

DISCUSSION PAPER

Perspectives on Fair Tax

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Perspectives on Fair Tax

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Acronyms used in this paper

HMRC	HM Revenue and Customs
ICAEW	Institute of Chartered Accountants in England and Wales
IFS	Institute for Fiscal Studies
IRD	Inland Revenue Department
NAO	National Audit Office
OECD	Organisation for Economic Co-operation and Development

1. Introduction

CONTEXT

This paper reviews the debate around 'fair taxation'. The discussion has become internationally topical, politically, in recent years. In the UK, for example, Gordon Brown in his former role as Chancellor of the Exchequer, is quoted:

It is essential that tax policy is based on clear principles. These are to encourage work, savings and investment, and fairness. Fairness by ensuring that everyone bears their fair share of taxation and pays the correct amount and which is seen to be fair by vigorous pursuit of tax avoidance and evasion (Financial Statement and Budget Report (FSBR) July 1997, see Hurwich 2001).

Again in the UK, on the introduction in 2003 of a package of compliance and enforcement measures, the Paymaster General of the time, Dawn Primarolo, commented:

We want to make sure that the burden of tax does not fall unfairly on taxpayers who play by the rules and pay their fair share (HMRC 2008a).

These two quotes give the flavour of UK government thinking, but no definition of what is to be regarded as fair. For a further view, as of February 2008, we are awaiting the outcome of the Mirrlees Review (IFS 2008), which is undertaking an economics-based examination of how a tax system might be structured in the present environment.

FAIRNESS IN TAXATION

It is difficult to define 'fair taxation' in a way that would both satisfy all interested parties for all time and then, even if that were achievable, translate that understanding into a coherent tax policy. Rather than attempting a rigid definition of the term, therefore, we have set out to highlight the factors identified in previous research as affecting fairness in taxation and its perception by the taxpayer. Additionally, we have obtained empirical data comprising the views of tax professionals in a number of countries regarding the factors influencing perceptions of fairness of the tax system.

In gathering this empirical data, the following definitions were used.

Simplicity

'Simplicity' is an important indicator when assessing the fairness of tax systems. The more complex a tax system, the greater opportunities there are for avoidance, evasion and other forms of abuse and also greater chance for exclusion for non-tax experts who are unable to understand the system. The simplicity of a tax system can be measured for instance by the ease to calculate tax liability, the number of tax rates and allowances and the number of loopholes in the system. Of course 'Simplicity' does not automatically result in 'fairness'. Where conflicts do arise, a trade off is needed.

Transparency

'Transparency' is the extent to which the tax system is designed to be easily understood and accessed. For example, how easy it is to obtain an allowance or deduction for tax purposes for a specific item, say a depreciation allowance for an asset used in the business. Transparency also relates to the extent to which it is understood how much tax is collected, and how this tax funds government activities.

Burden

'Burden' refers to the extent to which certain groups, such as businesses and families, may pay disproportionately more tax. The tax 'burden' may also include the level of administration required in order to comply with the requirements of the tax regime. Taxes that cost a lot to administer not only distort the economy but can place an onerous burden on certain groups.

METHODOLOGY

We have undertaken a review of the literature in order to assess the views of economists, accounting scholars, philosophers and psychologists on the problems of defining 'fair taxation', as well as the factors to be taken into consideration. During this review we also examined proposals for alternative tax systems, eg flat taxes and consumption-based taxes.

Additionally, responses from an ACCA member survey have been analysed and tested for statistically significant differences between countries. The survey was undertaken among members in six countries, which were believed to represent a spread of different types of economy with different complexities of tax system. In evaluating the results of the survey, we were concerned to discover whether views about the tax system vary between different types of economy and tax system. Chapter 4, which reports the quantitative research, contains a summary of key questions and responses. It was also decided to hold focus groups in each country surveyed in order to assess tax professionals' views of the factors that influence opinions of the fairness of tax systems.

2. Ideas from the literature review

WHAT IS THE PURPOSE OF TAX?

An early idea is that the purpose of tax is to raise revenue for the provision by the government of public service benefits; this notion was articulated by Adam Smith in his first canon¹ and is relevant today even though the nature and magnitude of the public service benefits have changed significantly, particularly during the last century.

Generally, taxation is used as a tool for supporting and paying for the basic functions of government; these include managing the economy, regulation (protection of the environment, the public and vulnerable groups within society), developing society and providing public goods (eg defence and education systems) (Lymer and Oats 2008: 2). Additionally, taxation may be used to promote behaviours believed to be for the good of the wider community, eg environmental taxes,² and if the Exchequer is seen to use the revenues from those taxes in ways that contribute to improving the environment, eg better public transport, it may be argued that the public is more likely to view these taxes as fair.³

Tax may be seen as a membership subscription for the society in which we live; Judge Oliver Wendell Holmes, US Supreme Court, stated 'Tax is the price we pay for living in a civilized society and in a fair society we expect to pay our fair share' (quoted in Hurwicz 2001).

This implies the compulsory nature of tax. As responsible members of a civilised society we should expect to contribute taxes to support the government, summarised as: 'A tax is commonly defined as a compulsory levy by the government on people's income or wealth without a direct quid pro quo' (Song and Yarbrough 1978: 442).

Some believe that the tax system should be used to influence economic outcomes (Mintz 2003) and that a consumption tax is the best way to achieve this. Similarly another (Graetz 2005) argues that an ideal and simple

1 Adam Smith's four canons are summarised as follows: Equity: a tax should be seen to be fair in its impact on all individuals; Certainty: taxes should not be arbitrary, the taxpayer should know his or her liability and when and where to pay it; Convenience: it should be easy for taxpayers to pay what they owe; and Efficiency: the tax system should not have an impact on the allocation of resources and it should be cheap to administer. (Adapted from Lymer and Oats 2008: 43)

2 Seen as desirable by some UK respondents to the survey; although the ICAEW Tax Faculty, in its memorandum submitted in October 2007 to the Chancellor of the Exchequer (ICAEW Tax Faculty 2007) state that 'As a general principle, we are not in favour of using the tax system to encourage behavioural changes'. It believes that tax is one of a number of policy options available for changing behaviour.

