

2015

EXPOSURE DRAFT

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COMMISSIONER'S REMEDIAL POWER

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EXPLANATORY MATERIAL



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## ***Table of contents***

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Glossary .....	1
Commissioner's Remedial Power .....	3



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## ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
AIA	<i>Acts Interpretation Act 1901</i>
APRA	Australian Prudential Regulation Authority
APS	Australian Public Service
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
Commissioner	Commissioner of Taxation
GST	Goods and Services Tax
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
LA	<i>Legislation Act 2003</i>
TAA	<i>Taxation Administration Act 1953</i>



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## ***Commissioner's Remedial Power***

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### **Outline of chapter**

1.1 Schedule # to this Bill establishes a Remedial Power for the Commissioner of Taxation (Commissioner) to allow for a more timely resolution of certain unforeseen or unintended outcomes in the taxation (including superannuation) laws.

1.2 The power allows the Commissioner to make, by disallowable legislative instrument, one or more modifications to the operation of a taxation law, to ensure the law can be administered to achieve its purpose or object. The power can only be validly exercised where:

- the modification is not inconsistent with the purpose or object of the provision; and
- the Commissioner considers the modification to be reasonable, having regard to both the purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the purpose or object;
- the Treasury or the Department of Finance advises the Commissioner that any impact on the Commonwealth budget would be negligible.

1.3 All references to legislative provisions in this Chapter are references to the *Taxation Administration Act 1953* (TAA), unless otherwise stated.

### **Context of amendments**

1.4 The Government announced on 1 May 2015 (and on 12 May 2015 as part of the 2015–16 Budget) that it would provide more certainty and better outcomes for entities and reduce the regulatory burden on individuals, business and community organisations by providing the Commissioner with a Remedial Power.

1.5 The announcement followed a targeted consultation process with representatives from the Treasury, the Australian Taxation Office (ATO), the Australian Government Solicitor and key industry and professional associations. The purpose of the consultation was to consider the feasibility of a Remedial Power and what factors would be relevant to the operation of such a power. This consultation has informed the framework of the Remedial Power provided to the Commissioner by Schedule # to this Bill.

1.6 The Australian taxation laws are complex and operate in the context of rapidly changing business practices as a result of the dynamic and transforming economy. This increasingly leads to unintended or unforeseen outcomes in the application of the taxation laws. These outcomes can create significant uncertainty and compliance cost impacts for entities.

1.7 Consistent with section 15AA of the *Acts Interpretation Act 1901* (AIA), the Commissioner applies purposive principles to the interpretation of the taxation laws to give effect to the purpose or object of the law. However, sometimes this approach is unable to remedy unintended consequences in the application of the taxation laws. For example, this can occur when dealing with new scenarios which were not known or contemplated when the provisions were drafted.

1.8 The Remedial Power allows the Commissioner to make a disallowable legislative instrument to modify the operation of a taxation law to ensure the law can be administered to achieve its purpose or object. There are similar legislative instrument making powers in Commonwealth law currently granted to the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). However, the APRA and ASIC powers can be exercised for a particular entity and are generally limited in terms of the provisions of the law which can be modified.

## Summary of new law

1.9 Schedule # to this Bill establishes a Remedial Power for the Commissioner to allow for a more timely resolution of certain unforeseen or unintended outcomes in the taxation laws.

1.10 The power allows the Commissioner to make, by disallowable legislative instrument, one or more modifications to the



operation of a taxation law, to ensure the law can be administered to achieve its purpose or object. The power can only be validly exercised where:

- the modification is not inconsistent with the purpose or object of the provision;
- the Commissioner considers the modification to be reasonable, having regard to both the purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the purpose or object; and
- the Treasury or the Department of Finance advises the Commissioner that any impact on the Commonwealth budget would be negligible.

1.11 The power is limited in its application and an entity (the first entity) must treat a modification made under the power as not applying to it and any other entity if the modification would produce a less favourable result for the first entity.

1.12 Before exercising the power, the Commissioner must be satisfied that any appropriate and reasonably practicable consultation has been undertaken to ensure the opportunity to identify and consider all implications from the exercise of the power and that the exercise of the power is appropriate in the circumstances. This is consistent with the approach to amendments of primary legislation, which are subject to public consultation.

