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strategy**

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Tax Simplification is Not a Simple Issue: The Reasons for Difficulty and a Possible Strategy¹

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are very welcome.

Abstract

Simplicity is an important attribute for a tax system and there have been many attempts at simplification in different countries including, of course, Australia. However these attempts have not been very successful. The main reason is that there are, of course, important factors that cause tax systems to be complex and not all of them are bad. Another important matter is that it is not always clear what is meant by tax simplification. A further difficulty has been that attempts at simplification have often been made on an *ad hoc* basis and, once the enthusiasm has exhausted itself, the trend towards greater complexity continues. It is therefore suggested that what is needed is a strategy for simplification. This should involve establishing the relative importance of simplification compared to other aspects of the tax system. Progress towards simplification should then be monitored and evaluated on a permanent basis. To ensure a balance between tax simplification and other goals it is proposed that a body be established to monitor on a permanent basis the tax system, the environment in which it operates and proposed tax reforms.

Introduction

In 2005 the Australian Taxation Office was awarded second place in the Plain English Campaign Golden Bull awards² for Section 165-55 *A New Tax System (Goods and Services Tax) Act 1999*:

For the purpose of making a declaration under this Subdivision, the Commissioner may:

- a) treat a particular event that actually happened as not having happened; and
- b) treat a particular event that did not actually happen as having happened and, if appropriate, treat the event as:
 - i) having happened at a particular time; and
 - ii) having involved particular action by a particular entity; and
- c) treat a particular event that actually happened as:
 - i) having happened at a time different from the time it actually happened; or
 - ii) having involved particular action by a particular entity (whether or not the event actually involved any action by that entity).

In fairness, the role of the ATO is to administer the law, not to draft it, so the ‘credit’ for this distinction probably lies elsewhere. For those interested, the overall winner in 2005 and for the second time was Rhodri Morgan, Welsh First Minister, for: ‘The only thing which isn't up for grabs is no change and I think it's fair to say it's all to play for, except for no change’.

There are also plenty of taxation illustrations from other countries. One UK example³ is:

Take notice that by virtue of Regulation 27A of the Income Tax (Employments) Regulations 1973 (as inserted by Regulation 5 of the Income Tax (Employments) (No. 15) Regulations 1985, Regulation 8A of the Income Tax (Sub-Contractors in the Construction Industry) Regulations 1975 (as inserted by Regulation 4 of the Income tax) (Sub-Contractors in the Construction Industry) Regulations 1985, and Regulation 27A inserted in Schedule 1 to the Social Security (Contributions) Regulations 1979 by Regulation 3 of the Social Security (Contributions) Amendment Regulations 1985.

Another is the following letter⁴ of explanation from the Inland Revenue (now HM Revenue and Customs):

Your accountant is correct in his advice to you as in accordance with the Legislation contained at Section 134 Income & Corporation Taxes Acts 1988 it is directed that where an individual (the worker) renders or is under an obligation to render personal services to another person (the client) and is subject to or to the right of supervision, direction or control as to the manner in which he renders those services; and the worker is supplied to the client by or through a third person (the agency) and renders

²Plain English Campaign (2005) <http://www.plainenglish.co.uk/bull05.htm#aus>. Accessed 23 October 2006.

³ <http://www.plainenglish.co.uk/bull85.htm#ir> accessed 27 January 2007

⁴ <http://www.plainenglish.co.uk/bull98.htm#ir> accessed 27 January 2007

or is under an obligation to render those services under the terms of the contract between the worker and the agency and remuneration receivable under or in consequence of the contract would not, apart from Section 134 be chargeable to income tax under Schedule E then for all the purposes of the Income Taxes Acts the services which the worker renders or is under an obligation to render to the client under the contract shall be treated as if they were the duties of an office or employment held by the worker and all remuneration receivable under or in consequence of that contract shall be treated as emoluments of that office or employment and shall be assessable to income tax under Schedule E accordingly.

So that clears that up!

Of course, academics in glass houses should not throw too many stones – the Institute for Fiscal Studies won its 2006 Golden Bull⁵ for a website document description:

While the literature on nonclassical measurement error traditionally relies on the availability of an auxiliary dataset containing correctly measured observations, this paper establishes that the availability of instruments enables the identification of a large class of nonclassical nonlinear errors-in-variables models with continuously distributed variables.

It may well be possible to provide a more accessible description. It does remind one of the wisdom in the observation attributed to Rutherford – that if a scientist cannot explain to the lady who cleans his laboratory what he is doing then he doesn't know what he is doing.

