

SIMPLICITY IN TAX



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SIMPLICITY IN TAX

Commentators and legislators alike extol the virtues of a 'simple' tax system. But just what do we mean by simplicity in tax, and how can it be achieved? Is it really the single most important driver, or should it be balanced against concepts such as stability or certainty?

This paper was first published in 2013. It has been re-released to support the 2020 report *Foundations for a sound tax system: simplicity, certainty and stability*. References to web resources have been checked and updated where necessary, but the body text has not been edited.

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Simplicity in the tax system

Introduction

ACCA believes that understanding and complying with tax legislation and requirements should be as simple and straightforward as possible. Where there is excessive complexity in the system, and a lack of clarity as to what is expected of taxpayers and their advisers, the potential will exist for mistakes and deliberate contravention of the rules. A commitment to simplicity will help both taxpayers and the tax authorities to ensure that the tax system operates effectively.

Simplicity, certainty and stability are in ACCA's view the three cornerstones of a good tax system – but what exactly does 'simplicity' mean? Paradoxically, it is probably the most complicated of the three cornerstones to define. Questions of 'simplicity' permeate every aspect of tax, from its underlying objectives through to the mechanisms chosen for achieving those aims and to the practicalities of implementation.

There is almost universal agreement that tax should be simple, but why might it ever not be? Are there acceptable reasons for allowing complexity to creep into the system? What can and should be done to promote simplicity in tax?

Why is tax so complicated and why has it become so?

Tax systems are expected to perform many different roles. Raising of revenue, redistribution of wealth/reallocation of resources, and behaviour modification ('regulation') are the three main areas. Revenue raising pays for pure public goods, while redistribution reduces the strain on social welfare spending, with 'sin taxes' such as excise duty on alcohol and 'green taxes' being examples of the regulatory function. Having decided what aim is to be fulfilled, there are then three main ways governments can seek to achieve their ends – taxation of spending, taxation of receipts, or taxation of capital. Most modern tax systems incorporate a mixture of taxes on income (personal and corporate), on consumption (VAT or GST) and, to a lesser extent, on wealth. Often the same ends are pursued through a number of different means and single taxes are expected to support more than one aim, leading to inevitable policy tensions.

Finally, having decided what is to be achieved, and which type of tax is best suited to achieve that end, it must be implemented. Again, there are three key areas to consider. First, what is to be the legal basis for the charge – this should be legislation, but will often be reliant on supplementary guidance or case law, and all subject to interpretation by the tax authorities on the one hand and taxpayers and their advisers on the other. Then there is the calculation and assessment of the tax – is this to be performed online, or on paper forms? Should there be annual, quarterly or ad hoc returns? Should reliefs be automatic, or claimed in an existing return or through independent claims forms? Finally, and perhaps most important of all, there is the collection method to consider. Wealth taxes are always going to fall on the owner of the capital, but all the transactional taxes involve (pretty much by definition) two parties – and it is very often not the party liable who actually remits the tax to the authorities. Examples include VAT, a tax borne by consumers but that is collected by sellers, and personal income taxes on employment earnings, which are typically withheld by employers and remitted to the authorities independently of the main pay run.

The majority of the complexity that taxpayers and their advisers notice manifests itself in the implementation of the policy, in the form of confusing paperwork, ambiguous or inconsistent legislation and dysfunctional bureaucratic processes. Often though, the source of the difficulty is a lack of clarity earlier in the policymaking process, or even the changing function of a given tax. Consider, for example, models for taxing, and funding, road use. Ad valorem taxes on the price of road fuel were historically viewed mostly as revenue-raising instruments, but are increasingly viewed as regulatory 'green' taxes. The alternative consumption tax with direct pollution impacts is road tolls, but whether these are treated as revenue raising, resource reallocation (shifting productive capacity from drivers to roadbuilders) or regulatory may depend on current political exigencies.



Finally, of course, there is the wealth tax on vehicles, levied in many jurisdictions around the world. Pricing of such taxes now increasingly depends upon the environmental characteristics of the vehicle, but has historically been based on factors such as list price or proxies such as engine size. Two types of tax (consumption and wealth taxes) operate in pursuance of three different aims through three different mechanisms, collected in different ways.

