MUCH ADO ABOUT NOTHING: RALPH’S CONSIDERATION OF SMALL BUSINESS

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I INTRODUCTION

In August 1998 the government, following the release of the Tax Reform, Not a New Tax, a New Tax System (the ANTS document),1 established the Review of Business Taxation chaired by John Ralph (commonly known as the ‘Ralph Committee’ or ‘Ralph Review’).2 The Ralph Committee's tax policy objectives were to:

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

against an overall revenue neutrality objective.

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1 Treasurer, 'Business Income Tax Consultation' (Press Release 14 August 1998). The origins of this round of business tax reforms was a statement by the Prime Minister John Howard on 25 May 1997 setting the framework for the reform process (see Michael Dwyer ‘PM’s tax reform rules’ The Australian Financial Review 26 May 1997, 1). This process was advanced by the Tax Task Force (a Liberal Party’s backbench committee chaired by Senator Brian Gibson (the Gibson Committee)), which completed its review in early 1998. Its findings, which were not published, were adopted in the Liberal government's proposals for a revamp of the Australian tax system. These proposals contained Peter Costello, Commonwealth, Tax Reform, Not a New Tax, a New Tax System (August 1998) (commonly called ANTS), were released on 13 August 1998 and included recommendations to introduce a goods and services tax (GST) and to tax trusts as companies.

Thus, 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 Taskforce), which was charged with assessing the regulatory burden on small business and the options for reducing that burden, agreed noting in its November 1997 report *Time For Business* that the ‘[t]ime consumed in taxation compliance is a dead loss, adding no value to business’. The report elaborated further, stating that:

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

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 Committee 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

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1 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) xxix (Beddall Report).

2 Small Business Deregulation Task Force (Charlie Bell (Chair)), Commonwealth, Time For Business: Report of the Small Business Deregulation Task Force (1996) (Time for Business), vii. The Small Business Deregulation Task Force was established to, amongst other things, compare the different approaches to reducing government ‘red-tape’ taken recently at Commonwealth, State and Territory levels; and to identify the lessons learned in devising and applying policies to reduce regulatory burden.

3 Ibid 28. See also Chris Evans, et al, A Report into Taxpayer Costs of Compliance (1997) concludes the costs are significant as well as including consideration of the positive business effects flowing from tax compliance.

4 Above n 4, 16.

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


9 Stephen Rimmer and Stuart Wilson, Compliance Costs of Taxation in Australia Staff Information Paper, Office of Regulation Review (July 1996), 26–27. See also above n 10, OECD, 8 and 13.
available resources taken in order to meet the taxpayer’s obligations.\footnote{A Tax System Redesigned, above n 2, 74 expresses the issue succinctly: ‘Small business proprietors must prepare and retain a myriad of documents for taxation and other purposes’ incurring substantial costs and having sub-optimal systems and expertise to do so’. See also Ralph Lattimore, et al, Design Principles for Small Business Programs and Regulations, Productivity Commission Staff Research Paper (August 1998) generally and particularly, xxiv.} However, despite the recognition by the government in 1997 of the importance of compliance/simplification issues to small business, and the asserted continuation of the reduction objectives in the Ralph Review compliance costs for small business have in fact increased.

Therefore, it is argued in this paper that the SME sector is the big loser under post-Ralph tax reform as:

- Ralph failed to meet its stated objective of reducing compliance costs for small business; and
- the small business concessions (the Simplified Tax System (STS) and the small business CGT concessions)\footnote{Chapter 17 of A Tax System Redesigned, above n 2 STS was generally endorsed by government and enacted by The New Business Tax System (Simplified Tax System) Act 2001. Chapter 17 also recommended streamlining and rationalising Capital Gains Tax (CGT) provisions for small business. This was accepted by government with minor alterations and enacted by The New Business Tax System (Capital Gains Tax) Act 1999 effective 21 September 1999.} introduced to ‘compensate’ small business for the increased compliance costs have proved to be inadequate in compensating small business.

The reasons underlying this compliance cost reduction failure and why compensation failed are also discussed. Although the paper focuses on the key policy objective for small business (compliance costs) any departure from the other Ralph tax policy objectives will be noted in that discussion. However, as the legal/policy analysis approach adopted does not easily lend itself to detailed analysis of system-wide objectives such as revenue neutrality, stability of tax arrangements and the tax base, these Ralph policy objectives will not be evaluated. Having established these arguments, the paper concludes by briefly exploring the possible ways forward for future reform processes to ensure that small business is not again the major casualty of tax reform.

The paper’s approach to analysing the increased level of compliance costs is in the main qualitative, not empirical, as there is to date no empirical data on the total cost to the taxpayer of tax system compliance post the implementation of the GST and the Ralph recommendations. A qualitative analysis of the situation of small business tax compliance after Ralph is at one level speculative. However, at a policy and system design level it is instructive so that we can identify and learn from the triumphs as well as the mistakes.
II CONTEXT: THE IMPORTANCE OF SIMPLIFICATION AND COMPLIANCE FOR SMALL BUSINESS

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

A common thread in the reviews and studies conducted from Adam Smith in 1776\(^{14}\) to the Board of Taxation’s 2003 report on the Review of International Taxation Arrangements\(^{15}\) is the use in most of those inquiries of the tax policy objective of simplicity in evaluating the effectiveness of existing laws and the proposed tax reforms.\(^{16}\) Academic commentators also broadly accept simplicity as one of three key tax policy objectives (equity, efficiency and simplicity) traditionally used for evaluating tax systems.\(^{17}\)

\[A\] Why Simplicity is Important to Compliance Costs\(^{18}\)

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

Simplicity is broadly accepted as an obvious goal of any revenue raising and regulatory system.\(^{19}\) It is generally accepted that income tax is in varying degrees intrinsically


\[16\] See Paul Kenny 'A “Simplified Tax System” for small business’ (2002) 6 The Tax Specialist 36, who reviews the Ralph Committee’s small business specific initiative, STS, against the good tax objectives of equity, efficiency and simplicity.


\[18\] This part of the paper is drawn from work done as part of Michael Dirkis’s PhD program.

\[19\] Though this is considered by some to be advanced as a platitude, for example Graeme S Cooper ‘Themes and Issues in Tax Simplification’ (1993) 10 Australian Tax Forum 417, 420 and also at 426–32, suggests ‘there is little empirical work that can verify the grand, but largely unsupported, claims for the benefits of simplification.’
complex and there have been continual complaints in reports and in the literature about the complexity of the tax system since its inception.

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

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

Despite the self-evident nature of the concept of simplicity, the myriad writings on the topic present what appears to be an unending array of definitions of what constitutes simplicity. Cooper, having reviewed the literature, suggests that the many and varied concepts discussed by writers can be distilled down to seven concepts that are

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21 Commonwealth, Royal Commission on Taxation, Reports (1933–34) (the 1932 Royal Commission), 6.

