



USAID/Economic Governance II Project
Bearing point Co.



Training Course on Drafting Tax Legislation

Tax Policy Unit-MOF

Prepared by: Touhami Rhaïem

Tax Lawyer



Preface

- **Tax laws are more than just directing who pays what and when, they are a vehicle for the implementation of much of a nation's economic, social, and fiscal policy.**
- **Tax laws determine overall public revenue amounts and thus the level of public services a nation is able to provide its citizens.**
- **Tax laws directly and indirectly act to help establish the macroeconomic environment in a country, including attractiveness for foreign investment, stability, and the international competitiveness.**
- **Tax law sets the legal framework, then these provisions themselves are implemented by Regulations and instructions.**
- **Most modern tax systems are designed around voluntary compliance through self-assessment.**



Requirement of drafting tax law

- Tax law must be effective in achieving the policy goals of the government, in terms of the amount of revenue to be raised with an eye to equity, efficiency, and simplicity;
- Tax laws must be drafted in the context of the style of legislative drafting in the country in question.
- Because languages and local drafting styles differ, the approach to drafting a tax law will vary widely from country to country.
- Poor drafting often leads to substantial problems in implementation of a new tax law;
- Drafting of tax law is an imperfect process, with errors or inefficiencies introduced at each stage;
- Errors may be introduced in drafting the provisions into law, and more still in translating them into regulations, instructions, and taxpayer behavior, with the additional unknown of court interpretation of tax law.



Using foreign Advisor

In order for a draft prepared by foreigners to be successful:

- **foreign advisor on drafting need an extensive experience in comparative tax law;**
- **has a strong knowledge of tax policy;**
- **A foreign advisor should have at least the ability to read in Arabic language the law being drafted to be able to read and discuss the draft with the counterparts;**
- **Translation is a cumbersome process, and problems of ambiguity or terminology are often obscured by translators;**
- **Where the foreign advisor cannot read the local language well enough, he will not be in a position to guarantee the integrity of the draft;**
- **The foreign advisor should not be a person who seeks to impose the law copied from another county;**



Using foreign Advisor

- Tax law is fundamentally based on legal relations with the different law sectors like civil law, administrative law, family law, business law, social law etc;
- If the foreign advisor has no knowledge of the Iraq legal system, it will be very difficult to draft a good tax law;
- Finally, as any legislation, tax law reflects the society social and cultural life, foreign drafter should have a minimum knowledge and understanding of the local cultural and customs.



Translating policies into law

- Tax policy drives the drafting process, but policy itself is not fully formed until the final legal draft is developed and the policy objectives operationalized;
- The policy embodied in tax law should represent the objectives of the government in these broad areas, and the law itself should be consistent with these objectives to the greatest degree possible;
- Policy cannot be precisely translated into a legal framework, resulting in some implementation inefficiency, and the law itself may have effects unforeseen and unwanted by its designers;
- Courts may choose to view law differently from its original drafter, and those who must follow the law, taxpayers and tax officials, will see different incentives as well;
- The original policy objectives should be incorporated in the law in a way to minimize unforeseen and perhaps counterproductive outcomes.



Designing Tax System



Tax Code vs. Tax laws

- **A Tax Code replaces separate tax laws;**
- **A tax code can assure consistent provisions are applied to every tax, e.g. consistent definitions, filing systems, penalties and timetables...**
- **A tax code is of value in combining all legislation in one location, making it easier for taxpayers and officials to locate provisions and to comply with laws;**
- **Tax code can also be simpler, as consistent definitions and directions can be used throughout;**
- **A tax code may be easier to maintain than separate tax laws;**
- **However it takes more time to draft a whole Tax Code, while Iraq needs a basic Income Tax Law as a start.**
- **The codification may occur later once the components of the tax code are drafted, Income Tax Law, Tax Administration Law, VAT Law...**



Constitution requirement for drafting

- **Law-making authority is subject to a number of constraints;**
- **Iraq's system of responsible parliamentary government is based on the rule of law. This means that laws must be made in conformity with the Constitution;**
- **Parliament and the provincial legislatures are limited by the constitutional distribution of powers;**
- **In designing a tax system, every nation must make a decision as to the appropriate division between roles of the constitution, law, and rules;**
- **Generally constitutions define the broad legal structure within which the tax system must operate;**
- **Typically most nations' constitutions contain only statements granting broad authority over tax and economic policy.**
- **Iraqi constitution is typical in that regard, simply including the basic right of the national government to tax;**



