Creating a more dynamic and resilient economy inquiry

Questionnaire response 42

Name: Paul McCullough

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1. Support business investment through corporate tax reform

1. What features of the Australian business environment have encouraged or restrained investment over the past 10 years?

Domestic policy uncertainty, inconsistency and lack of coherence have made a contribution alongside tax settings and external factors (dating back to the GFC, COVID-19, and including the current unpredictability in the USA).

2. What elements of the corporate tax system encourage and/or discourage investment and risk-taking?

As developed in the attached papers, taxation levels, the design of corporate tax system and general misunderstanding of aspects of it have affected business investment by distorting investment choices, and adding unnecessary costs.

3. Which parts of the corporate tax system do you find the hardest, or most time or cost-intensive to comply with? How could the compliance burden of the business/company tax system be reduced?

See detailed explanation in accompanying papers.

2. Reduce the impact of regulation on business dynamism

1. What areas of regulation do you see as enhancing business dynamism and resilience? What are the reasons for your answer?

While a certain level of regulation is important for public health and safety, financial security and revenue collection, etc, all regulation should be regularly monitored and evaluation to ensure it achieves its policy goal, at least cost, and with minimal other impacts. Australia's system for controlling the flow of new regulation and reviewing the stock aneed to be improved. As developed in the attached papers, poor stewardship of regulation affecting businesses has affected business investment by adding unnecessary costs.

2. How has your regulatory burden changed over time?

Supplementary papers refer to historical regulatory cost calculations.

3. What regulations do you find time-consuming, overly complex or otherwise constraining business dynamism and resilience? What are the reasons for your answer?

As explained in accompanying papers, the cumulative effect of many regulations each of which would individually be regarded as justfied, needs to be considered.

4. Can you share any specific examples of where you think a regulator has done a good or bad job of understanding and reducing regulatory burden on businesses and why?

While regulators can ease or exacerbate regulatory costs by their approaches, much unnecessary cost of regulation stems from poor policy (or legislative) design, and failure to evaluate regulations once promulgated.

Cover sheet: Supporting document #1

Options for improving Corporate Taxation

Overview

The Productivity Commission (PC) has invited submissions on how corporate taxation could be used to boost investment, especially in plant and technology. Conscious of the Budget impact of any recommendations, the PC is contemplating a package that is broadly revenue neutral, or only a small cost to the Commonwealth Budget.

To accurately assess the costs, benefits and impacts of any changes, the current system must be understood as an integral part of Australia's personal income tax system that is neither designed nor intended to levy a final tax on companies, but rather to tax investors. This design feature is critical, and appreciating it reveals why some answers to the PC's question may be partial (at best) and ineffective or counter-productive (at worst).

Investment can be encouraged simply and effectively either by a corporate rate cut, if the incentive is to be general, or through grants, if the sought-after investment is to be targeted. However, both these approaches cause difficulties for governments for varied reasons. Large grants tend to make governments appear less fiscally responsible, and company rate cuts are often misunderstood as favouring higher income earners, or amounting to 'trickle down' economics. If the real effect of these measures was properly explained, the approaches would be more palatable. As neither requires major change to existing arrangements, they could be implemented quickly and at low cost. Fiscal impacts could be offset by a range of revenue measures, many of which would provide the added benefit of achieving other policy goals, improving integrity, or reducing system complexity and compliance costs.

How the Australian corporate taxation system operates

In the tax systems of most other countries, companies pay tax on earnings, and shareholders are further taxed on the distributions of company profits they receive[1]. Under such systems, company tax is a cost that reduces shareholders' return on investment (ROI), so investors can be encouraged to invest more by lowering the company tax cost, to increase their ROI. This can be done by lowering the headline corporate tax rate[2] to increase investor returns at large, or by adjusting the corporate tax base to favour certain types of investment[3].

By contrast, Australia is one of the few countries in the world that operates a different system (full *dividend imputation*), and the difference is important. In Australia, while tax is initially levied at the corporate level, credit for that tax flows to the individual shareholders when distributions (dividends) are made to them. That credit can be offset against the

1. To reduce the 'double taxation' of the same income in the hands of both the company and the shareholder, earnings and distributions are often taxed at concessional rates, or shareholders are given tax rebates.
2. For example, under the *Tax Cuts and Jobs Act* in 2017 the USA reduced their corporate tax rate for C Corporations from 35% to 21% to encourage greater investment.
3. Typical base adjustments include accelerated depreciation, investment allowances and deduction incentives. Accelerated depreciation allows plant to be amortised over a period shorter than its income-producing life; investment allowances allow a bonus deduction or loading on the purchase cost of depreciable assets; and deduction incentives allow more as a tax deduction than the expenditure incurred.

shareholder's tax liabilities on income from all sources, or refunded where their liability is less than the credit[4]. Under this system, company tax forms an integral part of calculating the shareholder's liability to income tax, so that the tax initially levied on companies is ultimately borne by the shareholder[5]. Through dividend imputation the Australian system is designed to tax shareholders at their personal tax rates[6].