22 Discussed in the following sections.

23 As complexities continue to rise so do complex boundaries for the ATO to police. The total cost of the tax system may rise as it is the sum of compliance costs and administrative costs borne primarily by the ATO. See Evans, above n 5, 86; and Cedric Sandford, 'International Comparisons of Administrative and Compliance Costs of Taxation' (1994) 11 Australian Tax Forum 291, 301.


27 Certainty about tax laws allows for a widespread, informed debate upon taxation policy issues, which is essential to the functioning of democracy. See C Havighurst, and R Hobbet ‘Foreword’ (1969) 34 Law and Contemporary Problems 671 cited in Burton, above n 26, 206.

28 It is argued that if taxpayers lose faith with the tax law as a body of rules, voluntary compliance will suffer and the government in introducing measures, which protect the revenue, will incur greater cost. See Ross Parsons, ‘Income Tax - An Institution in Decay?’ (1986) 3 Australian Tax Forum 233; and Adam Broke, ‘Simplification of Tax or I Wouldn’t Start From Here’ (2000) British Tax Review 18, sees four causes of complexity: diversity, volume, drafting and language.
embodied in the notion of simplicity. 29 Although other writers have distilled what appear to be different concepts underlying simplicity, these are generally based upon subtle differences in classification and expression. 30 A common thread is that low compliance costs of both taxpayers and the tax system generally is a desirable goal within the rubric of simplicity that is in turn a central pillar of good tax policy. Why it and compliance costs are of such specific relevance to small business is that compliance costs are regressive.

Bearing in mind the above, the key measurement approach is to focus on the cost of compliance. 31 Most academic research has focussed on the compliance costs from the taxpayer’s perspective 32 as the global costs of collection are usually obtained from the budgets of the revenue authorities. 33 Although there has been a lot of research, the accuracy of the results has been questioned, based on methodological concerns 34 including sample size, response rates 35 and the inability to measure the impact upon compliance costs when changes are implemented. 36 The Australian position regarding these fundamental issues of the identification and the quantification of tax compliance costs is discussed under the following two headings.

29 Cooper, above n 19, 424 being: predictability (ease of understanding) of a rule’s intended (and actual) scope; proportionality (complexity proportional to the policy); consistency (avoids arbitrary distinctions); low compliance; easy administration; coordination with other tax rules; and clear expression.


33 For example Banks, above n 10, 3 notes that in 2001–02 the ATO employed 19 381 staff of the 30 720 employed by the main Commonwealth regulatory agencies with expenses of $3043 million (out of an all main regulatory agency expense total of $4566 million).

34 OECD, above n 10, 13–15.


36 Cooper, above n 19, 426. However, the identification and measurement of transitional compliance costs is an area receiving considerable recent attention (possibly due to the pace of tax system change). See for example Binh Tran-Nam, and John Glover ‘Estimating the Transitional Compliance Costs of the GST in Australia: A Case Study Approach’ (2002) 17 Australian Tax Forum 499; and Nhath Rametse, and Jeff Pope, ‘Start-up Tax Compliance Costs of the GST: ‘Empirical Evidence from Western Australian Small Businesses’ (2002) 17 Australian Tax Forum 407.
B Compliance Costs with Special Reference to Small Business

The Small Business Deregulation Taskforce Report provides a useful definition of compliance costs that it refers to as ‘burden’ being:37

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

This accords with accepted writings in the area,38 though more recent writings also net these compliance costs against managerial benefits from tax compliance,39 for example cash flow monitoring benefit as part of GST compliance.

At a macro level compliance costs must be viewed within the context of two overarching facts. First, from September 1985, when it was first announced that traditional taxation administration arrangements were to be replaced with self assessment, a large compliance burden has shifted from the tax administrator to the taxpayer.40 In Australia it is submitted that its introduction from 1 July 1986 was piecemeal and that there has been a failure of the system to fully address the power imbalance created through ensuring timely, accessible and binding information.41

Second, this macro community cost can be increased through incompetent advice and inadvertent non-compliance as a result of complexity.42 Complex income tax laws, which make it impossible to form a defendable view in respect of the law, discourage thorough tax advisers, as they are unable to justify their fees for such uncertain outcomes. As a result, less thorough advisers can charge less for their equally uncertain advice (the so called Gresham’s Law).43

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37 Time for Business, above n 4, 1.
III FAILURE TO REDUCE COMPLIANCE COSTS?

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

A The Pre-Ralph Compliance Burden

As far back as 1990 a parliamentary committee expressed major concern at the growth in the tax laws in the preceding five years—\(^44\)—the pace of change has only picked up from there. At the time of the 1996 Bell Taskforce Australia’s tax compliance burden was ‘generally towards the higher end of comparable tax regimes, but by no means the highest in the OECD’.

A recent OECD paper analyses and compares small and medium business compliance costs in three areas of regulation: tax, employment and environment for the April 1998 to May 1999 (pre-Ralph) period of 11 countries, including Australia and New Zealand.\(^46\) This report is instructive as it reinforces the points made previously in this paper that overall tax is the largest single component of the small business regulatory burden\(^47\) and that regulatory burden is regressive, cumulative, significant\(^48\) and increasing.\(^49\)

The OECD report finds 80 per cent of those surveyed in Australia asserted that their tax compliance increased in the two years before 98–99—this is the second highest ranking after Mexico.\(^50\) In terms of a pre-Ralph sample the report identifies complexity of the tax laws as the main compliance cost vector,\(^51\) though now tax system change may be an increasingly significant cost component in the current Australian environment. In a study published twelve years ago on the New Zealand tax compliance situation, researchers were of the view that the stability of the system was important in order to minimise ‘temporary compliance costs’.\(^52\) Given the acknowledged rate of change in Australia’s tax system these costs may well be near endemic, skewing the responses to research and inflating the costs as located.

The OECD study found that Australian firms surveyed were particularly critical of the service provided by their regulations and regulators. High by comparison to other surveyed countries 94 per cent of Australian respondents were of the opinion that

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\(^{44}\) Beddall Report, above n 3, xxix.


\(^{46}\) OECD above n 10.

\(^{47}\) Ibid, 23.

\(^{48}\) Ibid, 21 asserting significance.

\(^{49}\) Ibid, 30 found that 60 per cent of those surveyed asserted this increase and the Australian position approximates that figure, 59.

\(^{50}\) Ibid, 56. 80 per cent figure cited by Banks above n 10, 4.


\(^{52}\) Sandford and Hasseldine above n 10, 119.
regulations did not achieve their goals as simply as possible. Further, Australian firms rated the quality of their contacts when seeking information from regulators (tax, employment and environment) consistently lower than firms in comparable countries.

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

**B Ralph Proposals Impacting on Small Business**

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

- introduce a Board of Taxation;
- introduce an integrated tax code;
- improve the reliability, certainty and timeliness of the rulings program and fees for selected rulings;
- lower company tax rates;
- alter the capital gains regime by removing indexation and averaging but halving the capital gains tax rate and altering the retirement concessions for small business;
- introduce a new regime for determining taxable income—a cashflow/tax value approach (commonly referred to as ‘Option 2’, but renamed the Tax Value Method (TVM));
- associated with the TVM change, treat individuals on a cash basis, while businesses with turnovers under $1 million be assessed under a new Simplified Tax System (STS).