Complexity does not just involve the language – the quantity of legislation also contributes to the problem. For example Australian GST legislation consists of:

- A New Tax System (Goods and Services Tax) Act 1999
- A New Tax System (Goods and Services Tax Transition) Act 1999
- A New Tax System (Goods and Services Tax Imposition - Customs) Act 1999
- A New Tax System (Goods and Services Tax Imposition - Excise) Act 1999
- A New Tax System (Goods and Services Tax Imposition - General) Act 1999
- A New Tax System (Goods and Services Tax Imposition (Recipients) - Customs) Act 2005 (1 of 2005)
- A New Tax System (Goods and Services Tax Imposition (Recipients) - Excise) Act 2005 (2 of 2005)
- A New Tax System (Goods and Services Tax Imposition (Recipients) - General) Act 2005 (3 of 2005)
- A New Tax System (Goods and Services Tax Transition) Regulations 2000
- A New Tax System (Goods and Services Tax) Regulations 1999

⁵ <http://www.plainenglish.co.uk/bull06.htm#ifs> Accessed 27 January 2007

Westminster Hall; all of which stuff you must carry in your mind at once, if you would make head of tail of it; for it makes altogether but one sentence; so well to they understand the art of poisoning language in order to fleece their clients. All which deeds might be drawn, not only more intelligibly, but surer, in short sentences, and in a twentieth part of the room.

The problem is not necessarily solved by simplifying the language used in tax literature. When Lloyd George was Chancellor of the Exchequer the Board [of Inland Revenue] sent him a paper expounding the technicalities of the estate duty charge on settled property. Lloyd George rejected this paper and demanded an explanation in words of one syllable. The Board sent a new paper – in words of one syllable; but it was reported that the subject matter remained as complicated as before and the monosyllables made it rather harder to understand.⁹

The Tax System Reflects General Trends

Complexity is not, of course, confined to taxation and tax to some extent reflects trends in public administration and society more generally. A sobering book¹⁰ was published by Ross Clark in 2006 on the explosion of regulations. Although he had plenty of examples for the title of his book, he chose *How to Label a Goat* - taken from the Sheep and Goats (Records, Identification and Movement)(Wales) Order 2006 regulating the size, shape and colour of ear tags on Welsh sheep and goats – it runs to 45 pages of densely written legalistic language. It is not an isolated example – in the year to 31 May 2006, the UK Government passed 3,621 separate pieces of legislation¹¹ – an average of more than 10 new sets of rules and regulations for every day of the year. On the basis of a sample of 10 per cent of this regulatory output, Ross estimated that the year's output alone was 72,400 pages of legislation and 26,200 of explanatory notes – a grand total estimated at 98,600 pages. The UK, of course, is subject to European Union legislation – which has made a massive contribution to the growth of legislation overall.

Plenty of legislation is also a general feature of modern tax systems. Peter Cussons¹² measured the number of pages of primary federal tax legislation found that Australia had 7,750. This was less than India with 9,000 pages and the United Kingdom with 8,300 but more than Japan (7,200), the United States (5,100) and just about everywhere else. Of course the number of pages of primary legislation is only crudely related to the complexity of tax systems and there is also secondary legislation in the form of regulations, case law, revenue authority interpretations and formal tax rulings but such figures indicate that the problem is not a small one.

⁹ Sir Alexander Johnson, *The Inland Revenue*, 1965, Allen & Unwin, London.

¹⁰ Ross Clark, *How to Label a Goat: The Silly Rules and Regulations that are Strangling Britain*, 2006, Harriman House, Ltd, Petersfield, Hampshire.

¹¹ *Op. cit.* p. 5.

¹² 'The increasing Burden of Tax Administration and Compliance' in *Paying Taxes: The Global Picture*, PriceWaterhouseCoopers and the World Bank, <http://www.pwc.com/extweb/pwcpublishings.nsf/docid/6FE224AC0BA720BB85257214004DA2E9> accessed 16 February 2007.

The Disadvantages of Complexity

There are some fairly obvious costs to complexity – particularly in administration and the costs to the community of complying with the tax system.

The connection between complexity and compliance and administrative costs is itself complex, but generally the more complexity the higher the costs. Furthermore, estimates of compliance costs have limitations which are sometimes considerable. One in particular is that surveys of compliance costs often include only those who are economically active in a particular way. Those who do not participate, for example who do not run a small business because of the complexity of tax and other regulations, are often not included in compliance cost studies.