Constitution requirement for drafting

- **Another common provision is a requirement that the tax be established by law, i.e. through action of the parliament;**
- **It is the tax law itself that sets the basic legal requirements for taxation – who pays, who collects, how the tax is computed, where the tax is paid;**
- **Equal protection provisions in the constitution that require uniform treatment of citizens under the law;**
- **constitutional guarantees such as restrictions on taxation of certain property, non-retroactivity clauses or due process requirements;**
- **International treaties or agreements that supersede law may also result in such challenges.**



Formal requirements for drafting

Three formal requirements and limitations affect the drafting process:

- 1. the form or style of the draft legislation;**
- 2. its content;**
- 3. the process by which the draft moves from introduction to enactment;**
 - This workshop is concerned with the first two types of requirements and limitations. Those that effect the form or style of the draft legislation, and those that affect its content;**
 - Both directly affect the drafter because they control to some degree what the drafter may or may not include in the draft legislation;**
 - The legislative process by which a draft once introduced as a bill becomes law is left out in this workshop.**



Criteria for drafting tax law

There are some criteria for a well drafted law that should be respected by the drafter:

- 1. Understandability:** refers to making the law easier to read and follow; that the meaning be unambiguous, the law should be clear in its meaning and intentions;
- 2. Internal consistency:** The provisions should be consistent and compatible with one another throughout the tax law and with other relevant laws;
- 3. Effectiveness** relates to the law's ability to enable the desired policy to be implemented; The law should accurately represent and convey the government's intention in tax, fiscal, and economic policy.
- 4. Integration** refers to the consistency of the law with the legal system and drafting style of the country.



Criteria for drafting laws

5. **Clarity:** removes opportunities for corruption by removing opportunity for discretion on the part of tax officials and reduces errors associated with compliance.
6. **Stability:** The law should change only slowly over time and in a consistent and predictable direction; stability requires a clear identification and widespread consensus among decision makers on the underlying policy
7. **Precision:** a well-drafted tax law spells out with precision the matters that are within its scope. But should not be precise at the expense of being complicated and impossible to understand.
8. **Simplicity:** The law should convey its meaning and be organized in as simple and brief a manner as possible;
9. **Consistency in interpretation:** The law should be interpreted by its intended audience -- taxpayers, tax officials, and the courts – in a consistent manner;



Formulating Tax Law Provisions



Formulating Tax Law Provisions

- **The effectiveness of tax policy can be maximized by following a structured approach to the design, drafting and enactment of tax law.**
- **In drafting tax law, a decision must be made as to which provisions should be included in law and which in regulations.**
- **Some countries have enacted very complex and prescriptive tax laws (i.e. the United States, Canada) while others have utilized relatively simpler structures;**
- **This debate occurred within the accounting profession between rules-based and principles-based systems.**
- **The debate over rules-based versus principles-based standards is helpful in assisting the drafter of tax law.**



Formulating Tax Law Provisions

- I. Rules-based system:
 - Rules-based system is a system with an excessive reliance on rules in the law;
 - Law that attempts to codify all rules becomes unwieldy and perhaps unstable, and will need frequent changes, changes that may come too late.
 - It would introduce inefficiencies in the economy and in the tax system, as taxpayers undertake financial engineering to avoid (or evade) taxes.



Formulating Tax Law Provisions

II. Principles-based system:

- Consists in that the Act says that profits of a trade are taxed, without defining either profit or trade.

A principles-based tax system would shift some of the issues of legal interpretation closer to the assessment and collection process, to tax administration;

- **A principles-based system may be seen as shifting authority from the legislative to the executive branches of government;**
- **It provides insufficient guidance for taxpayers and tax officials, and in nations with still developing rulemaking processes and legal oversight, gives too much authority to these weak institutions opening an opportunity for corruption;**
- **It may give too much discretion to the courts and administration in interpretation of the law, with potentially disastrous results if the courts rule that regulations violate the law.**



Formulating Tax Law Provisions

III. Objectives-oriented system:

- **The objective-oriented system is the result of a compromise structure between principles-based and rules-based;**
- **In tax law, objective-oriented system would suggest a clear statement of purpose at the outset, to direct the rulemaking process, facilitate taxpayer understanding, and provide guidance for any subsequent legal challenge, followed by a general statement, itself followed by exceptions.**
- **An objectives-oriented approach to tax law would clearly state the objective or intent of each major provision to provide direction to taxpayers, tax officials and to the courts, helping ensure consistent interpretations;**
- **This approach would suggest clear statements of principles, limited use of bright line standards, i.e. the use of set percentages or fixed amounts, replaced by ranges that allow for some judgment by the tax administration.**
- **This system differs from the principles-based system by requiring that a higher level of detail be provided;**



