A comparative analysis of tax advisers’ perception of small business tax law complexity: United States, Australia and New Zealand

Brett Freudenberg*, Binh Tran-Nam**, Stewart Karlinsky*** and Ranjana Gupta****

Abstract

There is no doubt that the tax laws of many countries are complex and difficult to comply with administratively. In particular, Australia, New Zealand and the United States have tax systems that are generally recognized as complex especially for small businesses. They also have the distinction of having had a significant portion of their tax policy literature address the issue of complexity and its impact. What has been given scant recognition is the ability of different tax systems to learn from the successes and failures of each other. This article will try to bridge that gap by comparing tax advisers’ perceptions of tax law complexities in these three jurisdictions that impact a crucial segment of the economy, small business.

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Section One

1 Introduction

An important part of many economies are small businesses,1 and this is true for the jurisdictions considered of the United States of America (the ‘United States’), Australia and New Zealand. In the United States small business generate 58 per cent of the non-farm workforce, 43 per cent of sales, and 51 per cent of private gross domestic product (‘GDP’).2 Of the United States’ non-farm companies, 99 per cent were small businesses.3 It was estimated that in Australia there were 1,961,337 private sector small businesses4 during 2008–2009, representing 96 per cent of all private sector businesses. Australian small business employs almost 3.6 million people, accounting for 49 per cent of all private sector employment,5 and around 30 per cent of Australia’s GDP.6 In New Zealand, the dominance of this sector is also great, with small and medium enterprises accounting for 97 per cent of all businesses.7

Apart from their contribution to a country’s GDP, small businesses are seen as important for future economic performance, being described as the ‘seed bed for a country’s future economic growth.’8 It has been stated:

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1 A small business can be defined in many different ways. As a matter of fact, over 40 alternative ways of defining small business, are described and discussed in Karlinsky, S. (2003). How Does U.S. Income Tax Law Define a Small Business? Let Me Count the Ways. Taxing Small Business: Developing Good Tax Policies, Australian Tax Research Foundation: Sydney (Conference Series 23): 45, at 45. For example, small businesses may be distinguished by sales, assets, number of employees or assets placed in service. This is discussed in more detail in Section One of this article.
2 Karlinsky, above n1, at 45.
3 Karlinsky, above n1, at 45.
4 Defined to be businesses that employ less than 20 people. Australian Bureau of Statistics. (2010). Counts of Australian Businesses, including entries and exits, June 2007 to June 2009, 8165.0, Canberra: AGPS: Table 13. These figures are based on those businesses registered for GST.
Evidence suggests small business can play a key role in diffusing new ideas and technologies as they operate in ‘innovative networks’, providing specialist equipment and services to boost the innovation potential of large firms.\(^9\)

However, precisely defining what is a ‘small business’ can be problematic with various measures used including turnover, employee numbers, asset holdings or equity raised. Quantitative measures to describe ‘small’ businesses include having turnover less than $10 million;\(^10\) or having fewer than 20 employees for non-manufacturing.\(^11\) Even the same piece of legislation may have differing quantitative measures. For example, Australia’s income tax act has at least two measures of small business: aggregate turnover being less than $2 million,\(^12\) or ‘net CGT assets worth $6 million or less’.\(^13\) These inconsistent measures of ‘small’ can themselves add to complexity for small businesses.

Quantitatively, business can be categorised micro, small, medium and ultimately large. Depending upon the definition adopted there can be some overlap in the issues faced between these categories. For the Australian Bureau of Statistics’ purposes the use of ‘employment’ is used to distinguish size, with a micro business employing less than five people, a small business employing 5 to 19, medium 20 to 199 and a large business with greater than 200 employees.\(^14\)

Another way to consider businesses is by qualitative characteristics, such as whether they are closely held. While it is acknowledged that ‘closely held’ and ‘small business’ are not per se interchangeable, the vast majority of closely held businesses will nonetheless be small to medium enterprises.\(^15\) The qualitative characteristics inherent


\(^12\) \textit{ITAA 1997} (Cth), Division 328.

\(^13\) \textit{ITAA 1997} (Cth), section 152-15: small business capital gains tax concessions. Other legislation can also have different measures to be regarded as small: \textit{Fringe Benefits Tax Assessment Act 1986} (Cth), section 58GA: exempt car parking fringe benefit: ordinary income less than $10 million. to determine the requirement for GST registration: turnover less than $75,000: \textit{A New Tax System (Goods and Services Tax) Act 1999} (Cth), section 23-15; and to determine whether the cash method can be used for GST purposes turnover less than $1 million: \textit{A New Tax System (Goods and Services Tax) Act 1999} (Cth), section 29-40.

\(^14\) Australian Bureau of Statistics, above n4.

\(^15\) Freedman, J., and Ward, J. (2000). Taxation of Small and Medium–Sized Enterprises. \textit{European Taxation} May: 158, at 159. There are some obvious exceptions such as in the United States, Cargill with over US$120 bil in Gross Revenue or Mars Corporation with over US$20 bil in revenue or Bechtel with over US$30 bil in revenue.
for a ‘closely held business’ is that membership interest\(^\text{16}\) is not widely dispersed, and that it is not publicly traded.\(^\text{17}\) Normally, a closely held business is one that is independently owned and operated, with most, if not all, capital contributed by members\(^\text{18}\) and managers. Furthermore, members are likely to participate in the management of the business (member-management).\(^\text{19}\) It is important to have these qualitative characteristics in mind as they can influence the complexity issues that will be discussed later.

Tax complexity is of concern for small businesses as research has demonstrated that they have the least capacity to cope with the burden of regulations.\(^\text{20}\) Further, primarily because of economies of scale, tax compliance costs tend to be regressive.\(^\text{21}\) Even if not regressive, tax compliance costs can detract from the economic efficiency of a business form, especially if there are insufficient benefits obtained from the compliance activity.\(^\text{22}\) Also tax compliance costs are not just purely financial, as non-financial costs can include stress, as well as distracting the member-manager from the core business.\(^\text{23}\) However, these findings need to be balanced against arguments that small businesses may have greater non-compliance, which to an extent, may offset the regressive nature of compliance costs.\(^\text{24}\)

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16 The term ‘membership interest’ is used to describe the recognition of the equity investment that a member has in a business form. A membership interest may or may not be a separate asset itself. For example, a membership interest in a corporation is known as a share (or ‘stock’ in the United States).

17 Holmes and Gibson, above n11, at 8; Coleman and Evans, above n6, at 149; Small Business Deregulation Task Force, above n10, at 13.

18 The term ‘member’ is used to describe: an equity investor in a business form. An example of a ‘member’ would be a sole proprietor, partner in a general or limited partnership and a shareholder in a corporation. In this article the term ‘member’ is adopted to ensure consistency and aid understanding when referring to an equity investor.


In the United States the research by Crain and Hopkins demonstrated the cost of regulation per employee is higher for smaller firms than for larger. For example for firms with less than 20 employees the annual cost of tax regulation per employee was US$1,202; whereas for firms with greater than 500 employees it was only US$562 per employee. In Australia the regressive nature of compliance cost was demonstrated by Evans et al.: small businesses average tax compliance cost per AU$1,000 of turnover was $34.13, whereas for a large business it was $1.84. While this lessened once tax deductibility of costs and cash flow benefits were factored in, there still remained a large differential. More recently, Lignier and Evans’ study confirmed that tax compliance costs continue to be regressive, particularly at the lower end of small business (less than $3M). Numerous studies in New Zealand have also highlighted the regressive nature of compliance costs.

It was for these reasons that Ingraham and Karlinsky undertook their initial study to gauge United States tax advisers’ perceptions about which measures in the tax system posed the greatest complexity for small businesses. Rather than surveying small businesses themselves, Ingraham and Karlinsky argued that tax advisers were on the ‘front line’ and well positioned to give insights to the areas of tax complexity.

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26 Evans, Ritchie, Tran-Nam and Walpole, above n 21, at 52.
27 Lignier, P., and Evans, C. (2012). ‘The rise and rise of tax compliance costs for the small business sector in Australia,’ Paper presented at the 10th *International Tax Administrative Conference*, Sydney, 2 & 3rd of April, at 5-7. A ‘small business’ was defined as 50 or less full time employees equivalent and questions addressed the 30 June 2010 financial year. The survey was completed by 159 small businesses in Australia. it was observed that compliance cost appeared to ‘flatten out’ around the $3M threshold.
30 Ingraham and Karlinsky, above n 29.
This survey was then replicated (with jurisdictional modifications) in Australia and more recently in New Zealand. However, while largely similar survey instruments were used for the studies considered, there were slightly different measures used for ‘small businesses’ due to jurisdictional differences. The measures used for small were: the United States: average gross receipts of less than US$10 million over three years, Australia: annual ordinary turnover of AU$2 million or less, and New Zealand: gross annual PAYE deductions of less than NZ$100,000. While it is acknowledged that these different measures of ‘small’ may affect the comparability of the three studies, that nonetheless important trends may be ascertained.

While the empirical findings of these three studies have been reported elsewhere, it was acknowledged that ‘a careful comparative analysis’ was beyond the scope of the later Australian study of Tran-Nam and Karlinsky. Similarly, the comparative analysis by Gupta of the New Zealand results with the earlier Australian and United States surveys was restricted. To address this, this article will carefully consider the findings of these three studies to determine what are the common themes facing small businesses.

To facilitate this critical analysis a comparative legal framework is utilised, to compare the different legal systems of the jurisdictions studied. To ensure some functionality to this comparison a common basis is utilised. This common basis is what tax advisers’ perceived as the most complex tax provisions applying to small businesses. Comparative analysis will enable common themes and peculiarities to be expressed, with the aim to formulate recommendations to try to decrease the complexity of the tax systems in jurisdictions studied.

Section Two of this article will provide a broad summary of the tax systems in the United States, Australia and New Zealand. The third section will then provide an outline of the surveys undertaken in the three jurisdictions. Section Four will provide the comparative analysis focusing on the pertinent issues of (a) retirement planning; (b) tax flow-through; (c) small business tax concessions; (d) stability of tax laws; (e) employee vs contactor and (f) integrity provisions. Through this analysis recommendations will be proposed, with future research being outlined in the fifth section of the article before concluding.

33 Tran-Nam and Karlinsky, above 31.
34 Gupta, above n32.
36 Zweigert and Kotz, above n 35, at 34.
37 Zweigert and Kotz, above n 35, at 11.
Section Two

2 Overview of tax systems

To contextualise this comparative analysis it is useful to present an overview of the tax systems in the three jurisdictions studied: the United States, Australia and New Zealand.

2.1 United States

The United States collects tax revenue from an individual income tax (45 per cent of total collected), a social security/self-employment tax system (36 per cent), corporate income tax (12 per cent), estate and gift tax as well as excise and customs taxes.38 The United States does not impose a goods and services tax (‘GST’!)39 or national sales tax, although many states impose a retail sales tax as well as income taxes, and real estate taxes.