In addition, overly complex and obscure legislation might reduce the willingness of taxpayers to comply voluntarily with the requirements of the tax system. This is particularly important with a system of self-assessment. To the extent that complexity impedes clarity it may also make the estimation of future revenue and costs more difficult and will therefore make economic decision-making harder.

It may also generate unfairness because, for example, not everyone is equally able to take advantage of the various complexities of a tax system. Finally complexity makes useful discussion of tax policy and the introduction of improvements more difficult.

The Advantages of Simplicity

The benefits of simplicity are generally, of course, the opposite of the costs of complexity - to reduce the burden of administration and compliance and probably improve the willingness to comply with the tax system. There is also a more general point: that the main purpose of most taxes is to pay for public expenditure. A tax system that is unnecessarily complicated might reduce public support for the improvement of important public services.

Do Taxpayers want Simplification?

A simple tax system obviously avoids the drawbacks of a complex one and, other things being equal, a simple tax will normally be preferred to a more complex one. However, there are many other aspects to a tax system. For example, one of the most important characteristics of a tax is that it must be seen to be fair. A simple tax may not take sufficient account of personal circumstances to meet this criterion. A good illustration was the UK Community Charge, or ‘poll tax’. It was simple in that it was basically a fixed charge for each person in a particular local authority jurisdiction. In terms of the economic criteria for a good tax, the poll tax also scored highly because it does not vary with economic behaviour and should not, therefore, cause people to do odd things for tax reasons. However, the tax failed on the criteria of fairness. The historical precedents were not encouraging. The Rising of 1381 originated from a

hatred of the poll tax.¹³ The Archbishop of Canterbury who, as Chancellor of the realm, represented the government was beheaded by Wat Tyler's men on Tower Hill and, quite remarkably, the rebels captured London itself. The modern version of the tax was introduced in Scotland in 1989 and in England and Wales in 1990. Nevertheless, as in the fourteenth century, its perceived unfairness demonstrated¹⁴ the power of taxation to influence behaviour, led to serious civil disobedience¹⁵ and was a factor in the events leading to the resignation of Mrs Margaret Thatcher as Prime Minister.¹⁶

More generally, when it comes to matters of fairness in taxation complexity often wins over simplicity. In Australia there is currently a tax free threshold of \$6,000 then tax rates of 15%, 30% (at 25,000), 40% (at 75,000) and 45% (at 150,000). The tax system would be much simpler if there were a zero tax free threshold and a flat rate of tax. There could be a flat rate deduction at source for wages, interest, dividends etc. and many individuals would not then have to lodge a tax return. Such a system may not be regarded as being fair compared to what exists now. Also if Australia had the UK system of generally not allowing employees' tax deductions for work related expenses it would have a simpler system but that might not be considered so fair.

Reasons for Complexity

Good though simplicity is, there are other considerations. The primary purpose of taxation is usually to raise revenue to support public expenditure and often to redistribute income. Tax systems are also used to support a range of other government policies. It would be inconsistent if these aims were not taken into account in the taxing process itself. Hence the role of 'tax expenditures' where some fiscal advantage is conferred on a group of taxpayers or a particular activity by reducing tax liability rather than by a cash subsidy – a phenomenon first extensively analysed by Surrey.¹⁷ The tax system may be used to impose a fiscal disadvantage on areas that are perceived to have disadvantages. Hence taxes can be used to correct adverse 'external effects' such as pollution and 'green taxes' generally together with 'sin taxes' such as those on alcohol and tobacco. Necessarily such provisions involve discrimination in the taxation of different activities and therefore add to complexity in themselves.

However, it is not always easy to use the tax system to achieve the intended aims effectively. Taxpayers are not always passive and some who were not the intended beneficiaries of the concession might find they can also advantage of it. The government may then try to attempt to stop them so adding further layers of complexity. An example was the UK Parliament's desire to avoid imposing value

¹³ G.M. Trevelyan, *English Social History*, 2nd ed. 1946, Longmans, Green and Co.

¹⁴ P. Smith, 'Lessons from the British Poll Tax Disaster', *National Tax Journal*, 1991, Vol. 44; J. Cullis, P. Jones and O. Morrissey, 'Evaluating the Poll Tax as a Tax Reform', *Local Government Studies*, 1993, Vol. 19.

¹⁵ D. Mair and R. Damania, 'Fiscal Crisis and Local Government Reform', *Local Government Studies*, 1992, Vol. 18.

¹⁶ J. Gibson, *The Politics and Economics of the Poll Tax, Mrs Thatcher's Downfall*, EMAS, 1990.