1.13 The Remedial Power does not change the requirement for the Commissioner to pursue an interpretation of the law which can achieve the purpose or object of the law in the first instance or to seek to use his or her general powers of administration. The Remedial Power is to be exercised as a power of last resort where the other options available to the Commissioner (such as applying purposive principles to the interpretation of the relevant taxation law or using the general powers of administration) have been considered and found not to provide a suitable solution. In some cases, it may be more appropriate for the Commissioner to seek an amendment to the primary legislation, rather than to use the Remedial Power.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Schedule # to this Bill provides the Commissioner with a Remedial Power which allows the Commissioner to modify the operation of a taxation law where:</p> <ul style="list-style-type: none"><li>• the modification is not inconsistent with the purpose or object of the provision;</li><li>• the Commissioner considers the modification to be reasonable, having regard to both the purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the purpose or object; and</li><li>• the Treasury or the Department of Finance advises the Commissioner that any impact on the Commonwealth budget would be negligible.</li></ul>	<p>No equivalent.</p>

## Detailed explanation of new law

### 1.14 Schedule # to this Bill:

- establishes a Remedial Power for the Commissioner
- outlines the limitations for exercising the power
- provides application rules for legislative instruments made under the power, and
- sets out when such legislative instruments commence and sunset.

## **Establishment of the Commissioner's Remedial Power**

### **Commissioner's Remedial Power**

1.15 Schedule # of the Bill establishes a Remedial Power for the Commissioner which allows the Commissioner to determine one or more modifications to the operation of a provision of a taxation law by a disallowable legislative instrument in accordance with certain limitations. A single legislative instrument made under the Remedial Power could contain multiple modifications. *[Schedule #, item 2, subsection 370-5(1)]*

1.16 A provision of a taxation law operates with any modifications made by the Commissioner using the Remedial Power. The Remedial Power does not allow the Commissioner to make a textual amendment to the relevant taxation law, or to alter the purpose or object of the law. It merely allows the Commissioner to modify the operation of a provision of the taxation law where that modification satisfies the limitations prescribed in subsection 370-5(1). *[Schedule #, item 2, subsection 370-5(2)]*

1.17 The Remedial Power is discretionary, so the Commissioner can choose whether or not to exercise the power. The Commissioner cannot be compelled to exercise the power.

1.18 Consultation and governance arrangements will be established by the Commissioner. This will assist him or her to manage the process for consideration of issues that could potentially be dealt with by the power and the exercise of the Remedial Power.

1.19 Should an entity consider that the Commissioner's exercise of the Remedial Power extends beyond the limitations of the power provided in the law, they will be able to seek review by the courts.

### **The need for the Commissioner's Remedial Power**

1.20 Consistent with section 15AA of the AIA, the Commissioner applies purposive principles to the interpretation of the taxation laws to give effect to the purpose or object of the law. However, sometimes this approach is unable to remedy unintended consequences in the application of the taxation laws. For example, this can occur when dealing with new scenarios which were not known or contemplated when the provisions were drafted.

1.21 While ascertaining the purpose or object of a provision is a critical part of the interpretive process, there are limitations on the manner in which a provision can be interpreted. These limitations can result in an application of the law that may seem inconsistent with the purpose or object of a provision when considered in its broader context. Where this happens, there are often calls for the law to be amended. However, amending taxation legislation can often be a lengthy process and delays can lead to uncertainty for entities and increased compliance costs.

1.22 The Remedial Power is intended to increase certainty in the administration of taxation laws by reducing the regulatory burden on entities that arise from unforeseen or unintended consequences in the application of taxation laws. The Remedial Power also ensures the Commissioner can administer the law consistently with its purpose or object. It is anticipated that this power will reduce the time it takes to give effect to some minor legislative corrections. It may also, where appropriate, allow for some minor technical corrections to be addressed where, due to their relatively low priority, this may not otherwise occur.

1.23 The exercise of the Remedial Power will be subject to certain limitations and, importantly, any legislative instrument created in exercise of the Remedial Power will be subject to full Parliamentary scrutiny and disallowance (see paragraphs 1.63 to 1.64).

### **Meaning of a ‘taxation law’**

1.24 Schedule # to this Bill allows the Commissioner to modify the operation of a provision of a ‘taxation law’. The TAA defines a ‘taxation law’ by reference to the *Income Tax Assessment Act 1997* (ITAA 1997). The ITAA 1997 defines a taxation law in subsection 995–1(1) to include an Act of which the Commissioner has the general administration and legislative instruments made under such an Act. A taxation law therefore could include superannuation laws or other laws dealing with matters other than taxation, provided that the Commissioner has the general administration of the relevant Act.  
*[Schedule #, item 2, subsection 370–5(1)]*

1.25 Where the Commissioner shares the general administration of an Act with another agency, it is expected that the Commissioner will consult with them as appropriate before making a decision about using the Remedial Power.

## **Limitations on exercising the Remedial Power**

- 1.26 The Remedial Power can only be validly exercised where:
- the modification is not inconsistent with the purpose or object of the provision,
  - the Commissioner considers the modification to be reasonable, having regard to both the purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the purpose or object, and
  - the Secretary of the Treasury, Secretary of the Department of Finance or an authorised APS employee of either department advises the Commissioner that any impact on the Commonwealth budget would be negligible.

