

11 Complexity and operating costs of the tax-transfer system

Outline

This section outlines the problem of complexity in the tax-transfer system. It explores the sources of this complexity and the costs it imposes on the community.

Key points

- There are no reliable estimates of the complexity or operating costs of the tax-transfer system but there is a strong sense in the community that they are too high.
- An excessive level of complexity impedes the ability of taxpayers and transfer recipients to make optimal decisions, diverts resources from more valuable uses, and gives rise to planning opportunities that undermine the fairness of the system. Its impact tends to be greatest on those with the least capacity to deal with it.
- A certain level of complexity and operating costs is required to implement the tax-transfer system in a manner that is efficient and equitable. However, at some point, equity or efficiency is likely to be compromised by increasing complexity.
- Current levels of complexity and operating costs are most likely above that which is optimal for society as a whole. Two important reasons for this are: incremental development of tax-transfer policy based on partial assessments of the associated benefits and costs; and income maximising behaviour through the tax-transfer system. Broader reform provides an opportunity to take a systemic view of the trade-offs between simplicity and other policy objectives.

11.1 Introduction

In 1975, the report of the Taxation Review Committee (Asprey et al, 1975) noted with some alarm that the income tax law extended to 526 pages, six times its original length in 1936. The income tax law is now 5,743 pages.

The complexity of the tax-transfer system and the level of compliance costs¹ borne by taxpayers and transfer recipients remain issues of considerable concern. Excessive levels of complexity impede the ability of taxpayers and recipients to make optimal decisions. The time and resources individuals devote to complying with the requirements of the law could

1 Compliance costs include, but are not limited to, the costs of: acquiring the necessary knowledge of relevant aspects of the tax-transfer system; compiling records; completing forms and reporting changes in circumstances; acquiring and maintaining record keeping systems; complying with audits or attending interviews; evaluating the effectiveness of alternative transactions or alternative methods of complying with the requirements of the law; and collecting and remitting taxes levied on employees and turnover.

be allocated to more productive or satisfying activities and therefore represent a significant efficiency cost to the economy. Complexity in the tax-transfer system can also give rise to tax planning opportunities that add to the efficiency costs of the system and reduce its fairness by shifting the tax burden from one individual to another. See Box 11.1 for further discussion about the problem of complexity.

To a significant extent, the complexity of the tax-transfer system and its operating costs (administration and compliance costs) arise from the underlying policy and legislation that defines the system. However, the administrative architecture and the way agencies implement the underlying policy and legislation can greatly influence the complexity that taxpayers and transfer recipients experience and the extent of their compliance costs.

Notwithstanding the concerns expressed about the complexity of the tax-transfer system and the associated compliance costs, taxpayers and transfer recipients behave in ways that contribute to the problem by seeking special treatment or seeking to maximise their incomes (after taking into account taxes and transfers).

Box 11.1: Why complexity is a problem

Complexity in the tax-transfer system makes it harder for people to understand their obligations and entitlements. Unless they get professional advice, people may rely on simplistic rules of thumb for making judgments, such as following 'tried and tested' practices without considering whether these arrangements give the best outcomes.

Importantly, complexity tends to have the greatest impact on those with the least capacity to deal with it, or the least means to get professional help. For example, it is generally accepted that the impact of complexity falls disproportionately upon smaller businesses. For these businesses and many individuals, an overly complex system can increase the risk of non-compliance and may impede good decision making.

Individuals may incur additional costs (time and money) dealing with the uncertainty complexity creates. Some individuals may conduct their affairs to minimise the complexity they have to deal with – for example, by avoiding activities involving greater uncertainty or risk of being penalised – even if it means they pay more tax than necessary or do not claim benefits to which they are entitled. Those with greater financial capacity may deal with complexity by engaging professional help.

System complexity may also create unintended opportunities for taxpayers and transfer recipients to maximise their disposable income (income *less* taxes *plus* transfers). This behaviour effectively increases the tax burden on others, which can undermine the fairness of the tax-transfer system. It can also have a broader impact on community support for the system and levels of voluntary compliance. Economic efficiency is also compromised through the diversion of resources from more productive pursuits into these planning activities.

11.2 Community concern

There has been a lot of community concern in recent years about the complexity of the tax-transfer system and the level of compliance costs, particularly from the business community.

In its *Tax Reform Blueprint*, the Australian Chamber of Commerce and Industry (ACCI 2004) highlighted, as two of its top five tax issues: the cost of tax compliance; and complexity in state taxation. It noted that surveys of business show that tax is consistently identified as a major problem. It drew attention to the ad hoc manner in which state taxes are applied – ‘with different rates, exemptions and definitions applying in different States to economically identical transactions and assets’ – and the increased compliance costs that result for businesses operating across multiple jurisdictions.

In its report to the Australian Government, the Taskforce on Reducing the Regulatory Burdens on Business (Australian Government 2006) noted that tax was rated by business as being among its highest regulatory burdens. It also noted the need to tackle the cumulative tax compliance burden as a strong and recurring theme of submissions to the Taskforce.

