

Small business: The first casualty of tax reform compliance costs

A qualitative study of the impact of tax reform on the compliance costs for small business

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Executive Summary

The Government, since 1996, has stated that the reduction of red tape (and the associated costs of complying with those rules) for small business is one of its key focuses. This recognises that compliance costs are a major impediment facing small business.

Despite these concerns, the reduction of compliance costs was not a focus of the 1998 *Tax Reform, Not a new tax, a new tax system* (the ANTS document), which included recommendations to introduce a goods and services tax (GST). However, it was adopted as one of the aims of the Review of Business Taxation (the so called Ralph Review).

In light of the above, the focus of this research was to undertake a qualitative study of the impact of tax reform on the compliance costs for small business and the possible causes of any resultant change.

The researchers found that:

- There are clear and consistent claims and some supporting empirical evidence that the global small business tax compliance costs post-ANTS/Ralph have increased significantly and are probably even more regressive than they were pre tax reform (1998); and
- The cost to the ATO of administering the GST are minor when compared to costs facing small business taxpayers.

The Report examines why the recent tax reform failed to reduce compliance costs. It found that the failure to reduce compliance costs occurred at both the Review and the implementation stages. In particular, the Ralph Review made recommendations for reform without due consideration of the vast volume of small business compliance cost research material available. It merely paid lip service to its compliance cost reduction objective. The Ralph Review avoided and/or refused to publicly analyse the root causes

of the small business compliance cost predicament and thus did not tailor recommendations in such a way as to minimise overall additional compliance costs.

The words of Yale University Professor Michael Graetz when speaking generally about the US Governments failure to address compliance costs sum up the Ralph treatment:

“ . . . 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.”

The other major reason for failure lies in poor implementation. Within this discussion the report identifies two causes: continued institutional failures and failures in consultation. Despite the level of consultation post Ralph being a major improvement on any previous reform process, the failure to adopt the recommendations of user-based design has compromised the most recent round of tax reform.

The Report concludes that one reading of the Ralph Review's 1999 final report (*A Tax System Redesigned*) is that the Ralph Review appears to have abandoned legislative simplicity, seeking instead to address the additional compliance costs through tax concessions. These concessions were principally the Simplified Tax System and Capital Gains Tax (CGT) concessions for small business.

However, the report concludes that both these measures have failed to adequately compensate for the increased compliance costs. For example, of the eligible taxpayers having lodged their 2002 tax returns (as at 17 April 2003), only 14% have opted into STS. The authors also explore the background as to why these compensation measures failed.

In order to guard against similar compliance cost blow-outs in the future the Report, against a general recommendation for further debate, recommends the following:

Recommendation 1

In order for the tax policy to be properly developed, it needs to be made with full knowledge about the cost of compliance of a measure. The Treasury, in consultation with the Australian Taxation Office should develop an enhanced ability to monitor and model the taxpayers' compliance costs in the tax system. This should be supported by technological infrastructure that allows for a timely and methodologically robust monitoring capacity.

Recommendation 2

In order for the Parliament to be fully informed about the cost of compliance of a measure, a more publicly accountable Regulation Impact Statement (RIS) process needs to be established which sets out taxpayer compliance costs arising from the proposed change so that they can weight up the public good against the compliance costs imposed.

Recommendation 3

To have in place the capacity to undertake timely, transparent and independent post-implementation reviews of all tax law and policy changes.

Recommendation 4

Where the public good is deemed to be more important than the additional compliance costs imposed, Government needs to investigate the feasibility of compensation via a direct concession, via rebate (tax offset), a cash grant (based upon a percentage of turnover or the actual level of cost to the business) or a lower tax rate for business income of small businesses.

These methods are used in other jurisdictions. Either approach has the advantages of being able to be clearly monitored for its revenue costs and take-up rate. It is also more amenable to adjustment up or down or to widen or contract the eligibility criteria should circumstances require.

In summary, the Report concludes that in order to safeguard future small business compliance cost reform from the casualty ward, the way forward should involve both compliance cost reduction and targeted compensation based upon robust research.

1. Introduction

The origins of Australia's recent round of tax reforms was a statement by the Prime Minister John Howard on 25 May 1997 setting the framework for the reform process.¹ This was followed in August 1997, when the Prime Minister announced a Taxation Task Force (an inter departmental committee headed by Treasury, with representatives from Prime Minister and Cabinet Department, the Australian Taxation Office (ATO), the Treasurer's office and the Cabinet Policy Unit) charged with the preparation options for reform of the taxation system and required to report to the Prime Minister in three months.²

In August 1998 the Government released³ the *Tax Reform, Not a new tax, a new tax system* (the ANTS document), which included recommendations to introduce a goods and services tax (GST) and to tax trusts as companies.⁴

In order to facilitate development of the GST reform proposals, the Treasurer announced on 27 October 1998 the appointment of a Tax Consultative Committee, chaired by David Vos, to assist in determining the final design of five key matters in the GST (health, education, religious services, charities and motor vehicles).⁵ One of the Committee's terms of reference was:

1 John Howard, 'Transcript of the Prime Minister the Hon John Howard MP Address to Bradfield Federal Electorate Autumn Lunch, Bradfield' (Sydney, 25 May 1997).

2 Prime Minister, 'Taxation Reform' (Press Release, 13 August 1997). The broad guidance given to the Task Force was that: (a) there should be no increase in the overall tax burden; (b) any new taxation system should involve major reductions in personal income tax with special regard for the taxation treatment of families; (c) consideration should be given to a broad based, indirect tax to replace some or all of the existing indirect taxes; (d) there should be appropriate compensation for those deserving of special consideration; and (e) reform of Commonwealth/State financial relations must be addressed.

This process was assisted by a Tax Reform Consultative Task Force (a Liberal Party's backbench committee chaired by Senator Brian Gibson (the Gibson Committee)), which took submissions from the public and channeled them into the Treasury Task Force. The Gibson Committee was not required to publish a formal report. Also see Peter Costello, Treasurer, 'Tax Consultative Task Force, tax reform', (Press conference, 23 October 1997).

3 Treasurer, 'A New Tax System for all Australians' (Press Release No 79, 13 August 1998).

4 Peter Costello, Commonwealth, *Tax Reform, Not a new tax, a new tax system* (August 1998). For a summary of this reform process see John Harrison, 'The GST Debate-A Chronology: Background Paper No 1 1997-98' (1997) (updated by Marilyn Stretton – 1999) at URL: <http://www.aph.gov.au/library/pubs/chron/1998-99/99chr01.htm> located on 1 March 2004.

5 Treasurer, 'Tax Consultative Committee' (Press Release No 103, 21 October 1998). The Committee released a report on 13 November 1998 - Tax Consultative Committee, Commonwealth, *The Report of the Tax Consultative Committee* (1998) at URL: <http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=168> located on 3 March 2004.

. . . in framing its recommendations to the Government, the Tax Consultative Committee will need to:

- . . . ensure the recommended scope of the GST-free areas are as simple and clear as possible; [and]
- ensure the resulting compliance and administrative costs of its recommendations are kept to a minimum.⁶

A subsequent Senate Inquiry into the ANTS proposals, which also focused on the tax free status of food, education and health, included compliance costs in its terms of reference. However, as with the Vos Committee, the compliance cost objective was limited to compliance costs arising from the zero rating food.⁷

To enable consultation with business on the business tax reform proposals released as part of the ANTS package, the Treasurer established the Review of Business Taxation, chaired by John Ralph (commonly known as the "Ralph Committee", "Ralph Review" or "RBT"). The Ralph Committee, which was to be assisted by the Treasury Tax Reform Task Force, was initially required to report to Government by 31 March 1999.⁸ The Ralph Committee's tax policy objectives were to:

- improve the competitiveness and efficiency of Australian business;
- provide a secure source of revenue;
- enhance the stability of taxation arrangements;
- improve simplicity and transparency; and
- reduce the costs of compliance

against an overall revenue neutrality objective.⁹

6 Press Release 103/98, *ibid*.

7 Treasurer, 'Senate Inquiry on Government's taxation reform package' (Press Release No 111, 10 October 1998).

8 Treasurer, 'Business Income Tax Consultation' (Press Release No 81, 14 August 1998). Subsequently the Treasurer appointed Bob Joss and Rick Allert to assist John Ralph and replaced the Treasury Tax Reform Task Force with a secretariat, located in Treasury (consisting of officers from the Treasury, the ATO and the Department of Industry, Science and Resources, as well as a number of external advisers), to assist the Review. The reporting date was extended until 30 June 1999 - Treasurer, 'Review of Business Taxation' (Press Release No 104, 27 October 1998). In June 1999 the reporting date was further extended to 30 July 1999 - Treasurer, 'Review of Business Taxation' (Press Release No 34, 17 June 1999).

9 The policy objectives of the RBT were set out in the Press Release 81/98, *ibid*, Attachment, in Review of Business Taxation, Commonwealth, *A Strong Foundation: Discussion Paper establishing objectives principles and processes* (1998) (A Strong Foundation) and the Review of Business Taxation, Commonwealth, *A Tax System Redesigned* (1999), v and vii (A Tax System Redesigned). The Review produced two other discussion papers: Review of Business Taxation, Commonwealth, *An International Perspective: An Information Paper commissioned from Arthur Andersen examining how other countries approach business taxation* (1998) and Review of

To summarise, when reviewing the policy objectives of the ANTS it is clear that compliance costs were not a focus. Further, in the subsequent GST reviews the impact of compliance costs was only a limited focus (ie limited to the compliance cost arising from zero rating certain GST services). In contrast, compliance costs were a policy objective of the Ralph Review. The Ralph Committee was charged with devising measures aimed at increasing the efficiency of all Australian businesses and, most importantly, tackling the related problems of the lack of simplicity and burgeoning compliance costs faced by business.

This compliance/simplification focus of the Ralph Review was crucial for small business as tax was, and is, seen as the largest regulatory compliance issue for small business.¹⁰ Prior to the Ralph Review the Small Business Deregulation Task Force (Bell Task Force), which was charged with assessing the regulatory burden on small business and the options for reducing that burden,¹¹ agreed noting in its November 1997 report *Time For Business* that the '[t]ime consumed in taxation compliance is a dead loss, adding no value to business.'¹² The report elaborated further, stating that:

[t]he complexity of regulations, the frequency of complying and coping with constant changes, and the time needed to comply with the record keeping requirements, added to the frustration felt by small business.¹³

This point and the fact that tax compliance was the largest component in small business compliance costs was unambiguously accepted by the Howard Government early in its

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- Business Taxation, Commonwealth, *A Platform for Consultation: Discussion Paper 2 Building on a strong foundation* (1999) (A Platform for Consultation).
- 10 Yellow Pages Small Business Index *Working Overtime: A National Survey of the Paperwork Burden on Small Business* Background Paper 3 Small Business Deregulation Task Force (October 1996) and House of Representatives Standing Committee on Industry, Science and Technology *Small Business In Australia – Challenges, Problems and Opportunities: Recommendations and Main Conclusions*, (David Beddall MP (Chair)) (January, 1990) at xxix (Beddall Report).
- 11 Small Business Deregulation Task Force (Charlie Bell (Chair)), Commonwealth, *Time For Business: Report of the Small Business Deregulation Task Force* (1996) (Time for Business). The Small Business Deregulation Task Force was established to, amongst other things, compare the different approaches to reducing Government 'red-tape' taken recently at Commonwealth, State and Territory levels; and to identify the lessons learned in devising and applying policies to reduce regulatory burden - see *Time for Business*, vii.
- 12 *Time for Business*, *ibid*, 28. Chris Evans, et al, *A Report into Taxpayer Costs of Compliance* (1997) concludes the costs are significant as well as including consideration of the positive business effects flowing from tax compliance.
- 13 *Time for Business*, *ibid*, 16.

first term.¹⁴ The Government¹⁵ and the Ralph Review¹⁶ 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.¹⁷ This regressive nature of tax compliance costs is endemic¹⁸ founded as it is on the scale of the business and available resources taken in order to meet the taxpayer's obligations.¹⁹ However, despite the recognition by the Government in 1997 of the importance of compliance/simplification issues to small business, and the asserted continuation of the reduction objectives in the Ralph Review, this report will argue that compliance costs for small business have in fact increased through the tax reform process rather than entering into a remission.

The political importance of the regulatory burden (not just tax) on small business can be seen in the 2004 federal pre-election skirmishing. On 26 November 2003 the Government announced the establishment of a new advisory body on small business, the Small Business Council. The Small Business Council is charged, amongst other things, with providing 'ideas to reduce the compliance burden for small business.'²⁰ The Labor

14 John Howard, Prime Ministerial Statement *More Time for Business* (24 March 1997), iv noted "[d]ealing with our complex tax system was the number one compliance issue identified by small business".

15 Treasurer, 'The New Business Tax System' (Press Release No 58, 21 September 1999).

16 A Tax System Redesigned, above n 9, 575-6 citing with approval Evans et al (1997) above n 12 and Chris Evans et al, *Costs of taxpayer compliance — Final Report* (1996).

17 Evans et al (1997) above n 12, viii and 85; Yellow Pages Small Business Index, above n 10, 3-7 and Chapter 3, OECD *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small and Medium-Sized Enterprises* (2001), 8 [Located at: <http://www1.oecd.org/publications/e-book/4201101E.PDF> on 20 December 2003] and Gary Banks (Chair, Productivity Commission), 'The good, the bad and the ugly: economic perspectives on regulation in Australia' (Paper presented at the Conference of Economists, Business Symposium, Canberra, 2 October 2003), 5. In the NZ context the results are comparable: Cedric Sandford and John Hasseldine, *The Compliance Costs of Business Taxes in New Zealand* (1992), 110.

18 Stephen Rimmer and Stuart Wilson *Compliance Costs of Taxation in Australia* Staff Information Paper, Office of Regulation Review (July 1996), 26-27 and OECD, *Ibid*, 8 and 13.