¹⁷ S.S. Surrey, *Pathways to Tax Reform*, 1973, Harvard University Press.

added tax on children's clothes. This involved establishing the definition of a child. If it is simply the age of a child then clothes sold for large children could be used by small adults. If it is based on the size of the child then the concession would be available to small children but not to large ones. Similar problems arose in trying to exempt food from value added tax. Originally take-away meals were exempt from VAT but not meals eaten on the premises. Since this was open to abuse, the rule was changed so that hot take-away food from restaurants was brought into tax. Hence caviar as a cold food is exempt from VAT food but fish and chips are not.

More generally moves to limit tax avoidance are one of the biggest causes of tax complexity. Taxpayers, or frequently their advisers, find some opportunity to exploit some aspect of the tax system and the official response is often more complex legislation to restrict their ability to do so. Taxpayers then find ways round those measures by developing more complex ways to avoid the new rules and so it goes on.

Nevertheless, one of biggest reasons for complexity is the desire for fairness between taxpayers. The tax system has to be designed, at least to some extent, to fit the particular circumstances of taxpayers. This is reinforced by the sheer weight of taxation in modern industrial countries. At low levels taxation can be relatively simple, that is rough and ready, in respect to taxpayers' circumstances. As the amount of taxation grows then more people will be affected in more ways and the tax system will have to be more closely aligned to their circumstances if the burden is not to become unbearable.

Another factor is the nature of tax law itself. As already indicated, complexity arises because taxation reflects wider economic and social trends. There is not much doubt that one important trend in the environment in which taxation has to operate is the increasing complexity of socio-economic systems.¹⁸ Hence Prebble's view¹⁹ is that complexity arises from trying to fit the law around the 'natural facts of economic life'. And it does not always fit. To take a fairly central issue, Vickrey²⁰ suggested that complications in the legislation and administration of income tax arise largely from the need to answer four types of question:

1. Is it income?
2. Whose income is it?
3. What kind of income is it?
4. When is it income?

Which leads into all sorts of wonderful discussions about the definition of income, capital gains, business profits and so on.

Surrey's view²¹ was that tax law complexity arises from:

¹⁸ S. James, 'The Future International Tax Environment and European Tax Harmonisation: A Personal View,' *European Accounting Review*, 1999, Vol. 8(4) pp. 731-747.

¹⁹ J. Prebble, 'Why is the Tax Law Incomprehensible?' *British Tax Review*, 1994, pp. 380-93.

²⁰ William Vickrey, 'Tax Simplification Through Cumulative Averaging', *Law and Contemporary Problems*, 1969, Vol. 34(4), 736-750 at p. 736.

²¹ S.S. Surrey, 'Complexity and the Internal Revenue Code: The Problem of Management of Tax Detail', *Law and Contemporary Problems*, 1969, Vol. 34, 673.

complex substantive tax rules with complex inter-relationships characterised by complex variations in the tax treatment of transactions often not differing greatly in substance or form, all of which are expressed in a complex statutory terminology and arrangement.

At least some of this, however, is clearly necessary. As Sir Ernest Gowers, a former Chairman of the Board of Inland Revenue, wrote in his *Complete Plain Words*,²² though with respect to a different example of legal language:

[The] sentence is constructed with that mathematical arrangement of words which lawyers adopt to make their meaning unambiguous. Worked out as one would work out an equation, the sentence serves its purpose; as literature it is balderdash.

There is often an attempt to cater for every eventuality which, particularly in a complex and changing economic and social environment, can only lead to greater complexity. One possibility might be greater use of purposive law rather than ‘black letter’ law. Avery Jones, for example, has argued²³ for less detailed legislation in line with principles and ‘not a continuation of the plague of tax rule madness’.

So, what can be done? A good start can be made by examining what is meant by simplification. Even that is not particularly simple.

What is Simplification?

Cooper²⁴ suggests there are at least 7 issues:

1. Predictability – in this context, a rule would be simple if that rule and its scope were easily and accurately understood by taxpayers and their advisers.
2. Proportionality. A rule would be simple if the complexity of the solution were no more than reasonably necessary to achieve the intended aim.
3. Consistency. This would apply where a rule deals with similar issues in the same way and without the need to make arbitrary distinctions.
4. Compliance. A rule would be simple if it were easy for taxpayers to comply without incurring excessive costs.
5. Administration. A rule would be simple if it were easy for a revenue authority to administer.
6. Co-ordination. A rule would be simple if it fitted appropriately with other tax rules; it would be complicated if its relationships with other rules were obscure.
7. Expression. A rule would be simple if it were clearly expressed.