*[Schedule #, item 2, subsection 370-5(1)]*

### **The modification must not be inconsistent with the purpose or object of the provision**

1.27 A modification to the operation of a provision of a taxation law made by the Commissioner will only be valid where the modification in question is not inconsistent with the purpose or object of the provision which is sought to be modified. This means that if the Commissioner were to make a modification which was inconsistent with the purpose or object of the provision, then the modification would be invalid because it would be outside of the limitations of the Commissioner's Remedial Power. *[Schedule #, item 2, paragraph 370-5(1)(a)]*

1.28 The requirement that the modification must not be inconsistent with the purpose or object of the provision is intended to be an objective test. Should an entity consider that the Commissioner's exercise of the Remedial Power extends beyond the limitations of the power provided in the law, they will be able to seek review by the courts. The courts will have ultimate responsibility for determining whether any modification is inconsistent with the purpose or object of the provision. In practice, the Commissioner will also need to consider whether the modification would be not inconsistent with the purpose or object of the provision in deciding whether the power is available to the Commissioner for the modification which he or she is seeking to make.

1.29 The expression ‘not inconsistent with the purpose or object’ is broader than the expression ‘consistent with the purpose or object’. The former expression is intended to ensure the Remedial Power can be used to cater for circumstances where it is reasonably clear that particular circumstances, arrangements or transactions may not have been contemplated at the time the law was drafted. It is inevitable that there will be a range of such circumstances, arrangements or transactions that were not known to exist, or did not exist, at the time of drafting. However, it may be reasonably ascertained that, had the circumstances, arrangement or transaction been considered at the time the law was drafted, applying the law in a modified way would not be inconsistent with the purpose or object of the law.

1.30 In identifying the purpose or object of the provision which is sought to be modified, any material that would assist in ascertaining the purpose or object of the provision may be considered. The material considered need not form part of the provision in question. However, in determining the purpose or object of the provision, consideration must be given to any documents that may be considered under section 15AB of the AIA (and that section as applied by section 13 of the *Legislation Act 2003* (LA)) in relation to the provision. [*Schedule #, item 2, section 370–10*]

1.31 Section 15AB of the AIA allows for the consideration of extrinsic material in the interpretation of the law to confirm the ordinary meaning of a provision or to determine the meaning where it is ambiguous or obscure or when the ordinary meaning leads to a result that is manifestly absurd or unreasonable. In considering whether the exercise of the Remedial Power would be valid or was valid, consideration must be given to the same materials but to ascertain the purpose or object of the law. This means that the consideration given to the material may not be the same as the consideration that would be given in ascertaining the meaning of a provision. This allows extrinsic materials to be considered straight away to determine the purpose or object of the relevant taxation law, rather than determining first what the ordinary meaning is or that the meaning is ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable.

### **Example 1.1**

The Commissioner is considering using the Remedial Power to modify the operation of a provision of a taxation law. In determining the purpose or object of the relevant provision to work out whether the power is available to the Commissioner, the Commissioner may consider a variety of materials that would assist in ascertaining the

purpose or object of the provisions. However, the Commissioner must consider any documents referred to in subsection 15AB(2) of the AIA. This includes the Explanatory Memorandum for the Bill which introduced the provision into the taxation law and the Second Reading Speech when the Bill was introduced to Parliament. Consideration of other relevant material including relevant Government announcements and the Explanatory Statement for some relevant Regulations may also be capable of assisting in ascertaining the purpose or object of the provision and the Commissioner may have regard to these.

1.32 The expression ‘purpose or object of the provision’ is intended to pick up language that is already used in sections 15AA and 15AB of the AIA. The opening words of both of those sections identify that they apply for interpreting a provision of an Act. The exercise required in relation to the Remedial Power is a different one. Here the purpose or object of a provision will need to be ascertained to determine whether a modification to the operation of a provision is not inconsistent with that purpose or object.

1.33 Applied to the present context of the Remedial Power, the purpose or object of a provision should always be objectively determined, but within these objective parameters should also be subject to a ‘sympathetic and imaginative discovery’.<sup>1</sup> In addition, the purpose or object of a provision need not, and is not, only the purpose or object as revealed in the statutory language. Nevertheless, the text of a provision and its surrounding statutory context will always be a relevant and important factor in ascertaining its purpose or object.

1.34 In relevant cases, it will also be important to take into account the full legislative history associated with a particular provision when determining purpose or object, not just the most recent amendment to that provision.

1.35 The material available to objectively determine statutory purpose will vary from provision to provision and from taxation law to taxation law. In particular, it might be the case that more material is available in relation to more recently drafted provisions. Nevertheless, this does not prevent the Remedial Power from being validly exercised in relation to any provision in the taxation law.

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<sup>1</sup> *Theiss v Collector of Customs* [2014] HCA 12, [23] per French CJ, Hayne, Kiefel, Gageler and Keane JJ, quoting *Cabell v Markham* (1945) 148 F 2d 737, 739.