19 Cynthia Coleman and Chris Evans 'Tax Compliance Issues for Small Business in Australia' in Neil Warren (ed) *Taxing Small Business: Developing Good Tax Policies* Conference Series No 23, Australian Tax Research Foundation (2003) 147, 169-170. A Tax System Redesigned, above n 9, 74 expresses the issue succinctly: "Small business proprietors must prepare and retain a myriad of documents for taxation and other purposes' incurring substantial costs and having sub-optimal systems and expertise to do so." See also Ralph Lattimore, et al, *Design Principles for Small Business Programs and Regulations*, Productivity Commission Staff Research Paper (August 1998) generally and particularly, xxiv.

20 Joe Hockey (Minister for Small Business and Tourism), 'Small Business Council First Meeting' (Media Release 03/254 26 November 2003). Located at: http://minister.industry.gov.au/media_releases.cfm?objectid=2189B58D-38C3-460F-A613C2A74B1A3A84 on 17 January 2004. A further illustration of the perceived political importance of the issue in an election year is the Treasurer's recent acknowledgement of the problem – see John Arbouw 'Costello: Tax, super and governance' (2004) 20(2) *Company Director* 10,13 and 14 and Terry Mc Crann 'Forecast' Issue 1 of *Business Owner*, a *Daily Telegraph* magazine supplement, 23 March 2004, 5.

Party in its bid for Government has focussed on the compliance impact of the Business Activity Statement (BAS) and on 12 January 2004 gave undertakings to reduce the burden.²¹ Interestingly the government's Small Business Council has been criticised as a re-badging of an expired committee²² and Labor's BAS policy has been branded a re-release of a policy dating back to March 2002.²³ If nothing else this illustrates the ongoing entrenched nature of the difficulties of reducing the small business compliance burden.

It is argued in this report that the Small/Medium Enterprise (SME) sector is the main casualty 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
- the small business concessions (the Simplified Tax System (STS) and the small business CGT concessions)²⁴ introduced to "compensate" small business for the increased compliance costs have proved to be inadequate in compensating small business.

Given that ANTS failed to address compliance costs, the report will focus on the argument that Ralph failed in its objective of reducing compliance costs in its business tax reform agenda. The reasons underlying Ralph's compliance cost reduction failure and why compensation failed are also discussed.

21 Mark Latham (Leader of the Opposition), 'A Simpler BAS for Small Business' (Media Release 12 January 2004). Located at: <http://www.alp.org.au/media/0104/20006707.html> on 17 January 2004. See also private members bill introduced by Mark Latham into the House of Representatives on 18 August 2003: *Taxation Laws Amendment (A Simpler Business Activity Statement) Bill 2003*.

22 Stephen Conroy (Deputy Leader of the Opposition in the Senate, Shadow Minister for Trade, Shadow Minister for Corporate Governance, Financial Services and Small Business), 'Hockey's Small Business Talk Fest' (Media Release 18 November 2003). Located at: <http://www.alp.org.au/media/1103/20006406.html> on 17 January 2004.

23 Joe Hockey (Minister for Small Business and Tourism), 'Labor Dusts Off Old Policy' (Media Release 12 January 2004). The Labor BAS simplification proposal is consistent with its position adopted in October 2001 in the lead up to the November 2001 Federal Election (see Allesandra Fabro 'Rollback shows ALP listening' *Australian Financial Review* (13 October 2001), 8).

24 Chapter 17 of A Tax System Redesigned, above n 9. STS was generally endorsed by government and enacted by *The New Business Tax System (Simplified Tax System) Act 2001*. Chapter 17 also recommended streamlining and rationalising Capital Gains Tax (CGT) provisions for small business this was accepted by government with minor alterations and enacted by *The New Business Tax System (Capital Gains Tax) Act 1999* effective 21 September 1999. These provisions are analysed and critiqued in Garry L Payne 'Problems With Current Tax Concessions For

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Although the report focuses on the key policy objective for small business (compliance costs) any departure from the other Ralph tax policy objectives will be noted in that discussion. However, as the legal/policy analysis approach adopted does not easily lend itself to detailed analysis of system-wide objectives such as revenue neutrality, stability of tax arrangements and the tax base, these Ralph policy objectives will not be evaluated.

Having established these arguments, the report concludes by briefly exploring the possible ways forward for future reform processes to ensure that small business is not again the major casualty of tax reform.

The report's approach to analysing the increased level of compliance costs is in the main qualitative, not empirical, as there is to date no empirical data on the total cost to the taxpayer of tax system compliance post the implementation of the GST and the Ralph recommendations. A qualitative analysis of the situation of small business tax compliance after Ralph is at one level speculative. However, at a policy and system design level it is instructive so that we can identify and learn from the operative successes as well as the (buried) mistakes.

2. Context – The importance of simplification and compliance for small business

Before embarking on exploring these arguments, it is important to provide some background and context, by briefly examining the importance of simplicity and the costs of tax compliance (and its quantification) on small business.

A common thread in the reviews and studies conducted from Adam Smith in 1776²⁵ to the Board of Taxation's 2003 report on the Review of International Taxation Arrangements²⁶ is the use in most of those inquiries of the tax policy objective of simplicity in evaluating the effectiveness of existing laws and the proposed tax reforms.²⁷ Academic commentators also broadly accept simplicity as one of three key tax policy objectives (equity, efficiency and simplicity) traditionally used for evaluating tax systems.²⁸

2.1 Why simplicity is important to compliance costs²⁹

Initially it is important to be clear what constitutes the term “simplicity” and why it is of particular importance to small business.

25 Adam Smith, *An inquiry into the nature and causes of the wealth of nations* (1776) - version used Edwin Cannan (ed) (1904), reprinted (1961).

26 The Treasury, Commonwealth, *Review of International Taxation Arrangements: Consultation Paper* (2002); The Board of Taxation, Commonwealth, *International Taxation: A Report to the Treasurer* (2003) and Treasurer, 'Review of International Taxation Arrangements' (Press Release No 32, 13 May 2003).

27 See Paul Kenny 'A 'Simplified Tax System' for small business' (2002) 6 *The Tax Specialist* 36, who reviews the Ralph Committee's small business specific initiative, STS, against the good tax objectives of equity, efficiency and simplicity.

28 See, eg, Geoffrey Lehmann and Cynthia Coleman, *Taxation in Australia* (5th ed, 1998), 65, Robin H Woellner et al *Australian Taxation Law* (13th ed, 2003), 26-37, Jeffrey Waincymer *Australian Income Tax: Principles and Policy* (2nd ed, 1993), 24-39 and Rodney Fisher 'Ralph Review: reform by name but not nature?' (2003) 7 *Tax Specialist* 61, 62. However, not all commentators agree that the objectives of simplicity, efficiency and equity are good predictors of the tax system. For example Simon Blount 'The Art of Taxation' (2001) 16 *Australian Tax Forum* 345, 355 argues that the better predictors are the objectives of elasticity, complexity and invisibility. Further, Graeme Cooper, Richard Krever, and Richard Vann, *Income Taxation: Commentary and Materials* (4th ed, 2002), 3, warn that although the three tax policy objectives dominate bureaucratic thinking, since the 1970s tax policy analysis in public finance literature has been based upon the use of welfare economics (ie optimal taxation).

29 This part of the paper is drawn from work done as part of Michael Dirkis's Phd programme.

Simplicity is broadly accepted as an obvious goal of any revenue raising and regulatory system.³⁰ It is generally accepted that income tax is in varying degrees intrinsically complex³¹ and there have been continual complaints in reports and in the literature about the complexity of the tax system since its inception.³²

The importance of simplicity is that in its absence tax laws are complex (uncertain) and poorly designed, which in turn:

- imposes high compliance costs on the community;³³
- imposes high administrative costs on the tax authorities;³⁴
- results in socially unproductive and costly tax litigation;³⁵
- is counterproductive to the economic development of the country,³⁶ in particular by jeopardizing economic neutrality;³⁷
- acts against public involvement in policy development;³⁸ and
- generates disrespect for the rule of law.³⁹

30 Though this is considered by some to be advanced as a platitude, for example Graeme S Cooper 'Themes and issues in tax simplification' (1993) 10 *Australian Tax Forum* 417, 420 and also at 426-32, suggests ". . . there is little empirical work that can verify the grand, but largely unsupported, claims for the benefits of simplification".

31 United Kingdom, *Report of the Income Tax Codification Committee* Cmd 5131 (1936), 17 noted "[t]he impossibility of producing a simple code of income tax law must be obvious to anyone who reflects for a moment . . . The countless complications of modern life must inevitably reflect in the complexity of the code which has to cope with them". This was cited with approval by the Commissioner of Taxation - see the Commissioner of Taxation, Commonwealth, *Eighteenth Report* (1936), 14. Also see Stanley S Surrey, 'Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail' (1969) 34 *Law and Contemporary Problems* 673, 680; Commonwealth, *Reform of the Australia Tax System: Draft White Paper* (1985), 42, 15, Michael Carmody, 'Issues Confronting Australia's Tax System' (Paper presented in Financial Review Leaders Lunch, Sydney, 29 July 2002), 14 copy located at: <http://www.ato.gov.au/content.asp?doc=/content/Corporate/sp200207.htm> accessed 22 December 2003, and Banks, above n 17, 3.

32 Commonwealth, Royal Commission on Taxation, *Reports* (1933-34) (the 1932 Royal Commission), 6.

33 Discussed in the following sections.

34 As complexities continue to rise and so do complex boundaries for the ATO to police. The total cost of the tax system may rise as it is the sum of compliance costs and administrative costs borne primarily by the ATO - Evans, above n 12, 86 and Cedric Sandford 'International Comparisons of Administrative and Compliance Costs of Taxation' (1994) 11 *Australian Tax Forum* 291, 301.

35 1985 Draft White Paper, above n 31, 14 & 15.

36 See, eg, Law Reform Commission of Victoria Plain English and the Law (1987), 59; Ed, 'Counting the costs' (1991) 26 *Taxation in Australia* 248; and Brian Nolan and Tom Reid 'Re-writing the Tax Act' (1994) 22 *Federal Law Review* 448, 450.

37 Complexity can create a lack of economic neutrality by favouring projects with more predictable tax outcomes - Mark Burton and Michael Dirkis 'Defining Legislative Complexity: A case study - the Tax Law Improvement Project' (1995) 14 *University of Tasmania Law Review* 198, 204.

38 Certainty about tax laws allows for a widespread, informed debate upon taxation policy issues, which is essential to the functioning of democracy - see C Havighurst and R Hobbet 'Foreword' (1969) 34 *Law and Contemporary Problems* 671 cited in Burton, above n 37, 206.

39 It is argued that if taxpayers lose faith with the tax law as a body of rules, voluntary compliance will suffer and the government in introducing measures, which protect the revenue, will incur greater cost - see Ross Parsons 'Income tax - An Institution in Decay?' (1986) 3 *Australian Tax*

Despite the self-evident nature of the concept of simplicity, the myriad of writings on the topic present what appears to be an unending array of definitions of what constitutes simplicity. Cooper, having reviewed the literature, suggests that the many and varied concepts discussed by writers can be distilled down to seven concepts that are embodied in the notion of simplicity.⁴⁰ Although other writers have distilled what appear to be different concepts underlying simplicity, these are generally based upon subtle differences in classification and expression.⁴¹ A common thread is that low compliance costs of both taxpayers and the tax system generally is a desirable goal within the rubric of simplicity that is in turn a central pillar of good tax policy. Why it and compliance costs are of such specific relevance to small business is that compliance costs are regressive.

Bearing in mind the above the key measurement approach is to focus on the cost of compliance.⁴² Most academic research has focused on the compliance costs from the taxpayer's perspective⁴³ as the global costs of collection are usually obtained from the budgets of the revenue authorities.⁴⁴ Although there has been a lot of research, the

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- Forum* 233 and Adam Broke 'Simplification of tax or I wouldn't start from here' [2000] *British Tax Review* 18 sees four causes of complexity: diversity, volume, drafting and language.
- 40 Cooper, above n 30, 424 being: predictability (ease of understanding) of a rule's intended (and actual) scope; proportionality (complexity proportional to the policy); consistency (avoids arbitrary distinctions); low compliance; easy administration; co-ordination with other tax rules; and clear expression.
- 41 For example: predictability, enforceability, difficulty and manipulability – Joel Slemrod 'Complexity, compliance costs and tax evasion' in JA Roth and JT Scholtz, *Taxpayer Compliance: Social Science perspectives* (1986) 156 cited in Binh Tran-Nam 'Tax Reform and Tax Simplicity: A New and 'Simpler' Tax System?' (2000) 6 *University of New South Wales Law Journal Forum* 6.
- 42 Joel Slemrod 'Did the Tax Reform Act of 1986 simplify tax matters?' (1992) 6 *Journal of Economic Perspective* 45 suggests that the total operating costs of the tax system is a measure of the complexity of the system – cited by Jeffrey Pope 'Policy Implications of research on compliance costs of taxation' in John G Head and Richard Krever (eds) *Taxation towards 2000* (2000), 617, 637.
- 43 Chris Evans, et al 'Taxation compliance costs: Some recent empirical work and international comparison' (1998) 14 *Australian Tax Forum* 93; For an excellent overview of some of the current debates and trends in this area see: Chris Evans, Jeff Pope and John Hasseldine (Eds) *Tax Compliance Costs: A Festschrift for Cedric Sandford* (2001), Volume 17 Number 4 *Australian Tax Forum* focussing on tax compliance cost research and dedicated to Cedric Sandford and a series of studies by Jeff Pope et al starting with Jeffrey Pope, Richard Fayle and M Duncanson, *The compliance costs of personal income taxation in Australia 1986/87* Research Study No 27, Australian Tax Research Foundation (1990) and more recently Jeff Pope and Prafula Fernandez 'The Compliance Costs of the Superannuation Surcharge Tax' (2003) 18 *Australian Tax Forum* 537.
- 44 For example Banks, above n 17, 3 notes that in 2001-2002 the ATO employed 19,381 staff of the 30,720 employed by the main Commonwealth regulatory agencies with expenses of \$3043 million (out of an all main regulatory agency expense total of \$4,566 million).

accuracy of the results has been questioned, based on methodological concerns⁴⁵ including sample size, response rates⁴⁶ and the inability to measure the impact upon compliance costs when changes are implemented.⁴⁷

2.2 Compliance Costs with special reference to small business

The Small Business Deregulation Task Force Report provides a useful definition of compliance costs that it refers to as ‘burden’ being:⁴⁸

The additional paperwork and other activities that small business must complete to comply with government regulations. The time and expense outlaid are over and above normal commercial practices. The burden includes lost opportunities and disincentives to expand the business.

