

Tax Law
Improvement Project

Building the New Tax Law

Information Paper No. 2
April 1995

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Building the new tax law

“Everything should be made as simple as possible, but not simpler.”

“The hardest thing in the world to understand is income tax.”

Albert Einstein.

Part 1: About the project

The story so far...

On 17 December 1993 the Government announced the Tax Law Improvement Project. It is a three year project, funded from 1 July 1994, to simplify the income tax law. The aim is to rewrite the law with a better structure and make it easier to understand.

The Tax Law Improvement Project is not about reviewing the policy behind the law. The Government has directed us to concentrate on improving the existing law.

What we've done to date

In August 1994 we issued 2 booklets:

1. Information Paper No 1 - The Broad Framework.

This paper gave a broad description of the major features of the project, including:

- the reasons for the project;
- what we hope to achieve;
- our approach to the project;
- how we intend to involve the wider community in the project;
- a list of the members of the project team and the Consultative Committee; and
- why we started our rewrite of the tax law with the provisions dealing with substantiating claims for deductions for work, travel and car expenses (the substantiation provisions).

2. Exposure Draft No 1 - Substantiation

This paper:

- gave the background to the first segment of law we tackled in the project - the substantiation provisions;
- explained the problems with the existing provisions, and how we propose to overcome them; and
- included an exposure draft of a Bill for the rewritten law we proposed to replace the existing law on substantiation.

We asked for feedback from the community on the issues raised in those two booklets and on the project generally.

We distributed over 3,600 copies of the exposure draft on substantiation. We gave seminars in Melbourne, Sydney, Brisbane, Adelaide, Perth, Hobart and Townsville. More than 1000 tax professionals attended, and about another 1000 people came from the Australian Tax Office.

We received around 160 responses to the questionnaires contained in the exposure draft. We also engaged Australian and overseas experts in communications to review and test the exposure draft with different users. As a result of this testing we have made changes to policy, structure, layout and the wording of the law.

The draft legislation on substantiation which was in Exposure Draft No 1 has now been enacted by Parliament in the form of the **Tax Law Improvement (Substantiation) Act 1995**.

Part 2: A new structure

Why? What is wrong with the old structure?

For many years, the income tax law has been criticised as being too difficult to read and understand. When the *Income Tax Assessment Act* was first introduced in 1936, it was only 126 pages long. It was quite logically arranged and its sections were numbered in simple sequence.

Now the tax law is over 5,000 pages long, and it has been heavily amended. The sheer volume of amendments has overloaded the numbering system, so now we have strange section numbers like 159GZZZZA. Adding so much new law to the Act has also interfered with what was once a logical arrangement of the sections. It is very difficult to find your way around the Act, and very easy to get lost and confused.

We have a chance now to devise a new structure. We need one which will not only make the existing law easier to follow and use, but also one which will cope well with future amendments. We have to anticipate that in the future the income tax laws will continue to be amended, and new sections will be introduced. We need a structure that is flexible enough to cope with that.

Our aims for the new law We want to restructure and rewrite the tax law so that a reader can: open up the new law; follow a path that takes him or her to exactly those provisions that apply to him or her (or his or her client); be certain that he or she has found all the relevant provisions; and understand and apply those provisions.

If we can achieve that, then we will also have more people understanding their tax rights and obligations. They will be able to work out more easily what tax they have to pay and they will save time and money.

Deciding on the right structure

You can see from our aims for the new tax law that this project is focusing firmly on the people who read and use the tax laws. We want to help the readers and users of tax laws to find what they are looking for and achieve their purposes, quickly and efficiently.

In the past, laws have rarely been written with the interests of the reader at heart. We want to put the focus back on the reader where it belongs.

We believe that tax is a practical subject and that tax laws must operate efficiently in the real world. Rewriting the tax laws is not an academic exercise: it is a practical one. So the new structure must fit with the way people read and use tax laws every day.

When we began to devise the new structure our starting point was the way people used the Act in practice. We spoke to many people: tax professionals, experienced drafters and experienced personnel from the Australian Tax Office. We heard what they had to say about the problems with the way the current Act is structured. We listened to their ideas on how they thought the Act could be rearranged and gradually our ideas fell into place.

We looked at the structures of tax laws in Britain, Canada, the United States and New Zealand. We also looked at what has been done in other countries which have been changing their tax laws. Most have tax laws which are quite different from ours, so we must be careful

in deciding what we can learn from them. But New Zealand's laws are not too different from ours, and New Zealand happens to be well into the process of rewriting them.

The New Zealand approach

The New Zealand project has broken down all the tax law into its basic elements (or building blocks) such as the 'core' income and deduction provisions, income and deductions 'further defined', and timing of income and deductions. All the provisions which relate to these general groupings are kept together.

The New Zealand approach has a very logical structure. It looks at the concepts behind income tax, and arranges all the sections dealing with each concept one after the other. But we don't find it as reader-friendly as it could be. For instance, it doesn't group together all the rules dealing with particular industries or activities.

A specialist approach

Another approach would be to introduce core income and deduction provisions, and then look at each area of tax which applies to specialist areas (for example, superannuation, companies, foreign income). We could gather all the relevant provisions together and deal with them one after the other. This approach would be very convenient for people with special tax liabilities. And with this approach, if more specialist areas were covered in new tax laws in the future, we could simply add them on. But there are important, widely applying, rules that are not easily broken up in this way.

The Modular approach

Recently, the Social Security Act was rewritten to make it easier to read and understand. A modular approach taken there was to focus on each class of beneficiary, and rewrite the Act so that it deals with each class of beneficiary in turn. So once the beneficiaries find the part of the Act which deals specifically with their class, they find all the provisions about their eligibility for payments.

But we don't think we can follow this approach in the income tax law rewrite. We have been unable to devise a system of classes of taxpayers which works. There are too many variables which can affect an individual's liability to pay tax. It also leads to extensive duplication of common provisions.