3 The focus groups identified the notion that it is unlikely that a tax system will be perceived as fair if the revenue it collects is not used responsibly.

solution would comprise a consumption tax combined with an income tax paid by the top 5% of the wealthiest citizens. In other words a return to the situation that existed in the early part of the 20th century. A fundamental part of this idea is that by removing large numbers of the lower paid from the direct tax system, the government would save significant administrative costs while potentially maintaining revenues at the previous level.

In contrast, Lloyd George (Lymer and Oats 2008: 15) believed that the tax system should ensure that everyone contributes taxes to the country, no matter how poor they are. This seems equitable given that public expenditure provides benefits for the common good, but such a policy comes with a cost in terms of administration as revenue authorities would need to maintain records for virtually every citizen, regardless of the extent of their capacity to contribute to the public purse.

Thus there are important decisions to be made by government about the principles underlying the tax structure, which will affect the tax system and instruments chosen.

THE EVOLUTIONARY NATURE OF TAXATION POLICY

The tax system in advanced democracies at the beginning of the 21st century is very different in structure and purpose from the system in place a century ago, when the tax take was typically less than 10% of GDP (Steinmo 2003: 209). Tax policy ideas in advanced economies during the 20th century developed as a result of political and social changes (Steinmo 2003), eg in the UK additional funding has been required to pay for two major conflicts and social changes such as the introduction of the old age pension and the National Health Service, two institutions that are the subject of considerable debate today. The introduction of PAYE proved advantageous to government both in terms of improved cash flow during the tax year, and because employers acted as collection agents, a system that was quite efficient when most people worked for large public or private sector organisations (Lymer and Oats 2008: 16). Additionally, the electorate became used to the idea of paying tax as a deduction from salary. Indeed, for 2006/7, the UK government's largest source of tax revenue was that collected through the PAYE system: £125 billion in income tax and £85 billion in National Insurance Contributions (NAO 2007).

Over the same period in these advanced democracies, political ideas changed, moving from the use of tax policy as a means of economic redistribution, through to Keynesian economic views that governments should use tax policy as an instrument of social and economic management. Then in the 1980s, political opinion in the western world shifted towards allowing the market to determine economic outcomes with a reduced level of intervention by government (Steinmo 2003: 217).

More recently there has been an increase in globalisation, leading to increased tax competition, which some predict (Mintz 2003) heralds the end of corporation tax.⁴

The difficulty with the constantly changing economic and social environment is that tax systems may lag behind and so contribute to uncertainty. It is interesting to note other writers' proposals for a fifth desirable quality in a tax structure: that of flexibility: the ability to 'cope with changing economic circumstances over time without requiring substantive changes' (Lymer and Oats 2008: 44).

DEBATES AROUND FAIRNESS

In the literature, certainty is seen to be of great importance, 'a very considerable degree of inequality, ... is not near so great an evil as a very small degree of uncertainty' (Adam Smith, quoted by Davidson 2006: 5). The focus groups also raised this issue.

Transparency and complexity are also seen as having a significant bearing on certainty. In their review of the tax compliance literature, Richardson and Sawyer (2001: 184–8) note the multidimensional nature of complexity as a variable and cite the six dimensions identified by Long and Swingen (1988): ambiguity (complexity arising from more than one defensible position); computations (complexity arising from the need for frequent or complex calculations); change (complexity arising from frequent changes in the tax laws); detail (complexity arising from numerous rules and exceptions to rules); record keeping (complexity arising from onerous record-keeping requirements); and forms (complexity arising from confusing taxpayer forms and instructions). Using complexity ratings by tax practitioners, this study suggests that higher levels of complexity result in increased non-compliance, both intentional and unintentional.

It might be argued that legislation in some jurisdictions has now reached such a degree of complexity that it appears both tax officials and tax advisers struggle to interpret the position and so it seems that ordinary taxpayers have little hope of finding clarity on their own.

If trained people on both sides [HMRC and tax advisers] don't understand how to interpret the legislation then there is a problem. (Accountant in a small practice – UK focus group)

Following on from this point, it is also suggested that the tax implications of a transaction should be capable of being understood before the transaction is undertaken (Lymer and Oats 2008: 49). Tax planning activities – the legitimate organising of a taxpayer's affairs in order to minimise the tax due – have been regarded as perfectly legal. In the UK, an example of where HMRC itself has contributed to uncertainty is the (2007) case of *Jones v*

Garnett (Arctic Systems). HMRC pursued the case all the way through the English legal process over a number of years, resulting in a great deal of uncertainty over the area of SME tax planning during that time. The legislation was apparently unclear to both the tax officials and tax advisers, and even though the House of Lords has now found in the taxpayer's favour,⁵ views continue to differ with regard to certainty because HMRC announced that it would change the law as a result. Discussions continue as to whether this response is fair, given that the taxpayer simply arranged his affairs by choosing, out of two legitimate options, the one which would result in a lower tax bill.

HMRC itself currently has to deal with uncertainty following the *Capability Review of HM Revenue & Customs* (Cabinet Office 2007), which has resulted in the implementation of a further change process within the department.

A major debate relates to the issue of equity and how this should be defined. A number of writers agree on the need for two forms of equity in the tax system (summarised in Lymer and Oats 2008: 44):

- horizontal equity – where taxpayers with equal taxable capacity bear the same burden
- vertical equity – where those whose need is greatest suffer the least tax.

Closer inspection reveals that these are both difficult to define.^{6 7}

Other writers argue against traditional tax analysis, suggesting that taxation should be viewed in the context of the whole pattern of government expenditure,

What matters is not whether taxes – considered in themselves – are justly imposed, but rather whether the totality of government's treatment of its subjects, its expenditures along with its taxes, is just (Murphy and Nagel 2002: 25).