This accords with accepted writings in the area,⁴⁹ though more recent writings also net these compliance costs against managerial benefits from tax compliance,⁵⁰ for example cash flow monitoring benefit as part of GST compliance.

At a macro level compliance costs must be viewed within the context of two overarching facts. First, from September 1985, when it was first announced that traditional taxation administration arrangements were to be replaced with self assessment, a large compliance burden has shifted from the tax administrator to the taxpayer.⁵¹ In Australia it is submitted that its introduction from 1 July 1986 was piecemeal and that there has been

45 OECD, above n 17, 13-15.

46 Joel Slemrod ‘Which is the simplest tax system of them all’ in Henry J Aaron and William G Gale (eds) *Economic effects of fundamental tax reform* (1996) and Banks, above n 17, 5.

47 Cooper, above n 30, 426; though the identification and measurement of transitional compliance costs is an area receiving considerable recent attention (possibly due to the pace of tax system change) see for example Binh Tran-Nam and John Glover ‘Estimating the Transitional Compliance Costs of the GST in Australia: A Case Study Approach’ (2002) 17 *Australian Tax Forum* 499 and Nthathi Rametse and Jeff Pope ‘Start-up Tax Compliance Costs of the GST: ‘Empirical Evidence from Western Australian Small Businesses’ (2002) 17 *Australian Tax Forum* 407.

48 Time for Business, above n 11, 1.

49 Binh Tran-Nam & Chris Evans ‘The Impact of Cedric Sandford on the Discipline of Tax Compliance Costs’ (2002) *Australian Tax Forum* 389 at 396-397.

50 See generally Binh Tran-Nam et al ‘Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia (2000) 53 *National Tax Journal* 229 and Kenny, above n 27, 37.

51 Aspects of the self-assessment system are to be reviewed by the Department of the Treasury: Treasurer, ‘Review of Aspects of Income Tax Self-assessment’ (Press Release No 98, 24 November 2003).

a failure of the system to fully address the power imbalance created through ensuring timely, accessible and binding information.⁵²

Second, this macro community cost can be increased through incompetent advice and inadvertent non-compliance as a result of complexity.⁵³ Complex income tax laws, which make it impossible to form a defensible view in respect of the law, discourage thorough tax advisers, as they are unable to justify their fees for such uncertain outcomes. As a result, less thorough advisers can charge less for their equally uncertain advice (the so called Gresham's Law).⁵⁴

52 Michael Dirkis and Michael Payne-Mulcahy 'Time for a change: Self assessment 14 years on' (2002) 36 *Taxation in Australia* 417.

53 Margaret McKerchar *The Impact of Complexity upon Tax Compliance: A Study of Australian Personal Taxpayers* Research Study No 39, Australian Tax Research Foundation (2003).

54 HH Monroe 'Fiscal Statutes: A Drafting Disaster' [1979] *British Tax Review* 265, 268; Committee on Tax Policy of the New York State Bar Association's Tax Section, 'A Report on Complexity and the Income Tax' (1972) 27 *Tax Law Review* 325, 327; and Burton, above n 37, 205.

3. Failure to reduce compliance costs

In order to establish that tax reform failed to meet its stated objective of reducing compliance costs for small business it is important to set out the level of compliance costs pre-ANTS and Ralph, the level of change and the compliance burden post-ANTS and Ralph

3.1 The pre-ANTS and Ralph compliance burden

As far back as 1990 a parliamentary committee expressed major concern at the growth in the tax laws in the preceding five years⁵⁵ - the pace of change has only picked up from there. At the time of the 1996 Bell Task Force Australia's tax compliance burden was:

Generally towards the higher end of comparable tax regimes, but by no means the highest in the OECD.⁵⁶

A recent OECD paper analyses and compares small and medium business compliance costs in three areas of regulation; tax, employment and environment for the April 1998 to May 1999 (pre Ralph) period of 11 countries, including Australia and New Zealand.⁵⁷ This report is instructive as it reinforces the points made previously in this report that overall tax is the largest single component of the small business regulatory burden⁵⁸ and that regulatory burden is regressive, cumulative, significant⁵⁹ *and increasing*.⁶⁰

The OECD report finds 80% of those surveyed in Australia asserted that their tax compliance increased in the 2 years before 98-99, this is the second highest ranking after Mexico.⁶¹ In terms of a pre-ANTS/Ralph sample the report identifies complexity of the tax laws as the main compliance cost vector,⁶² though now tax system change may be an increasingly significant cost component in the current Australian environment. In a study

55 Beddall Report, above n 10, xxix.

56 Chris Evans and Michael Walpole *Compliance Cost Control: A Review of Tax Impact Statements in the OECD Research Study No 27*, Australian Tax Foundation (1999), 15.

57 OECD above, n 17.

58 Ibid, 23.

59 Ibid, 21 asserting significance.

60 Ibid, 30 found that 60% of those surveyed asserted this increase and the Australian position approximates that figure, 59.

61 Ibid, 56. 80% figure cited by Banks above n 17, 4.

62 Ibid, 30-31.

published twelve years ago on the New Zealand tax compliance situation researchers were of the view that the stability of the system was important in order to minimise ‘temporary compliance costs.’⁶³ Given the acknowledged rate of change in Australia’s tax system these costs may well be near endemic, skewing the responses to research and inflating the costs as located.

The OECD study found that Australian firms surveyed were particularly critical of the service provided by their regulations and regulators. High by comparison to other surveyed countries 94% of Australian respondents were of the opinion that regulations did not achieve their goals as simply as possible.⁶⁴ Further, Australian firms rated the quality of their contacts when seeking information from regulators (tax, employment and environment) consistently lower than firms in comparable countries.⁶⁵

Overall the OECD report finds Australia to be just above the average for compliance costs over the aggregate of the three areas sampled. For the purposes of Trans-Tasman comparison the report finds the New Zealand aggregate costs of compliance over tax, employment and the environment to be the lowest of the eleven countries analysed.⁶⁶ However, the tax compliance cost per employee in Australia was reported as being slightly less than the cost in New Zealand.⁶⁷

3.2 ANTS and Ralph proposals impacting on small business

The introduction of the GST⁶⁸ had a major impact on small business, with the number of businesses collecting indirect taxes rising from 78,936 (for wholesale sales tax

63 Sandford and Hasseldine above n 17, 119.

64 OECD, above n 17, 64

65 Ibid, 73.

66 Ibid, 22.

67 Ibid, 108 figure 5.

68 The GST measures were part of a package of 17 Bills. The main GST implementation provisions were contained in the following three Acts: *A New Tax System (Goods and Services Tax) Act 1999*, *A New Tax System (Goods and Services Tax Transition) Act 1999*, and *A New Tax System (Goods and Services Tax Administration) Act 1999*. The GST measures, since introduction, have been subjected to hundreds of changes. These are principally contained in *A New Tax System (Indirect Tax and Consequential Amendments) Act (No 1) 1999* and *A New Tax System (Indirect Tax and Consequential Amendments) Act (No 2) 1999*.

registrants) in 1998-1999⁶⁹ to 2,193,707 million (registered businesses for GST) in 2000-01.⁷⁰ On top of the costs associated with new record keeping and receipting (tax invoice) systems, most business were faced with a new quarterly GST reporting and collection process. For many other business taxpayers with GST refunds, such as pharmacists, monthly activity statements are the norm. This measure alone results in small business having between five and thirteen visits to an accountant compared with one previously.⁷¹

Despite the awareness of the compliance burden on small business and its compliance reduction focus, the Ralph Committee⁷² in its final 808 page report, *A Tax System Redesigned*,⁷³ made 280 recommendations and was accompanied by 274 pages of draft legislation accompanied by 320 pages of Explanatory Notes. The recommendations included proposals to:

- introduce a Board of Taxation;⁷⁴
- introduce an integrated tax code;⁷⁵
- improve the reliability, certainty and timeliness of the rulings program and fees for selected rulings;⁷⁶
- lower company tax rates;
- alter the capital gains regime by removing indexation and averaging but halving the capital gains tax rate and altering the retirement concessions for small business;
- introduce a new regime for determining taxable income - a cashflow/tax value approach (commonly referred to as “Option 2”, but renamed the Tax Value Method (TVM));⁷⁷

69 Australian Taxation Office, Commonwealth, *Taxation Statistics 1998-99* (2001). Of these registrants, 3.8% collected 84% of the revenue - see, Neil Warren, *Tax Facts Fiction and Reform Research Study No 41*, Australian Tax Research Foundation (2004), 229.

70 Australian Taxation Office, Commonwealth, *International Benchmarking of GST Administration* (2004), 13. Copy obtained by *The Australian* under Freedom of Information Act 1982 (Cth) 19 January 2004.

71 For a brief examination of the early difficulties faced by small business see Michael Dirkis, 'The BAS Changes – They promised it would be easy' (2001) 35 *Taxation in Australia* 414 and Michael Dirkis, 'The BAS Changes – A failure in consultation or a failure to listen?' (2001) 35 *Taxation in Australia* 417.

72 The following description of the Ralph outcomes is drawn from Michael Dirkis, 'Observations on the Development of Australia's Income Tax Policy and Income Tax Law' (2002) 56 *Bulletin for International Fiscal Documentation* 522.

73 A Tax System Redesigned, above n 9. For a more detailed history of the reform process see Peter A Harris "Will Australia Go 'The Full Monty?'" (1998) 52 *Bulletin for International Fiscal Documentation* 478 and Peter A Harris "Corporate Tax Reform Down-Under: Maybe Not The Full Monty But . . ." (1999) 53 *Bulletin for International Fiscal Documentation* 249.

74 A Tax System Redesigned, above n 9, recommendations 1.4 to 1.7.

75 Ibid, recommendation 2.1.

76 Ibid, recommendation 3.1 to 3.6.

77 Ibid, recommendations 4.1 to 4.24.

- associated with the TVM change, treat individuals on a cash basis,⁷⁸ while businesses with turnovers under \$1 million be assessed under a new Simplified Tax System (STS);⁷⁹
- tax trusts as companies (the entity taxation regime), including the introduction of a profits first rule and new dividend imputation rules;
- introduce a system of consolidated group taxation; and
- review reform recommendations in respect of the taxation of non-residents, source rules and double tax agreements.⁸⁰

The Government's accepted the majority of the recommendations contained in the final Report.⁸¹ This led to the Government, between June 1999 and the dissolution of Parliament on 5 October 2001 for the Federal Election, introducing into Parliament 144 taxation, superannuation, excise and license fee bills, with a further 44 taxation and superannuation related bills introduced in 2002 and 20 taxation and superannuation bills in 2003. The Productivity Commission has noted that more telling than the number of bills is the steady increase in the average length of legislation and that the length of the *Income Tax Assessment Act 1936* (1936 Act) and *Income Tax Assessment Act 1997* (1997 Act) alone was about 7,000 pages.⁸²

Although the length of the law in itself does not give rise to complexity,⁸³ the impact of the measures upon tax law affecting small business does indicate increased complexity and compliance costs. These bills contained a new business registration system (the Australian Business Number (ABN) System), the new tax collection system (the Pay As You Go (PAYG) System⁸⁴ – mooted to get rid of provisional tax) and a new penalty regime.⁸⁵ The ABN system required 4.1 million businesses to incur the compliance costs associated with registering for an ABN,⁸⁶ while the PAYG system introduced quarterly activity statements for most small business.

78 Ibid, recommendation 4.4.

79 Ibid, recommendations 17.1 to 17.6.

80 Ibid, recommendations 22.18 to 22.24 and 23.1 to 23.3.

81 The recommendations were accepted by the Government in Press Release No 58, above n 15 and Treasurer, 'The New Business Tax System: Stage 2 Response' (Press Release No 74, 11 November 1999).

82 Banks, above n 17, 2-3.

83 Despite some claims that length inevitably causes complexity, eg, Trevor Boucher, 'Tax Simplification - Some Different Dimensions' (paper presented to the Monash University Law School Foundation, Melbourne, 3 September 1991), 2; edited version 'The simplification debate: Too simplistic' (1991) 26 *Taxation in Australia* 277.

84 *A New Tax System (Pay As You Go) Act 1999*.

85 The legislation is contained in *A New Tax System (Tax Administration) Act (No 2) 2000*.

86 As at 30 June 2000 there were 2,898,000 ABNs (Taxation Statistics 1998-99, above n 69, Table 11.2). The Government forecasted in 1998 that there would be only 2.1 million ABNs, but this has

Small business was specifically targeted by so-called integrity measures such as the anti-alienation of personal services income measures (which specifically increased compliance costs for small contractors),⁸⁷ and the non-commercial losses quarantining regime (which attacked new small business ventures). As an example of the complexity of these measures, of the 3,202 taxpayers (between 2000-01 and 2002-03) who applied to have the Commissioner treat them as a Personal Service Business (ie applied for PSB determinations), only 36% were granted PSB status, while a massive 44% of applications were withdrawn as invalid.⁸⁸ Also, the alienation and non-commercial loss measures continued and introduced extra artificial distortions in the tax system, further decreasing efficiency of small business. Other integrity measures having a compliance impact were the modifications to the prepayment rules⁸⁹ and new specific general anti-value shifting measures (GVSR).⁹⁰

The new capital allowance (depreciation) regime, although praised as reducing 37 depreciation regimes into one,⁹¹ is another measure that imposed additional compliance costs on small business.⁹² The increase in compliance costs occurred at two levels. First,

continued to rise with 3.89 million ABNs by 30 June 2002 and 4.1 million by 30 June 2003 (Warren (2004), above n 69, 227). Warren (at 228) also notes the number of GST registrants was 2.2 million by 30 June 2003 compared with 1998 Government predictions of 1.5 million by mid-2001.