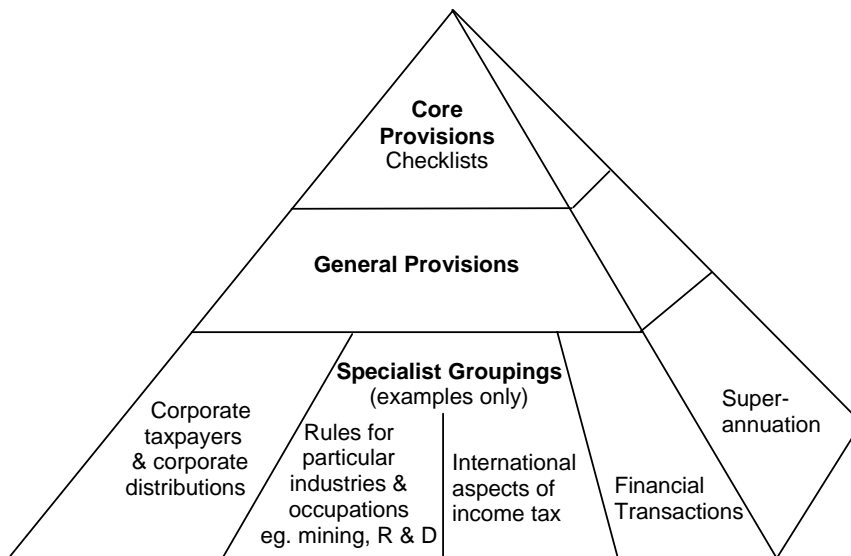
For the same reasons, we don't think it is practical to have a separate Tax Act dealing only with individuals who have simple tax affairs.

Our approach - the pyramid

We have not adopted any one of these approaches, and yet all of them shaped our thinking, and helped us to come up with our own solution to the problem of reorganising the income tax law into a structure which best helps the users of the law.

We liked the New Zealand technique of breaking things down into basic building blocks. We also liked the idea of dealing with specialist topics in separate areas of the law. Finally, we see sense in helping readers of the Act to go directly to the provisions that apply to them

The structure that we have devised has used all these ideas but is different again. It is easiest to visualise it in the form of a pyramid.



The pyramid shape helps explain the conceptual structure we have in mind. It also illustrates the way we intend to organise the tax law, moving down from the top of the pyramid, from the most basic (or 'core') concepts to the more specialised or detailed provisions.

Moving down the layers

What we would like to achieve is that a reader of the tax law could enter the law at the top of the pyramid and read the basic concept of tax law - that you must pay tax on your income. They would then see a 'signpost' directing them to a more detailed explanation of what income is. Then they would be directed on to the next layer of detail, and the next and so on.

Eventually, by following these signposts a reader will find all the information they need to tell them exactly what the tax obligations are for a person in their position and circumstances.

We want the reader to move smoothly down each layer, as far as they need to go (and no further). We want them to be able to limit what they read to only that material which relates to their precise circumstances. We don't want to force them to read any irrelevant material.

This technique could easily be adapted to computer-based hypertext systems, which deliver material on-screen at progressive levels of detail.

The top layer - the Core and Lists

1. The Core

If you reduce the idea of how much income tax you pay to its most basic, it is an equation:

$$T = TR (AI - AD) - R$$

That is:

tax payable equals the *tax rate*, multiplied by an amount equal to *assessable income* minus *allowable deductions*, minus *rebates* (or 'offsets', as we will be calling them in the new law).

All the rest is detail. It tells you what assessable income is. It tells you what allowable deductions are. It tells you what offsets you can get. And it fills in all the details which relate to particular circumstances or specialist groups.

So we have used that equation as our starting-point. All the concepts which relate to that core equation at its most basic level are in the top layer of the pyramid - the 'core' provisions of the Act.

The core provisions address questions at different levels of detail such as, at the top level:

- What is income tax?
- How do you calculate how much income tax you owe?
- When do you have to pay it?
- What are your rights and obligations under the income tax laws?
- At a lower level the income part of the equation is broken down into:
- What is assessable income ?
- How much is assessable?
- Whose assessable income is it?
- When does it become assessable income?

The core provisions contain the general income and general deduction provisions. They operate to determine whether amounts are assessable income or allowable deductions in the vast majority of cases

How the new provisions are the same

What is income according to ordinary concepts, and the meaning of such key notions as when income is 'derived' and when an expense is 'incurred' have been developed by an extensive body of court decisions over a long period. The project team has maintained those concepts intact but has set them out more clearly.

How they are different

There is no general explanation of the purpose of the Act or how the Act works in the existing law. The new provisions give you a conceptual framework for the workings of the Act. For example, they tell you what questions the Act is to answer about income and deductions.

Why have we done it this way

We consider that by giving people an overview and an explanation of the big picture of the income tax system they will be in a better position to see how it all fits together. This will make it easier to understand the requirements of the law. By progressively going down layers of detail it allows users to quickly locate the relevant provisions without reading a lot of unnecessary information. It also allows a user to be certain that all the relevant provisions have been located.

2. The Lists

The lists are checklists of and signposts to the provisions that specifically affect what is income, exempt income, deductions and rebates (now offsets). They are there to help readers find their way to the provisions they need quickly.

The second layer - the general provisions

The 'general provisions' are the provisions that apply to a wide group of taxpayers. They explain how the law deals with particular kinds of income, exempt income, deductions and offsets. For example, there are the rules dealing with depreciation and trading stock.

