Session One:

Tax Systems and Taxpayer Behavior

2009 IRS Research Conference

Measuring the Impact of Tax Systems on Economic Behavior Using New Cross-Country Data

Leslie Robinson, Tuck School of Business at Dartmouth
Joel Slemrod, University of Michigan

2009 IRS Research Conference

Motivation

- Tax systems are multi-dimensional; e.g., rates and bases as stated may, or may not be, well administered and enforced.
- Existing cross-country studies of the impact of tax systems on behavior use measures of tax rates, and (sometimes) recognize the importance of administration and enforcement using rough proxies.
- Leaving out important aspects of tax systems may bias estimated partial effects of tax rates, and/or miss entirely the effects of other tax system features.

Overview

- We construct 38 measures of tax system aspects for 44 countries based on OECD (2006) and in this paper we examine 10 measures in 1 important context.
- We analyze the relation between new and existing proxies for tax administration and enforcement.
- We re-examine the tax system as a determinant of the size of the informal economy (in the process we search for exogenous variation in our measures).

Existing Measures

Economics Literature

- Tax rates are negatively associated with unofficial activity, while the tax burden is positively associated; WEF SURVEY (Johnson et al -AER 1998)

- Tax rates are not associated with unofficial activity after controlling for better-run administrations; GDP and LEGAL INDEX (Friedman et al -JPE 2000)

- Tax rates are positively associated with unofficial activity, while tax enforcement is negatively associated; SEIGNIORAGE and LEGAL INDEX (Ihrig and Moe -JDE 2001 -AEJ 2004)

Existing Measures

Economics Literature

- Tax administration has a positive association with the number of new business registrations; TAX PAYMENTS AND HOURS Djankov et al. (working paper, 2008)

- Tax rates have a negative association with self-employment when tax enforcement is strong and no association when tax enforcement is weak; CORRUPTION INDEX (Torrini -LE 2005)

Existing Measures

Finance and Accounting Literature

- Tax enforcement has spillover effects on corporate governance; WEF SURVEY (Dyck and Zingales -JF 2004)
- Governance (but not tax enforcement) affects the relation between corporate tax rates and corporate tax revenues; WEF SURVEY (Desai et al. -JFE 2007)
- Tax enforcement constrains earnings management; WEF /IMD SURVEY (Haw et al. -JAR 2004, Wysocki -JAR 2004)

New Measures (OECD, 2006)

Table 1

1. **Use of Withholding**
   - for 6 payment types
2. **Tax System (for individuals)**
   - 4 classifications
3. **Collect Power**
   - out of 15 types of powers
4. **Maximum Penalty**
   - for failure to correctly report tax liability
5. **Administrator Coverage**
   - revenue agent per 1,000 workers
6. **Use of Reporting**
   - **for 7 payment types**
7. **Self-Assessment**
   - **who computes tax liability?**
8. **Use of Matching**
   - **for 6 payment types**
9. **Bank Access**
   - **strength of back secrecy laws and revenue agents' ability to overcome them**
10. **Verification Power**
    - **search and seizure powers**

Correlations

Table 2 (top)

	Per Capita Income
	1
Per Capita Income	1.0000
Tax Hours	**-0.5371**
Tax Payments	**-0.4371**
Corruption	**0.8154**
Bribery	**0.7543**
Law and Order	**0.7399**
Seigniorage to GDP	**-0.5827**
Seigniorage	**-0.7281**
Tax Compliance	**0.5944**
Tax Burden	0.2682

Correlations

Table 2 (bottom)

	Per Capita Income	*Tax Hours*	*Tax Payments*	*Corruption*	*Bribery*	*Law and Order*	*Seigniorage to GDP*	*Seigniorage*	*Tax Compliane*	*Tax Burden*
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Per Capita Income	1.0000	**(0.5371)**	**(0.4371)**	**0.8154**	**0.7543**	**0.7399**	**(0.5827)**	**(0.7281)**	**0.5944**	0.2682
Use of Withholding	**(0.4399)**	**0.4317**	0.2278	**(0.5533)**	**(0.4796)**	**(0.3090)**	**0.3258**	**0.5713**	**(0.4351)**	(0.0654)
Administrator Coverage	**0.3078**	**(0.3174)**	(0.1245)	**0.2642**	0.2505	**0.4718**	**(0.3198)**	**(0.6254)**	0.0358	0.0886
Tax to GDP	**0.4902**	**-0.3114**	**-0.3161**	**0.4268**	**0.4112**	**0.4519**	**-0.3634**	**-0.5586**	-0.0075	-0.2133
Self Assessment	**-0.2851**	**0.2833**	0.0205	**-0.4015**	**-0.2907**	**-0.3010**	**0.3845**	**0.3532**	-0.0622	-0.1618
System1	**-0.3466**	**0.3305**	0.0255	**-0.3965**	**-0.2651**	**-0.2699**	0.1374	0.2001	-0.1856	0.0140
System2	0.0198	-0.0062	0.1208	-0.0415	-0.1388	0.0150	0.1137	0.1240	-0.0641	-0.1727
System3	**0.3365**	**-0.2653**	-0.1752	**0.4364**	**0.4111**	**0.3414**	-0.2188	**-0.3677**	0.0996	0.0177
System4	0.1869	**-0.2626**	-0.0110	**0.2603**	0.2025	0.0426	-0.1469	**-0.0840**	**0.3292**	0.2339
Use of Reporting	**-0.2928**	**0.4461**	0.0272	**-0.3449**	**-0.3103**	-0.1453	0.2246	**0.6906**	-0.0906	-0.0350
Collect Power	**-0.3733**	0.1880	-0.0016	**-0.3161**	**-0.3319**	**-0.2930**	0.1237	0.2143	**-0.4962**	**-0.3489**
Max Penalty	**-0.3059**	**0.3612**	0.1380	-0.1812	-0.2114	-0.2130	0.2642	0.3331	-0.0339	0.2123

Correlations

- Countries with strong legal systems /less corruption:
  - Less self-assessment of tax liabilities
  - Less use of withholding and information reporting
  - Less power to enforce collection of tax debts
  - More tax administrators per worker

- Why should we characterize these countries as having strong tax administration and enforcement or low tax burdens?

MAXIMUM PENALTY RATE		ADMINISTRATOR COVERAGE		PER CAPITA INCOME	
LOWEST QUARTILE (1) Cyprus Finland **Iceland** Japan **Luxembourg** Russia South Korea Sweden	(2) Australia Canada France Hungary Norway USA	(1) **Chile** **China** Japan Mexico **Singapore** **South Africa** South Korea USA	(2) Argentina Austria Cyprus Italy Lithuania New Zealand Spain Turkey	(1) Argentina **Chile** **China** Latvia Mexico Russia **South Africa** Turkey	(2) Cyprus Hungary Italy Lithuania New Zealand **Singapore** South Korea Spain
(3) Argentina Latvia Lithuania Mexico Netherlands New Zealand Spain Turkey UK	HIGHEST QUARTILE (4) Austria Belgium **Chile** **China** Denmark Ireland Italy **Singapore** **South Africa**	(3) Australia Canada Finland France Hungary Russia Sweden UK	(4) Belgium Denmark **Iceland** Ireland Latvia **Luxembourg** Netherlands Norway	(3) Australia Belgium Finland France Japan Netherlands Sweden UK	(4) Austria Canada Denmark **Iceland** Ireland **Luxembourg** Norway USA

