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FOREWORD

The papers included in this edition of the *Journal of the Australasian Tax Teachers Association (JATTA)* are based on presentations made at the 17th Annual Conference of the Australasian Tax Teachers Association (ATTA) held on Wednesday 26 January to Friday 28 January 2005 at Victoria University of Wellington, New Zealand.

The conference commenced with two half day workshops, the morning session a doctoral workshop organised by Associate Professor David White, Victoria University of Wellington, and the afternoon session a teaching workshop organised by Dr Margaret McKerchar. These two sessions were followed by the formal conference opening by the Dean of Victoria University of Wellington's Faculty of Commerce and Administration, Professor Tony van Zijl and Head of School of Accountancy and Commercial Law, Professor Brenda Porter. Plenary presentations were given on the opening day of the conference by the Hon. Justice Graham Hill, (Patron of ATTA), and David Butler, Commissioner of Inland Revenue. Sadly this was the last occasion that Graham was able to contribute to an ATTA Conference. Graham passed away on 24 August 2005. On the second day of the conference the plenary speaker was Dr Kevin Holmes from the IBFD.

The conference generated considerable interest from tax academics, policy makers and practitioners across both Australia and New Zealand, with over fifty papers presented. The papers in this edition of *JATTA* provide a snapshot of the variety of topics addressed by conference presenters. It is hoped that these papers will make a valuable contribution to the literature and stimulate the engagement and contribution of others, including students, to improving our respective tax systems.

Finally, the efforts of many made the 17th Annual Conference the great success that it was and have culminated in the publication of this edition of peer reviewed papers. Sincere thanks to all those involved. With your ongoing support, ATTA will undoubtedly continue to thrive as a valued organization, along with its key publication, *JATTA*.

Associate Professor Adrian Sawyer (University of Canterbury, New Zealand)

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22 February 2006

THE RHETORIC OF TAX INTERPRETATION – WHERE TALKING THE TALK IS NOT WALKING THE WALK

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‘There is a distinction – and there may be a divergence – between what Judges say they are doing, what they think they are doing, and the most accurate objective description of what they actually are doing’.¹

I INTRODUCTION

Despite concerted attacks from, most notably, the realist and critical legal studies ‘schools,’ liberal legalism remains the dominant legal discourse in the Australian community. For the purposes of this article liberal legalism may be understood to maintain that the exercise of coercive power by the state² is just when authorised by rules of general application promulgated by the sovereign law making body.³ According to this liberal theory of justice, determinate rules ensure that the law is purely prospective in its application, thereby enabling taxpayers to structure their affairs to maximise their pleasure returns under a system with predictable rules.⁴

In the realm of taxation jurisprudence adherence to this liberal legal discourse of legal determinacy is pervasive. In the secondary legal literature judges and commentators debate the respective merits of ‘literalism’, ‘purposive interpretation’ and/or a quest for certainty founded upon communal

¹ JL Mackie, *Persons and Values* (1985) at 135; cited in James Allan, ‘Statutory Interpretation and the Courts’ (1999) 18 *New Zealand Universities Law Review* 439 at 439.

² For an overview of the rationale for the existence of the state under liberal political theory see Duncan Kennedy, ‘Legal Formality’ (1976) *Journal of Legal Studies* 351. Briefly, the existence of the state is justified upon contractarian grounds (Hobbes, Locke), upon the basis of legal positivism (Austin, Bentham, Kelsen, Hart) or under an economic rationale (Mill, Coase, Posner).

³ See, for example, Australia, *An Assessment of Tax* (1993) xx.

The reference to rules is to rules in the broadest sense, such that even statutory ‘rules’ susceptible to a Dworkinian/Gadamerian interpretation fall within the definition of liberal theory. As will be described below, at least initially Hart proposed a positivist theory of law founded upon rules supplemented by judicial lawmaking. Some would require additional constraints upon the sovereign law making power of the legislature, such as Rawls and Dworkin, who maintain that moral rights ‘trump’ statutory obligations. The existence and proper extent of such constraints is beyond the scope of this paper.

For a fuller consideration of the content of legal formalism, or legalism, see J. Shklar, *Legalism*, (1964); D. Kennedy, *op cit* n 2; E. Balibar, ‘Positivism and Irrational Thought’ (1978) 107 *New Left Review* 3.

⁴ For the purposes of this paper, I refer to this depiction of statutory rules as the ‘determinacy thesis’.

In his earlier work, H.L.A. Hart, for example, suggested that positivism proposes that ‘a legal system is a “closed logical system” in which correct legal decisions can be deduced by logical means from predetermined legal rules without reference to social aims, policies or moral standards.’ (my emphasis) H.L.A. Hart, ‘Positivism and the Separation of Law and Morals’ (1958) 71 *Harvard Law Review* 601-602. Unger suggests that the strong definition of formalism entailed the ‘belief in the availability of a deductive or quasi-deductive method capable of giving determinate solutions to particular problems of legal choice.’ R. Unger, *The Critical Legal Studies Movement* (1986), 1. Unger notes that there are few adherents of this version of formalism today, and suggests that a more modern version of formalism can be defined as ‘a commitment to, and a belief in the possibility of, a method of legal justification that contrasts with open-ended disputes about the basic terms of social life, disputes that people call ideological, philosophical, or visionary.’ (*Critical Legal Studies Movement*, 1).

morality.⁵ In general, even the pragmatic reviews of tax interpretation suggest that the courts should adopt an interpretive approach which is founded upon the metwand of some, presumably finite and determinate, body of principle such as economic theory.⁶ The common theme of this enormous body of literature is the thesis that statute law should, and can, if written properly, convey a determinate meaning which is available to those who use the right interpretive method.⁷

As a relative latecomer to this well ploughed jurisprudential field of statutory interpretation, there is good reason to question whether I have anything new to add on this topic. However, the purpose of this article is to question the relevance of the determinacy thesis outlined above.⁸ Whilst accepting that the determinacy thesis is an appealing theory of law in a first best world, it is doubtful whether such normative accounts are of any benefit in our second best world where semantic indeterminacy prevails.⁹ I therefore wish to offer an alternative *descriptive* account of tax interpretation, founded

⁵ DC Pearce and RS Geddes, *Statutory Interpretation in Australia*, (4th edn 1998), 238: 'Thus, while the courts will do all that is possible to ascertain the meaning of a taxing Act, they regard the imposition of a tax ... as of such importance that it is incumbent on the legislature to make its intentions clear beyond doubt'. Further, Kreyer discusses literalist and purposive interpretation of tax legislation apparently upon the basis that this dichotomy describes the jurisprudential debate with respect to statutory interpretation: R Kreyer, 'Taming Complexity in Australian Income Tax' (2003) 25 *Sydney Law Review* 46. For an earlier expression of a similar view see; Rick Kreyer, 'Avoidance, Evasion and Reform: Who Dismantled and Who's Rebuilding the Australian Income Tax System?' (1987) 10 *University of New South Wales Law Journal* 215. See also: Robert Allerdice, 'The Swinging Pendulum: Judicial Trends in the Interpretation of Revenue Statutes' (1996) 19 *University of New South Wales Law Journal* 162; DG Hill, 'How is Tax to be Understood by Courts' (2001) 4 *The Tax Specialist* 226; D Goldberg, 'Between the Taxpayer and the Executive: Law's Inadequacy; Democracy's Failure?' [1996] *British Tax Review* 9 at 11; Geoffrey de Q Walker, *The Rule of Law: Foundation of Constitutional Democracy* (1988) at 344.

⁶ See, for example, Neil Brooks, 'The Responsibility of Judges in Interpreting Tax Legislation' in G Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 93 at 99.

Although Grbich sees problems with the application of economic principles to the resolution of tax disputes, he suggests that such a model offers greater social benefit than the 'legalist' model: Y Grbich, 'Is economics any use to tax lawyers? Towards a more substantial jurisprudence to replace legalism' (1980) 12 *Melbourne University Law Review* 340. For a more overt recommendation that the tax base should be redefined in terms of Simons' concept of income, see Jeff Waincymer, 'If at first you don't succeed ... Reconceptualising the income concept in the tax arena' (1994) 19 *Melbourne University Law Review* 977, 1019. For a fascinating insight into this debate and an interesting discussion of the decision in *Eisner v Macomber* 252 U.S. 189 see H Cairns, 'A Note on Legal Definitions' (1936) 36 *Columbia Law Review* 1099. Cairns argues that the legal institution seeks rules which are functional rather than necessarily consistent with theory applicable in other realms such as economics. Thus, he argues, the economic concept of income is irrelevant to framing a workable 'income' tax.

⁷ Prebble argues that the income tax is inevitably complex because the concept of income is mired in legal concepts rather than the 'real' economic world: John Prebble, 'Income taxation: a structure built on sand' (2002) 24 *Sydney Law Review* 301. Quare whether profits do, indeed, 'exist in the natural world' (at 310) as a 'profit' is itself an artificial construct and has no intrinsic objective value (as it does not necessarily measure my ability to acquire goods and services because that ability will be affected by a host of subjective factors, such as my relative ability to drive a hard bargain). Even if Prebble's critique of the income tax is justified those within the domain of liberal legal theory would assert that an income tax built upon the quicksand of legal fictions could still produce determinate results if crafted with sufficient care. One significant rhetorical aspect of the determinacy thesis is the suggestion that law is like a science – hence the emphasis upon the 'legal method' drummed into successive generations of budding lawyers upon the basis that correct application of 'the method' will lead inexorably to legal truth (on the assumption that science is the epitome of rational thought – see Paul Feyerabend, *Against Method*, (revised edn, 1988); Alan Chalmers, *What is this thing called science?* (2nd edn 1982).

⁸ Burton attempted to set out the theoretical basis for this alternative account of legal practice; see: M Burton, 'Determinacy, Indeterminacy and Rhetoric in a Pluralist World' (1997) 21 *Melbourne University Law Review* 544; M Burton, 'The Song Remains the Same - The Search for Interpretive Constraint and the Rhetoric of Legal Theory in Hart and Hutchinson' (1997) 20 *University of New South Wales Law Journal* 407.

⁹ For a good introduction to language theory see Terry Eagleton, *Literary Theory* (1983).

in the pragmatic interpretive tradition. This article, then, does not offer a normative account of statutory interpretation because I fall into the ‘postmodern camp’ which accepts that any normative account is ultimately founded upon subjective assumptions and is therefore susceptible to criticism for failing to meet the criteria founded upon alternative (subjectively derived) standpoints.¹⁰

The thesis of this article is that the perceived separation of the political and legal realms, described as the ‘rule of law’ and embodied in the accounts of determinate statutory interpretation, offers an inaccurate description of what judges do when they interpret tax legislation.¹¹ Following a consideration of the portrayal of the determinacy thesis by some judges in their extra-curial writing, the article challenges this mainstream account of tax interpretation by offering an alternative descriptive account of the judicial practice of statutory interpretation. This alternative account draws upon the concept of rhetoric, or the art of persuasion. Arguing that the meaning of taxation law is contingent, the article suggests that the function of a judge is to develop a compelling argument for a particular interpretation rather than the judge searching for the ‘right’ interpretation.¹² In developing an argument for a particular interpretation the judge will rely upon various rhetorical devices.¹³ The article sets out a rudimentary categorisation of rhetorical devices relied upon by the judiciary when grappling with our taxation law. The article concludes with a consideration of the institutional reforms which might be expected to flow from the adoption of this alternative account of the interpretive process.

II WHAT ‘OFF DUTY’ JUDGES SAY THAT THEY DO – JUDICIAL PRAGMATISM OR RIGHT ANSWERS?

Over the past decade a number of ‘off duty’ Australian judges have been willing to share their views upon what they do when interpreting statutes. In general, it is fair to say that four approaches to the interpretation of legislation are described in these extra-curial statements. These views reflect the ongoing debate with respect to the question of whether judges exercise a broad interpretive discretion or do arrive at the ‘right’ legislative meaning when interpreting legislation.

A *Pragmatism*

The first approach adopts a pragmatic theory of interpretation in that it accepts that there is no ‘right answer’ for a particular interpretive problem. Rather, the role of the judge is described in terms of a discretion to select from any number of possible alternative interpretations of the relevant statutory text. The exercise of this discretion is unconstrained by principle, being influenced by subjective

¹⁰ Of course, postmodernist discourse would also challenge claims to a universally truthful descriptive account such as the account presented here. It is beyond the scope of this paper to engage with this strong counterclaim. Suffice to say, that I argue that knowledge is ultimately founded upon the ability to persuade others to accept the weight of the argument and so the purpose of this paper is essentially a rhetorical one – the purpose will be achieved if the reader puts the paper down and says ‘yes, that is a convincing account of the practice of tax interpretation’.

¹¹ The basic tenets of this thesis are not new – whether a text has a determinate meaning has troubled philosophers for millennia. For a good account of the perceived disorder of law from this sceptical perspective see C Sampford, *The Disorder of Law: A Critique of Legal Theory* (1989). For a consideration of the application of Sampford’s account to Australian statutory interpretation see Jeffrey Barnes, ‘Statutory Interpretation, Law Reform and Sampford’s Theory of the Disorder of Law’ (Pt 1), (1994) 22 *Federal Law Review* 116; Jeffrey Barnes, ‘Statutory Interpretation, Law Reform and Sampford’s Theory of the Disorder of Law’ (Pt 2) (1995) 23 *Federal Law Review* 77.

¹² Hans Blumenberg summed up the rhetorical position that we routinely find ourselves in when he observed ‘Lacking definitive evidence and being compelled to act are the prerequisites of the rhetorical situation’: Hans Blumenberg, ‘An Anthropological Approach to the Contemporary Significance of Rhetoric’, trans Robert Wallace in Kenneth Baynes, James Bohman and Thomas McCarthy (eds), *After Philosophy: End or Transformation?* (1987), 441.

¹³ For a fuller discussion of the theoretical basis of this account see M Burton, ‘Determinacy, Indeterminacy and Rhetoric in a Pluralist World’, (1997) 21 *Melbourne University Law Review* 544.

judicial conceptions of 'justice'. At times various judges have conceded the merits of this description of the judicial approach to statutory interpretation. Thus, for example, Justice Hill states:

And while the rules of interpretation may not be contentious as such, their application to the statute and then the application of that statute as interpreted to the given facts will give the judge much judicial discretion to reach a conclusion which he or she perceives to be just. And the possible width of that discretion will operate to make an adviser's task even more difficult in predicting an outcome.¹⁴

In similar vein, Justice Kirby states:

The view that the judge, construing the Constitution or an Act of Parliament (or other legislative instrument), merely has to look long and hard enough to find the "intention" of the relevant Parliament, has given way to an increasing awareness that talk of "intention" is liable to be misleading; that the process of construing ambiguous language is a complex one; and that the search is really one for the preferable, or more consistent, meaning which achieves the purpose of the law derived from the text and structure of the instrument stating it. In many cases, particularly of legal instruments written in the English language, there is inescapable ambiguity. Somebody has to cut the Gordian knot. In our form of society, that somebody is ultimately, usually, a judge. Sometimes there is no clear, perfect and unarguable resolution of the ambiguity. The judge must simply offer the preferred result with reasons to explain why it, rather than alternatives, has been preferred.¹⁵

The suggestion that judges create meaning has occasionally also been made verbally by judges. Thus, for example, Geoffrey de Q Walker records:

At a gathering in Canberra in 1984 a High Court justice, who is a member of the usual majority on that court, said in front of several witnesses who included the writer that sociological and economic theories were of use in adjudication because they could be used to 'dress up' a conclusion already reached on other grounds.¹⁶

The recognition of judicial discretion in the interpretive domain suggested by these statements is heresy to those who maintain that the judge is merely the conduit for a determinate legislative message.¹⁷ It must therefore be questioned whether the three judges intended to go so far as to adopt a pragmatic account of statutory interpretation. While the oral statements of judges may be explained away as idle chat, the written statements extracted above require closer scrutiny.

Justice Hill suggests that the judge must seek a 'just' result. Although many argue that justice is a subjective concept, many others argue that justice has an objective meaning (formal justice, utilitarian justice, or justice according to finite moral norms (universal or specific to a particular culture)). It is possible that Justice Hill is adopting the latter understanding of 'justice', in which case his statement would be consistent with the determinacy thesis.

¹⁴ DG Hill, 'How is tax to be understood by Courts' (2001) 4 *The Tax Specialist* 226 at 233.

¹⁵ M Kirby, 'Judging: Reflections on the Moment of Decision' (1999) 18 *Australian Bar Review* 1 at 5. See also M McHugh, 'The Judicial Method' (1999) 73 *Australian Law Journal* 37 at 48-9.

¹⁶ Walker, above n 5, 429 (n 48).

¹⁷ Walker, above n 5.

Justice Kirby's statement may also be understood as an endorsement of the determinacy thesis. Although the latter part of the extract clearly envisages an interpretive discretion, this is prefaced by the comment that the search is really one for the preferable meaning which achieves the purpose of the law. One interpretation of Justice Kirby's observation, then, would be that the purpose of the law is the bedrock upon which any resolution of textual ambiguity in a statute may be resolved.¹⁸

It is therefore unclear whether Justices Kirby and Hill would endorse the postmodern account of adjudication suggested by Sampford:

This analysis of the judges' position suggests a new way of arguing for judges. They could seek to demonstrate that traditional techniques of legal interpretation produce conflicting answers and hence demonstrate the existence of the choice. Then they could state their reasons, in terms of values and political theory, for choosing the way they do.¹⁹

Sampford's account therefore contemplates unconstrained judicial discretion in deciding cases – a view which appears inconsistent with the suggestions of constraint imposed by 'justice' and 'legislative purpose'.

B *Legislative purpose*

This narrow reading of the 'pragmatic' statements of Justices Kirby and Hill respectively is also supported by their reliance upon a purposive theory of interpretation to reaffirm the view that judges do arrive at the 'right answer'. This purposive theory of statutory interpretation represents the second judicial description of statutory interpretation.

While many judges and commentators refer to 'the purposive approach' there are in fact three purposive approaches discernible in the literature.²⁰ These approaches differ upon the critical issue of the nature of the purpose which is considered to be the object of the interpretive process:

1. The actual subjective purpose of the legislature;²¹
2. The 'counterfactual purpose'²² – that is, a consideration of what Parliament would have intended had they considered the application of the statute to a particular set of circumstances.

¹⁸ Despite his acceptance of judicial law-making, Justice McHugh maintains that one factor that a judge must take into account is the need to maintain the rule of law': McHugh, above n 15, at 48. This seems to suggest that McHugh's concept of judicial law making is closely circumscribed; a suspicion confirmed by his statement that 'if the social or economic consequences of extending or modifying liability are problematic, the extension or modification should not be made. Courts are not law reform commissions. ... They do not have the resources to undertake a comprehensive survey of permanent social values or the social or economic ramifications of judicial changes to the law and, even if they did, that exercise is incompatible with their constitutional function.' (at 48).

¹⁹ Sampford, above n 11, 275.

²⁰ For a general discussion of alternative theories of purposive interpretation see M Moore, 'The Semantics of Judging' (1981) 54 *Southern California Law Review* 151.

²¹ See, for example, DG Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 *Australian Law Journal* 685 at 692 ('if earlier legislation has been the subject of court clarification and the terms of that legislation are repeated in consolidating legislation it is presumed *that Parliament intended* to use the terms in the way which is consistent with the earlier case law.' (emphasis added))

²² Some refer to this branch of purposive construction as 'imaginative reconstruction'; William N Eskridge et al, *Legislation and Statutory Interpretation*, (2000) at 218-20.

This type of purpose may be referred to by Justice Hill in the following passage:

If there is more than one possible construction open, think about the consequences which flow from each and ask what was it more likely that parliament intended. In doing this you will be doing just what the courts will have to do if the matter comes before them and your answer will most likely be right';²³ and

3. The objective purpose of the legislation (as part of the entire legislation of a jurisdiction,²⁴ in its entirety or the objective purpose of each particular provision within an Act of Parliament).