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53 OECD, above n 10, 64
54 Ibid, 73.
55 Ibid, 22.
56 Ibid, 108 figure 5.
59 A Tax System Redesigned, above n 2, recommendations 1.4–1.7.
60 Ibid, recommendation 2.1.
61 Ibid, recommendation 3.1 to 3.6.
• tax trusts as companies (the entity taxation regime), including the introduction of a profits first rule and new dividend imputation rules;
• introduce a system of consolidated group taxation; and
• review reform recommendations in respect of the taxation of non-residents, source rules and double tax agreements.65

The government’s accepted the majority of the recommendations contained in the final Report.66 This led to the government, between June 1999 and the dissolution of parliament on 5 October 2001 for the Federal Election, introducing into Parliament 144 taxation, superannuation, excise and license fee bills, with a further 44 taxation and superannuation related bills introduced in 2002 and 20 taxation and superannuation bills in 2003. The Productivity Commission has noted that more telling than the number of bills is the steady increase in the average length of legislation and that the length of the Income Tax Assessment Act 1936 (ITAA1936) and Income Tax Assessment Act 1997 (ITAA1997) alone was about 7000 pages.67

Although the length of the law in itself does not give rise to complexity,68 the impact of the measures upon tax law affecting small business does indicate increased complexity and compliance costs. These bills contained a new business registration system (the Australian Business Number (ABN) System), the Goods and Services Tax (GST),69 the new tax collection system (the Pay As You Go (PAYG) System70—mooted to get rid of provisional tax) and a new penalty regime.71 The PAYG system introduced quarterly activity statements for most small business. For many other taxpayers with GST refunds, such as pharmacists, monthly activity statements are the norm. This measure alone results in small business having between five and thirteen visits to an accountant compared with one previously.72

63 Ibid, recommendation 4.4.
64 Ibid, recommendations 17.1 to 17.6.
65 Ibid, recommendations 22.18–22.24 and 23.1–23.3.
67 Banks, above n 10, 2–3.
69 The GST measures were part of a package of 17 Bills. The main GST implementation provisions were contained in the following three Acts: A New Tax System (Goods and Services Tax) Act 1999, A New Tax System (Goods and Services Tax Transition) Act 1999, and A New Tax System (Goods and Services Tax Administration) Act 1999. The GST measures, since introduction, have been subjected to hundreds of changes. These are principally contained in A New Tax System (Indirect Tax and Consequential Amendments) Act (No 1) 1999 and A New Tax System (Indirect Tax and Consequential Amendments) Act (No 2) 1999.
71 The legislation is contained in A New Tax System (Tax Administration) Act (No 2) 2000.
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),\(^7\) and the non-commercial losses quarantining regime (which attacked new small business ventures).\(^4\) 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\(^7\) and new specific general anti-value shifting measures (GVSR).\(^6\)

The new capital allowance (depreciation) regime\(^7\) was another measure that imposed additional compliance costs on small business. Of lesser direct effect on small business are the corporate consolidation regime (which takes away from all companies the benefit of the inter-corporate dividend rebate provisions, loss transfer provisions, capital gains tax rollover concessions, and the transfer of excess foreign tax credits),\(^8\) the demerger regime,\(^9\) and a new dividend imputation regime (Simplified Imputation System (SIS)).\(^8\)

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


\(^4\) See, for example, Robert Douglas, ‘Farmers Nil, Commissioner Nil. Thanks, Ralph Great Result’ (2001) 35 Taxation in Australia, 387, 392 who argues that any innovative farm value-adding activity runs the risk of being classified as a separate business activity with the resultant quarantining of losses. Similar concerns are expressed in a pending RIRDC Report, prepared by Alistair Watson, Rick Lacy and John Crase entitled ‘Economic Effects of Income-Tax Law on Investment in Australian Agriculture (with Particular Reference to New and Emerging Industries)’.

\(^6\) 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.


\(^9\) Also contained in the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002.

model (for example, the capital allowances regime and the SIS). This approach deprives taxpayers of the advantages of historic learning, thereby creating greater uncertainty and higher initial compliance costs.

Further, much of the ‘new’ drafting style is highly theoretical, abstract and vague—a point appreciated by the drafters of the GVSR law who appear compelled to follow each definition with a concrete example. 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. Without clear laws taxpayers have little hope of meeting that expectation. As a result, the validity of the self-assessment model in the current post-Ralph tax reform landscape is further undermined as well as transitional and (probably continuing) compliance costs being higher than they otherwise would be.

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

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

- 2002 were: Rulings: 89 Class, 11 draft and 6 final GST, 147 Product, 1 draft and 1 final Fuel Grant and Rebate, 2 Wine Equalisation Tax and 13 draft and 21 final Tax; Determinations: 5 draft and 5 final GST, 4 Superannuation Contributions, 1 Superannuation Guarantee and 16 draft and 28 final Tax;
- 2003 were: Rulings: 112 Class, 9 draft and 16 final GST, 82 Product, 3 Product Grants and Benefits, 10 draft and 16 final Tax; Determinations: 23 draft and 32 final Tax, 5 draft and 3 final GST, 4 Superannuation Contributions, 1 Luxury Car Taxation and 7 Superannuation Guarantee; and Bulletins: 2 GST.

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 (for example, the Consolidation Guide, the Receivables Manual and ATO Access Guidelines). The ATOID count for

83 See for example Dirkis and Payne-Mulcahy, above n 41.
84 See Dirkis (IBFD 2002), above n 57 and in section IV point B following.
85 For example, released in 1999 were: Rulings: 14 draft and 1 final GST, 104 Product and 21 draft and 19 final Tax; and Determinations: 103 draft and 84 finalised Tax and 6 Sales Tax. Released in 2000 were: Rulings: 23 draft and 37 final GST, 119 Product and 36 draft and 18 final Tax; and Determinations: 6 draft and 12 final GST, 1 final Superannuation Guarantee, 1 Superannuation Contributions 2 Sales Tax, 23 draft and 54 final Tax.
2002 alone stands at 1116 and at 1135 for 2003.\textsuperscript{88} Much of this activity has been generated by the GST and post-Ralph changes.\textsuperscript{89}

\section*{C The Compliance Burden Post-Ralph}

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

Anecdotally, post-Ralph tax compliance is considered by many as horrendous and that overall the post-Ralph tax system is making considerably more compliance demands on taxpayers.\textsuperscript{90} There are significant voices from tax practitioners claiming that the post-Ralph changes have lead to an intolerable compliance burden that especially (probably predictably) impacts on small business.\textsuperscript{91} The issue has also been raised at various National Tax Liaison Group (NTLG) meetings, including 2 December 1999\textsuperscript{92} just after the government’s initial responses to the Ralph Committee.