WITHHOLDING		REPORTING		PER CAPITA INCOME	
LOWEST QUARTILE (1)	(2)	(1)	(2)	(1)	(2)
Australia	Austria	Argentina	Australia	Argentina	Cyprus
Canada	Cyprus	Austria	Canada	Chile	Czech Republic
Denmark	Finland	Belgium	Estonia	**China**	Greece
France	Germany	**Luxembourg**	France	Estonia	Hungary
Luxembourg	Iceland	**Netherlands**	Germany	Mexico	Malta
Netherlands	Malta	Slovak Republic	Ireland	Poland	New Zealand
Norway	New Zealand	Switzerland	Malta	Slovak Republic	Portugal
Singapore	Sweden		New Zealand	South Africa	Slovenia
South Africa	Switzerland		Norway	**Turkey**	South Korea
USA			South Africa		**Spain**
			Sweden		
(3)	HIGHEST QUARTILE (4)	(3)	(4)	(3)	(4)
Argentina	**China**	Denmark	Chile	Australia	Austria
Belgium	Hungary	Finland	**China**	Belgium	Canada
Chile	Ireland	Greece	Cyprus	Finland	Denmark
Czech Republic	**Japan**	Hungary	Czech Republic	France	Iceland
Estonia	Mexico	Iceland	**Japan**	Germany	Ireland
Greece	South Korea	Mexico	Portugal	**Japan**	**Luxembourg**
Poland	**Spain**	Poland	**Spain**	**Netherlands**	Norway
Portugal	**Turkey**	Singapore	**Turkey**	Singapore	Switzerland
Slovak Republic		Slovenia	USA	Sweden	USA
Slovenia		South Korea		UK	
UK		UK			

WITHHOLDING		REPORTING		CORRUPTION	
LOWEST QUARTILE (1)	(2)	(1)	(2)	HIGH (1)	(2)
Australia	Austria	Argentina	Australia	Argentina	Cyprus
Canada	Cyprus	Austria	Canada	**China**	Estonia
Denmark	Finland	Belgium	Estonia	Czech Republic	Hungary
France	Germany	**Luxembourg**	France	Greece	**Japan**
Luxembourg	Iceland	**Netherlands**	Germany	Mexico	Malta
Netherlands	Malta	Slovak Republic	Ireland	Poland	Portugal
Norway	New Zealand	Switzerland	Malta	Slovak Republic	Slovenia
Singapore	Sweden		New Zealand	South Africa	South Korea
South Africa	Switzerland		Norway	**Turkey**	**Spain**
USA			South Africa		UK
			Sweden		
(3)	HIGHEST QUARTILE (4)	(3)	(4)	(3)	LOW (4)
Argentina	**China**	Denmark	Chile	Austria	Australia
Belgium	Hungary	Finland	**China**	Belgium	Denmark
Chile	Ireland	Greece	Cyprus	Canada	Finland
Czech Republic	**Japan**	Hungary	Czech Republic	Chile	Iceland
Estonia	Mexico	Iceland	**Japan**	France	New Zealand
Greece	South Korea	Mexico	Portugal	Germany	Norway
Poland	**Spain**	Poland	**Spain**	Ireland	Singapore
Portugal	**Turkey**	Singapore	**Turkey**	**Luxembourg**	Sweden
Slovak Republic		Slovenia	USA	**Netherlands**	Switzerland
Slovenia		South Korea		USA	
UK		UK			

SELF-ASSESSMENT		TAX SYSTEM (INDIVIDUAL TAX)		CORRUPTION	
DO NOT USE		SYSTEM 1	SYSTEM 2	HIGH (1)	(2)
Austria **Belgium** **Denmark** **Finland** **Germany** Greece **Iceland** **Luxembourg** **Netherlands** **Norway** **Singapore** Slovenia South Africa **Sweden**		Argentina **Austria** Brazil **Chile** China Cyprus Czech Republic **Germany** **Ireland** Italy Japan South Korea Latvia Lithuania **Luxembourg** Mexico **Netherlands** **New Zealand** Russia Slovak Republic Slovenia South Africa Turkey UK	**Australia** **Belgium** **Canada** Greece Hungary India Malta Poland Portugal Spain **USA**	Argentina China Czech Republic Greece Mexico Poland Slovak Republic South Africa Turkey	Cyprus Estonia Hungary Japan Malta Portugal Slovenia South Korea Spain UK
USE			SYSTEM 3	(3)	LOW (4)
Argentina **Australia** **Canada** **Chile** China Cyprus Czech Republic Estonia **France** Hungary **Ireland** Japan	Malta Mexico **New Zealand** Poland Portugal Slovak Republic Slovenia South Korea Spain **Switzerland** Turkey UK **USA**		**Denmark** Estonia **Finland** **Iceland** **Norway** **Sweden**	**Austria** **Belgium** **Canada** **Chile** **France** **Germany** **Ireland** **Luxembourg** **Netherlands** **USA**	**Australia** **Denmark** **Finland** **Iceland** **New Zealand** **Norway** **Singapore** **Sweden** **Switzerland**
			SYSTEM 4		
			France **Singapore** **Switzerland**		

Informal Economy – Prior Analysis

Johnson et al (AER 1998)

- Johnson et al (1998) regressed the level of IE against a measure of tax rates and an executive assessment of the tax burden, interpreted as "the way the tax system is administered."

- **Finding**: High IEs are associated with low tax rates, and high tax burdens. The two RHS variables are, however, not entered into the regression at the same time.

Freidman et al (JPE 2000)

- Freidman et al (2000) regressed the level of IE against a measure of tax rates, a "law and order" index and (sometimes) GDP per capita.

- **Finding**: Tax rates have a negative affect on IE, but have no effect once one controls for "law and order" or GDP (which have a negative effect on IE).

IV Regressions

Table 4

Independent Variables	1	2	3	4	5	6	7	8
	FJKZ				RS			
Intercept	0.3573 *** (0.0875)	0.4531 *** (0.0783)	0.4772 *** (0.0636)	0.5046 *** (0.0654)	0.4185 *** (0.0893)	0.5690 *** (0.0740)	0.5717 *** (0.0653)	0.6218 *** (0.0666)
Tax Rate	-0.3654 * (0.2012)	0.0789 (0.2170)	0.3002 (0.2149)	0.3481 (0.2137)	-0.4786 ** (0.2193)	-0.0866 (0.2876)	-0.1690 (0.2607)	-0.0871 (0.2732)
Log GDP Per Capita		-0.0932 *** (0.0243)		-0.0377 (0.0232)		-0.1027 *** (0.0344)		-0.0547 * (0.0298)
Law and Order			-0.0492 *** (0.0097)	-0.0410 *** (0.0110)			-0.0349 *** (0.0118)	-0.0247 ** (0.0118)
First stage F	4.13	3.71	5.28	4.58	8.75	8.42	10.99	8.29
Adj R-sq	0.0690	0.3732	0.5391	0.5564	0.0881	0.3912	0.4467	0.4808
N	32	32	32	32	40	40	40	40

- Columns 1-4
  - IVs are *legal origin*, *religion*, *latitude* and *ethnic fractionalization* from La Porta et al (1999)
- Columns 5-8
  - IVs are *conflict* and *democracy* from Besley and Persson (2007)

Informal Economy – New Analysis

- Tax rates have no significant effect on IE, while new tax system measures have significant positive *and* negative effects.
- In some specifications, per capita income and the legal environment have no significant effect.
- Suggests that the relationship between income and IE may result from tax system choices shaped by other institutional factors that are correlated with income.