The earlier extract from Justice Kirby's article indicates his resort to the purpose of the statute (drawing a distinction between the intention of parliament and the purpose of the statute), a steady navigational reference point to which he returns later in his article. Reflecting upon the fact that he has found himself in the minority in a number of cases, his Honour notes:

Doubtless in some cases I have just been wrong. At least, that is what the majority has held. But in other cases, where there is a genuine difference of view on the meaning of the words taken in their context, I suspect that the difference may (at least occasionally) be explained by reference to the more insistent demand that I feel to ascertain, and give effect to, the legislative purpose as I see it in the language under consideration.²⁵

A similar approach to discerning the legislative purpose by examining the statutory text in its context was expressed by Sir Ivor Richardson. While conceding that tax legislation was innately complex and that his 'scheme of the legislation and purpose' approach would not always provide the right answer, his Honour suggested that such an approach was 'likely' to produce the right answer.²⁶

C *Legal Hermeneutics*

The third approach to statutory interpretation referred to in some of the judicial writing questions both pragmatic and purposive methods of statutory construction. Instead, this approach maintains that judges confronted with legislative ambiguity take account of community standards when deliberating upon the meaning of a statutory text. These judges and other commentators argue that judges must have recourse to fundamental communal moral norms in 'making' law in some sense. For example, Sir Anthony Mason opined:

No one would suggest nowadays that statutory interpretation is merely an exercise in ascertaining the literal meaning of words. Statutory interpretation calls for reference not

²³ DG Hill, 'How is tax to be understood by Courts' (2001) 4 *The Tax Specialist* 226 at 234.

²⁴ Which might include reference to 'fundamental' legislative purposes, such as maintaining the integrity of the political system: see Max Radin, 'Statutory Interpretation' (1930) 43 *Harvard Law Review* 863 at 867.

²⁵ Michael Kirby, 'Judging: Reflections on the Moment of Decision' (1999) 18 *Australian Bar Review* 1, 19.

²⁶ Sir Ivor Richardson, 'Appellate Court Responsibilities and Tax Avoidance' (1985) 2 *Australian Tax Forum* 3, 9; see also Sir Ivor Richardson, 'Reducing Tax Avoidance by Changing Structures, Processes and Drafting' in G Cooper, above n 6, 327.

only to the context, scope and purpose of the statute but also to antecedent history and policy as well as community values.²⁷

Similarly, Sir Ivor Richardson observed that ‘the interpretation approach taken inevitably depends on judicial attitudes and the perceptions judges have of community values, as well as on any statutory directives.’²⁸ Further, in an article penned in 1995 Justice Hill referred to community expectations on several occasions, before observing:

If the community expects the High Court to take a different course from that which it now does, whether in taxation or other matters, it is for the community (not politicians) to make the Court aware of that. Court decisions, if they are to be widely accepted, need to be built on community standards.²⁹

This represents a tacit adoption of Ronald Dworkin’s hermeneutic approach to statutory interpretation.³⁰ According to this view, reference to the literal meaning and/or the purpose of legislation is incapable of describing the process of statutory interpretation. Rather, a hermeneutic theory holds that legislation is interpreted with the purpose of continuing the legislative story initiated by the legislature – one which is in accordance with the moral norms embedded in the authorised legal texts (ie statutes and case law). This hermeneutic process is furthered by finding the interpretation of the legislation which achieves the best fit with these authoritative legal materials.³¹

D Textualism

The fourth approach is what might be described as textualist. While I have adopted the textualist label, this approach is often described by the judges as literalism. It is somewhat incongruous with the concept that the word ‘literalism’ appears to have assumed at least three meanings in the primary and secondary literature.³²

²⁷ Sir Anthony Mason, ‘Changing the Law in a Changing Society’ (1993) 67 *Australian Law Journal* 568 at 569. For extra curial judicial statements to similar effect see Sir Anthony Mason, ‘Future Directions in Australian Law’ (1987) 13 *Monash University Law Review* 146, 158-9; Sir Anthony Mason, ‘The Role of a Constitutional Court in a Federation - A Comparison of the Australian and the United States Experience’ (1986) 16 *Federal Law Review* 1, 5; Sir Anthony Mason, ‘Courts and Community Values’ (1996) 6 *Eureka Street* 32; Michael McHugh, ‘The Law-making function of the Judicial Process’ (Pt 1) (1988) 62 *Australian Law Journal* 15; Sir Ivor Richardson, ‘Reducing Tax Avoidance by Changing Structures, Processes and Drafting’ in G Cooper, above n 6, 327 at 330.

For criticism of this approach generally see Paul Finn, ‘Of Power and the People: Ends and Methods in Australian Judge-Made Law’ (1994) 1 *Judicial Review* 255.

In the more recent literature this theory of language is reflected in the suggestion that the Australian community needs to collaboratively construct meaning for the purposes of taxation law by engaging in ‘regulatory conversations’: J Braithwaite, *Making Tax Law More Certain: A Theory*, (Working Paper No 24, Centre for Tax System Integrity, Canberra, 2002).

²⁸ Sir Ivor Richardson, ‘Reducing Tax Avoidance by Changing Structures, Processes and Drafting’ in G Cooper, above n 6, 327 at 330.

²⁹ DG Hill, ‘Great Expectations: What do we expect from judges in tax cases?’ (1995) 30 *Taxation in Australia* 21, 29.

³⁰ Ronald Dworkin, *Law’s Empire* (1986), viii-ix, 76-86.

³¹ This idea of ‘best fit’ was referred to by Kirby P, as he then was, in *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1995) 96 ATC 4098 at 4101.

³² It seems that there is little express consideration of the varying streams of literalism in the primary or secondary literature in Australia, as most authors refer to ‘literalism’ apparently upon the assumption that it has just one denotation.

'Literalism' is sometimes taken to refer to the purported practice of interpreting legislation according to the 'literal' meaning of the words.³³ Appealing for its apparent simplicity, this approach is founded in formalist language theory which maintains that each word has an assigned and finite meaning. Judicial interpretation of tax legislation, according to this theory of language, is merely a matter of joining the dots which, presumably, virtually anybody with a dictionary could do.

Secondly, literalism has sometimes been modified by the adjective 'strict',³⁴ although it is unclear what this adjective adds to the literalist concept as literalism appears to be an absolute. Nevertheless, the concept of 'strict literalism' developed the connotation of reading the legislation narrowly (even artificially narrowly) and therefore often has assumed pejorative connotations if someone is described as a 'strict literalist'.³⁵

Finally, literalism is taken to refer to the practice of identifying the meaning of the legislative text, which may entail consideration of the statutory context of particular provisions and relevant common law assumptions regarding the interpretation of legislation. Thus, in what is taken to be one of the classic Australian statements of the literalist approach, Higgins J stated:

The fundamental rule of interpretation, to which all others are subordinate, is that a statute is to be expounded according to the intent of the Parliament that made it: and that intention has to be found by an examination of the language used in the statute as a whole. The question is, what does the language mean; and when we find what the language means, in its ordinary and natural sense, it is our duty to obey that meaning, even if we find that the result to be inconvenient or impolitic or improbable.³⁶

The reference to interpreting the legislation as a whole is significant here, as it clearly recognises the significance of the statutory context to the interpretive process.³⁷

Perhaps owing to the pejorative connotations of the third understanding of 'literalism', few if any contemporary judges expressly avow a 'literalist' stance. However, many contemporary judges appear to adopt a textual approach to statutory interpretation falling within the third understanding

It should also be noted that Kreyer seems to define literalism as a formalist approach to the characterisation of the material facts of a case: Kreyer, above n 5, at 476-7. Although a formalist characterisation of the facts and what purports to be a literalist approach to statutory interpretation are often deployed together, they are separate aspects of the interpretive process. Interpretation entails identifying the meaning of the legislation, while the characterisation of the facts (on a substantive or formal basis) is the first step of the process of applying the legislative meaning to the facts of a particular case. Accordingly, I have not considered this formalist characterisation of the facts of a case, which Kreyer describes as literalism, in my discussion of statutory interpretation.

For discussion of the subtleties of textualist approaches adopted in the United States of America, see M Mullins Sr, 'Coming to Terms with Strict and Liberal Construction' (2000) 64 *Alberta Law Review* 9.

³³ The classic judicial statement of which may be seen in *The Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64 at 71.

³⁴ See, for example, John Ward, *De Rothschild v Lawrenson* [1994] *British Tax Review* 250.

³⁵ *FCT v Westraders Pty Ltd* (1980) 144 CLR 55 at 80 per Murphy J.

³⁶ *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129 at 161-2; with the exception of the concluding clause, this statement of principle was accepted as a correct statement of the law by Mason and Wilson JJ in *Cooper Brookes (Wollongong) Pty Ltd v FCT* 81 ATC 4292; (1981) 147 CLR 297 at ATC 4305.

³⁷ In the United States of America this form of literalism has been promoted by Justice Antonin Scalia, *A Matter of Interpretation: Federal Courts and the Law* (1997). For a critical reading of Scalia's work see William D Popkin, 'An "Internal" Critique of Justice Scalia's Theory of Statutory Interpretation' (1992) 76 *Minnesota Law Review* 1133

of 'literalism' outlined above. These judges maintain that the terms of the legislation are the focus of statutory interpretation and the consideration of matters beyond the four corners of the legislation is irrelevant. Even some judges who appear to adopt one of the other three theories of statutory interpretation appear to concede that such a textualist approach has its place in the judicial skill set. Thus while Lord Steyn apparently endorses an activist approach to adjudication in the case of statutory interpretation, he notes that 'fiscal legislation may sometimes require a stricter approach than social welfare legislation'.³⁸ Similar reservations about a creative interpretive approach are also noted by the former Chief Justice of the High Court of Australia, Sir Anthony Mason:

In the case of statutes which impinge upon fundamental values, it is possible to say that an unambiguous and unmistakable expression of intention is required to justify an interpretation which trenches upon the values. To insist upon the expression of such an intention is to enhance the legislative process by compelling those who introduce legislation to make plain to the legislature what the effect of the legislation will be.³⁹

Perhaps a more overt expression of a textualist approach may be seen in Justice Hill's article of 2001, where he defends the 'literalist' approach that he adopted in deciding the CPH matter.⁴⁰

Indeed, some recognition of this textualist approach may even be found in the statements of Justice Kirby. For example, in the earlier extract from his 1999 article he suggests that his views may differ from those of his brethren because of the 'more insistent demand that I feel to ascertain, and give effect to, the legislative purpose as I see it in the language under consideration.'⁴¹ This implies that the statutory text is at least the primary focus of the judge when ascertaining the legislative purpose.

E *Pragmatism or determinacy? What off duty judges conclude*

The preceding overview of extra-curial judicial discussion of statutory interpretation supports the proposition that, when they do take the opportunity to express their views on this topic, judges generally endorse one or more versions of the determinacy thesis. Despite some recognition of pragmatic theories of statutory construction which hold that judges 'make it up as they go', judges seem to resile from such radical pragmatism and accept that communal morality, the legislative text and/or the legislative purpose are the bedrock upon which a theory of interpretive certainty may be founded. Moreover, some of the judges suggest that the two main sources of interpretive determinacy are purposive interpretation and textualism, even going so far as to say that the case law reflects a pendulum-like oscillation between these two 'extremes'.⁴²

³⁸ J Steyn, 'The Intractable Problem of the Interpretation of Legal Texts' (2003) 25 *The Sydney Law Review* 5, 8.

³⁹ Personal communication from Sir Anthony Mason to Professor John Braithwaite, quoted in John Braithwaite, 'Community Values and Australian Jurisprudence' (1995) 17 *Sydney Law Review* 350, 366. Without expressly considering the alternative definitions of literalism, Sir Anthony had indicated in an earlier article that he considered that the construction of tax legislation entailed consideration of the entire statute: Sir Anthony Mason, 'Where Now?' (1975) 49 *Australian Law Journal* 570 at 574. For the proposition that interpretation of statutes 'more readily lend themselves to a legalistic approach' see Sir Anthony Mason, 'The Role of a Constitutional Court in a Federation' (1986) 16 *Federal Law Review* 1 at 5.

⁴⁰ Hill, 'How is Tax to be Understood by Courts', above n 5, at 232-3. His Honour then carries on noting that the difference of opinion with the Full Federal Court reflects the scope of judicial discretion with respect to statutory interpretation.

⁴¹ Kirby, above n 25 at 19; in the same way, Sir Ivor Richardson appears to sheet his purposive construction home to the 'scheme of the legislation' which is to be gleaned from the statutory text: Richardson, above n 26.

⁴² See, for example, G Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 *Australian Law Journal* 685 at 685; Hill, above n 5 at 234.

Regardless of whether there is a swinging interpretive pendulum, according to this secondary literature judges exercise only a limited discretion when interpreting legislation. In any particular case, it seems, a judge chooses between just three possible alternative approaches to the interpretive task. Furthermore, these three approaches are referred to in terms which suggest that each interpretive approach supports just one interpretation. Thus, for example, the reference to ‘the community’, ‘the’ legislative purpose or ‘the’ literal meaning indicates that, once a judge has selected one of the three ‘authorised’ interpretive methods, it is a relatively straight and narrow path to the ‘right’ interpretation of the relevant legislation.

III WHY TALKING THE DETERMINACY TALK PREVAILS

As already noted, the same judges that adopt these alternative formulations of the determinacy thesis also appear to suggest that the determinacy thesis is a fiction.⁴³ A fiction which is appealing for its neat categorisation of institutional functions and its reassuring depiction of rule certainty is a fiction nonetheless. However, as noted above, these suggestions are but faintly suggested and no judge appears to develop a comprehensive account of pragmatic adjudication – the suggestions of pragmatism are always compromised or undercut by reliance upon some formulation of the determinacy thesis. This begs the question of why judges are so reluctant to pursue their occasional assertions of judicial pragmatism to their logical conclusion – some form of broad judicial discretion. Why is it that the judges always appear to return to the determinacy fold?

While talking with a federal court judge some years ago, the judge freely admitted that judges make law. In reply, I asked why it was that judges did not say this in their judgments. The judge replied ‘because we wouldn’t get away with it’. Why is this judge, and presumably others, constrained to live this Sartrean bad faith? My argument is that statements such as this suggest that we have been beguiled by our own rhetoric – we want to believe the rule of law and its determinacy thesis. Indeed, it would be an interesting process to analyse the rhetorical devices embodied within the concepts of the determinacy thesis and the rule of law. The elements of this discourse which strengthen its rhetorical appeal include:

1. its foundation in an essentially liberal world view which appeals to many members of an essentially liberal society:
 - a. reference to the rights of the individual against the oppression of the state;
 - b. the proposition that an individual should be allowed the freedom to maximise their personal wealth within a framework of legal rules with clear application and an independent umpire (the judiciary) remote from the influence of the political realm; and
2. the appeal to the rhetoric of science – the ‘science of law’ is embodied in the concept of the legal method – judges apply this method with metronomic consistency and arrive at the ‘right’ answer.⁴⁴

⁴³ See the material referred to above under the heading ‘Pragmatism’.

⁴⁴ It is therefore significant that many describe legal practice in terms of a systematic code. See, for example, Justice M McHugh, ‘The Judicial Method’ (1999) 73 *Australian Law Journal* 37; F.A.R. Bennion, *Statutory Interpretation* (2001). In the context of taxation law see Francis Bennion, ‘Scientific Statutory Interpretation and the Franco Scheme’ [1983] *British Tax Review* 74; D Brown, ‘The Canons of Construction of Taxation and Revenue Legislation’ (1980) *Australian Tax Review* 81.

These elements combine to tell an appealing story which we *want* to believe. One does not have to go far to find instances of arbitrary oppression of individuals/sub-communities and we want to believe that such oppression cannot happen in ‘our’ world in Australia ‘because we have the rule of law’. The underlying theme of the vast amount of literature advocating adherence to the rule of law is that it will keep the devil of anarchy/arbitrary oppression at bay. The rule of law is taken as an article of faith which must be repeated loudly and often – presumably to drown the voices of dissent. It is therefore unremarkable that questioning key tenets of the rule of law, such as the determinacy thesis, almost invariably provokes a strong response from those who want to believe the fiction.⁴⁵

And yet, here I am proposing that we reconsider what it is that judges do when they interpret legislation. I believe that such a reconsideration is necessary because of the fact that the various determinacy theories do not offer a persuasive descriptive account of legal practice. Further, I believe that adherence to the determinacy thesis is impeding progress towards a more realistic approach to statutory interpretation and statutory drafting.

IV EXPLANATORY VALUE OF THE DETERMINACY THESIS – DO JUDGES WALK THE TALK?

One question which, in my view, has never been satisfactorily answered is why, if the law is determinate, so many supposedly rational members of the community would expend substantial sums of money on litigation if the answer was ‘there’ all along. If they had a skilled lawyer well versed in the dark art of statutory interpretation, surely they should receive infallible advice regarding the meaning of the law. Of course, it is expected that some taxpayers will want to have their day in court no matter what. However, it is also the case that most who litigate and those who advise them honestly believe that they are right, and yet one side must walk away with the crushing realisation that they were ‘wrong’ all along.

Furthermore, the fact that some litigants insist upon having their day in court does not explain the embarrassing frequency with which judges disagree upon the nature of the ‘right’ answer.⁴⁶ As the high priests of the legal order, judges’ judgments are supposedly the embodiment of the legal method which should lead us to the right answer – and yet so often so many judges are ‘wrong’. Despite the fact that judges are so frequently ‘wrong’, no one sincerely suggests that judges are incompetent merely because their peers disagree with them. No one calls for their dismissal because they have not applied accepted legal doctrines:

By the time a disputed case gets there [ie to a court], there is usually a choice to be made between two competing approaches to the law. Often, neither is indisputably correct –

⁴⁵ Although he does not consider statutory interpretation expressly, Justice Heydon’s defence of the rule of law is typical of such a response: JD Heydon, ‘Judicial activism and the death of the rule of law’ (2003) 23 *Australian Bar Review* 1. See also G de Q Walker, above n 5; G de Q Walker, *The Tax Wilderness: How to restore the rule of law*, (Working Paper, Centre for Independent Studies, Melbourne, 2004); G Craven, ‘The High Court of Australia: A Study in the Abuse of Power’, (1999) 22 *University of New South Wales LJ* 216; T Campbell, ‘Judicial Activism: Justice or Treason?’ (2003) 10 *Otago Law Review* 307.

⁴⁶ Despite Hercules’ ethereal legal skill, Dworkin concedes that past Herculean judges will have made mistakes (*Law’s Empire*, 271) without elaborating upon how such mistakes could emanate from such a judge. At this point Dworkin would have to concede that his account is no more than an ideal (at least from his perspective) vision for law, rather than an accurate descriptive account of ‘law in action’. For example, Dworkin does consider what underpins the judgments of non-Herculean real judges. Even if a real judge shares Dworkin’s ideal vision for the law, even Dworkin concedes that there is a world of difference between the ideal vision and reality. If a real judge does not have Hercules’ capacity, to what extent do arbitrary considerations influence the mind of the judge in making judgment? Dworkin leaves this critical question unanswered and therefore confines his vision for law to the mythical realm.

witness the numerous 4:3 decisions in our highest court. Talented, civilised and highly trained lawyers differ on the meaning to be given to words, whether of statutes enacted by Parliament or of past judgments of courts of high authority. Judges, as it seems to me, must be more than mere technicians.’⁴⁷

The fact that so many seem to be so wrong about the meaning of the law does not comprise a knockdown argument warranting rejection of the alternative formulations of the determinacy thesis. Lawyers clearly are human and it is possible, for example, that they do fall into error on such a regular basis that it is not considered a ‘sackable infringement’ to be wrong about the meaning of the law. But if to be human is to be wrong about the law on occasion, how do we know that the limited cases that do ascend to the pinnacle of the court hierarchy are rightly decided? After all, High Court judges are human too. Is the determinacy thesis a mythical ideal or is it descriptively accurate? To consider this question further it is appropriate to examine the theoretical merits of the variants of the determinacy thesis.