Formulating Tax Law Provisions

- **This system differs from a rules-based system by minimizing the reliance on fixed rules and reducing the number of exemptions from a standard;**
- **For example, policy in defining income, expenses, or a tax credit could be set out as direction for the administration, with detail only in listing exceptions or providing limitations;**
- **This structure would assist in meeting many of the objectives in tax law drafting such as clarity, efficiency and consistency in interpretation;**
- **Minimizing the detail included in the law while, at the same time, providing sufficient direction to the administration to be able to implement the law through rules or instructions.**



Tax law internal organization



law or regulations

- **A provision should go in the law or in the regulations?**
- **The dividing line between law and regulations is based on:**
- **Authorization, with the law authorizing the regulations that follow;**
- **Complexity, with the law establishing the general principle and the rule the detailed administration; and**
- **Stability, with the law including those items that do not require frequent amendments.**
- **For example, the tax law may state that business expenses for advertising are deductible in determining taxable income. The regulations would follow by defining what constitutes an advertising expense.**
- **The decision of where to place a provision, in law, regulations or instructions, is based on factors discussed above. If the provision establishes broad policy, it should be in law.**
- **If it significantly affects a broad group of taxpayers or tax officials, it also likely belongs in law.**
- **If it is likely to need frequent change, then care should be taken to minimize the need for that change, putting the implementing language in regulations.**



Common features in drafting tax law

- **There are common features in the drafting the law, that it moves from general to specific, and follow the tax process itself in rough chronological order.**
- **Key elements: taxpayers, tax base, tax rates, procedure and administration;**
- **Begins with a broad purpose section stating the reason for the law, coverage, exceptions, followed by definitions of terms.**
- **Then general tax provisions covering individual taxes in general order by type**
- **Following are sections on filing deadlines, penalties and interest, audits and record keeping, and general tax administration provisions.**



Drafting principles



Drafting principles

- **The goals of tax law drafting are Clarity, simplicity, and efficiency;**
- **Use simple structures, short paragraphs, a logical arrangement, and consistent wording;**
- **The drafting process should also be inclusive, both inside and outside of government, as the law will be interpreted in a somewhat hostile environment by courts and taxpayers;**
- **The linear nature of drafting, where an initial draft law is sent to Consultancy Council (Ministry of Justice) for revision.**
- **The Consultancy Council t may have a different understanding of the law, and then to parliament, which may amend yet again, all before the final law is ever discussed;**
- **We suggest that the drafting process be recursive, with TPU –which determines tax policy – having the final say over the draft that is released in parliament;**



Drafting principles

Overall structure:

- A well-organized law typically begins with a statement of what the law is, what it does, and what it covers;
- Tax law follows a chronological or procedural sequence as well as movement from the general to the specific;
- For example, laws first establish a tax, then define terms, next state who is subject to the tax, then define tax computation period, provide details on computation, then filing instructions and timing, next payment or refund directions, establish the appeal process, and so on...
- Sections within the law are also usually organized alphabetically, to facilitate ease of location of terms;
- Each general section should specifically identify the person (or entity) who is responsible for meeting each of the requirements specified within that section, as well as setting out the consequences for failure to follow the law contained in that section;
- Who is subject to the tax, provisions defining gross income, deductions from income to determine taxable income, tax rates, credits, and payment procedure.



Drafting principles

- **Sections commonly follows these general provisions is one containing definitions of terms to be encountered subsequently in the law;**
- **As to flow of provisions within sections, it is common to move from the broader, more general provisions to the specific, and begin with clear statements of who is to do what under each section.**



Drafting principles

Brevity

- Elegance, brevity, and clarity of expression are to be sought
- A short statute requires less effort to understand it, and the compliance with is easier
- Every word in a statute should have a definite purpose and no unnecessary word should be used

Transparency

- A statute is transparent if it easily allows the reader to understand the rationale of the rules
- To be transparent a law must state its purpose and not only general statement
- A specific and operational statement could facilitate the interpretation of ambiguous provisions in the law

Plain language

- Use a plain language makes the law easier to understand avoiding legalistic language,



Drafting principles

- However, the drafter should not hesitate to use technical terms where appropriate;

Numbering of Sections

- Most countries have adopted the practice of numbering the sections of a law sequentially, that is, 1, 2, 3, and so on;
- However most tax laws are amended frequently, therefore amendments create problems for sequential numbering;
- If amendments have to be placed at the end of the statute, in which case they are not in the logically appropriate place;
- If the amendments are inserted in the appropriate place in which case the sections of the law have to be renumbered;
- Or they can be inserted under a hybrid alphanumerical designation;
- Renumbering is confusing and should be avoided because references to section numbers in other laws, in legal documents, in judicial decisions, in regulations, and in articles become incorrect.