The effect of tax preferences in the imputation system

Company tax rate and base changes can have different outcomes for different shareholders.

For resident shareholders

As a result of the dividend imputation system, the net tax paid by an Australian tax resident or domestic shareholder is the same whether dividends are paid out of profits taxed at the company level (*franked* dividends) or from untaxed profits[7] (*unfranked* dividends).

To illustrate that the corporate tax *rate* has no direct tax effect on domestic shareholders, compare two shareholders receiving $100 dividend from their respective companies, the first from a large company with a tax rate of 30 per cent, and the second from a small company taxed at 25 per cent. In the first case the shareholder receiving a *fully franked* dividend of $100 would get $70 in cash from the company and a $30 *franking credit* for tax paid by the company[8]. The second shareholder would get $75 in cash from the company but only $25 franking credit. In both cases the shareholders' after-tax result is the same.

The same arithmetic holds where a company's tax rate is effectively zero because adjustments to the corporate tax base create untaxed profit for shareholders. For example, if the resident shareholder who received a fully franked dividend of $100 ($70 in cash and $30 as a franking credit) were to receive instead $100 dividend paid out of untaxed profits, the shareholder gets $100 cash, with no franking credit, and the same net tax outcome. In all three examples, a domestic shareholder with a personal tax rate of 40 per cent would enjoy an after-tax benefit of $60 from the $100 dividend.

From this simple analysis, it can be seen that reducing either the company tax rate or base (collectively referred to as *tax preferences*) has no direct effect[9] on the amount of tax paid by Australian tax resident shareholders on dividend income from Australian companies. They pay tax on dividends at their personal income tax rate as if they had made the investment directly themselves, rather than through the company. Thus, resident shareholders are largely indifferent as to any tax preferences at the company level, and company tax rate or base changes have no aggregate effect on the amount of tax collected[10] from them.

4. For example, when the taxpayer's income is below the taxable threshold.
5. Some countries achieve partial imputation through rebates, but Australia has full imputation.
6. Or, if the investor is a foreign tax resident, withhold some tax for the benefit of Australians (see below).
7. As can occur when the company's 'taxable income' is less than the accounting profit.
8. Although the shareholder might think of the cash received as the dividend, the gross amount including any franking credit counts as their income.
9. Companies may change their distribution policies because of lower holding costs caused by tax preferences.
10. Although annual government Budget accounting might be affected by timing differences between when the company remits corporate tax and the individual lodges an income tax return that includes the dividend.

For dividends paid to domestic shareholders it can be useful to regard the corporate taxation system as broadly the equivalent of the Pay-As-You-Go (PAYG) system for employees, where the company (employer) withholds an amount on behalf of the shareholder (employee) and sends that to the Australian Tax Office (ATO), but the final tax liability for the shareholder (employee) is determined when they lodge their annual tax return, and the balance due creates a debt, or an excess withheld results in a refund.

For non-resident shareholders

The situation is different for tax residents of another country (i.e. foreign shareholders), as they are not entitled to the benefit of franking credits. Tax preferences *will* affect foreign shareholders, as franking credits attached to dividends received by them are lost[11].

To illustrate, if a non-resident shareholder is entitled to a fully franked dividend of $100 from a company taxed at 30 per cent, they receive $70 in cash from the company, but the $30 franking credit is forfeited[12]. If, however, the company tax rate was lowered to 25 per cent, the non-resident would receive $75 in cash from the company with only $25 franking credit lost. The non-resident's ROI would increase by $5 because of the lower rate.

Loss making companies and retained earnings

Not all companies make profits every year, or choose to distribute all profit to shareholders, and dividends can be paid whether the company makes profits in a given year on not. Retained or temporarily undistributed profits may be franked or unfranked when ultimately distributed as dividends, but the principles explained above will apply, albeit with timing differences[13]. Smaller companies with little access to external capital may value the lower tax on retained earnings as it allows greater self-financing.

Other ways of providing investment incentives

The tendency of the imputation system to negate incentives provided by tax preferences can incline governments to seek alternative ways of providing benefits to domestic investors through mechanisms that provide cash bonuses to shareholders[14], or adjusting the effective tax rate for certain types of foreign investment by creating separate tax regimes[15]. By their nature, these mechanisms need to be tightly specified, and can be prone to abuse.