It is beyond the scope of this paper to consider in detail the vast literature dealing with language theory in general and statutory interpretation in particular. However, it is necessary for the sake of the argument presented in this paper to raise some of the key problems with the alternative versions of the determinacy thesis referred to by the judges in their ‘off duty’ writing.⁴⁸

A *The explanatory value of textualist accounts*

1 ‘Literalism’ or ‘strict literalism’

The ‘literalist’ approach has been criticised upon a number of grounds, including:

1. a literal theory of interpretation which focuses upon dictionary meanings has been criticised for its failure to specify which dictionary is authoritative.⁴⁹ Even if one dictionary is selected as authoritative, almost invariably a number of different meanings will be provided;⁵⁰
2. a formalist theory of meaning fails to account for the dynamic nature of language – meanings change with time (raising the question of which edition of the authoritative dictionary should prevail) and the same word will have different meanings within different sub-cultures in a community (such that the selection of one dictionary as authoritative may be perceived as arbitrary). One need only consider the contemporary usage of the word ‘gay’ to recognise the fluidity of meaning.⁵¹ This means that a judge must make a choice between, for example, the ‘technical legal meaning’, the ‘ordinary meaning’ and even the ‘commercial’ meaning of statutory terms. The existence of such choice denies the literalist claim to legal determinacy founded simply upon ‘the meaning of the words’;

⁴⁷ M Kirby, ‘The Judges’ (ABC, Sydney, 1983), 27.

⁴⁸ For a good critical introduction to language theory, see generally Eagleton, above n 9. For a good overview of the problems of alternative versions of the determinacy thesis, albeit expressed in the terminology applied in the United States of America, see William N Eskridge et al, *Legislation and Statutory Interpretation* (2000).

⁴⁹ Eskridge, Frickey and Garrett, *supra*, n 48, at 233.

⁵⁰ A point recognised by Justice DG Hill, *supra*, n 42, at 686.

⁵¹ Gay can mean ‘happy’, refer to a homosexual male or, more recently, be used when describing something as weak or ineffectual (‘that is so gay’).

3. the exclusion of the importance of the context of a statement in determining its meaning. At least since the work of Wittgenstein⁵² it has been generally accepted that meaning depends in part upon context – allowing a baby sitter to teach your children a ‘game’ does not necessarily mean you have authorised tuition in gambling ‘games’.

Although some parts of legislation refer to ‘objective’ phenomena,⁵³ invariably the meanings of some statutory words within any provision will vary depending upon their context – and the judge must decide which aspect of the context should be given the greater weight.⁵⁴ As Lord Diplock observed, ‘words mean whatever they are said to mean by a majority of the appellate committee dealing with the case, even though a minority might think otherwise’;⁵⁵

4. many challenge literal interpretation upon the basis that a speaker will not necessarily say what they intend. True, legislation is theoretically the product of close scrutiny by Parliament and so legislative ‘slips of the tongue’ should be rare or non-existent. However, given that words do not have one finite meaning, and hence given the importance of the context of a legislative statement in identifying the most appropriate meaning, to exclude what the speaker thought they intended is to omit consideration of an important aspect of the ‘meaning calculus’;⁵⁶ and
5. The fact that a literalist approach would, if it achieved its promise, be one way of achieving formal justice but would not necessarily achieve substantive justice. From a normative perspective, then, it is argued that literalism does not enjoy universal support as a political theory.⁵⁷ Further, as a descriptive account, the emphasis upon formal justice elides⁵⁸ the frequent reference to notions of substantive justice in the course of judgments.⁵⁹

These criticisms suggest that, leaving to one side the question of whether literal interpretation makes for an appealing political theory of adjudication, a literalist theory does not withstand close scrutiny. Indeed, vagaries of ‘literal meaning’ were demonstrated in the course of the *Consolidated*

⁵² Ludwig Wittgenstein, *Philosophical Investigations*, trans G.E.M. Anscombe, Basil Blackwell, Oxford, 1968 (3rd edn).

⁵³ Such as time, age, value denominated in particular currency and such like. This is not to say that the statutory reference to such objective ‘phenomena’ means that the interpretive process is *necessarily* closed – as it is possible for such expressions of ‘objective’ rules to be nonsensical (adjudged from any number of perspectives including legislative purpose [however defined], public policy, etc). Of course, this second level question is irrelevant from the literalist standpoint, as correcting legislative error is not the task of a judge:

⁵⁴ For judicial recognition of the significance of context see Justice Bryson, ‘Statutory Interpretation: An Australian Judicial Perspective’ (1992) 13 *Statute Law Review* 187 at 188-190; Justice JM Macrossan, ‘Judicial Interpretation’ (1984) 58 *ALJ* 547 at 552.

⁵⁵ *Carter v Bradbeer* [1975] 1 WLR 1203 at 1205-6.

⁵⁶ See, for example, Eskridge et al, op cit n 22 at 225.

⁵⁷ Steven Smith, ‘Law without Mind’ (1989) 88 *Michigan Law Review* 104.

⁵⁸ For a discussion of the rhetorical force of elision see below under the heading ‘Elision’.

⁵⁹ See the text below under the heading ‘Substantive Justice v Formal Justice’.

Press Holdings litigation⁶⁰ where different judges purported to apply a 'literal interpretation' of the same provision but disagreed upon the result.⁶¹

2 The Explanatory Value of Purposive Theories

A theory of legislative determinacy founded upon subjective purpose is unattractive for a number of reasons:

1. At the most basic level, intentionalist communication theory is founded upon the view that the speaker develops a finite intention with respect to a particular topic. The speaker's psyche is portrayed as a determinate and fixed phenomenon conveyed in the speaking act. However, psychoanalytic theory raises questions with respect to this portrayal of the 'essential self' by portraying the deep divisions within the subject.⁶² According to this understanding of the human psyche, the individual is constantly engaged in an internal dialogue which never reaches the point of complete self knowledge.⁶³ The corollary is that self-knowledge, and hence a finite intention formed with the legislative mind, is a dubious proposition at best;
2. Intentionalist theory presupposes that a speaker's purpose can be prelingual and this prelingual intention is then 'put into words'. According to purposive theory, the speaker's objective is to make the words fit the pre-lingual intention. A good speaker will achieve this outcome, while for others the recipient will need to double check by comparing the message with the speaker's pre-lingual intention. However, how does one ascertain the pre-lingual intention?⁶⁴ Even if the speaker is asked to express their intention with respect to a particular speaking act, acceptance of the vagaries of language begs the question of how the expression of an intention escapes from the imprecision of language; and
3. When talking about legislation, the shortcomings of intentionalist communication theory are exacerbated by the fact that the 'author' of legislation is all or some part of Parliament. Constructing authorial intention in this context is highly artificial and hardly a basis for legal determinacy;⁶⁵

⁶⁰ *CPH Property Ltd v FCT* 98 ATC 4983; *FCT v Consolidated Press Holdings Ltd* 99 ATC 4945 (Full Federal Court); *FCT v Consolidated Press Holdings* 2001 ATC 4343.

⁶¹ Thus, the Full Federal Court observed that 'the constructional choice which encompasses zero foreign source income is open upon a literal reading of the section. In this regard we respectfully differ from his Honour's view that this is "a construction which the literal language of s 79D does not bear"' 99 ATC 4945 at 4964. See the discussion of the CPH litigation in DG Hill, *supra* n 5, 232-3. Also note that the High Court agreed with the decision of the Full Federal Court: *FCT v Consolidated Press Holdings Ltd* 2001 ATC 4343.

⁶² See: Jacques Lacan, *Ecrits: A Selection*, A Sheridan (trans) (1980); Rainer Nägele, 'Freud, Habermas and the dialectic of Enlightenment: on real and ideal discourses' (1981) 22 *New German Critique* 41-62 for a discussion of psychoanalysis and Habermas's attempt, in Jurgen Habermas, *Knowledge and Human Interests* (1971) 214-245, to contain the fractious self within norms of coherence to the point that Habermas' interpretation of Freud is virtually unrecognisable.

⁶³ See, for example: Jacques Lacan, Jacques-Alain Miller (ed), *The Seminar of Jacques Lacan Book II: The Ego in Freud's Theory and in the Technique of Psychoanalysis*, (S Tomaselli trans) (1988), 166.

⁶⁴ A problem conceded by ED Hirsch, *Validity in Interpretation* (1967) at 173.

⁶⁵ See, for example, Ronald Dworkin, *Law's Empire* (1986), 318-20; and W David Slawson, 'Legislative History and the Need to Bring Statutory Interpretation under the Rule of Law' (1992) 44 *Stanford Law Review* 383. For early consideration of manipulation of the legislative record in order to 'create' a legislative purpose see Alfred Conrad, 'New Ways to Write Laws' (1947) 56 *Yale Law Journal* 458 461-2.

4. Communication theory also questions whether, if there is such a phenomenon as the speaker's intention, it should determine the meaning of a statement. According to this theory, the role of the recipient of a statement is passive as there is no need to construct meaning from the statement. In terms of political theory, this begs the question of why the intention of an earlier Parliament should govern the contemporary life world, given that the legislative intention may have been formulated in a context of different social values.

The shortcomings of a subjective purpose approach have led some to suggest the counterfactual purposive approach. However, the counterfactual approach to statutory interpretation suffers from many of the shortcomings of the subjective purposive approach. If psychoanalytic theory is accepted, the constructing one finite hypothetical purpose entails a leap of faith which almost invariably will lead to an arbitrary determination of what 'the legislative purpose' was. Further, whose hypothetical purpose is relevant here and what evidence will lead the reader to a finite resolution of the interpretive issue?

The third purposive approach escapes from the shortcomings of subjective purpose theories by focusing upon the objective purpose of the legislation. Rather than worrying about what particular legislators had in mind when passing legislation, this approach examines the objective evidence in authorised materials with a view to inferring the legislative intention. This approach seems to take for granted that there is a core of determinate meaning to be gleaned from the authorised texts from which legislative interstices may be closed by analogical reasoning. This approach to statutory interpretation is open to challenge upon two grounds:

1. It may be seen that this theory adopts literalist theory in order to lay the foundations for the objective legislative intention. However, if the criticisms of a literalist theory of meaning are accepted, the existence of this objective legislative foundation is open to question;
2. If a literalist theory is accepted, the objective purpose theory must explain why the legislative text should be supplemented
3. The theory suggests that the known legislative scheme provides sufficient insight into the framework of the parliamentary intention as to provide a firm footing for the inductive extrapolation. However, many recognise that the income tax legislation embodies varying degrees of rationality, or irrationality, as the case may be.⁶⁶ As eloquently noted by many other authors, the income tax is riddled with lacunae, inconsistencies, special legislative 'deals' pandering to specific interest groups and so forth.⁶⁷ Ascribing a rational legislative scheme to a parliament which sanctions such labyrinthine legislation is an act of faith which borders on the irrational.

For example, it is doubtful that a purposive approach would lend much to the elaboration of the meaning of 'ordinary income' for the purposes of section 6-5 as that provision amounts to an abdication by the legislature in favour of allowing the judiciary to apply often irrelevant doctrines gleaned from a range of sources in defining a core element of the income tax base. For reasons which go to the core structure of the legislation, it is also

⁶⁶ Cf Lord Millett, 'Construing Statutes' (1999) 20 *Statute Law Review* 107 where it is suggested that the general scheme of income tax legislation is 'tolerably clear'.

⁶⁷ In this regard the vast public choice literature is relevant – for an introduction to which see Daniel Farber and Philip Frickey, *Law and Public Choice: A Critical Introduction* (1991).

doubtful that a purposive approach would be of much assistance in interpreting the provisions within Part IVA.⁶⁸

With respect to statutory provisions of more limited scope, a schematic purpose approach which accepts a literalist theory of meaning confronts the problem of identifying those circumstances where the legislative text will be supplemented in order to close a perceived gap in the legislation. What evidence will warrant the conclusion that there is a gap in the legislation and how can a court be sure that such a gap was unintended? Reference to the case law suggests that this objective purpose approach is a matter of judicial discretion rather than providing a strong foundation for the determinacy thesis. The legislation considered by the High Court in *Ryan v FCT*⁶⁹ and *Consolidated Press Holdings*⁷⁰ provided two examples of legislation which arguably invited 'judicial legislation', and yet the High Court did not expressly adopt the objective purpose approach in either case.⁷¹

In response to these shortcomings of a broadly framed objective purpose approach, some argue that the relevant objective purpose is the purpose of each specific provision.⁷² However, this does not escape the assumption that the language of the relevant provision (and the associated extrinsic materials) conveys a determinate meaning. This more narrow objective purpose test is therefore difficult to differentiate from literalist theory other than for the fact that it seems to countenance reference to extrinsic materials that many 'literalists' would reject.

3 The explanatory value of the plain meaning of statutory words (given their context)

The perceived shortcomings of 'strict literalism' have led many judges and language theorists alike to search for an alternative foundation for determinate meaning.⁷³

One such alternative has been found in a compromise between literalism, Wittgenstein's context theory and purposive theory which also accommodates appeals for a judge to arrive at interpretations which accord with substantive justice. According to this interpretive theory, the ascertainment of legislative meaning entails an examination of the words of a particular statutory provision in their context with a view to identifying the legislative intention. This approach is

⁶⁸ The purpose of Part IVA is generally considered to be the negation of 'tax avoidance', but as noted by Passant and others, the definition of tax avoidance is problematic in the context of income tax legislation which is not unified by a coherent income concept: John Passant, 'Tax avoidance in Australia: Results and prospects, (1994) 22 *Federal Law Review* 493.

⁶⁹ *Ryan v FCT* 2000 ATC 4079.

⁷⁰ *FCT v Consolidated Press Holdings Ltd* (2001) 179 CLR 625; 2001 ATC 4343.

⁷¹ These cases are briefly considered below.

⁷² J Waincymer, 'The Australian Tax Avoidance Experience and Responses: A Critical Review' in Cooper, above n 6, 247: 'It is submitted that the proper approach to a purposive analysis of the *Income Tax Assessment Act* is to consider the purpose of the particular provision under examination. To do so will ordinarily require a consideration of the purpose of the generic type of provision as opposed to the purpose of the Act as a whole.' (at 260). The reference to the 'generic type of provision' is unclear – many statutory provisions will represent a unique reconciliation of competing objectives/interests and so recourse to a generic provision (the existence of such a universal must also be open to doubt) is problematic.

⁷³ For a referential theory of language see JS Mill, *A System of Logic* (1947), 48-9. For a formalist theory of language see F de Saussure, C Bally and A Sechehaye (eds), *Course in General Linguistics* (1966) 67ff.

reflected in the joint judgment of Brennan CJ, Dawson, Toohey and Gummow JJ in *CIC Insurance Ltd v Bankstown Football Club Ltd*:⁷⁴

[T]he modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses "context" in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means such as those just mentioned, one may discern the statute was intended to remedy. Instances of general words in a statute being so constrained by their context are numerous. In particular, as McHugh JA pointed out in *Isherwood v Butler Pollnow Pty Ltd* [(1986) 6 NSWLR 363 at 388], if the apparently plain words of a provision are read in the light of the mischief which the statute was designed to overcome and of the objects of the legislation, they may wear a very different appearance. Further, inconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which, by the steps identified above, is reasonably open and more closely conforms to the legislative intent.⁷⁵

This statement of interpretive doctrine is a masterpiece in rhetorical discourse as it incorporates virtually all theories of meaning. There is something for everyone here:

1. A 'literalist' would be happy to see that the concept of the 'literal meaning' has survived and even appears to have the upper hand in the absence of countervailing evidence;
2. Those advocating purposive theories will be pleased to note that the ultimate objective is the identification of meaning which accords with the 'legislative intent';
3. Legal pragmatists will be happy to see that the High Court concedes that pragmatic considerations may influence the selection of an appropriate meaning ('inconvenience or improbability of result ...'); and
4. Those hoping for accommodation of their concern that the Courts interpret statutes with an eye to substantive justice will also be pleased to see an apparent recognition of their concerns ('inconvenience').

However, as with any compromise of competing absolutes this statement of principle unwinds if the competing threads are teased out and the rhetorical rope unwound:

1. The reference to 'legislative intent' is vague⁷⁶ and provides an insubstantial foundation for legal determinacy;
2. The tension between 'literal' meaning and 'legislative intent' is unresolved – what does one do in the case of drafting error where the legislature has left the judge with little interpretive space?
3. While reference to context is included, it should be noted that the reference to examples of contextual factors is an inclusive list. Are there any limits to this context? To put this

⁷⁴ (1997) 187 CLR 384.

⁷⁵ Ibid at 408. In support of the latter part of this statement, their Honours cited the decision of Mason and Wilson JJ in *Cooper Brookes (Wollongong) Pty Ltd v FCT* 81 ATC 4292; (1981) 147 CLR 297 at 320-1.

⁷⁶ For discussion of the shortcomings of purposive language theory see above under the heading 'The explanatory force of purposive theories'.

another way, is the relatively circumscribed list of ‘extrinsic materials’ referred to in the *Acts Interpretation Act 1901* (Cth) s 15AB otiose?

Some extra-curial statements by judges suggest that reference to a broad range of contextual factors including economic and social outcomes will be warranted.⁷⁷ How is such evidence to be admitted and what qualifications do judges hold to assess, for example, econometric projections?

4. From what standpoint(s) are ‘inconvenience’ and ‘improbability of result’ to be judged? At the micro level or at the macro level? At the micro level, it will be ‘inconvenient’ for a taxpayer if they have to pay more tax and it will be ‘inconvenient’ for a government if it does not extract additional tax revenue from the taxpayer. At the macro level inconvenience or improbability of result might be judged from any number of perspectives – economic theory, sociological theory (ie systems theory), social psychology, substantive justice, formal justice and so forth. Is there any limit to the type of evidence that may be lead in advocating a particular interpretation?⁷⁸

These unresolved internal contradictions and ill-defined concepts mean that the High Court’s statement of principle is a weak foundation for a theory of determinate statutory meaning.

4 The explanatory power of hermeneutic theories of interpretation

Even the more refined hermeneutic theory of Dworkin proposes judicial excavation amongst ‘authorised’ legal texts in order to unearth the relevant communal convictions.⁷⁹ Under any of these alternative accounts of the determinacy thesis the interpretation of tax legislation is supposedly an instance of the rule of law in action – judges are merely the intermediaries between the sender of the legal message (Parliament) and a limited number of its recipients (those subjects who can afford to litigate upon the meaning of tax legislation).

Ronald Dworkin offers a ‘right answers’ thesis in which he suggests that an ideal judge (Hercules) is able to arrive at a right answer. However, Dworkin concedes that real judges do not have the time nor the skill to achieve the normative perfection that Dworkin describes: ‘[Hercules] does what they [ie ‘real judges’] would do if they had a career to devote to a single decision; they need, not a different conception of law from his, but skills of craft husbandry and efficiency he has never had to cultivate’.⁸⁰ Such a concession to the constraints experienced by any judge suggest that, despite his suggestion that his is a descriptive as well as a normative account of legal practise, Dworkin’s account is remote from the real world.⁸¹

⁷⁷ See, for example, McHugh, above n 15 at 48-9.

⁷⁸ For this reason McHugh’s seems to delineate a very circumscribed role for judicial law-making: see McHugh, above n 18.

⁷⁹ Dworkin, above n 30, 337ff.