87 *New Business Tax System (Alienation of Personal Services Income) Act 2000, New Business Tax System (Alienated Personal Services Income) Tax Imposition Act (No 1) 2000 and New Business Tax System (Alienated Personal Services Income) Tax Imposition Act (No 2) 2000.*

88 Statistics from National Tax Liaison Group (NTLG) Minutes 3 December 2003, item 23. See also Robert Douglas, 'Farmers nil, Commissioner nil. Thanks, Ralph Great Result' (2001) 35 *Taxation in Australia*, 387, 392 who argues that any innovative farm value-adding activity runs the risk of being classified as a separate business activity with the resultant quarantining of losses. Similar concerns are expressed in a pending RIRDC Report, prepared by Alistair Watson, Rick Lacy and John Crase entitled "Economic effects of income-tax law on investment in Australian agriculture (with particular reference to new and emerging industries)" and in Rick Lacy and Alistair Watson, *Economic effects of income-tax law on investment in Australian agriculture: with particular reference to managed investment schemes and Division 35 of the Income Tax Act* (Paper presented to Conference of the Australian Agricultural and Resource Economics Society, Melbourne, 11 February 2004).

89 The changes are contained in *New Business Tax System (Integrity and Other Measures) Act 1999* and *New Business Tax System (Miscellaneous) Act (No 2) 2000.*

90 The core provisions are contained in the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* and the special rules applying in relation to the consolidation regime in the *New Business Tax System (Consolidation and Other Measures) Act 2003*. Further modifications are contained in the *Taxation Laws Amendment Bill (No 9) 2003*.

91 See A Platform for Consultation, above n 9, which lists the 37 systems at 31-32 and A Tax System Redesigned, above n 9, 308.

92 *New Business Tax System (Capital Allowances) Act 2001* and *New Business Tax System (Capital Allowances - Transitional and Consequential) Act 2001.*

at the legislative design level the rewrite did not give rise to simplicity as, despite the claims that 37 separate depreciation regimes were combined under one holistic system, many of the 37 separate systems were in fact merely rewritten as exceptions to the general rules set out in Division 40 of the 1997 Act (appearing as sub-divisions of Division 40) or remaining un-touched in Division 43 of the 1997 Act.⁹³ Also, the resultant simplification (if any) from the merger would have had little impact on the compliance costs of small business, as many of the systems rewritten provided amortisation for large-scale capital expenditure (eg pipelines). Finally, by adopting new, non-standard terms instead of the then existing depreciation terminology, which was based upon accounting concepts common to a number of jurisdictions, the rewrite increased complexity. For example, the term “base value” is used instead of “written down value”, “capital allowance” rather than “depreciation”, “opening adjustable value” rather than “opening written down value” and “depreciating asset” rather than “plant”. The terminology changes may better reflect the transaction in the eyes of the legislative drafter, but as they are an Australian tax oddity the process has only created confusion and increased implementation compliance costs.

Secondly, at the policy design level, the decision to remove the automatic write-off of low cost assets (ie those costing less than \$300) has created unnecessary record keeping (or wholesale non-compliance) as small electrical tools, such as drills, planes etc, costing as little as \$70 must legally be placed in low value pools.⁹⁴

Of lesser direct effect on small business is the corporate consolidation regime (which takes away from all companies the benefit of the inter-corporate dividend rebate provisions, loss transfer provisions, capital gains tax rollover concessions, and the transfer of excess foreign tax credits),⁹⁵ the demerger regime,⁹⁶ and a new dividend imputation regime (Simplified Imputation System (SIS)).⁹⁷

93 For example the rules applying to water facilities and horticultural plant are in Subdiv 40-F, land care and electrical connection are in Subdiv 40-G, mining operation, exploration and transport are in Subdiv 40-I, while the forestry and building write-off provisions remain in Div 43.

94 The Commissioner has attempted to minimise the impact of the loss of the \$300 concession by allowing a write-off of items less than \$100 (inclusive of GST) and under a sample approach – see *ATO Practice Statement Law Administration PS LA 2003/8* “Taxation treatment of expenditure on low cost items for taxpayers carrying on business”.

95 The basic operative provisions of the new consolidation regime are contained in four Acts: the *New Business Tax System (Consolidation) Act (No 1) 2002*, the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*, the *New Business Tax System*

As touched upon above, compounding the level of initial compliance costs arising from the sheer volume of legislative change is the fact that much of recent tax reform has been approached by throwing away the old provisions, terminology and understanding and creating a new model (eg the capital allowances regime and SIS). This approach deprives taxpayers the advantages of historic learning, thereby creating greater uncertainty and higher initial compliance costs.

Further, much of the ‘new’ drafting style is highly theoretical, abstract and vague; a point appreciated by the drafters of the GVSR law who appear compelled to follow each definition with a concrete example.⁹⁸ Such expansive drafting, combined with removal of historic precedent is inexcusable in a self-assessment environment where there is a clear obligation upon taxpayers to be aware of their legal rights and obligations.⁹⁹ Without clear laws taxpayers have little hope of meeting that expectation. As a result, the validity of the self-assessment model in the current post Ralph tax reform landscape is further undermined¹⁰⁰ as well as transitional and (probably continuing) compliance costs being higher than they otherwise would be.

However, some of these problems may not be Ralph per se but a demonstrated failure by the ATO, Treasury and Office of Parliamentary Council (OPC) to heed the Ralph’s recommendations in respect of a better legislative design and consultative process.¹⁰¹

(Consolidation and Other Measures) Act 2002 and New Business Tax System (Consolidation and Other Measures) Act 2003.

96 Also contained in the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002.*

97 The new Imputation system was introduced from 1 July 2002 via a package of Acts - the *New Business Tax System (Imputation) Act 2002*, the *New Business Tax System (Over-franking Tax) Act 2002* and the *New Business Tax System (Franking Deficit Tax) Act 2002*. Further changes were contained in the *New Business Tax System (Franking Deficit Tax) Amendment Act 2002*, the *New Business Tax System (Consolidation and Other Measures) Act 2003* and *Taxation Laws Amendment Act (No 8) 2003*. Further proposed changes are set out in Minister for Revenue and Assistant Treasurer, 'Business Tax Legislation Introduced' (Press Release, 27 September 2002) and Minister for Revenue and Assistant Treasurer, 'Amendments to Further Simplify Dividend Imputation Rules' (Press Release, 20 December 2002)

98 Michael Dirkis 'Improved model or another old banger? Evaluating the new general value shifting regime (GVSR)' (presented at Taxation Institute of Australia's 10th National Tax Intensive Retreat, Coolool, 29 August 2002), 10.

99 Expansive drafting produces "imprecise, fluid and elastic provisions" which lack clear policy direction and creates uncertainty for taxpayers - see Ian Stanley 'The debt equity rules: Debt interests' (Paper presented at NSW Division of the Taxation Institute of Australia Seminar, Sydney, 16 August 2001), 1.

100 See eg Dirkis and Payne-Mulcahy, above n 52.

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To compound this problem of the pace of legislative change the Commissioner continued the flood of rulings, determinations and interpretative decisions.¹⁰² For example, the number of rulings, etc issued by the Commissioner in:

- 2002 were: Rulings: 89 Class, 11 draft and 6 final GST, 147 Product, 1 draft and 1 final Fuel Grant and Rebate, 2 Wine Equalisation Tax and 13 draft and 21 final Tax; Determinations: 5 draft and 5 final GST, 4 Superannuation Contributions, 1 Superannuation Guarantee and 16 draft and 28 final Tax;¹⁰³
- 2003 were: Rulings: 112 Class, 9 draft and 16 final GST, 82 Product, 3 Product Grants and Benefits, 10 draft and 16 final Tax; Determinations: 23 draft and 32 final Tax, 5 draft and 3 final GST, 4 Superannuation Contributions, 1 Luxury Car Taxation and 7 Superannuation Guarantee; and Bulletins: 2 GST;¹⁰⁴ and
- as at 24 March 2004 were: Rulings: 29 Class, 34 Product, 1 Final GST, 2 final Tax, and 1 Draft Product Grant and Benefit (PGBR); Determinations: 1 Draft GST, 6 draft Tax and 3 final Tax.

Add to this huge information flow the list of non-binding statements (on the taxpayer, contra for ATO staff) such as ATO Interpretative Decisions (ATOID), Taxpayer Alerts, Practice Statements, fact sheets and explanatory material (eg the Consolidation Guide, the Receivables Manual and ATO Access Guidelines). The ATOID count for 2002 alone stands at 1,116, at 1,135 for 2003 and 247 so far in 2004.¹⁰⁵ This massive information flow can be viewed as a further illustration of the size of the reform changes and the resultant increase in implementation compliance costs as much of the Commissioner's activity has been generated by the GST and post-Ralph changes.¹⁰⁶

101 See Dirkis (IBFD 2002), above n 72 and in section IV point B following.

102 For example, released in 1999 were: Rulings: 14 draft and 1 final GST, 104 Product and 21 draft and 19 final Tax; and Determinations: 103 draft and 84 finalised Tax and 6 Sales Tax. Released in 2000 were: Rulings: 23 draft and 37 final GST, 119 Product and 36 draft and 18 final Tax; and Determinations: 6 draft and 12 final GST, 1 final Superannuation Guarantee, 1 Superannuation Contributions 2 Sales Tax, 23 draft and 54 final Tax.

103 TR 2002/List issued 19 December 2002.

104 TR 2003/List issued 19 December 2003.

105 As at 25 March 2004 - located at URL: <http://law.ato.gov.au/atolaw/browse.htm?toc=04%3AATO%20Interpretative%20Decisions%3ABy%20Year%3A2004>.

106 Although the Administrative Appeals Tribunal (AAT) and the Courts have also been busy with 109 Court and 42 AAT decisions in 2003 (as per CCH reports at 19 December 2003), with the major areas of focus being the in the areas of deductibility of interest and Part IVA, this litigation is not a direct result of Ralph, rather it is business as usual. For example, there were 95 Court and 61 AAT decisions in 1999 and in 2000 there were 87 Court and 15 AAT decisions.

3.3 The compliance burden post-Ralph

Given this amount of change it would seem logical to expect that small business has faced huge initial compliance costs from the introduction of these changes. However, there is yet to be a study published of the global tax compliance position of Australian small business post the implementation of the GST and the Ralph recommendations, nor has there been any published research on the cumulative impacts of the introduction of the GST and the Ralph initiatives. Therefore, in attempting to assess the quantum of current tax compliance costs we are relying on available qualitative information and as such there is plenty of room for conjecture.

Anecdotally post-ANTS/Ralph tax compliance is considered by many as horrendous and that overall the post-ANTS/Ralph tax system is making considerably more compliance demands on taxpayers.¹⁰⁷ There are significant voices from tax practitioners claiming that the post-Ralph changes coming on top of ANTS have lead to an intolerable compliance burden that especially (probably predictably) impacts on small business.¹⁰⁸ The issue was raised at various ATO consultative, the first occurring within 10 weeks after the Government's initial responses to the Ralph Committee.¹⁰⁹

107 'Instead of simplifying the compliance to the law, [the RBT reforms] actually increased the burden significantly.' Ray Conwell, former President of the Taxation Institute of Australia, quoted in Allesandra Fabro, 'ATO not delivering, say CEO's', *Australian Financial Review*, 2 September 2002, 5.

108 Stephen Harrison (CEO: Institute of Chartered Accountants in Australia) 'Open Letter to Tax Commissioner Carmody' (13 August 2002) Located at <http://www.icaa.com.au/news/index.cfm?menu=226&id=A105289876> accessed on 17 December 2003), Ray Regan, (President: National Tax & Accountants' Association) 'NTAA supports call for tax practitioners to revolt' (Press Release, 15 August 2002) and Gil Levy (President, Taxation Institute of Australia) 'Tax Crisis – Hard Times Call for Hard Actions' (Press Release 13 August 2002) located at <http://www.taxinstitute.com.au/cda/media/1,1316,1-39159,00.html> accessed on 20 December 2003. CPA Australia while not endorsing the ICAA response identifies the same problems existing in the tax system: Greg Larsen (CEO CPA Australia), 'CPA Australia works to resolve Australian tax administration issues' (Press Release, 14 August 2002) Located at: http://www.cpaaustralia.com.au/01_information_centre/24_advocacy/1_24_6_13_ato.asp accessed on 17 December 2003). In the context of FBT this is referred to in the ATO's NTLG FBT Subcommittee Minutes 21 February 2002, point 9 accessed at: <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/21199.htm&page=1&pc=001/005/036/002/003&mnu=6547&mfp=001&st=&cy=1> on 19 December 2003.

109 NTLG Minutes, 2 December 1999, item 11 located at URL: <http://www.ato.gov.au/content.asp?doc=/content/Professionals/NTLGMinutesDecember1999.htm> &page=1#H11 on 2 April 2002: no longer available on ATO website. The issue was also raised at 31 August 2000 NTLG meeting: Minutes located at URL:

This seems at odds with the first phase Treasurer's response to the Ralph Committee recommendations, which included a special press release directed at small business that included 'selling' STS with a focus on its compliance cost benefits.¹¹⁰ Such a focus on sectional interests via discrete government response was not the norm in the initial post-ANTS/Ralph tax reform period. The existence of a separate release may lend support to the government's continued concern over small business compliance costs, or a cynic may say it was an appeal to one of its constituencies.