As a simple, transparent, targetable, and measurable way to pay an investor a cash amount is by way of a grant, it may be surprising that governments do not choose that approach more often. This can possibly be explained by the fact that using the tax system rather than grants creates the appearance of a smaller taxing and smaller spending government in annual Budget Papers. For example, compare the net fiscal discipline of two governments with different approaches: the first raises twice as much as the second by way of taxation and spends it on a combination of essential government services, plus grants (outlays) to

11. Tax base changes creating unfranked dividends may be subject to *Dividend Withholding Tax* (DWT).
12. Credits lost in this way are referred to as 'wasted'.
13. Which may alter both ROI to the investor and revenue costs of policy change, but are comparatively minor.
14. As has been done for research and development expenditure, or certain renewal energy investments.
15. Such as for *Managed Investment Trusts*, which applies a 15 per cent withholding rate for foreign investors.

encourage particular activities; the second collects just enough tax to cover the cost of government services, and encourages the same activities through tax foregone. The former will appear to be a higher taxing and higher spending government than the latter, but there is no real difference in their fiscal discipline.

Differences between companies by size and type

Companies do not form a homogenous cohort. Tax policy changes may have different effects according to the size of companies or the nature of their endeavours, or affect one segment of the company market but not another. Although broad generalisations are inevitably inadequate, it is useful to think of the cohort of companies as being made up of three distinct sizes and types, each with different behaviours and characteristics[16].

The vast majority of companies have small turnovers, very few if any non-resident shareholders, nominal share capital, run a single type of business activity, and their shares are not available for public sale. There is no economic or commercial reason for them to pay dividends at all, as their owner/operators can choose instead to take their rewards as salaries, or retain profits in the business, rather than pay dividends to themselves. Corporate tax changes will have little or no impact on their behaviour.

At the other end of the spectrum, a small number of very large companies, often running diverse or vertically integrated businesses, are listed on the Stock Exchange, with shares publicly traded. Many have a significant portion of overseas institutional or portfolio investors[17], and pay dividends annually. Stocks in those companies are often valued in part by reference to the regularity of payment and franking status of their dividends.

Although a generalisation, for the purposes of considering tax policy, small companies can be thought of as being predominantly owned by Australian resident shareholders, while very large listed companies are likely to have significant numbers of foreign residents as investors, either directly, or through collective investment vehicles.

Between those two extremes, medium-sized unlisted companies are of various types, with many forming part of privately-owned family or similar groups of tax entities. Shares in these companies are not traded, but may change hands as the group is restructured from time to time, and companies may have common ownership with other entities. These companies may distribute profits to other closely held vehicles under arrangements that have been designed to optimise the tax planning for the group. As such they have great control over their effective tax rates, and timing of payments[18].

16. Companies in turn have different characteristics and behaviours compared to other business types such as trusts, partnerships and sole traders.
17. Such as foreign pension or sovereign wealth funds.
18. This is not the place for a detailed exposition of tax planning devices, but it is well accepted that different tax treatments (rate or base) between entities, over time or in different jurisdictions create opportunities for tax arbitrage and deferral.

Alternative systems of taxing companies

A classical company tax system

In Australia, concerns have been expressed that large companies do not pay tax, or should pay more[19]. This seems to arise from a view that high *turnover* companies should pay high taxes even when they make little profit, or a loss. The ATO has explained that a company's failure to pay tax in a given year does not necessarily mean an abuse of the system, as they may have large expenses, or losses from prior years[20]. Taxing companies on their annual turnover alone would be such an arbitrary approach that it would have massive dampening and unpredictable effects on investment, and no credible experts are proposing it.

As explained above, in the absence of imputation, companies (as distinct from investors) *would* pay tax, so if there were compelling reasons to shift the economic incidence of taxation onto companies, repealing imputation would achieve that. However, it is hard to imagine such reasons outside of a major reform of the entire taxation system, and repealing imputation should not be approached lightly. It has been a vital part of income tax for nearly 40 years, with refundability a feature for 25 years, and is now fundamental to Superannuation Funds' long-term investment and individuals' retirement strategies. As such, the risks of unintended consequences and costs of policy change would be high.

Further, at current corporate rates, simply removing imputation would have no effect on foreign investors' ROI, but would result in double taxation for domestic investors and a consequent increase in overall tax collection. Reducing personal income tax rates to produce a revenue neutral outcome would only partially compensate shareholders as the benefit would largely flow to other taxpayers. On the other hand, reducing corporate rates to produce a revenue neutral outcome would increase foreign investors' ROI, but may deter some domestic investors.

Rent, profit and cash-flow taxes

Commentators sometimes suggest that the current method of taxing companies on income be replaced or supplemented by taxes levied on some other measure, such as cash flow or 'super profit'. Despite different names, these taxes all seek to tax *economic rents*, or the difference between the price an output, such as a resource, is sold and its extraction and production costs, while relieving investors of any tax until a certain ROI has been achieved.

