THE COMPLEXITY OF TAX SIMPLIFICATION

EXPERIENCES FROM AROUND THE WORLD

EDITED BY
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Experiences From Around the World

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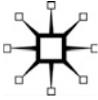

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Preface

Tax simplification has long been an area of concern to many people, including the present editors. The earliest venture by one of us into this difficult area was an article entitled 'Fiscal Fog' published in the *British Tax Review* as early as 1977. More publications followed over the years, including comparisons of attempts to simplify taxation in Australia, New Zealand and the UK by two of us with Ian Wallschutzky and, more recently, comparisons including Turkey by all three of us.

It became clear early on that tax simplification is not a simple subject – a reflection of the strong pressures on tax systems to accommodate a range of important factors and the complex and changing national and international environments within which modern tax systems have to operate. The scope for simplification also has a range of manifestations – simplifying the taxes themselves, simplifying tax law, simplifying tax forms, simplifying explanatory literature and so on.

Furthermore, there are many different approaches and potential measures that could be taken to promote simplification. There seemed to be enormous scope to examine the experience of tax simplification in many more countries, and we were therefore very grateful for the enthusiasm of Aimee Dibbens, commissioning editor at Palgrave Macmillan, for her help in getting this project off the ground. We are also very grateful for the hard work undertaken by all the contributors and Grace Jackson at Palgrave Macmillan for her help in the final stages of preparation of the book.

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Theuns Steyn is a qualified chartered accountant (CA(SA)) with a Ph.D. in Taxation. He is an associate professor in the Department of Taxation, University of Pretoria, where he is the Programme Leader for the Master's in taxation. His research interest is the tax burden of individual taxpayers. His doctoral study received the CCH/ATTA Doctoral Series Award for 2015. This study was also awarded the first prise in the Norton Rose South Africa Tax Thesis competition in 2012. In 2013 he received an academic excellence award from the South African Institute of Tax Practitioners in recognition for the contribution his research made to the taxation discipline.

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published extensively in the areas of intergovernmental finance in both developed and developing countries, incidence and compliance costs of taxation in Canada and language policy in Canada, particularly in Québec. He has been a visiting scholar in Australia, Belgium, France, India, Ontario and the US (Fulbright Scholar). He has done consulting for numerous Québec, Canadian and non-Canadian (AFD, OECD, UNDP, World Bank) organisations, with the latter work focusing on local and intergovernmental finance.

1

The Complexity of Tax Simplification: Experiences From Around the World

Tamer Budak, Simon James and Adrian Sawyer

1 Introduction

It seems clear that simplicity in taxation has considerable potential advantages, but there are important reasons why tax systems become complex. In a paper presented at the Conference of the Tax Research Network (TRN) in 2014, the present authors reviewed progress towards simplification in Australia, New Zealand, Turkey and the UK, finding that attempts towards greater simplicity in taxation had not been very successful (Budak *et al.,* 2014). One of the main reasons is that attempts to simplify tax systems are only likely to be successful and enduring if they take account of the reasons why taxation is complex. It may then be possible to find the right balance between simplicity and the aims of a tax system in terms of efficiency, equity and so on, as well as taking account of the complex environment in which tax systems have to operate. Such factors will change over time, and so the appropriate balance between simplicity and complexity is also likely to change. In addition, the situation is likely to differ from jurisdiction to jurisdiction.

Furthermore, there are different dimensions to simplification. For instance, Cooper's (1993) examination of tax simplification has been mentioned by the contributors in the following chapters: Australia, China, Thailand, and the UK. Cooper explored seven simplification issues: predictability, proportionality, consistency, compliance, administration, coordination and expression, and also suggested there were different levels of simplification: the choice of the tax base, the design of the rules applying to that tax base, the expression of those rules and the administrative requirements imposed on taxpayers.

To gain some idea of the experience of tax simplification in different jurisdictions, the authors of the chapters that follow were invited to report on the experiences of simplification in particular countries. They were also asked to include, if it were appropriate, relevant information on the following aspects of tax simplification:

- Simplification of tax systems
- Simplifying tax law
- Simplifying taxpayer communications
- Simplifying tax administration
- Longer-term or more fundamental approaches to simplification

Table 1.1 provides details of the contributors to this collection of tax simplification country reports.

Their contributions offer further evidence that simplification is rarely the highest priority in tax design and reform, but it is often an important consideration. The chapters provide a wide range of experiences relating to tax simplification in different contexts and countries, and this chapter draws some of them together. Section 2 begins with a brief summary of general issues regarding the complexity of taxation followed by a more specific examination of the themes listed above. Section 3 discusses simplifying tax systems, and sections 4, 5 and 6 deal

Table 1.1 Contributors to *The Complexity of Tax Simplification: Experiences From Around the World*

Chapter	**Contributor(s)**
Australia	Binh Tran-Nam, University of New South Wales
Canada	François Vaillancourt, University of Montreal and Richard Bird, University of Toronto
China	Nolan Sharkey, University of Western Australia
Malaysia	Veerinderjeet Singh, Chairman, Taxand Malaysia and Adjunct Professor, Monash University Malaysia
New Zealand	Adrian Sawyer, University of Canterbury, New Zealand
Russia	Alexander I. Pogorletskiy, Elena V. Kilinkarova and Nadezhda N. Bashkirova, Saint Petersburg State University
South Africa	Theuns Steyn and Madeleine Stiglingh, University of Pretoria
Thailand	Thamrongsak Svetalekth, Kasetsart University
Turkey	Tamer Budak and Serkan Benk, İnönü University
UK	Simon James, University of Exeter
USA	Hughlene Burton, University of North Carolina at Charlotte and Stewart Karlinsky, Emeritus Professor, San Jose State University

in turn with simplifying tax law, simplifying taxpayer communications and simplifying tax administration. Section 7 turns to longer-term and more fundamental approaches to simplification, such as the Office for Tax Simplification in the UK, that of the Turkish Tax Authority and the Tax Working Group (TWG) in New Zealand. Finally some conclusions are drawn.

2 Simplicity and complexity

Simplicity in taxation has, of course, advantages in terms of taxpayers being more likely to understand how they are being taxed, to be able to comply with their obligations and to be in a better position to make economic decisions. Nevertheless, as already indicated, there are powerful forces that can cause tax systems to become complex. These include the desirability of taking account of individual circumstances, the complexities of economic life, promoting certainty and countering tax avoidance. So the issue is how to identify unnecessary complexity as opposed to complexity necessary to ensure the tax system is reasonably fair, efficient and certain – see for example Ulph (2012).

It would be helpful if there were a reliable way of measuring complexity. This is certainly not an easy subject, though the work of the UK's Office of Tax Simplification (OTS) in developing a complexity index shows a promising way forward. The OTS index includes factors such as the number of exemptions, the length and readability of the legislation, the number of times it has been changed, the number of taxpayers and their average ability and the risk of tax avoidance but there are considerable difficulties involved in estimating some of these variables. Tran-Nam and Evans (2014) look to construct their own index of tax system complexity, which they develop as a summary indicator of the overall complexity of a tax system measured at a particular point in time. The aim of such an index, if utilized, would be to facilitate comparisons of the relative complexity of different countries' tax systems in the future, as well as enable assessment of the changing level of a country's tax system complexity over time.

Collectively from the chapters that follow, it is clear that tax simplification is a matter of concern in many countries, with numerous attempts having been made to simplify taxation with differing degrees of success. Measuring the level of complexity is only part of the issue of identifying the level of complexity that is 'necessary' to accommodate the various pressures on tax systems. It is also likely that the views of the different participants, including taxpayers, tax agents, revenue

authorities, policymakers and other interests will differ. Finally, there may be trade-offs between complexity and the various pressures on the tax system, so there are unlikely to be easy solutions.

Issues such as the meaning and measurement of complexity are clearly very important in developing simplification policies and are examined further by some of the authors such as Tran-Nam in the chapter on Australia and Vaillancourt and Bird in the chapter on Canada. However, the main content of contributions relating to each country is the experience of simplification, and the following section starts with the simplification of tax systems.

3 Simplification of tax systems

The most fundamental form of simplification is that of tax systems, including the number of taxes in any jurisdiction, the tax bases, the number and nature of exemptions and the structure of tax rates. Perhaps surprisingly, such simplification is not a common feature of tax reform, which perhaps provides further evidence that simplification is not the most important factor in tax design and reform. Nevertheless, there have been some significant moves in this area and one of these concerns the 'flat tax.' Essentially, this is a tax levied at a single rate on taxpayers' income whether they are rich or poor (see, for example, Keen *et al.*. 2008). There has been much discussion about the merits of such a tax in the US and in OECD countries, among others, so of particular interest is the introduction of a flat tax in Russia. In 2000 the five rates of income tax of 12% to 35% were replaced with one basic rate of 13%. Some countries of Central and Eastern Europe have followed the Russian example; see for instance Belarus, Bulgaria, Hungary, Latvia and Czech Republic.

For some other countries, the reform process is yet to be completed. In China, the ongoing reform of its business income tax and value added tax may lead to a modern form of VAT, like those used in Europe. Inextricably linked to the reform of the tax base is reform of the tax administration itself, which is also the experience of China.

It is not hard to find other cases where simplification has been achieved. For instance, in Turkey in 2004, direct taxation was reformed resulting in a simpler system. Nonetheless the pattern that seems to emerge more generally in any particular country is one where sometimes simplification is achieved, but this is offset by increases in complexity elsewhere in the tax system. In Canada, the abolition of the federal and provincial succession duties and some other taxes reduced complexity, but the

introduction of GST increased it. Many attempts at simplification have not been successful, as in the United States, where the U.S. Congress has tried and failed to simplify business taxation. It seems there is a general tendency to increasing complexity in tax systems but another possibility, given a particular tax system, is to simplify the tax law.

4 Simplifying tax law

The nature of law also poses some difficult challenges for simplification. Sir Ernest Gowers, a former chairman of the UK Board of Inland Revenue, produced a book, *The Complete Plain Words,* designed to help officials in their use of language. Gowers pointed out that the law is used to promote certainty rather than easy reading:

> [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 (Gowers, 1954).

It is not hard to see why tax law tends to be complex, and hence Prebble (1994) took the view that complexity arises from trying to fit the law around the 'natural facts of economic life'. Tax law also seeks to create artificial constructs, such as the annual measurement of income, along with seeking to tax what may be inherently complex transactions.

There have been tax law review projects in Australia, New Zealand and the UK and similar initiatives in other countries, such as Turkey. There have also been specific contributions to simplifying tax legislation such as the Tax Administration Act (TAA, 28 of 2011) in South Africa. The tax law reviews were major projects and have shown it is possible to make tax law easier to read and understand, but on their own, such initiatives are insufficient to simplify taxation generally – particularly for the vast majority of taxpayers who are very unlikely to consult the legislation themselves. At least as important as such tax law rewrite projects are communications that are aimed at taxpayers directly.

5 Simplifying taxpayer communications

Moves to simplify taxpayer communications have been made in a many countries. In the US, several presidents have sought to enhance taxpayer communications through improved access to government information and services facilitated by more clearly written documents. Such

administrative action is intended to be rolled out to legislation and regulations. To this end, the US has led the way from the highest level.

The South African Revenue Service (SARS) has implemented a number of interventions that directly or indirectly contribute towards the simplification of communication including a 'filing season' campaign of high interaction between the government and taxpayers, and both permanent and mobile branches as well as online help services.

New Zealand's Inland Revenue Department (IRD) has been proactive with respect to making its communications clearer, receiving numerous awards for its use of plain English in materials and for having the best government website. This is important given the IRD's current aim that the principal means of interaction with its customers should be via its website. Some countries such as Thailand use social media to communicate with taxpayers.

There has also been particular success with simplified (including pre-filled) returns such as the United States' 1040EZ.[1] 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

There is considerable potential for simplifying tax administration for many taxpayers even when the tax system itself is both complex and extensive, 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 can, at least in principle, withhold tax to a very high degree of accuracy. New Zealand'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, and all employee deductions eliminated) has greatly reduced compliance costs and enabled the IRD and tax agents to focus on taxpayers with more complex tax affairs. From 2014 Malaysia also made a change in this direction so that employees with specified straightforward circumstances no longer have to complete an annual return.

Alongside efforts to simplify the return filing obligations is the pre-filling or pre-populating of tax returns with data already collected by the revenue authority. These are returns incorporating information received

from third parties about the taxpayer's income and other details and the development of pre-filled returns has been examined by Highfield (2006). The role of the taxpayer in this process is to confirm that the information on the return is correct or amend it and to supply any other information required. Pre-populated returns have been used for some time, but as the application of technology to tax administration has progressed, more countries have also introduced pre-filled returns, for example Australia in 2006 (Evans and Tran-Nam, 2010). Such returns can contain details of most major sources of income together with the tax withheld, asset purchases and sales, specific deductions that are obtained from third party sources or calculated according to a formula, personal tax allowances, tax credits and even calculations of tax payable or overpayments of tax to be refunded.

In Russia, tax authorities have been executing ambitious plans to create a high-tech digital infrastructure, with the general intention being to increase tax revenue and provide better services for taxpayers. This follows a period of significant reform to the Russian tax system during the early 2000s.

Perhaps the most important challenge facing all countries is the need to ensure their tax information systems are robust and fit for purpose in relation to the increasing demands placed on them. In this regard, NZ is a case in point where any ageing system is undergoing a major overhaul that eclipses all other NZ Government information system projects, with the success of the project crucial to every aspect of the country's future tax system. The risks associated with a potential 'failure' would have a serious impact on tax simplification initiatives going forward.

7 Longer term and more fundamental approaches

Longer term fundamental approaches to tax simplification are beginning to emerge in several countries. Examples of initiatives to establish more long-term approaches to simplification include the Office for Tax Simplification in the UK, which has just entered its second period of operation following the 2015 UK Parliamentary elections. The OTS was made permanent with effect from 8 July 2015. The OTS has made progress with respect to identifying a number of important policy issues representing the 'low hanging fruit', but considerable scope remains for it to address the major policy issues that give rise to much of the tax complexity in the UK.

The Tax Working Group (TWG) in New Zealand during 2009–10 made a number of significant recommendations, including major changes to

tax rates, structures and bases. The New Zealand Government announced a major overhaul of the New Zealand tax system as part of its 2010 Budget, adopting many of the recommendations of the TWG.

James *et al.* (2015) raise the notion of 'borrowing' a concept from the setting of monetary policy, where the central bank is charged with managing inflation and interest rates. The authors suggest that, while it would be difficult to conceive any government passing operational control of taxation to an independent body in this way, they comment:

> [P]erhaps 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.

8 Discussion and conclusions

Simplification is indeed a complex issue; it is multifaceted and extremely difficult, if not impossible, to fully understand and restrain the risks of future increases in complexity. Perhaps one key point to recognize is that what may be the 'best tax system' is unlikely to be the simplest. Thus, there must be a process to weigh the trade-offs between simplicity and the other aims of the tax system such as equity and efficiency, the objectives and realities of a tax system, and the national and international environment in which it has to operate.

The meaning and measurement of complexity is another issue. As Tran-Nam (1999) suggests, there is both legal simplicity (measured by how difficult a tax law is to read and understand), and effective simplicity (just how easy is it to determine the correct tax liability). Most of the efforts to address complexity have been to create legal simplicity without really making any serious attempt to address the factors that act counter to effective simplicity to assist taxpayers to accurately determine their tax liability. Where some progress has been made, it is to eliminate the need for wage and salary earners to file tax returns, such as in New Zealand and the UK.

The balance between simplicity and the other considerations involved in tax design and reform is crucial. Where there is a disjoint, the potential

for unnecessary complexity is great. This suggests that those charged with the design and reform of the tax system should include simplicity as one of the key evaluators of any design or reform proposals.

Simplification of the tax system is the most fundamental form of tax simplification, but this is usually the most challenging and unlikely to be undertaken by a government. Nevertheless, a great deal can be achieved regarding the other aspects of tax simplification, such as tax law drafting, taxpayer communications, tax administration and longer term approaches (such as reviewing the tax structure and underlying major tax policy concepts). There is evidence of tangible success in these areas from a number of the country summaries.

Nevertheless, it is our view that permanent success is only likely if simplification is incorporated into the process of developing tax policy more generally, which necessarily requires that there be a clear process by which tax policy is developed. In this regard, New Zealand Generic Tax Policy Process (GTPP) is an exemplar of a process that facilitates inclusion of simplification that has led to moderate levels of success. Beyond this, the creation of some form of independent overseeing body, such as that suggested by James *et al*. (2015), may be necessary to bring about effective simplicity. The political reality of such a body emerging is slim, at best.

Note

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2
Tax Reform and Tax Simplification: Conceptual and Measurement Issues and Australian Experiences

Binh Tran-Nam

The chapter is derived from an Australian Research Council (ARC) Linkage project being conducted by the author in conjunction with Professor Chris Evans (UNSW Australia), Professor Richard Krever (Monash University) and Dr Phil Lignier (University of Tasmania) together with the Institute of Chartered Accountants in Australia (ICAA). The views expressed in this paper are those of the author and do not necessarily reflect those of the ARC or ICAA. This chapter also draws from previously published materials by the author. Most of these materials have first appeared in *Australian Tax Forum* and have been reproduced with permission from the Tax Institute.

1 Introduction and context

Tax reform and tax simplification are virtually synonymous. In developed countries during the past 40 years, there are no major tax reform packages that fail to mention the need for simplifying the tax system (see, for example, Institute for Fiscal Studies (IFS) 1978, 2010; United States Congress 1986; Australian Treasury 1998, 2009). In spite of that, tax systems around the world, especially in developed nations, have evolved into complex ones. Concrete international evidence of various aspects of this 'complexification' abounds. For example, an Australian Federal Court judge remarked that tax 'legislation in general is simply far too complex' (Perram 2010, p. 184). In the same year a US report noted that 'taxpayers and businesses spend 7.6 billion hours and incur significant out of pocket expenses each year complying with federal income tax filing requirements' as a direct result of tax complexity (President's Economic Recovery Advisory Board 2010, p. 3).

Governments around the world are not oblivious to this unhealthy development and have in recent years introduced various initiatives to reduce red tape burden, including tax compliance burden. Specific examples include the European Union's Action Programme for reducing administrative burdens stemming from European Union legislation (European Commission 2012, p. 2), the establishment in the UK of the Office of Tax Simplification, charged with responsibility of addressing the existing complexity of the tax system (HM Treasury 2010, p. 1), and the New Zealand's *Better Public Services* programme which aims to reduce business costs from dealing with government by 25% within five years (Ministry of Business, Innovation and Employment 2012, p. 1).

Despite the growing concerns about tax complexity in many countries as mentioned above, there is little, if any, systematic monitoring of the changing level of tax complexity in a country over time.[1] This is primarily because reliable estimates of tax collection costs (defined as the sum of tax administrative and compliance costs), widely regarded as the most meaningful measure of tax complexity, are extremely difficult to obtain on a regular basis, even with the support of the central tax administration agencies. For example, in the case of Australia, there is a time gap of about 17 years between nationwide studies of tax compliance costs (Tran-Nam et al. 2000; Tran-Nam, Evans and Lignier 2014). Similarly, in spite of the various claims of simplification-driven tax reforms in recent years, there are hardly any rigorous and comprehensive studies or evaluations of the simplification (or complexification) impact of such tax changes. To date, most assessments tend to be qualitative, lacking the support of convincing quantitative evidence.

In this context, the present chapter seeks to make a contribution to the literature by providing a comprehensive and coherent discussion on how tax simplification may be achieved or measured, and discussing Australian experiences in tax simplification (or complexification) in the past 25 years. In so doing the chapter examines three issues. First, it explores the justification for and meanings and types of tax simplification. Second, it identifies, in the Australian context, which types of tax simplification are most likely to be successful in practice. Third, it critically examines the use or misuse of tax collection costs in monitoring the changing level of tax system complexity, and proposes a way forward. The discussion in this chapter is based primarily on an economic perspective, although legal considerations are not disregarded. Further, although the scope of the chapter is confined to Australian data and examples, the arguments put forward apply generally to other tax jurisdictions of comparable countries (such as Canada, New Zealand, the UK and the US).

The remainder of the chapter is organised as follows. Section 2 considers conceptual issues relating to the justification for and meanings of tax simplification. This section seeks to establish that tax simplification is indeed welfare improving in the Pareto efficiency sense, at least potentially. Another key point here is that there are different types of tax simplification, and they may not be jointly compatible. The history of tax simplification in Australia in the past 25 years is briefly traced out in the next section. Using this as background, this section seeks to demonstrate that that tax policy simplification has not been achieved in Australia so that tax procedural simplification via the use of technology remains the most viable way to move forward. Section 4 critically examines the use of tax collection costs in monitoring the changing level of tax complexity that may arise from a tax simplification initiative. It is shown that tax collection costs, whether measured absolutely or relatively, are not appropriate for this purpose. An alternative approach, based on a tax system complexity index, is proposed. Section 5 concludes.

2 Conceptual issues

A typical modern tax system is inherently complex and dynamic. It is complex as it involves virtually all members of society either directly (through income tax) or indirectly (through consumption tax). Its process is complex and consists of distinct but interrelated stages such as tax policy design, tax law drafting and enactment, tax collection and enforcement, and tax dispute resolution. Its daily operation is also complex, involving not only a large number of tax administrators, but also numerous businesses acting as tax collectors on behalf of the government. The tax system is often driven by multiple policy objectives, many of which may not be jointly compatible. Furthermore, because of the absence of the linkage between personal tax liabilities and personal benefits, many individual taxpayers are reluctantly compliant at best. To make it worse, technological developments (e.g., e-commerce), increasingly complicate business practices, whereas international economic integration can also add to the overall complexity of a tax system.

It is therefore not surprising that tax complexity (or its inverse, tax simplicity) is itself complex. Being a multidimensional concept, the meaning of tax complexity is very context dependent. As a consequence, tax simplification is capable of having a variety of different interpretations. It can mean different things to different people depending on their perspectives or interests. For example, to personal taxpayers, tax

simplification means less time and out-of-pocket expense spent in complying with the requirements of tax laws, particularly the income tax law. To tax accountants, tax simplification means fewer chargeable hours in preparing clients' income tax returns or in providing them with tax advice. To tax lawyers, tax simplification refers to more certainty in comprehending and applying a body of tax law in various practical situations including tax planning, objections or appeals.

This chapter has so far proceeded under the implicit, common-sense premise that tax simplicity is good (or, conversely, tax complexity is bad) and that tax simplification is beneficial (or, equivalently, tax complexification is harmful). However, the above examples clearly demonstrate that tax simplification may not be immediately beneficial to tax intermediaries such as accountants or lawyers. If some people may indeed be worse off as a result of tax simplification, in what sense can tax simplification be said to be gainful? First, it may be argued that while some tax intermediaries may be worse off in the short term (because of lower chargeable hours[2]), they can expect to be better off in the long term (because of a higher level of economic activities resulting from tax simplification). Second, those tax intermediaries who are worse off can, in principle, be compensated by those who are better off, so that no one is worse off and at least one person is better off. Using economic jargon, tax simplification is said to be potentially Paretian, or welfare improving.

There is a conceptual issue relating to the gains from tax simplification. Tax simplicity is desirable as a property rather than an ultimate goal of the tax system, which is to ensure that the economy functions as efficiently and equitably as possible. This implies that tax simplification may not be an appropriate approach in all circumstances. The tax system can be complex for good reasons, and simplifying the tax system may reduce its equity or efficiency. For example, Surrey and Brannon (1968, p. 916) suggest that attempts to pursue tax rules that are easier to administer may generate tax rules that are less fair. Similarly, McCaffery (1990, pp. 1292–1294) summarised a number of arguments that support the contention that complexity is an inevitable outcome of the pursuit of greater efficiency in the tax system. In view of the potential trade-offs between simplicity and equity, or simplicity and efficiency, tax simplification is by itself desirable only if increased simplicity/reduced complexity can be achieved without excessive reduction in equity or efficiency.

There is yet another conceptual complication that deserves mention. The fact that tax simplification is desirable implies that the current level

of tax complexity is above some 'optimal' level of complexity. This raises two problems. First: Is the optimal level of tax complexity, sometimes mentioned in the tax literature (see, for example, Slemrod and Yitzhaki, 1996; Oliver & Bartley, 2005), well-defined? If it is, such a concept would be very appealing to public finance economists, tax lawyers, tax policy makers and tax administrators alike. However, as argued by Evans and Tran-Nam (2010, pp. 445–446), the optimal level of tax complexity is not well-defined, needs not be unique and lacks practical value to tax policy making, not least because the information needed to implement policy changes is not available. Second, it is difficult to empirically demonstrate that the present level of complexity indeed exceeds the optimal level. In view of these difficulties, it is proposed that we should proceed with tax simplification without worrying about any optimal level of tax complexity.

Having discussed the justification for tax simplification, it is now time to examine the meaning of tax simplification more deeply. An obvious approach is to interpret tax simplification in terms of the core attributes of tax simplicity (see, for example, Slemrod 1989, p. 157). Using the core attributes approach, tax simplification can be interpreted as any combination of the following: (i) greater predictability (tax laws become more certain), (ii) more effective enforceability (lower tax administrative costs in collecting the same amount of tax revenue), (iii) lower degree of difficulty (lower computational tax compliance costs for the same amount of tax liabilities) or (iv) less opportunities for manipulability (less tax planning, particularly aggressive planning). The internal consistency of these four possible interpretations of tax simplification will be further considered later in this section.

As an alternative, it is also possible to interpret tax simplification using the process approach (Evans and Tran-Nam 2010, p. 249). Under this approach, tax simplification can be identified in terms of the stage of the operation of the tax system where complexity may occur. In this way we can distinguish between (i) tax policy simplification (changes in tax policy design that reduce the resource costs for collecting a given amount of tax revenue), (ii) tax law simplification (rewriting of existing tax laws or replacing existing tax codes with simpler tax codes), (iii) tax administration simplification (reducing procedural red tape) and (iv) tax compliance simplification (making tax compliance operationally easier for taxpayers or for businesses acting as tax collectors).

Because tax complexity can be validly interpreted as having different meanings, a natural question that immediately arises is how compatible are the corresponding aspects of tax simplification? In other words,

do the various simplification attributes discussed above always move together in response to a tax change? If the different attributes of tax simplification are indeed jointly compatible, then the fact that the tax simplification does not have a unique meaning becomes irrelevant (or redundant). In this happy hypothetical situation, the tax authorities only need to concentrate on just any one aspect of tax complexity without worrying about any other aspects. Sadly this is not the case. It will be shown that, in some situations, these various simplification attributes move together, while, in other cases, they move in opposite directions.

This nonmonotonic relationship arises mainly because of the distinction between statutory simplicity and effective simplicity (Tran-Nam 1999, p. 508). Legal simplicity is primarily concerned with how a hypothetical taxpayer's 'true' tax liability can be determined from the tax law under consideration. Effective (or economic) simplicity refers to the value of resources expended by the society in raising a given amount of tax revenue. In shifting from comprehensibility to applicability, effective simplicity emphasises the interaction of the tax law and the economy. This is analogous to that between local income tax progression and overall tax progressivity, where local tax progression refers to the progressiveness of the income tax schedule and tax progressivity refers to the progressiveness resulting from the interaction between an income tax schedule and a distribution of income.

It is apparent that the definition of effective simplicity encompasses statutory simplicity in the following sense. Other things being equal, statutory simplification will lead to effective simplification. However, such a ceteris paribus assumption, often invoked in theoretical reasoning, does not generally hold in the real-world situation. A hypothetical example will illustrate the point. Consider, for example, two revenue-equivalent taxes *A* and *B*. Suppose that tax *B* is legally simpler than tax *A,* in the sense that it is easier to determine any taxpayer's tax liability under tax *B* than tax *A*. However, tax *B* involves many more taxpayers than tax *A*. Suppose that the increase in number of taxpayers is sufficiently large so that the aggregate collection costs of tax *B* are higher than those of tax *A*. In this case, while a tax reform that replaces tax *A* with tax *B* represents a tax law simplification, such a reform corresponds to neither an administrative nor a compliance simplification.

Similarly, it is not difficult to visualise a situation in which effective tax simplification can be achieved without legal tax simplification. For example, a substantial reduction in income tax rates may give rise to

reduced tax compliance costs (especially tax planning costs) holding the tax base constant. Similarly, an improvement in information and communication technology may lead to lower tax collection costs holding the tax laws constant. In fact, a very large innovation in information and communication technology may lead to lower tax collection costs even though tax laws have become slightly more complex. In this case, effective tax simplification and tax law simplification may move in opposite directions.

There exists an important attribute of tax complexity that is relevant to the success or otherwise of any proposed tax simplification initiative. Some factors that influence tax complexity lie beyond the direct control of the government. These include, for example, taxpayer preferences for tax liability minimisation or the risk-taking behaviour of tax intermediaries. In certain cases (e.g., high wealth individuals or large firms), the complexity of the tax system can be viewed as the outcome of a noncooperative, multi-player (taxpayers versus tax authorities) game. A complication of this game is that the behaviour of taxpayers is unlikely to be independent (e.g., successful tax planning activities by some taxpayers may induce other taxpayers to engage in similar activities). Thus, the observed level of complexity in a tax system depends not only on government policy intentions and tax administrative procedures, but also on behavioural responses of taxpayers and tax advisers.

To summarise, tax complexity is capable of having different meanings or interpretations so that the success or failure of any tax simplification initiative cannot be ascertained unless the policy objectives are clearly articulated.

3 Australia's tax simplification experiences

This section sketches out Australian tax simplification experiences in the past 25 years. It begins with a brief overview of empirical evidence regarding the complexity of the present Australian system. A concise summary of policy responses and tax simplification initiatives is then provided. It is followed by an assessment of the simplification impact of some of these tax initiatives.

3.1 Overview of the complexity of the Australian tax system

This subsection briefly reviews the complexity of the Australian tax system using the traditional indicators of tax complexity, including number of taxes, legal simplicity, use of tax intermediaries and tax collection costs.

In terms of the number of taxes, there are currently at least 125 taxes in Australia, the majority of which are imposed by the Federal Government (Australian Treasury 2008, p. xii). This total number appears to be high for a country whose governments of both political persuasions have consistently claimed to promote regulation and simplification.

Australia's two major tax laws are the income tax and the Goods and Services Tax (GST), both of which are quite massive in size. The length of the *Income Tax Assessment Act 1936* has increased from 126 pages at its inception to over 5,743 in 2008. The combined length of the *Income Tax Assessment Act 1936* and *Income Tax Assessment Act 1997* now stands at about 7,000 pages, after the removal of a significant number of pages (close to 30%) of inoperative provisions in the 1936 and 1997 Acts. The length of the GST Act is in excess of 850 pages, significantly longer than the now repealed *Wholesale Sales Tax (WST) Act*.

Reading the Australian income tax legislation is difficult and requires university education. According to Smith and Richardson (1999, p. 330), the Flesch readability index has improved from 38.44 for the *ITTA 1936* to 46.42 for the *ITTA 1997*. Both scores fall well short of an index of 65 or higher for plain English speaking. A similar situation exists for the GST with a Flesch readability index of 40.3 (Richardson and Smith 2002, p. 481).

Evans et al. (1997b: 52) found that the most common reason (62.3%) for people seeking professional advice was to comply with the legal requirements imposed by their tax obligations. In this regard, the proportion of individual taxpayers relying on the services of tax intermediaries for the completion and lodgement of their tax returns increased tremendously, from approximately 38%–40% in 1977–1978 (McKinstry and Baldry 1997, p. 136) to well over 70% in the period since 1996–1997 (Davidson 2009, p. 73). Australian individual taxpayers are generally considered to be amongst the most intermediary-dependent in the developed world (McKinstry and Baldry 1997, p. 126). An OECD survey established that 77% of all personal income tax (PIT) returns in Australia were prepared with the assistance of tax intermediaries in 2004 (OECD 2005, Table 9). Only Italy (with 96%) had a higher figure than Australia. However, the proportion of individual taxpayers using tax intermediaries has slightly decreased in recent years, falling from a peak of 77.5% in 1999–2000 (near the introduction of a GST) to less than 71% in 2009–2010 but then climbing back up to 73.5% in 2012–2013 (ATO 2010, p. 9; 2015a: Table 4).

Broadly speaking, tax administrative costs in Australia have remained at less than one per cent of net tax revenue since 2010–2011. At the

federal level, statistics published by the ATO indicate that the federal tax administrative cost ratio has declined from 1.06% in 2000–2001 (GST implementation) to 0.94% in 2006–2007 and then increased very slightly to 0.95% in 2007–2008 and 0.96% in 2008–2009 (ATO 2009b: 134). Since 2009–2010, it has steadily declined to 0.90% in 2013–2014 (ATO 2015b: Figure 2.6). Taking the States' tax administration into account, the administrative costs of the ATO and state revenue offices were about 0.9% of revenue collected in 2006–2007 (Australia's Future Tax System Review 2009, p. 309).[3]

There is a paucity of evidence regarding tax compliance costs in Australia. Empirical studies to date include those by Pope (1994), Evans et al. (more popularly known as the Atax study, 1997a, 1997b) on federal taxes, a number of smaller studies relating to the transitional and recurrent compliance costs of the GST and very recent studies by Tran-Nam, Evans and Lignier (2014), Lignier, Evans and Tran-Nam (2014) and Evans, Lignier and Tran-Nam (2014). Generally speaking, Australian tax compliance costs have been shown to be not only significant but also regressive and increasing over time (Tran-Nam, Evans and Lignier 2014, p. 152; Lignier, Evans and Tran-Nam 2014, p. 241–242).

Gross tax compliance costs of Australian personal taxpayers in 2011–2012 were estimated to vary, on average, from A$470 to A$4,000 for the lowest taxable income range (less than A$37,000) and highest taxable income range (more than A$180,000) respectively (Tran-Nam, Evans and Lignier 2014, p. 155). For Australian business taxpayers, their average gross tax compliance costs in the same financial year ranged from A$3,392 for a micro business to A$54,605 for a medium business (Lignier, Evans and Tran-Nam 2014, p. 241). Further, just under half of the overall increase of tax compliance costs of small and medium businesses from 1995 to 2012 may be attributed to the introduction the GST in 2000 (Lignier, Evans and Tran-Nam 2014, p. 247). An online survey of tax directors/chief financial officers established that the average costs of tax compliance for large Australian businesses in 2011–2012 were about A$3 million per firm, or $0.40 per A$1,000 of annual turnover (Evans, Lignier and Tran-Nam 2014).

In recent years, the ATO has started to collect and publish data on time taken to complete tax returns[4] and costs of managing tax affairs (i.e., fees paid to tax intermediaries) although only a small fraction of taxpayers is willing to respond to the ATO requests. For example, the ATO (2009a: 140) found that the average cost for managing individual tax affairs was A$268 in 2006–2007, an increase of nearly 7% on the 2005–2006 figure. For 2007–2008 the figure has further increased by 12% to A$301 (ATO

2010, p. 140). From 2010–2011 to 2012–2013 these costs has risen from A$356 to $379 (ATO 2015a: Table 39). Generally speaking, these costs have grown at a faster rate than the CPI inflation rate.

In view of the above, it is not surprising that Australian taxpayers, particularly business taxpayers, have repeatedly expressed their concerns of the growing complexity of the tax system. For example, prior to the Australian federal election in 2001, the Australian Chamber of Commerce and Industry (ACCI) undertook a mail survey of its members to assess the policy change sought by the business community. This national survey of Australian employers attracted more than 2,300 respondents. Among the 63 issues listed in the questionnaire, the most important one was frequency and complexity of changes to federal tax laws and rules (ACCI 2001, p. 1). This reflects an ongoing concern by businesses on the compliance burden of business taxation.

3.2 Policy responses and initiatives

Australia has had a long history of tax simplification. Repeated calls for tax simplification have been received from different quarters of Australian society, including businesses, tax researchers, tax lawyers and professional organisations. Various policy initiatives have been undertaken by the Australian Federal Government in the past 25 years, sometimes reactively but other times proactively. A list of Australian policy responses and initiatives relating to tax simplification is listed below.

- the Beddall Report (Parliament House of Representatives' Standing Committee on Industry, Science and Technology, 1990);
- the Tax Simplification Task Force (Treasury and Australian Taxation Office (ATO), 1990);
- the Joint Committee of Public Accounts (JCPA) Report (Australian Parliament, 1993);
- the *Time for Business* Report (Small Business Deregulation Task Force, 1996);
- the A New Tax System (ANTS) (Australian Treasury, 1998);
- the Ralph Report (Review of Business Taxation, 1999);
- various projects and post-implementation reviews commissioned by the Board of Taxation;
- the Banks Report (Regulation Taskforce, 2006);
- e-tax and pre-filled income tax returns (ATO);
- the Standard Business Reporting Program (Australian Treasury, ATO, the Australian Securities and Investments Commission, the Australian

Prudential Regulation Authority, State and Territory Revenue Office and the Australian Bureau of Statistics, 2006–2010); and
- the Henry Review (Australian Treasury, 2008–2010).

Some of the above initiatives will be described in the remainder of this subsection and then evaluated in the next subsection.

Since the late 1980s, there has been growing public awareness of and concern for the collection costs of the tax system in Australia. This growth of interest — by the academic community, the business sector, the professional bodies and the government — has mirrored similar activities overseas. In the late 1980s and early 1990s, major surveys on individual income tax, company income tax, employment-related taxes and WST were carried out by a group of university academics in Western Australia led by Jeff Pope. Their studies, commissioned in part by the Australian Tax Research Foundation, found that Australian federal tax compliance costs are very high, accounting for more than 12 per cent of relevant tax revenue in 1990–1991 (for a summary refer to Pope 1995, pp. 104–105). Subsequently, the ATO commissioned a project consisting of in-depth case studies of tax compliance costs to small firms, undertaken by Wallschutzky and Gibson at the University of Newcastle. Using the diary entry and interview approach, they concluded that '…the tax compliance issue has been grossly exaggerated. For the small businesses interviewed it was not a first order problem' (Wallschutzky and Gibson 1993, p. 541).

For its part, the Australian Federal Government has taken a number of initiatives to simplify the tax laws and to reduce compliance costs. The Beddall Report by the House of Representatives' Standing Committee on Industry, Science and Technology made a number of specific recommendations for tax simplification, some of which were implemented, for example, quarterly payments of WST and group tax (Parliament House of Representatives Standing Committee on Industry, Science and Technology 1990). However, the first major step was the appointment by the then federal Treasurer Paul Keating of a Tax Simplification Task Force involving the Treasury and the ATO in February 1990. Since then, there have been repetitions of the government's commitment to modernising tax laws and greater use of plain English (for details refer to Cooper 1993, pp. 417–418; Pope 1997, pp. 638–640).

Later, the Joint Committee of Public Accounts (JCPA) of the Australian Parliament (now the Joint Committee of Public Accounts and Audit) conducted a wide-ranging inquiry into the ATO. In its report released

in November 1993, the JCPA recommended that (Parliament Joint Committee of Public Accounts 1993, pp. xxvi–xxvii):

> the Government establish a broadly based task force to redraft the *Income Tax Assessment Act 1936* (Recommendation 22, Paragraph 5.38)
>
> and
>
> all future tax legislation be supported by a Taxation Impact Statement which details the impact on taxpayers of the legislation, including total compliance costs and the extent to which simplification objectives have been achieved (Recommendation 26, Paragraph 5.67).

In response to Recommendation 22, the Tax Law Improvement Project (TLIP) was established by the Australian Federal Government in December 1993. The mandate of the TLIP team was to 'simplify' the income tax law by rewriting and restructuring the 1936 Act with the ultimate aims of reducing compliance costs and improving compliance. As a result of the TLIP, a considerable body of rewritten laws commenced operation in the 1997–1998 financial year. It is contained in the *ITAA 1997*, which was intended to replace the 1936 Act. However, the Coalition Government's A New Tax System (ANTS) reform package (to be discussed later) announced the end of TLIP (Australian Treasury 1998, p. 149) and 1997 Act has remained incomplete.

In response to this recommendation, the Revenue Analysis Branch (RAB) of the ATO commissioned a research team from the Australian Taxation Studies Program (Atax) at the University of New South Wales to conduct a national study of tax compliance costs. The ATAX team was initially sponsored by the ATO to report upon incremental compliance costs of taxes collected by the ATO, and in particular to identify the variables that cause such costs to change as a result of legislative amendments. The full results of the incremental cost study, based on three large-scale mail surveys, were made public in Australia in 1997. Subsequently the Atax team was asked by the ATO to estimate the magnitude and incidence of total compliance costs of the Australian federal tax system in the 1994–1995 financial year, and to compare those costs with those encountered in the OECD countries. The Atax team's main findings tend to support earlier results by Pope that the compliance costs in Australia represent a significant fraction of relevant tax revenue (Evans *et al.* 1997b: ix).

The most significant Australian tax initiative during the past 25 years arose from the 1998 Australian federal election, which was fought in a

large part on alternative tax reform packages proposed by the Coalition Government and the Labor Opposition Party. In its ANTS package, the Howard Coalition Government recognised the complexity of the current Australian tax system and devoted an entire chapter to simplification of tax administration (Australian Treasury 1998, pp. 131–152). The key feature of ANTS was the replacement of the narrow-based WST (and a few State taxes) by the broad-based GST. Another major tax simplification proposal contained in ANTS was to replace five existing payment and reporting systems (Pay as You Earn, Prescribed Payments System, Reportable Payments System, provisional tax and company instalments) with a single Pay as You Go (PAYG) system. The Howard Government then claimed that its tax reform package 'will deliver higher economic growth and more jobs for Australia as a result of ... lower tax compliance costs' (Australian Treasury 1998, p. 10).

At the same time, the Howard Government also established a Review of Business Taxation (RBT), popularly known as the Ralph Review, to make recommendations on the reform of the Australian business tax system. In its first report, the RBT (1998, p. 13) asserted, amongst other things, that 'ensuing complexity of the tax law adds significantly to the costs of compliance and administration' and that a key objective of the business tax system is 'facilitating simplification' (RBT 1998, p. 60). The tax policy objective of 'promoting simplification and certainty' was reiterated in the final report of the RBT (1999, p. 105). This report also cited the findings of the Atax study mentioned above as evidence of tax system complexity in Australia (RBT 1999, pp. 575–576). One of RBT's major recommendations that is directly relevant to this chapter is the Simplified Tax System (STS) (Recommendations 17.1–17.4).

A more recent, significant tax initiative in Australia is the Australia's Future Tax System Review (AFTSR), commonly known as the Henry Tax Review, commissioned by the Rudd Government in 2008. It is the first major review of the Australian tax and transfer system since 1975. The Terms of Reference of AFTSR made direct reference to the goal of tax simplification in four of the nine objectives laid down for the Review Panel. These included that the Review should '... minimise complexity for taxpayers and the community'; consider '... simplifying the tax system, including consideration of appropriate administrative arrangements across the Australian Federation'; 'ensure there are appropriate incentives for ... reducing tax system complexity and compliance costs'; and 'take into account the relationships of the tax system with the transfer payments system ... with a view to ... reducing complexity and maintaining cohesion' (AFTSR 2009, Part 1, pp. vii–viii).

This early focus was maintained during the process of the Review's deliberations and in the Review's final report. In a document prepared for the Henry Review, the Australian Treasury (2008) devoted a full chapter to complexity and the collection costs of the tax-transfer system. Further, in the subsequent Consultation Paper by the AFTSR (2008), the words simplicity and complexity were mentioned as often as fairness/equity/inequity and efficiency/inefficiency combined. According to Kerr (2010, p. 174), throughout 280 pages of the *Consultation Paper*, the Review Panel mentioned 'complexity and simplicity 229 times, compared to 110 mentions of fairness and equity/inequity and 120 for efficiency/inefficiency'.

The Henry Review's vision of a 21st century tax and transfer system includes, significantly, the desire to 'exploit opportunities to reduce compliance costs and make interactions with the tax and transfer system easier, more certain and more understandable' (AFTSR 2009, Part 1, p. xvii). The Review noted that 'Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax and transfer systems' and suggests that 'rationalisation of the tax and transfer architecture should now be a strategic priority' (AFTSR 2009, Part 1, p. xvii). Later the Review argued that 'personal tax compliance has become inordinately complex…An opportunity exists to greatly simplify personal tax, to make its policy more transparent, and to use 21st century technologies to make it fairer, easier to comply with and more robust' (AFTSR 2009, Part 1, p. xix).

This emphasis continued throughout the two volumes of Detailed Analysis contained in the AFTSR Report. For example, specific sections deal at length with such topics as developing a simple and transparent personal tax system (AFTSR 2009, Part 2, Volume 1, pp. 5–6) and ensuring an improved client experience of the tax and transfer system (AFTSR 2009, Part 2, Volume 2, pp. 697–705). While the Henry Review and its earlier publications clearly contained a lot about the importance of simplifying the tax system, it is still unclear whether this focus moves beyond rhetoric or whether the relevant recommendations in the Review can lead the way to a more simplified interaction between the key participants.

In addition to the above tax policy initiatives, it is also worthwhile to consider the various administrative reforms that have affected tax complexity. The ATO has a long-standing commitment to simplify tax administrative requirements. For example, in March 2002, the ATO commenced the *Listening to the Community* program to develop ideas to make it easier and cheaper for people to comply with their tax

obligations. The program was first documented and published in 2003 (ATO 2003) with annual updates.

Although changes that have affected tax administrative procedures are too numerous to enumerate, key initiatives are primarily in the tax reporting area. They include Business Activity Statement (BAS), e-tax and pre-filling, and SBR (Standard Business Reporting). BAS was introduced by the ATO as an administrative aspect of the ANTS reform. It is a tax reporting requirement for businesses issued by the ATO on either a monthly or quarterly basis. It is used for reporting and paying GST, PAYG instalments, PAYG withholding tax and other tax obligations.

SBR is a standard approach to digital business record keeping and reporting to the government. The origin of SBR can be traced back to the findings and recommendations of the Regulation Taskforce, established by the Australian Government in 2006, to study the impact of regulations on business. SBR is aimed at reducing business reporting burden through increased automation of reporting, minimising duplication of business to government reporting and common data exchange language (see Zakowska 2010, p. 197). Its ongoing implementation commenced on 1 June 2010.

Significant improvements in information and communication technology have resulted in a substantial reduction in the costs of entering, storing, transmitting and retrieving tax-related data. This has made it feasible for the ATO to offer improved electronic services in response to taxpayers' needs. They include online access to information such as rulings and publications, online registration for an Australian Business Number, improvements to the ATO website's search capabilities, and social media such as Facebook, and most importantly, electronic lodgement and pre-filling. Electronic lodgement, called *e-tax*, is a free tax return preparation and lodging software for self-prepared individual taxpayers, first developed by the ATO in 1999. It has been progressively updated to include pre-filling of tax returns.

Pre-filled (also known as pre-populated or pre-completed) tax returns refer to income tax returns in which the tax administrators use information derived from third parties and their own sources to fill in relevant data for taxpayers. It began in Denmark in the late 1980s and subsequently has spread to other Nordic and EU countries (see Australian National Audit Office (ANAO) 2008). Pre-filling can be carried out with varying degrees of sophistication, ranging from the most limited level (a paper form with limited taxpayer identity or history information) to the most complete level (full automation) (OECD 2010, p. 31). Australia currently sits somewhere in the middle of this continuum, although

adoption and implementation of the recommendations of the Henry Review potentially would place it much further along the path towards full automation.

In Australia, pre-filled tax returns,[5] are relatively new, having been first mooted in 1998 and formally introduced in 2006–2007 after minor trials in earlier years. In its ANTS document, the Liberal Federal Government foreshadowed the introduction of pre-filled income tax returns by discussing the replacement of the taxpayer annual tax return by an ATO generated income statement for personal taxpayers with relatively simple tax affairs (Australian Treasury 1998, pp. 148–149). It was stated that the ATO would pilot these income statements for the financial year 2000–2001 (Australian Treasury 1998, p. 149), although nothing specific appears to have subsequently emerged from this announcement. In its 1998–1999 Report on tax file management, the ANAO (1999) suggested that the ATO should be able, in principle, to provide the information it had available in its data-matching activities to certain types of taxpayers to simplify the completion and lodgement of their annual income tax returns. The ATO accepted this recommendation, although again little appears to have happened in the immediately following years.

The second guiding principle of the *Listening to the Community* program, launched by the ATO in 2002 states that 'taxpayers will have online access to information that is personal to their dealings with the ATO'. This is closely related to the ultimate introduction of pre-filled tax returns. The ATO began piloting the concept of pre-filled tax returns using e-tax in the financial year 2004–2005 (ANAO 2008, p. 84). In this pilot, the pre-filled information was limited to two types of data collected by agents of the Australian Federal Government: Centrelink (social security) payment summaries and medical expenses recorded by Medicare Australia. In 2005–2006, the pre-filling pilot was expanded to include the 30% childcare rebate, and interest and managed fund information from selected financial institutions. Further federal funding was provided to the ATO to enable it to design and implement a more comprehensive pre-filling service for personal income taxpayers in 2007–2008 and subsequent financial years (Costello 2007).

3.3 Assessing the simplification impact of selected tax initiatives

Before attempting to evaluate the simplification impact of those tax initiatives described above, it is important to recognise from the outset that effective tax simplification in Australia and elsewhere is extremely difficult. This is because there are inherent forces from key stakeholders of the economy that work against tax simplification. From the government

perspective, tax policy is typically employed to achieve multiple, often conflicting, objectives. Whenever there is a conflict between efficiency and simplicity, or between equity and simplicity, efficiency or equity is likely to be pursued at the expense of simplicity. This is consistent with the argument, put forward in Section 2 of this chapter, that simplicity should be considered as a desirable property of the tax system, whereas efficiency and equity are truly ultimate objectives of the tax system. It is therefore not surprising that governments tend to pay only lip service to the need for tax simplification.[6] A similar situation exists at the tax administration level. Tax administrators are often under pressure to collect tax revenue. When facing a trade-off between tax revenue and administrative simplicity, the revenue motive tends to prevail.

From the taxpayer perspective, there is evidence suggesting that both personal (nonbusiness individual) and business taxpayers are willing to tolerate tax complexity to lower their tax liabilities, that is, they prefer lower tax payments over lower tax compliance costs. Businesses, especially large, multinational corporations, may also prefer complex or uncertain tax laws to exploit anomalies and loopholes and to engage in tax planning. In the case of Australian personal taxpayers, this is known as the 'tax refund' culture. A past taxpayer survey found that the majority of taxpayers considered the current personal income tax (PIT) system to be not simple (Evans, Tran-Nam and Andrew 2007, p. 41). Yet there is also strong evidence of opposition to the simplification proposal of replacing current work-related deduction claims by a flat $300 annual tax credit, with 37% of taxpayers against the idea compared to only 29% of taxpayers who supported the proposal (Evans, Tran-Nam and Andrew 2007, p. 44). In addition, like taxpayers, welfare organisations in Australia may also be more interested in shifting tax burdens away from their own stakeholders than in reducing overall tax complexity.

Tax intermediaries may not support tax simplification in view of the potential reduction in their chargeable hours as discussed in Section 2. This has been borne out empirically especially with regard to tax intermediaries whose time spent on personal and business tax returns constitutes a large part of their income. In fact, the same PIT survey above also found that, while 76% of tax practitioners regarded the current PIT system as being not simple, 67% of them opposed the proposal of replacing current work-related deduction claims by a flat $300 annual tax credit, compared with 27% who supported it (Evans, Tran-Nam and Andrew 2007, pp. 42 and 44).

Bearing in mind that major stakeholders of a tax system may not be supportive of tax simplification without conditions, we are ready to

examine in detail the previously described tax initiatives under the three heading of statutory, policy and procedural simplifications.

Statutory simplification

From a statutory perspective, simplification may be achieved by replacing an existing tax law with a comparable and simpler tax law, rewriting an existing tax law (in the linguistic and organisational sense), and removing inoperative provisions of an existing tax law. It is clear the replacement of the WST by the GST has not achieved any statutory simplification (see Evans and Tran-Nam, 2010). With its broad base, few exemptions and single rate, the GST is often described or perceived as a simpler tax than the WST. In fact, it is generally agreed among tax lawyers that the GST legislation is more comprehensive and complex than the WST legislation. Since the WST commenced in 1930, a more sensible comparison would be between the WST legislation in 2000 and the GST legislation in 2070. This is not a promising comparison for the GST.

Attempts at statutory simplification by rewriting tax legislation in simpler English and in a more coherent manner have yielded limited successes at most (see, for example, Woellner *et al.* 1998, p. 202; James, Sawyer and Wallschutzky 2015, p. 292). There is some evidence that the 1997 Act (an updated but incomplete Act) is more readable than the 1936 Act (Smith and Richardson 1999, p. 330). However, due to the discontinuation of the TLIP in 1998, income tax in Australia is now governed by two parallel pieces of legislation: the 1936 and 1997 Acts. Any gains from TLIP would have been negated, at least partly, by the coexistence of the 1936 and 1997 income tax Acts.

The third option is to rationalise the income tax legislation by removing inoperative provisions. Following an initiative launched by the Board of Taxation in 2003, an Atax research team was engaged to identify the inoperative provisions of the two income tax acts. The result of this work was the recommendation to repeal a significant number of pages (over 2,100 pages) of provisions in the 1936 and 1997 Acts. The recommendation was accepted by the Treasurer resulting in close to 30% reduction in length of the combined acts. While this has achieved some degree of statutory simplification, its affect on effective complexity would be rather limited.

Policy simplification

Tax policy reforms in Australia have not achieved effective tax simplification. The most striking example is the Howard Government's ANTS

GST-based reform. Despite lip service to tax simplicity (Australian Treasury 1998, p. 18), effective tax complexity in Australia has increased as a result of the ANTS reform. This is primarily because: (i) GST is a transaction based tax, and (ii) there are far more business taxpayers acting as tax collectors on the ATO's behalf under GST (over two million) than under WST (about 75,000). At the aggregate level, under some plausible assumptions, Tran-Nam (2004, p. 381) estimated that the annual collection costs (sum of recurrent and an annual equivalent of start-up costs) of the GST in 2002–2003 would be about A$3.1 billion, while the repeal of the WST and some State taxes would have saved the Australian economy about AUD$1.6 billion in the same year. A recent national study of business taxpayer compliance costs has confirmed that for small and medium businesses, the compliance costs of the GST and income tax would be approximately the same (Lignier, Evans and Tran-Nam 2014). The replacement of the WST by the GST has also generated higher tax administrative costs, as the ATO needs far more employees to administer the GST.

Two points deserve mention here. Despite various government claims about the GST's potential simplification impact, it was really driven by revenue (especially in the context of population ageing) and efficiency considerations. Thus, the introduction of the GST is a good example demonstrating the previous argument that when efficiency and simplicity are in conflict, it is efficiency that ultimately prevails. The second point is that under the conventional approach of 'base broadening', there is a fundamental inconsistency between tax policy reform and tax simplification. This is because base broadening typically implies compliance burden broadening, which will in turn generate pressure on aggregate tax collection costs to rise.

Another example of failed tax policy simplification is the STS mentioned previously. The STS was specifically motivated by the BTR's intention to reduce tax compliance costs for small business. In its final report, the BTR (2009, pp. 294–300) attributed small business' onerous compliance burden to accruals income tax accounting rules, deductions prepayment framework, capital allowances regime and trading stock rules. Following the publication of the BTR's final report, the STS was enacted, closely following the BTR's recommendations. The legislated STS proved to be very unpopular to its intended stakeholders, with only about 14% of eligible business taxpayers taking up this option as of 30 June 2002 (Kenny 2008, pp. 3–4). While some modifications were added to the STS to improve its attractiveness to small business, it was eventually abandoned on 30 June 2007.

Kenny (2008, pp. 12 and 28) argued that the BTR erroneously identified the cause of small business tax compliance costs as being the small business income tax accounting rules. As a result, a poorly targeted STS was developed. More specifically, the STS recommendations (i) did not provide an appropriate definition of a small business to be employed across the various tax laws, (ii) were inflexible and complex, and (iii) favoured a minority of small business. Kenny (2008, pp. 29–30) further attributed these problems to (i) a very tight timeline for the entire review, (ii) lack of knowledge of small business among three members of the BTR's Head Committee, and (iii) lack of consultation with tax experts and researchers.

To complete the discussion on tax policy simplification, we shall briefly consider the potential simplification impact of the Henry Review recommendations (for a more detailed analysis, refer to Evans and Tran-Nam 2010). The Henry Review made 138 recommendations, roughly one quarter of which mentioned simplicity/complexity or had an obvious impact on the simplicity/complexity of the tax system (Evans and Tran-Nam 2010, p. 448). Major proposals relating to personal tax simplification included pre-filled personal tax returns and simplifying personal Capital Gains Tax whereas proposals relating to business tax simplification included GST, Payroll Tax, Fringe Benefits Tax, Principles-based drafting, Trusts, Third-party reporting and SBR.

Since most of the Henry Review recommendations have been largely ignored by successive Australian Federal Governments, it seems sufficient to reproduce below an overview, a qualitative assessment of the simplification impact of the Henry Review's recommendations (Evans and Tran-Nam 2010, pp. 459–460):

> ...despite the terms of reference of the Review and its articulated vision of tax simplicity, it is also apparent that simplification is not a truly fundamental concern of the Review. In fact, looking at the structure of the two volumes of Part 2 of the AFTS Report, one cannot help but wonder whether or not simplification is truly integrated with, or embedded in, the process of tax reform. On face evidence, simplification often seems to be a 'bolt-on' or afterthought to other aspects of reform. As a result, the collection of simplification related policy recommendations contained in the Review lacks comprehensiveness and specificity.
>
> ....
>
> Moreover, many of the recommendations relating to tax simplicity/ complexity are rather vague and contain little detail as to how some

of the principles that are often espoused can be translated into meaningful action. Worse, some other proposals may even serve to increase the complexity of the Australian tax system.

Procedural simplification

From the administrative perspective, simplification can be directly achieved through:

- greater coordination with non-tax reporting (e.g., SBR);
- reduction of administrative requirements (e.g., reduce frequency of tax reporting or reduced annual filing); and
- easier completion and lodgement of income tax returns/Business Activity Statements.

A good example of greater coordination with non-tax reporting is the SBR initiative. SBR is expected to deliver numerous benefits to participating businesses, intermediaries, government agencies and the whole Australian economy. The aggregate benefit was estimated by the Australian Treasury to be approximately A$800 million in 2013–2014 when the SBR take up rate would be about 60% (Zakowska 2010, p. 203).

