

Submission to the Regulation Taskforce

By

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Introduction and scope of submission

This submission addresses issues of tax law design and administration and models of taxation policy and legislative development with specific reference to compliance burden. The analysis is qualitative and relates to the tax law and policy changes following from the Government's implementation of the policies articulated in August 1998 in *Tax Reform, Not a new tax, a new tax system* (ANTS) that ushered in the Goods and Services Tax (GST) and the Review of Business Taxation (RBT) that reported in July 1999. It is submitted that those issues and concerns remain current to the late 2005 small business tax compliance situation.

The publications attached form part of this submission and are:

- Michael Dirkis and Brett Bondfield 'The RBT ANTS Bite: Small Business the First Casualty' (2004) 19 *Australian Tax Forum* 107-158 (referred to as Dirkis and Bondfield 2004 in this submission)
- Michael Dirkis and Brett Bondfield 'At the Extremes of a "Good Tax Policy Process": A Case Study Contrasting the Role Accorded to Consultation in Tax Policy Development in Australia and New Zealand' (2005) 11 *New Zealand Journal of Taxation Law and Policy* 250-276 (referred to as Dirkis and Bondfield 2005 in this submission)
- Michael Dirkis and Brett Bondfield "Small Business: The first casualty of compliance costs" Qualitative Report by the Taxation Institute of Australia (published March 2004). This report is based on Dirkis and Bondfield 2004 and contains a comprehensive bibliography of relevant references in this area.

It is my submission that the analysis and issues discussed in these papers, in particular Dirkis and Bondfield 2004, remain current and relevant to the Taskforce's review and deliberations. In the following discussion I will draw out the main themes contained in these publications as are relevant to the Taskforce's consideration of the issues before it. There may of course be material that the Taskforce finds relevant in the attached papers that is not specifically addressed below.¹

¹ This submission and the publications that form part of it represent my views and are not to be taken to represent the current views of my co-author or the Taxation Institute of Australia.

Overview:

Increasing regulatory burden appears to be an intractable problem when considering practical options for alleviating the Commonwealth's taxation 'red tape' burden on business

The problems of governments failing to address compliance costs is not confined to Australia. Yale University Professor Michael Graetz notes:

[e]ven when treated as a separate goal, rather than a facet of economic efficiency, simplicity always seems to be the forgotten stepchild of income tax policy. Routinely lip service is offered to the idea that tax law ought to be as simple to comply with and administer as possible; then, after a nod and a wink, vaulting complexity overleaps itself.²

This observation is applicable in Australia where ANTS, the RBT and the subsequent implementation processes have combined to increase compliance costs for small business and failed to adequately compensate for those costs.

Without detracting from the importance of the Taskforce's work it needs to be pointed out that there is a long history of such reviews. The most significant in recent times is that 10 years ago by the Small Business Deregulation Taskforce, its various reports and the Government's response in *More Time for Business*. The recommendations of that Taskforce, which were in the main accepted by Government, are still highly appropriate to our current taxation compliance climate.³ In fact the current tax compliance burden is probably greater now and relatively much greater on small business than in 1996.⁴

This is all the more concerning because:

[T]he fact that tax compliance was the largest component in small business compliance costs was unambiguously accepted by the Howard Government early in its first term. The Government and the Ralph Review [RBT] also accepted that no matter what method of evaluation is used tax compliance costs are strongly regressive and inversely proportional to the size of the business concerned. This regressive nature of tax compliance costs is endemic founded as it is on the scale of the business and available resources taken in order to meet the taxpayer's obligations.⁵

Here it is submitted that the key aspect to successful compliance burden reduction is political will and commitment as pointed out by the Small Business Deregulation Taskforce in 1996. The Joint 12 October 2005 Press Release 'Taskforce on Reducing the Regulatory Burden on Business' states that '[t]he Australian Government is determined to reduce the burden of regulatory activity' which could well have been a direct quote from the announcement of the 1996 Taskforce. As would the reference

² Michael J Graetz 'Taxing international income: Inadequate principles, outdated concepts, and unsatisfactory' (2001) 54 *Tax Law Review* 261 cited in Michael J Graetz *Foundations of international income taxation* (2003), 36.