However, care must be taken to separate out the elements that practitioner bodies claim to have led to this situation, these include poor ATO administration of the system, the rate of legislative change and poor legislative and policy design of both the law and the administrative systems. Yet it is clear that a considerable proportion of the current compliance burden can be sheeted to the laws themselves.¹¹¹ On the other hand the authors could not locate considered statements claiming that the compliance burden has reduced post-ANTS/Ralph.

As set out previously, research into Australian tax compliance costs with reference to small business indicates that at the time of the Ralph Review (and before the introduction of the GST) these costs were either above average for comparable OECD countries¹¹² or high (but not in the highest) in comparison with such countries.¹¹³ Add to this a recent study by the State Chamber of Commerce (NSW) lends support for there being a significant rise in compliance costs in the post ANTS/Ralph period.¹¹⁴ That study found "the most time consuming tax for business is the quarterly GST returns and associated Business Activity Statement."¹¹⁵

Empirical evidence to date suggests that the transition into the GST has been costly on small business. In Western Australia a study has concluded that start-up costs for firms

<http://www.ato.gov.au/content.asp?doc=/content/Professionals/NTLGMinutes31August2000.htm&page=2#H12> on 20 September 2002: no longer available on ATO website.

110 Treasurer, 'Small Business and Primary Producers to Benefit from the New Business Tax System' (Press Release No 59, 21 September, 1999).

111 Harrison, above n 108, Regan, above n 108, Levy, above n 108 and Ray Conwell quoted above n 107.

112 OECD, above n 17.

113 Evans and Walpole, above n 56, 15.

114 State Chamber of Commerce (NSW) *Red Tape Register – The Tax Burden* (2003).

115 *Ibid*, 2.

with up to \$10 million turnover was \$5,006, excluding time, and total cost, including time of \$7,626.¹¹⁶ The study confirmed that the cost impacts were regressive and that there are some benefits going forward as firms have better accounting practices.¹¹⁷

Another study of small business placed the transitional costs of the GST within a similar bandwidth of \$7,673 (mean) and \$4,500 (average) when dealing with GST, ABN, PAYG and BAS.¹¹⁸ This study noted the impact of system design and change on the stress levels of the taxpayers surveyed. Together these studies demonstrate the high costs associated with system change both quantitative and qualitative. To this GST impact we need to add the impact of Ralph, remembering that several of its integrity measures would be expected to impact disproportionately on small business.

A recent study has attempted to quantify the recurrent compliance costs of the GST. The study put these costs to small business at \$2,481 (mean) and \$2,443 (median).¹¹⁹ It found that the costs were still high (though expected to decrease) due to the length of time it takes to get used to a significant tax change (here a new tax).¹²⁰ These transitional and recurrent costs to the taxpayer need to be contrasted with the cost of collection. In a recent Working Paper the ATO records that government investment per business related to GST administration and collection was \$280 in 2000-2001 and \$235 in 2001-2002.¹²¹ This asymmetry of costs is important to bear in mind when a government considers any change to the tax system.

Another recent study concluded that tax (including tax compliance) and government charges remain the most obvious constraint to small business investment.¹²² Yet, as

116 Ramatse and Pope, above n 47 at 408.

117 Ibid at 437-438.

118 Tran-Nam and Glover, above n 47 at 521.

119 Binh Tran-Nam and John Glover 'The GST Recurrent Compliance Costs/Benefits of Small Business in Australia: A Case Study Approach' (Paper presented to the 16th Annual Australasian Tax Teachers Association Conference 'Tax Reform = Fairer, Efficient, Simpler Tax???' Adelaide, 30 January 2004), 17.

120 Ibid.

121 International Benchmarking of GST Administration, above n 70, 24. The Report also notes that these figures are lower per business as a number of registered businesses were not required to register as their income was below the \$50,000 threshold. Warren (2004), above n 69, 228 puts that figure as 36% of registered businesses.

122 Australian Chamber of Commerce survey of the non-farm sector reported that "[t]ax still biggest constraint on SMEs investment" cited in Centre for Professional Development, *CPD Communicator*, Issue 31, 27 May 2002. This result was 'not unexpected' and was consistent with

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discussed in this section tax compliance costs have just kept rising (maybe to crisis point). This is despite the tax compliance burden on small business being known to governments for a long time. In fact the Howard Government's expressed concern over the 'plight' of small business in this regard, along with a strong commitment to address the problem, as part of its first term policy from as far back as 1996.¹²³

Thus, from the above it can be seen that there are clear and consistent claims and some supporting empirical evidence that the global small business tax compliance costs post-ANTS/Ralph have increased significantly and are probably even more regressive than they were previously. As there are clear signs that the patient's condition is getting worse it is time to turn our attention to the quality of its treatment.

the last 10 year's results. See also Yellow Pages *A Special Report on Small Business Growth Aspirations and the Role of Exports* (February 1995) cited in Time for Business, above n 11, 16.
123 Evans and Walpole, above n 56, 12-15.

4. Why Ralph did not succeed in reducing compliance costs

Given the apparent Ralph failure to reduce compliance costs, the following discussion explores some reasons why the Ralph changes have led to this position, despite a key objective of the Review being the reduction in compliance costs. Given the absence of any real and articulated compliance cost reduction policy objective within ANTS there is little point served in exploring it in this context. The reasons can be broken up into two broad categories, failures by the Review and failures in implementation.

4.1 Failures by the Ralph Review

The failures by the Review relate to two areas: a failure to engage with the wealth of small business compliance cost research and the strict adherence to revenue neutrality (which had a significant limitation to Ralph's response to small business).

4.1.1 *A failure to engage with the wealth of small business compliance cost research*

In his Chairman's Introduction John Ralph describes the desired outcome in respect of small business as:

[a] tax system for small business, with a more concessional approach to writing off their capital and expenditure and a reduced record keeping load.¹²⁴

And, just before that:

[a] tax system which is easier to understand and comply with, and makes fewer demands on the time of ordinary taxpayers.¹²⁵

The first Ralph Committee discussion paper, *A Strong Foundation*, had an emphasis on the need to, and benefit of, reducing the complexity of tax laws and tax compliance.¹²⁶ It strongly asserted the importance of simplicity and considered complexity inherent in

124 A Tax System Redesigned, above n 9, 2.

125 Ibid.

126 A Strong Foundation, above n 9; in particular chapters 3 and 4.

the tax system and the issue was how to avoid it increasing.¹²⁷ Despite this focus *A Strong Foundation* does not make reference to previous reports on the issue of compliance costs and complexity¹²⁸ nor are there any references back to previous inquiries in chapter 17 of *A Tax System Redesigned* that recommends STS.¹²⁹

At this point the authors' questioning of the depth of the Ralph Review's concerns for the compliance cost position of small business and those of the government that accepted its recommendations becomes more pointed. Ralph does cite some empirical research on compliance costs undertaken by ATAX¹³⁰ (the patient's symptoms) but there appears no taste to discuss the factors and forces that underlie these costs, the pressures for their increase nor the pitfalls to avoid in seeking to address and redress those costs.

The Ralph report seems to have little overt regard to the November 1996 report of Small Business Deregulation Task Force, *Time For Business*,¹³¹ the Prime Ministerial Statement on 24 March 1997 entitled *More Time for Business* running to some 121 pages,¹³² nor the *Lessons Learnt*, a Background Paper for the Small Business Deregulation Task Force¹³³ (which identified seven standout reports that dealt with regulatory burdens). At that time the Task Force and the government's response were prominent articulations of the government's concern over small business compliance costs.

In light the above, and in the STS discussion following, it is submitted that the Ralph Report merely paid lip service to its compliance cost reduction objective. The Report avoided and/or refused to analyse the root causes of the small business compliance cost predicament and thus did not tailor recommendations in such a way as to minimise additional compliance costs. This failure is inexcusable given the existence of several

127 Ibid, xviii and xxix.

128 However, *A New Tax System*, above n 9, 131 makes brief reference to *Time for Business* above n 11.

129 It does reference ATAX reports: Evans et al (1997), above n 12 and Evans et al (1996), above n 16.

130 Ibid.

131 Above n 11.

132 Above n 14.

reports into the compliance burden of small business that are considered by the authors as providing clear, though in places unpalatable, analysis and ways forward when dealing with the impact on small business of the tax system. Basically the Ralph Review did not advance far from stating platitudes.

The key points from previous reports and initiatives into small business compliance cost reduction identified in *Lessons Learnt* were listed as:¹³⁴

- Success in achieving regulatory reform is critically dependent on political commitment and support;¹³⁵
- If regulatory reductions are to be achieved, the necessary adjustments will need to be made from the Government side [a whole of government approach is required];
- The extent of reforms have often been greatest in smaller jurisdictions by virtue of the close contact between stakeholders, the fact that the absolute scale of logistical charges are more manageable, and the political process is perhaps more closely attuned to the needs of the local small business community;
- Before substantial improvements in red tape can be introduced methods for the systematic evaluation of potential regulatory costs and benefits must be in place;
- Dedicated research offers sound prospects for improving policy targeting and delivery;
- The prospects for successful reform are highest under strategies where incremental changes, sustained over the longer term, receive adequate political backing and attract reasonable resources;
- Even the best policies for regulatory reform may fail to deliver results if insufficient attention is given to the logistical aspects of their delivery; and
- Overseas experience can play only a limited role in assisting Australia to select the most appropriate reform strategies.

We can add to this:

- The acknowledged restrictive impact of the requirement of revenue neutrality.¹³⁶
- The acknowledged scale of the task to make meaningful inroads into compliance costs.¹³⁷
- The importance of transparency and consultation in the design phase of law and policy.¹³⁸

133 Price Waterhouse Economic Studies and Strategies Unit *Lessons Learnt: Review of Inquiries and Reports on Regulatory Reform*, Background Paper 1 Small Business Deregulation Task Force (August 1996) (Lessons Learnt).

134 Ibid, 20-21, also see ii.

135 Reinforced in *Time for Business*, above n 11, 19.

136 The Bell Task Force stressed in several places the significant level of constraint that was placed on its recommendations by the requirement of revenue neutrality: *Time for Business*, above n 11, 12 and 31.

137 *Time for Business*, above n 11, 19.

138 Ibid.

- Regulation Impact Statements (RIS's) in their current guise stem from the government's response to the Bell Task Force.¹³⁹
- The scale and complexity in tax compliance cost reduction was summarised in 1996 as:¹⁴⁰

[A]fter a decade of sustained efforts at regulatory reform, taxation remains perhaps the single most important area of Government regulation of concern to small business. However, in the absence of fundamental changes to the way in which the government approaches economic management, reforms in this area have in some cases reached the point where further rationalisation may place equity at risk.

The points above can be used as a guide to assess the Ralph small business scorecard as well as providing a platform to discuss broader tax system impacts. It is not that the above points are sacrosanct because they come from the Bell Task Force. Rather they are considered a fair distillation of the reports and initiatives in the area of small business cost compliance reduction and were endorsed by the Government.¹⁴¹

4.1.2 *Strict adherence to revenue neutrality*

The pursuit of avoidance coupled with a very parsimonious approach not to deviate from revenue neutrality, would seem some of the keys as to why the Ralph reforms have adversely impacted on small business, especially in terms of compliance costs.¹⁴² The terms of reference to the Ralph Committee made it clear that the policies contained in the Government's ANTS document¹⁴³ would direct but not bind the Review's deliberations and recommendations.¹⁴⁴

The ANTS document stresses that the policy approach was not just to 'tinker' with the existing tax system.¹⁴⁵ However, there is no evidence from the post-Ralph writings or research published to date that much more than tinkering has happened with the tax system as regards reducing or stemming the increase in small business compliance

139 Evans and Walpole, above n 56, 54.

140 Lessons Learnt, above n 133, ii see also pages 20-21.

141 See, eg, the Time for Business report was endorsed in More Time for Business, above n 14.

142 For an example of how these have instructed legislative design see Brett Bondfield, 'If There is an Art to Taxation the Simplified Tax System is a Dark Art' (2002) 17 *Australian Tax Forum* 313, generally and in particular at 355-56.

143 ANTS, above n 4.

144 A Tax System Redesigned above n 9, Terms of reference, v-vii and also 10.

145 ANTS, above n 4, 3-5.

costs. This is evidenced by the low STS take-up rate and the assertions from the profession that compliance costs have significantly increased.

As discussed later STS may provide some assistance. Though the discussion of STS in chapter 17 of Ralph does not expressly recognise the potential for the integrity driven initiatives that particularly impact on small business (as detailed previously) to overrun the STS concessions. This represents more than just a lack of any real fundamental tax system reform flowing from Ralph due to institutional and political dynamics.¹⁴⁶ The tax compliance position of small business evidences callous neglect with Ralph recommendations in many places explicitly raising the compliance burdens on small business and its compensatory responses being inadequately structured, or at the very least poorly articulated. This occurred in an environment where the pre-existing pace of system change¹⁴⁷ and tax law complexity was of considerable concern.¹⁴⁸

4.2 Failures in implementation

There are two key areas where Ralph's implementation has impacted on compliance costs; continued institutional failures and a failure to consult. Both these issues may impact on the future treatment of small businesses' compliance costs.

4.2.1 Continuing institutional failures

A considered approach to government regulatory enactments has been identified as important in small business compliance cost reports. This takes several forms including the need to take a whole of government approach when making new regulations, transparency in the process of regulatory design and analysis to seek to ensure the regulations have as low a compliance cost as possible (given their objective (proportionality)). RIS's are intended to achieve these and other objectives.¹⁴⁹

146 Fisher, above n 28, discusses these dynamics.

147 Beddall Report, above n 10, xxix.

148 Time for Business, above n 11, 28-31, confirmed by the OECD, above n 17, 30-31.

149 Evans and Walpole, above n 56, 78-84.

The Australian experience with tax RIS's (pre-Ralph) is discussed by Evans and Walpole,¹⁵⁰ the authors conclude that the tax RIS process was having some impact in meeting these objectives but was falling a long way short of ideal with form, as opposed to the underpinning policy, being followed.¹⁵¹ They saw it as a real concern with an increasing volume of legislative change that the officials would pay lip service to them rather than seeing them integral to tax design.¹⁵² The experience with the flood of Ralph reforms and their associated RIS's suggests that this concern was justified. The RIS process has not proved an impediment to the claimed explosive increase in compliance costs.