IV Regressions

Table 5

Intercept	0.7708 ***	0.6972 ***	0.0574	0.3286	0.4761 ***
	(0.0918)	(0.0622)	(0.3332)	(0.1981)	(0.1256)
Tax Rate	**-0.3494**	**0.0287**	**-0.4263**	**-0.3712**	**-0.2507**
	(0.2173)	**(0.2167)**	**(0.4220)**	**(0.3253)**	**(0.2590)**
Log GDP Per Capita	-0.0860 **	-0.0986 ***	0.0074	-0.0085	-0.0294
	(0.0330)	(0.0317)	(0.0666)	(0.0212)	(0.0317)
Law and Order	-0.0093	-0.0355 ***	-0.0133	-0.0103	-0.0248 **
	(0.0108)	(0.0123)	(0.0137)	(0.0444)	(0.0109)
Max Penalty	**-0.0524 ** **				
	(0.0204)				
Administrator Coverage		**0.0710 ** **			
		(0.0267)			
Collection Power			**0.0396 * **		
			(0.0228)		
Use of Withholding				**0.0389 * **	
				(0.0210)	
System1					**0.1580 * **
					(0.0874)
System2					**0.1034**
					(0.0829)
System3					**0.1928 ** **
					(0.0850)
1st stage F - System Measure	3.97	4.96	3.20	2.44	1.87 2.29 13.97
1st stage F - Tax Rate	6.59	7.81	5.60	5.56	4.32
Adjusted R-sq	0.5644	0.6210	0.4157	0.3753	0.5171
Sample	30	39	37	32	40

Conclusion

- Tax system aspects – other than rates – matter.
- Ignoring them skews one's view of the influence of tax rates on behavior.
- Unexplored variables await the attention of future research.

Session One:

Tax Systems and Taxpayer Behavior

2009 IRS Research Conference

A PANEL ANALYSIS OF BEHAVIOUR CHANGE IN CANADIAN INDIVIDUAL INCOME TAX COMPLIANCE

Presented by Attah Boame

July 8, 2009

2009 IRS Research Conference, Washington, D.C., USA

Canada Revenue Agency | Agence du revenu du Canada

Canada

OUTLINE

- Background and Objectives
- Methodology
- Study Results
- Areas for Further Research
- Questions or Comments?

Background:

- Personal income taxes are a major source of income for the federal, provincial and territorial governments.
- Personal income taxes generated an average of $81.6 billion quarterly from 2000 to 2004 for the federal government.

Study objectives:

- To study the trends in Canadian individual income tax compliance from 1996 to 2002.
- To analyze the factors that influence individual income tax compliance for the study period.

Tax Compliance Defined

The Compliance Measurement Framework (CMF) identifies the following main compliance requirements for individuals:

- Filing required tax forms on time;
- Reporting complete and accurate tax information; and
- Paying any amounts due in a timely manner (without enforcement action).

Operational Definition
Tax Compliance

- Filing Compliance Rate - The number of taxpayers filing on-time (i.e., with no late filing penalty) as a percentage of the panel population.
- Reporting Compliance Rate - The number of taxpayers reporting accurately (i.e., with a tax payable difference of less than or equal to $50 between assessment and what is reported) as a percentage of the panel population.
- Payment Compliance Rate - The number of taxpayers without arrears interest charges or instalment interest charges as a percentage of the panel population

Data

- Sources: Initial Assessment and Reassessment of individual taxpayers tax returns (T1)
- Study period: From 1996 to 2002
- Variables: As defined in the datasets
- Type: Panel (Longitudinal) data
  - To achieve a **balanced** panel, only individual taxpayers who filed their tax returns for all seven years are included in the analysis.
- Observations:18,300,485 for each tax year

Methodology

- Descriptive Statistics
  - Frequency distributions and Cross-tabulations

- Multivariate Analysis
  - Logistic regression (identifies the likelihood of the individual taxpayers filing their taxes on-time, reporting their taxes accurately, and paying their taxes owing on-time, without enforcement action by the Agency).

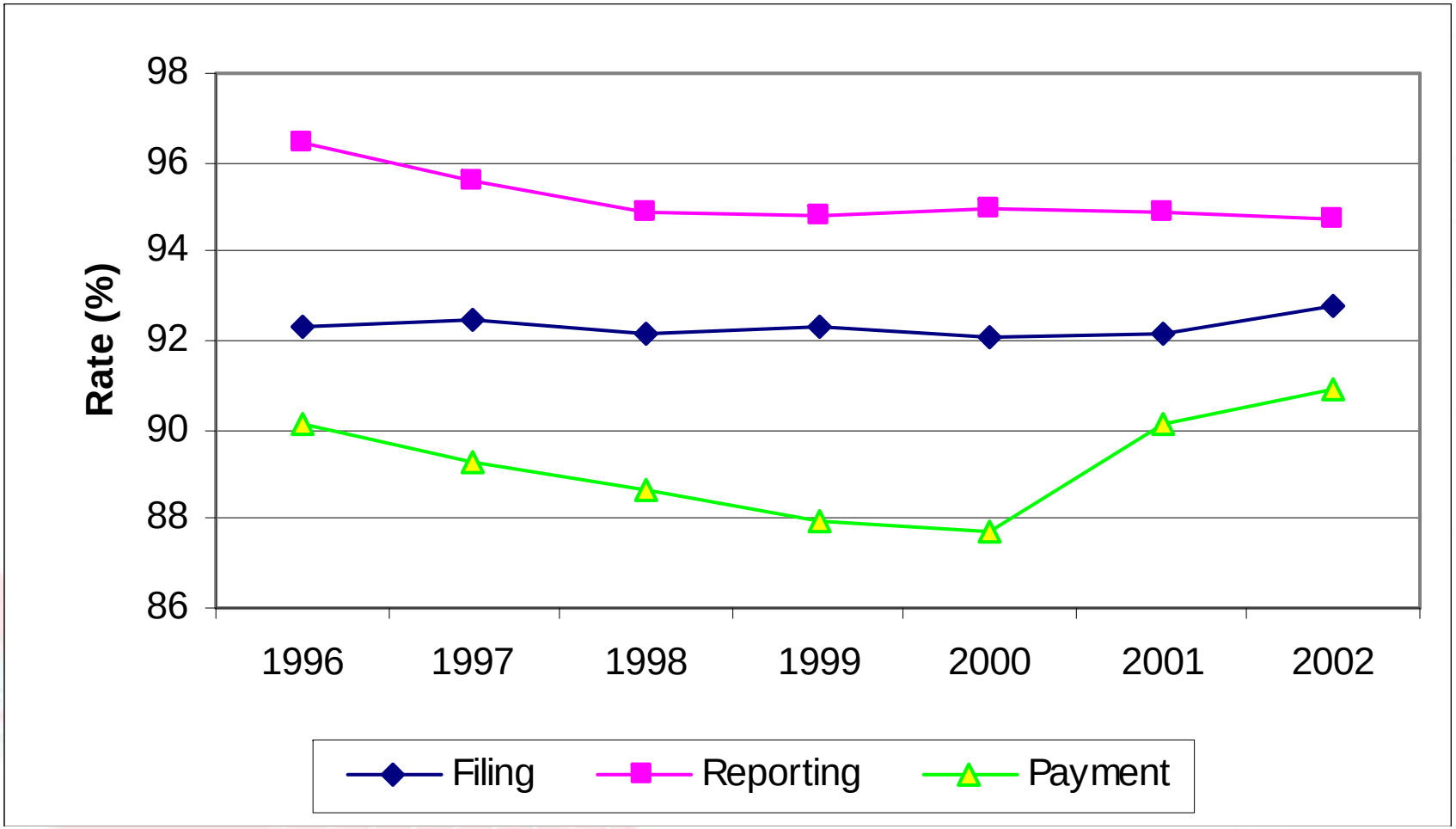
Caveats

- Non-filers are excluded from the analysis.
- Taxpayers with no tax payable are included in order to preserve the balanced structure of the data.
- The data are applicable to most T4 recipients (that is, employees).
- The number of observations for each tax year represent about 80% of the filing population for each tax year.
- Taxpayers over-reporting their tax payable are considered reporting compliant.
- The logistic regression models assume no interaction between variables (weak dependencies identified among independent variables).

