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Submission to Department of Prime Minister and Cabinet
On review of
Regulatory best practice principles and new arrangements for performance reporting.

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1. Introduction

This submission responds to the invitation from the Department of Prime Minister and Cabinet to comment on its review of *Regulatory best practice principles and new arrangements for performance reporting*. In particular we are interested in the review's agenda where it states:

> "…under the Government's deregulation agenda [there is a shift] from a focus on the design of regulation, to also include implementation, recognising that even well designed regulation can be undone by poor implementation."

In our response we draw on our 20+ years of advocacy for improved small business regulation. We highlight some examples from our involvement with the States' Small Business Commissioners, the Australian Taxation Office, the Australian Competition and Consumer Commission and the Australian Building and Construction Commission.

2. A top-end principle and practice for good regulation

Our response focuses on a straightforward, high-end principle that we contend should be a core base for all good regulatory design and practice. That is:

- When designing regulation, Parliament should to seek to ensure that policy instructions to regulators are clearly stated in legislation and designed to achieve practical outcomes.
- There should be minimal reliance on regulators' needing to define the specifics of the outcomes sought. Outcomes should be obvious in the legislation.

Further, and consistent with clarity of outcomes:

- Wherever possible, legislation should clearly state the enforcement procedures that regulators are required to follow.
- There should be minimal reliance on regulators' needing to decide for themselves the procedures and processes that they use to enforce regulations.

We say this because, in our experience, too frequently the approach in Australia is to set policy objectives and leave it to the regulators as to how to implement and enforce. Too

often the processes of enforcement, in particular, are overly generalised and almost vague in how they are described in legislation. Enforcement processes are left to the regulator to decide. This is, of course, not always the case. There are plenty of examples of good regulatory design and practice and we mention some below based on our experience. However, there are bad examples. We highlight the ATO's enforcement activities as one particularly bad example.

3. It's all about clear signs

With road rules the regulatory practice is to ensure clear signage.

If a speed sign says *'60km',* all drivers know that to exceed 60 km per hour is to break the law. But if road signs were to say *"60km but depending on the traffic, road and weather conditions, the speed limit might be 50km'*, then road rules would be chaotic. Enforcement would be subject to the police's view of the conditions at the time. Drivers really wouldn't know what the speed limit was. The police would effectively be lawmakers subject to their own views of the road/weather conditions of the day. Complexity and the cost of enforcement would be high.

With road rules, it is clear, obvious common sense to ensure that signage is also clear and obvious. But clarity in signage is not what always occurs in other areas of regulation.

Our recommendation to the PM&C review is to keep firmly in mind that the community needs clear "road signs" in all regulatory matters. There should be a simple question asked of all regulations, namely:

- Does the regulation provide clear and practical sign posts that can be understood by the community and the regulator in their day-to-day application?

It's an obvious guiding question but one we think needs to be highlighted.

4. The professionalism of the public service as regulators

In our experience we have a highly professional public service at each level of government in Australia. One thing that can be relied upon is that if the regulators receive clear legislative instruction, they will dutifully apply the letter of the law.

However, if the legislative instruction is vague or generalised, the public service regulator is put in an awkward position of having to create what they think the parliament may have intended. The consequence of this is that the regulators' interpretation of the generalised legislative instruction changes over time. We provide an example of this below with the ATO (see section 7).

We recognise that total legislative clarity in a practical sense is often difficult. Further, that entities in the community that may wish to flout, avoid or exploit a regulation will often play technical legal games to achieve their ends. The balance is not always easy. The following case studies consider this dilemma and how it may be resolved.

5. Case study: What is a small business?

Under the current unfair contract laws applicable to small businesses, many large businesses have sought to avoid the intent of the laws by challenging the definition of what constitutes a small business. In doing so they have often sought to expose or create complexity so that they can challenge what might be defined as a small business at law. This has frustrated the ACCC which is charged with enforcing the laws.

One way of resolving this is to allow the regulator the flexibility to determine what a small business is. This is the approach applied by the Small Business Commissioners in each State in relation to their powers to undertake small business dispute resolution. The Commissioners have the discretionary power to declare a business to be a small business.

But this discretionary power to define only relates to the fairly limited powers of the Commissioners to undertake non-compulsory dispute mediation of commercial disputes. The Commissioners cannot impose a decision or a sanction on parties in dispute. The discretionary power to define a small business is in this instance appropriate and balanced, we say, because of the Commissioners' limited enforcement powers.

However, in relation to the unfair contract laws, the powers of the ACCC are more onerous. Under current unfair contract law, a contract clause can be declared void by the courts upon ACCC application. Given this sanction we don't believe it appropriate for the ACCC to have the discretionary power to declare a business to be 'small'. Rather, if the intent of the law is being flouted, it is instead appropriate to create enhanced legislative clarity. And this is indeed what is occurring.

The current proposed changes to the unfair contract laws will expand the definition of small business and create greater clarity around that. That's good and we hope that the new law, if passed, will limit the ability of large businesses to flout the unfair contract laws by playing definitional games.