A preliminary study by Evans, Tran-Nam and Zakowska (2012) found that the take up rate of SBR has been significantly lower than expected, mostly due to the low level of awareness of SBR among its potential users, namely, businesses and reporting intermediaries, and to a lack of conviction and consensus about the expected benefits and beneficiaries of SBR. The study further suggested that, while SBR may have some potential to reduce the reporting compliance burden of businesses in the longer term, the Government's initial business case that predicted savings of A$800 million in 2013–2014 was overstated. It recommended the government to take ownership of driving the demand for SBR, which should involve direct educational and marketing programs tailored to specific information and reporting needs of the potential SBR stakeholders.

With respect to reduction of administrative requirements, Australian progress to date has been not been positive. For example, BAS requires businesses to report income and pay income tax more regularly than in the past. It seems to be motivated by tax revenue consideration and its origin can be traced back to the findings of the Atax study (Evans et al. 1997b) on cash flow benefits enjoyed by some business taxpayers in complying with tax requirements. It is well-known that more frequent

reporting of business income adds to tax procedural complexity and increases tax compliance burden of businesses, particularly small businesses.

With respect to income tax returns, Evans (2004) put forward the case for reduced annual filing for certain categories of personal income taxpayers in Australia. He identified three conditions for making such a reduction possible (i) fewer personal income tax rates (Australian currently has five rates), (ii) a more comprehensive and cumulative tax withholding at source regime, and (iii) the removal of most work-related deductions. To date, however, Australia has not moved in this direction, preferring instead to adopt the less radical alternative of pre-filled tax returns. This preference for pre-filling rather than reduced filing is confirmed in the recommendations of the Henry Review and in the Government's initial response.

To the best of the author's knowledge, there are surprisingly no rigorous empirical evaluations of the costs and benefits of e-tax and pre-filling in Australia and overseas to date, despite the fact that these initiatives started about two and half decades ago. Mots claims of or discussions about the benefits of e-tax or pre-filling are based on common sense and tend to be qualitative (OECD 2008, p. 4; Evans and Tran-Nam 2010). There is nonetheless some evidence of the benefits of e-tax and pre-filling in Australia. Perhaps the most visible evidence of e-tax's benefit is the declining trend of dependence on tax intermediaries which started from 1999 to 2000 when e-tax was first introduced. This would also imply a decrease in aggregate personal taxpayer compliance costs. For personal taxpayers electing to use e-tax (without pre-filling) instead of tax intermediaries, their savings from tax intermediary fees would outweigh the value of extra time spent on completing and submitting their tax returns.[7]

Pre-filled tax returns in Australia basically leverage off the ATO's data-matching activities. In fact, pre-filling is defined by the ATO as the provision of information that it typically uses for data-matching purposes, directly to an individual e-tax preparation or record keeping tool. Although data on the recent trend of pre-filling usage in Australia is not publicly available, a previous study by Evans and Tran-Nam (2010) demonstrated that the proportion of e-tax users and tax intermediaries (who use pre-filling information) was rising rapidly from 2006–2007 to 2008–2009. In the case of pre-filling, a second area in which there may potentially be compliance cost savings is in the reduced time taken by both self preparers and tax intermediaries in completing tax returns as a result of the more ready availability of data relevant to the returns.

Further, the psychological benefits to taxpayers (knowing that their tax records are consistent with pre-filling data) would be immense.

In this sense, pre-filling can be interpreted as the Australian government's attempt to build a direct bridge between the ATO and individual taxpayers, further strengthening the existing bridge between the ATO and tax intermediaries. It is a bridge building exercise because of the ATO's goodwill in revealing to individual taxpayers (either directly or via their tax intermediaries) what the ATO knows about them. This may have a positive impact in the cultivation of a cooperative tax culture. However, it is important to note that, because of the use of technology, the relationship between taxpayers and tax administrators continues to remain impersonal (no face-to-face contact). Thus, the expected degree of objectivity and impartiality can be maintained in the conduct of tax administration.

Pre-filling could potentially reduce tax administrative costs to the ATO via reduced needs for data matching, auditing and tax dispute resolution. At the same time, the uploading of pre-filling data to e-tax and the Tax Agent Portal requires additional resources. Further, the provision of third-party information for pre-filling also requires resources. While there is no concrete data, it seems plausible that to suggest that the net savings in tax administrative costs (including the costs incurred by third-party information providers) that result from pre-filling would be negligible in either direction.

Summary assessment

In summary, tax statutory reforms in Australia have generated a very modest simplification impact, whereas tax policy reforms have resulted in overall complexification. More specifically, the GST-based reform has produced a more complex federal tax system from both statutory and tax compliance burden perspectives. This is primarily because modern tax reforms are often based on the principle of tax base broadening, which typically implies compliance burden broadening.

It is argued here that in Australia procedural simplification is most likely to be achievable and have the greatest impact. This partly reflects the strength and ability of the ATO in implementing administrative reforms. An indirect benefit of procedural simplification is its ability to promote a more cooperative tax culture, especially between ATO and individual taxpayers. Note however that procedural simplification mainly results in reduced computational costs of tax compliance, but not necessarily planning costs of tax compliance.

For completeness, we should also mention those tax reforms, which are not intended to simplify the tax system, do have positive influence on

tax compliance costs. An example of such reform is a tax reform which lowers the individual income tax rates (both the average and marginal rates, especially the top marginal tax rate). While such a reform does not represent a legal simplification, it can nevertheless be an effective simplification in the sense that a decrease in the marginal individual income tax rates or an increase in income tax bands may diminish individual taxpayers' intention to engage in tax planning and thus reduce tax compliance costs. Note that individual income tax rates in Australia have been reduced many times in the past 25 years, but there is no formal study of the impact of these changes on tax planning behaviour of individual taxpayers.

4 Measurement issues: how to monitor the changing levels of tax complexity

Having considered conceptual issues relating to tax simplification and Australia's experiences in this area, it is now time to examine how tax complexity can be measured over time or across tax jurisdictions. Specifically, how can we measure the simplification impact of a tax change or initiative? Or, more generally, how do we measure the changing level of tax complexity? Since tax collection costs have been widely considered the most meaningful measure of tax complexity, this section will examine the use of the tax collection costs in measuring or monitoring the changing level of complexity. For the sake of simplicity, the following discussion will focus on tax compliance costs, since they constitute the bulk of tax collection costs.

Empirical studies of tax compliance costs tend to report both absolute and relative estimates of tax compliance burden. The absolute estimate is typically the annual dollar value of average tax compliance costs (i.e., dollars per firm per year). The relative estimate is normally calculated as either (i) the ratio of aggregate tax compliance costs over some relevant tax revenue collection, or (ii) the ratio of average tax compliance costs over taxpayers' income (for personal taxpayers) or turnover (for business taxpayers). While both absolute and relative estimates are widely reported in empirical studies, there are a variety of issues associated with these estimates as an indicator of tax complexity. These are (i) determining the appropriate concept of tax compliance costs, (ii) the tax rate effect, and (iii) the combined effect of non-tax factors on tax compliance costs. Each of these will be considered in turn below.

An important contribution of the Atax study (Evans et al. 1997b) is the distinction between social and taxpayer compliance costs, which are

sometimes referred to in the literature as gross and net tax compliance costs respectively. The former represents the costs to the economy (deadweight losses) and is a figure likely to be of greater interest to governments and economists. The latter can be taken as the costs directly borne by taxpayers, i.e., additional production costs to business taxpayers or additional taxes to personal taxpayers. Taxpayer compliance costs are therefore the figure that is likely to be of greatest interest to the business or other taxpayer lobbies and to revenue departments. Taxpayer compliance costs are often derived by subtracting offsetting benefits to taxpayers (such as tax deductibility and cash flow benefits/costs, and direct cash subsidies) from social compliance costs. Note that offsetting benefits are in fact costs to the government and thus vanish from the social perspective.

The distinction between social and taxpayer compliance costs is not merely pedantic since these costs do not necessarily vary in the same direction. For example, it was found that, in 2011–2012, the average social compliance costs of Australian personal taxpayers in the highest and second highest taxable income ranges were A$3,998 and A$1,556 respectively (Tran-Nam, Evans and Lignier 2014, p. 152) whereas their corresponding average taxpayer compliance costs were A$740 and A$977 respectively (Tran-Nam, Evans and Lignier 2014, p. 156). This inconsistency raises the question about the suitable concept for measuring or monitoring tax complexity. Based on a public finance perspective, North American researchers regard social compliance costs as being appropriate for measuring tax complexity.[8] To them, taxpayer compliance costs are not relevant to tax policy making. Assuming that required data is available, it is preferable to estimate and report both social and taxpayer compliance costs.

A related issue is that of managerial benefits, which may be defined as improved business decision-making arising from better information being available as a result of more stringent record keeping requirements. Unlike tax deductibility or cash flow benefits or direct subsidies, managerial benefits are genuine benefits to both businesses and the society as a whole. Thus, in principle, social compliance costs should be defined net of managerial benefits to business taxpayers. However, up to now, conceptual and empirical monetisation of managerial benefits is only at a preliminary stage (see, for example, Lignier 2009).[9] It is apparent that incorporating managerial benefits into tax compliance cost estimation represents a very promising direction of research in future empirical studies.

The unit-free ratio *ATCC*/*T* (where *ATCC* stands for estimated aggregate tax compliance costs and *T* for relevant tax revenue) has been

frequently used as a basis for comparing the compliance complexity over time or across countries. As pointed out by Sandford (1995), this sort of comparison is fraught with difficulties and is more likely to mislead rather than inform. This chapter goes further by arguing that the ratio $ATCC/T$ is conceptually an unsatisfactory indicator of tax complexity. Sandford (1995, p. 297) observed:

> In 1977–78, as well as a zero rate, the UK had a standard rate of VAT of 8 per cent and a higher rate of 12½ per cent. In 1979, the higher rate was abolished and the standard rate raised to 15 per cent. The effect, once the change was fully implemented, was to reduce the cost/yield ratio by almost a half from just over 2 per cent to just over 1 per cent.

According to the relative measure of aggregate tax compliance costs $ATCC/T$, raising the tax rate alone brings about tax simplification. This does not make sense, and the need to find an alternative measure is apparent.

Since tax revenue is equal to the tax base multiplied by the tax rate, dividing $ATCC$ by T adjusts for the effect of the tax base (e.g., number of taxpayers and business cycle). To adjust for tax severity, it is necessary to multiply $ATCC/T$ by the overall tax rate T/Y where Y is total output or GDP. This yields $ATCC/Y$, which seems to be a more appropriate relative cost measure than $ATCC/T$. Put simply, the proposed measure is equal to the conventional measure multiplied by the degree of tax severity (i.e., the overall tax rate).

The unit-free ratio TCC_i/S_i (where TCC_i stands for estimated average tax compliance costs of the ith-category taxpayer and S_i for ith-category taxpayer's average income or turnover) has been frequently used as a basis for measuring the extent of regressivity of tax compliance burden. Unlike $ATCC/T$, this ratio does not directly suffer from the tax rate problem, and can thus be used for temporal or international comparisons. However, there is still a practical problem in determining S_i, as the required data is typically unavailable to the researcher. The common practice of using an arbitrary midpoint of a income tax band or a turnover range is practical but not conceptually sound.

The use of absolute measures of tax compliance burden for comparison is slightly more problematic because it is unit-dependent. However, for temporal comparisons, the effect of price inflation can be eliminated by expressing tax compliance costs in constant dollars (i.e., by dividing tax compliance costs in current dollars by some appropriate price index

series). For international comparison, either the nominal exchange rate of the purchasing power parity exchange rate can be employed.

Finally, there is a question regarding the effects of non-tax determinants of tax compliance costs. In view of the discussions so far in this chapter, we can express tax compliance costs as a function of tax and non-tax variables as follows:

$$TCC = f(C, t, TECH, \boldsymbol{Z})$$

where TCC = tax compliance costs (in constant dollars), C = legal complexity, t = the (marginal) tax rate facing the taxpayer, $TECH$ = extent of the taxpayer's use of information technology, and $\boldsymbol{Z}$ is a vector of taxpayer's relevant characteristics, such as legal form, industrial sector, size and age of business (for business taxpayers) or income and employment status (for personal taxpayers). It is assumed that, other things being equal, TCC varies in the same direction as C and t, and in the opposite direction as $TECH$.

In the above equation, estimates of TCC can be derived from survey research. If the values of t, $TECH$ and Z remain unchanged, then the change in TCC over time represents the change in tax complexity over time. Since all the variables in the right-hand side of the above equation tend to vary simultaneously over time, it is not at all clear how much of the change in TCC can be attributed to tax simplification/complexification. In other words, we cannot deduce the simplification impact of a tax initiative on the basis of estimates of tax compliance costs alone. In principle, a regression analysis can be performed to isolate the influence of C on TCC. In this case, a change in C can be deduced from a change in TCC. However, such analysis requires data on C, which is the very answer we are seeking. That is, if we know how C changes over time, there is no need to perform the regression analysis in the first place. In any case, available estimates on TCC are unlikely to be sufficient for such regression analysis.

There are basically two ways forward. A simple approach is to report how $ATCC/Y$ and a variety of relevant indexes (such as overall tax rate and use of technology) change over time. In this way, a picture of how tax complexity varies over time may emerge.

A more sophisticated, and much more data demanding, approach is to construct a tax system complexity index (Tran-Nam and Evans 2014). It is proposed that the tax complexity index should be calculated as a weighted geometric mean of relative changes in identified complexity factors, which are in turn derived from careful empirical studies.

Complexity factors include, for example, number of taxes, proportion of taxpayers affected by the legislation, length and readability of tax laws, frequency of tax law changes, etc. It is also suggested that the weights associated with complexity factors should be derived from careful stakeholder input using a Delphi methodology. The successful construction of such indexes depends critically on the difficult and challenging task of obtaining reliable estimates of complexity factors and establishing appropriate weights.

5 Summary remarks

This chapter provides a comprehensive discussion on (i) how tax simplification may be defined and measured, and (ii) the simplification impact of Australia's tax reforms in the past 25 years.

First, the justification for and meanings and types of tax simplification are considered. The chapter proposes that, unlike equity and efficiency, tax simplicity is desirable as a property rather than an ultimate goal of the tax system. Bearing in mind that there may be losers from tax simplification and provoking the compensation principle of welfare economics, tax simplification is shown to be potentially Paretian improving. The chapter also suggests that tax simplification should be pursued regardless of the optimal level of tax complexity, whether such a level exists or not.

Two main approaches to defining/interpreting tax simplicity are presented: the core attributes, and the process approaches. As a multidimensional concept, tax complexity is capable of different meanings so that the interpretation of tax simplification can also be very context dependent. Legal and effective simplification are distinguished. It is then argued that the relationship between legal and effective simplification can be nonmonotonic or inconsistent. This poses as a challenge to tax policy makers. A further challenge is that some factors that influence tax complexity lie beyond the direct control of the government.

Second, Australia's tax simplification experiences in the past 25 years are examined. It is suggested that tax simplification is difficult to achieve because there are inherent forces from key stakeholders that work against it. Not surprisingly, despite past simplification efforts, the current Australian tax system is shown to be complex in terms of conventional indicators of tax complexity, such as number of taxes, legal complexity, use of tax intermediaries and tax collection costs. A summary list of major simplification-related tax initiatives in Australia since 1990 is provided. In particular, the Beddall Report, TLIP, GST-based reform, Ralph Review

of Business Taxation, the Henry Review of Australia's Future Tax System, and a small number of tax administrative reforms are reviewed.

It is argued that tax statutory reforms in Australia have produced negligible simplification impact, whereas tax policy reforms have 'complexified' the federal tax system. This is simply because tax reforms in Australia have been associated with tax base broadening, which in turn implies compliance burden broadening. Australia's procedural simplification, which makes use of information technology improvements, such as e-tax, pre-filling and SBR, is most likely to be achievable and have the greatest impact. While the benefits of such changes are confined to computational compliance costs, procedural simplification, especially pre-filling, is also capable of contributing to a more cooperative tax culture. It is also noted that reducing income tax rates or lengthening the income tax bands can potentially reduce tax compliance burden through less tax planning.

Third, the chapter examines the use of tax compliance costs as an indicator of the changing levels of tax system complexity. Apart from the availability problem, there are also issues in using conventional absolute and relative measures of tax compliance costs in monitoring how tax complexity changes. Three specific issues, namely: the use of social versus taxpayer compliance costs, the tax rate and the influence of non-tax determinants of tax compliance costs, are considered. It is shown that even if even if reliable estimates of tax compliance costs were readily available, it would still be very problematic to use such information to compare tax complexity over time or across countries. Thus, the simplification impact of any tax initiative cannot be inferred from changes in tax compliance costs alone. A way to move forward, which involves the construction of a data demanding tax system complexity index, is then proposed.

Notes

1. An exception is perhaps New Zealand, where the Inland Revenue (IR) has either sponsored or conducted comprehensive surveys of tax compliance costs of small and medium enterprises at regular intervals in 2004, 2009 and 2013 (Brunton 2004; IR 2010, 2014).
2. In addition to lower chargeable hours, tax intermediaries may also incur direct costs in learning about tax simplification. These costs are most relevant to those tax intermediaries who are about to retire from work.
3. The Australian Treasury did not cite their sources. Their figure implies that the administrative cost ratio of all States combined is less than that of the ATO, which is not obvious to the author.

4. The (optional) time box was introduced to tax returns in the late 1990s following a recommendation of the Atax study.
5. While pre-filling appears as 'pre-filling service – e-tax' on an ATO webpage (see http://www.ato.gov.au/individuals/content.asp?doc=/content/58871.htm), it is known within the ATO as 'pre-filling of income tax returns' or more often just as 'pre-filling'. The term 'e-tax' is omitted because e-tax is used by self preparers (individuals) while three quarters of pre-filling use is by tax agents via the Tax Agent Portal.
6. The demise of the tax value method (TVM) proposal on the basis of potentially excessive transitional costs of implementation represents an exception.
7. In terms of time spent on completing and submitting income tax returns, the Atax study suggested that there is a clear difference between those personal taxpayers who self prepare (2.2 hours annually) and those who use tax intermediaries (1.8 hours annually) (Evans *et al.* 1997b, p. 77).
8. It is interesting to note that Australian Treasury (2008, p. 310) chose to report Atax's findings on taxpayer compliance costs, which in turn misled Slemrod (2009, p. 5) since his own research is only concerned with social compliance costs. In fact, keeping the size of the economy in mind, Atax's estimate of social compliance cost ratio of 11.9% for all taxpayers is comparable with his estimate of income tax compliance costs at 10% of income tax revenue for US taxpayers (Slemrod 2009, p. 5).
9. A research team that includes the present author is currently working on an Australian Research Council (ARC) project on tax system complexity that involves estimating the magnitude of managerial benefits.

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3

Simplicity in the Chinese Context: The Categories of Differential Income Tax Treatment and Their Complications

Nolan Cormac Sharkey

1 Introduction

Simplification of income taxation in China is an issue that differs significantly from most of the other countries covered in this book. Indeed, the very question of whether Chinese income taxation is relatively simple or relatively complicated by international comparative standards is not readily determined. The essence of the difficulty of typifying the Chinese tax simplicity situation is the tax institutional environment in China which does not represent strong, developed rule of law. By way of expansion, elsewhere in this book,[1] the difficulty of understanding the concept of complexity in taxation is considered and reference is made to Cooper[2] who suggested that there are at least seven issues to be considered:

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. Coordination. 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.

Reviewing these seven issues, it can be seen that simplicity is being understood in terms of 'a rule'. This way of understanding simplicity highlights one of the core challenges of understanding tax simplicity in China, in that it is not always clear in China what is or is not a rule in the first place.[3] There are, in addition, a number of other challenges in understanding tax simplicity in China. This chapter will consider a number of dimensions of income tax law, administration and practice in China to highlight how it raises significant different challenges to ideas of simplicity in tax. It will show how, in some ways, tax in China is simple while in others it is highly complex. The only certainty about the situation is that it is getting more complicated with the growth and diversification of the Chinese economy and its links to the world.

The scope of this chapter is limited in scope to China's income tax. That said, a number of the issues raised apply just as significantly to China's other taxes. These include, notably, the Value Added Tax and the Business Tax, which are very important in China.[4] The chapter will highlight a number of features of the Chinese tax environment that may be considered to affect simplicity in Chinese tax. It will not offer any economic impact assertions but will seek to only raise points of relevance from a conceptual perspective.

2 Law and administration – China's core challenge to simplicity

The author of this chapter has explored the key challenge of Chinese income tax extensively in other work.[5] This will not be repeated here, although it must be briefly reviewed as it is both the core complicating (or simplifying) factor in Chinese taxation and makes the issues that are explored in this chapter significantly more complicated in practice than they already appear here. The core challenge has two major dimensions:

1. The scope of the tax law is not clear in relation to many commercial transactions, structures and features.

2. Administrative decision making determines unclear tax outcomes in practice, and this is highly decentralised in a very large jurisdiction.

The first factor arises because Chinese income tax law is very brief by international standards despite the fact that it deals with complex concepts.[6] This is in contrast to the extensive law of a country such as Australia that also deals with complex concepts or the briefer law of a jurisdiction such as Hong Kong that adopts simpler tax base concepts. China's enacted tax laws are in fact significantly briefer than Hong Kong's. China's laws are supplemented by a number of regulations, announcements and notices. However, the entire body remains brief, taken as a whole. In addition there are significant issues in relation to the status and applicability of many of these other notices and announcements. Issues related to translation and language add to complications both from a non-Chinese reader's perspective and because the various announcements may attempt to translate international practice into Chinese.[7]

This situation with law means that even though it is simple in the sense that it may be read quickly, it ultimately leaves many unanswered questions about its scope. Thus it becomes complicated as taxpayers, tax administrators and professionals need to deal with the unanswered questions before they can anticipate tax outcomes or finalise tax compliance.

The answers to these questions in China are not generally found through taxpayer or professional research. Neither are they found through litigation. Rather, they are generally found through direct consultation with the tax administrator. Taxpayers generally work closely with tax administrators in China and ask what tax outcomes will be. While there may be some scope for negotiation, there is generally little that is done to dispute or challenge the tax administrator's view.[8]

This institutional situation, therefore, has both complicating and simplifying features. While there are genuine rule of law issues and there may be problems with many planning issues, there are arguments that tax compliance may actually be simpler where answers are obtained from administrators rather than through legal research, advice and litigation.[9] However, there are many complicating factors in a system where reference must be continually made to the administrator for certainty. Such reference is time-consuming and may not be feasible in early stages of business planning. Notably, no body of public information develops to provide answers to other taxpayers who may have the same questions.

The second core factor noted above makes the Chinese tax system far more complicated given the role of the administrator noted immediately

above. This is that the relevant administrative decision making is, in the greatest proportion, done at a highly decentralised level. Tax administration is managed at the city or sub-city level of government in China. There is little elevating of decision making up the administrative hierarchy to a provincial or national level. This decentralised detailed decision making is an essential feature of administration generally in China and is not easily departed from.[10]

In many ways this aligns well with how tax certainty is sought by business in China as discussed. However, it creates a significant complexity when considering the regime as a whole. This is because it is clear that tax outcomes in relation to the same businesses or transaction forms must be treated differently in different parts of China despite the nationally applicable law. This is inevitable given the uncertainty in the available law and the fact that this uncertainty is resolved in many different locations in China with little exchange of information amongst them. Even with the best efforts to interpret the law directly, variation is inevitable. However, it is also the case that Chinese administrators may administer with local economic goals and other factors in mind. Therefore, depending on these, they may alter their interpretation consciously to facilitate particular goals. While this may arguably be contrary to the spirit of the tax law, it is not necessarily contrary to the overall economic model of government in China that caters to local variation to suit local goals.

What is clear from this form of administration is that taxation in China is far more complex in practice than it otherwise appears. It has the potential for significant differences in tax treatment at a city, or even sub-city, level. This means that it is difficult to say how many transactions will be treated for tax purposes in China. The counter to this is that many uncertainties can be resolved quickly in consultation with officials in a relevant city. This may make tax practice simpler in China in some respects. However it is clear that a taxpayer who has the ability to move between cities may arbitrage between them given the local variations. This creates significant complexity in what appears on first impression to be a simple tax regime.

This institutional context is critical to any understanding of taxation in China and any commentary on it, whether academic or professional. It is highly relevant to any discussion of simplicity in China, although how it may be ultimately summarised in this context is difficult to determine. The chapter will now consider a different aspect of the simplicity discussion in China. The analysis will focus on complexities in the core concepts and distinctions that define the income tax base in China.

In this discussion, the complexities of the institutional context just reviewed are not covered. However, it is clear that they will make the complexities identified far more significant in practice.

3 Structure of the income tax regime and its development

Income tax in China is currently levied under two laws which provide for two separate taxes. These are the Enterprise Income Tax Law,[11] which provides for the Enterprise Income Tax and the Individual Income Tax Law,[12] which provides for the Individual Income Tax. Prior to the 2008 tax reform that saw the introduction of the new EIT, income tax was levied under three separate taxes, the IIT, the (Domestic) Enterprise Income Tax[13] and the Foreign Investment Enterprise and Foreign Enterprise Income Tax.[14] Hong Kong and Macau are treated as separate jurisdictions for tax purposes and have their own tax laws. Income tax laws and regulations were also rationalised from 1990 to 1993, which saw the introduction of the DEIT and the FEIT to replace a number of different income taxes that applied to different forms of enterprise in China.

4 Different taxes, not simply different statutes

It is important to note that these are and have been separate taxes as opposed to just different laws imposing a single tax, as is the case in Australia, for example. In Australia the income tax covers individuals and companies, and tax liability is determined under two Acts, the Income Tax Assessment Act of 1936 and 1997.[15] However, the two Acts cover one tax, and individuals and companies are taxpayers under the one tax. This is not the case in China, where the separate tax laws and regulations have imposed their own taxes.

The distinction is that in Australia, the law imposes the same rules on all taxpayers whether they are companies or individuals, other than in cases where it provides for different treatment. In China, the taxpayer needs to be considered under each tax to consider their liability under that tax in accordance with its rules only.[16] The difference between the two situations is more significant than it may appear to be. First it means that all rules (say for deductibility of expenses) and all discussion about them has limited application to only one tax. This means that a controversy resolved under one tax may not resolve a similar controversy under another tax. While it should not occur in principle, there is also the possibility of double taxation under the two taxes if they can both be argued to apply to the same economic activity.

5 Schedules as taxes

The structure of the IIT exacerbates this situation in that it has a scheduler structure with eleven schedules.[17] The way that these work allows a strong argument that the IIT, in itself, imposes not one but eleven separate taxes. This is because, to a very significant extent, liability under one schedule of the IIT is determined by the rules applicable to that schedule with very little concern for other schedules.[18] The rules also vary significantly from schedule to schedule with no harmony of treatment. For example, the schedule applicable to dividends imposes a flat 20% tax on the gross receipt, the schedule applicable to wages imposes marginal tax rates on the monthly wage with a deemed deduction and the schedule applicable to personal service income imposes tax on individual payments at 3 different rates depending on the amount of the payment.

Notably, liability under one schedule has no impact on liability under a different schedule. A person with a monthly wage of X will pay the same tax on that wage regardless of the amount of income they have derived under other schedules. So wages are subject to marginal tax rates, but these only increase in proportion to monthly wages, not individual income generally.[19] Even the taxpayer under the different schedules is not entirely consistent. Industrial and commercial households are taxable under the IIT on their business profits. However, it is the household itself that is the taxpayer in these cases and not the individual.[20] Thus there exists the possibility of an enterprise taxpayer under the IIT distinct from under the EIT.

6 The complexity of determining the applicable tax

The broad coverage of China's income tax regime given thus far indicates one of its significant areas of complexity and also one of China's attempts at simplification. At the same time, it will be shown below that one of the motivations for the apparently complex system is an attempt at simplicity. This apparently paradoxical situation will be explored below.

The complexity of the structure of the laws with different taxes and schedules is significant. It creates, at the outset, the need for a taxpayer, advisor or administrator to allocate an activity or amount of income to one of the broad taxes or schedules. A decision needs to be made as to whether an enterprise exists that will allow the EIT to be considered or whether the item needs to be considered under the IIT. If under the IIT,

it needs to be considered which of the eleven schedules it falls under. The eleven schedules of the IIT are[21]:

1. Wages and salaries
2. Business and production income of industrial and commercial households
3. Enterprise contracting/leasing
4. Personal services
5. Manuscript remuneration
6. Royalties
7. Rentals
8. Property sales
9. Interest and dividends
10. Contingency
11. Other

Thus combining the eleven schedules with the EIT, there are twelve regimes that might apply to a particular transaction or activity.

7 Historical reforms and their simplifying impact

Prior to the tax reform of 2008, there was an additional distinction to consider in that the EIT was split between the DEIT and FEIT, and therefore enterprises needed to be considered to determine whether they fell into one category or the other. As noted, prior to the 1990–1993 tax reform, the enterprise landscape was even more complicated with a number of different tax regimes linked to the different enterprise forms possible in China in addition to the IIT. What is apparent from this is that one of the stories of income tax simplification in China is already observable. That is the harmonisation of the different forms of enterprise tax into either the DEIT in 1993 or the FEIT in 1991 was, in part, an attempt to simplify China's income tax regime. This process was continued with the 2008 unification to the DEIT and FEIT tax bases. There were of course other motivations for the reform. From a broad perspective, the desire to treat things the same has simplification benefits as well as efficiency and equity benefits as treating enterprises the same is viewed as both fairer and as reducing economic distortions.

8 Historical context

The history of contemporary China's income tax development is instructive as to how the divided system arose and why it became

inadequate. The core drivers behind the inadequacy will, it is submitted, continue to create a need for reform that harmonises the various regimes in China's income tax. China's original tax structure is intimately connected to Chinese economic policy from the late 1970s through the 1980s.[22] It is important to note that the allowance of both private sector economic activity and foreign trade and investment by the Communist government has been a gradual process that started from nearly none at the beginning of 1979 and developed to the comprehensive and flourishing private sector and foreign trade and investment of the current century. Although it is tempting to view the process as being a planned gradual transition (as distinct from a big bang process), the better view is that there was no major transitional goal at the outset and that various allowances were made in a piecemeal fashion with specific economic benefits in mind. It was only when the benefits became clear that a more thorough policy of transition was adopted in the early 1990s, which then became complete and extensive at the turn of the century.

Given the redundancy of taxation under communism, the specific allowances for specific types of private economic activity only required tax rules specific to those activities. Thus the income tax rules prior to the 1991 to 1993 tax reform consisted of specific rules introduced in conjunction with or in relation to rules that permitted types of economic activity. For example, Sino-Foreign Equity Joint Ventures (EJVs) had their taxation rules proffered as part of the rules permitting EJVs.[23] As the various forms of private economic activity were initially viewed as limited, for a specific purpose and not part of a change to the overall economic structure, there was not the necessity to consider comprehensive income tax rules covering a comprehensive income tax base.

The Chinese experience was, however, one where private economic activity, both domestic and foreign, was immensely successful and often developed more rapidly than the economic laws that permitted it. Often a new rule allowing a particular form of activity simply legitimated an economic evolution that had already occurred. Thus, China's economic diversity and development outpaced its commercial laws and, more significantly, its tax laws.[24]

The extensive and diverse economic activity in China at the end of the 1980s exposed the inadequacy of the tax regime in place at the time. The more extensive the private sector, the more issues of efficiency, equity and simplicity became critical. The differences in the tax treatment under the different rules created distortions and also provided a motivation to arbitrage between the different regimes to obtain tax benefits. In addition, the extent and the success of the private sector

called the performance of the state-owned sector into question at the end of the 1980s. Prior to this, it was assumed that China was a state-owned economy with some private and foreign concessions for specific benefits.[25] The success of these, however, raised the issue of the comparative economic performance of the two sectors as a whole. It was realised at this time that the private sector would be permanent and significant if it was allowed to continue. By 1992, it was clear that China would fully embrace the private economy as was symbolically acknowledged through Deng Xiao Ping's tour of the south.[26]

These changes in the Chinese economy spurred its need for tax reform. The 1991 to 1993 reform of enterprise taxation through the introduction of the FEIT and the DEIT simplified taxation by harmonising the taxation treatment of all enterprises under one or the other of the two laws. Now all enterprises would be subject to taxation under the same core rules. Notably this included State-Owned Enterprises (SOE). It was seen as essential that all enterprises be treated similarly to ensure equal performance motivation and efficiency. The previous laws had treated different structures differently, and this was sought to be remedied. In addition, the policy towards SOEs changed with an aim of making them subject to market forces to improve management. Having them taxed in the same way as other enterprises was part of this new policy toward SOE management.

Thus, the reform provided a significant simplification of tax structure in China. However, the distinction between the DEIT and FEIT remained in place. Within the DEIT, all 'domestic' enterprises were to be treated similarly, while within in the FEIT, all foreign investment and foreign enterprises were treated similarly in a structural sense. In addition, the DEIT and FEIT adopted similar structural approaches to one another, focusing on the income of the enterprises. The large formal distinction between the laws was that the FEIT contained a range of tax concessions that were aimed at attracting foreign investment. The continuation of this policy was the core reason for the retention of the two taxes. There were, in addition, other reasons in relation to appropriate administration for the two sectors.[27]

Thus, the early 1990s saw the acceptance by Chinese policy makers that private enterprise was no longer a special situation but a core or major part of the economy and this had a significant relationship with the tax reform of the early 1990s. By the end of the decade, there was a similar acceptance that foreign investment and other economic activity in China was also no longer a special exception to the overall economy but a core part of it. Much as Deng Xiao Ping's tour of the South can

symbolise the final acceptance of the private sector China's joining the WTO can be seen as symbolising its acceptance of foreign investment and involvement as a standard part of its economy and its acceptance of its involvement in foreign economies. Again, this change drove tax reform and simplification.

The reform of the taxation of enterprises to harmonise the treatment of domestic and foreign business was debated from the turn of the century. It was ultimately realised in the form of the Unified Enterprise Income Tax that was made available in 2007 and came into force in 2008. This law treats all enterprises in the same manner regardless of foreign links and in this respect represented a major simplification of China's income tax regime.[28] It also enhances economic efficiency and equity for the same reason. Again, the change in China's economy had resulted in such significant foreign interaction that to treat it differently was the cause of too much inefficiency and inequity. It also caused significant complication. Thus it can be seen that while China's tax structure might have changed at a significant rate by international standards, its economy has changed at a higher rate, and this economic change has brought about tax reform.

9 Enterprise distinctions and their complexities

It is worth commenting on why the former tax structures caused significant tax complexity in and of themselves. The income tax of enterprises in the 1980s provided a variety of different income tax treatments to different forms of enterprise. This continued after the 1991–1993 reform to the extent of the distinction between the FEIT and the DEIT. The reason for the distinctive treatments must be understood in the context of policy makers considering each new form (or established form) of enterprise activity and attempting to design an appropriate tax regime for it. What was considered appropriate for one form of activity was not necessarily considered appropriate for another. There were a number of reasons that motivated differences, including:

- Assumptions being made about the scope and complexity of the relevant economic activity
- Assumptions being made about the type of economic activity
- Assumptions about whether the type of economic activity was desirable
- Assumptions about the nature of economic policy that should be applied to the activity

- Assumptions about what motivated the entrepreneurs or others undertaking the economic activity

Depending upon the assumptions made in relation to these and other factors, a policy maker may make very different decisions on taxation. Some specific relevant examples from the Chinese experience are:

- In the 1980s, it was assumed that foreign investment enterprises needed incentives before they would become involved in China. It was also assumed that their activities would be limited and specific in scope but major in terms of value.
- It was assumed that the size of domestic private enterprises, such as industrial and commercial households, would be very small individually and as a sector. It was also assumed that they would be doing rudimentary businesses, such as small family-run restaurants that supplemented the state-owned economy.

The assumption of such differences resulted in the implementation of different tax regimes that suited the assumptions. For example, incentives were given to foreign investment enterprises. In addition, the taxes for these enterprises were designed for large-scale undertakings with international interaction. On the other hand, the rules for many domestic enterprises were kept rudimentary given the small size of the specific enterprises and the limited scope of the sector. SOE were completely excluded from the rules because their inclusion would be contrary to their very basis in a communist economy.

10 Arbitrage and distinctions

While the rationale for the differences is clear, the reality of their existence (as well as other differences in the legal treatment of different types of enterprise) altered the behaviour of people involved in enterprise. In such systems, entrepreneurs and, to the extent they exist, professional advisers, become cognisant of the different tax and other legal treatments possible in the regime and attempt to use these to find the most beneficial tax and legal treatment for their business. This drives arbitrage generally and tax planning specifically. Anything that drives arbitrage and planning is driving cost and consequently driving complexity.

What commences as a government attempt to keep taxation simple and appropriate for different types of enterprise becomes subverted through complex planning and arrangements that seek to take advantage

of different beneficial treatments. This process may simply be one of presenting one thing as another. However, more often, complex arrangements may arise that seek to spread a single entrepreneurial activity over several categories to take advantage of different features of all of them. Categories of differing tax treatment are the essential driver of arbitrage internationally. Great cost is incurred in engaging in arbitrage and great cost is incurred in countering arbitrage. The entrepreneur tries to fit his or her activity or part of it in a particular category which requires effort and cost. The administrator needs to try and identify where this has occurred and reverse it, and this also results in significant effort and cost.

Some of the well-established problems of arbitrage in the Chinese system were domestic concerns attempting to access the foreign investment treatment[29] and, in earlier years, private enterprise attempting to access the state-owned treatment. The former was often achieved through the process of round robin investment, while the latter was colloquially known in China as 'wearing the red hat'. Round robin investment simply saw domestic capital leave China and re-enter as a form of foreign investment. This would often be achieved through a Hong Kong company, but many international low tax jurisdictions were also used. 'Wearing the red hat' was a more subtle process whereby formal SOEs were informally run for the benefit of private interests.[30] In addition, there is also the phenomenon of very significant commercial enterprises being presented in such a way as to appear small and insignificant to take advantage of formal concessions given to small business or an informal process whereby small businesses are not made to pay full taxation.

Of course, the above could be highly elaborate and what should have been a single large domestic enterprise may ultimately involve a foreign investor, an SOE and some small businesses. For example, separate domestic small enterprises might be established as suppliers of materials to the foreign investment enterprise that is itself indirectly controlled by local residents. An SOE may also be involved in the structure as part of the EJV with the foreign enterprise. There is ample scope for very significant complexity once these strategies are concerned. This complex approach to running businesses effectively makes a tax system complex with significant compliance costs notwithstanding the arguably simple approach of the tax regimes.

11 Geographical zones to arbitrage

A feature of enterprise income tax in China prior to 2008 added significantly to the complexity of situations discussed above. This was the

recognition in the FEIT of a variety of geographical regions as zones where different taxation rules applied. This started with the Special Economic Zones such as Shenzhen, Hainan, Zhuhai, Xiamen and Shantou and, later, rapidly extended with a very large range of other zones.[31] Again the origin of the zones can be understood as part of the process of allowing particular forms of economic activity for specific purposes and isolating them from the major centrally planned economy. However, again the great success of the zones resulted in more and more of them as the general success of zone economies became recognised as desirable for other areas. In terms of income tax, the significance of the zones is that a multitude of tax incentives was given for enterprises registered in the zones and generating income in the zones. These incentives differed for different categories of zones. The policy intention of these incentives was to again give appropriate incentives to foreign investment generally and to encourage particular activities in particular areas.[32]

However, in a similar manner to above, the different treatments offered to different geographical areas created arbitrage opportunities in the Chinese tax context. This was because those who did not intend to operate in the relevant zones (or the particular industries in the zones) sought to access the concessions regardless. This was done either through complex structuring or simply through misstatement. An example of the latter would be to register the enterprise in the zone and record the income as derived there as appropriate when the income was actually derived or economic activity actually occurred outside the zone. A more complex structure would be to form an enterprise in the zone to invoice an ultimately related enterprise outside the zone and thereby transfer profits to the lower tax jurisdiction. Thus the complexity thorough arbitrage noted above became significantly more complex as a geographical aspect was added to the factors at play in Chinese tax outcomes. The zones in themselves created, within China, a number of the tax problems that are more often encountered in international tax. To address these issues, the tax authorities would need recourse to issues such as source, residence and transfer pricing. None of these were contemplated under the tax law.[33]

12 Tax reforms that simplified through harmonisation

Having noted the significant complexity that arose through arbitrage in Chinese income tax, it is clear that the tax reforms of 1991–1993 and 2008 constituted major simplifications of taxation in China. In essence they removed the categories of differential treatment that motivated the

elaborate efforts made to arbitrage the system. The 1991–1993 reform removed the distinctions between different domestic enterprises, including SOEs, under the DEIT and the structural differences between different forms of foreign investment and foreign enterprise under the FEIT. The reform of 2008 removed the distinction between the foreign and domestic sectors as well as the differing tax treatment given to geographical zones in the country. In this way, they must be considered as major simplifications. They did not remove all arbitrage of the sort discussed, as other legal incentives remain possible for different types of enterprise. However, the significance is beyond doubt.

13 The current tax regime and its distinctions

Having noted the major arbitrage issues and complexities that existed in the enterprise sector, we can consider the current income tax situation in China from a similar perspective and consider whether there remain similar issues. From the earlier discussion, it is clear that there do. However, now they are limited to the overall divide between the EIT and the IIT and the divide between the different schedules of the IIT.

These divides exist for similar reasons to those discussed above. The IIT was introduced at a time where people could only engage in very limited and specified economic activity with the overall planned economy. The various schedules catered to the taxation of these activities in a simple robust manner. Again, however, these schedules and the divide between the EIT and the IIT present a context that creates an incentive for very significant and complex arbitrage between the various categories of income. Such arbitrage is to be expected when it offers significant financial benefits to many persons in relation to their activities and transactions.

A review of the schedules of the IIT highlights the potential for planning or arbitrage choices. This can be elaborated through some international comparisons. Firstly, it is clear that the comment made above – that the situation within China has parallels with an international taxation situation – remains applicable. The distinction made in Double Tax Agreements between business profits, dependent personal services income, independent personal services income, dividends, interest, royalties, rentals and capital gains is a major driver of international planning involving treaties. This is because the different categories are given different tax treatment under the treaties, and this motivates attempts to recharacterise income or to create certain income flows while reducing others. For example if royalty income has

preferable treatment, simple examples of the two different strategies could be:

1. A services agreement may be drafted so as to become a royalty payment agreement.
2. Alternatively, a royalty expense might be paid to a related entity that has the effect of reducing business profits.

Given that the IIT has many of the categories of the DTAs as schedules with different treatment (and others), these international tax planning strategies become relevant in domestic Chinese taxation. This is exacerbated by the distinction between the EIT and the IIT, which allows businesses run under the EIT to potentially pay amounts to the underlying individuals that arbitrage the different schedules. Thus a private business run under the EIT will be taxed at the rate of 25%. However, it may seek to reduce this tax by paying amounts to shareholders or others which will be deductible to the business. This situation is not unusual internationally. However, in China, the arbitrage issue is significant, given that such payments, if earned by a taxpayer under the IIT, are subject to a large number of different tax treatments. It is noteworthy that the IIT even includes an alternative business treatment for Industrial and Commercial households and other operations that have been amalgamated under this schedule through administrative practice. This means that business-supply arbitrage becomes a factor for consideration.

The above shows how business operation under China's tax regime can involve international tax planning types of arbitrage with similar considerations to investment and treaty situations. The second illustrative comparison is from the Australian experience. Australian tax encountered significant arbitrage and consequent complexity problems in relation to the distinction between employment and personal service business income.[34] This problem was driven by the fact that personal service business income could be derived through an entity, while employment income could not. The use of an entity allowed notable tax advantages to arise to many taxpayers and created an incentive for those who were earning certain types of employment income to attempt to recharacterise the income and activity as business income. This recharacterisation is difficult to control, given the fine line that can separate an employment situation from a personal services business. This distinction may be clouded in situations where an employee has more than one employer, for example, on a part-time basis. If taxpayers see the distinction as solely determined by the number of different employing

income sources, they may seek to create situations where they artificially increase the number of employers. If the distinction is not based upon numbers but on contractual responsibilities, these may be altered to achieve the necessary outcomes.

Arbitrage around the employment/personal services business distinction proved to be significant in Australian tax compliance and motivated statutory change. However, it remains a significant source of complexity in Australian tax law notwithstanding these changes.[35] Australia is, however, structurally simpler than China in that it is only a question of business income or dependent service income in these situations. Reference to China shows that the tax regime complicates these distinctions. At the very least, three IIT schedules and the EIT provide for four different tax regimes for this form of income. The type of service income at issue in Australia may possibly be characterised as wage income, personal service income or business income under the IIT as well as income of an enterprise under the EIT with four different treatments. In addition, depending on the exact nature of the work or operation, the royalty, manuscript remuneration or enterprise contracting income schedules may also be argued to be the correct category. Thus, the Chinese situation at this structural level is significantly more complicated than the situation in Australia, due to the different categories that provide arbitrage possibilities and compliance costs. The complexity facilitated by these grows significantly when a taxpayer tries to spread the income through different schedules to attract the benefits associated with the different categories on different portions of what was originally the same income source. In Australia, a person who has argued that the service income is business income and isolated it in an entity may then seek to pay themselves a wage from the entity to take advantage of the lower income rate thresholds. In China, these possibilities multiply.

Other distinctions that have created arbitrage and tax planning possibilities with consequent compliance cost issues in international tax and worldwide domestic taxes are the distinction between revenue and capital and the distinction between dividends and interest. All these distinctions are made in China's IIT and overall tax regime with the resulting arbitrage possibilities.[36]

Thus, despite the tax reforms of 1991–1993 and 2008, with their removals of distinctive treatment for different forms of enterprise and locations, significant arbitrage opportunities remain in China's income tax at a structural level. These opportunities will create compliance costs on the part of taxpayers seeking to exploit the opportunities and on the

part of administrators trying to deal with these taxpayers' behaviour. This behavioural effect removes simplicity from the tax regime.

14 A simple aspect of Chinese income tax

Simplification in taxation is never a simple issue. Above, the complicating impact of arbitrage was considered in light of China's tax regime with its categories of income with differential treatment. However, it was noted above that the distinctions in the Chinese rules were originally intended to create simple, appropriate tax rules for different sectors of the economy. It must be noted that in the case of the IIT, there continues to be a simplification rationale for the system as it stands. This is that the tax represents an attempt to have a system that largely relies upon final withholding of individual income tax while retaining elements of progressivity, equity and efficiency.[37]

Withholding of individual income tax is when the payer of the income tax retains the necessary tax from payments and the recipient gets the net amount. Final withholding is when the retained amount represents the correct income tax impost on the amount and the recipient does not need to worry any further about taxation compliance. The payer/withholder then remits the correct amount to the Tax Authority, and there is no further tax compliance. There are very significant simplification benefits and consequent compliance cost savings to such a system, in that many individuals never need to worry about income tax returns or dealing with the tax authority. There are generally far fewer payers than recipients given that employers may have large numbers of employees. In addition, many payers have business systems equipped to deal with tax compliance that recipients do not have. A contrast to a system of final withholding would be Australia, where it is often noted that a huge proportion of the population needs to lodge a relatively complex income tax return annually, and these returns need to be dealt with by the administrators. There are often calls to reduce the number of tax returns in Australia through proposals to remove particular taxpayers form the system due to the significant compliance costs created by returns.[38]

Thus a tax that allows final withholding is in many ways a simple tax. It must be noted that the IIT generally allows a system of final withholding and therefore in this sense presents a simple taxation model. A negligible proportion of Chinese individuals need to lodge an income tax return or deal with tax compliance in respect of their own income due to this system.

The final withholding system, with its compliance and simplicity benefits as outlined above, depends on the ability of the payer to readily determine the correct tax liability on an amount paid. This necessitates robust and simple rules of tax liability. Individual income tax liability cannot be determined on the basis of gross annual income less gross annual deductions, as is the case in Australia, for example. The payer would not be able to determine the liability when making a payment. It cannot even be based upon income less actual deductions within a category, as the payer is not in a position to determine these. It is in the context of final withholding that China's rules of individual income tax liability need to be understood. This is why final wage liability is determined on a monthly basis with a deemed deduction. It is also why personal services income liability is determined on a payment basis with a deemed deduction, and many passive amounts are simply subjected to a gross 20% with or without a deemed deduction. All these rules are designed to allow a simple calculation of the correct legal liability by the payer, who then withholds the relevant amount.

Thus, China's rules are motivated by final withholding, a major form of simplicity. However, the simple rules of final withholding can come at the cost of equity and efficiency. This is because the most efficient and equitable tax is one that taxes the actual economic return the same or in accordance with appropriate marginal tax rates. A rule that taxed all cash receipts at the same rate would not be equitable or efficient, given that the cash receipt may bear little resemblance to the actual net income derived. It essentially depends on the costs a person incurs to derive a particular receipt. China's IIT schedules are an attempt to allow for an amount of variation in the rules associated with different types of income in recognition of these equity and efficiency issues. They are underpinned by significant assumptions about how particular categories of income are derived and how much of different types of income people earn (in relation to ideas of progressivity). These do not always hold true, but this is the rationale behind the distinctions.

Thus, the 'dilemma' of China's IIT and EIT in the context of simplification becomes clear. The removal of the different schedules for a single robust rule for final withholding would increase inequity and inefficiency in the tax given the different costs and factors involved in deriving different forms of income. On the other hand, the harmonisation of all forms of income under a tax that more correctly taxes the actual economic return on different income sources and applies marginal rates appropriately cannot be consistent with a system based on mass final withholding. Thus, China's simplicity generating system of final

withholding is founded on the same features that generate complexity through arbitrage in relation to the different schedules.

15 Uncertainty beyond arbitrage

The analysis thus far has considered the categories and distinction in China's income tax regime and how they create a complicating tendency in a tax system that is in many ways designed for simplicity. The analysis can now turn to another aspect of simplicity in these categories that does not relate to arbitrage. The issue being whether the distinctions at issue are actually clear, independent of the exercise of arbitrage and planning methods. This is because taxpayers need to be able to determine the appropriate tax regime for a particular category of transaction or amount of income to determine the correct tax treatment and plan their economic affairs.[39] The tax administrator also needs to be able to determine the correct regime to ensure compliance. Thus the issue to be considered is whether this determination can be done readily. If it cannot be done readily, time and cost need to be expended on the determination and this removes simplicity form the system and increases compliance costs. Thus it must be considered whether the categories used in China's income tax regime are clear and easy to apply.

In this context, it is argued here that China's economy has outpaced the simple distinctions made in the various schedules of the IIT and between the IIT and the EIT. This is because of two broad factors. First, the Chinese economy and the private economic activities of individual Chinese residents have become far more extensive and diverse. They will also continue to become more so. Second, the IIT and EIT are interfacing with the activities of foreign individuals and entities to a far greater extent than before and in a more diverse extent than before.[40] These trends should continue to rapidly develop. The local diversification means people are involved in activities that span the various categories simultaneously. The foreign interaction brings China's taxes into contact with unexpected foreign economic activity and legal structures that are not clearly treated under the laws.

The above issues can be explored in more detail. In terms of the distinction between the EIT and IIT, it must be considered whether it is clear or leaves scope for uncertainty. A taxpayer who seeks to understand whether they are taxable under the EIT or the IIT needs to determine whether they have an enterprise of the type that falls under the EIT. The distinction in Chinese tax law is atypical by international standards. This is because it is the product of the history outlined above.[41]

The current EIT tax unit is the result of tax regimes designed for the exceptional enterprise laws of the command economy of the late 1970s and 1980s that have been harmonised through the 1991 to 1993 and 2008 reforms while being partially adapted to international entity forms in 2008. While these adaptations clarify the tax unit in many circumstances, the legacy of the fundamental concepts that underpin them mean that uncertainty remains, fuelling the potential for complexity.

At the core of the EIT tax unit remains a concept of enterprise. This has been supplemented with the concepts of organisation and corporation. The early enterprise laws allowed entrepreneurial activities rather than incorporation. While elements of incorporation were included in some of the 1980s laws, China's company law did not come into being until 1993. The company law was later followed by internationally familiar partnership and sole trader laws, but the earlier enterprise laws remained in place and underpinned the tax unit.[42]

The result of the above is that it is clear that companies and a number of enterprises formed under the laws of China are enterprises for the purposes of the EIT. There do, however, remain some significant uncertainties. New forms of domestic enterprise may raise questions. For a significant period, there were questions as to the appropriate treatment of partnerships and the new form of sole trade enterprise. These have now been clarified by regulation or through the 2008 tax reform.[43] However, the nature of China's laws meant that these were uncertain for a notable period. There also remain uncertainties in relation to certain partnership structures. It has been clarified that partnerships formed under the Partnership Law and Sole Trader Enterprises formed under that law are to be taxed under the IIT. However, it remains unclear how business arrangements that are in substance partnerships and sole traders are to be treated. These issues arise in China where people have undertaken business activity without applying to do so under a particular law. In addition, regulations that allocate partnerships to the IIT may only be considering a particular form of small business partnership and not anticipate partnerships undertaking large ventures.[44]

The complexity of the distinction between the EIT and IIT essentially arises when income is being derived through a structure or arrangement that is not anticipated by the tax law. This may occur when:

1. Domestic business takes advantage of a new Chinese law that is not yet dealt with in the tax law,
2. Domestic business proceeds on a basis that is not grounded in any particular Chinese law, either because it does not consider business

regulation at all or because it is inspired by foreign legal structures, or
3. Foreign legal structures or forms of business are interacting with Chinese tax jurisdiction.

When any of the above scenarios occur, the tax treatment will depend on some assessment of how the concepts that do exist in the EIT should apply to the particular structure. It is in this exercise that China's tax law becomes significantly complicated, in that the boundaries of these concepts are very uncertain. It is notable that China is interfacing significantly with foreign laws, and this issue will become more difficult in view of China's laws.

In relation to non-Chinese forms, the EIT defines as an enterprise for its tax unit purposes:

1. Enterprises
2. Other organisations

established or set up under a foreign law. These categorisations present a highly difficult proposition when considering structures. Firstly because 'enterprise' is a concept based in a concept of activity[45] rather than entity and secondly because 'organisation' is a very wide concept. The difficulty may be demonstrated by reference to a selection of simple foreign legal concepts and business structures. The following, for example:

1. A trust
2. A consolidated corporate group
3. A large-scale professional sole trader
4. A large-scale professional partnership

There have been announcements in relation to some of the above, but the scope of the categorisation issue is far from certain. For example, a trust may certainly manifest itself as an organisation in certain circumstances and an enterprise in others. However, it would be hard to see many trust arrangements as organisations or enterprises. Announcements by the Chinese tax authority made in the context of questions about two particular types of trust do not necessarily clarify the appropriate treatment for all forms of trust.

Foreign consolidated groups have not attracted attention in relation to China's tax, but there is certainly scope in the above definitions for an argument that the group constitutes an enterprise or organisation.

It appears under the law and through regulation that enterprises with legal personality should be treated as separate taxpayers in their own right. However, it is submitted that this does not necessarily clarify the treatment of all consolidated groups, given the definition of enterprise and organisation.

The issue with large-scale partnerships and sole traders is: whether they are enterprises in their own right or whether they should be considered under the IIT. Even under the IIT, it is questionable whether they should be considered in their own right or simply as the income of the underlying persons. In the domestic context, it is now clear that sole traders and partnerships are excluded from the EIT. However, it is clear in the law that these rules apply to only those formed under the Chinese law. There is good reason to think that foreign forms are better viewed as enterprises in their own right. Or at least some should be.

There is scope for far more specific analysis on the above issues. However, the key point for the purposes of this chapter is that the basis of China's tax law in concepts from a different economic system raises complexities in relation to how business forms and how entities are categorised. This is a critical complicating factor in the context of China's economic dynamism. How the taxpayer is identified in a situation not only alters Chinese tax treatment, it alters the entire analysis in international taxation and under double tax agreements. It should also be noted that here, particularly, the earlier comments about how uncertainty is resolved through consultation with the tax administrators is highly critical. There is scope for immense uncertainty in the area of Chinese taxation.

Finally, it is clear that the IIT categories suffer from similar issues of uncertainty. This is because some are based in concepts from China's earlier transition, as has just been discussed, while others are inherently uncertain, as shown in international practice and touched upon in the arbitrage analysis. In addition, as noted at the opening of this chapter, the wording of the IIT law itself is far from clear in many respects. What is meant by the categories and how much they relate to internationally familiar concepts is uncertain. For example, it is questionable how much a foreign debate on the distinction between personal service income and business income can be applied to understanding the concepts used in the IIT schedules.

Thus it is clear that there is significant uncertainty in the core concepts that define the applicable tax regime in China, and that this drives complexity in Chinese tax. It is notable that when a taxpayer is uncertain concepts of the income of the taxpayer are also uncertain.

16 Conclusion

This chapter has reviewed a number of aspects of complexity in Chinese tax law. It is far from comprehensive, and the scope and challenges of the Chinese taxation environment mean that there is potential for far more study in relation to this issue. The most critical factor in China must be the lack of rule of law and the decentralised and diverse administrative decision making. This I have written about extensively elsewhere and simply introduced here. The chapter ultimately considered how the distinctions that are at the core of taxation in China fuel arbitrage while placing this in historical context. The remaining uncertainty that arises in the use of outdated concepts was also traversed, as well as China's extensive use of final withholding and the tension this causes with the issue of arbitrage.

Notes

1. Particularly Chapters 1 and 2.
2. Graeme S. Cooper (1993) 'Themes and Issues in Tax Simplification', *Australian Tax Forum*, 10, 417–460.
3. Qiu, D.M. (2014) Interpretation of Tax Law in China: Moving Towards the Rule of Law? *Hong Kong Law Journal* 44, 589–620; Wei Cui (2011) 'What is the 'Law' in Chinese Tax Administration?' *Asia Pacific Law Review*, 19(1), 75–94.; Sharkey, N. (2012) 'Enterprise Income Tax in China: Simplicity to Complexity through Institutional Context', in Blazey & Chan (eds.) *Commercial Law of the Peoples' Republic of China*, Thomson Reuters.
4. The Business Tax is a tax on. Generally, the supply of services and shares the tax base more commonly associated with a VAT with China's VAT.
5. See, for example: Sharkey, N. (2006) 'Tax Evasion and Administration Realities in the Peoples' Republic of China: Some Initial Findings from Discussions with Tax Officers in Fujian Province', in M. McKerchar, M. Walpole (eds.) *Further Global Challenges in Tax Administration*, Fiscal Publications, Birmingham, pp. 175–182. Also the following forthcoming publications: Sharkey, N. (2012) 'Default Assessments & Rule of Law in Different Institutional Environments', in Gee K.K. (ed.) *Substantive Taxation and Tax Payers Rights*, ZhaoYuan, Taiwan. Sharkey, N. (2012) 'Localization of Central Taxation in China', in Sharkey (ed.) *Tax in ASEAN and China*, Routledge.
6. Sharkey, N. (2007) 'China's New Enterprise Income Tax Law: Continuity and Change', *UNSW Law Journal,* 30(3), 833–841.
7. Sharkey, N.C. (2014) 'The Correctness of the Chinese Position of Enterprise Residence in Chinese Law: The Institutional and Treaty Implications', *Bulletin for International Taxation*, 68(11), 617–626.
8. Sharkey, N. and Murray I. (2015) 'The Rule of Law and Leadership in Substitution and in Conflict: Social Psychological and Legal Perspectives on Chinese Tax Administration', *Australian Tax Forum*, forthcoming.

