Small Business and Tax Reform: Red Tape, Rhetoric and Reality

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I. Introduction

Well my view has always been that the average Australian wants a tax cut and if he or she wants a tax cut that desire is not mollified by some long academic speech saying that we have reformed the tax system but you’re still paying the same amount of tax. … That’s not to say you can’t reform the system.

[John Howard: Prime Minister]

The importance of tax system reform and tax rates has been recognised by the Howard government since early in its first term. These changes have in the main been progressed through implementing the recommendations of both the “A New Tax System” and the Review of Business Taxation (commonly known as the "Ralph Committee" or "Ralph Review", as it was chaired by John Ralph, or "RBT").

Consistent with the government’s stated agenda tax rates for both personal and corporate taxpayers have declined through its tenure. Representatives of big business tend to focus their attention on tax rates and tax burden and the government remains very sensitive to these views, responding to a recent claim of increased corporate tax burden within two days.

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


Of course the rate of taxation is important for any taxpayer. However, the effort required for a taxpayer to meet calculate their tax bill and meet their legal obligations is also important. One of the major issues facing small business and their advisors are not the level of tax, not concessions but the costs of working within a tax system - the so-called compliance costs. These costs are illustrated at a practical level as all small businesses have to deal with new systems to collect GST, fill in IAS and BAS, superannuation contributions and FBT. A simple tax return is now well more than 10 pages. These tasks represent a cost to business for which the business is not compensated.

In fact, the broad community concern of the high level of compliance costs has placed regulatory burden and compliance costs back on the political radar. There has been a recent spate of red tape reduction committees and their reports. However, tax reform committees in recent times seem to have little regard to the any of the reports commissioned by the Government since 1996 on reducing the cost of compliance (eg Report of Small Business Deregulation Task Force Time For Business, and the Prime Ministerial Statement on 24 March 1997 entitled More Time for Business). In fact the 1998-99 Review of Business Taxation in its final report A Tax System Redesigned does not deal in any direct way with small business in its own right, nor does it analyse and adopt previous reports or studies on regulatory burden in any depth (though it briefly refers to Time for Business).

Although these issues were canvassed in a 2004 paper ‘The RBT ANTS Bite: Small Business the First Casualty’ the problems remain. This is evidenced in Rethinking Regulation the report of the Taskforce on Reducing Regulatory Burdens on Business of January 2006 and the Federal Government’s acceptance of its conclusions and most of its recommendations. This paper seeks to update that earlier work and explore whether change is now possible


9 Ibid 35-36.


12 A Tax System Redesigned above n 4.


In this paper the treatment of small business compliance costs will be examined against the rhetoric of the stated concern that these be reduced. This rhetoric must be seen in the context of the tax system changes wrought by the implementation of the ANTS and Ralph recommendations.\(^{16}\) In those reforms tax rate cuts bring with them a focus on tax system integrity, often directed to small business.\(^{17}\) There were two measures in the Ralph Review directed to respond to small business compliance costs: the soon to be defunct Simplified Tax System (STS), and to provide specific compensation to small business, changes to the small business Capital Gains Tax (CGT) concessions.\(^{18}\) STS shall be reviewed by way of comparison to the tax rate changes to seek to distill how much rhetoric there is surrounding the stated concerns to address small business tax compliance burdens.

It is argued that history seems cursed to repeat itself unless concerted action is taken. It is acknowledged that there has been an increased focus on compliance costs and regulatory burden but a decade on from *Time For Business* and small business is still calling out for help. The government is speaking of its concerns and promising to act. But this call and response has been going on for at least 10 years. Just how much has really changed?

Contrast this with the steady decline of tax rates, both personal and corporate. Moreover contrast this with the sensitivity of government to claims that tax burden has done anything other than decrease. Those claims are not the province of committees and reviews and receive an immediate and direct government response.

Here it is submitted that the key aspect to successful compliance burden reduction is political will and commitment as pointed out by the Small Business Deregulation Taskforce in 1996 and again by the Taskforce on Reducing Regulatory Burdens on Business in January 2006. Thus, the paper seeks to explore where the rhetoric stops and where the reality begins. It may be that the reality is there is little scope for real compliance cost reduction given the current level of political capital willing to be invested into the task. If so the language of the debate may need to shift.

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\(^{16}\) For further detail see: Michael Dirkis and Antony Ting, ‘Cataloguing Business tax reform seven years on’ (2006) 21 *Australian Tax Forum* forthcoming (Dirkis and Ting).


\(^{18}\) These were contained in Chapter 17 of *A Tax System Redesigned* above n 4. That the main Ralph small business initiatives were those of small business CGT concessions and the Simplified Tax System (STS) that sought to reduce both the burden and incidence of tax on small business is supported by: Prime Minister, the Minister for Industry Tourism and Resources, and the Minister for Small Business and Tourism *Committed to Small Business* (6 July 2004), 16. Located at: [http://www.dpmc.gov.au/publications/small_business/index.html#downloads](http://www.dpmc.gov.au/publications/small_business/index.html#downloads) on 19 September 2006. These provisions are analysed and critiqued in Garry L Payne 'Problems With Current Tax Concessions For Australian SMEs' in Neil Warren (ed) *Taxing Small Business: Developing Good Tax Policies* Conference Series No 23 Australian Tax Research Foundation (2003) 83.
II. Compliance costs and tax reform: Context and Rhetoric

In order to set a context for the discussion in this paper it is necessary to briefly chart how small business compliance burdens have been recognised in the tax reform arena. As it will be argued through this paper the most relevant specific promise to small business of the Ralph process was to make compliance less burdensome. It is necessary to remember that the Ralph changes do not exist in isolation. As is often the case with the adverse impacts of the tax system on small business, history has a habit of repeating itself and not well documenting itself.