### **Commissioner must be satisfied the modification is reasonable**

1.36 Before exercising the Remedial Power, the Commissioner must be satisfied that the modification would be reasonable, having regard to both the purpose or object of the provision which is sought to be modified and to whether the cost of complying with the provision is disproportionate to achieving that purpose or object. [*Schedule #, item 2, subparagraphs 370-5(1)(b)(i) and (ii)*]

1.37 These considerations would enable the Commissioner to modify the operation of a provision of a taxation law so he or she can:

- administer the law in accordance with its purpose or object, where the current outcome provided by the law is inconsistent with its purpose or object; or
- provide an outcome that reduces compliance costs where the outcome provided by the law is consistent with the purpose or object of the law, but in achieving that outcome the application of the law imposes compliance costs that are disproportionate to achieving its purpose or object.

1.38 In deciding whether it would be reasonable to exercise the Remedial Power and make a modification, the Commissioner may consider a range of matters. Although Schedule # to this Bill provides limitations on the exercise and operation of the power, the Remedial Power is a discretionary power and the Commissioner may choose to take into account other matters in addition to the limitations when determining whether it is appropriate to exercise the power. The power does not prescribe other matters the Commissioner may take into account, which is consistent with similar delegated legislative powers in Commonwealth law granted to APRA and ASIC. Other matters that it is anticipated the Commissioner may take into account, and weigh up against each other, before deciding to exercise the power include:

- the extent to which the modification is favourable to entities
- the extent to which the modification has any adverse direct impact on the tax liability of a third party
- the impacts on any current judicial interpretation of the relevant law; and
- any other relevant matters.



1.39 The extent to which a modification to the operation of a taxation law would be favourable to entities is a matter the Commissioner may consider in deciding whether the proposed modification is reasonable. For example, if a proposed modification would not be favourable to any entities, it would not be reasonable to use the Remedial Power as the modification to the operation of the relevant provision would have no application (see paragraphs 1.53 to 1.60).

1.40 In addition, the Commissioner may decide it is not reasonable to use the power where it could lead to asymmetrical outcomes. That is, due to the operation of the application rule, the modification could apply to an entity on one side of a transaction but not an entity on the other side of the same transaction, resulting in an inappropriate asymmetrical tax outcome (see paragraphs 1.53 to 1.60).

1.41 Where the proposed modification could have adverse direct impacts on the rights or obligations under a taxation law for many third parties, the Commissioner may decide that it is not reasonable to use the Remedial Power. As explained below, a particular entity (the first entity) must treat a modification made under the power as not applying to it and any other entity if the modification would produce a less favourable result for the first entity (see paragraphs 1.53 to 1.60).

1.42 There may be rare circumstances where the Commissioner could consider determining a modification which is contrary to a judicial interpretation of the relevant law. Such a determination would not apply to an entity where it would affect a right or liability under an order made by a court before the commencement of the determination [*Schedule #, item 2, subsection 370-5(5)*] (see paragraph 1.61). Therefore, in considering whether it is reasonable to make a determination under such circumstances, consideration should be given to the number of entities affected and this should be balanced against careful consideration of any perceived conflict with the separation of powers. In many such cases, any change to the operation of the law may be more appropriately dealt with by the Parliament.

1.43 The Commissioner may consider that an issue highlights systemic issues with the law and it may not be appropriate to use the power to resolve the issue. In some cases, systemic issues may be more appropriately addressed through a review of the law and principles-based legislative amendment by the Parliament.

1.44 In addition, the Commissioner may not consider it reasonable to use the Remedial Power where there are differing views on how an

issue may be resolved. In such cases, the issue might be better addressed by the Parliament.

1.45 Once the Commissioner decides that it is reasonable to use the power, the Commissioner will consider whether it is appropriate for the modification to operate prospectively or retrospectively. Although it is generally expected that the legislative instruments made under the Remedial Power will operate prospectively, there may be circumstances where it is appropriate and reasonable for the legislative instrument to apply retrospectively. This is consistent with the LA because an entity (the first entity) must treat a modification made under the power as not applying to it and any other entity if the modification would produce a less favourable result for the first entity. Note that although an instrument may apply retrospectively, it will still only commence after the disallowance period for Parliament has expired (see paragraphs 1.63 to 1.64).