The Federal Government of the United States applies a global income tax on its citizens and residents. Taxation of foreigners largely depends upon whether such items are connected to a United States’ trade or business. The taxpayer gets a credit for foreign taxes paid subject to limitations. Taxpayers (most often corporations) may establish a foreign corporation that will not be subject to tax in the United States until they repatriate their earnings to a United States taxpayer.40

Individuals are subject to marginal tax rates up to 35 per cent on taxable income for the 2012 tax year, although the levels to which these apply vary depending upon a number of circumstances, such as marriage.41 The point at which one is taxed at the highest marginal rate in the United States is relatively high (over $370,000). However, most capital gains are taxed at a maximum statutory rate of 15 per cent. From 2003 through to 2012, the tax rate applying to dividends is equivalent to the capital gains tax (‘CGT’) rate of only 15 per cent.42

38 See Brookings Institute and Urban Institute Tax Policy Briefing Book from Congressional Budget Office.
39 Also known as a Value Added Tax (‘VAT’) in some jurisdictions.
40 Assuming the funds are considered permanently reinvested, they will be included in financial statement income but the United States tax related to the foreign income will not have to be accrued: Accounting Principles Board Opinion No. 23: 1972.
41 Due to inflation adjustments the income level at which the 35 per cent rate applies changes but it is in the $370,000 of taxable income range. Individuals may also be subject to an alternative minimum tax (‘AMT’) if the AMT exceeds their regular tax liability: section 55(a) Internal Revenue Code 1986 (US) (‘IRC’).
42 Section 1(h)(11) IRC/US 1986 introduced by the Jobs and Growth Tax Relief Reconciliation Act (US) 2003 (passed May 2003). This reduced the top capital gains tax and dividend tax rate to 15 per cent (0 per cent for individuals taxed on net ordinary income in the first two brackets) for the period 1 January 2003 to 31 December 2012.
The United States’ *Internal Revenue Code 1986 (US)* (‘IRC’) categorises businesses as either sole proprietors; partnerships; C Corporations; or S Corporations. All business forms, including business trusts, associations, limited partnerships, limited liability companies (‘LLCs’) and limited liability partnerships (‘LLPs’) are taxed under one of these regimes. Partnerships, sole proprietors, trusts and S corporations are generally taxed once at the members’ level.

The United States has a number of tax flow-through companies, such as LLCs, LLPs and S Corporations. Tax flow-through companies provide a statement to their members detailing what they have been allocated for the year.

C corporations and its shareholders are taxed on both income earned and property distributed at graduated rates of up to 35 per cent. An entity approach applies with no tax integration between a C corporation and its shareholders. Thus, there is no franking or foreign tax credit pass-thru to individual shareholders, although currently there is the concessional tax rate applying to the receipt of dividends.

In terms of the utilisation of these different business forms, the most popular business form for tax purposes was the sole proprietor with 22,659,976 filing tax returns in the 2009 year. To better demonstrate the utilisation of other business forms, sole proprietors have been excluded from Figure 1. This demonstrates that in the United States the number of S Corporations exceeded the number of LLCs filing tax returns. However, this data needs to be interpreted cautiously, as the tax figures could under-report the number of LLCs. Data which compares the tax filings to state registration

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43 C corporation derive their nomenclature from Subchapter C of the IRC 1986 (US) while S corporations are defined and governed by the provisions of Subchapter S.

44 An LLC could potentially have a number of different tax treatments. For example an LLC could elect under Check-the-Box to be taxed as a partnership or a C corporation. Then for an LLC that has elected to be taxed as a corporation it could then make a valid election under Subchapter S.

45 Note the decision of Knott v Commissioner United States Tax Court, 1991. 62 T.C.M. 287 confirmed that the income of an S Corporation need not be distributed in order to be included in the taxable income of the member.

46 The term ‘Tax flow-through company’ is used to describe the following attributes of a corporation’s separate legal entity status and limited liability, with an aggregate tax treatment. The term ‘company’ is adopted to indicate the characteristics of separate legal entity status and limited liability, even though some jurisdictions have used the term ‘partnership’ in describing their tax flow-through company (as defined).

47 Sections 1366(a) and 702 IRC 1986 (US): referred to as ‘distributive share’. This form is called the K-1. The assessment of members of this business forms is independent of any actual distributions made to them.

48 IRS Statistics of Income January 23, 2012. For 2008, it was 22,614,483 and the number of partnership returns filed for 2008, the latest data available was 3,146,006 while C corporation’s accounted for 1,762,483 returns and S corporations 4,049,944.

49 This is because single-member LLCs with tax flow-through treatment are treated by the Internal Revenue Services (US) (United States IRS) as a ‘disregarded entity’. Disregarded entities are not reported in this tax data as LLCs, but are instead included in the figures relating to the member’s own status (This could be mean that the single-member LLC is included in the figures as a sole
of LLCs indicates that the number of LLCs may be more in the vicinity of 6 million compared to the 2 million in the tax filings.\textsuperscript{50}

\textbf{Figure 1: Business form tax return lodgements}

![Graph showing business form tax return lodgements from 1985 to 2008 for US.](image)


\section*{2.2 Australia}

Australia collects tax revenue from individual income tax (47 per cent of total revenue collected), corporate income tax (20 per cent), sales tax (including GST) (16 per cent), petroleum and other excise (9 per cent), superannuation (2 per cent), fringe benefits

There is tax on capital gains, but net capital gains are included in assessable income and taxed as such rather than applying a separate CGT. Australia does impose a Federal GST at 10 per cent, although the GST revenue ($48,093M for the 2011 year) is shared among the states rather than retained by the Federal government. The Australian states do not impose income tax, but do impose payroll tax, land tax and stamp duty on some transactions.

Australian tax law, like the United States version, is one integrated body of statutes that covers individuals, corporations, flow-through entities and trusts. Income tax is imposed on a worldwide basis such that an Australian resident is taxed on its income whether earned in Australia or elsewhere. Similar to the United States, the Australian taxpayer gets a credit for foreign taxes paid to the foreign country subject to limitations. Taxpayers (most often corporations) may establish a foreign corporation that will be not subject to tax in Australia until they repatriate their earnings to Australia taxpayer.

Income derived from business activities conducted by a sole trader is included in the individual’s assessable income, and taxed pursuant to their appropriate marginal tax rates, plus Medicare levy. Currently, Australia has progressive marginal tax rates with the maximum rate for individuals at 45 per cent for taxable income over $180,000.

A general partnership is subject to tax flow-through with members paying tax in accordance with their individual shares of the net partnership income or loss. Australia has adopted an imputation system for the taxation of corporations and their members. Pursuant to an imputation system the corporation is still taxed separately on its income, though resident members in receipt of franked dividends from Australian resident corporations can obtain credit for a proportional amount of income tax paid by the corporation. Franked dividends are those paid from profits.

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52 See: Treasury. (2012). Federal Budget 2011/12: Budget Paper No 3 Australia’s Federal Relations. The distribution of the GST to the states is done in accordance with the principle of horizontal fiscal equalisation (this aims to allow each state to provide the same standard of service, providing it makes the same effort to raise revenue from its own sources.), and recommendations of the Commonwealth Grants Commission.
53 The transactions that stamp duty (now known as simply ‘duty’ in many states) can be on the transfer of property (such as business assets, land, formation of partnerships/trusts, taxi licences), vehicle registration, insurance and corporate trustees. See for example: Duties Act (2001) (Qld).
54 Section 6-5 Income Tax Assessment Act (‘ITAA’) 1997 (Cth).
55 Sections 160AE to 160AFF ITAA 1936 (Cth).
56 Unless the Controlled Foreign Company (Section 316 ITAA 1936 (Cth)) or Foreign Investment Funds (Section 468 ITAA 1936 (Cth)) regimes apply.
57 Section 92 ITAA 1936 (Cth).
58 This includes corporate limited partnership (except for the tightly regulated venture capital incorporated limited partnerships: ITAA 1936 (Cth), section 94D (2)) and public unit trusts.
59 Section 207-20 ITAA 1997 (Cth).
that have borne corporation tax. Currently, the corporate tax rate in Australia is 30 per cent.60

Another popular business form in Australia is trusts, which are subject to only a partial tax flow-through system.61 This is because income can be assessed directly to members (beneficiaries), but losses are confined within the trusts themselves, and tax preferences do not always flow-through to them.62 Beneficiaries who are presently entitled to the income of the trust are taxable on their respective share of the trust's net income.63

When considering income tax returns data, of the 2,906,073 taxpayers in 2010 indicating they were conducting a business 36 per cent were sole proprietors, 27 per cent corporations, 24 per cent trusts and 13 per cent partnerships: Table 1.

<table>
<thead>
<tr>
<th>Table 1: AUS: Lodgement of Tax Returns - Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>---------------</td>
</tr>
<tr>
<td>Sole proprietor</td>
</tr>
<tr>
<td>Partnerships</td>
</tr>
<tr>
<td>Trusts</td>
</tr>
<tr>
<td>Corporations</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>


In terms of size, 99.9 per cent of sole proprietors have less than $2 million in turnover. Excluding those taxpayers who have 'nil business income', then for businesses with less

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60 Individual members in receipt of franked dividends include in their assessable income the amount of the cash dividend received and the imputed amount of the corporation's profits (often referred to as the 'gross-up' amount of the dividend). A credit is then given to the taxpayer (a 'franking credit' or 'franking rebate'); equal to the imputed amount that is then decreased from the individual's primary tax liability. If there are excess franking credits, then from 1 July 2000 certain members are eligible to a refund of this excess amount.


63 Section 97 *ITAA 1936* (Cth). In the circumstance where the beneficiary, although presently entitled, is under a legal disability, the trustee is taxable on the share of trust net income in a representative capacity. The trustee is also assessable in cases where the beneficiary is a non-resident. All net income of the trust to which no beneficiary is presently entitled initially falls within the ambit of section 99A, with the trustee liable for tax. In a limited number of cases, the Commissioner has discretion to assess the trustee under section 99.
than $10 million income: 45 per cent are sole proprietors; 28 per cent corporations; 14 per cent partnerships and 13 per cent trusts. For taxpayers with business income greater than $10 million the corporation is the most popular with 73 per cent, followed by trusts (19 per cent), partnerships (5 per cent) and sole proprietors (2 per cent): Table 2.

Table 2: AUS: Lodgement of Tax Returns - Size

<table>
<thead>
<tr>
<th>Business form</th>
<th>Loss &lt; $0 (ie not in business)</th>
<th>Micro &gt; $0 but &lt; $2M</th>
<th>Small &gt; $2M but &lt; $10M</th>
<th>Medium &gt; $10M but &lt; $100M</th>
<th>Large &gt; $100M but &lt; $250M</th>
<th>Very Large &gt; $250M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole proprietor</td>
<td>1,352</td>
<td>11,335,642</td>
<td>1,038,850</td>
<td>3,734</td>
<td>445</td>
<td>2</td>
</tr>
<tr>
<td>Partnerships</td>
<td>301</td>
<td>69,481</td>
<td>304,414</td>
<td>7,139</td>
<td>979</td>
<td>54</td>
</tr>
<tr>
<td>Trusts</td>
<td>727</td>
<td>405,871</td>
<td>271,285</td>
<td>20,281</td>
<td>3,754</td>
<td>122</td>
</tr>
<tr>
<td>Corporations</td>
<td>1,817</td>
<td>110,598</td>
<td>600,431</td>
<td>49,419</td>
<td>12,916</td>
<td>1,099</td>
</tr>
<tr>
<td>Total</td>
<td>4,251</td>
<td>11,921,592</td>
<td>2,214,980</td>
<td>80,573</td>
<td>18,094</td>
<td>1,277</td>
</tr>
</tbody>
</table>

Source: Australian Taxation Office. (2012). Taxation Statistics 2009-10: A summary of tax returns for the 2009-10 income year and other reported tax information for the 2009-10 financial year, Canberra: Australian Taxation Office, Table 1.3: Data processed up to 31 October 2011.