In 2007, the Business Council of Australia and the Corporate Tax Association (BCA and CTA 2007) released a report outlining concerns with the division between the Australian Government and state tax systems. The report stated that there were up to 56 different taxes that Australian businesses had to deal with – 21 Australian Government taxes, 33 state taxes and two local government taxes – and noted that this was more than twice the number identified in the United Kingdom. The report drew attention to ‘the highly inefficient manner in which some revenues are raised’, noting that for the 92 businesses surveyed, the corporate income tax accounted for two-thirds of the tax borne. The remaining third was raised through ‘a complex array of 50 additional taxes’, some of which yielded relatively little revenue but involved considerable compliance costs. The report also highlighted the additional complexity and compliance costs due to differences in the rates and bases of similar taxes applied by individual States.

Individual taxpayers and transfer recipients are also concerned at the level of complexity they face in the tax-transfer system. For example, a strong theme in the Joint Committee of Public Accounts and Audit inquiry into tax administration was the complexity of our tax laws and the uncertainty and costs this imposes on the community (JCPAA 2008).

With regard to the transfer system, welfare advocacy groups such as the Australian Council of Social Service (ACOSS) have over the years expressed concern about the capacity of some vulnerable income support recipients to understand and properly deal with the requirements for gaining and maintaining eligibility for payments. There has also been ongoing concern about the impact of system complexity on outcomes for other Australians, such as working families who are required to estimate their future income in order to receive family assistance.

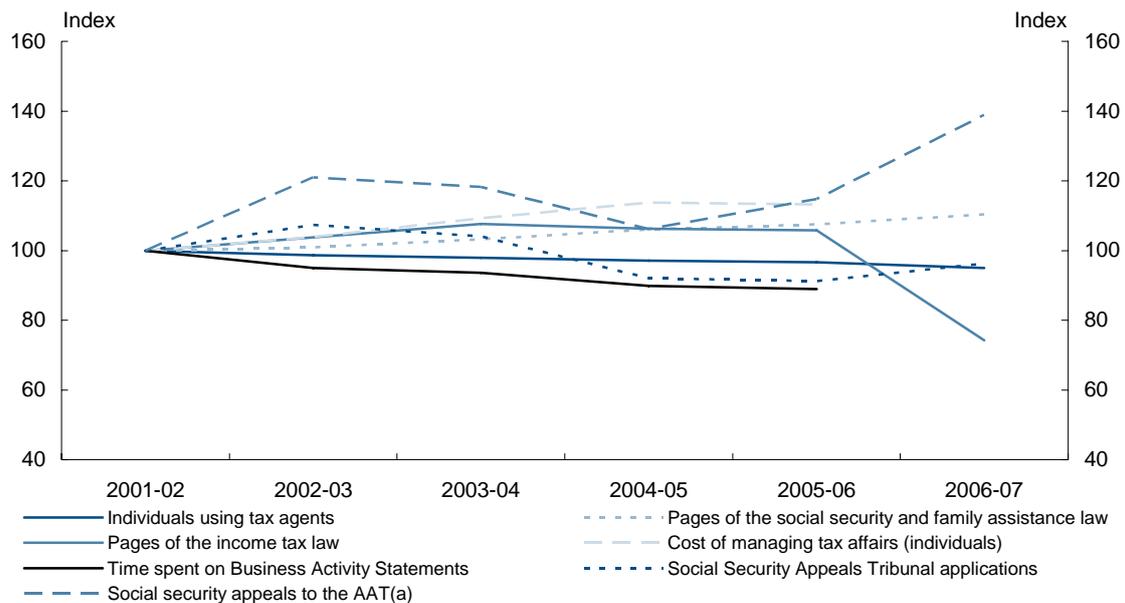
11.3 How big is the problem?

There is no direct measure of complexity in the tax-transfer system

While there is a community view that the tax-transfer system is complex, and the level of complexity has been increasing, it is very difficult to measure this complexity in an objective way. Proxies for complexity are often cited as evidence of the complexity of the tax-transfer system. These include: the number of pages of legislation; the frequency with which it is amended; the proportion of taxpayers using tax agents to complete their tax returns; the time taken to prepare tax returns; the average level of customer contact required in the administration of transfers; the number of administrative rulings that are required to clarify the law; the number of reviews of administrative decisions and the number of disputes that are litigated.

These measures are at best only indicative of possible trends in complexity and each must be viewed with some caution. For example, while there is likely to be a positive correlation between the overall size of the income tax legislation and its complexity, this relationship does not always hold. In the late 1990s the Tax Law Improvement Project was established to rewrite the income tax law to make it easier to understand. The new drafting style, while clearer, better structured and shorter, did not involve any significant policy simplification. Similarly, the removal of more than 4,100 pages of 'inoperative provisions' from Australia's income tax legislation in 2006 improved its readability. However, the reduction in complexity was not commensurate with the reduction in the size of the law, as it did not reduce the number of operative rules or their complexity. The proportion of taxpayers using tax agents is another frequently cited indicator of complexity in the tax system. However, the use of tax agents may reflect taxpayers' assessments about the value of their time or an expectation of a better tax outcome if they use an agent.