### **The Treasury or the Department of Finance advises the Commissioner that any impact on the Commonwealth budget would be negligible**

1.46 Before making a legislative instrument under the Remedial Power, the Commissioner must receive advice from the Secretary of the Treasury, the Secretary of the Department of Finance or an authorised APS employee of either department that any impact on the Commonwealth budget would be negligible. *[Schedule #, item 2, paragraph 370-5(1)(c)]*

1.47 Impacts on the Commonwealth budget will be determined through ordinary processes and budget rules.

### **Commissioner will undertake public consultation**

1.48 The ordinary rules about consultation for legislative instruments set out in the LA apply to the exercise of the Remedial Power. This means that before exercising the power, the Commissioner must be satisfied that any appropriate and reasonably practicable consultation has been undertaken (see section 17 of the LA). If consultation is not appropriate or reasonably practicable, it does not need to be undertaken under section 17 of the LA. However, it is anticipated that the Commissioner will undertake public consultation to ensure the opportunity to identify and consider all implications from the exercise of the power and that the exercise of the power is appropriate in the circumstances. This would be consistent with the approach to amendments to the primary legislation which are subject to a period of public consultation. Failure to consult will not affect the validity or enforceability of a legislative instrument (see section 19 of the LA), though might attract adverse comment from Senate Committees.

## **Application of legislative instruments made under the Remedial Power**

### **Application of determinations generally**

1.49 A legislative instrument made by the Commissioner under the Remedial Power applies in relation to all entities, or, if stated in the determination, to a specified class of entities or in specified circumstances. *[Schedule #, item 2, subsection 370-5(3)]*

1.50 The Remedial Power cannot be used to modify the operation of a taxation law for a particular entity. This includes exercising the power in relation to a class that is so narrowly defined that it could practically only consist of a particular entity. This can be distinguished from a class that may be capable of consisting of many entities but actually only applies at any given time to one particular entity.

1.51 Having the Remedial Power apply broadly to entities and circumstances ensures that the power properly relates to taxation and prevents it from being exercised in an arbitrary way. This ensures that its use is consistent with the requirements of the Constitution.

1.52 A determination may provide that it only applies in specified circumstances [*Schedule #, item 2, paragraph 370-5(3)(b)*]. In addition to the favourable application rule (see paragraphs 1.53 to 1.60), an entity will have to consider the terms of the legislative instrument to work out the scope of application of the particular determination and whether it applies to them. For example, a legislative instrument may provide that it does not apply to you if it would:

- produce a less favourable result for another entity because the other entity's rights or obligations under a taxation law are worked out by reference to your rights or obligations under a taxation law; and
- be reasonable for you to be aware of this impact on the other entity – for example, where it would be reasonable to expect you to be aware that the other entity's rights or obligations under a taxation law are worked out by reference to yours.

### **Example 1.2**

Sharyn and Carolyn operate a partnership together. The partnership agreement provides that Sharyn is entitled to 100% of the capital gains and Carolyn is entitled to 100% of the income of the partnership.

The Commissioner determines a modification to the operation of a provision of the relevant taxation law via legislative instrument. The legislative instrument provides that it does not apply to you if you are reasonably aware that it would produce a less favourable result for another entity because the other entity's rights or obligations under a taxation law are worked out by reference to your rights or obligations under a taxation law. Sharyn falls within the class for which the determination has been made. The modification has the effect of characterising some of the profits of the partnership as income.

However, were it not for the modification, those profits would have been characterised as capital gains under the relevant taxation law.

In working out whether the determination applies to her, Sharyn considers the impact of the modification of the operation of the law on both herself and Carolyn. This is because Carolyn's rights and obligations under the taxation law are calculated by reference to Sharyn's rights and obligations under the taxation law because they are in a partnership. The determination is favourable to Sharyn because she will not need to account for the profits in question. However, the determination is less favourable for Carolyn because Carolyn will need to account for the profits in question. Sharyn therefore concludes that the determination will not apply to her because of the less favourable result for Carolyn.

The determination will nonetheless be a valid legislative instrument.

### **No application where less favourable result**

1.53 To ensure particular entities are not adversely impacted by a modification, an entity (the first entity) must treat a modification made under the power as not applying to it and any other entity if the modification would produce a result for the first entity that is less favourable than would have been the case had the relevant provision of the taxation law not been modified [*Schedule #, item 2, subsection 370-5(4)*]. This means that the particular modification will have no effect for an entity if it would produce a less favourable result. In the current self-assessment regime, an entity will need to self-assess whether a modification is less favourable to it, and whether it must therefore treat the modification as not applying to itself and to any other entity. If an entity is required to treat a modification as not applying, then the Commissioner must also treat the modification as not affecting the entity.

1.54 This application rule ensures that a modification which is less favourable to one or more entities can still be valid and apply to entities who do not have a less favourable outcome from the modification.

1.55 Having an application rule as opposed a 'favourable only' limitation for the Remedial Power prevents a modification from being found invalid should that modification be less favourable to even one entity in the class. Where this occurs, the effect of the application rule is that the modification would not apply to that particular entity, but the legislative instrument making the modification would be valid and would be capable of applying to other entities.

1.56 The principle that a legislative instrument is treated as not applying where it produces a less favourable result has been adopted, as opposed to the positive expression that a legislative instrument only applies where it produces a favourable result. This ensures it caters for neutral outcomes. For example, the Commissioner may modify the outcome of a particular provision to reduce compliance costs that are disproportionate to achieving the purpose or object of the law. In such a case, the modified outcome should have no impact on the entity's tax liability and therefore cannot be said to be favourable for their tax liability. However, the modified outcome applies because the outcome is not less favourable.