Rent taxes can be attractive revenue sources as they do little or no economic damage when highly taxing profits that are unexpected or deemed excessive (i.e. higher than needed to make the investment attractive). For example, if a group of investors embarked on a mining project expecting a particular ROI, and the price of the resource later soars, the State owner taking a share of the bonus return seems fair. Of course, those investors may have numerous enterprises, some which fail, and the windfall may merely be an offsetting part of their overall investment profile. Furthermore, in highly speculative endeavours (such as mineral

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19. See e.g., https://greens.org.au/news/media-release/ato-confirms-1-3-large-companies-are-paying-no-tax.
20. See https://www.abc.net.au/news/2024-11-01/companies-that-paid-no-tax-in-2022-23-revealed-profit-shifting/104545520.

exploration or pharmaceutical research) the likelihood of some expensive failures can mean that the expectation of keeping rare 'excess profits' is essential to attract investment.

Compared to an annual income tax, rent taxes take a longer-term view of the profits of an endeavour. Key design features include immediate expensing for the acquisition of plant from equity sources, preserving the value of losses (by indexing or uplift), not taxing 'normal' returns, and higher rates of tax on above-normal returns. Broadly speaking, a cash flow calculation of the profits of a 10-year equity-funded mining project would show larger losses in the early years and larger returns in the later years, driven by immediate deductions for capital expenditure compared to that cost being amortised over the life of the project.

While rent taxes on resources can raise significant revenue[21], and the approach is entirely sound when looking at a single project at a single location, the revenue base can be fragile if geographic and other restrictions are not present. For example, without restrictions, if a mining company opened up a second project at a separate location when first project became cash flow positive and due to pay tax, the tax on the first project would be deferred by the immediate expensing of capital purchases for the second project. The process can be repeated indefinitely. In practice this can make the revenue stream very unreliable for government planning purposes[22].

Similarly, cash-flow calculations need to separate out sources of super profits and related expenses from lower-than-normal profit operations conducted by the same company. This is not merely a theoretical concern as large Australian companies have historically owned both highly profitable mining operations and much lower profit retail stores. If the two sources of profit are not separated, the super profit can be absorbed or diluted, and tax collection can be almost indefinitely deferred by the simple act of expansion. As deductions for financing costs are not allowed, debt financing can be relatively discouraged.

Further, calculation of tax by way of cash-flow or rents is not compatible with the current imputation system, as the bases are different. The imputation system would need to be modified by making the part of the dividend relating to a normal return tax exempt. However, there is no international experience with having done this. In any case, changing imputation would introduce inconsistencies between companies and other forms of business taxation that would have unpredictable consequences.

Finally, while transition to a system wide cash-flow style tax may not have the same revenue risk and volatility[23], it is likely to have significant budgetary implications in terms of transitional costs. An allowance for the undeducted cost of past investment combined with immediate expensing of new investment could significantly reduce the corporate tax base for several years[24]. On the other hand, because service companies often have low levels of

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21. For example, the Norwegian *Resource Rent Taxes.*
22. While the value of the tax deferral will typically be reflected to the price of shares, revenue from any capital gains will not be predictable or guaranteed.
23. As immediate deductions for capital would typically be offset by immediate receipts of equivalent income, or cash receipts by government.
24. Temporary full expensing introduced in the 2021-22 as a Covid-19 response measure was estimated to cost the Budget nearly $11 billion in its first full year of operation, see https://archive.budget.gov.au/2021-

capitalisation, and hence high ROI, they would pay more as a result of the higher rate on their above normal returns.

Overcoming these difficulties may be too much for a rent, cash flow or super profits tax to achieve on economy-wide basis. Nevertheless, existing rent taxes could be made more effective by simple adjustments to the uplift factors, and better valuation rules.

Implications for policy change

Analysis of the practical operation of the corporate tax system demonstrates several things:

- Alterations to the corporate tax rate or base will affect resident shareholders and foreign investors differentially. While generally neutral for domestic investors, tax preferences affect the ROI for foreign investors. Foreign institutional and portfolio investors may be more influenced by cuts to the headline tax rate than narrowing the base, as the former will be transparent, guaranteed, and need no specialised tax advice to understand or take advantage of.
- Because small turnover companies tend to have domestic owners who are assessed at personal tax rates, they are unlikely to receive any direct benefit from company tax preferences and can largely be ignored in any analysis of investment incentives[25].
- Because the system of collecting tax from companies is a part of the much larger income tax system focussed on individuals, incentives for shareholders must be considered in conjunction with consequences for other types of businesses. If not, increased incentives at the company level may simply result in a transfer of investment that would otherwise have occurred through another tax vehicle.
- The presence of different treatments in the tax system creates integrity risks and the opportunity for exploitation. Investment incentives that operate outside the system, other than grants, can also create opportunities for tax arbitrage, undermine system integrity, and add unnecessary costs.
- The tax system is complex, and not well grasped by the general public. Nevertheless, many well-advised investors[26] have adopted long term strategies for the receipt of dividends on current terms. Fundamental changes may have unintended revenue risks, and consequences for investors including for retirement strategies.