The Ralph Committee's stated 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.

Compliance costs were not a focus of preceding tax initiatives such as ANTS that brought in the GST. In contrast, compliance costs were a stated 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.

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, agreed noting in its is November 1997 report *Time For Business* that:

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19 For detail of the context of the Ralph Review see: Dirkis and Ting above n 16.
21 Dirkis and Bondfield 2004, above n 13, 110.
22 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).
23 Time for Business, above n 10. The Small Business Deregulation Task Force was established to, amongst other things, compare the different approaches to reducing Government 'red-tape'
[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.  

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 first term. The Government and the Ralph Review also accepted that no matter what method of evaluation is used tax compliance costs are strongly regressive and inversely proportional to the size of the business concerned. This regressive nature of tax compliance costs is endemic founded as it is on the scale of the business and available resources taken in order to meet the taxpayer’s obligations. 

These conclusions are supported by the report of the most current red tape review commissioned by the Federal Government, *Rethinking Regulation* which reported in January 2006. 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 compliance costs for small business have in fact increased through the tax reform process.
The political importance of the regulatory burden (not just tax) on small business was seen in the 2004 federal pre-election skirmishing.\textsuperscript{33} This continues with the recent regulatory reform report from the Business Council of Australia assessing compliance burdens remain a big issue, citing four areas of concern as [in order]: taxation reform, infrastructure renewal, workplace relations reform and cutting the red tape burden on business.\textsuperscript{34} This report quotes the Chair of the Regulation Taskforce Gary Banks in the following terms:

Behind this initiative [the Taskforce on Reducing the Regulatory Burdens on Business] were mounting concerns from business at the growth of regulation and its cumulative burdens. The concerns emanated from a cross-section of business interests, and culminated in a major report by the BCA in May 2005. The regulatory backlash was broadly-based, but had a particular focus on regulation of financial services, taxation, employment and the environment. [emphasis added]\textsuperscript{35}

This followed \textit{Committed to Small Business}, a statement from the Prime Minister, the Minister for Industry Tourism and Resources, and the Minister for Small Business and Tourism, released on 6 July 2004.\textsuperscript{36} That statement reiterated the Government’s ‘long track record’ of action to help small business dating to \textit{More Time for Business}.\textsuperscript{37} If nothing else this illustrates the ongoing entrenched nature of the difficulties of reducing the small business compliance burden. In fact \textit{Rethinking Regulation} and the Government’s response can be seen as \textit{Time For Business} and \textit{More Time for Business} nine years on with them noting the:\textsuperscript{38}

- Exponential increase in regulation (chapters 2 & 5);
- Adverse impact of that regulation on business (chapter 2);
- Regressive nature of that impact on small business (chapter 2);
- Need for more meaningful consultation on regulatory measures (chapters 3 & 7); and
- Need for better government processes to recognise the costs imposed by regulation (chapters 3 & 7).

That this can be repeated nine years on is of concern. It is either rhetoric aimed at placating the small business sector with statements the government cares. Or it may be a measure of the lack of political commitment to tackle the root causes in any meaningful way. Alternately it may be that the issues are systemic, entrenched and intractable. In all likelihood it is a combination of all these. But the cyclical expressions of concern and red tape reviews in the face of the increased compliance burdens discussed in the following sections do raise concerns that there is a fair bit of rhetoric displayed in the government’s response to small business tax compliance costs.

\textsuperscript{33} Dirkis and Bondfield 2004, above n 13, 112-113.
\textsuperscript{35} Ibid.
\textsuperscript{36} \textit{Committed to Small Business}, above n 18.
\textsuperscript{37} Ibid, 8.
\textsuperscript{38} Chapters refer to those of Rethinking Regulation, above n 14.
III. Ralph and the importance of simplification and compliance costs for small business

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. Academic commentators generally accept simplicity as one of three key tax policy objectives (equity, efficiency and simplicity) traditionally used for evaluating tax systems.

The Ralph Review expressly recognised the nexus between simplicity and compliance costs when it expressed the objective of simplification as:

41. Simplification poses fundamental questions about optimum design of the business tax system — in particular, how to ensure in the tax legislation:

- much needed clarity via expressed principles and their structured application;
- far greater simplicity, certainty, uniformity and consistency of application;
- improved adaptability in the face of continuing change; and
- significantly increased ease of compliance and administration.

42. Simplification of administration, as well as of the tax legislation, is also essential for promoting voluntary taxpayer compliance.