Ralph took the issue of intra-governmental (as well as public)¹⁵³ consultation and involvement in legislative design as a serious issue. *A Strong Foundation* expressed the concerns as:

- “. . . the potential for policy to be developed without a full appreciation of all its implications and its interaction with the wider tax law and tax system. Conversely, practical solutions to technical issues might often compromise policy intentions”; and
- poor law design arising from the various agencies failing “. . . to clarify progressively their understanding of the proposal and its intended effect and application,” and the inclusion of OPC drafters, often after announcement of a policy change.¹⁵⁴

Following the re-emergence in early 2002 of the debate concerning the removal of the tax policy and law development functions from the ATO,¹⁵⁵ the Treasurer¹⁵⁶ accepted the Board of Taxation's recommendation to transfer ATO policy staff to Treasury.¹⁵⁷ The debate arose due to concerns about the ATO's ability to deliver integrated design

150 Ibid, 54-77.

151 Ibid, 77.

152 Ibid, 76-77 and 85.

153 Discussed under the following heading.

154 *A Strong Foundation*, above n 9, 48.

155 This issue was flagged by Hon Senator Helen Coonan (Minister for Revenue and Assistant Treasurer) in her 27 February 2002 speech to the Sydney Institute "Safety in Numbers - Tax Reform and the National Nest Egg", 6 and in evidence to Senate Economic Legislation Committee, Estimates Hearings 20 February 2002 at E7.5.

156 Treasurer 'Reforms to Community Consultation Processes And Agency Accountabilities in Tax Design' (Press Release No 22, 2 May 2002).

157 Board of Taxation 'Government Consultation with the Community on the Development of Taxation Legislation - A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer' (March 2002), Recommendation 10.

given some very public failing in respect of the implementation of new tax systems and laws.¹⁵⁸

Although there was a positive response to the announcements, concerns remain. The centralisation of policy in one area outside the ATO may not resolve the implementation and administration design issues, which often plague policy implementation.¹⁵⁹ Further, in general, Treasury's culture is imbued with even higher levels of secrecy than the ATO, which could result in less open consultation and discussion and a policy team further isolated from the community.¹⁶⁰ Further, it is believed in some quarters that the growth in complexity and compliance costs in the tax law can be directly related to the growing ascendancy of the Treasury in tax policy over the last 10 to 17 years. Further, by leaving OPC outside the equation, accountability for poorly drafted law remains elusive.¹⁶¹

In summary, as with the new consultative process (discussed following), whether the new administrative arrangements work can only be gauged in the future.

4.2.2 *Failure of consultation*¹⁶²

Ralph and previous small business reports¹⁶³ saw consultation as important to improve legislative quality and minimise compliance cost increases. The post Ralph position set out below evidences some matters of concern as to whether this was taken to heart in the transition from Ralph recommendation to tax law.

Flagged in the STS discussion following are the problems with consultation in the post-Ralph era. Consultation generally was conducted through convened committees with

158 Dirkis (IBFD 2002), above n 72, 532.

159 Ibid.

160 Jeff Schubert of Australian Business Limited warns that ". . . with policy removed from the ATO and effectively completely installed in Treasury . . . [t]he people making tax policy may then be even further removed from the practical business community, with a danger that events like the consolidation consultation . . . will not occur" - "Business shoots itself in the foot!!" 25 February 2002 - <http://www.australianbusiness.com.au/economytoday> web news broadcast accessed 26 February 2002.

161 Dirkis (IBFD 2002), above n 72, 532-533.

162 The following description of the failure of consultation is drawn from Dirkis (IBFD 2002), above n 72.

163 Time for business, above n 11, 19.

selected invitees (usually specialists or key stake holders).¹⁶⁴ Many meetings were one off¹⁶⁵ and in the authors' view token.¹⁶⁶ Where the issue under consideration was deemed to need more than one consultation meeting,¹⁶⁷ the meetings were often organised in a haphazard way and (except for consolidations consultative process) and there was little feedback following meetings.¹⁶⁸ Also strict secrecy requirements imposed upon external parties attending the meetings acted to limit input.

The meetings generally focused on technical improvement rather than policy, with the Review's recommendations generally viewed as sacrosanct. Generally it was only where political pressure arose that there were departures from the recommendations.¹⁶⁹

A positive feature was the extended use of exposure draft legislation releases. However, these drafts and associated explanatory material (despite some being reissued) tended to be "final" documents, rather than first or second cut documents intended to create discussion. Further, the time allowed for submissions was unreasonable (usually four weeks), particularly given the size of the material and the timing of the release of the drafts (a number were released just prior to Christmas shutdowns). Even where externals made submissions,¹⁷⁰ despite the impediments, there was rarely feedback from the law

164 Part of the problem is the number of representative groups. As well as the members of the NTLG there is the Corporate Taxpayer Association (CTA), the Business Coalition for Tax Reform (BCTR) - a coalition of industry Associations, accounting bodies, accounting firms and corporates), peak business Associations (Business Council of Australia (BCA) and Australian Business Limited (ABL)) and the National Farmers Federation (NFF).

165 These include meetings on ruling changes (ATO sponsored), changes to the 13 month Rule changes (payments in advance and expenditure under tax shelters), partnerships and other joint activities, the taxation regime for buildings and structures, leases and rights, non-resident withholding tax, offshore trusts and foreign expatriates and residents departing Australia.

166 Alienation of personal services income and non-commercial losses consultative meetings.

167 Tax Value Method, Simplified Tax System, scrip for scrip, entity tax (including simplified imputation, loans by members, excluded trusts, trust transitionals, capital allowances, thin capitalisation, debt/equity and consolidation).

168 For example at the NTLG meeting of 4 December 2001 questions were posed why issues announced for 1 July 2002 start have had no consultation for over 12 months. In fact there had been no updates of progress. The three areas identified were: non-resident withholding tax (last meeting 11 May 2000), foreign expatriates and residents departing Australia (last meeting 19 May 2000) and simplified imputation (last wide consultation on 19 October 2000 following entity tax draft release). With the pressures of a looming 1 July 2002 legislative start date a number consultative meetings have been convened. For example a consultative meeting (under strict confidentiality conditions for the five invited external representatives) on simplified imputation was held on 25 February 2002 with draft legislation circulated on 10 May and a meeting to review of draft legislation in respect of expatriate on 30 April.

169 Examples are the artist and primary production exemption from the non-commercial loss provisions and the elevation of the results test in s 87-18 of the 1997 Act to the primary test for the anti-alienation of personal service income provisions.

170 The Taxation Institute of Australia's submissions can be found at www.taxinstitute.com.au.

design teams, with externals left to ponder why certain policy alternatives were unacceptable.

An outcome of the failure to adopt a user based design system, was that the resultant law and administrative systems were of a mixed standard. Where consultation was not undertaken (such as in the new tax collection system (PAYG) and the circular trust anti-avoidance (ultimate beneficiary statement) measures) or was token (such as in the non-commercial loss and anti alienation of personal service income measures¹⁷¹) the legislative outcomes were poor, requiring remedial legislative or administrative intervention.¹⁷² The measures that seem to work better are those where more consultation was carried out, such as in respect of STS (ignoring whether its policy basis is flawed). Even where the law was perfected, the lack of integration with ATO administrative systems led to severe pressures on the ATO systems.¹⁷³

This leads one to be cautious of the value of consultation in policy development. Even if the consultation is seen to be of a high order it may not have been grounded in the best available material and policy viewpoints. There is no way of knowing whether such material was part of the consultation process as there is no public transparency into those discussions and the Ralph report does not discuss them.

In summary, the level of consultation is a major improvement on any previous reform process. However, the failure to adopt the recommendations of user based design has again compromised the most recent round of tax reform.

171 The Alienation measures were a typical example where a single meeting was held on 24 November 1999 where participants were briefed on the proposal and all policy concerns as well as requests for further consultation were rebutted.

172 The need for this intervention is evidenced by the existence of ATO working parties such as the PAYG working party, Alienation working party, and the Non-commercial loss working party.

173 An example of a failed system was the Running Balance Account (RBA) System, which was introduced to record a taxpayer's liabilities and credits on one file. Problems are still being resolved two years after introduction.

5. The failure to adequately compensate

Reflecting on those Ralph changes that specially impact on small business (anti alienation of personal services income and non-commercial loss quarantining are the prime examples) leads back to a consideration of compliance cost reduction and its link to the good tax policy criteria, simplicity. There is inevitably a trade-off between the good tax policy criteria of efficiency, equity and simplicity in the design of any tax system, given that many of the objectives operate inconsistently, give rise to conflicting policy directions¹⁷⁴ (as various tax rules serve different policy aims)¹⁷⁶ and are unable to provide definitive policy guidance.¹⁷⁷ Thus, the more one tax policy objective is satisfied the less another is adequately realized, for example:

adopting a particular tax provision might increase the rate of economic growth. However, the same provision might also reduce the fairness of the system by providing some group of individuals with a tax advantage relative to others in the same circumstances.¹⁷⁸

Ultimately the most appropriate methodologies adopted will arise from a compromise being struck between often unavoidable conflicts between policy objectives.¹⁷⁹ Thus, a measure that reduces simplicity (and in all probability increases compliance costs) may be justifiable because it remedies an anomaly that was inequitable.

In the opinion of tax professionals, as discussed above, there is no such trade-off evident from the Ralph measures. Therefore, it is difficult to see what justifies the increasing of the already regressive tax compliance costs on small business.

174 McKerchar, above n 53, 24-36 and Canada, *Report of the Royal Commission on Taxation* (1966) (the Carter Commission), 3.

175 Taxation Review Committee, Commonwealth, *Full Report* (1975) (Asprey Report), 20.

176 Ibid.

177 RI Downing, et al, *Taxation in Australia — An Agenda for Reform* (1964), 48 after noting the conflicts recommend any changes based upon economic efficiency should only be made having examined the possible effects on income distribution. Also Robert Couzin, 'The Process of Simplification' (1984) 32 *Canadian Tax Journal* 487, 494 suggests that the cause of much complexity is the competing objectives of the tax system, which affect tax policy, the legislation and its administration.

178 Carter Commission, above n 174, 3.

179 The Asprey Report, above n 175, 12 and 1985 Draft White Paper, above n 31, 14.

However, these costs may have been inevitable and outside the control of Ralph. This may explain why Ralph identified the loading of social policy considerations and programs into the tax system as placing a considerable cost burden on small business.¹⁸⁰

The Ralph Committee agreed that the appropriate response was to *compensate* small business for this regressive cost impost in acting on the government's behalf, though how to do it through the tax system was identified as problematic [emphasis added].¹⁸¹

The main Ralph compensatory initiatives, from the vantage point of small business, were:

- Simplified income tax calculation rules and capital allowance and prepayment concessions for small businesses (STS measures),¹⁸² and
- CGT concessions that mainly assisted passive investors or persons selling a business, and had most value if the person was retiring from running a business, yet they did not provide a great deal of benefit for those running a business as a going concern.

Thus, with the exception of these concessions and the SIS the balance of the Ralph changes mentioned above are integrity or tax base focused.¹⁸³

The STS, the centrepiece of Ralph's compensation for small business, was projected to be one of the most revenue expensive of the Review's initiatives.¹⁸⁴ The public selling point of STS was and remains compensation through the simplification of records and

180 Such as HECS and Child Support Payments see A Tax System Redesigned above n 9 at 73. The scope of the ATO's involvement in areas outside the traditional tax collection role are evident in Michael Carmody (Commissioner of Taxation) 'The Art of Tax Administration' Address to the 5th International Conference on Tax Administration (4 April 2002), 1. Located at: <http://www.ato.gov.au/corporate/content.asp?doc=/content/sp200203.htm> accessed on 20 December 2003.

181 A Tax System Redesigned, above n 9, 74, paragraph 336.

182 *New Business Tax System (Simplified Tax System) Act 2001*. The original proposal for a simplified tax system for small business arose out of concerns about the application of the proposed TVM on small business. The STS' main features are a cash accounting regime, a simplified depreciation regime and a simplified trading stock regime. For further discussion see Michael Dirkis 'Staying in the Shallows - Simplified Tax System' (Paper presented to Taxation Institute of Australia's 2001 Queensland State Convention, Gold Coast, 18 May 2001), Kenny, above n 27 and Bondfield, above n 142.

183 This focus on integrity is seen as consistent across comparable OECD countries and greatly increasing system complexity. Adrian Sawyer 'Compliance cost Impact Statements in New Zealand – How far have we come? (2003) 17 *Australian Tax Forum* 443, 446.

184 A Tax System Redesigned, above n 9 chapter 24, in particular at 698 and 720-722.

accounting systems with the concessional depreciation advantages (the main concession) being down played.¹⁸⁵

Whether the package as a whole, and STS in particular, can deliver the necessary level of compensation will be ultimately determined by a combination of the number of taxpayers who can access the particular concession and the actual number who in turn see value in and actually access the concession. Given the claimed size of the STS concession and the claimed large numbers of eligible taxpayers, the following discussion focuses on evaluating the actual number of taxpayers who have opted to take up the STS element of the compensation package. The CGT small business concessions are also briefly discussed, with the focus, in absence of uptake data, on the scope of the concession for a trading small business.

5.1 Failure in STS uptake

The pessimistic views of the practicality of STS appear to be supported by its current take-up rate.¹⁸⁶ The government, adopting Ralph report figures,¹⁸⁷ claimed that 95% of all businesses and 99% of farming businesses would be eligible for STS.¹⁸⁸ Available figures at 17 April 2003 disclose that, of eligible taxpayers having lodged their 2002 tax returns, only 14% have opted into STS.¹⁸⁹ This may not be representative as take-up may require a period of time to mature but it does seem very low.