2.3 New Zealand

In 2010-11, New Zealand Inland Revenue collected 49 per cent of the total tax revenue from an individual income tax, corporate tax (17 per cent); GST (27 per cent); other direct taxes (6 per cent) and other indirect taxes (1 per cent).64 New Zealand imposes a GST at a rate 15 per cent.

New Zealand shares some similarities with Australia, including having a full imputation system for corporate distributions to members and a GST. A major difference between the Australian and New Zealand tax system is the absence of a broad CGT in New Zealand.

In terms of business forms, New Zealand has sole proprietors, general partnerships, special partnerships, corporations and trusts. Also, until 31 March 2011 it had a partial tax flow-through company known as the Loss Attribution Qualifying Company (‘LAQC’) which has been replaced with Look-Through Companies (‘LTCs’).65 In New Zealand Revenue. (2009). Annual Report 2011, Wellington, at 13. During 2008 – 09 income year individual income tax was 52 per cent, GST 20 per cent and corporate tax 20 per cent of the total tax revenue. The main reason for this shift is GST was increased from 12.5 per cent to 15 per cent and individual income tax rates decreased from 38 per cent to 33 per cent.

65 Commencing 1 April 2011: See: Freudenberg, above n50, at 3-216.
Zealand the corporate tax rate is 28 per cent from 1 April 2011, and the top personal marginal tax rate is 33 per cent, as is the trust tax rate.

In respect of business operations of the 1,942,000 taxpayers in 2010, sole proprietors accounted for the largest number of tax return lodgements (56.5 per cent); followed by corporations (20.3 per cent); trusts (12.2 per cent); partnerships (6 per cent), and others (4.9 per cent): Table 3.

Table 3: NZ: Lodgement of Tax Returns – 2006–2010 (,000)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole proprietor</td>
<td>1,096.0</td>
<td>1,122.5</td>
<td>1,163.4</td>
<td>1,150.2</td>
<td>1,097.9</td>
</tr>
<tr>
<td>Partnerships</td>
<td>143.5</td>
<td>137.8</td>
<td>132.2</td>
<td>125.0</td>
<td>117.1</td>
</tr>
<tr>
<td>Trusts</td>
<td>223.1</td>
<td>239.2</td>
<td>242.1</td>
<td>243.4</td>
<td>237.5</td>
</tr>
<tr>
<td>Corporations</td>
<td>340.8</td>
<td>367.6</td>
<td>393.1</td>
<td>399.6</td>
<td>394.5</td>
</tr>
<tr>
<td>Total</td>
<td>1886.0</td>
<td>1953.1</td>
<td>2020.4</td>
<td>2011.1</td>
<td>1942.0</td>
</tr>
</tbody>
</table>


Section Three

3 Overview of the surveys’ findings

The focus of this article is a comparative study of three similar surveys initially conducted in the United States and then subsequently replicated (with modification) in Australia and New Zealand. The three studies surveyed tax advisers about their perceptions about the areas of tax law which were most complex for small businesses. It should be noted that the three studies were not conducted contemporaneously, although they were conducted within the first decade of the new millennium. Also the precise questions did differ to take into account jurisdictional differences. For example while the United States has estate and gift taxes these do not exist in Australia and New Zealand.

The United States survey was conducted by Ingraham and Karlinsky who surveyed United States’ small business tax advisers about their perception of the complexity of 37 areas of tax law. These chosen areas of law were based on previous research, consultation and analysis of congressional hearings, panels on small business and professional bodies’ publications.67 89 small business advisers completed this

66 http://www.ird.govt.nz/aboutir/external-stats/tax-returns/customers-by-returns/. Of course not all trusts would be used for conducting business operations. Unfortunately, the data did not disclose the trusts’ activity.

67 Ingraham and Karlinsky, above n 29.
survey and had to rank various tax items in terms of complexity on a scale with 1 (not complex) to 5 (extremely complex). An extract of the findings of Ingraham and Karlinsky is reproduced in the Table 4. The study found great consistency in the top five complex items, as well as the least five complex items (progressive tax rates, estimated taxes, social security/self-employment taxes, corporate capital gain and cash vs accrual method).

**Table 4: US: Complexity Ranking of Small Business Tax Items**

<table>
<thead>
<tr>
<th>Ranking of complexity</th>
<th>Small business tax item</th>
<th>Average complexity score (scale 1 to 5) (5 being highest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Partnerships</td>
<td>3.4167</td>
</tr>
<tr>
<td>2.</td>
<td>Estate &amp; Gift Tax Valuation</td>
<td>3.1910</td>
</tr>
<tr>
<td>3.</td>
<td>Tax Deferred Exchanges</td>
<td>3.1058</td>
</tr>
<tr>
<td>4.</td>
<td>Frequency of Tax Law Changes</td>
<td>3.1023</td>
</tr>
<tr>
<td>5.</td>
<td>Retirement Plans</td>
<td>2.9772</td>
</tr>
<tr>
<td>6.</td>
<td>AMT-Individuals</td>
<td>2.9333</td>
</tr>
<tr>
<td>7.</td>
<td>Accumulated Earnings Tax</td>
<td>2.8539</td>
</tr>
<tr>
<td>8.</td>
<td>AMT-Corporate</td>
<td>2.7159</td>
</tr>
<tr>
<td>9.</td>
<td>Inventory (FIFO, LIFO, Unicap)</td>
<td>2.7079</td>
</tr>
<tr>
<td>10.</td>
<td>Passive Activity Losses</td>
<td>2.6897</td>
</tr>
<tr>
<td>11.</td>
<td>Constructive Ownership</td>
<td>2.5814</td>
</tr>
<tr>
<td>12.</td>
<td>S Corporation Tax Rules</td>
<td>2.5281</td>
</tr>
<tr>
<td>13.</td>
<td>Revenue Recognition</td>
<td>2.5114</td>
</tr>
<tr>
<td>14.</td>
<td>Carryover Utilization</td>
<td>2.3932</td>
</tr>
<tr>
<td>15.</td>
<td>Personal Holding Company Tax</td>
<td>2.3810</td>
</tr>
</tbody>
</table>


Later, Tran-Nam and Karlinsky repeated the United States’ study in Australia to assess what were the Australian tax advisers’ perceptions about the issues of complexity for small businesses.68 The survey contained many of the tax items in the Ingraham and Karlinsky study with modifications made to represent the Australia tax environment resulting in 35 items. An on-line survey was conducted of Australian tax advisers

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with 121 complete responses obtained. The 15 most complex items are represented in Table 5.

Table 5: AUS: Complexity Ranking of Small Business Tax Items

<table>
<thead>
<tr>
<th>Ranking of complexity</th>
<th>Small business tax item</th>
<th>Average complexity score (scale 1 to 5) (5 being highest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Non-resident trusts</td>
<td>3.60</td>
</tr>
<tr>
<td>2.</td>
<td>Frequency of tax law changes</td>
<td>3.54</td>
</tr>
<tr>
<td>3.</td>
<td>Retirement planning</td>
<td>3.51</td>
</tr>
<tr>
<td>4.</td>
<td>Small business CGT concessions</td>
<td>3.27</td>
</tr>
<tr>
<td>5.</td>
<td>Deeming provisions</td>
<td>3.23</td>
</tr>
<tr>
<td>6.</td>
<td>Franchise tax</td>
<td>3.13</td>
</tr>
<tr>
<td>7.</td>
<td>Taxable fringe benefits</td>
<td>3.12</td>
</tr>
<tr>
<td>8.</td>
<td>Capital gains/losses – Business</td>
<td>3.11</td>
</tr>
<tr>
<td>9.</td>
<td>Contractor vs. Employee status</td>
<td>2.93</td>
</tr>
<tr>
<td>10.</td>
<td>Small business entity concessions</td>
<td>2.69</td>
</tr>
<tr>
<td>11.</td>
<td>Resident trusts</td>
<td>2.69</td>
</tr>
<tr>
<td>12.</td>
<td>Tax deferral arrangements</td>
<td>2.69</td>
</tr>
<tr>
<td>13.</td>
<td>Capital gains/losses – Individual</td>
<td>2.68</td>
</tr>
<tr>
<td>14.</td>
<td>Debt vs Equity classification</td>
<td>2.66</td>
</tr>
<tr>
<td>15.</td>
<td>GST</td>
<td>2.57</td>
</tr>
</tbody>
</table>


For the Australian study the least complex items were: (a) progressive tax rates, (b) PAYG – withholding BAS; (c) Negative gearing; (d) PAYG – Instalment BAS; and (e) Revenue recognition.

More recently Gupta replicated the study in New Zealand, conducting an on-line survey of 167 tax advisers with modifications made to reflect the New Zealand tax laws and regulatory environment. Advisers had to rank 35 items as well as having the opportunity to list additional items of complexity. The 15 most complex items are detailed in Table 6. The five least complex items related to: (a) progressive tax rates (1.32); (b) work related/home office deductions (1.38); (c) depreciation rates (1.52); (d) carry forward losses (1.63); and (e) provisional tax and PAYE (1.65).
Table 6: NZ: Complexity Ranking of Small Business Tax Items

<table>
<thead>
<tr>
<th>Ranking of complexity</th>
<th>Small business tax item</th>
<th>Average complexity score (scale 1 to 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Overseas share investments and fair dividend rate method</td>
<td>3.97</td>
</tr>
<tr>
<td>2.</td>
<td>Associated persons rule – income tax</td>
<td>3.88</td>
</tr>
<tr>
<td>3.</td>
<td>Frequency of tax law changes and guidance from IRD</td>
<td>3.80</td>
</tr>
<tr>
<td>4.</td>
<td>Land regime</td>
<td>3.78</td>
</tr>
<tr>
<td>5.</td>
<td>Dispute resolution process – NOPA, NOR</td>
<td>3.69</td>
</tr>
<tr>
<td>6.</td>
<td>Non-resident trust</td>
<td>3.61</td>
</tr>
<tr>
<td>7.</td>
<td>Deeming provisions (eg dividends)</td>
<td>3.55</td>
</tr>
<tr>
<td>8.</td>
<td>Portfolio investment entity (PIE) and Portfolio investor tax rate (PIR)</td>
<td>3.53</td>
</tr>
<tr>
<td>9.</td>
<td>Use of foreign investor tax credits</td>
<td>3.37</td>
</tr>
<tr>
<td>10.</td>
<td>Associated persons rule – GST</td>
<td>3.04</td>
</tr>
<tr>
<td>11.</td>
<td>Limited liability partnership taxation</td>
<td>2.75</td>
</tr>
<tr>
<td>12.</td>
<td>Qualifying companies (QC) and Loss Attributing QC – election, revocation etc</td>
<td>2.68</td>
</tr>
<tr>
<td>13.</td>
<td>Contractor vs employee status (alienation of personal services)</td>
<td>2.63</td>
</tr>
<tr>
<td>14.</td>
<td>Management / guarantee fees</td>
<td>2.60</td>
</tr>
<tr>
<td>15.</td>
<td>GST – change of use adjustments</td>
<td>2.60</td>
</tr>
</tbody>
</table>


**Section Four**

4 Comparative analysis

When these studies are compared and contrasted it is argued that there are a number of themes that emerge through ‘commonalities’ and ‘differences’. Of course these findings and analysis are not conclusive, although it appears that some insights can be made. The themes that emerge relate to retirement planning, tax flow-through, small business concessions, stability of tax law, employee vs contractor and integrity measures. Each of these are discussed and analysed below.
4.1 Retirement Planning