Although there are weaknesses in each of these partial measures of complexity, collectively the various indicators in Chart 11.1 suggest the level of complexity in the tax-transfer system may not have changed markedly in recent years. However, this does not provide any insights into whether the current levels of complexity and compliance costs are appropriate.

Chart 11.1: Partial indicators of complexity in the tax-transfer system

(a) AAT means Administrative Appeals Tribunal.

Source: ATO, FaHCSIA and Australian Treasury estimates.

Only limited data are available on administration and compliance costs

An alternative approach to evaluating the impact of complexity in the tax-transfer system is through the direct assessment of administration and compliance costs. The relationship between them is again not necessarily a strict one. However, administration and compliance costs are of interest in their own right, since they represent an important part of the efficiency cost of the tax-transfer system.

Administration costs

In 2006-07, the administration costs of the ATO and state revenue offices were around \$2.9 billion, or 0.9 per cent of the revenue collected. On the transfer side, the administration costs of Centrelink, which administers the Australian Government income support system, was around \$2.5 billion in 2006-07, or 3.5 per cent of Australian Government payments.

These figures underestimate the total administration costs associated with the tax-transfer system because they exclude the costs of policy formation, and the costs of other agencies involved in the collection of tax revenue and administration of transfers.

Compliance costs

Only two major studies of the costs of complying with the main Australian Government taxes have been conducted in Australia. These were the ATO-commissioned study by the Australian Taxation Studies Program (ATAX) (Evans et al, 1997) based on 1994-95 survey data, and an earlier study led by Jeff Pope based on 1990-91 data (Pope 1994). There has been no aggregate study of compliance costs in Australia since *The New Tax System* and the *Review of Business Taxation* reforms were implemented.

The ATAX study found total taxpayer compliance costs in Australia in 1994-95 to be around 1.4 per cent of GDP, slightly less than the Pope study, which estimated total taxpayer

compliance costs to be 2.1 per cent of GDP in 1990-91 (Table 11.1). The ATAX study found significant differences in compliance costs as a percentage of revenue collected between individuals (4.0 per cent) and businesses (9.4 per cent). It is unclear how representative these estimates might be of existing compliance costs because of subsequent changes in the structure of the tax system and the likelihood that survey respondents may not differentiate the incremental cost of tax compliance from other costs, such as those necessarily associated with running their business.

Table 11.1: Survey estimates of aggregate taxpayer compliance costs in Australia

| | ATAX(a) | | Pope | |
|--------------------|---------|---------------|---------|---------------|
| | % GDP | % Tax revenue | % GDP | % Tax revenue |
| Personal taxpayers | 0.34 | 4.0 | 0.96(b) | 9.2(b) |
| Business taxpayers | 1.02 | 9.4 | 1.14(c) | 6.6(c) |
| All taxpayers | 1.36 | 7.0 | 2.10 | 11.9 |

(a) All Australian Government taxes administered by the ATO.

(b) Personal income tax.

(c) Employers' PAYE and PPS collections, fringe benefits tax, company income tax and wholesale sales tax.

Source: Evans et al (1997); Pope (1994).

Generally, small businesses face a higher compliance cost burden relative to the amount of tax they pay than large businesses. For example, the ATAX study estimated that small businesses incurred half of tax related business compliance costs, while contributing only around 13 per cent of business tax revenue.

There are no reliable estimates of the costs incurred by transfer recipients to gain and maintain eligibility for payments, or the costs incurred by business in complying with requests for information under the social security law.

There are many examples of complexity in the tax-transfer system

Previous sections of this paper have identified a range of aspects of the tax-transfer system that involve considerable complexity, including:

- the large number of taxes levied by governments, many of which raise relatively little revenue, and the lack of consistency in rates, bases and administration of similar taxes levied by different governments (Section 2);
- the many differences in the income tests used to determine eligibility for different transfers and tax concessions (Section 7);
- interactions between the tax and transfer systems that obscure signals about the rewards for working and saving (Section 7);
- the extensive array of tax expenditures, many of which are designed to achieve non-tax policy objectives through the tax system (Section 2);
- the inconsistencies in the taxation of different assets and entities (Section 8) and the multiplicity of arrangements for pricing Australia's natural resources (Section 2); and
- the difficulties in taxing cross-border flows of income (Section 8).

11.4 An optimal level of complexity and operating costs

Complexity and operating costs

A certain level of complexity and operating costs is required to implement the tax-transfer system in a manner that is both efficient and equitable. For example, it is recognised that means testing is required to ensure that transfers are targeted to those in need of assistance. However, at some point, equity or efficiency is likely to be compromised by increasing levels of complexity. There is also a limit to how much complexity individuals can bear without needing to engage professional assistance, particularly in a self-assessment system such as income tax. See Box 11.2 for a discussion of the theoretically optimal level of complexity.