The point we make for the purposes of this review is that in redefining a small business for unfair contract purposes, it is the Parliament that is deciding the definition and creating a clearer sign post. This is the way it should be in a democracy. It is the parliament that should design the sign posts, not the regulators.

6. Case study – Security of Payments Construction sector

Self-Employed Australia has a representative seat on the Australian Building and Construction Commission's (ABCC) Security of Payments working group. As a consequence, we have some knowledge of the operations of the ABCC in the enforcement of security of payment laws in the construction sector. In addition, we were active advocates for the establishment of the ABCC and so have some knowledge of the policy background to the ABCC's powers.

The ABCC is charged as a regulator to ensure that subcontractors are paid by construction contractors 'on time'. The legislative sign posts for enforcement are clear both for the ABCC and for the construction sector. In summary, they are:

- The ABCC's powers only relate to construction projects subject to Commonwealth funding.
- A contractor must pay subcontractors within the terms of the appropriate contract and/or within the statutory requirement.
- Contractors must report any late payments they make to the ABCC.
- A subcontractor can request the ABCC to intervene to require payment.
- The only sanction available to the ABCC for late payment is to apply to the Minister to exclude the contractor from access to Commonwealth-funded work.

In this case study, the enforcement sign posts are clear and have practical application. As with good road signs, all parties—the regulator and regulated—know the cut-off points. To see if a payment is late, is a matter of identifying the facts. For example: What are the payment terms within the relevant contract or the statute? Have those payment terms been met?

In observing the enforcement practices by the ABCC we have seen the following:

- A significant education program by the ABCC to ensure that contractors were/are aware of the laws.
- The ABCC has worked with contractors who have advised that their internal administrative procedures were inadequate and that late payments were occurring due to poor administration. The ABCC has worked with such contractors (within the limits of the ABCC's authority) until those contractors improved their administration to effect on-time payments.
- The ABCC has established a process for administering late payment reports from contractors to monitor payment times adequately.

It took some 18 months from the declaration of the laws for the ABCC to establish its procedures, educate the industry and 'get up to speed' on enforcement for the effects to start to be felt. On our observation the enforcement processes have been comparatively 'light touch'. Once contractors in the industry became aware of the laws and enforcement processes and adjusted their procedures to these, our observation is that payment times to contractors have improved markedly. There has only been one instance of which we are aware where a contractor sought to deliberately defy the laws and not pay contractors on time. The ABCC moved with enforcement sanctions in this instance.

In our view the model of the ABCC Security of Payment regulation is the sort of regulation model of which we would seek to see more. It has:

- A clear legislative objective—namely, to have subcontractors paid on time on Commonwealth-funded projects
- Clear and practical administrative triggers for enforcement that are verifiable—namely, whether payment has occurred within the contractual or legislative time frame.
- Sanctions that are known and commercially 'attention getting' and which do not rely on drawn-out legal processes for an outcome.

The outcome of both the regulations and enforcement by the regulator, we observe, has been that construction contractors have moved to voluntary compliance.

This demonstrates one of our main points. If the laws are clear and practical on both the requirement and enforcement processes, most people will seek to comply.

7. Case Study – ATO – Personal Services Income tax laws

The PSI laws are reasonably obscure tax laws that date from around 2000. They were intended to prevent or limit self-employed people from distributing 'personal income' of one person to another entity (typically a spouse) thereby accessing lower tax thresholds.

The laws are quite convoluted and not easily understood by laypeople. They rely heavily on the interpretation of the laws by the ATO through the ATO's tax rulings. Note that tax rulings are not law, but the ATO's view of the law. Tax rulings have a habit of changing over time.

Around 2005, the ATO issued a PSI Tax Ruling which stated that, as a consequence of a 2004 Federal Court decision, self-employed people operating through a partnership could legitimately split their income with their spouses. The reasoning was that, in a partnership, losses of the partnership are the responsibility of each of the partners, therefore profits should also be equally shared by each partner.

However, as is typical of ATO rulings, the headline ruling then had a series of cascading 'what ifs' and 'buts' making the headline subject to unclear and unstated ATO interpretations. Further, at some time around 2009, the ATO changed the ruling and, unannounced, removed the reference to the Federal Court decision upon which the ruling was based.

The consequence was that numbers of taxpayers who had acted on the 2005 tax ruling were subsequently charged by the ATO (as late as 2012) with breaching the PSI rules. They received large back-dated tax charges with significant penalties and interest.

In this example the tax sign posts are vague, imprecise and essentially impossible for any ordinary taxpayer to understand. The meaning of the law is essentially subject to the whim of the ATO, a whim that may and does change over time. This is bad regulatory design, both in terms of identifying the 'sign post' about what the law actually is and in having clear enforcement procedures for the regulator (ATO) and the community (taxpayers).

