

# Tax simplification: A review of initiatives in Australia, New Zealand and the United Kingdom

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## ***Abstract***

This paper examines the role of tax simplification in the operation of a tax system as a whole and then uses that framework to analyse initiatives in Australia, NZ and the UK. We begin with the subject of simplification itself and what it can mean, and follow this with a discussion concerning how to simplify tax systems. The paper then focusses on three key steps with simplifying tax systems, namely: simplifying tax law, simplifying taxpayer communications and simplifying tax administration.

The paper then examines several long term approaches to simplification, such as the Office for Tax Simplification in the UK and the TWG in NZ. The paper observes the contrasting approach of Australia, such as pre-filing tax returns, which has not simplified its tax system. Prior to the concluding observations, the paper suggests that the establishment of some form of independent authority may enable effective simplification of the tax systems in the three jurisdictions reviewed.

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*The complexity of our code in the main is not there because of some mischief. Most of it is there in the effort to do more perfect justice.*

Senator Russell Long, Former Chairman, US Senate Finance Committee<sup>2</sup>

*[We] will first settle the broad outline of the kind of tax system it would like to see established eventually and work back from that to the changes in the present system that would have to be made before that long-term aim could be realised*  
(Asprey Review)<sup>3</sup>

*[T]he Review has taken a systemic approach in redesigning the tax and transfer system ... that is, the Review has evaluated specific taxes and transfers from the perspective that each is a part of a single national tax and transfer system. Recommendations on the implementation of reforms as they affect the system's administration, the client interface and the assignment of revenue within the federation also reflect this perspective.*  
(The Henry Review)<sup>4</sup>

## 1. INTRODUCTION

Simplicity is an important attribute for a tax system and there have been many attempts made to simplify tax systems in different countries. 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. Taxes are primarily used to raise revenue but are also a valuable instrument for achieving government policies through influencing taxpayer behaviour.

The aims of particular taxes have to be achieved in a complex and changing socio-economic environment where issues such as fairness also have to be given appropriate consideration and many attempts at simplification have not given sufficient consideration to the relative importance of all the key aspects involved. Indeed there is evidence that taxpayers in general may prefer fairness to simplicity and this necessarily then involves a balancing between competing tax policy principles as both are ideally desirable in a good tax system. An important example is the United Kingdom (UK) community charge or 'poll tax', which was about as simple as a major tax could be, but taxpayers considered it to be unacceptably unfair and it generated such powerful negative responses it had to be repealed.

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, trends towards greater complexity continue. We comment on how the Internet (and e-commerce more specifically) will continue to make tax systems more complicated and observe how simple systems are open to avoidance and evasion which will in turn inevitably lead to change (which adds to complexity).

Comparative research enriches our understanding through exploring similarities and differences between jurisdictions which can provide policymakers and other researchers with the opportunity to reflect upon the implications of different choices,

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2 Quoted by Sheldon D. Pollack, 'Tax Complexity, Reform, and the Illusions of Tax Simplification' 2 Geo. Mason Indep. L. Rev. [iii] (1993-1994) at 319.

3 Taxation Review Committee, Full Report, 1975, para 1.12.

4 Australia's Future Tax System, Final Report, 2010, Part 1, Overview, Chapter 2.

as well as provide a benchmark for other jurisdictions that may contemplate similar tax reform.

In 2005 the Australian Taxation Office (ATO) was awarded a Plain English Campaign Golden Bull award<sup>5</sup> 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:
  - c) having happened at a particular time; and
  - d) having involved particular action by a particular entity; and
- e) treat a particular event that actually happened as:
  - f) having happened at a time different from the time it actually happened; or
  - g) 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 award may lie elsewhere. However, this example illustrates the pressures on tax systems and the purpose of this particular piece of legislation is examined further in section 3.4 of this paper which deals with tax avoidance. Of course, scholars in glass houses should not throw too many stones – the Institute for Fiscal Studies in the United Kingdom (UK) won a 2006 Golden Bull<sup>6</sup> 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.

While public pressure may have encouraged institutions to improve their communications, there is still scope for improvement. For instance HM Revenue and Customs received a Golden Bull in 2013 for this response<sup>7</sup> to a taxpayer who had sent an email:

<sup>5</sup> Plain English Campaign (2005) <http://www.plainenglish.co.uk/campaigning/awards/2001-2010-awards/2005-awards/800-golden-bull-awards-2005.html>. Accessed 20 February 2014.

<sup>6</sup> <http://www.plainenglish.co.uk/campaigning/awards/2001-2010-awards/2006-awards/794-golden-bull-awards-2006.html>. Accessed 6 February 2014.

<sup>7</sup> <http://www.plainenglish.co.uk/campaigning/awards/2013-awards/golden-bull-awards.html>. Accessed 6 February 2014.

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However, the simplification issue is not just one of language. As tax systems generally have become more complex, calls for tax simplification have become a frequent phenomenon. Most such calls seem to assume that simplification is easily achievable but the difficulty is that the issue is not a simple one. As this paper will demonstrate, there are many considerations that include not only the drafting of legislation and taxpayer communications but also that modern tax systems are often used to advance a range of policy objectives and have to operate in a complex and changing socio-economic environment in a way that is broadly acceptable to taxpayers. There have been initiatives in Australia, New Zealand (NZ) and the UK concerned with simplification but they have not always taken an approach that takes sufficient account of the competing forces on tax systems to be both successful and sustainable. The terms of reference of the Review of Australia's Future Tax System<sup>8</sup> (AFTS, or the Henry Report) included simplifying the tax system and it certainly made a valuable contribution but, as Evans<sup>9</sup> has argued, it did not go far enough. This may have been because the successful achievement of simplification is indeed a complex issue and this paper sets out to indicate why. In contrast, the Tax Working Group (TWG) in NZ was more successful than AFTS, where Sawyer comments that “[t]iming, the early embracing of the work of the TWG, and NZ's relatively small tax community, facilitated the work of the TWG, including the ultimate outcome of major tax policy legislative reform.”<sup>10</sup>

In terms of methodology this paper utilizes a comparative case study framework,<sup>11</sup> through which the experiences of Australia, NZ and the UK are contrasted against the framework of various initiatives designed to redress the growing level of complexity through adoption of measures intended to initially simplify their tax legislation and more recently seek to tackle the more important ramifications of complex tax policy.