Recommendations

For reasons that should be clear from the above analysis, lowering the corporate tax rate would be a simple and effective method of increasing investment generally. As there are currently several corporate rates, these could be harmonised for simplicity, system integrity benefits and to reduce compliance costs.

22/bp2/download/bp2_2021-22.pdf. Based on that annual flow of capital investment, the total of undeducted past investment could be hundreds of billions of dollars.

25. Although small companies need to be considered in term of compliance costs of systems and changes.

26. For example, large Superannuation Funds.

I recommend the following:

- The corporate rate for large companies should be reduced from the current 30 per cent to the small company rate of 25 per cent. This would align the rate for all companies, lessen the gap between Australia's corporate tax rate and those of our international competitors, make franking rules easier, and remove the current anomaly whereby smaller companies deriving investment income are taxed at 30 per cent. As detailed above, the primary beneficiaries of the tax rate reduction will be foreign investors, however, there will be a flow on reduction in the cost of capital for domestic investors[27].

- If needed, targeted incentives should be provided only by way of grants. The alternatives of increasing tax expenditures or creating new tax-based cash incentives should be avoided as not transparent, and imposing unnecessary system complexity and integrity risks. All new incentives should be time-limited and reviewed after implementation to examine their effectiveness, and unintended consequences[28].

- To help with public acceptance of a corporate tax rate cut, the PC should take a role in explaining the operation of the current system, leveraging tax experts, economists, commentators and journalists to get correct messages across to the public, and remove unnecessary political disputation.

- To improve transparency of Budget accounting, the *Charter of Budget Honesty*[29] should require a presentation of government revenue and expenditure that includes *Tax Expenditures*[30] as outlays. In this way, the choice of policy instruments by governments will be transparent and treated as economically and politically neutral.

Compensatory revenue raising measures

As the mandate for the exercise requires a degree of revenue neutrality, sources of revenue equivalent to the cost of these measures must be found. While revenue could come from any source, I have focused on measures that connect to the taxation of companies, will complement the Government's overall investment goal, and will not add to system complexity. Adopting all these measures would raise significantly more revenue than required, so not all would be needed, or each could make a partial contribution.

- Reducing incentives for mining and fossil fuel production. As mining is generally highly profitable due to continued high commodity prices, and the Government desires to transition away from fossil fuels, existing incentives for certain mining and oil and gas production could be reduced across the board, or removed for particular

27. See https://treasury.gov.au/publication/analysis-of-the-long-term-effects-of-a-company-tax-cut.
28. See related submission to the PC on compliance costs of regulation.
29. Commonwealth *Charter of Budget Honesty Act* 1998.
30. Tax expenditures are variations from the accepted taxing standard. Treasury publishes an annual *Tax Expenditures and Insights Statement* (see https://treasury.gov.au/publication/p2025-607085).

activities. As well as certain accelerated depreciation, exploration incentives and other concessions, mining companies benefit from the *Diesel Fuel Rebate Scheme*[31].

- Improving existing Resource taxes by adjustments to the overly generous uplift factors, and better gas transfer pricing rules[32]. Alternatively, as 'super profits' from resources often merely reflect the 'sale' of the resource at a lower price than can be justified, the Commonwealth could apply default rates of excise to replace existing *Petroleum Resource Rent Tax* arrangements and supplement State royalties for mining. The excise could be designed to be responsive to price fluctuations and be creditable against State royalties to avoid double taxation and preserve existing Commonwealth/State financial arrangements.

- Raising the withholding rate for distributions from *Managed Investment Trusts* from the present rate of 15%. A small increase in the rate would reduce tax competition for foreign investment between active and passive investment, and better reflect the expectations of Australia as a champion of multi-national arrangements to minimise base erosion and profit shifting through the global minimum tax rate[33].

- Removing corporate tax preferences that are ineffective, outdated or open to abuse. Treasury's latest annual review of tax expenditures lists 93 business tax expenditures, with a revenue foregone value of several billion dollars. While not all relate to companies, or are unwarranted, some pre-date the imputation system, and all should be reviewed, and modified or repealed as necessary.

- Introducing a small Dividend Withholding Tax on franked dividends[34].