### **Example 1.3**

The Commissioner exercises the Remedial Power and makes a legislative instrument which modifies the operation of a provision in the income tax law for a class of entities. Gordon falls within the class of entities. To work out whether the determination applies to him, Gordon considers whether the modification would be less favourable for him than the existing taxation law had the operation of the law not been modified. Gordon works out that although his tax liability for the relevant income year will not change, his compliance costs will be reduced. Therefore, although the determination results in a neutral outcome for Gordon in the sense that his tax liability will not change, the impact of the instrument is not less favourable (and in fact is favourable in the sense that it reduces his compliance costs). The determination applies to Gordon.

1.57 The formulation that the first entity must treat a modification made under the power as not applying to it and any other entity if the modification would produce a less favourable result for the first entity ensures that an entity must ignore any modification that would have a less favourable result for it. This is intended to capture any less favourable flow on effects to a particular entity from another entity applying the modification. This is to cater for circumstances in the taxation law where the application of a modification will directly impact on more than one entity to produce an outcome that is beneficial to one entity and not beneficial to another. For example, if one entity (the first entity) applied a modification because it was favourable to it, but a second entity would have a less favourable result because of the first entity applying the modification, then the second entity would treat the modification as having not been applied to itself or the first entity. This would be the case even though the first entity had in fact applied the modification (because it was favourable to the first entity). Requiring the second entity to treat the modification as not

applying ensures that the second entity is not adversely affected by the first entity's application of the modification.

1.58 An example of this is the treatment of supplies under the core provisions of the Goods and Services Tax (GST) law. If a supply is a taxable supply, the supplier will be liable to pay GST in respect of that supply, but the acquirer may be entitled to an input tax credit, based on the GST payable on the supply, provided the acquirer satisfies other conditions (for example, the acquisition was made in carrying on an enterprise and the acquirer is registered for GST).

1.59 A modification to the operation of such a provision made under the Remedial Power may have differential impacts in these circumstances. For example, a modification to treat a supply as not being a taxable supply may produce a more favourable result for the supplier, but a less favourable result for the acquirer if they are no longer able to claim an input tax credit in respect of that acquisition. In these circumstances, the supplier would be able to apply the modification but the acquirer would treat the modification as not applying to itself and the supplier.

1.60 However, in situations where the law, as in this GST example, intends that there is a symmetrical outcome between the impacted parties, the Commissioner may consider that the modification would not be reasonable because it leads to an inappropriate asymmetrical tax outcome (see paragraph 1.40). It is anticipated that asymmetrical outcomes would be handled in the following way:

- in cases where the risk of unintended asymmetry cannot be reasonably managed, it is anticipated that the Commissioner would not exercise the power, and
- in cases where the risk of unintended asymmetry can be reasonably managed (for example, through sharing of information between the entities impacted by the provision), the Commissioner may make the modification, but it is anticipated that the modification would stipulate specific conditions within the instrument, which would need to be satisfied before the modification could apply (see paragraph 1.52 and Example 1.2).

### **No application where it would interfere with a court order**

1.61 A determination made under the Remedial Power will not apply to an entity where it would affect a right or liability of that entity under an order made by a court (including any judgment, conviction or sentence) before the commencement of the determination. This ensures that the exercise of the Remedial Power will not interfere with a decision of a court in a particular matter. Ensuring that a determination would not apply in such circumstances reflects the importance of the separation of powers, and ensures that there is not an interference with federal judicial power in a manner that is inconsistent with the Constitution. *[Schedule #, item 2, subsection 370–5(5)]*

### **No enforceability where legislative instrument not registered**

1.62 The ordinary rules about registration of legislative instruments set out in the LA apply to the exercise of the Remedial Power. This means that any instruments made using the power must be registered on the Federal Register of Legislation (see subsection 15H(1) of the LA). Failure to register an instrument will make it unenforceable (see subsection 15K(1) of the LA). This ensures that all legislative instruments are made publicly available (see further section 15C of the LA).

## **Commencement and sunseting of legislative instruments made under the Commissioner’s Remedial Power**

### **Commencement of legislative instruments**

1.63 Legislative instruments made by the Commissioner under the Remedial Power can only take effect on or after the first day that the relevant legislative instrument is no longer able to be disallowed (or taken to be disallowed) by Parliament. This will ensure that Parliament has had a full opportunity to scrutinise the instrument and, if it considers necessary, to disallow it. *[Schedule #, item 2, subsection 370–15(1)]*

1.64 Under section 42 of the LA, the Houses of Parliament have 15 sitting days each following the tabling of an instrument to bring a notice of a motion to disallow the legislative instrument. Generally, where a notice of motion is agreed to, the instrument is disallowed and ceases to have effect. If a notice has not been resolved or has not been withdrawn within 15 sitting days of the notice being given, the



instrument is deemed to have been disallowed and ceases to have effect.