²² Sir Ernest Gowers, *The Complete Plain Words*, 1954, London, HMSO.

²³ J. Avery Jones, ‘Tax law: rules or principles?’ *Fiscal Studies*, 1969, Vol. 17(3), pp. 63-89.

²⁴ G.S. Cooper, ‘Themes and Issues in Tax Simplification’, *Australian Tax Forum*, 1993, Vol. 10, pp. 417-60.

Simplification at Different Levels

Cooper also suggested that simplification could be seen as being at different levels. The first level is the choice of the tax base, whatever that may be. The second is the design of the rules to be applied to the tax base. The third is in the expression of those rules and the final level of complexity is the administrative requirements imposed on taxpayers.

This, of course, demonstrates the importance of ensuring that simplification at one level does not cause difficulties at other levels.

What Can be Done?

Simplification at one level is possible though still needs to be co-ordinated with other levels and aspects of the system. The author can recall attending a presentation where an academic graphic design specialist had offered to help the Revenue and redesigned part of an Inland Revenue form. This was before that aspect of the tax system had been computerised and the designer had improved one part of the form only. The result was impressive. Text had been moved around the form as well as good improvements in graphics, layout and presentation. Sadly, however, the designer had not troubled herself to understand the role of the form. In that pre-computerised document the four part form had been designed so that the completion of the top copy by the tax officer would simultaneously produce three carbon copies below - all different because they were designed for different purposes. The designer was very pleased with her work but did not discover that the only purpose of this exercise was public relations - to respond to her lobbying by giving her something to do! Unfortunately she had not taken a systematic approach to her proposals for improvement and her efforts were worthless – except as an object lesson of the importance knowing as much as possible about what it is you are trying to improve.

It is possible to avoid large numbers of taxpayers having to complete a tax return at all. In the UK most taxpayers are not required to complete a tax return each year because the cumulative tax Pay-As-You-Earn system can withhold tax to a very high degree of accuracy.²⁵ There has also been success with simplified returns such as the US 1040EZ. Furthermore, with advances in technology it is also becoming feasible to issue returns which already include information about the taxpayers' circumstances that has been supplied by third parties electronically.²⁶

There is plenty of scope for the maintenance of good communications with taxpayers with improvements in forms, explanatory leaflets and so on.²⁷ Others have also suggested more positive help for taxpayers.²⁸

²⁵ Simon James, and Ian Wallschutzky, 'Should Australia Adopt a Cumulative Withholding Tax System?' *Australian Tax Forum*, 1994, Vol. 11(3), pp. 311-335.

²⁶ R. Highfield, 'Pre-populated Income Tax Returns', 7th International Tax Administration Conference, 2006, ATAX, Faculty of Law, University of New South Wales.

²⁷ S. James, A. Lewis, and F. Allison *The Comprehensibility of Taxation: A Study of Taxation and Communications*, 1987, Avebury, Aldershot.

²⁸ P. A. Hite, 'A Positive Approach to Taxpayer Compliance,' 1989, *Public Finance*, Vol. 44, pp. 249-266.

Although there are, of course, reasons why tax law may be complex, there is often scope for simplifying it. Like many other people Lord Howe has pointed out that plain language law – which is clear and user-friendly - is obtainable and the key components are:

a clearer structure of what it is intended to achieve; much shorter sentences, clearer and better signposted definitions; modern design and layout and headings that help the user.²⁹

In the 1990s improving the language seemed to be the way forward and the tax law improvement projects were set up.

Tax Law Reviews

In both Australia and the UK there have been tax law review projects. In the UK the Tax Law Review Committee was set up in 1994 to rewrite tax legislation in plain English and examine explanatory documentation. In Australia the process began with a report produced by the Joint Committee of Public Accounts in 1993³⁰ and the Tax Law Improvement Project (TLIP) was set up with the task of improving the ‘understanding of the law, its expression and its readability.’ There is no doubt that improvements have been made though such attempts have not always been well received. For example, in Australia Geoffrey Lehmann referred to some of the rewritten law as ‘kindergarten babble’. He cited ‘Your assessable income includes income according to ordinary concepts, which is called ordinary income’. Warming to his theme, Lehmann suggested that ‘the rewrite of the core provisions has not resulted in simple legislation, but a loquacious, patronising and confused babble of educationese. Reading it is like trying to wade through styrofoam mixed with treacle.’³¹

There are two main reservations about simplifying tax law in this way. The first is that rewriting the law may inadvertently change its meaning in places when over many years Courts have gone to considerable trouble to establishing precise meanings. The second is that taxpayers themselves do not normally read primary tax legislation and therefore there is no need to direct it at them. The present author got the impression at the time that the tax law rewrites were seen as the solution to the problem of excessive complexity but, certainly on their own, they are not.

