SOLOMON ISLANDS NATIONAL PARLIAMENT

BILLS AND LEGISLATION COMMITTEE

REPORT

ON

THE INCOME TAX (AMENDMENT) BILL 2005

National Parliament Paper No. 21 of 2005

CONTENTS

The Members of the Bills and Legislation Committee are:

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Hon. Edward J. Huniehu, MP
Chairman

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Hon. Manasseh Sogavare, MP
Member

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Hon. Clement Kengava, MP
Member

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Hon. Dr. Steve S. Aumanu, MP
Member

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Hon. Meshach M. Maetoloa, MP
Member

1. **TERMS OF REFERENCE**

To examine and report to Parliament the Committee's observations and recommendations on:-

"The Income Tax (Amendment) Bill 2005".

2. **FUNCTIONS**

In accordance with Section 62 of the Constitution as read with Section 71 of the Standing Orders, the Bills and Legislation Committee's functions in addition to the provisions in Standing Orders 50 and 55, shall be to:-

(a) examine such matters as may be referred to it by Parliament or the Government;

(b) review all draft legislation prepared for introduction into Parliament;

(c) examine all subsidiary legislation made under any Act so as to ensure compliance with the Acts under which they are made;

(d) monitor all motions adopted by Parliament which require legislative action;

(e) review current or proposed legislative measures to the extent it deems necessary;

(f) examine such other matters in relation to legislation that, in the opinion of the Committee require examination; and

(g) make a written report to each Meeting of Parliament containing the observations and recommendations arising from the Committee's deliberations.

3. **ACKNOWLEDGEMENT**

The Committee would like to acknowledge the attendance of the Legal Officer from the Attorney General's Department, the Commissioner of the Income Tax of the Department of Finance and Treasury, and the Modernization Project Manager (RAMSI) of the Inland Revenue Division, who have availed themselves to help explain and clarify questions that may emanate from the members.

4. **PURPOSE OF THE INCOME TAX (AMENDMENT) BILL 2005**

The objects and reasons as stated in the amending Bill are as follows:

> The Bill seeks to amend the Income Tax Act so as to make the deduction of tax from certain payments as final tax on the income to which the payment relates.

[The Bill contains extensive explanatory notes addressing each amendment.]

5. **BACKGROUND**

The *Income Tax Act* requires every employee to lodge a tax return.

The new Bill obliges an employer to deduct tax from the gross amount of employment income paid to an employee and seeks to remove the obligation of employees having to lodge individual tax returns.

It is proposed that the Act and associated Tax Deduction Rules will come into force on 1 January 2006.

The Committee considered the Bill within a framework of the following fundamental principles of tax policy:

- equity,
- efficiency and
- simplicity.

Noting that within these broad principles are important criteria such as:

- certainty,
- transparency,
- neutrality,
- stability and
- integrity.

The Committee notes that for over two centuries, there has been fundamental agreement on what constitutes 'good' tax policy. An extract from the dissertation on tax principles by the 18th Century economist, Adam Smith, demonstrates that fundamental views of what constitutes a good tax system are not driven by short-term trends.

Adam Smith on tax maxims

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. …The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.

IV. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.

A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways.

***First**, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax …*
***Secondly**, it may obstruct the industry [of] the people, and discourage them from applying to certain branches of business which might give maintenance and unemployment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so.*

***Thirdly**, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in* *proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it…*

Fourthly*, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it.*

It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign.

The evident justice and utility of the foregoing maxims have recommended them more or less to the attention of all nations.

Equitable taxes spread the tax burden fairly across the population.

- o It is important that a properly resourced tax administration underpins equitable tax laws by achieving high levels of compliance with those laws.
- o It is also important that tax administration itself is equitable in that it allows all taxpayers fair and equal access to information, advice, review mechanisms and other tax administration services.
- o

- **Efficient** taxes do not skew resource allocation decisions across the economy, contributing to a strong, productive economy.
  - o In the course of this review, business groups questioned whether Australia's tax system could be considered efficient while its complexity continues to divert vast amounts of accounting, legal and business expertise away from strategic management into routine tax compliance functions.
  - o
- **Simplicity** in tax design and administration involves minimising uncertainty and compliance costs for taxpayers.
- The three basic principles of equity, efficiency and simplicity are considered to provide reliable and basic signposts for improving tax administration. [1]

[1] Australian Inspector-General of Taxation's Issue Paper No 2: Policy Framework for Review Selection, pp 1-3,

6. **OBSERVATIONS**

Due to the complexity and technical nature of the Bill, the Committee requested the Manager, Modernization Project (RAMSI) of Inland Revenue go through the Bill Clause by Clause.

