

Tax complexity metric

Measuring complexity in Australia

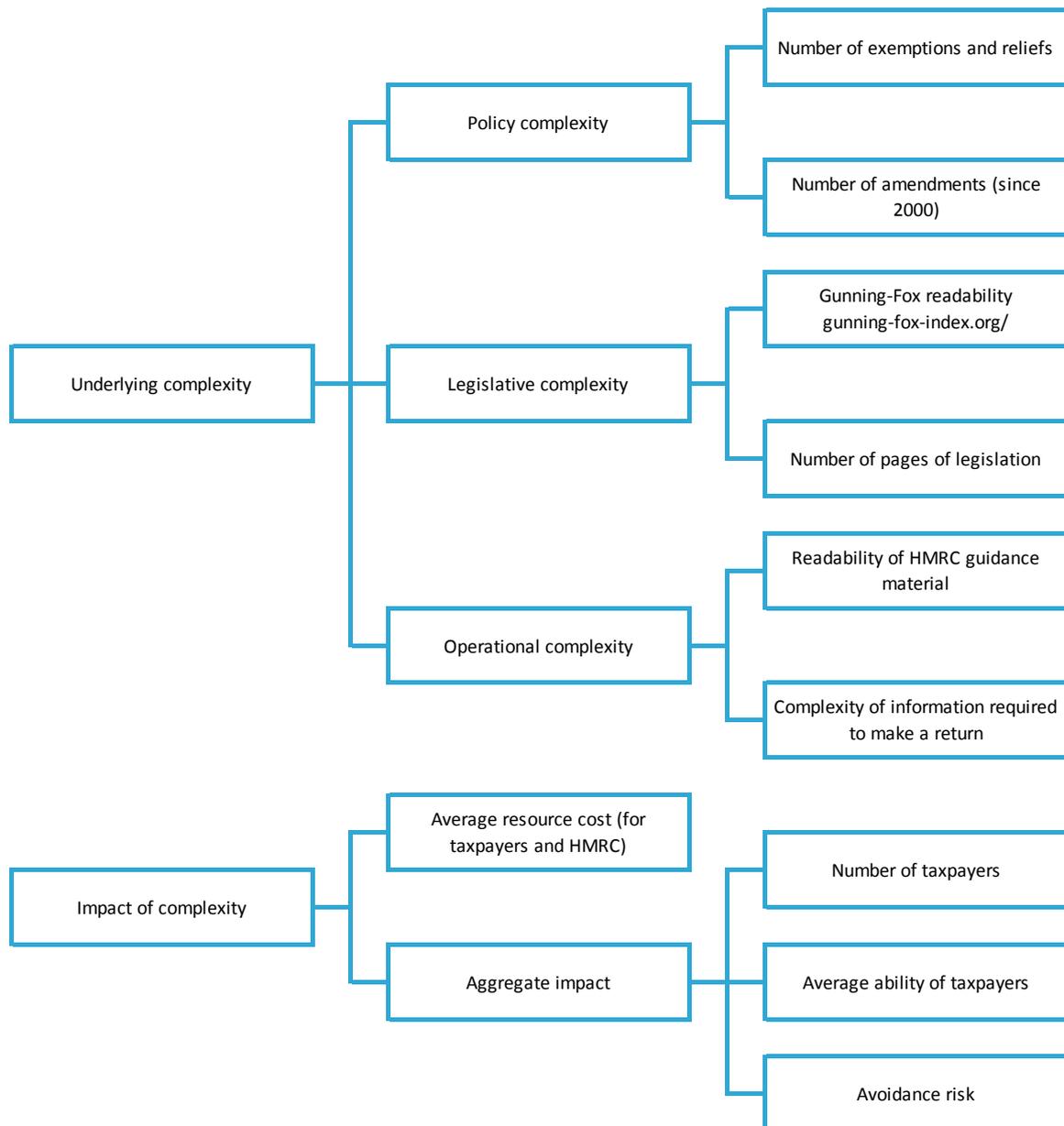
Developing a metric to measure the complexity of Australia's tax law could assist in future assessment of the areas of the tax law most in need of simplification, and the areas where reform could have the greatest impact. A metric may also provide an opportunity to measure relative complexity over time. The idea of developing a tax complexity metric has received increasing attention from government and academics around the world.

There is no single, easily measurable factor that directly correlates with the overall complexity of an area of tax law (unlike, for example, price changes, which are measured in the Consumer Price Index). The closest practical approach seems to be to use a range of factors as proxies, combined into an index. Factors are most useful if they are easily measured, while still providing an accurate proxy for complexity. To be useful, a metric would need to be intuitive and easy to use, while still providing a meaningful measure of tax complexity.

An example of the sort of metric that could be adapted to the Australian context is the tax complexity index being developed by the United Kingdom Office of Tax Simplification (OTS). In its paper on the proposed index, the OTS suggests that factors of complexity could be separated to create two separate measures of complexity: a measure of underlying complexity and a measure of the impact of complexity.²⁵⁰ Factors would be weighted and then added together to determine a numeric measure. The factors making up each proposed measure are shown in Figure A.1.

250 Office of Tax Simplification and HM Treasury, *Developing a tax complexity index for the UK*, Office of Tax Simplification and HM Treasury, London, viewed 9 December 2014:
www.gov.uk/government/uploads/system/uploads/attachment_data/file/285944/OTS_Developing_a_Tax_Complexity_Index_for_the_UK.pdf.

Figure A.1 Schematic diagram of the UK Tax Complexity Index



Source: Office of Tax Simplification and HM Treasury, *Developing a tax complexity index for the UK*, Office of Tax Simplification and HM Treasury, London, viewed 9 December 2014: www.gov.uk/government/uploads/system/uploads/attachment_data/file/285944/OTS_Developing_a_Tax_Complexity_Index_for_the_UK.pdf.

Some of the factors the OTS includes in its ongoing work may also be appropriate for an Australian metric. For example:

- **Number of exemptions:** exemptions and special cases cause a significant amount of the complexity in the tax law as taxpayers try to figure out how to apply the law to their circumstances. Alternative but similar measures include the number of exceptions to basic rules, or the number of possible paths to reach each outcome. These measures may provide a useful assessment of the maze that taxpayers must navigate, although there is some subjectivity in their application (for example, different people may classify a rule as either a single exception or a collection of similar exceptions).

- **Number of amendments:** frequent changes to the tax law are often identified as an important factor of complexity. Finding out how new rules apply to them imposes costs and uncertainty on taxpayers. Very frequent changes may also indicate that an area of the tax law is not working well in practice, although that is not always the case. The number of amendments over a certain period of time is objective and relatively easy to measure, but does not necessarily provide an indication of the relative significance of the changes.
- **Number of pages of legislation:** this measure of complexity is often used as an indicator of complexity. It is objective, easy to measure and simple to understand. However, a high number of pages does not always correspond to more complex law. In some cases, more pages may be used to make the legislation less dense and easier to read, or to add aids to interpretation such as diagrams, examples and signposts to related rules.

An alternative metric for Australia has been proposed by Tran-Nam and Evans.²⁵¹ Instead of differentiating between underlying complexity and the impact of complexity, they created separate measures for business and personal taxation. They also used different factors to the UK OTS, such as:

- the number of federal, state and local taxes;
- the number of requests for private rulings from the Australian Taxation Office;
- the number of external disputes;
- the use of tax agents by personal taxpayers; and
- the frequency of reporting and payments for business taxpayers.

251 Tran-Nam, B and Evans, C 2014, 'Towards the Development of a Tax Complexity Index', *The Journal of Applied Public Economics*, vol. 35, issue 3, pages 341-370.