An initial part of the Australian rewrite duly appeared as the *Income Tax Act 1997*. In reviewing the position, Krever³² pointed out that a superficial look at that Act seemed

²⁹ Geoffrey Howe, ‘Tax Law Simplification in the United Kingdom’ in C. Sandford ed., *Further Key Issues in Tax Reform*, 1998, p. 108.

³⁰ Summarised by the Tax Law Review Team, *The Broad Framework*, 1994, Canberra, Australian Tax Office.

³¹ G. Lehmann, ‘The reform that does not reform and the simplification that does not simplify - The Tax Law Improvement Project Fiasco’, *Butterworth’s Weekly Tax Bulletin*, 1995, no. 33, pp. 530-33.

³² Richard Krever, ‘Taming Complexity in Australian Income Tax’, *Sydney Law Review*, 2003, Vol. 25, pp. 467-505.

to support the view that the complexity of the system was the fault of the drafters of earlier legislation. However he went on to say that taxpayers and their advisers soon discovered that, although the new legislation was easier to read and comprehend than what had gone before, the complexity was still there. In fact the process had exposed the true cause of the previous law's complexity – that is its 'wholly irrational and inconsistent policy base.'³³ Furthermore, TLIP seemed to have distracted attention from the normal process of revising tax legislation outside the project where problems continued and might even have increased. In the UK the Tax Law Review Committee's final report³⁴ listed three types of complexity – linguistic, policy and compliance – and acknowledged that a comprehensive tax reform would have to address all three areas (paragraph 6.10). The Committee also stated that 'without policy changes the benefits from rewriting legislation are limited' (paragraph 12).

A recent Australian contribution has been the Taylor Report³⁵ on reducing tax law complexity and it makes a number of recommendations for improvement.

A More Systematic or Strategic Approach

Although initiatives such as tax law improvement are to be welcomed, in both Australia and the UK they were limited in that they were concerned with only part of the problem, complexity of language, and sometimes that is only a small part of the problem. There was no attempt to address the underlying complexity of the tax system and the process of tax reform generally from which such complexity arises.³⁶ Therefore it is this wider perspective that should be considered but the special case of small businesses will be briefly mentioned first.

Small Businesses

A very important sector in particular need for the tax system to avoid unnecessary complexity is small business. There is certainly widespread support for help for small businesses³⁷ and for good reason. Among other things, small enterprises, and particularly very small ones, do not normally have the expertise and other resources to cope with complexity. However, special provisions may be possible. For example, in the UK small businesses with a very modest turnover are assisted by arrangements for the submission of simplified accounts – requiring only the figures for turnover, expenses and net profit - to HM Revenue and Customs. Of course more could be done in this direction such as increasing the turnover limit – which was last increased in 1992. An Australian example might be GST – it is not compulsory for a business to

³³ *Ibid.*, at p. 493.

³⁴ Tax Law Review Committee, *Final Report on Tax Legislation*, 1996, London, Institute for Fiscal Studies.

³⁵ C. John Taylor, *Beyond 4100: A report on measures to combat rising compliance costs through reducing tax law complexity*, (2006), Sydney, Taxation Institute of Australia.

³⁶ See, for example, Simon James and Alison Edwards, *A Strategic Approach to Personal Tax Reform*, paper presented to the Personal Income Tax Symposium, to be presented at the Australian School of Taxation, University of New South Wales, Sydney, April 2007.

³⁷ See, for example, D. Holz-Eakin, 'Should small businesses be tax-favoured?' 1995, *National Tax Journal* Vol. XLVIII, No. 3, 387-395

register for GST unless turnover exceeds \$50,000. By not registering for GST businesses save themselves the need to lodge Business Activity Statements (BAS). These are usually lodged every quarter though some small traders can elect to lodge annually. However, unless they register businesses cannot claim input tax credits on acquisitions.

A Strategy for Simplification

There is also good reason to promote simplicity for all taxpayers and the way forward seems to be to develop a sustainable strategy for simplification that is embedded in a more systematic or strategic approach to tax reform generally.