5 The Special Commissioners (June 2004) and the High Court (March 2005) found in favour of HMRC, on the basis that there was a 'settlement' (as defined by s.620 ITTOIA 2005) and that the exemption in s.626 did not apply. This was overturned by the Court of Appeal (November 2005), which decided in favour of the taxpayer on the basis that there was no settlement and therefore the settlements legislation could not apply. Finally in the House of Lords (July 2007), all five judges agreed that the case should be decided in the taxpayer's favour and although all but one took the view that there was a settlement, they were unanimous that the exemption in s.626 applied.

6 For a discussion of tax equity in distributive justice, see Musgrave (1990:114–7).

7 For a discussion of the history and principles of approaches to tax equity, see Musgrave (1996: 342–8).

4 Sheffrin (1996: 324) suggests, however, that the public holds the view that all entities should pay tax.

Some authors debate what kinds of taxes are most effective: income (Musgrave 1996) versus consumption (Mintz 2003 and Graetz 2005), flat (Davidson 2006) versus progressive (Musgrave 1990 and 1996). There are those who suggest the tax system is a means of achieving distributive justice, rather than as a requirement of justice itself (Sugin 2004).

In general terms, a consumption tax is claimed to be simpler (Mintz 2003 and Graetz 2005), but the rate at which this would need to be set, in order to maintain revenues, is suggested to be relatively high. Meanwhile, those in favour of an income tax suggest that it has the advantage of being visible to voters as the cost of public services (Musgrave 1996: 352), although the administrative cost must be weighed against this.

With regard to flat taxes, the most important characteristic of flat tax is that the tax rate should not vary over the income or expenditure range (Davidson 2006: 14). While this principle is simple to define, there are complexities to be resolved: what should the tax base be and what rate should be applied? And so the debate continues about the desirability of progressive taxation (Musgrave 1996).

THE IMPORTANCE OF PUBLIC ATTITUDES AND PERCEPTIONS

A number of writers suggest that taxpayer acceptance is important for the workability of the tax system (Musgrave 1996, Song and Yarbrough 1978, and Rawlings 2003). Those surveys that have attempted to measure public attitudes and perception may be misleading because of the following points.

- There are issues around the understanding of the technical terms and concepts – when subjects' views on tax were tested using a mix of abstract and concrete questions, it became apparent that there was a lack of public understanding of the concept of a progressive tax and how it operates (Roberts et al. 1994: 185).
- There may be differences between attitudes and behaviour (Seidl and Traub 2001: 257) – taxpayers may agree with a concept, but may feel differently when faced with the prospect of parting with their own hard-earned cash.
- Preferences may be heavily influenced by the structure and level of tax rates in force at the time the survey was taken (Sheffrin 1996: 318).
- Attitudes may be affected by perceptions of other taxpayers' behaviour – where taxpayers perceive that others, particularly high-wealth individuals, are not paying their fair share, this may lead to a breakdown of trust in the system and views that the wealthy should pay more (Rawlings 2003: 286).

There may also be general issues around survey design, framing of questions and measurement error.

The problem is encapsulated as follows:

...fairness as process and fair in outcome are deeply subjective concepts of expected behaviour and action concerning the fulfilment of mutually agreed upon, or expected obligations and bargains concerning resource distribution. In practice however, fairness is dynamic, fluid and contingent (Rawlings 2003: 279).

Increasing complexity, lack of certainty that others are contributing their fair share and a tax system that lags behind the pace of economic change may all contribute to a breakdown of trust and ultimately threaten the future perceived legitimacy of the tax system. The danger to the state is that as trust in the tax system decreases, levels of compliance fall and tax effectively becomes voluntary.

Another study (Sheffrin 1996: 311) notes that the public is more aware of some taxes than others and it is the more visible taxes that seem to be most unpopular with the general public.⁸

Given his finding that the public has limited knowledge of taxation matters, Sheffrin (1996) wonders whether the public could be educated about these issues. Another researcher notes, however, that as with any other area of government policy:

It is reasonable to expect that individuals, given the cost of acquiring and retaining information, would be unlikely to amass significant detail about a subject in which they have no direct decision making power (Gravelle 1996: 335).⁹

Nonetheless, despite the fact that individuals have limited knowledge about taxation matters, it is apparent that they hold strong views on the subject, although a tax system based on these views may not necessarily be efficient. Gravelle (1996: 336) suggests that the problem has the following components: first, what is the influence of public attitudes on decision making (which itself comprises two issues: the perceptions and knowledge of policymakers, and the influence of public attitudes on the structure of the tax system); and secondly, what are the implications for policymakers in formulating a desirable tax policy. The former is difficult to measure, and with regard to the latter:

The success of educating the public seems doubtful; indeed, it is not even clear that economists can get their message across to policymakers. To design tax policies so that they seem more acceptable to the public is the alternative (Gravelle 1996: 337).

⁸ Commenting on Sheffrin's paper, Hite (1996: 340) noted: 'People often focus on that part of the tax system that affects them the most'.

⁹ Gravelle (1996) commenting on Sheffrin's paper in Slemrod (1996), Tax Progressivity and Income Inequality. Also Hite (1996: 340) was of the view that the public may not be so ignorant and that ignorance is often rational, given that information is costly to obtain.

From a slightly different perspective, another study presents evidence that citizens tend to be more compliant when they have a positive view of the state (Frey 1997: 1050–2), finding its constitution and laws fair and believing that they are treated with respect by the authorities. Additionally, this work with the Swiss cantons suggests that where citizens consider they have a higher level of direct political control, their tax ethics are more developed and they are more likely to comply with the tax system.¹⁰

The implication for governments is that in setting tax policy the state should strive to be seen as neutral in its dealings with citizens (Rawlings 2003) in order to promote perceptions of fairness and procedural justice. Rawlings recognises, however, the difficulty of this being achieved by individual states in this time of increasing globalisation. Nevertheless, he argues that a number of initiatives, including international cooperation, could be used to restore fairness and balance.