When reviewing take-up rates it is also important to consider whether businesses are entering something like STS for the 'right' reasons. For example after three or more bad seasons primary producers, otherwise ineligible to enter STS because of the \$1 million turnover bar, may well fit the STS criteria. They may be willing, in order to

185 Bondfield, above n 142, 350-360. A recent press release continues this trend: Minister for Revenue and the Assistant Treasurer 'Roll-over relief for Simplified Tax System partnerships' (Press Release C013/03, 4 March 2003).

186 Peter Hendy 'Threats to Small and Medium Sized Enterprises from Tax and Other Regulations' in Neil Warren (ed) *Taxing Small Business: Developing Good Tax Policies* Conference Series No 23, Australian Tax Research Foundation (2003) 113, 134-135 and Fisher, above n 28, 65.

187 A Tax System Redesigned, above n 9, 74. These figures in the report were based on the sole criteria of turnover and do not take into account the effects of the other eligibility criteria.

188 Explanatory Memorandum to New Business Tax System (Simplified Tax System) Bill 2000 (STS EM), paragraph 1.5.

lock assets into the accelerated depreciation pools, to accept the increased costs associated with working out the interface with primary production specific tax concessions to enter STS and in adopting cash accounting (ie the opportunity costs of deferring “incurred” expenses (prima facie deductible under s 8-1 of the 1997 Act), and the additional compliance cost of keeping two set of records, a cash basis set for STS and accrual accounts for accounting purposes). This would not be a triumph of STS reducing compliance costs.

In the writers’ submission a more concerning element is the assertion that the Ralph Committee anticipated that only 60% of those eligible would elect into STS.¹⁹⁰ The costings in the Ralph report recognised the central importance of the participation rate of eligible businesses and that this would be less than 100%.¹⁹¹ Yet, the authors cannot locate a reference to the 60% take-up estimate referred to above within the Ralph report. It seems disingenuous and playing on public perceptions to claim STS eligibility in the high 90%’s while costings are being based on 60% of those eligible. A more important question to be answered is why bother implementing a *system* of small business taxation that was expected to benefit a little over half of those eligible.

As stated previously equity (in its various guises) is a central pillar of good tax policy. If small business compensation for the regressive impacts of tax compliance costs is important surely a near 100% expected take-up rate would be equitable. A targeted direct concession would be far more likely to be of more general application, unless weighed down by integrity measures.¹⁹²

189 ATO Tax Practitioner Forum (ATPF) issues log (register No. A27). Figures reported in Australian Tax Practice ‘Simplified Tax System (STS): 14% take-up rate so far’ *ATP Latest Tax News* (No 163, 25 August 2003).

190 Ibid.

191 A Tax System Redesigned above n 9, 721 paragraphs 152-153.

192 Poor design and onerous integrity measures are asserted as causes for a low take-up rate of the baby bonus: Deputy Leader of the Opposition, ‘Further evidence the Howard Government’s Baby Bonus is a big flop’ (Media Release, 14 December 2003) Copy located at <http://www.jennymacklin.net.au/infocentre.asp?data=480A010307074F5851515E587E45555F48454B4E> on 20 December 2003.

5.2. CGT concessions

The small business focussed CGT concessions¹⁹³ that flowed from Chapter 17 of Ralph were generally well received.¹⁹⁴ They were aimed at rationalising and extending the then existing concessions that applied to small business.¹⁹⁵ The small business CGT concessions at the time of Ralph were the 50% goodwill concession, the CGT retirement exemption and the replacement asset rollover.

The Ralph recommendations, as accepted, then replaced the 50% goodwill concession with a more general 50% active asset concession with eligibility consistent across the concessions with a \$5 million net asset threshold. In addition to the Ralph recommendations, the government introduced an exemption for active assets held for more than 15 years. As well, businesses than ran through structures that could access the general 50% CGT discount could apply it in addition to the small business specific concessions.¹⁹⁶

Looked at in total, the small business CGT changes were viewed as providing important policy changes, particularly as the concessions could be used cumulatively.¹⁹⁷ However, there is a view that they do not simplify the provisions enough.¹⁹⁸ Even though the provisions of the legislation have been rationalised their fundamental design requires very careful and long term planning to take maximum advantage of them.¹⁹⁹ In this regard they have not delivered a significant compliance cost reduction dividend. Further, as the events to which these concessions apply occur infrequently in the life cycle of a small business the compensation that they offer is not a meaningful response to compliance cost impact per se.

193 Enacted in *A New Business Tax System (Capital Gains Tax) Act 1999*.

194 Chris Evans 'Small business CGT concessions – a little ray of sunshine' (2001) 36 *Taxation in Australia* 99.

195 A Tax System Redesigned, above n 9, 586-589.

196 Paul Ingram 'CGT: Small Business Relief' (2000) 4 *Tax Specialist* 85 is the source of the preceding description.

197 Ibid, 85.

198 Arthur Athanasiou, Keith Harvey and Shane Bilardi 'Get a grip! – CGT' (2002) 36 *Taxation in Australia* 290.

199 Ingram, above n 196, 93.

6. Why the compensation package failed

The failure of STS uptake combined with the infrequency of application of the small business CGT concession illustrates that the compensation package is not commensurate compensation for compliance costs. Further, both measures are complex in operation, and thereby impose further compliance costs. The following discussion focuses on why the compensation package appears inadequate. This discussion will focus on STS, although the rationalization of the capital gains concessions will be briefly examined.

6.1 Why STS has failed

The reasons for the failure of STS are twofold, there appeared to be no compelling argument for STS and that the rules were poorly designed.

6.1.1 *Lack of reasons for STS*

The Ralph Committee's recognition of a need to compensate small business for the regressive compliance burden of the tax system was seen at the time by interested parties as a positive step.²⁰⁰

However, Ralph's reasoning as to why STS was the appropriate response is far from persuasive. The diversity of the functions performed by business on behalf of government and the diversity of small business itself were seen as issues of concern in using the tax system to compensate small business.²⁰¹ Yet, the articulated reasoning leading to STS was really only a conclusion being that the review was 'firmly of the view' that some recognition for this impost was required and that the reduction of compliance costs associated with the business tax system was the appropriate way to do

200 Taxation Institute of Australia, *Submission on the Exposure Draft: Business Tax System (Simplified Tax System) Bill 2000* (17 November 2000), 8, Chris Evans and Jacqui McManus *Tax Reform Issues for Small Business Australian Society of CPA's Discussion Paper on "A Tax System Redesigned"* (November 1999), 22 and Robert Douglas 'The Simplified Tax System for Small Business – An Overview' (2000) 35 *Taxation in Australia* 28, 34.

201 A Tax System Redesigned above n 9, 74 paragraph 336.

this.²⁰² If there were persuasive arguments why the reduction of compliance costs was *the* answer (short of the base need for revenue neutrality) they are not set out. This is a significant omission as there were credible reports suggesting that the scope for a compliance cost reduction dividend was marginal and a complex whole of government issue to achieve at a meaningful level.²⁰³

6.1.2 *Failure to meet good law design principles*

The incarnation of Ralph's small business support as STS was not warmly endorsed. Although the concept was attractive the actual design of the measure was not.²⁰⁴ Overall the thresholds for eligibility to enter STS, the integrity measures within it²⁰⁵ and the fact that it was an all or nothing package that delivered the tax concessions indirectly (mainly through accelerated depreciation) were cited as the main design problems.²⁰⁶

It is not the purpose of this report to deal in any detail with the operational aspects of STS. However, emblematic of the changes made to the tax system from the Ralph recommendations STS itself is long and in places convoluted. The STS Explanatory Memorandum is 84 pages excluding index and Regulatory Impact Statement. The STS provisions in ITAA 1997 run to some 27½ pages in the 2003 CCH version.²⁰⁷ Then there are two Tax Rulings: TR 2002/6: *Income tax: Simplified Tax System: eligibility – grouping rules* (38 pages) and TR 2002/11 *Income tax: Simplified Tax System eligibility – STS average turnover* (33 pages).

Conceptually STS is a potentially concessional tax system that sits on top of and has to interact with the rest of the tax laws. Surely having an add on system that delivers

202 Ibid.

203 Lessons Learnt, above n 133, ii see also pages 20-21.

204 The concept of a separate small business system does have merit. The New Zealand government agreed (in part) to a recent New Zealand review of business compliance costs recommendation that saw benefit in researching the applicability of a separate simplified tax regime for small business starting from analysis of STS: New Zealand, Government, *Striking the Balance: Government response to the Ministerial Panel on Business Compliance Costs* (December 2001), 37 response to recommendation 154.

205 In particular grouping rules and the turnover calculation.

206 See Brett Bondfield 'A year on in the Simplified Tax System: Has the reality matched the rhetoric?' (2002) 37 *Taxation in Australia* 251 at 252 and brief list of articles describing and analysing STS, 255-256 and Dirkis (2001), above n 182.

concessional treatment of some tax items (prepayments (really a timing issue) and capital allowances) is not inherently simple.²⁰⁸ Why not have some simple concession or rebate the eligibility for, and quantum of, being dependent on a measure of business size?

As stated before, integrity has made the STS system itself complex and potentially impractical. For example STS eligibility is set out in s 328-365 and contains 11 terms that themselves have a definition, which illustrates that the basic proposition that eligibility to STS is a simple three point test is misleading.²⁰⁹ Those three points are tightly defined and potentially complex in their operation. So much so that the ATO has issued the two TR's mentioned previously.

As identified by other writers the government has often proved slow in widening the ambit of tax concessions such as STS.²¹⁰ It was identified at the outset of STS that eligibility based on turnover would discriminate against otherwise worthy businesses that operate on large volumes and low margins such as petrol stations.²¹¹ Seemingly confirming the alacrity of concessional legislative response, it has taken till 20 March 2003 for a regulation to be made that provides petrol stations relief from the \$1 million maximum turnover threshold for STS (retrospective to 1 July 2001).²¹²

From a legislative design perspective, it may be argued that STS has basic design flaws as it ignores commercial reality of small business operations such as asset protection aspects of accounting and business structures.²¹³ It's stated focus of benefiting 'small businesses with straightforward and uncomplicated affairs'²¹⁴ may be too focussed at the micro business end of the spectrum. This is compounded by concerns over its

207 CCH, *Australian Income Tax Legislation* (2003), Vol 1.

208 Bondfield above n 142, 330-331.

209 Under subdivision 328-F ITAA 1997 to be eligible to be an STS taxpayer a taxpayer must:

- carry on a business in that year;
- have an average business turnover net of GST (including the turnover(s) of entities that it is grouped with) of less than \$1 million, and
- have less than \$3 million in depreciating assets held by it and other entities with which it is grouped.

210 Douglas (2000) above n 200, 30.

211 Dirkis (2001) above n 182, 25.

212 Income Tax Assessment Amendment Regulations 2003 (No 1) [Statutory Rules 2003 No 39].

213 Bondfield above n 206 and articles referred to at 255-256.

214 STS EM above n 188, 6.

practicality given the thresholds for entry, the fact that its concessions are indirect and its integrity driven complexities.

The Inspector General of Taxation's [ITG's] priorities adds weight to these concerns. The administrative aspects and application of STS is on the short list of nine matters and is to be reviewed with a view to reducing compliance burden.²¹⁵ The ITG Issues Paper that includes consideration of STS records small businesses' particular STS concerns as the:

- turnover thresholds for adopting cash vs accrual accounting methodologies;
- accounting treatment of capital vs revenue items, where they are isolated from accounts to comply with tax laws;
- debt to equity rules that apply to loans to a company by principals of that company; and
- need to modify accounting and information technology systems to match those which are used or required by the ATO.²¹⁶

This is wrapped up in a take it or leave it system sitting beside and interacting with the rest of the tax laws. This then requires a potential user to undertake an analysis to determine whether *on balance* they will be better off. Thus, it is submitted that the failure of STS lies in poor legislative design.²¹⁷ This legislative design being informed by a strong revenue protection starting position which points to the tight eligibility criteria and strong integrity focus.

6.1.3 Summary

As discussed above the reasons why STS was appropriate at all are opaque. Thus, the use STS as a case study to evaluate the success of Ralph (in addressing the small business specific issue of compliance costs) has to remain qualitative at this stage and

215 Inspector General of Taxation, Commonwealth, 'January 2004 Work Program Consultation' (29 January 2004), URL: http://www.igt.gov.au/content/work_program/consultation.asp located on 6 February 2004. From this list of nine issues four matters have been selected as priorities to be reviewed, being: small business audits; the administrative cost to business of an audit; GST refunds; and the ATO's small business debt collection practices: see Inspector General of Taxation, Commonwealth, 'Upcoming Reviews' (30 January 2004), URL: http://www.igt.gov.au/content/work_program/upcomming_reviews.asp located on 6 February 2004.

216 Inspector General of Taxation, Commonwealth, *ATO/Client Interface Systems* Issues Paper Number 5 (2003), 13. Located at: http://www.igt.gov.au/content/Issues_Papers/Issues_Paper_5.pdf on 6 February 2004.

217 Bondfield above n 142, Dirkis (2001), above n 182.

to an extent involves some conjecture. Yet, an analysis of STS suggests the government's attempts to compensate small business for the regressive nature of compliance costs is flawed²¹⁸ and we suggest misdirected. This is demonstrated by its low take-up rate to date.

Consultation cannot be blamed, as the consultation on the implementation of the flawed design was one of the better post Ralph consultations.²¹⁹ However, the slavish adherence by Treasury and the ATO to only permitting consultation on the Ralph model as accepted by government, despite now justified concerns by tax professionals, is a weakness of all of the post-Ralph consultation, not just STS.

This leaves us with the culprit being poor legislative design that is overly concerned with revenue protection and meeting overall revenue neutrality constraints. This leads one to conclude that the low take-up rate is explicable because: the system does not provide adequate monetary compensation to justify entering it; the non-monetary compensation of the touted lower tax compliance costs is illusory when looked at in the light of the totality of the post Ralph tax system changes; or poor targeting and setting of entry criteria (or a combination of all three).