43. Complexity, as the other side of the simplification coin, is not something identifiable that has been grafted onto the business tax system. It derives from multiple sources such as tax legislation that encourages highly technical interpretation by courts; importation of external legal concepts into tax legislation; a wide range of tax preferences; equity concerns; and complex business arrangements, to name but a few. Because of that, complexity cannot easily be excised from the business tax system; the simplification objective will accordingly demand an effective strategy and process for its realisation.

Simplicity is broadly accepted as an obvious goal of any revenue raising and regulatory system. It is generally accepted that income tax is in varying degrees intrinsically complex and there have been continual complaints in reports and in the literature.
about the complexity of the tax system since its inception\textsuperscript{44} these remain\textsuperscript{45} with ‘business rat[ing] tax issues among their highest regulatory burdens’.\textsuperscript{46}

Importantly there is a political dimension to the ‘intrinsic complexity of tax’ debate. As Ralph points out:

\begin{quote}
[because] complexity cannot easily be excised from the business tax system;\textit{the simplification objective will accordingly demand an effective strategy and process for its realisation} \textsuperscript{47}
\end{quote}

If there is political acceptance that simplicity is an illusive goal there may be a commensurate lack of will to invest political capital to achieve something that is perceived as at best a marginal gain. As opposed to the more immediate political gratification of cutting tax rates. To quote from the Prime Minister:

Well you can make it simpler, but it is an unachievable Nirvana to pretend that in a complicated business world, you can have a Tax Act of 10 pages.\textsuperscript{48}

I’m simply saying if you have a complicated way of running a business, you’re going to end up with a rather complicated Tax Act. And I really think it is pie in the sky to imagine that with complicated business arrangements that you can have a Tax Act that thin, but I’d like to see it much smaller than it is now.\textsuperscript{49}

This attitude is important to bear in mind as improving simplicity and reducing compliance costs have been advanced as some of the more tangible evaluative criteria by which to assess the success of the Ralph reforms.\textsuperscript{50} Why simplicity and compliance costs are of such specific relevance to small business is that compliance costs are regressive. That being the case a lack of simplicity will impact on another good tax system objective, equity, a point expressly recognised by Ralph.\textsuperscript{51} If it does it will not be addressed by general tax rate cuts, especially if they bring with them more complexity in the form of integrity focussed measures. This, it is submitted, is a real legacy of the current round of tax changes.

Accepting that simplicity and compliance costs are valid criteria for assessing tax system reforms generally and that they were expressly accepted as important by the Ralph Review we should turn our attention to the reality of the changes brought in by the implementation of its recommendations.

\begin{footnotes}
\item[44] Commonwealth, Royal Commission on Taxation, \textit{Reports} (1933-34) (the 1932 Royal Commission), 6.
\item[45] Rethinking Regulation, above n 14, 107-111. This is not contradicted in the Government Response, above n 15 or its accompanying press release Treasurer (Press Release no.88/06 15 August 2006), above n 15.
\item[46] Rethinking Regulation, above n 14, 107.
\item[47] \textit{A Strong Foundation}, above n 20 at xvii-xviii paragraph 43.
\item[49] Transcript of the Prime Minister: Joint Press Conference (30 March 2006), above n 1.
\item[50] Diriks 2006 above n 17, 42-49.
\item[51] \textit{A Strong Foundation}, above n 20 at xvii-xviii, paragraph 43.
\end{footnotes}
IV. Compliance burdens pre and post Ralph

As far back as 1990 a parliamentary committee expressed major concern at the growth in the tax laws in the preceding five years. Then with ANTS, the introduction of the GST had a major compliance cost impact on small business. The pace of change has only picked up from there.

Substance: The changes themselves

Michael Dirkis and Antony Ting have traced the staggering volume of business tax reforms arising from the Ralph Review. In another paper Michael Dirkis summarises the current position thus:

The Government, between June 1999 and 2006 has introduced into Parliament in excess of 290 taxation, superannuation, excise and license fee bills. More telling than the number of bills is the steady increase in the average length and complexity of Australia’s taxation laws. The income tax assessment Acts alone have grown from 4000 pages in 1998 to in excess of 10,000 pages in mid 2006 before falling to about 8100 pages on 14 September 2006.

Although the length of the law in itself does not give rise to complexity, the impact of the general measures upon tax law affecting small business does indicate increased complexity and compliance costs.

52 Beddall Report, above n 22, xxix.
53 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.
54 For further detail see: Dirkis and Bondfield 2004, above n 13, 119-132.
55 Dirkis and Ting above n 16.
56 Dirkis 2006 above n 17, 1.
59 A Strong Foundation above n 20, 14.
60 This calculation does not include the law contained in other tax acts including the Taxation Administration Act 1953 (Cth), International Agreements Act 1953 (Cth) and the Fringe Benefits Tax Assessment Act 1986 (Cth). Banks (2003) above n 28 at 4, noted, that at current growth rates “. . .by the end of this century the paper version of the Tax Act would amount to 830 billion pages; it would take over 3 million years of continuous reading to assimilate and weigh the equivalent of around 20 aircraft carriers!”.
61 Following royal assent of the Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006 (Cth) 4100 pages of taxation legislation is to be repealed including 1900 pages on income tax law.
Moreover, 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), and the non-commercial loss quarantining regime (which attacked new small business ventures). 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 rules and new specific general anti-value shifting measures (GVSR).