9. See: Sharkey, N. and Murray I. (2015) 'The Rule of Law and Leadership in Substitution and in Conflict: Social Psychological and Legal Perspectives on Chinese Tax Administration', *Australian Tax Forum*, forthcoming. More generally see: Perry, A.J. (2000) 'Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence', *International and Comparative Law Quarterly,* 49, 779–799.
10. Sharkey, N. (2012) 'Localization of Central Taxation in China' in Sharkey (ed.) *Tax in ASEAN and China*, Routledge.
11. EIT, 2008.
12. IIT, 1980 as amended.
13. DEIT 1993.
14. FEIT, 1991.
15. ITAA 1936 and ITAA 1997.
16. See for example s5–5 of the ITAA 1997. The 'you' in question includes individuals and companies.
17. Article 2 of the IIT.
18. See Article 3 and Article 6 of the IIT for example.
19. Article 3, IIT.
20. Article 6 (2) of the IIT.
21. Article 2, IIT.
22. A concise clear review of this period can be found in Gregory C. (2002) *China's Economic Transformation*, Blackwell.
23. For a review of commercial legal development during from the late 1970s into the 1990s see: Alice Tay and Gunther Doeker-Mach (eds.) (1998) *Asia Pacific Handbook*, Volume 1: China, Nomos Verlagsgesellschaft.
24. Again, a review can be found in Gregory C. (2002) *China's Economic Transformation,* Blackwell.
25. Sharkey, N (2004), 'Tax Reform in the China Context: The Corporate Tax unit & Chinese Enterprise', *eJournal of Taxation* 2(2) Sydney.
26. Deng's speeches as he toured the heartland of Chinese private enterprise were of very significant symbolic value.
27. Sharkey, N. (2007) 'China's New Enterprise Income Tax Law: Continuity and Change', *UNSW Law Journal,* 30(3), 833–841.
28. Sharkey, N. (2007) 'China's New Enterprise Income Tax Law: Continuity and Change', *UNSW Law Journal,* 30(3), 833–841; Sharkey, N. (2012) 'Enterprise Income Tax in China: Simplicity to Complexity through Institutional Context' in Blazey & Chan (eds.) *Commercial Law of the Peoples' Republic of China,* Thomson Reuters.
29. Sharkey, N. (2007) 'China's New Enterprise Income Tax Law: Continuity and Change', *UNSW Law Journal,* 30(3), 833–841.
30. This was considered recently in Chen, W. (2007) 'Does the Colour of the Cat Matter? The Red Hat Strategy in China's Private Enterprises', *Management and Organization Review,* 3(1), 55–80.
31. See Article 7 of the FEIT as well as Article 69 and following of the Detailed Implementing Regulation of the FEIT.
32. See for further information: Cartier, C. (2001) '"Zone Fever", the Arable Land Debate, and Real Estate Speculation: China's evolving land use regime and its geographical contradictions', *Journal of Contemporary China*, 10(28), 445–469.

33. Sharkey, N. (2007) 'China's New Enterprise Income Tax Law: Continuity and Change', *UNSW Law Journal,* 30(3), 833–841.
34. For some discussion on the point: Pennicott, S. (2007) 'Resolving The Personal Services Income Dilemma In Australia: An Evaluation of Alternative Anti-Avoidance Measures', *Journal of Australian Taxation,* 10(1), 53–103.
35. The quantity of information on the issue on the ATO site is instructive. See, for example: https://www.ato.gov.au/Business/Personal-services-income/In-detail/Introduction/Personal-services-income---basic-information-you-need-to-know/
36. See IIT Article 2.
37. See IIT Article 8 and following.
38. See: Evans, C.C. and Drum, P. (2006), 'Ten million reasons for personal tax reform in Australia', in Fisher, R. and Walpole, M. (eds.), *Further Global Challenges in Tax Administration*, 1st edn, Fiscal Publications, Birmingham, pp. 377–394.
39. Sharkey, N. (2012) 'Enterprise Income Tax in China: Simplicity to Complexity through Institutional Context' in Blazey & Chan (eds.) *Commercial Law of the Peoples' Republic of China,* Thomson Reuters.
40. Sharkey, N.C. 2012, 'China's Tax Integrity in the Context of the Emerging International Tax System', *The Chinese Economy: Translation and Studies*, 45(3), 56–75.
41. For some discussion see: Sharkey, N. (2005) 'China's Income Tax Concept of "Enterprise" and the Concept of "Company" – Interaction with the Australia-China Tax Treaty', *Bulletin for International Fiscal Documentation* Amsterdam, 59(2), 157–166.
42. Sharkey, N. (2004) 'Tax Reform in the China Context: The Corporate Tax Unit & Chinese enterprise', *eJournal of Taxation* Sydney, 2(2), 210–215.
43. Article 1 of the EIT.
44. Article 2 of the Detailed Implementing Regulation of the EIT specifies that only partnerships and sole traders formed under Chinese law and regulation are covered by Article 1 of the Law.
45. Sharkey, N. (2004) 'Tax Reform in the China Context: The corporate tax unit & Chinese enterprise', *eJournal of Taxation* Sydney, 2(2), 210–215.

4

Tax Simplification in Canada: A Journey Not Yet Mapped

François Vaillancourt and Richard Bird

1 Introduction

Although simplification is presumably the opposite of complexity, or at least a move in the opposite direction, tax simplification is complicated. It is complicated in part because tax complexity itself is complicated, and may be manifested in many ways with many different effects and many causes. Similarly, tax simplification may be undertaken for a variety of reasons and take different forms and have different consequences in different circumstances. Comparisons across countries are thus not only inherently difficult but always subject to many qualifications. The danger of drawing inferences from simple international comparisons is clear from studies such as the World Bank's Paying Taxes (2015), in which countries that, for whatever reason, have the temerity to have more than one tax collection agency tend to score worse than those with a more monopolistic public sector.[1] Because there is clearly more to a good tax system and a well-run country than simply centralizing tax collection, it is important in assessing tax simplification in any country to begin with a clear understanding of the nature of the tax system. We thus begin by setting out a few salient features of Canada's tax system in the next section.

In discussing tax simplification, it is also important to remember that the tax system consists not only of the legal structure of taxes (rates and bases) but also the details of how taxes are enforced and administered – who reports what information, how, and to whom, how taxes are remitted and collected, how people can learn what it is they are supposed to do to comply with the system, and how failures to comply are dealt with (enforcement and appeal).[2] Following brief discussions of the basic issue of how to measure tax complexity (or its opposite, simplicity) in

its various dimensions and of the relatively small extent to which the issue of tax simplification has to date been addressed in Canada, in the balance of the paper, to the extent data permit, we provide some indicators related to the issue of tax simplicity in Canada.

2 The Canadian tax system

The Canadian tax system rests on two sections of the Canadian constitution proclaimed in 1867 and never amended. They read as follows:

> ***91.*** *It shall be lawful for the Queen, by and with the Advice and Consent of the Senate and House of Commons, to make Laws for the Peace, Order, and good Government of Canada, in relation to all Matters not coming within the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces ... [including:]3. The raising of Money by any Mode or System of Taxation ... .*
>
> ***92.*** *In each Province the Legislature may exclusively make Laws in relation to ... 2. Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes.*

At first reading, these sections may appear to mean that provinces have less taxing power than the federal government. In fact, however, subsequent judicial interpretation of the constitution and in particular of the meaning of direct taxation has resulted in a system in which the two major tax bases, income and sales, can be and are taxed by both federal and provincial governments.[3]

Broadly, tax policy history in Canada may be divided into three periods. For most of the country's first century, the federal and provincial governments acted independently, introducing various taxes from time to time with no coordination. By the time of the Great Depression in the 1930s, the result was often referred to as a 'tax jungle'. A Royal Commission (1940) was established to suggest both a financial solution to the fiscal problems created by the depression and a way out of this jungle.

By the time this Commission reported, however, World War II had begun, and a (brief) second period of tax policy began in 1942 when the provinces agreed to rent their powers to tax personal income, corporate income and wealth transfers at death (succession duties) to the federal government to finance the war effort. After the war, the federal government argued, essentially on Keynesian stabilization grounds,

that the largely centralized revenue structure thus created should be maintained.

However, the provinces did not agree, and the rental agreements were terminated in 1947, launching a half-century period during which the provincial role became steadily more important in income tax, starting with Québec's establishment of a separate personal income tax in 1954. The culmination of this process came in 2000, when the federal government, which had originally agreed to collect provincial income taxes provided such taxes were imposed as a flat surtax on the federal tax (tax-on-tax), instead allowed provinces to impose whatever rates they wanted so long as the base was essentially the same as that of the federal tax (tax-on-income).[4]

A number of other important changes were made in income taxes over this period, including major reforms in the base (mainly related to the treatment of capital gains) in 1972 and 1988. In addition, both federal and provincial succession duties disappeared in a drawn-out and somewhat disorderly process (Bird 1978) and the federal manufacturer's sales tax, which had long existed side-by-side with provincial retail sales taxes, was replaced by a VAT (the Goods and Services Tax, or GST) in 1991. Over the next two decades a largely integrated national sales tax gradually emerged, consisting of the federal GST, a provincial VAT (combined with the GST as the HST or Harmonized Sales Tax) in five provinces, and a separate VAT – the TVQ (taxe de vente du Québec, or Québec Sales Tax) imposed on essentially the same base as the GST in that province but administered separately, together with the federal GST in the province, by the provincial government.[5]

In the first three decades after the war (1947–1977), the federal share of taxes fell from 76% to 51%, while the provincial share rose from 14% to 37% and the local share remained almost the same. At the same time, the revenue importance of the personal income tax rose sharply, from 24% to 47%, with both corporate income taxes and consumption taxes declining, from 22% to 14% and from 43% to 30% of total tax revenues respectively.[6] These trends have continued. In 2011, the provincial share of taxes was 49% compared to a federal share of only 42%. Income taxes and especially personal income taxes continue to be the most important revenue source for both levels of government. Interestingly, despite the introduction of the GST, the share of federal revenues coming from consumption taxes has actually declined in recent years, in part owing to rate reductions in 2006 and 2008. However, provincial dependence on consumption tax revenues increased to some extent in the last two decades, as did payroll taxes (mostly pension contributions and mostly

collected at the federal level), which more than doubled after a rate increase at the turn of the century.[7]

3 The demand for tax simplification

In Canada, as elsewhere, tax simplification is often put forward as desirable, even necessary. Recently, for example, the Canadian Chamber of Commerce (2013) called for tax simplification, noting that 'piecemeal changes to tax legislation by successive governments and the enactment of temporary provisions have increasingly complicated the tax system' (p. 8). In addition to clarifying the language of the tax law, and reviewing and limiting tax expenditures, this report also suggested such long-sought (by business) changes in income taxation as consolidated reporting (or at least easier loss transfer) and the modification of certain withholding rules on non-residents and some anti-avoidance rules in order to '…reduce compliance costs for individuals and businesses, reduce administration costs for governments, allow tax administration to focus on tax oversight, increase efficiency of tax collection and provide incentives for all transactions to be officially reported' (p. 9).

A few months earlier, another report (CGA 2013) had singled out such sources of complexity as the number and diversity of taxes, the number of targeted incentives, the language of the income tax act, and the peculiar quirk of legislative procedure under which a tax change is implemented when put forward in the budget but may not be formally approved for several years. A few months later, Manley (2014), speaking for the Canadian Council of Chief Executives, again returned to the theme of tax simplicity and, like the other reports mentioned, urged action soon, suggesting in particular that Canada would do well to emulate the UK and create an Office of Tax Simplification to advance the cause.

Of course, these were not the first and certainly will not be the last calls for tax simplification in Canada, usually by business groups. In reality, however, as Clark and Farber (2011) note, 'there have been very few attempts to simplify the tax system…. The reason is very clear. Tax simplification comes at a very high political cost, since any reform will involve choices and trade-offs, and have both winners and losers' (p. 5). Whatever the reason, to date neither federal nor provincial governments have reacted to the various pleas for simplicity – or complaints about complexity – heard from many quarters over the years, although many official tax reports say at least a few good words about the need for more simplicity.[8] One recent thorough reform proposal in Québec (2015),

however, did not even mention the issue and indeed proposed to go in the other direction by increasing the number of income tax brackets.

Complexity in the tax system arises for many reasons. For example:

- *Governments need revenue*. They not only need to impose taxes – and sometimes to increase them – but also to protect the revenue by making and enforcing rules to curb avoidance and evasion.
- *People want taxes to be fair*. In a complex world in which the tax system must accommodate many different situations, the desire for fairness breeds complexity and tends to override the desire for simplicity.
- *People also want certainty*. Benjamin Franklin reportedly once said that nothing is more certain than death and taxes. However, few people seem to be very certain about their tax position, and everyone seems to want more certainty in this area. In a rapidly changing world, however, the search for certainty often leads to frequent changes in tax rules and language, thus giving rise to more uncertainty.
- *Governments want to be elected*. To do so they are constantly driven or tempted to use the tax system to achieve a variety of specific objectives, with each new objective requiring new rules to distinguish the activity or entity that benefit from those less favoured – and each such distinction creates a new support group for a particular complexity now entrenched more or less deeply in the tax system.[9]

In part perhaps because tax complexity arises from so many different causes, it is often far from clear exactly what people are looking for when they ask for tax simplicity. Indeed, the first recommendation made by one of the reports cited above was that Canadians needed to 'reach a consensus on the definition of tax simplification' (CGA 2013, p. 21) before they could figure out what they wanted to do or how they could do it. An earlier study (Couzin 1988, p. 435) suggested that one way to bypass this problem might simply be to assume that 'a tax measure may generally be said to enhance tax simplification if it facilitates compliance'.[10] However, this does not seem a good way to proceed, in part because it is not evident how compliance should be measured and in part because the effects of complexity on compliance are not the full story.

For instance, one can distinguish different dimensions of simplification: simplifying tax structures (fewer taxes, simpler bases, fewer rates); simplifying tax law (simpler language or shorter laws: can one have both?); simplifying tax administration (fewer collection agencies, fewer forms, pre-filled forms, e-filing, etc.); or simplifying taxpayer communications (single contact point, better and more readable documentation,

more attention to serving taxpayers). One can also distinguish a variety of possible consequences of interest such as: reduced compliance costs; increased numbers of taxpayers complying properly; less incentive to informality; lower administrative costs; less economic distortion per dollar of revenue collected; and broader public acceptance of legitimacy of the tax system.

4 Measuring tax complexity

Assuming that the objective of tax simplification is to aid efforts to reform the system or at least the information provided to taxpayers, Ulph (2013, p. 10) stresses the importance of measuring separately '...tax design complexity from operational complexity, and...the costs of tax complexity separately from the measure of tax complexity per se'. Couzin (1988) observed that whether one understands reducing complexity in terms of clearer concepts, better linkage of these concepts to statutory language, or more uniform information that is disseminated quickly, there was no evidence of reduced tax complexity in Canada between the Carter report (1966) and the Wilson budget (1988). Lareau (2012) reached the same conclusion for a longer period and added that, although complexity was often identified by the courts as a burden imposed on taxpayers by unclear laws, the courts themselves often created or at least intensified the burden they deplored.

Measuring tax complexity, it turns out, is no easier than achieving tax simplicity.[11] Although there are some interesting theoretical contributions on this topic (e.g., Kopczuk 2007 and Barton 2008), we focus here on more empirically oriented papers, as recently reviewed by Lugo and Vaillancourt (2015). The more salient contributions, all based on US data, include Scott (2005), Slemrod (2005), and Weinstein (2014), each of which used a different measure:

- The number of words in the Internal Revenue Code and accompanying regulations: This index increased by 648% from 1955 to 2005 (Scott 2005).
- The number of lines on the income tax form and the number of pages in the instruction booklet, in both cases modified slightly to ensure comparability between states: Both indexes rose on average (by 14% and 46%, respectively) for the 35 states for which data were available over the 1980–2000 period (Slemrod 2005).
- The number of tax expenditures by state: For the 43 states for which information is available, the number ranged from more than 550 for

> Washington to under 50 for Alaska – interestingly, neither of these states has an income tax – with the most common range (for 11 states) being in the 100–150 range (Weinstein 2014).

Are these three measures good indicators of tax complexity? As Slemrod (2005) notes, longer legislation (or text in an information booklet) may *reduce* complexity sometimes, for example, if it allows the use of plain English or clarifies the coverage of various possible types of taxpayers.[12] One might perhaps also suggest netting out complexity arising from some tax expenditures because they are not related to taxes as such, but rather to the attempt to achieve non-fiscal aims through the tax system. On the whole, however, if a jurisdiction chooses to use the tax system for non-tax purposes, whether one's concern is with the effects on compliance, costs, or citizen satisfaction, it seems appropriate to include the complexities this decision introduces into the tax system in any measure of tax complexity.

The three measures of complexity presented above are related as shown in Figure 4.1. To begin with, governments may choose to favour a specific behaviour or group by introducing a tax preference – or, as it is often called, a tax expenditure. To implement the new tax preference, new legal language and regulations are needed. Finally taxpayers must be informed of how to qualify for and obtain the preference, for instance, by introducing the right lines in the tax form and expanding the instructions in the tax booklet (or on the webpage). Each of these stages may give rise to an increase in the administrative and compliance costs of the tax system.

The number of lines on the tax form has the additional advantage that it can be linked to the extensive literature on tax compliance costs (TCC) by estimating the cost per line. In Canada, this procedure was employed by Erard and Vaillancourt (1993) to estimate the prospective cost of an autonomous personal income tax system in Ontario. Vaillancourt and

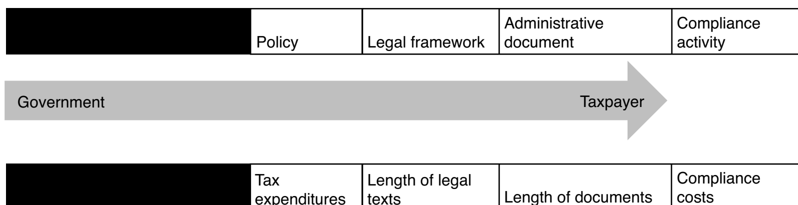

Figure 4.1 Tax Activity–Complexity Measurement Continuum
Source: Vaillancourt, Roy and Lamman 2015

Blais (1995) used a similar methodology to measure the evolution of TCC over time, estimating that between 1971 and 1993, the average time required to comply with federal personal income tax obligations by filers with simple returns rose by about 25% (from 1.41 to 1.76 hours), although estimated total compliance costs as a share of revenues remained more or less constant (0.66%) and administrative costs increased substantially (from 0.77% to 1.32%) over the same period.

5 Tax system simplification

Against this background, we next consider several distinct approaches to assessing the state of tax simplification in Canada. The first question is whether the tax system as a whole has become simpler in the last 40 years.

In some respects, it clearly has. For example, the abolition of the federal and provincial succession duties did away completely with a complex tax. Although the inclusion at death (or at the death of the surviving spouse, for couples) of unrealized (deemed) capital gains in the final personal income tax return added to the complexity of the income tax, it is probably still true that the net result was some tax simplification since succession duties are invariably accompanied by very high compliance costs (Eichfelder and Vaillancourt 2014).

On the other hand, although a principal motivation for the substantial widening of the income tax base in the 1971 income tax reform and the later, less significant but still important widening exercise in the 1988 budget was to simplify the system, it is arguable how effectively this goal was achieved. For example, from 1972 onwards, 50% of taxable capital gains were included in taxable income. In 1985 a lifetime capital gains exemption was introduced. Initially set at $10,000, this exemption was to increase to $25,000 in 1986 and to rise to $250,000 by 1990. However, in 1988 it was capped at $100,000 – the target for that year – and the inclusion rate of capital gains changed from 50% (for gains prior to 1988) to two-thirds for gains in 1988 and 1989 and three-quarters for 1990 onwards. In 1991, the general gains exemption was removed, although taxpayers were allowed to use it to protect existing unrealized capital gains (so-called 'crystallization' of gains). However, a $500,000 exemption continues to exist for certain specified forms of capital gains (mainly from the sale of small businesses and farms).[13] In 2000, the inclusion rate was reduced on budget day – 27 February 2000 – from 75% to two-thirds for gains between that date and 17 October, and 50% thereafter. Although this system has

since been unchanged, life was certainly not simple for taxpayers with capital gains in the 1990s.

Turning to the important replacement of the manufacturer's sales tax (MST) by the GST, while this reform undoubtedly increased the efficiency of the tax system by reducing the taxation of intermediate inputs and may also have increased economic growth (Smart and Bird 2009), it undoubtedly increased compliance costs by drawing a substantial number of new business taxpayers into the fiscal net. In 1985 57,000 firms were subject to the MST, a number that was likely about 62,000 by 1990, when the tax was replaced by the GST.[14] In contrast, in the 1992–1993 fiscal year (ending March 31), there were 1,819,810 GST registrants, or 30 times as many.[15] It is thus not surprising that the costs of administering the federal sales tax similarly rose substantially, from $90 million in the last full year (1989–1990) of the MST – or only 0.5% of the $17.8 billion collected from this tax – to $518 million in 1992–1993, or 3.5% of the $14.8 billion collected in that year (Salvail 1994). High start-up costs were inevitable when such a major tax change was in the end, owing to political complications, applied to a largely unready taxpaying population by an administration that had chosen at the last minute to accommodate some major and complicating changes in the law and was then hampered by political opposition from adequately informing people of what was coming (Bird 1994). Even two years after launching the tax, however, costs remained high, owing to the complicated zero-rating structure introduced late in the development of the tax, the low threshold for registration, and the fact that over 400,000 businesses below that threshold also registered for a variety of reasons (Salvail 1994).

Since compliance costs with this totally new form of taxation were also high, although costs came down over time, on balance it seems reasonable to conclude that, to put it mildly, the introduction of the GST did little or nothing to simplify the federal tax system. However, the subsequent transformation of six provincial sales taxes into VATs, five as part of the federally collected Harmonized Sales Tax (HST) and one as a stand-alone Québec Sales Tax (QST) collected along with the federal GST in the province by Québec authorities, should have reduced tax complexity.

In one province, British Columbia, where the provincial retail sales tax (RST) was replaced by the provincial component of the HST in 2010, this action was seen by many as betrayal of a promise made during the election campaign of 2009. Facing the threat of a recall campaign of members of the provincial legislative assembly, the government agreed

to a postal referendum held in the summer of 2011. Voters were asked whether the HST should be retained or the pre-2010 system, with a separate federal GST and provincial RST, restored. After 54.7% of voters opted to return to the past, the provincial RST was reinstated in 2013.

One may question the appropriateness of tax policy by referendum (Richards 2012) but this episode raises the interesting question of why the HST failed in British Columbia but the identical reform succeeded in Ontario. In addition to the anger in B.C. arising from the campaign 'betrayal' mentioned earlier, Robertson (2012) notes that Ontario made the transition much more intelligently in political terms. First, although both provinces received a transitional payment from the federal government for adopting the HST, Ontario used the payment to issue checks directly to people, while B.C. simply took it into general revenue. Secondly, although under the HST agreements both provinces were entitled to modify their tax bases up to 5% of the federal base, B.C. used its entire margin immediately to de-tax fuel while Ontario kept some in reserve to make adjustments as the debate occurred – for example, by making low-cost meals non-taxable. As this episode shows, when it comes to changing tax systems, it is not only what is done but how it is done that matters.

Finally, another important issue relates to provincial income taxes. The change from tax-on-tax to tax-on-income noted earlier allowed provinces to vary the progressivity of their tax through the choice of number of brackets, bracket limits and rates for each bracket. Figure 4.2 depicts the dispersion of rates between provincial personal income taxes (as measured by the coefficient of variation) and shows clearly that the

Figure 4.2 CV statutory tax rates, provincial PITS, nine provinces, five years, three rates

Source: Guimond and Vaillancourt (2013) for 1999-2008 and calculations by the authors for 2012 using data from Canadian Tax Foundation, Finances of the Nation, table 3.7.

result of increasing provincial freedom to vary tax rates was to increase the complexity of the tax system. On the other hand, it is not clear that Canadians were necessarily worse off as a policy which gave the provinces – other than Québec, which already had its own personal income tax – more freedom to impose taxes more or less progressively than the federal system. Alberta, for example, quickly introduced a flat-rate tax; others, over time, increased the progressivity of their income taxes, even though cross-border mobility may mean that such attempts to alter post-tax income distribution may not have been very effective.

Summing up, with death taxes (with high compliance cost) put to rest, a federal sales tax (MST) with a small number of taxpayers replaced by a tax (GST) with many more taxpayers but which over time resulted in the disappearance of a half-dozen separate provincial taxes, and income taxes which in some respects became less and in others more complex, it is far from clear that the Canadian tax system has become simpler in the last 25 years or so.

6 Tax laws and tax simplification[16]

Whatever happened to the simplicity of Canada's tax system, given its architecture, have the tax laws become simpler? For the time period for which we have data, the answer is clearly no. We present evidence in this section for the three indicators set out in Figure 4.1, first for the federal taxes and then, to the extent possible, for provincial taxes.

6.1 Federal tax expenditures

Figure 4.3 shows that, from 1991 (the first year in which systematic and comparable data are available) to 2011, the number of federal personal income tax (PIT) tax expenditures increased by 17% (from 105 to 123). Federal corporate income tax (CIT) tax expenditures grew even more, by 33% (from 48 to 64). On the other hand, although not shown in Figure 4.3, the number of GST tax expenditures grew only by 6% from 1991 to 2011.

Figure 4.4 depicts the value of federal PIT tax expenditures – both in nominal terms and after adjusting for inflation – over the same period. During the 20-year period for which we have data, the value of PIT expenditures grew by 187% in nominal terms and 98% in real terms. Although not shown here, the value of CIT expenditures grew even more quickly, by 295% in nominal terms and 103% in real terms. On the other hand, although nominal GST tax expenditures grew by 77% over the same period, there was little growth in real terms.

Figure 4.3 Number of Federal PIT and CIT tax expenditures in Canada, selected years, 1991–2011

Note: The number of GST tax expenditures is almost unchanged over the period, going from 33 to 35

Source: Vaillancourt, Roy, and Lamman 2015, figure 2

One reason for the increases shown in Figure 4.4 was the growth in tax filers (and thus potential tax expenditure users) from 19.1 million to 26.3 million. As Figure 4.5 shows, however, the inflation-adjusted value of federal PIT tax expenditures per tax filer still grew by 44%. The increasing use of the personal income tax to deliver tax expenditures for a wide variety of purposes has clearly made the federal tax system more complex in recent years.

6.2 Provincial tax expenditures

Can the same be said about provincial tax expenditures? A question that arises in this connection is whether one should count as provincial tax expenditures those that simply mirror federal tax expenditures. One province, Québec, has long had an independent PIT. There are differences between the federal and Québec PITs, particularly in the definition of taxable income. For example, Québec includes employer-paid health insurance premiums in income, and the federal government does not. There are also differences in the treatment of children (Lachance and

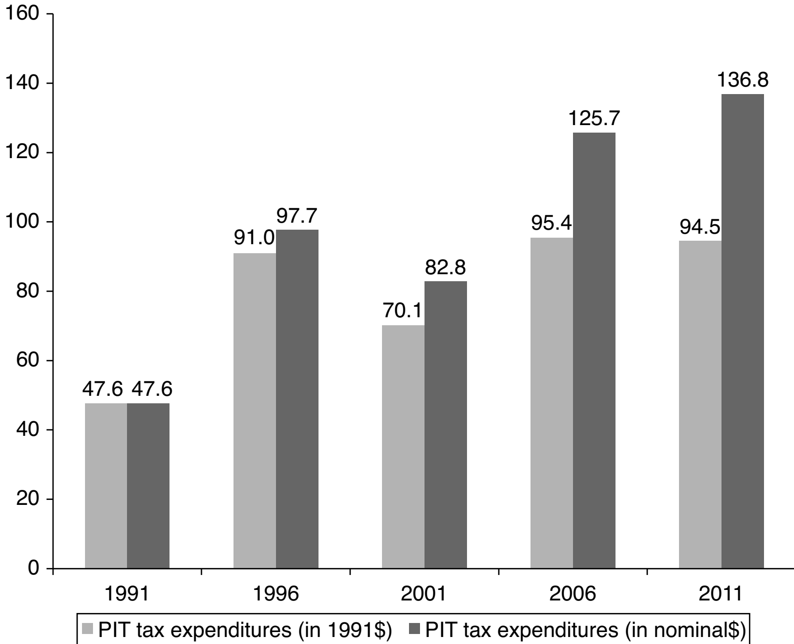

Figure 4.4 Value of Federal PIT tax expenditures in Canada (in billions of $), selected years, 1991–2011

Source: Vaillancourt, Roy and Lamman 2015, figure 3a

Vaillancourt 2001) and more recently in the rules for splitting pension income. In this case, since the duplication of federal policy choices is itself a deliberate policy choice, such expenditures should definitely be counted.

However, the other nine provinces, in order to have the Canada Revenue Agency collect the provincial PIT (or CIT) free of charge, must accept the same definition of taxable income as the federal government. For this reason, Ontario and some other provinces in their tax expenditure statements distinguish two groups, those shared with the federal government (that is, in the federal tax base) and those additional deductions, credits and exemptions introduced by the province.

Another problem in considering provincial tax expenditures is that such expenditures are reported differently both across provinces and within a province over time. About all we can do here is to note briefly a few facts about tax expenditures in five of the provinces, including the

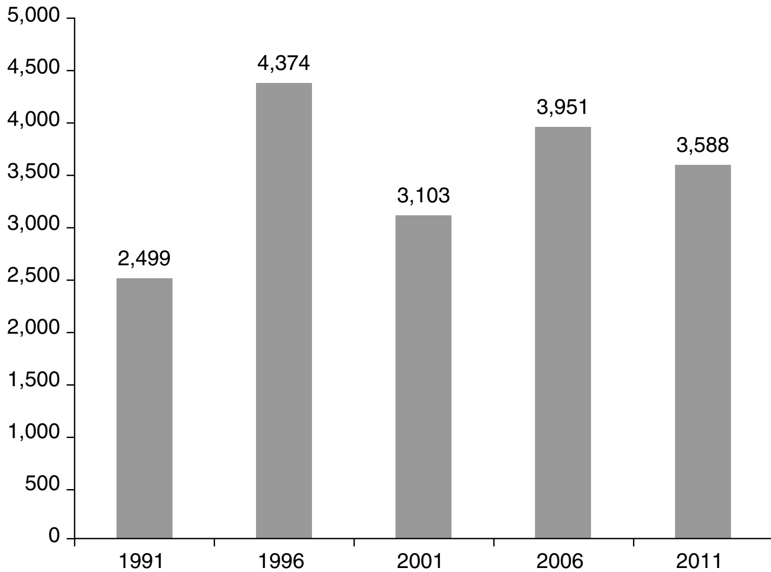

Figure 4.5 Federal PIT tax expenditures per tax filer in Canada (inflation-adjusted 1991$), selected years, 1991–2011

Source: Vaillancourt, Roy, and Lamman 2015, figure 4

four largest: from east to west Nova Scotia, Québec, Ontario, Alberta and British Columbia.

Nova Scotia.[17] Considerable information is available for the 2001–2010 period, although tax expenditures parallel to the federal system are not singled out from province-specific expenditures. As in the other provinces, some items are unique to the province – for example, a post-secondary tax credit introduced in 2006 and replaced in 2009 by a graduate retention rebate aimed at retaining graduates of Nova Scotia's universities in the province.

Québec: The data most comparable to that reported earlier for the federal government, although for a shorter period, is that for Québec, as depicted in Figure 4.6, which shows a 90% increase in nominal terms and a 54% increase in real terms in the value of PIT tax expenditures for Québec over the 2001–2011 period. These increases are substantially higher than the 65% nominal and 34% real increases in federal PIT tax expenditures over the same period.

Ontario.[18] Ontario also provides considerable information on tax expenditures for the 2004–2014 period. Figure 4.7 shows the evolution

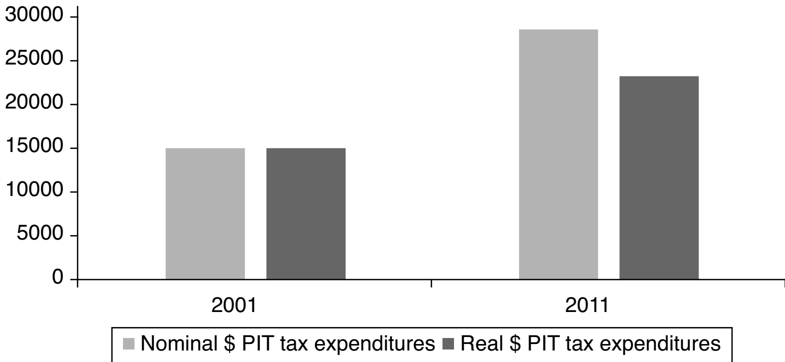

Figure 4.6 PIT total tax expenditures (in millions of $), Québec 2001 and 2011

Source: Authors using information from the annual report on Dépenses fiscales
2001: http://www.budget.finances.gouv.qc.ca/budget/2002-2003/fr/pdf/DepensesFiscales.pdf.
2011: http://www.finances.gouv.qc.ca/documents/autres/fr/AUTFR_DepensesFiscales2011.pdf

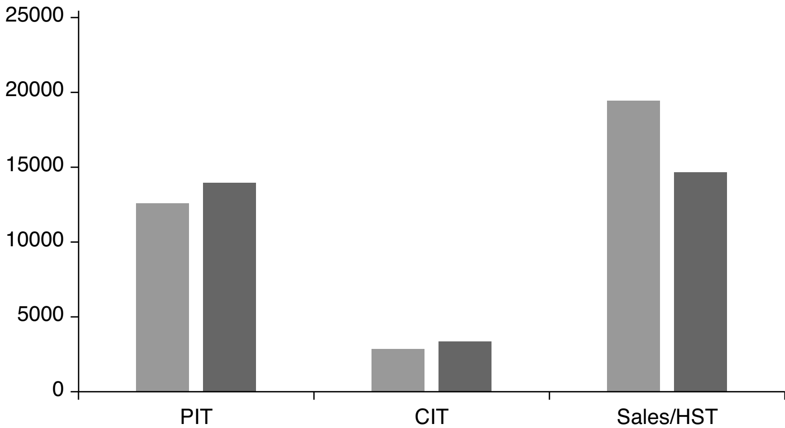

Figure 4.7 Tax expenditures (in millions of $), Ontario 2005 and 2014

Note:2005: http://www.fin.gov.on.ca/en/budget/fallstatement/2005/05fs-paperc.html2014:http://www.fin.gov.on.ca/en/budget/fallstatement/2014/transparency.html The exact title and location within the budget or economic statement documents changes from year to year.

Source: Authors using data from Ministry of Finance of Ontario "Transparency in taxation"

in nominal dollars of the value of tax expenditures between these two years. What is interesting is the drop in the value of the sales/HST expenditure, linked to the move from a provincial retail sales tax to a harmonized federal/provincial VAT.

Alberta.[19] Information is available only for 2013 and 2014. In the latter year, the province reports the estimated revenue cost for 15 purely provincial PIT expenditures to be over $5 billion – more than 10 times the size of the 12 federal expenditures recorded and close to half the amount of PIT collections. Almost all this huge cost was attributable to a family of family deductions – a basic personal amount, a spousal amount, and an eligible dependent amount. Some information on three CIT expenditures and four associated with the fuel tax was also reported.

British Columbia.[20] Tax expenditures have been reported annually since 1995. In 2012–2013, estimates are provided for 17 provincial PIT expenditures – compared to only four in 1995[21] – along with the provincial tax cost of seven federal tax expenditures. In this case, however, the cost of the federal expenditures in 2012–2013 (mostly related to savings) considerably exceeded those of the purely provincial expenditures, with the largest provincial PIT expenditure being the HST credit (since the HST was in force at the time). Tax expenditures for fuel tax, CIT and HST are also reported. An interesting PIT item is a Low Income Climate Action credit intended to offset for lower-income taxpayers the estimated impact of the provincial carbon tax introduced in 2008. As in the other HST provinces, the HST expenditures mainly took the form of point of sales rebates applied to fuel, books, and a few other items such as child car seats/boosters..

Although this account of provincial tax expenditures is short and incomplete, it is clear that provinces from coast to coast can and do use tax expenditures for many purposes – from encouraging filmmaking in British Columbia to encouraging graduates of local universities to live in Nova Scotia. In doing so, of course, they make the Canadian tax system considerably more complex than it would otherwise be – a cost of federalism that Canadians, if they are aware of it at all, are seemingly willing to pay.

7 Tax legislation

Taxation in Canada has thus certainly become more complex over time in part as a result of the increasing exercise of provincial fiscal autonomy. What has happened to tax legislation? Figure 4.8 depicts (in index form) the changing size of the federal Income Tax Act including regulations (in English) and of the Québec income tax law including regulations (in French).[22] Both cover both personal and corporate income taxes. Each index takes the value of 1.0 for the middle year of the federal data set (2000). Total size is measured by multiplying the number of pages by the

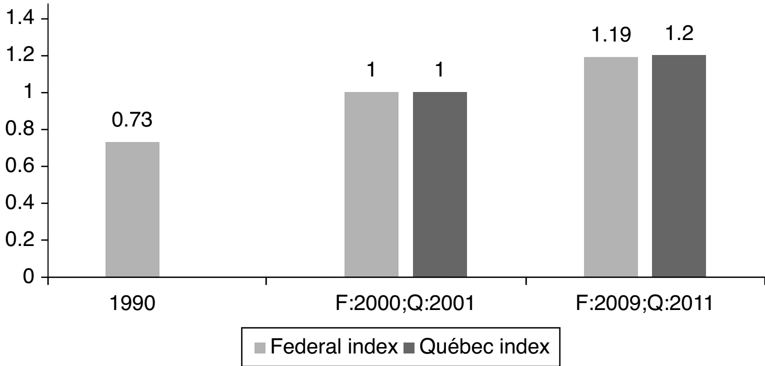

Figure 4.8 Income tax acts, federal and Québec, size index, selected years, 1990–2011

Note: Size of text is number of pages multiplied by page size in cm².
Source: Federal Vaillancourt, Roy, and Lamman 2015, figure 5; Québec calculations by authors using the CHH guides

book's page size in centimetres-squared (which increased 69%), so that the total size of the text is in centimetres-squared.[23]

As Figure 4.8 shows, from 2000/2001 to 2010/2011, the (adjusted) text size of the federal and Québec legislation increased by about 20% (compared to the 69% increase in the number of pages, with a somewhat larger increase occurring in the federal legislation over the preceding decade.

8 Administrative documents

Figure 4.9 depicts changes in the length of the federal personal income tax guide (for Ontario) in select years over the period 2001 to 2011 (this period is determined by the availability of comparably formatted documents online in PDF format). The number of pages (unchanged in size) in this federal administrative document increased from 56 to 70 or by 25% over the period. For the 2006–2001 period, during which the federal document increased by seven pages, the comparable – and somewhat longer – Québec document increased by only five pages. While it is not clear if the longer documents were more or less complex, what is clear is that, as with the previous quantitative indicators shown, the indicator increased in both jurisdictions.

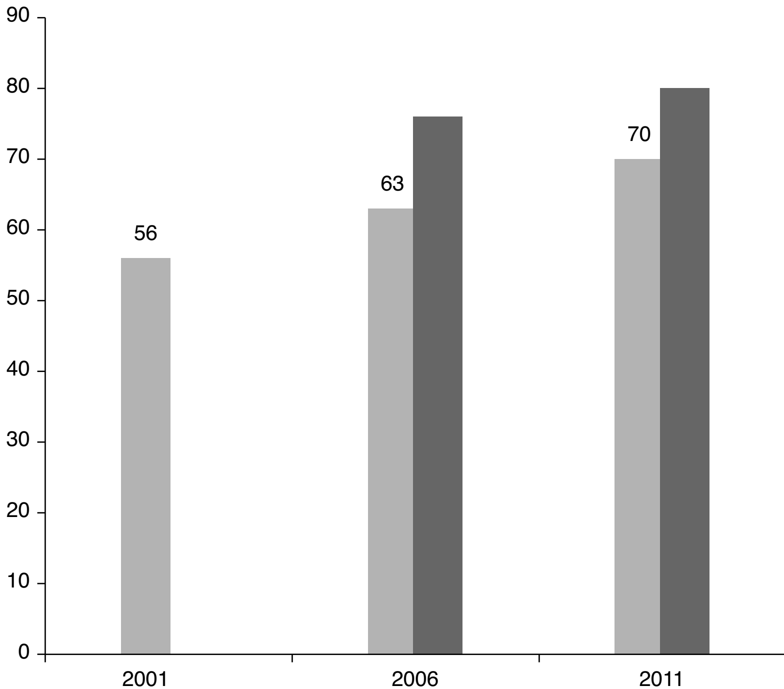

Figure 4.9 Number of pages, PIT guides, federal (Ontario) and Québec, 2001–2011 (some years)

Source: Federal Vaillancourt, Roy, and Lammon 2015, figure 7; Québec calculations by authors.

9 Compliance cost

We have little comparable information over time on the compliance cost of taxes. Figure 4.10 shows that the use of tax preparers has increased substantially over time, which hardly suggests that there has been much simplification. However, over the last thirty or so years, compliance costs of the PIT as a share of GDP have remained surprisingly constant, at 0.3–0.4% of GDP (Vaillancourt, Roy-César and Barros, 2013), perhaps in part because increasing computerization and e-filing (see Figure 4.11) has helped keep costs down in the face of increased complexity.

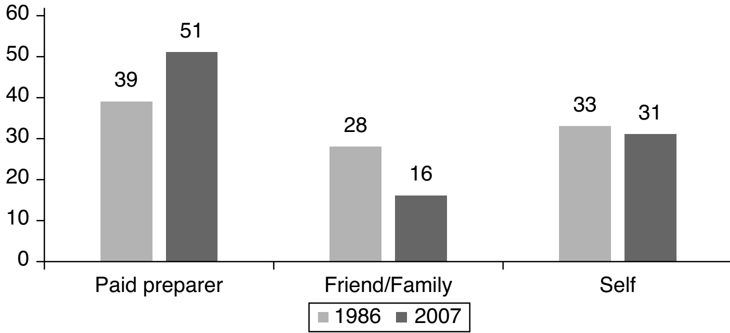

Figure 4.10 Type of tax preparer used, percentage, PIT, Canada, 1986 and 2007
Source: Vaillancourt, Roy-César, and Barros 2013.

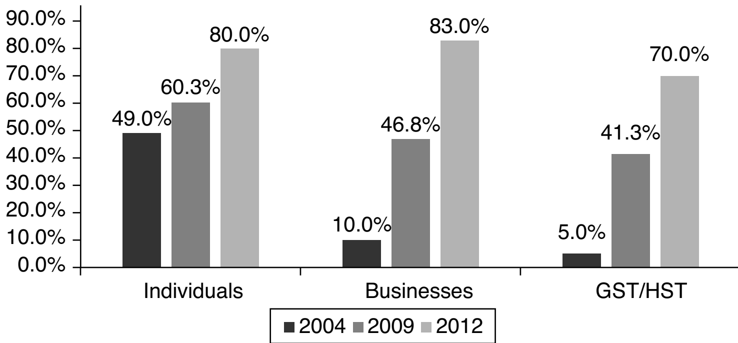

Figure 4.11 Percentage of returns e-filled, Canada, PIT, CIT, GST/HST 2004–2009–2012
Source: *Canada Revenue Agency Annual Report to Parliament* various years.

10 Simplifying taxpayer communications

Another thing that does not seem to have changed much over the years is the absence of much, if any, improvement in the effectiveness or simplicity of communications between the government and taxpayers. Of course the generalisation of e-filing means that the time when filing a PIT return implied stuffing an envelope with paper copies of tax documents already in the hand of the government, often in electronic form, has now passed for most filers. But the federal government does not send out pre-filled tax returns, the computerized assessment notices

received by taxpayers remain largely impenetrable, and taxpayers with questions and problems continue to find it almost impossible to have any sustained contact with any official, either electronically or any other way.

Although the Québec government launched an initiative using pre-filled returns for a subset of taxpayers (older and with simple sources of income), it quickly abandoned the attempt (Vaillancourt 2011). However, quite unlike the federal government, Québec at least makes it possible for users of tax software to download Québec tax slips. For example, the typical employment income slip (Relevé 1 – similar to the federal T4) that one can obtain from the administration shows the Québec labour income, amounts paid to pension plans, social security plans and unions and Québec income tax withheld at source. However, information on the federal labour income and the federal tax withheld at source are not available.

11 Simplifying tax administration

In contrast, substantial simplification has taken place in tax administration in Canada in recent years, largely because five provinces have now turned over administration of their provincial sales taxes to the Canada Revenue Agency (CRA) and because Ontario now has its CIT administered by the federal government. Apart from this, however, it is hard to single out any other marked simplification on the administrative side, and indeed, with reduced funding at the federal level for the CRA in recent years, management may have sufficient problems in maintaining and keeping happy its largely unionized work force to ensure that no major changes in administration are likely in the near future. This last statement is based on the fact that CRA funding was $3.6 billion in 2000–2001 and $4.1 billion in 2013–2014. However, in real terms (in 2000 dollars), it actually declined slightly, from $3.6 billion to $3.5 billion over this period, and as a share of GDP – a rough indicator of taxable activity – it fell from 0.32% to 0.23% over this period. Taxes may not have become simpler, but government (at least federal) has been spending relatively less on administering them than it once did, although, as indicated earlier, it appears compliance costs have changed little.

12 Conclusion

This paper briefly summarizes the Canadian tax system and discusses what tax complexity means. It then shows that some major reforms of

the Canadian tax system may have simplified it while others most likely increased its complexity. Then using three indicators of tax complexity – tax expenditures, length of tax legislation, and length of tax guides – it concludes that there has been an increase in federal and provincial tax complexity over the period 2000 to 2011. Of particular note is the similarity in the evolution of the federal indicators in recent years. From 2000 (or 2001) to 2011 (or 2014), the number of federal PIT tax expenditures increased 22%, the length of tax legislation increased 19%, and the size of the federal PIT guide increased 25%. There is little evidence of simplification of taxpayer communication or tax administration, and recent pleas for tax simplification seem not to have been heard.

Is this likely to change soon? We do not think so. If one looks at an emerging area of taxation, carbon taxation, for example, one finds divergent approaches between provinces: British Columbia has opted for a carbon tax while Québec and now Ontario have opted for a cap and trade approach using a continental market with California and the federal government has maintained its long-standing approach of doing nothing. Also telling is that while the Recommendations Report of the federal Red tape Reduction Commission of 2012 sets out possible steps to reduce the burden of taxes, the Red Tape Reduction Action Plan put out in response by the federal government also in 2012 does not mention taxation.[24]

Notes

1. The ranking penalty suffered by multi-level governments has been reduced in recent years by the expansion of e-filing, since the indicator in question (number of payments), which accounts for about a quarter of the final ranking, is based on the number of actions taxpayers must take to comply, and only one filing is needed to trigger a series of subsequent payments.
2. For a useful recent overview of the importance of thinking about the tax system in this sense, see Slemrod and Gillitzer (2014).
3. Although the wealth tax base is also open to both the federal and provincial levels, in fact the only tax on wealth as such now levied in Canada is that on real property, which is primarily a local tax, although imposed to a small extent also by some provinces. The local level, which includes various municipal entities and school boards, has no explicit constitutional revenue status and hence derives its revenue powers entirely from provincial decisions. For a detailed discussion of the judicial and political development of tax-base sharing (co-occupancy of tax bases) over time in Canada, see Alarie and Bird (2011).
4. See Guimond and Vaillancourt (2013). The development of the income tax agreements over time is discussed further in Bird and Vaillancourt (2006).
5. Three provinces continue to impose their own retail sales taxes, while in a fourth province (Alberta) as well as in three sparsely populated three northern

territories only the federal GST is applied. For a more detailed examination of the evolution of the sales tax system, see Bird (2014).

6. All data are taken from Bird (1979).
7. Calculated from data in Department of Finance Fiscal Reference Tables 2014 http://www.fin.gc.ca/frt-trf/2014/frt-trf-14-eng.asp consulted 05/04/2015.
8. For example, a recent provincial report recommended abolishing a special tax holiday for new small businesses largely for this reason (Nova Scotia 2014).
9. This list, although not this wording, is based on Clark and Farber (2011).
10. Couzin (1988) understands compliance as including administration.
11. Although measuring legal complexity is even less advanced than measuring tax complexity, a recent study applying a knowledge acquisition protocol to analyse the complexity of the United States Code broken down by Title (bankruptcy, taxation, etc.) found that the tax section (Internal Revenue Code) is the second most complex title of the Code (Katz and Bommarito, 2014).
12. See also Turnbull-Hall and Thomas (2012).
13. This exemption continues to exist, with a current limit of $800,000, for qualifying owners of small businesses, farmers and fishermen.
14. The 1985 figure comes from Arthur Andersen (1986). Since there were 36,854 manufacturing establishments in Canada in 1985 and 39,864 in 1991 (Statistics Canada *Table 301–0001 – Manufacturing activities, by Standard Industrial Classification, 1980 (SIC),* CANSIM database, accessed 11 May 2015), assuming that the number of MST taxpayers increased proportionately implies that there would have been 61,500 taxpayers in 1990.
15. Distribution of GST Registrants by Province and Territory http://www.cra-arc.gc.ca/gncy/stts/gb01/pst/gst_hst/pdf/table1-eng.pdf
16. This section draws heavily on Vaillancourt, Roy and Lamman (2015).
17. https://www.novascotia.ca/finance/site-finance/media/finance/Overview_of_NS_Tax_System_2011–04–04.pdf
18. http://www.fin.gov.on.ca/en/budget/fallstatement/2014/transparency.html is the latest and http://www.fin.gov.on.ca/en/budget/fallstatement/2005/05fs-paperc.html the earliest tax expenditure estimate for Ontario.
19. http://www.finance.alberta.ca/publications/Budget/budget2014/fiscal-plan-tax-plan.pdf, p. 123.
20. http://www.bcbudget.gov.bc.ca/2013/bfp/2013_Budget_Fiscal_Plan.pdf, pp. 113–118.
21. http://www.fin.gov.bc.ca/archive/budget95/95rpt_f.htm
22. In choosing what language to use, we were faced by the fact that it is the English version of the federal income tax act that is most commonly used in Canada while it is the French version of the Québec income tax act that is most commonly used in Québec. Although our choices reflect what most taxpayers face, the information is not as comparable as if we compared the two documents in the same language.
23. It's important to adjust page counts for size since the format of the book by the same publisher (CCH) changed over time. Font size does not appear to have changed over time.
24. See respectively http://www.reduceredtape.gc.ca/heard-entendu/rr/rr-eng.pdf and http://www.tbs-sct.gc.ca/rtrap-parfa/rtrapr-rparfa-eng.pdf

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5 Tax Simplification: The Case of Malaysia

Veerinderjeet Singh

1 Introduction and background

Taxation is a very significant component of the national revenue of Malaysia. For the 2014 calendar year, taxes (both direct and indirect) contributed around 80% of the national revenue (per the 2014/2015 Economic Report issued by the Ministry of Finance, October 2014). To many individuals, taxation is also a significant cost. Appreciating the importance of tax revenue to the nation and how such revenue is used to meet the developmental needs of the nation is important. The importance of education, simplification of legislation, ensuring fairness, enforcing legislation in a proper and fair manner, providing adequate services to taxpayers, the need for an efficient and effective tax agency and understanding the psychology of taxpayers through appropriate research are essential components in attempting to meet the targets set for the nation. Self-assessment requires that all the factors outlined above need to be looked at in enhancing tax compliance behaviour so that there is a balance between taxpayer rights and the powers granted to the tax agency in enforcing the tax law.

Taxation continues to be an important ingredient in attracting investment and encouraging reinvestment in various developing economies, including Malaysia. In the context of globalisation and liberalisation, no country is immune to changes occurring outside its borders. As a result, the tax system in many jurisdictions is subjected to modifications and reform by way of studying and adopting what may have been applied in other jurisdictions. At the same time, the pressure to simplify the system continues unabated together with the need to improve service delivery initiatives as a part of measures to enhance compliance and to make the tax system more efficient.

Tax reforms are an ongoing process that must be based on regional and worldwide developments as well as the economic/structural developments and needs of a country. It is impossible for any country to say that it has completed reforming the tax system, as the changing dynamics within and outside the country necessitate suitable responses and action plans. On most occasions, what normally happens is that there may be a particular focus on aspects of the tax system and specific approaches are identified at a particular point of time. However, things do not remain static. One must always be surveying the landscape to see what else is happening around us and how we should respond to various developments.

One of the key thrusts of the Government has been to strengthen the nation's institutional and implementation capacity. The Government has stated its commitment to improve the efficiency and effectiveness of the public sector service delivery system so as to provide quality service and create an enabling environment for business. It has, over the years, taken various steps to improve service delivery. Although these initiatives have yielded commendable results in some aspects, the Government needs to step up its effort to further improve the public service delivery system in order to enhance Malaysia's competitiveness and attraction to investors. The tax system is one such area and a key enabler to energising investment activity.

In Malaysia, direct taxes are administered by the Inland Revenue Board (IRB), whereas the indirect taxes are administered by the Royal Malaysian Customs Department. The income tax system has been a self-assessment system since the year 2001. The Goods & Services Tax has been introduced on 1 April 2015 to replace the narrow-based Sales Tax and Service Tax.

Compliance management is not simply about audits, verification and enforcement. It is also about making it as easy as possible for people to comply. A significant part of the budget of the tax authorities should be directed at the provision of advice and assistance involving marketing and education programmes, advisory visits for new businesses, seminars and responding to telephone and written enquiries. However, there is no public data on how much is actually spent on these areas.

Effective tax administration requires establishing an environment in which citizens are induced to comply with tax laws voluntarily, while efficient tax administration requires that this task be performed at minimum cost to the community.

An important element in any successful administrative reform is simplicity. It is important to simplify procedures for taxpayers, for example, by eliminating demands for superfluous information in tax

returns. Tax administration requires facilitating compliance, monitoring compliance and dealing with noncompliance. Facilitating compliance involves improving services to taxpayers by providing clear instructions, understandable forms, and assistance and information as necessary. Timeliness is crucial.

Studies on taxpayer behaviour do seem to suggest that services to taxpayers that facilitate reporting, filing and paying taxes, or that impart education or information to citizens about their obligations under the tax laws, may in many circumstances constitute a more cost-effective method of securing compliance than measures designed to counter non-compliance. This would involve providing certainty and clarifying legal ambiguities, communicating clearly and assisting in lowering compliance costs to taxpayers. There is much to be gained from viewing taxpayers more as clients than would-be defaulters.

The tax revenue base of Malaysia is reported to be extremely narrow. The 2012/2013 Economic Report (Ministry of Finance, October 2013) stated that 11% of registered companies and 14.8% of employees pay income taxes. With 1.7 million people paying income taxes compared to a workforce of 12 million, this puts into focus the extremely narrow base from which the Government tries to extract its tax revenue. In addition, oil-related revenues generate around 33% of the total revenue of the Government.

The personal tax base is affected by the granting of too many personal reliefs, and there is a need to collapse these into 4 or 5 broad categories. Instead, as part of political expediency, reliefs keep increasing. The 2013 Budget change to lower personal income tax rates was a populist move that took 170,000 taxpayers out of the tax net, and this was a continuation of policies in the past 15 years where taxpayers went out of the tax net for similar reasons. As part of the move to draw foreign direct investment and remain competitive, Malaysia too needs to cut its corporate tax rate with probably a 1% annual cut so as to move slowly from the current 25% rate to a 20% rate.

As such, the Government does face some serious constraints, and the issue of tax evasion and under-reporting of income is also an area that needs substantial research, as the hidden and informal sectors could well generate substantial tax revenue. A robust fiscal framework (over, say, a 5 to 10 year time frame) to outline the way forward is what is needed.

Given the years of ad hoc changes within some parts of the Malaysian tax legislation, and without an overarching focus on the broad tax policy envisaged for the country in its plan to become a high income and developed nation, there is a general view that a holistic review of the

tax system is needed to prepare the nation towards achieving developed nation status by the year 2020. Such a review should outline the various steps and changes that need to be taken over a period of time to ensure the tax system is progressive, fair and robust, in addition to generating the tax revenue needed to fund and lead the nation to budget surpluses into the future.

In light of the current fiscal position that Malaysia faces, there is a need for the country to grow its revenue and reduce, or at least contain, its expenditure. There are concerns that national revenue is unable to keep pace with the growth of operating and development expenditures, thereby increasing the country's fiscal deficit. In this regard, it is paramount that Malaysia widens and diversifies its source of revenue (besides introducing the goods and services tax (GST) in April 2015), while at the same time eliminating tax incentives that are counterproductive. It is also important to streamline untargeted subsidies and replace them with assistance aimed at the truly needy.

2 Simplification of tax systems

Complexity often exists in tax systems for good reasons. Tax systems have to operate in an increasingly complex and changing socio-economic environment, and globalisation also means that tax systems have to be more finely tuned to the environment in which they have to operate. Furthermore, the Base Erosion and Profit Shifting (BEPS) initiative supported by the G20 countries on the grounds that profits 'should be taxed where economic activities are performed and where value is created,' and the move towards an increasing exchange of tax information among jurisdictions will also add significantly more complexity to tax systems. As far as Malaysia is concerned, all the action steps in BEPS may not have a significant impact on the income tax system but it is envisaged that the Malaysian tax authorities will pick and choose changes that they feel should be introduced and one immediate area of change will be the transfer pricing rules.