## 2. SIMPLICITY AND COMPLEXITY

It may seem self-evident that simplicity has considerable advantages over complexity in tax systems. There are some fairly obvious costs associated with complexity – particularly in administration and the costs to the community of complying with the tax system. The connection between complexity and the costs of compliance and

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<sup>8</sup> *Australia's future tax system, Report to the Treasurer*, December 2009. The Henry Report was submitted on 23 December 2009 but not publicly released until 2 May 2010. It has two Parts: Part 1 is an Overview (216 pages); Part Two, which contains the Detailed Analysis, has two volumes – Volume 1 (377 pages) and Volume 2 (479 pages). Altogether, there are over 1,000 pages and 138 recommendations.

<sup>9</sup> Chris Evans, 'Priority reform directions for the tax and transfer system', <http://www.treasury.gov.au/~media/Treasury/Policy%20Topics/Taxation/Tax%20Forum/Statements%20and%20Submissions/Academics/PDF/UNSW%20Evans.ashx>, 2011. Accessed 21 February 2014.

<sup>10</sup> Adrian Sawyer, 'Moving on from the Tax Legislation Rewrite Projects: A Comparison of Approaches in New Zealand and the United Kingdom' *British Tax Review*, 2013 (3), 321-344, at 344. See also Adrian Sawyer, 'Rewriting Tax Legislation: Can Polishing Silver Really Turn It Into Gold?', *Journal of Australian Taxation*, 2013, 15(1), 1-39.

<sup>11</sup> See generally Robert K. Yin, *Case Study Research: Design and Methods*, (3rd ed, Sage, 2003).

administrative is itself complex, but generally there is a positive correlation.<sup>12</sup> 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 not normally included in compliance cost studies.<sup>13</sup>

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. 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 very complicated and difficult to understand might reduce public support for the improvement of important public services. Furthermore a high level of complexity in a tax system can make discussion of tax policy and the introduction of improvements more difficult.

However, there are many pressures for greater complexity and it is often a necessary feature of a tax system that is to function successfully in the face of all the demands placed on it in an increasingly complex and changing socioeconomic environment. Indeed an indication of the challenge simplification faces becomes apparent even as soon as the meaning of simplification is explored. Cooper<sup>14</sup> suggests there are at least seven 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.

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<sup>12</sup> See for example, Louis Kaplow, 'How Tax Complexity and Enforcement Affect the Equity and Efficiency of The Income Tax' *National Tax Journal* 1996, 49, 135-50; and Chris Evans, 'Studying the studies: An overview of recent research into taxation operating costs', *eJournal of Tax Research*, 2003, 1, 64-92, stating at p 72: "Complexity of legislative provisions together with the frequency of legislative changes are identified as prime causes of high compliance costs".

<sup>13</sup> Simon James and Ali Edwards, *An Annotated Bibliography of Tax Compliance and Tax Compliance Costs*, 2010, ESRC: <http://www.esrc.ac.uk/my-esrc/grants/RES-000-23-1595/outputs/read/e026df04-3812-4aa1-96fe-10cd4b442e49>. Accessed 20 February 2014.

<sup>14</sup> Graeme S. Cooper, 'Themes and Issues in Tax Simplification', *Australian Tax Forum*, 1993, 10, 417-60.

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.

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 or elsewhere at the same level. One of the present authors can recall a vivid example which illustrated the difficulties of attempting to improve one aspect of the tax system in terms of simplicity and comprehensibility without considering other aspects. This example came to light at a presentation to relevant tax officials at a UK university by an academic graphic design specialist who had offered to help the Revenue and redesigned an Inland Revenue form. The result was initially very impressive. Text had been moved around the form and excellent improvements in terms of graphics, layout and presentation had been incorporated. Sadly, however, the designer had not troubled herself to understand the role of the form. That part of the tax system had not yet been computerised and the form was one of four parts of a document designed so that completion of the top form by a tax official would simultaneously produce carbon copies of the same information on the forms beneath. The information was the same but they were different forms because they were designed for different purposes. There was no point in redesigning one part without ensuring it continued to be compatible with the other three. The designer was very pleased with her work but 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 of taking account of all aspects of the issue under consideration.

Against the above background, the question of what simplification in a tax context means warrants consideration. It is useful to consider tax simplification within two broad areas, namely legal simplicity (focussing on readability and understandability of tax legislation), and effective simplicity (how easy it is to determine the correct tax liability).<sup>15</sup> Much of the effort in the three jurisdictions which are considered in this article has focussed on the former, and much less on the latter.

This paper takes a more systematic approach to the question of simplification. Cooper's first level of simplification, the choice of the tax base, is a good place to start and the paper now turns to issues concerning simplification of the tax system itself.

### 3. SIMPLIFICATION OF TAX SYSTEMS

A simple tax system obviously avoids many of the disadvantages of a more complex one and, other things being equal, a simple tax will normally be preferred to a more

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<sup>15</sup> See further Binh Tran-Nam, 'Tax Reform and Tax Simplification: Some Conceptual Issues and a Preliminary Assessment', *Sydney Law Review*, 1999, 21, 500.

complicated one. However, the comment shown at the beginning of the paper by Senator Russell Long captures one of the basic features of the whole subject: “The complexity of our code in the main is not there because of some mischief. Most of it is there in the effort to do more perfect justice”. Complexity often exists in tax systems for good reasons.

There is much agreement about the main criteria that could be used to assess a particular tax or proposed tax reform: the effects on efficiency, incentives, fairness, compliance costs, administrative costs and so on.<sup>16</sup> Simplicity is one factor, of course, but by no means always the most important one. Other important considerations include the socioeconomic environment in which a tax system has to function, the multiple policy objectives that might be supported by the tax system, the requirement for tax systems to be seen to be fair by taxpayers, responses to anti-avoidance behaviour and certainty in taxation. These are discussed in turn.