To compound the problem of the pace of legislative change the Commissioner continued the flood of rulings, determinations and interpretative decisions, all of which are cumulative, unless expressly withdrawn. 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), Practice Statements, fact sheets and explanatory material (eg the Consolidation Guide, the Receivables Manual and ATO Access Guidelines). The ATOID count for 2002 alone stood at 1,116, at 1,135 for 2003, 982 for 2004, 368 for 2005 and 341 for 2006. It is good to see that the new stock is not being rolled out so quickly but again the old stock stays on the books till expressly withdrawn. 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.

In this context it must be noted that the Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006 repeals 4,100 pages from Australia’s tax legislation as well as seeking to align some definitions within the acts. This initiative flows from a Board of Taxation report which had its origins in Ralph as part of its consideration of the Tax Value Method. Any reduction of the volume of tax legislation and the

65 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.
67 For further detail see Dirkis and Bondfield 2004, above n 13, 127 see also TR2006/List Income tax and other taxes: Determinations, Rulings, notices of withdrawal, addendum and erratum issued in 2006. the TR 'year'/List Rulings go back to 1996.
associated supporting material is to be welcomed. However, as the provisions were inoperative it is unlikely that their removal will impact in any real way on the compliance burden faced by small business. In terms of the current concerns expressed as to the weight of the compliance burden the Prime Minister concedes that the tax laws will still be longer after the removal of these provisions than they were at the start of the current Treasurer’s tenure.

Form: The drafting of those changes

The current detailed drafting style is also considered to lead to ‘regulatory accretion’, explained by the Chairman of the Productivity Commission thus:

Perhaps the most celebrated example of regulatory accretion in Australia is the Income Tax Assessment Act … has grown to some 7000 pages from the paltry 120 pages that did the job when it was first introduced back in 1936. Some of this growth no doubt reflects necessary additional detail, but it also illustrates the tendency for regulation to feed off itself as one measure invites an unanticipated response that requires a counter measure, and so on.

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.

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). Further, much of the ‘new’ drafting style is considered highly theoretical, abstract and vague. 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. As well transitional and (probably continuing) compliance costs are higher than they otherwise would be.

72 Transcript of the Prime Minister the Hon John Howard MP Interview with Alan Jones, Radio 2GB, Sydney (19 April 2006) above n 48.
75 Discussed in (Dirkis and Bondfield 2004), above n 13, 124-125.
76 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, Coolum, 29 August 2002), 10.
77 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
The next step in the drafting debate is the adoption of ‘coherent principles drafting’ to new tax provisions. This concept has its genesis in the Ralph process and has been described in the following terms by the relevant Minister at release:

> [t]he coherent principles approach aims to write the law in a series of operative rules - that are principled statements about what the law is intended to do - rather than details about the mechanism that gets it there.

 Treasury stated that:

> [t]he approach involves identifying the intent or the general principle behind an announced Government policy and stating it clearly and concisely in the law.

 According to the Treasurer:

> these [p]rinciples synthesise the detail that would otherwise be set out in black letter rules, to achieve the substantive effect of the measure.

 Criticism and concern has been expressed that a radical departure from accepted drafting practice will of itself lead to uncertainty, lose the accumulated knowledge of the interpretation of the law as currently drafted and thus increase compliance costs. Further, just as much legislative material may be required in the form of expanded Explanatory Memorandums and Regulations. As well the courts and the ATO could be required to ‘fill in the blanks’ through interpretation and, in the case of the ATO, administrative practice that of itself would create more material to understand. Until there are more concrete examples of the new approach to discuss it is noted that the approach may have the advantages of succinctness and readability but there is a compliance cost concern.

### C. Measuring the compliance burden post-Ralph


79 Ibid (Dirkis and Bondfield 2005), 255 references omitted.


Rethinking Regulation notes that there has been a dramatic growth in the volume of regulation and its complexity, as well as making the point that its impact is hard to quantify. The report also clearly accepts that the regulatory burden falls disproportionately on small business and that these costs are substantial. The Foreword to the report puts the proposition starkly:

Tailoring regulation to limit the impact on small business and keeping regulatory costs down generally are essential if the ‘engine room’ of employment and economic growth is to prosper.

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.

As set out later in this section in November 2005 the Treasurer requested the Board of Taxation to complete a scoping study on the estimation of compliance costs. Though, the level of real government concern must be questioned as this activity is happening a long way from where the cost vectors commenced with the 1999 reforms.

At a recent ATO SME committee the following discussion was recorded that indicates subsequent changes to the tax system, regardless of whether they originate from Ralph, are on the whole having an adverse compliance impact on small business taxpayers. This extract is quoted at length because it provides a representative qualitative summary of the small business compliance cost environment post Ralph as discussed in the preceding paragraphs of this paper:

In addition, some agents have indicated that, as well as the increased costs of the complexity, there is some concern that the agents are sometimes left to make business decisions on behalf of the client, or to steer clients towards outcomes they identify as the best fit for the client, because the client doesn’t understand the complexity or the tax implications and does not want to deal with these matters. This raises concerns as to future liability if a client considers that the advice they received was limited (that is, the choices were limited by the agent and not all the alternatives provided) and adversely impacted on business outcomes.