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 a tool for achieving a range of Government economic and social policies. Thus certain activities which are considered to have undesirable effects (such as smoking and drinking) are subject to additional taxation in Malaysia in the form of higher import and excise duties. As such, the issue of fairness obviously leads to the conclusion that a simple tax may not be acceptable.

However, 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 may find opportunities to exploit the tax system and the tax authorities may then introduce more changes to the tax law and the result is more complex legislation to curtail any unacceptable avoidance of the tax liability. This has happened in Malaysia over the years and in almost every annual Budget presentation, new changes are introduced to plug a gap or to define an item more precisely or to limit the deduction in respect of certain expenditure such as entertainment, etc.

Certainty is another important factor in a tax system. 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 guidelines/rules being issued which then also complicates the tax system. In Malaysia, advance rulings were introduced in 2007 to provide an element of certainty in the income tax legislation, but it came with specific parameters and conditions. Therefore, it is difficult to achieve a proper balance between simplicity and fairness.

In the Malaysian context, the income tax system has been on a self-assessment basis since 2001 (for companies) and progressively covered all taxpayers in 2004. That places the onus on the taxpayer to get his/her tax affairs in proper order and to comply with the law. That also means that more guidance should be available to taxpayers so that they make the right decision. The Real Property Gains Tax (a limited form of a capital gains tax on real property and shares in real property companies) will also move to self-assessment in 2016, and the Stamp Duty (a transaction tax) is also moving towards self-assessment, probably in 2017.

As part of the process of consultation and obtaining feedback, the Government annually invites, in early April, all trade associations, chambers of commerce, professional organisations and universities and other bodies to submit views on what should be included in the Budget announcements that would be presented in Parliament in October. Some of the proposals submitted are aimed at simplification of the tax system, whereas others relate to improving tax administration, etc.

As such, the simplification of the tax system is an ongoing effort primarily driven by the needs of taxpayers. However, as pointed out earlier, the push for greater tax revenue and the aggressive stance of the IRB in carrying out tax audits does make simplification of the tax system to be a long-term objective rather than a short- or medium-term objective.

3 Simplifying tax law

Are the Malaysian tax laws complex? Consider the following:

- If your employer sends you on a foreign assignment, do you stop paying tax here? Much depends on whether your foreign duties are incidental to your employment here. Whilst this may sound simple, the IRB had issued a Public Ruling on this that runs 32 pages. You will find that your understanding of what 'incidental' means may not be what you thought.
- If you are a frequent traveller, whether on business or pleasure, you should know that your tax resident status requires the application of four tests, each of which involves counting the number of days you were away (evidenced by your passport) and the reasons for your absence. Temporary absences for specified reasons are not counted, but not if you are on vacation – a seemingly innocuous issue that turned contentious, requiring intervention by the Court of Appeal.
- Business deductions are subject to the rule that the expense must be 'wholly and exclusively incurred in the production of income' and not after the income has been produced. We therefore find that Annual General Meeting expenses, costs of printing accounts and annual reports and costs of making dividend payments fail to be disallowed, based on the admirable notion that the law must be read strictly.
- Ensuring that you get all your personal tax breaks or tax reliefs is no longer quite as simple an exercise, as there are almost twenty such reliefs.

So what is hindering the process of simplification of our tax laws if everyone, including the Government, agrees that this should be the aim? The culprit is the conflict between simplicity and other tax policy objectives. This often results in simplicity being compromised.

For example, the fact that the personal income tax return asks for details as to marital status, number of dependents as well as composition of expenditure or income is because of the aim to make taxes fairer by tailoring tax burdens to the characteristics of individual taxpayers. The political process involved in introducing new tax measures creates complexity. Granting targeted groups tax subsidies or special tax breaks complicates the tax system by drawing distinctions among taxpayers and sources and use of income. Many provisions became complicated due to the need to raise revenue on complex business structures. Equally

a provision could be complicated by attempts to close loopholes in order to prevent abuse.

By far the most complex provision in the Malaysian tax law is the one to deter tax avoidance. This anti-avoidance provision (section 140 of the Income Tax Act 1967) is not complex in the language but in its application. It is couched in the widest of terms so that it leaves many a taxpayer asking: 'Will it apply to me?' Thus, if lack of clarity or certainty makes a measure complex, this is certainly it.

In Australia, New Zealand (NZ), the United Kingdom (UK), and a number of other countries, there have been tax law review projects intended to rewrite tax legislation in plain English and examine explanatory documentation as well as improving the 'understanding of the law, its expression and its readability.' The intention was to make the legislation more understandable through improving the text of the law by making it more readable. There is no doubt that improvements can be made in simplifying tax law. However, as with the tax system, the complexity of simplifying tax law suggests that there should be a more comprehensive approach.

The Malaysian authorities also saw the benefits of simplification when the Tax System Review Panel was set up in 2005. However, there was no attempt to rewrite the legislation so as to make it more readable because no one saw that as an issue. The 2005 Budget presented in September 2004 announced the setting up of a Taxation System Review Panel. It was stated that the objective of carrying out a review was to make the tax system more efficient, equitable, business-friendly, transparent and capable of generating a stable source of tax revenue. It was also announced that the Review Panel would also look into the proposed GST that was to be introduced in Malaysia in January 2007. Since the Panel's work appeared to have been largely on the GST, work on simplification and modernisation of the existing tax laws did not produce substantive changes.

4 Simplifying taxpayer communications

Simplifying communications with taxpayers in the form of tax explanatory leaflets, guidelines and public rulings is another area where there is scope for improvement. In view of the self-assessment income tax system, public rulings and guidelines started being issued from the start of the self-assessment period. However, it has been a slow process of issuing such public rulings mainly due to the shortage of resources in the IRB. Nevertheless, the IRB recognises its role to issue such public rulings

whenever some major amendments are made to the tax legislation. There is a need for the tax authorities to be more forthcoming with the issuance of clear guidelines/rulings on a timely basis to ensure transparency in the tax system. Speedier and more efficient processing of tax returns and of refunds of overpaid taxes would promote greater confidence in the system. Hence, a holistic technological transformation is absolutely essential. With the transformation, it is hoped that the tax authorities will be more proactive/responsive in issuing timely clarifications on relevant areas which will assist taxpayers in making their financial decisions.

The website of the IRB is populated with the latest tax technical news, press releases and technical information including the Income Tax Act 1967, public rulings and the various double tax agreements. As such, it is quite informative.

Of course, on a going-forward basis, there is a need to focus on making tax compliance a way of life and a national duty. Continuous education cannot be limited to media advertisements by the tax agencies. Some suggestions include the following:

- We need to have a tax file number allocated to all persons irrespective of the tax status of a person;
- We need to widen the scope of withholding taxes to cover all payments among residents and exempting such withholding only if a tax file number is disclosed to the payer;
- We need effective consultation with all stakeholders and not just hold meetings for the sake of being seen as being inclusive and courteous.

5 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 as in NZ and the UK.

Malaysia introduced a similar change in the 2014 Budget where it was stated that for ease of administration, with effect from the year of assessment 2014, employees whose total income tax is equivalent to the amount of monthly tax deduction (MTD) deducted throughout the year need not submit the annual income tax returns. Thus, the amount of MTD will be the final tax paid. This exemption from filing a tax return is only applicable to:

i) employees who receive certain categories of employment income;

ii) employees whose MTD are made under section 107(2) of the Income Tax Act 1967 and the *income tax (deduction from remuneration) rules 1994*;
iii) employees serving under the same employer for a period of 12 months in that year of assessment;
iv) employees whose MTD are not borne by the employer for that year of assessment; and
v) employees who have not elected for joint assessment with the spouse under section 45 of the Income Tax Act 1967.

Where an employee meets the above conditions and no return for that year of assessment has been furnished by that employee:

(i) the employee is deemed to have made an election not to file a return;
(ii) the total amount of MTD deducted shall be deemed to be the tax payable of the employee for that year of assessment; and
(iii) the Director General of the IRB shall not make an assessment in respect of the employee for that year of assessment.

However, the Director General of the IRB retains the power to raise a deemed assessment or an additional assessment if there is reason to do so.

From the year of assessment 2015, employees whose employment income includes benefits-in-kind or living accommodation, or where the employment with an employer for a year of assessment is less that twelve months can now elect for the monthly tax deduction to be treated as final tax and no income tax return form needs to be submitted for that year of assessment. This is a continuation of the measure introduced in the 2014 Budget.

With effect from the year of assessment 2014, the following amendments were introduced via section 77A(4) of the Income Tax Act 1967:

(i) A company is required to file its tax return to the Director General of the IRB in the prescribed form in an electronic medium or by way of electronic transmission in accordance with section 152A; and
(ii) A company's return furnished to the Director General has to be based on accounts audited by a professional accountant, together with a report made by the said professional accountant in accordance with sections 174(1) and 174(2) of the Companies Act 1965.

The imposition of e-filing on companies is a positive measure to enhance the efficiency of the tax filing system. This amendment will push companies to ensure the timely preparation of their audited accounts. There are no plans as yet to compel individuals to file their income tax returns electronically, but the take-up rate for e-filing has been on the upswing. It has been reported in the local media that the IRB expects 4 million individuals to file their tax returns electronically this year (where the timeline for submission of personal income tax returns **had** been extended to 15 May 2015 instead of the timeline of 30 April 2015, as stipulated in the law).

As for the GST introduced on 1 April 2015, the filing of tax returns electronically is available, and if there are any refunds due to a GST-registered person, the refund will normally be made within 14 working days from the submission of the tax return, whereas it would be 28 days if a paper return is filed. Of course, this will depend on the completeness of the GST tax return and certain other criteria that may be set by the Customs Department in vetting the tax returns.

As reported in local media (The Star Online, 19 March 2015), the IRB has announced that tax payments can now be made via credit card, and this has been introduced for the taxpayers' convenience. It presents another alternative for taxpayers to pay, especially for those who need to make payments urgently at the last minute. So, taxpayers have the choice to remit the payments using pre-existing methods, that is, cash or cheque at the counter, Cash Deposit Machine or via Internet banking.

Effective from 1 January 2015, the Corporate Tax Department of the IRB has been renamed the Large Taxpayer Branch in Peninsular Malaysia and Large Taxpayers Unit in the States of Sabah and Sarawak (which are located on Borneo Island). The Multinational Tax Department has also been renamed as the Multinational Tax Branch and the Petroleum Division has been renamed as the Petroleum Branch. This change is to improve the quality of services in respect of large and high profile taxpayers and the handling of their tax files.

Furthermore, with advances in technology, it is also becoming feasible to issue tax returns that already include information about the taxpayers' circumstances. Such information is obtained/supplied by third parties to the tax authority via electronic means. These 'pre-populated' tax returns can contain details of most major sources of income, personal tax reliefs, tax credits and the calculations of tax payable or refundable. The role of the taxpayer in this process is to confirm that the information is correct and to supply any further information required. The same approach is being adopted in Malaysia for the tax returns of individuals who file their

tax returns electronically. However, the amount of information that can be populated is limited, as it is dependent on employers submitting the relevant information on employees electronically.

In order to continue to collect more tax revenue (which will be essential in assisting future moves to attain a balanced budget), the need for effective enforcement by the tax agencies (both the IRB and Customs Department) is an important component. It is time the tax agencies are transformed into truly service-oriented entities that use information technology effectively and efficiently. Existing systems and procedures need to be redesigned and streamlined with the latest technology. There will be a need for the Government to budget for such expenditure. Malaysia must move along this road, but it requires a holistic approach – that is, the whole agency must be wired, trained and have a service-oriented mindset. A proper and systematic approach towards implementing technology and efficient and well-trained staff will lead to a more effective tax agency. This will lead to the registration of more taxpayers, effective recovery action and thus greater tax revenue. Over the years, the tax authorities have been spending capital on improving their systems and this will continue to occur over time.

There are various areas in which a review of tax administrative practices may need to be done as part of the move to build a tax system that is more efficient, equitable, business-friendly and transparent and espouses the upholding of taxpayer rights. In this context, modern tax systems have to seriously consider the need to ensure that taxpayers are given due respect and provided effective services so that tax compliance is enhanced.

Three aspects which could be looked at closely by the Malaysian tax authorities involve the need to:

- Review the manner in which tax audits and tax investigations are being carried out. A clear mechanism/process must be in place which shows mutual respect for taxpayers as well as tax officers of the IRB. With the Tax Audit and Tax Investigations Framework in place, this means that the enforcement of the Frameworks must be monitored continuously to ensure fair play and consistency.
- Enhance and protect taxpayers' rights by enhancing and monitoring the Taxpayer's/Client Charter. Quite obviously, having a charter (as various government agencies, including the IRB, have) is not enough. Its effectiveness must be monitored, and steps should be taken to improve matters. Perhaps the Auditor-General's Office could do

this, or an independent watchdog could be set up to monitor all Government agencies.

- Create the office of an Ombudsman to provide an avenue for taxpayers to complain about the action or inaction of tax officials.

6 Longer term approaches

More recently, there have been initiatives to establish more long-term approaches to simplification, like the Office for Tax Simplification in the UK, which is heavily dependent upon consultation with the tax profession, taxpayers, and input from tax officials. Only time will tell if these initiatives have been successful, as there is always a specific period of time allocated and at times, it is up to the Government of the day to decide if such an initiative should be continued. In most situations, such bodies or panels end up focusing on minor issues rather than broad-based issues, as happened with the Tax System Review Panel set up by Malaysia in 2005.

In Malaysia, a number of areas have been suggested by various organisations as part of the move to improve the tax system so that it becomes efficient, simple and leads to effective compliance. Improving tax administration is also part of reforming the tax system. Some areas in tax administration that should be looked at over the longer term include the following:

- Using technology effectively to provide services to taxpayers, to assist staff in responding on a timely basis and to collect taxes quickly.
- Enhancing tax administration by looking at the following aspects which will improve service delivery:
  - Review the legislative framework to simplify current provisions and to remove archaic ones. In doing this, the private sector must be consulted to provide its input and assistance.
  - Keep tabs on improvements in the tax administration structure in the region and other parts of the world. Make proactive suggestions to reform and enhance the current structure so that we are in step with worldwide developments.
  - Focus on the educational role so as to be able to disseminate tax information (including using the website) effectively.
  - Service counters must be manned by experienced personnel with specific decision-making powers, that is, problem-solving is the focus.
  - Improve timeliness in responding to queries from taxpayers, appeals, objections, etc., and measure adherence to these timelines and benchmarks.

- Collect what is due and penalise intentional noncompliance quickly. Attempt to avoid arrears and avoid chasing for collection of tax liabilities years after these have been established.
- Introduce an effective human resource policy so that technical capabilities are enhanced, that is, get the right personnel. Outsource certain aspects, for example, the research into a highly technical area that may be the subject of an advance ruling, so that there is an effective understanding of the specific issue and the industry.
- Train officers by getting contributions from the private sector so that we develop staff with a broader mindset and more business knowledge.

Given the 2020 target and the tremendous changes needed to achieve developed nation status, it seems appropriate to review the tax system holistically and develop one that is sustainable and effective. We have resorted to tinkering with the system on an ad hoc basis, so much so that there are leakages, abuse and misperceptions. The tax revenue to GDP ratio is still low compared to advanced economies. So a public review of the tax system is timely.

7 A more systematic or strategic approach

Although initiatives for simplification can often result in improvements, it is often felt that it may be better to adopt a more comprehensive approach by focussing on the areas or sectors from which complexity arises.

A very important sector that is in need of a simple tax system is small business. Small enterprises 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.

In Malaysia, there has not been too much of a focus on small businesses to the extent of commissioning research on the sector and compliance costs faced by the sector. So there appears to be a lack of a systematic approach towards resolving issues faced by the sector. Nevertheless, certain favourable measures have been introduced for small businesses, such as a two-tier corporate tax rate structure of 20% (to be reduced to 19% in 2016) for the first RM500,000 of chargeable income and 25% (to be reduced to 24% in 2016) for anything in excess of that.

In addition, a small and medium enterprise (SME) resident and incorporated in Malaysia that has commenced operations in a year of assessment is not required to furnish an estimate of tax payable or make

instalment payments for a period of two years, beginning from the year of assessment in which the SME commences operations under section 107C of the Income Tax Act 1967.

In addition, the focus should be on the rights of a taxpayer in terms of complying with the income tax law in Malaysia. Some of these would be included in the relevant tax legislation whereas some would be stated in a taxpayers' charter/bill of rights and some would be presumed to be a logical expectation.

As such, one can list various rights that a taxpayer should have as follows:

- The right to receive the relevant information
- The right to obtain clarifications on aspects of the law and administration
- The right to appoint a representative or a tax adviser to represent the taxpayer before the tax agencies
- The right to receive efficient service from the tax agencies
- The right to confidentiality of one's tax affairs
- The right to be treated fairly in the conduct of a tax audit or tax investigation
- The right to object against an assessment (including penalties)
- The right to make an appeal and to an effective settlement of a tax dispute
- The right to a speedy refund of overpaid taxes

Most of the above does exist in Malaysia, such as the availability of call centres, the advance rulings process, the website of the tax agencies, the right to appoint a qualified tax adviser (under section 153 of the Income Tax Act 1967), confidentiality of tax affairs (in section 138 of the Income Tax Act 1967), the right to appeal against an assessment (in section 99 of the Income Tax Act 1967), the tax audit and tax investigation framework which sets out the process and obligations of both parties, the right to refunds of overpaid taxes and the right to receiving a compensation for any delay in the refund of overpaid taxes (via section 111D of the Income Tax Act 1967 which took effect from the year of assessment 2013). There should be more effective use of the website of the Inland Revenue Board (IRB) and more information should be displayed on a timely basis. However, the key issue would be the question of how effectively are such 'rights' being delivered and how fairly are guidelines being implemented. This is always a subjective matter, and taxpayers will need to have an avenue of expressing their views on such matters – a form

of an administrative tribunal (without the formalities of a court) or the setting up of an Ombudsman may well be an option to consider if the usual discussions with the authorities are not satisfactory. The desired outcome in such situations is a speedier resolution of a dispute.

The IRB updated its charter in 2008 and specified certain timelines in delivering its services to taxpayers. However, there does not appear to be any mechanism in place to measure how the IRB has performed in implementing the Charter and to report it to the public. In Australia, the Australian Tax Office is accountable to Parliament and reports to Parliament on its performance. The area of accountability is one area in which Government agencies definitely need to do a lot of work.

8 Conclusion

All in, Malaysia needs a long-term plan to outline its fiscal policy direction and be bold in its outlook. This includes changing the mindset of the citizens, having consistent application of rules across the nation as well as enforcing and monitoring them effectively. It is timely that Malaysia has announced a comprehensive fiscal reform that is wide-based and wide-ranging, and put into place a long-term plan to mould a world-class tax system that will be comparable to leading developed nations in the world. It is time to let go of the ad hoc approach of tinkering with the tax system.

Tax reforms are an ongoing process that must be based on regional and worldwide developments as well as the economic/structural developments and needs of the nation. There can be no such thing as saying that we have finished reforming the tax system. What can happen is that there may be a particular focus on aspects of the tax system and specific approaches that are identified at a particular point of time. However, things do not remain static. One must always be surveying the landscape to see what else is happening around us and how we should respond to various developments.

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6

Complexity of Tax Simplification: A New Zealand Perspective

Adrian Sawyer

1 Introduction

Compared to many developed countries, New Zealand's tax system is relatively simple, coherent and transparent. Why is this so? A number of reasons may underlie this, including New Zealand's constitutional structure (operating with a unicameral Parliament, having a single House of Representatives, in which the New Zealand Government in conjunction with its coalition partners, holds a majority), coupled with a unitary State (which eliminates the issues that frequently arise in a Federal system). A further reason may be attributed to the relatively transparent and coherent public sector, to which the private sector has ready access, not only through making submissions, but also being able to discuss issues and share information (where permitted), which is facilitated by the small population and transparent and coherent tax policy process.

Furthermore, New Zealand has, over the last twenty years, undertaken a number of initiatives that have served it well in terms of reducing complexity at various levels, as well as making inroads into simplification, particularly for small and medium enterprises (SMEs). Nevertheless, scope remains for further improvement in simplifying the tax system and reducing tax compliance costs. This chapter provides a brief review of many of these initiatives; readers are encouraged to explore the analysis contained in a number of empirical studies that are referred to in this chapter.

2 Simplification of tax systems

2.1 Overall tax system

Tax systems are frequently used for more reasons than merely raising revenue for the government to enable it to function. Tax systems can be

a means of redistribution of income, implementing tax expenditures, and facilitating political objectives. The literature shows clear links between complexity, ambiguity, and noncompliance,[1] which has laid a platform for extensive research exploring whether, amongst other things, simplifying the tax system may lead to enhanced compliance. The non-tax revenues and expenditures transacted through the tax system in a New Zealand context include student loans and welfare support (such as family support, and parental tax credits), which collectively have become a major contributor to the tax law's conceptual complexity.

Prior to the mid-1980s, New Zealand relied principally upon income tax, with very high individual marginal tax rates ranging as high as 66%. Unsurprisingly, tax planning was rampant with various schemes employed to enable wealthy taxpayers to reduce their income. The newly elected Labour Government in 1984 faced an economy in crisis and in need of a radical overhaul. Much of what occurred over the following three years (1984–1987) can be seen as a radical economic liberalisation experiment that was facilitated by perfect conditions, namely: an economy in desperate need of a radical overhaul; a new government with an electoral mandate to implement change; and a Minister of Finance with a clear plan to overhaul the economic environment. Importantly, tax reform was an integral part of the reform process.

A major component of the tax reform platform package was the Goods and Services Tax (GST), combined with a reduction in the top individual marginal tax rate on income tax of 66% to 33%. The GST was a major component of a partial, but significant, move away from direct to indirect taxation, along with a broadening of the tax base. The GST that emerged set the international benchmark for purity and efficiency, evidenced by having few exemptions (other than complex areas such as financial services and life insurance), as well as provision for nonprofit organisations and excluding house sales (some of these were due to an inability at that time to measure the value added without undue complexity).[2]

The next major step came in the mid-1990s when the New Zealand Government instigated the Organisational Review of Inland Revenue,[3] under the chairmanship of Rt Hon Sir Ivor Richardson, retired Court of Appeal Judge.[4] Of the many recommendations made by the Organisational Review, perhaps the most significant in terms of this chapter was to urge the New Zealand Government to ensure that the tax system operates with a transparent and coherent structure for developing and implementing tax policy. Sir Ivor Richardson identified a

number of problems with the previous process for developing tax policy, noting that:[5]

> ...the subject matter is complex, and tax legislation is very complex and difficult to understand. The tax policy process was not clear, neither were the accountabilities for each stage of the process. There was insufficient external consultation in the process.

A Cabinet directive[6] implemented the Generic Tax Policy Process (GTPP) rather than a legislative enactment, which reflects both the strengths and weaknesses of the GTPP. Through the GTPP, the New Zealand Government and policymakers are able to draw upon the technical and practical expertise of the business community, and to factor in compliance and administrative effects of potential policy changes. A downside is that the GTPP has been occasionally bypassed, and that supplementary order papers with last-minute legislative amendments can be introduced without going through all phases of the GTPP. Furthermore, the GTPP also provides a mechanism to communicate the rationale for policy changes. The GTPP is set out in Figure 6.1.

The GTPP has operated almost without incident to the present day despite various changes,[7] including the process by which parliamentarians are elected. From the 1996 general election onwards, New Zealand changed from a First Past the Post (FPP) electoral system to that of a Mixed Member Proportional (MMP) system. MMP has led to the emergence of coalition governments, frequently where the government does not command an absolute majority in Parliament, but operates with Confidence and Supply agreements with one or more minority parties.

The GTPP has also facilitated the initiatives directed at reducing complexity and compliance costs over the last twenty years, including the Rewrite Project (which is discussed in the next section of this chapter), as well as initiatives to measure and reduce the compliance costs of SMEs. The amount of effort by private sector individuals who volunteer their time and professionalism in a number of reviews of the tax system over the last twenty years is unprecedented internationally. This ability to work together across government, business, tax professionals and academia is one of New Zealand's greatest strengths, and something that other countries have generally found to be elusive.

A number of areas remain complex in the New Zealand tax system, notwithstanding simplification efforts, including the various regimes for dealing with cross-border taxation (such as thin capitalisation, transfer pricing, and attribution of income). To be fair, the degree of complexity

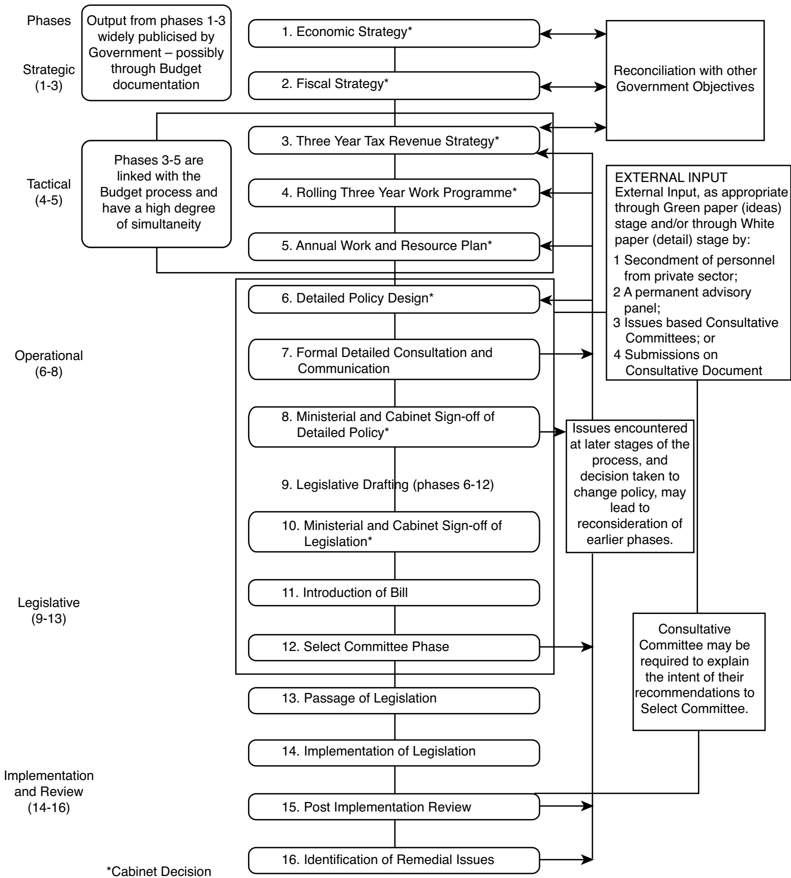

Figure 6.1 The Generic Tax Policy Process (Organisational Review Committee, 1994).

is in part a function of the complex nature of business and transactions, as well as the desire for governments to protect their tax base. Unsurprisingly, efforts by Inland Revenue to counteract tax-avoidance activities have been intensifying, largely to protect New Zealand's tax base. Company taxation is perhaps the most complex area, and within this mire of provisions is a mechanism to reduce double taxation of corporate income that has become out of favour globally, namely the dividend imputation/franking system.[8] New Zealand shares this mechanism with Australia, although efforts to harmonise these two systems

as part of an ongoing initiative to have the same regulatory regime in both countries have failed to bear fruit (largely due to inaction from Australia).

New Zealand's tax system was perceived to be deficient in terms of policy coherence and efficiency until the recommendations of the Tax Working Group (TWG) were implemented in 2010.[9] The TWG, established by Victoria University of Wellington (VUW – with support from the Treasury, Inland revenue and the New Zealand Government), undertook widespread consultation and extensive reporting to the New Zealand Government, resulting in a series of recommended options for major tax policy reform. Specifically, the TWG sought to:

(1) identify concerns with the current taxation system;
(2) describe what a good tax system should be like;
(3) consider options for reform; and
(4) evaluate the pros and cons of these options.

The TWG concluded that NZ's tax system faced three critical issues:

(1) its structure was inappropriate;
(2) it lacked coherence, integrity and fairness; and
(3) significant risks to the sustainability of the tax revenue base existed.

Consequently, the TWG established six principles to guide its analysis and recommendations for reform, namely:

(1) the overall coherence of the system;
(2) efficiency and growth;
(3) equity and fairness;
(4) revenue integrity;
(5) fiscal cost; and
(6) compliance and administration costs.

The TWG made a number of significant recommendations, including major changes to tax rates, structures and bases. These recommendations, which included a series of options or combinations of structural tax reforms, were referred to the New Zealand Government for its consideration. A capital gains tax (CGT) was, by a narrow majority, not recommended. Several months later, in its budget delivered on 20 May 2010, the New Zealand Government announced a major overhaul of

the New Zealand tax system, adopting many of the recommendations of the TWG.[10] Significant changes were: an increase in the rate of GST to 15%; the removal of a deduction for depreciation on buildings; and lowering the top marginal tax rate on the income of individuals from 38% to 33%.

One small blessing is that New Zealand, when implementing tax reform, does not have to work around the complexities of a Federal system, as do Australia,[11] Canada and the United States, through operating a single uniform tax system for all of the country. Alongside central government, local authorities raise revenue through various user-pays services and the levying of rates on real property.[12]

2.2 Compliance costs[13]

A number of studies of compliance costs have been undertaken in New Zealand. The first major study of business compliance costs in New Zealand was conducted by Sandford and Hasseldine in the early 1990s with the support of Inland Revenue.[14] The study reported that, in comparison to small firms, bigger firms were largely unaffected by tax compliance costs. Furthermore, for the very largest firms, they were found to benefit from the cash flow benefits in retaining taxes collected from employees (PAYE) and customers (GST), and paying the collected taxes to Inland Revenue over several days or weeks after collection. A study focussing on the compliance costs of the New Zealand-controlled foreign company regime was commissioned in 1991 by the New Zealand Treasury. Data was drawn from the Sandford and Hasseldine study, with the research finding that when comparing the compliance costs for the controlled foreign companies with those for domestic companies, the costs for the former appear to be lower than for the global results of the Sandford and Hasseldine sample, but more expensive when compared with the costs incurred within groups of sizes that are more comparable.[15]

In a series of interviews conducted in 2010 by Inland Revenue with large enterprises, the interviewees stated that there were a number of underlying factors driving their tax costs, including the complexity of tax legislation, and the frequency of tax legislation changes.[16] To date, there has been no public announcement of any proposals to address the concerns raised from these interviews.

In relation to SMEs, Inland Revenue commissioned Colmar Brunton (a commercial marketing firm) in 2004 to conduct a mail survey of over 1,700 SMEs and 270 tax agents in New Zealand to measure SMEs' tax compliance costs. The aim of the survey was to design initiatives to

make it easier for small businesses to comply with their taxation obligations. The findings from this study indicated that the average internal and external compliance costs for each SME in 2004 were over $5,500,[17] with the average internal cost over $4,000 and external cost over $1,500. The results were intended to act as a baseline for comparison before the introduction of several initiatives aimed at reducing business tax compliance costs.

Five years later, Inland Revenue, using methods comparable to 2004, carried out a follow-up survey of more than 1,700 businesses and over 340 tax agents. This information was also used to evaluate the effectiveness of some major tax initiatives and changes introduced since 2004.[18] The survey results showed that the average combined internal and external compliance costs for SMEs in 2009 were over $5,500.[19] External compliance costs in nominal dollars were virtually the same as they had been in 2004. Considering the inflationary costs in the economy, this represented a significant decrease in real terms. Nevertheless, the compliance costs, as a proportion of turnover, were still much higher for the very small businesses. Furthermore, extrapolating out Inland Revenue's 2009 compliance cost study data suggests that with almost 450,000 SMEs in New Zealand, aggregate compliance costs for SMEs is around $2.5 billion (or more than 1% of NZ's GDP). This does not include the compliance costs for large enterprises and other taxpayers.

In October 2009, the New Zealand Institute of Chartered Accountants (NZICA) and Tax Management New Zealand (TMNZ) issued a discussion paper[20] setting out proposals to help reduce tax compliance costs for small businesses. The discussion paper proposed that small businesses should not be required to spend more than one hour on tax compliance, file more than one tax return or make more than one tax payment, every month. To date, the NZ Government has not formally responded to the proposals.

Gupta and Sawyer surveyed the views of 118 New Zealand SME taxpayers regarding internal and external tax compliance costs.[21] The authors found that the gross cost of complying with all taxes was significantly higher than Inland Revenue's studies, coming in at more than $31,000 for the 2011–2012 income year (comprising over $25,000 for internal costs and $6,000 for external costs). The authors also found that GST requires the greatest internal compliance cost for SMEs, followed by Income Tax, Pay As You Earn (PAYE), Fringe Benefit Tax (FBT), and KiwiSaver. The results also revealed that larger businesses are more reliant on paid employees, with greater use being made of external tax advisers. Like all prior studies, the results measured by the business size category

confirm that gross tax compliance costs are regressive. On the positive side, a majority of the businesses perceived significant managerial benefits in tax compliance for their business and were using computerised accounting systems. An overwhelming majority of the respondents were unsure or unaware of the effectiveness of various small business tax concessions (SBTCs), such as for low value trading stock. The respondents indicated that they preferred a simple tax system and lower tax rates.

Most recently in April 2015, Inland Revenue and Research New Zealand released the results of the 2013/2014 quantitative research that surveyed 1206 SMEs about tax compliance costs and compared results from two earlier surveys in 2004 and 2009.[22] The report shows tax compliance costs have reduced by 11.7 per cent since 2004. The report recognises the significant role that tax policy plays in reducing compliance costs, especially for SMEs. Making tax obligations simpler to understand is a good place to start a process of reducing compliance costs, which is part of a wider New Zealand government objective to reduce by 25% the cost to the private sector of dealing with all public sector departments. At present, the costs involved in dealing with Inland Revenue contributes a disproportionately large share. The report also provides a stress score, which is an attempt at providing a barometer of the level of stress on business when it is required to meet Inland Revenue's requirements (this excludes finding money to pay the tax). The number of businesses reporting lower stress from dealing with Inland Revenue was 63% in 2013 compared with 50% in 2004.

Inland Revenue also released the findings of a small scale qualitative study that sought the views of 25 SMEs.[23] These SME business owners were recruited based on the results of the 2013 SME Cost of Compliance Survey and a longitudinal panel survey, with the emphasis placed on those who were 'highly stressed'. The report outlines the results arising from the SMEs' practical ideas and suggestions that would help them interact more efficiently and effectively with Inland Revenue, as well as to reduce the effort and stress in doing so, and to be more tax-compliant as a result. During May and June 2014 this was undertaken in two stages:

1. An exploratory stage that aimed to generate practical suggestions that would make meeting SMEs' taxation obligations and other compliance obligations easier (i.e., require 'less effort');
2. A focus on identifying which of the practical suggestions outlined in the first stage would deliver the most value to SMEs.

The suggestions were refined down to the top 12, which can be classified into the following themes: simplification; relationship/trust/discretion; and communication with experts. Going forward, the report authors recommend that Inland Revenue undertake quantitative research to see to what extent the findings may be generalised, as well as that the equivalent of this qualitative study is completed with accountants and tax agents who primarily provide taxation services to SMEs.

3 Simplifying tax law

3.1 Reading complexity and understandability

New Zealand has been at the forefront of efforts to reduce complexity through rewriting and reorganising its income tax legislation. However, is rewriting legislation for the purpose of improving readability likely to be a process that delivers effective simplification? Tran-Nam suggests that there is both legal simplicity (how difficult a tax law is to read and understand) and effective simplicity (how easy it is to determine the correct tax liability).[24] The New Zealand Rewrite Project, like that of Australia and the United Kingdom, focused on the former and largely neglected the latter.[25] Thus effective simplicity was unlikely to emerge.

New Zealand's Rewrite Project employed a novel approach (a reorganisation step before any rewriting) as well as utilising a very influential overseer, the Rewrite Advisory Panel (RAP), chaired by Sir Ivor Richardson.[26] The major drivers for the Rewrite Project included the 1994 Organisational Review of Inland Revenue, and the Consultative Committee on the Taxation of Income from Capital (known as the Valabh Committee).[27]

The first step, the reorganisation of the Income Tax Act 1976 (ITA 1976) and the Inland Revenue Department Act 1974 (IRDA 1974), led to the creation of three new statutes: the Income Tax Act 1994 (ITA 1994); the Tax Administration Act 1994 (TAA); and Taxation Review Authorities Act 1994 (TRAA). The second phase was rewriting the core provisions in the ITA 1994, followed by the major income, deduction and timing provisions (plus the definitions), were rewritten as the ITA 2004. Finally, the rewrite addressed the remaining parts of the ITA 2004, being rewritten as the ITA 2007. As part of New Zealand's project, a schedule of intended policy changes (and their associated sections) was included as part of each iteration of the ITA. This made it easier to ascertain when previous case law, rulings and analysis could not be used in conjunction with interpreting the rewritten legislation.

With regard to the Rewrite Project, Sawyer concludes:[28]

> The collective results of readability research on the NZ tax rewrite project provide evidence of improvements in readability (and to a lesser degree suggest improvements in understandability) through the process of simplifying the text of the ITA. Such an outcome should enable taxpayers and their advisors to more readily determine their tax obligations, thereby facilitating an environment that is conducive to improvements in the level of tax compliance.

Sir Ivor Richardson has provided unique insights into the success of the New Zealand project through his role of chairing the RAP, emphasising several factors, including the collaborative nature of the rewrite.[29] Sir Ivor highlights in particular the response to the exposure of the first phase of the rewritten ITA in 2004, the extensive attention to quality control, and the setting of goals. Finally, Sir Ivor acknowledges the commitment of the small groups of experts and officials who were collectively crucial to the success of the NZ Rewrite Project.

Subsequent amendments to the ITA 2007 have used the Rewrite Project team's drafting style, layout and section-numbering approach. However, as Sawyer observes,[30] this in itself is no guarantee that the resulting text will be understandable when it is assessed using various forms of readability testing. For readers that are interested in understanding more about the Rewrite Project, a number of studies have been publishing and analysing the improvements in the readability of the new legislation.[31] The TAA and TRAA have not been rewritten, and neither has the Goods and Services Tax Act 1985 (GSTA).

3.2 Policy complexity

Readability is but one aspect of assessing the impact of legislative simplification. Its weaknesses include an inability to embrace more complex issues, such as underlying concepts and the influence of the policy process. Unfortunately, readability is frequently considered to be synonymous to understandability, especially by policymakers. Although readability may be used as a proxy for understandability, there is much more to legislation being understandable than the extent to which it is readable. Specifically, further factors that influence complexity include underlying policy concepts, layout, legibility and length.[32]

New Zealand has taken steps to improve its tax policy, as set out in the first section of this chapter exploring the overall New Zealand tax system. The GTPP, along with the contribution of the TWG, have been

instrumental in this regard, making as far as is practical the linkages and process transparent and cohesive. However, without the ongoing presence of the TWG (it was disbanded soon after reporting to the New Zealand Government), and the disestablishment of the RAP in 2014,[33] a real risk remains that policy complexity will increase, and the GTPP will struggle to address this complexity. Strong reliance on Inland Revenue, to monitor and bring issues to the attention of the New Zealand Government with regard to addressing unnecessary complexity, is risky. Tax practitioners and researchers will need to monitor the levels of tax complexity and place pressure on Inland Revenue to review and propose reforms to address that unnecessary complexity.

3.3 Remaining areas for simplification

As noted in the regard to the prior discussion under the heading 'Reading Complexity and Understandability', the TAA and TRAA, along with the GSTA, have not been rewritten. Notwithstanding support for rewriting the GSTA from the judiciary,[34] and for the TAA from the tax profession, the New Zealand Government appears to have no appetite to undertake further rewriting of tax statutes. Consequently, complexity will remain, as these statutes devolve into something akin to their forebears, namely the ITA 1976 and the IRDA 1974.

Simplification is also needed for SMEs in terms of reducing their compliance costs. The NZICA/TMNZ package of reforms[35] remains the only significant proposal to address this issue, yet there remains a complete lack of political will to do anything in this area other than tinkering at the edges.

Furthermore, there remain calls, especially from the tax profession, for the New Zealand Government to provide statutory guidance for the remaining areas of black-hole expenditure. To date, the New Zealand Government's response has been to address these concerns in a piece-meal fashion.

4 Simplifying taxpayer communications

Inland Revenue has continued to make progress at simplifying the ways it communicates with taxpayers and tax agents. Undoubtedly the growth in use of electronic formats, coupled with technological advances, has made Inland Revenue's website the principal source of information and interface with taxpayers and tax agents.[36] Inland Revenue has continued its efforts to simplify tax returns and guidebooks, including making all of these available electronically via its website. Nevertheless,

Inland Revenue has not sought to adopt simplification initiatives such as combining returns and payments on the same form for taxes such as GST and FBT, or GST and income tax.

One positive initiative is the New Zealand Government's strategy of creating a single point of contact for new business taxpayers, for which Inland Revenue is a partner agency. The New Zealand Business Number (NZBN), a 13-digit number, is a single identifier which, over time, is intended to become the only number that businesses use to interact with a range of government agencies and other businesses. The NZBN identifier is part of a platform being built that will ultimately link business information for use by businesses, their business partners (such as accountant, advisers and bank), government agencies and the public. The ultimate aim is that businesses will be able to update their details in one place, which will automatically update this same information in other places, without businesses having to do anything further. Ultimately this should assist in reducing overall business compliance costs, and potentially tax compliance costs.

In 2013 Inland Revenue won the Best Plain English Turnaround category, awarded by WriteMark New Zealand.[37] Inland Revenue was recognised for achieving their goal of making the new tax guides 'relevant and readable'. This award comes alongside Inland Revenue's success with its website being recognised as the top New Zealand Government website at the annual NetGuide Awards.[38] Most recently, Inland Revenue won the award for Best Government Website in December 2014; this was no doubt facilitated through the website having more than 20 million visitors in 2014.[39] Inland Revenue's website has won the Government category in the 2006, 2008, 2009, 2010, 2011 and 2012, and was a finalist in 2007. Inland Revenue, at the time of writing, has more than 1.7 million customers registered for secure online services through Inland Revenue's MyIR portal, which allows people to check their tax details, child support, Working for Families and KiwiSaver accounts, as well as to submit GST returns online.[40]

Inland Revenue introduced in 2012 a mobile web app which gives customers access to their account information 24 hours a day, seven days a week.[41] Most recently, Inland Revenue ran an APP4IR challenge, with the winner (along with Sush Mobile), at the time of writing, almost ready to launch. This app, which Inland Revenue advises will be continually updated, aims to provide a new way for small businesses to more easily comply with GST obligations.[42]

Inland Revenue's Community Compliance and Communications staff have followed up with newly established small businesses and their

advisers, building on efforts to understand the issues they face, by developing what they have termed 'Better for Business' solutions. These solutions are a set of short, animated online videos, covering key tax topics such as business expenses, income and provisional tax, GST, and depreciation in what users have found to be easy and engaging.[43]

The greatest source of frustration for many taxpayers and tax practitioners is Inland Revenue's telephone service, where huge delays are experienced at peak times. Initiatives that have improved the experience include: enabling taxpayers to speak with staff in a number of languages via an interpreter (a service provided for all Government departments)[44] and automation of the telephone service, with over one million people now using Voice ID, which is a secure digital identification service that allows customers to verify their identity and access automated tax self-services. Voice ID has enabled over 8500 hours of telephone time to be saved each year.[45]

In most situations, formal communication by Inland Revenue with taxpayers and tax practitioners is through written letters, facilitated through use of electronic formats and/or the postal service. In this regard there remains scope for Inland Revenue to improve the readability of its communications when made in the form of letters and advice. Prior research on readability includes assessment of Inland Revenue's Tax Information Bulletins (TIBs) that are published monthly for taxpayers to use, along with published binding rulings.[46]

5 Simplifying tax administration

The New Zealand Government, along with Inland Revenue, has sought to simplify tax administration in the modern era, since the late 1990s. The first major tax development was the removal of the ability for wage and salary earners to claim deductions from the 1999–2000 income year, which in turn means that such taxpayers do not need to file an individual IR 5 tax return. Although this has led to a substantial compliance cost reduction benefits for these taxpayers, it meant for many that their tax burden increased.

This followed the commencement of the Rewrite Project, and the earlier recommendations of the Waugh Committee,[47] which were aimed at simplifying the tax system. Some of these recommendations were to align payment dates, reduce the number of returns and forms, and to increase thresholds. Indeed, it was the Waugh Committee that recommended that the wording of the tax legislation be simplified in a number of regards, including drafting it in simple and clear language

that was understandable to the ordinary taxpayer so that the intent of the legislation was clear.[48] Furthermore, there were three major reviews that appeared in 1998 and 1999, which collectively led to the discussion document, *Less Taxing Tax*, released in September 1999.[49] In addition, the Business Compliance Cost Panel was formed in 2000 to review compliance costs for businesses and to recommend reform. Throughout the 2000s, the New Zealand Government and Treasury released discussion documents and issues papers outlining proposed changes, with the vast majority being enacted by way of legislation through the New Zealand Government's Tax Policy Work Programme (TPWP).[50] The current TPWP covers three broad areas:

1. Improving current tax settings within a broad-base, low-rate tax framework;
2. International tax reform and addressing base erosion and profit shifting; and
3. Business transformation and Better Public Services.

The NZ Government and Inland Revenue have continued to regularly review the tax system and propose reforms directed at making it simpler for taxpayers, especially for small business taxpayers. For example, in 2010 an online submission process was set up entitled: 'Making tax easier' in which taxpayers and tax practitioners were encouraged to discuss ways to simplify Inland Revenue's systems and processes to provide more responsive online services, reduce the amount of paper required, provide tailored support for taxpayers and intermediaries, and reduce business compliance costs.[51] This led to the current Business Transformation Programme, which is discussed in the next section of this chapter.

Changes to the Financial Reporting Act in 2014 have led to medium-sized companies being no longer required to produce complex financial statements, which should mean a substantial reduction in compliance costs for most companies with annual revenue/turnover between $2 million and $30 million. The Financial Reporting Act also mandates that SMEs no longer have general-purpose reporting obligations as of 1 April 2014; instead they are required to prepare simplified statements, which should result in significant compliance cost savings for many businesses.[52]

Like most countries, appropriations for government departments are continually being tightened in real terms, with expectations to do more with fewer financial resources and staffing. One exception to this trend

in New Zealand has been regular targeted increases in appropriations for Inland Revenue to apply towards increasing its audit activity, with high expectations about the return per dollar spent.[53]

6 Long-term approaches

Inland Revenue is conducting a multi-year change programme to modernise New Zealand's tax system. Business Transformation is a multi-stage change programme intended to modernise New Zealand's tax service to make it simpler and faster for New Zealanders to pay their taxes and give more certainty that taxpayers will receive their entitlements.[54] The Business Transformation Roadmap is set out in Table 6.1.

Inland Revenue has set up the Commissioner's Transformation Reference Group to provide Inland Revenue with insights and perspectives from across the business, tax, and individual communities, which will be used to inform the Business Transformation Programme (BTP). In addition, the Information and Communications Technology (ICT) ICT Reference Group was set up to provide an independent voice and sounding board for the BTP. ICT professionals are encouraged to contribute individual perspectives and experiences on the impact of the planned BTP on business and the community.

The third reference group is the Tax Simplification Panel (TSP), which is made up of individual taxpayers, small businesses, and the active tax advisory community.[55] The aim of the TSP, through meeting quarterly from August 2014 for two years, is to modernise and transform the New Zealand tax system so paying tax is made simpler. The TSP is charged with providing an external and independent voice that challenges Inland Revenue's thinking about ways to improve its customers' experience.[56] The TSP's reports will be made publicly available.

In launching the TSP, the Minister of Revenue stated that this:[57]

> ... is a chance for Kiwis to have their say on Inland Revenue's processes, to tell us about the things that might frustrate them, and submit ideas about how things can be done better' ... I am particularly keen that we engage with individual taxpayers and small-to-medium business owners about how we can reduce the amount of time they spend on red tape and tax compliance.

Thus the BTP will form the roadmap for future work by Inland Revenue for simplifying aspects of the tax system, enabling new features to be added to what is an outdated computer system first launched in the early

Table 6.1 Business transformation roadmap[a]

Stage Key Outcomes	**One Enabling secure digital services**	**Two Streamline income and business tax processes**	**Three Streamline social policy delivery**	**Four Complete delivery of the future revenue system**
	The majority of customers self-manage and use digital services	Compliance burden to fulfil income and business tax obligations is further reduced	Social policy processes are digital and streamlined	Revenue system is flexible and government has policy agility
	Digital Border established	Less processing and customer contacts surrounding income and business taxes	Less processing and customer contacts surrounding social policy	Infrastructure supporting the revenue system is robust
	Businesses compliance burden to fulfil PAYE and GST obligations is reduced	Compliance assurance activities are intelligence-led	Enforcement activities are more focused and require fewer resources	Revenue system compliance is higher
	Improved data accuracy and certainty of income tax deductions and social policy entitlements and obligations for individuals	Increased reliability and flexibility (including policy agility) for income and business tax	Increased reliability and flexibility for social policy products	Inland Revenue is intelligence-led, leaner and more productive
	Less processing and customer contact			Increased inter-operability with other agencies/third parties
	Customers have confidence that their personal information is secure			

[a]Based on IRD, *Business Transformation Roadmap*; available at: http://www.ird.govt.nz/resources/b/0/b0ec93cf-c4a8–4e66–8a9c-3845b3e919db/business-transformation-roadmap.pdf.

1990s, and it underpins Inland Revenue's focus on an electronic platform as the centre of how it communicates and interacts with taxpayers. This massive project, with an estimated cost of $1.5 billion, is not without its risks. These risks include the likelihood that the new system will not work exactly as planned, will involve compromises that lead to a less than optimal system, will incur cost overruns, and that some taxpayers will be left behind (especially the elderly and those with limited access to the internet). This new platform cannot, and should not, fully replace either face-to-face or telephone as channels for communication between Inland Revenue and taxpayers.

Alongside the BTP is Inland Revenue's ongoing work in the international sphere through the work of the OECD, such as in regard to the Base Erosion and Profit Shifting (BEPS) initiatives,[58] along with its exchange of information agreements and other treaty obligations.[59] Detection of noncompliance for cross-border transactions is anticipated to become easier for revenue authorities through the operation of these international agreements,[60] as well as increase the compliance costs for wealthy taxpayers and multinational enterprises (MNEs) as they face increased audit activity and request for information.

7 Conclusions

Tax simplification efforts in New Zealand do appear to have made real and substantial progress over the last thirty years, commencing with the Douglas reforms in the mid- to late-1980s under the Labour Government (when, for example, the GST was introduced, which continues to serve as the global benchmark), right up to the last major reform arising from the TWG's report in 2010. To be fair, the size and scale of New Zealand's economy and tax system has contributed, as it is easier to effect change when the scale is small.

What is apparent is that there has been a strong, sustained and largely unified commitment to reform, both on the part of both politicians and of policymakers. Furthermore, having a unicameral Parliament has been influential in this regard, and the change to a MMP election process has challenged, but not hindered, the tax simplification process. The level of consultation and the willingness of officials and the New Zealand Government to make modifications in the light of reasoned argument, especially from tax practitioners, have been features of the process. This is underpinned by the GTPP, which has served the tax policy development process well over the last 20 years.

Furthermore, the general public appears to have accepted the need for, and the direction taken by, the reform measures, although acceptance is far from uniform, reflected by the ongoing debate over introducing exemptions and multiple rates into the GST on the premise that this will make it fairer for lower-income households. Overall, the New Zealand tax base includes both direct and indirect taxes, which from a tax policy perspective, are well integrated and coherent in design and application. The notable exception, the elephant in the room, is the absence of a comprehensive tax on capital gains; debate on this potential missing strand will continue.

Notwithstanding this generally positive assessment, much more work is necessary to reduce compliance costs for SMEs, including exploring whether Inland Revenue can come out with simpler (but not generally concessionary) rules for SMEs in certain circumstances, and make compliance easier with regard to payroll obligations.[61] The recently released SME compliance cost reports indicate that Inland Revenue's efforts at reducing compliance costs are showing tangible progress, but there remains some way to go in meeting the NZ government's overall compliance cost reduction targets. One area where complexity remains, and no doubt will continue to increase, is in regard to cross-border taxation base protection measures, including obligations by MNEs and wealthy individuals to respond exchange information requests and additional audit activity. Given the global nature of business, this seems unavoidable.

Notes

1. See, for example, Jackson, B. and Milliron, V. (1986), 'Tax Compliance Research: Findings, Problems and Prospects', *Journal of Accounting Literature*, 5, 125–165; and Richardson, M. and Sawyer, A.J. (2001), 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects', *Australian Tax Forum*, 16(2), 137–320.
2. See further, Sawyer, A. (2013) 'New Zealand's Successful Experience with Introducing GST: Informative Guidance for Hong Kong?', *Hong Kong Law Journal*, 43(1), 161–187.
3. Sir Ivor Richardson *et al.*, (1994) *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue*. Wellington, NZ Crown)
4. For a tribute recognising many of the contributions of the Rt Hon Sir Ivor Richardson, see for example: Sawyer, A. (2015) 'Sir Ivor Richardson: A Tribute', *New Zealand Journal of Taxation Law and Policy*, 21(1), 7–10.
5. See Richardson *et al.*, (above n 3), at 5.
6. The Cabinet is part of the Executive Branch of Government – a directive sets up a convention but does not have the force of law.

7. For a comprehensive analysis of content, processes and successes of the GTPP, see Sawyer, A. (2013) 'Reviewing Tax Policy Development in New Zealand: Lessons from a Delicate Balancing of 'Law and Politics', *Australian Tax Forum*, 28(2), 401–425. The GTPP has come under scrutiny and pressure on two occasions, the first in 1999 and the second in 2010. For an analysis of how it could assist another jurisdiction, in this case, Hong Kong, see: Sawyer, A. (2013) 'Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand offer Instructional Guidance for Hong Kong?' *Hong Kong Law Journal*, 43(2), 579–609.
8. For further explanations of dividend imputation, see for example, Dabner, J. (2004) 'Responding to Globalisation: Are Imputation Systems up to the Challenge?', *New Zealand Journal of Taxation Law and Policy*, 10(3), 271; and Palmer, C. (2008) 'The International Tax Consequences of New Zealand's Imputation System: Past, Present and Future', *New Zealand Journal of Taxation Law and Policy,* 14(2), 231.
9. Tax Working Group, *A Tax System for New Zealand's Future Report of the Victoria University of Wellington Tax Working Group*. Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, January 2010. (A Tax System for New Zealand's Future).
10. For details of the New Zealand Budget 2010 announcements, available at http://www.treasury. govt.nz/budget/2010. For further discussion on the work of the TWG, see: Sawyer, A. (2013) 'Moving on from the Tax Legislation Rewrite Projects: A Comparison of New Zealand Tax Working Group/Generic Tax Policy Process and the United Kingdom Office of Tax Simplification', *British Tax Review*, 3, 321–344.
11. At the time of writing, Australia is facing the challenge of whether it should review its GST, and if so, how can this be done, given the challenges faced by the Federal-State interactions for constitutional and tax reform.
12. In early 2015, a review commissioned by Local Government New Zealand (LGNZ) raised the possibility of local authorities raising additional revenue through a form of local (income) tax; see LGNZ, *Local Government Funding Review: a discussion paper* (2015); available at: http://www.lgnz.co.nz/home/news-and-media/2015-media-releases/lgnz-review-launches-discussions-on-new-funding-model-for-local-government/.
13. Some of the discussion on compliance costs is drawn from the following work involving the author: Gupta, R. and Sawyer, A. (2015) 'Tax Compliance Costs for Small Businesses in New Zealand: Some Recent Findings', *Australian Tax Forum*, 30(1), 135–177.
14. Sandford, C. and Hasseldine, J. (1992) *The Compliance Costs of Business Taxes in New Zealand*. Wellington: Institute of Policy Studies. A summary of this study is published as: Hasseldine, J. (1995) 'Compliance Costs of Business Taxes in New Zealand', in Sandford, C. (ed.), *Tax Compliance Costs Measurement and Policy.* Bath UK: Fiscal Publications, pp. 126–141.
15. Prebble, J. 'Costs of Compliance with the New Zealand Controlled Foreign Company Regime', in Sandford, C. (ed.), *Tax Compliance Costs Measurement and Policy.* Bath UK: Fiscal Publications, pp. 321–352.
16. Inland Revenue, Large enterprises tax compliance costs (2010); available at: http://www.ird.govt.nz/aboutir/reports/research/le-compliance-report/ (the author was a consultant working with Inland Revenue on this project).

17. The report is available at www.ird.govt.nz/aboutir/reports/research/report-business-tax-compliance.
18. The major changes were GST and provisional tax alignment, subsidised payroll intermediaries, a discount for early payment of provisional tax in the first year of business and introduction of KiwiSaver. The report is available at www.ird.govt.nz/aboutir/reports/research/report-business-tax-compliance.
19. It consists of approximately $4,000 internal cost and $1,500 external cost. A copy of this second report, along with a copy of the comparative report between the 2004 and 2009 findings, see: http://www.ird.govt.nz/aboutir/reports/research/sme-compliance-eval-report-1/; and http://www.ird.govt.nz/aboutir/reports/research/sme-compliance-eval-report-2/. Inland Revenue is also undertaking longitudinal research into the impact of adverse events (the Canterbury earthquakes were used as the catalyst) on the tax compliance behaviour of SMEs; for the more recently available results, see http://www.ird.govt.nz/aboutir/reports/research/adverse-events-reports-yr3/.
20. The discussion paper by NZICA and TMNZ, 'Simplifying the taxation of small business in New Zealand', is available at www.smetax.co.nz. The revised version was released in 2012. NZICA has since joined with the Institute of Chartered Accountants in Australia (ICAA) to form Chartered Accountants Australia and New Zealand, as from July 2014.
21. See note 13 above.
22. Research New Zealand and National Research Unit of Inland Revenue, SME tax compliance costs 2013: Evaluation Report 1 and (June 2014) Research New Zealand and National Research Unit of Inland Revenue, SME tax compliance costs 2004 to 2013: Evaluation Report 2 (June 2014). Both reports are available at: http://www.ird.govt.nz/resources/8/a/8a11891e-e5f5–497a-a432–0484c1081663/sme-tax-compliance-costs-2013-evaluation-report-1.pdf; and http://www.ird.govt.nz/resources/4/a/4a31ee11–4a0e-4a77–9e7b-86f5144e2820/sme-tax-compliance-costs-2004–2013-evaluation-report-2.pdf, respectively.
23. Penny Salmon and Research NZ, National Research and Evaluation Unit of Inland Revenue, *A qualitative investigation to identify steps Inland Revenue could take to reduce effort and compliance cost of SMEs* (November 2014); available at: http://www.ird.govt.nz/resources/e/3/e346aae8–20fa-4ae9–99f3–58066b9d48e0/sme-tax-compliance-qualitative-report.pdf.
24. Tran-Nam, B. (1999) 'Tax Reform and Tax Simplification: Some Conceptual Issues and a Preliminary Assessment', *Sydney Law Review*, 21, 500.
25. For further discussion, see Sawyer, A. (2013) 'Rewriting Tax Legislation: Can Polishing Silver Really turn it into Gold?' *Journal of Australian Taxation*, 15(1), 1–39.
26. For an analysis of the RAP, see Sawyer, A. (2008) 'RAP(ping) in Taxation: A Review of New Zealand's Rewrite Advisory Panel and its Potential for Adaptation to Other Jurisdictions', *Australian Tax Review*, 37(3), 148–163.
27. Consultative Committee on the Taxation of Income from Capital (Valabh Committee), *Final Report* (New Zealand Government, 1992).
28. See also Sawyer, A. (2011) 'Enhancing Compliance Through Improved Readability: Evidence from New Zealand's Rewrite "Experiment"', in Gangi, M.E. and Plumley, A. (eds.), *Recent Research on Tax Administration*

and Compliance: Selected Papers Given at the 2010 IRS Research Conference. Washington DC: IRS, pp. 221–253, at 247.