The academic discipline that has paid most attention to the subject of developing strategy is Management. An essential input in the development of successful strategies is the systematic analysis and understanding of the factors involved. This includes the wider environment in which the activity is being conducted as well as the areas of immediate concern. A key part in the development of strategy is implementation. Henry Mintzberg³⁸ is one of the most prominent management scholars in this area and he believes that strategy is an interactive process requiring constant feedback between thought and action and that successful strategies evolve from experience. He also stresses the importance of strategists having expertise in the area and that they should not simply pontificate at a high level of abstraction and leave it to others to implement the strategies (and certainly not blame them for any shortcomings in the strategy). Other commentators such as Grant³⁹ are also clear that the formulation and implementation of strategy go together. A well-designed strategy should take account of the process of implementation and it is through the implementation that a strategy can be refined and reformulated.⁴⁰

In terms of tax simplification the process may be summarised in four main areas:

- Evaluate the importance of different aims of tax policy.
- Incorporate simplification into the tax policy process itself.
- Develop a ‘simplification culture’.
- Monitor and review progress.

As already stated, simplification is not the sole aim of tax policy – indeed it is incidental to the main purposes of taxation. For long term improvement to be achieved, the relative importance of simplification to other goals should be established – and this may change over time so the process must be a continuing one. In the UK the Revenue has encouragingly discussed the creation of a ‘simplification “culture” within the Revenue which it is important to maintain and encourage.’⁴¹ It is

³⁸ H. Mintzberg, *Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*, 2004, San Fransisco: Berret-Koehler, Publishers, p. 55.

³⁹ R. M. Grant, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, 4th ed., 2002, Oxford: Blackwell.

⁴⁰ S. James, ‘Tax Compliance Strategies to Tackle the Underground Economy’ in Chris Bajada and Freidrich Schneider (eds.) *The Size Cause and Consequences of the Underground Economy: An International Perspective*, 2005, Ashgate, pp. 275-289.

⁴¹ Inland Revenue, *The Path to Tax Simplification: A Background Paper*, 1995, London, HMSO.

also desirable that such a culture should extend to the tax policymaking process as well. It is important to be able to measure the outcome to establish how far the aims have been achieved and whether they are being maintained and different approaches to such measurement have been examined by Wallschutzky.⁴²

A Proposal

It is quite likely that any project to simplify taxation on its own will not achieve lasting success – the forces generating complexity are simply too strong. There is also the key point that the simplest possible tax system is not the aim. There is a trade-off between simplification and other goals.

The direction of possible lasting improvement might be indicated by the conduct of monetary policy. The main economic policies available to governments are monetary policy – associated with interest rates and the money supply and fiscal policy – taxation and public expenditure. In the UK, while the Government retains final control of the aims and objectives of monetary policy, in 1997 it granted operational independence to the Bank of England in setting interest rates. Section 11 of The Bank of England Act 1998 states that the objectives of the Bank of England in respect to monetary policy shall be (a) to maintain price stability and (b) subject to that to support the economic policy of the government including its objectives for growth and employment. However the Bank's Monetary Policy Committee is free to pursue these objectives by setting interest rates without reference to the government of the day. Similarly in Australia the Reserve Bank Board sets interest rates independently of the political process. Such arrangements are also used in other countries in order to avoid the political manipulation of interest rates and to ensure that monetary policy is used to pursue long-term goals.

Fiscal policy in many ways is so bound up in almost every conceivable way with the operation of the economy and government influence over it that it is hard to imagine any government passing operational control to an independent body in the way that it has been done with monetary policy. However, perhaps it might be worth exploring the possibility suggested by Dr Ian Wallschutzky,⁴³ that an independent contribution to the development of tax strategies could be advantageous. Currently most of the input in this area comes from *ad hoc* enquiries and miscellaneous contributions from both the public and private sectors. If an appropriate body were charged with the responsibility of collecting the information necessary to develop strategies on a permanent basis, it could offer systematic guidance to the process of reforming taxation over time. An obvious example is in observing how inflation and economic growth is affecting the tax structure. Such a body could also take account of other factors such as economic growth and economic and social change more generally, both nationally and internationally. There may even be scope for some limited aspects of the tax system to be changed, in much the way interest rates are for monetary policy, without the need for direct government involvement. An example is the way some countries have linked tax thresholds to inflation.

⁴² I.G.Wallschutzky, 'TLIP: Stage 1 – Benchmarking', *Australian Tax Forum*, 1995, Vol. 12, pp. 115-55.

⁴³ In discussion with the author.