The cost/time/complexity issue has been raised across markets. Agents pointed out that one of the particular issues for the SME market is that government policy is often drafted to achieve large-market tax policy needs, but manifests

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82 Rethinking Regulation, above n 14, chapter 2.
83 Rethinking Regulation ibid, para 2.3.
84 Rethinking Regulation ibid, Foreword.
85 For further detail and some of the available empirical data see: Brett Bondfield (2006) above n 39, 18-23.
itself in unintended complexity when applied to SME clients. Many examples were provided, including trust losses; concessions; s45B rules and de-mergers; capital gains tax rollovers; and consolidations.

There were some examples of complex areas briefly discussed for further exploration. One area that prompted discussion was consolidations. There was general agreement that this area was felt to be very complex and that, as a result of this, clients and agents would tend to avoid this topic where possible. In addition to the legislative complexity, the agents indicated that there was administrative complexity adding to the burden. These issues were thought to have more impact on agents that are working in, or running, general practices. Larger agencies are able to specialise. The general consensus was that this is an area in which compliance was at risk – and where some benefits were lost to clients that they may otherwise be eligible to receive them – because it is overly difficult.

As 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 (and continuing) commitment to address the problem, as part of its first term policy from as far back as 1996 with the opportunity to assert it again in 2004. Surely eight years was time enough to make a start on the project, if not at least to have the decency to admit that to date it was not effective.

As will be discussed later there is a real question of political will raised from the foregoing saga of ‘red tape’ reviews and reports. Rethinking Regulation, the ‘next’ red tape review after Time For Business finds all the same problems and vectors of compliance burden with particular reference to small business exist now as they did near a decade ago. Further, the systemic reforms it proposes are in the same areas as those proposed way back then. One of these is to seek to remedy the lack of robust data on the costs of regulatory burden and/or require such data to be created as part of the regulation making process.

The Ralph committee commissioned some research into taxpayer compliance costs. Yet in view of all that has been detailed in this part of the paper it was not until late 2005 the Treasurer tasked the Board of Taxation to undertake a specific scoping study on small business compliance costs with the following areas of inquiry:

- the purpose and object of the law;
- the relationship between taxpayer compliance costs and government administration costs;

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87 Committed to Small Business above n 18, Prime Minister’s Foreword.
88 Government response above n 15, recommendation 5.48, 7.2-7.4, 7.8 & 7.13.
• costs incurred by business for non-tax reasons and any additional costs incurred by businesses or their advisors for tax reasons (tax compliance costs);
• transitional costs and ongoing tax compliance costs;
• taxpayer circumstances and commercial practices;
• other legislation; and
• any other matters the Board considers materially impact on small business tax compliance costs.

In view of the foregoing this is a welcome initiative, even if it is only a scoping study. However the terms of reference fail to recognise the role legislative design that implements a ‘purpose and object of the law’ plays in the level of compliance cost imposed.91 The brief analysis of STS in the following sections provides an example of this importance of legislative design in reducing compliance costs, how not to do it.

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. There has been a lot of government talk about small business compliance burden eg Committed to Small Business. There has been a lot of process such as Rethinking Regulation and the Board of Taxation scoping study. But there does not appear to be much to show for it in the outcome department. Whereas the tax rate reduction campaign has displayed consistent results.92

As discussed in this paper any increased compliance burden will fall disproportionately on small business (in fact some compliance focussed measures have targeted small business). This will adversely affect tax system neutrality (hence equity) unless something is done about it by way of remedy or compensation. General rate reductions will not address this concern. In the following sections the paper briefly revisits the background to why Ralph and its implementation failed to meet one of its self set performance criteria of compliance cost reduction (or at least minimisation)93 and whether adequate compensation has been provided.

V. Why Ralph did not succeed in reducing compliance costs

At this juncture it is appropriate to briefly update the points made in 2004 in ‘The RBT ANTS Bite: Small Business the First Casualty’. The concerns can be broken up into two broad categories, failures by the Review and failures in implementation.94

A. Failures by the Ralph Review

In the 2004 paper it was pointed out that the Ralph review had failed to engage with the then existing wealth of small business compliance cost research and thinking. In 2006, Rethinking Regulation was endorsed and, on the whole accepted, by the Federal

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92  Above n 5, 14-17.
93  Dirkis 2006 above n 17, 42-43, 48-49.
94  For further detail see Dirkis and Bondfield 2004, above n 13, 132-141.
Government,\textsuperscript{95} the same Federal government that endorsed the Bell Task Force report a decade earlier. \textit{Rethinking Regulation} is by no measure derivative of what has come before it, yet its analysis and the recommendations that it makes for systemic reform\textsuperscript{96} read consistent with those endorsed in \textit{More Time for Business}. They are also consistent with views currently expressed by experts in the area such as the Chair of the Productivity Commission.\textsuperscript{97} That those issues remain current serve as testament that this lack of engagement by Ralph produced a flawed basis for implementation.