Study Results

- Compliance trends:
  - Reporting compliance rate exceeded both filing and payment compliance rates for the study period. Reporting compliance rate decreased from 96% in 1996 to 95% in 2002.
  - Filing compliance rate exceeded payment compliance rate for all the years of the study period. Filing compliance rate increased slightly from roughly 92% in 1996 to 93% in 2002.
  - Payment compliance rate was lower than both filing and reporting compliance over the study period.

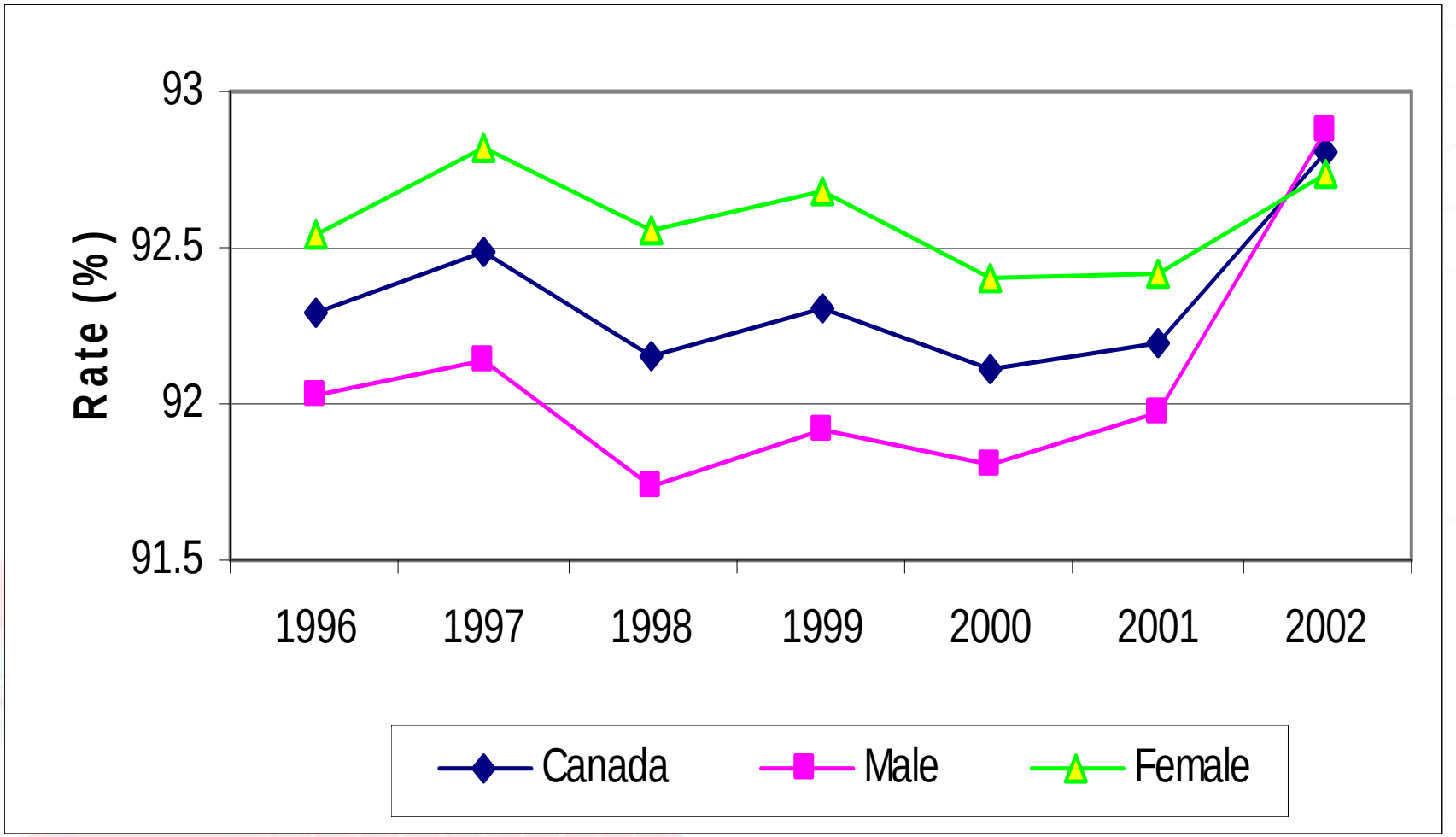
Filing, Reporting and Payment Compliance, 1996-2002