- Reviewing compliance rules and integrity mechanisms that relate to the corporate tax rate and base, such as the safe harbour in the *Thin Capitalisation* regime, arrangements for *Multi-Entry Consolidated Groups*, and the 45-day holding rule.

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31. The Australia Institute estimates the benefit of the DFRS to mining companies to be over $10 billion per annum, see https://australiainstitute.org.au/post/scrap-fuel-tax-rebates-for-mining-industry-not-farmers/.
32. See the *Petroleum Resource Rent Tax: Review of Gas Transfer Pricing Arrangements Final Report* at https://treasury.gov.au/publication/p2023-388153.
33. See https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/multinationals/global-and-domestic-minimum-tax.
34. International arrangements allow a default DWT rate of 15 per cent on unfranked dividends. While the usual DWT rate for franked dividends is zero, a 5 per cent rate on unfranked dividends could be imposed without breaching treaties. A 5 per cent DWT on franked dividends would recoup about 80% of the cost of the headline tax rate reduction (the difference being between the $5 revenue cost of the tax cut per hundred dollars dividend and the $3.75 recoupment under the withholding tax). As DWT is generally creditable to the foreign investor in their own country, DWT will not reduce the investment incentive created by the corporate rate cut. However, as this approach shifts much of the cost of the corporate rate cut from the Australian Budget to sovereign Treasuries, it may need to be approached carefully.

Cover sheet: Supporting document #2

Reducing Regulatory Burden

The challenge

The Productivity Commission (PC) has invited Submissions on ideas to reduce the burden of regulation on business dynamism.

A certain amount of regulation is necessary for the protection of the public, to shape societal behaviours, describe eligibility for entitlements and raise revenue for the essential expenditures of government. However, there is no point in regulating unless the expected benefits from doing so exceed the cost it imposes. This cost/benefit analysis is crucial as it not only justifies a given proposal, it provides the basis for assessing whether, once implemented, the regulatory proposal has been worthwhile.

As all regulation imposes a burden, it is vital that even a proposal that seems justified on the available evidence is designed, implemented, and administered so that its burden is minimised, and achieves its stated goals with minimal cost or negative impact. And, after implementation, if the realised benefits are significantly lower or the actual costs higher than expected, it may be better to repeal the regulation, or modify it to improve the cost/benefit ratio. Even if a regulation is initially well-designed, efficient and effective, and works as expected for a time, vigilance is needed. Much like an old technology, regulations can become outdated as the economy changes.

The unnecessary or excess burden of regulation generally consists of:

- Economic costs created when unintended consequences negatively affect the target group or others.
- Greater compliance or administration costs than necessary caused by poor regulation design, or poor regulatory practice.

Historically, governments have sought to minimise regulatory burden by trying to ensure that proposed regulations are well-designed, using post-implementation evaluation to assess whether its initial value proposition was correct, and appealing to regulators to adopt pragmatic approaches to administration. These are important steps, but they must be applied consistently and comprehensively.

Australia has formally adopted pre-enactment Regulatory Impact Assessment (RIA) processes since the 1980s, and attempted to reduce the stock of regulation from time-to-time, yet despite these efforts, the regulatory burden is large, and continues to grow. In 2015, estimates put the whole-of-government cost of regulation at $67 billion annually, with $47 billion of that in the Treasury portfolio alone[1], and the statute books have expanded since then. While much of Treasury's regulation is considered necessary to collect taxes, and control the activities of corporations and financial institutions, if the total cost could be

1. Commonwealth of Australia, Treasury *Stocktake of Regulation*, 2015 https://treasury.gov.au/sites/default/files/2019-03/Stocktake-of-Regulation.pdf.

reduced by, say, 10 per cent for the same outcomes, that would amount to around $15 billion dollars over the Budget forward estimates period, with the benefit to be shared approximately three-quarters to business and one-quarter as Budget improvement[2].

Regulatory reform could drive productivity growth in many ways, including removing restrictions on innovation and preventing inappropriate economic rents and subsidies[3].

A different way to think about regulation

Australia's total body of regulations should be regarded as a significant national asset.

The Commonwealth investment in regulation over 125 years since Federation has produced a formidable body of regulation. The Parliament, Ministers, Departments, businesses, and the community have all spent a great deal of time and effort in identifying problems, developing and consulting on potential solutions, drafting and debating Bills, conducting hearings, commissioning and responding to reviews. Similarly, the community has invested heavily, with businesses in particular needing to understand the rules, seek advice, train staff, buy equipment, adopt technologies, and comply with the rules.

Using physical infrastructure (roads, railways, bridges, communications, utilities, etc.) as an analogy, quality regulatory infrastructure needs to be well-planned, designed and built, and properly maintained. Elements need to be integrated, or flows will be misdirected and running costs will escalate. Quick responses to blockages and accidents can save money and lives, and repairing potholes is often better value-for-money than a new road.