Both the Australian and the United States studies found that tax advisers had perceptions that dealing with provisions concerning retirement planning were some of the most complex areas of tax law for small businesses. For example the Australian study found that ‘retirement planning’ the third most complex, and in the United States ‘retirement plans’ were the fifth most complex and the related issues of ‘estate and gift tax valuation’ was second.70

In contrast, in the New Zealand study ‘retirement planning’ was only ranked the 18th complex tax item (2.46 out of 5). This may be in part due to the New Zealand’s central retirement planning system. New Zealand had been unique in offering little or no tax concessions for additional private retirement savings.71 Kiwi Saver a voluntary, work based retirement savings scheme has been recently introduced from 1 July 2007. Kiwi Saver is intended to complement New Zealand superannuation and provide a higher standard of living than the state old age pension can alone provide.72

The impact about the complexity of retirement planning in the United States and Australia may be caused by governments push to move from government funded pensions to taxpayers being self-funded. It is argued that this has caused a ‘shift’ not only in funding but also complexity. The magnitude of this complexity is likely to increase due to the amount that is invested in self managed superannuation and retirement funds.73 For example, currently in Australia there is 373,195 self-managed superannuation funds (2009-10) and 4,498 Australian Prudential Regulated Authority funds.74 Over 99 per cent of all of these funds are small with less than $10M turnover.75 Indeed 98.3 per cent are regarded as micro with the less than $2M

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70 It is argued that ‘estate & gift tax valuation’ is tangentially related to retirement – as it can involve the gifting of assets as part of retirement and/or lowering asset holdings to minimise/reduce the exposure to estate taxes on death of the taxpayer. It appears part of the complexity involved in the United States is the ascertainment of ‘value’ of these assets.
72 From 1 April 2013 the default and minimum employee contribution rate and compulsory employer contribution rate has been increased from two per cent to three per cent. Savings are locked-in until the age of eligibility for New Zealand superannuation, currently 65 except in cases of: financial hardship, permanent emigration and serious illness. New Zealand’s superannuation is not linked through a means test to Kiwi Saver.
74 Australian Taxation Office. (2012). Taxation Statistics 2009-10: A summary of tax returns for the 2009-10 income year and other reported tax information for the 2009-10 financial year, Canberra: Australian Taxation Office, Table 1.1: Data processed up to 31 October 2011.
75 Australian Taxation Office, above n74, Table 4.2: Data processed up to 31 October 2011.
turnover. This is of concern if one considers the regressive nature of compliance costs, which has been found to exist for superannuation funds.\(^{76}\)

Both the United States\(^ {77}\) and Australian governments have established concessional tax environments to encourage self funded retirement.\(^ {78}\) For example, in Australia, there has been implemented a superannuation system that sees superannuation funds concessionally taxed at 15 per cent.\(^ {79}\) To ensure contributions to these funds there is a guarantee superannuation scheme imposed on employers, requiring them to contribute currently nine per cent (proposed to increase to 12 per cent) of employee wages. Self-employed persons\(^ {80}\) can make their own contributions to a complying superannuation which they can elect to claim a tax deduction on.\(^ {81}\) Also it is possible for spouse to assist each other to build retirement savings through splitting contributions\(^ {82}\) and obtaining offsets for contributions on-behalf of a low income spouse.\(^ {83}\) Generally, the withdrawal of money from superannuation fund can be tax free provided the relevant member is over 60, unless the superannuation fund has not be subject to tax on its earnings.\(^ {84}\)

However, with the grant of any tax concession there are inevitable ‘tax integrity’ measures to try to stem abuse. Such integrity measures are needed as governments are faced with the challenge of raising sufficient tax revenue to deal with current spending requirements – let alone those in the future. For example one mechanism used in Australia is the capping (restriction) of the annual amount that can be contributed into a superannuation fund which is eligible to receive concessional treatment,\(^ {85}\) as

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\(^{76}\) Evans C., Ritchie, K., Tran-Nam, B., and Walpole, M. (1996). *A Report into the Incremental Costs of Taxpayer Compliance*, AGPS, Canberra. This study found the average compliance cost for superannuation funds per AUD$000 of turnover in 1994-95 as: $32.08 for small (<$100,000); $1.78 for medium ($100,000 to <$10M) and $1.49 for large (> $10M).

\(^{77}\) As a background, in the United States tax if a taxpayer is an employee or self-employed, they are entitled to allocate some of their earnings (often matched by the employer) into various retirement plans and get a deduction for the pension plan contribution. When they withdraw the funds during retirement or when disabled or dead, the funds (employer contribution, deductible employee contribution and earnings on the funds) would be taxable. The exception to this rule is the Roth IRA in which the contribution is not deductible when made and the withdrawal is not income when withdrawn.

\(^{78}\) In the United States a myriad of programs and acronyms have been put in place to encourage individuals to save for retirement: Defined Benefit, Defined Contribution, 401(k), 403(b), IRA, Roth IRA, Rollover IRA, SIMPLE IRA, SEP, SRAs, ESOP, H.R. 10, cash balance plan and 457 plans. These have created significant complexity for employers and employees.

\(^{79}\) Division 295 *ITA 1997* (Cth).

\(^{80}\) Defined in section 292-160 *ITA 1997* (Cth).

\(^{81}\) Section 292-150 *ITA 1997* (Cth).

\(^{82}\) Section 290-170 *ITA 1997* (Cth).

\(^{83}\) Section 290-230 *ITA 1997* (Cth).

\(^{84}\) Section 307-215 *ITA 1997* (Cth). There are alternatives to a lump sum payments, including transition to retirement and pension payments.

\(^{85}\) For example section 292-80 *ITA 1997* (Cth) which sets the cap for non-concessional contributions.
well as provisions dealing with related party income received by the superannuation fund. The impact of integrity measures with complexity is explored further at section 4.6 of this article.

The notion that retirement planning is complex should come as no surprise when one considers the multitude of issues that can arise. In the Australian context this involves considering income tax law rules, superannuation, fringe benefits and CGT – as well as non-tax issues such as life expectancy, divorce, standard of living and investment strategies. This multitude of issues combined with the uncertainty that can be involved consequently has a level of in-built complexity and it would be naive to think otherwise.

It is argued that one reason for this complexity is due to the variety of ‘choices’ available to taxpayers and the required calculations of the potential options to ascertain which is more beneficial. For example, in the United States it is possible to postpone earned income many years and the necessary subjectivity of valuation of in specie contributions.

The complexity in the United States is compounded by the numerous integrity rules enacted by Congress including discrimination, contribution limits, minimum distribution rules and minimum participation and funding. This area is obviously a complex one for small businesses in the United States.

For many small businesses the issue of ‘retirement planning’ can be confounded as it may not occur until retirement is about to occur, which may be related to the lack of finance to fund the business operations. This is because the small business principal’s wealth can be caught-up in their business’ operations rather than retirement.

In Australia this has been recognised by the government with the introduction of small business CGT concessions that allow taxpayers on the sale of business assets the ability to reduce their capital gain by contributions to superannuation (up to a lifetime limit of $500,000). Also, there can be a total exemption from CGT for

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86 Section 295-545 ITAA 1997 (Cth).
87 The valuation issue is reflected in the numerous court cases involving the value of assets transferred to a related party as a gift or inheritance as well as the appropriate discount in the valuation. For example Estate of Marie Jensen TCM 2010-182 August 10, 2010, Also the establishment of a family limited partnership (‘FLP’) is an issue: See Estate of Samuel P. Black Jr. (133 TC 5).
88 Other integrity rules include integration with social security, cliff vesting, catch-up, qualified employee rules, loans and related hardship distributions, penalty for early distributions, prohibited transactions, automatic enrolment, synthetic equity and overall limitations.
90 In the years of operation the business may not have the ‘track record’ to satisfy creditors, nor have tangible assets which can stand as security for the loans.
91 Section 152-305 ITAA 1997 (Cth).
businesses assets held greater than 15 years;\textsuperscript{92} and for other business assets a 50 per cent reduction in gain.\textsuperscript{93} However, the complexity surrounding this area appears to be great, as the fourth most complex area perceived in the Australian survey was the small business CGT concessions (3.27). Part of this complexity can relate to tracing the concession to the member when a legal business form is used, for example in determining whether there is a ‘significant individual’ when a company or trust has been used.\textsuperscript{94} The particular issues surrounding small business tax concessions are discussed later in section 4.3.

Another underlying reason for the complexity with retirement savings could be the ‘frequency of tax law changes’ that can occur in this area. It should be recalled that ‘frequency of tax law change’ was the 2\textsuperscript{nd} most complex in Australia and 4\textsuperscript{th} in the United States. These changes can reflect governments struggling to introduce policies that address the aging population and the strains on revenue that this entails. Over the last number of years the Australian Government has changed the amounts that can go into the concessional superannuation tax environment to help address the current Federal budget deficit. Recently in the 2012 Australian Federal Budget it was announced that the maintenance of a higher superannuation contribution cap for older Australians would be deferred for two years which was only for a budget saving measure.\textsuperscript{95} This means that there is a change in the superannuation rules for a two year period.

It is argued that if the level of change is too great it may undermine taxpayers’ willingness to invest for their retirement, as in making potential long term decisions taxpayers have to consider that the rules may change. Also, this continued change of rules is adding to the complexity of the retirement system. Stability of tax laws and its impact on complexity is discussed in further detail at section 4.4. Comparatively, the New Zealand Inland Revenue Department conducted many seminars to educate tax agents about Kiwi Saver scheme and since its introduction in April 2007 no significant changes have been made to the scheme. This may be another factor contributing to New Zealand’s lower ranking of this issue.

Another reason for the level of perceived complexity by advisers could be the advisers own lack of knowledge in this area. This may be because advisers may not have sufficient or any formal training in the retirement planning area. For example it is questionable to what level accountants and lawyers’ undergraduate degrees involve looking at strategies and laws involved with retirement planning. As a matter of fact, almost no United States’ undergraduate programs have a course in this area and many masters in tax programs do not even cover this segment of the tax law. In Australia, only Bachelor of Commerce majoring in Financial Planning would have coverage

\textsuperscript{92} Section 152-105 ITAA 1997 (Cth).
\textsuperscript{93} Section 152-205 ITAA 1997 (Cth).
\textsuperscript{94} Section 152-110 ITAA 1997 (Cth).
of this area, whereas a student majoring in Accounting only require one tax course for professional accreditation. The new Tax Practitioners regime in Australia is in part addressing this, as an area of education required for registration includes superannuation tax law.

Other studies considering the retirement related issue of ‘philanthropy’, found that advisers can be lacking the ‘hard technical tax knowledge’ relevant to it. Madden and Newton found the capacity for Australian advisers to provide philanthropic advice appeared to be lacking as a large percentage of advisers thought that they were only somewhat informed at best (compared with well informed or extremely informed).

**Recommendations**

For New Zealand, this comparative analysis should serve as a warning that moves towards self-funded retirement is likely to lead to increased complexity for advisers. This is re-enforced by the fact that there is no requirement that tax agents in New Zealand to hold any tax qualification or any professional qualification. Even currently, it is suggested that New Zealand’s Kiwi Saver has too many providers which could be wasteful and should be considered by the government if New Zealand moves to more self funded retirement. It is also important that Government should get the default arrangements right.