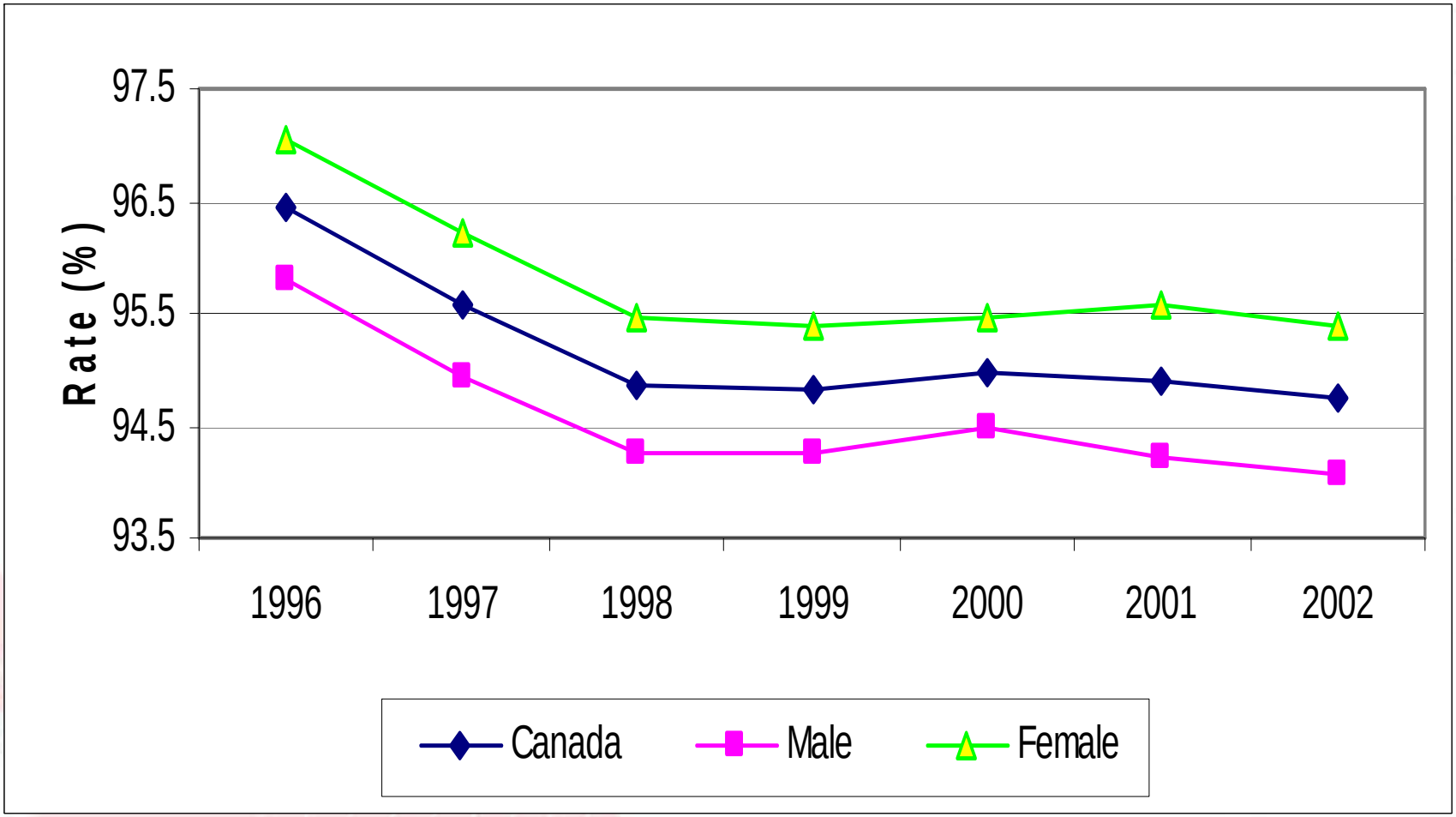
Study Results

- Demographic trends:
  - Females are more tax compliant (filing, reporting, and payment) than males.
  - Middle age taxpayers are less tax compliant (filing, reporting, and payment) compared to the young and old taxpayers.
  - Widowed taxpayers are more tax compliant (filing and reporting) than those in the other marital status categories.

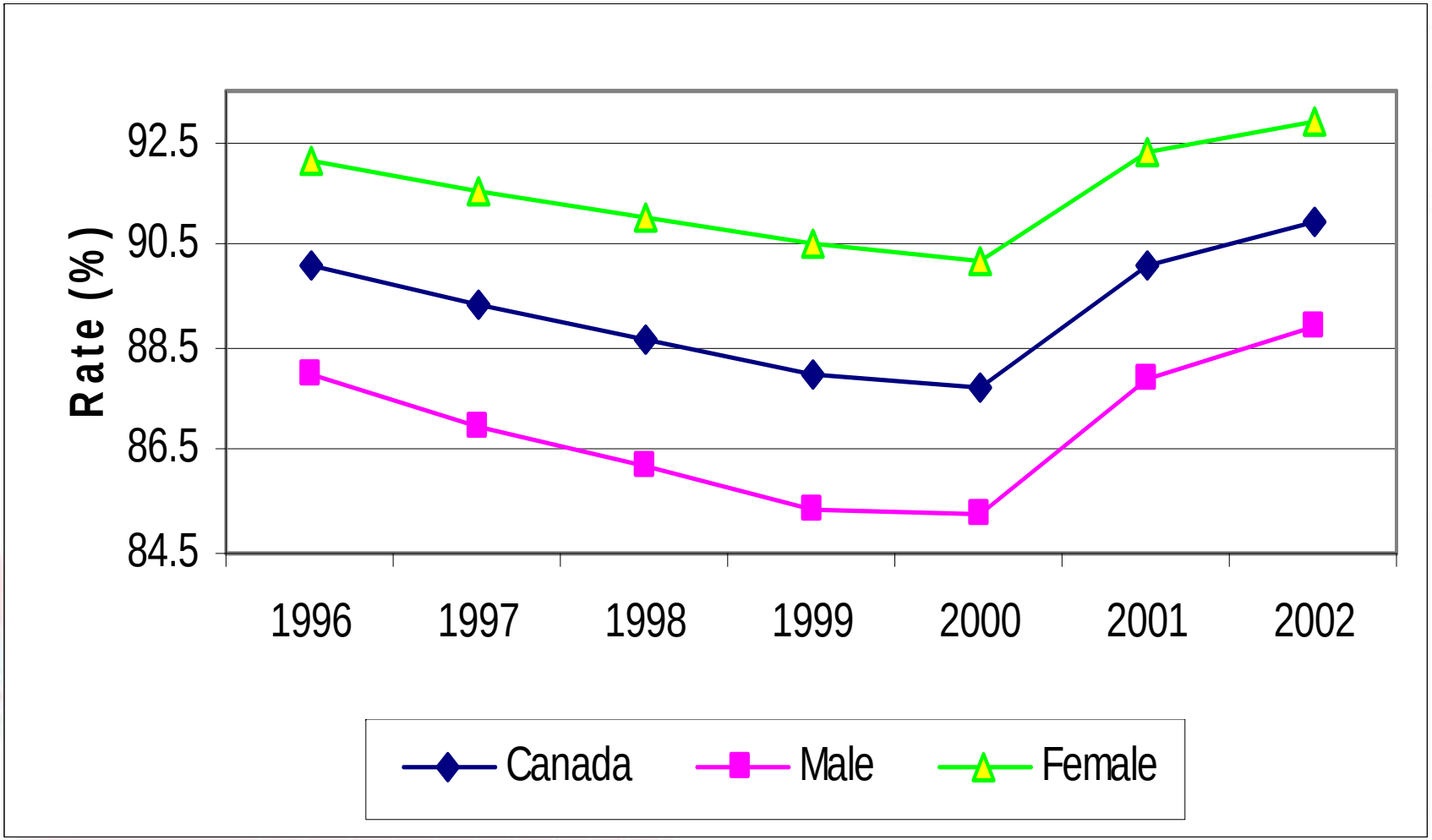
Canada, Filing Compliance by Gender (%), 1996-2002



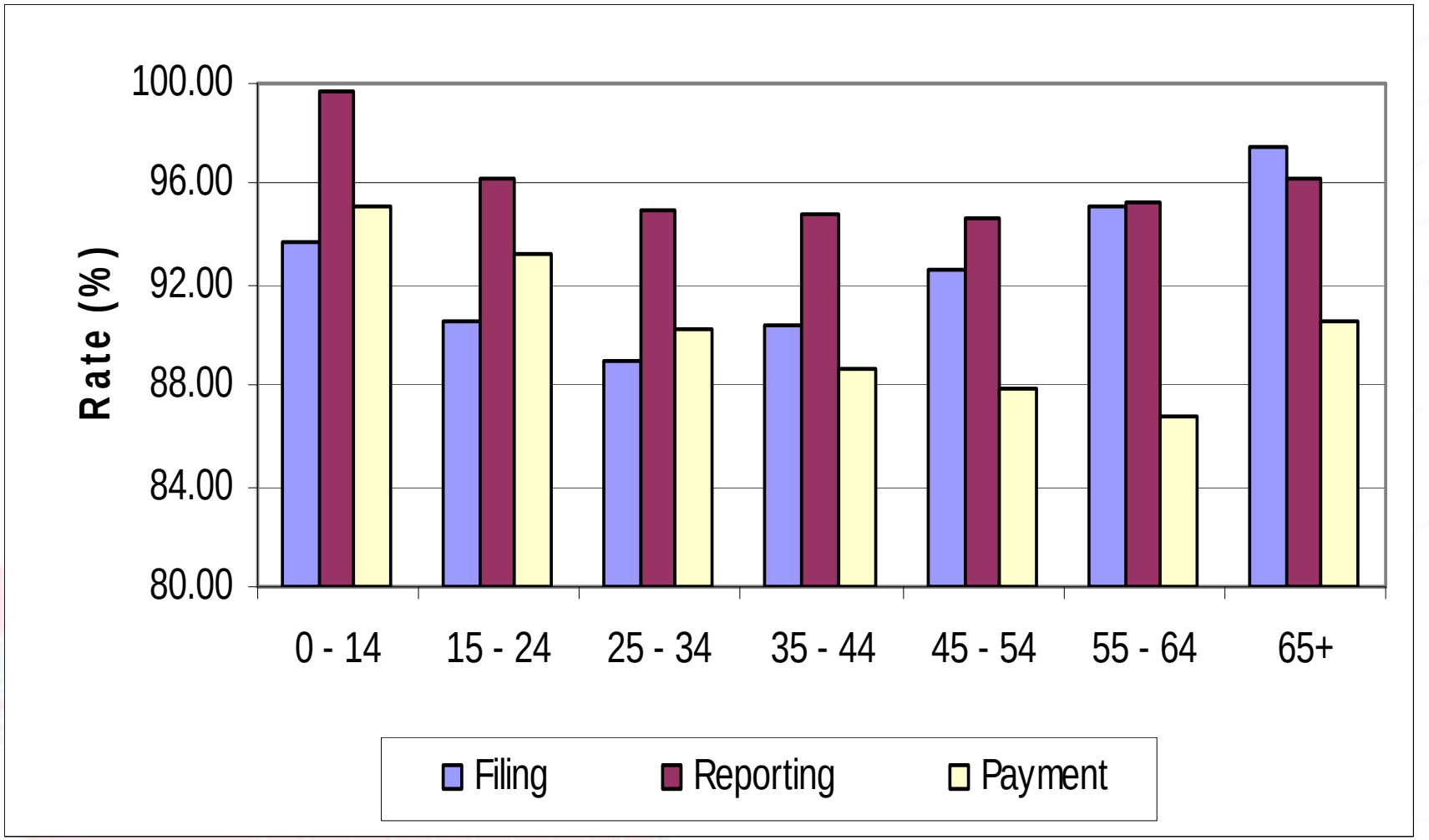
Canada, Reporting Compliance by Gender (%), 1996-2002



