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Comments on Compliance and Administration*

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Aggregate Estimates of Small Business Taxpayer Compliance Burden, by Donald DeLuca, Scott Stilmar, John Guyton, Wu-Lang Lee, and John O'Hare

The authors of this study are tackling a question that is very difficult, but, nevertheless, a very important issue. Unfortunately, there are limited ways of trying to address this question. One approach is simply counting the lines on the form, or trying to subjectively weight the complexity of each item on the form. This approach has many limitations and is difficult to use to quantify costs. An alternative approach used here is to survey taxpayers and ask them to report their own estimates of costs, in both time and money. There is also a tremendous weakness in this approach. I am inclined to think that respondents tend to exaggerate the costs they face, especially in complying with a system that they may tend to resent. There is also an issue of whether the nonrespondents are really different in some important ways from the respondents.

I do have some technical issues and questions. First, it would have helped to be able to look at the survey document, or at least to reproduce the compliance burden-related questions. Otherwise, one is a bit in the dark here.

There are also some specific technical questions. First, how are the subjective weighting factors in the nearest neighbor approach derived? Second, how is the monetization of time determined? And, finally, which businesses have no business receipts? What sorts of businesses are these? And are they appropriately in the sample?

I also have another major reservation about the results. The biggest cost by far is recordkeeping, which still remains subject to two major uncertainties. The first is how to value time. But second, and more importantly, is the joint nature of recordkeeping. Ideally, one would like to know how recordkeeping would change in the absence of the tax. How to deal with State and local taxes is an impossible problem—what is marginal? As long as firms have to comply with these taxes, they have to keep essentially the

* The views in this comment do not necessarily reflect the views of the Congressional Research Service.

same records as they do for the Federal tax. Do we assume that without Federal taxes, there would be no State and local taxes? Or, do we assume that these taxes would remain, in which case the recordkeeping costs for the Federal tax should be negligible?

But even aside from the State and local issue, it seems that the vast majority of records should be kept just to run a good business or obtain credit. In fact, to the extent tax rules force recordkeeping, it may be beneficial. There is very little in the paper other than general assurances that this allocation of recordkeeping costs has been done appropriately. For that matter, there is some evidence that it was not appropriately allocated, as with the software purchases that seemed to also include bookkeeping services. For the results to be persuasive, there should be something much more concrete on this issue.

While the authors are to be congratulated on trying another approach to this important issue, the combination of the unreliability of survey responses and the problem of joint recordkeeping makes me skeptical of the results, and I suspect the burden may be overstated.

Tax Complexity and its Impact on Tax Compliance and Tax Administration in Australia, by Margaret McKerchar

Unfortunately, but through no fault of the author, the results of some of the planned studies of complexity and compliance are not available, including the studies of the Inspector General and the Board of Taxation. It will be interesting to have a followup paper at some point that includes the results of these studies.

The discussion in this paper is interesting and particularly interesting to the United States, because both Australia and the U.S. face some constraints of divided government that can lead to compromises that produce complexity. In addition, the history of the Australian tax system indicates some parallels with the U.S. in the growth in use of the tax code to help particular industries and sectors.

The U.S. has also traditionally separated policymaking and legislative drafting from tax administration, which is suggested to be an important characteristic. My own, admittedly subjective, judgement about this issue is that it might not be that important. U.S. legislators tend to provide more lip service to simplification than action. In fact, I would find it useful to have more involvement by the Internal Revenue Service on which legislative changes would pay large dividends in terms of tax administration and compliance.

Turning to one of the simplification initiatives discussed, it would be useful to shed more light, if that is possible, on what aspects of the optional simplified tax system for small business might have caused it not to be adopted.

At one point, the paper stresses the growth and number of taxpayers who use paid preparers as a sign of complexity. However, can one be sure about paid preparers as a sign of complexity? In the U.S., many people who continue to have very simple returns use tax preparers. For that matter, consider the example of paying someone to change the oil in one's car. This task is not a complex one, but it may be seen as worth the price for time saving. Did the shift to paid preparers simply occur because the service became available? Also, in the U.S., tax preparers provide instant refunds to taxpayers, which may be attractive for those who are liquidity-constrained. Does this issue arise in Australia? Taxpayers may also have fear of the tax authorities and fear of making a mistake. Or they may distrust the tax authorities' advice on forms and feel that preparers will get them a better deal. It would be helpful in future work to explore what issues, other than complexity, might be driving the movement to more paid preparation, before one concludes that it is an important indicator of complexity.

I also do not find it surprising that large firms did not take up the Forward Compliance Agreements. It is understandable that large firms want to keep their affairs private. Are businesses and the tax authorities partners or opponents? It is natural to be opponents, but hard to be partners. Again, my admittedly subjective observation is that, in the U.S., large firms like to talk about complexity, but they really care about the level of taxes paid and are quite willing to deal with a greater degree of complexity if there is some hope of lowering their taxes.

I think that are two fundamental issues that still need to be addressed in considering the relationship between complexity and compliance. First, is it complexity or perception that is the problem? Many tax returns in the United States, at least, are really quite simple to complete. Another issue is how far can one go in achieving greater compliance with the carrot rather than the stick? Do people obey speeding laws because the speed limits are posted frequently or because police are lurking around the corner? Sadly, the evidence from the U.S. suggests that compliance is greatest where withholding and information reporting occur, dramatically greater. Wage reporting is supposed to be 99-percent compliant, and it is subject to withholding, while small business, which does not involve third-party reporting, is only 50-percent, and much of that is underreporting or not reporting.