The vectors of failure set out above are of particular concern because small business compliance costs had been previously well researched and reported on. Ralph did not overtly engage with this wealth of small business compliance cost research and reports analysing the underlying pressures that cause these costs. Rather, there is an emphasis on revenue protection at the expense of accessible compensation. Further, the lip service given to simplification has meant that when compensation became the only inevitable consequence, as with all afterthoughts, the compensation was ill considered and inadequate, being delivered through indirect means (eg accelerated depreciation) which have limited benefits for low capital asset small businesses (eg those engaged in the provision of services).

218 Bondfield above n 142 and n 206 (referring to other papers on STS), Dirkis (2001) above n 182.

219 Treasury at the NTLG meeting of 7 December 2000 asserts that STS consultation was very close to 'ideal', but were concerned that professional bodies did not share this view. Copy of minutes located at: <http://www.ato.gov.au/content.asp?doc=/content/Professionals/13389.htm&page=3#H6> accessed on 2 April 2002 checked at 20 December and no longer listed on ATO website.

6.2 The CGT concessions

The CGT concessions as such are not a failure, but they are little compensation for the generic increase in compliance cost burden, as they are mainly of benefit when selling or retiring from a business as opposed to running one. As the events that these concessions apply to occur infrequently in the life cycle of a small business the compensation that they offer is not a meaningful response to a continuing compliance cost impact per se.

Further, the concessions appear to fail Ralph's efficiency objective as the 15 year retirement concession is considered by some to be too generous and leading to market distortion by the locking in of assets rather than their active redeployment.²²⁰

220 Chris Evans 'CGT after Ralph', (2000) 3 *Tax Specialist* 313 at 324.

7. Conclusions on tax reform

The Ralph Review noted that:

[i]n the end, tax design in a complex environment is as much art as it is science: judgement is often as important as fact and analysis.²²¹

The ‘judgement’ has not been exercised for small business. If tax compliance costs are an endemic systematic issue, what are needed are radical solutions. As this report shows what we have from the ANTS/Ralph implementation has not worked. If the tax rules cannot be simplified, then instead of focussing on regulatory burden it may be time to debate arguments about compensation.

The case study of STS above and its low take-up to date provides a window into how Ralph failed small business by increasing compliance costs and failing to provide appropriate compensation.²²² When this is expressed in terms of good tax policy objectives the lack of simplicity is being skewed even further against small business given the Ralph changes that particularly impact small business. This puts at issue tax system equity if there is not adequate compensation for those disproportionate cost increases.

The outcome noted above is of particular concern because the difficulties of tax compliance cost reduction (and small business compliance cost reduction more generally) were well known through various government reports and initiatives. At the time of Ralph the most current ones respectively were *Time For Business* and *More Time for Business*. These reports stressed the difficulty, complexity and cost to government involved in implementing meaningful tax compliance cost reductions and reinforced the importance of attention to detail and consultation in the design and implementation phases. Given this backdrop it is a very real concern that Ralph and its implementation as regards small business are so open to criticism over poor consultation, policy and legislative design and implementation.

221 *A Strong Foundation*, above n 9, xvi.

222 See also Hendy, above n 186, 134-135 and Fisher, above n 28, 65.

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This gives cause to reflect on the presence or absence in ANTS and Ralph and its implementation of the first indicator of successful small business compliance cost reform: political will.²²³ As this report has sought to point out, even though tax compliance costs are an issue recognised by government as a concern as to their impact on small business, the elements in the tax system that increase these costs remain omnipresent and show no signs of abating. There been not been any effective government action to its slowing, merely the rehashing of old proposals pending a 2004 federal poll. This is all in the context of vocal and well-informed groups pointing out that we are drowning in tax compliance post-ANTS/Ralph.

Overall, the consideration of small business by ANTS and Ralph and in its implementation has recognised the patient's symptoms. As to the treatment, at best it is palliative, at worst, callous neglect.

²²³ Time for Business, above n 11, 19.

8. The way forward

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.²²⁴

This observation is applicable in Australia where ANTS, the Ralph Review and the subsequent implementation processes have combined to increase compliance costs for small business and failed to adequately compensate for those costs. It has been said that “[i]n Australia, tax system simplicity is an oxymoron”.²²⁵

Therefore, in light of this common experience, it is even more important in closing to briefly explore the possible ways forward for future reform processes to ensure that small business is not the major casualty of tax reform. In doing so we should challenge any general acceptance that income tax is in varying degrees intrinsically complex.²²⁶ The focus must be to ensure that complexity only arises where it is truly unavoidable.²²⁷

The following sets out the possible ways forward for future reform processes to ensure that small business is not the major casualty of tax reform. This is not intended to be a comprehensive plan, rather it is a series of suggestions built on some of the current features of the tax administration and review systems and other suggestions flowing from conclusions drawn from this report. They are intended to generate discussion and further work. Thus, in keeping with this objective, it is not intended at the end of the report rehash our conclusion expressed above about the failures of tax reform, rather the report seeks to conclude, after discussing option for the future, with a call for further debate.

224 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.

225 Geoff Carmody (director of Access Economics) cited in David Uren ‘Latham’s tax gamble’ *The Australian*, 3 March 2004, 11.

226 See reports referred to at n 31.

227 Banks, above n 17.

8.1 Facing compliance costs

It is still important to focus on compliance cost reduction, as there are things that cannot be compensated.²²⁸ 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.

8.1.1 *Calculating the compliance costs*

In both the policy setting and Parliamentary debate phases it is important to calculate the true compliance costs of the proposed initiatives.

So rather than criticise the methodology of academic compliance cost researchers,²²⁹ the ATO/Treasury should enter the debate by developing an enhanced ability to monitor and model the compliance costs of the tax system. This should be supported by technological infrastructure that allows for a timely and methodologically robust monitoring capacity. Although it is recognised this has political implications, the Government has instructed the ATO to collect compliance statistics in respect of BASs²³⁰ and some other post-ANTS/Ralph measures, which should be expanded upon.

The United States has no such reservations with the Internal Revenue Service (IRS) currently reported as working with IBM to develop such a system wide capacity.²³¹

228 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.

229 For example the ATO simply notes the disagreement in international benchmarking of GST administration without being able to advance an alternate researched ATO view, above n 70, 6.

230 This process has not been very successful with only 23% of BASs lodged having the time box completed. The information captured indicates that for Quarter One 2003/04 the time for completion was 3.56 hours down from 3.81 hours for Quarter One 2001/02 - National Tax Liaison Group (NTLG) Minutes 24 March 2004, item 18. A State Chamber of Commerce (NSW), above n 114, survey estimates that 44% of small of businesses spent 1 to 2 hours completing the BAS while another third of small businesses spend up to 60 hours preparing a BAS (over \$1300 per year). It must be noted that these figures are for BAS preparation cost and do not capture the entire record keeping cost.

231 Peter Arena, John F O'Hare and Michael P Stavrianos 'Measuring Taxpayer Compliance Burden: A Microsimulation Approach' in Ranjana Madhusudhan (ed), *National Tax Association: Proceedings of 95th Annual Conference* (2002), 333.

Failure to do so merely raises conspiracy theories about a hiding the true compliance cost picture.

Both policy formulation and implementation should be based upon co-design principles, involving accurate compliance cost data included in enhanced RIS documents.

8.1.2 *Continuing Ralph's proposed institutional reforms*

Given the above discussion on the reasons for Ralph's failures to adequately treat small business compliance costs 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.

The key initiative needed to achieve this is meaningful consultation at the legislative design and implementation phases of new tax initiatives. The infrastructure is in place with the requirement for RIS's and the establishment of the Board of Taxation. However, concern has been expressed (as detailed in this report) that in the Ralph implementation phase, with the exception of the consolidation regime, meaningful consultation has not necessarily occurred. The resultant design of tax law and administration has been the worse for this.

After review and recommendation by the Board of Taxation on the place of community consultation in tax law, policy and administration changes²³² the Treasurer responded with the adoption of a model of consultation based on the Board's analysis.²³³ This model has been described as starting from the basis of mandatory consultation with exceptions for commercial sensitivity, revenue risk and tax avoidance sensitivity.²³⁴ That

232 Board of Taxation, above n 156.

233 Treasurer, above 155.

234 Dirkis (IBFD 2002), above n 72, 531-532.

governments accept such obligations is not fanciful, since 1994 New Zealand has in place a formal and consultative Generic Tax Policy Process.²³⁵

After over 18 months after the Treasurer's media release above the Treasury has released a document of a bit more than two and a half pages of text entitled *Engaging in Consultation on Tax Design*.²³⁶ In that document there is no such generic commitment to consultation and it broadens the range of circumstances where consultation is not appropriate to include *political sensitivities*. The tone of the document is that consultation shall be on Treasury's terms with Treasury having the final say, whatever the consultation process raises. In particular the requirements on participants are mandatory such as strict secrecy and the accepting of time constraints of government process. Whereas, the requirements adopted by Treasury are qualified by 'where possible' and 'try at all times' to provide, amongst other things, realistic timeframes and feedback. This does not bode well into the future given the concerns that continue from the Ralph consultation process discussed previously.

Thus, a greater role for consultation in a more publicly accountable RIS process needs be investigated.²³⁷

8.1.3 *Providing for review*

Finally, there is a need to have in place the capacity to undertake transparent and independent post-implementation reviews of tax laws and policies. The Board of Taxation is currently commencing its first such review of the quality and effectiveness of the non-commercial loss quarantining provisions.²³⁸

This process requires permanent independent quality assurance monitors of the tax system. Post-Ralph the Board of Taxation and the Inspector General of Taxation have

235 Described and discussed in Adrian Sawyer 'Broadening the Scope of Consultation and Strategic Focus in Tax Policy Formulation: Some Recent Developments' (1996) 2 *New Zealand Journal of Taxation Law and Policy*, 17 and Dirkis (IBFD 2002), *Ibid*, 531.

236 Treasury, 'Engaging in Consultation on Tax Design' (January 2004). Located at: <http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=784> on 17 January 2004.

237 Hendy, above n 186, 138-145 and Sawyer, above n 183 for the NZ experience in this area.

238 Post-implementation reviews were foreshadowed in Treasurer, above n 143. For details of the non-commercial losses review see Board of Taxation website at: http://www.taxboard.gov.au/content/post_imp_reviews.asp accessed 21 December 2003.

roles in this regard and this is to be welcomed.²³⁹ Though the multiplicity of review mechanisms may of itself cause system complexity.²⁴⁰

However, despite the existence of such bodies, it is only with precise compliance cost figures that the success of a measure can be evaluated. With data such as the global costs of compliance post Ralph and the GST (ANTS) the authors would have had empirical research to discuss whether, on balance, small business is better off post Ralph in terms of their compliance costs when all tax system changes are taken into account.

8.2 Compensation

Despite these measures there will be occasions where compliance costs are inevitable and compensation is the 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 given for the actual cost.

The initial suggestion is, rather than persevere with STS, investigate the feasibility of a direct concession via rebate (tax offset) or cash grant (based upon a percentage of turnover or the actual level of cost to the business) or lower tax rate for business income of small businesses. Both methods are used in other jurisdictions.²⁴¹ Either approach has the advantages of being able to be clearly monitored for its revenue costs and take-up rate. It is also more amenable to adjustment up or down or to widen or contract the eligibility criteria should circumstances require.

In part this suggestion stems from our conclusion that the ANTS and Ralph treatment of small business evidences the intractability of tax compliance costs that regressively impact on small business, as well as the tendency for them to continue to rise. That the compliance cost reduction return is marginal, in the absence of very significant whole of government efforts, is also relevant to this point.

239 Business Coalition for Tax Reform, 'Federal Budget Submission' (January 2004), 4-5. Located at: http://www.bctr.org/upload/BCTR_Budget_Submission_for_release_150104.pdf on 17 January 2004.

240 Fisher, above n 28, 63.

8.3 Recommendations

Recommendation 1

In order for the tax policy to be properly developed, it needs to be made with full knowledge about the cost of compliance of a measure. The Treasury, in consultation with the Australian Taxation Office should develop an enhanced ability to monitor and model the taxpayers' compliance costs in the tax system. This should be supported by technological infrastructure that allows for a timely and methodologically robust monitoring capacity.

Recommendation 2

In order for the Parliament to be fully informed about the cost of compliance of a measure, a more publicly accountable Regulation Impact Statement (RIS) process needs to be established which sets out taxpayer compliance costs arising from the proposed change so that they can weight up the public good against the compliance costs imposed.

Recommendation 3

To have in place the capacity to undertake timely, transparent and independent post-implementation reviews of all tax law and policy changes.

Recommendation 4

Where the public good is deemed to be more important than the additional compliance costs imposed, Government needs to investigate the feasibility of compensation via a direct concession, via rebate (tax offset), a cash grant (based upon a percentage of turnover or the actual level of cost to the business) or a lower tax rate for business income of small businesses.

241 See eg Warren (2004), above n 69, 192, Table 12.3, which sets out the target small business tax

These methods are used in other jurisdictions. Either approach has the advantages of being able to be clearly monitored for its revenue costs and take-up rate. It is also more amenable to adjustment up or down or to widen or contract the eligibility criteria should circumstances require.

In summary, in order to safeguard future small business compliance cost reform from the casualty ward, the way forward should involve both compliance cost reduction and targeted compensation based upon robust research.

8.4 A call for further debate

The report has found that tax reform has recklessly injured small business through the imposition of greater compliance costs, in complete disregard of its oath (policy objective) of compliance cost reduction. The preceding analysis does raise some avenues for future reform, but there are possibly many more.

In the upcoming election it would be refreshing to see debate focused on practical resuscitation measures such as compensation, rather than broad, high level changes which often amount to placing the small business patient in isolation and allow nature to take its course.

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