⁸⁰ Ibid, 265.

⁸¹ For the suggestion that institutional constraints are a sorely neglected aspect of legal interpretive theory and that incorporation of institutional constraints into interpretive theory suggests that a formalist interpretive approach adopted by generalist courts might generally be justified see, for example: Cass Sunstein and Adrian Vermeule, *Interpretation and Institutions*, (John M Ohlin Working Paper No 156 (2nd series), University of Chicago, 2002) (available at <http://www.law.uchicago.edu/Lawecon/workingpapers.html>). The assumption, of course, is that there is such a thing as a formal legal meaning. The preceding discussion suggests that the existence of such a construct is open to challenge.

V SEARCHING FOR AN ALTERNATIVE DESCRIPTIVE ACCOUNT - LAW AS RHETORIC

The preceding discussion with respect to the theoretical merits of alternative formulations of the determinacy thesis can only serve to heighten our suspicions that there is no determinate legal meaning applied by the courts in resolving tax disputes. So if the judges are not doing what they say they are doing, applying determinate legal meaning, what are they doing?

It is beyond the scope of this article to revisit the massive amount of literature with respect to communication theory more generally and the debate within the 'legal' community with respect to the ramifications for alternative communication theories. Suffice to say that in an earlier article I have attempted to set out a theory of interpretation which questions the merits of the determinacy thesis as a descriptive account. Further, I argued that judges assume a law-making function whenever they interpret legislation because they invariably exercise a discretion when determining the interpretive approach to be adopted in a particular case.⁸² Finally, I have argued that the judge as lawmaker is a rhetorician, adopting rhetorical devices and discourses in order to win support for her/his particular interpretation. The fact that any judgment will necessarily be built upon rhetoric explains why judgments are so frequently overturned on appeal – the majority of an appellate court simply adopts alternative rhetorical devices and discourses which lead the court to a different conclusion.

The rhetorical devices and discourses used by any judge will often be similar to the rhetorical devices used by the lawmaker when making the legislation, but this does not mean that there need be an identity between the two. This similarity of rhetorical devices may be traced to the fact that, generally speaking, the same interest groups will have an interest in the formation and application of a particular piece of legislation. Thus, for example, in the context of tax legislation it is clear that some key constituencies include the various sectors of the 'business' community – small business, large business, the farming sector (agribusiness and small farmers) as well as the social welfare lobby groups who seek to represent low income earners and socially disadvantaged sectors of the community. Often tax legislation will represent a compromise between such (often) competing constituencies and the government of the day will strive to garner support for its legislative proposal by persuading interested members of the community that the legislative reform is for the social good. Clearly here there is a considerable role for the art of rhetoric.

When tax legislation is brought to court it almost invariably, or always, embodies a compromise which leaves the way open for alternative interpretations of the nature of that compromise. Whether done consciously or subconsciously, a judge embarks upon the process of interpretation with a view to persuading any reader of his or her judgment that their judgment arrived at the 'right' answer. Rather than applying law and arriving at the 'right' answer, the judge is searching for rhetorical devices which will ensure the success of her/his particular interpretation. It may be seen that this account of statutory interpretation is very close to the pragmatic account described by some judges in an extra-curial context.⁸³

The purpose of this article is to take this depiction of statutory interpretation beyond the theoretical realm by developing a taxonomy of rhetorical devices applied by the courts in deciding Australian income tax cases. By developing this taxonomy, it is hoped that the future analysis of tax case law will recognise the contingent nature of the process of statutory construction. Rather than such case

⁸² Mark Burton, 'Determinacy, Indeterminacy and Rhetoric in a Pluralist World', (1997) 21 *Melbourne University Law Review* 544.

⁸³ See the material referred to above under the heading 'Pragmatism'.

analyses proceeding upon the assumption that the outcome in a particular case is the right answer, case analyses would consider why the judicial reasoning appears convincing and consider what alternative conclusions were available had the court adopted differing rhetorical devices. Thus, it is hoped that the future analysis of case law would focus not only upon the text of the judgment, but what the judgment ignored.

By reorienting the analysis of the adjudication of tax cases it is hoped that material benefits could be achieved in terms of the simplification of the Australian income tax legislation, an enhanced legitimacy of the courts and the adoption of a more systematic approach to statutory interpretation.

VI RHETORIC – THE POOR COUSIN IN THE SEARCH FOR TRUTH?

Whether or not it is accepted that the use of rhetorical devices by judges leads to the conclusion that judges are law makers, a study of the rhetorical devices commonly employed by Australian judges in tax cases has not been undertaken. It is beyond the scope of this paper to consider the philosophical debate that has raged for two millennia regarding the role of rhetoric in the search for truth. Suffice to say that although Plato and Socrates considered that the study of rhetoric would enhance philosophic discourse in the quest for truth, the study of rhetoric subsequently fell into disrepute as it was considered to be the deceptive art of the Sophists.

Given that the use of rhetoric is often labelled as sophistry and hence anathema to the quest for truth, a discussion of the rhetoric of law inevitably provokes a response from those who maintain the sanctity of the rule of law and the determinacy thesis. However, it should be remembered that I am seeking to present a *descriptive* account of tax interpretation rather than a normative account. If the determinacy thesis is to hold as a descriptive account, it needs to explain the existence of rhetorical devices in the tax case law. It would be far too ambitious to hope to chart all of the rhetorical devices and discourses used by judges in tax cases. However, in the next part of this paper I wish to identify what I consider to be some of the more significant rhetorical devices used in the taxation case law. By doing so, I will also illustrate how recourse to such devices strengthens the rhetorical effect of judgments but undermines the assertion that judges arrive at a particular conclusion by applying the legal method drummed into successive generations of law students.

A *Substantive justice v formal justice*

Given that the *raison d'être* of the law is to manifest justice in the community there will invariably be disputes about what constitutes justice. On occasion judges in tax cases rely upon a rhetorical appeal to substantive justice in support of their particular conclusion. Thus, for example, in the Full Federal Court decision in *Placer Pacific Management Pty Ltd v FCT*⁸⁴ Davies, Hill and Sackville JJ concluded in a joint judgment that the taxpayer should be allowed to claim a deduction under ITAA 1936 s 51(1) with respect to a compensation payment made to a customer of a business formerly carried on by the taxpayer. Their Honours suggested that their conclusion ought to be adopted because it was the just and equitable result:

On the facts of the present case the occasion of the loss or outgoing ultimately incurred in the year of income was the business arrangement entered into between Placer and NWCC for the supply of the conveyor belt which was alleged to be defective. The fact that the division had subsequently been sold and its active manufacturing business terminated does not deny deductibility to the outgoing. *A finding to the contrary would lead to great inequity.* Many businesses generate liabilities which may arise in the considerable future.

⁸⁴*Placer Pacific Management Pty Ltd v FCT* 95 ATC 4459.

Such liabilities are sometimes referred to as "long tail liabilities". *To preclude deductibility when those liabilities come to fruition on the basis that the active trading business which gave rise to them had ceased would be unjust.*⁸⁵ (emphasis added)

This statement derives considerable force from the unargued proposition that the application of the law should produce a result which is substantively fair. However, for other judges such appeals to substantive justice are merely nonsense on stilts. For example, in *Ryan v FCT*⁸⁶ Gleeson CJ, Gummow and Hayne JJ observed:

Although put in various ways, the taxpayer's contention was that it was "unjust" or "incongruous" or "absurd" if a taxpayer assessed to \$1 tax could not be reassessed after the expiration of three years from the date on which the tax was due and payable, but a taxpayer who had been told by the Commissioner that nothing was owed, "remained at risk" without any limit of time.

19. There are several features of this contention that should be noted. First, it assumes that the Act adopts as a general policy or overall intention that "certainty and finality" be reached after a time. But the question for decision is "What are the circumstances in which an amended assessment may lawfully be issued?" That question is not answered by asserting the existence of any "policy" or "general intention" unless that policy or intention is to be found reflected in the provisions of the Act. Appeals to general notions of "fairness" or "justice" do no more than attempt to mask the absence of any foundation in the legislation for the conclusion which is asserted.⁸⁷

By contrast to the statement in *Placer Pacific*, the majority decision in *Ryan* achieves considerable rhetorical power from its reliance upon the depiction of the law as a finite bulwark against subjective notions of fairness.

It is evident from the preceding two extracts that some judges believe that there is a competition between competing visions of justice which dictates that a judge must make a critical choice between these competing visions in the course of adjudicating upon a matter. Further, it is clear

⁸⁵ Ibid, at 4464.

⁸⁶ *Ryan v FCT* 2000 ATC 4079.

⁸⁷ Ibid, at 4083-4. As an aside which I leave for another day, this raises the question of the standing of the oft cited statement of Mason and Wilson JJ in *Cooper Brookes (Wollongong) Pty Ltd v FCT* 81 ATC 4292; (1981) 147 CLR 297:

On the other hand, when the judge labels the operation of the statute as "absurd", "extraordinary", "capricious", "irrational" or "obscure" he assigns a ground for concluding that the Legislature could not have intended such an operation and that an alternative interpretation must be preferred. But the propriety of departing from the literal interpretation is not confined to situations described by these labels. It extends to any situation in which for good reason the operation of the statute on a literal reading does not conform to the legislative intent as ascertained from the provisions of the statute, including the policy which may be discerned from those provisions.

Quite obviously questions of degree arise. If the choice is between two strongly competing interpretations, as we have said, the advantage may lie with that which produces the fairer and more convenient operation so long as it conforms to the legislative intention. If, however, one interpretation has a powerful advantage in ordinary meaning and grammatical sense, it will only be displaced if its operation is perceived to be unintended.

If recourse to 'fairness' is illegitimate, it is unclear whether this dictum remains relevant today, given that the statement in *Ryan* was made by a majority of the High Court but did not expressly refer to the decision in *Cooper Brookes*.

from the disagreement within the High Court in *Ryan's case* that the adoption of either vision of justice can be used to justify strikingly different outcomes in a particular case.⁸⁸

This conflict between approaches predicated upon substantive justice on the one hand, and formal justice on the other, has troubled many judges over the centuries past⁸⁹ and has also spawned a vast amount of secondary literature amongst proponents of the competing views.⁹⁰ However, from the perspective of law as rhetoric, it can be argued that the debate about which critical perspective ought to be adopted by a judge, substantive justice or formal justice, is misguided. Both conceptions of justice have merit and there is no universally accepted grundnorm for determining which should prevail in particular cases. To an audience aware of the rhetorical devices deployed by judges, a good judgment would expressly consider this chestnut and set out reasons for why one of the two approaches should prevail in the particular case at hand.

B Common sense

An appeal to common sense is a powerful rhetorical device as the speaker assumes to herself the power of a fundamental truth to which all of the community would agree. An appeal to common sense, then, is one means of asserting the power of a univocal community:

Common sense is a value which reflects the community's current thinking on a subject. It has nothing to do with a legal doctrine. Moreover, common sense views change as the community's knowledge and understanding of a subject change.⁹¹

To challenge a 'common sense' proposition a person must first rebut the imputation that they are a social outcast who lives outside the domain of socially accepted norms – and hence a person whose voice should not be heard. The realm of 'common sense' is a no-go zone for minorities and those raising a dissonant voice. Implicitly, the onus shifts to the challenger to show why they should be heard. The rhetorical force of the 'common sense' trope therefore stems from the fact that it diverts attention from the speaker and what the speaker says to an assessment of the person who would challenge the speaker. The power of the device of common sense is reflected in the errors of judgment attributed to common sense – at one time it was, for example, a matter of common sense that the earth was flat and that the earth was too heavy to move. Yet when a speaker relies upon 'common sense' we collectively forget such errors and believe that common sense affords a strong foundation for logical exposition.

On a regular basis judges make reference to common sense.⁹² For example, in *FCT v Cooling*⁹³ Hill J (Lockhart and Gummow JJ concurring on this point) supported his conclusion that the lease incentive payment was assessable upon the footing that it accorded with common sense:

⁸⁸ Note the dissenting opinion given by Kirby J.

⁸⁹ For a recent expression of this tension see DG Hill, above n 29 at 29: 'There will often be a tension between the need for certainty or predictability in the law, on the one hand, and the need for a just result, on the other. Justice requires that like cases are treated alike, just as it requires that a fair result be reached.'

⁹⁰ See, for example, Yuri Grbich, 'The Duke of Westminster's Graven Idol on Extending Property Authorities into Tax and Back Again' (1978) 9 *Federal Law Review* 185; Doreen McBarnet and Christopher Whelan, 'The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control' (1991) 54 *Modern Law Review* 848; Graeme Macdonald, 'Substance, Form and Equity in Taxation Accounting' (1991) 54 *Modern Law Review* 830.

⁹¹ Justice M McHugh, 'The Judicial Method', (1999) 73 *Australian Law Journal* 37 at 45.

⁹² A search for 'common sense' in the CCH tax cases database reveals 394 references to this concept dating back to 1969, although there are multiple references to the concept in particular cases. Further, it should also be noted that there may be double counting by virtue of the fact that a judgment may refer to an earlier decision in which common sense

In my view the transaction entered into by the firm was a commercial transaction; it formed part of the business activity of the firm and a not insignificant purpose of it was the obtaining of a commercial profit by way of the incentive payment. *This result accords with common sense.* The firm had the alternative of paying less rent and therefore obtaining a smaller tax deduction for its outgoings or paying a higher rent (assuming its lessor (Bengil) passed on the rental holiday), and therefore obtaining a larger tax deduction but receiving an amount in the form of assessable income.⁹⁴ (emphasis added)

Here Hill J was referring to the fact that the taxpayer's firm was, in effect, 'purchasing' what he (the taxpayer) hoped was a non-assessable amount by incurring deductible expenditure (the additional rental payment). While it can be accepted that judicial sanction of such an arrangement would not comply with tax policy (or common sense), most would also accept that tax legislation does not necessarily incorporate sound tax policy. For example, allowing taxpayers to purchase lowly taxed capital gains with fully deductible expenditure in the form of negatively geared investments is hardly sound tax policy. The courts have never adopted a common sense approach to negatively geared investments (which they might have done by interpreting the apportionment rule in the general deduction provision in a different fashion). Justice Hill's appeal to 'common sense' must therefore be seen as a rhetorical device designed to garner support for his conclusion. The courts have not adopted the same 'common sense' approach to other transactions, so why should Mr Cooling have been treated differently?

More recently, the Full Federal Court was called upon to determine whether an accruals basis taxpayer had derived an amount with respect to the supply of goods in circumstances where the obligation to make the payment is the subject of a 'bona fide' dispute between the parties to the contract.⁹⁵ This raised the question of whether evidence of the accounting treatment of such disputed amounts should be adopted for the purposes of interpreting the meaning of 'derived'. Earlier case law had supported the conclusion that such evidence was not determinative of the issue, although it could be taken into account. Referring to the evidence of the accounting treatment of such amounts, Hill and Heerey JJ justified their reliance upon such evidence upon the footing that it accorded with 'common sense':

It is clear that the accounting position as stated by Professor Walker accords with common sense. Where the whole or part of the consideration for the sale of a commodity or goods is not the subject of dispute then clearly income is to be recognised to the extent of the undisputed amount as soon as the commodity or goods is or are delivered. Where, on the other hand, the whole or part of the consideration is the subject of a bona fide dispute, the disputed amount is not recognised as being an asset of the vendor so as to take the place of the stock previously on hand. Non recognition will particularly be the case where the value of the claim can not be reliably estimated. Indeed, if a company accounted otherwise, its accounts would clearly not give a full and true view. One has only to consider the question whether a company in the position of the taxpayers here could properly treat there as being a

was mentioned, although the later decision may not necessary adopt the common sense trope. A search for 'commonsense' in the same database discloses 181 references dating back to 1969, not all of which are in the same cases revealed under the 'common sense' search.

⁹³ *FCT v Cooling* 90 ATC 4472.

⁹⁴ *Ibid* at 4484-5.

⁹⁵ *BHP Billiton Ltd v FCT* 2002 ATC 5169.

profit brought to account at the time gas was delivered out of which it could declare dividends to understand the difficulty of any other approach.⁹⁶

At the conclusion of their joint judgment, Hill and Heerey JJ once again referred to the common sense of their conclusion when noting that it was consistent with the treatment of disputed amounts in other jurisdictions.⁹⁷

C *Opposing perspectives - Substance vs legal form*

Reference to the substance of the case could be considered to be a subset of the rhetoric of common sense. Judges refer to the substance of the case when appealing to the popular misconception of the law which holds that the legal worldview is 'artificial' or founded upon fictions.⁹⁸ Thus, for example, in *Thorpe Nominees Pty Ltd v FCT*⁹⁹ Lockhart J (Sheppard J concurring on this point) concluded:

Viewed as a matter of substance rather than form it is plain, in my opinion, that the source of the income in question is Australia not Switzerland. The activities in Switzerland were obviously part of a prearranged plan, which if not prearranged in every detail was at least prearranged in all important respects with only a few loose ends to be determined. Switzerland was selected as a place outside Australia, there being no particular reason for Switzerland as opposed to some other place outside Australia other than the favourable income tax rates offered by the Canton of Glarus. The Canton of Glarus was selected because of those favourable income tax rates at a time when it appears to have been thought that the beneficial tax rate afforded by sec. 23(q) of the Assessment Act would form the basis of the scheme. In that sense Switzerland was but an accident in the selection of an international scene for an essential step in the plan. It would give undue weight to matters of form to regard Switzerland as the source of the income in question. Having regard to the practical realities of the situation and the substance of the matter, the real source of the income in question was Australia.¹⁰⁰

Here Lockhart J appeared to reject the artificiality of legal doctrines, which focus upon the legal form of a transaction, in favour of the practical 'substance' of the case. In doing so, his Honour apparently accepted that there is an objective factual substance which can be distilled for the purposes of applying the law but which is generally ignored by the courts.

Once again, the implicit appeal to the common sense of characterising the facts upon the basis of their practical substance makes this rhetorical device superficially appealing. However, one need only state this to recognise the nonsense of it. When adopting a 'substance' approach, judges are effectively saying 'we are happy to live in what we accept is the ethereal world of formal legal

⁹⁶ Ibid at 5184.

⁹⁷ Ibid at 5187.

⁹⁸ Of course, there are many who suggest that any worldview is necessarily contingent as it is founded upon subjective considerations of what is important. Thus, for example, some suggest that the 'science' of economics is grounded upon the reality of universal truths, while law is based upon the shifting sands of a fictional worldview.

⁹⁹ *Thorpe Nominees Pty Ltd v FCT* 88 ATC 4886.

¹⁰⁰ Ibid at 4894. In *Reuter v FCT* 93 ATC 5030 the Full Federal Court did not refer to the substance of the case, they adopted a similar preparedness to discount the legal form of the transaction in favour of the 'obvious' characterisation of the facts (at 5037).

artificiality most of the time, but today I want to descend from Plato's cave and deal with the concrete facts of the case for a change'.

This merely begs the questions:

1. Why are judges generally happy to inhabit a world which, on occasion, they describe as artificial?; and
2. What makes judges switch from one world view as opposed to another if it is not the fact that the favoured world view offers stronger rhetorical appeal?

Although Lockhart J justifies recourse to the substance of the facts in *Thorpe Nominees* upon the basis that focussing upon the legal form of the transactions would be artificial, he does not explain why a substance approach is not adopted universally.

D Formalism

The decision in *Thorpe Nominees* may be contrasted with the decision of the Full Federal Court in *FCT v Lamesa Holdings BV*.¹⁰¹ In *Lamesa* the Full Federal Court was called upon to decide whether a non-resident holding company, which initially held all of the shares in an Australian company which was at the head of a multi-tier chain of Australian companies, held 'real property' for the purposes of Article 13 of the Australia/Netherlands double taxation agreement. Article 13 set out an inclusive definition of 'real property', which stated that real property shall include:

... shares or comparable interests in a company, the assets of which consist wholly or principally of direct interests in or over land in one of the States or of rights to exploit, or to explore for, natural resources in one of the States.