Changes in technology and the information marketplace can be an important determinant of society's capacity to deal with complexity and the accepted balance between complexity and other policy objectives. The evolution of more advanced low-cost computer hardware and software, and the advent of the internet and electronic filing, have increased the capacity of taxpayers/recipients and administrators to deal with more sophisticated procedures and to deal with existing procedures at lower cost. For example, advances in information technology have increased the ATO's ability to put some information into taxpayers' tax returns for them.

Box 11.2: A socially optimal level of complexity

The socially optimal level of complexity is where the benefit of an additional unit of complexity just equals the cost of that additional unit of complexity. Beyond this point the incremental cost exceeds the incremental benefit and overall wellbeing is reduced, other things being equal. The difficulties in determining the optimal level of complexity are substantial. Careful subjective judgments are required when assessing policy choices and these judgments are typically made with limited information. However, it is clear that for a given set of policy objectives, society will be better off if those objectives are achieved with less complexity and lower operating costs.

From the perspective of an individual taxpayer or transfer recipient, the optimal level of complexity is also influenced by any benefit they might receive from engaging in tax-minimising/transfer-maximising behaviour or seeking a targeted tax concession or enhanced transfer. This behaviour results in a higher level of complexity than is socially optimal. The additional costs arise from the complexity of multiple tax concessions or transfers and revenue or expenditure protection provisions intended to circumvent that behaviour. The extent to which complexity, administration costs and compliance costs exceed the socially optimal level will be influenced by a range of factors, including: the expected size of the benefit to the individual from such behaviour; community attitudes towards such behaviour; the extent of awareness of the broader costs of such behaviour; and the policy response. See Oliver and Bartley (2005) for further discussion of this issue.

The allocation between administration costs and compliance costs

To an extent, administration costs and compliance costs may be substitutes for one another. For instance, the move to self-assessment in the income tax system in the 1980s reduced administration costs while increasing compliance costs. In deciding the appropriate balance

between administration and compliance costs there are several important considerations. First, it may be more or less cost effective for particular activities to be handled by the administration than by individual taxpayers and transfer recipients. Second, the allocation of costs between the administration and taxpayers may influence behaviour by altering the direct cost to the taxpayer/recipient of exploring tax-minimising or transfer-maximising strategies. Third, the balance between administration and compliance costs has equity implications, since the ultimate burden of administering the tax-transfer system falls on taxpayers in general, rather than on specific groups of taxpayers.

11.5 Sources of complexity and operating costs

There is a range of factors influencing the complexity of the tax-transfer system and the levels of administration and compliance costs.

Increasingly complex policy objectives

Tax-transfer policy and its implementation is an obvious determinant of the level of system complexity and operating costs. More complex policy objectives tend to result in increased system complexity and higher operating costs. To a considerable extent, the complexity of tax-transfer policy is a reflection of the complexity in markets for factors of production, goods and services. For example, a growing number of Australian taxpayers now own equity investments, are involved in complicated business structures, or invest or work overseas. Increasing globalisation, e-commerce and financial innovation have also prompted more sophisticated tax rules.

The review of Australia's tax history in Section 4 outlined the progression over time in the objectives sought from tax reform, from the feasibility of administration, to revenue raising capacity, to improving the performance of the tax system. As one set of policy objectives is achieved the focus shifts to more complex policy outcomes. The Taskforce on Reducing the Regulatory Burdens on Business (Australian Government 2006) noted the changing needs and expectations of society, driven in part by increasing affluence, knowledge and an aversion to risk, as a key driver of increased regulation.

Tax policy considerations may extend beyond the trade-offs between complexity, equity and efficiency to include other considerations. For example, the tax system is sometimes used to deliver non-tax policy objectives such as delivery of social security, industry assistance or environmental initiatives. These objectives often require targeted implementation of tax provisions using information that is not otherwise relevant to revenue collection.²

Changes in social circumstances have also led to a more sophisticated transfer system. The increasingly complex financial and working arrangements of Australians have resulted in significant changes to transfer design, as have other changes to family structures and relationships. Policy considerations have broadened over the past two decades from a primary focus on poverty alleviation, to a system that also encourages self-provision

2 While moving these functions outside the tax system would decrease tax system complexity and operating costs, it may not decrease the overall level of complexity and operating costs imposed by government. This will be the case where the tax system is a more efficient means than an expenditure program or regulatory mechanism to achieve the same policy outcome.

(through work and saving) and is better integrated with other social services and economic policies. The complexity within the transfer system is seen in the different eligibility criteria, payment structures (including rates of payment and available supplementary payments) and the income and assets testing arrangements that apply to different entitlements.