³ Dirkis and Bondfield 2004 at 110-112 and 133-135.

⁴ Dirkis and Bondfield 2004 at 119-132.

⁵ Dirkis and Bondfield 2004 at 111 references omitted.

in the same paragraph to ‘more rigorous use of cost-benefit analysis within government before new regulations are introduced.’

The reasons for the failures of previous initiatives to lower, or at least to slow the increase, of the regulatory burden of the tax system over the long term needs careful consideration by the Taskforce. It is submitted that continued political commitment to this goal and an associated change over time in regulatory culture are essential to the long term abatement of the increase in regulatory burden and hopefully its overall reduction. There is also the need to consider ‘bold’ initiatives as the ‘standard’ ones that have arisen from previous reviews of regulatory burden do not appear to have had any lasting effect.

Identification of where regulation in the tax system is unnecessarily burdensome and complex

This submission focuses to reducing tax compliance burden and not deregulation. It does not argue for specific changes to the primary tax laws. Instead it takes a more macro review of the way that specific initiatives [ANTS and the RBT] have been designed and implemented and the insights that may be gleaned from these experiences.

Obviously some tax compliance burden on business is inevitable. It is submitted that in the design of recent tax law and policy initiatives that more directly impact on small business this impost has been higher than necessary, both in terms of complexity and administrative compliance.⁶ This is in no small part due to:

- the design of the initiatives placing a zealous focus on integrity and anti-avoidance;⁷ and
- a lack of initial and meaningful consultation at the early stages of policy design and later at the implementation phase.⁸

In terms of lowering tax compliance burdens the first mentioned matter of risk vs. return to the revenue could often be better dealt with through targeted enforcement strategies as opposed to detailed law and complex administrative process.

As regards the significant tax system changes flowing from ANTS and the RBT it is submitted that the Small/Medium Enterprise (SME) sector incurred significant compliance cost impacts post-tax reform as:

- ANTS ignored the compliance cost impact on small businesses resulting from the introduction of the GST;
- Ralph failed to meet its stated objective of reducing compliance costs for small business; and

⁶ Dirkis and Bondfield 2004 at 135-136. The specific example used in that article is the Simplified Tax System (STS) introduced as part of the RBT initiatives. For a more detailed critique of STS in this regard see Brett Bondfield 'If There is an Art to Taxation the Simplified Tax System is a Dark Art' (2002) 17 *Australian Tax Forum* 313-360.

⁷ Dirkis and Bondfield 2004 at 121-128.

⁸ Dirkis and Bondfield 2004 at 139-141 and more generally Dirkis and Bondfield 2005.

- the small business concessions (the Simplified Tax System (STS) and the small business CGT concessions) introduced to “compensate” small business for the increased compliance costs have proved to be inadequate in compensating small business.⁹

Possible solutions that allow legitimate tax policy objectives underlying the regulations to be achieved at less cost to business

Relax the initial strong constraint of revenue neutrality as a condition precedent for tax system change

Any meaningful reduction in compliance burden is very unlikely to come at no cost to the revenue. This is both in terms of system integrity and avoidance. The focus on revenue neutrality, integrity and anti-avoidance measures in tax system changes have lead to system complexity and the associated complexity of compliance along with stifling of novel responses to ameliorating or reducing compliance burden.¹⁰

Anti-avoidance and system integrity measures are important but it is how tightly they are drawn that impacts taxpayer compliance burden and this is an issue of risk management. If such tight checks are considered integral to the functioning of the tax system with it being accepted they have a disproportionate effect on small business and in certain cases are targeted at small business, such as the personal services income and non-commercial loss provisions that flowed from the RBT,¹¹ an argument for compensation to those affected may be entertained.