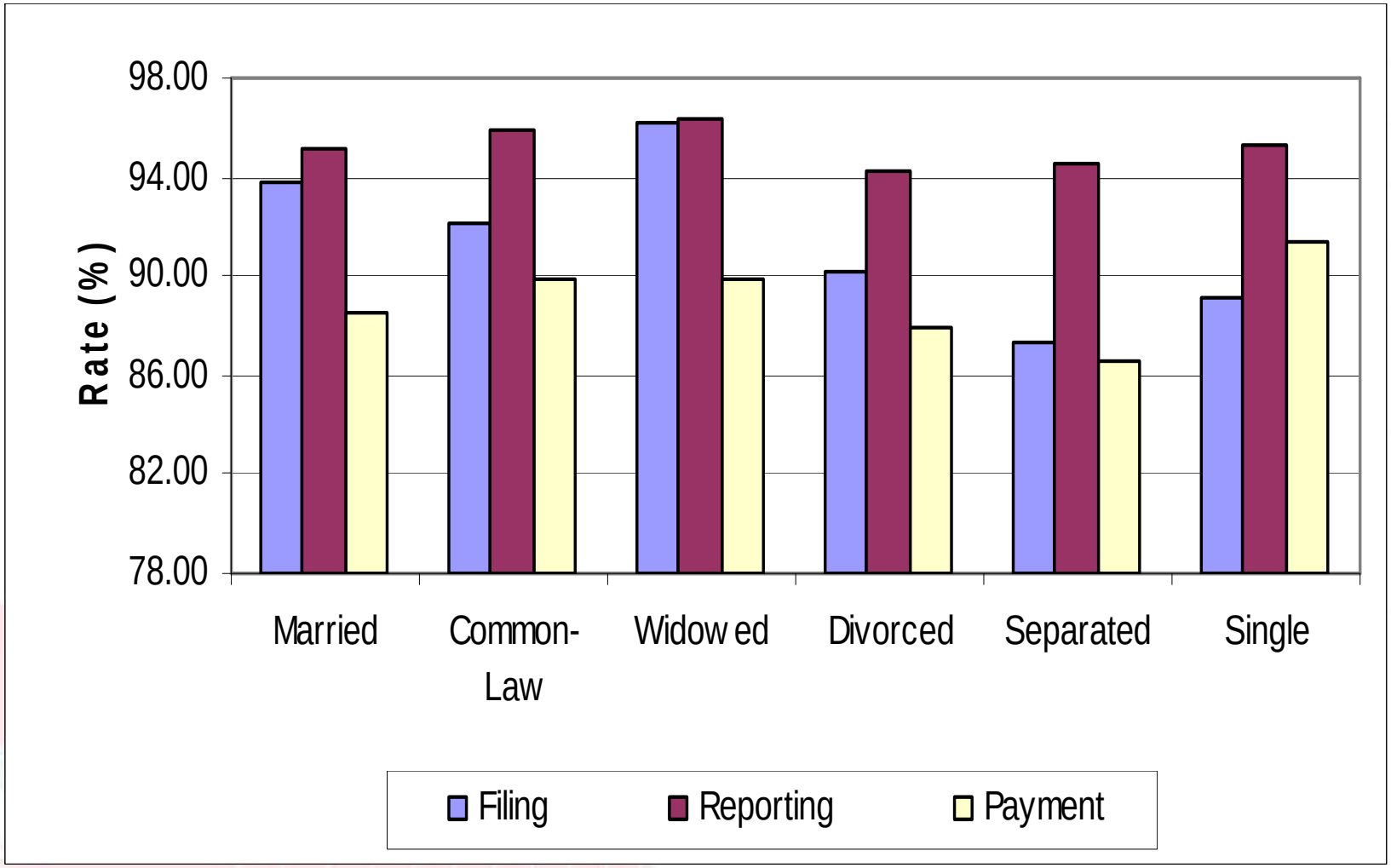
Canada, Payment Compliance by Gender (%), 1996-2002