### **Sunsetting of legislative instruments**

1.65 A legislative instrument made under the Remedial Power will sunset on the first of April or first of October five full years after it was registered. Under subsection 50(1) of the LA, a legislative instrument would usually sunset on the first of April or first of October ten full years after it was registered, but the sunset period for instruments made by the Commissioner using the Remedial Power is five years. Limiting the sunset period to five years may limit the impacts on compliance costs because it may reduce the number of additional legislative instruments which may need to be considered by affected entities. *[Schedule #, item 2, subsection 370-15(2)]*

1.66 As the sunset date approaches, it is necessary to review whether an instrument is still required. A review will determine whether it is necessary to remake the instrument or if it is more appropriate to allow the instrument to cease. Such a review could also consider whether, for some issues, changes to the primary legislation should be made if there was capacity at that time.

### **Review of legislative instruments**

1.67 It is expected that the Commissioner will review any legislative instrument which modifies the operation of a tax law following any amendments made to the primary legislation to ensure that the amendments to the primary legislation and the legislative instrument can operate together. Where the amendment to the primary legislation and the modification cannot operate together, or the modification is no longer necessary, it is anticipated that the Commissioner will repeal or amend the relevant legislative instrument that made the modification (see subsection 33(3) of the AIA). If a new instrument is made to repeal or amend an existing instrument, this will be a new exercise of the Remedial Power.

### **Application and transitional provisions**

1.68 Schedule # of the Bill commences on the day after Royal Assent. This allows the Commissioner to make legislative instruments from that date to modify the operation of a taxation law.

1.69 Legislative instruments made under the Remedial Power are subject to subsection 12(2) of the LA. This ensures that a legislative instrument with purported retrospective effect will have no effect if it would disadvantage the rights of a person. In addition, a legislative instrument made under the Remedial Power can only take effect on or after the first day that it is no longer able to be disallowed (or taken to be disallowed) by Parliament (see paragraphs 1.63 to 1.64).

## EXAMPLE LEGISLATIVE INSTRUMENT AND EXPLANATION

An example of a modification that could be made using the Remedial Power is included below.

### Taxation Administration (Remedial Power – Natural Disaster Replacement Asset Programs) Determination 2016

#### 1 Name

This is the *Taxation Administration (Remedial Power—Natural Disaster Replacement Asset Programs) Determination 2016*.

#### 2 Commencement

(1) Each provision of this instrument specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms.

Commencement information		
Column 1	Column 2	Column 3
Provisions	Commencement	Date/Details
1. The whole of this instrument	The first day this instrument is no longer liable to be disallowed, or to be taken to have been disallowed, under section 42 of the <i>Legislation Act 2003</i> .	

Note: This table relates only to the provisions of this instrument as originally made. It will not be amended to deal with any later amendments of this instrument.

(2) Any information in column 3 of the table is not part of this instrument. Information may be inserted in this column, or information in it may be edited, in any published version of this instrument.

### **3 Authority**

This instrument is made under the *Taxation Administration Act 1953*.

### **4 Schedules**

Each modification of the operation of a taxation law that is set out in a Schedule to this instrument is determined for the purposes of section 370–5 in Schedule 1 to the *Taxation Administration Act 1953*.

#### **Schedule 1—Natural disaster replacement asset programs**

1. The operation of Subdivision 124–B (Asset compulsorily acquired, lost or destroyed) of the *Income Tax Assessment Act 1997* (and any other provision of a taxation law the operation of which is affected by the operation of that Subdivision) is modified in the way set out below.

##### *Scope of modification*

2. The modification applies if, under a natural disaster replacement asset program, you dispose of a CGT asset (the original asset) you own and you receive money or another CGT asset (except a car, motor cycle or similar vehicle), or both, as a replacement for the original asset (or part of it).

3. A natural disaster replacement asset program is a program that is run by an Australian government agency or local governing body under which assets affected by a natural disaster are replaced with money or other assets, or both.

4. The modification applies to all entities.

5. The modification applies to CGT events happening on or after 1 July 2011.

##### *Modification*

6. The modification is that the disposal is to be treated, for the purposes of Subdivision 124–B, as the loss or destruction of the original asset, and subsection 124–70(2) is to be disregarded.

## **Taxation Administration (Remedial Power – Natural Disaster Replacement Asset Programs) Determination 2016: Explanation**

### **Explanation**

1. The following is information to help you understand the Commissioner's determination of the modification specified in Schedule 1 to the *Taxation Administration (Remedial Power – Natural Disaster Replacement Asset Programs) Determination 2016*.