### 3.1 The Socio-economic environment

Tax systems have to operate in an increasingly complex and changing socioeconomic environment. An analysis of the tax environment indicates some powerful trends towards increasing complexity.<sup>17</sup> Social factors include demographic variables, social mobility and increasing levels of education. Demographic factors include less stable family structures and an increasing number of older people who tend to have more complex financial affairs involving a range of investments and pensions. A further aspect is that higher levels of education and consumer awareness may enable and encourage taxpayers to take a greater and more effective interest in tax matters, again often adding to the pressure for greater complexity. Economic factors include rising incomes often drawn from a variety of sources, and an increasing variety and complexity of financial instruments. Technological developments such as electronic commerce have added further challenges to tax systems.<sup>18</sup> Furthermore as the pressure of increased public expenditure has driven up the requirement for tax revenues, taxes have to be more closely attuned to individual circumstances: a simple rough and ready tax system might be acceptable at low rates of taxation but it is far less likely to be so at much higher rates of taxation. Globalisation, with increased economic interdependence and increasing mobility of capital and labour, has also tended to mean that tax systems have to be more finely tuned to the environment in which they have to operate. There are also further implications. For example, the communiqué issued following the meeting of the G20 Finance Ministers and Central Bank Governors in Sydney in February 2014 affirmed their commitment to a global response to Base Erosion and Profit Shifting (BEPS) on the grounds that “profits should be taxed where economic activities are performed and where value is created”,<sup>19</sup> to the exchange of tax information among G20 members and for more jurisdictions

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<sup>16</sup> Simon James and Chris Nobes, *The Economics of Taxation: Principles, Policy and Practice*, 13<sup>th</sup> ed, 2013, Fiscal Publications, Birmingham.

<sup>17</sup> Simon James, ‘The Future International Tax Environment and European Tax Harmonisation: A Personal View,’ *European Accounting Review*, 1999, 8(4), 731-747.

<sup>18</sup> See, for example, Aaron Lukas, *Tax Bytes: A primer on the taxation of electronic commerce*, Trade Policy Analysis, CATO Institute, 1999, <http://object.cato.org/sites/cato.org/files/pubs/pdf/tpa-009.pdf>. Accessed 20 February 2014.

<sup>19</sup> G20, “G-20 Communique Following Feb. 22-23 Meetings in Sydney” (Sydney, February 2014), para 9, [https://www.g20.org/sites/default/files/g20\\_resources/library/Communique%20Meeting%20of%20G20](https://www.g20.org/sites/default/files/g20_resources/library/Communique%20Meeting%20of%20G20)

to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Such initiatives have much to be said for them but they may well add significantly more complexity to tax systems.

### 3.2 Multiple and changing policy objectives

While one of the main functions of a tax system is, of course, to raise revenue for government expenditure and redistribution, the tax system is also one of the most powerful tools for achieving a range of government economic and social policies. Thus certain activities such as smoking and drinking which are considered to have undesirable effects might be subject to additional taxation. Conversely the government may use the tax system in order to encourage activities considered to be desirable, such as saving and contributing to a pension by setting up a variety of tax concessions. More generally there is the whole issue of ‘tax expenditures’ where some fiscal advantage is conferred on a group of taxpayers or a particular activity by reducing tax liability rather than a cash subsidy – a phenomenon first extensively analysed by Surrey.<sup>20</sup> Necessarily such provisions involve discrimination in the taxation of different activities and therefore add to complexity themselves. They also have implications for anti-avoidance measures discussed below. Furthermore the objectives of policy makers are often multi-dimensional and priorities can change, sometimes quite quickly.

### 3.3 Fairness

As a prime example of Senator Long’s point about tax complexity being mainly a result “the effort to do more perfect justice”, tax systems have to respond to perceptions of fairness if they are to be acceptable to taxpayers. As tax systems have tended to extend their reach further and further into the everyday life of more and more people and to be levied at higher rates, they have had to be increasingly compatible with taxpayers’ views of fairness.

The issue of fairness means that a simple tax may not be acceptable. An extreme but highly relevant example 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 did not vary with economic behaviour and should not, therefore, cause people to behave inefficiently 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.<sup>21</sup> 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<sup>22</sup>

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[%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%202022-23%20February%202014\\_0.pdf](#). Accessed 25 February 2014.

<sup>20</sup> Stanley S Surrey, *Pathways to Tax Reform*, 1973, Harvard University Press.

<sup>21</sup> George M. Trevelyan, *English Social History*, 2nd ed. 1946, Longmans, Green and Co.

<sup>22</sup> Peter Smith, ‘Lessons from the British Poll Tax Disaster’, *National Tax Journal*, 1991, 44; J. Cullis, P. Jones and O. Morrissey, ‘Evaluating the Poll Tax as a Tax Reform’, *Local Government Studies*, 1993, 19, 77-91.



led to serious civil disobedience<sup>23</sup> and it was a factor in the events leading to the resignation of Margaret Thatcher as Prime Minister.<sup>24</sup> Its replacement, the Council Tax, was designed to take far more account of personal circumstances and has survived successfully.

A celebrated example of the results of the complexity that can arise from trying to design a fair tax system involves VAT in the UK. To increase the political acceptability of VAT, the zero rate band is applied to a range of items such as many types of food.<sup>25</sup> This involves complex arrangements to establish whether some foods are taxable or not and one famous case involved small cakes with chocolate coverings. Customs and Excise had treated such items as chocolate covered biscuits and therefore considered them to be taxable at the standard rate of tax whereas cakes should be subject to the zero rate. As one implication of the case later came before the House of Lords in 2005 on its way to the European Court of Justice, Lord Hoffman said:

The supply of food is in general zero-rated for VAT ... But there are exceptions. One exception is confectionery ... But there is an exception to that exception: cakes or biscuits are in general also zero-rated. There is however an exception to that exception to the exception, namely biscuits wholly or partly covered with chocolate. They are standard-rated.<sup>26</sup>

More generally, when it comes to matters of fairness in taxation complexity often wins over simplicity. For instance, in Australia for the tax year 2013/14 there is a tax free threshold of \$18,200 for income tax then tax rates of 19% (over \$18,200), 32.5% (over \$37,000), 37% (over \$80,000) and 45% (over \$180,000). The tax system would be much simpler if there were a zero tax free threshold and a flat rate of tax on all income. There could then be a flat rate deduction at source for wages, interest, dividends etc. and many individuals would not have to lodge a tax return. Although such a system may be a very simple one, it is unlikely to be acceptable to Australian taxpayers. What is acceptable can vary over time and between countries. For example Australia could adopt the simpler UK arrangement of generally not allowing employees' tax deductions for work related expenses but, despite some discussion, has not chosen to do so.<sup>27</sup> In contrast, NZ has focused on having a tax system with the hallmarks of efficiency and relative simplicity, and less so on fairness (as measured by way of highly progressive rates of taxation).