The Committee heard evidence that:

- Consultation had occurred and the Bill was generally supported by the Chamber of Commerce.

- The Bill was drafted with the assistance of IMF to follow international best practice in tax law, which practice countries like Samoa, Tonga and New Zealand now follow.

- The new system will be beneficial to the Inland Revenue Division in allowing it to operate more efficiently and improve compliance and collection of taxes that are due to the Government particularly in the area of company tax.

- The Committee identified that the legislation changed the provisions relating to income from employment in that it added the concept of gain or profit of a '*capital nature"* when referring to *'gains or profits from employment.'*

  The Adviser agreed that it was a new addition to the legislation. As the Bill was not intended to change the taxation base or rate of taxation the Committee suggested that it may be best to move an amendment to delete the addition.

  Following the meeting the Adviser provided the following explanation and argument for maintaining the proposed wording:

  > "The inclusion of the words was made at the suggestion of the IMF legal draftsman as a measure to counter the growing trend of structuring employee payments as capital and thus avoiding a tax liability. The present legislation in Solomon Islands only taxes payments that are revenue in nature. There are presently no issues in Solomon Islands relative to taxing all employment payments but tax jurisdictions in Australia and New Zealand have encountered a significant number of instances where employers make payments to employees under the guise of a capital payment. If they were held by the Courts to be capital, no tax is payable as the law only taxes revenue amounts.

Examples of capital payments in the context of Australia and NZ are:

1. Compensation for termination of employment. Payments are categorised as a payment for "hurt and humiliation" (for loosing a job) and the payment is then not a taxable payment.

2. Payments to secure the services of an employee or retain the services of an employee - so called "Golden Handshake and Golden Handcuff payments" These are capital as they relate to the intellectual property (the brain if you like) of the employee rather than the provision of services and are not taxable as they are capital.

The proposed Solomon Island legislation to include capital payments as income where they are paid in relation to employment is part of the international move to have tax laws that capture all employment related payments. It is essentially another anti-avoidance provision.

The inclusion of all revenue and capital payments in Clause 5 of the Bill is not important in the scheme of the new PAYE regime but it could be important some years down the track when the economic and financial climate in Solomon Islands becomes more sophisticated. On reflection, I would like to leave it in as it has no revenue implications now but could counter any future loss of revenue from payments that should have been subject to tax.

- The Committee also notes that the Bill does not provide any tax benefit for Solomon Island tax payers either by increasing the tax free threshold or reducing the rates of taxation. The Committee emphasized that Members and the public would expect that improvements and efficiency in the tax system would lead to a reduction in levels of personal tax.

- The Committee also noted that the Draft Tax Deduction Rules 2005 referred to in the new section 36A must be tabled in Parliament and are subject to disallowance. As the Bill and the Rules are due to commence on 1 January 2006 the Committee recommends that Rules are tabled with the Bill in Parliament in order that this Committee may consider the Rules and report to Parliament accordingly. Parliament may then consider approving the Rules in accordance with section *62 (3) of the Interpretation and General Provisions Act 1978.*

- As a general comment, the Committee found quite a number of minor drafting errors and missing words which affect the accuracy of the Bill and which need rectification by the Attorney General prior to the commencement of the Act.

7. **<u>RECOMMENDATIONS</u>**

With the above observations, the Committee **RECOMMENDED**:

1. That the Draft Tax Deduction Rules 2005 referred to in the new section 36A be tabled with the Bill in Parliament in order that this Committee may consider the Rules and report to Parliament accordingly. Parliament may then consider approving the Rules in accordance with section *62 (3) of the Interpretation and General Provisions Act 1978.*

The Committee has considered the Bill and recommended that **"The Income Tax (Amendment) Bill 2005"** be presented and debated on in Parliament.