\textsuperscript{88} As at 12 December 2003.
\textsuperscript{89} Although the Administrative Appeals Tribunal (AAT) and the Courts have also been busy with 109 Court and 42 AAT decisions in 2003 (as per CCH reports at 19 December 2003), with the major areas of focus being in the areas of deductibility of interest and Part IVA, this litigation is not a direct result of Ralph, rather it is business as usual. For example, there were 95 Court and 61 AAT decisions in 1999 and in 2000 there were 87 Court and 15 AAT decisions.
\textsuperscript{90} ‘Instead of simplifying the compliance to the law, [the RBT reforms] actually increased the burden significantly.’ Ray Conwell, former President of the Taxation Institute of Australia, quoted in Allesandra Fabro, ‘ATO not Delivering, Say CEO’S’, Australian Financial Review, 2 September 2002, 5.
This seems at odds with the first phase Treasurer’s response to the Ralph Committee recommendations, which included a special press release directed at small business that included ‘selling’ STS with a focus on its compliance cost benefits.\textsuperscript{93} Such a focus on sectional interests via discrete government response was not the norm in the initial post-Ralph tax reform period. The existence of a separate release may lend support to the government’s continued concern over small business compliance costs, or a cynic may say it was an appeal to one of its constituencies.

However, care must be taken to separate out the elements that practitioner bodies claim to have led to this situation, including poor ATO administration of the system, the rate of legislative change and poor legislative and policy design of both the law and the administrative systems. Yet it is clear that a considerable proportion of the current compliance burden can be sheeted to the laws themselves.\textsuperscript{94} On the other hand the authors could not locate considered statements claiming that the compliance burden has reduced post-Ralph.

As set out previously, research into Australian tax compliance costs with reference to small business indicates that at the time of the Ralph Review (and before the introduction of the GST) these costs were either above average for comparable OECD countries\textsuperscript{95} or high (but not in the highest) in comparison with such countries.\textsuperscript{96} Add to this a recent study by the State Chamber of Commerce (NSW) which lends support for there being a significant rise in compliance costs in the post GST and Ralph period.\textsuperscript{97} That study found ‘the most time consuming tax for business is the quarterly GST returns and associated Business Activity Statement.’\textsuperscript{98} To this GST impact we need to add the impact of Ralph, remembering that several of its integrity measures would be expected to impact disproportionately on small business.

Another recent study concluded that tax (including tax compliance) and government charges remain the most obvious constraint to small business investment.\textsuperscript{99} Yet, 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 expressed concern over the ‘plight’ of small business in this regard, along with a strong commitment to address the problem, as part of its first term policy from as far back as 1996.\textsuperscript{100}

\textsuperscript{93} Treasurer, ‘Small Business and Primary Producers to Benefit from the New Business Tax System’ (Press Release No 59, 21 September, 1999).
\textsuperscript{94} Harrison, above n 91; Regan, above n 91; Levy, above n 91; and Ray Conwell quoted above n 90.
\textsuperscript{95} OECD, above n 10.
\textsuperscript{96} Evans and Walpole, above n 45, 15
\textsuperscript{97} State Chamber of Commerce (NSW) Red Tape Register – The Tax Burden (2003)
\textsuperscript{98} Ibid 2.
\textsuperscript{99} Australian Chamber of Commerce survey of the non-farm sector reported that ‘[t]ax still biggest constraint on SMEs investment’ cited in Centre for Professional Development, 31 CPD Communicator, 27 May 2002. This result was ‘not unexpected’ and was consistent with the last 10 years’ results. See also Yellow Pages A Special Report on Small Business Growth Aspirations and the Role of Exports (February 1995) cited in Time for Business, above n 4, 16.
\textsuperscript{100} Evans and Walpole, above n 45, 12–15.
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-Ralph have increased significantly and are probably even more regressive than they were previously.

**IV WHY DID RALPH NOT SUCCEED IN REDUCING COMPLIANCE COSTS?**

Given the apparent Ralph failure to reduce compliance costs, the following discussion explores some reasons why the Ralph changes have lead to this position, despite a key objective of the Review being the reduction in compliance costs. The reason can be broken into two broad categories, failures by the Review and failures in implementation.

**A Failures by the Ralph Review**

The failures by the Review relate to two areas: a failure to engage with the wealth of small business compliance cost research and the strict adherence to revenue neutrality.

1 *A Failure to Engage with the Wealth of Small Business Compliance Cost Research*

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

[a] tax system for small business, with a more concessional approach to writing off their capital and expenditure and a reduced record keeping load.\(^{101}\)

And, just before that:

[a] tax system which is easier to understand and comply with, and makes fewer demands on the time of ordinary taxpayers.\(^{102}\)

The first Ralph Committee discussion paper, *A Strong Foundation*, had an emphasis on the need to, and benefit of, reducing the complexity of tax laws and tax compliance.\(^{103}\) It strongly asserted the importance of simplicity and considered complexity inherent in the tax system and the issue was how to avoid complexity increasing.\(^{104}\) Despite this focus *A Strong Foundation* does not make reference to previous reports on the issue of compliance costs and complexity\(^{105}\) nor are there any references back to previous inquiries in Chapter 17 of *A Tax System Redesigned* which recommends STS.\(^{106}\)

\(^{101}\) A Tax System Redesigned, above n 2, 2.

\(^{102}\) Id.

\(^{103}\) A Strong Foundation, above n 2; in particular chapters 3 and 4.

\(^{104}\) Ibid, xviii and xxix

\(^{105}\) However, A New Tax System, above n 1, 131 makes brief reference to Time for Business above n 4.

At this point the authors’ questioning of the depth of the Ralph Review’s concerns for the compliance cost position of small business and those of the government that accepted its recommendations becomes more pointed. Ralph does cite some empirical research on compliance costs undertaken by ATAX\textsuperscript{107} but there appears no taste to discuss the factors and forces that underlie these costs, the pressures for their increase nor the pitfalls to avoid in seeking to address and redress those costs.

The Ralph report seems to have little overt regard to the November 1996 report of Small Business Deregulation Task Force, \textit{Time For Business},\textsuperscript{108} the Prime Ministerial Statement on 24 March 1997 entitled \textit{More Time for Business} running to some 121 pages,\textsuperscript{109} nor the \textit{Lessons Learnt}, a Background Paper for the Small Business Deregulation Taskforce\textsuperscript{110} (which identified seven standout reports that dealt with regulatory burdens). At that time the Taskforce and the government’s response were prominent articulations of the government’s concern over small business compliance costs.

It is submitted here and in the STS discussion above that the Ralph Report discloses an approach that asserts conclusions on small business compliance costs, rather than reasoning them. As identified under this heading this stands in stark contrast with several reports into the compliance burden of small business that are considered by the authors as providing clear, though in places unpalatable, analysis and ways forward when dealing with the impact on small business of the tax system. Basically the Ralph recommendations baldly conclude the desired small business outcomes first quoted above and effectively leave the analysis at that, not advancing far from stating platitudes.