### 3.4 Tax avoidance

It is not always easy to use the tax system to achieve policy aims including fairness effectively. Where there are concessions in the tax system in the interests of fairness, or for other purposes, taxpayers, or frequently their advisers, may find opportunities to exploit the tax system and the official response is often more complex legislation to restrict their ability to do so. The purpose of the section in the Australian GST

<sup>23</sup> D. Mair and R. Damania, 'Fiscal Crisis and Local Government Reform', *Local Government Studies*, 1992, Vol. 18, 179-190.

<sup>24</sup> John Gibson, *The Politics and Economics of the Poll Tax, Mrs Thatcher's Downfall*, EMAS, 1990.

<sup>25</sup> Simon James 'The contribution of behavioral economics to tax reform in the United Kingdom', *Journal of Socio-Economics*, 2012, 41(4), 468-475.

<sup>26</sup> *Marks and Spencer plc v. Customs and Excise*, [2005] UKHL 53.

<sup>27</sup> Simon James, Ian Wallschutzky and Clinton Alley, 'The Henry Report and the Taxation of Work Expenses', *Journal of Finance and Management in Public Services*, 2013, 11(2), 46-58.

legislation quoted at the beginning of the paper was to counter tax avoidance, specifically:

The object of this Division is to deter schemes to give entities benefits by reducing GST, increasing refunds or altering the timing of payment of GST or refunds. If the dominant purpose or principal effect of a scheme is to give an entity such a benefit, the Commissioner may negate the benefit an entity gets from the scheme by declaring how much GST or refund would have been payable, and when it would have been payable, apart from the scheme. This Division is aimed at artificial or contrived schemes.<sup>28</sup>

This Division then continues by describing circumstances in which these provisions do not apply.

A specific example of complexity to restrict tax avoidance involved the UK Parliament's desire to avoid imposing VAT on children's clothes. This involved establishing the definition of children's clothing. If it is simply related to 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. The result is considerable complexity. To be zero-rated for VAT under this heading an item has to be an article of clothing or footwear, it must not be made of fur, it must be designed for young children, and it must only be suitable for young children. To give a flavour of the resulting complexity it is sufficient to look at one example 'hats and other headgear'. It seems young children have proportionately larger heads than older people and so many children's hats will fit adults. However they can still be zero-rated if they are suitable only for young children such as babies' bonnets and school hats or if they are clearly held out for sale for young children. Whether or not riding hats may be zero-rated is a more complicated matter and they may need written approval from the tax authorities in order to get the concession. Then there is a distinction between 'clothing' in the form of hats and 'accessories' which do not cover the whole head such as 'alice bands', hair ribbons, 'scrunchies', sun visors and ear muffs or 'toys' such as novelty hats, party hats and play hats. These are subject to VAT at the standard rate. Similar problems arose in zero-rating food. Originally take-away meals were free of VAT but not meals eaten on the premises. Since this was open to abuse and apparently led to a remarkable increase in the level of food claimed to be consumed off rather than on the supplier's premises, the rule was changed so that hot take-away food from restaurants was brought into tax. Hence in the UK caviar as a cold food is zero rated but fish and chips are not. More generally moves to limit tax avoidance are one of the biggest causes of tax complexity.

### 3.5 Certainty

Certainty is a further important factor in a tax system and may be seen as another aspect of Long's "effort to do more perfect justice". Both taxpayers and tax officials require guidance where the law is, or may be, unclear. This leads to new provisions in the law or new authorities which may clarify but also complicate the tax system. On a practical level Paul suggested that a new legal authority will appear when the amount

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<sup>28</sup> *A New Tax System (Goods and Services Tax) Act 1999*–Sec 165.1.

of tax revenue at stake in clarifying an uncertainty exceeds the cost of producing the authority.<sup>29</sup>

### 3.6 Scope for simplifying the tax system

There is no doubt that many aspects of a tax system could be less complicated than they have turned out to be and still achieve government objectives, counter tax avoidance and so on. However, what is quite clear is that general calls for the simplification of the tax system without carefully addressing the issues raised in this section are unlikely to be helpful. What is needed is a more comprehensive approach and this is developed further in section 8. The next major aspect is simplifying tax law.

## 4. SIMPLIFYING TAX LAW

### 4.1 Tax law complexity

The nature of tax law itself is another important factor. As already indicated, one important trend in the environment in which taxation has to operate is the increasing complexity of socio-economic systems.<sup>30</sup> Hence Prebble's view<sup>31</sup> that complexity arises from trying to fit the law around the "natural facts of economic life". This is not necessarily a straightforward process. To take a fairly central issue, Vickrey<sup>32</sup> 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?

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

Surrey's view<sup>33</sup> was that tax law complexity arises from:

[C]omplex 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.

<sup>29</sup> Deborah L. Paul, 'Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?' *North Carolina Law Review*, 1997-1998, 76, 151.

<sup>30</sup> Simon James, 'The Future International Tax Environment and European Tax Harmonisation: A Personal View,' *European Accounting Review*, 1999, 8(4), 731-747.

<sup>31</sup> John Prebble, 'Why is the Tax Law Incomprehensible?' *British Tax Review*, 1994, 380-393.

<sup>32</sup> William Vickrey, 'Tax Simplification Through Cumulative Averaging', *Law and Contemporary Problems*, 1969, 34(4), 736-750 at p. 736.

<sup>33</sup> Stanley S. Surrey, 'Complexity and the Internal Revenue Code: The Problem of Management of Tax Detail,' *Law and Contemporary Problems*, 1969, 34, 673.

At least some of this, however, is clearly necessary. As Sir Ernest Gowers, a former Chairman of the UK Board of Inland Revenue, wrote in his *Complete Plain Words*,<sup>34</sup> 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 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 argued<sup>35</sup> for less detailed legislation in line with principles and “not a continuation of the plague of tax rule madness”. The advantages of such an approach though may be outweighed by a loss of certainty and a resulting increase in compliance and administrative costs.

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.<sup>36</sup>

In the 1990s improving the language seemed to be the way forward and various Tax Law Improvement Projects (TLIPs) to address this were established.