Incremental policy based on partial assessments

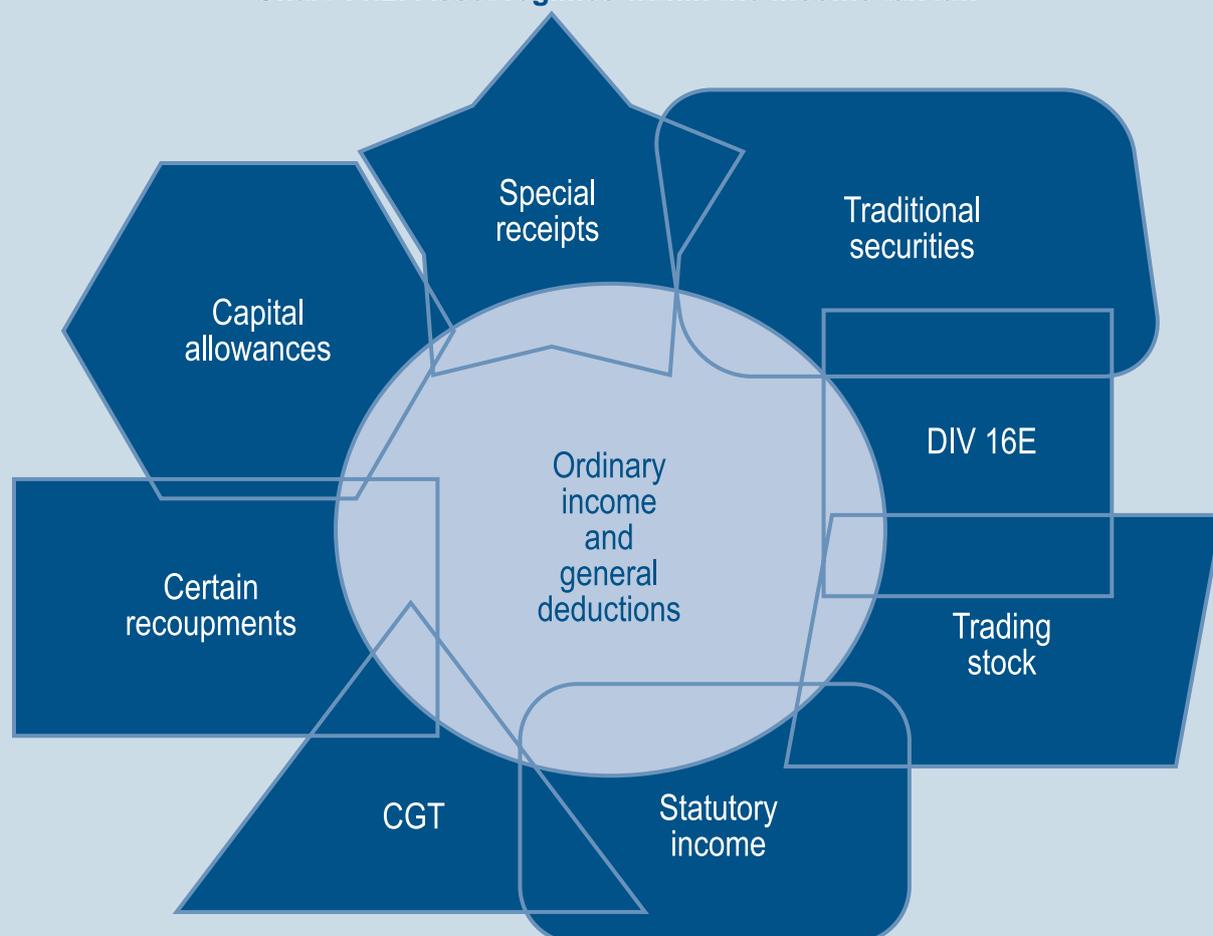
Many seemingly worthwhile small changes to policy may result in the evolution of a tax-transfer structure that is inherently complex and potentially inconsistent (see example in Box 11.3). A new tax or transfer measure does not have to be complex itself to increase the level of system complexity and associated compliance costs. Often government is asked to make a 'simple' change to the tax law, but the compounding effect of many separate relatively simple tax measures can result in a complex set of interrelated provisions.

The current system reflects the outcome of many independent choices about the trade-offs between simplicity, equity and efficiency. These choices are often made in a constrained policy environment with limited information about potential impacts, interactions with other parts of the law and real world practices. Incremental change has often been preferred because it is less disruptive than more fundamental change. A key issue is the extent to which these incremental policy choices, when viewed as a whole, reflect a preferred outcome.

Box 11.3: An example of complexity arising from incremental policy change

Since its inception in 1915, many separate regimes have been added progressively to the income tax system to achieve an appropriate treatment of assets (Chart 11.2). These regimes have been added in response to concerns about the equity and efficiency of the tax system. As the various regimes have been added, gaps and overlaps have considerably increased the complexity of the income tax system and associated operating costs. They have also created fertile ground for tax planning and the need for revenue protection provisions.

Chart 11.2: Asset regimes within the income tax law



Source: Board of Taxation, *Tax Value Method, An Overview*, March 2002.