Other studies (as reviewed by Richardson and Sawyer 2001) have explored the relationship between taxpayers' perceptions of fairness and their compliance, with inconclusive results. Some of this they attribute to uncertainty as a result of the multidimensional nature of fairness as a compliance variable. They highlight a distinction between, for example, perceptions of the fairness of the tax system in general and of the fairness of specific provisions in the tax laws. Whether or not perceptions of fairness influence compliance behaviour, they suggest that it is preferable for taxpayers to have a favourable perception of the fairness of the tax system. They cite a number of ways in which taxpayer perceptions may be positively influenced: education of taxpayers about the tax system; providing taxpayers with justifications for specific tax law changes made; reducing complexity; and giving taxpayers persuasive messages about the fairness of the tax system.

THE INFLUENCE OF TAX PROFESSIONALS

Individuals make use of tax specialists sometimes for compliance reasons and sometimes for tax planning purposes. Tax planning ranges from minimising the tax payable by ensuring that clients claim all the allowances to which they are entitled, to the other extreme, which may involve aggressive schemes that some might view as evasion. That tax advice in all its forms is a significant area of business may be demonstrated by the fact that the UK tax practice fee income for the top 50 accountancy firms totalled £2.267 billion in 2007 (*Accountancy Age* 2007).

As a result of their training, tax practitioners are by definition more educated about tax matters than the general public and so may hold different views. Song and Yarborough (1978) show a disparity between what tax specialists view as equitable and what the public believes is equitable.

Hite and McGill (1992) suggest that the training for tax advisers exposes them to a culture of aggressive tax planning techniques and required behaviours over a number of years. Therefore their aggressive stance may be independent of their clients' wishes, and may reflect their own understanding of tax minimisation. The study found no evidence to support a taxpayer preference for aggressive tax advice; in fact, taxpayers appeared to prefer conservative advice.

Roberts (1998) reviews 52 studies of tax accountants' 'judgement/decision-making' and proposes a model linking five categories of factors affecting this: individual cognitive and affective psychological factors; economic risks and rewards in the external environment; task inputs; cognitive processing; and task outputs. Key factors identified included individual psychological factors (eg tax accountants' knowledge, experience and advocacy attitude); and economic environmental factors such as the amount of tax savings at stake and, risks of audit and penalties, client risk preference and maintaining client relations.

PROCEDURAL ISSUES

Fairness may also be interpreted in the context of the procedures applied to taxpayers. As noted above, the majority of UK tax revenue is collected through the PAYE system; it is therefore a matter of concern to read in the National Audit Office (NAO) report on HMRC's 2006/7 accounts that as a result of difficulties with the PAYE computer systems, compounded by inconsistent working practices within the Department, it is estimated that each year the Department may not be pursuing some £880 million of tax due, and taxpayers are likely to have overpaid around £340 million, resulting in potentially five million taxpayers not paying the right amount of tax (NAO 2007). This cannot have a favourable impact on fairness perceptions in the UK.

Then, of course, there are the self-employed and their problems in finding their way through the self-assessment system.

It seems that the rigid mechanisms that have worked reasonably well in the past struggle to cope with the complexities of modern economic existence. One solution to this is the notion of responsive regulation in taxation (Braithwaite 2007), which works on the basis that taxpayers may be influenced to pay taxes if they are treated with respect. This involves remedying faulty tax system procedures and then using persuasion and education to encourage compliance. This supportive and more consensus-based approach is suggested to influence perceptions that paying tax is a desirable means of supporting a democracy. Of course, where non-compliance continues, a range of regulatory interventions would be used.

Discussions continue about the efficacy of a general anti-avoidance rule (GAAR).

10 For a discussion of theories of tax evasion and Frey's later work, see Heard (2005).

3. Research methods

There are three components to this study. The first is a review of previous research papers that either discuss or refer to the concept of 'fair taxes'. The second is quantitative research by means of an online questionnaire which sought the views of tax professionals in six countries. Thirdly, it was decided to obtain qualitative responses from tax professionals in each of the countries by holding focus groups.

The review of previous research examined the existing literature in order to assess the views of economists, philosophers, accounting scholars and psychologists relating to the problems of a definition as well as the factors to be taken into consideration. During this review we also examined proposals for alternative tax systems, eg flat taxes and consumption-based taxes.

Quantitative data was used from a survey undertaken by ACCA of its members having some professional expertise in the area of tax in six countries: Australia, Canada, Hong Kong, Singapore, the UK and the US. These are believed to represent a spread of different types of economy with varying levels of complexity in the tax system.

An overview of these countries is contained in Table 1.

The survey sought members' views as to the overall fairness and simplicity of the tax regime in the country in which they worked. The introduction to the questionnaire included definitions of fairness (simplicity, transparency and burden) in order to reduce uncertainty around the cultural and linguistic perceptions of fairness.

The analysis of the data was carried out using a combination of Excel and SPSS (Statistical Package for the Social Sciences). Although there was a relatively low response rate, we found that there was consistency between the views held by each country's tax professionals when the survey results were compared with the outcomes of the focus groups.

For the qualitative section of the research, a protocol was established for running the focus groups and this contained a structure in terms of expected length of the session and suggested questions for the chair. The object was to carry out this process independently of the questionnaire to enable a comparison of the views expressed through each medium and to explore accountants' perceptions of the issues that influence opinions regarding the fairness of tax systems. All focus groups were taped and a report was prepared based on the transcript. In Canada it was not possible to find a convenient time to hold the focus group owing to time constraints.

Table 1: Overview of selected countries

	Tax as % of GDP 2005	GDP 2006 in millions of US \$	Population 2006 '000s	GDP growth 2005
Australia	30.8%	768,178	20,521	2.8%
Canada	31.9%	1,251,463	32,556	2.9%
Hong Kong	10.49%	189,798	7,011	7.3%
Singapore	13.0%	132,158	4,393	6.4%
US	26.8%	13,201,819	298,988	3.2%
UK	37.5%	2,345,015	60,361	1.8%

Source: for Tax as % of GDP, see Table A3 in the appendix. The remaining statistics were sourced from World Bank (2008a). NB All six countries are described as high-income economies by World Bank (2008b).