## 4.2 Tax law reviews

In Australia, NZ and the UK there have been various 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 1993<sup>37</sup> 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.” In NZ, the Tax Rewrite Project (TRP) was accompanied by a Rewrite Advisory Panel (RAP), comprising tax experts from the professions and IRD/Treasury, and operated within the framework of the Generic Tax Policy Process (GTPP).<sup>38</sup> The intention was to make the legislation more understandable through reorganising and rewriting the text.<sup>39</sup> There is no doubt

<sup>34</sup> Sir Ernest Gowers, *The Complete Plain Words*, 1954, London, HMSO.

<sup>35</sup> John Avery Jones, ‘Tax law: rules or principles?’ *Fiscal Studies*, 1969, 17(3), 63-89.

<sup>36</sup> Geoffrey Howe, ‘Tax Law Simplification in the United Kingdom’ in C. Sandford ed., *Further Key Issues in Tax Reform*, 1998, p. 108.

<sup>37</sup> Summarised by the Tax Law Review Team, *The Broad Framework*, 1994, Canberra, Australian Tax Office.

<sup>38</sup> See further on the GTPP: Adrian Sawyer, “Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’”, *Australian Tax Forum*, 2013, 28(2), 401-425.

<sup>39</sup> See further Adrian Sawyer, ‘New Zealand’s Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity’, *British Tax Review*, 2007 (4), 405-427. With regard to the reliability of assessing readability as a measure of understandability, see Adrian Sawyer, ‘Enhancing Compliance Through Improved Readability: Evidence from New Zealand’s Rewrite “Experiment”’, in M E Gangi and A

that improvements have been made though such attempts have not always been well received. For example, in Australia 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”.<sup>40</sup>

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. It seems at the time the tax law rewrite initiatives 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 Assessment Act 1997*. In reviewing the position, Krever<sup>41</sup> pointed out that a superficial look at that Act seemed 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”.<sup>42</sup> 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 report<sup>43</sup> 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).

There is no doubt that improvements can be made in simplifying tax law. A valuable Australian contribution has been the Taylor Report<sup>44</sup> on reducing tax law complexity and it makes a number of recommendations for improvement. However, as with the tax system, the complexity of simplifying tax law suggests there should be a more comprehensive approach of the sort described in section 8.

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Plumley (eds), *Recent Research on Tax Administration and Compliance: Selected Papers Given at the 2010 IRS Research Conference*, IRS, 2011, Washington DC, 221-253.

<sup>40</sup> Geoffrey 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, 33, 530-533.

<sup>41</sup> Richard Krever, ‘Taming Complexity in Australian Income Tax’, *Sydney Law Review*, 2003, 25, 467-505.

<sup>42</sup> *Ibid.*, at p. 493.

<sup>43</sup> Tax Law Review Committee, *Final Report on Tax Legislation*, 1996, London, Institute for Fiscal Studies.

<sup>44</sup> 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.

## 5. SIMPLIFYING TAXPAYER COMMUNICATIONS

Simplifying communications with taxpayers in the form of tax explanatory leaflets and so on is another area where there is often scope for improvement. There have been campaigns, such as the Plain English Campaign referred to in the introduction, and particular initiatives such as simplifying the language in tax guides and other tax literature by using shorter sentences and simpler words. However even in such an apparently straightforward area there can be pitfalls. Nor are they new and one illustration is reported by Sir Alexander Johnson. The Board of Inland Revenue had sent Lloyd George, who was then Chancellor of the Exchequer, a paper about Estate Duty Liability on settled property:

Mr 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.<sup>45</sup>

However, there is no doubt that this is an area where much can be done and communications with taxpayers can often be made more comprehensible.<sup>46</sup> There has also been particular success with simplified returns such as the United States' 1040EZ.<sup>47</sup> This consists of remarkably few questions for a tax return and may be used by US taxpayers with relatively simple circumstances. However, it is worth noting that the 1040EZ can only be as simple as it is because of arrangements elsewhere in the system, which leads on to the next aspect: tax administration.

## 6. SIMPLIFYING TAX ADMINISTRATION

It is possible to have a very complex tax system overall but to keep the administration simple for many taxpayers, for example by avoiding the requirement for 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, at least in principle, can withhold tax to a very high degree of accuracy.<sup>48</sup> NZ's decision to remove the requirement for the majority of individual taxpayers to file tax returns (where their income is taxed at source and information is collected from third parties), has greatly reduced compliance costs and enabled the IRD and tax agents to focus on taxpayers with more complex tax affairs. The income statement confirmation process is simple, although some taxpayers who are in a refund situation may not be receiving the refunds they are entitled to.

Furthermore, with advances in technology it is also becoming feasible to issue returns which already include information about the taxpayers' circumstances supplied by third parties to the tax authority electronically.<sup>49</sup> These 'pre-populated' tax returns can

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<sup>45</sup> Sir Alexander Johnson, *The Inland Revenue*, 1965, Allen & Unwin, London.

<sup>46</sup> Simon James, Alan Lewis, and Frances Allison *The Comprehensibility of Taxation: A Study of Taxation and Communications*, 1987, Avebury, Aldershot.

<sup>47</sup> <http://www.irs.gov/pub/irs-pdf/f1040ez.pdf>. Accessed 20 February 2014.

<sup>48</sup> Simon James and Ian Wallschutzky, 'Should Australia Adopt a Cumulative Withholding Tax System?' *Australian Tax Forum*, 1994, 11(3), 311-335.

<sup>49</sup> Richard Highfield, 'Pre-populated Income Tax Returns', 7<sup>th</sup> International Tax Administration Conference, 2006, ATAX, Faculty of Law, University of New South Wales.

contain details of most major sources of income together with the tax withheld, asset sales and purchases, specific deductions that are obtained from third party sources or calculated according to a formula, personal tax reliefs, tax credits and the calculations of tax payable or refundable. The role of the taxpayer in this process is to confirm the information is correct and to supply any further information required. Such arrangements have been used for some time – Denmark led the way by introducing such arrangements in 1988 though these originally were quite primitive since the amount of information that could be collected and processed was quite limited. However, the system was progressively enhanced during the 1990s and similar arrangements were introduced in Sweden in 1994 and Norway in 1998. As the application of technology to tax administration progressed moves in this direction have also been made elsewhere.<sup>50</sup> The case for such a development in the US has been examined by Cordes and Holen<sup>51</sup> but they concluded that “adopting a return-free tax preparation system is not an advisable course of action for the federal government” (p. 27). Their analysis indicated that costs savings would be modest and additional costs to employers and others would be substantial as well there being a range of other challenges. This seems to indicate yet again that successful simplification of one part of the system has to take account of a range of other factors. The paper now turns to some longer term initiatives in Australia, NZ and the UK.