For Australia and the United States, it is argued that there needs to be more support for tax advisers in this area. This support could include training for advisers for retirement planning issues and law, as well as moving towards having recognised specialists in retirement planning. Also, for complexity to be reduced there needs to be greater stability of tax laws relating to retirement savings (see section 4.4). Furthermore, to reduce issues around valuations (particularly in the United States) the use of accredited government valuers could reduce the potential for manipulation of valuations when in specie contributions are made.

### 4.2 Tax flow-through business forms

Another common theme that appears to emerge from the three studies is the complexity that can arise when tax flow-through applies to business forms utilised by small businesses, particularly if the business form provides some flexibility of

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96 Note CPA Australia no longer requires tax as part of the undergraduate degree.


allocating income as well as liability protection for members. The complexity relates to the introduction of flow-through companies in the United States and New Zealand, as well as the use of trusts for business operations in Australia and New Zealand. Each of these is discussed below.

The surveys revealed complexity for tax flow-through companies. A ‘tax flow-through company’ is a business form with the attributes of a corporation’s separate legal entity status and limited liability, with an aggregate (tax flow-through) treatment. Recently there has been a trend around the world adopting tax flow-through companies.\textsuperscript{100} However, the adoption of these tax transparent companies may increase complexity.

For example, when considering the United States data the most complex business form’s taxation is ‘partnerships’ – ranking first. This initially may be surprising for those not familiar with the United States’ tax system, as partnerships are generally regarded as a simple business form. In Australia the ‘taxation of partnerships’ ranked only 29\textsuperscript{th} complex out of 35 items in Australia – being the easiest business form surveyed.\textsuperscript{101}

In Australia this would tend to indicate that tax flow-through for this business structure is easier than trusts and corporations. The reasons for this could be:

- General partnerships in Australia do not provide liability protection for members;
- Partnerships are used for simpler business operations;
- Less aggressive tax planning strategies available to this business form;
- Simpler governance regime; and
- Less tax integrity measures apply to this business form.

The use of partnerships in less aggressive tax planning strategies is supported by a recent study of Queensland tax advisers which ranked general partnerships as the second lowest business form providing tax planning strategies.\textsuperscript{102} Unfortunately, no direct comparison can be made to the New Zealand study, as it did not ask about partnerships, although the study by Colmar Brunton would tend to indicate that partnerships have lower compliance costs than corporations but not individuals.\textsuperscript{103}

This is further supported by a small study by Ritchie where the general partnership

\begin{footnotesize}
\begin{enumerate}
\item Freudenberg, above n50, at 1-100.
\item Note sole traders were not directly surveyed in the Australian study.
\item Freudenberg, B. (2012). ‘Knowing the beast: to what extent do advisors understand compliance issues about business structures?’ Paper presented at the 3\textsuperscript{rd} Queensland Tax Researchers’ Symposium, James Cook University, Cairns, 29 June 2012. Partnerships ranked behind discretionary trusts, unit trusts and corporations.
\item Colmar Brunton, above n28, at 100: Table 9.6.
\end{enumerate}
\end{footnotesize}
The form had the lowest tax compliance hours compared to others utilising the corporate or LAQC form. The reason for the complexity surrounding ‘partnership’ taxation in the United States, is that in the United States Sub-Chapter K setting out the partnership tax rules not only applies to ‘general partnerships’ but also business forms with liability protection, such as: limited partnerships, LLCs, LLPs as well as those entities that avail themselves of Check-the-Box for flow-through treatment. These four latter business forms provide members with flexibility in allocating income and limited liability protection and separate legal entity status. Particularly the LLC has a number of ‘corporate’ characteristics which has seen it grown in popularity over the last fifteen years in the United States.

However, the combination of tax flow-through is not without its detriment as there are a number of integrity measures that have been introduced such as: anti-avoidance provisions; limiting the ability of the entity to borrow money to increase access to losses and requiring that allocations have ‘substantial economic effect’. This last rule is described as ‘among the most complex’ in all of the United States tax law, and are accompanied by ‘voluminous’ regulations. While the ability to make ‘special allocations’ has been stated as one of the most important tax benefits of an LLC, it appears that doing so entails increased tax compliance costs in order to satisfy the integrity rules. Also the loss restriction rules applying to allocated losses to members appears to be particularly complex.

Accordingly, it is the application of particular tax integrity rules to LLCs that could be a major contributing factor to the high complexity of ‘partnership’ taxation in the United States.

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107 Section 704 IRC 1986 (US).
109 Section 1.704-1(b)(2)(i) Treasury Regulation.
112 Refer to the discussion about the potential impact of integrity rules for complexity in section 4.6.
The touted benefit of greater flexibility of LLCs in part adds to their greater complexity. This is supported by the finding that the other flow-through entity (with liability protection for members) in the United States – S Corporations – is ranked only as the 12th complex. It is commonly accepted that S Corporations and the eligibility rules that apply to them mean that they involve less flexibility. For example, with an S Corporation, each item is allocated pro rata to members on a per membership interest per day basis. Unlike S Corporations, LLCs do not have the limitation of having one class of membership interests: this enables LLCs greater flexibility with respect to attributing specific tax attributes.

The higher complexity found in the United States and the potential link to LLCs is supported by the data in the study by DeLuca et al. This data demonstrated that general partnerships had the lowest overall tax compliance costs ($1,516) of all business forms, whereas LLCs had the highest ($2,611). This is interesting as general partnerships and LLCs are both assessed under the same rules, and therefore this difference of 72 per cent may be attributed to how the LLC’s legal characteristics (particularly limited liability) interact with tax flow-through.

Also, the complexity of transparent companies was seen in the New Zealand data, as limited partnerships (‘LPs’) and LAQCs were ranked 11th and 12th complex respectively. The complexity of the LAQC regime in particular is supported by the small study by Ritchie which details that those businesses utilising the LAQC form did have higher tax compliance hours than those using a company. However, these findings need to be noted with some caution due to the very low sample size. Also the complexity of LPs identified may be attributed to the fact that they were introduced only 18 months before the survey was conducted, so advisers were still

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113 Section 1361 IRC 1986 (US). For S Corporation status to be obtained: a) the corporation itself and its members must be United States residents, b) there must be only one class of membership interest, c) membership must not exceed 100, d) the shareholders must be individuals, estates, certain trusts and certain tax exempt organizations including ESOPs, and e) there must be a valid election for S Corporation status. How much revenue or if it is foreign or domestic is irrelevant. See: Freudenberg, above n111, at 399.

114 Of income, losses, deductions and credits.

115 Section 1377(a)(1) IRC 1986 (US).


118 Note sole proprietors were not included in the survey. It is not clear whether this data also includes time spent on the members’ tax compliance, as technically it is the members of both S Corporations and LLCs who are assessed on the income or losses of the business.

119 In comparison, members of a general partnership do not have liability protection. Note in the United States some general partnerships provide for a separate legal entity with the adoption of the Revised Uniform Partnership Act in 1994.

120 Ritchie, above n104; and Ritchie, above n21.
trying to understand and apply the new regime. A reason for LAQCs’ complexity could be their use for aggressive tax planning.\textsuperscript{121} Also the legislation of the LAQC regime was complex with a comprehensive code for the tax treatment of LAQCs, for instance particular criteria must be met before a LAQC can attribute losses to its shareholders.\textsuperscript{122} In response to concerns about LAQCs,\textsuperscript{123} from April 2011 loss attribution rules for LAQC’s have been repealed to improve fairness to tax system and Look Through Companies (‘LTCs’) with flow-through treatment were introduced.\textsuperscript{124} LTC regime ensures that income is taxed at marginal rates and limit losses claimable to economic loss.\textsuperscript{125} However, it is questionable whether the LTC regime will reduce the complexity, as the standard of legislative drafting is poor, with number of relatively common issues have been raised which could have been foreseen by some officials who had some practical experience in tax.\textsuperscript{126} In our opinion the main reason for these pitfalls is tax policy being developed using Generic Tax Policy Process (‘GTTP’) inappropriately (this is explored in more detail in section 4.4).\textsuperscript{127}

It is argued that tax flow-through applied to a business form with limited liability and separate legal entity status may impose additional tax compliance cost due to several legal and institutional factors, including the eligibility requirements for transparency, the extent of aggregation, the loss restriction rules, and the cross-jurisdictional issues.\textsuperscript{128} Considering the jurisdictions it appears that the greater flexibility available in a business form (particularly when it provides liability protection for members) necessarily leads to greater tax complexity for advisers. While this may appear obvious, it needs to be clearly articulated as there continues to be calls for greater


\textsuperscript{125} Section HB 11 \textit{ITA 2007} (NZ).


\textsuperscript{128} Freudenberg, above n50.
flexibility and choice in the United States. Without judging the merits of such calls, it is prudent for those involved (and policy advisers) to be cognitive of the factor that ‘choice’ and flexibility appears to be positively correlated with greater complexity.

Similarly, in Australia, there are continued calls for a broader implementation of flow-through companies by the resource industry, academics and small business commentators. What needs to be appreciated that the contentions that the introduction of such a form would reduce compliance costs appears to be at best questionable given the data considered in this article.

While full tax flow-through companies appears to be complex, an integrated system such as dividend imputation does not appear as complex. For example in Australia the 27th most complex item was ‘dividend imputation system’ which was 17th in New Zealand. This would indicate that an integrated system is easier for advisers to use and understand. Alternatively, it may be the concept has been relatively stable over time and that practitioners are now comfortable with the system. In our opinion the main reason for ranking imputation system higher in New Zealand (compared to Australia)

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129 The proposed 2005 amendments are in S Corporation Reform of 2005 Bill (US), which was before the House Committee on Ways and Means. If implemented, these proposed 2005 amendments would further enhance an S Corporation’s flexibility, as they would allow trusts constituting an individual’s retirement account [Proposed section 1361(c)(2)(A)(vi) IRC 1986 (US)], and non-residents to become members of an S Corporation: section 9 S Corporation Reform of 2005 Bill (US).


131 The benefit of tax transparency for the resource industry is the flow-through of losses and the depreciation of high cost machinery in the early years of operation, as well as claiming exploration expenditure which may never be recouped. Australian Institute of Mining and Metallurgy. (2006). Pre-Budget Submission 2007-08, Carlton, November 2006, at pp 6-7, Available at www.ausimm.com.au.


134 Institute of Chartered Accountants in Australia and Deloitte, above n133.
is the company tax rate changes and transitional rules. That is why we might find a correlation between those provisions that legislation changes often and complexity.

Another example of complexity with a flow-through business form is the popular use of trust for business operations in Australia and New Zealand. For example, the most complex item for the Australian study was 'non-resident trusts', which was the 6th complex in New Zealand. The reason that non-resident trusts do not feature as a complex issue in United States is that trusts are not a popular business form there. In the United States, trusts may not be used for business purposes, but are intended to protect and invest the assets entrusted to this entity by the grantor. Also, the tax rate on trusts is burdensome.\textsuperscript{135} If a trust does conduct an active trade or business, it will be treated like a partnership or a corporation.\textsuperscript{136}

In Australia discretionary trusts have increasingly been adopted as an alternative business structure,\textsuperscript{137} with small businesses accounting for the vast majority of the use of trusts, as 85 per cent of trading trusts operate within the $1 to $1 million business income range.\textsuperscript{138}

The high ranking of complexity in Australia and New Zealand of non-resident trusts might highlight the complexity that can arise with a flow-through entity, particularly when used for cross-jurisdictional activities. The reasons for the increased complexities may relate to:

- Other jurisdictions not recognising trusts;
- Asymmetrical tax treatment between jurisdictions;
- Trusts may be used for complex tax planning / minimisation strategies (i.e. aggressive tax planning); and
- Complex nature of trust law itself – particularly with the conduit nature of income and the increased complexity that arises once a tax regime is imposed in addition to this.