The key points from previous reports and initiatives into small business compliance cost reduction identified in \textit{Lessons Learnt} are listed as:\textsuperscript{111}

- Success in achieving regulatory reform is critically dependent on political commitment and support;\textsuperscript{112}
- If regulatory reductions are to be achieved, the necessary adjustments will need to be made from the government side [a whole of government approach is required];
- The extent of reforms have often been greatest in smaller jurisdictions by virtue of the close contact between stakeholders, the fact that the absolute scale of logistical charges are more manageable, and the political process is perhaps more closely attuned to the needs of the local small business community;
- Before substantial improvements in red tape can be introduced methods for the systematic evaluation of potential regulatory costs and benefits must be in place;

\textsuperscript{107} Ibid.
\textsuperscript{108} Above n 4.
\textsuperscript{109} Above n 7.
\textsuperscript{110} Price Waterhouse Economic Studies and Strategies Unit \textit{Lessons Learnt: Review of Inquiries and Reports on Regulatory Reform}, Background Paper 1 Small Business Deregulation Taskforce (August 1996) (\textit{Lessons Learnt}).
\textsuperscript{111} Ibid 20–21, also see ii.
\textsuperscript{112} Reinforced in \textit{Time for Business}, above n 4, 19.
Dedicated research offers sound prospects for improving policy targetting and delivery;
The prospects for successful reform are highest under strategies where incremental changes, sustained over the longer term, receive adequate political backing and attract reasonable resources;
Even the best policies for regulatory reform may fail to deliver results if insufficient attention is given to the logistical aspects of their delivery; and
Overseas experience can play only a limited role in assisting Australia to select the most appropriate reform strategies.

We can add to this:

The acknowledged restrictive impact of the requirement of revenue neutrality.\textsuperscript{113}
The acknowledged scale of the task to make meaningful inroads into compliance costs.\textsuperscript{114}
The importance of transparency and consultation in the design phase of law and policy.\textsuperscript{115}
Regulation Impact Statements (RISs) in their current guise stem from the government’s response to the Bell Taskforce.\textsuperscript{116}
The scale and complexity in tax compliance cost reduction was summarised in 1996 as: \textsuperscript{117}

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

The points above can be used as a guide to assess the Ralph small business scorecard as well as providing a platform to discuss broader tax system impacts. It is not that the above points are sacrosanct because they come from the Bell Taskforce. Rather they are considered a fair distillation of the reports and initiatives in the area of small business cost compliance reduction and were endorsed by the government.\textsuperscript{118}

Under the following three headings we firstly consider revenue neutrality as a significant limitation to Ralph’s response to small business. The two headings following assess important consultative and institutional issues that may impact on the future treatment of small businesses’ compliance cost interests.

\textsuperscript{113} The Bell Taskforce stressed in several places the significant level of constraint that was placed on its recommendations by the requirement of revenue neutrality: Time for Business, above n 4, 12 and 31.
\textsuperscript{114} Time for Business, above n 4, 19.
\textsuperscript{115} Time for Business, above n 4, 19.
\textsuperscript{116} Evans and Walpole, above n 45, 54.
\textsuperscript{117} Lessons Learnt, above n 110, ii see also pages 20–21.
\textsuperscript{118} See, for example, the Time for Business report was endorsed in More Time for Business, above n 7.
2 Strict Adherence to Revenue Neutrality

The pursuit of avoidance coupled with a very parsimonious approach to not deviate from revenue neutrality, would seem some of the keys as to why the Ralph reforms have adversely impacted on small business, especially in terms of compliance costs.119 The terms of reference to the Ralph Committee made it clear that the policies contained in the government’s policy document *A New Tax System*120 would direct but not bind the Review’s deliberations and recommendations.121

*A New Tax System* stresses that the policy approach is not just to ‘tinker’ with the existing tax system.122 However, there is no evidence from the post-Ralph writings or research published to date that much more than tinkering has happened with the tax system as regards reducing or stemming the increase in small business compliance costs. This is evidenced by the low STS take-up rate and the assertions from the profession that compliance costs have significantly increased.

As discussed later STS may provide some assistance. Though the discussion of STS in chapter 17 of Ralph does not expressly recognise the potential for the integrity driven initiatives that particularly impact on small business (as detailed previously) to overrun the STS concessions. This represents more than just a lack of any real fundamental tax system reform flowing from Ralph due to institutional and political dynamics.123 The tax compliance position of small business evidences callous neglect, with Ralph recommendations in many places explicitly raising the compliance burdens on small business and its compensatory responses being inadequately structured, or at the very least poorly articulated. This occurred in an environment where the pre-existing pace of system change124 and tax law complexity was of considerable concern.125

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.

1 Continuing Institutional Failures

A considered approach to government regulatory enactments has been identified as important in small business compliance cost reports. This takes several forms including the need to take a whole of government approach when making new regulations, transparency in the process of regulatory design and analysis to seek to ensure the

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119 For an example of how these have instructed legislative design see Brett Bondfield, 'If There is an Art to Taxation the Simplified Tax System is a Dark Art’ (2002) 17 Australian Tax Forum 313, generally and in particular at 355–56.
120 Above n 1.
121 A Tax System Redesigned above n 2, Terms of reference, v–vii and also 10.
122 Above n 1, 3–5.
123 Fisher, above n 17, discusses these dynamics.
124 Beddall Report, above n 3, xxix.
regulations have as low a compliance cost as possible (given their objective (proportionality)). RISs are intended to achieve these and other objectives.126

The Australian experience with tax RISs (pre-Ralph) is discussed by Evans and Walpole,127 the authors conclude that the tax RIS process was having some impact in meeting these objectives but was falling a long way short of ideal with form, as opposed to the underpinning policy, being followed.128 They saw it as a real concern with an increasing volume of legislative change that the officials would pay lip service to them rather than seeing them integral to tax design.129 The experience with the flood of Ralph reforms and their associated RISs suggests that this concern was justified. The RIS process has not proved an impediment to the claimed explosive increase in compliance costs.

Ralph took the issue of intra governmental (as well as public)130 consultation and involvement in legislative design as a serious issue. A Strong Foundation expressed the concerns as:

• ‘the potential for policy to be developed without a full appreciation of all its implications and its interaction with the wider tax law and tax system. Conversely, practical solutions to technical issues might often compromise policy intentions’; and
• poor law design arising from the various agencies failing ‘to clarify progressively their understanding of the proposal and its intended effect and application’ and the inclusion of OPC [Office of Parliamentary Counsel] drafters, often after announcement of a policy change.131

Following the re-emergence in early 2002 of the debate concerning the removal of the tax policy and law development functions from the ATO,132 the Treasurer133 accepted the Board of Taxation’s recommendation to transfer ATO policy staff to Treasury.134 The debate arose due to concerns about the ATO’s ability to deliver integrated design given some very public failing in respect of the implementation of new tax systems and laws.135