The third layer - specialist topics

The idea here is to help readers by grouping specialist topics together in one location. The third layer will contain all the special material for specific groups of taxpayers, special types of tax, and special tax obligations. For example, we propose to include these specialist topics in the third layer:

- capital gains tax; corporate taxpayers and corporate distributions;
- financial transactions (such as leveraged leasing and the proposed new financial transactions laws);
- partnerships and partnership distributions;
- trusts and trust distributions;
- superannuation;
- life insurance;
- co-operative and mutual societies;
- rules for particular industries and occupations (such as mining,
- quarrying and petroleum mining, Australian films, primary
- production and research and development);
- international aspects of income taxation; and
- anti-avoidance provisions.

There may be other specialist topics which we will want to deal with separately, once we examine each section of the law again in more detail.

The mechanical provisions

There are some provisions that don't really fit into this conceptual structure. They are the 'mechanical' provisions. For example, there are the sections which deal with collecting and recovering tax, and the other administrative provisions. They can apply to everyone, and they are very important aspects of our tax system, but they don't fit neatly into the pyramid structure. So we have decided to group them together and put them in the Act after the third layer provisions - the specialist topics.

Then there are all the interpretation provisions and definitions of words in the current Act. Some of these are listed at the beginning, and some are sprinkled throughout the Act. What will we do with these?

We want to put these provisions where the reader will find them easily. Strictly, though, it probably doesn't matter so much *where* we put these provisions. as long as the reader can find them.

The toolbox

There are quite a few words and ideas that occur regularly throughout the Act. Many of those words and ideas have special meanings which you need to find in order to understand them. We have decided to collect those definitions together in one place. At the moment, we are calling that place the 'toolbox'. In the toolbox, we will explain words and phrases like:

- agreement, arrangement, understanding, scheme, etc.;
- associate,
- arm's length consideration;
- beneficially owned;
- market value; and
- group company, related company.

The toolbox will be at the end of the Act, but there will be clear signposts when these words appear throughout the Act, pointing the reader to the definitions they need to understand in the sections they are reading.

Other definitions

Some definitions relate only to one section, or one division or part of the Act. We will put those definitions in that section or at the end of that division or part. Again we will use signposts when these words occur in the text, to point the reader to the definitions they need.

Arranging these concepts on paper

Clearly, we can't let ourselves be too constrained by the conceptual structure of the pyramid. It is a good image, but the income tax law will never *actually* look like a pyramid.

We see it this way: there are two different aspects to the way the new law will be structured:

- the conceptual structure - the pyramid idea;
- and the way the sections are arranged on paper.

We have one picture in our minds of the way the Act should be structured. But we have to put the law down on paper, in sections, one after the other. To do this, we have to arrange all the sections of the new law into a book format. And there is such a volume of material that we need to break it down into smaller, more digestible chunks, just as writers and publishers do with books, and computer programmers do with software.

For what the structure of the new Act will look like, see Appendix A.

Sections, divisions, parts and chapters

We have decided to break the material down in the way that provisions have traditionally been organised in Acts.

The basic unit is the section. Each section should deal with one main idea only.

We organise sections which deal with the same or similar ideas into groups of related sections called divisions. We organise divisions into larger groups called parts. And if there is enough material in the Act - and there probably will be - we organise parts into larger groups called chapters, illustrated as follows.

Chapter 3 - Specialist rules affecting liability for income tax	
Part 3-1	Capital gains tax
Part 3-2	Corporate taxpayers and corporate distributions
Part 3-3	Financial transactions
Part 3-4	Partnerships and partnership distributions
Part 3-5	Trusts and trust distributions
Part 3-6	Superannuation
Part 3-7	Life insurance business
Part 3-8	Co-operatives and mutual societies
Part 3-9	Rules for particular industries and occupations
Part 3-10	General international aspects of income taxation
Part 3-11	Attribution of income
Part 3-12	Anti-avoidance

This means that the new income tax law will not look like a pyramid when it is all written down. But we think it will work like one for the reader

Organising the subjects

We have tried to find a way to arrange the provisions of the new law in a coherent order, while still keeping the logic of our pyramid structure. One common way to put material in order is to do it by subject-matter. But what if a provision relates to more than one subject? Where do you put it? One option would be to repeat the information in *each* subject area it relates to. But we have such a large amount of material to begin with. We want to avoid duplicating material if we can

Signposts

And so we have decided to organise the material in layers, from the basic provisions to the more detailed and more specialised, grouping related material together in the most efficient way. Then we direct the reader through the new law with a series of signposts.

The advantage of doing it this way is that readers can ignore large sections of the Act if they want to, knowing that those sections do not apply to them.

Signposts come in various forms. For example, if a word or phrase is explained in the toolbox, there might be a small picture (or icon) in the margin - perhaps a hammer.

Key principles

Key principles are one particular type of signposting. At the beginning of each topic in the Act, there will be one section which explains the basic principle or purpose of that topic. There are many examples of this in Exposure Draft No 2 - **Income Tax Assessment Bill 1995 - The New Act**. For example, see section 36-5 'Dealing with deductions for tax losses'.

Numbering

We also want to improve and simplify the way the sections, divisions, parts and chapters are numbered. This issue involves quite some detail, and we have dealt with it separately, in Part 3 of this paper (see page 17).

Other design improvements

Designing a good structure for the Act is one thing, but it does **not solve all** the problems with the old Act. We want to do more to make it user-friendly. We want to introduce good communications design principles and ideas. We have already outlined some of our ideas on design in Exposure Draft No 1 - Substantiation .

Signposts, key principles and a new numbering system are some aspects of this improvement. So is redrafting the law in plain language. We are also using other techniques, like:

- navigational aids;
- white space around text;
- running headings, which show you where you are in the Act;
- diagrams; and
- other graphics.

The whole area of document design is exciting. We want to do more work in this area, and we will have more to report on this in the near future.

With all these things, our fundamental aim is to make it as easy as possible for readers to find what they are looking for, and know they have found it.

What will all this look like?