## 7. LONGER TERM APPROACHES

More recently there have been initiatives to establish more long term approaches to simplification such as the Office for Tax Simplification in the UK and the Tax Working Group (TWG) in New Zealand. Looking first at NZ, the TWG cannot be considered in isolation, in that without the Generic Tax Policy Process (GTPP), it is unlikely that the TWG would have been formed or successful in convincing the government of the need for structural tax reform. Much has been written about the GTPP,<sup>52</sup> which is essentially a structure for developing tax policy (that eventually becomes legislation) which is heavily dependent upon consultation with the tax profession, taxpayers, and input from tax officials. Its hallmarks are transparency and rigorous analysis, with important review and feedback loops. The TWG operated as an independent external input recommending a package of tax policy changes that eventually with the support of the government worked through the legislative process.

The TWG’s focus was on reviewing the tax system with the goal of addressing structural deficiencies, rebalancing the tax mix, but done within the fiscal constraint

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<sup>50</sup> François Vaillancourt (ed.), *Prefilled Personal Income Tax Returns: A Comparative Analysis of Australia, Belgium, California, Quebec and Spain*, 2011, Fraser Institute, available at: <https://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/prefilled-personal-income-tax-returns.pdf> . Accessed 20 February 2014.

<sup>51</sup> Joseph Cordes and Arlene Holen, *Should Government Prepare Individual Tax Returns?* 2010, Technology Policy Institute, Washington DC.

<sup>52</sup> For some recent examples, Adrian Sawyer, “Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’”, *Australian Tax Forum*, 2013, 28(2), 401-425; Adrian Sawyer, “Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?”, *Hong Kong Law Journal*, 2013, 43(2), 579-609; and Struan Little, Geof D. Nightingale, and Ainslie Fenwick, “Development of Tax Policy in New Zealand: The Generic Tax Policy Process”, *Canadian Tax Journal/Revue Fiscale Canadienne*, 2013, 61(4) 1043-1056.

that all series of recommendations must be revenue neutral. Importantly all national-level taxes were within the scope of the review, unlike the Henry Review in Australia where GST was “off limits”. As Little et al observe:<sup>53</sup>

The TWG proved to be a considerable success. It was a good forum for debate of the pros and cons of various tax changes. The TWG provided an open discussion process, with papers from the meetings and a record of debates being published on the Internet. This helped to inform the wider public on key tax policy issues.

It would be fair to say that the TWG would not have been as successful if the GTPP were not in place.<sup>54</sup> It also involved academics in the consultation and policymaking process, something that the GTPP has struggled with previously.<sup>55</sup> A word of caution, however, is that the TWG was largely a ‘right of centre’ leaning group, with a right of centre government in place at the time. Should there have been a ‘mismatch’ of political tax philosophy, then the TWG’s success (and possibly recommendations<sup>56</sup>) would have differed. Like the GTPP, the TWG was an example of a successful delicate balancing between law and politics when seeking to develop tax policy.<sup>57</sup> To a sizeable extent, the TWG removed some of the politics from tax policy development, enabling key tax principles, such as simplicity, to have a reasonable opportunity to feature in any policy recommendations. The TWG was much more successful in seeing its recommendations adopted and implemented, than for example, the Tax Review 2001.<sup>58</sup> Unfortunately in our view, the TWG was disbanded after it provided its recommendations, suggesting that when the need arises for major tax reform in the future, a new body, perhaps similar to the TWG, will need to be established.

Turning to the OTS in the UK, it should not come as a surprise that given the relatively ineffectual outcome of the TLRP in the UK, the need for a mechanism to address major policy challenges and concerns underlying the UK’s tax system was necessary. The OTS was established in July 2010 to provide advice to the UK Chancellor of the Exchequer (Chancellor) on simplifying the UK tax system, with the objective of reducing compliance burdens on both businesses and individual taxpayers.

It was set up with a limited life (the current UK parliamentary term which expires in 2015), given a sizeable agenda, although as Sawyer comments, it has focussed largely on minor issues, and left untouched major structural issues that add to complexity.<sup>59</sup>

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<sup>53</sup> Little et al, *Ibid*, 1052.

<sup>54</sup> Adrian Sawyer, ‘Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?’, *Hong Kong Law Journal*, 2013, 43(2), 579-609, at p.587.

<sup>55</sup> Struan Little, Geof D. Nightingale, and Ainslie Fenwick, ‘Development of Tax Policy in New Zealand: The Generic Tax Policy Process’, *Canadian Tax Journal/Revue Fiscale Canadienne*, 2013, 61(4) 1043-1056, 1056.

<sup>56</sup> Adrian Sawyer, ‘Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?’, *Hong Kong Law Journal*, 2013, 43(2), 579-609, at p.589.

<sup>57</sup> Adrian Sawyer, ‘Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’’, *Australian Tax Forum*, 2013, 28(2), 401-425, p.423-424.

<sup>58</sup> Adrian Sawyer, ‘New Zealand’s Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity’, *British Tax Review*, 2007, 4, 405-427, 329-330.

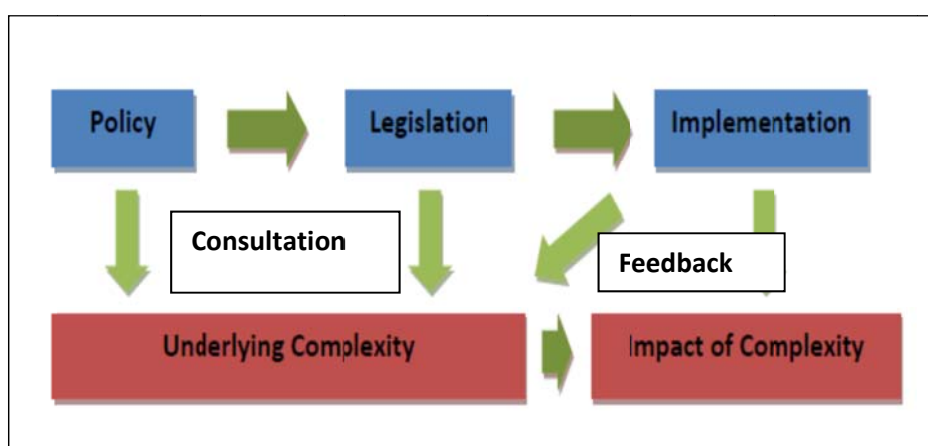
<sup>59</sup> Adrian Sawyer, ‘The Office of Tax Simplification: An Evaluation from Downunder’, paper submitted to *British Tax Review*, 2013, 30-31.