Then there is the pursuit of avoidance coupled with a very parsimonious approach not to deviate from revenue neutrality. This integrity focus would seem some of the keys as to why the Ralph reforms have adversely impacted on small business, especially in terms of compliance costs and system complexity.\textsuperscript{98} In particular Ralph did not expressly recognise the potential for the integrity driven initiatives that particularly impact on small business (as detailed previously) to overrun the concessions it offered small business.\textsuperscript{99}

\section*{B. 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.\textsuperscript{100}

1. \textit{RIS and good data}

For at least a decade 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)).

The need to improve these things features prominently in the suggested systemic improvements of the most current red tape reviews \textit{Rethinking Regulation}\textsuperscript{101} at the Federal level and the IPART Final Report in NSW.\textsuperscript{102} RIS’s are intended to achieve these and other objectives\textsuperscript{103} but they are not the only means. The experience with the flood of Ralph reforms and their associated RIS’s suggests that this need was justified. The RIS process has not proved an impediment to the claimed explosive

\begin{footnotesize}
\begin{enumerate}
\item Government Response, above n 15 and its accompanying press release Treasurer (Press Release no.88/06 15 August 2006), above n 15.
\item \textit{Rethinking Regulation}, above n 14, chapters 2 & 3 analysis and review and Chapter 7 systemic issues and recommendations.
\item Banks (2005) above n 73, 7-9.
\item Dirkis 2006 above n 17, 46-47.
\item For an example of how integrity concerns have instructed legislative design see Brett Bondfield, ‘If There is an Art to Taxation the Simplified Tax System is a Dark Art’ (2002) 17 \textit{Australian Tax Forum} 313, generally and in particular at 355-56.
\item For more detail see Dirkis and Bondfield 2004, above n 13, 136-141.
\item \textit{Rethinking Regulation}, above n 14, chapters 3 & 7.
\item Independent Pricing and Regulatory Tribunal above n 8, chapter 3.
\end{enumerate}
\end{footnotesize}
increase in compliance costs.\textsuperscript{104} The centrality of getting these administrative matters ‘right’ has been recognised as an important issue across government.\textsuperscript{105}

2. \textit{Failure of consultation}\textsuperscript{106}

Ralph and previous small business reports\textsuperscript{107} saw consultation as important to improve legislative quality and minimise compliance cost increases. The post Ralph position evidences some matters of concern as to whether this was taken to heart in the transition from Ralph recommendation to tax law.\textsuperscript{108}

There is evidence that the importance of consultation and early consultation is being recognised by the players with the Commissioner of Taxation stating that:

\begin{quote}
our catch-cry of the 3 Cs – consultation, collaboration and co-design has the potential to reduce compliance costs for the community.\textsuperscript{109}
\end{quote}

In summary, the level of consultation is a major improvement on any previous reform process. Into the future the Federal Government has made very significant commitments to more open consultation on regulatory matters across government\textsuperscript{110} though from the discussion of the post Ralph experience considerable political and administrative will is considered necessary to facilitate meaningful consultation at all levels of tax system design.\textsuperscript{111}

\section*{VI. The failure to adequately compensate: STS as a case in point}

There is overwhelming qualitative evidence that the current round of tax reform has exacerbated the compliance burden the tax system places on small business and its regressive incidence. The two small business specific compensation packages were STS\textsuperscript{112} and changes to the small business CGT concessions. The CGT concessions have provided some compensation but as they focus on the end of a business cycle

\begin{footnotesize}
\begin{enumerate}
\item[]\textsuperscript{104} Rethinking Regulation, above n 14, chapters 3 & 7.
\item[]\textsuperscript{105} Government Response, above n 15, chapter 7 and its accompanying press release Treasurer (Press Release no.88/06 15 August 2006), above n 15.
\item[]\textsuperscript{106} For further details of the failure of consultation see Dirkis (IBFD 2002), above n 74 and (Dirkis and Bondfield 2005) above n 78, 258-261.
\item[]\textsuperscript{107} Time for business, above n 10, 19.
\item[]\textsuperscript{108} As does Australian Government: Government Response, above n 15, chapter 7 and its accompanying press release Treasurer (Press Release no.88/06 15 August 2006), above n 15. See also Dirkis (2005) above n 74.
\item[]\textsuperscript{110} Rethinking Regulation, above n 14, 150-154 and chapter 7 generally and Government Response, above n 15, Recommendations 7.5-7.7 in particular and chapter 7 matters generally and its accompanying press release Treasurer (Press Release no.88/06 15 August 2006), above n 15.
\item[]\textsuperscript{111} (Dirkis and Bondfield 2005) above n 78, 258-261 and 270-275.
\item[]\textsuperscript{112} These are discussed in more detail in: Brett Bondfield (2006) above n 39, Kenny above n 40 and Bondfield above n 99.
\end{enumerate}
\end{footnotesize}
they are considered not an adequate response to a generic increase in small business compliance burden.  

The bulk of the Ralph changes that specially impact on small business were integrity focussed.  

This then 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. In the opinion of tax professionals, as discussed in the 2004 paper, there is no such trade-off evident from the Ralph measures. Therefore, it is difficult to see what justified the increasing of the already regressive tax compliance costs on small business unless there was adequate compensation.