Mean Compliance By Age Group (%),1996-2002



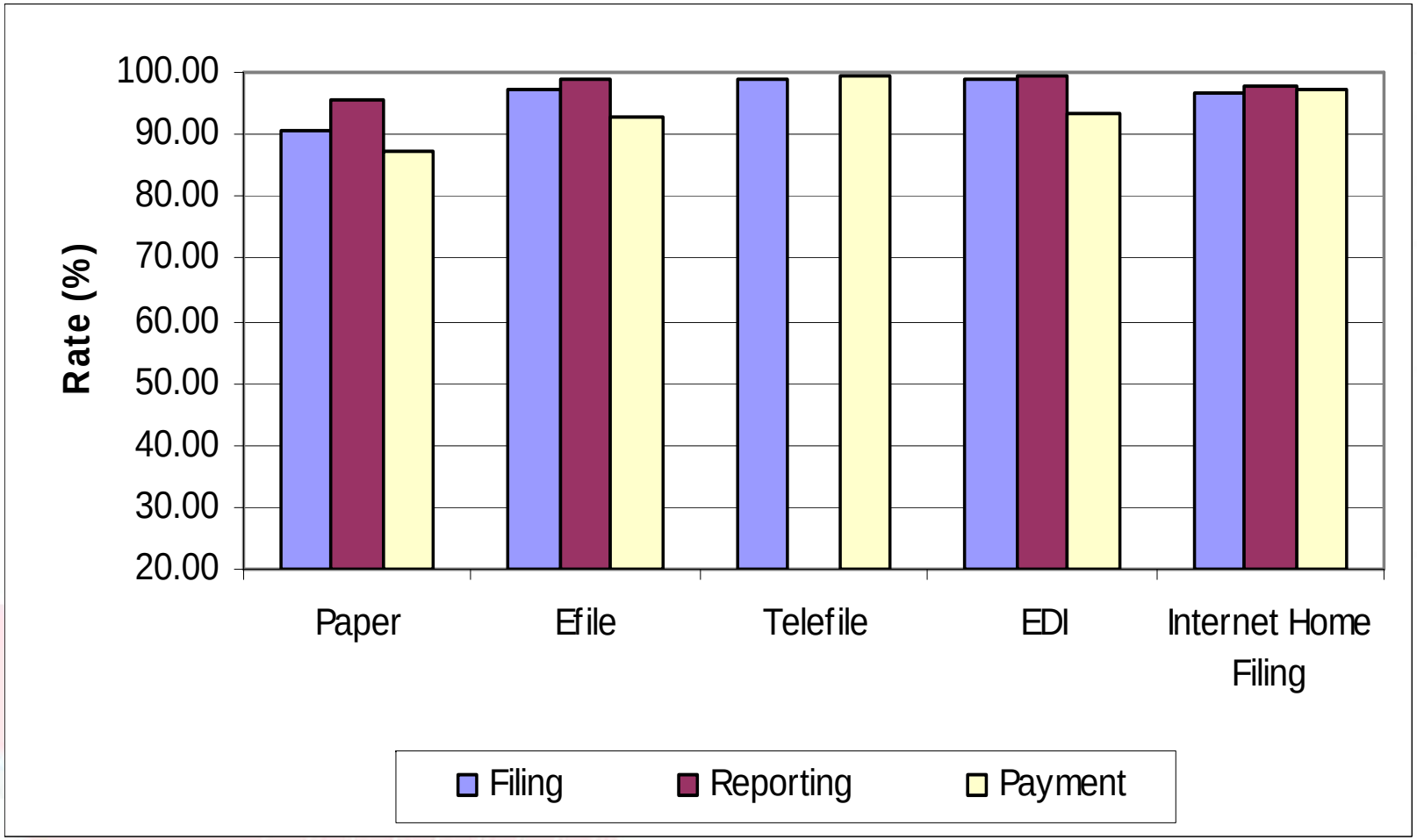
Mean Compliance by Marital Status (%),1996-2002



Study Results

- Filing Methods:
  - Taxpayers using electronic methods (Efile, Telefile, and Netfile) have a higher compliance rate (filing, reporting, and payment) relative to taxpayers who use paper-filing (hard copy).

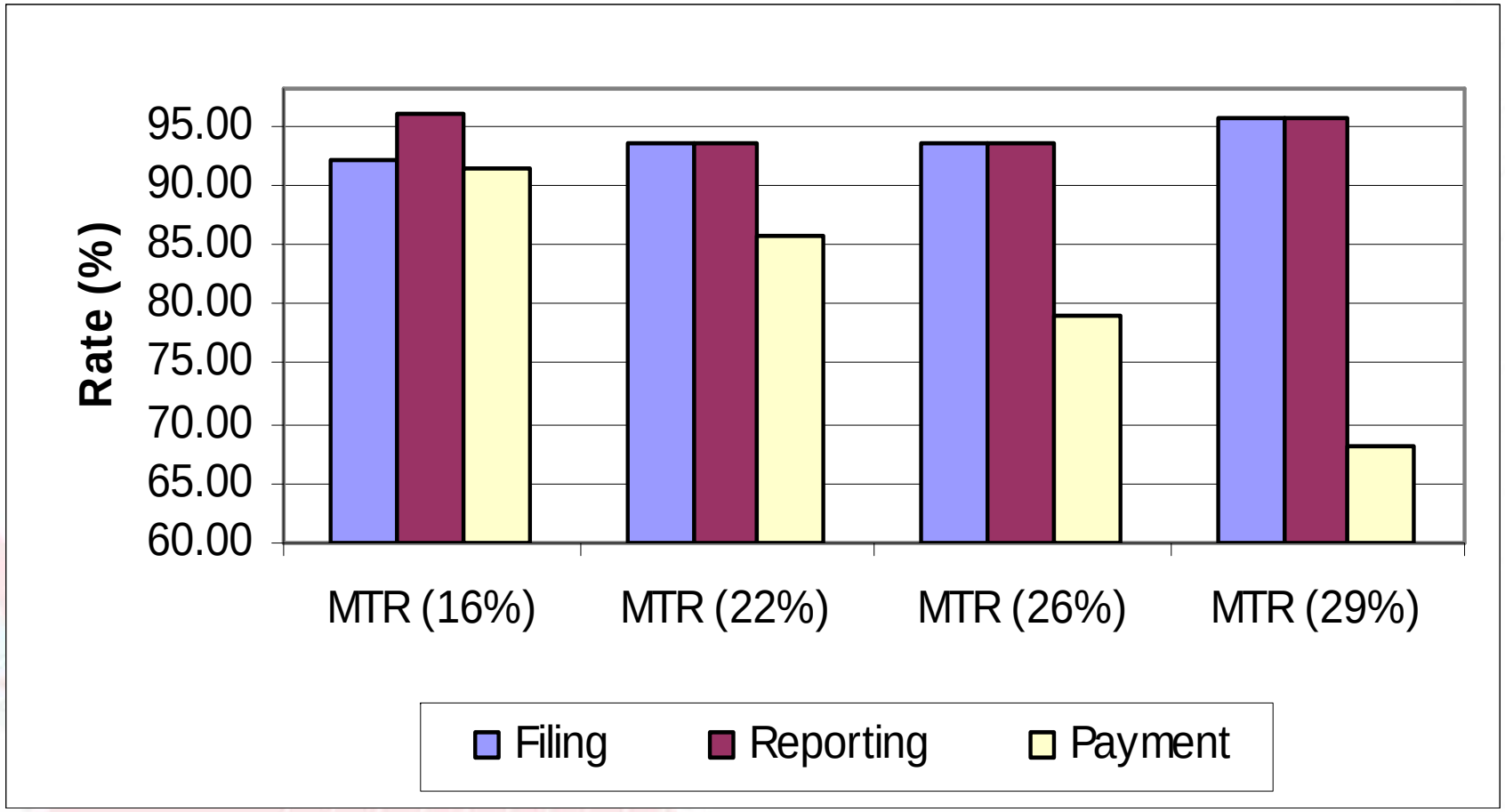
Mean Compliance by Filing Method (%), 1996-2002



Study Results

- Marginal Tax Rates:
  - The payment compliance rate declines with the marginal tax rates. That is, the lower marginal tax bracket (16%) has a higher payment compliance rate relative to the other marginal tax brackets (22%, 26% and 29%).
  - The lower marginal tax bracket (16%) has the highest reporting compliance rate compared to the other marginal tax brackets (22%, 26% and 29%).

Mean Compliance by Marginal Tax Rates (%), 1996-2002



Logistic Regression Results

- Odds ratio analysis:
  - The *Odds ratio* indicates how much more likely a certain event occurs in one group relative to its occurrence in another group, all other things being the same. For example, how much more likely are females (reference category) filing compliant compared to males?