Proposal

To improve the regulatory environment at both Commonwealth and State levels, we need a whole-of-system model of regulatory oversight that addresses the flow, stock and accumulation of regulation, and its administration. The model should be mandated by statute, so that it cannot be set aside in favour of the day-to-day pressures of program delivery or new policy proposals. The framework should establish clear long-term accountability, have measurable goals, targets, and reporting requirements, set consistent expectations for the evidence base, and place a premium on transparency.

A comprehensive program would include the following complementary elements, which are developed further below:

- Establishing permanent accountability for oversight of regulations within government.
- Improving the quality of new regulation through changes to the RIA process.
- Allowing rapid post-implementation refinement to correct unintended consequences.

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2. Assuming an average tax rate of 25 per cent applied to the profit increase created by the cost reduction.
3, Douglas, Justin (2014), *Economic Roundup*, Issue 2, 2014 – Deregulation in Australia, Commonwealth Treasury.

- Applying rigour to post-implementation evaluation to ensure regulations stay relevant and effective.
- Tracking the cumulative costs of regulations, and setting targets for reduction of the overall regulatory burden.
- Setting expectations for regulators' behaviour towards their regulated target, and working collaboratively with other regulators.
- Revitalising *National Partnership Arrangements* to make regulatory reform a national focus.

A comprehensive *Regulatory Improvement and Renewal Program*

The elements necessary to ensure quality, accountability, sustainability and responsiveness of a regulatory system are developed in more detail below.

Establishing accountability – regulatory stewardship

Political and economic circumstances often force governments to focus on the short term. Regulation, however, typically outlives multiple governments. It follows that long-term accountability for the system should be established permanently by statute, and fall to the institutions of government, rather than the government of the day. This concept is sometimes referred to as *regulatory stewardship*.

A stewardship approach is reported to work well in New Zealand[4], where statutory responsibility falls upon regulators and Agencies to undertake continuous evaluation of their stock of regulation. Departments are accountable for policy and legislative improvement, and regulators are accountable for making their regulatory culture a positive influence. New Zealand's Treasury describes this approach in these terms:

- *[Regulatory stewardship is] a responsibility of government regulatory agencies. It involves them adopting a whole-of-system, lifecycle view of regulation, and taking a proactive, collaborative, approach to the monitoring and care of the regulatory system(s) within which they have policy or operational responsibilities.*

Thus, the concept of regulatory stewardship embodies a concern for regulatory assets both now and into the future. Each successive generation of stewards would be expected to leave the body of regulations and practice of regulators in better condition. Secretaries would be charged with budgeting resources for the maintenance of the regulatory infrastructure within their portfolio (in proportion to the size of their legislative footprint) to prevent immediate priorities absorbing all the available resources. Public accountability would be provided through legislation requiring Departments and Agencies to identify the resources they devote to stewardship activities (as opposed to statutory obligations, program delivery or new policy proposals) and report achievements in their annual reports.

Improving the quality of new regulations through better RIA

Where Departments are required to prepare *Regulation Impact Statements*[5], they become part of a Cabinet Submission, with the consequence that the Minister, not the Department, has the final say as to content. Particularly in cases where there is limited circulation to other Departments, or a need to present technically complex material in a succinct form, key risks can be lost, or not drawn out sufficiently. Restricted circulation of draft Submissions and pressure on Departments to 'lean in' to government priorities can mean there may be no one able to point out an error or risk, or with the incentive to do so.

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4. New Zealand's *State Sector Act* defines stewardship as the "active planning and management of medium- and long-term interests, along with associated advice". See further https://www.treasury.govt.nz/information-and-services/regulation/regulatory-stewardship.
5. See https://oia.pmc.gov.au/resources/guidance-impact-analysis/australian-government-guide-policy-impact-analysis.

Cabinet processes should ensure that key information is put to decision-makers, with a rigorous process around wide circulation and provision of coordination comments, and an obligation on every Department consulted to actively support (or not) rather than to merely note the Submission, or decline to comment. Regulation Impact Statements should either be independently validated, or failing that, be subject to scrutiny at the time the decision is made, rather than later when legislation is introduced.

Integrity of government decisions can be further enhanced by earlier public release of Cabinet documents. This form of transparency is often argued against on the basis that Cabinet Submissions would be sanitised if the papers are to be published, with verbal advice filling the gap. However, poorly documented or evidenced decisions would be easily exposed as inadequate, political or pre-determined.

As shown by the Robodebt enquiry, independent scrutiny of Government decisions can bring important issues to light. New Zealand Cabinet papers and minutes must be published within 30 business days of final decisions being taken by Cabinet, in the absence of a good reason not to publish, or to delay the release. Australia’s current standard of 20 years before release compares poorly.