There is an example of what all this will look like in the companion booklet, Exposure Draft No 2 - **Income Tax Assessment Bill 1995 - The New Act**. There is another example in Exposure Draft No 1 - Substantiation.

Part 3: A new numbering system

Problems with the old numbering system

One of the most common criticisms of the *Income Tax Assessment Act 1936* is that it contains provisions with numbers like 159GZZZZA(2)(b)(iii)(B).

Numbers like this confuse and disorient taxpayers and their professional advisers, and this wastes time and money. We need to develop a better numbering system.

The numbering system currently used in Commonwealth Acts numbers sections in sequence from one up. This is simple enough, but problems arise when new material is inserted in an existing Act. For example, how do you insert a number between four and five? The current solution is to use a capital letter, so that the new section between four and five is 4A.

That system works well enough in Acts which aren't amended often. But the *Income Tax Assessment Act* is 60 years old, and has been amended many times. That is why we have ended up with sections like section 159GZZZZA.

We have developed a new numbering system for the new tax law. We think it is a great improvement on the old system. It passes all the tests we devised for the ideal numbering system. It gives us a fresh set of numbers and minimises the possibility that the old problems will occur again.

The new numbering system - main features

These are the main features of the new numbering system.

1. Section numbers have two components

Section numbers have two components, separated by a dash. The first component is the number of the division. The second component is the number of the section, starting with the number one at the start of each division.

Example: Section 601-22 is section 22 of Division 601.

We have used a dash instead a decimal point because it is distinctive, and because a decimal point would be misleading in a system that is *not* a decimal system of numbering.

At the start of each new division section numbers start again from one.

Example: After the last section of Division 601 (say 601-29) comes section 602-1

Under the old system, 'section 360' uniquely identified one section. Under the new system, 'section 230-1' identifies it. It is a slightly longer number, but it gives you more information - it gives you the section's location in the relevant part of the Act.

But the main advantage of having two components is that it copes with inserted material better than the current system does. Numbers like 159GZZZZA should never again come up, because the section number has *two* elements that can be changed. So if we need to add a whole new division, we simply add one capital letter to the division number, and immediately we can add unlimited sections without using more letters.

Example: Division 601A would be a potential new division between Divisions 601 and 602. Section numbers could run from 601 A- 1 up.

Unfortunately, we will eventually have to use some capital letters. But there will be far fewer of them, and they should never come in long strings.

2. Division numbers run in sequence, but with gaps

Division numbers run in one sequence throughout the Act. They do not start again at one at the start of each part. This is essential, because otherwise many sections might have the same number.

After the last division in a part, we will usually leave a gap in the sequence of division numbers. This keeps some numbers in reserve, so we can insert future divisions later, without having to use capital letters. We will do the same for part numbers too, so that we can insert new parts in future if necessary.

At the start of important building blocks in the law, the first division will have an easy-to-remember number.

Example: The first division in the part about deductions might be Division 400.

Initially, we will leave gaps of five part numbers and five division numbers to allow ample room for future parts and divisions to be inserted. Although this means that most division numbers will start with three digits, it does minimise the need to use letters to supplement numbers.

3. Part numbers identify chapter numbers

Part numbers identify the chapters to which they belong.

Example: Part 5-10 means Part 10 of Chapter 5.

This makes cross-references shorter

The relationship between chapters, parts, divisions and so on is explained on page 21.

We decided not to include part numbers as another component of the section number. If we did, you would need to know the part number as well as the division and section numbers in order to identify a section. And section numbers would become too long.

4. Clearer cross-references

Cross-references to provisions will usually specify the *name* of the provision, as well as its number.

Example: "See section 405-2 (Deduction for pigs)"

After the last division in a part, we will usually leave a gap in the sequence of division numbers. This keeps some numbers in reserve, so we can insert future divisions later, without having to use capital letters. We will do the same for part numbers too, so that we can insert new parts in future if necessary.

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How it would look in practice

This table shows a list of draft provisions showing how the numbering system would look. It assumes the new Act will use chapters.

TABLE OF PROVISIONS

Chapter 2 - Further liability rules of general application

Part 2-2—Deductions

Division 33 Capital allowances

Subdivision 33-A—Introduction

33-1 Guide to this Division

Subdivision 33-B—What is a capital allowance?

33-5 The key principle
33-10 What expenditure qualifies?
33-15 Who may deduct?
33-20 How to work out the deduction
33-25 Termination of use: balancing adjustment

Subdivision 33-C—Summary and finding table

33-30 Table of capital allowances

Subdivision 33-F—Common rules

33-200 Scope of this Division
33-233 Definitions
33-225 The key principle
33-230 When is roll-over relief available?
33-235 Motor vehicle count as asset
33-240 What does the relief consist of?
33-250 How are the balancing adjustment provisions affected?

- 33-255 subsequent applications of this common rule—relief available even if subsequent transferor gets no deduction
- 33-260 subsequent termination—modify the balancing adjustment
- 33-265 Commissioner may amend assessment after recoupment despite section 170
- 33-275 Partial change of ownership
- 33-280 Non-arm's length transactions
- 33-285 You are taken to be owner of property for purposes of certain anti-avoidance provisions
- 33-290 Recoupment of capital expenditure.

The new numbering system - details

1. Chapters

At this stage we think the new Act will be divided into chapters. However, it probably doesn't matter. We can decide that when we work out the structure for parts.

Chapters have a single component number.

Example: Chapter S. Chapter 6 etc.

If in the future we need to insert a chapter between Chapter 5 and Chapter 6 we will use a capital letter and attach it to the first of the two chapter numbers.

Example: We insert Chapter 5A between Chapter S and Chapter 6. Then Chapters 5B, 5C etc.

2. Parts

Parts are numbered in two components separated by a dash. The first refers to the chapter, if there is one. The second refers to the part.