Often, governments or individual politicians will perceive that there is scope for rewarding or engaging with particular pressure groups for their own ends by managing the impact of taxes. The US Federal budget is notorious for the complexity of its tax expenditures and the thicket of derogations, exemptions and amendments incorporated for the benefit of particular groups. Once established in the system, these wrinkles in the fabric of administration can be remarkably enduring

Once a tax has been designed and implemented, it then has to sit among all the other taxes affecting those who pay it. Some individuals and groups will try to reduce the tax's impact on themselves. Taxpayers may take matters into their own hands, and attempt to move themselves outside the scope of the tax; artificial attempts to manage this are widely known as 'tax avoidance', and tend to generate anti-avoidance legislation, which is a particularly fertile ground for complexity.

Of course, all the foregoing relates to just a single jurisdiction. Once taxpayers, whether individuals or businesses, start to try to operate across more than one tax jurisdiction the complexities can grow exponentially.

The 28 member states of the European Union have 76 different rates of VAT, and a business operating across the EU would be expected to apply correctly the differing rules on any permutation of 'supplies' between different member states. Moreover, while the basis of a consumption tax may be comparatively easy to define, calculations of income or profits, especially in the case of large complex businesses, can be far harder to pin down. Multinational businesses may need to report results under a number of different reporting standards, and the inconsistencies between them result in inevitable complexity. Accounting for the profit on a contract to sell a dollar denominated future based on Kazakh grain prices traded on a London Exchange by a Swiss-based dealer on behalf of clients based in Hong Kong and Brazil will be challenging enough in itself; deciding where the contract is made, what profits on it crystallise and when and where they will fall to be taxed, adds another layer of interpretation to each stage of the process.

What are the advantages to taxpayers and accountants of simplification?

Research by the World Bank¹ shows that, globally, companies spend over a month each year complying with tax regulations – 9 days for corporate income taxes, 12 days for labour taxes and contributions and 13 days for consumption taxes. A fair proportion of that time will relate simply to the filling out, and filing, of forms. Revenue authorities can, and should, work to reduce the number of forms that taxpayers have to fill in, and the difficulty of completing them. It is a particularly striking finding of the 2013 World Bank report, after more than eight years of

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¹ PwC and The World Bank Group (2013) *Paying Taxes 2013 The global picture*, <<https://www.doingbusiness.org/content/dam/doingBusiness/media/Special-Reports/DB13-Paying-Taxes.pdf>>, accessed 20 July 2020.

global analysis, that reducing the administrative burden on business appears to be linked with economic growth more strongly than with cutting tax rates.

In many cases technology can play a part, not just in allowing the instantaneous process of online filing, but in reducing the need for taxpayer input. Any figure used more than once in a tax filing need be input only once if the filing is done electronically; the software should be able to reuse the information as many times as needed. There may even be scope for removing the human element from data input altogether. Many jurisdictions now base filings on accounts prepared in XBRL (Extensible Business Reporting Language, a format of data storage that is easily readable by other software), which automatically imports much of the basic information.

ACCA advocates the restriction of deviations for standards-compliant accounting in the preparation of tax computations, so far as possible. Where there must be adjustments, these should be framed as clearly, logically and intelligibly as possible, reducing the need for expert input and interpretation in the basic preparation of returns and computations.

When considering the underlying legislation, simplicity comes in many forms, and may not always mean brevity alone – it must also address the factors of usability and comprehensibility. Those drafting the legislation need to consider its context and the audience who will be using it. In some countries, taxpayers must self-assess their liability from scratch, and will themselves be the primary users of tax legislation. Given this, the language used must be clear and unambiguous, and should not require detailed background knowledge or cross-referencing to other provisions of the tax system. For such taxpayers, guidance can also be a key feature of the system, but where this is so the authorities must be very clear about the limits of such guidance, and ensure its availability to those who will need it. While many taxpayers now have access to the internet, and may be able to search for legislation and guidance online, this brings new challenges for

the administrators. Taxpayers may legitimately request guidance relating to earlier years, and legislation that has now been superseded. How can this be clearly identified when hosted online? And how should updates to legislation be displayed?