2. The legislative instrument provides an example of a modification to a taxation law that the Commissioner might make. It is based on the *Capital Gains Tax Relief for Taxpayers Affected by Natural Disasters Proposals Paper* dated 9 October 2011, but only reflects a component of those proposals. This is because the scope of the Remedial Power is limited, as demonstrated by the roll-over modification in the legislative instrument.

#### ***Modification is not inconsistent with purpose or object of provision***

3. A replacement asset roll over under Division 124 of the *Income Tax Assessment Act 1997* allows you, in special cases, to defer the making of a capital gain or loss from one CGT event until a later CGT event happens. It involves your ownership of one CGT asset ending and you acquiring another one.

4. Subdivision 124-B allows you to disregard a capital gain that you make in certain circumstances and prescribes a number of events where you can choose roll over relief. All of these events relate to circumstances where:

- (a) an asset you own is compulsorily acquired, lost or destroyed (as stated in the heading to the Subdivision); and
- (b) in return you receive money, another CGT asset or both.

(See also the Explanatory Memorandum to the relevant Bill (the Tax Laws Improvement Bill (No. 1) 1998).)

5. Roll-over relief under the unmodified taxation law would generally be available if an asset has been lost or destroyed as a result of a natural disaster. However, this is not always the case. For example, when the Lockyer Valley Regional Council gave the flood devastated residents of Grantham the option to move to higher ground as part of a voluntary land swap initiative following the 2011 Queensland floods, the residents were not able to satisfy the conditions of section 124-70; their land was neither

compulsorily acquired, nor lost or destroyed, and the replacement land was not compensation for an event listed in subsection 124–70(1).

6. The purpose or object of Subdivision 124–B is to provide an optional CGT roll-over if, because of events outside of your direct control, your CGT asset is replaced by money or other assets. Given the nature of natural disaster replacement asset programs, it is not inconsistent with this purpose or object to extend the roll-over to such programs.

7. The modification made by the legislative instrument treats the disposal of the asset (CGT event A1) as a loss or destruction of the asset for the purposes of ensuring the roll-over is available under Subdivision 124–B. The disposal of the asset will still be a CGT event A1, but will be treated as a loss or destruction for the purpose of obtaining the roll-over.

***Modification is reasonable***

8. The Commissioner considers the modification to be reasonable, having regard to the matters mentioned in paragraph 370–5(1)(b) in Schedule 1 to the *Taxation Administration Act 1953*. The modification recognises the difficulties faced by entities that have been affected by a natural disaster. In particular, the modification reduces an obstacle to participation in government replacement asset programs and makes it easier for entities to comply with their future CGT obligations.

9. Under the unmodified taxation law, if you are affected by a natural disaster you may face immediate CGT consequences when an asset you own is lost or destroyed, or if you dispose of the asset. This CGT outcome applies even where you participate in a government assistance program that provides replacement assets to entities affected by natural disasters. If you participate in such programs you would not be able to access a CGT roll-over in order to defer any CGT consequences because the available roll-overs would not cover your circumstances. As a result, if you dispose of your original asset in order to receive a replacement asset, the first element of the cost base of the replacement asset is the market value of what you gave to receive the replacement asset – that is, the market value of the original asset.

**Example: Current treatment**

William owns an investment property in an area affected by a natural disaster. The natural disaster substantially damaged the house on William's land, and it is no longer inhabitable. William acquired the property after 20 September 1985, and the house and land are treated as a single asset.

William is eligible to participate in a land swap program run by his local Council in response to the disaster. To participate, he must transfer his property (including the house) to the Council and the Council will provide him with a new parcel of land in return.

William's cost base (and reduced cost base) for the original investment property is \$200,000. The value of the replacement land at the time William acquires it is \$250,000.

William makes a capital gain of \$50,000 on the disposal of his property to the Council. William cannot access roll-over relief under Subdivision 124-B, as his property was neither compulsorily acquired, nor lost or destroyed.

10. With the modification, you will be able to choose a CGT roll-over for assets that a government agency (Commonwealth, State, Territory or local) replaces as a consequence of a natural disaster. Where you choose the roll-over, the capital gain from the disposal is disregarded and the first element of the replacement asset's cost base is the original asset's cost base at the time of the disposal (unless you acquired the original asset before 20 September 1985, in which case different rules apply).

11. You may choose not to access the roll-over if you wish to realise a capital gain and have the relevant records or can reconstruct them.

*Purpose or object of provision*

12. The purpose or object of Subdivision 124 B of the *Income Tax Assessment Act 1997* is discussed earlier in this explanation.

*Compliance cost*

13. The cost of complying with the unmodified taxation law is not disproportionate to achieving its purpose or object.

*Budgetary impact*

14. The Commissioner has received advice from the Secretary of the Treasury, the Secretary of the Department of Finance or an authorised APS employee of either department that any impact of the modification on the Commonwealth budget would be negligible.