Example: Part 5-6 is Part 6 of Chapter 5. If the Act doesn't have chapters, the same part would be Part 6.

If in the future we need to insert a part between Part 5 and Part 6 we will use a capital letter and attach it to the first of the two part numbers, just as we did for chapters.

Example: We insert Part 5-5A between Part 5-5 and Part 5-6. Then Parts 5-5B, 5-5C etc.

If there are no chapters, we would insert Part 5A between Part 5 and Part 6. Then Parts 5B, 5C etc.

3. Divisions

Divisions have a single component number, the same as chapter numbers do.

Example: Division 5, Division 6 etc

If in the future we need to insert a division between Division 5 and Division 6 we will use a capital letter, and attach it to the first of the two division numbers

Example: We insert Division 5A between Division 5 and Division 6. Then Division 5B, 5C, 5D etc.

Under the new system, division numbers rise from 1 upwards throughout the whole Act. This differs from the present system, where the division numbers restart at 1 for each new part. So under the new numbering system, divisions are really divisions of the Act, even though they are still grouped into parts (and the parts may be grouped into chapters). This also allows us more flexibility in numbering sections.

4. Subdivisions

Subdivision numbers have two components, separated by a dash. The first component is the number of the division. The second component is a capital letter in the sequence A, B, C, etc.

Example: Subdivision 5-A is Subdivision A of Division 5-B.

If in the future we need to insert a subdivision between Subdivision 5-A and Subdivision 5-B we will use another capital letter.

Example: We insert Subdivision 5-BA between Subdivision 5A and Subdivision 5-B.

If we need more subdivisions between Subdivision 5-BA and Subdivision 5-B, we can use Subdivision 5-BB, 5-BC etc.

The reason we insert 5-BA between 5-A and 5-B is that if we used 5-AA, there would be nothing to go before 5-A.

5. Sections

Section numbers have two components, separated by a dash. The first component is the number of the division. The second component is the number of the section. starting with the number 1 at the start of *each* division

Example: Section 5-15 is section 15 of Division 5. Section SA 1 S SR section 15 of Division 5A.

If in the future we need to insert a section between Section 5-15 and Section 5-16, we will use a capital letter and attach it to the first of the two section numbers, just as we did for division numbers.

Example: We insert Section 5-I5A between Section 5-15 and Section 5-16. Then Section 5-I5B, 5-I5C etc.

This system means that each section number is unique, so there is no need to refer to a higher unit to which the section belongs. That is why the sequence of division numbers runs throughout the whole Act, instead of starting again at the beginning of each part.

6. Smaller units

We are not changing the way units within a section are numbered. However, sections should have fewer subsections. Paragraphs will rarely be divided into sub-paragraphs, and never into sub-subparagraphs.

How the new system measures up

Before we developed the new numbering system, we wrote down our key objectives for an ideal numbering system. They were:

1. Each unit of law should have a unique number to identify it.
2. For any two conceivable numbers within the system. it should be immediately apparent which one is higher.
3. Numbers should be easy to read.
4. Numbers should be able to be said aloud without being ambiguous.
5. The system should flow naturally and be predictable.
6. We should keep existing drafting conventions unless there is a reason to abandon them, but we should feel free to change them if they are causing problems.
7. Each number should identify the 'building block' to which it belongs.

8. The system should cope well if a large amount of new material is inserted later.

We think the new system we have devised meets all these objectives. It is not perfect, and there are certain problems caused by having to anticipate that a great deal of new material may be inserted in the future. But we still think we, have come up with a system which will work well in practice.

Part 4: How should we deliver the new law?

The choices

The Tax Law Improvement Project is expected to take three years.

We cannot rewrite the whole of the law at once, so we will rewrite it progressively.

The question is: what is the best way for the project team to deliver the rewritten law to Parliament and, ultimately, the community?

There are several ways we could do this. We could:

- (a) introduce the rewritten law as one big package at the end of the project; or
- (b) introduce parts of the rewritten law progressively over the life of the project; or
- (c) make a compromise between these two approaches.

Our recommendation—progressive replacement

The Tax Law Improvement Project recommends that the rewritten income tax law be delivered to Parliament and the community progressively, in several stages over the project's life.

We call this technique 'progressive replacement'.

With progressive replacement, when a significant segment of the law is rewritten, it would be brought in as new legislation, using both the structure of the new tax law and its new numbering system. This would happen in stages.

We suggest that the first segment of the rewritten law could be introduced into Parliament around November 1995, with further segments being introduced at the end of 1996 and 1997. The whole of the rewritten law could be introduced in three annual segments over the life of the project.

It may be that some of the provisions in these segments of rewritten law would not come into effect immediately. We would consider very carefully the effect any of these changes could have on the community, and set appropriate commencement dates bearing that in mind.

Once the rewritten law comes into effect, the rest of the existing law (minus those areas of law which have been rewritten) would continue to operate alongside the new law.

There will be some temporary provisions in the old Act to ensure that the old and new law can work together, until the old law is completely replaced.

How we decided on progressive replacement

We have made our recommendation based on several important objectives. We wanted to:

- maximise the benefits of the rewritten law to its users;

- minimise the potential disruption to users during the transition from the current law to the rewritten law;
- make it as easy as we can for users to organise the education and training they will need in the new law, and to review published material, manuals, computer software and the like to deal with the new law;
- encourage the community to participate in the project; and
- make sure the project works quickly and efficiently.

We know we can only write better income tax laws if we consult widely with the community. The way we deliver the new law must also allow that consultation, and as well it must encourage community interest and goodwill, for the whole length of the project.

We must also take into account the fact that the project is actually progressing at two levels at the same time.

The first level is concerned with 'big picture' issues such as the structure and design of the rewritten law, and a new numbering system. We have already done a lot of work on those areas, as you can see by reading the Structure section of this article.