29. Sir Ivor Richardson, (2012) 'Simplicity in Legislative Drafting and Rewriting Tax Legislation', *Victoria University of Wellington Law Review,* 43, 517.
30. See Sawyer, above note 25, and Sawyer, above note 28.
31. Tan, L.M. and Tower, G. (1992) 'The Readability of Tax Laws: An Empirical Study in New Zealand', *Australian Tax Forum,* 9, 355; Richardson, M.-A. and Sawyer, A. (1998) 'Complexity in the Expression of New Zealand Tax Laws: An Empirical Analysis', *Australian Tax Forum,* 14, 325; Harrison, J. (2006) *Submission to Inland Revenue, The Readability of the Income Tax Act 2004: A Report to Inland Revenue for the Rewrite Advisory Panel,* Auckland.; Pau, C., Sawyer, A. and Maples, A. (2007) 'Complexity of the New Zealand's Tax Laws: An Empirical Study', *Australian Tax Forum,* 22, 59; Saw, K. and Sawyer, A. (2010) 'Complexity of New Zealand's Income Tax Legislation: The Final Instalment' *Australian Tax Forum*, 25, 213. See also, Sawyer, above note 28.
32. For a summary of what makes a document readable, see: Castle, R. (2007) 'What Makes a Document Readable?', *Clarity* 58 (November), 12.
33. For further details post the disestablishment of the RAP, see: http://taxpolicy.ird.govt.nz/news/2014–12–02-rewrite-panel-now-disestablished.
34. Encouragement to rewrite the GST Act from a member of the NZ Supreme Court to address legislative complexity has fallen on deaf ears.
35. See note 20 above.
36. Inland Revenue has two main websites: http://www.ird.govt.nz and http://taxpolicy.ird.govt.nz.
37. See further: http://www.plainenglishawards.org.nz/2013-writemark-new-zealand-pla/.
38. The NetGuide Awards are the premier awards for excellence on the web, with 225,000 votes cast in 2012 across 27 categories.
39. See further: http://netguide.co.nz/story/irds-netguide-award-shows-government-committed-make-tax-simple/.
40. McClay, T. (June 2014) Speech to 21st century tax conference; available at: http://taxpolicy.ird.govt.nz/news/2014–06–12-speech-21st-century-tax-conference.
41. Further details are available at: http://www.ird.govt.nz/aboutir/media-centre/media-releases/2012/media-release-2012–09–21.html.
42. See McClay, note 40 above.
43. For further details see: http://www.mbie.govt.nz/what-we-do/better-for-business/case-studies/IR%20Case%20Study%201.pdf/view.
44. See http://ethnicaffairs.govt.nz/story/interpreters.
45. See McClay, note 40 above.
46. See Richardson and Sawyer, Pau *et al*. and Saw and Sawyer, above note 31.
47. Tax Simplification Consultative Committee (the Waugh Committee), *Final Report* (1990).
48. See Tan and Tower, above note 31, at 358.
49. The three reviews were undertaken by the: Commerce Committee Inquiry into Compliance Costs for Business; The Committee of Experts on Tax Compliance; and Parliament's Finance and Expenditure Select Committee.
50. This is available at: http://taxpolicy.ird.govt.nz/work-programme. Several important aspects of the current TPWP that will potentially have an effect

on compliance are: considering whether the tax and transfer system can be simplified either legislatively or operationally to reduce complexity for individuals; ensuring that the policy and legislative framework is fit for purpose to improve and streamline the collection of PAYE and GST information; and considering simplification, technical and base maintenance issues that arise under current tax rules applying to closely held companies, including improving the overall coherence of the rules (this includes the rules for look-through companies and other close company regimes).

51. See further: http://www.ird.govt.nz/technical-tax/general-articles/making-tax-easier-government-consultation.html.
52. For further information, see Foss, C. and T McClay, T. 'Changes to Financial Reporting Requirements' (March 2014) Media Release; available at: http://taxpolicy.ird.govt.nz/news/2014–03–13-changes-financial-reporting-requirements. See also: Tax Administration (Financial Statements) Order 2014 LI 2014/69.
53. For example, in the 2014 Budget, the Government allocated an additional $132 million to Inland Revenue over the next five years to bolster its tax compliance activities and for pursuing unfiled returns. Of this, $48.6 million was in cash, and the remaining $84 million to cover tax being written off where this is unlikely to be paid. It is estimated that the new funding would generate a gross increase in Crown revenue of $297.5 million over the next five years. See further: http://www.beehive.govt.nz/release/budget-2014-extra-132m-tax-compliance.
54. See further: http://www.ird.govt.nz/transformation/. For further discussion on the project, see Inland Revenue (June 2014), *Tax Administration for the 21st Century: A policy vision, An officials' draft working paper*; available at: http://www.ird.govt.nz/resources/c/a/caea3866-d831–477a-9b45–7a30bf45bbf3/tax-administration-policy-vision-draft-working-paper.pdf. See also the BTP brief provided by Inland Revenue, which is available at: http://www.ird.govt.nz/resources/8/e/8eefed0f-fd7a-43fb-980a-af2ebb3d8001/changing-ir-transformation-market-brief.pdf.
55. See further http://www.ird.govt.nz/aboutir/commitment/tax-simplification-panel.html.
56. See further the TSP's terms of reference, available at: http://www.ird.govt.nz/resources/1/6/16d18068–07a8–4707–9794-a81b24a3eb6a/tsp-terms-of-reference.pdf.
57. Inland Revenue, 'Time to speak up – New Zealanders to have their say about the future of the tax system' (2014) *Media Release* (August 140: available at: http://www.ird.govt.nz/aboutir/media-centre/media-releases/2014/media-release-2014–08–14.html. For an early commentary on the TSP, see: http://www.interest.co.nz/personal-finance/70303/terry-baucher-urges-taxpayers-give-tax-simplification-panel-plenty-useful-fee.
58. Information on the OECD and G-20 led BEPS project is available at: http://www.oecd.org/ctp/beps.htm.
59. For further details on New Zealand's tax treaties, see: http://taxpolicy.ird.govt.nz/tax-treaties.
60. Such multinational agreements include the *Convention on Mutual Administrative Assistance in Tax Matters*, which became operative from 1 January 2015 for New Zealand; and the *Agreement between the Government*

of New Zealand and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA, which is effective from 3 July 2014. In relation to the OECD and G-20 initiative endorsing automatic exchange of information, New Zealand intends to align its timetable with Australia's and begin exchanging information on a voluntary basis from 2018, and then aiming for mandatory reporting in 2019.

61. The Minister of Revenue spoke of ongoing work in this area at the 2014 Chartered Accountants Australia and New Zealand Tax Conference; see further: http://taxpolicy.ird.govt.nz/news/2014–10–31-address-caanz-tax-conference.

7
The Complexity of Tax Simplification: Russia

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1 Introduction

Modern national tax systems must meet requirement of simplicity, clarity and stability that were introduced by the founders of economic theory. The result of the evolution of the Russian tax system in the 1990s, 2000s and 2010s became a significant simplification of the national tax legislation, decreasing number of taxes and the level of tax burden. Tax Code introduced in 1999–2001 replaced the previous numerous and diverse legal documents governing the taxation and optimised structure of taxes. Instead of the original, which imposed more than 50 taxes, the current Russian tax system imposes only 14. Tax rates significantly decreased in accordance with the requirements of the stimulating nature of taxes and economies of scale for budget revenues. The severity of the tax burden was gradually moved in the direction of taxation of producers and exporters of raw materials (this contributed to the emergence in 2002 of the special tax on extraction of mineral resources). Finally, the Russian tax reform implemented at the turn of the 21st century is still considered to be one of the most successful in the world and the most consistent among series of reforms implemented by Russian authorities.

In this chapter we will assess processes of tax simplification in Russia with regard to national tax system, tax legislation and tax administration. Section 2 deals with simplification of Russian tax system, Section 3 discusses simplification of tax legislation, Section 4 analyses simplification of tax administration and taxpayer communications and Section 5 examines long-time approaches for tax simplification in Russia. Finally some conclusions are drawn.

2 Simplification of Russian tax system

2.1 Russian tax system of 1990s: complexity of first years of implementation

The modern tax system originated in the Russian Federation in 1992 just after the dissolution of the Soviet Union in conditions of transition towards a market-oriented economy. The tax system existing under the Soviet Union was hardly comparable to the tax system of a market economy, and a fundamental overhaul of existing tax system and tax law was required.

The Russian tax system experienced a number of radical changes in the 1990–2000s. Since its establishment, the tax system of the Russian Federation is based on the experience of several leading countries of the world. Thus, the structure of the Russian tax (and budget) system is focused on such federal states as Germany and the US. It involves the division of taxes at the federal, regional and local level. The system of revenue allocation of tax between the Federal budget and budgets of subjects of the Federation has been copied from Germany (for instance, revenues from the corporate profit tax in Russia are distributed between federal and regional budgets, exactly as in Germany). The United States served as an example of moderate tax policy, stimulating the development of entrepreneurship. For this reason, the postulates of supply-side economics, including Arthur Laffer's tax curve, have become especially popular among Russian tax reformers. However, Russia also partly used the experience of the organisation of the tax systems of unitary state. France has served as a model of centralisation in tax policy decisions. To improve tax collection in a country with initially low tax morale and the lack of a proper legal and ethical culture of taxpayers, a repressive character of tax administration and a tax police as special tax service were adopted, in the model of Italy. [1]

During the first years of their existence, Russian tax system and tax legislation were considerably complicated and eclectic. In 1990s miscellaneous taxes and fees were introduced, and the total number of imposed payments exceeded fifty. [2] Tax legislation consisted of numerous laws adopted on all levels of state and local authority. Tax revenues remained low (60–70%, and for some types of taxes even 40% of the planned revenues[3]). Notwithstanding the total amount of taxes and fees, tax compliance was very poor.

Among many types of taxes used in that period, only five taxes (corporate profit tax, value added tax (VAT), individual income tax, resource fees and excises) were effective, giving 95% of tax revenues.[4]

The effectiveness of other taxes was immaterial. The situation in the fiscal sphere was complicated by so-called 'parade of sovereignties' that emerged in the soil redistribution of the powers of the Federal centre and subjects of Federation, and led to the fact of a real tax separatism in Russia in the mid-1990s. A number of regions refused to transfer the collected taxes to the Federal budget, paralysing the implementation of many social programs. This situation has led to the fact that in 1995 and 1996, on the background of the uncertain political situation (unclear re-election prospects of the first President of Russia Boris Yeltsin for the second term), tax revenues fell to a record low of 20% of GDP.[5] The financial crisis of August 1998 in Russia (which counted low level of tax collection among the main reasons for the crisis) summed up the first stage of formation of the Russian tax system, mostly with a negative tinge, and made experts think about change for the better. A new tax system for Russia needed to be simpler and easier for taxpayers, to have a sound legal basis in the form of the Tax Code, and taxes had to focus not only on fiscal appetites of the government, but on the task of regulating and stimulating business activity.

2.2 Modification of the Russian tax system in 2000s: simplicity, clarity, efficiency

Serious tax reform resulted in the enactment of the Tax Code of the Russian Federation – the first part of the code in 1999, and the second part in 2001. This process was initiated by President Boris Yeltsin and his team, and it was continued by the next Russian president, Vladimir Putin. New legislation led to significant simplification of the Russian tax system and creation of a unified tax system with significantly reduced amount of taxes and fees.

Under the Constitution of the Russian Federation, each person shall be obliged to pay legally imposed taxes and fees. The unified tax system was created by provision of the Tax Code, which states that only taxes and fees mentioned in the Code can be imposed.

The Tax Code of the Russian Federation gave legal definitions of tax and fee and introduced division of taxes and fees into three categories – federal, regional and local. This legally binding classification is based on two main criteria: the territory on which taxes and fees are payable, and which level of authority that has the right to impose the payments. Federal taxes and fees are payable on the entire territory of the Russian Federation and are imposed only by the Tax Code of the Russian Federation. Regional taxes and fees are payable on the territory of the subject of the Russian Federation and are imposed by both the Tax Code

of the Russian Federation and the laws of the corresponding subject of the Russian Federation. Local taxes and fees are payable on the territory of the municipality and are imposed by both the Tax Code of the Russian Federation and acts issued by the corresponding local authorities (with exceptions for local taxes in Moscow and Saint Petersburg, which are imposed at the level of the subject of the Russian Federation – Moscow and Saint Petersburg, correspondingly). However legislative taxing powers of the subject of the Russian Federation and local authorities are strictly limited; they can regulate several elements of regional and local taxes only if the Tax Code of the Russian Federation doesn't regulate these elements.

There is no correspondence between the type of tax and budget in which it is payable. For example, federal tax can be the source of the revenue for the budget of the subject of the Russian Federation.

Above-mentioned federal, regional and local taxes were introduced as a part of a so-called general regime of taxation. At the same time, the Tax Code of the Russian Federation contains provisions on special regimes of taxation that can be regarded as a mechanism of simplification of taxation for certain categories of taxpayers. Under special regimes of taxation, several taxes (usually VAT and corporate or individual income and property taxes) are replaced by a single payment. Application of a special regime of taxation can be voluntary or obligatory for a taxpayer.

At the moment of its enactment on 1 January 1999, the Code allowed to impose 16 federal taxes and fees, seven regional taxes and fees and five local taxes and fees. Since 1999, the list of taxes and fees imposed according to the Tax Code of the Russian Federation has been changed significantly and Russian tax system has become simpler. The current tax system of the Russian Federation includes six federal taxes and two federal fees, three regional taxes, two municipal taxes and one municipal fee (see Table 7.1). The total number of taxes and fees, therefore, is 14, which is almost four times less than the number of tax payments in 1990s.

The described reduction of the amount of taxes is one of the characteristics of tax system, and from this prospective we can say that Russia has made significant steps towards simplification of its tax system. However, we should note that taxes are not the only type of compulsory contributions imposed in Russia. According to the Constitution of the Russian Federation, each person shall be obliged to pay legally imposed taxes and fees. Only three fees are mentioned in the Tax Code of the Russian Federation, and there are many more fees imposed by other laws. The legal regulation of fees imposed by other laws is insufficient

Table 7.1 Types of taxes and levies in the Russian Federation, 2015

Level of taxation	Types of taxes and levies according to the Tax Code of the Russian Federation
Federal taxes	• value added tax; • excises; • individual income tax; • corporate profit tax; • tax on extraction of mineral resources; • water tax; • fees for the use of objects of fauna and for the use of objects of aquatic biological resources; • state duty
Regional taxes	• tax on property of organisations; • tax on gambling business; • transport tax
Municipal taxes	• land tax; • tax on property of individuals; • trade fee

Source: Tax Code of the Russian Federation. Articles 13, 14, 15.

and inconsistent and cannot be called simple. Even regulation of fees in the Tax Code is quite contradictory. For example, if we analyse elements of the trade fee that was introduced at the end of 2014, we will understand that, although it is called 'trade fee,' its legal construction is much closer to tax.

We should assess the level of simplicity of tax system not only by the total number of taxes but also with the help of other factors such as complexity of applicable legal constructions, level of tax burden, etc. Regarding simplicity of legal regulation and applicable legal constructions, it is too early to speak about significant simplification. For example, one of the most crucial notions for income taxation – notion of income – is rather vague and sometimes contradictory. Much more successful is the simplification of the tax system in respect to level of tax burden and to efficiency of tax administration.

Tax reform in the early 2000s led to a significant reduction in rates of the main taxes, increase of their collection, as well as improvements in tax administration.[6] In addition, in 2002 a new tax appeared that was very important in the Russian context: the tax on extraction of mineral resources, with a rate connected to the world market prices for oil and gas. Moreover, social taxes and charges were extremely important for the formation of extra-budgetary funds, and contribution system for pensions and medical insurance fees was also modified. Further

improvement of the Russian tax system was typical for the period of the global financial crisis of 2008–2009, which operated until 2008 tax rates were again corrected. Those changes primarily affected the income tax and social taxes and charges. Table 7.2 provides information on basic tax

Table 7.2 Dynamics of main Russian taxes rates, 1990–2010s

	Time period and appropriate tax rates		
Type of tax	**1990s**	**2000s**	**2010s**
Corporate profit tax	**1992–1993:** 32% – basic rate; 45% – profit from intermediary activity 1994: 35% – profit from intermediary activity; 38% – basic rate; 43% – profit of financial companies 1995–1999: 35% -basic rate; 43% – profit of financial companies and profit from intermediary activity	**2000–2001:** 35% – basic rate; 43% – profit of financial companies and profit from intermediary activity 2002–2008: 24% since 2009: 20%	20%
Individual income tax	Progressive scale with rates of 12, 20, 25, 30 and 35%	**since 2000:** basic rate – 13% (flat rate); 30% income of nonresidents of the Russian Federation from Russian based sources; 35% gambling income and extra-interest on banking deposits	basic rate – 13% (flat rate); 30% income of nonresidents of the Russian Federation from Russian based sources; 35% gambling income and extra-interest on banking deposits
Value added tax (standard rate)	**1992:** 28% **since 1993:** 20%	**till 2003:** 20% **since 2004:** 18%	18%

Sources: URL: http://vestnik-evropy.squarespace.com/all-articles/2011/3/9/19912008.html
http://www.tradingeconomics.com/russia/
http://www.budgetrf.ru/Publications/Analysis/iet/an_iet_250902/an_iet_250902150.htm

rates for income taxes and VAT in Russia in their dynamics starting from the period of 1990s. The table shows the trend toward simplification of the tax system of Russia in terms of the applicable tax rates.

Flat rate individual income taxation in Russia: Example of progressive tax simplification

The current Russian system of individual income taxation has become one of the easiest and most efficient in the world. Instead of the progressive scale of the 1990s, with five rates ranging from 12 to 35%, from 2000 onward there has been only one basic rate of tax on income of individuals – residents of the Russian Federation. The rate is 13% and is levied on all types and sizes of revenues, excluding lottery winnings and gambling, as well as financial windfall (which has a rate of 35%). Why does the 'unlucky' number 13 appear in the base rate of the Russian individual income tax? The fact is that the modification of the system of individual income tax in 2000 was based on the previous minimum rate of progressive tax (12%), to which was added the rate of social contributions on wages of citizens, which were levied in Russia at the source of payment in the period from 1993 to 1999 (1%). Nonresident individuals pay tax on income earned in Russia at a rate of 30% (dividends and interest in this case are taxed at the rate of 15%). In addition, individuals – residents of the Russian Federation are obliged to file tax returns only in the following cases: if the tax has not been withheld at source; if income was earned abroad; if taxpayers want to get a social or property tax deduction. This system is simple both for taxpayers and for the public tax administrators. It encourages taxpayers not to evade tax, and it promotes high tax collection. Receipts from individual income tax are one of the main sources of income of the budgets of the region and generate 20% of the consolidated budget of the Russian Federation. Immediately after introduction of the flat rate, proceeds from the individual income tax to the Russian budget increased by 25%.[7]

It should be noted that Russia has become the first major economy in the world that has introduced a proportional individual income tax rate in the tax system. In turn, the already successful Russian experience has led to numerous discussions about the possibility of transition to flat rate taxation of incomes of individuals in OECD countries, and some countries of Central and Eastern Europe followed the example of Russia (in particular, Belarus, Bulgaria, Hungary, Latvia and Czech Republic). Table 7.3 contains data on individual income taxation in some countries of the world. We can draw attention to the fact that most of these tax rates are significantly higher than in the Russian Federation, but in this

Table 7.3 Individual Income Tax Rates around the World, 2015

Country	Individual Income Tax Rates	Country	Individual Income Tax Rates	Country	Individual Income Tax Rates
Argentina	9–35%	Finland	6.5–31.75%	Latvia	24%
Australia	17–45%	France	5.5–41%	Mexico	0–30%
Austria	21–50%	Germany	14–45%	Netherlands	5.85–52%
Belarus	12%	Greece	0–42%	New Zealand	0–39%
Belgium	25–50%	Hungary	16%	Norway	28–49%
Brazil	7.5–27.5%	India	10–30%	**Russia**	**13%**
Bulgaria	10%	Indonesia	5–30%	Spain	24.75–52%
Canada	15–29% (federal tax)	Ireland	20–41%	Sweden	0–57%
China	3–45%	Israel	10–50%	Turkey	15–35%
Czech Republic	22%	Italy	23–43%	United Kingdom	0–45%
Denmark	38–65%	Japan	5–50%	USA	0–39.6%

Source: Tax Rates around the World 2015. URL: http://www.worldwide-tax.com/

case there is the problem of collection of individual income taxes due to the high degree of evasion of payment (at least this is true for Greece, Italy and Spain).

Currently in Russia, discussions regard the appropriateness of the flat rate tax. Periodically there are proposals on the necessity of transition to a progressive scale of taxation of incomes of individuals. How is it justified? In our opinion, both Russian experience and the experience of other countries show that it all depends on priorities in the ongoing policy of the state: economic feasibility or social fairness. From the point of view of pragmatism, a flat tax scale seems to be the best solution, including the degree of simplicity of the tax system and methods of tax administration.[8]

2.3 Evaluation of the contemporary Russian tax system: Ease of taxation ranking and level of tax burden

The simplicity of the contemporary Russian tax system can also be assessed by the level of attractiveness of doing business in Russia on the basis of the World Bank Group's Doing Business Reports. As can be seen from the Table 7.4, the position of the Russian Federation has significantly improved since 2006 when the World Bank ranked countries on the attractiveness of tax systems for business for the first time. So after a 2009 finish in 134th place in the ranking of the attractiveness of the

Table 7.4 The dynamics of Russia's position in the World Bank's Doing Business Ranking, the 'Paying Taxes' Criteria, 2005–2015.

	Reporting Years									
Indicators	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Ease of Doing Business Ranking	79	96	106	120	120	123	120	112	92	62
Paying Taxes Ranking	...	98	130	134	103	105	105	64	56	49
Tax Payments (Number per Year)	27	23	22	22	11	11	9	7	7	7
Time Spending for Tax Accountancy and Tax Paying (Hours per Year)	256	256	448	448	320	320	290	177	177	168
Total Tax Rate (% of Profit)	40.8	54.2	51.4	48.7	48.3	46.5	46.9	54.1	50.7	48.9

Sources: Doing Business Reports 2006–2015, World Bank. URL: http://www.doingbusiness.org/reports/global-reports/

tax system for business (the corresponding position of the country was even worse than its 120th place in the overall ranking of ease of doing business) Russia has made a significant step forward and has reached 49th place for its tax criteria in 2015, which is considerably higher than its 62nd place in the overall ranking.

Indeed, from the estimation of components for its attractiveness to business, the Russian tax system shows a sufficient simplification of tax administration: reduction in the number of tax payments per year (from 27 in 2006 to 7 in 2015) and in the total time for completing tax reporting (from 448 hours in 2008–2009 to 168 hours in 2015). The effective tax burden on business also slightly decreased: The general level of taxes on profits of companies achieved 48.9% in the Doing Business Report 2015 (compared to 54% in 2007 and 2013). The conclusion is that the general direction of the Russian government's tax policy is set to simplify the tax system in the country, particularly from the point of view of improvement of tax administration for Russian businesses and foreign residents who receive income from sources in the territory of the Russian Federation.

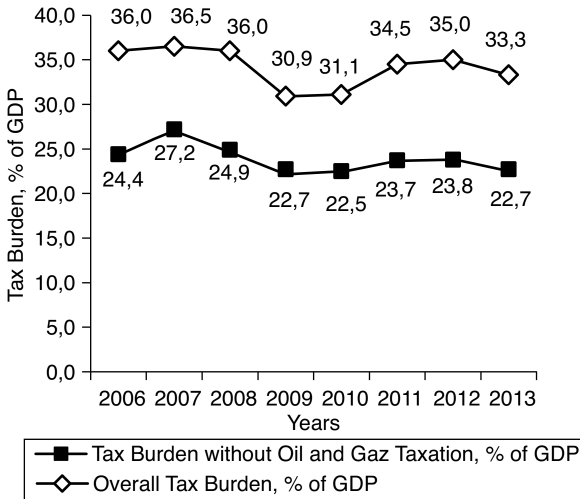

Figure 7.1 Dynamics of tax burden in Russia, 2006–2013

Source: Ministry of Finance of Russian Federation (Main directions of tax policy of the Russian Federation for 2014 and for the planning period 2015 and 2016; Main directions of tax policy of the Russian Federation for 2015 and for the planning period 2016 and 2017).

We will now try to answer the question of how strong the tax burden in Russia is, not according to surveys of entrepreneurs on the basis of which conclusions are drawn in the rankings of Doing Business Reports, but using official statistics from the Russian Ministry of Finance. The level of tax burden in Russia (the share of tax revenues in percent of GDP) is presented in Figure 7.1, and it is quite moderate.

As can be seen from the graphs, the tax burden has reached one-third of GDP at the present time, which is about average for OECD countries (34.9% in 2012). If the value of the tax burden does not take into account taxes and other payments associated with the taxation of oil, gas and petroleum products, the tax burden in Russia is now more than moderate (averaging data for 2013 was only 22.7%). This is one of the lowest rates for member States of the OECD. Thus, it is possible to draw a conclusion about the quite liberal character of Russian taxes as a whole, especially in the non-oil and non-gas sectors of the economy.

2.4 Complexity of type of taxes: Structure of tax revenues in federal budget and consolidated budget of Russia

The structure of tax revenues of the Russian budget system is presented in Figures 7.2 and 7.3. For the Federal budget, the most important

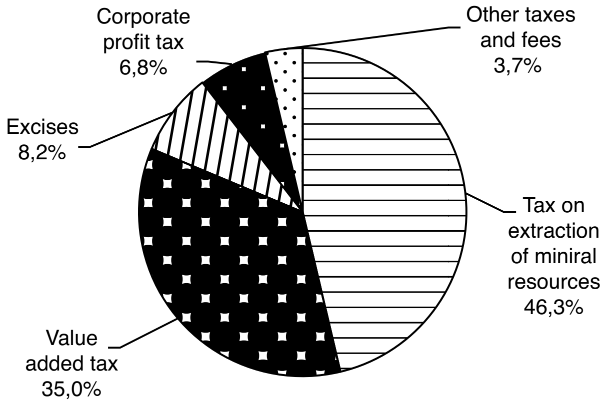

Figure 7.2 Structure of tax revenues of the Federal budget of Russia, January–October 2014

Source: Federal Tax Service of Russia, URL: http://analytic.nalog.ru/portal/index.ru-RU.htm

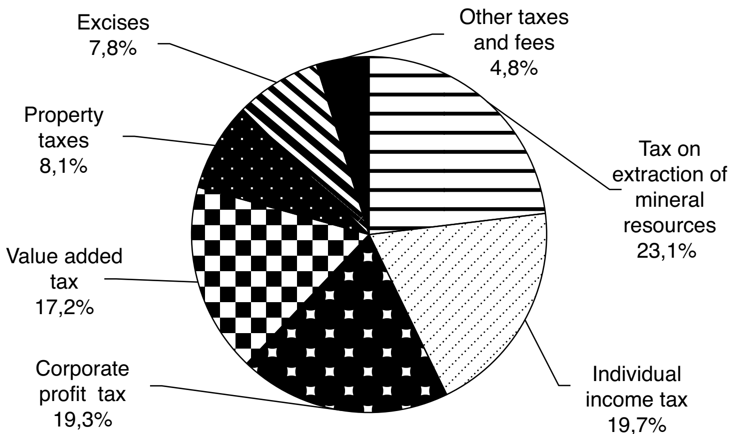

Figure 7.3 Structure of tax revenues of the consolidated budget of Russia, January–October 2014

Source: Federal Tax Service of Russia, URL: http://analytic.nalog.ru/portal/index.ru-RU.htm

(collectively more than 80% of tax revenues of the Federal budget) taxes are: tax on the extraction of mineral resources and VAT. From the point of view of the consolidated budget, the most important taxes are: tax on the extraction of mineral resources, individual income tax, corporate profit tax and VAT. Those taxes together comprise nearly 80% of tax

revenues of the consolidated budget. So, the basis of the Russian tax system consists of six taxes – tax on the extraction of mineral resources, individual income tax, corporate profit tax, VAT, property tax and excises (comprise 95% of tax revenues of the consolidated budget).

The conclusion is that the main difference between the Russian system of taxation from the tax systems of the major developed countries lies in the fact that the tax on the extraction of mineral resources is the main source of tax revenues in both the Federal and in the consolidated budget. This makes the tax system of the Russian Federation quite vulnerable to fluctuations in raw material prices.

3 Simplifying tax law

A simplified tax system won't work effectively in conditions of complex legal regulation of taxation, which is why it is very important to simplify tax law. Several steps towards simplification of tax law were made in Russia: codification of tax legislation and introduction of special rules of amending tax legislation.

The sources of tax law are similar in all countries, however we should take into consideration differences in their relative role that depend on the legal system in general and tax culture in particular. In Russia sources of tax law are legislation, treaties and regulations. Judicial decisions are not formally binding sources of tax law, but there is a place for discussion about the role of decisions of supreme courts, especially the Constitutional Court of the Russian Federation.

The main source of tax law is tax legislation that includes federal and regional laws and acts of representative body of local authorities. Powers of executive authorities to issue normative acts on taxation are seriously restricted. Three levels of tax legislation are predetermined by stated in the Constitution of the Russian Federation federalism and independence of local authorities. However, although there are three levels of tax legislation, federal legislation is the dominant element in the system of tax law sources.

In the 1990s, taxes were regulated by numerous federal and regional laws. Federal tax legislation was codified at the turn of the 21st century: The first part of the Tax Code of the Russian Federation was enacted in 1999, and the second part in 2001.

The Tax Code of the Russian Federation is an example of almost total codification of federal tax legislation. The first part of the Tax Code deals with general aspects of tax assessment, including system of sources of tax law, notions, types and lists of taxes and fees, rights and obligations of

taxpayers and tax authorities, general rules of tax procedures, including tax control, enforced collection of unpaid taxes, administrative dispute resolutions. The second part of the Tax Code includes chapters that regulate certain taxes and fees imposed as a part of general and special regimes of taxation. The last crucial amendments to the second part of the Tax Code were adopted in 2014 – chapters on individual property tax and trade fees were added. After the adoption of chapter on individual property tax and abolishment of separate federal law that regulated this tax since 1991, it is only the Tax Code of the Russian Federation that imposes certain taxes on the federal level.

Russian Tax Code is one of the leaders in Russian legal system in terms of number of amendments per year. Since its enactment in 1999, more than 300 federal laws were adopted with amendments to the Tax Code of the Russian Federation, which is approximately 20 laws per year. 2014 was not an exception – 40 federal laws were adopted with amendments to both parts of the Code. This amount of amendments doesn't help to simplify tax law. That is why it is important to mention a new rule that was introduced in 2013 – a federal law that amends federal tax legislation can contain only tax related provisions.

A more deliberate approach to the procedure of amendment of tax legislation can be regarded as a step towards tax law simplification. However, it is not the procedure but the content of the amendments that matters. And the content of the Tax Code of the Russian Federation doesn't seem to simplify. On the contrary, rules become more and more complicated. For example, we can mention the introduction of transfer pricing rules, special rules of taxation of consolidated groups of companies and controlled foreign companies, and tax monitoring. In comparison with its original content at the beginning of the 2000s, the Tax Code of the Russian Federation has become more and more complicated.

4 Simplifying tax administration and taxpayer communications

4.1 Tax administration in Russia: General characteristics

At the moment, recent changes to Russia's Tax Code, while generally seen as beneficial, are still in progress. The Federal Tax Service of the Russian Federation (FTS) nowadays tries to create the most comfortable conditions for the taxpayer and to improve standards for services provided by official authorities. Tax authorities have been executing

ambitious plans to create a high-tech digital infrastructure, the general idea being to increase tax revenue and provide better services for taxpayers. Some new services and procedures have been implemented in Russian practice, for example, the institution of tax monitoring can replace tax review by alternative methods of control, due to online data exchange on an ongoing basis. Tax authorities attempted a difficult task to decrease administrative pressure on the business and to increase the service role of the FTS. The main purpose of FTS is not tax collection, but rather control on fulfillment of the taxpayers' duties.

Nowadays, FTS has become more efficient. The effect of the reorganisation within the FTS is most clearly seen in the number of tax audits conducted each year and the amount of tax revenue recovered as a result of these audits. According to the Russian Statistics Committee, the Russian GDP has increased 9.8% from 2010. And in-payments to the consolidated budget have increased 16.8%.[9] The difference of 7% has been achieved due to more efficient tax collection based on major changes in approaches to the tax administration in Russia.

While there is still much work to do, the country is already beginning to experience results that are being recognised by outside observers. Russia moved up 41 places in the tax administration ranking of the World Bank and IFC's report, Doing Business 2013[10]: Smarter Regulations for Small- and Medium-Sized Enterprises, from 105th in 2011 to 64th in 2012, which is the fastest progress made by any country in the world over the course of the last year. And the progress continued in later years as well. According the World Bank and IFC's report, Doing Business 2014 Russia has improved the business environment for five of the 10 indicators considered in the research. The result of the new report was the best ones for the country in the entire history of ranking and observations. Key indicators of the Russian Federation are as follows: In terms of the simplicity of business registration, the country is ranked 88th in the world; in terms of the level of taxation, it is ranked 56th correspondently. It was mentioned in the report that tax legislation and administration reform in Russia is in progress, and Russia's ambitious target is to achieve 20th place in 2018.

But if positive changes being driven from the top of the FTS are a relative strength, the experience at the level of the local tax office can still lag behind, and tax legislation itself requires further improvement. Many Russian businessmen consider the current stage of tax regime as a containing barrier to investment, with Russian tax legislation overly complex in some areas and too vague in others. Also, overly prescriptive and excessive demands regarding documentation continue to be a challenge to the business community.

4.2 Main achievements in tax administration simplification

The general idea of tax administration reform in Russia is to construct and develop a system that is flexible when possible and strict where necessary. In order to achieve this purpose, the following directives were developed:

1. Pre-trial adjustment of disputes aimed to eliminate a conflict before the sitting of the court;
2. Horizontal monitoring aimed to prevent a conflict;
3. Online services aimed at realising a program of partnership between tax authorities and taxpayers in order to simplify all tax procedures;
4. Publicly available standards for tax risk assessment aimed to update the process of tax audit and control.

Both pre-trial adjustment of disputes and horizontal monitoring can reasonably be considered as various stages of alternative methods of prevention and exclusion of tax mitigation; alternative forms of dispute resolution are employed in all developed countries: the United States, the United Kingdom, Australia, Canada, France, Germany and others.

The most frequently cited reasons for increased tax liabilities were alleged lack of economic justification of expenditures and inadequate documentation. A number of such cases involved a disputed sum totalling more than $1m per year.[11] Notwithstanding this, the taxpayers participating in the survey continued to be very successful when challenging the tax authorities in court, obtaining a positive decision in more than two-thirds of the cases. The reasons for such results were:

- weak evidence base and documentary information of tax authorities participating in cases;
- insufficient qualifications of tax authority representatives;
- courts overcharging for tax cases.

The Federal Tax Services of the Russian Federation has significantly changed their approach to the tax administration. The major breakthrough in the field of legal certainty became the 2009 implementation of the system of the compulsory trail adjustment of disputes. Utilisation of alternative dispute resolution methods has been efficient and has brought quick results. Tax authorities became more successful in court, obtaining a positive decision in about half of their cases, due to

elimination of losing cases at the stage of alternative dispute resolution and more careful training for the rest of the cases.

Later in 2013, the new form of the tax administration was introduced by the Federal Tax Services – expanded informational interaction, or horizontal monitoring. The main purpose of the horizontal monitoring is the informational exchange between the tax authorities and taxpayers, aimed at observation of tax legislation, increase of predictability of the tax regulation and improvement of the quality of tax control. Such approach to the control for the fulfillment by the taxpayers of their duties extends to varieties of methods for the adjustments of disputes before the trial. For Russia, horizontal monitoring is a new method of extended informational interaction between the tax authorities and taxpayers based on confidence and trust. This method of tax control implies cooperation between taxpayers and tax authorities. In the process of such cooperation, taxpayers receive an opportunity to inform tax authorities about their current and potential tax risks in an attempt to avoid some mistakes and mitigate tax risk consequences. Horizontal monitoring can be implemented only by special agreement between the tax authorities and the taxpayer.

In general, implementation of horizontal monitoring reduces cost of analysis and control for the taxpayers. The idea was to reapportion financial, technical and human resources of tax authorities to strengthen control of tax compliance and tax discipline. Nowadays, FTS in Russia is close to working out the precise criteria for horizontal monitoring efficiency as well as criteria for selection of taxpayers who are able to participate in this program. It is absolutely essential now to determine priority-driven guidelines in developing and updating the tax legislation regarding horizontal monitoring regime application.

Creating a high-tech digital infrastructure with about 40 online services has become an important step on the way to the mutual understanding, effective cooperation and feedback between tax authorities and taxpayers. Digital infrastructure with online services appears to be not only a simple and comfortable tool for relations between tax authorities and taxpayers, but it also helps to improve clarity and reduce the documentation burden on taxpayers. Implementation of this system could be considered an effective method of avoiding the possibility for human error, as well as a personal agreement between taxpayers and tax representatives. If all procedures are transparent, clear and understandable, there is a real opportunity to diminish corruption and increase tax discipline. It is logically clear that high-tech digital infrastructure is more important than some law enforcement duty.

Generally, the major target of the new form of tax administration is to increase predictability of tax regulation and quality and efficiency of tax control. Some positive achievements have been made in the area of tax control modernisation. Publicly available standards for tax risk assessment have been worked out and officially announced. The criteria has been developed to help the taxpayers self-assess the tax risks stemming from the interpretation of the legislation which they adhered to in making the business decisions affecting their tax positions. Following those criteria, the taxpayer obtains an opportunity of the self-assessment of the tax review probability. In practice, tax review in Russia is a long-term stressful event – and time-consuming process for the taxpayers under review. Predictability of the tax review probability facilitates harmonising the relationships between tax authorities and taxpayers. Business indicates that, whereas before, companies would be audited once every two years, now they are being audited on average once every three years, with the primary focus being on profits tax and VAT. The following figures demonstrate an evidently positive dynamic: Say, in 2003, the FTS audited 11.5% of companies and recovered an average of RUB 517,000 (approximately $17,233) per field audit. By 2013, the FTS was auditing less than 1% of companies, but in that year alone, it recovered an average of RUB 4,328,000 (approximately $144,267) per on-site tax inspection.[12]

4.3 Transformation of the Russian federal tax service

Russia's entry into the WTO, as well as the ongoing discussion regarding OECD accession, is driving further reform efforts. Ongoing reform attempts will help Russia become a more attractive place for doing business. Particular attention should be paid to addressing current deficiencies in both legislation and ground-level administration. Since 2001, consolidation within the FTS has reduced the total number of tax inspectorates by 60%. Despite the reduced numbers, careful reorganisation has enabled the FTS to retain its presence in almost all areas where it was previously active.

Technology has played a key role in the optimisation of the FTS. In the 1990s, the FTS was troubled by poor logistics on the national level. The absence of computers and automated processes meant that many operations were performed manually. During the past 10 years, the FTS has become a leader among Russian public authorities in adopting new information technology. The breakthrough began in 2000, when the tax authorities introduced unique software for local tax authorities, and it continued with the development of complex software for system and

data processing. Over the past few years, the FTS has been implementing digital means for submitting tax returns.

As a result of the technology restructuring, the FTS has improved its ability to implement tax legislation and inform taxpayers of developments. New technologies such as e-filing are also helping to reduce the workload for taxpayers, although much greater progress would be made by enabling full filing electronically (often, documentation that has to be submitted with tax returns must still be lodged in hard copy).

An absolutely new form of communication with taxpayers for Russian FTS is the client-oriented approach in which tax authorities try to be more open, positive and friendly with businesses. One of the newly implemented services is an online repository of 'frequently asked questions' where tax authorities provide taxpayers with explanations regarding complicated situations in the tax legislation. It should be specifically marked that there are no tax consultants in the structure of Russian FTS. Work performed by tax authorities' representatives is rather in the area of informing than explanation and never consulting. Generally, since the moment of creating and developing of the tax system in Russia, the dynamics of the role of tax authorities in the performing of tax consultancy has been clearly determined. In 1992, by the Order of State Tax Services, tax authorities were not allowed to provide taxpayers with tax consulting. But just at that time, a special Educational and Communicatory Centre was opened under the Moscow Tax Inspectorate. The priority-driven task of the centre was restricted clarification of the tax legislation and limited informational support.

Later in 1999, the Order prohibiting tax consultancy work performed by the tax authorities was repealed, and the Tax Code of the Russian Federation, which came into authority in 1999, charged tax authorities with the following duties[13]:

- explaining the application of tax legislation;
- providing free information regarding current taxes and duties;
- providing taxpayers with forms of tax returns, explanatory work for order of filing and submission them, explanations of order of calculation and paying taxes.

In the course of the administrative reform, the functions of legal regulatory work and control-and-supervision have been separated. Explanatory work regarding application of the taxes and duties legislation was deputed to the Ministry of Finance. In general, the Ministry of Finance

must provide clear and useful direction to taxpayers and tax authorities requesting clarification of the interpretation of tax law. Informational support of taxpayers was delegated to the tax authorities. But there is a huge difference between informational support, explanatory work and consulting itself.

4.4 Changing tax environment

Russia's tax legislation continues to be subject to change. Laws are updated, amended, streamlined and replaced, with some changes having a significant effect on companies and others little to no effect. The transfer pricing law which took effect on 1 January 2012 has had a major impact on companies. The new law necessitated a top-to-bottom review of covered transactions and a reengineering of internal business processes to involve tax at the early stage of pricing decisions. For many, the transition has been a challenge. Overall, companies view the tax regime in Russia as having a neutral effect on investment flows into Russia. However, a sizeable percentage sees the tax regime as having a negative or, for a small percentage, very negative effect on the investment attractiveness of the country. Investors continue to push for simplified tax legislation and documentation requirements, saying that an improvement in these two areas would have a positive effect on Russia's overall investment attractiveness.

Despite the breakthrough results Russia has achieved in the field of tax administration, the country still ranks 64th in the world – a sign that much remains to be done. In 2012, the most notable change in the area of tax administration was a shortening of the time period for VAT reimbursement, which previously was a significant problem for most companies dealing with cross-border transactions. While this is certainly a welcome development for companies doing business in Russia, further progress in improving the country's tax climate will depend more on the experience of business people on the local level.

Taxpayers in Russia continue to experience a difference between the tax system on paper, which is comparatively favourable to doing business, and the tax system that they experience on a day-to-day basis. In order to improve the situation, the government will need to focus on bringing consistency to the tax code and achieving a better, more consistent, service experience for taxpayers on the local tax administration level.

According to the Chief of Russian FTS Michael Mishustin's opinion,[14] the resource of the tax administration has been exhausted. In this case, the only option to increase tax funds is to work over tax discipline

improvement, including development of tax culture of not only taxpayers but also tax and governmental authorities.

5 Prospects of development of the Russian tax system: Middle and longer term approaches

The second half of 2014 and the beginning of 2015 revealed a clear trend of decrease in world oil prices, which is extremely unpleasant for the Russian economy and fiscal system. As we know, the main source of tax revenues both for Federal and for consolidated budget (see Figures 7.2 and 7.3) is the tax on the extraction of mineral resources, which depends on the dollar prices for oil and gas. In addition, the dramatic consequences of the Ukrainian crisis contributed to the growth of the influence of geopolitical factors on the development of the Russian economy, including its financial and tax components. Evidently the prices of major Russian export commodities (oil, gas) and geopolitical contradictions between Russia and the West may predetermine the development of the Russian tax system in the medium- and long-term perspective.

5.1 Changes in Russian tax policy due to lower oil prices

In order to characterise the dependence of the Russian tax system on oil/gas price volatility we should admit the current absence of clear strategies of the Russian government to get out of this difficult situation. It is obvious that for the Russian economy in the long-term it is not possible to get rid of excessive dependence on raw materials, which would require a radical change in its sectorial structure in the direction of the development process priority, especially by stimulating high-tech industries as well as services (tourism, transport, financial services). Accordingly, the tax strategy of the government should clearly define priorities involving the creation of tax incentives for producers of related goods and services, as well as simple, clear and stable rules of taxation. This strategy of the Russian government was, in early 2015, still in the development stage, although the above priorities have been announced many times by Russian President Vladimir Putin, Prime Minister of Russia Dmitry Medvedev and members of the Russian government. In particular, the proposal of the Ministry of Economic Development of the Russian Federation assumed a serious reduction in the tax burden on businesses until 2018, with lower rates of social contributions, the wide application of the simplified taxation system for small and medium-sized businesses, the introduction of tax incentives for investment projects and import-substituting production.[15]

5.2 Geopolitical factors in contemporary Russian tax policy

How do new geopolitical challenges affect tax policy and tax systems of Russia? It seems we need to pay attention to the main geopolitical factor, which affects public finances and taxes of the Russian Federation – the exchange of economic and trade sanctions between Russia and Western nations (sanctions against financial, energy and defence sectors of the Russian economy due with the events in Ukraine in 2014 were introduced by the US, 28 EU member States, Japan, Canada, Australia, New Zealand, Norway, Switzerland, Ukraine and Moldova).

Trade and economic sanctions entered against Russia now are most clearly manifested in the financial sector, causing a significant devaluation of the Russian national currency (ruble) and a massive flight of capital abroad. Highlighting the possible effects that the policy of sanctions imposed as the result of a new round of geopolitical confrontation between Russia and Western countries, the Russian tax policy is to pay attention to the following:

- the use of tax incentives to compensate exporters' losses[16] (Russian authorities have already adopted the relevant draft law on tax maneuver in the oil and gas industry, involving the resetting of the tax on extraction of mineral resources for new deposits, as well as supporting the construction of the gas pipeline 'Power of Siberia' to boost export supplies of alternative energy consumers[17]);
- the implementation of tax regulators in the financial market to weaken speculative attacks on national currency (in Russia were already put forward proposals for the introduction of a tax on the export of capital[18] or the use of an analogue of the Tobin tax on currency transactions[19]);
- the strengthening of anti-offshore policy concerning the Russian tax residents, having controlled foreign companies[20];
- the limitation of benefits of using a consolidated group of taxpayers to prevent loss of tax revenues of regional budgets from holding structures registered in low tax jurisdictions.[21]

It should be noted that the regime of sanctions and counter-sanctions will bring a negative impact on the Russian economy, whose forthcoming prospects are not so optimistic. So, the fall in GDP will be at least 3% in 2015 and will continue in future[22] Incomes and business activity will reduce, and problems in public finances due to the reduction of tax revenues will increase. Therefore, at the present stage of development of

the Russian Federation, we need to balance fiscal and regulatory (stimulating) roles of taxes and, if possible, not to complicate tax systems that were well-reputed in the previous period. The contraction in revenues (due to reduction in tax revenues from the manufacturers and exporters of goods and services under the sanctions) requires adequate substitution by redistributing the tax burden on business and population. On the other side, the increase of the tax burden in the period of stagnation and recession is not the best decision of the government. It is not by accident that in present-day Russia there are some critics of the possibility of raising taxes on the background of the exchange of sanctions.

Only time will tell how the tax system of Russia will develop in the new geopolitical conditions and how simple it will be in the future. However, we already see a rapid reaction of the Russian government on the above-mentioned geopolitical factors in the national tax policy. The most difficult decision for the authorities is how to achieve proper balance between the fiscal and regulatory (stimulating) roles of taxes in terms of the slowdown in the national economy due to the influence of geopolitics.

6 Conclusions

Summarising the characteristics of the evolution, current state and prospects of the tax system of the Russian Federation, it is possible to make following conclusions:

- taxation in Russia at the turn of the 21st century can be characterised by a transition from a bulky and complex tax system with ever-changing tax regulations, high tax rates, and a large number of taxes and fees to a simple and effective program for the state and for business taxation in the early 2000s;
- the reform of the Russian tax system in 1990s and 2000s was based on the advanced experience of foreign countries, however, Russia independently, relying on the criterion of simplicity of taxation, made a number of unique transformations in the national tax system;
- from the point of view of ease of doing business according to the 'taxation' criterion in the World Bank's Doing Business Report for the period from 2009 to 2015, Russia significantly improved its position from 134 to 49;
- the level of the tax burden in Russia corresponds to the average for OECD countries, and even lower, except the taxation of raw material sectors of the economy;

- Russian practice of tax administration is one of the most significant in the world in its simplicity, benevolence for taxpayers and efficiency from the point of view of the guarantee of tax revenues to the budgets of different levels;
- Russian tax legislation has undergone significant changes over the period 1990–2010, changed first from complexity to simplicity, and then from simplicity to a new level of complexity;
- in today's global turbulence, volatility in oil prices and geopolitical uncertainty, the tax system of Russia will be modified to accommodate these factors and to respond to the most pressing problems.

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8

The Complexity of Tax Simplification: Experiences from South Africa

Theuns Steyn and Madeleine Stiglingh

1 Introduction

Tax system simplification requires a balance between the competing goals of efficiency, equity, and administrative ease (World Bank, 2009, p. 6). The World Bank's notion is honourable and makes intuitive sense. However, for the South African government (past and present), the reality is that tax reform efforts are nearly always negated by political and economic objectives, tipping the balance towards the goal of equity in lieu of efficiency and administrative ease. Despite this, historical tax reform crusades by the South African government in some instances did result in tax simplification interventions.

2 Simplification of the South African tax system

Generally, tax systems tend to grow complex alongside accumulated accretions of statutes, regulations, administrative practices, bureaucratic conventions and evolving societal norms (World Bank 2009, p. 11). This also applies to the South African tax system. This tax system became relatively complex over many years, mainly through numerous changes to tax legislation, various changes in administrative practices and significant changes in society and politics, especially after 1994 when the first democratic election was held in South Africa.

Prior to the establishment of the Union of South Africa in 1910, the country consisted of smaller administrative regions – the original Cape Colony (first under Dutch and then under British rule), later Natal (under British rule), the self-governing Oranje Vrijstaat, and the

Zuid-Afrikaansche Republiek in the former Transvaal area. Each of these areas governed itself and its own finances. The colonial tax policies and tax policies of the independent republics had an important influence on the development of taxes in the 20th century in South Africa (Lieberman 2003, p. 107).

Over time income tax emerged as the major source of revenue for the South African government, contributing around 57% of the national government's tax revenues in 2015 (National Treasury 2015, p. 189). However, having one major source of revenue in the tax system does not necessary simplify the system. Over and above income tax as the primary source of revenue, the South African government has historically used a diverse range of taxes to raise revenue for funding the public sector, and this practice still prevails today (Steyn 2012, p. 155). Transfer duty was introduced in South Africa in 1686 and is the oldest tax still in use in the country today (Franzsen 2005, p. 154). Estate duty was introduced in 1955 and a stamp duty in 1968. In 1978, a general sales tax (GST) was implemented, but this tax was replaced in 1991 by a value-added tax (VAT). In 2015 VAT contributed around 26% of the national government's tax revenue.

Numerous other taxes also form part of the existing tax system. For instance, on a national level, there is a capital gains tax, dividends tax, donation tax, customs duties, excise duties, and a variety of levies on specific goods and services (National Treasury 2015, p. 189). On a provincial level, taxes are imposed on casinos and horse racing (National Treasury 2014a, p. 21) and at a local level, rates (taxes) are imposed on property and on the supply of water, electricity, sanitation services, refuse and other services in the form of surcharges (National Treasury 2011, p. 58). In addition to these taxes, the tax system in South Africa also consists of a large number of different administration fees, licence fees, user charges, user levies, consumer tariffs, compulsory contributions to government-regulated social security funds and various other government imposts (Steyn 2012, p. 106–111). Inevitably, this diverse range of taxes has resulted in a very complex tax system in South Africa. Over and above these taxes that perplex the tax system, numerous other complicated administrative rules and regulations, imposed by legislation, have added to this complexity.

The notion that the tax system in South Africa is complex becomes a reality through the results of various research studies conducted in this regard. For instance, in one of these studies, taxpayers clearly expressed the opinion that the tax system in South Africa is highly complex (Oberholzer and Stack 2013). Another study illustrated that taxpayers

made great use of professional tax practitioners to ensure that they comply with the tax legislation, which they deemed to be very complex (Lubbe and Nienaber 2012). A related study proposes a service-quality framework that tax practitioners can use as a tool to assess the services of the South African Revenue Service (SARS) in order to assist SARS to improve their service offerings, which might result in higher tax compliance in South Africa (Stiglingh 2014). Another study made contributions to the tax interventions implemented by SARS in an attempt to simplify the tax compliance requirements for small and medium enterprises (SMEs) in the country (Smulders 2013).

The studies mentioned above have all been conducted since 2012, but a number of relevant studies preceded them. Since 1910, the South African government has appointed several commissions and committees to investigate specific tax-related issues and to make recommendations to government. However, none of the earlier commissions or committees focussed on the South African tax system as a whole. It was only in the late 1940s that commissions were specifically appointed and commissioned to review the South African tax system extensively.

In 1949 a *Committee of Enquiry into the Income Tax Act* (the Steyn Committee) became the first to be specifically appointed to investigate the income tax regime in the Union of South Africa in all of its facets (Lavine 1952, p. 135). The main undertaking assigned to the Steyn Committee was to investigate the various Acts relating to income tax that existed in the Union and its provinces and to make recommendations to consolidate them into one income tax Act. However, their terms of reference were subsequently amended, and this cramped the committee in its deliberations (Lavine 1952, p. 135). The Steyn Committee issued their first report in 1951 (Steyn Committee 1951) and their second in 1952 (Steyn Committee 1952). These reports made recommendations that were mainly underpinned by the equitable distribution of the tax burden, the increase of national revenue and the efficiency of tax collection, but practically none of the committee's recommendations were implemented at the time.

During the 1960s, a *Commission of Enquiry into Fiscal and Monetary Policy in South Africa* (the Franzsen Commission) was appointed to investigate the overall tax system in South Africa. This commission issued an interim report in 1968 (Franzsen Commission 1968), followed by two more (Franzsen Commission 1970a, 1970b) in 1970. These three reports presented the Franzsen Commission's recommendations, most of which were accepted by the government and subsequently implemented (Browne 1983, 159–162). In essence, the Franzsen Commission

concluded that the South African tax system inhibited economic growth and hence recommended structural changes (Steenekamp 2012, 277). The commission specifically recommended a reduction in the progressiveness of the direct tax structure, the abolishment of the source basis of taxation, a shift towards indirect taxation and a broadening of the income tax base through redefinition; all but the last recommendation were adopted by government (Koch, Schoeman and Van Tonder 2005, 194). One of the major changes stemming from this commission's recommendations, which contributed to a simpler tax system in South Africa, was the 1971 withdrawal of the right of provinces to levy personal and income taxation on individuals, consolidating the provincial personal and income tax scales with those of the central South African government (Heyns 1999, p. 65).

Until the end of the 1970s, tax system reform efforts in South Africa were mainly governed by the goal of increased revenue for government, economic and social goals, and improving the collection of taxes. Reforms to the tax system that also considered the simplification of the tax system as a goal only really gained momentum from the 1980s onward. At that time, a widespread notion existed that the country's tax system was much too complicated, inefficient and unfair (Heyns 1994, p. 165). In 1984 a *Commission of Inquiry into the Tax Structure of the Republic of South* Africa (the Margo Commission) was appointed, and in 1994 the *Commission of Inquiry into certain Tax Aspects of the Tax Structure of South Africa* (the Katz Commission) was appointed. These two commissions went to considerable effort to make recommendations based on international best practices, taking cognisance of some basic principles underpinning taxation, namely: equity, neutrality, simplicity, certainty, administrative efficiency, cost effectiveness, flexibility, stability, distributional effectiveness and a fair balance between direct and indirect taxes (National Treasury 2006, p. 26–27). Some of the more important recommendations by the Margo Commission – which the South African government accepted and which contributed towards the simplification of the tax system – were the replacement of married couples by the individual person as the unit of taxation, the lowering of personal income tax by adopting tax tables that comprised fewer income tax brackets, and the replacement of GST with a relatively simple invoice-based VAT system (Steenekamp 2012, p. 278). Another important tax reform that came about between 1984 and 1994 was the reduction of the company tax rate from 50% to 35%. However, this simplification effort was undermined by the implementation of a secondary tax on companies (STC) in 1993, which in effect further

complicated the tax situation of companies in South Africa (Steenekamp 2012, p. 277).

The Katz Commission was appointed in 1994 with a very broad mandate to investigate virtually every aspect of the South African tax regime against the backdrop of the political, social and economic goals of the incumbent government (Manuel 2002, pp. 2–3). Between its inception in 1994 and 1999, the Katz Commission issued nine interim reports that dealt with various issues and recommendations that provided a solid foundation for tax reform in South Africa. Since 1994, tax reform efforts mainly focused on simplifying the tax system, broadening the tax base and reducing tax rates to enhance a fiscal environment within which economic growth could take place (National Treasury, 2006:iii). These tax system reform efforts can broadly be grouped under the themes of constitutional changes, institutional changes and specific tax policy changes (National Treasury 2000, p. 67):

- Constitutional changes in South Africa had a significant impact on the tax regime of the country. Changes that came about as part of the Constitution of the Republic of South Africa (the Constitution) and that had an impact on the tax system were the Bill of Rights, the setting of taxing powers between national, provincial and local governments, the establishment of a national treasury and the setting of public administration guidelines.
- Institutionally, the most important change was the establishment of SARS as an independent tax and customs administration agency in terms of the South African Revenue Service Act (34 of 1997).
- The majority of changes to the tax system in South Africa since 1994 have taken place in the area of tax policy. Some of the more important changes during this time were the move from a source-based income tax to a resident-based income tax, the implementation of a capital gains tax, the levying of income tax on fringe benefits from employment, the introduction of a payroll tax in the form of a skills development levy, the implementation of a turnover tax regime for SMEs, and the implementation of a dividend withholding tax.

