Keep it Simple, Stupid—the New Tax Reform

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IT seems that everyone has had enough of tax reform—and no wonder! The most visible signs from our new reformed tax system include:

- an administrative system burdened by the weight of having over-extended itself for years;
- tax practitioners feeling so over-tired that they are at risk of collective chronic fatigue syndrome, with worse to come as the tax professions hæmorrhage with their best and brightest looking for an easier life; and
- the business community, big and small, less satisfied than ever with the work required just to comply with their tax obligations.

That is not to say that there may be some enduring benefits from tax reform. But in securing those benefits, somewhere along the tax-reform road the whole show went off the rails. So what went wrong, and what can be done about it?

BIG DREAMS, BIGGER LET-DOWNS

One of the reasons for the current malaise with our tax system is undoubtedly the expectation built up by such a long public debate on big-picture tax reform, where it became all things to all people, before any detail was announced. In the inevitable compromise that comes with any reform requiring Parliamentary approval, it was never going to be able to deliver.

Worse still, because reform is so difficult to achieve, there was enormous pressure to include all elements in one package and to get it through on a timeline that matched the three-year Parliamentary term. It was an understandable, and perhaps even necessary, step given the constraints, but it created the seeds of discontent.

The initial tax package was going to see the introduction of a GST, a whole restructuring of the administration of income-tax payments through the Pay As You Go system and a raft of business tax reforms, that were all, on the original timetable, to be introduced from 1 July 2000. The GST on its own was a massive undertaking. Adding so much more on to the agenda was inviting system burn-out.

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The scope was truly breathtaking. The intentions were good, but the outcomes never could have been in such a pressure-cooker environment. Some elements of the package were delayed, others were altered beyond recognition, and still others turned out to have rather different implications once the legislative fine-print became available.

THE CLOCK IS RUNNING

Time constraints are Public Enemy Number One when it comes to valuable tax reform. Some time pressure can be a good thing to get the wheels of bureaucracy turning. But when the pressure becomes a straitjacket that dictates the outcomes to a point where they are degraded, it is time to find a better way of doing things.

In the rush to legislate, impossible timelines are set. Exhausted people toil to turn out draft legislation so that other exhausted people can try to apply the emerging barrage in practice. There is little or no time for quality control and peer review of legislative drafting, little or no time for meaningful consultation, and little or no time to educate administrators and practitioners about the new law before it comes into force. Often, in fact, the law is applied before final legislation is passed.

There is little acknowledgement of the problems this creates for systems development or business planning and advice. It also tends to lead to verbose law which, in turn, increases administrative and compliance costs.

IMPROVING THE PROCESS

As unexciting as it may sound, the key to a better tax environment lies in a better tax policy and law-making process. A structured process can help put the brakes on when required, and ensure that simplicity is not lost in the maze of competing reform objectives. Getting this process right should be the next tax frontier to be tackled.

There is some prospect of useful progress in this area. The GST industry partnerships, the Small Business Consultative Committee and other forums are evidence that business input has become an increasingly welcome ingredient in reviewing and assessing tax administration and law. The Tax Advisory Board has commissioned work on the process of consultation and tax-law development. The Coalition has announced that it will appoint an Inspector General of Taxation who may be able to provide some improvements in this area.

The aim is to get higher-quality policy decisions that can be translated into clear and better legislation. Better legislation will, in turn, deliver more certainty, stability and consistency in tax law, and that will reduce compliance and administration costs.

Ideally, the approach would be applied in a consistent and comprehensive manner to all tax change. It is based on ensuring greater interaction between the people that make the tax law and those that work with it from the initial development of a fiscal strategy right through to post-implementation review.

Such an approach has been part of the New Zealand tax-policy and law-making process for some years and has resulted in a much more harmonious relationship between taxpayers and the tax authorities, and enduring and far-reaching tax reforms.

ELEVATING SIMPLICITY

Good tax policy, to an economist, involves three key features—equity, efficiency and simplicity. The difficulty in designing good policy is getting the balance between these three elements right.

It appears more than coincidence that simplicity is usually last on the list—the element to be juggled once the strategy for equity and efficiency has been worked out. Treating simplicity as a poor first cousin to equity and efficiency is a major shortfall in current policy design that also needs to be taken up in this era of reform fatigue.

If it seemed that introducing a GST was hard, try measuring it against the task of making the existing tax system simpler! Many countries around the world have tried and failed to bring genuinely simpler tax arrangements to their citizens. The last two major tax reform efforts in Australia promised simplicity but delivered quite the opposite.

Why is simplicity so hard to achieve? It is partly a product of the more complex world in which we live. Cross-border transactions, including electronic ones, are challenging the old ways of doing things. But that is not the whole story. Governments around the world have been voracious in their pursuit of more revenue. Tax authorities have, by various methods, been pressed to squeeze more dollars out of the existing tax bases. Complexity has often emerged as a result.

The time factor is a big issue here, too. The usual process involves committing to a policy position before the impact of that position, in terms of data collection costs for taxpayers, has been established. As a result, a complicated end result can emerge, even when all the players wanted something simple. The policy-makers sign on the dotted line when things look simple—but having made an irrevocable commitment, they are forced to live with, and try to defend, the complex implementation consequences.

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The idea of integrated teams (from the Office of Parliamentary Counsel, ATO and Treasury) working within the bureaucracy to develop tax law was recommended by the Ralph Review and is still being considered. It gives some hope that the same people who generate the policy ideas in Treasury will actually get their hands dirty filling in the forms that the policy change requires, and vice versa. Seeing the compliance cost fruits of a policy idea is probably the best way of ensuring those compliance costs are minimized in future.

An example of the way in which tax arrangements are adding to compliance costs might help. A simple formula can be used to establish income tax deductions for motor vehicle running expenses. This greatly reduces the compliance costs for taxpayers by relieving them of the need to keep every invoice relating to car expenses through the year. (If a taxpayer chooses to keep a log book rather than use a formula, invoices must be kept, but petrol and oil expenses can still be estimated.)

Then the GST was introduced. The easy way to allow for input tax credits on motor vehicle running expenses would have been to allow for a proportion of the income tax deduction to be claimed. Instead, every taxpayer has to keep every invoice for every motor vehicle expense if he wants to claim any input tax credits for those expenses. Imagine the national cost of keeping and recording all that information.

The key point is that while so much effort is put into maximizing the efficiency of the tax system, more needs to be done to recognize compliance costs. These costs impose the same kind of economic burden as efficiency costs. What's more, any Government prepared to tackle simplifying the tax system head-on may find an electorate that is eternally grateful.

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