The Full Federal Court rejected the Commissioner's invitation, expressed in alternative ways, to adopt a substance approach in this case:

It seems to us quite consistent with rational policy that the Agreement was intended to assimilate as realty only one tier of companies rather than numerous tiers. Separate legal personality is a doctrine running not only through the common law but the civil law as well. No suggestion is made to the contrary. That is consistent with the plain and quite unambiguous language which the Agreement has employed. When legislation speaks of the assets of one company it invariably does not intend to include within the meaning of that expression assets belonging to another company, whether or not held in the same ownership group.¹⁰²

Given that the key issue was whether the Australian holding company held a 'direct' interest in the assets of its subsidiary companies, and given that the interpretation of treaties is purportedly undertaken in a more liberal manner than might apply to the interpretation of domestic legislation,¹⁰³ it might have been expected that the Full Federal Court would have dwelt upon the meaning of 'direct interest'. That is, there was some merit in the Commissioner's argument that *Lamesa* held shares in a company which held a 'direct interest', interpreted in the sense of

¹⁰¹ 97 ATC 4752.

¹⁰² *Ibid*, xx.

¹⁰³ For an elaboration of the principles purportedly applied in the interpretation of treaties see *Applicant A v Minister for Immigration and Ethnic Affairs* (1997) 71 ALJR 381, 394-7 per McHugh J.

substantive control as opposed to direct ownership, in the mining leases at the end of the corporate chain.

A formalistic approach will not always serve the interests of the taxpayer. In some cases the courts have struggled to justify a decision which has little to commend it in terms of logic. In *FCT v Cooper*¹⁰⁴ the taxpayer was a professional footballer who was advised to eat particular foodstuffs by the team coach (this advice was prompted by the taxpayer who was seeking a tax deduction for the additional food he was obliged to consume). The taxpayer demonstrated that in previous seasons he had struggled to maintain a sufficient body weight for him to remain in the first grade team – he earned less income if he was relegated to the second grade team.

In rejecting the taxpayer's claim for a deduction for the additional food and drink which he consumed, the majority of the Full Federal Court drew a very narrow description of the taxpayer's income earning activities by focusing upon the taxpayer's contractual obligations. Hill J observed:

The income-producing activities to be considered in the present case are training for and playing football. It is for these activities that a professional footballer is paid. The income-producing activities do not include the taking of food, albeit that unless food is eaten, the player would be unable to play. Expenditure on food, even as here "additional food" does not form part of expenditure related to the income-producing activities of playing football or training.¹⁰⁵

As noted in the dissenting judgment of Wilcox J, this is an unduly narrow description of the taxpayer's income earning activities. Reference to any credible sports training textbook supports the view that rest and nutrition are a vital part of any athlete's training regime.¹⁰⁶

E *Individual vs the state*

On occasion judges will refer to the contradiction inherent within liberal society – the tension between the freedom of the individual and the regulatory power of the state. Thus in the oft-cited judgment of Barwick CJ in *FCT v Westradors*¹⁰⁷ Barwick CJ observed that 'again, the freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society.'¹⁰⁸ In the equally oft-cited riposte to this assertion, Murphy J rejoined by stating:

It has been suggested, in the present case, that insistence on a strictly literal interpretation is basic to the maintenance of a free society. In tax cases, the prevailing trend in Australia is now so absolutely literalistic that it has become a disquieting phenomenon. Because of it, scorn for tax decisions is being expressed constantly, not only by legislators who consider that their Acts are being mocked, but even by those who benefit. In my opinion, strictly literal interpretation of a tax Act is an open invitation to artificial and contrived tax avoidance. Progress towards a free society will not be advanced by attributing to Parliament meanings which no one believes it intended so that income tax becomes optional for the rich while remaining compulsory for most income earners. If strict literalism continues to

¹⁰⁴ *FCT v Cooper* 91 ATC 4395.

¹⁰⁵ *Ibid*, 4414. Lockhart J adopted similar reasoning at ATC 4403.

¹⁰⁶ See, for example, Louise Burke, *The Complete Guide to Food for Sports Performance: A guide to peak nutrition for your sport* (1995).

¹⁰⁷ *FCT v Westradors* (1980) 144 CLR 55.

¹⁰⁸ *Ibid* at 61.

prevail, the legislature may have no practical alternative but to vest tax officials with more and more discretion. This may well lead to tax laws capable, if unchecked, of great oppression.¹⁰⁹

It may be that the High Court was echoing the approach of Murphy J when it accepted, in *FCT v Spotless Services Ltd*¹¹⁰ that 'taxes are what we pay for a civilized society'. To similar effect, in his dissenting judgment in *Trust Company of Australia Ltd v Commr of State Rev (Qld)*¹¹¹ Kirby J rejected the proposition that there was a presumption against double taxation, relying in part upon reference to 'the larger needs of government'.¹¹²

F *Floodgates*

In many cases judges rely upon the floodgates argument as a justification for their decision. Denigrating the alternative by promoting the fear of the unknown in the form of countless claims is one way for the judge to portray their decision as appropriate. Thus, for example, in *Handley v FCT*¹¹³ Murphy J rejected the taxpayer's claim for deductions with respect to his home office and relied in part upon the proposition that to allow the claim would only encourage more (perhaps difficult) cases:

Acceptance of the taxpayer's claim could lead to curious or even absurd results. Many lawyers, to the annoyance of their domestic partners, do a lot of legal reading in the bedroom. Also there is much scientific and anecdotal evidence in favour of the view that intellectual work goes on subconsciously as well as consciously, even during sleep. Perhaps the next claim would be for deducting part of the upkeep of the bedroom, or even a claim for part of the upkeep of the garden in which a barrister thinks about the conduct of cases whilst resting or strolling.¹¹⁴

From an alternative standpoint, it might be argued that tax policy and substantive fairness require that the true costs of producing income are recognised and so the cases to which Murphy J referred may well justify some deduction if appropriate evidence was provided. While the prospect of a burgeoning growth in such claims may threaten the revenue, a legal formalist would merely suggest that it is for the legislature to express the rules with sufficient clarity in order to rule such claims either 'in' or 'out'.

G *Alternative world views*

1 Plain meaning

Although it is often noted that there is rarely a 'plain' meaning of a particular term, judges regularly assert that their respective judgments are founded upon the plain meaning of the statutory text. A

¹⁰⁹ Ibid at 80.

¹¹⁰ 96 ATC 5201, 5206.

¹¹¹ 2003 ATC 4427.

¹¹² Ibid at 4440.

¹¹³ 81 ATC 4165.

¹¹⁴ Ibid, 4173.

strong version of this approach was adopted by Hartigan J in *Case W58*,¹¹⁵ where he (perhaps somewhat optimistically) declared that the terms of Part IVA of the ITAA 1936 were unambiguous:

I am of the view that the primary source is the statute itself. The words of the statute are plain. I cannot use the Minister's words to displace the plain language of Parliament. I refer to the words of *Mason C.J., Wilson and Dawson JJ. in Re Bolton, Ex parte Beane (1987) 162 C.L.R. 514 at p. 518*: "The words of a Minister must not be substituted for the text of the law."¹¹⁶

Similarly, as noted above in the discussion of *Lamesa Holdings*, the Full Federal Court relied upon what it considered to be the 'plain and unambiguous' language of the double tax agreement. Although the majority in the High Court in *Ryan v FCT*¹¹⁷ did not expressly refer to the plain meaning of the legislation, their decision upholding a seemingly irrational distinction between taxpayers who are obligated to pay even a small sum of tax and taxpayers who receive a nil assessment was implicitly, at least in part, founded upon the assertion that the plain meaning of the legislation necessitated this outcome:

At the very least, language is strained by saying that tax becomes "due and payable" on a particular date in circumstances where the Commissioner has issued a document informing the taxpayer that the Commissioner has determined that the taxpayer owes no amount for tax. No amount of teasing of the words of s 170(3), or of the words of s 204, can reduce, let alone eliminate, that strain. Whatever may be the elasticity of the expression "the date upon which the tax became due and payable", it does not, and cannot, accommodate the case where no tax is due and payable. Nor do the words of s 204, when read and understood in their context, enable any such accommodation.¹¹⁸

Such assertions that statutory terms are unequivocal elide the possibility of statutory polyvalence and thereby obviate the need for the judge to expose the process of choosing between often equally meritorious interpretations.

By way of contrast, one year later the High Court considered the meaning of section 79D in *FCT v Consolidated Press Holdings Ltd.*¹¹⁹ Once again, this case raised the old question of whether Parliament said what it meant, or perhaps more correctly, said what a person would attribute to a presumably rational parliament. Section 79D as it then stood quarantined foreign income deductions on a pro rata basis to the extent that they exceeded 'the amount of a class of income derived by a taxpayer in a year of income from a foreign source.' One issue that arose in that case was whether CPH fell within section 79D, given that CPH had not derived foreign source income in the relevant year.

At first instance Hill J held that section 79D did not apply to CPH, in part because it could not be said that CPH had derived an 'amount' of foreign source income. His Honour referred to the ordinary and natural meaning of the provision, and in particular to the word 'amount'. The Full Federal Court rejected this approach, concluding that the reference to an amount of foreign source

¹¹⁵ 89 ATC 524.

¹¹⁶ *Ibid* at 533-4.

¹¹⁷ *Ryan v FCT* 2000 ATC 4079.

¹¹⁸ *Ibid* at 4083 para 15.

¹¹⁹ *FCT v Consolidated Press Holdings Ltd* (2001) 179 CLR 625; 2001 ATC 4343.

income was adjectival and so the provision could apply where the taxpayer had not earned any foreign source income in a particular year:

For a given deduction related to a class of foreign income, the lesser the amount of the income, the greater the excess of the deduction over it. Therefore the greater will be the proportion of that deduction not able to be claimed as an allowable deduction. That is to say, the less the foreign source income for a given deduction, the greater the amount of the deduction that is quarantined. But if the section does not touch the case of zero income in the relevant class then, when the income diminishes to zero, the whole of the deduction becomes potentially allowable against non-foreign source income. On the construction for which ACP contends, the case of zero foreign source income creates a singularity or discontinuity which annihilates the operation of s 79D. There is no requirement in logic nor reason in policy why this should be so.¹²⁰

In a unanimous joint judgment the High Court agreed with the Full Federal Court after stating:

When regard is had to the legislative context, it is not impossible to apply the words of s 79D to a case where, in a given year, income has not yet begun to be derived or, indeed, where, in the events that happen, no income is derived. And it is possible to identify the class and source of prospective or potential income, bearing in mind the necessity to know enough about such income to conclude that s 51(1) would apply. There is no apparent legislative policy to be served by distinguishing, in s 79D, between a small amount of income and a case where income has not yet commenced to flow. Although the taxpayer's argument on this point has considerable force, the meaning given to s 79D by the Full Court is to be preferred.¹²¹

2 Legal world view

At times the mythology of law invades judgments and the idea of the law as an abstract domain ruling the everyday world from afar is referred to in supporting a particular interpretive approach. This is a powerful rhetorical device because it suggests that the law is able to abstract itself from the mundane and, by rising above the everyday world, the law is able to crystallise the legal principles governing the mundane world. The force of this rhetorical device is also enhanced by the fact that it reserves the right of judgment, and hence of critical appraisal of judgment, to those 'within' the legal domain.¹²²

One example of this approach can be seen in the decision of the High Court in *FCT v James Flood Pty Ltd*.¹²³ There the High Court rejected the argument that the meaning of 'incurred' ought be determined mechanically by reference to commercial and accounting practice. In a Delphic statement the High Court noted that:

It may be going too far to say that he must have come under an immediate obligation enforceable at law whether payable presently or at a future time. It is probably going too far

¹²⁰ *FCT v Consolidated Press Holdings Ltd* 99 ATC 4945 at 4964.

¹²¹ *Ibid*, at ATC 4358.

¹²² In times past, the capacity to criticise judges' judgments was limited even to 'insiders' by virtue of the legal custom of refraining from criticising judgments. Although this custom has diminished, the rhetorical device of reserving the law to the lawyers remains.

¹²³ *FCT v James Flood Pty Ltd*. (1953) 88 CLR 492.

to say that the obligation must be indefeasible. But it is certainly true that it is not a matter depending upon “proper commercial and accountancy practice” rather than jurisprudence. Commercial and accountancy practice may assist in ascertaining the true nature and incidence of the item as a step towards determining whether it answers the test laid down by s 51(1) but it cannot be substituted for the test.¹²⁴

This seems to suggest that the Court believed that the legislative test stood independent of commercial and accounting practice, but that commercial and accounting practice was relevant to determining the meaning of the test.

3 Practical/business standpoint

However, by contrast to the approach adopted in cases such as *James Flood*, on occasion judges will also claim that the correct interpretation is to be found by adopting a ‘practical’, ‘commercial’ or ‘business’ standpoint. This approach is a rhetorically strong device for reasons exactly opposite to the rhetorical force of the rhetoric of a remote legal standpoint. According to this rhetorical ‘spin’, the law is ‘grounded’ in the real world and therefore better placed to make ‘common sense’ decisions. The law, perhaps like a good monarch, is ‘of the people’ rather than an inhabitant of a remote, fairytale world.

This rhetorical device is a recurrent theme in tax judgments. Thus, in *Nathan v FC of T*¹²⁵ Isaacs J considered the source of dividends and observed:

The Legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact.¹²⁶

In *Hallstroms Pty Ltd v FC of T*¹²⁷ Dixon J as he then was said:

What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.¹²⁸

Similarly, in *Arthur Murray (NSW) Pty Ltd v FCT*¹²⁹ the High Court stated that:

The ultimate inquiry in either kind of case, of course, must be whether that which has taken place, be it the earning or the receipt, is enough by itself to satisfy the general understanding among practical business people of what constitutes a derivation of income. A conclusion as to what that understanding is may be assisted by considering standard accountancy methods, for they have been evolved in the business community for the very purpose of reflecting received opinions as to the sound view to take of particular kinds of items. This was fully

¹²⁴ Ibid at 506.

¹²⁵ *Nathan v FC of T* (1918) 25 CLR 183.

¹²⁶ Ibid at 189-90.

¹²⁷ *Hallstroms Pty Ltd v FC of T* (1946) 72 CLR 634.

¹²⁸ Ibid at 648.

¹²⁹ *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 114 CLR 314.

recognized and explained in *Carden's Case* (1938) 63 CLR 108, especially in the judgment of Dixon J.; but it should be remarked that the Court did not there do what we were invited to do in the course of the argument in the present case, namely to treat the issue as involving nothing more than an ascertainment of established book-keeping methods. A judicial decision as to whether an amount received but not yet earned or an amount earned but not yet received is income must depend basically upon the judicial understanding of the meaning which the word conveys to those whose concern it is to observe the distinctions it implies. What ultimately matters is the concept; book-keeping methods are but evidence of the concept.¹³⁰

H *Elision*

'Elision' refers to the omission of parts of a book. By elision I mean the rhetorical device of selective presentation of arguments – the omission of alternative accounts which would threaten the seemingly ineluctable progression towards the judicially identified 'right answer'. In a different context, Judge Harold Leventhal used a metaphor which describes the device of elision. 'The trick', the Judge said, is to look over the heads of the crowd and pick out your friends.¹³¹ It is the elusive nature of elision, the fact that the judge does not expressly say anything, which generates the rhetorical force of this device. The reader is lead through a line of reasoning without reference to countervailing interpretations – the result being that the conclusion is presented as the only possible interpretation of the statutory language.

For example, in the recent Full Federal Court decision in *Commissioner of Taxation v Amway of Australia Ltd*¹³² the Full Federal Court (Hill, Sundberg and Kenny JJ) unanimously held in a joint judgment that virtually all of the costs of providing travel, accommodation, meals and drink to the taxpayer's sales agents at a leadership seminar met the requirements of the former ITAA 1936 s 51(1) and, further, were not precluded from deductibility by the former ITAA 1936 s 51AE. In the course of arriving at this decision the Full Court was required to consider the meaning of 'entertainment' for the purposes of s 51AE(3) of the ITAA 1936. Having noted the definitions of 'entertain' and 'entertainment' provided in *The Macquarie Dictionary*, the Court observed that 'in modern Australian usage it may be said that the concept of "to give pleasure" and "hospitality" underlie the meaning of the word "entertainment" when used in connection with matters such as food and drink.'¹³³ It is doubtful that the Court's reference to 'hospitality' adds anything here as the *Shorter Oxford English Dictionary* indicates that hospitality means 'the reception and entertainment of guests, visitors, or strangers'. The Court continued by stating that the purpose of the person providing food or drink is irrelevant to determining whether or not food or drink is 'entertainment'. Given that the core of 'entertainment' is 'to give pleasure' it is clear that this is correct – it is the subjective experience of the recipient that is central to the concept of entertainment.

The Court continued by suggesting that the identification of entertainment:

'involves a matter of characterisation. What is required is that regard be had to the essential character of what is provided. Regard will need to be had to all the relevant circumstances such as the locale where the food or drink is provided, the quality of the food or drink, the occasion for its provision, its cost and its nature. Clearly expenditure on the gala dinner

¹³⁰ Ibid at 318.

¹³¹ Scalia, above n 37, at 36.

¹³² *Commissioner of Taxation v Amway of Australia Ltd* 2004 FCAFC 273.

¹³³ Ibid at para 60.

would be entertainment. Indeed counsel for Amway did not suggest otherwise. By contrast the provision during a working session by an employer of sandwiches or coffee and tea to an employee would not be.¹³⁴

Clearly, the Full Federal Court accepted that ‘entertainment’ can be differentiated from that which is mundane – thus mere sustenance will not comprise entertainment. Further, the extract indicates that the Court propounded an objective test for determining whether or not the recipient had received ‘pleasure’ in the way of food or drink – the relevant circumstances referred to (although not an exclusive list) suggest that the Court had in mind ‘relevant objective circumstances’.

This approach to differentiating entertainment from the mundane appears to be founded upon the Platonic proposition that everything has a fundamental essence. Arguably, however, the concept of entertainment focuses not upon the essence of things (such as food or drink), but upon the recipient’s subjective experience of those things. In many cases a glass of Dom Perignon will ‘give pleasure’ and so constitute ‘entertainment’, but a glass of Dom Perignon will not be entertainment if taken by a teetotaler who feels constrained by the rules of etiquette to sip (with veiled distaste) a toast at a business/formal function.

If the recipient’s pleasure is at the heart of ‘entertainment’, then in the absence of any statutory rules elaborating upon how the existence of entertainment is to be inferred from objective factors (cf ITAA 1936 s 177D), the focus of the inquiry should be upon the recipient’s subjective experience. Here the Full Federal Court appears to have adopted an approach to the characterisation of entertainment which was not supported by the definition of the term that the Court was purporting to apply. This elision of the focus upon the recipient’s pleasure is understandable from a pragmatic perspective. A statutory test which focused upon the subjective experience of the recipient would be unworkable - tax administrators and tax advisors alike prefer to rely upon objective factors when determining whether a statutory requirement is satisfied. For this reason the Court’s preparedness to elide the subjective element of ‘entertainment’ has merit from a pragmatic perspective, but the legal method of statutory interpretation generally ignores pragmatic considerations.¹³⁵

I *Neutrality*

An alternative approach to the concept of substantive fairness is to assert that like taxpayers should be treated alike. While this concept of equity falls short of notions of substantive fairness which would see unequals treated unequally (ie reverse discrimination) it is closer to the concept of legal formality which maintains that all are equal before the law.