126 Evans and Walpole, above n 45, 78–84.
127 Evans and Walpole, above n 45, 54–77.
128 Evans and Walpole, above n 45, 77.
129 Evans and Walpole, above n 45,76–77 and 85.
130 Discussed under the following heading.
131 A Strong Foundation, above n 2, 48.
132 This issue was flagged by Hon Senator Helen Coonan (Minister for Revenue and Assistant Treasurer) in her 27 February 2002 speech to the Sydney Institute 'Safety in Numbers: Tax Reform and the National Nest Egg', 6; and in evidence to Senate Economic Legislation Committee, Estimates Hearings 20 February 2002 at E7.5.
135 Dirkis (IBFD 2002), above 57, 532.
Although there was a positive response to the announcements, concerns remain. The centralisation of policy in one area outside the ATO may not resolve the implementation and administration design issues, which often plague policy implementation.\textsuperscript{136} Further, in general, Treasury’s culture is imbued with even higher levels of secrecy than the ATO, which could result in less open consultation and discussion and a policy team further isolated from the community.\textsuperscript{137} Further, it is believed in some quarters that the growth in complexity and compliance costs in the tax law can be directly related to the growing ascendancy of the Treasury in tax policy over the last 10 to 17 years. Further, by leaving OPC outside the equation, accountability for poorly drafted law remains elusive.\textsuperscript{138}

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

2 Failure of Consultation\textsuperscript{139}

Ralph and previous small business reports\textsuperscript{140} saw consultation as important to improve legislative quality and minimise compliance cost increases. The post-Ralph position set out below evidences some matters of concern as to whether this was taken to heart in the transition from Ralph recommendation to tax law.

Flagged in the STS discussion following are the problems with consultation in the post-Ralph era. Consultation generally was conducted through convened committees with selected invitees (usually specialists or key stakeholders).\textsuperscript{141} Many meetings were one off\textsuperscript{142} and in the authors’ view token.\textsuperscript{143} Where the issue under consideration was deemed to need more than one consultation meeting,\textsuperscript{144} the meetings were often organised in a haphazard way and (except for consolidations consultative process) and

\textsuperscript{136} Ibid.
\textsuperscript{137} Jeff Schubert of Australian Business Limited warns that ‘with policy removed from the ATO and effectively completely installed in Treasury … [t]he people making tax policy may then be even further removed from the practical business community, with a danger that events like the consolidation consultation … will not occur’ at ‘Business shoots itself in the foot!!’ 25 February 2002 - http://www.australianbusiness.com.au/economytoday web news broadcast accessed 26 February 2002.
\textsuperscript{138} Dirkis (IBFD 2002), above 57, 532–33.
\textsuperscript{139} The following description of the failure of consultation is drawn from Dirkis (IBFD 2002), above n 57.
\textsuperscript{140} Time for business, above n 4, 19.
\textsuperscript{141} Part of the problem is the number of representative groups. As well as the members of the NTLG there is the Corporate Taxpayer Association (CTA), the business Coalition for Tax Reform (BCTR)—a coalition of industry Associations, accounting bodies, accounting firms and corporates), peak business Associations (Business Council of Australia (BCA) and Australian Business Limited (ABL)) and the National Farmers Federation (NFF).
\textsuperscript{142} These include meetings on ruling changes (ATO sponsored), changes to the 13 month Rule (payments in advance and expenditure under tax shelters), partnerships and other joint activities, the taxation regime for buildings and structures, leases and rights, non-resident withholding tax, offshore trusts and foreign expatriates and residents departing Australia.
\textsuperscript{143} Alienation of personal services income and non-commercial losses consultative meetings.
\textsuperscript{144} Tax Value Method, Simplified Tax System, scrip for scrip, entity tax (including simplified imputation, loans by members, excluded trusts, trust transitionalities, capital allowances, thin capitalisation, debt/equity and consolidation).
there was little feedback following meetings. Also strict secrecy requirements imposed upon external parties attending the meetings acted to limit input.

The meetings generally focussed on technical improvement rather than policy, with the Review’s recommendations generally viewed as sacrosanct. Generally it was only where political pressure arose that there were departures from the recommendations. A positive feature was the extended use of exposure draft legislation releases. However, these drafts and associated explanatory material (despite some being reissued) tended to be ‘final’ documents, rather than first or second cut documents intended to create discussion. Further, the time allowed for submissions was unreasonable (usually four weeks), particularly given the size of the material and the timing of the release of the drafts (a number were released just prior to Christmas shutdowns). Even where externals made submissions, despite the impediments, there was rarely feedback from the law design teams, with externals left to ponder why certain policy alternatives were unacceptable.

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

This leads one to be cautious about the value of consultation in policy development. Even if the consultation is seen to be of a high order it may not have been grounded in the best available material and policy viewpoints. There is no way of knowing whether

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

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

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

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

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

150 An example of a failed system was the Running Balance Account (RBA) System, which was introduced to record a taxpayer’s liabilities and credits on one file. Problems are still being resolved two years after introduction.
such material was part of the consultation process as there is no public transparency into those discussions and the Ralph report does not discuss them.

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

V THE FAILURE TO ADEQUATELY COMPENSATE?

Reflecting on those Ralph changes that specially impact on small business (anti-alienation of personal services income and non-commercial loss quarantining are the prime examples) leads back to a consideration of compliance cost reduction and its link to the good tax policy criteria, simplicity. There is inevitably a trade-off between the good tax policy criteria of efficiency, equity and simplicity in the design of any tax system, given that many of the objectives operate inconsistently, give rise to conflicting policy directions151 (as various tax rules serve different policy aims152), and are unable to provide definitive policy guidance.153 Thus, the more one tax policy objective is satisfied the less another is adequately realised. For example,

...adoption of a particular tax provision might increase the rate of economic growth. However, the same provision might also reduce the fairness of the system by providing some group of individuals with a tax advantage relative to others in the same circumstances.154

Ultimately the most appropriate methodologies adopted will arise from a compromise being struck between often unavoidable conflicts between policy objectives.155 Thus, a measure that reduces simplicity (and in all probability increases compliance costs) may be justifiable because it remedies an anomaly that was inequitable.

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

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

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153 RI Downing, et al, Taxation in Australia — An Agenda for Reform (1964), 48. The authors, after noting the conflicts, recommend that any changes based upon economic efficiency should only be made having examined the possible effects on income distribution. Also Robert Couzin, ‘The Process of Simplification’ (1984) 32 Canadian Tax Journal 487, 494. Couzin suggests that the cause of much complexity is the competing objectives of the tax system, which affect tax policy, the legislation and its administration.
154 Carter Commission, above n 151, 3.
155 The Asprey Report, above n 152, 12 and 1985 Draft White Paper, above n 20, 14
The Ralph Committee agreed that the appropriate response was to compensate small business for this regressive cost impost in acting on the government’s behalf, though how to do it through the tax system was identified as problematic [emphasis added].

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

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

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

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. The public selling point of STS was and remains compensation through the simplification of records and accounting systems with the concessional depreciation advantages (the main concession) being down played.

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

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157 A Tax System Redesigned, above n 2, para 336.

158 New Business Tax System (Simplified Tax System) Act 2001. The original proposal for a simplified tax system for small business arose out of concerns about the application of the proposed TVM on small business. The STS’s main features are a cash accounting regime, a simplified depreciation regime and a simplified trading stock regime. For further discussion see Michael Dirkis, ‘Staying in the Shallows: Simplified Tax System’ (Paper presented to Taxation Institute of Australia’s 2001 Queensland State Convention, Gold Coast, 18 May 2001); Kenny, above n 16; and Bondfield, above n 119.