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. In fact the current Commissioner listed the ATO’s responsibility as social policy first in a recent speech: ‘we administer dozens of Acts that implement social and economic policy.’ This highlights the need to assess whether compensation has been adequate as it is a choice to load these things into the tax system hence impact on compliance costs. To do otherwise impacts on the equity of the system where compliance burden is regressive.

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. Yet in a recent paper on tax concessions for primary production (one of the target groups of the initiative) it does not even rate a mention. Effectively STS will cease to exist on 1 July 2007 when the government's new small business framework comes into force.

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113 These are discussed in more detail in: Ibid Brett Bondfield (2006), 33-34 & 40.
114 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.
116 Dirkis and Bondfield 2004 above n 13, 128-132
118 Michael D’Ascenzo above n 109, 1.
119 A Tax System Redesigned, above n 4 chapter 24, in particular at 698 and 720-722.
120 Ibid.
projected to cost $150 million.\textsuperscript{123} These concessions can be accessed individually and include those currently available for STS tax payers.

According to the Press Release small businesses meeting the $2 million annual turnover test will not need to make any further decisions to enter into the new arrangements, nor will they be obliged to adopt any concessions not suited to their requirements. Any business meeting the new small business definition will be able to choose those concessions that meet its business needs. It is claimed that this single definition of small business will result in reduced compliance costs for some 2 million Australian small businesses, or 96% of all Australian businesses. The Taxation Institute of Australia welcomed this initiative in the following terms:

The announcement by the Treasurer and the Minister for Small Business that the Government will introduce legislation to standardise the eligibility criteria for small business tax concessions from 1 July 2007 is very welcome. The Taxation Institute has been working for many years to convince Government that a standardisation of rules was necessary. It is good to see finally that the Taxation Institute’s 15 November 2005 pre budget submission and its 28 November 2005 submission to the Government’s regulation taskforce on reducing the regulatory burden on business have borne fruit. [emphasis added]\textsuperscript{124}

Such an initiative is welcome. The question is why such an obvious and practical initiative took so long to be implemented. However, a review of STS’s brief history remains instructive of the way small business compliance costs and compensation have been treated within the Ralph reforms and their implementation in order to distinguish between rhetoric and reality.

The public selling point of STS was originally compensation through the simplification of records and accounting systems with the concessional depreciation advantages (the main concession) being down played.\textsuperscript{125} The value of this concession has now been reduced due to more favourable general depreciation calculations applying to all eligible assets acquired on or after 10 May 2006.\textsuperscript{126} 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.\textsuperscript{127} The system in its own right was still referred to with a compliance reduction flavour, though with increased prominence of the compensatory aspects in 2006.\textsuperscript{128}

\textsuperscript{123} Ibid.
\textsuperscript{124} Taxation Institute of Australia 2006 Taxvine No 44 ‘Small business concession tests standardised to cover 96% of businesses’ (17 November 2006).
\textsuperscript{125} Bondfield, above n 99, 350-360 and example with Minister for Revenue and the Assistant Treasurer ‘Roll-over relief for Simplified Tax System partnerships’ (Press Release No 013, 4 March 2003).
\textsuperscript{126} Treasurer, ‘Improving Australia’s Depreciation Arrangements’ (Press Release No 041, 9 May 2006) The Government will increase the diminishing value rate for determining depreciation deductions from 150 per cent to 200 per cent for all eligible assets acquired on or after 10 May 2006.
\textsuperscript{128} Treasurer ‘Further Measures to Simplify and Streamline the Tax System (Press Release No 039, 9 May 2006).
[The Government] introduced the STS to reduce the tax compliance burden falling on small businesses by reducing the effective tax burden on small business and simplify record keeping and reporting requirements.

Following promises made in the 2004 election STS was amended and its eligibility widened by the Tax Laws Amendment (2004 Measures No 7) Act 2005 effective in the 2005-2006 tax year. This included the removal of the requirement to account on a cash basis and technical amendments to depreciating assets in an STS pool that are disposed of. They demonstrate the impact and potential overreach of integrity focused drafting. Here the depreciation changes were stated as ‘ensuring consistency with the treatment of taxpayers using the uniform capital allowances regime’,129 How did it come to pass that the STS rules were more restrictive and/or complex than those of general application? The removal of the requirement to account on a cash basis is referred to by the Treasurer as providing ‘businesses the flexibility to calculate their taxable income using the accounting method most appropriate to their circumstances.’130 This begs the question of why was this legitimate business choice was restricted in the first place.

As well entry into STS is now being used as a gateway to access other concessions such as the 25% entrepreneurs’ tax rebate (effective 1 July 2005) and proposed to avoid the net assets test to qualify for the small business CGT concessions,131 though this CGT asset test will be removed by the government's new small business framework.132

The failure of STS as a compensation package is demonstrated by its low take up rate.133 The proposed new small business framework goes some way to addressing the concerns expressed in this section of the paper. However, the announcement continues in the grand political tradition of never admitting to your mistakes. Right till the end STS was being tinkered with in an attempt to either address its original design flaws or to be turned into something it was not originally designed for, a gateway to other tax concessions. STS as a separate system will no longer exist as of 1 July 2007. Thus, it is submitted that the failure of STS lies in poor legislative design informed by a strong revenue protection starting position which brings with it complexity and compliance cost.135

VIII. Conclusions on tax reform

Well life is a bit complicated and the Tax Act reflects the complication of life and the complication of business. I well remember having a meeting with some businessmen about 30 years ago and they said we want a simpler tax act.