In *FCT v Mount Isa Mines Ltd; Mount Isa Mines Ltd v FCT*¹³⁶ the Pincus and Ryan JJ relied upon this concept of neutrality in allowing as a deduction the cost of the taxpayer’s mineshafts. In *Mount Isa Mines* the taxpayer operated a mine in which a deep vertical shaft had been sunk in order to gain access to the ore body, with horizontal shafts constructed for the purpose of exploiting the ore body. It was accepted that the cost of sinking the vertical shaft was of a capital nature as it was constructed merely for the purpose of gaining access to the ore body.

¹³⁴ Ibid.

¹³⁵ Although note that in *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 35 ALR 151 Mason and Wilson JJ observed that where legislation is ambiguous the advantage may lie with that which produces the fairer and more convenient operation so long as it conforms to the legislative intention’.

¹³⁶ *FCT v Mount Isa Mines Ltd; Mount Isa Mines Ltd v FCT* (1991) 21 ATR 1294; 91 ATC 4154.

However, at the same mine the taxpayer had also utilised sloping tunnels, called ‘declines’, in following the ore body. Although the decline followed the ore body downwards, the decline was excavated approximately thirty metres from the ore body. The nature of this decline was therefore distinguishable from the passageways excavated by the taxpayer in *Denison Mines*. In their joint judgment Pincus and Ryan JJ described the nature of the decline thus:

The decline in question was dug, not vertically, but at a slant and in what was described as a “flat S” shape. The purpose of digging the decline was to follow down a particular rich body of nickel ore. The tunnel constituting the decline was dug in such a way that trucks could be driven down it to be loaded with ore won by the miners and, of course, driven back up again. At intervals along the decline, mining operations would take place by digging out to the ore body and then making use of a procedure called “stopping”. That involves making a substantial chamber in the ore body by repeatedly blasting ore from the roof and walls of the chamber. The ore thus dislodged is loaded mechanically into trucks.¹³⁷

In their joint judgment Pincus and Ryan JJ noted that the characteristics of the taxpayer’s decline that distinguished it from the type of mineshaft considered in the earlier British case law were:

1. That the decline was not excavated in one push, but rather was excavated over a number of years in an ongoing process of small, incremental extensions; and
2. ‘the decline was not dug as an asset to be used in the mine as a whole, but was made in the process of getting access to the particular part of the ore to be mined “in the near future”’¹³⁸

Their Honours concluded that the cost of constructing the decline was of a revenue nature, placing emphasis upon the fact that the decline was progressively constructed for the purpose of gaining access to ore that was to be mined in the near future.

Underlying this decision is the concern of the majority judges to maintain neutrality between different forms of mining. Had their Honours held that the cost of excavating the decline was of a capital nature, it was possible that underground mines would be treated disadvantageously under the income tax law by comparison to open cut mines. This aspect of the judgment is apparent from the consideration of the Canadian case of *Johns-Manville Canada Inc v R*.¹³⁹ In *Johns-Manville Canada* the taxpayer operated an open-cut mine. As the ore body was excavated the open-cut pit deepened, necessitating the purchase of bordering of neighbouring land and the excavation of material in order to maintain a safe slope on the sides of the mine pit. The issue in this case was whether the cost of acquiring the neighbouring land and excavating the material was of a capital or of a revenue nature.

In concluding that the expenditure was of a revenue nature, the Supreme Court of Canada noted in passing that:

In the mining industry, where the undertaking is underground mining with the associated assets such as vertical shafts and horizontal transportation elements not created directly by the removal of commercial ore, the tax treatment of capitalization is invoked. On the other

¹³⁷ Ibid at ATC 4,166.

¹³⁸ Ibid at ATC 4,169.

¹³⁹ *Johns-Manville Canada Inc v R* (1985) 21 DLR (4th) 210.

hand, open pit or strip mining requiring none of these fixed facilities leads to the attribution of the associated expenditures to the revenue account.¹⁴⁰

In an apparent rejection of this statement, the joint judgment of Pincus and Ryan JJ in *Mount Isa Mines* observed:

If that is the law to be applied in this country, then there would be a disinclination to open underground mines as opposed to open-cut (or “open-cast”) mines, the former being subject to a tax disadvantage. In broad terms, a question which arises is whether mining by decline method should be assimilated to open-cut mining, for tax purposes.¹⁴¹

J *Combinations of rhetorical devices*

Of course, a more powerful rhetorical device combines multiple tropes, thereby multiplying the persuasive power of the device. Such combinations are common in judicial decisions. Thus, for example, in *Hepples*¹⁴² Deane J endorsed the opinion of Rich and Dixon JJ in *Anderson*¹⁴³ to the effect that a tax must be imposed in plain terms. His Honour continued, suggesting that such a proposition was a matter of common sense:

It is supported by strong reasons in both law and common sense. For one thing, statutes imposing taxation derogate from the ordinary rights of the citizen in that they represent a compulsory exaction of money. For another, the framing of the provisions of such legislation is essentially within the control of government. Indeed, in so far as provisions of the Act are concerned, it would seem that, particularly in relation to technical matters, the content and drafting of such provisions may, on occasion, reflect the advice and views of officers of the Australian Taxation Office itself (see e.g., Boucher, “Living with Tax Reform — The Taxation Office Approach” (1988) 22 *Taxation in Australia* 652, at p 653). In circumstances where the heavy burden of legal costs is likely to constitute an insurmountable obstacle to the challenge by the average taxpayer of an assessment in the courts and where successive administrations have allowed the Act to become a legislative jungle in which even the non-specialist lawyer and accountant are likely to lose their way in the search to identify the provisions relevant to a particular case, the least that such a taxpayer is entitled to demand of government is that, once the relevant provisions are finally identified, a legislative intent to impose a tax upon him or her in respect of a commonplace transaction will be expressed in clear words. So to say is not, of course, to deny that complicated and even obscure taxation provisions may be necessary either to deal with technical situations or to prevent the avoidance of tax by artificiality of form or other device. However, it could not realistically be suggested that there would be any difficulty at all in plainly expressing a legislative intent that an amount received by an employee as consideration for a promise to refrain from competing with his or her employer or divulging or using the employer's information after the termination of the employment should be included in the employee's assessable income for income tax purposes.

Here Deane J offers a compelling array of rhetorical devices in support of the ‘narrow’ approach to statutory construction which he appears to endorse: common sense, the rule of law and the

¹⁴⁰ *Ibid*, 229.

¹⁴¹ *FCT v Mount Isa Mines Ltd; Mount Isa Mines Ltd v FCT* (1991) 21 ATR 1294; 91 ATC 4154 at 4168.

¹⁴² *Hepples v FCT* 91 ATC 4808 at 4818-9.

¹⁴³ *Anderson v. The Commissioner of Taxes (Victoria)* (1937) 57 CLR 233 at 243.

perceived unconscionability of allowing the government any leeway in circumstances where it has the upper hand in terms of bargaining power because the heavy burden of legal costs is less onerous for a well resourced state.

VII RHETORICAL ANALYSIS OF TAX JUDGMENTS – RESULTS, CHALLENGES AND PROSPECTS

A *What does the preceding review of the case law tell us about the judicial process?*

The preceding review of the case law suggests that rhetorical devices, in the sense of recourse to discourses which carry rhetorical appeal, are a significant part of tax judgments in Australia. In support of their decisions judges routinely call upon discourses originating in generally accepted principles or concepts such as common sense, fairness (substantive fairness, formal fairness, neutrality, horizontal equity and a fair balancing of the often competing interests of the individual and of the state), business expedience and fiscal expedience (the floodgates argument). Further examination of the case law would doubtless uncover other discourses expressly referred to in the course of judgments. Moreover, studying the case law may also reveal implicit references to discourses.¹⁴⁴

Indeed, even the rules of statutory construction underpinning tax interpretation are framed in rhetorically laden terms. For example, when ascertaining the ‘meaning’ of a particular statutory term the courts may have recourse to the ‘ordinary meaning’ of that term, a specific understanding of the term adopted in a particular industry or an economic sector (for example, the ‘technical legal meaning’ or ‘commercial and accounting understanding’), the meaning of the term gleaned from its specific statutory context or the meaning of the term from a ‘practical’ perspective.

All of these paths to statutory meaning are framed in terms which, when viewed in isolation, have strong rhetorical appeal. It *is* comforting to think that judges are one with the people in adopting the ‘ordinary’ meaning of a term (although recourse to a dictionary suggests that this referential theory of language is nonsensical, as much depends upon the context). Similarly, it is comforting to think that judges read legislation with a ‘practical’ eye (although this begs the question of from whose perspective should the practicality of legislation be determined? A ‘practical’ interpretation could mean enhancing the public revenue in order to secure the power of the state, or a ‘practical’ interpretation could mean minimising taxes in order to allow the ‘wealth generators’ in our communities to feel uninhibited in generating more wealth or a practical interpretation could be one which allows a taxpayer to escape taxation but which lays down a relatively clear precedent for prospective application.)

¹⁴⁴ It will be noted that in my preceding review of rhetorical practice I have restricted my examples to express statements of the judiciary. This is not to say that reference to rhetorical discourses may be implicit within a text – my only reason for excluding such examples is one of space. For example, in the course of its decision in the *Spotless* litigation the High Court noted: ‘In Australia, State and Territory stamp duty laws have been a particularly significant factor in the shaping of business transactions. However, the tax laws are one part of the legal order within which commerce is fostered and protected. Another part is Pt IV of the Trade Practices Act 1974 (Cth), which regulates or proscribes certain restrictive trade practices. In this broad sense, “[t]axes are what we pay for civilized society”, including the conduct of commerce as an important element of that society.’ (*FCT v Spotless* 96 ATC 5201, 5206). This statement is suffused with the view that taxpayers must pay their ‘fair share’ of taxes in accordance with some sort of benefit theory of taxation. The relevance of this view to the interpretive issues at hand is obscure. However, it does carry strong rhetorical force in support of the argument that the anti-avoidance rules should be given a broad interpretation in combating transactions which smell of ‘tax avoidance’ (an elusive concept – see: J Passant, ‘Tax Avoidance in Australia – Results and Prospects’ (1994) 22 *Federal Law Review* 493; GT Pagone, ‘Tax Planning or Tax Avoidance?’ (2000) 29 *Australian Tax Review* 96.

Leaving to one side the rules of statutory interpretation, the rhetorical devices noted in the preceding review, such as appeals to common sense, fairness, the floodgates argument and neutrality have no apparent basis in the tax legislation, yet they have clearly played a pivotal role in the course of the respective tax judgments referred to.

The fact that rhetoric has played such a significant role in Australian tax adjudication over such a long period of time, that the existence of rhetoric in judgments predates what some consider to be the scourge of judicial activism and that even judges who professed the 'rule of law' faith such as Dixon CJ used rhetoric in their judgments, suggests that rhetoric is intrinsic to tax adjudication.

B *Responses to the depiction of the rhetoric of judgment*

This begs the question – what do we do in light of this fact? For those upholding the rule of law, the response might be to argue that the cases referred to in the preceding review were mere aberrations and that the rhetorical aspects of the judgments should be ignored. However, the suggestion of turning a Nelsonian eye to such judicial indiscretions would amount to nothing less to a severe case of Sartrean bad faith. To put it another way, following the head burying example of the ostrich, I would argue that rhetoric in tax judgments is too widespread for such a selective reading of the history of Australian tax judgments to be credible.

An alternative response might be to accept that, hitherto, even the rule of law judges such as Dixon CJ have erred on the side of 'activism' and that all of the case law needs to be recognised as defective if the rule of law is to be applied. This is a far stronger argument in the sense that it cannot readily be knocked down. While I may point to the rhetoric interwoven within the vast body of Australian case law, and argue that rhetoric is indeed intrinsic to the act of judgment, mine is essentially an inductivist argument. 'The last x thousand tax judgments have been riddled with rhetorical devices, so the next tax judgment will be as well'. Those wanting to hold to the rule of law would reject such inductivist logic, arguing that the past need not be a guide to the future. They would argue that the failure to attain the ideal in the past should not stop us from striving for the ideal in the future.

In response to this all that I can say is that I do not agree with the theories of language which underpin alternative formulations of the determinacy thesis and, hence, the rule of law. Those who uphold the rule of law as an ideal are, I suggest, noble dreamers because they aspire to an unattainable world in which language has a finite meaning. In earlier articles I have attempted to make some contribution to the elaboration of the argument that language is intrinsically incapable of conveying a finite meaning.¹⁴⁵ But those upholding the rule of law insist that language is capable of conveying finite meaning and that we need to develop appropriate legal systems to ensure that statute law with finite meaning is enacted.

At the end of the day the debate about the achievability of the rule of law comes down to whether or not one is prepared to accept that language is capable of finite meaning *and* that judges are capable of discovering that finite meaning. Having scrutinised the interpretation of particular examples of tax legislation over the past three centuries, I have not found any evidence to suggest that there has ever been a period where legislation conveyed a finite meaning and that judges have merely been the oracle for such finite meaning. Rhetoric always has played a part in tax adjudication and, I suggest, always will.

¹⁴⁵ M Burton, 'Determinacy, Indeterminacy and Rhetoric in a Pluralist World' (1997) 21 *Melbourne University Law Review* 544; M Burton, 'The Song Remains the Same - The Search for Interpretive Constraint and the Rhetoric of Legal Theory in Hart and Hutchinson' (1997) 20 *University of New South Wales Law Journal* 407.

This is not to say that I am implacably opposed to the ideal of the rule of law. If a language with a finite meaning were to be achieved I would happily promote the rule of law because I believe that it offers the best reconciliation of the interests of the individual and the commonwealth. However at the moment I suggest that such a language is a remote prospect or an impossible dream.

1 The rule of law or the rule of judges? Reconsidering the role of the judge

To some the fact that rhetoric will be an intrinsic aspect of tax judgment into the future may seem a bleak prospect.¹⁴⁶ The apparent nightmare of activist judges making decisions upon the insecure foundation of a whim, and justifying the decision with beguiling rhetorical devices, appears a short road to a politicised judiciary which is a hallmark of authoritarian rule. If judges are not finding the law that is 'there', then how can the judicial function be legitimate? If the legitimacy of the courts is jeopardised, what social institution will have the authority to protect the individual from the seemingly ever expanding powers of the state?

Despite this bleak portrayal of a world without the rule of law, I am much more optimistic about the world which we could create by recognising the rhetorical aspect of tax adjudication. After all, I suggest that I am only describing judicial practice as it currently exists and the world has not fallen in around our ears.

Given the vast literature dealing with statutory interpretation, and the enormous subset of that literature which argues that judges make law in more than an interstitial way, it is surprising that little attention has been given to what pragmatic theories of interpretation mean for statutory drafting. If judges make meaning, then what is the point of drafting legislation in an effort to constrain the judicial law making discretion? In the following paragraphs I have set out my thoughts upon the benefits that would flow if we were to expressly recognise the role of rhetoric in tax judgment, and also my thoughts about how tax administration would need to change to accommodate rhetorical practice.

2 Enhancing judicial legitimacy by embracing the rhetorical aspect of judgment?

As an academic I feel that I talk with tax practitioners far too infrequently. But when I do speak with them inevitably the recent case decisions arise in our conversations. Almost invariably the conclusion in a particular case is noted and then dismissed as an example of 'judge x' arriving at a conclusion based upon her/his particular worldview/subjective preferences. Generally, practitioners view such examples of subjectivity influencing the decision as a departure from the rule of law ideal and a blot on 'Judge X's' copybook.

My point is that even now the legitimacy of the courts is questionable amongst the informed members of the community. Wouldn't it be far more honest for the judiciary to accept the reality of rhetoric as part of the adjudication process? At the least, the criticism of judges for failing to uphold the rule of law would cease because such criticism would be akin to measuring one's personality against the idealised personality of a character in a 'feel good' Hollywood movie – why assess one's performance against the unattainable? After all, at times in their reflections upon the art of judging, the judges referred to earlier in this article appear to accept that the determinacy thesis is an unachievable ideal.¹⁴⁷

¹⁴⁶ Given the centrality of the determinacy thesis to the rule of law, rejection of the determinacy thesis necessarily entails rejection of the existence of the rule of law. Absent the rule of law it seems our society will plummet into chaos: Heydon, above n 45 at 5; Walker, above n 45; Craven, above n 45.

¹⁴⁷ See, for example, McHugh, above n 15.

Rather than perpetuating the current misdescription of a judgment as an elaboration of absolute truth (ie enunciation of ‘the law’), it would be far more honest to recognise the role that rhetorical devices play in judgments, embrace that rhetoric and engage with it by developing a pragmatic theory of adjudication which accommodated rhetoric. What I am arguing, then, is simply that the theory of adjudication we adopt should match the current reality. This would not entail wholesale change of judicial or practitioner practises. Rather, the only significant change would be in how we describe what we have done on a day to day basis. This change in conceptualisation of the interpretive process, however, might engender some flow-on consequences which would, I suggest, be beneficial.

3 Towards a more methodical approach to judging

If the role of rhetoric was recognised there is much that we could learn from the Ancient Greeks. In those times rhetoric was considered as a method of elucidating the truth and was therefore a subject of great importance to the Ancient Greek philosophers. Arguments about ‘the truth’ were constructed by reliance upon rhetorical devices and tested in the cauldron of debate.

In a similar way alternative statutory meanings could be expressly contemplated and their merits assessed from the perspective of alternative rhetorical devices, some of which I have outlined above. It would be taken for granted that judges would be applying their best endeavours to arriving at the best interpretation (the one with the greatest rhetorical force) rather than arriving at the ‘right’ answer. Judges would overtly and systematically consider alternative interpretations of legislation, weighing the perceived merits of competing interpretations and arrive at their ‘best effort’ conclusion.

By ‘systematically’ I mean that a judgment would expressly address each key rhetorical device and explain whether or not that device was relevant to the interpretive issue at hand. Rather than a judge appearing to adopt a particular rhetorical approach (and eliding alternative approaches), judges would have to expressly explain why a particular approach (substance/form, ordinary/commercial/technical legal/practical meaning, substantive fairness, etc) was warranted and why the alternatives were rejected. As happens now, judges would make choices about which perspective should be adopted when assessing the rhetorical force of competing interpretations. For example, ‘should substantive fairness be emphasised in this case or formal fairness? What are the consequences of emphasising substantive fairness here, and what are the consequences of emphasising formal fairness?’ As was seen in the preceding discussion with respect to the discourses of substantive and formal fairness, often members of the same court appear to talk at cross purposes to each other without engaging with the alternative viewpoint. This is considered acceptable because both sides of the argument can maintain that they are right and that the other is wrong. Accepting that absolute truth in the law is a comforting but artificial construct would mean that judges with alternative viewpoints would have to engage with the other in constructive criticism – a mindset which would foster the self-critical application of alternative interpretive approaches. While such self-critical adjudication will not necessarily mean that judges will achieve unanimity upon a particular interpretation, at the least it will mean that there will be a far more rigorous debate about the respective merits of alternative interpretations.

4 Enhancing the critical appraisal of judgments/rulings/tax advice – covering the rhetorical devices on the judicial ‘wheel of fortune’

In similar fashion, express recognition of the complete array of rhetorical devices deployed in the interpretation of tax legislation would only serve to enhance the practical administration of taxation law. Tax practitioners would construct and assess alternative interpretations founded upon

alternative rhetorical discourses. As already noted, this is what happens today, albeit in a less overt fashion – alternative interpretations are assessed upon the basis that only one is absolutely right, rather than upon the basis of determining which has the greatest rhetorical force.