These and other changes contributed significantly to the creation of a relatively robust and competitive tax system in South Africa and led to the country's tax policy and administration comparing favourably to those of many developed and emerging economies (DTC, n.d.a.).

In 2013, the *Davis Tax Committee* (Davis Committee) was appointed to investigate the contributions of the South African tax system to a

coherent and effective fiscal policy framework to address unemployment, poverty and inequality in South Africa (DTC, n.d.b.). In 2014, this committee released its first two reports for public comment, which dealt with the tax regime of SMEs and base erosion and profit shifting (BEPS). Since its formation, this committee has also commenced with three other investigations, one focusing on VAT, a second focusing on the tax regime of mines, and a third focusing on the role of wealth taxes (National Treasury 2014b, p.51).

3 Simplifying tax legislation

Tax legislation in a country tends to become more and more complex as time passes. Tax legislation serves various economic and social goals, which causes frequent amendments to this legislation. Not only must tax Acts keep up with new financial instruments and innovations in tax avoidance, but also with international transactions underpinned by transfer pricing rules and numerous double-taxation treaties. Tax Acts may also become complex through numerous amendments underpinned by court case decisions, especially if the decision of the court does not reflect what government expected (World Bank 2009, pp. 7–8). South African tax legislation is no exception to this rule, and numerous changes were made to this body of legislation over the years. These changes sometimes contributed to the simplification of tax legislation, but sometimes, and perhaps more often than not, contributed to a relatively complex tax Act regime in South Africa.

After South Africa became a Union in 1910, the various mining tax Acts that existed at that time were consolidated under the Mining Taxation Act (6 of 1910). The first income tax for the Union of South Africa was introduced under the Income Tax Act (28 of 1914). In 1917, this Income Tax Act and the Mining Tax Act of 1910 were consolidated and replaced by the Income Tax Act (41 of 1917). In 1925, the old Income Tax Act (14 of 1917) was repealed with the introduction of another Income Tax Act (40 of 1925). This Act was in turn replaced in 1941 by a new Income Tax Act (31 of 1941). World War II gave rise to special imposts known as the Excess Profit Special Levy and the Trade Profits Special Levy. The war ended in 1945 and both levies were repealed in 1947. In 1955, a tax on donations was introduced and included in the Income Tax Act. Later, all Income Tax Acts from 1941 to 1961 were consolidated into the Income Tax Act (58 of 1962) (De Koker and Urquhart 1989, pp. 1–3; Lieberman 2003, p. 107; Meyerowitz and Spiro 1986, pp. 1–3). At that time, this consolidation made a significant contribution towards simplifying the

income tax legislation in South Africa. Since the Income Tax Act was enacted in 1962, the Act has been frequently amended to make provision for changes in tax policy and administration as well as for changes originating from numerous court cases. Some of these amendments contributed towards the simplification of the assessment, collection and administration of some taxes regulated under the Income Tax Act, for instance the introduction of Pay-as-You-Earn (PAYE) system to administrate and collect employee tax, and the implementation of a dividends withholding tax in 2012 that replaced the old STC system. However, on the other hand it can also be said that some of the other amendments to this Act have resulted in the relatively complex Act that in 2015 imposes income tax in South Africa. For instance, the introduction of a donations tax and capital gains tax as an integral part of the Income Tax Act contributed nothing towards making the Income Tax Act in South Africa simpler. The Income Tax Act was further complicated with the introduction of corporate rules in 2001. Although South Africa does not have a group taxation regime, the corporate rule aims to offer partial tax relief for transactions within groups. Unfortunately, the relief measures introduced by the corporate rules tax are complex as illustrated by the numerous amendments made to the bulk of these provisions each year since its introduction in 2001.

In addition to the Income Tax Act, tax legislation in South Africa comprises numerous Acts that govern a vast number of other taxes, user charges, levies, administration fees, tariffs, duties, royalties and licence fees imposed by government (Steyn 2012, pp. 106–111). In the national sphere of government, for example, a VAT is imposed in terms of the Value-Added Tax Act (89 of 1991). After personal income tax, VAT is the second most important source of revenue for the South African government. South Africa initially introduced a one-stage GST in 1978. One of the main objectives was to keep the tax rate as low as possible, and towards this end, a broad tax base was envisioned. However, in implementation, the general exemption of food items and the exclusion of most services eroded the sales tax base. In addition, businesses abused GST credit certificates to escape the cascading effect of GST (Krever 2008, p. 459). The zero rating of certain basic food items and the exemptions of some services was contained when the GST was replaced by VAT in 1991 (Krever 2008, p. 460).

Part of the mandate of the Katz Commission in 1994 was to investigate VAT with special reference to the advisability and effectiveness of zero-rating or the exemption of certain foodstuffs and other goods and services, and multiple differential rates of VAT. In 1996, pursuant to the

Katz Commission's recommendations, the definition of the VAT base was extended to include all fee-based financial services, but the various zero-ratings and other exemptions remained (Manuel 2002, pp. 9–10). In general, it is agreed that a multiple VAT rate system is not only an ineffective way of trying to redistribute income, but that it also complicates the tax system and gives increased scope for evasion (Irish Commission 1984, p. 62). However, South Africa's adherence to a very simplistic, two-tiered version of a multiple VAT rate system, where VAT is either 14% or zero-rated, means that the South African VAT system appears to be one of the better-performing VAT systems in the world (Krever 2008, p. 460). Despite this, the administrative burden relating to VAT in South Africa is currently one of the worst in the world (PwC 2012b, p. 4).

In the provincial sphere, taxes on casinos and horse racing are imposed in terms of different provincial regulations, set by the nine provinces independent from one another. For instance, in Gauteng these provincial taxes are regulated in terms of the Gauteng Gambling Amendment Act (6 of 2001), but in the Western Cape in terms of the Western Cape Gambling and Racing Law (4 of 1996). On the level of local government, property rates are imposed in terms of the Local Government: Municipal Property Rates Act (6 of 2004). Municipal surcharges on electricity, water, refuse removal and sanitation services are provided for in terms of sections 227 and 229 of the Constitution. In addition, these municipal imposts are also governed by the Municipal Fiscal Powers and Functions Act (12 of 2007), the Local Government: Municipal Systems Act (32 of 2000), and the Local Government: Municipal Finance Management Act (56 of 2003). This vast number of Acts in South Africa contributes to a relatively complex tax legislation framework.

Since 1994, the simplification of the tax system was one of the main objectives underpinning tax reform efforts in South Africa (National Treasury 2006, iii). However, the amendments to the tax legislation at that time, and even in 2015, do not necessarily originate from the government's objective of simplification. Constitutional, economic and social objectives are the more pressing issues of the South African government (DTC, n.d.b.; Manuel 2002). These objectives can therefore also conceivably be the main ones driving the tax reform efforts in South Africa. This tax reformation finally vests in amended tax legislation, but does not necessarily simplify tax legislation. The notion that tax legislation in South Africa may be too complicated becomes evident as the government recognises a need for the simplification of some of the tax legislation in South Africa (National Treasury 2000, p. 73; 2009a, p. 69). As a result of this, the South African government has embarked

on a process to revise tax legislation in South Africa, specifically focussing on the Income Tax Act, the Customs and Excise Act (91 of 1964), stamp duty and legislation related to tax administration.

The South African Income Tax Act (58 of 1962), which currently governs income tax, donations tax, capital gains tax, dividend tax and employees tax, was enacted more than 50 years ago in 1962. The original Act was approximately 90 pages long, but with annual (and sometimes more frequent) amendments this Act has grown considerably since then. The 2014/2015 version comprises around 320 pages. In 2009, the Minister of Finance announced the first phase of rewriting the Income Tax Act (National Treasury 2009a, p. 69). The first phase focused on simplifying the employment income tax base, which resulted in a uniform definition of employment income that is applicable to the PAYE system, contributions to the Unemployment Insurance Fund and the Skills Development Levy. However, after this initial phase, no other phases of rewriting the Income Tax Act have been announced by the government up to the beginning of 2015. The idea to rewrite the Income Tax Act was postponed several times due to complications and resource constraints, but the need for a complete rewrite has now become pressing, and South African taxpayers will hopefully see some further progress in this regard (Mandy, 2013).

When the Customs and Excise Act (91 of 1964) was initially drafted, it overemphasised the government policy of import administration, with practically no provisions related to exports. Since 1994, with South Africa's readmission to the international arena, the focus of customs has changed to some extent from revenue collection to the control and facilitation of international trade. (National Treasury 2000, p. 73). As a result of this initiative, the Customs Duty Act (30 of 2014), the Customs Control Act (31 of 2014) and the Customs and Excise Amendment Act (32 of 2014) were promulgated in July 2014. However, it still remains to be seen if the practical application of these three Acts does in fact simplify the assessment, collection and administration of customs and excise duties in South Africa.

Stamp duty was introduced in 1968 (Stamp Duty Act, 77 of 1968) and was abolished again in 2009. SARS (2009:1) stated that its abolition formed part of ongoing efforts to reduce the administrative burden on taxpayers and simplify the South African tax system.

Another significant change in the tax legislation in South Africa came about in 2012 with the enactment of the Tax Administration Act (TAA, 28 of 2011). The main purpose of this Act is to ensure the effective and efficient collection of tax by aligning the administration provisions

of the different taxes administered by the Commissioner of SARS. In addition, this Act also clarifies the rights and obligations of taxpayers as well as the powers and duties of tax administrators, which simplifies the interpretation of these aspects of taxation. This Act makes a significant contribution to simplifying tax legislation in South Africa and will hopefully provide much-needed momentum to simplify broader tax legislation in South Africa. The concern commentators have with this Act relates to some duplications that are retained in other Acts. Taxpayers and tax practitioners will therefore have to look at various Acts to determine whether or not they contain administrative provisions about a specific matter (PwC 2012a, p. 12). Although the drafting of this Act was announced as a project to incorporate into one piece of legislation certain generic administrative provisions, the scope of the project has since been extended so that it can now be seen as a preliminary step to the rewriting of the Income Tax Act. SARS (2011, p. 178) states that this Act will assist in dividing the work of rewriting into more manageable parts, since the administrative part of the Income Tax Act comprises about 25% of the Act.

Another aspect of taxation in South Africa that might require tax legislative framework simplification is the small business tax regime. With regard to small businesses, three different tax legislative regimes are applicable. The first is an elective turnover tax system that is available for micro-businesses with a turnover of up to R1 million per annum. Put simply, the turnover tax is a tax calculated on the turnover (total receipts) of a small business, and not on its profit or its net income. This method eliminates the need for keeping detailed records of expenses and has the option of the submission of tax returns biannually compared to the monthly submission of some returns (Stiglingh 2015, p. 1034). It is interesting to note that although the intention is to simplify the administration for small businesses, it has been found that most small businesses prefer to render tax returns more frequently as it assists them with their recordkeeping functions. It is also doubtful if a small business would be able to understand the turnover tax rules without the assistance of a tax intermediary which would again complicate their compliance and not contribute to the simplification thereof. One factor prohibiting the system from simplifying tax matters for small businesses is the fact that the system is a voluntary one, and businesses usually want to calculate their tax under both tax systems to ensure that they choose the one with the lowest tax expense. A second factor is the inherent complexity in the tax legislative framework governing the turnover tax to ensure that the legislation combats most avoidance

practices in order to ensure that the system is only used by 'true' small businesses and not for rendering personal services.

The second tax regime relating to small businesses is a complicated system that provides preferential income tax rates and accelerated capital allowances within the current income tax system. The third regime is the normal income tax regime applicable to bigger businesses as well. The Davis Committee (DTC 2014a) recommended extensive simplifications to tax legislation relating to small businesses to exempt all small businesses with a turnover that would result in an estimated net profit that is comparable with the annual tax threshold for individual taxpayers. They further recommend that the second tax regime that provides preferential income tax rates and accelerated capital allowances be scrapped. In the place of the current legislation, they recommended a simplified refundable compliance rebate for all small businesses (DTC 2014a). These recommendations by the Davis Committee seem to contribute to the objective of tax simplification, but only time will tell if it will be implemented.

4 Simplifying taxpayer communication

The simplification of taxpayer communication in South Africa really only gained momentum after 1994 and reached an important milestone in 2008 when the National Treasury and SARS issued a joint publication of tax statistics in South Africa. These statistics have since been published annually. With the improvements in each publication, it is evident that the National Treasury and SARS are attempting to improve the reporting of tax statistics in South Africa. Unfortunately, these publications include only some of the taxes imposed at the level of national government, making these statistics incomplete. In addition, these statistics also exclude the taxes imposed by provincial and local governments in South Africa, and although the National Treasury issues separate publications for these two levels of government, these publications are not available annually and are only published every five years or so. However, it must be recognised that this attempt by the National Treasury and SARS is a step in the right direction to improve communication by tax authorities in South Africa. Other reforms of taxpayer communication since then can be broadly divided between interventions under the remit of the National Treasury and those under the remit of SARS. The National Treasury is responsible for drafting and amending South Africa's taxation laws, while SARS is responsible for administering those laws and also for drafting and amending administrative and customs laws.

4.1 National Treasury

Section 216 of the South African Constitution mandates that the National Treasury ensure transparency, accountability and sound financial controls in the management of public finances. In turn, the legislative mandate of the National Treasury is described in the Public Finance Management Act (1 of 1999). Based on this mandate the National Treasury implemented a number of interventions that directly or indirectly contributed towards the simplification of taxpayer communication in South Africa. The following are examples of these interventions:

- The implementation of the Economic Reporting Format and Standard Chart of Accounts: The main aim of this is to provide better quality fiscal information and to improve transparency and accountability in government (National Treasury 2009b, p. 1).
- The publishing of the statement of national revenue, expenditure and borrowing: This is published within 30 days after the end of each month. The cashbook transactions recorded in the general ledgers of national government serve as the basis for this relatively new reporting structure that has replaced the previous practice of using only bank statement transactions as a basis (SARB 2013, p. 20).
- The appointment of the Tax Advisory Committee (National Treasury 2000:69): The Tax Advisory Committee consists of tax experts from the private and public sectors who advise the Minister of Finance on technical and legal tax matters.
- Adopting the internet as a major communication tool, making information available on a dedicated open website (National Treasury, n.d.).

4.2 South African Revenue Service (SARS)

SARS is the nation's tax collection authority and their approach to promoting compliance is based inter alia on effective communication with taxpayers, making them aware of their obligations and making it easy for them to do business with this authority (SARS, n.d.). In pursuit of this, SARS has implemented a number of interventions that directly or indirectly contribute towards the simplification of communication between SARS and taxpayers in South Africa. The following are examples of these interventions:

- The implementation of an advance tax ruling, alternative dispute resolution and nonbinding opinion system. The purpose of these systems is to promote clarity, consistency and certainty regarding the interpretation or application of a tax Act.

- Adopting the internet as a major communication tool, making information available on a dedicated open website and an electronic interface called e-filing for the submission of returns, the making of tax payments and the receipt of tax assessments and other correspondence from SARS (n.d.). A recent introduction of a separate website for mobile devices has ensured an even broader reach (SARS 2014b, p. 43).
- The introduction of the 'Filing season' campaign. The campaign entails a high degree of interaction between the South African government and millions of its citizens with the aim of simplifying the tax compliance obligation of the taxpayers (SARS 2006 p. 1).
- SARS also provides clarity, consistency and certainty on the interpretation of tax legislation and other laws it administers by issuing interpretation notes, guides and brochures on new and/or contentious areas of legislation (SARS 2014b, p. 57).
- SARS communicates with taxpayers via their permanent or mobile branches, a telephone call centre, text messaging and online help services for their electronic platforms (SARS 2014b, p. 43). The extent of taxpayer interaction is seen in the fact that SARS's branches and mobile tax units facilities received more than 7.2 million visits in 2014 (SARS 2014b, p. 42).
- SARS also engages in tax education interventions and engaged with more than 725 000 taxpayers in 2014 in this regard (SARS 2014b, p. 42).

Apart from SARS's interaction with taxpayers, SARS continues to strengthen its interactions with other government institutions in South Africa. Examples of their interactions with other government institutions include following up on payments made by the other government institutions to tenderers to check whether full tax disclosure was made. SARS has also established electronic data links with the Companies and Intellectual Property Commission (CIPC) and the Department of Home Affairs (DHA) that enable it to validate entity details with information held by these state agencies. In future, companies that register with the CIPC will automatically be registered with SARS. The electronic interfaces established between SARS, the CIPC and the DHA will support the government's plans to create a simple, single business register (SARS 2014b, p. 46).

Like other revenue administrations, SARS is concerned about the threat to its tax base posed by corporations shifting profits to locations with low or no income tax. This concern is underlined by SARS's involvement in the BEPS project of the Organisation for Economic Co-operation and

Development (OECD). SARS's participation in this project enables it to promote the concerns of developing nations. In the 2013/2014 financial year, SARS continued to co-chair the OECD's Task Force on Tax and Development. SARS also participates in the World Trade Organisation's initiatives and multi-lateral forums globally (SARS 2014b, p. 7).

Negotiations emanating from an intergovernmental agreement between South Africa and the United States of America were concluded early in 2014, and an electronic interface with the Internal Revenue Service was established to exchange data in compliance with the United States of America's Foreign Account Tax Compliance Act. Provision for the sharing of information with other tax authorities under the terms of the Convention on Mutual Administrative Assistance was also explored. SARS continues to participate in the international Financial Action Task Force, which SARS chairs. SARS is also a leading member of the Global Forum on Transparency and Exchange of Information for Tax Purposes to which 122 jurisdictions subscribe. The Global Forum has set the standard for the automatic exchange of information. SARS participates as one of 40 tax authorities in a pilot study for the automatic exchange of tax information (SARS 2014b, 12). SARS also continues its relationship with other international bodies, such as the People's Republic of China's General Administration of Customs, the African Tax Forum and the Indian, Brazil and South Africa (IBSA) Revenue Working Group (Smulders 2014, p. 6).

5 Simplifying Tax Administration

The government that took office in South Africa in April 1994 faced a multitude of challenges (Stiglingh 2008, p. 1). Usually, any government investment in tax reform and improvements in tax administration is given a low priority compared to more visible (tangible) and less controversial national programmes (Dhillon and Bouwer 2005, p. 1). However, the South African government that came to power in 1994 was deeply aware of the urgent need to modernise revenue administration in South Africa (Manik 2005, p. 1; Manuel 2002, p. 2). Since that time, the South African government has implemented a number of interventions aimed at tax administration effectiveness and efficiency. This section adopts the World Bank's (2009, pp. 84–91) key simplification issues – which underpin an effective and efficient tax administration – as a framework for discussing the interventions implemented by the South African government. These simplification issues are autonomy (paragraph 5.1), external reporting and accountability (paragraph 5.2), management

flexibility and decision powers (paragraph 5.3) and internal organisation and outsourcing of selected functions (paragraph 5.4).

5.1 Autonomy

After years of isolation, South Africa was still 'hamstrung' by revenue departments that performed poorly as well as by a burdensome and bureaucratic tax regime (Manik 2005, p. 1). Pre-1994, South Africa had five different tax administrations, including one for each of the four homeland states of Transkei, Bophuthatswana, Venda, and Ciskei. After 1994, these homelands were abolished and South Africa was divided into nine provinces. The tax system was earmarked for revision, and since then, most of the revenue-raising authority resides with the national government (Aaron and Slemrod 1999, p. 2).

The most important institutional reform to the tax system in South Africa was the establishment of SARS as an autonomous entity in terms of the South African Revenue Service Act (34 of 1997). The Margo Commission found that the revenue authority in South Africa laboured under severe disabilities and has from 1986 recommended that the autonomy of the then existing Inland Revenue division and the Customs and Excise division be reconsidered. However, it was only after a recommendation of the Katz Commission in 1994 that attention should urgently be paid to enhancing the status and administrative autonomy of the then Commissioner for Inland Revenue that SARS was finally created as an organ of the state within the public administration, but as an institution outside the civil service.

Although SARS is an institution outside the civil service, it operates under the executive authority of the Minister of Finance. This restructuring put SARS in a strong position to reach its key objectives of collecting all national taxes, duties and levies by attracting and retaining competent people, using modern information technology and adopting efficiency-enhancing organisational structures and incentive schemes (Manuel 2002, p. 3). Since 1997, extensive organisational transformation has elevated SARS to a model of domestic public sector transformation and technology innovation (Manik 2005, p. 1).

5.2 External reporting and accountability

Until the start of the 21st century, there was no effective recourse for taxpayers who had administrative difficulties in their dealings with SARS, and the need was identified for the establishment of a tax ombudsman to restore some balance in the relationship between taxpayers and revenue authorities (Stiglingh 2008, p. 6). The first step

towards the establishment of a tax ombudsman and another big step towards a more customer-focused approach was the launch of the SARS Service Monitoring Office (SSMO) in October 2002. The purpose of the SSMO is to determine whether SARS lives up to its promise of efficient service delivery, as this office provides a channel for taxpayers to voice their complaints about areas in which they do not receive the service they deserve (Nathan 2003). The office does not report to Parliament, but it functions independently from SARS operations. It reports directly to the Commissioner for SARS. This structure enables the commissioner to obtain information regarding problem areas from an independent source and to take the necessary action to rectify problems. (Olivier 2006, p. 23).

The SSMO facilitates the resolution of problems of a procedural nature that have not been resolved by SARS offices through the normal channels (Tustin, De Clercq and Venter 2006, p. 30). Apart from the SSMO, another opinion poll is the 'tracker survey', an ongoing survey of perceptions and attitudes regarding the South African government. In general it tracks shifts in perceptions, informs SARS taxpayer education campaigns and determines the impact of these campaigns. A representative spread of South African citizens aged 18 years and older is polled daily throughout the year, and the results are collated each quarter. From the beginning of 2004, questions relating to SARS and taxation have been included in the tracker survey. SARS has used the tracker to establish benchmarks on taxpayer consciousness, taxpayer literacy and compliance perceptions. (SARS 2005, p. 35).

As the new democracy matured, the South African government adopted the 'Batho Pele' principle ('*Batho Pele*' is the Sesotho term for 'putting people first'). SARS pioneered this shift towards a service ethic by adopting an enterprise-wide citizen relationship management vision (Areff and Mabaso 2005, p. 124). SARS has identified and determined the manner in which it plans to maximise its responsiveness – it has developed a capability model and transformational strategy that will propel it to higher levels of efficiency and service delivery (Areff and Mabaso 2005, p. 124). One of the components of this strategy is customer management – the bastion of the reorganisation effort towards improving service delivery – by taking the service to the people and empowering the front end of SARS (Areff and Mabaso 2005, p. 124). However, many taxpayers who have had dealings with the tax authorities in the past would probably be sceptical, and in the words of Croome (2006, p. 1), 'they would probably believe that there could be peace in the Middle East before they could imagine a world where SARS answers all telephone calls within

20 seconds.' Nevertheless, SARS has begun to benchmark its service standards against international best practices, and in 2005, the final SARS Service Charter, which sets out its service standard guidelines (including the objective of answering the telephone within 20 seconds), was released. It sets standards publicly, in the spirit of '*Batho Pele*,' for the level of service SARS officials are expected to offer taxpayers. SARS annually accounts for its progress regarding service levels in its annual report.

Although the service quality of SARS increased significantly, taxpayers still perceive themselves to have limited remedy in the case of poor services rendered by SARS. As a further attempt to offer a simple and affordable remedy to taxpayers who have legitimate complaints regarding administrative matters, poor service or failure by SARS to observe taxpayer rights, the Minister of Finance officially introduced the Tax Ombud in 2014. The Tax Ombud must review and address a complaint lodged by a taxpayer and resolve the dispute using informal, fair and cost-effective measures. However, the taxpayer must first try to resolve the complaint through SARS's internal complaints resolution procedures before approaching the Tax Ombud (SARS 2013, p. 16). Thereafter, if the complaint remains unresolved, the issue has to be taken up with the SSMO. Only once all these mechanisms have been exhausted without success, can the Tax Ombud be approached. There are, however, exceptions to this rule; when there is sufficient urgency or a possibility of undue hardship, the Tax Ombud may be approached directly. In resolving a matter, the Tax Ombud may make recommendations to the taxpayer or SARS, but these recommendations are not binding for any of the parties involved. This is also a cause for concern, because it raises doubts about the effectiveness of the institution. It is submitted that the Tax Ombud would be a more useful institution if SARS and taxpayers were similarly bound by its recommendations (Katzke 2012, p. 36). The dominant view amongst commentators is that the Tax Ombud is simply a statutory version of the SSMO. Even though the Tax Ombud is obliged to report to the Minister of Finance annually and to SARS quarterly, which may act as an incentive for the Tax Ombud to perform, there is no clear and direct enforcement mechanism if it fails (Katzke 2012, p. 36). Furthermore, the Tax Ombud is funded by SARS and staffed by SARS employees who are seconded on request. These factors are of great concern because they bring into question the Tax Ombud's independence from SARS. Even though it has the ability to make findings and recommendations, it is still without any power to compel SARS to undertake or refrain from undertaking any action (PwC 2012a, p. 19).

SARS (2014b, p. 46) further has a zero tolerance of corruption and fraud. Unlike the perception about other state agencies in South Africa, the positive perception of SARS among South Africans in this regard simplifies interactions with SARS significantly.

5.3 Management flexibility and decision powers

The TAA introduced controversial changes and new concepts to the South African tax regime, which extended the rights of SARS. In order to understand these rights better it is important to note that the Commissioner for SARS is authorised to determine the tax environment in general, but they may delegate these powers and duties to a SARS official. A SARS official includes a senior SARS official, an employee of SARS or a person contracted by SARS. Some rights and functions are reserved for senior SARS officials and include functions such as the issuance of official publications, withdrawal or amendment of decisions and the authorisation to conduct an audit or criminal investigation or lay criminal charges against a taxpayer (SARS 2013, p. 13). A taxpayer can assume that SARS officials have the authority required to make decisions and issue notices on behalf of SARS. However, these may be challenged. SARS officials who exercise their powers are required to produce an identity card upon request by a member of the public (PwC 2012a, p. 15).

In order to ensure the proper administration of a tax Act, SARS may select a person for an audit, but SARS is required to keep the taxpayer informed of the status of the audit and must provide the taxpayer with a document detailing the outcome (section 42 of the TAA). However, if there is reasonable belief that the purpose, progress or outcome of the audit will be hindered, SARS may immediately proceed by issuing an assessment without informing the taxpayer of the outcome of the audit. In this instance SARS is required to provide grounds for the assessment within a specified time (PwC 2012a, p. 30).

In conducting an audit or using the powers granted to SARS to gather information, SARS can inspect business premises, relevant material, conduct an interview or formally conduct an audit or criminal investigation. In terms of section 45 of the TAA, SARS officials can inspect the business premises without prior notice at any given time, even after business hours. Regarding the powers to obtain relevant material, a request for such information may be sent to the taxpayer or any third party that has information about the taxpayer (sections 46 and 47 of the TAA). This could mean that SARS may request a business to provide certain information about its clients (PwC 2012a, p. 32). For instance, SARS could require banks to provide details about clients that hold significant

cash investments or to provide information on all deposits received by a taxpayer during a year of assessment (Retief 2012, p. 9). Refusal to provide all the requested information or failure to respond truthfully and completely to the request is a criminal offence (SARS 2013, p. 26). A person may be required to attend an interview at a time and place designated by SARS to present or explain information or material. The intention of the interview must be to clarify concerns SARS may have and to possibly avoid a more intrusive and prolonged audit. The interview may not be conducted with a third party and may also not be for the purposes of a criminal investigation (SARS 2013, p. 27). With regard to formal audits and criminal investigations in terms of section 48 of the TAA, a SARS official must be authorised to conduct the audit or investigation, and must give the taxpayer a minimum notice before the audit or investigation commences (SARS 2013, p. 27).

It is also important to elaborate on the search and seizure rights of SARS representatives. Here we have to distinguish between a search and seizure with a warrant and search and seizure without a warrant.

Under a search and seizure warrant, SARS may enter the premises of a taxpayer without prior notice to conduct a search and seize relevant material, however, PwC (2012a, p. 35) noted that the minimum required contents for lawful warrants, as determined by the Constitutional Court, are broader than the minimum requirements specified by the TAA. If a senior SARS official has reasonable grounds to believe that relevant material is being kept on premises that are not identified in the initial warrant, a search and seizure may be conducted on the other premises without obtaining a new warrant. An inventory of seized material must be provided to the person from whom the items were seized, who will be entitled to examine it or make copies thereof. SARS may retain and preserve the items seized until they are no longer required, but the TAA contains no requirements to ensure that the seized items are satisfactorily returned to the owners (PwC 2012a, p. 35). SARS may be requested to return the seized materials and to compensate the owner for any damages or costs incurred in the process. The High Court can be approached if SARS refuses this request.

In certain cases, a senior SARS official is allowed to exercise the right to search and seizure without a warrant (PwC 2012a, p. 36). A warrantless search may be conducted if the owner of the premises consents thereto in writing or if there are reasonable grounds to believe that the relevant material has been removed or destroyed and that the delay caused by efforts to obtain a warrant would defeat the object of the search (SARS 2013, p. 32). Before the search is conducted, the person in charge of the

premises must be informed of the alleged tax offence that justifies the search and that the search will be conducted in accordance with the regulations of the TAA (SARS 2013, p. 32). Although the warrantless search and seizure provisions in the TAA contain wording that in theory ought to rule out any subjective, unpredictable or otherwise irresponsible application thereof, the question remains whether these constraints will be effective in practice (Bovijn and Van Schalkwyk 2012, p. 509). Croome (2013, p. 20) is also concerned that although a warrantless search of premises is intended to occur only in exceptional circumstances, there will always be some concern about possible abuse of power by SARS officials. Search and seizure without a warrant therefore requires the balancing of SARS's interests and those of taxpayers. On the one hand, SARS requires this power in order to enforce the law. On the other hand, it could be seen as an extreme power that could infringe on taxpayers' rights (Bovijn and Van Schalkwyk 2012, p. 524). Another concern is that it was revealed in 2015 that SARS has a special investigation unit that subjected a number of taxpayers to 'surveillance, investigation and interrogations using covert and illicit methods' and 'intelligence equipment,' including eavesdropping equipment, vehicle trackers and recording equipment implanted in car keys and pens (Rampedi 2015). This is clearly a contravention of South Africa's Constitution, tax legislation, legislation relevant to electronic communications and national strategic intelligence as well as SARS's own code of conduct (Rampedi 2015). This unit was operative before the TAA provisions regarding the expansion of SARS's search and seizure powers to also include search and seizure in certain cases without a warrant. The exposure of the illegal unit within SARS raises concerns regarding the extended powers now granted to SARS representatives.

The actions taken by SARS under the TAA are, however, subject to the requirements of the Promotion of Administrative Justice Act (3 of 2000) (SARS 2013, p. 10). In terms of the Act, when the rights of taxpayers are materially and adversely impacted by tax administrative actions, certain requirements in terms of fairness must be met. In order to ensure administrative fairness, the Davis Committee (DTC 2014b) recommends that taxpayer administration should be simplified. Taxpayers should therefore be absolved from complying with subsequent information requests by SARS when the same information or documentation has already been provided to SARS on a previous occasion and the taxpayer can furnish proof that the information or documentation has been delivered. Save in the case when SARS still requires resubmission of documentation or information that the taxpayer can prove has been

provided previously, taxpayers should be compensated, for example, in a case where the documentation has been misplaced by SARS.

5.4 Internal organisation and outsourcing of selected functions

The Siyakha ('we are building') transformation programme was launched in 2000 to reshape SARS into a 21st-century organisation which will be able, inter alia, to address service inefficiencies and the lack of a service culture (National Treasury 2002, p. 69; SARS 2005, p. 85). This transformation programme, which was applied until 2006, focused on internal racial and process transformation. It aimed to improve, modernise and standardise operational processes and procedures to increase efficiency and service levels throughout the organisation. The existing inward-looking, bureaucratic organisational culture was to be replaced by an outward-looking, client-orientated ethos that strove for continual improvement and excellence. Technological improvements were deliberately excluded during this phase.

The implementation of the Siyakha transformation programme was staggered. After the successful roll-out of the programme in KwaZulu-Natal (2001), the Western Cape (2003) and a large part of Gauteng (2004), Siyakha was rolled out to the remainder of the country between 2005 and 2006.

During this period, administrative functions were centralised into a few national offices, and branch officers were reoriented towards customer service in an attempt to improve compliance. The main thrust of the programme was on re-engineering work processes and realigning jobs to achieve the following results:

- increasing operational efficiency by standardising business processes;
- introducing more appropriate organisational structures;
- establishing a better working environment;
- creating multi-functional teams;
- enhancing service; and
- providing a stable platform on which future changes could be built.

The implementation of the Siyakha programme has yielded a wide range of benefits for SARS and has positioned it so that it is able to build on a solid foundation as it embarks on the next phase of its development – the SARS Modernisation programme, which was launched in 2007. Modernisation was now a necessity as the tax register grew by 67% and revenue collection grew by 61% from 2001 to 2006.

The first initiative in the SARS Modernisation programme was an outsourcing initiative – the implementation of a fully electronic channel for both individual and business taxpayers to file income tax returns in 2007 (referred to as e-filing). Another important initiative was the launch of e@syFile for tax practitioners in 2008 (Sapa 2008). The international recognition of this initiative confirmed that SARS has transformed itself into a world-class revenue authority.

The introduction of the modernisation programme further resulted in the number of registered individual taxpayers increasing from 5.9 million (2009/2010) to 16.8 million (2013/2014) with the total number of taxpayers annually growing to 21.3 million registered taxpayers in the 2013/2014 fiscal year. Not all taxpayers are required to submit tax returns, and 6.6 million returns were submitted to SARS, of which 99% were submitted electronically (SARS 2014b, p. 6). This modernisation programme included an improved employee tax system requiring all persons in formal employment to register with SARS, the introduction of a substantially faster e-filing interactive internet application and, more recently, mobile solutions. The SARS modernisation programme has simplified and improved tax administrative processes since 2006. Significant improvements are visible since:

- the turnaround time for the processing of income tax returns improved from 2.6% of returns being processed within 48 hours to 94.5% of all personal income tax returns filed to be processed within three seconds and all corporate tax returns filed to be processed within 0.47 days (SARS 2014b, p. 42);
- the number of calls answered by the SARS Contact Centre increased from 3.8 million to 5.7 million per annum, and they exceeded their first contact resolution target of 82% (SARS 2014b, p. 42);
- the introduction of a compliance programme in 2012 focusing on seven areas for improved compliance (wealthy South Africans and their trusts, large businesses and transfer pricing, construction industry, cigarettes, clothing and textiles, tax practitioners and trade intermediaries, and small businesses); and
- a new customs management system was introduced in 2013 (SARS 2014b, p. 6) which built on a customs front-end solution programme that was re-engineered in 2012. The new customs management system resulted in the conversion of paper-based systems into a fully automated and centralised processing system for all commercial trade across South Africa's borders, minimising the cost of red tape.

To further simplify tax administration, a single registration system, which underwent extensive testing during the 2013/2014 financial year, is to be introduced in 2015 to provide SARS with real-time information about the tax and customs products used by a registered entity, be it an individual, company or trust (SARS 2014b, p. 10). This single registration system will also allow taxpayers and traders to request tax clearance certificates online.

The internal transformation of a revenue authority does not only include technological simplification of tax compliance burdens, but also includes the segmentation of taxpayer services. The Siyakha transformation programme primarily focusses on restructuring the internal organisation of SARS, but such internal reorganisation is a continuous process.

The first segmentation reform (introduced in 2004) was the establishment of the Large Business Centre (LBC). The establishment of this centre was in line with international best practice, and it was designed to introduce a new era in the interaction between SARS and the country's largest corporate taxpayers. The services performed by this centre include end-to-end processing activities, risk profiling, auditing, and a newly created relationship management function. It aims to provide a more customised service to these taxpayers. Despite the many benefits of improved service and business knowledge of taxpayers within sectors, the operating model was revisited as it was resource-intensive. In 2010, a new functional model of the LBC was approved by SARS, and it included five core functions, i.e.: the Taxpayer Interface function; the Revenue, Risk and Intelligence function; the Assurance function; the Client Account Management function and the Specialist Support function (SARS 2014b, p. 46).

A second step towards the segmentation of SARS's services was taken in 2006 when SARS established the Tax Practitioners Unit as part of developing a comprehensive practitioner-specific service strategy and began to engage quite extensively with practitioners. To assist tax practitioners to optimise the services they render to taxpayers, SARS's website has tailored offerings for tax practitioners. There is also a separate tax practitioner call centre channel and email function, and some branches even have a tax practitioner help desk (SARS 2014b, p. 43).

Small businesses receive special attention within the legislative framework, but did not receive special assistance with their tax compliance burden in 2015. Given the importance of small businesses in any economy, and that tax administrative costs of small businesses are regressive, the Davis Tax Committee (DTC 2014a, p. 31) recommends that

SARS develop a communication strategy specifically aimed at taxpayers who could potentially fall within the small business tax regimes. The strategy could include focussing on issues such as communication by text message, web-based communication (and e-learning) and the establishment of a unit or desk in SARS contact centres that would focus on small business tax education (DTC 2014a, p. 31).

Although internal transformation, modernisation, improved technology and the segmentation of SARS's service offerings are commended, they do not guarantee the simplification of tax compliance. However, they can play a very important role in this.

6 Longer term approaches

The World Bank (2009, p. 1) reports that:

> The goals of most tax reforms have been to raise more revenue for government, achieve various economic and social goals, and improve the efficiency of the tax collection process. However, tax reforms in general have paid little attention to improving the tax system to make it easy for businesses and entrepreneurs to comply. This is especially true in developing countries.

South Africa is no exception to this notion. Historical tax reform efforts in South Africa mainly originated from the economic and social goals of the government in power at the time of the reform. It is also possible that this situation will not necessarily change in the foreseeable future.

The long-term strategic plans of both the National Treasury (2013) and SARS (2014a) refer to specific tax simplification aspects, but in reality they do not focus on simplifying the South African tax system per se. These strategic plans are underpinned by the main aims of the South African government to build a fast-growing economy that creates jobs and addresses income inequality. These aims are also in line with the main objectives of the Davis Tax Committee, which, at the time of writing, is investigating the tax system in South Africa. The Davis Tax Committee is evaluating the economic and social impact of the tax system and has to assess the ability of the current tax structure to generate sufficient and sustainable revenues to fund government's current and future expenditure priorities (DTC, n.d.b.). Although the terms of reference of this committee include the simplification of taxation, the scope of its first draft report is mainly directed towards the promotion of SMEs by

reducing the cost of tax compliance. In its second draft report, some of the tax proposals to combat tax avoidance in line with the international focus on BEPS seem to be very detailed, and this might contribute to further tax legislative complexities.

Simplification will always be a very fine balancing act. Then there will always be the debate about whether tax legislation should fundamentally follow a principle-based approach that is supplemented with general anti-avoidance provisions versus a very detailed rules-based approach that inevitably complicates legislation. Although the intention of the detailed rules is mostly to provide tax certainty and to combat tax avoidance, the same rules open up new tax-planning opportunities. Therefore, like its predecessors, this tax reform initiative by the South African government will not necessarily balance the scale between the competing goals of efficiency, equity, and administrative ease, an essential requirement for tax system simplification as stated by the World Bank (2009, p. 6).

It is therefore clear that South Africa currently lacks a focussed strategy directed at tax simplification. No tax simplification initiatives similar to the Office for Tax Simplification in the United Kingdom or the Tax Working Group in New Zealand currently exist in South Africa. Longer term strategies directed at tax simplification require input originating from tax compliance cost surveys. In addition, such a strategy requires a complete tax inventory of all the taxes in existence in the country, as well as process maps to illustrate the tax administration process, emphasising the points of contact with taxpayers (World Bank 2009, p. 8). In South Africa, input of this nature is very limited. Academic studies by Nienaber (2013) Smulders (2013), Steyn (2012) and Stiglingh (2008) reported on some of these issues, but by 2015 only the study by Smulders (2013) was considered by the government.

In conclusion, it is possible to state that tax reform efforts in South Africa are essentially not approached from a tax simplicity point of view, but are mainly approached from a government perspective, underpinned by political and economic goals. In addition, the tax simplification efforts in South Africa do not originate from a comprehensive long-term strategy and, therefore, there is a real need in South Africa for some sort of 'Office of Tax Simplification' that can assist government in finding a balanced scale between the goals of efficiency, equity and administrative ease. The notion of an office of tax simplification is not new in South Africa and is promoted by the Association of Certified Chartered Accountants and the South African Institute of Tax Practitioners (Temkin 2012, p. 1).

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9

The Complexity of Tax Simplification: Experiences from Thailand

Thamrongsak Svetalekth

1 Introduction to Thai tax administration and tax simplification

Tax simplicity is an important part of a tax system. There have been many attempts to improve tax simplification in different countries, and some of them are successful, but not all. Thai tax authorities attempt to simplify tax in terms of increasing fairness, decreasing problems of tax avoidance and tax evasion, amending the tax law, creating good tax administration and increasing the efficiency of communication with taxpayers.

This chapter examines the role of three main revenue authorities of Thailand in tax simplification for the operation of a tax system. Secondary data analysis and semi-structured interviews from a variety of level of tax officials are used for data collection. It is found that the three main departments attempt to decrease tax complexity, increase simplicity of tax administration and increase taxpayer satisfaction. However, problems of complexity of some tax systems are still there. Tax simplification is not simple as expected. Simplification of tax laws is implemented, but the processes of tax law amendment are long. Several alternatives for tax payment are arranged for increasing taxpayer satisfaction. However, a higher corporate tax rate is still a problem for foreign investors. Complexity in the structure of excise tax and customs tax together with difficulty of tax calculation are obstacles to tax simplification. Perhaps collaboration among parties, risk management and public hearings from taxpayers can increase tax simplification and help develop the tax system.

Historically, Thai tax collection was levied from the 13th century in the kingdom of Sukhothai Era. The main taxes were 'Rusha' (charges), 'Suai' (corvee), 'Arkon' (duty) and 'Jangkob' (ports tax). Nowadays, the main source of government revenue in Thailand, as well as other countries, is tax revenue. Three main organisations which have direct responsibility for revenue are the Revenue Department, the Customs Department and the Excise Department. In addition, the office of state enterprises has a responsibility for state enterprises and levy revenues to government, and the Treasury Department has revenues from rental of government land.

The Revenue Department is responsible for the administration of personal income tax, corporate income tax, value added tax (VAT) and specific business tax such as financial and real estate businesses. Personal income tax is a direct tax, imposed on income from sources both inside and outside Thailand during the taxable year. The progressive rate of personal income tax is between 5% and 35% on net income. However, from net income can be deducted expenses and personal allowances for the assessable incomes. In terms of the corporate tax, companies and registered partnerships face a tax rate at 20% on their net profits. However, small and medium-sized enterprises (SMEs) and some other organisations that have exemption from the Board of Investment (BOI) face tax at reduced rates. The VAT is levied on a wide range of goods and services supplied in Thailand, including imports and exports at 7%. However, some exported goods and services are exempted at 0%. Specific business tax (SBT) is imposed on certain types of businesses that provide services and are not subject to VAT. So, these businesses could not claim payment for VAT paid and could not charge VAT to customers. SBT is computed on monthly gross receipts, depending on the types of business – such as banking or a similar business – and tax is imposed at 3% of gross receipts, whereas a life insurance comany is imposed at 2.5%.

Secondly, the Customs Department has the responsibility of the administration of customs duties. Customs duty is mainly imposed on imported and selected exported goods, specified by the law. Duties are levied either at an Ad Valorem rate or a specific rate, whichever is the greater. The customs tariff rates are imposed under the Customs Tariff Decree B.E. 2530 (1987). The value of imports is the basis for the computation of the CIF prices and the customs tariffs range between 0 and 80%.

Thirdly, the Excise Department has the responsibility of the administration of excise tax. Excise tax is levied at either a specific rate or

Ad Valorem rate, whichever is greater, on selected goods or services. Currently, they are imposed on 20 goods and services, such as liquor, tobacco, petroleum products, air conditioners, yachts, horse racing etc. All three departments attempt to follow the principle of tax administration as OECD (2001a) suggested. Good tax administration does not mean collecting the maximum amount of revenue. There are numerous functions of good tax administration, such as gathering or processing the information of taxpayers efficiently (OECD, 2001b), interacting with tax organisations in other countries, paying or refunding taxes and verifying the clients' taxation status.

In terms of tax laws, The Revenue Department has promulgated the Revenue Code since April 1939 as the main legal precedent for collecting taxes. For the Customs Department, the customs tariff rates are imposed under the Customs Tariff Decree B.E. 2530 (1987), whereas the Excise Department used the Excise Tax Act B.E. 2527 (1984), Tobacco Tax Act B.E. 2509 (1966) and Liquor Tax Act B.E. 2493 (1950) for collecting excise tax. Even though all tax laws were outdated, they were continuously revised and updated for social and economic conditions. However, they still have loopholes to avoid paying taxes.

These three departments attempt to decrease tax complexity through tax reform, amendment of tax laws to decrease ambiguity of definition and close the loopholes of tax law to decrease tax avoidance, increasing simplicity of tax administration and increasing taxpayer satisfaction. However, problems of complexity of some tax systems still exist. Tax simplification is not simple as expected. Some of them are successful, however, some of them are still waiting to develop. In particular, Asean Economic Community (AEC) is moving things forward. At the end of 2015, tax harmonisation among 10 ASEAN countries should be achieved, as the European Union has the framework for taxation in EU countries. In terms of methodology, this chapter examines the experiences of tax simplification in three main revenue departments in Thailand and how the Thai officials can work to decrease tax complexity.

This chapter starts with an introduction in Section 1. Section 2 examines with tax simplicity and tax complexity. Section 3 details simplification of the tax system. Section 4 determines simplification of tax laws, and Section 5 discusses simplification of taxpayer communication. Section 6 discusses about simplifying tax administration. Section 7 proposes a longer-term and strategic approach to simplification and decreasing tax complexity. Finally, Section 8 ends with the conclusion.

2 Simplicity and complexity

Isa (2014) mentions that whenever taxpayers feel that they have faced difficulty in compliance, this seems to mean there is complexity. Cooper (1993) says there are seven issues of tax simplification: predictability, proportionally, consistency, compliance, administration, coordination and expression. On the other hand, Long and Swingen (1987) identify six characteristics of tax complexity: ambiguity, computation, frequent changes, numerous rules, detailed record keeping and confused format. Richardson (2005) supports the idea that tax complexity is the most important factor of tax evasion among countries. The countries that have a complex tax system will face low voluntary tax compliance. Self-assessment is a good example of tax simplification. If the revenue authorities assess all tax payments towards taxpayers, absolutely, they use up the times. Self-assessment improves the level of voluntary tax compliance and reduces compliance costs. Che Ayub (1994) mentions that Both Canada and the United States have launched self-assessment systems to increase voluntary tax compliance. In addition to self-assessment, a variety of channels for tax payment simplifies matters. Optionally, taxpayers can pay tax via an online system, pay by post, or pay at the tax office. In terms of tax laws, tax simplification means a tax law that can be understood easily and without interpretation. This includes simplification to calculate a tax payment. However, Thai tax laws are still needed to amend and interpret. Details about these laws will be explained in Section 4. In terms of simplification towards taxpayers, though, a good information technology system facilitates things for taxpayers. Similarly, it facilitates things for the tax authority in terms of tax evaluation, improving its administration, database and services. In addition, a simplified tax return is another crucial thing for tax simplification. Vogel (1974) identifies complicated tax return as a cause of tax complexity. As a result, taxpayers decrease tax compliance.

For tax complexity is the opposite of tax simplification. If taxpayers face difficulties in tax payment, it will increase noncompliance. Entrepreneurs who produce or import new motor vehicles must have three kinds of taxes: customs tax, excise tax and VAT. This excludes corporate tax that is annually paid. However, it is not a one-stop service. Because of the separation of the three revenue authorities, producers pay taxes towards three departments. Apart from paying taxes, entrepreneurs must finish a daily account and monthly balance sheet showing particulars of the raw materials within three days, and they must then submit

it to tax authorities in the first fifteen days of the following month. Moreover, in some sections in tax laws, particularly, definitions are still ambiguous, such as the definition of ex-factory price, expenses for entertainments or service fees that allow for the calculation of tax profits, and so on. Complexity of tax calculations causes a decrease in voluntary tax compliance. A variety of tax rates of excise tax and withholding tax, both personal income tax and corporate tax for Thai and foreign taxpayers cause tax complexity that does not harmonise with tax efficiency. Similarly, numerous types of personal income tax and personal tax allowance create loopholes in the tax laws and such tax complexity, this can lead to tax avoidance. So this chapter will give clear examples of tax simplification and tax complexity in terms of tax systems, tax laws and taxpayer communication in the following sections.

3 Simplification of tax systems

3.1 Upcoming AEC

One of the main issues raised in ASEAN is the upcoming Asean Economic Community: AEC at the end of 2015. It will generate single market and production base, free flows of goods, services, investment, skilled labour and the free flow of capital..Thailand is one of the ASEAN members that will realise free flows of investment into its various regions. ASEAN will be the production base in the near future. A measurement of the decrease of the corporate tax rate was launched to show strength, that Thailand might be seen as competitive on the world stage. Several countries decided to decrease the corporate tax rate in order to motivate investment from overseas (Foreign Direct Investment: FDI). Thailand decreased the corporate tax rate from 30% of net income used since 1992 to 23% in 2012 and decreased to 20% since the period of 2013. Comparatively, Thailand has lower corporate tax than other countries in ASEAN except Singapore, which is collected at 17%. The measure of the decreased corporate tax rate makes it easier for foreign investors to make a decision to invest in Thailand because investors can make more profits. The decrease of corporate tax generated an increase of government revenue of about £1.05 billion in 2012. Moreover, decrease of corporate tax rate builds up domestic employment. People have more purchasing power. Even though it had many advantages from the decrease of its corporate tax rate, Thailand cannot compete with Singapore in terms of FDI. Off-ASEAN investors still invest in Singapore rather than Thailand. One of the reasons comes from Thai tax complexity. Investors must not only pay Thai corporate tax, they must also pay dividend tax. However,

there is no dividend tax in Singapore. This problem impedes foreign investors who want to invest in Thailand.

Apart from a reduced rate of corporate tax to make Thailand's economy more competitive in forthcoming AEC, the Revenue Department exempted personal income tax for Thai residents who received dividends from foreign companies who registered their stocks in the Thailand stock exchange. In addition, they have exempted personal income tax for income derived from selling shared registered stocks in the stock exchange of ASEAN countries via the trading system that was set up by the Thailand stock exchange. All this promotes the Thai capital market development plan, which support the free movement of capital within AEC countries.

3.2 Tax reform

Obviously, Thailand achieved tax reform by changing from business tax to VAT in 1992. The main objective was to replace business tax that levied tax from products and services by a different ad valorem tax rate. Structure of business tax was considered, in that it was unfair for some products to be taxed at a higher rate. VAT is an indirect tax imposed on the value added of each stage of production and distribution. It is levied at 10%, but the government reduced it to 7% in 1992 to relieve the population burden. However, some activities, such as export of goods or supply of goods and services between bonded warehouses or free zones are levied at a rate of zero percent.

Even if the Thai VAT tax rate is one of the lowest rates in the world, compared with European VAT tax rates of around 19–27%,[1] the problem of tax evasion still increases continuously, seen in practices such as making tax invoices to deduct input tax, or a taxable person who has an annual turnover exceeding 1.8 million baht is not registered as a VAT person. The main reason is that non-VAT registered corporations do not need to be examined by a tax official. In addition, they do not need to propose tax payment including output and input tax reports within the first 15 days of the following month. Furthermore, at the beginning of 2015, the Revenue Department increased the number of items on tax invoices, such as Tax Identification Number, address of purchaser, and so on. Even though it is easier to examine, however, it increases compliance cost for taxpayers. As a result, there is difficulty with compliance.

Apart from the VAT issue, inheritance tax is raised for tax reform. Occasionally, the tax authority is opposed to the idea of collecting tax only from middle and working class people via the VAT system while the upper class can avoid tax by exploiting loopholes of the tax laws.

Inheritance tax can decrease inequity between the working class and upper class. The tax rate will be levied at 10% of value of heritage over 50 million baht from the heir. It is not too difficult to avoid inheritance tax. Heritage can be divided for less than 50 million, tax free. So, it is not simple for the government to collect inherit tax in the forthcoming period.

3.3 The Socioeconomic environment

Budak *et al.* (2014) mentioned 'social factors include demographic variables, social mobility and increasing levels of education'. In addition, economic factors relate to a variety of sources of income and the complexity of a financial instrument. Personal income tax in Thailand may be one of the good examples of making it simpler for individual taxpayers to decrease their tax burden. Taxable income is calculated from assessable income minus deductions and allowances. James and Nobes (2014) show that allowances for personal income tax consist of: personal, married couple, income limit for age-related issues, and a blind person allowance. On the other hand, Thai personal income tax has 14 allowances. The personal income tax system considers demographic data, economic factors and socioeconomic environment. There are 65 million people in Thailand. Only 10 million people submit income tax forms, and about half of them submit the form to pay personal income tax. The government needs taxable persons to get into the system. To relieve the tax burden and support growing children, the government has increased its child allowance from 7,500 baht to 15,000 baht (limited to three children). To support taking care of aging parents, a taxpayer can deduct 30,000 baht for the parent allowance. However, parents must be above 60 years old, and earn an annual income of less than 30,000 baht. In addition, if the taxpayer takes care of disabled persons, they can deduct an allowance of 60,000 baht per person. Moreover, the government supports the idea that taxpayers should save money for the future. A taxpayer who invests in a long-term equity fund and retired mutual fund can deduct allowances from the amount actually paid, not more than 15% of assessable income, but not exceeding 500,000 baht. In addition, taxpayer can deduct allowances from life insurance premium, provident fund, home mortgage interest, social insurance contribution. Finally, if a taxpayer has charitable contributions, he can deduct the allowance amount actually donated but not exceeding 10% of the assessable income after deductions and all allowances. In addition, the government has a campaign to help disabled people and to support education. If a taxpayer contributes facilities for disabled persons or provides

a scholarship for students, he or she can deduct an allowance double the amount actually donated but not exceeding 10% of the assessable income after deductions and all allowances. It motivates the individual taxpayer to contribute for disabled persons and students. Even though the government relieves tax burdens with lots of allowances, it may increase complexity significantly with too many allowances. Taxable persons do not use all their allowances. Some tax allowances increase the burden for taxpayers in the future such as life insurance premium, home mortgage interest, long-term equity fund (LTF) and retired mutual fund (RMF). A taxpayer may have a burden for buying insurance for the next 20 years and buying a house for the next 30 years. For LTF and RMF, the taxpayer has the condition to hold the funds for a minimum of five years, however he earns benefit from allowance for only the first year.

3.4 Fairness

The most important thing for tax payment is that taxpayers feel they get benefits back from tax payment. The more you pay, the more you get benefits. Whenever people pay higher tax and they get nothing, they will feel it is unfair. An individual taxpayer has more assessable incomes, so they can find some allowances such as LTF, RMF or buying insurance to deduct assessable income. In other words, they have more choices to deduct taxes. However, the middle class may feel it's unfair if they must buy some funds or insurances to get some allowances. As mentioned from World Bank (2010), the Thai central region generates income 44% of all income but is allocated an expenditure budget of only 7% of the whole budget, whereas the northeastern region produces income at 11% but is allocated expenditure budget of only 6%. However, Bangkok creates income at 26% but is allocated expenditure budget of over 72%. Most of expenditures relate with public transportation such as the sky train, underground and expressway that facilitate movement and easier commutes for Bangkok people. Absolutely, it is unfair for non-Bangkok people. More than that, people in higher tax brackets know how to avoid tax by exploiting loopholes of the tax law. Some taxpayers allegedly pay bribes to tax officials and are not strictly examined, whereas a person with less assessable income or SMEs may be closely examined. When taxpayers feel the system is unfair, a simplified tax system is useless.

3.5 Tax avoidance

One of the difficulties of tax administration is tax avoidance. James and Nobes (2014) say that the main causes of tax avoidance are higher tax rates, imprecise laws, low penalties and inequity. But the main cause of

Thai tax avoidance is loopholes in tax laws. Thai tax laws have lots of loopholes. Perhaps tax avoidance may be acceptable tax planning. Some of them will be discussed in this section and Section 4: Simplifying tax law.

Budak *et al.* (2014) mentioned economic factors relate a variety of sources of income and complexity of the financial instrument. This may cause of tax avoidance. Sources of income can be divided into two sources: sources from Thailand and sources from overseas. A person who obtains income from overseas will pay personal income tax when he stays in Thailand more than 180 days and brings income into Thailand. So it is not difficult to not pay personal income tax. He or she can open the bank account overseas and bring the money into Thailand the next year.

Continuously, Thai personal income tax is levied from five sources: individual taxpayer, deceased during tax year, undivided estate, non-registered ordinary partnership and group of persons.[2] Tax avoidance of Thai personal income tax was found from group of persons. The provision for a group of persons was set up to avoid paying tax in higher progressive tax rate. For example, a coffee shop that has actually 10 branches in Bangkok is registered as a group of persons: mother and father, father and uncle, mother and daughter and so on, to avoid paying a higher rate. However, if the taxpayer pays tax as one group of persons that consists of 10 branches, he or she will pay personal income tax at a higher rate.[3] To simplify for a revenue authority and decrease overusage of the loophole of paying tax for a group of persons, the Revenue Department issued the regulation at the beginning of the year 2015 by amending the definition of a group of persons that relates with sharing profits. If a group of persons shares profit, they will pay tax from assessable income. In addition, if they share profit from assessable income remained from paying tax, the taxpayer(s) will pay personal income tax again as an individual taxpayer. Some tax specialists have critiqued this system by saying that it looks like duplicate tax to pay tax for twice. However, it is anticipated that the problems of loophole of a group of persons will decline. Instead of setting up a group of persons, it's speculated, they will set up a corporation and pay the corporate tax rate of 20%.