Table 2: Overall usable response rates

	ACCA members surveyed	Usable response total	Response %
Australia	1,163	97	8.34%
Canada	1,005	46	4.58%
Hong Kong	11,432	266	2.33%
Singapore	3,454	132	3.82%
US	1,012	42	4.15%
UK	39,220	1,122	2.86%
Total	57,286	1,705	2.98%

Survey period: 25 September 2006 to 16 October 2006.

4. Quantitative research: online survey

The following definitions were used for the online survey.

‘Simplicity’ is an important indicator when assessing the fairness of tax systems. The more complex a tax system, the greater opportunities there are for avoidance, evasion and other forms of abuse and also greater chance for exclusion for non-tax experts who are unable to understand the system. The simplicity of a tax system can be measured for instance by the ease to calculate tax liability, the number of tax rates and allowances and the number of loopholes in the system. Of course ‘Simplicity’ does not automatically result in ‘fairness’. Where conflicts do arise, a trade off is needed.

‘Transparency’ is the extent to which the tax system is designed to be easily understood and accessed. For example, how easy it is to obtain an allowance or deduction for tax purposes for a specific item, say a depreciation allowance for an asset used in the business. Transparency also relates to the extent to which it is understood how much tax is collected, and how this tax funds government activities.

‘Burden’ refers to the extent to which certain groups, such as businesses and families, may pay disproportionately more tax. The tax ‘burden’ may also include the level of administration required in order to comply with the requirements of the tax regime. Taxes that cost a lot to administer not only distort the economy but can place an onerous burden on certain groups.

FAIRNESS AND SIMPLICITY

As a general comment, the findings are, for many of the questions, that respondents in both Hong Kong and Singapore have an overall positive view of the fairness (see Table 3) and simplicity (see Table 4) of their tax regime.

Fairness is a concept of relativity. When the three elements, namely ‘simplicity’, ‘transparency’ and ‘burden’, are taken into account to assess the fairness of a tax system, Hong Kong’s tax system is fair as compared to other jurisdictions in the region (Big Four tax partner, Hong Kong focus group).

Table 3: The tax system in my country is fair

	Mean	Median	Mode
Hong Kong	3.47	4.00	4
Singapore	3.92	4.00	4
Canada	2.74	2.50	2
US	2.93	3.00	4
Australia	2.55	2.00	2
UK	2.46	2.00	2

(1 = strongly disagree through to 5 = strongly agree)

Statistically significant differences in means at the .05 level were found between Australia, Canada, and the UK compared with Hong Kong and Singapore; Hong Kong compared with Singapore; and the US compared with Singapore.

The view from respondents in the UK, Australia and Canada for those issues was that their regimes were less fair (Table 3) and somewhat complex (Table 4). US respondents believed their tax system was relatively complex, but their opinions were more evenly spread with regard to fairness.

Table 4: Overall, how would you describe the tax system in your country in terms of simplicity?

	Mean	Median	Mode
Hong Kong	4.19	4.00	4
Singapore	3.52	4.00	4
Canada	2.26	2.00	2
US	2.02	2.00	1
UK	1.83	2.00	2
Australia	1.80	2.00	2

(1 = very complex through to 5 = very simple)

Statistically significant differences in the means were found at the .05 level between Australia compared with Canada, Hong Kong and Singapore; Canada compared with Hong Kong, Singapore and the UK; Hong Kong compared with Singapore, the US and the UK; Singapore compared with the US and the UK.

CAUSES OF COMPLEXITY

It is interesting to note that the results show overwhelming support across all countries for the view that it is the volume of directives/laws/regulations that has the greatest effect on complexity. The least important contributor to complexity in all countries was perceived to be filing/payment procedures.

There was also majority agreement across all countries that reducing complexity in the tax system would lead to a reduction in the level of tax avoidance and tax evasion.

Following on from this, the survey explored whether participants thought their country's tax legislation clearly differentiates tax avoidance from tax evasion. A clear majority of respondents in Hong Kong and Singapore believed their country's tax laws do clearly differentiate avoidance from evasion. A more evenly spread result was recorded from Australia, Canada and the US, although the mode score was 'Yes'.

Table 6: Do you think current tax regulations in your country clearly differentiate tax avoidance from tax evasion?

	Mean	Median	Mode
US	1.93	2.00	1
UK	1.80	2.00	2
Australia	1.80	2.00	1
Canada	1.63	1.50	1
Singapore	1.50	1.00	1
Hong Kong	1.47	1.00	1

(1 = Yes, 2 = No, 3 = Don't know)

Statistically significant differences in the means were found at the .05 level between Hong Kong compared with Australia, the US and the UK; and Singapore compared with the UK.

Table 5: Causes of complexity in the tax system

	All		Australia		Canada		Hong Kong		Singapore		US		UK	
	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean
Volume of directives/laws/regulations	1	1.61	1	1.44	1	1.72	1	2.04	1	2.03	1	1.68	1	1.47
Number of adjustments to be made in arriving at taxable profits/income	2	2.70	2	2.69	2	2.62	2	2.71	2	2.35	2	2.35	2	2.75
Number of taxes in place	3	2.84	3	2.80	3	2.77	3	2.96	3	3.30	3	3.19	3	2.76
Number of tax rates in place	4	3.53	4	3.65	4	3.62	4	3.56	4	3.56	4	3.68	4	3.50
Filing/payment procedures	5	4.00	5	3.92	5	3.69	5	3.74	5	3.81	5	3.86	5	4.10

(1 = greatest effect through to 5 = least effect)

It was only in the UK that a majority of respondents (54%) expressed the view that there is no clear differentiation between avoidance and evasion (the only country where the mode score was 2).