STS is used in Dirkis and Bondfield 2004 as an example of system design and focus on integrity that make a concept unnecessarily complex, as the risk to revenue is overly zealously guarded.¹² It is noted that since 2004 there have been changes made to STS in order to make it more user friendly with cash accounting no longer being mandated. The new 25 per cent entrepreneurs' tax offset is also tied to being a STS taxpayer.¹³

Seek to ensure that future large tax reform initiatives such as ANTS and the RBT engage with the wealth of small business compliance cost research

As set out in Dirkis and Bondfield 2004 there is evidence that singular significant initiatives in the area of tax reform such as the RBT do not pay sufficient attention to research that has gone before them and as such risk repeating previous errors and/or wasting resources.¹⁴

⁹ As argued in Dirkis and Bondfield 2004.

¹⁰ Dirkis and Bondfield 2004 at 135-136.

¹¹ Dirkis and Bondfield 2004 at 123-124.

¹² Dirkis and Bondfield 2004 at 141-151.

¹³ Both changes contained in *Tax Laws Amendment (2004 Measures No 7) Act 2005* with Royal Assent received on 1 April 2005.

¹⁴ Dirkis and Bondfield 2004 at 132-135.

Calculating the compliance costs

It is always important to focus on compliance cost reduction, as there are things that cannot be compensated.¹⁵ However, in order to combat compliance costs it is crucial to know what are the costs of particular measures at both the initial consultative phase and at the Parliamentary debate phase. Only with such knowledge can different approaches be evaluated and Government made aware and accountable for the costs it imposes.

It is heartening to see that the Board of Taxation is undertaking a scoping study of small business tax compliance costs.¹⁶ Further, it is submitted that the ATO/Treasury should enter the debate by developing an enhanced ability to monitor and model the compliance costs of the tax system.

Consultation: continuing the RBT's proposed institutional reforms

It is important to maintain the momentum of institutional reform to ensure that compliance costs are an essential part of any consultation process. There must be a will to meet the spirit of consultation and open up debate on all tax design and implementation aspects, rather than just the detail flowing from a set policy position.

Dirkis and Bondfield 2005 speaks to the importance of transparency as part of fundamental tax law design and the role of consultation therein. Openness and transparency in tax policy development comes at a cost and takes time, as is the New Zealand experience. Also a culture of consultation takes time to imbue in government agencies. The NZ model should be considered in this regard, not least in that it stresses the need for a culture of consultation and work load planning. Further, if such a defined and open consultative system slows the pace of tax system change that would be seen by most as a good thing.

Providing for post implementation review

There is a need to have in place the capacity to undertake transparent and independent post-implementation reviews of tax laws and policies. There is evidence that this capacity is starting to be being built. In October 2005 the Board of Taxation completed a post-implementation review of the quality and effectiveness of the small business capital gains tax concessions and commenced its first such post implementation review of the quality and effectiveness of the non-commercial loss quarantining provisions in 2003.¹⁷

¹⁵ Peter Burn 'Tax and Small Business - The Way Forward Roundtable Plenary Session' in Neil Warren (ed) *Taxing Small Business: Developing Good Tax Policies* Conference Series No 23 Australian Tax Research Foundation (2003), 217-218 stresses both the need to focus on compliance cost reduction and points out potential pitfalls in relying on compensation.

¹⁶ Treasurer 'Board Of Taxation To Undertake Scoping Study Of Small Business Tax Compliance Cost' (Press Release No 95, 4 November 2005)

¹⁷ For details of the non-commercial losses and small business capital gains tax concessions reviews see Board of Taxation website at: http://www.taxboard.gov.au/content/post_imp_reviews.asp accessed 21 November 2005.

Compensation

Despite measures to abate compliance burden there will be occasions where compliance costs are inevitable and regressive in their impact on small business and compensation is an appropriate course. Although, there are things that cannot be compensated (such as business opportunities missed because business resources were needed to meet the tax compliance requirements), compensation should still considered as an option.

Yours faithfully

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