It was thought unusual that small business advisers would frequently be involved with non-resident trusts – their high ranking may be attributed (in part) to being 'atypical'.

\textsuperscript{135} 35 per cent on taxable income of $13,000 as opposed to a single or married couple encountering this tax rate at $370,000 in taxable income, more than 25 times higher.

\textsuperscript{136} This could change in the future in the United States due to the increase use of Statutory Business Trusts, that is trust established pursuant to a piece of legislation compared to the common law.


for advisers and thereby perceived as more complex due to lack of familiarity. This is supported by the finding that 34 of the 121 (28 per cent) Australian advisers completing the survey responded ‘don’t know/not applicable’ rather than score 1 to 5 for ‘non-resident trusts’.139

Nevertheless the complexity of trusts for Australian advisers is supported by the finding that the 11th most complex item was ‘resident trusts’,140 which may again highlight the complex nature of trust flow-through can have – particularly given the number of tax integrity measures that the Australian Government has introduced to deal with concerns about aggressive tax planning use (such as unpaid present entitlements, trust losses, 45 day holding rule, ultimate beneficiary disclosure – also the complexity in using concessions such as small business CGT concessions).

Also, currently in Australia the correct taxation of trusts and their beneficiaries is in some flux due to uncertainty created by case law (and the Government’s legislative response). For example, the ability (and correct calculation) of a trustee streaming certain types of income (such as a capital gain or franked dividend) to particular beneficiaries is unclear due to Bamford’s case141 and the resulting legislative changes.142

The data from the surveys is supported by the research by Evans et al. in terms of taxpayer compliance cost which demonstrates that greater compliance costs can be experienced when a trust structure is adopted for small businesses compared to other business forms.143 That research demonstrates that an Australian small business operating through a trust structure has on average 178 per cent greater compliance cost than one operating through a corporation, and 206 per cent greater than a general partnership.144

A reason for trusts’ complexity (and their popularity) is that trusts, especially discretionary trusts, have substantial flexibility in the distributing and splitting of income, which has seen them identified by Australian advisers as the business form with the greatest tax planning benefits.145 In part this is due to the trustee being able

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139 Although, in New Zealand only two of the 161 (1.25 per cent) advisers responded similarly.
140 This was 20th in the New Zealand study.
143 Evans, Ritchie, Tran-Nam and Walpole, above n 21: for business with turnover less than AUD$100,000.
144 Once the tax deduction for compliance cost is taken into account, businesses operating as a trust have on average 194 per cent greater compliance cost than corporations. Unfortunately, the recent study of Lignier and Evans did not provide an analysis of business structure and compliance cost: Lignier and Evans, above n27. It is understood this is in part due to the study being skewed with many respondents using the corporate structure rather than the other structures available.
145 Freudenberg, above n102.
to choose among the beneficiaries (mere objects) prescribed in the trust deed.\textsuperscript{146} In choosing which beneficiary(ies) will be presently entitled to trust income, the trustee may consider a beneficiary’s tax profile for the year to minimize the overall tax burden.\textsuperscript{147} Again, it could be argued that the more flexibility available inherently involves greater complexity.

\textbf{Recommendations}

It is questionable to what extent that a tax flow-through company is a preferable vehicle for small businesses. It may be that an integrated tax system is preferable – such as imputation. Alternatively, the tax flow-through system with not as much flexibility for example requiring one class of membership interest (such as the S Corporation) may be preferable.\textsuperscript{148} However, the eligibility requirements for such a regime have its own intrinsic complexity.\textsuperscript{149}

Even if a more ‘flexible’ alternative is mooted it is important that advisers and their clients are made aware of the complexity that can rise. This involves considering whether the potential tax savings outweigh the increased compliance costs (both monetary and psychological as well others). Also, governments should be wary of claims that tax flow-through companies as a method of taxation that will be a less complex method for small businesses.\textsuperscript{150} A problem in New Zealand is that the new tax flow-though companies of LTCs and LP are not treated identically. It is argued that it would be preferable if a standard loss distribution rule could apply to both entities. Such standardisation would help to reduce the compliance cost and overcome cryptic drafting issues in that jurisdiction.

\subsection{Small business tax concessions}

As previously canvassed, in the jurisdictions studied small businesses are considered an important component of the economies, both in terms of GDP as well as an important source of innovation and support for larger businesses.\textsuperscript{151}

Due to these reasons, as well as political popularity, governments have been quick to be seen as pro-active in supporting the small business sector. The introduction of tax

\textsuperscript{146} The general basis of taxation of a discretionary trust and its members is found in Division 6 of Part III of the \textsl{ITAA 1936} (Cth). The number of beneficiaries prescribed can be very broad and need not be static, as beneficiaries could be introduced through birth, marriages and the purchase of membership inertest in other entities. For example a trust deed could provide that ‘beneficiaries include Cooper and any corporations that Cooper holds membership interest in.’

\textsuperscript{147} For example the level of income, availability of losses (revenue or capital in nature). Distributions to individuals less than 18 years of age can be restricted due to the penal rates that apply pursuant to Division 6AA \textsl{ITAA 1936} (Cth). To facilitate accessing the low 30 per cent rate applying to corporations, a corporation may be a potential beneficiary.

\textsuperscript{148} See arguments raised in: Freudenberg, above n50.

\textsuperscript{149} See: Freudenberg, above n111.

\textsuperscript{150} Institute of Chartered Accountants in Australia and Deloitte, above n133.

\textsuperscript{151} Karlinsky, above n1.
concessions is considered as a highly visible way to be seen to be doing something. However, it appears that a perverse and adverse consequence of special rules for small businesses is the greater complexity that this can entail for small business advisers. Part of this problem is that small businesses are heterogeneous, and it can be misleading to represent them as anything else.\textsuperscript{152} Also restrictions and integrity measure that ‘fence-in’ these provisions could add to the complexity.\textsuperscript{153}

For example in the Australian survey the 4\textsuperscript{th} most complex item was ‘Small business CGT Concessions’\textsuperscript{154} and the 10\textsuperscript{th} was ‘small business entity concessions’.\textsuperscript{155} This complexity may relate to arguments that they are ‘ill-conceived’\textsuperscript{156} and have struggled with aims to reduce complexity for small businesses.\textsuperscript{157} The CGT concessions are seen as being very generous as they have the potential to reduce a large taxable capital gain to nil. However, it appears this comes with the price of increased complexity. Marsden et al. study noted that the small business CGT concessions have increased compliance costs.\textsuperscript{158} This is supported by the recent findings of Lignier and Evans as 33 per cent of respondents agreed or strongly agreed that the small business tax concessions are ‘so complex it is hardly worth the effort’.\textsuperscript{159} However, specific responses to the CGT concessions were ambiguous as 81.4 per cent of participants responded that they ‘unsure/not applicable/not relevant’ about their complexity, with only 15.7 per cent thinking they were moderately or very complex.\textsuperscript{160} This may be due to apparent confusion about the small business concessions generally, which of itself indicates a level of complexity about eligibility or not.\textsuperscript{161} Also, it may back-up the original claims by Ingraham and Karlinsky that tax advisers are best positioned to give insights to areas of tax complexity rather than business owners themselves.\textsuperscript{162}

In the United States’ survey there are few small business concessions specifically listed in the survey, although the S Corporation provisions (which ranked 12\textsuperscript{th} complex)

\textsuperscript{152} Holmes and Gibson, above n11, at 8. For example there can be different levels of member activity, ranging from a single-member coffee shop to a-ten member publicity firm or a 100 member accounting firm: Hillman, R.W. (1992). Limited Liability and Externalization of Risk: A Comment on the Death of Partnership. \textit{Washington University Law Quarterly} 70:477, at 485.

\textsuperscript{153} The impact of integrity measures on complexity is developed further in section 4.7 of this article.

\textsuperscript{154} Division 152 of \textit{ITAA} 1997 (Cth).

\textsuperscript{155} Division 328 of \textit{ITAA} 1997 (Cth), relating to depreciation and trading stock rules. Previously known as ‘STS’.


\textsuperscript{157} Institute of Chartered Accountants in Australia and Deloitte, n 133, at 11.


\textsuperscript{159} Lignier and Evans, above n27, at 5-28.

\textsuperscript{160} Lignier and Evans, above n27, at 5-29.

\textsuperscript{161} Lignier and Evans, above n27, at 5-27.

\textsuperscript{162} Ingraham and Karlinsky, above n 29.
and the LLC tax treatment are commonly touted as concessions for small business operators to relieve them of the level of taxes otherwise imposed under Sub-Chapter C.\textsuperscript{163} Note since the United States’ survey specific small business concessions have been enacted.\textsuperscript{164}

In New Zealand, the ‘small business entity concessions’ was ranked one of the least complex items, being 23\textsuperscript{rd} out of 35 (1.97). Part of the reason for the simplicity of this may be that the New Zealand provisions are not generous and just include simplified trading stock rules, simplified depreciation rules and GST accounting and reporting concessions. Given that New Zealand does not have a comprehensive CGT, the CGT concessions are not required like Australia.

What this may demonstrate is that while generous concessions for small business may be politically popular, they ironically may be counter intuitive and add to the complexity of the tax system for the sector that they are suppose to assist.

**Recommendations**

Rather than specific concessions, it may be preferable to have broader simplified tax rules applying to all business taxpayers regardless of size. Given the regressive nature of compliance costs for small businesses, it is argued that carve outs for small businesses may add undue complexity to advisers and it may be that the tax system (and its administration) would be better served by removing such concessions with the aim of reducing the complexity of the tax system overall. Also there are arguments that such concessions have negative ‘threshold effects’ where small business may try to preserve being small to be able to take advantage of the concessions rather than grow.\textsuperscript{165} The removal of these concessions could be compensated by reducing the applicable tax rate applying to business/capital income, especially at the lower end of the income spectrum. Such recommendations would appear to be supported by the findings of Lignier and Evans, with 48.8 per cent of respondents agreeing or strongly agreeing that the small business tax concessions are a ‘waste of time; would be better off with lower taxes and simpler tax regime’.\textsuperscript{166} Another way to look at this issue would be to make the tax rates more progressive on a broader base.

What may be more beneficial then tax concessions is ‘affordable’ professional advice for small business operators. For example, in a survey of the arts industry which can


\textsuperscript{164} In the United States there are concessions for small business which the new tax law enacted in December 2010 exempting 100 per cent of gains from small business membership interest but only for membership interests investments held more than five years and acquired between a certain short time frame: Section 1202 IRC 1986 (US).


\textsuperscript{166} Lignier and Evans, above n27, at 5-28.
involves many small businesses, one-quarter of respondents supported the statement that “I wish I had more money to seek professional advice”. When the income levels were taken into account those artists earning less than $50,000 in artistic income were desirous of more money to seek professional advice (40 per cent) compared to those artists earning more (13 per cent). This would tend to indicate that the level of income is indicative of being able to seek professional tax advice, especially for micro businesses. The importance of professional advice is particularly important as very small businesses may be more inclined to access free or informal tax advice from friends and family. In New Zealand owners, partners, directors and/or trustees spend on average 55.0 hours a year on tax compliance, paid employees 18.3 hours and unpaid family and friends spend 2.8 hours.