Parameters		Filing Compliance Outcome	
Demographic Factors		**Less Likely to File Late**	**More Likely to File Late**
Gender	Male vs. Female		11%
Age Group	Middle vs. Young	8%	
	Old vs. Young	106%	
Marital Status	Widowed vs. Married/CL		26%
	Divorced vs. Married/CL		39%
	Separated vs. Married/CL		45%
	Single vs. Married/CL		27%

Parameters		Filing Compliance Outcome	
CRA Program Factors		**Less Likely to File Late**	**More Likely to File Late**
Filing Method	EFILE vs. Paper	385%	
	TELEFILE vs. Paper	603%	
	NETFILE vs. Paper	204%	
Marginal Tax Rates (%)	22% bracket vs. 16% bracket	5%	
	26% bracket vs. 16% bracket	16%	
	29% bracket vs. 16% bracket	85%	

Parameters		Filing Compliance Outcome	
Income Factors		**Less Likely to File Late**	**More Likely to File Late**
Pension Income	Pension vs. No Pension	109%	
RRSP Income	Income vs. No Income		18%
Tax-Exempt Income	Exempt vs. No Exempt		20%
Main Source of Income	Investment/Rent vs. Wages	29%	
	Capital Gains/Loss vs. Wages	32%	
	Self-Employed vs. Wages		2%

Parameters		Reporting Compliance Outcome	
Demographic Factors		**Less Likely to Underreport**	**More Likely to Underreport**
Gender	Male vs. Female		33%
Age Group	Middle vs. Young		13%
	Old vs. Young		8%
Marital Status	Widowed vs. Married/CL		10%
	Divorced vs. Married/CL		25%
	Separated vs. Married/CL		29%
	Single vs. Married/CL		4%

Parameters		Reporting Compliance Outcome	
CRA Program Factors		**Less Likely to Underreport**	**More Likely to Underreport**
Filing Method	EFILE vs. Paper	152%	
	NETFILE vs. Paper	133%	
Marginal Tax Rates (%)	22% bracket vs. 16% bracket		13%
	26% bracket vs. 16% bracket		11%
	29% bracket vs. 16% bracket		4%

Parameters		Reporting Compliance Outcome	
Income Factors		**Less Likely to Underreport**	**More Likely to Underreport**
Pension Income	Pension vs. No Pension		22%
RRSP Income	Income vs. No Income		58%
Tax-Exempt Income	Exempt vs. No Exempt	178%	
Main Source of Income	Investment/Rent vs. Wages		3%
	Capital Gains/Loss vs. Wages		40%
	Self-Employed vs. Wages		17%

Parameters		Payment Compliance Outcome	
Demographic Factors		**Less Likely to Pay Late**	**More Likely to Pay Late**
Gender	Male vs. Female		30%
Age Group	Middle vs. Young		6%
	Old vs. Young	20%	
Marital Status	Widowed vs. Married/CL		19%
	Divorced vs. Married/CL		30%
	Separated vs. Married/CL		33%
	Single vs. Married/CL		2%

Parameters		Payment Compliance Outcome	
CRA Program Factors		**Less Likely to Pay Late**	**More Likely to Pay Late**
Filing Method	EFILE vs. Paper	170%	
	TELEFILE vs. Paper	1,310%	
	NETFILE vs. Paper	333%	
Marginal Tax Rates (%)	22% bracket vs. 16% bracket		35%
	26% bracket vs. 16% bracket		51%
	29% bracket vs. 16% bracket		60%

Parameters		Payment Compliance Outcome	
Income Factors		**Less Likely to Pay Late**	**More Likely to Pay Late**
Pension Income	Pension vs. No Pension		27%
RRSP Income	Income vs. No Income		60%
Tax-Exempt Income	Exempt vs. No Exempt	138%	
Main Source of Income	Investment/Rent vs. Wages		28%
	Capital Gains/Loss vs. Wages		41%
	Self-Employed vs. Wages		64%

Further Research

- A profile and compliance trends for:
  - Taxpayers who use professional tax preparers to file their tax return;
  - Taxpayers who use the Community Volunteer Income Tax Program to file their tax return;
  - Taxable filers;
  - Non-taxable filers; and
  - Refund returns.

QUESTIONS or COMMENTS?

THANK YOU

MERCI

Session One:

Tax Systems and Taxpayer Behavior

2009 IRS Research Conference

Taxpayer response to the recent 'flat tax' UK capital gains tax (CGT) reform and the implication for corporate tax simplification

Peter Jelfs

Mazars LLP

MAZARS

Introduction

- **UK corporate tax law is complex – the longest in the world**
- **Taxpayers and government both claim to want it simplified**
- **Every year the legislation increases in length and complexity – why?**
- **Taxpayer response to the recent CGT reforms may help to explain**

UK corporation tax

- **Companies taxed separately from their shareholders**
- **Controlled by statute, case law and practices of HM Revenue & Customs (HMRC)**
- **Legislation constantly updated**
- **Responsibility usually delegated by government to HMRC**

Reasons for complexity

- **Complexity can arise through length of legislation or language used**
- **A number of specific factors in the UK:**

- **Conflict between policy goals**
  - **often equity and simplicity**

- **Fiscal incentives**
  - **create distinctions**

Reasons for complexity (2)

- **Anti-avoidance legislation**

  - loopholes created and exploited

- **Tax Law Rewrite Project**

  - designed to simplify language

Reasons for complexity (3)

Other reasons:

- **Relieving capital expenditure**
- **Tax neutrality**
- **Earlier shortcomings**
- **True reflection**
- **Transfer pricing**

Effects of complexity

- On first principles length of legislation can measure complexity
- UK tax law increased from 5952 pages in 2001 to 10134 in 2008
- Cost/benefit analysis for obtaining tax advice
- Compliance falls through ignorance rather than evasion
- Several surveys conclude taxpayers find system too complex

‘Flat tax’

- **Two kinds – Hall Rabushka (HR) and Eastern European (EE)**
- **HR a theoretical consumption based tax – not well known in UK**
- **Flat tax in UK means EE**
- **EE flat tax retains income base but has single rate of tax**

Flat tax and simplification

- **Debate in UK as to whether flat tax would simplify legislation**
- **Possible removal of capital/income planning and fewer exemptions**
- **Effect on length of legislation predicted to be small**

CGT reforms

- **9 October 2007 – flat tax rate of 18% on capital gains for individuals**
- **Substantial simplification of CGT legislation**
- **Removal of complex calculations of taper relief reducing gain depending on time asset held and whether used in business**
- **Taper relief described as 'a mess' – range of CGT rates from 5-40%**
- **Distorted investment decisions**

CGT reforms(2)

- UK government does not like ‘flat tax’
- Critical report in 2005 mainly on equity grounds – reduction in marginal rate for highest earners
- Report considered important the fact that no flat tax introduced in a Western economy
- Government introduced this reform with flat tax simplification arguments – ironic!
- How will taxpayer respond?

CGT reforms(3)

- **Bitterly denounced by small business representatives!**
- **Reason – flat rate was higher than the current 10%**
- **Tax practitioners – pragmatic approach by schemes to avoid new rates**
- **Simplicity a principle easily sacrificed**

Government response

- **Quickly gave in**
- **Introduced ‘entrepreneur’s relief’ to maintain 10% rate on first £1 million of capital gain – remainder at 18%**
- **Simplification implications – disastrous**
- **No simpler than taper relief and less generous**

Conclusions

- **Classic example of taxpayer response to a radical system change**
- **Rate of tax is the key factor**
- **Simplification will remain elusive**

MAZARS

Session One:

Tax Systems and Taxpayer Behavior

2009 IRS Research Conference

Tax Systems and Taxpayer Behavior

Discussant: Pamela Olson

Skadden, Arps, Slate, Meagher & Flom LLP

2009 IRS Research Conference

Session One:

Tax Systems and Taxpayer Behavior

2009 IRS Research Conference

During the break, please visit the SOI Booth in the upper lobby.

2009 IRS Research Conference