There are other provisions of business tax that, by their very nature, will only ever be of relevance to sophisticated taxpayers who will be in a position to appoint advisers or employ their own in-house experts to deal with tax affairs and interpretation of legislation. For them, consistency and continuity of language can be key, especially where existing tax treatments are built upon a long history of developing provisions and case law. Changing the words of the legislation so that they no longer align with the legal precedents that seek to define the boundaries of the law is far from a simplification, and will only create uncertainty. Even here, authorities must be mindful of the need for transparency and accountability and the importance of being able to explain and justify the system to other stakeholders.

The reliance of tax upon the wider legal principles of interpretation and the struggle for universal applicability is illustrated most clearly by the field of ‘anti-avoidance legislation’. The question of whether such measures should exist at all is more properly discussed under the heading of ‘certainty’, but if they are going to exist we have to acknowledge that they are the antithesis of simplicity, requiring taxpayers either to keep abreast of the range of targeted rules, or to ‘second guess’ the intentions of the legislature when trying to ascertain the tax impact of given transactions.

The most fundamental driver of simplicity (or complexity) in a tax system is the attitude of its designers to the function of tax. A system designed purely to raise revenue has far greater potential to be simple, as the sole design constraints will be neutrality and efficiency. The base of the tax system will be as wide as possible, and in order to reduce economic distortions it will be as homogeneous as possible. A significant proportion

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of taxes in most jurisdictions are, however, specifically designed to influence behaviour, and are the antithesis of neutrality. In some cases, for example excise duties on alcohol or tobacco, the tax itself is relatively simple, and does not necessarily conflict with principles of simplicity. Nonetheless, many of the measures designed to influence taxpayer behaviour are more finely tuned, and take the form of deliberate distortions of the application of broader taxes. Using the tax system to differentiate at a fine level of detail is unavoidably complicated, by definition. It inevitably adds extra steps to the process of determining liabilities, as the simple ‘if A, then B’ structure of the system is extended to ‘unless C, in which case, D’.

Simplicity of concepts

Complexity in the tax system, whether in the structure of rates and levies or in definitions of specific measures, is in itself a distortion of the economy, diverting productive energies into non-productive administration. The number of tax rules, and their ability to interact (or even conflict) with each other, should be kept to a minimum. Anti-avoidance provisions, in particular, should be considered carefully as by their nature they tend to flourish in areas of complexity, and beget further complexity. Eliminating the underlying ambiguities in the original legislation is to be preferred.

There is, of course, a counterpoint to simplicity, and that is fairness. The simpler and less granular a tax system, the less finely it will be able to differentiate between the circumstances of differing taxpayers. The model that is sometimes held up as being the ultimate in simplicity is the flat tax, but that has been subject to significant criticism for introducing unfairness into the system by abolishing the ‘progressive’ nature of taxation. In practice, the theoretical simplicity of the model is not even matched by real-world administrative efficiencies, and a number of nominally ‘flat tax’ jurisdictions in fact demonstrate a range of effective rates, especially in the employment taxes arena where the income tax coexists with social security contributions.²

Whenever any new tax measures or procedures are proposed they should be designed to cause minimum disruption to existing arrangements. Where measures already exist, ACCA believes that they should be simplified where this is possible. In general though, changes in tax law – particularly those which reverse previous tax breaks or incentives and on the basis of which taxpayers have made plans – should ideally be kept to a minimum. It is inevitable that any mechanism that introduces choices for taxpayers, and differential treatment designed to encourage one course of action over another, will increase complexity.

Finally, the design and maintenance of tax systems should be considered in the wider context of the global economy. Undue complexity, or perceived instability of policy, will discourage inward investment from other jurisdictions. The growing trend towards tax harmonisation, including the potential for unitary taxation based on formulary apportionment (whether regionally or on a wider basis), conflicts with an over-reliance on tax expenditures. Economies that rely heavily on the idiosyncratic features of their tax systems will find integration with other jurisdictions more difficult, which may in turn restrict opportunities to benefit from wider coordination of tax systems.

In summary, ACCA believes that a commitment to achieving simplicity in the tax system will produce the following benefits:

- reduced costs of administration
- greater accountability through clarity and transparency, and
- improvements in stability as the potential for unintended interactions and consequences and the corresponding need for counteracting measures are reduced.

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² James Rogers and Cécile Philippe, ‘Belgian Workers’ Wages are Highest-Taxed in Western Europe’ [online article], *L’Anglophone*, 26 May 2010, <<http://www.langlophone.com/fullbn.php?id=419>>, accessed 20 July 2020.