TRANSPARENCY

Another issue explored in the questionnaire was transparency (see Table 7). Again, respondents from Hong Kong and Singapore perceived their country to have the most transparency. UK respondents rated their country as the least transparent. Opinions were more diverse in the remaining three countries.

Table 7: Do you consider the tax system in your country to be transparent?

	Mean	Median	Mode
Hong Kong	4.09	4.00	4
Singapore	3.97	4.00	4
Australia	2.93	3.00	2
Canada	2.89	3.00	2
US	2.66	2.00	2
UK	2.30	2.00	2

(1 = not transparent through to 5 = very transparent)

Statistically significant differences in means at the .05 level were found between Australia and Canada compared with Hong Kong, Singapore and the UK; Hong Kong compared with the US and the UK; Singapore compared with Australia, Canada, the US and the UK.

COMMUNICATION BY TAX AUTHORITIES

The questionnaire also explored respondents' views on how well their country's tax authorities communicated with citizens. Again, respondents in Hong Kong and Singapore expressed the most comments agreeing that compliance requirements are clearly communicated by the tax authorities (see Table 8), closely followed by Australia and Canada. Respondents in the UK expressed the highest levels of disagreement with this statement although, once more, a considerable minority agreed. In the US, responses were evenly spread over the middle ground.

Table 8: Compliance requirements are clearly communicated by the tax authorities in my country

	Mean	Median	Mode
Singapore	3.77	4.00	4
Hong Kong	3.64	4.00	4
Australia	3.34	4.00	4
Canada	3.33	4.00	4
US	2.93	3.00	3
UK	2.67	3.00	2

(1 = strongly disagree through to 5 = strongly agree)

Statistically significant differences in means at the .05 level were found between the UK compared with Australia, Canada, Hong Kong and Singapore; Australia and Canada compared with Singapore; Hong Kong compared with the US; Singapore compared with the US.

When asked if the rationale for the existence of various taxes is clearly communicated by the tax authorities, the highest scores in agreement with the statement again came from Hong Kong and Singapore. The UK had the strongest level of disagreement, and the remaining three countries, although tending to disagree, also had considerable minorities who thought there was clear communication.

Table 9: The rationale for the existence of various taxes is clearly communicated by the tax authorities in my country

	Mean	Median	Mode
Singapore	3.58	4.00	4
Hong Kong	3.51	4.00	4
Canada	2.67	3.00	2
Australia	2.61	2.00	2
US	2.51	2.00	2
UK	2.12	2.00	2

(1 = strongly disagree through to 5 = strongly agree)

Statistically significant differences in means at the .05 level were found between Australia and Canada compared with Hong Kong, Singapore and the UK; Hong Kong compared with the US and the UK; Singapore compared with Australia, Canada, the US and the UK.

Overall, the respondents from Hong Kong and Singapore seemed to hold a more positive view of their countries' tax systems. This could be due to a number of factors: for example, they have in common with each other that they are relatively small (in terms of land area, population and economy), rapid growth and low tax international economies, whereas the other four countries surveyed are larger in terms of population and size of economy, and currently have slower growth rates. There may also be other factors at play, for example the implications of cultural, historical, political and constitutional factors. Additionally, Frey's work (Frey 1997) suggests that positive opinions about tax systems are more likely to occur where there is a 'trusting' tax system. In contrast, Frey (1997) quotes a previous study where he found that a 'distrusting' tax system exists in countries such as the Federal Republic of Germany, France and Italy, which are probably more similar to the UK historically and culturally (Frey and Weck-Hannemann 1984).

A disturbing trend throughout the questionnaire is that there appears to be a consistent response from the UK that taxes are unfair, too complex, lack transparency and that there is inadequate communication from the tax authorities. This is echoed in the UK focus group.

The complexity of legislation, particularly the increase over the last ten years, makes it difficult for laypeople to understand. This complexity creates unfairness and most people are disadvantaged (Accountant in a small practice – UK focus group).

Participants in the UK focus group also believed that retrospective changes to tax policies are unfair, citing the Arctic Systems case as typifying this.

There certainly seems to be a message from the UK in general that the lack of clarity in the legislation combined with increasing complexity and a seemingly aggressive stance by HMRC is leading to a breakdown of trust in the system, as summarised in the following view.

For tax to be fair and for people to have confidence in it, it has to be simple. It seems to me that the tax legislation ... has become so complex in the last three or four years that it's become inequitable. No one knows now what's going on. There's been a mushrooming of legislation: every day [the] Inland Revenue website will be introducing something. I mean, I deal with tax and that's all I deal with, and I can't keep up with the deluge of regulations and legislation. And it's just become inequitable, I think (Tax manager in a regional practice, quoted in Chittenden and Derregia 2006).

5. Qualitative research: focus groups

Focus groups were held in Australia, Hong Kong, Singapore and the UK with 32 participants.

Table 10: Focus group participants

Country	Number of practising ACCA members
Australia	4
Hong Kong	9
Singapore	7 attenders plus 3 giving views by email
UK	9

Owing to the logistical difficulties in bringing together a focus group in the US, a telephone conference was held following the focus group protocol with six practising ACCA members participating.

Participants were selected by ACCA in accordance with the protocol which prescribed the inclusion of members in the following areas: advising small firms; advising large firms; working in a small or medium-sized private company; working in a quoted company, specialising in direct taxes; specialising in indirect taxes; and specialising in personal (as opposed to business) taxes.

Each of the groups recognised that fairness in this context is difficult to define. The general view across all groups was that in order to be perceived as fair, a tax system should exhibit the following characteristics: simplicity, transparency and equity.

US participants rated the fairness of their country's tax system on a 0–10 scale. The ratings were all around the middle of the scale with a low score of 4 and the highest at 6–7. This group also noted the increase in complexity due to the levying of taxes at both federal and state level, with different systems in each state.