It is argued that if correct advice can be sought early then many problems may be averted (which can save on the cumulative effect of poor decision making early on). However, the timing of this professional advice is problematic – particularly given that many small businesses may exit or cease after a few years. It may be more beneficial to have concessional professional advice at the end of the second year of the business’ operation (an intervention) where a tax rebate is provided to small business operator to seek professional advice. As a rebate this would cover the cost dollar-for-dollar and could be capped at $10,000 over two years. This may be a better tax expenditure rather than poorly designed small business tax concessions. Such a concession could possibly address arguments that small business concessions should be framed around a ‘life cycle model’.

4.4 Stability of tax laws/regulations

One of the strongest similarities between all three studies is the high ranking of ‘frequency of tax law changes’ as increasing complexity for advisers: the United States 4th, Australia 2nd and 4th for New Zealand. This is supported by the findings that the more ‘mechanical’ provisions and frequently used tax provisions are less complex for advisers. For example with the Australian study, the less complex items included the ‘progressive tax rates’, ‘PAYG withholding BAS’, ‘PAYG withholding instalment BAS’, and ‘depreciation’.

167 Approximately two-thirds of the advisers participating in the survey gave advice to small and medium artistic businesses.
168 Freudenberg, B. (2011). ‘Change for Change’s sake: are tax reforms required to assist the Australian arts sector?’ Cultural Trends 20(1): 85-106, at 91. Similarly 25 per cent of advisers surveyed thought that their clients would agree that they wished they had more money to seek professional advice.
169 Freudenberg, above n168, Table 15.
170 Freudenberg, above n168, at pp 96-97.
171 Freudenberg, above n168.
172 Inland Revenue, above n28, at 26.
This would tend to indicate that changes to the tax system do add to complexity for advisers. This can be due to having to learn new rules and consider how they potentially apply to an array of clients. Also it may be that many of the advisers themselves are small (and medium) businesses, and therefore the comments in respect of complexity and how it is difficult to keep up-to-date similarly apply to their own practices.

Given the move to self assessment, jurisdictions are relying more and more on advisers to support and assist taxpayers to meet their tax obligations. For example, in Australia over 80 per cent of taxpayers use a tax agent to assist them with preparing their tax returns. In the United States 80 per cent to 90 per cent of businesses have their tax returns prepared by professionals. In New Zealand at least 72 per cent of business returns were lodge through tax agents.

Tax law changes would be difficult for advisers who already have heavy workloads with little capacity to undertake further study. While maintaining up-date-knowledge (ongoing professional development) is a characteristic of many professional bodies, this can be exacerbated by the transition rules often embodied in new law changes as well as applying old rules and then the new laws.

The problem with this ‘change’ is that it is not only attributed to the government introducing new legislative provisions, but also is influenced by new court decisions that may change/clarify/adjust previously accepted practices. Also, the uncertainty surrounding change can be compounded by the governments announcing ‘proposed’ tax changes which can take months or years for actual implementation. This is further compounded by the factor that the legislation that is eventually passed by Parliament/Congress can differ (sometime significantly) from that originally proposed. This is problematic if the amendments apply retrospectively to the original ‘announcement’ date of the proposal. Accordingly, this highlights the importance of the process of legislative reform can have on complexity.

While New Zealand has on paper a sophisticated consultative process set out for the development and enactment of tax policy as part of its GTPP, it is not always implemented in a meaningful way. For example, New Zealand Inland Revenue Policy Division’s failure to follow GTPP while drafting LTC provisions resulted in lot of difficulties for tax practitioners.

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174 Australian Taxation Office, above n74.
175 http://www.ird.govt.nz/aboutir/external-stats/ This is because tax agents can file returns using efiling, online filing and paper based filing. Taxpayers themselves cannot use efiling system. In New Zealand 72 per cent business returns were efiled during 2011. Some agents may have filed business returns using online filing and paper base filing.
176 For example the new Tax Agents Regime in Australia requires: Tax Agent Services Act 2009, section 30-10.
Another source of ‘change’ is practices by the revenue authorities such as Internal Revenue Service (US), the Australian Taxation Office and the Inland Revenue (NZ). While not strictly ‘law’ these practice rulings do influence compliance because it highlights to advisers (and their clients) the position of the relevant revenue authority and the likelihood of adverse audit outcomes.

Another concern with compliance costs for closely held businesses is that regulations are likely to be dealt with by the principal decision maker of the business, which can distract the person from the decision maker’s core role. In this regard it is important to appreciate that these figures do not capture the lost opportunities and disincentive effects created by the compliance burdens. Furthermore, the complexity of the tax legislation may cause inadvertent non compliance. Also, the application of other regulations can increase overall compliance cost burden, such as employment issues, superannuation, occupation health and safety, and workplace relations legislation.

Note in this way the survey findings may be biased in that items may be given a higher complexity ranking when the item has only recently been legislated or if it is atypical for the adviser.

**Recommendations**

It is understandable that amendments apply from the announcement date to restrict the ability for taxpayers to alter their circumstances to circumvent the new law. However, given the notion that legislation should be prospective and it would be preferable from a complexity point of view that the start date should be from when the legislation has been actually enacted. This allows advisers time to learn and understand the enacted laws and how they might apply to their clients, rather than ‘learning on the run’ – particularly when what you are learning is a ‘moving feast’ due to changes between proposal announcement and enactment.

Also, this highlights to policy makers the importance of well thought out tax provisions and not acting too fast or premature with the introduction of provisions. The stability of tax laws is important to establish or reduce complexity. Thus in the United States, where it is not uncommon to have one or two fairly major tax law legislations per year, further complexity is engendered.

Dirkis and Bondfield argue that New Zealand’s GTPP would require consultation, and early consultation, on a proposal to adopt ‘coherent principles drafting’. In their view ‘coherent principles drafting’ represents a potential impact on the tax system that is greater than any rewrite. A transparent and accountable culture enables it to

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180 Board of Taxation, above n23, at pp 105 – 108.

181 Dirkis and Bondfield, above n127.
operate effectively.\footnote{Dirkis and Bondfield, above n127} For example, widespread consultation and extensive reporting to government, during the period of the Tax Working Group, set up by Victoria University of Wellington in 2009 resulted in a series of recommended options for major tax policy reform\footnote{Tax Working Group. (2010). \textit{A Tax System for New Zealand's Future Report of the Victoria University of Wellington Tax Working Group}, Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, (January).} and many of the recommended reforms were included in New Zealand Budget 2010.

However Sawyer takes a different view of the utility of GTPP when he states:\footnote{Sawyer (1996), above n127.}

\begin{quote}
[i]s merely a mechanism for dealing with policy changes. The GTPP does not, and indeed cannot, influence directly the policy decisions initiated as part of the rewrite process in New Zealand as this comes within the bounds of the overall rewrite project which has as its focus improving understandability and readability without changing the law.
\end{quote}

In commenting on the survival of GTPP in a changing political climate and the support it continues to receive from tax practitioners and policy makers Sawyer opined:\footnote{Sawyer (2011), above n127.}

\begin{quote}
... the lack of legislative backing is both a weakness and strength of the GTPP – it enables it to be easily avoided but at the same time removes much of any politicisation that formal regulation may engender.
\end{quote}

Sawyer recognises the practical difficulties of the GTPP as the significant consultation places pressure on a small group of skilled and directly-affected policy officials and business community representatives.\footnote{Sawyer (2011), above n127.} Nevertheless, it is recommended that greater consultation should occur prior to announcing legislation. This should help to remedy defects or highlight problems prior to enactment and retrospective changes to fix problems (or unintended consequences).

Also given the important role that advisers play in supporting the tax system, particularly with self-assessment system (where advisers sometimes complain about being unpaid workers/tax collectors) the government should give serious consideration to organising or funding tax training programs to allow advisers to attend for free tax updates.\footnote{Note the Australian Tax Office does this to some extent already.} This could be facilitated through grants to professional bodies, such as the CPA or the Tax Institute, which could organise more focused/tailored seminars for their members. We suggest this would be money well spent by the government, as it would lead to improved compliance (and less audit activity). It would assist small business advisers who may have limited financial capacity to pay for additional training.
Another issue that arises in the jurisdictions for advisers is the distinction between ‘employee’ and ‘contractor’, although with varying degrees of perceived complexity. It is important to consider that some of this complexity may not be due to only the tax rules but also the underlying employment law operating in each jurisdiction. This is because the legal distinction between whether someone is an employee or contractor may influence legal responsibility for actions, as well as additional employment taxes and charges (such as payroll tax, superannuation contributions and insurance premiums).

The findings by Freedman and Godwin in their study in the United Kingdom about why firms chose to incorporate may help to illuminate this issue. They found that there was a group of dissatisfied businesses that had incorporated due to the pressure from agencies or businesses that they generally contracted with. The reason for this enforced incorporation was in part due to avoid labour [tax] costs and the shifting of risk (such as sickness and injury) and the ease to terminate contract on short notice.

For the United States’ study the distinction was ranked very low on the complexity scale (26th: 2.0337). The reason for this is probably due to a long standing provision of the tax law, allowing a safe harbour if industry standard and filing of information returns is done. In these circumstances the contractor status will not be challenged. This appears to have worked relatively well, as shown by its low complexity rating compared to the other two jurisdictions. This has been supplemented by a recent amnesty to those that may not meet the criteria in a Voluntary Classification Settlement Program.

However, for the other two countries the distinction between employee and contractor was ranked relatively high on the complexity scale: Australia (9th most complex item: 2.93) and New Zealand (13th most complex item: 2.63). This may be due to two reasons. Firstly it may apply to the role of a small business person working for a larger company (‘sub-contracting’). Secondly, it may apply to small businesses that hire workers and their proper classification as either employee or contractor. Each of these is considered below.

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188 An employee is defined in section 6 of the New Zealand Employment Relations Act 2000 (ERA 2000). Under s6(1) an: “employee ... means any person of any age employed by an employer to do any work for hire or reward under a contract of service ...”. Section 5 of the ERA states that an “employment agreement means a contract of service”. The term contract of service is taken from the common law and is used to distinguish the status of an employee from other types of ‘worker’.

189 Board of Taxation, above n23.


191 Freedman and Godwin, above n190, at 122.

192 Section 530 1978 Tax Act (US).

Sub-contracting is reflective of that many small businesses are member-managed – that is they are independently owned and operated, with most, if not all, capital contributed by members and managers. Indeed; many small businesses do not actually employ anyone apart from the principal and have little aspiration for growth. For example in Australia, about 60 per cent and in New Zealand 69 per cent of businesses do not employ any staff. With single operations it may be hard to distinguish the business form from the member-manager, and it may be that there is only one major client. Consequently, ascertaining whether someone is an employee or contractor can be problematic. The distinction between an employee versus a contractor can have important legal and tax consequences. In terms of tax there can be advantages of being an employee or contractor depending upon the jurisdiction.