In the UK in 2006 the Tax Reform Commission suggested in its report⁴⁴ that a Joint Parliamentary Select Committee should be created to improve parliamentary scrutiny of tax legislation. It also suggested the creation of an Office of Tax Simplification (OTS) that would report to the Select Committee. The OTS would be set up along the lines of the National Audit Office (which reports to the Public Accounts Committee), producing reports and becoming an ‘authoritative, independent voice on tax law.’⁴⁵ Its remit would be twofold. First of all to review current tax law and make proposals for its simplification. Secondly it would examine proposed legislation to determine whether it is consistent with the principles of tax law and whether the proposal itself is reasonably simple.

However there is a risk that such a specialised arrangement might become sidelined. The suggestion here is for an arrangement with a much wider remit, covering all relevant aspects of the tax system and its operation, and including simplification as a standard dimension on which taxes must be continually assessed.

There would be no shortage of work for such a body. Particular aspects include attempts at weighing up the importance of different aspects of the income tax. For example, how far should the income tax be tailored to individual circumstances and how far should simplicity be sought and complexity be limited. Clearly answers to questions such as this may change over time and be different in different contexts. Another substantial task is analysing the economic, social, political and technological environment in an international context⁴⁶ and the implications for the successful operation of the tax system.

There is clearly scope for a more detailed analysis of the possible role and powers of such a body. Some existing bodies might have the potential to play at least part of this role. The Australian Tax Research Foundation, for example, exists to undertake independent and impartial research into the reform of taxation. The Taxation Institute of Australia and the Australian Taxation School of Taxation (Atax) also come to mind.

What seems very clear is that the present situation, in which complexity continues to grow until there is an *ad hoc* response, is not the optimal arrangement. In addition to anticipating necessary change, such an independent authority could also assess other proposals systematically for suitability for implementation. It has been suggested that the political process might provide temptations to generate tax changes, and more complexity, in order to improve short-term popularity rather than long stability – for example, there have been many contributions to the literature on the political-business cycle since Kalecki’s contribution over half a century ago.⁴⁷ With elections taking place at least once every five years in the UK and once every three years in Australia, an independent authority might be a powerful force for rational decision-making with respect to tax reform.

⁴⁴ Tax Reform Commission, *Tax Matters: Reforming the Tax System, Report of the Tax Reform Commission*, October 2006 <http://www.taxreformcommission.com/>, p. 111.

⁴⁵ *Ibid.*, p. 112.

⁴⁶ See, for example, Simon James, ‘The Future International Tax Environment’, *International Tax Journal*, 1999, Vol. 25(1), pp. 1-9.

⁴⁷ M. Kalecki, ‘Political Aspects of Full Employment’, *Political Quarterly*, 1943, Vol. 14(4), 322-310,

Conclusions

Tax simplification is a very desirable aim but previous attempts at achieving it have not been very successful. One of the main reasons is that there are some important reasons why tax systems are complex and those wishing to simplify the tax system must take account of them. That is also the way towards an optimal tax system overall. The best tax system is unlikely to be the simplest. Therefore there must be a process to weigh up the trade-offs between simplicity and the other aims, objectives and realities of a tax system and the environment in which it has to operate. The failure to do this seems to have been the main underlying reason why previous initiatives have not had the success their supporters had hoped might have been achieved. For permanent improvements in tax simplification, and other aspects of the tax system, there should be a permanent and comprehensive approach to taxes and tax reform.

Appendix Comments on these Issues are Very Welcome

We are currently conducting a research project into ‘Optimum Tax Compliance Costs and Tax Simplification’ and welcome as many views on the issues as possible.

Summary of the Project

It is not difficult to demonstrate that the costs of complying with tax systems are often high or that tax systems are complex. However the purposes of tax systems and the environment in which they have to be administered often necessarily involve high compliance costs and that at least some tax provisions will be very complex. The issue is to balance reform in these areas with other important considerations. The aim of this project is therefore to identify the main factors that should be considered in developing a strategy regarding compliance and tax simplification taking account of the needs of taxpayers and tax systems more generally. Such an approach should, for example, improve understanding of how to improve tax compliance without resorting to methods that might be seen as heavy handed and punitive. An excessive reliance on such methods might reduce the willingness of taxpayers to comply voluntarily and undermine other government policies such as promoting economic enterprise in general and small businesses in particular. The project is based mainly on an analysis of the contribution of existing research together with the views of tax agencies and tax advisers.

All comments and contributions on these matters would be very welcome and should be sent to:

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