All groups shared the view that complexity contributes to unfairness. The UK group noted that to be fair a tax system should be capable of being understood by everyone, not just practitioners. The Australian group thought that their system was unfair in the sense that complexity can be addressed by wealthier people who can afford good tax planning advice and the cost of legal action if the need arises. This view was echoed by both the UK and US groups.

The Hong Kong group believed that although the tax rules in Hong Kong are simple, uncertainty is created by the way the Inland Revenue interprets the legislation and this leads to unfairness. They stated that commercial transactions are becoming more complicated as the economy develops, and that it is important for a tax system to keep up with these changes in order to ensure fairness for taxpayers. The attitude of the Inland Revenue towards taxpayers was seen as fundamental to the fair operation of the tax system. The group called for consistency in application of the tax rules by the Inland Revenue.

The Singapore group registered a view that 'compassion' or 'empathy' should be included as a characteristic of a

fair tax system. They thought that the Singapore tax system was more 'compassionate' compared to other tax systems in the region. It was less aggressive towards taxpayers and was generally seen to be sympathetic towards the man on the street and micro-entities, and empathetic with local culture and practices. This group also noted that the characteristics identified (simplicity, transparency, equity and empathy) are interdependent and yet may even work in different directions. They gave the example that simplicity may impose an inequitable burden on specific groups of taxpayers, such as a simple, flat GST, which they believed had an adverse effect on equity as it resulted in the less wealthy paying a higher proportion of tax relative to income compared with high-wealth individuals. They came to the view that a tax system should strive for an optimal mix of characteristics in order to maximise the fairness of the system.

The overall view of the Australian group was that their tax system is perceived as complex, with fairly high taxes and compliance costs. When tax laws are changed, this tends to be for political reasons without adequate regard for the consequent increase in complexity and uncertainty. This group suggested a step towards simplification would be the removal of the need for the lower paid to complete tax returns.

In the US group, there was general agreement that the tax system was complicated and burdensome, but not necessarily unfair to all concerned. They noted that complexity had increased in recent years and saw no prospect that this would diminish in the near future. On a realistic note, they acknowledged that this complexity was responsible for their employment. One participant described a 'good' tax system as equitable, stable and promoting economic growth. The notion that it should be based on the ability to pay was also expressed.

The UK focus group also noted an increase in complexity in recent years. Participants expressed the view that there are too many taxes in the UK and that this adds to complexity. Particular issues regarded as unfair were: the increasing role of employers as collecting agents for government, retrospective changes, stealth taxes (eg failure to index-link thresholds and allowances) and the frequent assumption of additional powers by HMRC. Practitioners were concerned that the legislation has now become so complex that trained people on both sides (practitioners and HMRC officials) struggle to interpret it. This, combined with the perception of the disparity of the treatment of errors on the part of taxpayers compared with those made by HMRC, contributes to a perception that the system is unfair.

Overall, the topics raised in the focus group discussions support the results of the online survey. Additionally, it became obvious that participants in the UK and US considered that their tax inspectors take an aggressive stance towards taxpayers, whereas participants from Singapore believed that their Revenue officials were seen to be more 'compassionate'. The Hong Kong participants noted that the Inland Revenue's attitude towards taxpayers is an important factor in the implementation of tax law.

6. Conclusions

From the review of research, it appears that a fundamental issue for governments, is to decide on the structure and purpose of the tax system, and to communicate the rationale behind the individual taxes to citizens in a clear manner. Nonetheless, we recognise the tension between formulating an efficient tax system and gaining political acceptance by all sectors of society.

It is apparent that policymakers' views of the purpose of tax policy and the need for equity therein have changed over time, resulting in a system which has been adapted to suit later intentions, thereby increasing complexity. An example of this is the legislation surrounding benefits in kind assessable on higher-paid employees and directors: a higher-paid employee in the UK is defined as earning £8,500 or more a year, a level set in 1979/80 that has remained unchanged¹¹ in spite of increases in wage levels and inflation. Hence, as also raised by the UK focus group, these rules now apply to all full-time employees and potentially, many part-time employees (Lymer and Oats 2008: 177). Focus group participants in all countries report a growth in the volume of legislation and directives, particularly in the last decade and this is also reflected in the survey results. Respondents in all countries in the survey, whether or not they believed their own country's tax system was complex, were clear that it is the volume of laws, directives and regulations that contributes most to complexity.

Again, from previous research it appears that certainty is a key issue in evaluating fairness and that transparency and complexity have an important bearing on this. The survey results support this as do the focus groups. The message to governments is to reduce the volume of laws, regulations and directives and communicate compliance requirements clearly.

Another issue related to economic change is the fact that the tax system typically cannot keep up with the pace of change. There are suggestions, both in the literature and from the focus groups, that governments should explore the creation of flexibility in the tax structure to allow a swift response to changing economic conditions. An example of an issue that was regarded as contributing to unfairness, both by UK survey respondents and the UK focus group, was that certain thresholds, eg stamp duty and inheritance tax, are perceived not to have risen in line with the general increases in house prices and thus there is a view that this lack of flexibility is disadvantageous. It should also be noted, however, that there may be a tension between flexibility and certainty. Of course 'fiscal drag' may have certain advantages for the Exchequer.

Just as policymakers' opinions have changed over time, so have public attitudes and perceptions towards fairness in taxation, and this appears to be encapsulated by Rawlings (2003) who describes fairness as 'deeply subjective... dynamic, fluid and contingent'.

Public attitudes may be influenced by economic and social conditions; views may change as the environment changes. Additionally, Frey's work (1997) suggests that taxpayer ethics will operate at a higher level within a 'trusting' constitution. The implication of this for the state is that by creating a 'trusting' tax system and thus raising the level of taxpayers' ethics, more taxpayers will feel inclined to comply, thereby reducing administrative costs

Another factor influencing public attitudes is whether other taxpayers are paying their fair share; for example, in the UK, there are frequent media references to high-profile wealthy individuals who are claimed to be paying less than their fair share of tax, such as the suggestion that the Rolling Stones have paid just 1.6% in taxes on their £240m earnings over the last 20 years (*Accountancy Age* 2006). There appears to be a need for governments to strive to be seen to be neutral in their dealings with all citizens and to be aware of the importance of communication in achieving that objective.