159 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.

160 A Tax System Redesigned, above n 2 chapter 24, in particular at 698 and 720–22.

concessions are also briefly discussed, with the focus, in absence of uptake data, on the scope of the concession for a trading small business.

A Failure in STS Uptake

The pessimistic views of the practicality of STS appear to be supported by its current take-up rate.\textsuperscript{162} The government, adopting Ralph report figures,\textsuperscript{163} claimed that 95 per cent of all businesses and 99 per cent of farming businesses would be eligible for STS.\textsuperscript{164} Available figures at 17 April 2003 disclose that, of eligible taxpayers having lodged their 2002 tax returns, only 14 per cent have opted into STS.\textsuperscript{165} This may not be representative as take-up may require a period of time to mature but it does seem very low.

When reviewing take-up rates it is also important to consider whether businesses are entering something like STS for the ‘right’ reasons. For example after three or more bad seasons primary producers, otherwise ineligible to enter STS because of the $1 million turnover bar, may well fit the STS criteria. They may be willing to accept the increased costs associated with cash accounting and working out the interface with primary production specific tax concessions to enter STS in order to lock assets into the accelerated depreciation pools. This would not be a triumph of STS reducing compliance costs.

In the writers’ submission a more concerning element is the assertion that the Ralph Committee anticipated that only 60 per cent of those eligible would elect into STS.\textsuperscript{166} The costings in the Ralph report recognised the central importance of the participation rate of eligible businesses and that this would be less than 100 per cent.\textsuperscript{167} Yet, the authors cannot locate a reference to the 60 per cent take-up estimate referred to above within the Ralph report. It seems disingenuous and playing on public perceptions to claim STS eligibility in the high 90 per cents while costings are being based on 60 per cent of those eligible. A more important question to be answered is why bother implementing a system of small business taxation that was expected to be of benefit to a little over half of those eligible.

As stated previously equity (in its various guises) is a central pillar of good tax policy. If small business compensation for the regressive impacts of tax compliance costs is important surely a near 100 per cent expected take-up rate would be equitable. A

\begin{itemize}
  \item \textsuperscript{162} Fisher, above n 17, 65.
  \item \textsuperscript{163} A Tax System Redesigned, above n 2, 74. The figures in the report were based on the sole criterium of turnover and do not take into account the effects of the other eligibility criteria.
  \item \textsuperscript{164} Explanatory Memorandum to New Business Tax System (Simplified Tax System) Bill 2000 (STS EM), para 1.5.
  \item \textsuperscript{165} ATO Tax Practitioner Forum (ATPF) issues log (register No A27). Figures reported in Australian Tax Practice ‘Simplified Tax System (STS): 14 per cent Take-Up Rate so Far’ ATP Latest Tax News (No 163, 25 August 2003).
  \item \textsuperscript{166} Ibid.
  \item \textsuperscript{167} A Tax System Redesigned above n 2, 721 paras 152–53.
\end{itemize}
targetted direct concession would be far more likely to be of more general application, unless weighed down by integrity measures.168

B CGT Concessions

Small business directed CGT concessions that flowed from Chapter 17 of Ralph were generally well received.169 They were aimed at rationalising the then existing concessions that applied to small business.170 However, there is a view that they do not simplify the provisions enough.171 Even though the provisions of the legislation have been rationalised their fundamental design requires very careful and long-term planning to take maximum advantage of them.172 In this regard they have not delivered a significant compliance cost reduction dividend. Further, as the events to which these concessions apply occur infrequently in the life cycle of a small business the compensation that they offer is not a meaningful response to compliance cost impact per se.

VII WHY DID THE COMPENSATION PACKAGE FAIL?

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

A Why is STS a Failure

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

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170 A Tax System Redesigned, above n 2, 586–89.
172 Paul Ingram, ‘CGT: Small Business Relief’ (2000) 4 The Tax Specialist 85, 93
1 Lack of Reasons for STS

The Ralph Committee’s recognition of a need to compensate small business for the regressive compliance burden of the tax system was seen by interested parties at the time as a positive step.\textsuperscript{173}

However, Ralph’s reasoning as to why STS was the appropriate response is far from persuasive. The diversity of the functions performed by business on behalf of government and the diversity of small business itself were seen as issues of concern in using the tax system to compensate small business.\textsuperscript{174} Yet, the articulated reasoning leading to STS was really only a conclusion being that the review was ‘firmly of the view’ that some recognition for this impost was required and that the reduction of compliance costs associated with the business tax system was the appropriate way to do this.\textsuperscript{175} If there were persuasive arguments why the reduction of compliance costs was the answer (short of the base need for revenue neutrality) they are not set out. This is a significant omission as there were credible reports suggesting that the scope for a compliance cost reduction dividend was both marginal and a complex whole of government issue to achieve at a meaningful level.\textsuperscript{176}

2 Failure to Meet Good Law Design Principles

The incarnation as STS of Ralph’s small business support was not warmly endorsed. Although the concept was attractive the actual design of the measure was not.\textsuperscript{177} Overall the thresholds for eligibility to enter STS, the integrity measures within it,\textsuperscript{178} and the fact that it was an all or nothing package that delivered the tax concessions indirectly (mainly through accelerated depreciation) were cited as the main design problems.\textsuperscript{179}


\textsuperscript{174} A Tax System Redesigned above n 2, 74 para 336.

\textsuperscript{175} Ibid.

\textsuperscript{176} Lessons Learnt, above n 110, ii; see also 20–21.

\textsuperscript{177} The concept of a separate small business system does have merit. The New Zealand government agreed (in part) to a recent New Zealand review of business compliance costs recommendation that saw benefit in researching the applicability of a separate simplified tax regime for small business starting from analysis of STS: New Zealand Government, Striking the Balance: Government Response to the Ministerial Panel on Business Compliance Costs (December 2001), 37 responses to recommendation 154.

\textsuperscript{178} In particular grouping rules and the turnover calculation.

\textsuperscript{179} See Brett Bondfield, ‘A Year on in the Simplified Tax System: Has the Reality Matched the Rhetoric?’ (2002) 37 Taxation in Australia 251 at 252; and brief list of articles describing and analysing STS, 255–56; and Dirkis (2001), above n 158.
It is not the purpose of this paper to deal in any detail with the operational aspects of STS. However, emblematic of the changes made to the tax system from the Ralph recommendations, STS itself is long and in places convoluted. The STS Explanatory Memorandum is 84 pages excluding index and Regulatory Impact Statement. The STS provisions in ITAA 1997 run to some 27 pages in the 2003 CCH version. Then there are two Tax Rulings: TR 2002/6: Income tax: Simplified Tax System: Eligibility – Grouping Rules (38 pages) and TR 2002/11 Income Tax: Simplified Tax System Eligibility – STS Average Turnover (33 pages).

Conceptually STS is a potentially concessional tax system that sits on top of and has to interact with the rest of the tax laws. Surely having an add-on system that delivers concessional treatment of some tax items (prepayments (really a timing issue) and capital allowances) is not inherently simple. Why not have some simple concession or rebate the eligibility for, and quantum of, being dependent on a measure of business size?