The rate of change in policy and the law

The complexity and compliance costs that taxpayers/transfer recipients experience may be further compounded by the rate of change in the law, whether due to the addition of new provisions or changes to existing provisions. The higher the rate of change, the more difficult and time consuming it can be for taxpayers/recipients to understand their obligations or entitlements. In 2004, Australian tax practitioners were surveyed on their attitudes to compliance costs relating to capital gains tax (CGT). The outcomes of the survey ranked the rate of change in the law as the third most important determinant of CGT compliance costs (Evans 2004) (Box 11.4).

Box 11.4: Sources of CGT compliance costs**Table 11.2: Key sources of CGT compliance costs identified by tax practitioners**

| Rank | Factor (in descending order) |
|------|------------------------------------|
| 1 | Complexity of legislation |
| 2 | The number of rules and exceptions |
| 3 | Frequently changing legislation |
| 4 | Record-keeping requirements |
| 5 | Poor legislative drafting |
| 6 | Small business concessions |
| 7 | Valuation issues |
| 8 | Uncertainty of application |
| 9 | Application to different entities |
| 10 | Other reliefs and concessions |

Source: Evans (2004).

Instability in tax settings may also reduce economic efficiency by increasing the level of uncertainty about the expected payoffs to long term investment decisions, such as investment in education, retirement products, long-lived productive assets or choice of business structure.

Implementation of policy

The implementation of policy has a direct bearing on the level of certainty, transparency and compliance costs. The experience of the taxpayer/transfer recipient is heavily determined by their interactions with those who administer the policy and legislation. The approach taken by administrators can have a significant bearing on the complexity experienced by taxpayers and recipients

Complexity will be lower where: the law and/or the administration enable people to readily understand the implications of their actions; policy is internally consistent and is consistent with broader economic objectives; and policy is well articulated and understood, so that people have confidence that its broad direction will be maintained. In addition to reducing complexity and uncertainty, transparency in the tax-transfer system imposes a degree of discipline on the decisions of policy makers and administrators.

The desire for certainty about the obligations or entitlements of taxpayers/transfer recipients can also be an important source of complexity in the legislation. A high level of precision within the law potentially provides the certainty to make optimal decisions at lower cost and with lower risk. However, such detail can obscure what the law is trying to achieve at a broader level and the linkages between different parts of the law may be lost in the technical detail. Striking the right balance can be difficult to achieve. The drafting approach used for recent tax legislation reflects a preference for more principle-based rules.

Income-maximising behaviour through the tax-transfer system

Private incentives to maximise after tax income (in the case of businesses) or disposable income (in the case of individuals) are also a significant driver of complexity and operating costs. Individuals and other taxpayers have an incentive to voluntarily incur compliance costs if they expect the beneficial change in their income to outweigh the costs of achieving

that outcome. Such behaviour might include testing alternative income calculation methods, searching for effective ways to structure transactions, or engaging in other activities. The existence of choice in the tax-transfer system, deliberate or otherwise, can lead to increased operating costs, as individuals and other taxpayers seek to navigate their way through the available (see examples in Box 11.5).

Box 11.5: Choosing between alternative transfers ...

There are many situations where the complexities of the transfer system present people with significant problems. For example, when a child turns 16 the maximum rate of Family Tax Benefit (FTB) Part A falls substantially and Youth Allowance becomes available for some families. Almost all low to middle-income families experience a reduction in assistance and many are faced with a choice which payment to receive. Making this choice is complicated:

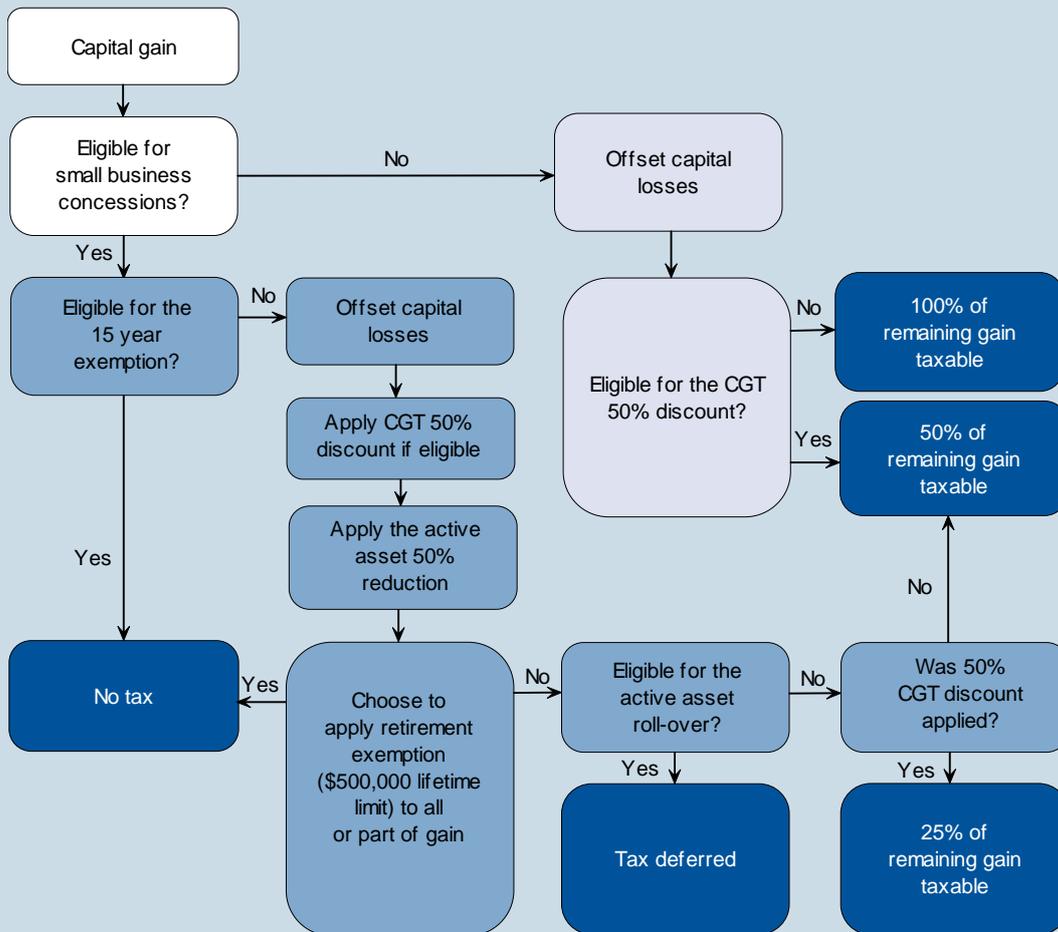
- the 'at home' rate of Youth Allowance for a 16-17 year old is lower than the maximum with supplement rate of FTB Part A for a 13-15 year old;
- the Youth Allowance parental income test has a lower income test threshold and higher taper rate than the FTB Part A family income test;
- children aged 16 years and over living 'at home' do not count for rent assistance purposes; and
- eligibility for FTB Part B ceases if a full-time student attracting FTB Part B for a parent turns 16 and commences receiving Youth Allowance or similar income support payment.

Feedback suggests many parents struggle to determine which payment choice will provide the greatest benefit. Compliance costs result from the time taken to understand their entitlements and evaluate their options.

... and tax concessions

The small business CGT concessions have been identified as a key source of complexity with the CGT provisions (Box 11.4) Chart 11.3 shows the benefits available from the small business CGT concessions. Limitations on some of the small business CGT concessions, particularly the retirement exemption, mean that different tax outcomes arise depending on how the concessions are applied.

Chart 11.3: Complexity in the small business CGT concessions



Individuals may also seek to reduce their tax liability, or increase their access to transfers, by lobbying government for preferential treatment. Lobbying may be successful because those seeking preferential treatment are more informed and better represented than the broader community. However, the community bears the direct cost, the operating costs and any loss of equity and efficiency. The benefit of a preferential treatment to the target group is also typically more easily measured, more tangible and of greater value to each taxpayer/recipient than the cost imposed on each member of the broader population.

Box 11.6: The capital allowance system

The *Review of Business Taxation* (1999) identified over 37 different regimes in the income tax law that provided annual write-off for depreciating assets. The rules were complex, inconsistent and involved significant duplication. A new system based on the effective life of assets was proposed in *A Platform for Consultation* (RBT 1999) to rationalise and simplify these provisions.

During consultation on the proposal, the review recognised that some variations to the consistent approach were necessary to preserve the current treatment for particular taxpayers, as well as to protect the revenue. In particular, the review reflected the then Government's commitment not to disturb specific primary producer concessions by retaining accelerated depreciation for them.

Since the inception of the effective life regime there have been further changes, on national interest grounds, with the introduction of statutory caps on the effective life of certain aircraft and some assets used in oil and gas production (2002), buses and trucks (2005) and tractors and harvesters (2007).

The new regime has been criticised as falling well short of simplification as it merely repackaged, as exceptions to the new general rules, the many separate systems that existed previously (Dirkis and Bondfield 2004).

'Grandfathering' (that is, preserving the treatment of pre-existing arrangements when rules are changed) often occurs in response to concerns about the equity and efficiency implications of a change in policy settings. However, it can add to the complexity of the tax-transfer system, particularly where its effects are long lived. For example, before the 2007 Better Super reforms, end benefit taxation had become very complex due to successive grandfathering of the taxation treatment of existing contributions and earnings, as illustrated in Table 11.3 and discussed in Section 4.1. This grandfathering was designed to ensure that an individual's accrued entitlements were not adversely affected by successive changes to the superannuation taxation arrangements.

