

Briefing Paper BP2-2016

It's just not simple. Why is tax so complicated?¹

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We may not all agree with Albert Einstein's famous quip that "the hardest thing in the world to understand is the income tax", but there is no doubt that most people find dealing with their tax affairs difficult. And this seems to be the case in virtually all countries. Whether you ask the person in the street, politicians or tax experts, most would agree that taxes are complicated and many would also argue that their particular tax system is the most complicated in the world. And they would be able to provide lots of evidence to back up their case. For example:

- in Australia the personal tax system is so complicated that nearly three out of every four personal taxpayers have to employ a tax agent to look after their own tax affairs;
- United States taxpayers and businesses spend 7.6 billion hours and incur significant out of pocket expenses each year complying with federal income tax filing requirements as a direct result of tax complexity;

¹ This briefing paper is loosely based on published and unpublished works by the author and colleagues, including *Tax Simplification*, Chris Evans, Richard Krever and Peter Mellor (Kluwer Law International, 2015) and a chapter on tax complexity written by Chris Evans and Binh Tran-Nam in *Comparative Taxation*, Chris Evans, John Hasseldine, Andrew Lymer and Robert Ricketts (Fiscal Publications, forthcoming 2016).

- In the United Kingdom the size of the tax legislation has increased 12 fold since 1960, and there are an estimated 13,000 pages of tax law – more than 30 times the number of pages required for the whole of the criminal law.

In July 2010 the Chancellor of the Exchequer George Osborne identified so much concern about tax system complexity in the UK that he established the Office of Tax Simplification (OTS) charged with the responsibility to “advise the Chancellor on delivering a simpler tax system, providing independent advice on options for addressing existing complexity in the tax system”. Six years on and the OTS is still working on improvements to the UK tax system, with some victories but a long way to go.

So why is tax so complicated and can anything be done about it?

One of the main causes of complexity is the increasing use of the tax system by governments to achieve social and political goals rather than simply using tax systems for what they are good at – raising revenue for government spending. Hence we use the tax system to try and change behaviour which may be regarded as inappropriate or socially unacceptable: for example, the use of so-called ‘sin’ taxes imposed to put us off smoking, drinking and emitting noxious fumes from our motor vehicles. Or we may use the tax system to pay out welfare benefits in the form of credits and rebates; reward innovative businesses through enhanced deductions or exemptions; or collect university fees from former graduates. All of these may be entirely laudable, but they come at the cost of making our tax system more complicated than it would otherwise be. We also need to remember that life today is far more complicated than ever it was in days gone by, and that the greater complexity of commercial and other transactions in the modern world inevitably means we need more, and more complicated, tax laws and rules to deal with complex transactions.

Many of these causes are outside the control of taxpayers, and often out of the control of governments. But some of the causes of complexity are within our control. For example, legislators often see ‘choice’ as a good thing. But if we give too many choices in the tax rules, we inevitably make things more complicated. It was recently reported in Australia that the rules for taxing fringe benefits (perks) included over 30 different ways of valuing a meal provided for

employees; hardly surprising that taxpayers and their advisers spent countless (wasteful) hours and no little money identifying which method of valuation gave them the best tax outcome. Sometimes trying to be too fair (to the taxpayer) comes at the real expense of simplicity.

Another cause of complexity that we are able to control is the sheer frequency of change of tax rules. The more often rules are changed, the more complicated they become. Add to that the process of 'complication' – adding more layers of rules to deal with unintended consequences of change to an existing base which is already creaking under the strain of previous inappropriate changes – and the result is yet more complexity.

So what – if anything – can be done about this tax system complexity? Quite a lot, as it happens. In the first place we can ask our legislators – advised by Treasury and Tax Office officials – to think very carefully about the policy side of tax changes. Is the tax system really the best way of achieving the policy outcome desired or would it be better, for example, to achieve the policy goal some other way? We want to encourage small businesses. Good. But is it better to do it by allowing them more deductions, or a lower rate in the tax system, or would direct subsidy (without involving the tax system) be the better policy option? And if it is decided that using the tax system is the best policy option, how can we implement it in a way that leverages off existing small business practice rather than imposing a new set of rules (including integrity rules because we don't want small businesses ripping off the system) that impose substantial new compliance burdens on the small business sector. So carefully considered policy options and simpler policy is one area where improvements can be made.

But we also need to be aware that simpler tax policy isn't always appropriate. For example, as a policy option, a poll tax is very simple, and it is also simple to legislate and to implement. No complicated sets of rules necessary: if you breathe, you pay tax. But it is also grossly unfair, bearing no relationship at all to ability to pay, one of the key considerations in a just tax system. So simplicity always has to be considered in the light of other key considerations such as equity and efficiency. The UK experience with the poll tax certainly brought that lesson home to Margaret Thatcher with a vengeance.

The other way in which real simplification can be achieved is by looking to smooth out the interactions between taxpayers and tax collectors such that taxpayers are shielded so far as possible from the necessary complexity that must underpin any modern tax system. Cumulative Pay as You Earn or Pay as You Go mechanisms, and other deduction-at-source regimes which ensure the right amount of tax is taken at the right time, can reduce any need for many taxpayers to have to deal with the tax system. In many countries it is now normal and accepted that taxpayers receive tax returns that are prepopulated with all necessary information (that data having been received by government from a variety of sources including employers, financial institutions, corporates and others) such that all they have to do is agree the contents – often with a simple SMS. And other forms of digital service delivery, such as Standard Business Reporting now used in many countries allowing smooth and one touch business to government reporting, are providing all sorts of other means by which friction between taxpayers and tax agencies can be minimised. These technological breakthroughs are so dramatic that in some countries taxpayers have virtually no contact with the tax agency and yet can know at any time the precise state of their tax affairs.

So it is not all doom and gloom. Even if tax is – as suggested – the hardest thing to understand, fortunately we don't actually have to understand it. It's a bit like driving a car. We may be sitting amidst the most amazing and complicated technology, but most of it will be well above our understanding. So long as we are able to drive the car and get from A to B, ideally without too much cost or too many traffic jams, we will be content. Likewise, so long as the tax system can operate smoothly in generating the revenue for those roads (and for the other things we value in society), without imposing too heavy a burden (whether in tax or in compliance), we will probably be as happy as anyone can be who has to pay taxes.

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