Drafting principles

- The solution adopted in the U.S. Code (one title of which is the Internal Revenue Code) is nonsequential numbering;
- The approach is to leave a gap in section numbering between each division of the statute;
- If new sections are added, they can be named by using the unused section numbers;
- For example, the first group of sections might run from 1 to 14, and the next group begin with section 20.

Section Headings

- The use of section headings makes it much easier to read and understand the law; moreover, it acts as a discipline for the drafter, (U.K. tradition);
- It is generally better to keep the headings short (one to four words); this makes it clear that the heading will not capture all the nuances of the section it heads;
- Many countries do not use section headings, but are simply designated by numbers. France, Germany, and Spain use title, part, chapter) do typically have headings. *E.g.*, FRA CGI;
- Recent legislation in a number of transition countries now contains section headings, KAZ TC.



Drafting principles

- **If a decision is made to use section headings, the question arises whether headings for subdivisions of a section should also be used;**
- **The use of headings for subdivisions of sections would lead to clutter. My suggestion would be to do this at the level of the section;**
- **But the matter should be decided in light of the characteristics of the law being drafted and of Iraq drafting style;**
- **Where section headings are used, the question of their legal effect should be considered in interpreting the law.**



Drafting principles

Sentence Structure

- Long, complex sentences should generally be avoided, since they impede understanding;
- In U.K. tradition, a section may not contain more than one sentence unless broken down into separate subsections, this tradition is followed in various countries of the Commonwealth, such as Canada and Australia;
- Where using more than one sentence, makes the section easier to understand, and if the goal is elegance and comprehensibility, the on-sentence rule may be abandoned;
- The shorter the statute, the less effort will be required to understand it, and the lower compliance burdens will be;
- **Paragraphing:** when a sentence is broken down by numbering and indenting its logical components;
- Paragraphing is a means of removing ambiguity, and it makes sentences easier to read.



Drafting principles

Title

- Almost every law requires to have a title;
- The requirement is usually tied to the single subject requirement;
- No law shall embrace more than one subject, which shall be expressed in its title;
- The subject must be clearly expressed in its title;
- The title should not contain much detail, it should be very general.

Enacting Clause

- The law must have an enacting clause;
- The law should specify the exact words of the enacting clause:
“The People of Iraq enact...”



Drafting principles

Grammar and wording

- The effectiveness of a tax law is enhanced if its words are meaningful, intelligible, well thought out, and well organized;
- The minimization of terms or use of words that can cause confusion or provide room for alternative interpretations in an adversarial situation;
- Consistent effort to avoid ambiguity or use of terms that can be interpreted in different ways, and through avoidance of vague terms or terms with unclear meanings;
- Similarly, over-generality, or use of terms beyond their meanings, should be avoided;
- jargon or of technical terms should be avoided unless absolutely necessary. If they must be included they should be well defined;
- abbreviations should be avoided, as should acronyms;
- Canons of construction, or well understood phrases or terms common to all laws: the use of “shall” is seen to require an action, while the use of “may” makes the action optional.



Drafting principles

Grammar and wording

- It is also commonly held that the singular include the plural, meaning that the singular should be used for sentence structure (“a taxpayer must” rather than “taxpayers must”);
- Sentence structure is also designed to be very clear and unambiguous. Passive sentences are to be avoided, gender-specific terms omitted, and complex sentence structure avoided;
- Sentences should be short and, where possible, provide simple directions;
- It is not necessary for a subsection to consist of only one sentence; breaking it up into shorter sentences in itself would make it easier to read.
- Lengthy paragraphs also should be avoided. Long sections should be designed so as to be segmented into clauses that can serve as easy reference;
- simple structures, short paragraphs, a logical arrangement, and consistent wording can help greatly to facilitate consistent understanding of provisions;
- Every word in a statute should have a definite purpose and no unnecessary word should be used, that is no word should be included if it does not serve a function.