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

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

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

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182 Under subdivision 328-F ITAA 1997 to be eligible to be an STS taxpayer a taxpayer must: carry on a business in that year; have an average business turnover net of GST (including the turnover(s) of entities that it is grouped with) of less than $1 million; and have less than $3 million in depreciating assets held by it and other entities with which it is grouped.
185 Income Tax Assessment Amendment Regulations 2003 (No 1) (Statutory Rules 2003 No 39)
186 Bondfield above n 179, and articles referred to at 255–56.
187 STS EM above n 164, 6.
practicality given the thresholds for entry, the fact that its concessions are indirect, and its integrity driven complexities.

All this is then wrapped up in a ‘take it or leave it’ system sitting beside and interacting with the rest of the tax laws. This then requires a potential user to undertake an analysis to determine whether on balance they will be better off. Thus, it is submitted that the failure of STS lies in poor legislative design.188 This legislative design being informed by a strong revenue protection starting position which points to the tight eligibility criteria and strong integrity focus.

3 Summary

As discussed above, the reasons why STS was appropriate at all are opaque. Thus using STS as a case study of Ralph’s addressing the small business specific issue of compliance costs has to remain qualitative at this stage and to an extent involves some conjecture. Yet, an analysis of STS suggests the government’s attempts to compensate small business for the regressive nature of compliance costs is flawed189 and, we suggest, misdirected. This is demonstrated by its low take-up rate to date.

Consultation cannot be blamed, as the consultation on the implementation of the flawed design was one of the better post-Ralph consultations.190 However, the slavish adherence by Treasury and the ATO to only permitting consultation on the Ralph model as accepted by government, despite now justified concerns by tax professionals, is a weakness of all of the post-Ralph consultation, not just STS.

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

The vectors of failure set out above are of particular concern because small business compliance costs had been previously well researched and reported on. Ralph did not overtly engage with this wealth of small business compliance cost research and reports analysing the underlying pressures that cause these costs. Rather, there is an emphasis on revenue protection at the expense of accessible compensation. The focus is on simplification rather than direct compensation and the compensation that is provided is indirect (a weakness), mainly via accelerated depreciation.

188 Bondfield above n 119; Dirkis (2001) above n 158.
189 Bondfield above n 119 and n 179 (referring to other papers on STS); Dirkis (2001) above n 158.
190 Treasury at the NTLG meeting of 7 December 2000 asserts that STS consultation was very close to ‘ideal’, but were concerned that professional bodies did not share this view. Copy of minutes located at: http://www.ato.gov.au/content.asp?doc=/content/Professionals/13389.htm&page=3#H6 accessed on 2 April 2002 checked at 20 December and no longer listed on ATO website.
B The CGT Concessions

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

Further, the concessions appear to fail Ralph’s efficiency objective as the 15 year retirement concession is considered by some to be too generous and leading to market distortion by the locking in of assets rather than their active redeployment.191

IX CONCLUSIONS ON RALPH

The Ralph Review noted that:

[i]n the end, tax design in a complex environment is as much art as it is science: judgement is often as important as fact and analysis.192

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

The case study of STS above and its low take-up to date provides a window into how Ralph failed small business by increasing compliance costs and failing to provide appropriate compensation.193

When this is expressed in terms of good tax policy objectives, the lack of simplicity is being skewed even further against small business given the Ralph changes that particularly impact small business. This puts at issue tax system equity if there is not adequate compensation for those disproportionate cost increases.

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

191 Chris Evans, ‘CGT After Ralph’ (2000) 3 Tax Specialist 313, 324.
192 A Strong Foundation, above n 2, xvi.
193 See also Fisher, above n 17, 65.
This gives cause to reflect on the presence or absence in 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 are omnipresent and show no signs of abating. Nor has there been any effective government action to its slowing. This is all in the context of vociferous and well-informed groups pointing out that we are drowning in tax compliance post-Ralph.

Overall, the consideration of small business by Ralph and in its implementation have been shown to be, in effect, much ado about nothing.

X THE WAY FORWARD

Given that the Ralph Review and the subsequent implementation processes have combined to increase compliance costs for small business and failed to adequately compensate for those costs, it is important to briefly explore the possible ways forward for future reform processes to ensure that small business is not the major casualty of tax reform. This is not intended to be a comprehensive plan, but rather a series of suggestions built on some of the current features of the tax administration and review systems and others flowing from the conclusions drawn from this paper. They are intended to generate discussion and further work.

A Direct Concession or Lower Tax Rate for Business Income of Small Businesses

The initial suggestion is, rather than persevere with STS, investigate the feasibility of a direct concession or lower tax rate for business income of small businesses. This has the advantages of being able to be clearly monitored for its revenue costs and take-up rate. It is also more amenable to adjustment up or down or to widen or contract the eligibility criteria should circumstances require.

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

B Reducing or Limiting Compliance Costs

There are things that cannot be compensated such as business opportunities missed because business resources were needed to meet the tax compliance requirements. Therefore it is still important to focus on compliance cost reduction. The suggestions that follow focus on compliance cost containment and reduction:

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194 Time for Business, above n 4, 19.
Research, especially into the global costs of compliance post-Ralph and the GST is a priority. The authors would be pleased if empirical research could show that on balance small business is better off post-Ralph in terms of their compliance costs when all tax system improvements are taken into account. However, all the available signs suggest that this is not the case.

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

The United States has no such reservations with the Internal Revenue Service (IRS) currently reported as working with IBM to develop such a system wide capacity.195 Failure to do so merely raises conspiracy theories about hiding the true compliance cost picture.

C Continuing Institutional Reforms Post-Ralph

Given the above discussion on the reasons for the failures it is also important to maintain the momentum of institutional reform. The key areas include:

- Have in place the capacity to undertake transparent and independent post-implementation reviews of tax laws and policies. The Board of Taxation is currently commencing its first such review of the quality and effectiveness of the non-commercial loss quarantining provisions.196

- Have in place independent quality assurance monitors of the tax system. Post-Ralph the Board of Taxation and the Inspector General of Taxation have roles in this regard and this is to be welcomed. Though the multiplicity of review mechanisms may of itself cause system complexity.197

- Meaningful consultation at the legislative design and implementation phase of new tax initiatives. The infrastructure is in place with the requirement for RISs and the establishment of the Board of Taxation. However, concern has been expressed (as detailed in this paper) that in the Ralph implementation phase, with the exception of the consolidation regime, meaningful consultation has not necessarily occurred. The resultant design of tax law and administration has been the worse for this.


197 Fisher above n 17, 63.
Thus there must be a will to meet the spirit of consultation and open up debate on all design aspects, rather than the details of a set policy position. A greater role for consultation in a more publicly accountable RIS process can also be investigated.198

In summary, in order to safeguard future small business reform, the way forward should involve both compliance cost reduction and compensation based upon robust research. Implementation should be based upon co-design principles.

198 See Sawyer above n 159 for comment on the NZ experience.