In terms of Thai corporate tax, it is calculated from net profit on the accrual basis in the income statement and is adjusted with the conditions of the Revenue Code. Some revenues, such as dividend income, are included a half of dividend received by Thai company. However, if the recipient is a listed company in the Thailand Stock Exchange, dividend

income will be excluded. In addition, from the Revenue Code section 65 (3), there are 20 items of expenses that are not allowed as expenses in net profit calculations. However, companies attempt to use the loophole of tax laws to avoid corporate tax such as entertainment or service fees, expenses that are not for the purpose of making business profits and so on.

In terms of the excise tax for motor vehicles, it will be levied from passenger cars or public transport vehicles with seating not to exceed 10 seats. Some entrepreneurs avoid tax by putting in a baby seat, to total 11 seats in the van. In addition, the tax base of motor vehicle is collected from ex-factory price. So, an entrepreneur could make a tax avoidance by claiming the ex-factory price is lower than it actually should be. It is difficult for a tax official to determine the actual ex-factory price. However, the Excise Department protects the lower ex-factory price by launching a regulation that ex-factory price must be higher than 76% of retail price.

4 Simplifying tax law

With complexity of tax laws, it normally causes an increase of tax avoidance and tax evasion. What is the main cause of complexity of tax law? It can be explained that tax law may have been appropriate in the past. However, currently, it is obsolete. A good tax law should be easy to understand. Whenever taxpayers or anyone who is interested read tax laws, they have no need for interpretation. With the processes of tax law, amendments are so long. Some definitions are still unclear, and tax laws still have loopholes. In the next section, we will discuss tax law complexity and how to simplify tax laws?

4.1 Tax rates

Generally, tax rate can be calculated in three types: Ad valorem tax rate, specific tax rate and mixed rate. Ad valorem taxes require strong tax administration systems and capacity, and the administrative burden is high since not only the volume of production or consumption needs to be ascertained but also the value of the product.[4] It can be easily understood. For example, the tax rate of VAT is 7%. This means 7% of value of the product. Specific taxes can either be set as a uniform specific tax, which levies the same value on all products, or at variable rates, which set different values on different products, for example, gasoline for diesel tax rate is 25 baht/litre. A mixed rate system is a mix between the ad valorem tax rate and specific tax rate. In Thailand, most tax rates are ad

valorem. Personal income tax is calculated from assessable income for 7 progressive rates from 5% to 35%. Corporate tax is levied from taxable income at a rate of 20%, whereas VAT tax rate is collected at 7% of retail price. Specific business tax (SBT) is imposed at 2.5–3% of gross receipts. However, customs tax and excise tax are levied from either ad valorem or specific tax rate, whichever is greater. Customs tax is not too difficult to explain to taxpayers. For example, an importer imports 1 kilogram of Arabica coffee that is valued at 5,000 baht. The customs tax for Arabica coffee can be calculated from an ad valorem tax rate at 40% of 5,000 baht compared with 4 baht per kilogram, whichever is greater. However, it is quite complex for the calculation of excise tax.

4.2 Tax calculation

4.2.1 Tobacco tax

The current tobacco excise tax rate is an ad valorem tax rate at 87% of ex-factory price or specific tax rate at 1 baht per 1 gram, whichever is greater. The Thai excise tax is an inclusive tax. This means that ad valorem tobacco excise tax equals tax rate* ([ex-factory price or CIF price] + excise tax).[5] Previously, the government increased the tobacco tax rate from 85% to 87%. It does not mean that the tobacco excise tax increased from 85% to 87% of ex-factory price or CIF price. It means there was an increase from 85% to 87% of ex-factory price plus excise tax. In other words, excise tax increased from 567% to 669% of ex-factory price or CIF price that includes excise tax. The details of tobacco excise tax rate are illustrated in Table 9.1.

However, people, particularly smokers, rarely know complex calculations. As can be seen, customs and excise tax are calculated from the ex-factory price, not retail price as EU or other countries calculate. The ex-factory price is still seen as the big loophole of tax law. The problem

Table 9.1 A comparison between tobacco excise tax rate informing towards taxpayers and real tobacco excise tax rate

Tobacco excise tax rate (%) informing towards taxpayers	Real tobacco excise tax rate (%) of ex-factory price or CIF price
75	300
80	400
85	567
87	669

Source: www.excise.go.th.

is that an entrepreneur declares the ex-factory price to be lower than it actually should be. It's possible that some companies have set up subsidiary companies to purchase goods for a cheaper price and then sell to customers in higher retail price. This includes the problem of imported cigarettes from a company that declares a CIF price much lower than import towards other ASEAN countries. As a result, the Customs Department can not declare this CIF price.

4.2.2 Liquor tax

Tax for liquor is charged from VAT and excise tax. Custom tax will be charged if liquor is imported from overseas. There are some complexities of liquor tax: classification of liquor and calculation. Thai liquor can be classified into 3 types and 11 kinds.[6] Each type has different tax rates. Previously, ad valorem and specific tax rate are applied whichever is greater. However, the ad valorem liquor tax calculation is more complex than tobacco tax. Liquor tax is still an inclusive tax that includes ex-factory price, excise tax and tax collected for the Ministry of Interior (10% of excise tax). Thus, if liquor tax is 60%, it means 60% of ex-factory price plus excise tax and tax collected for the Ministry of Interior, or 176.47% of ex-factory price or CIF price.[7] This calculation is very complicated to communicate to taxpayers. To decrease the complexity of liquor tax and decrease the problem of declaring a lower ex-factory price than it actually should be, the Ministry of Finance changed the liquor tax structure as in Table 9.2.

From Table 9.2, we found that the last wholesale price deducted VAT replaced ex-factory price, which can decrease the problem of declaring a lower price. However, tax structure changed from either ad valorem or specific rate to mixed rate. Comparatively, EU countries are concerned with health rather than luxury. They used specific rates applied by hector litre. The higher the degree of alcohol, the more tax you pay. More importantly, the new Thai liquor tax is absolutely more complex because specific rates of tax will be compared between baht/litre/100 degree and baht/litre. In addition, if the specific tax rate is higher than the condition, it will be charged at the higher tax rate. So, a new liquor tax rate may make tax paying more complex than in the past.

4.2.3 Motor vehicle tax

Similar to liquor tax, tax on a motor vehicle is charged from VAT, excise tax. Custom tax will be charged if the motor vehicle is imported from overseas. In terms of excise tax, there are 43 classifications of motor vehicle, for example: passenger car, pick-up truck, eco-car, double cab,

Table 9.2 Some parts of liquor excise tax rates

	Old tax rate (A) or (B) which is greater		New tax rate (Since September 2014) = (1)+ (2) or (3) which is greater + (4)					
	(A) Ad Valorem	(B) Specific			Specific tax rate		Tax rate that has higher degree	
Types of liquor	**%**	**Baht/ litre/ 100 degrees**	**Condition**	**(1) Ad Valorem (%)** [8]	**(2) Baht / litre/ 100 degree**	**(3) Baht/ litre**	**Condition**	**(4) Baht / litre/ degree**
Beer	60	100		48	155	8	>7 degrees	3
Wine	60	100	Last wholesale price <=600 baht	0	1000	225	>15 degrees	3
			Last wholesale price > 600 baht	36				
White Spirit	50	150		4	145	40	>40 degrees	3
Blended Spirit	50	350		25	250	50	>45 degrees	3
Special Spirit	50	400		25	250	50	>45 degrees	3

Source: www.excise.go.th.

and modified passenger car and so on. There are, of course, different tax rates based on engine size, fuel used and types of motor vehicle. Both customs and excise tax for the motor vehicle are calculated by ad valorem tax rate based on ex-factory price (Inclusive tax). A passenger car that has less than 2,000 CC has an excise tax rate of 30%. It does not mean that the excise tax is 30% of ex-factory price, but it means 30% of the ex-factory price plus excise tax and tax for the Ministry of Interior (10% of excise tax). Actually, excise tax for this passenger vehicle is 44.77% of ex-factory price. Details of motor vehicle excise tax rates are shown in Table 9.3.

However, most people rarely know the complex calculation method. Obviously, the current motor vehicle excise tax does not support alternative energy, inefficiently uses up energy and not concerned about the

Table 9.3 Some parts of motor vehicle excise tax

Motor vehicle excise tax rates (%) informing towards taxpayers				**Real motor vehicle excise tax rates (%) of ex-factory price or CIF price**		
Engine Size for passenger car	E10	E20	E85	E10	E20	E85
< 2,000 CC	30	25	22	44.77	34.48	29.02
2,001–2,500 CC	35	30	27	56.91	44.77	38.40
2,501–3,000 CC	40	35	32	71.42	56.91	49.38
>3,000 CC	50	50	50	111.11	111.11	111.11

Source: www.excise.go.th.

environment. In addition, it has the complexity of calculation together with a variety of motor vehicle tax rates. The Ministry of Finance made it simpler by submitting a motor vehicle tax reform that will be used at the beginning of 2016. First, the level of CO_2 is based for tax calculation to support using efficient energy. If car emits CO_2 in excess of the standard, it will be charged a tax penalty at 5% above the normal tax rate. On the other side, if car emits CO_2 at a lower rate than the standard, it will obtain tax bonus at 5% of the normal tax rate. Secondly, classifications of motor vehicles are grouped into fewer categories: from 43 types to 17 types. The new structure of motor vehicle tax is fair for entrepreneurs. The more you emit pollution, according to this law, the more you pay tax. Nevertheless, the problem of exaggerated ex-factory price claims does not decrease because it is still the tax base for calculation.

4.2.4 Nightclub and discotheque tax

Normally, nightclubs and discotheques are charged additional tax at 10% of gross receipt. However, most entrepreneurs rarely pay tax for nightclubs and discotheques. The main reason is unclear definition of what constitutes a nightclub or discotheque. The definition of nightclub and discotheque is that they are places for drinking and dancing and for having either a musical show or using a stereo for entertainment. Even if the place has no clear dancing area but dancing frequently happens inside, it is classified as a nightclub and discotheque. So, many places avoid the tax by displaying a sign that says ‘No Dancing’.

With this unclear definition, it follows that taxpayers avoid the tax. As a result, the government has lost tax revenue. Moreover, complex tax calculation is too difficult to communicate to taxpayers that it is inclusive tax. So, retail price should be tax-based. Otherwise, they

should be levied by specific taxes such as tax per ton, per stick or per litre and so on.

5 Simplifying taxpayer communications

Three main revenue departments attempt to communicate new regulations, announcements via websites and also via social media towards taxpayers. Leaflets and formal letters are sent to listed companies, and to tax consultant companies when there are some amendments of the Tax Act or new regulations. At the beginning of year 2015, the Revenue Department amended the definition of a group of persons that relates with sharing profits and also added items on the tax invoice such as Tax Identification Number and the address of purchaser. It uses a variety of channels to communicate the new regulations to taxpayers. Furthermore, the director-general communicates new regulations via newspaper and television. Free training courses to inform taxpayers of new tax knowledge are arranged by the Revenue Department. However, most of the seminars occur in Bangkok.

With forthcoming of Asean Economic Community, three revenue departments simplify foreign taxpayers with English. Tax knowledge, the Revenue Code, Excise Tax Act and Customs Tax Act are shown on department's website. A tax calendar and electronic form can be downloaded from website and also from app store. Finally, call centres and clinic tax are tax advisory. They are beneficial for entrepreneurs and stakeholders to ask any information about tax. However, it may be difficult for foreigners, because call centres and tax clinics speak exclusively Thai.

6 Simplifying tax administration

The Ministry of Finance of Finland[9] (2001) defines the taxation process as consisting of gathering client data, verifying the client's taxation status, making taxing decisions, refunding tax, collecting overdue tax and transferring taxes and charges to the revenue budget of the government. OECD (2001b) reports that the core functions of the tax administration were tax collection and imposing sanctions for noncompliance. Tax collection could be categorised into two main sub-functions. They are: collection of taxes from taxpayers who pay voluntarily and the collection of delinquent taxes. In addition, the gathering and processing of information are significant mechanisms of tax administration. To put it briefly, good tax administration should be concerned with collecting

revenue, gathering or processing taxpayer information efficiently, interacting with tax organisations both in domestic and in other countries and paying or refunding taxes and verifying the clients' taxation status.

The Revenue Department is a public organisation that receives accolades from the Thai population and tourists alike in terms of good service organisation. In 2012, the Revenue Department won two rewards from the office of the public sector development commission. Firstly, it was awarded 'Excellent service for VAT refund for tourists with cloud computing'. This system links data between the Revenue Department and Customs Department with a smart card. It helps decrease of time processing for tourist VAT refund. Secondly, the Revenue Department won best ICT award. Apart from providing information on their website, taxpayers can simply file taxes online for all types of tax. Online services were extended to VAT registration, credit card payment and also the connection of the database to other public organisations. Taxpayers can file taxes via smartphone in the channel of smart tax. Interactive call centres can answer tax queries. It can be said that the Revenue Department has an outstanding IT network and infrastructure. With a modern database, a transaction control log system can be used to facilitate the tax payment process. In other words, data of all types of taxes are linkage and tax officials can, in real time, examine the status of tax payment. It makes, of course, tax administration simpler for both tax officials and taxpayers. Apart from the Revenue Department, the Excise Department has taxpayer service. Taxpayers can make electronic filing, such as extend a license for selling liquor and tobacco, make a tax payment online and have a call centre like the Revenue Department.

The Customs Department facilitates importing and exporting with e-import, e-export and e-tracking. In case of an exemption from inspection (Green Line) of export, an exporter has no need to meet the customs officer and also has no need to print the original copy of the declaration. However, if there is a problem about the export permission (Red Line), inspection will be produced to the Customs Service Unit at the port of exportation within 15 days from the date of balancing the goods. In terms of import, E-import can diminish the working steps to be more streamlined. It links data to release of goods at the warehouse or the port more quickly. This generates quick resolutions and makes taxpayers happy.

The Excise Department linked the list of information and designed IT systems to support linkage and transferring database to the Customs Department's National Single Window System. In terms of interacting with other countries, the Excise Department is the core for cooperation

on excise tariffs among ASEAN countries, particularly liquor and tobacco products.

As can be seen, three main revenue departments attempt to make tax simpler. However, it has some complex tax administration as follows: Different goals of parties, complicated tax structure, inconsistency of politics and government policy, focusing on revenue collection and negative attitudes of the taxpayer.

1. In terms of tax collection, the Ministry of Finance attempts to increase efficiency of tax collection but, perhaps, it needs collaboration with other parties. Revenue collection of tobacco tax will increase if smokers consume continuously. It has, of course, a conflict with the Ministry of Public Health that aims to decrease tobacco consumption. Tax structure of petrol and motor vehicle are concerned with many parties: the Ministry of Finance, the Ministry of Industry and the Ministry of Energy and also the Federation of Thai Industries. It may make more complex tax administration because the goals of each party are totally different.
2. Complicated tax structures are a cause of confusion of taxpayers' understanding in their duties and responsibilities. Thailand has many important taxes that are levied from direct taxes, such as personal income tax, corporate tax, petroleum income tax, indirect taxes such as VAT, specific business tax, customs duties, excise tax and stamp duties. In addition, there are some taxes that are levied by the local administration. Furthermore, most Thai taxes have a multiplicity of tax rates, lots of deductible expenses and allowance both in personal income tax and corporate tax and lots of exemption in taxes. Obviously, there are 43 different excise tax rates for motor vehicle tax. A variety of tax rates causes difficulties of administration. Many taxpayers do not have enough knowledge of tax laws and fail to fill tax return forms. In contrast, with the complexity of Thai tax laws, it stimulates finding loopholes of tax avoidance.
3. One of the Thai political problems, as in many countries, is inconsistency of government policy. For example, obviously, before an election, the government announces a subsidy of the petrol price. However, after the election, the new government changes the policy by using a floating-price petrol policy because the government can not subsidise the petrol price. Nevertheless, the most important problem of Thai politics is instability of government. Even though Thai politics had the highest stability in the era of the former Prime Minister Thaksin Shinawatra from January 2001 to February 2006,

his government faced massive allegations of corruption. As a result, it caused public protest. Finally, it led to the military coup in September 2006, and it happened again in May 2014. Many countries seem to not accept the government from the military coup. Foreign investors were reluctant to invest.

4. The Ministry of Finance focuses more on revenue collection targets in each fiscal year. Government launches lots of policies that needed revenues from the Ministry of Finance to support government expenditure. So, it is a huge burden of the Ministry of Finance to support revenues, particularly, from taxes. Controversially, government tends to not support policies that can increase tax revenues, for example, every government decided to extend reduction VAT 7% from 10% until now (year 2015). Sujjapongse (2005) mentioned that 1% increases in VAT can increase 30 billion baht but leads to 0.95% reduction in GDP growth. Government supported tax incentives such as tax allowance of 30,000 baht in personal income tax is provided for taxpayers who take care of their parents, the exemption of assessable income was changed from the first 60,000 baht to the first 150,000 baht to decrease the burden of taxpayers who have low income. However, these policies affect overall revenue collection of the Ministry of Finance. So, it is the problem of the Ministry of Finance to increase the efficiency of tax administration to achieve its revenue target.
5. The fifth main tax administration in Thai is taxpayer's attitude. Taxpayers' attitude towards Thai tax officials and three main revenue departments tends to be negative. Many taxpayers do not see direct benefits from paying tax, but they perceive tax evasion from some large companies via the media. Taxpayers, particularly the middle class and lower class, feel that they are unfairly treated. They feel that the revenue department is strict with them and tend to ignore auditing some large companies that cooperate with politicians. Thai taxpayers believe that even the leader of government avoided paying tax and abused his power to protect his businesses. These attitudes are one of the causes of increase in perceptions of tax evasion and corruption. Finally, perceptions of evasion and corruption in Thailand are prevalent in every level of all three main revenue departments. There are many types of tax evasion and allegations of corruption. Some of them incriminate only tax officials or taxpayers. However, some cases occur from both parties. There are lots of news stories about arresting those who smuggle petrol, cigarettes, tobacco, logs and intellectual property infringement goods both at the border and at the port.

These problems are too difficult to solve within a short time period. Stringent penalties and more auditing may reduce tax evasion and corruption in Thai society.

These problems shown above may be difficulties for simplifying tax administration. However, it is not too difficult to solve. In the next section, we will suggest some strategies for tax simplification.

7 Longer term and strategic approaches

As can be seen from previous sections, Thailand attempts to make tax simplification in a variety of aspects. Tax reform by was introduced since 1992 with the launch of VAT. Corporate tax was decreased from 30% to 20% in 2013 to motivate foreign investors to invest in Thailand. Personal tax allowance makes fewer burdens for the individual taxpayer. Self-assessment makes it easier for taxpayers to pay taxes and reduces compliance costs. The Customs Department changed its slogan from maximise revenue collection to making it faster and easier for importers and exporters. E- Export and E-import are recommended to decrease procedures and can release goods more quickly. The Excise Department restructures motor vehicle tax by decreasing numerous tax rates and changing tax calculations from engine size to CO_2 emission. In addition, VAT is now deducted with reference to the wholesale rather than the ex-factory price to reduce the scope for manipulation. The Revenue Department makes things simpler for foreign taxpayers with an English E-form. Tax knowledge in English can be accessed via their website. Moreover, new regulations and announcement can be searched on the website and also on smartphone. These improvements made taxpayers happy and made communication easier.

Nevertheless, among attempts to simplify taxation, Thailand still faces tax complexity. Loopholes of tax laws and unclear definitions cause an increase of tax avoidance. Even though tax restructuring makes things fairer for the taxpayer, it still causes tax avoidance. For example, inheritance tax can be easily avoided by sharing inheritances to relatives before death. Motor vehicle tax structuring can solve the problems of declaring lower price because ex-factory is still tax base. The mixed system of liquor tax brings real tax complexity of calculation. More importantly, the three main revenue departments work separately. As you can see, if taxpayers want to make a tax payment – VAT, excise tax and customs tax – they must pay tax three times separately. It is not a one-stop service. So, the tax entities need more collaboration.

Even though self-assessment systems and online services are being developed continuously and improved, documents are still needed in some cases to cross-check with the costs. In the case of excise tax, entrepreneurs must finish daily accounts and monthly balance sheets showing particulars of the raw materials within three days, and submit to tax authorities within fifteen days of the following month. The Revenue Department added items of tax identification number and address of purchaser in tax invoice. This makes compliance costs towards VAT entrepreneurs.

In terms of strategic approach, Thai taxation can be simplified as follows:

1. To decrease problems of informing lower ex-factory price, the simplest way is that customs tax and excise tax should be collected by a specific tax rate. In other words, tax should be levied by a quantity such as per litre, per kilogram, per stick or per bottle. Furthermore, they may change tax calculation from ex-factory price to retail price to decrease the problem of declaring a lower ex-factory price.
2. Another possible way to simplify tax structures is that the government should simplify tax laws and procedures to reduce misunderstanding and confusion among taxpayers. Additionally, public relations and taxpayer education should be enhanced so that taxpayers clearly realise and understand the importance of their duties. More significantly, communication of new regulations and rules towards taxpayers in numerous channels will decrease tax complexity.
3. When AEC is put into place, 10 countries will be aggregated as a community. However, countries have their own tax structures. To simplify for tax administration, at least, it should have a framework of tax harmonisation in these 10 countries. Linkage of taxpayer information among countries will be beneficial for good tax administration.
4. Taxpayers' attitudes cannot be overlooked. Most importantly, the government must make taxpayers happy to pay tax. In other words, taxpayers should receive some benefits and welfare from tax payment. When they feel that they are treated fairly, it will increase voluntary tax compliance. However, tax evasion and tax avoidance from politics and large companies were found as usual. Adjusting of tax rates were known by those who have insider information. In terms of strategic approach, transparency will increase the positive attitude towards tax paying among taxpayers.
5. Another strategic approach that should be recommended is risk management. Categorisation of taxpayers based on characteristics

and behaviours can decrease times for auditing by tax authorities. In other words, good taxpayers should not be much audited, whereas more risky taxpayers should be strictly audited by tax authorities. Revenue departments should analyse cause of nonvoluntary tax compliance. Perhaps, the cause stems from complexity of regulations and rules, not from taxpayers.

8 Conclusion

Tax simplification is attempted in every country, including Thailand. Simplification means an increase of voluntary tax compliance from taxpayers, efficient tax administration, and clear tax laws. Good information technology helps taxpayers. Three main revenue departments pursue tax simplification continuously from tax restructuring, closing loopholes in tax laws to decrease tax evasion and tax avoidance, making e-forms in English and developing online service from tax payment, communicating new rules via several channels and so on. However, tax complexity has continuously appeared. Complex tax calculation, non-one stop service, interpretation from tax laws can still cause difficulties. Documents and daily account arrangements are still needed from tax authorities. Perhaps collaboration among parties, risk management and public hearings from taxpayers can increase tax simplification. Alternatively, it is suggested that setting up an independent tax institution may be a way to increase Thai tax simplification and further develop the tax system.

Notes

1. Source from http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_En.pdf
2. The definition of non-registered ordinary partnership is group of persons more than one person making the business profit. Group of persons are similar to non-registered ordinary partnership but they do not need to make the business profit such as exhibition arrangement for donation.
3. Personal income tax is calculated from assessable income for 7 progressive rate from 5%-35% and exempted for assessable income lower than 150,000 baht. So, if assessable income of each group of persons is less than 150,000 baht. They have no duty for making a tax payment.
4. Source from http://apps.who.int/gb/fctc/PDF/cop5/FCTC_COP5_8-en.pdf
5. From the equation for tobacco excise tax calculation, excise tax = ((ex-factory price or CIF price)* tax rate) / (1-tax rate). So, if tobacco excise tax rate is 87%, actually, excise tax will equal 669% of ex-factory price or CIF price.
6. Three types of liquor tax consist of fermented liquor, distilled spirit and absolute alcohol. Fermented liquor has 4 types: beer, wine and sparkling wine,

local fermented liquor and other fermented liquor. Distilled spirit consists of white spirit, blended spirit, special blended spirit, special spirit and other spirits. Absolute alcohol composes used in industry, used in medicine and used in others.

7. From the equation for liquor excise tax calculation, excise tax = ((ex-factory price or CIF price) * tax rate) / (1–1.1tax rate). So, if liquor excise tax rate is 60%, actually, excise tax will equal 176.47% of ex-factory price or CIF price.
8. Ad Valorem Rate = the percentage of the last wholesale price deducted VAT.
9. Source from www.vero.fi

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10
The Complexity of Tax Simplification: Turkey Perspective

Tamer Budak and Serkan Benk

1 Introduction

Tax complexity is not a new phenomenon, though it has reached new heights in recent decades. When income tax was enacted the first time, it was aimed at applying to a minority of people, tax rates were modest, and complexity was not a problem (Morris 2012, p. 256). Ever since, excessive complexity has been a constant complaint of taxpayers as well as being a favourite theme for the reformers (Pollack 1994, p. 322). Problems of tax complexity have drawn criticism by all reformers, including politicians and economists for years. There is a common unanimity that the tax systems are very complicated, and that this heavy burden of complexity affects all taxpayers alike (Norman and Collier 2009, p. 3).

As in the case of many countries, the reasons for tax complexity in Turkey may be construed as a public policy, fiscal incentives, true reflection, avoidance, transfer pricing, capital items, structural, tax neutrality, symmetry, tax capacity, miscellaneous and other factors.

2 Main features of Turkish tax system

The Turkish tax regime is a multi-tax system. The system can be classified under three major headings, namely; Income Taxes, Taxes on Expenditure, and Tax on Wealth. Income Tax includes Personal Income Tax (PIT) and Corporate Income Tax (CIT). Taxes on Expenditure cover Value Added Tax (VAT), Special Consumption Tax (SCT), and Banking Insurance Transaction Tax, Stamp Duty, Special Communication Tax, and Tax on Customs. Taxes on Wealth is composed of Inheritance and Gift Taxes, Property Tax, and Motor Vehicle Tax (RA 2006, p. 17). The rules of taxation regarding individual income and earnings are provided

under the Law of PIT 1960. For the taxation of corporations, the rules are contained in the Law of CIT 2006.

Taxes that are taken in indirectly are divided into three major types: taxes on consumption of goods and services, stamp tax, and foreign trade tax. Consumption of goods and services that fall under indirect taxation are extensive and come in a variety of forms. In regards to VAT, Turkey can not be referred to as different from the Organization for Economic Co-operation and Development (OECD) average. The reason is the extent of the other two types of taxes on consumption of specific goods. In fact, consumption taxes constitute a significant share of tax revenue. The existence of a large informal sector that is not easily taxable is an important characteristic of developing economies. The considerable size of the so-called informal sector/economy affects the taxation mechanism and makes it difficult and costly to collect taxes. Informal economy in Turkey in 2013 was determined in the GDP as 26.5%, which was well above the European Union average of 18.5% (Schneider 2013, p. 3). As a result of lower administrative costs of tax collection in indirect taxes than those in direct taxes, developing economies depend very much on indirect taxes (Ardic *et al.* 2010, p. 2). With the consideration of the proportion, the total tax revenue in the GDP was 23%. In terms of tax types, the proportion of PIT was 4.083%; the proportion of CIT was 1.85%; the proportion of VAT was 6.45%; the proportion of SCT was 5.47% in GDP. At the same time, 57% of the total budget incomes of 2013 were only gathered from indirect taxes (VAT and SCT). Therefore, the Turkish taxation system significantly feeds from the indirect taxes (Maliye 2014, p. 34).

3 Simplification of tax system

A number of applications are required to be carried out by the Turkish tax system on the subject of the simplification of both tax compliance and distribution of tax revenues in the budget. Hence, complexity in the tax system has a negative effect on both taxpayers and tax authorities. Not only is the complexity compelling taxpayers to fulfil their tax obligations quickly and accurately, but it is also causing negative affects and extra burden on the tax administration, causing an increased workload in the tax jurisdiction (Budak *et al.* 2014, p. 12). On account of jurisdiction, in 2012, the number of tax-related lawsuits in the Council of State's offices were 83.142 (Justice 2012, p. 14). It is worth mentioning that, in 2003, while the number of cases filed in tax court as court of first instance were 97,568, in 2013 the number increased considerably to 168,683 (Adli Sicil 2013, p. 12).

The main tax reform initiatives that are related to tax simplification in the Turkish tax system have been criticized for their complexity. This complexity has deteriorated because of tax policy instability as well as high and unstable inflation rates in the past. Complexity and instability are a result of the propagation of special additional taxes and surcharges due to urgent pressure to reduce the fiscal deficit (OECD 2004, p. 6). The main aim of the reform strategy was to improve stability, equity and transparency of the taxation system that was to be achieved through measures that broaden the tax base, minimize tax distortions, and advance the competence of the tax administration. The strategy had three main elements:

- Rationalization of indirect taxation by replacing several taxes with one single tax (SCT).
- Rationalization of personal and corporate income taxes.
- Reorganization of the tax administration.

In this context, to make the tax system more rational and more modern, many initiatives had to be implemented. Although Turkey has a considerable level of informal economy, this situation is one of the main indicators that voluntary compliance to tax is not at an adequate level. Also, one of the most important reasons why informal economy and tax compliance are not at adequate levels is the complexity of the tax system. Notwithstanding this fact, although there is no project carried out by any specific committee for the simplification of the Turkish tax system, goals such as the simplification of the tax system; continuous improvement of the quality of service provided to taxpayers; the standardization of taxpayer process and increasing tax awareness in all sectors of society have been set on a regular basis since 2003 in the various strategic plans and annual reports of the Ministry of Finance (MF) (GIB 2014a, p. 32). Moreover, in this regard, in 'Action Plan Against Informal Economy (2011–2013)' by the MF, all kinds of declarations, notices and forms used by taxpayers on tax-related processes were revised and aimed to be clearer, simpler and straightforward in order to increase voluntary compliance (GIB 2011a, p. 6). In terms of this process, different applications entered into force independently in different years.

3.1 Review/rewrite tax code: Integration of tax codes

Almost all tax reforms target one main goal: to increase tax revenue. But Turkey's tax reforms were based on two different goals in recent decades, 'simplifying' and 'modernizing the tax system'. Since the

beginning of the 21st century, the aim of creating a legal infrastructure which is compatible with the needs and realities of the time played a major role in addressing the issue of legal system in general in Turkey. In this context, the new Civil Code and the Penal Code were rewritten. On the other hand, after reaching an agreement by eliminating the factors that caused insecurity in the economy, consideration for radical changes began to be implemented. Structural transformation in the Turkish tax system was attempted in the shape of three main principles, as follows:

- To be understandable and applicable in a simple way by citizens regarding the main principles of tax legislation,
- To have a legislation with a stable and foreseeable structure,
- To provide better quality service for taxpayers and to have an administration which promotes voluntary compliance.

With a coherent tax strategy, a legislative package in the direct tax reform was implemented as of January 2004. It was aimed at harmonizing the tax rates on income and system of investment incentives with financial investments. Also, it aimed at reforming the system of income tax credit and simplifying the taxation of corporate earnings and dividends. The goal was to bring Turkey's PIT and CIT regimes closer to the OECD standards. In this manner, a simplification of the complicated and bureaucratic investment tax allowance system was carried out for the first time in 2003. Allowance rates of 100 and 200% were replaced by the new system of a uniform 40% investment tax allowance. The new allowance represented a simplification due to its automatic mechanism. The new system is much simpler, more transparent and incurs lower compliance costs (OECD 2004, p. 6).

To lessen the tax burden on taxpayers, at the end of 2004, the marginal PIT rate was reduced from 40% to 35% for wage-income and for non-wage-income owners to be reduced in 2005 from 45% to 40%. With an amendment to the PIT Law in April 2006, a rearrangement of the structure of the PIT tariff occurred, both the tax rates and the number of tax brackets. The new PIT tariff has four tax brackets instead of the previous five, and the tax rates currently stands from 15% to 35%, progressively. In addition to this, the different tariff for wage and non-wage income were unified. On the other hand, the CIT rate reduced from 30% to 20%, with a competitiveness contemplation in parallel with the developments in European Union and OECD countries (OECD 2004, p. 7).

In 2005, Turkey's State Minister for the Economy declared that 'What is important for us is that the system is modernized and aligned with

world standards'. Turkish income tax was the big problem, both personal and corporate. At the same time, the Revenue Administration (RA) stated that 'the old CIT code was not satisfying the need of foreign investors'. Because the former Code of CIT was very complex and clumsy, there was a lack of provisions for modern tax concepts such as transfer pricing and foreign participation. It has to be pointed out that the former CIT was a major barrier to reasonable business planning. Furthermore, the Code contained scores of temporary provisions, and some of the temporary provisions overruled the permanent provisions, leading to ambiguity and inefficiency. As a result, the government was alarmed that the CIT code was obstructing direct foreign investment (Otonglo and Trumbic 2006, p. 68).

In the name of rationalization and simplification of the tax system, the project of rewriting CIT Code was initiated. At the beginning of 2005 a Corporations Tax Act bill was passed, based on social consensus, and entered into force and became the new law with broad participation of public, private sector, civil society organizations and academics under the supervision of the MF on June 2006. The new corporate taxation concept came about to alleviate the situation, especially in areas that were hardly regulated in Turkey before. The new changes manifested themselves in transfer pricing, foreign participation exemptions, anti-avoidance measures, and provisions explicit to controlled foreign companies. The new transfer pricing provisions attracted the attention of the multinationals based in Turkey. Turkey's law formally adopted the arm's length principle established by the OECD regime. Another remarkable change is the coming into force for the first time of the anti-abuse legislation as part of Turkey's tax law. The aim of this creation was to enhance the efficiency of the tax collection system and at the same time seal loopholes, particularly in regards to tax havens. Revenue of CIT has risen more than twice during 2006–2013 period after a simplified version of the article numbered 5520 of the CIT Law entered into force in 2006. While the previous CIT Code consisted of 19,448 words, the new one was reduced to 15,671 words. From 2006 until today, 23 articles of the new law have been changed and updated.

Current Law on PIT consists mainly of pensions, salaries, wages and similar remuneration for work. Income from self-employment, trade and agriculture are also considered earned incomes. All forms of earned income taxes are levied at a progressive rate. From 1963 to 1980, personal income tax tariffs did not change. Tax rate ranged from 40% to 75% in 1981 depending on earned income brackets. These were also the highest income tax rates of the Turkish income tax history. Later, top marginal

tax rate on earned income decreased from 55% in 1998 to 35% in 2010 (Celikkaya 2010, p. 52). Any changes made over time on PIT, which has been implemented since 1961, have disrupted the law systematically and have already made it more difficult to understand laws that were more complex. In addition, the PIT laws have affected the predictability of a multitude of temporary laws. In order to overcome the disadvantages brought by the dual income tax law, in 2006, the attempts to rewrite the New PIT Code were completed under the MF and on 13 June 2013, it was transferred to the Turkish Grand National Assembly (TGNA) Presidency. But, the New PIT Code has not been enacted so far.

There has been a new development in relation to the Codes of the CIT and the PIT in these days, so that Turkey is rewriting a new tax code, namely, the Unified Income Tax Law. The main feature of the bill is that all income taxes gathered through the tax system are to be collected in a single law. Going forward, the law that collects the income taxes of the people remaining separate from, CIT Law will end and a single Income Tax Law will be created by combining the two. The New Income Tax Law was designed to consist of 92 articles by combining CIT Law, which consists of 45 items and 39 pages and 26 of those exemptions plus the number of reliefs. The Draft Law on Income Tax is a simpler document, integrating the existing income and corporate tax laws into a single code. Several fundamental principles of taxation, such as income and gains definition (including financial and capital markets), definition of taxpayers (both for individuals and corporate), rates, exemptions, tax security measures has been retained. The planned reform represents an opportunity to support sustainable economic growth more efficiently and reduce the informal economy. The new Income Tax Code expects to simplify and narrow exemptions on speculative capital and property gains, which helps to make taxation fairer. To ensure the expected benefits of a reorganized tax structure in order to speed up income tax reform should be followed swiftly by a reform of the tax procedures code (World Bank 2014, p. 2). The redesigning of Incorporate Income Tax Law, former CIT article of 5520, which had been applied for 12 years with the aim of EU harmonization processes, was on the agenda again in 2013, despite the steps taken concerning both design and simplification of the new Incorporate Income Tax Law.

And therewithal, one of the main goals of the Performance Program of 2015 MF was that: 'the creation of tax legislation which is few in number, can easily be understood and compliance can be achieved' is determined. In this context, current tax legislation is aimed to be rewritten according to today's needs by simplifying in 2015, in order to

be clear enough, understandable and easy to integrate. In this regard, as well as the current New Income Tax Law, adaptation to economic and social policies of Tax Procedural Law (TPL), the main aim of this procedure is to review and establish a simpler and easier to apply tax system (Ministry of Finance 2014, p. 39).

4 Simplifying taxpayer communications: VIMER

It is fair to say that to have taxpayers voluntarily and properly pay their taxes is crucial, and the RA takes advantage of every opportunity to boost taxpayers' understanding of their tax responsibilities. In order to provide information directly to taxpayers, the RA's free e-mail information service has been put into practice as a part of the taxpayer-focused services. All actual information about tax applications and recent improvements in the RA website is sent to subscribers freely and simultaneously through the web-based informational system. As well as informing the taxpayer about tax codes, it also provides cabinet decrees, regulations, general statement, circulars, news from the RA and also the results of tax statistics, and activities are sent freely to subscribers.

Since the middle of the first decade of the 20th century, tax management in Turkey embarked on a number of enterprises in order to expedite work related to taxpayers. Furthermore, officials hoped to find solutions to problems related to the taxpayers and to improve interaction problems between the tax office and the taxpayer. However, the most important attempt was to establish the Tax Communication Centre (VIMER/444 0 189). The main purpose of the call centre (VIMER), which began its service on December 2007, is to answer taxpayers' questions on tax issues and assist them on procedural matters. The rights and obligations of the taxpayer would be explained and the information on taxation would be provided through the call centre's sample information, as well as filing tax returns, due dates of taxes and required practicable methods. The central focus of the new plan was to meet expectations and provide satisfaction for taxpayers (RA 2006, pp. 39–40). The number of calls answered by VIMER is constantly increasing; it exceeded 2 million on December 2013. In 2013, the average of responses to taxpayers instantly is 98.74% (Ministry of Finance 2014, p. 78).

As of 2010, the services offered by VIMER have been increasing. In this context, in addition to an 'Information Consultation' service, it added 'Notice Management' in September 2010, 'Call Back' in June 2011 and 'English E-mail Reply' services in May 2012. Moreover, VIMER, which is now the first access point of the RA, has led the way in establishing

a professional call centre for other public institutions. Also, a 'Taxpayer Satisfaction Survey' is carried out periodically by the RA in order to measure service quality and increase taxpayer satisfaction. In a recent survey in 2012, the taxpayer-satisfaction rate for services offered by the VIMER was 80.82% (GIB 2014a, p. 27). Since its establishment, VIMER has been providing, within the scope of information advisory service, answers to questions on issues related to Turkish tax legislation. Some specific questions by taxpayers are recorded by VIMER, and taxpayers are being called back by VIMER representatives within three working days after extensive research has been done on their issue. Incoming calls are answered in accordance with 'taxpayer-oriented service concept'. In 2009 answered-call numbers were around 200,000; by the year 2014 numbers approached 800,000. At the same time, providing solutions on the first call is important for the taxpayer-oriented service concept. VIMER's first-call resolution rates have remained above the 97% level since system began service. VIMER's goal is to increase this ratio to 100% level.

To meet the demand for information of foreign individuals and institutions outside of Turkey about the Turkish tax system and application, on 16 May 2012 'English e-mail service' began its operation. Under this service, when a foreign individual or institution fills out the form in English in terms of their tax questions, the questions are answered as soon as possible.

The number of e-mails that are answered in English are approximately 160/year. In terms of taxpayer communication and assistance, VIMER also coordinates the issuance of assistance services to taxpayers who cannot access certain tax services. Taxpayers above the age of 60, or taxpayers with disabilities or illness, will receive assistance from income and tax office workers to help them to fill in the declaration.

5 Simplifying and modernizing tax administration

The new tax strategy has also included tax administration issues dealing with institutional improvements, transparency, automation, taxpayer services, compliance, and tax audits. To be able to realize these reforms, by 16 May 2005, the new law on the organization and duties of the RA was enacted (Law on Organization and Tasks of Presidency of Revenue Administration, No. 5345 in Official Gazette No. 25817, on 16 May 2005). The aforementioned law's objective is to lay down the necessary legal basis to ensure that the RA operates on; the principles of transparency, accountability, and the participation of taxpayers. Collecting taxes in the most cost-efficient method possible and to ensure voluntary

compliance by taxpayers. In addition, to take necessary measures so as to help taxpayers meet their liabilities by providing them with high-quality services based on the respect for the taxpayer rights. The main institutional and organizational change brought about by the law is the formation of a semi-autonomous tax administration that will be operating on a functional basis. RA has a plan to carry out their tax responsibilities by simplifying the system and to provide essential assistance to the taxpayers as a means of minimizing the burden on citizens. In order to achieve its mission; the administration has established the following strategic objectives for improvement during the years of 2004–2006:

- Improve efficiency and effectiveness of the tax administration,
- Establish a modern integrated IT support system,
- Rationalize and simplify the tax system.

To reach the targeted objectives, the Tax Policy Department of the MF is upgraded, and the tax audit management capacity has been strengthened. Regarding main organizational change, an entirely new function was assigned to the RA as a part of the reorganization process. For the first time, functions such as taxpayer services, audit, and strategic planning were introduced and organized both at the headquarters' and the local level. As a complementary component of the strategic planning function, a performance management system is also being established based on best international practices. This system is supported by the use of information technology (IT) and management information system in performance measurement. The tax policy function, alternatively, has shifted to the General Directorate of Revenue Policies, separately established under the MF as one of the main service units of the MF in February 2006 (OECD 2004, pp. 5–6). Substantial progress in strengthening its IT infrastructure is in progress. However, it still needs to improve its capacity fully to use the wealth of data assembled from the IT systems in its operational activities, especially regarding audits (Ter-Minassian 2009, p. 6).

5.1 The declaration of taxpayers' rights

The RA has aimed to work with principles of transparency, accountability, participation and taxpayer-focused policy by serving rapid, accurate, complete information and high-quality services, and by respecting taxpayer rights. It has given importance to informing taxpayers, improving voluntary cohesion to tax laws and making taxpayers conscious of their responsibilities and rights. Within the context of these

studies, towards the realization of an effective cooperation between the RA and taxpayers, The Declaration of Taxpayers' Rights was published, in order to achieve a clear determination of taxpayer rights and responsibilities. With this Declaration, Presidency of the RA affirmed their commitment in performing the following:

- We will serve with clear, reliable and adequate information on time.
- We will direct you to get in touch with the correct people for all sorts of information within the framework of The Law of Information Obtaining Right.
- We will announce the improvements about tax by our continuously updated website and printed documents within the shortest possible time.
- If you subscribe to our e-mail system, which is free of charge, you will learn tax improvements at the source and instantaneously.
- We are respectful of your personal information. We will not use this information except the cases that TPL requires.
- We will provide you with help in the fulfillment of your tax obligations.
- While implementing operations, realizing regulations, we will refer to the principle of the application of tax laws by fair, legal, impartial and maintaining competition.
- In the tax examinations, we will openly, impartially and consistently implement the tax laws. We will inform you at every stage of tax examination.
- If you notice your complaints with your true identity and communication information, we will respond to you with a result in the shortest possible time.
- We will renew ourselves consistently and be in search of presenting more qualified service to you.

Even though, various regulations have recently been released, and information has been provided regarding taxpayers' rights and their implementation, it remains a considerable challenge for the taxpayer to keep abreast with the new rules, regulations and their related legal rights. For the concerned rights to be fully implemented, the incomplete legal regulations have to be completed without delay, a provision entitled taxpayer's rights has to be included in the TPL and all the rights have to be itemized under this provision (Yurtsever 2010, p. 345).

Besides the declaration of taxpayers' rights, a number of services and projects have been set-up to simplify tax administration. The most

important of which are e-Tax Office, e-Notification, e-Tax Return, Interactive Training, Proposal Development System, BTrans (electronic information system), Tax Office's Full Automation Project (VEDOP), The Data Warehouse Project (VERIA), Electronic Accounting Registration Archives System Project (EMKAS), Local Tax Auditors Automation Project (VEDOS), Motor Vehicles Tax Offices Automation Project (MOTOP), Tax Identification Number Application, and Publication of brochures.

5.2 Tax office automation project: VEDOP

It is worth noting that VEDOP started as a pilot project in 1995. The first phase, which included the period from 1998 to 2001, had a budget of USD $75 million. The second phase of the VEDOP project began in 2004 with a budget of USD $64 million. RA was the responsible agency, which is a semi-autonomous agency within the body of the MF with 44,000 personnel (OECD 2007, pp. 134–135). Reducing the workload of tax offices has been achieved by using the IT system, increasing the effectiveness and efficiency of tax administration studies and from the information collected on IT management system database. As of today, 599 tax offices around Turkey have been operating within the scope of VEDOP.

Correspondingly, e-government applications and taxation services are being implemented by the use of IT services on a large scale (Cakmak *et al.* 2011). It is also implementing a variety of different taxes with different collection time periods. Today, typical businesses have to prepare on an annual basis more than 30 tax returns and declaration forms as well as visit tax offices to submit tax returns nearly three times a month. On top of wasting the taxpayers' time, the paper-based system could be regarded as the misuse of the tax officials. In order to alleviate this problem, tax office automation projects have three main goals: to ensure equitable distribution of the tax burden, to make tax collections more efficient, and to provide better services to taxpayers and businesses (OECD 2007, p. 78).

5.3 Modernization of RA's web page

Since the RA modernizes the system and taxpayer satisfaction as a principle, it strives to develop the technological infrastructure aimed at spending less time in fulfilment of tax responsibilities and accessing information in a faster manner. Through technological improvements, the RA endeavours to improve its website in terms of innovation and speed through delivering the correct information concerning the tax law and its applications to taxpayers in the fastest way possible. Furthermore,

the RA uploads helpful and informative documents, namely: the most frequently asked questions (FAQs) for their reference. In addition, they provide up-to-date information regarding the latest changes to the tax law in the country. The latest improvement in that organization and tax system can be followed up through RA's website, which continues to develop as an indicator of updated information to the wider society and to provide transparency and accountability to the public.

Substantial changes have been performed on the website of the RA in recent years in order to provide the taxpayers a better and simpler service. Necessary groundwork regarding this context has been created to allow taxpayers to perform the operation through the taxpayers' website, by performing tasks such as Tax ID Check for companies and for foreign nationals, E-Tax Plate Check, Tax Debt Check, E-invoice, E-book, VAT return operations check, and reaching the tax statements and petition check. Additionally, a smartphone application has been created within the scope of Debt Check Service.

5.4 E-filing and invoicing

It is obvious that the RA has focused on taking advantage of the latest technology, including e-filing for online tax returns and filing assistance on the website based on e-government, to help reduce taxpayers' tax return filing burdens, transform tax offices from operational units to specialization units by minimizing their workload and collect information for the data warehouse like balance sheets, income tables, and all other forms. In fact, e-filing was established in October 2004 and widely accepted in a very short period of time by the taxpayers, and therefore its usage ratio is continuously on the increase. Forty-three different types of declaration and appendices can be sent as e-declaration via the internet. Username-password pair is being used for authentication and its infrastructure is already attuned to Digital Signature (GIB 2014a, p. 65). In Turkey, 99% of taxpayers now present their returns electronically with 25 banks and post offices enabling e-filing. Participating revenue bodies, within their respective legislative environments, have instigated initiatives to boost the use of electronic filing channels and payment options. Using electronic services to reduce costs of compliance and administration has been a significant driver of their increasing use in Turkey (OECD 2011, p. 55).

In addition, in 2008, the introduction of electronic invoicing has saved companies from having to issue hard-copy invoices. Inspired by this, the MF is looking to extend the use of electronic invoicing to all kinds of taxpayers such as companies, but initially, a focus would be directed

at business transactions. The ultimate aim is to create cost efficiency for companies as they are obliged under current guidelines not only to issue hard-copy invoices, but also to store them for ten years. The removal of hard-copy printing should eradicate the associated storage and printing costs. E-invoicing also brings upgraded transparency that makes both internal and external audits easier (Gunduz 2014, p. 98). In parallel with the transformation of taxpayer-focused in developed countries in order to increase the quality of public services, RA has been brought into a taxpayer-focused structure in the restructuring process.

5.5 Pre-filled rental income tax return system

In return-free systems, the government tax authorities rather than the taxpayer, is the instigator of returns for eligible PIT filers, and makes use of a range of third-party information sources. The two general types of return-free tax systems are: Pay As You Earn (PAYE) and Tax Agency Reconciliation (TAR). The Turkish system is based on TAR. According to the TAR system, eligible taxpayers can choose to have the tax authority prepare their return. Taxpayers are offered a chance to provide basic information to the tax authorities, who then calculate the liability based on that information plus the data it receives from employers, financial institutions and other parties concerned. The taxpayer reviews the government's prepared form and may subsequently accept or override the calculations, and then would make a final payment or alternatively receives a refund (Cordes and Holen 2010, p. 5).

A pre-filled rental income tax return system is a service adopted by Turkey, in which the RA has prepared pre-filled tax returns by using data held by public institutions such as postal administrations, banks, insurance companies and land registry. The data is then submitted online to the approval of taxpayers. Taxpayers with rental income only or with no income tax liability can use this system. In the case of no liability record at the tax offices, it will be registered automatically after the rental income tax return is processed electronically. The payments for this rental income tax return can, therefore, be made through contracted banks or all tax offices. There is no obligation by taxpayers to use this system. Returns can be submitted in person to tax offices or electronically via E-return Preparation Program (TPA 2011, p. 80). The system that was introduced widely to the public through various television, newspaper, internet mediums with the slogan of 'We prepared your rent statement, you just approve' and 'It is not worth taking risks' has sped up both simplification of the tax system and voluntary compliance with taxes (GIB 2014c, p. 18) As a result, the number of the taxpayers

has doubled in the last two years due to the pre-filled rent statement. The rent revenue that was declared has increased 65% compared to the previous year. In sum, the tax amount calculated for the rent revenues declared in March 2013, amount indicates an increase of 33% compared to the previous year (Milliyet 2014).

6 Training programme for children

Training for children related to taxation is an important topic for next generation in Turkey. In this aspect, tax awareness improvement education, informing children about taxes in accordance with the child's developmental level and starting from elementary school raising the consciousness of all individuals in society concerning tax education could be done in collaboration with the Ministry of National Education (MNE) and the MF. In this context, students in the 3rd and 4th grade of primary school will be at the first stage of this process, and then middle and high school students would be involved in this educational process. Within the scope of this process, appropriate education was given to 4,915 million students in 81 provinces (GIB 2014a, p. 74). One of the important projects related to child-training is the VERGIBILIR (Tax Awareness) Project.

The Project is conducted by the Presidency of the RA in cooperation with the MNE under the 'Vergibilir Study Protocol' announced on June 2007. The target audience of the Project is approximately 4 million primary school students in 3rd, 4th and 5th grades. The main object of the training is to teach and to raise tax awareness related to the some questions.

- What is tax, and who pays tax?
- Why are taxes necessary?
- Where and how are taxes spent?
- How are tax collection and budget spending audited?

In this concept, materials of the project includes visual stimulus, teacher handbook, student book, and a related website (www.vergibilir.gov.tr) prepared by RA and MNE. Training is given by 299 trainers who are social science teachers, class teachers and trade school teachers educating on a volunteer basis and selected by the MNE from all 81 provinces in Turkey. A website was also prepared which contains educational and entertaining games, stories and different activities about tax. Within the scope of the project, 7 units of scenarios were

determined to search for solutions by identifying the given problem. These scenarios are converted into comics, and a certain problem is given at the end of each chapter. Problem situations are determined by the 'Seven Doors' approach. According to the aim of this approach, on created problems, students are responsible for identifying the problems, understanding the problems, and searching for solutions (GIB 2013). At the same time a CD called 'Vergibilir Songs' has been prepared for primary school students under this project, aiming at primary school children to provide for families and schools, to develop hygiene and nutrition habits and ultimately to raise tax awareness (Ministry of Finance 2007, p. 11).

6.1 Activities in tax week

One of the most substantial and long-term activities of the MF is the so-called 'Tax Week', which has been celebrated since 1990. This activity is organised in the last week of February every year in order to encourage the volunteer payment of tax. Its aim is to raise the tax perception and volunteer compliance of citizens by distributing fliers and brochures on which tax slogans are widely advertised throughout Turkey during the event week. Additionally, visits to Non-Governmental Organizations (NGOs) and occupational organization are carried out to inform them about the importance of tax; as well as to organize seminars, panels, and conferences across Turkey for this event (GIB 2011b).

Also, as an incentive, retro-style radios are given as a gift to the tax payers by the tax office employees during their visits, and a specially designed framed plate is presented to the national tax record holder. Radio advertisement spots and tax-themed programmes are aired on national and local television channels, radio channels and internet pages within the context of the event. Visits to various schools are organized, and gifts for the students are distributed within this scope. At the same time, since 1997, tax-themed painting, poetry and poster competitions are held with joint studies conducted between RA and the MNE in order to ensure awareness of the importance of tax to all segments of society and to increase the voluntary compliance to taxation, to teach tax concepts in the younger generation and to ensure the development of tax awareness at a younger age (GIB 2014b). However, it is worth mentioning that such activities have not contributed greatly to the compliance of the taxpayers in last 24 years. For this reason, the activities of tax week ought to be revised and turned into something more effective.

7 Long-term approaches

As a starting point, an expected long-term outcome of the tax reform is to increase tax revenue through broadening of the tax base, improving compliance fundamentals and sealing the gaps for revenue leakage. Indeed, Turkey expects to collect higher tax returns and simplify its tax system in the medium and long term (Otonglo and Trumbic 2006, p. 71).

The Tenth Development Plan of Turkey has been in force, having been published in the Official Gazette of (2014–2018) in 2013. Various aims have been set out in the plan regarding the tax and revenue policies. Fundamental principals which were determined in order to reduce the complexity of the tax system are as follows (Official Gazette 2013):

1. Additional resources shall be evaluated in a manner that they will raise the volunteer compliance and ensure a reduction of the grey economy and encourage the production and employment primarily the reduction of the operation taxes and to contribute to the economic growth.
2. The tax base shall be expanded in a manner to ensure a fairer taxing.
3. The fundamental tax legislation will be rewritten in a way that it will be simpler and compliant within the framework of economical and social policies.

Additionally implementation of various programs is one of the aims in order to reach fundamental principals as sub-goals. Improving the Quality of Public Revenue Programme is very substantial among them. The aim of this programme has been detected as follows: 'Collection of public revenues in a healthy and permanent way through modern methods for an effective public finance system is very important and taking not only the financial concerns but also the economical and social purposes into account in this process has become a necessity for the modern public management, Improving the quality of formulation of the revenue legislations, collection of revenues and informing the public becomes more of an issue'. A road map has been decided in order to reduce the time spent by the taxpayers for the compliance with tax and also to maximize the satisfaction of taxpayers and to ease the tax system, and these are:

1. Revision of Exceptions, Exemptions and Reductions
   - Foreseeing the financial effects of tax expenses emerged because of exceptions, exemption and reductions,

- Removal or revision of regulations which are not effective,
- Determination of the criteria regarding exceptions, exemptions and reduction foreseen to be included in the system and regular evaluation of implementation results.

2. Improving the Effectiveness of Tax Administration
   - Improving the human and technological opportunities of the tax administration,
   - Activation of taxpayers' services,
   - Reinforcement of the information shared between the tax administration and the public institutes and organization,
   - Improving the cooperation with foreign tax offices.
3. Improving the taxing practicability and predictability
   - Improving the predictability in the legislation and administrative implementations,
   - Implementation of tax legislation regulations in a process that is contributed by the public and the additives of the concerning parties,
   - Continuation of the studies to simplify the tax legislation,
   - Popularization of technology use in taxation.

Besides the Tenth Development Plan in Turkey, 'to reach the Turkish Republic's contemporary civilization level in 2023', it is the policy of the present government that the Turkish Republic's 100th anniversary can only be achieved through creation of a vision that has certain targets and the implementation of policies through a determination of the strategies that will help in achieving these targets. Within this strategy, some significant advances have to be achieved in the coming years. The aim of 'Turkey's Strategic Vision 2023' project is to develop ideas about how the strategy of Turkey should be in line with foreign policy and political, economic, sociocultural, technologic, and security related areas. The projects also aims at creating a far-reaching discussion environment about targets and policies. Even though not many goals have been determined regarding the taxation mechanism, the most important goal is to implement the tax reforms determined in advance within the frame of 2023 vision (TASAM 2008, p. 105).

8 Conclusion

The middle of the first decade of 21st century has been very important regarding the simplification of tax system, to increase the volunteer tax compliance and reorganization of the tax administration. While

the operation of the tax administration makes the modernization of the system and utilization of current technological developments more essential, it also makes the new regulations regarding the minimization of time and cost necessary. Within this scope, a series of implementations which can be regarded as reforms are put into force in different periods. However, it is odd that a professional technical unit such as the Office of Tax Simplification in United Kingdom, which researches about the simplification of tax system and increases volunteer tax compliance has not been established in Turkey. Hence, implementations put into force have not been able to be carried out within the scope of a strategic road map; they are implemented separately as a consequence. Despite everything, the aim of 'compliance and harmonization with the European Union' stands out as a fundamental factor for the reason of reforms. So the importance of the compliance process and technological developments cannot be ignored for the operations, such as rewriting the tax laws, applications aimed at taxpayers and reorganization of the tax administration.

The passive factor of tax relation for the implementation of the financial and nonfinancial goals of the current taxing, the importance of taxpayer perception and its psychological affect have increased. Therefore, tax administrations have tended to perform their operations aimed at taxpayers. The Turkish Tax Administrations provides a series of applications based on taxpayers both for the simplification and the modernization of tax administration not ignoring this trend.

In summary, Turkey has already made significant progress in establishing a modern tax system and tax administration. But this process cannot stop, because economic and social life are very dynamic and an ongoing process.

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11

The Complexity of Tax Simplification: The UK Experience

Simon James

1 Introduction

Complexity has long been a feature of taxation in the UK. For instance, the original Act of Parliament introducing the income tax in 1799 was a complex document of some 152 pages so that the government felt it necessary to issue a guide entitled *A Plain, Short and Easy Description of the Different Clauses of the Income Tax so as to render it Familiar to the Meanest Capacity* (Farnsworth 1951, p. 15).