In summary, for a tax system to be perceived as fair by citizens, governments should strive to maintain a trusting constitution where citizens consider they have played a part in setting the system and that the system treats them with respect. Additionally, governments should maintain neutrality in their dealings with all citizens and all sectors of society and be seen to do so. Although it may be difficult to achieve, there appears to be support among participants in this study for exploring mechanisms for flexibility within the tax system to allow a quick response to rapidly changing economic conditions, thereby ensuring that the tax system keeps pace with changes in the economy. Finally, complexity was seen as a major issue with regard to certainty and thus fairness. Respondents from all countries believed that the chief contributing factor to complexity was the volume of directives, laws and regulations. Therefore, a key message for governments arising out of this study is the need to reduce, or at least contain, the volume of directives, laws and regulations and thereby moderate complexity.

11 Although the threshold may be removed as a result of the current consultation on the alignment of tax and National Insurance Contributions.

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Appendix: tax structures and administration

Table A1: Key points in the tax system (income tax, corporation tax and VAT)

a) Income tax

	No of rates	Lowest rate	Highest rate	Remarks
Australia	5	0%	45%	0% for taxable income below A\$6,000. NB A 1.5% Medicare levy is also applicable on incomes above the Medicare threshold (approx A\$16000).
Canada (federal rates)	4	15.5%	29%	The federal and provincial governments charge individual income tax.
Hong Kong	2	2%	19%	A standard rate of 16% is applied where the total tax payable, when applying this standard rate, is less than the tax payable when applying progressive rates. From 2007–8 onwards the highest rate is 17%.
Singapore	7	0%	20%	The first \$20,000 is 0% and the remaining rates range from 3.50% to 20%.
US	6	10%	35%	
UK	3	10%	40%	Individuals have tax free allowance of £5225 pa (2007/08) which can be considered as 0%.

b) Corporation tax

	No of rates	Lowest rate	Highest rate	Remarks
Australia	1	30%	30%	There is no other state or municipal tax on corporate profits.
Canada (federal rate)	1	38%	38%	Corporation income tax is also charged at provincial and territorial level. All provinces except QC have at least two rates for corporate income: lower rates levied on income that qualifies for small business deduction, and higher rates that are levied on other corporate income. Lower rates range from 3% to 5% while higher rates range from 11.5% to 16% (as at 1 Jan. 2007). AB, ON and QC administer their own corporate income taxes and their tax bases may differ. CCPCs (Canadian-controlled private corporations), which comprise the majority of corporations in Canada, qualify for reduced rates on their first \$400,000 of income. For 2007 the lowest rate is 13.12% and the highest rate would be 35.79% (investment income rate).
Hong Kong	1	17.5%	17.5%	The tax rate is 16% for unincorporated businesses.
Singapore	1	18%	18%	Flat rate of 18%. Effective tax rates are lower as partial tax exemptions exist for different levels of income.
US	6	15%	39%	
UK	2	20%	30%	Changes were announced in Budget 2007 to reduce the normal rate of corporation tax to 28%, with effect from 1 April 2008. The small companies' rate (previously 19%) increased to 20% from 1 April 2007 with further increases announced such that it reaches 22% by 1 April 2009.

c) VAT

	No of rates	Lowest rate	Highest rate	Remarks
Australia	2	0%	10%	Certain goods are exempt.
Canada (federal rate)	2	0%	6%	Various other sales related taxes are also collected at provincial level; they range from 7% to 10%. Certain goods are exempt (not 0%).
Hong Kong	0	–	–	No VAT/GST rates for Hong Kong.
Singapore	1	7%	7%	Standard rate of 7%.
US	0	–	–	There is no VAT or GST at federal level.
UK	3	0%	17.50%	Certain goods are also exempt.

Table A2: Top taxes as a percentage of total taxation receipts

	Personal Income	Corporation	Property	VAT	Social security and payroll	Others
Australia 2005–6 ^a	39.8	18.9	8.7	13.1	4.4	15.1
Canada* 2006–7 ^b	39.1	12.5	11.1	14.8	10.3	12.2
Hong Kong*** Fiscal year 06–7 ^c	27.18	46.37	16.97	–	–	9.48
Singapore 2005 ^d	15.33	26.06	6.78	13.56	–	38.27
US**** 2006 ^e	80.85	15.02	1.13	–	–	3.0
UK** 2005–6 ^f	32.79	10.51	3.51	18.31	21.49	13.39

Source:

a. Australian Bureau of Statistics (2007).

b. Statistics Canada (2007).

c. IRD (2008).

d. Government of Singapore (2007a).

e. US Department of the Treasury (2008).

f. HMRC (2008b).

* The figures consist of taxes collected at federal, provincial and local levels.

** Taxes on property include stamp duty and capital gains tax

*** Others include stamp duty, estate duty, betting duty, business registration fee and hotel accommodation tax.

**** The figure for personal income combines individual income taxes and employment taxes. The figure included under property relates to estate and gift taxes.

Table A3: Tax burden (Total taxes as % of GDP)

	2000	2001	2002	2003	2004	2005
Australia ^a	31.8	30.4	31.5	30.7	31.2	30.8
Canada ^b	n/a	34.1	33.0	31.9	31.6	31.9
Hong Kong ^c	n/a	7.8	7.29	8.61	9.89	10.49
Singapore ^d	n/a	n/a	n/a	12.9	12.5	13.0
US ^e	29.9	n/a	26.4	25.7	25.5	26.8
UK ^f	37.4	37.2	35.5	35.5	36.2	37.5

n/a = not available

Source:

a. Australian Bureau of Statistics (2007).

b. Statistics Canada (2007).

c. IRD (2007) and Census Dept (2007).

d. Government of Singapore (2007b).

e. and f. OECD (2007).

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