C *Legislative change*

1 Plain English drafting – determinacy dreaming?

Although it is readily conceded by many that tax legislation is complex for a multitude of reasons,¹⁴⁸ one source of complexity is perceived to be the drafting style adopted.¹⁴⁹ The call to rewrite taxation law in ‘simple’ English was adopted in 1996¹⁵⁰ but the commentators’ respective assessment of the simplification benefits is not flattering.¹⁵¹

The problem with plain English drafting is that it is just another form of literalism. The assumption is that by reducing ‘the legislative intention’ to ‘prose that communicates directly and effectively with its intended audience’¹⁵² a determinate legal outcome may be achieved. As noted previously, this formalist language theory has been challenged, I suggest, convincingly.¹⁵³

Section 6-5 has been written in simple English for several years now, and its predecessor could hardly be said to have been written in complex English. And yet section 6-5 continues to attract a great deal of interpretive scrutiny. When viewed from the perspective that any interpretation is intrinsically rhetorical, the suggestion that the redrafting of statute law in simple English will resolve semantic doubt must be rejected.

2 Rationalising tax concepts

Many commentators have also pointed to the conceptual complexity of the income tax. While some are pessimistic about the prospects for income tax simplification upon the basis that conceptual complexity is intrinsic to an income tax, others argue that there is room for improvement. One simplification strategy would include a rationalisation of the concepts around which an income tax is framed, with a view to creating a coherent income concept. Many argue that the economic concept of income would be a more coherent framework¹⁵⁴ by comparison to what is commonly referred to as the trust law concept of income.¹⁵⁵

¹⁴⁸ For a good discussion of the sources of tax complexity in the United States of America see Sheldon D Pollack, ‘Tax Complexity, Reform and the Illusions of Tax Simplification’ (1994) 2 *George Mason Independent Law Review* 319.

¹⁴⁹ See, for example, Law Reform Commission of Victoria, *Plain English and the Law*, (Report No 9, Victoria, 1987).

¹⁵⁰ For a brief account of the historical background see Brian Nolan and Tom Reid, ‘Re-writing the Tax Act’ (1994) 22 *Federal Law Review* 44.

¹⁵¹ See, for example, Krever, ‘Taming Complexity in Australian Income Tax’, above n 5.

¹⁵² Peter Butt, ‘Modern Legal Drafting’ (2002) 23 *Statute Law Review* 12.

¹⁵³ For a critique of the plain English approach in the context of legislative drafting, see: Brian Hunt, ‘Plain Language in Legislative Drafting: Is it really the answer?’ (2002) 23 *Statute Law Review* 24; Brian Hunt, ‘Plain Language in Legislative Drafting: An Achievable Objective or a Laudable Ideal?’ (2003) 24 *Statute Law Review* 112.

¹⁵⁴ See, for example, G. Lehmann and C. Coleman, *Taxation Law in Australia*, (5th edn 1998), at 81; R. Krever, ‘Avoidance, Evasion and Reform: Who Dismantled and Who’s Rebuilding the Australian Income Tax System?’ (1987) 10 *University of New South Wales Law Journal* 215, 229.

¹⁵⁵ As Prebble notes, the authority for this proposition appears rather slim: Prebble, above n 7. However, this proposition has been repeated frequently such that it has been accepted: Graeme Cooper, Robert Deutsch and Richard Krever, *Income Taxation Commentary and Materials* (2nd ed, 1993) 3-6; Fiona Schaeffer, ‘The Uneasy Alliance

From a law as rhetoric perspective the substitution of the economic discourse upon income can be seen as an attempt to constrain the interpretive dialogue. However, the wealth of literature considering whether there is, in fact, one concept of economic income suggests that the adoption of an 'economic' concept of income may not be the panacea that some suggest.¹⁵⁶ Uncertainty regarding the nature of the 'economic income' concept will therefore engender a new rhetorical dialogue upon the 'meaning' of the revised income tax scheme.

Further, no one seriously suggests that a pure 'economic' concept of income would be practicable. A close reading of Henry Simons' watershed work indicates that he referred to at least two 'ideal' concepts of income.¹⁵⁷ Political compromises will invariably have to be made to take account of competing structural objectives (such as fiscal imperatives, compliance costs, etc) and such compromises will add to income tax complexity.¹⁵⁸ Once again, the legislative expression of such compromises will foster rhetorical dialogue upon the nature of such compromises.

3 Purposive legislative statements

Many commentators have suggested that literalist interpretation promotes a legislative response in the form of more particular and complex legislation which seeks to paint bright lines, and this prompts tax advisors to recharacterise arrangements such that they fall outside of the bright lines.¹⁵⁹ As already noted, the existence of one literal meaning of any utterance is a hotly contested issue in the field of communication theory.

Nevertheless, some argue that one path to tax simplification is the inclusion of purposive statements in the tax legislation to supplement the operative rules.¹⁶⁰ Others seem to argue that we should abandon any attempt to write detailed legislative rules and just write general statements of principle, leaving the detail to be fleshed out by the executive arm of government.¹⁶¹ The earlier discussion of

between the judicial and economic concepts of income: the treatment of capital gains' (1992) 5 *Business and Corporate Law Journal* 1.

It may be the case that this concept is founded upon the views of earlier commentators: see W Strachan 'The Differentiation of Capital and Income' (1902) 18 *Law Quarterly Review* 274; W Strachan, 'Economic and Legal Differentiation of Capital and Income' (1910) 26 *Law Quarterly Review* 40; W Strachan, 'Capital and Income (Lifeowner and Remainderman)' (1912) 28 *Law Quarterly Review* 175; W Strachan, 'Capital and Income Under the Income Tax Acts' (1913) 29 *Law Quarterly Review* 163.

¹⁵⁶ See, for example, Boris Bittker, "A 'Comprehensive Tax Base' as a goal of Income Tax Reform" (1967) 80 *Harvard Law Review* 925; W. Andrews, "Personal Deductions In An Ideal Income Tax" (1972) 86 *Harvard Law Review* 309.

¹⁵⁷ Henry Simons, *Personal Income Taxation* (1938), ch 2: Simons refers to psychic income, his formulaic income definition (at p 50) and a modified income base taking account of issues of practicality.

¹⁵⁸ Alternatively, an uncompromising adherence to 'the' economic concept of income may engender its own complexity: Pollack, *op cit* n 148, 342-4.

¹⁵⁹ Yuri Grbich, *Operational Strategies for Improving Australian Tax Legislation*, (Working Paper, Monash University Law School, Melbourne, 1984).

¹⁶⁰ Krever, *above n* 154, at 502, 504. Of course, this work builds on the more general work of many others advocating a purposive approach to statutory interpretation. For a seminal work in this field see JA Corry, 'Administrative Law and the Interpretation of Statutes' (1935) 1 *University of Toronto Law Journal* 286.

¹⁶¹ See, for example, Y Grbich, 'Revisiting the main deduction provision: clear concepts for a mass decision-making tax system' (1990) 17 *Melbourne University Law Review* 347. By blurring the 'bright lines' this 'fuzzy law' approach might, it is also suggested, that this may be a useful strategy in combating tax avoidance as tax planners would not be so confident in advising that a tax minimisation strategy was clearly outside of the tax net; Grbich, *above n* 159; Millett, *above n* 66. Given the experience in the United States, it cannot be assumed that such an approach would succeed: Pollack, *above n* 148 at 339.

the shortcomings of the purposive theory of interpretation indicates that either approach will not necessarily produce the legal determinacy that the commentators suggest.

The idea of including purposive legislative statements springs from the idea that there is a clear divide between the pre-lingual formation of a legislative intention and committing that intention to statutory writing. The purpose of purposive statements is therefore to enable the reader to access the pre-lingual mind of the legislature. The problem here, of course, is that it is doubtful whether there ever is a pre-lingual intention and even if there is, how can we be sure that the purposive statement accurately describes it? Purposive statements therefore confront the same interpretive challenges as confront the 'operative' statutory rules – they will not guarantee universal agreement upon the meaning of a particular statutory rule.¹⁶²

This is not to say that the provision of additional legislative commentary upon the legislative objectives of a particular statute/statutory provision is pointless. It does mean, however, that we need to reconceive what we are trying to achieve by providing such discussion. Further, the preceding discussion suggests that 'purposive statements' will need to be somewhat more detailed than might be appropriate for inclusion in the legislative text.

4 Development of extrinsic materials

It is remarkable that, more than two decades after the enactment of general purposive interpretive rules,¹⁶³ Parliament has failed to make it easy for those interpreting legislation to identify the purpose of the legislation. To take just one example, in 1999 the Commonwealth Government decided to legislate a raft of capital gains concessions to apply to 'small business'.¹⁶⁴ Discussion of the legislative purpose of these rules in the legislation¹⁶⁵ and extrinsic materials¹⁶⁶ is rudimentary, to say the least. Even reference to the Treasurer's media releases¹⁶⁷ with respect to these measures

For an account of the demise of the United Kingdom government's proposal to introduce purposive drafting of tax law by leaving the detailed rules to be spelt out in secondary legislation or extrinsic materials see Natalie Lee, 'A purposive interpretation of tax statutes?' (1999) 20 *Statute Law Review* 124.

¹⁶² To take Krever's example with respect to the capital gains discount, as Krever notes, the inclusion of this tax expenditure was justified by the desire to increase capital investment. Statement of this purpose would not necessarily mean that capital gains realised by the disposal of private assets would be excluded from the tax concession. For example, what if I sold a holiday home in order to invest further in a business? What if, after realising a profit on the holiday home, I retained the profit in relatively liquid investments pending the identification of a suitable business investment? How long could I refrain from making a business investment and still qualify for the concession? A broad statement of principle would not necessarily provide clear guidance here.

¹⁶³ See, for example, *Acts Interpretation Act* 1901 (Cth) s 15AA.

¹⁶⁴ See *Income Tax Assessment Act* 1997 Div 152.

¹⁶⁵ Section 152-1 begins with the vague suggestion that 'to help small business, if the basic conditions for relief are satisfied, capital gains can be reduced by the various concessions in this Division'.

¹⁶⁶ See the explanatory memorandum accompanying *New Business Tax System (Capital Gains) Bill* 1999.

¹⁶⁷ See Rt Hon Peter Costello, The New Business Tax System, (Media Release No 58, 1999); 'Small business and primary producers to benefit from the New Business Tax System, (Media Release No 59, 1999). These documents are not, it should be noted, expressly included in the list of extrinsic materials given in *Acts Interpretation Act* 1901 (Cth) s 15AB(2) but would nevertheless constitute 'material not forming part of the Act' (s 15AB(1)). It is unclear whether the Treasurer's media releases would be admissible as extrinsic evidence, as reference to such material would need to overcome the 'due notice' requirement imposed under subsection 15AB(3).

is vague.¹⁶⁸ More needs to be done if the reforms to the interpretation of legislation, undertaken in the 1980's, are to achieve their potential.¹⁶⁹

This reluctance on the part of statutory drafts people to develop a comprehensive extrinsic commentary upon the legislative text is understandable. The determinacy thesis demands that the legislature speak with one voice. Expressing the same idea using different words in legislative form and also in extrinsic materials magnifies the risk of actual or perceived inconsistency. Ironically the attempt to clarify the legislative meaning may only obscure it.

Recognition of the rhetorical aspect of tax adjudication, however, entails acceptance of the fact that a legislative re-write will not achieve the determinacy that some suggest.¹⁷⁰ Rather, legislation is part of a continuing dialogue within a community, rather than the endpoint of the law making process. With this in mind, the legislation and/or extrinsic material might incorporate reference to alternative interpretations of the legislative compromise embodied in the legislation (founded upon varying rhetorical discourses) and explain why a particular interpretation was desirable by stating which rhetorical discourse(s) should be emphasised. The incorporation of examples into the legislative text is the first tentative step down this path. But in general the examples provided in the legislation do little to elaborate upon the interpretive discourses relevant to the interpretation of the particular provision concerned.¹⁷¹

The proposal to modify extrinsic materials might be taken to be the purposive approach to statutory drafting dressed up in rhetorical robes. A purposive approach assumes that there is a finite purpose underlying legislation which is more or less ably expressed in the legislative text.¹⁷² However, the recognition of the rhetorical aspect of law entails acceptance of the fact that in most, if not all, cases legislation will attempt a compromise between competing objectives (or discourses). The difference is crucial because the rhetorical approach accepts that no statement of legislative purpose can ever produce a determinate result – all that can be hoped for is that the interpretation of any text is constrained by a consideration of the rhetorical discourses which inform the legislative text.

Some might also suggest that the incorporation of a commentary upon alternative interpretations within the legislative text and/or the extrinsic materials would expand the legislation dramatically and make it unworkable. True, the length of the legislation and/or extrinsic materials would increase, but at the same time the need to consider numerous cases, tax rulings and extrinsic materials would diminish or be superseded by the revised approach to legislative drafting. Rather than the existing interpretative materials purporting to distil the kernel of determinate meaning that is supposedly embedded within the text, the extrinsic and legislative materials would comprise a frank discussion of alternative rhetorical discourses underpinning the text. Extrinsic materials would

¹⁶⁸ The Treasurer merely observes that these capital gains measures 'will further reduce impediments to investment by small businesses. Moreover, this measure will protect from tax those assets that appreciate broadly in line with inflation.'

¹⁶⁹ For a more positive appraisal of these reforms see Patrick Brazil, 'Reform of Statutory Interpretation – the Australian Experience of Use of Extrinsic Materials: With a Postscript on Simpler Drafting' (1988) 62 *Australian Law Journal* 503, 512.

¹⁷⁰ Ian Turnbull, 'Drafting Simple Legislation' (1995) 12 *Australian Tax Forum* 247.

¹⁷¹ Thus the example accompanying ITAA 1997 s 152-105 is merely another example of stating the obvious. The far more problematic concepts mentioned in the provision, such as 'retirement', are not explored. For example, what if a person works part-time but considers themselves to be 'retired'?

¹⁷² Although some suggest that the legislative purpose is expressed in the legislative text, which is tantamount to rejecting a purposive approach and upholding a textualist approach.

emerge from the fairyland.¹⁷³ Further, the additional length of the legislation would be ameliorated by the introduction of appropriate indexing, cross-referencing and annotation. As it stands at the moment, a person wishing to ascertain the relevant law is reliant upon the vagaries of various parliamentary, commercial (if they are available) and administrative search engines in identifying relevant extrinsic materials, case authorities and administrative rulings/discussion. This is an archaic information system which has survived into the twenty first century. Tax legislation should be capable of incorporating cross references to all relevant material as well as discussion of the salient points to be drawn from that material. Much work needs to be done in bringing the concept of the statute into the era where information technology enables massive amounts of data to be stored, organised and randomly accessed.

5 Tax rulings in the rhetorical age

Whether or not you subscribe to the rule of law as a convincing political theory, the existing taxation rulings system is open to criticism from a number of perspectives. Leaving the separation of powers issue to one side, the problem with the taxation rulings system is that it creates an actual or perceived conflict of interest. It would be understandable for a tax collection agency to develop a culture of maximising tax collections rather than developing a culture of applying the law in a disinterested way. Given the possibility that the tax administration is focused upon maximising revenue, and given that there is not a determinate answer to many tax interpretive issues, it is possible that taxation rulings would be constructed with one eye on maximising the revenue.¹⁷⁴

Try as he might by thoroughly analysing the relevant legal authorities, recognising the rhetoric of law means that the Commissioner will never be able to disinfect his taxation rulings of this perceived conflict of interest. Recognition of the fact that the determinacy thesis is a myth, and that the interpretation and application of taxation law is a rhetorical process, only heightens the need for those charged with interpreting and applying the law to be free of any actual or perceived conflict of interest. Accordingly, the taxation rulings function should be undertaken by a body, judicial or quasi-judicial, which is remote from the tax collection function.¹⁷⁵

¹⁷³ Lord Reid, 'The Judge as Lawmaker' (1972) 12 *Journal of the Society of Public Teachers of Law* 22 at 22.

¹⁷⁴ For a good overview of the issues associated with a taxation rulings system see: Veronica Webb, 'The Taxation Rulings System: A helpful child or a potential bully?' (1990) 7 *Australian Tax Forum* 217; D Sandler, *A Request for Rulings* (1994).

Grbich is apparently prepared to accept the possibility of such a conflict of interest: Y Grbich, 'Operational Strategies for improving Australian Tax Legislation' (1990) 19 *Federal Law Review* 266. See also Y Grbich, *supra* n 160: in the course of discussing the role of tax rulings in elaborating the detailed operation of general provisions such as the former ITAA 1936 s 51, Grbich states that many of the characterisation of expense questions should be 'based on a systematic weighing of economic and distributional issues and some very practical administrative concerns. Inevitably tax deductibility provides a subsidy, a 'tax expenditure' (to use the technical term in an extended sense) for the activity in question.' (at 366). This seems to suggest that tax rulings should be framed with a view to maximising tax revenue rather than taking account of tax policy (as the economic concept of income would suggest that expenditure incurred in deriving income should be recognised – the critical question then being how to determine whether the necessary nexus between expenditure and income is satisfied).

¹⁷⁵ In this regard the Advisory Opinions decision is crucial, as there must be a 'matter' (ie a 'real' dispute) before the judicial power of the Commonwealth may be exercised: *Re Judiciary and Navigation Acts (Advisory Opinions Case)* (1921) 29 CLR 257.

6 Penalties in the rhetorical age

Once it is accepted that adjudication of a case does not result in a declaration of the correct interpretation of the legislation (but rather a contingent view as to the best interpretation that a judge's best effort can produce), the function of penalty provisions need to be reconsidered.

There are two types of penalty provisions:

1. Those which fall within the civil penalty regime within Part 2-1 of the *Taxation Administration Act 1953*; and
2. Those which deny the taxpayer the benefit of a provision which would otherwise lower the taxpayer's tax liability (or, perhaps, increase their tax loss) for a particular income year. An example of such a provision is ITAA 1997 s 26-25, the predecessor of which was significant in the recent case of *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation*.¹⁷⁶ In that case the taxpayer was denied a deduction for some \$42 million dollars of royalty payments made to a non-resident because the taxpayer had failed to withhold tax from the payments, despite the fact that the taxpayer presented a credible argument that the legislation did not necessarily dictate that such withholding was required. Such penalty provisions are particularly onerous given that they are not subject to any of the provisos found within the civil penalty regime of the TAA – there is no exclusion if the taxpayer has taken reasonable care or adopted a reasonably arguable position.

Aspects of both types of penalty provisions would need to be reconsidered. With respect to the former, the concept of a 'reasonably arguable position' may need reconsideration if it is accepted that the meaning of many tax rules is subject to reasonable debate, depending upon the particular rhetorical perspective from which the legislation is viewed. Adopting a self assessment system within the context of a revised theory of law which acknowledges the contingent nature of statutory 'meaning' while leaving taxpayers to run the gauntlet of the 'reasonably arguable position' test promotes non-neutrality – investors will either avoid such tax systems or will restrict themselves to 'safe harbour' investments. This situation is hardly conducive to an efficient international economy.

With respect to the second category of penalty provisions, such provisions should be brought within a unified penalty regime by incorporating provisos which reflect the possibility that taxpayers may quite reasonably have adopted a course of action in the honest belief that they were complying with the law. Not to do so might be warranted if the meaning of the primary obligation was determinate – but in the absence of determinate meaning the imposition of penalties is clearly inequitable.

In this regard I have had the benefit of reading a draft paper written by Professor Justin Dabner which I would commend to the reader.¹⁷⁷ Dabner argues that the role of the courts needs to be reinvented by recognising the law making power of the courts and the retrospectivity of a judgment. He continues by suggesting that costs orders might be made against the tax authorities even in cases where the tax authority's view of the law is upheld. I believe that Dabner's paper incorporates the seeds for development of an alternative approach to the penalties and rulings systems which sits comfortably with my argument that tax judgments are intrinsically rhetorical and hence contingent.

¹⁷⁶ *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* [2004] FCA 1044.

¹⁷⁷ Justin Dabner, 'In Search of a Purpose to our Tax Laws', (Unpublished manuscript, 2005) – on file with the author.