The second level is concerned with the actual rewriting of each section of the income tax law. This work began with the sections which cover substantiation (see Exposure Draft No 1). There are further examples of rewrites in Exposure Draft No 2: for example, the law dealing with deductions for losses, and the mining industries provisions.

We think the progressive replacement option takes all these facts and objectives into account because:

- users of income tax law get the benefit of the rewritten law much earlier;
- it should be much easier for Parliament, the Australian Taxation Office, taxpayers and tax professionals alike to take on board the rewritten law in smaller packages; and
- there is no need to rewrite the law more than once.

What other options are there?

Apart from the progressive replacement option, we considered three other ways of delivering the new law.

1. The New Zealand approach

New Zealand is also rewriting its tax laws at the moment.

That project is being done in two stages. The first stage is complete. It was limited to restructuring and renumbering the existing law. There was no change to the substance of the law during this stage. The second stage is the rewriting stage, which will be done progressively

There are several reasons why we think the New Zealand approach would not suit the Australian tax law. They are because:

- it is a two-stage process, it involves double handling of the law. All the provisions must be reorganised and numbered once in the first stage, and then rewritten and possibly renumbered again after the rewriting stage;
- it is much easier to create a completely new structure than it is to graft a different structure onto the existing law; and
- we have a huge task and limited time to complete it. We cannot afford to delay rewriting the law itself. In fact, rewriting is well under way already.

2. The 'substance now, structure later' option

Under this option, the project team would work at the same time on two levels - on both the big picture level (looking at the structure and arrangement of the provisions, numbering and related matters) and the fine-detail level of the actual rewriting of each section.

The idea here is to introduce rewritten segments of the law into Parliament progressively. But, unlike the progressive replacement option which we prefer, each rewritten segment would be put into the **existing** law (with its existing structure and numbering). This would allow us to delay deciding on the new structure of the law until later. Then, at the end of the project, all the rewritten law would be transferred across into the structure of a new Act, and there would be transitional rules to govern when the old law would no longer apply. This time the new law would reflect the new structure and the new numbering system.

One benefit of doing it this way is that we could take advantage, at one level of the project, of whatever lessons we learn or insights we gain from work we do at the other level. It would also give us the maximum amount of time to work on structuring the new law.

But this option has a major disadvantage, too. During the life of the project, the rewritten law would be inserted back into the existing law in its existing location. We would be mixing the existing law with the rewritten law. This could cause great confusion for users of the law.

There are other disadvantages: it is likely that provisions would be renumbered not once, but twice. It involves double handling of law. And the benefits of the new structure and the new numbering system would be postponed until the end of the project.

For all these reasons, we do not favour the 'substance now, structure later' option.

3. The big bang option

Using the 'big bang' option, we would finalise the whole of the rewritten law (both at the big picture level and at the fine-detail level) before it is introduced into Parliament at the end of the project.

This option has several advantages:

- it would allow us the maximum amount of time to decide on issues such as the new structure of the rewritten law;
- it would allow us the maximum amount of time to correct any errors, oversights and unintended consequences which crop up as we rewrite the income tax law;
- on one particular date the old law stops, and the new law starts; it is easier to evaluate the rewritten law as a whole; and
- there would be no double handling of material, and no need to renumber provisions more than once.

It also has some disadvantages:

- users of the income tax law would not get the benefit of the rewritten law until the end of the project;
- it would be extremely difficult for the Australian Taxation Office, taxpayers and tax professionals to take on board such a large volume of rewritten law in one huge package at the end of the project;
- introducing all the rewritten law for Parliament to consider and pass in one sitting would make it more difficult for Parliament to review the new law; and
- if the existing law had to be amended in the meantime, we would have to rewrite those segments of the rewritten law **again**, to take account of those amendments. This could slow the project down and make it less efficient.

Do the advantages outweigh the disadvantages?

One view is that the fact that the big bang option would allow us the maximum amount of time to correct any errors and unintended consequences in the new law is a compelling reason to go with the big bang approach. But the project team doesn't agree.

We recognise that a progressive drafting approach like the progressive replacement option may allow some errors to slip through into legislation. Errors are impossible to avoid in a project this large and complex. But the project team is very conscious of the need to detect and correct any errors as quickly as possible, and of course we want to keep them to a minimum in the first place.

If the rewritten law is brought in progressively over the life of the project, we can still correct any detected errors in later legislation sponsored by the project.

We think that our objectives to:

- maximise the benefits to users of the income tax law;
- maintain community support for the project;
- consider the potential impact of the rewritten laws on Parliament and the community; and to
- make sure the Project works quickly and efficiently,

all make a very strong case against the big bang option.

In fact, we think they all point to the progressive replacement option.

How the progressive replacement option compares with the alternatives

The progressive replacement option has significant advantages over the other options. In summary:

- the users of the income tax law get the benefit of the rewritten law much earlier;
- it will be easier for Parliament, the Australian Taxation Office, taxpayers and tax professionals to take the rewritten law on board;
- there is no double-handling of provisions;
- provisions are renumbered only once; and
- we do not mix existing law with rewritten law.

It is true that the progressive replacement option forces us to decide about structure and numbering much earlier. But we do not see this as a disadvantage, because we have already done much of the work in both these areas.

Conclusion

The Tax Law Improvement Project recommends delivering the rewritten income tax law to Parliament, and the community, in progressive stages over the life of the project.

As each segment of the law is rewritten, we recommend that it be immediately inserted into the new tax law, using the new structure and new numbering system we are developing.

Specifically, we suggest introducing the rewritten law into Parliament in three annual stages beginning in November 1995. As each segment of new, rewritten law is passed through Parliament, the corresponding segments of old law would be discontinued. The rest of the old law would continue to operate alongside the new law, until its time comes to be rewritten and replaced.

There may be a need for different commencement dates within the annual instalments, depending on what impact the changes might have on users of the new law.