This regulatory situation is endemic within the ATO. It is why, in 2018, high profile and respected tax lawyer Mr Mark Leibler AC described the powers of the Australian Taxation Office (ATO) as follows:

> "…for all intents and practical purposes, it's effectively the (Tax) Commissioner who lays down the law." "For taxpayers who want to avoid the delay and the expense of action through the courts or tribunals, the **Commissioner effectively continues to act as lawmaker**…" (emphasis added)

Self-Employed Australia has been a long-time critic of the ATO because of the adverse consequences for taxpayers of bad sign-posting. The PSI example above is just one of many examples. It's not that the regulator (ATO) intends to behave badly. Rather, it is the

consequence of Parliament failing to have tax laws that achieve clarity—particularly in the way the regulator conducts enforcement.

Instead of being a critic only, we have sought to present solutions. Following a deep investigation into the enforcement powers of the US Internal Revenue Service (IRS) we have produced a report comparing the enforcement powers of the IRS with those of the ATO. The US Congress has created clear statutory sign posts for the IRS in terms of how the IRS can and is required to conduct enforcement procedures. We consider these IRS enforcement laws to be good regulation. We are advocating for these US laws to be used as a template for reforming the enforcement powers of the ATO. If it is of interest to PM&C attached is our detailed report that has been supplied to the House of Representatives Standing Tax and Revenue Committee.

We consider the enforcement regulations applying to the IRS to be an example of regulatory best practice.

8. Case Study – ATO – JobKeeper

The design and implementation of the JobKeeper program we consider to be a good example of regulation modelling and implementation.

When the Covid crisis hit and lockdowns and so on occurred we had heavy demand from our members and other self-employed people to explain the JobKeeper, JobSeeker and associated support packages. We put together summaries that we published on our website, conducted zoom discussions and fielded large numbers of enquiries. There was heightened panic from small business and the self-employed.

However, the JobKeeper package was tightly targeted and had clear 'sign posts', namely:

- Eligibility was tied to a 30 per cent plus drop in GST revenue comparing one revenue period in (say) 2019 with the relevant period in 2020.

This and other verifiable triggers meant that self-employed people could readily assess if they were eligible and the ATO's enforcement procedures could be tested back against the facts. Where people were being honest in their revenue declarations, there was (and is) high certainty about compliance. That is, compliance was/is not tied to the ATO applying interpretations of revenue. The sign posts were and still are clear.

This clarity was significantly important in calming the fears of self-employed, small business people who were (and are) under enormous stress from the prospect of business collapse due to Covid. With clear regulation signage, people were able to reassess and re-budget as they moved forward, even if their businesses faced terminal collapse. At least there was some measure of certainty about the support they could seek.

In this environment the administration of JobKeeper by the ATO was critical. It was necessary not only to have the support policies but to deliver on the policies as well. Because the policy signage was clear, the ATO was able to put in place effective administration of JobKeeper. We praised the ATO for its success in putting the administration in place under considerable pressure and with great speed.

We consider the JobKeeper and related Covid support packages to be good regulatory models. There was clarity for both the community and the regulator, the ATO. Such clarity enabled effective implementation.

9. Achieving sign post clarity strengthens the rule of law and democracy

We are pleased to see this review with its focus on both regulation design and implementation. We make the point that having good regulation and implementation is not just about technical tweaking of regulation for the purposes of efficiency and so on. It's much more than that as it involves issues which impact upon the operation of democracy and the rule of law.

Democracy involves more than simply the ability to vote at elections. The rule of law involves more than just the ability to appeal to independent courts for dispute settlement.

For democracy and the rule of law to be strong, the overarching presence of government as the community regulator must be clear, transparent, accountable and predictable.

This compares to the rule by dictatorship, for example, where rules are unclear, unpredictable, opaque and/or the regulator is not accountable. For example, the Chinese journalist Zhang Zhan has recently been jailed in China for reporting on the Wuhan Covid-19 outbreak. She has been found 'guilty' of "picking quarrels and provoking trouble", a law/regulation that is entirely subject to the interpretive whims of the regulator, in this case the thought police of the Chinese Communist Party.

History shows that the journey from authoritarian rule to democracy and the rule of law is an ongoing quest. In Australia we have pockets of authoritarian, dictatorship-style powers operating within some of our regulatory structures. We must always be alert to this and take steps to reform them.

In a 2001 speech, the then-Chief Justice of Australia, Murray Gleeson, put forth an hypothesis concerning the nature of the rule of law. The Chief Justice said:

> *Suppose legislation created an office of Tax Collector, and decreed that every person who derived income should pay to the Collector such percentage of that income as the Collector, in his or her absolute discretion, with uncontrolled power to discriminate, might think fit.* ***That would be a tax. But would it be a law, within the meaning of a Constitution which assumes the rule of law?*** [emphasis added]

We encourage PM&C in its quest for regulatory improvement. It's a quest that's not simply about technical improvements to regulations and regulators. Rather, it is an ongoing quest to strengthen and solidify our democracy and the application of the rule of law.