Allowing for rapid post-implementation refinement

As the economy is complex and rapidly evolving, not every circumstance can be predicted before a regulation is passed. Experience improves understanding of the policy impact, and small adjustments can improve the regulatory focus, reduce compliance costs, or remove unintended consequences. While adapting regulations quickly to new circumstances would be ideal, political circumstances often make revisiting past policy via legislation a high risk for governments, even if the refinements should be non-controversial.

A more agile and dynamic post-implementation response could start with assigning the rules to the right level in the regulatory hierarchy. In simple terms, as legislation is typically hardest to change, it should contain only those fundamental rules that are constitutionally required to be in primary legislation, and intended to endure. This would result in a body of relatively simple principles-based primary legislation which would be capable of applying to a range of changing scenarios over time.

Secondary regulation (i.e., regulations, ministerial determinations, and other legislative instruments) would govern machinery provisions and aspects that are liable to change as the economy changes. These instruments can respond more quickly to developments without the need to reintroduce legislation. Non-binding regulators’ guidance completes the package. By way of example, tax laws should establish the liability for taxation, to whom it applies, and the basis on which the tax is levied. However, secondary details such as collection mechanisms, record-keeping requirements, and other machinery provisions should be dealt with via regulations. Taxation rulings then set out guidance for users that binds the regulator only. In this way, when a new technology emerges, the regulations can be changed to take advantage of it without revisiting the primary policy or legislation. While this might seem a theoretical concern, only relatively recently, advances in digital technology uptake made statutory requirements for notices on paper or ‘mailed to’ persons outmoded.

Rigorous post-implementation evaluation

We live in an age where the pace of change is unprecedented, and our regulatory frameworks must keep up. Once regulation has been in place for some time, evaluating whether it still achieves its policy goal, meets its implementation cost targets, or results in unintended consequences is important to allow responses that reduce unnecessary burden.

Fine-tuning past policy has a low priority for governments that continually have novel issues to deal with, and brings political risks of admitting that their own policies were not 'perfect' the first time, so it is unusual for governments to initiate this. Therefore, stewardship should mandate rigorous post implementation review as a regular and automatic function[6].

Addressing the cumulative regulatory burden

While any individual regulation might be justified, where multiple regulations affect the same entity or market, the cumulative burden can be overwhelming. Small businesses, in particular, find complying with various licensing, planning, health and safety, workplace relations and tax laws difficult. Despite sporadic 'deregulation' exercises over many years, the process does not have a permanent underpinning or accountability.

Under the regulatory stewardship mantle, Portfolios with significant regulatory footprints should be obliged to continually evaluate their regulatory stock. Each portfolio should have a standing program, preferably required by statute, to review its regulations to ensure that:

- The original regulatory aims are still relevant, and the regulation still necessary.
- The expected balance of benefit to cost has been delivered.
- The regulation achieves its objectives in the most efficient and effective way.
- The regulation creates no unintended consequences.

As a further discipline, no regulation should be allowed to be reinstated at the expiry of its sunsetting period without public consultation. New *tax expenditures*[7] ought to be given sunsetting dates automatically.

Optimising the roles of regulators

Behaviours of regulators can be a significant source of regulatory burden[8]. Good administration that understands the policy and empathises with the market can reduce unnecessary burden through pragmatic approaches.

Governments seek to maintain high standards and expectations from regulators, and get them to work collaboratively where the same market is subjected to regulations by two or

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6. Independent post implementation reviews are common in Europe, where analysis of key regulations is conducted by a dedicated Commission, see https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation_en.
7. Tax expenditures are variations from the accepted taxing standard. Treasury publishes an annual Tax Expenditures and Insights Statement (see https://treasury.gov.au/publication/p2025-607085).
8. As explained by Malcolm Sparrow, see, for example https://anzsog.edu.au/about-us/contact-directory/malcolm-sparrow/.

more regulators using *Statements of Expectations* (SOEs)[9]. The stewardship arrangements would provide that SOEs must have a dedicated section on reducing regulatory burden.

Revitalising National Partnership Arrangements *for regulatory reform*

The 2016 *National Competition Agreement* included a provision for incentive payments from the Commonwealth to the States to support action in the areas identified by the 2015 *Competition Policy Review*, including restrictions such as commercial planning and zoning, taxis and ride sharing, retail trading hours, pharmacy ownership, liquor and gambling, agricultural marketing arrangements, mandatory standards, and occupational and professional licensing. Progress has been made on some aspects of those priority reform areas, but more could be done.

9. See, for example, https://treasury.gov.au/the-department/accountability-reporting/statements-of-expectations.