Table 11.3: Grandfathering of superannuation benefit taxation

| Year | Taxation arrangement | Grandfathering |
|------|---|---|
| 1983 | Post-1983 component introduced. New pension deduction arrangements. | Tax rate applying to lump sum payments accrued pre-July 1983. |
| 1984 | New non-qualifying component (integrity measure) introduced. | |
| 1988 | New reasonable benefit limits (RBL) system applied — formula based. 15 per cent tax on contributions and earnings introduced. | |
| 1994 | New RBL system applied — flat rate. New post-June 1994 invalidity component introduced. New undeducted purchase price introduced. | Previous RBL system for amounts above flat rate. Concessional benefit component for payments made before 1 July 1994. Previous undeducted purchase price for existing balances. |
| 2007 | Better Super reforms implemented. For 90 per cent of people, benefits are not subject to tax after age 60. | |

Twenty-three years after the introduction of CGT, the exemption for pre-1985 assets continues to add considerable complexity to the provisions. With respect to the transfer system, the regular practice of ‘saving’ transfer recipients from changes to income support arrangements that would otherwise reduce their entitlements adds to system complexity.

For a given budgetary position, the behaviour outlined above reflects a ‘negative sum game’. Such behaviour shifts the tax burden from one individual to another. It results in a higher rate of tax applied on the remaining narrower base, typically increasing the efficiency costs imposed on the broader community. The added complexity increases total operating costs. Equity may also be compromised, though this will depend on the overall distribution of the preferential treatment. The net result is usually a reduction in the wellbeing of society as a whole.

Income-maximising behaviour also tends to result in higher compliance monitoring and enforcement as well as a wider use of integrity rules in the tax-transfer system. These responses benefit society by preserving equity and efficiency in the tax-transfer system but they increase system complexity and operating costs. For instance, the existence of the cash economy threatens the equity of the system, but there are considerable administration and compliance costs involved in more active enforcement of the law. These benefits and costs need to be appropriately balanced. The optimal point is where the benefits of additional compliance activity just equal the costs it imposes. Determining this point in practice is often a matter of judgment. Some in the community argue that there has been too much emphasis on equity and efficiency through the use of integrity provisions, given the consequential impacts on operating costs.

Coordination between governments

In Australia’s federal system of government, the many taxes referred to in Section 2 are administered by several layers of government. For an individual, their interaction with the tax system is typically in terms of the Australian tax system and that of the State and local area in which they reside. In contrast, businesses which operate in several jurisdictions or nationally have to comply with a much wider range of tax systems. These businesses face a cumulative burden of complexity and compliance costs due to differences in the way essentially similar taxes are imposed in different jurisdictions. The differences between jurisdictions also extend to the administrative systems and procedures applied by governments, as well as the taxes themselves.

For individuals, the multiplicity of transfers provided at different levels of government can make it difficult and time consuming to understand one’s entitlements and obligations.

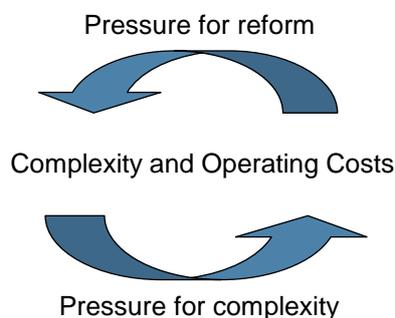
11.6 A cycle of complexity

Many of the sources of complexity outlined above operate in a systemic manner to increase the complexity and compliance costs of the tax-transfer system over time. As complexity and compliance costs increase, their impacts become more evident to taxpayers and transfer recipients leading to calls to simplify the system.

Following reform (or even during the reform process) these sources of complexity will begin to undermine any gains to simplicity. This ‘cycle’ of complexity is consistent with the

observed pressure to increase the complexity of the tax-transfer system, particularly through the income maximising behaviour of individuals, interspersed by periodic calls by taxpayers and transfer recipients for fundamental simplification (Chart 11.4).

Chart 11.4: A cycle of complexity



11.7 Recent attempts to address complexity in the tax-transfer system

A range of steps have been taken over the past few years, or are in the process of being implemented, by the Australian and state governments in an attempt to address the growing complexity of the tax-transfer system. These include:

- improving the process of evaluating new policy proposals, with greater emphasis being given to the assessment and reporting of compliance cost impacts;
- improving the clarity of legislation through, for example, the application of plain language and principles-based drafting techniques;
- increased consultation on policy design and its implementation;
- abolishing a number of inefficient state taxes through the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* and harmonising the structure of other state taxes, such as payroll tax;
- reducing the complexity and compliance costs associated with the existing stock of legislation through targeted measures;
- implementing, by 2010, a single standard business reporting portal, via which business can provide information to all levels of government; and
- several States setting targets to reduce the total burden of their regulation.

At an aggregate level, the effectiveness of these steps is difficult to ascertain due to parallel implementation of new policy that has added to the complexity of the tax-transfer system.

Reducing complexity through targeted measures can be hard to achieve, as it typically involves a trade-off between simplicity and other policy objectives and results in both winners and losers unless policy settings are made more generous. Broader reform provides an opportunity to take a systemic view of the trade-offs between simplicity and other policy

objectives and to balance the demands of individual stakeholders through at least partially compensating policy adjustments. An awareness of the factors that drive complexity and operating costs may assist in gaining community acceptance of the trade-offs required to achieve a measurable reduction in the complexity and operating costs of the tax-transfer system.