Part 5: What do you think?

Income tax is a complicated subject. It operates in a complicated world. We cannot make the income tax law as simple as most people would wish it to be.

There is a lot of detail to cover, and much to explain. We must explain the law in enough detail for people to understand all their rights and obligations. We cannot leave anything out, unless what we leave out was unnecessary in the first place. So even after rewriting the income tax laws, we will still end up with a lot of pages, and a lot of law.

But we will be organising the law better. We will be writing it in plain language. We will be laying it out in a way that is easier to read. We will have signposts to point the way. And we will arrange things so that you don't have to read the law from cover-to-cover. You should be able to skip through the provisions, reading only those that you need to read.

We think that will make a much better income tax law.

We think we have created a new tax law structure that will make the law easy to understand. It should allow the rewritten Act to last for a very long time. We have drawn on our own experience, we have looked at other tax laws, and we have examined other laws which have recently been revised. We have built our new tax laws with firm objectives in mind.

Now we want your input. The philosophy of the Tax Law Improvement Project is to involve taxpayers, tax advisers and tax administrators at each stage of the project.

So we are seeking your comments and suggestions on what we have outlined in this paper.

You can comment on our proposals for:

- the structure of the Act;
- the way the material will be organised;
- the design features;
- the numbering system; and
- the way we propose to deliver the new law or on any other aspect of this paper.

Please send your comments and suggestions by 21 July 1995 to:

Project Director

Tax Law Improvement Project

Australian Taxation Office

P.O. Box 900

CIVIC SQUARE ACT 2608

Appendix A

Introduction

This is an outline of the structure of the new Income Tax Assessment Act. It is provided as a guide so that you have an idea of what the framework of the new Act will look like.

A more detailed picture of how some rewritten parts of the law will look in the new structure is contained in Exposure Draft No. 3 (The mining, quarrying and petroleum mining industries) and Exposure Draft No. 4 (Deductions for losses).

Structure of the New Act

Chapter 1 Introduction and core provisions

Chapter 2 Further liability rules

Chapter 3 Specialist rules

Chapter 4 Collection & recovery

Chapter 5 Administration

Chapter 6 Tool box

Chapter 1—Introduction and core provisions

(Divisions 1 -19)

Part 1-1—Preliminary

Division 1 - Short title and commencement

Part 1-2—Introduction

(Divisions 2 - 9)

Division 2—What this Act is about

Division 2A—What instalments of income tax do you have to pay?

Division 3—How do you calculate how much income tax you owe?

Division 4—Working out your taxable income

Division 5—Adding up your assessable income

Division 6—What is exempt income?

Division 7—Adding up the amounts you can deduct

Division 8—What tax offsets are there?

Part 1-3—Checklists

(Divisions 10 -14)

Division 10—Particular kinds of assessable income

Division 11—Particular kinds of exempt income

Division 12—Particular kinds of deductions

Division 13—Particular kinds of offsets

Chapter 2—Further liability rules of general application

(Divisions 20 - 99)

Part 2-1—Assessable income

(Divisions 20 - 29)

Division 20—Assessable income further defined

Part 2-2—Deductions

(Divisions 30 - 39)

Division 30—General limitations
Division 31—Specifically deductible
Division 32—Deductible gifts
Division 33—Overview of capital allowances
Division 34—Depreciation of plant and articles
Division 35—Buildings and structures
Division 36—Calculation of car expenses
Division 37—Non-deductible expenses
Division 38—Losses of earlier income years

Part 2-3—Exempt income

(Divisions 40 - 44)

Division 40—Exempt taxpayers
Division 41—Certain taxpayers' special income is exempt
Division 42—Social Security and similar payments

Part 2-4—Tax Offsets

(Divisions 45 - 49)

Division 45—Introduction
Division 46—Generally applicable offsets
Division 47—Heritage conservation offsets
Division 48—Lump sum payments in arrears
Division 49—Miscellaneous offsets

Part 2-5—Trading stock

(Division 50)

Division 50—Trading stock

Part 2-6—Taxation of non-cash benefits

(Divisions 51 - 54)

Division 51—Interaction with Fringe Benefits Tax
Division 52—Non-cash business benefits

Part 2-7—Rules affecting PAYE taxpayers

(Divisions 55 - 59)

Division 55—Rules affecting PAYE taxpayers

Part 2-8—Rules affecting self employed

(Divisions 60 - 64)

Division 60—Rules affecting self employed

Part 2-9—Leases

(Divisions 65 - 69)

Division 65—Leases

Chapter 3 - Specialist rules affecting liability for income tax

(Divisions 100- 749)

Part 3-1 - Capital Gains Tax

(Divisions 100 - 149)

Division 100 - Overview of Capital Gains Tax

Part 3-2 - Corporate taxpayers and corporate distributions

(Divisions 150- 199)

Division 150—Dividends

Division 155—Imputation - Franking of dividends.

Division 165—Change in ownership or control of a company

Division 170—Treatment of company groups

Division 175—Use of company tax losses to avoid tax

Division 180—Pooled development funds

Division 185—Certain entities treated as companies

Division 190—Share cancellations and buy-backs

Division 195—Private companies

Part 3-3 - Financial transactions

(Divisions 200 - 249)

Division 200—Financial transactions

Part 3-4 - Partnerships and partnership distributions

(Divisions 250 - 254)

Division 250—Partnerships

Division 251—Changes in partnership interests

Part 3-5 - Trusts and trust distributions

(Divisions 255 - 259)

Division 255—Overview of trusts

Division 256—Trust income

Part 3-6 - Superannuation

(Divisions 260 - 319)

Division 260 - ETPs and kindred payments

Division 265 - Deductibility of contributions

Division 270 - Rebates

Division 275 - Superannuation pensions and annuities

Division 280 - Reasonable Benefit Limits
Division 285 - Special rules
Division 290 - Taxation of super funds

