulations is a lengthy process, which usually begins with an announcement that the government intends to undertake a particular project. Every year, the assistant secretary for tax policy (who heads the Office of Tax Policy and reports to the secretary of the treasury), the IRS commissioner, and the IRS chief counsel jointly publish a priority guidance plan that lists the regulations and other published guidance projects that the Office of Tax Policy and the IRS will work on in the coming year. The process for issuing regulations normally involves internal memorandums, drafts, meetings, and briefings.

In preparing and issuing regulations, the Office of Tax Policy and the IRS follow the *Internal Revenue Manual* (an internal IRS document)<sup>23</sup> and the Administrative Procedure Act.<sup>24</sup> Accordingly, there is generally formal notice and the opportunity for comment by the public. In addition to formal procedures for comment, there is informal interaction between the government and the private sector about issues being considered in regulatory projects. In these informal discussions, government employees are careful not to divulge confidential or otherwise sensitive information, such as the specific content of the regulations or their effective date.

Regulations are first issued in proposed form. A notice and comment period follows. If requested, a public hearing is held. Regulations are finalized after receipt and consideration of the public comments. Most regulations have an effective date as of the date of finalization. Some regulations are both proposed and temporary (that is, immediately effective) in order to provide currently needed guidance or to prevent abuse.

Regulations have the force of law. Their validity can be challenged, but a challenger must satisfy a relatively high standard in order to prevail. In *Mayo Foundation v. United States*,<sup>25</sup> the US Supreme Court applied a two-part analysis in upholding the validity of a regulation. Under this analysis, a challenge will be successful only if the regulation is contrary to a statute that is unambiguous or if the regulation is an unreasonable interpretation of the statute.

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23 See Internal Revenue Service, *Internal Revenue Manual* (Washington, DC: IRS), at part 32.1 regarding regulations.

24 See 5 USC section 553.

25 131 S. Ct. 704 (2011).



## **CONCLUSION**

The US constitution established a system of checks and balances that underlies the structure of the US federal legislative process, including the process for enacting tax legislation. The system of checks and balances is intended to promote debate and ensure consensus. The tax policy debate in the United States is extensive, with substantial interaction within the government and between government officials and the public. The level of the debate is enhanced by the participation of numerous tax policy experts, both inside and outside the government.

Although the system of checks and balances has certain advantages, it operates today in an environment of intense partisanship and a pervasive concern about budget deficits. This combination of factors has made it difficult for Congress and the president to achieve the agreement necessary to resolve pressing fiscal issues, including the need for tax reform.