One small area of relative success has been the Complexity Index launched for consultation by the OTS in 2012, leading to debate and refinement.<sup>60</sup> The Complexity Index was published in December 2012 with the aim being to provide an indication of which areas of tax legislation are considered to be particularly complex compared to others and to develop a tool that can help prioritise the future work of the OTS. The methodology is intended to assist UK tax policymakers prioritise areas for future tax simplification and avoid unnecessary complexity. The Complexity Index is intended to be applied to the complete UK tax system (including EU legislation that operates in the UK).

Within the OTS's Complexity Index methodology paper is an interesting diagram of how the OTS sees complexity arising within the tax system. This is reproduced below as Figure 1:

**Figure 1: How complexity arises within the policy framework<sup>61</sup>**



As Sawyer observes, Figure 1 suggests the OTS recognises that the policy process itself is critical to addressing issues of complexity.<sup>62</sup> The OTS also recognises that complexity may be minimised if some broad guidelines are followed when designing policy, legislation, and implementation, although Sawyer comments that the OTS has yet to undertake research to develop some general principles to minimise tax complexity.<sup>63</sup>

Whether the Complexity Index will prove effective remains unclear, as while it focuses on legislative complexity, it does not appear to be able to differentiate between business size and sector, both critical factors in the debate over complexity. As Evans and Tran-Nam observe, in order to "... develop a rigorous and acceptable

<sup>60</sup> Adrian Sawyer, 'New Zealand's Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity', *British Tax Review*, 2007, 4, 405-427, 336-337.

<sup>61</sup> Office of Tax Simplification, *The Office of Tax Simplification Complexity Index* (2012), 2 (boxes for Consultation and Feedback have been included at their anticipated places in the process). The OTS has not provided an updated version of Figure 1 in the second version of its Complexity Index; see Office of Tax Simplification, *The Office of Tax Simplification Complexity Index – Version 2* (2013),

<sup>62</sup> Adrian Sawyer, 'The Office of Tax Simplification: An Evaluation from Downunder', Department of Accounting and Information Systems Working Paper, (University of Canterbury, 2013), 17.

<sup>63</sup> *Ibid.* 17.

tax system complexity index it is necessary to review both the tax complexity literature and the basic theory of index numbers”.<sup>64</sup>

The OTS came within the public spotlight with the Public Accounts Committee’s (PAC’s) investigation into tax avoidance and the role of large accountancy firms in 2013.<sup>65</sup> This report suggested that the OTS has made little in the way of substantial contribution to the simplification of the UK tax system. The Rt. Hon Michael Jack, Chair of the OTS, was quick to respond to ‘correct’ some of the statements made.<sup>66</sup> The Chair of PAC, Rt. Hon Margaret Hodge, responded that the PAC supports the OTS’s work, and accepts that the OTS ‘punches above its weight’ given the resources at its disposal.<sup>67</sup> Hodge went on to urge the UK Government to increase the support and resources of OTS. Of particular interest also was the comment that HM Treasury and HMRC should “... work together to make more radical progress in addressing the inadequacies of existing tax law.” A formal response from the UK Government to the PAC’s concerns over the OTS’s resourcing has not been made to the writers’ knowledge.

Going forward, an unresolved matter is the outcome of discussion over the type of evaluation that should be undertaken on the OTS to assist the UK Government in deciding what to do about the OTS post-2015, as well as potentially assisting the OTS in the shorter term with how it carries out its reviews.<sup>68</sup>

Comparing the TWG and OTS, it should not come as a surprise that the TWG has been more effective in bringing about change to the tax structure, including aspects of simplification although this was not a major focus of its review of the tax system. The OTS, on the other hand, has an almost total focus on aspects of simplification, although it has approached its work by seeking to address minor issues and ‘avoid’ the major policy issues that contribute to complexity. Thus, even with its uncertain future, it would come as a surprise if the OTS were to deliver effective simplification of the UK tax system. Indeed it would be fair to suggest that enhanced equity is considered to be more important as a goal than greater simplicity, whereas in New Zealand, simplification is considered as important as equity, although efficiency appears to have been the most important criterion for recent tax reform in NZ.

Australia, while not taking up the opportunity to simplify its tax system in a manner similar to NZ and the UK, has sought to make tax compliance simpler through various initiatives. One such initiative is the pre-filing of tax returns. Evans and Tran-Nam<sup>69</sup> are of the view that tax policy simplification is virtually not possible and that tax law simplification has limited benefits. The authors examine the pre-filing of income tax returns in Australia as an example of administrative simplification. Writing in 2010, they conclude that the approach in Australia is a step in the right direction but had not

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<sup>64</sup> Chris Evans and Binh Tran-Nam, ‘Towards the development of a tax system complexity index’, *Fiscal Studies*, 2014, 35, 341-370, at p.367.

<sup>65</sup> House of Commons Committee on Public Accounts, *Tax Avoidance: The role of large accountancy firms* (April 2013) 44 Report of Session 2012-13 at 3, 12 and Ev 18.

<sup>66</sup> Rt. Hon. Michael Jack, Letter to Rt. Hon Margaret Hodge re ‘Tax Avoidance: The role of large accountancy firms’ (1 May 2013).

<sup>67</sup> Rt. Hon. Margaret Hodge, Letter to Rt. Hon Michael Jack re ‘Tax Avoidance: The role of large accountancy firms’ (5 June 2013).

<sup>68</sup> *Ibid.*, 337.

<sup>69</sup> Chris Evans and Binh Tran-Nam, ‘Managing Tax System Complexity: Building Bridges Through Pre-Filled Tax Returns’, *Australian Tax Forum*, 2010, 25, 245-274.

yet led to significant operating cost savings. If the recommendations of the Henry Review<sup>70</sup> were to be fully accepted and implemented, the authors see the opportunity for positive change. However, to date most of the Henry Review's recommendations have not been implemented, including those that would enhance the future value of pre-filing of returns.