Part 3-7 - Life insurance business

(Divisions 320 - 324)

Division 320—Life insurance companies
Division 321—Life insurance policy holders
Division 322—Friendly society life insurance

Part 3-8—Co-operatives and mutual societies

(Divisions 325 - 329)

Division 325—Co-operative and mutual companies

Part 3-9—Rules for particular industries and occupations

(Divisions 330 - 419)

Division 330—Mining, quarrying and petroleum mining
Division 350—Scientific research
Division 355—Research and development
Division 375—Australian films
Division 380—Industrial property
Division 385—Primary production
Division 390—Timber operations and timber mill buildings
Division 395—Development allowance
Division 400—Environmental impact studies
Division 402—Environment protection expenditure
Division 405—Averaging income of certain professionals

Part 3-10 - General international aspects of income taxation

(Divisions 420 - 519)

Division 420—General provisions
Division 422—Residence
Division 424—Source
Division 426—Income and deductions with a foreign source
Division 428—Overseas ships
Division 430—Disguised dividends
Division 435—Foreign exchange gains and losses
Division 440—Exempt foreign income
Division 450—Foreign tax credits
Division 455—Offshore banking units
Division 460—Australian branches of foreign banks
Division 465—Regional headquarters
Division 470—Transfer pricing provisions
Division 480—Thin capitalisation rules

Part 3-11 - Attribution of income

(Divisions 520 - 569)

Division 520—Attribution of Income of controlled foreign companies
Division 540—Foreign investment funds and foreign life assurance policies
Division 560—Non-resident trusts estates (transferor trusts)

Part 3-12 - Anti-avoidance

(Divisions 570 - 589)

- Division 570—Schemes to reduce income tax
- Division 575—Losses and outgoings incurred under tax avoidance schemes
- Division 580—Period of deductibility of advance expenditure
- Division 582—Assessable income diverted under tax avoidance schemes
- Division 584—Alienation of income
- Division 585—Income of children

Chapter 4 - Collection and recovery of income tax

(Divisions 750- 849)

Part 4-1—Introduction and core collection provisions

(Divisions 750- 754)

Part 4-2—Periodic collection of income tax instalments

(Divisions 755- 759)

- Division 755—Pay-as-you-earn instalments by salary and wage earners
- Division 756—Provisional tax instalments
- Division 757—Instalments of tax by corporations, superannuation funds and approved

deposit funds

Part 4-3—Transaction-based collection of income tax instalments

(Divisions 760- 764)

- Division 760—Prescribed payments system
- Division 761—Reportable payments system
- Division 762—Income from investments
- Division 763—Natural resource payments to non-residents
- Division 764—Withdrawals from Australian film industry trust fund accounts

Part 4-4—Withholding taxes: liability and collection provisions

(Divisions 765- 769)

- Division 765—Withholding tax on dividends, interest and royalties
- Division 766—Withholding tax on payments for mining operations on Aboriginal land
- Division 767—Interest paid by companies on bearer debentures
- Division 768—Withholding tax on income notionally accruing under certain deferred interest investments

Part 4-5—Returns and assessments

(Divisions 770- 774)

- Division 771—Assessments

Part 4-6—Balance payable or refundable

(Divisions 775 - 779)

Division 775—Crediting instalments of income tax against income tax liability for the income year

Division 776—Collecting balance of income tax payable

Division 777—Refunding excess payments

Part 4-7—Recovery of tax

(Divisions 780 - 784)

Part 4-8—Collecting Medicare levy and HECS with income tax

(Divisions 785- 789)

Division 785—Medicare levy

Division 786—HECS

Chapter 5—Administration

(Divisions 850 - 949)

Part 5-1—General administrative provisions

(Divisions 850 - 854)

Part 5-2—Tax file numbers

(Divisions 855 - 864)

Part 5-3—Registration of tax agents

(Divisions 865 - 874)

Part 5-4—Prosecutions and offences

(Divisions 875 - 884)

Part 5-5—Rights

(Divisions 885 - 894)

Division 885—Taxpayers' rights

Division 886—Commissioner's rights

Part 5-6—Penalty tax

(Divisions 895 - 899)

Part 5-7—Record-keeping and other obligations

(Divisions 900 - 904)

Part 5-8—Miscellaneous

(Divisions 905 - 909)

Chapter 6—The toolbox

(Divisions 950 - 995)

Part 6-1—Concepts and topics

(Divisions 950 - 994)

Division 950—Related companies

Part 6-2—Definitions

Division 995—Definitions

Other Booklets

At the same time as we publish this paper, we are publishing three other booklets:

1. Income Tax Assessment Bill 1995—The New Act Exposure Draft No 2

Exposure Draft No 2 is a bill for the rewritten law we propose to replace the existing tax law. It contains rewrites of some areas, including:

- core provisions;
- those for the general mining, quarrying and petroleum mining industries; and
- deductions for losses.

2. The General Mining, Quarrying and Petroleum Mining Industries Exposure Draft No 3

This paper is designed for a specialist audience who are particularly interested in these industries and the tax laws that affect them. It sets out the draft legislation we propose to replace the existing tax law covering these industries. (This draft legislation is repeated in the draft bill in Exposure Draft No 2). Exposure Draft No 3 also explains the changes proposed to the existing law, in some detail.

3. Deductions for Losses - Exposure Draft No 4

This paper is designed for a specialist audience who are particularly interested in the tax laws on deductions for losses, including losses of a prior year, the right to transfer losses between companies within a group and losses of a year in which there is a change of ownership of a company. It sets out the draft legislation we propose to replace the existing tax law on deductions for losses. (This draft legislation is repeated in the draft bill in Exposure Draft No 2.) Again, Exposure Draft No 4 explains the changes proposed to the existing law, in some detail.