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129 Committed to Small Business above n 18, 22.
131 Ibid.
133 Brett Bondfield above n 39, 31-32.
Draft: Not for citation

I said well let’s have a Tax Act where you just pay tax on what you earn and you have absolutely no deductions, and then they said but you’d have to allow for depreciation wouldn’t you? And then somebody else said you’d have to allow some investment incentive and somebody else said you’d have to allow and in the end it was all back where we started. Now I’m simply saying if you have a complicated way of running a business, you’re going to end up with a rather complicated Tax Act. And I really think it is pie in the sky to imagine that with complicated business arrangements that you can have a Tax Act that thin, but I’d like to see it much smaller than it is now.\textsuperscript{136}

[John Howard: Prime Minister]

If the key aspect to successful compliance burden reduction is political will and commitment. Then why does the 2005 announcement of the Taskforce on Reducing the Regulatory Burdens on Business\textsuperscript{137} state that ‘[t]he Australian Government is determined to reduce the burden of regulatory activity’? This could well have been a direct quote from the announcement of the 1996 Bell Taskforce. As would the reference in the same paragraph to ‘more rigorous use of cost-benefit analysis within government before new regulations are introduced.’ Why is history repeating?

Rather than political will we see rhetoric like that expressed in the paragraph above as regards the government’s commitment to reduce compliance burdens on small business. Where tax rates are concerned there is evidence of considerable political will and those rates have reduced. The concerns over compliance costs appear cyclical and we are at the peak of one of those cycles now following the government’s acceptance of the vast majority of the recommendations contained in \textit{Rethinking Regulation}. As set out in recent paper presented to the APEC Finance Ministers’ Technical Working Group:

\begin{quote}
Since the 1980s, increased attention has been paid to reforming the tax system to improve equity and efficiency and, more recently, to reducing tax system complexity.\textsuperscript{138}
\end{quote}

As shown by this paper, that recent attention to reducing tax system complexity is belated at best and rather cynical. It comes after the explosive changes wrought from the GST and Ralph reforms and their resultant compliance burden on small business detailed in this paper. Here it must be remembered that the Ralph Review expressly accepted compliance cost minimisation and simplicity as goals. So if tax compliance costs are an endemic systematic issue, what are needed are radical solutions.

As this paper shows what we have from the ANTS/Ralph implementation has not worked to reduce compliance burdens or compensate small business for them. STS is a star example in this regard. This is confirmed in the findings of the most current red tape review report \textit{Rethinking Regulation}. As tax rates reduce there appears a commensurate increased focus on tax system integrity that brings with it complexity.

\textsuperscript{136} Transcript of the Prime Minister Joint Press Conference (30 March 2006), above n 1.
\textsuperscript{138} Above n 5, 10.
Draft: Not for citation

and cost as discussed in this paper. Much of that focus has been directed to small business.

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 a system wide level it is of very great concern that a decade on from the Bell Taskforce *Rethinking Regulation* and the Government response traverse the same ground and find the same problems.

If this is true and the tax rules cannot be simplified, then instead of focussing on regulatory burden it may be time to debate arguments about compensation. 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.

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. As this paper 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 another taskforce that concludes the same problems subsist for the same reasons.

It seems government just can’t help itself when it comes to tax change. Witness the next phase of the Taxation of Financial Arrangements (TOFA) legislative programme as described in a seminar agenda:

In a departure from the pre-Christmas tradition, the Government last week released a revised exposure draft and explanatory material addressing TOFA. The TOFA measures will impact upon the tax treatment of a wide range of financial arrangements, including debt, derivative and foreign currency transactions.

There have been major changes and additions to the proposed TOFA measures. The new package runs to over 300 pages, as compared to the previous exposure draft material (126 pages) released in December 2005.

Both policy formulation and implementation should be based upon co-design principles, involving accurate compliance cost data included in enhanced RIS documents. 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. It is submitted that continued political commitment to this goal and an associated change

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139 Time for Business, above n 10, 19.
140 Greenwoods & Freehills ‘TOFA Briefing – major change in tax law proposed’ (seminar Wednesday, 24 January 2007).
over time in regulatory culture are essential to the long term abatement of the increase in regulatory burden and hopefully its overall reduction.

There is also 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 has currently completed two post implementation reviews into Ralph initiatives being: the small business CGT concessions\(^{141}\) and the integrity driven non-commercial loss quarantining provisions.\(^{142}\) Particularly in the case of the non-commercial loss review concern has been expressed that the terms of reference of these reviews are overly constrained as regards commenting on the appropriateness of the underlying policy and its legislative articulation.\(^{143}\)

However, despite the existence of such a review body, it is only with precise compliance cost figures that the success of a measure can be evaluated. It is of concern that it has taken this long to commence just a scoping study on small business compliance costs.\(^{144}\) Though the initiative is welcome the alacrity of its commencement in the face of stated concern again gives cause to question the political will devoted to compliance cost reduction.


\(^{143}\) Kenny (2006) above n 64 and Greenleaf above n 64.