## 8. A MORE SYSTEMATIC OR STRATEGIC APPROACH

Although initiatives for simplification can often result in improvements, it may be better to follow a more comprehensive approach by addressing the range of factors from which complexity arises.<sup>71</sup> Before doing so, the special case of small businesses will be briefly mentioned first.

### 8.1 The case of small businesses

A very important sector in particular need for the tax system to avoid unnecessary complexity is small business. There is widespread support for help for small businesses<sup>72</sup> 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. They are also collectively a very large and often dynamic part of economic life. Special provisions for small businesses are 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. Another example in New Zealand is to allow small business to use their GST return as the basis for making their provisional tax payments. In Australia, for example, the small business tax concessions have provided some gains but not to the extent anticipated by the Australian Government. Burton argues that the evidence relied upon for their introduction and continuation is both partial and flimsy.<sup>73</sup> More recently, Lignier and Evans examine the small business tax concessions as part of their survey of Australian SME compliance costs, concluding that many respondents were unaware of their eligibility and that these concessions frequently introduced further complexity into the tax system.<sup>74</sup>

### 8.2 A strategy for simplification

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

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<sup>70</sup> Australia's Future Tax System, *Final Report*, 2010.

<sup>71</sup> See, for example, Simon James and Alison Edwards, 'A strategic approach to personal income tax reform', *Australian Tax Forum*, 2007, 22(2), 105-126.

<sup>72</sup> See, for example, D. Holz-Eakin, 'Should small businesses be tax-favoured?' 1995, *National Tax Journal* 48, 3, 387-395.

<sup>73</sup> Mark Burton, 'The Australian small business tax concessions—public choice, public interest or public folly?', *Australian Tax Forum*, 2006, 21, 71-130.

<sup>74</sup> Philip Lignier and Chris Evans, 'The rise and rise of tax compliance costs for the small business sector in Australia', *Australian Tax Forum*, 2012, 27, 615-672.

immediate concern. A key part in the development of strategy is implementation. Mintzberg<sup>75</sup> 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 Grant<sup>76</sup> 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.<sup>77</sup>

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 discussed the creation of a ‘simplification “culture” within the Revenue which it is important to maintain and encourage.’<sup>78</sup> It is 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.<sup>79</sup>

## 9. 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 policy goals which requires a careful balancing of competing priorities that might ultimately be determined by the ruling political party at the relevant time.

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<sup>75</sup> Henry Mintzberg, *Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*, 2004, San Francisco: Berret-Koehler, Publishers, 55.

<sup>76</sup> Robert M. Grant, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, 4<sup>th</sup> ed., 2002, Oxford: Blackwell.

<sup>77</sup> Simon James, ‘Tax Compliance Strategies to Tackle the Underground Economy’ in Chris Bajada and Friedrich Schneider (eds.) *The Size Cause and Consequences of the Underground Economy: An International Perspective*, 2005, Ashgate, 275-289.

<sup>78</sup> Inland Revenue, *The Path to Tax Simplification: A Background Paper*, 1995, London, HMSO.

<sup>79</sup> Ian G. Wallschutzky, ‘TLIP: Stage 1 – Benchmarking’, *Australian Tax Forum*, 1995, 12, 115-55.

To achieve structural and long-term benefits, what may be required is the establishment of a permanent body to oversee on a long term basis the development of tax policy, including simplification.

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 and NZ, their respective Reserve Bank Board and Governor set 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 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.

The suggestion here is for a body with a much wider remit than the OTS, 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. The NZ GTPP and TWG also give an indication of what might be done.

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 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 context<sup>80</sup> 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 (ATRF), for example, exists to undertake independent and impartial research into the reform of taxation and the Taxation Institute (TI) could also play a useful role.

An independent Tax Studies Institute was proposed at the National Tax Forum held in Australia in 2011. The National Tax Forum recommended:<sup>81</sup>

The Commonwealth Government should respond positively to Recommendation 134 of the AFTS Review (2009) by committing funds to the development of an independent multidisciplinary and multi-institutional tax research centre, The Australian Centre for Tax Research. Commonwealth funding should comprise \$2.5 million each year for 10 years; such funding to be accompanied by State and Territory Governments and the private sector both contributing \$0.25 million per annum over 10 years.

To date this recommendation has yet to be accepted by the Australian Government and implemented.

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.<sup>82</sup> With elections taking place at least once every five years in the UK and once every three years in Australia and NZ, an independent authority might be a powerful force for rational decision-making with respect to tax reform.

We accept that there is enormous political difficulty in accepting this recommendation. For example, in an Australian context, when a suggestion was made at the National Tax Forum in 2011, the response we received was that the “government was not going to contract out what it was elected to do.” This may be interpreted as a polite dismissal of such suggestions. Also, it is foreseeable that governments may be reticent to agree with such suggestions as they may perceive this as the government losing control/power over tax policy. Should a precedent for such an approach emerge somewhere in the world, it should be examined closely by policymakers and researchers.

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<sup>80</sup> See, for example, Simon James, ‘The Future International Tax Environment’, *International Tax Journal*, 1999, 25(1), 1-9.

<sup>81</sup> National Tax Forum, *Statement of Reform Priorities*, 2011, Joint Statement to Tax Forum on Government Response to AFTS (2009) Recommendation 134 (emphasis added).

<sup>82</sup> M. Kalecki, ‘Political Aspects of Full Employment’, *Political Quarterly*, 1943, 14(4), 322-310.

## 10. 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 important reasons why tax systems are complex and those wishing to simplify the tax system have to take them into account if overall improvements are to be gained. 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 to achieve. For permanent improvements in tax simplification, and other aspects of the tax system, there should be a long term and comprehensive approach to taxes and tax reform. Possibly an independent authority, as outlined section 9, could be established to address complexity in the tax system.

Research opportunities in the area of tax simplification abound. Jurisdictions other than the three reviewed in this paper will have stories and experiences that contribute to our broader understanding of the intricacies of tax simplification. The desirable level of simplification within a given jurisdiction's tax system is unlikely to be optimal for another jurisdiction.

Furthermore, the views of the various actors, including taxpayers, tax agents, revenue authorities and policymakers are unlikely to be in agreement as to the optimal level of simplification. Nevertheless, there are expected to be features common across jurisdictions that enhance or hinder simplification, and further research that shares insights may lead towards a more collective understanding of the importance of simplification. We encourage further research into this and other aspects of tax simplification.