Drafting and tax timing

- **Tax timing means adjusting economic behavior so as to minimize tax liability;**
- **Shifting income and/or expenses from one year to the next is relatively simple, i.e. through buying next year's supplies or inventory in December;**
- **In drafting tax law, it is advisable to look at transition provisions that prevent shifting by either including special treatment from one year to the next or phasing in changes so as to make tax timing less rewarding and therefore less likely to be used, as well as minimizing damage to the treasury;**
- **For example, if a tax law change allows new business deductions in a following year, there is an incentive to delay expenditures of these deductible items or;**
- **similarly, if the law eliminates such deductions there is an incentive to increase expenditures of these items in the current tax period at the expense of the next;**



Drafting and tax timing

- **Change in tax rates, imposition of a new tax, or the repeal of an existing tax can have a similar effect;**
- **Any change that allows a taxpayer to delay tax payments will also cause an immediate negative effect on revenues; there is an old saying that “A tax delayed is a tax avoided.”**
- **When a tax rate is increased. for example, a nation levies a cigarette excise tax at the wholesale or distributor level, a common practice, there will be for retailers to greatly increase their inventory before the increase takes effect;**
- **A similar effect occurs in the case of previously untaxed items, or other increases in taxes on items collected at the wholesale level, such as fuel or alcohol.**



Drafting and unintended consequences



- **As inefficiencies in tax law drafting may result in serious inefficiencies in the economy, this structuring should be subject to far more scrutiny than is commonly the case;**
- **Tax law drafting and design is an inexact science, and a change in one provision (e.g. a minimum tax) can have ripple effects in other areas due to changing behavior and result in unintended consequences;**
- **This is more of a problem in tax law than in other public sector activities, as tax law is often interpreted by those hostile to it;**
- **Taxpayers whose desire to avoid or minimize taxation place them in opposition to the government's intent, and with problems quickly exploited by taxpayers to achieve financial savings;**
- **Unintended consequences can become difficult to reverse, as a new set of winners and losers can emerge from that change.**



Drafting and interpreting tax legislation



Drafting and interpreting tax legislation



- **The drafter should keep in mind the techniques of interpretation of tax legislation while drafting the law:**
- **Textualistic or literal approach, that the law says exactly what it means, and should be followed literally, word for word**
- **Intentional approach , that a law should be interpreted according to what the parliament and government wanted it to do.**
- **interpretive approach, that the law should be considered to mean within the context of changed circumstances. ask how the law would have been written, or what it would have intended.**



Techniques of interpretation of tax legislation



I. Internal tools to interpretation

The courts have developed a whole range of rules to interpret the legislation. Among the most commonly used rules are the following:

- The mention of one thing excludes another (“*expression unius est exclusus alterius*”).
- Word takes some of its meaning from the words with which it is used (“*noscitur a sociis*”).
- A general word is limited by the more specific words with which it is used (“*eiusdem generis*”) . *MNR v. Citibank Canada*, 2002 DTC 6876
- Words are used in their ordinary meaning unless a technical meaning is suggested by the other words in the statute.



Techniques of interpretation of tax legislation



- **Every word in a statute must be given effect.**
- **Different words have different meanings.**
- **Words are to be interpreted according to the rules of grammar and punctuation.**
- **The same word used in different places has the same meaning.**
- **“Shall” is mandatory and “may” is permissive.**
- **“And” is conjunctive and “or” is disjunctive.**



Techniques of interpretation of tax legislation



II. External Sources to interpretation

Court will refer to external sources for two principal purposes – to ascertain the general purpose of the law and to aid in interpreting a particular provision. A listing of external sources includes:

- The title, purpose clause, and section headings in the statute;
- Legislative history including committee reports;
- Related statutes;
- Similar statutes in other jurisdictions and judicial constructions of them;
- Administrative constructions.



Techniques of interpretation of tax legislation

Some of these references have their own canons of construction. They include the following:

- 1. a statute will be construed in accordance with its purpose;**
- 2. a remedial statute will be construed liberally;**
- 3. a statute of derogation will be construed strictly;**
- 4. statutes “*in pari materia*” must be construed together;**
- 5. definitions and rules of construction in an interpretation statute will be followed;**
- 6. titles, purpose clauses, and section headings are not controlling but may be used as guides to meaning;**
- 7. words and phrases that received judicial construction before enactment are to receive the same construction;**
- 8. constructions of an administrative agency charged with administering the statute are to be followed unless clearly erroneous.**



Conclusion



- **The goal of a modern tax system is to maximize voluntary compliance based on self-assessment, taxpayers must first be aware of the law and second understand it, at least in time to comply;**
- **Once the draft law is enacted, it is important to keep it current and prevent the need for periodic massive changes.**