There have been many proposals for tax simplification in the UK, for example, the independent Tax Reform Commission concluded that the level of complexity in the system was becoming unsustainable and reform was required (Tax Reform Commission 2006, p. 128). However, it has long been appreciated that tax simplification is a complex issue – see for example Cooper (1993). More recently, the Mirrlees Review (2011, p. 42) pointed out that, of course, a simple tax system is better than a more complex one if it achieves the same objectives. Among other things, a simple system is likely to be relatively transparent and cost less to operate. Nevertheless, the Review also pointed out that the world is sufficiently complex for it to be unlikely that any tax system could be truly simple. Proposals for simplification often do not give sufficient weight to the other objectives of the tax system and the complex and changing environment in which it has to operate. Perhaps the best way forward might be to take the different factors into account by developing a strategy for simplification (James and Wallschutzky 1997) as part of a more coordinated approach to the development of tax policy and reform (James and Edwards 2008).

This has not been the approach usually followed in the UK. Section 3 examines simplification of tax systems in the UK and shows that

significant improvements have been made regarding tax rates. Also, work expenses are often very simple in practice because many employees are not entitled to any. However in other important areas, considerations of simplification have not prevailed, for example in the reform of local government taxation and, so far at least, various proposals for the merger of income tax and National Insurance contributions. Section 3 looks at simplifying tax law and the work of the Tax Law Review Committee and the Tax Law Rewrite project, both of which, in the absence of simplification of the tax system itself, could do no more than make limited improvements. Section 4 turns to simplifying taxpayer communications. It is clear this is a major area, and UK tax authorities have often taken steps to improve matters. The biggest factor in the future is technological advances and there are proposals to replace the annual tax return with digital accounts. The knowledge that has been gained in improving taxpayer communications is likely to be at least as useful in the digital age and almost certainly there will be new challenges regarding simplicity. Section 5 turns to simplifying tax administration. The merger of the Inland Revenue and HM Customs and Excise in 2005 was a major reform with considerable scope for simplification but the experience also shows that reforming institutional arrangements in this way may involve significant difficulties. The Pay-As-You-Earn system of withholding tax at source has proved to be a major factor regarding simplification – avoiding the need for many taxpayers to have to complete an annual return. Section 6 turns to the setting up of the Office of Tax Simplification. Finally some conclusions are drawn in Section 7.

2 Simplification of tax systems

There have been some successful reforms regarding the simplification of the UK tax system, but in other areas simplification has not been achieved, suggesting perhaps that it is not always a priority.

2.1 The tax structure

Some significant initiatives to simplify income tax rates have been made over the years. Before 1973 income tax was levied at a single standard rate and surtax was levied at a series of higher rates on higher incomes. There was also a relief of two-ninths for earned income (but not investment income). In 1973 income tax and surtax were formally unified, with the standard rate becoming known as the basic rate and surtax as higher rates of tax. The two-ninths earned income relief was abolished, although the discrimination between earned and unearned income was

retained by the introduction of an investment income surcharge, but this was abolished in 1984. Furthermore, the number of higher rates was reduced from nine to five in 1979 and the range of income covered by each of the remaining bands widened considerably. In 1988 all the higher rates of income tax were abolished except one. Subsequently an additional higher rate was introduced in 2010. For the tax year 2015/2016 there were only three rates of income tax: the 20% basic rage of tax applied to the first £31,000 of taxable income, 40% to £31,785 to £150,000 and 45% to the excess.

A particular aspect of simplicity in the UK is that most income taxpayers pay tax at the 20% basic rate – an estimated 24.1 million out of a total of 29.8 million in 2014/2015 (HMRC, 2015). This is partly because it enables the cumulative Pay-As-You-Earn method of holding tax at source (described below) to cover incomes from other sources very accurately as rates can be set on the assumption that the basic rate is the correct withholding rate for most taxpayers. It also means that most taxpayers are able to establish without difficulty their marginal rate of tax, which would, of course, be much harder with a more graduated scale of rates.

However not all moves to simplify tax rates have been successful, which illustrates the importance of other considerations. One in particular related to an additional lower rate of income tax of 10%, which had been introduced at the bottom of the scale in 1992. To simplify the tax structure in 2008, it was brought into line with the basic rate. However, the government had failed to anticipate the strength of the public response that it was unfair that taxpayers on low incomes would be starting to pay income tax at 20% rather than 10%. Members of Parliament successfully campaigned against the new arrangement, and this led to an increased personal tax-free allowance to compensate those adversely affected. The eventual result was an improvement (Johnson 2008), but it also made clear that UK taxpayers often value fairness as least as much as simplicity.

2.2 Work expenses

One feature of the UK structure that can be particularly simple is work expenses for employees. Such expenses are only allowed against taxable income if they are 'wholly, exclusively and necessarily' incurred *in the performance* (authors' italics) of the duties of the employment and these conditions are strictly applied. (The self-employed are subject to less restrictive requirements in claiming expenses.) The result is one of simplicity, since in practice many employees are not allowed to claim

any expenses. Vaisey J. in *Lomax* v. *Newton* (1953 34 TC 558 at 561–562) indicated just how restrictive the arrangements are for employees:

> I would observe that the provisions of that Rule are notoriously rigid, narrow and restricted in their operation. In order to satisfy the terms of the Rule it must be shewn that the expenditure incurred was not only necessarily but wholly and exclusively incurred in the performance of the relevant official duties. And it is certainly not enough merely to assert that a particular payment satisfies the requirement of the Rule, without specifying the detailed facts upon which the finding is based. An expenditure may be 'necessary' for the holder of an office without being necessary to him in the performance of the duties of that office; it may be necessary in the performance of those duties without being exclusively referable to those duties; it may perhaps be both necessary and exclusively referable to those duties, but still not wholly so referable. The words are indeed stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the Rule is to be claimed successfully.

A recent illustration which received much media attention occurred when a BBC news reader's claim for the costs of professional clothing was disallowed. At her appeal (*Ms Sian Williams* v. *Revenue & Customs* [2010] UKFTT 86 (TC)), it was argued on her behalf that she would lose her job if she frequently wore the same clothes, and she would be willing to read the news naked, but the BBC required her to be clothed. However the appeals tribunal had little difficulty in finding that her clothing expenses were not incurred wholly, necessarily and exclusively in the performance of her duties. The provisions regarding work expenses may not be fair, but they can be very simple, and further discussion can be found in James *et al.* (2013).

2.3 Local taxation in the UK

Although it was introduced for other reasons, the reform of local taxation in the UK in 1989 and 1990 provides an important example of a major simplification to the tax system that proved to be unacceptable to taxpayers. This took place when the local property tax was replaced by the community charge as the major form of local taxation. The tax is described in more detail by Smith (1991) and Butler *et al.* (1994), but essentially it was very simple, with the same amount being levied on all adults in a local authority area (except for some relief for the poorest). This is why it became known as the poll tax, and its introduction in

Scotland in 1989 and in England and Wales in 1990 was followed by extensive protests and even civil disobedience. Indeed it was such a failure that it was a factor in the resignation of Margaret Thatcher as Prime Minister in November 1990 (Gibson, 1990). In 1991, only two years after its introduction in Scotland and one year in England and Wales, the government decided to repeal it, and it was replaced in 1993 by the council tax.

Apart from fairness, the community charge met the economic criteria not only for a good tax in general but also for a good form of local tax (James 2014). However, fairness outweighed all the other considerations including simplicity. Many commentators such as Vanistendael (1996) attributed the rejection of the community charge by UK taxpayers directly to its failure to reflect the ability-to-pay principle. It might be worth mentioning that there had also been a dramatic precedent. The Rising of 1381 originated from hatred of the poll tax (Trevelyan 1946) and the Archbishop of Canterbury who, as Chancellor of the realm represented the government, was beheaded by Wat Tyler's men on Tower Hill. The rebels even captured London itself. Although the community charge did not provoke such an extreme response, it provides strong evidence that taxpayers can value fairness in a tax system above simplicity.

2.4 National insurance contributions

It is also instructive to examine specific proposals for simplification that have not happened, at least so far. One of these is the possible merger of income tax and National Insurance contributions. In his Budget Speech of March 2011, the Chancellor of the Exchequer said:

> There is one ... step that we want to undertake that will dramatically simplify the tax system. For decades, we have operated income tax and national insurance as two fundamentally different taxes and forced businesses large and small to operate two completely different systems of administration, with two different periods and bases of charge. The resulting anomalies are legion, and it imposes totally unnecessary costs and complexity on employers and costs the taxpayer in the extra burden that it places on Her Majesty's Revenue and Customs. So I am announcing today that the Government will consult on merging the operation of national insurance and income tax. (Hansard HC, 23 March 2011, cols. 954 and 955).

The integration of income tax and National Insurance contributions has been discussed for many years – for example by Adam and Loutzenhiser

(2007). There are several reasons for proposing such a merger. As the Chancellor acknowledged, National Insurance contributions, despite their name, are a form of taxation. Tax has been defined as 'a compulsory levy made by public authorities for which nothing is received directly in return' (James 2012a) and the relationship between contributions paid and benefits received is often weak or nonexistent. The rates of contributions have been changed for reasons other than specifically paying for benefits, and the amount future claimants will receive will depend on what future taxpayers will let them have. As the Chancellor also indicated, income tax and National Insurance contributions have different tax bases, different tax structures and different systems of administration. Such a merger would be a considerable step towards simplification, not least because they are two of the biggest UK taxes. Income tax has long been the largest source of government revenue – raising £158 billion in 2013/2014 with National Insurance contributions accounting for a further £107 billion together making up over 45% of the total tax revenues of £583 billion (HM Treasury 2015, p. 110).

However, when the subject of a merger has come up before, it soon becomes clear that simplification is not the only consideration. One suggestion has been that taxpayers might be more willing to pay taxes when they are called contributions. Also, at least in the past, the government has said that 'it is right to retain a link between contributions paid and benefits received' (Reform of Social Security: Programme for Action 1986). Despite the Chancellor's statement in 2011, at the time of writing (Spring 2015) no significant steps had been taken towards the integration of income tax and National Insurance contributions, and it seems reasonable to conclude that simplification once again, at least so far, turned out to be less important than other considerations.

3 Simplifying tax law

The view that tax law was too voluminous and incomprehensible to most people led to the establishment of the Tax Law Review Committee (TLRC) by the Institute for Fiscal Studies in 1994, and its work is described by Davidson (1996). The TLRC produced an interim and then a final report (Tax Law Review Committee 1995, 1996). It accepted that tax legislation had to be sufficiently precise to be interpreted as intended but suggested that it could be more user-friendly without any loss of accuracy. It proposed that tax legislation be written in plain language which would involve the use of shorter sentences, a clearer structure and the avoidance of jargon where possible. However the TLRC also accepted that

there are complex areas where tax legislation cannot always be expected to be clear beyond doubt. The Committee's second proposal was therefore that tax legislation should be accompanied by memoranda to help users to understand and interpret it. A third proposal was that a pilot study be set up to rewrite existing tax legislation.

The government was working along similar lines and in his Budget statement of November 1995 the Chancellor of the Exchequer proposed that tax law be rewritten in plain English. Shortly after that, a detailed account of the reasons for such a rewrite and what it would involve were laid out in a report *The Path to Tax Simplification* together with a background paper (Inland Revenue 1995a, 1995b). After a period for public consultation, the Tax Law Rewrite (TLR) project was set up in 1996 to rewrite primary direct tax legislation in the UK to make it clearer and easier to use but without changing the law. An important feature of the TLR's work was consultation – both structured consultation with specialist groups on particular topics and the dissemination to interested parties of draft rewritten legislation for comment (Salter 2010). The original intention was ambitious – to rewrite most of the existing primary legislation on income tax, corporation tax, capital gains tax, inheritance tax, petroleum revenue tax and stamp duties (Inland Revenue 1996). Substantial progress was made, but in 2009 it was decided not to proceed with further rewrites of complete Acts. In a written statement in July 2009 the Financial Secretary to the Treasury stated:

> Since it was set up, the [TLR] project has played a key role in modernising tax legislation and making it far more accessible and easier to apply. Its work has rightly been widely praised, and has provided considerable benefits for users. However the benefits of rewriting other parts of the direct tax code are less clear and there is less support for extending the work of the project into these areas. I am satisfied that when the project's next two Bills are enacted, the time will be right to bring this work to an end (Hansard HC, 16 July 2009).

The TLR's work continued until 2010, by which time it had produced the following rewritten legislation:

- The Capital Allowances Act 2001
- The Income Tax (Earnings and Pensions) Act 2003
- The Income Tax (Pay as You Earn) Regulations 2003
- The Income Tax (Trading and Other Income) Act 2005
- The Income Tax Act 2007

- The Corporation Tax Act 2009
- The Corporation Tax Act 2010
- The Taxation (International and Other Provisions) Act 2010

The TLR project has certainly contributed to simplification. Salter (2010) concluded that it drew attention to the value of consultation between HMRC and other interests in improving tax law; used innovative approaches and techniques in rewriting legislation; and included effective parliamentary scrutiny before its enactment. There is also some evidence that tax professionals believed the rewrite had made the legislation clearer and easier to use. However there had been an expectation that the TLR project was a solution to the problem of excessive complexity. Perhaps at the time, and certainly with the benefit of hindsight, it should have been appreciated that this was unlikely. As James (2008) put it:

> Although initiatives such as those for tax law improvement are to be welcomed, in Australia, New Zealand and the UK they have been 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. These initiatives made no serious attempt to address the underlying complexity of the tax system and the process of tax reform generally from which such complexity arises. Nor was there much recognition that other aims and realities of the tax system might sometimes be more important than simplification.

Sawyer (2013a, pp. 36–37) suggested that such rewrites, including the UK project, have had some success in making legislation more understandable in the context of expert users, but that otherwise their contribution to effective tax simplification is very limited. The focus in the UK has shifted to the new Office of Tax Simplification, and this is examined in Section 6.

4 Simplifying taxpayer communications

Perhaps the most important aspect of simplification for most taxpayers is the communications they receive from the tax authority. Ensuring such communications are always sufficiently comprehensible to taxpayers is a major task. HMRC (2014) stated that from 2012 to 2013 telephone and paper contact consisted of:

- 245 million forms and guidance

- 200 million outbound letters
- 73 million customer support phone calls
- 70 million items of post received

The revenue authorities in the UK have often made considerable efforts to improve communications with taxpayers, but these have not always been successful. For instance a particular example came to public attention in 1998 when the Inland Revenue, as it was then, was awarded a Plain English Campaign Golden Bull award for the following extract from a letter to a taxpayer:

> 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 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 (Plain English Campaign 1998).

It should, of course, be acknowledged that many other institutions seem to have similar difficulties expressing themselves in plain English – in the tax area the Institute for Fiscal Studies won a 2006 Golden Bull 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 (Plain English Campaign, 2006).

There have certainly been improvements in the UK. The Plain English Campaign (2010) credited HMRC with 'some surprising and impressive improvements' in their communications with taxpayers over the previous 15 years. Indeed HMRC were one of the earliest corporate members of the Plain English Campaign. However, with constant changes in legislation and administration, it is difficult to maintain standards in this area, and only the year following the praise from the Plain English Campaign it awarded HMRC its 'Kick in the Pants' for an 'unacceptable' number of complaints from the public to the Campaign (Plain English Campaign 2011).

However official attempts to improve matters continue, and a step in the right direction came with the publication of a new Charter which listed taxpayers' rights and obligations HMRC (2013). In a list of nine taxpayer rights, three are particularly relevant in the present context. The second one, 'help and support you to get things right' includes the following two statements:

[HMRC] will:

- provide information that helps you understand what you have to do and when you have to do it
- provide information that clearly explains the taxes, duties, exemptions, allowances, reliefs and tax credits that we are responsible for.

The fourth section of taxpayers rights included:

We will:

- help you understand your legal rights
- explain what you can do if you disagree with our decisions or want to make a complaint
- provide you with information in a way that meets your particular needs
- Finally, the ninth one was concerned with keeping taxpayers' compliance costs down and included:

We will:

- try to make our services straightforward and easy to access
- make it as cheap as we can for you to contact us
- explain clearly what we need from you
- do our best to give you complete, accurate and consistent advice
- do our best to get things right first time.

There is a clear intention to promote good communications with taxpayers even though this can be difficult to achieve – see, for example, James *et al.* (1987). Readability measures have been available for many years, and generally analyse a sample of prose to estimate the degree of difficulty, grade or reading age – the age at which a child could reasonably be expected to understand the material. Measures which have been applied to UK tax literature include Gunning's FOG index where FOG is an acronym for 'Formula of Gobbledegook' (Gunning 1952) and the SMOG measure 'Simple Measure of Gobblydegook' (McLaughlin 1969), and they are usually based on variables such as sentence length and the number of syllables. Early studies applying such measures to official tax literature in the UK include James and Lewis (1977) and James *et al.* (1981), but readability is only part of the process of simplification. The comprehensibility of such documents may be enhanced by a whole range of features such as clear step-by-step instructions, sample returns and examples and simple returns for taxpayers with simple circumstances. Furthermore, the whole process can be supported by appropriate civic education and taxpayer assistance.

Changes in technology add a new dimension to taxpayer communications. The intention in the UK is that each taxpayer should have his or her own personalised digital tax account together with digital support services (HMRC 2014). Needless to say, perhaps, simplicity is just as important in digital communications as in any other communications. Perhaps even more care may needed, as many taxpayers do not have advanced computer skills, and one digital encounter with a taxpayer led to another Golden Bull award for HMRC after the taxpayer had sent an email and received the following response:

> The submission of this document has failed due to departmental specific business logic in the Body tag. Your submission contains an unrecognised namespace (Plain English Campaign 2013).

However, technology has huge potential in promoting simplification. Returns pre-filled with information sent to the revenue authorities have been mentioned elsewhere, but computerisation could even save taxpayers from completing annual returns at all. In his Budget statement of March 2015, the Chancellor of the Exchequer announced such a development:

> Today, we can bring simpler taxes to many more people. Some 12 million people and small businesses are forced to complete a

> self-assessment tax return every year. It is complex, costly and time-consuming. So, today I am announcing that we will abolish the annual tax return all together. Millions of individuals will have the information the Revenue needs automatically uploaded into new digital tax accounts. A minority with the most complex tax affairs will be able to manage their account online. Businesses will feel like they are paying a simple, single business tax, and again, for most, the information needed will be automatically received. This revolutionary simplification of tax collection will start next year ... Tax really does not have to be taxing, and this measure spells the death of the annual tax return (Hansard, HC, 18 March 2015, col. 777).

5 Simplifying tax administration

A major change in UK tax administration with implications for simplification was the merger in 2005 of the then Inland Revenue, which was primarily responsible for direct taxation, and Customs and Excise, which was primarily concerned with indirect taxation, to form HM Revenue and Customs (HMRC). One of the anticipated benefits of such a merger was an element of simplification. As the then Chancellor of the Exchequer said in his Budget Speech of 17 March 2004, it would mean businesses would then have to deal with only a single tax service. Nevertheless, the experience of the merger is that success is not always easily achieved by organisational change in tax administration, and there were concerns about the subsequent performance of HMRC (James 2012b).

One aspect of tax administration that provides a major form of simplification is the Pay-As-You-Earn (PAYE) system, which is sufficiently accurate to avoid the need for most UK taxpayers to complete an annual return. The way it works is that an individual's tax-free income is calculated, and the total (but not the individual elements) communicated to his or her employer. Because the system is operated on a cumulative basis, the correct amount of tax should then be withheld at each pay period right through to the end of the tax year, even when a taxpayer's marginal rate of tax changes during the course of the tax year. As the great majority of taxpayers in the UK pay tax at the basic rate, the PAYE system can often be used without difficulty to withhold tax at the correct rate on other sources of income as well.

6 The Office of Tax Simplification

A more general approach to simplification took place with the establishment of the Office of Tax Simplification (OTS) in 2010, initially for

the lifetime of the current Parliament (to May 2015) but it was made permanent from July 2015. The purpose of the OTS is to provide independent advice to the Chancellor about achieving a simpler tax system. From the beginning it was recognised that simplification was not the only concern, and in providing advice on different options, the OTS also considers the potential impact of its advice on the government's other objectives for the tax system (Office of Tax Simplification 2010a). Indeed, at the time the OTS was set up its Tax Director John Whiting commented:

> I'd better emphasise that I don't believe we can ever have a truly simple tax system in the UK. We live in an increasingly complex world, and tax must reflect that, especially if we want a fair system – fairness tends to pull against simplicity. But the system can be simpler – both administratively and technically. Above all, we can commit to doing things in an easier, more straightforward way (cited in Sawyer 2013b, p. 334)

The OTS faced a formidable task with only limited resources and concentrated on specific issues rather than undertaking a fundamental examination of the causes of complexity and how best they might be addressed. It started with reviews of tax reliefs and small business taxation and by March 2015 it had completed nine simplification reviews (OTS 2015) with final reports published as follows:

Tax Reliefs, March 2011
Small Business Tax, February 2012
Employee Shares Schemes:
  approved schemes March 2012, unapproved schemes January 2013
Pensioners' Taxation, January 2013
Employee Benefits and Expenses, August 2014
Partnerships, January 2015
Competitiveness of the UK Tax Administration, October 2014
Tax Penalties, November 2014
Employment Status, March 2015

Perhaps one of the most noticeable aspects of the work of the OTS is that it demonstrates how complex the UK tax system is and that the issue is not only a massive one but is also ongoing. The review of tax reliefs provides a good example. In November 2010 the OTS produced a list of 1,042 tax reliefs. The following month it published an interim report which stated it would be a 'huge task to look in detail at each of the

1,042 reliefs' and therefore it had been decided to focus on 74 of them together with a further 75 if 'time permits' (OTS 2010b, p. 5). By the end of the review, it had looked in detail at 155 reliefs recommending that 54 remain unchanged, 37 be looked at in more detail, 47 be abolished and 17 be simplified. That left 883 that had not been looked at in detail, even though there was scope for simplifying a number of them (OTS 2011). However, the number of tax reliefs in the system continued to increase and the updated list published by the OTS in August 2014 consisted of 1,140 reliefs.

These recommendations were divided into 'big picture' and 'other' recommendations. Of the 60 big picture recommendations, 16 had been accepted by the government, 9 partly accepted, 22 were under review and 13 had either received no response or been rejected. Of the other 342 recommendations, 150 had been accepted, 24 partly accepted, 96 were under review and 72 had either received no response or been rejected.

Although these recommendations are valuable, they do not form a major simplification of the tax system as a whole and it is hard to see how such changes could do so without a fundamental approach to simplification. The Committee of Public Accounts (2013, p. 5) concluded that:

> The Office of Tax Simplification is grossly understaffed and has focused on abolishing tax rules that are no longer necessary, rather than more radical simplification. HM Treasury and HMRC should work together to make more radical progress in simplifying the UK's tax code, and should equip the Office of Tax Simplification with the resources and influence it needs to help them do so.

The OTS had been doing rather more than abolishing unnecessary tax rules, but the calls for more radical progress and sufficient resources were well-founded. Freedman (2013) suggested that the OTS had not been set up in a way that would allow it to tackle the fundamental difficulties regarding simplification, even though it is fully aware of them and refers to them in its publications. The problem is that to achieve successful and lasting simplification, proper account has to be taken of the other important aspects of taxation and simplification should be integrated into the tax policy process, as has been suggested many times and recently for example by Bowler (2014).

One notable contribution the OTS has been making is developing a complexity index – described by Jones *et al.* (2014). The purpose was to develop a methodology for measuring the relative complexity of different parts of the UK tax system in order to identify those areas with

the greatest potential for simplification. The index may be developed further, but the second version consists of two separate scores. The first is underlying complexity, which indicates the complexity of the structure of the tax consisting in the policy design and legislation. The second is the impact of complexity, which is concerned with the compliance costs of an individual taxpayer as well as the total cost for all taxpayers. The methodology uses 10 factors of complexity – six to measure underlying complexity and four to measure the impact of complexity. The six factors for underlying complexity consist of two related to policy complexity – the numbers of exemptions and reliefs and the number of changes in the law to the area (since 2000); two factors measure legislative complexity – a readability index and the number of pages of legislation – and two operational complexity – one relating to HMRC guidance and the other to the complexity of information required to make a return. The four factors indicating the impact of complexity were the net average cost incurred by taxpayers and HMRC, the number of taxpayers, the average ability of taxpayers and the risk of tax avoidance.

Clearly there are considerable difficulties in measuring some of these factors but there is also the point that some degree of complexity is necessary if a tax system is to be reasonably fair, efficient and certain. So the question turns to identifying unnecessary complexity as opposed to complexity necessary for acceptable reasons. This is likely to receive more attention as these matters are developed further – see, for example, Ulph (2012).

In summary, the OTS has made some valuable contributions to tax simplification, but there is considerable scope for further developments, particularly by integrating tax simplification much more into the tax policy process.

7 Conclusion

As indicated in the introduction, tax simplification is not a simple issue. The experience in the UK is that sometimes moves towards greater simplification are successful, but the more general experience is that other factors are also important, often much more so than simplification. Complexity is an inevitable feature of modern tax systems. The intriguing question is how much of this is necessary as opposed to unnecessary complexity. Setting up the Office for Tax Simplification was a notable step forward, and its achievements significant but limited. What would seem to be the best way to proceed would be a strategy for simplification (James and Wallschutzky 1997) which could be part of a more coordinated and wider

approach to developing tax policy and reform, which takes account of the all the objectives of tax policy as well as the complex and changing environment in which the tax system has to operate (James and Edwards, 2008). Within such a process, tax simplification could have a special place. In the UK the Inland Revenue as it then was (1995b, para 2.1) discussed the creation of a simplification culture. Such a development might well help to balance the continuous pressure for increased complexity.

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12
Complexity of Tax Simplification: USA Perspective

Hughlene A. Burton and Stewart Karlinsky

1 Introduction

All of us who deal with the United States Federal income tax law will readily agree that it is complex. The relevant question is: Does it require a huge overhaul, or will an alignment and a tune-up fix the system? To put all this rhetoric in perspective, Jeffrey Owens, former OECD Tax Commissioner, who has the advantage of an international perspective on the tax system, pointed out 'that there is no crisis, but lots of room for improvement'.[1]

2 Simplification of tax systems

The link between complexity leading to more ambiguity, and ambiguity leading to less tax compliance has been shown and is a principal rationale for simplifying the tax system. Unfortunately from the complexity perspective, the tax system is being used for a variety of political, social and economic purposes, rather than just to raise revenue so that the government may function. These nonrevenue uses of the tax system are a major contributor to the tax law's conceptual complexity. In the authors' professional and academic experience, any time you differentiate the essentially same item into different tax treatments, you get a more complicated system and create opportunities for tax planning and tax abuses. In David Camp's recent Tax Reform Act of 2014[2] draft proposal, he pointed out that there are 15 different tax benefits related to education that often overlap. Making the definitions and terms uniform among these provisions and consolidating the rules would help reduce the conceptual complexity of this area. Similarly, there are twelve (12) different tax-advantaged retirement planning vehicles available to

the workforce and their employers. Simplifying and consolidating these provisions would make the law easier to apply and enforce for the vast majority of businesses, particularly smaller ones.

Another issue related to the United States tax code complexity is the overlapping or cross-referencing of tax sections. The Internal Revenue Code (IRC) is currently 5,296 pages[3] and has close to 7,000 sections. Making the tax code even more difficult is that many code sections reference other sections. Therefore, if a taxpayer is trying to find the meaning of one code section, they may have to research a number of other sections before they can determine the correct answer. For example, if a reader looks up IRC Section 32 which discusses the refundable earned income credit; Section 32 references 12 other tax code sections. Thus IRC Section 32 is dependent on 12 other tax code sections for clarification of the rules. The interrelationship of the sections makes the tax code much more complex and difficult to use.

One of the more solvable complexity issues is the enormous number of phase-ins, phase-outs and transition rules that Congress enacts that primarily impact individual taxpayers[4]. These mathematical calculations for normal every day tax features probably faze (pun intended) the middle income and upper middle income taxpayer more than most. For example, there are phase-outs of the itemised deductions, personal and dependency exemptions at one level, Alternative Minimum Tax (AMT) exemption phase-out at a different level, active real estate loss provisions at a third level, etc. To make this computation even more complicated, there are nine (9) different definitions of income, above which the phase-out kicks in. For example, the AMT exemption is phased out at $158,900 Alternative Minimum Taxable Income (AMTI), while IRC Section 469(i) begins to be phased out at $100,000 of modified AGI which is computed before IRA deductions, IRC Section 199 deductions, and qualified real estate professionals (QRP) real estate losses. Ridiculous! Another area that would be easy to fix is the number of areas in the tax code that are no longer relevant. The American Institute of Certified Public Accountants (AICPA) recently performed a review of the tax code and found 43 sections that were termed deadwood sections.

An area that is made complex and is crying for standardisation and simplification is the tax treatment of interest expense. For individuals, the US tax law has seven (7) different treatments – business, investment, home mortgage, passive, personal, tax exempt and capitalised. Each of these has different rules attached to them; and if it is deductible, is deductible on different parts of the tax return. So for example, if you borrow money to buy stocks and bonds, then the interest is categorised

as investment interest expense, and IRC Section 163(d) would limit the deductible expense in the current year to the net investment income for the year. If an individual borrowed money to acquire a real estate investment, a whole different set of rules would apply (IRC Section 469). Similarly, if you buy a personal residence or a vacation home, it is personal interest (non-deductible), except the interest paid on the first $1,100,000 of mortgage liability is deductible. To make this area even more complex, it should be obvious to the reader that funds are fungible. There are complicated rules to try and trace what the money was used for in Regulation Section 1.163–8T.

Constructive ownership is another area that is begging for simplification. There are at least four (4) major IRC provisions[5] and many modifications and exceptions to these rules in dealing with who is deemed to own an entity. For example, IRC Section 318 covers parents, grandparents, children and grandchildren, while IRC Sections 267 and 544 adds brothers and sisters as well as all ancestors and lineal descendants. In some cases IRC Section 1563 does not attribute a husband's stock to a wife or a father's stock to a son or daughter. A corporation's ownership of an entity will be deemed owned proportionately for purposes of IRC Section 267 and 544, but ignored unless it has a threshold more than 50% for purposes of IRC Section 318, and 5% for purposes of IRC Section 1563. Why not have one central definition of constructive ownership?

Similarly, control is defined differently in at least eleven (11)[6] places in the tax law. Making the definitions uniform would go a long way to simplifying the conceptual scope and readability of the tax law. In one of the ironies of tax life, it is well documented that the tax and regulatory compliance cost for small business on a revenue or employee basis is significantly higher than for mid-size and large companies. The same is true for other costs such as health care, shipping, and manufacturing. Therefore, the tax law has traditionally provided provisions that favour small business. Yet, there are over 40 different ways[7] that the tax law has defined a small business, and taking advantage of these myriad of provisions involves compliance costs that are the raison d'etre of the provision in the first place. Clearly, two or three – or ideally one – provision(s) could be used to define small business for all tax purposes.

Another major complicating factor is that capital gains and qualified dividends are favourably treated under the US tax system (0, 15% or 20% flat tax rate) over interest income, rent or royalty income and other investment returns (39.6% marginal tax rate). On the other hand, the tax benefit of capital losses are limited for individuals to capital gains plus $3,000 of ordinary income. Thus, if someone lost, say $300,000 in

the 2009 Great Recession or the 2000 Dot-Bomb, they would need to be Methuselah and live over 100 more years to get the benefit of their losses. The amount of complexity attributed to the special capital gain/loss provisions alone has been estimated to complicate the tax law by 15%.[8] It also impacted 383 different code provisions out of 584 in existence at the time.

One of the more ironic complexity issues deals with the AMT as it affects individuals and corporations. Although the minimum tax concept has gone through several iterations since its implementation in 1969, its basic concept is to prevent perceived abuses of the tax system by high-income individuals, who were paying no federal income taxes. Ironically, under the current system, wealthy people can and are still avoiding paying any taxes by investing in tax exempt bonds.

Nonetheless, the phase-out of the exemption at relatively low levels of AMT income ($158,900) and the high rate of tax (26% and 28%) relative to the regular tax rates (33%, 35% and 39.6%) make the AMT a political time bomb that could be diffused by reducing the rates. The complex part of AMT is really the minimum tax credit (MTC) mechanism in which a permanent and temporary difference computation must be made. Ironically, it is not a complexity issue for corporations, only individuals. Applying the corporate MTC model to individual would significantly reduce the complexity of this parallel income tax system.

On the corporate AMT side, the differentiating AMT adjustments from the adjusted current earnings (ACE) adjustment is clearly something that could easily be eliminated and reduce complexity. There is no particular policy reason why some preferences are 75% bad and others are 100% bad. Thus, the tax system could be easily simplified by making all AMT adjustments and preferences either 100% or 75%, while eliminating the need to differentiate between various tax treatments and requiring different tax bases calculations, different gain or loss computations and different tax rules.

One area of the corporate AMT that Congress intelligently and simply enacted was IRC Section 55(e), which exempts small companies from the AMT calculation. Congress should use this as a model to enact other simplifying provisions. Based on gross receipts, a small business corporation was exempt from the complicated corporate AMT. If its gross receipts exceeded the designated limits, then it only encountered the AMT on a prospective basis, so it truly was not required to keep track of AMT depreciable basis for assets acquired while it was exempt.

Another area where Congress has tried but failed to simplify is business taxation. Currently, a business can be operated as either a sole

proprietorship, a partnership, an S corporation or a C corporation. Each of the entity choices are filed on a distinct form. The rules relating to how to compute taxable income, what is deductible and where the information is reported are each different, even though the Internal Revenue Code covers all these business entities.

For example, the hobby loss limitations (IRC Section 183) do not apply to C corporations but they apply to all other business forms. The investment interest expense limitations discussed above do not apply to C corporations, but do to the other business forms. The passive activity loss rule (IRC Section 469) virtually does not apply to most C corporations but does very much apply to the other entities. Another good example is the amount paid to owners for their services. If the business is an S corporation or a C corporation, the payment is a salary and is deductible by the company. If the entity is a partnership, the payment is either a guaranteed payment or a distribution and is only deductible by the entity if the payment is a guaranteed payment and if the entity is a sole proprietorship, the payment is a distribution and not deductible.

The flip side of this issue has also engendered significant complexity. The income earned by a C or S employee/shareholder is subject to social security, but any distributions are not. For a general partner or active member of a partnership or LLC, income attributed, whether or not distributed, is self-employment income, but investment income is not subject to self-employment taxes. Carried Interest has been held to be investment in nature, so far. In Representative Camp's 2014 tax bill 70% of income from S corporations and partnerships would be subject to social security tax, but there was no change for C corporations. Also in previous versions of tax reform, Congress has attempted unsuccessfully to simplify the part of the tax system by combining S corporations and partnerships and taxing them the same.

A new area of complexity that has arisen in the US recently occurs when there is a different tax treatment for an income item for federal versus state purposes. For example, a number of states have legalised the sale of marijuana. For those states, the sale of marijuana is a business, and the taxpayer reports the taxable income just like any other business. But the sale of marijuana is not legal for federal purposes, so the taxpayer must report the income but can only deduct the cost of the product.

Another difference that arises between the federal law and state laws is related to same sex unions. For federal purposes the couple is considered to be married and will file a joint tax return. Some states do not recognise same sex unions and in those states, the couple must file separate tax returns which means dividing and separating all of the income and

deductions for items they own jointly. The difference in tax treatment in both the marijuana and same sex union cases complicates the filing requirements for many taxpayers.

3 Compliance costs

The cost of this complexity is staggering. *Forbes* magazine recently had a four-part series that looked at the cost of complying with the federal tax code. According to Forbes, The Information Collection Budget of the US Government estimates in 2013 it took citizens 9.453 billion hours to complete paperwork requirements from six independent agencies. Tax compliance represented approximately 75% of this amount. This is a drop from the 2012 9.467 billion hours, but is up significantly from 2010 and 2011. On average, a human life lasts 80 years, which is 29,200 days and 700,800 hours. This means that 2013s 9.5 billion hours of compliance work is the equivalent to close to 13,488 lifetimes. To put it in greater perspective, assume that each person identified with completing some sort of compliance tasks is paid $20 per hour. This cost of compliance would result in $176 billion. However, according to *Forbes*, accountants and auditors are generally paid an average of $33.15 per hour, making that tax compliance equal to $237.5 billion {(75% × 9.453B/hours) × $33.15/hour}.[9] Another way to look at these huge numbers is to estimate the number of hours per taxpaying individual entity. If it took 9.453B hours, of which 75% is income taxes, and there are roughly 140MM individual tax returns filed each year, then roughly 7B hours divided by 140MM tax returns equals 50.64 hours of compliance per filing taxpayer. From the productivity perspective, this is more than a week of missed production.

Likewise, in 2000, federal paperwork costs (mostly taxes) accounted for nearly 20% of the $1.255 trillion in overall regulatory and compliance costs of that era. Earlier studies by the University of Michigan Business School found business tax compliance at $102.3 billion in 1993 and $141.1 billion in 1994. Bringing this up to date a little, in 2008 the Small Business Administration (SBA) relied primarily on Internal Revenue Service data which compiled 4.3 billion hours of paperwork hours. 2.3 billion hours for businesses and 2 billion hours for individuals/nonprofits. As for direct compliance in 2014, the National Taxpayers Union found federal tax compliance to cost $226 billion. As mentioned in the previous reports, the Treasury Department accounts for most hours of paperwork burden in the 'Information Collection Budget'. In the 'FY 2013 Burden Changes by Agency' chart, the Department of Treasury accounted for 7.007 billion hours of the

total 9.453 billion-around 74%. Obamacare will most certainly add to the complexity and amount of time required to prepare a tax return, which will only inflate these numbers even further. It will end shortcuts such as the 1040-EZ Form for many who get subsidies among other things. To put things in perspective, H&R Block had nearly $3 billion in revenue pre-Obamacare. This will almost certainly lead to an increase of business for the H&R Blocks of the world.[10]

4 Simplifying tax law

4.1 Reading complexity

It is clear from the literature that complexity is multi-faceted and that conceptual complexity and difficult readability combine to make the tax law difficult. Judge Learned Hand in his usual mellifluous manner captured the feeling on tax complexity when he said[11]:

> ... the words of such an act as the Income Tax, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception – couched in abstract terms that offer no handle to seize hold of – leave in my mind only a confused sense of some vitally important, but successfully concealed purport, which it is my duty to extract, ... only after the most inordinate expenditure of time ....

Another movement that has received attention worldwide as will be referenced in this text, but the United States is a bit late to the party is Plain English. What is Plain English drafting? According to the Plain English campaign in the UK, Plain English[12]:

> ... is presenting information so that in a single reading, the intended audience can read, understand and act upon it. Plain English means writing with the audience in mind and presenting information clearly and accurately.

One of the obvious issues is who is the intended audience? Is it tax professionals or is it the average taxpayer?

However, as the plain language movement has progressed over the years, the results have not always been positive. According to Daly, Dorsey and Kumar,[13] the readability of Tax Court Opinions have actually decreased over time.

There have been a number of academic research projects examining different readability measures. Most of these studies have found that the US Tax Code is very complex not only because of the issues the law covers but also because of the way the law is written. There are many complex sentences and phrases that seem to run on for a number of lines which makes reading and understanding the law very difficult. The problem with readability is also increased by new amendments to the Tax Code that only adds a clause to the material instead of rewriting the entire sentence.

4.2 Conceptual complexity

Most observers agree that the current tax system needs changing. The more important question is 'What is the best way to do so?' Among the stated reasons for a change in the current system is a need for more efficiency, equity and simplicity. There have been several proposals in the last two decades to change the US tax code. Each of these proposals would either eliminate the current tax law the US currently has or would change a major piece of the current law. Each of the proposals claims to be better than the current law with regard to equity, efficiency and complexity. That remains to be seen. If the US were to adopt a different type of tax system, it would have to be because it was better from a tax policy standpoint, but it would also have to raise as much revenue as the current system. One of the major stumbling blocks to raising the same revenue is that unlike most of the US's trading partners, this country does not have a VAT or GST to equalise revenue raised by lower rates. Some of the proposals will be examined below.

4.3 Flat tax proposals

One change, which has received limited support, is a consumption-based tax or a flat tax. According to its supporters, the flat tax will decrease the complexity of the current tax system and should decrease the tax liability for many taxpayers. Hall and Rabushka[14] concluded, 'The current personal and corporate taxes tax wages heavily and business income lightly. The flat tax would reverse this inequity and benefit the great majority of Americans, whose income comes almost entirely in the form of wages' (pp. 92–93).

- The most basic flat tax would have two parts, an individual wage tax and a business tax. The individual tax would be levied on wages, salaries, and pensions less a standard deduction. Individuals would not be allowed itemised deductions for mortgage interests, state and

local taxes, charitable contributions or medical expenses. In addition, the earned income credit would disappear.

- The business tax would be a comprehensive withholding tax on all income other than wages. It would be levied on total revenue from sales of goods and services less costs. Costs include purchases of inputs including investment goods, wages and salaries, pension expenses, and taxes on purchases of inputs including investment goods, wages and salaries, pension expenses, and taxes on purchases of inputs. Current expensing of property purchased would be allowed. Expenses that are not deductible include non-pension fringe benefits, other taxes (mainly payroll, income and property), interest paid, bad debts, gifts and contributions, and charges for depreciation, depletion and amortisation since the expenditure for property is immediately deductible. Receipt of interest income, dividends and capital gains would not be taxable. Accounting for business transactions would be on a cash basis. In this type of tax system, all forms of business are taxed the same way. The flat tax applies to all domestic transactions.

Projections of the flat tax proposals indicate that they will not produce any more tax revenue that the current system, and in fact Summers[15] suggested that the last Congressional proposals for a flat tax would actually lose $138.3 billion annually. Summers argued that the tax rate would need to be higher than 20% for a flat tax to be revenue-neutral. Therefore, the change in the tax law will not by itself decrease the budget deficit and may in fact increase it. What the change should do, according to its supporters, is stimulate the economy.

Opponents of the flat tax contend that it is a zero sum game and that the tax burden will only shift under the current flat tax proposals. According to these critics, the flat tax will shift the tax burden from the high-income and low-income taxpayers to the middle class taxpayer.

According to other critics of the flat tax, a decrease in tax rates will not create a substantial increase in economic growth. Stokey and Rebelo[16] and Lucas[17] both found that tax reform would have little or no effect on growth rate. Based on prior experience with tax changes, Summers agreed with Stokey and Rebelo and Lucas. Summers also noted that a flat tax system may not be as simple as its supporter's claim, due to transition issues that must be addressed and the possibility of allowing taxpayers to deduct certain expenses such as mortgage interests and charitable contributions.

In addition, some have questioned the fairness of the flat tax. Summers noted that the elimination of the earned income tax credit could be

a problem. Supporters of the flat tax counter that the elimination of the earned income tax credit would make no difference because most taxpayers who are allowed an earned income tax credit would not be subject to tax under the flat tax. However, he notes that the earned income tax credit has two purposes: a reduction of taxes for low-income taxpayers and an incentive to work. The earned income credit provides a mechanism to offset other taxes such as payroll taxes and food stamp benefits. Low-income families lose about 39 cent for every dollar they make due to these two items. The earned income tax credit offsets this loss by providing up to 40 cent of every dollar earned. By making work pay, the earned income credit encourages taxpayers to go from welfare to the workforce. Without the incentive, many taxpayers may return to the welfare system. Both of the latter problems could cause serious policy issues.

4.4 Corporate integration issues

The US tax system is a classic double tax system that levies two separate taxes on corporate income. The first tax occurs at the corporate level when income is earned. The second tax occurs at the shareholder level if and when the corporation pays dividends. This double tax increases the cost of capital and makes it expensive to do business in the corporate form. According to Hickman[18] the double tax creates economic distortions and inefficiencies including a misallocation of resources between the corporate and non-corporate sectors, a bias in favour of debt financing and a tendency to retain an excess amount of earnings at the corporate level.

Those who support a double tax on corporate income justify it by using the entity theory. Supporters say that the two tier-tax system is justified because the corporation and its shareholders have separate utility functions and make investment decisions separately. Since each party has the ability to make independent decisions, each should pay tax on the income. According to its critics, the separate income tax is not justified by the commonly accepted principles of taxation, equity and efficiency.

Since corporate income is the only form of income that bears the double tax, investment decisions are influenced by the tax effect. The double tax creates a substitution effect because investors tend to move away from the more heavily taxed investment to other choices that are not taxed as heavily. This misallocation of investment dollars decreases the efficiency of the economy and creates a misallocation of resources.

To increase investment in the corporate sector, economists have investigated alternative methods to the current tax system. One alternative is to integrate the individual and corporate tax systems by eliminating the tax shareholder's pay when they receive dividends from a corporation. The integration system which has been used most often by other countries, most often called an imputation system, eliminates the tax on dividends by providing the shareholder a credit based on the tax paid by the corporation.

However, it not clear whether an integrated tax system would actually accomplish these goals. Many other countries, such as the UK, Australia and New Zealand, have tried an integrated tax system with varying levels of success. For example, after a number of years operating an integrated tax system, the UK eliminated the tax credit shareholders received for the tax on dividends without creating major economic issues.

4.5 International tax issues

The US employs a worldwide tax system for all US citizens and residents. This system taxes a US citizen or resident's entire income no matter where the income is earned. The taxpayer is then allowed a credit for the tax paid to foreign countries on the income.

One exception to the general rule is the income earned by foreign corporations that are owned by US shareholders. Under this exception, foreign corporate income is not taxed in the US until the earnings are paid as a dividend to the US shareholder. This exception has caused many foreign subsidiaries to retain a large percentage of the earnings which can create an economic distortion. By not paying dividends to the parent company, there is a possibility of a misallocation of resources.

Currently, the US is one of only a handful of countries that uses the worldwide system. The worldwide system is more complex and difficult to manage, as the shareholder has to calculate a complex formula to compute the appropriate tax credit. Most countries such as the UK, France and Germany use a territorial tax system. Under a territorial system the country only taxes income that is earned in the country. A territorial system should alleviate the misallocation of resource problem. It should also simplify the tax system as corporation would not have to compute a foreign tax credit. However, it would increase the issue of sourcing of income.

Representative Camp in his 2014 proposed tax bill would convert the US tax system to a territorial tax system. An alternative that has been proposed by President Obama would be to eliminate the exemption

for foreign corporate income. Both proposals should be more economically efficient and simpler to understand. However, there would be a number of transition issues that would have to be addressed, which could make the US tax system even more complex for a number of years.

4.6 Alternative tax sources

Proposals have also been made to adopt a completely new tax. In some cases these taxes would be in addition to the current income tax system and some cases (National Sales Tax) would replace the current income tax system. By raising additional tax revenue from other sources, proponents argue that the income tax system could be made fairer and simpler.

4.7 National sales tax/GST/VAT

One suggestion is to eliminate the income tax and replace it with a national sales tax. The latest version of a national sales tax is called the Fair Tax. The idea is that everyone pays their fair share based on what they spend rather than what they earn.

Proponents argue that taxing consumption rather than productivity would encourage saving and investment, in turn stimulating production and economic growth. The most recent proposed national sales tax would fall between 23% and 30%. It could replace the income tax and the 6.2% employee portion of the Social Security tax. If the income tax was eliminated, the Internal Revenue Service, as well as thousands of pages of the tax code, would be obsolete.[19]

Critics suggest that a national sales tax is regressive, favouring the rich. This criticism depends on how you measure rich, that is, what you use as a denominator. If you measure dollars spent per dollars of income, the tax is regressive. Another problem with a national sales tax which would add to its complexity is how the tax would be collected. Some researchers have suggested that collection should be done by state agencies, since they already collect a state sales tax. However, to make state agencies also collect the federal tax would add an extra burden to state governments that are already overburdened. The cost of this extra burden would have to be borne by some agency, presumably the federal government.

In addition, the idea of a national sales tax raises some constitutionality issues. It has historically been state and local governments who collected sales tax. Many states have argued that the federal government does not have the right to assess a sales tax.

4.8 Carbon tax

Many people are concerned about the environment and have proposed a tax on CO_2 emissions (Carbon Tax). For example, the government[20] estimated in 2011 a Carbon Tax could raise up $1.2 trillion the first decade (assuming a $20 per ton rate and increasing 5.6% each year thereafter). According to the report from the CBO, if the money derived from such taxation on Carbon was used to reduce the federal deficit then the benefits would outweigh the costs; however, if the revenue was not used correctly, the revenues derived from the tax might not be enough to outweigh the cost of the tax itself. The report goes on to state that while the Carbon Tax would produce a substantial amount of tax revenue, the fossil fuels would increase in price in direct proportion with their carbon content. Consumers would see price increases in everyday uses of Carbon like electricity. However, the report noted that there was also a possibility that the revenue generated from the taxation of Carbon could be used to lower the marginal tax rates on individuals and corporations.

4.9 Legalise marijuana and tax it

As we noted earlier, some states have legalised marijuana, but the federal government has not. Not only would legalising marijuana cut out some of the complexity in the current tax system, it would also generate a huge revenue stream. According to a 2010 study, tax revenue from the legalisation of marijuana could generate up to $8.7 billion annually. Researchers used the assumption that marijuana would be taxed similarly to alcohol and tobacco. However, this isn't the only way legalising marijuana could help generate revenue. It would also save the individual state and federal governments billions annually in regulating the drug. The state of Washington estimates that it will generate as much as $1.9 billion in the next five years due to the legalisation in that state.[21] Likewise the state of Colorado budget office projected the state would collect approximately $134 million in taxes from medical and recreation marijuana sales in fiscal 2014–2015.[22] If the Administration moved the classification of marijuana from a Class or Schedule 1 drug like heroin or cocaine to Class 3, research on the impact of marijuana could commence, an important step for nationwide legalisation.

5 Simplifying taxpayer communications

There has been a recent trend to utilise Plain English in tax correspondence, regulation writing and even tax legislation in several developed nations. The United States is a 'johnny-come-lately' to the simplification

process. Most recently, President Barack Obama signed legislation[23] that is meant to 'enhance citizen access to Government information and services by establishing that Government documents issued to the public must be written clear'. The purpose of the law is to 'improve the effectiveness and accountability of Federal Agencies to the public by promoting clear Government communication that the public can understand and use'.

This legislation covers all Executive Branches of the government, which includes the Treasury Department and the Internal Revenue Service (IRS). It defines covered documents to include items necessary for obtaining any Federal Government benefit or service and filing taxes. Unfortunately, it specifically excludes regulations[24] as well as congressionally enacted laws since they are not under the Executive Branch of the government. The law defines 'plain writing' as 'clear, concise, well-organised and follows other best practices appropriate to the subject or field and intended audience'.

Subsequent to this legislation, the President issued Executive Order 13563,[25] which essentially expanded the law to regulations. It ordered that the regulatory system must: 'promote predictability and reduce uncertainty. It must identify and use the best, most innovative and least burdensome tools for achieving regulatory ends'. 'It must ensure that regulations are accessible, consistent, written in plain language and easy to understand'. 'It must measure, and seek to improve, the actual results of regulatory requirements', weighing the benefits and costs both in a quantitative and qualitative sense. This administrative law and the follow-up executive order is not the first time a US President has ordered plain language to be used in the tax arena. Executive Order 12988,[26] signed by President Bill Clinton, tried to improve civil justice by proposing that Treasury's proposed legislation and regulations specify 'in clear language' the impact of the proposals on existing law, and whether it is repealing, circumscribing, modifying a law and defines key statutory terms explicitly. These executive orders go on to say that the regulations should be 'effective, consistent, sensible and understandable'. In E.O. 12866 President Clinton orders, per Section 1(b)(12) that 'each agency shall draft regulation to be simple and easy to understand'.

In the United States, the extent of the efforts seems to be a brief inclusion on the IRS Website entitled IRS Guidance in Plain English[27] which has a small section IRS Guidance – A Brief Primer[28] and a study by Siegel and Gale rewriting IRS letters to taxpayers to make them more readable.[29]

The reason for the United States' apparent lack of action may be reflected in a former IRS Commissioner's statement, 'Tax simplification is everyone's favorite orphan. All of us involved in the tax system – Congress, the executive branch, practitioners and taxpayers – proclaim our affection for this child of our dreams, but few are willing to adopt her as our own'. Other comments you typically hear is that tax simplification has no constituency to lobby for it.[30] Nonetheless, the National Taxpayer Advocate, Nina Olsen, in many of her annual reports to Congress, identified tax law complexity as the greatest single problem facing taxpayers and tax administrators.[31]

A recent Treasury Inspector General for Tax Administration (TIGTA) report found that the IRS was doing a decent job complying with the Plain Writing Act, but they did not have a full list of all letters and messages sent to taxpayers. Also, half the letters and two-thirds of notices weren't written clearly or didn't provide enough information. This is somewhat understandable as more than 200 million letters and notices are issued each year by the IRS from 44 separate systems in dealing with professionals and the general public with regard to corporations, partnerships, individuals, trusts, estates, missing information, etc., and unless you have standard, clearly plain English documents, there will be significant miscommunication being evidenced.

6 Simplifying tax administration

Working within the US tax system is also time-consuming and costly. In the US the taxpayer is required to file a tax return within 8½ or 9½ after its year-end. With the complexity of the US Tax Code, many individuals and almost all business entities need costly professional assistance in filing these returns. The Internal Revenue Service has three years from the date the tax return was filed to audit a return. In many cases, when a return is audited, the taxpayer needs further professional assistance. If the taxpayer disagrees with the IRS official, there are a number of avenues they can go through to appeal the decision. But many of these options take a very long time and are quite expensive.

One option that the taxpayer has had in the past to help in filing their tax return was a free taxpayer assistance offered by the government. The taxpayer could get advice on how to file a certain form or if an item was either income or a deduction either over the phone or in person. Unfortunately, Congress has cut the IRS budget each of the last four years, and so this service is no longer available except for some very basic questions.

Another issue related to the administration of the US tax code concerns all the forms and elections taxpayers are required to file. The timing of when certain elections need to be made, such as the election to be an S corporation or the election by a partnership to make a basis adjustment, are not clear to many taxpayers. Likewise, in 2015 almost all businesses may have to file a Form 3115, Change in Accounting Method, related to the new repair regulations. But many taxpayers do not know the requirements or even that there is a requirement that the form be filed. The IRS and the Department of the Treasury have just issued regulations attempting to simplify these issues by allowing an extended time to file certain elections and exempting smaller taxpayers from certain required filings, but these exemptions still do not help a large number of taxpayers. It would help to simplify the administration of the tax law if there were more exemptions such as these.

7 Long-term approaches

One way of significantly reducing both conceptual and readability complexity might be to adopt Professor Joseph Bankman of Stanford Law School's Ready Return concept,[32] which would take the burden off the lower and middle class taxpayer by sending them a pre-populated tax return reflecting their salary, wages, interest and dividends, and the tax thereon. If they were satisfied with the computation and inclusions, they would simply sign and mail back the return. If the analysis was not correct, they could file their own return. This is something that 36 countries are currently doing. Pre-filing has been found to be popular with many taxpayers in California, even though paying taxes will never be. Ironically, David Camp's Tax Reform proposal, which allegedly is trying to promote simplicity, has a provision[33] that absolutely prohibits pre-populated tax returns.

Another long-term approach would be to write a completely new tax code. The last time the US tax code was rewritten was in 1986. Unfortunately, even that attempt might have made the tax code more complex. At that time, instead of rewriting the entire tax code, many sections were kept intact with new sections added. Because the 1986 Tax Code is a combination of old and new sections, the terminologies are not the same. One of the most confusing issues for taxpayers that was introduced in the 1986 Tax Code is definitions of 'passive income' and 'passive activity income'. The meaning of these two very similar clauses have very different meanings in practice.

Several countries have tried to rewrite their tax law into a simpler format with mixed success. Part of the reason for the failure is that research has found that for simple sections and very complex sections, readability issues don't significantly help. That is, for simple concepts, people get it, and for complex sections, simplifying the presentation style does not help enough due to the underlying complexity of the provision. However, there is a middle ground of moderately complex sections that may be helped by a simpler writing style.

7.1 International readability experience: Australia, New Zealand and the United Kingdom

Instructive guidance for the US can be gleaned from the experience of rewriting tax legislation in each of Australia, NZ and UK. Sawyer succinctly reviews the three jurisdictions' efforts in rewriting their tax legislation, and concludes that while mistakes were made[34]:

> ...it is more a case of their goals being unrealistic, their timing misplaced and their breadth too narrow. While it is much easier to make suggestions after the event, if each jurisdiction was able to address significant (big P) policy and conceptual issues, and redraft their legislation in conjunction with these reviews, the outcomes would have been different. Potentially they might have delivered some real and effective simplification.

The NZ rewrite has been the 'most successful' of the three projects, in part due its generic tax policy process (GTPP),[35] along with the creation of the Rewrite Advisory Panel (RAP) to provide technical support to users of the rewritten legislation, which remains in place post the rewrite.[36] One important point is that the UK took a concept-based approach, whereas NZ took reorganisation and then parts of the Act based approach to achieve their goals.

7.2 Policy recommendations and conclusion

There are clearly lessons to be learned for the US. This includes developing a clear strategy;[37] build a constituency, including a leader who will take ownership in the project, and be the point person to head a panel such as NZ did with the RAP. It requires more than just a rewriting of the legislation, but a process that addresses the fundamental policy issues that may be causing the complexity which may serve to negate most (if not all) of the benefits of plain English drafting. The US should not

underestimate the challenges and needs to be prepared to see it through to the end.

Notes

1. Cited in Aaron, H. and Slemrod, J. *Crisis in Tax Administration*, Brookings Institution, 2004, Washington D.C.
2. Current Chairman of House of Representatives Ways and Means Committee which is the Constitutional source of revenue bills. Issued 26 February 2014, Subtitle 6 (p. 8).
3. Internal Revenue Code; Income, Estate, Gift, Employment and Excise Taxes (Summer 2014 Edition). ISBN 10:0808038095.
4. Tax Notes, 18 April 2005, p. 276 point out that there are 14 different phase-outs just within benefits to families.
5. Major constructive ownership provisions include Section 267, 318, 544, 1563, variations on a theme include 304, 382, 958, and 1239.
6. See Sections 52, 269, 304, 332, 367, 355, 368(c), 414, 1239, 1504, and 1563.
7. See How Does US Income Tax Law Define a Small Business? Let Me Count the Ways, by Stewart Karlinsky pp. 45–60, in Taxing Small Business: Developing Good Tax Policies, Australian Tax Research Foundation.
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