In Australia and New Zealand, there is differing tax treatment applying to self-employed persons compared to employee-members. For example, the status of being an employee for an active member can be beneficial as it may increase access to concessationally taxed fringe benefits and preferable superannuation treatment. However, wages paid to an active member could be subject to payroll taxes levied by the various Australian states and territories, whereas the allocation of profits would not be. Overall, then, the status as an ‘employee’ for active members can be beneficial and the Australian government considers some practices to achieve this status as

194 In Australia, it is estimated that 70 per cent of small and medium enterprises are ‘traditional’, following a low growth path, with few if any growth aspirations, and exist principally to provide their members with a source of employment: Australian Chamber of Commerce and Industry. (2003). Evaluation of Small Business Assistance Programs: ACCI Submissions to the Office of Small Business, Barton, at 6: Senate Report on Small Business Employment [Employment, Workplace Relations and Education References Committee, Small Business Employment, February 2003].
196 For example in the United States receiving wages as an employee in addition to be subject to income tax would be subject to social security taxes (employment taxes), which amount up to an additional 15.3 per cent of gross salary. Such as employment taxes, federal social-security taxes (FICA), medicare taxes, interest and penalties. IRC 1986 (US), sections 1401 and 3101 impose self-employment tax on an individual’s net earnings from self-employment. In 2011, the self-employment tax and combined social security tax rate was 12.4 per cent on earnings up to $106,800, and 2.9 per cent on all earnings for hospital insurance. Whereas business income earn as a contractor is subject to this rate of tax but on net income, that is after all expenses are deducted which may be a small profit or even a loss.
197 Employers in New Zealand pay fringe benefit tax for the benefits provided to employees, contribute to Kiwi Saver, ACC but employment related expenses are not deductible. Contractors can claim deductions for expenditure incurred in deriving income but they have to pay ACC, register for GST, pay provisional tax.
198 However, this is subject to many qualifications and legislative changes. For example commencing 1 July 2007, a self-employed person can now claim a 100 per cent deduction on contributions made to a qualifying superannuation fund. ITAA 1997 (Cth), section 290-170.
199 Including fringe benefits and superannuation.
200 However, this payroll tax can be mitigated through the manipulation of the wage level paid to active members.
abusive. For example, the Australian government introduced Personal Services Business provisions, which restrict the extent that the benefits can be obtained.\textsuperscript{201} Also there have been introduced caps on the extent of salary packaging allowed for employees of tax-exempt employers. However, for the head contractor it can be beneficial for them if a worker is regarded a contractor as opposed to an employee. For the small businesses the head contractor may force small business operators to a ‘contractor’ relationship rather than ‘employee’ as illustrated by the Freedman and Godwin study.\textsuperscript{202} The effectiveness of such pseudo ‘contractor’ relationship has been called into question by a number of cases.\textsuperscript{203}

**Recommendations**

It is argued that it would be preferable if some certainty could be provided in this area to enable a clear distinction between employee and contractor. With modern working environments it is acknowledge that this is in no means easy. Given the results in the United States an option that may be viable is for safe harbour provisions to allow for the election for employee status when certain criteria exist. Also, greater consistency for the different laws (and taxes) that rely on this distinction would assist businesses, although this would require cooperation in Australia between the state and Federal governments.

4.6 Integrity provisions (Incl. losses)

In prior discussions it has been highlighted how integrity provisions may be contributing to increased complexity in the tax system (such as section 4.1 Retirement Planning; 4.2 Tax flow-through companies; 4.3 Small business tax concessions and 4.5 Employee vs contractor). Governments are concerned with the protection of the tax revenue base from aggressive tax planning. In an attempt to reduce this potential, governments have introduced integrity measures (avoidance measures). Sometimes the need for these arise because asymmetric tax treatment between different transaction types or business forms. However, these integrity measures contribute to the overall complexity of the tax systems reflected in the survey findings: Table 7

\textsuperscript{201} Division 84 to 87, ITAA 1997 (Cth). The operation of these provisions restrict taxpayer’s ability to shelter personal services income in an entity taxed at a lower rate, to split income among a number of taxpayers, and the ability to access concessional fringe benefits and superannuation provided to employee-members. ITAA 1997 (Cth), section 86-15. The personal services income provisions are contained in Division 84, 85 and 86. It appears that if these provisions do apply then it is possible for losses to be allocated to the personal services provider. While section 86-20(1) provides it is not possible for deductions to be allocated in excess of income amounts, section 86-27 subsequently provides excess deductions can be allowed. In New Zealand personal services income rules are contained in sections CA 1(1), CE 1 and CB 1 of NZ Income Tax Act 2007 (NZ).

\textsuperscript{202} Freedman and Godwin, above n190.

\textsuperscript{203} For example: On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation (No 3) [2011] FCA 366 (13 April 2011).
Table 7: Integrity measures identified in surveys

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<thead>
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<th>Rank</th>
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<th>Australian study</th>
<th>New Zealand study</th>
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<td>6th</td>
<td>AMT – Individuals</td>
<td>8th</td>
<td>capital gain/losses – business</td>
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<td>Accumulated earnings tax</td>
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<td>debt/equity classification</td>
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<td>8th</td>
<td>AMT – corporations</td>
<td>19th</td>
<td>non-commercial losses</td>
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<td>Passive activity losses</td>
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<td>11th</td>
<td>Constructive ownership</td>
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**Recommendations**

Given the acknowledged regressive nature of compliance costs for small businesses, it is important that policy makers are mindful that the introduction of such integrity provisions could adversely increase compliance cost for small businesses. This may require considering who are the provisions really aimed at and consider whether they necessarily need to apply to small businesses.

Currently, there is a practice to draft integrity measures broadly and then provide some small carve out. While this is in part understandable to try to protect tax revenue, it can have the unintended consequences of increasing compliance costs for all (and sometimes trapping the unwary). If studies are correct that a large percentage of taxpayers do want to comply with the tax law, then it calls into question the necessity for blanket integrity measures rather than specific. One possibility could be a standard carve out for small businesses from these integrity measures. Alternatively, governments should strive for greater tax neutrality in the tax system to remove the incentives for tax arbitrages.

**Section Five**

5 Limitations and future research

It is impossible for the comparative analysis conducted in this paper to be exhaustive, as this would require an analysis of an extensive number of jurisdictions. Instead, the scope has been to make a comparative study that is extensive enough to identify...
general similarities and differences from an international perspective in relevant legal areas. Survey questions in the three surveys were not identical due to differences in the tax laws of the three countries. To overcome this problem we have focused our analysis on complexity of those items which are similar in the three countries. In all the jurisdictions studied there is also a difference in the educational requirement to register as a tax agent which could have an impact on their perception of complexity of different items. In contrast to Australia, there is no requirement in New Zealand that tax agent should hold any tax qualification or any professional qualification.

It should be noted that while the three surveys were all done in the same decade, they were not conducted contemporaneously. Nonetheless, there is nothing to the authors' knowledge that suggests that intervening events occurred to greatly affect the results between the studies. With the themes discussed, hopefully this article has provided some initial foundations that subsequent studies can test and explore.

Future research could consider if advisers make mistakes in the most complex areas (compared to the simple areas). Also, research could explore what are the attributes underlying the complex areas – what is the reason that makes the provision so complex? Also, an area of potential behavioural interest would be to study if people would be willing to pay a little more in taxes for less complexity.

In all the jurisdictions studied, it would be beneficial if there were comprehensive compliance cost studies considering tax flow-through, integration and entity tax approaches. Such a study should consider if there is a relationship with these different taxing methodologies and a business form's characteristics, particularly limited liability. These studies should distinguish between governance and tax compliance costs, as well as identifying industry and size. From such a study, more informed conclusions could be drawn about the precise factors that influence compliance cost and its relationship with tax flow-through.

Also future research could survey business owners about their perceptions of complexity and compare how these relate to advisers' opinions. As it might be that advisers' ideas of complexity might not relate to the time which small businesses actually deal with tax laws.

Another fruitful area for further research could be how taxpayers manipulate their status between employee and contractor under different tax law regimes.

It would be better to ascertain advisers' level of familiarity with provisions and whether this relates to the perceived complexity of the provision. It may be that the less familiar a tax adviser is with an area the more complex they consider the area. Similarly, how long the tax provision has been in the law, relatively unchanged, may be worthy of study as to perceptions of complexity.

Also, it would be worthwhile to ascertain whether the aggressive tax planning strategies by taxpayers was directly related to the complexity of their situation. In that the simpler the tax structure the less complexity involved and vies-a-versa.

204 In contrast to Australia, there is no requirement in New Zealand that tax agent should hold any tax qualification or any professional qualification.
Section Six

6 Conclusion

The imposition of taxation on businesses is very important and has flow-on affects in society more generally. In particular, taxes imposed on businesses can influence market allocations of resources.205

This article has sought to ascertain what are some of the similarities and differences of the perception of tax complexity facing small business advisers in the United States, Australia and New Zealand. The article initially provided an overview of the tax systems in the jurisdictions and then outlined the surveys conducted. The article then using a comparative framework analysed the themes of retirement planning, tax flow-through, small business tax concessions, stability of tax laws, employee vs contractor and integrity measures. In this analysis a number of recommendations were proposed to try to reduce the complexity of the tax systems in each of the jurisdictions.

In terms of retirement planning it appears in the countries that have a greater push for self-funded retirement (the United States and Australia) has led to greater tax compliance costs than New Zealand with greater central planning. The underlying reasons for such increased complexity may relate to the frequency of changes to the tax laws this area, the integrity measures to ensure that the tax concessions provided are not abused, the uncertainty of the many facets that need to be considered, the variety of choices available and advisers own lack of specific knowledge and skill in this specialised area. Principle recommendations included greater stability of the law in this area and the education of advisers.

The choice of business form for a small business can be an important choice that has ongoing legal and tax implications. It appears that tax flow-through forms (especially those with limited liability) may lead to greater tax compliance costs. This in part may be due to the tax planning strategies offered by such vehicles. It was recommended that governments should be wary of lobbyist calling for greater availability of tax flow-through companies, especially when such calls are based on reduced compliance costs. Also, if implemented constraints should be introduced to reduce the possible flexibility and tax arbitrage potential.

While governments may be eager to be seen as assisting small business through the introduction of tax concessions, it may be that such concessions (and their accompanying integrity measures) may raise compliance costs. This is especially the case if the measures have the potential to substantially reduce tax liabilities. It was argued that rather than a carve out for small businesses it may be preferable to reduce the complexity of the overall system and the tax rate applying to business profits.

205 Harris, above n19, at 8.
One of the strongest similarities between all of the three jurisdictions was the high ranking of ‘frequency of tax changes’ as increasing tax compliance costs. Such changes can be hard for businesses to stay abreast of, as well as their advisers. It was recommended that stability of tax laws is critical, which requires well thought out tax provisions as well as the reduction of retrospective legislation.

The fifth issue that raised complexity in two of the jurisdictions particularly (Australia and New Zealand) was the distinction between employee and contractor. Given the low rating of this factor in the United States, it appears that providing of safe harbour provisions to give greater clarification and certainty may assist small businesses to reduce their tax compliance cost in this area.

A final similarity gauged from the surveys was the way integrity measures can be some of the most complex faced by small business advisers. It was recommended that policy makers need to be more acutely aware of the adverse implications that integrity provisions may have on this sector. This is particularly the case if the integrity measures are more to do with the practices of larger firms but they still apply to small businesses.

It is argued that it is important to consider the salient factors confronting this important part the economy, as unnecessary compliance with the tax system may be hindering the economic development of the jurisdictions. It is also hoped that government tax policy makers can learn from each other and reduce system complexity. It is through such comparative analysis that jurisdictions learn from each other to strive for a tax system with less complexity.