VIII CONCLUSION

Adjudication upon legislation entails unravelling the competing discourses embodied in the legislation (such as equity, fiscal necessity, administrative practicality and global competitiveness). Even if it is accepted that the hypothetical 'legislative mind' is capable of formulating a pre-lingual compromise of these competing discourses, it must also be accepted that language is capable of accurately conveying the precise nature of that compromise. A review of some extra-curial judicial rumination upon the practice of statutory interpretation indicates that there is some disquiet with simplistic theories of language which underpin theories of statutory interpretation framed within the rule of law. A review of the taxation case law confirms the view that the mainstream account of the rule of law does not provide a convincing account of judicial practise and is, indeed, a powerful combination of rhetoric and wishful thinking.

In adjudicating tax cases judges are compelled to make choices between competing interpretations which have been framed from the perspectives of competing discourses (or combinations thereof). There is no critical perspective from which to assess the merits of such competing interpretations – all that the judge can do is to identify which interpretation may be constructed in the most rhetorically forceful fashion. In passing judgment, then, the judge must provide rhetorically appealing justifications for what is essentially a subjective decision; hence the judicial recourse to rhetorical devices, such as those discussed earlier in this paper. Rhetoric is an intrinsic feature of the law and of judgment. This is not a prescriptive finding but rather a descriptive fact. In an ideal world perhaps our language would be capable of conveying finite meaning such that the rule of law would be descriptively accurate. However, in our second best world we need to dispel the myth of the rule of law and reinvent our understanding of legislation by taking account of the reality of legal practise. Until this happens we will continue to live in Sartrean bad faith – the judges accept that the rule of law is a myth but are reluctant to dispel it once and for all.

PROSPECTS FOR A TAX ADVISORS' PRIVILEGE IN AUSTRALIA

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I INTRODUCTION

As is the case generally in the common law world, communications between legal advisors and their clients in Australia are protected from compulsory disclosure under the doctrine of legal professional privilege. Specifically, such communications need to be for the dominant purpose of (a) the provision of legal advice, or (b) in relation to contemplated or current litigation.¹ While it has been settled that legal professional privilege has been accepted as part of the substantive law in Australia,² the content and application of the privilege is still a matter of debate, a state of affairs that at least one Federal Court judge has found surprising.³ Recent case law in Australia has seen the adoption of a dominant purpose test after almost a quarter of a century of applying a sole purpose test,⁴ considered whether the privilege is abrogated by taxation⁵ and trade practices legislation⁶ and addressed the question of whether the two heads of the privilege are in fact unified by a single rationale.⁷ This flurry of curial activity has also sparked a swathe of commentary analysing the role of legal professional privilege in the modern Australian legal setting.⁸

The second head of the privilege, where the communication is made in the context of either contemplated or actual litigation, is usually invoked when a party to proceedings attempts to attach the privilege to communications involving third parties. To qualify for the privilege under this head, the communication needs to have been made for the purpose of intended use in that litigation.⁹ The Full Federal Court decision in *Pratt Holdings* rejected the notion previously held

¹ *Esso Australian Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49; J D Heydon *Cross on Evidence* (7th ed, 2004) para 25210.

² *The Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* (2002) 192 ALR 561, 564 (Gleeson CJ, Gaudron, Gummow and Hayne JJ). Note that in that same case, it is also described as being "an important common law immunity" (565), a description the Full Federal Court in *Pratt Holdings Pty Ltd v Federal Commissioner of Taxation* (2004) 207 ALR 217 used as evidence that the privilege goes beyond being "merely a rule of substantive law"; 207 ALR 217, 219 (Finn J).

³ Finn J, above n 2, 219.

⁴ *Esso Australian Resources v Federal Commissioner of Taxation*, above n 1 (overturning *Grant v Downs* (1976) 135 CLR 674).

⁵ *JMA Accounting Pty Ltd v Carmody* 2004 ATC 4916; *Pratt Holdings Pty Ltd v Federal Commissioner of Taxation*, above n 2 (s 263 *Income Tax Assessment Act 1936* (Cth)); *Federal Commissioner of Taxation v Coombes* 99 ATC 4634 (s 264 *Income Tax Assessment Act 1936* (Cth)).

⁶ *The Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission*, above n 2 (s 155 *Trade Practices Act 1974* (Cth)).

⁷ *Pratt Holdings Pty Ltd v Federal Commissioner of Taxation*, above n 2.

⁸ S McNicol, 'Esso Australia Resources Ltd v Federal Commissioner of Taxation' (1999) 21 *Sydney Law Review* 656; M McLennan, 'The Statutory Power of the Commissioner of Taxation and the Common Law Doctrine of Legal Professional Privilege' (1999) 28 *Australian Tax Review* 139; K Devos, 'To what Extent has the Commissioner of Taxation Exploited the Doctrine of Legal Professional Privilege through the Issue of s 264 Notices?' (2000) 29 *Australian Tax Review* 205; A Bruce, 'The Trade Practices Act 1974 (Cth) and the Demise of Legal Professional Privilege' (2002) 30 *Federal Law Review* 373; R Fisher, 'Whither the Common Law Privileges: Vale Client Privilege in Tax Investigations?' (2002) 28 *Monash University Law Review* 327; R Fisher, 'Preserving Professional Privilege: Implications for Tax Investigatory Powers' (2003) 32 *Australian Tax Review* 7; V Morfuni, 'Legal Professional Privilege and the Government's Right to Access Information and Documents' (2004) 33 *Australian Tax Review* 89.

⁹ Heydon, above n 1, [25235]. This position is usually traced back to the decision in *Wheeler v Le Marchant* (1881) Ch D 675 (CA).

by the profession that third party communications (that is, non-employees or non-agents of the client) need to be directed to the legal advisor, rather than to the client. To insist that the legal advisor acts as the conduit for the privilege to attach, even if the communication was ultimately to be made to the client, was described as an “inevitable and obvious triumph of form over substance”.¹⁰

The facts of *Pratt Holdings* were that the taxpayer was restructuring and refinancing its corporate group. In doing so, an issue arose with respect to some accumulated losses within one of the entities in the group. The taxpayer sought advice from its legal advisor, who advised them to obtain a valuation of assets from a large accounting firm to assist in determining the losses. The taxpayer approached the accounting firm directly and received the valuations before passing them on to the legal advisors. During a later tax audit, the Commissioner sought access to the accounting firm’s documents (including working papers). The taxpayer asserted legal professional privilege over the documents held by the accounting firm. The Full Federal Court overturned the finding at first instance, holding that it is not necessary that the communication be commissioned by nor communicated directly to the legal advisor for privilege to attach. Essentially, the Full Federal Court allowed the taxpayer to claim privilege for the provision of legal advice,¹¹ as no litigation was contemplated at the time the advice from the lawyers was sought.¹²

While this decision may be viewed as expanding the ambit of the privilege in Australia, or at least allowing clients to be somewhat more pragmatic in their affairs, the involvement of a legal advisor is still a necessary requirement. Under the present state of the law, using the facts of *Pratt Holdings*, privilege would not attach to exactly the same communication if the taxpayer had approached the accounting firm for advice on the taxation treatment of the losses without ever involving their legal advisor. While *Pratt Holdings* may be seen as a victory of sorts for a substance over form approach, it is suggested that the chosen profession of the advisor consulted should have no bearing on the outcome of the question of whether privilege will attach to a given communication.

While the involvement of a qualified legal advisor is a feature of the common law privilege in all common law jurisdictions, the United States, since 1998, has extended a similar sort of privilege to tax advisors.¹³ In June 2005, legislation was passed by the New Zealand Parliament that introduced a similar extension into New Zealand law.¹⁴ This article will explore the scope for such an expansion to be incorporated into Australian law. This will be done through an examination of the underlying rationale for the common law privilege in Australia, the reasons why the privilege has been restricted to the legal profession, the experience of the United States since the introduction of the statutory privilege and the content of the New Zealand legislation.

II RATIONALE FOR THE PRIVILEGE

The original rationale for the privilege was based on the lawyer’s ethical duty to keep client confidences.¹⁵ This afforded a protection to the lawyer. By the late nineteenth century, the

¹⁰ Finn J, above n 2, 219.

¹¹ This was referred to as “advice privilege” in the judgment of the Federal Court (*Federal Commissioner of Taxation v Pratt Holdings Pty Ltd* (2003) 195 ALR 717, 726).

¹² While this may suggest the existence of a unified rationale, the court explicitly did not address this question directly, despite being put forward in argument by the taxpayer.

¹³ Internal Revenue Code s 7525.

¹⁴ *Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005 (NZ)*.

¹⁵ *Pratt Holdings Pty Ltd v Federal Commissioner of Taxation*, above n 2, 235 (Stone J).

privilege was recognised as protecting the client. The popular formulation of the basis for the privilege is taken from the High Court decision in *Grant v Downs*:

The rationale of this head of privilege, according to traditional doctrine, is that it promotes the public interest because it assists and enhances the administration of justice by facilitating the representation of clients by legal advisers, the law being a complex and complicated discipline. This it does by keeping secret their communications, thereby inducing the client to retain the solicitor and seek his advice, and encouraging the client to make a full and frank disclosure of the relevant circumstances to the solicitor. The existence of the privilege reflects, to the extent to which it is accorded, the paramountcy of this public interest over a more general public interest, that which requires that in the interests of a fair trial litigation should be conducted on the footing that all relevant documentary evidence is available.¹⁶

Similar statements of the purpose of legal professional privilege can be found in most common law jurisdictions.¹⁷

Subsequent statements have emphasised the importance of protecting the individual, particularly from intrusion into their private affairs by the state, and creating a climate in which their legal advisors may be fully abreast of the relevant facts in order to provide appropriate advice. For example, Dawson J in *Baker v Campbell*¹⁸ stated that:

[I]f a client cannot seek advice from his legal adviser confident that he is not acting to his disadvantage in doing so, then his lack of confidence is likely to be reflected in the instructions he gives, the advice he is given and ultimately in the legal process of which the advice forms a part.¹⁹

Further, Deane J stated in the same case:

That general principle represents some protection of the citizen – particularly the weak, the unintelligent and the ill-informed citizen – against the leviathan of the modern state. Without it there can be no assurance that those in need of independent legal advice to cope with the demands and intricacies of modern law will be able to obtain it without the risk of prejudice and damage by subsequent compulsory disclosure on the demand of any administrative officer with some general statutory authority to obtain information or seize documents.²⁰

Concerns such as these have long been held in the common law, as evidenced by Jessel MR's statement in *Anderson v Bank of British Columbia*²¹ over a century before *Baker v Campbell*. Further, Lord Brougham LC identified these issues and the concomitant public interest balancing act in *Greenough v Gaskell*:

¹⁶ *Grant v Downs* (1976) 135 CLR 674, 685. See also *Esso Australia Resources Ltd v Federal Commissioner of Taxation*, above n 1 and *Commissioner of Australian Federal Police v Propend Finance Pty Ltd* (1997) 188 CLR 501, 550 (McHugh J).

¹⁷ For example, *Greenough v Gaskell* (1833) 1 My & K 98, 103; 39 ER 618, 621 (United Kingdom); *Fisher v United States* 425 US 391, 403 (1976); *Upjohn Co v United States* 449 US 383, 391 (1983) (USA); *Solosky v Canada* (1979) 105 DLR (3d) 745, 755-757 (Canada); *Commissioner of Inland Revenue v West-Walker* [1954] NZLR 191, 219 (New Zealand).

¹⁸ *Baker v Campbell* (1983) 153 CLR 52.

¹⁹ *Ibid*, 130.

²⁰ *Ibid*, 120.

²¹ *Anderson v Bank of British Columbia* (1876) 2 Ch D 644, 649.

It is not (as has sometimes been said) on account of any particular importance which the law attributes to the business of legal professors, or any particular disposition to afford them protection ... But it is out of regard to the interests of justice, which cannot be upholden, and to the administration of justice, which cannot go on without the aid of men skilled in jurisprudence, in the practice of the courts, and in those matters affecting rights and obligations which form the subject of all judicial proceedings. If the privilege did not exist at all, every one would be thrown upon his own legal resources. Deprived of all professional assistance, a man would not venture to consult any skilful person, or would only dare to tell his counsellor half his case.²²

McNicol asserts that the rationale presented applies only to the first head of the privilege.²³ This is on the basis that the first head is justified on the basis that it engenders an environment in which the client is free to confide in their legal advisor without fear that such confidences will be compulsorily disclosed to the client's prejudice. This has traditionally not enabled communications involving a third party to be covered by the privilege. For such third party communications to attract the privilege, the communication must have been made with litigation in mind.²⁴ The communication may be between the legal advisor and the third party without any involvement of the client. Consequently, the state of mind of the client, specifically, whether the client felt comfortable making the relevant disclosure to the legal advisor, does not apply in these circumstances. However, while the Full Federal Court in *Pratt Holdings* did not directly address the question of whether the two heads are based on a unified rationale, the finding that communications between a legal advisor and third party were privileged even in the absence of anticipated litigation goes some way to suggesting that a single rationale underlies both. This rationale would appear to be a public interest in the form of the promotion of the administration of justice through the services of trained professionals, namely lawyers.²⁵ Such promotion necessarily would be based on candour and trust. Such a unified rationale was contemplated by McNicol.²⁶

Prior to examining the reasoning for restricting legal professional privilege to communications with qualified lawyers, it is relevant to consider the application of statute. Sections 118 and 119 of the *Evidence Act 1995* (Cth) provide for a "client legal privilege" in federal proceedings²⁷ that is substantially the same as the common law legal professional privilege. The major difference between the statutory privilege and the common law privilege prior to 1999 was that the *Evidence Act 1995* used a dominant purpose test, whereas the common law privilege used a sole purpose test in identifying communications that attracted the privilege. The High Court in *Esso Australia Resources*²⁸ used the statutory dominant purpose test as evidence that legal values had moved on from those that applied when *Grant v Downs* was decided and held that the common law test should be one that adopted the dominant purpose test, making it consistent with the statutory privilege.

However, the High Court stated in *Esso Australia Resources* that the statutory privilege in the *Evidence Act 1995* only applies to the adducing of evidence.²⁹ The common law privilege extends beyond the adducing of evidence during trial, encompassing such matters as discovery and inspection of documents. In taxation matters, specifically s 263 and s 264 investigations, assertions

²² Above n 17.

²³ S McNicol, *Law of Privilege* (1992) 48.

²⁴ This head was referred to as "litigation privilege" by the Federal Court in *Federal Commissioner of Taxation v Pratt Holdings Pty Ltd*, above n 11, 726.

²⁵ Where applicable, this term is used throughout to refer collectively to barristers and solicitors.

²⁶ McNicol, above n 23.

²⁷ Section 120 provides a similar privilege to unrepresented parties.

²⁸ *Esso Australian Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49.

²⁹ *Ibid*, 55.

of legal professional privilege are made in the context of access, rather than litigation. Consequently, the privilege given to litigants by the *Evidence Act 1995* is insufficient to prevent the Commissioner accessing sensitive documented communications.³⁰

III RATIONALE FOR RESTRICTING THE PRIVILEGE

It should be noted explicitly that support for legal professional privilege is not universal. This stems from the delicate balancing act asked of the courts. Some very eminent jurists prefer the public interest of truth in litigation served by full disclosure in open court to the public interest of full and frank disclosure to trained legal advisors encouraged by the privilege. For example, to justify limiting the scope of legal professional privilege so that the other considerations of the public interest are not unduly affected, Mason J (as he then was) stated:

Notwithstanding strong judicial assertions of the value of the public interest said to be promoted by the privilege [referring to *Greenough v Gaskell* as an example], it is by no means self-evident that the value of this public interest is greater than the public interest in facilitating the availability of all relevant materials for production in litigious disputes.³¹

Other comments have been directed at specific aspects of the privilege. For example, Pincus J in *Dingle v Commonwealth Development Bank of Australia*³² described the law relating to privileged third party communications as a “rather unattractive body of doctrine”.³³

Despite such reservations, though, it is quite clear from the present state of the case law that third party involvement does not necessarily abrogate any claim to legal professional privilege. However, the one thing that is quite clear is that an appropriately legally qualified professional must have some connection to the communication. Even in *Pratt Holdings*, where the Full Federal Court quite openly adopted a substance over form approach, the communication that was the subject of the dispute was made at the instigation of the lawyer. The accountant’s valuation would never have been made if it were not required for the purpose of supporting the lawyer’s subsequent advice.

There is currently no provision within the common law for communications between persons and their non-legally qualified professional advisors, such as accountants, surveyors or merchant bankers, to be protected by the privilege. The courts have previously rejected arguments for the extension of the privilege to other professional advisors that were based on client communications made in an environment of confidence.³⁴

Notwithstanding such judicial restraint, commentators have continued periodically to argue for extending the privilege to other professionals under certain circumstances. For instance, Baxt argues for the privilege to be extended to professional advisors under circumstances where the services they provide their clients is not materially different from the services provided by lawyers. Allowing privilege to attach to communications made with a legal advisor and not if the communication is made with some other form of professional advisor provides a comparative advantage to the legal profession.³⁵ Similar concerns have been raised in New Zealand³⁶ and the United States³⁷ specifically in relation to tax matters.

³⁰ It should be further noted that, as the *Income Tax Assessment Act 1936* is a Federal Act, the consideration that the *Evidence Act 1995* is limited in its application to proceedings in federal and ACT courts is irrelevant.

³¹ *Baker v Campbell* (1983) 153 CLR 52, 74 (in dissent).

³² *Dingle v Commonwealth Development Bank of Australia* (1989) 91 ALR 239.

³³ *Ibid*, 243.

³⁴ *Chantrey Martin & Co v Martin* [1953] QB 286; [1953] 2 All ER 691.

³⁵ R Baxt, ‘A Matter of Privilege’ (1989) 60 *Chartered Accountant* 34.

Italia also argues for the extension of privilege with respect to tax advice to accountants not only on the basis of the similarity of services provided by the two professions, but also through reference to the encouragement of full and frank disclosure in communications.³⁸

It should be noted, though, that the courts are not oblivious to the notion that other professional relationships are based on a high degree of trust and confidence between the professional and their clients. In rejecting the extension of the privilege to other forms of relationship, Jessel MR stated in *Wheeler v Le Marchant*:

In the first place, the principle protecting confidential communications is of a very limited character. It does not protect all confidential communications which a man must necessarily make in order to obtain advice, even when needed for the protection of his life, or of his honour, or of his fortune. There are many communications which, though absolutely necessary because without them the ordinary business of life cannot be carried on, still are not privileged. The communications made to a medical man whose advice is sought by a patient with respect to the probable origin of the disease as to which he is consulted, and which must necessarily be made in order to enable the medical man to advise or to prescribe for the patient, are not protected. Communications made to a priest in the confessional on matters perhaps considered by the penitent to be more important even than his life or his fortune, are not protected. Communications made to a friend with respect to matters of the most delicate nature, on which advice is sought with respect to a man's honour or reputation, are not protected. Therefore it must not be supposed that there is any principle which says that every confidential communication which it is necessary to make in order to carry on the ordinary business of life is protected. The protection is of a very limited character, and in this country is restricted to the obtaining the assistance of lawyers, as regards the conduct of litigation or the rights to property.³⁹

With respect to arguments for extending legal professional privilege to other types of confidential professional advice, the opening words of the quotation taken from *Greenough v Gaskell* reproduced earlier⁴⁰ set out the common law justification for restricting the privilege to the legal profession. The law does not attempt to elevate the status of the legal profession nor give its members a comparative advantage over other professions by keeping their communications with their clients secret. The privilege is not designed to encourage citizens to seek the services of a lawyer in preference to some other equally capable professional. Nor is it designed to encourage full and frank disclosure per se. It is the administration of justice that is the *raison d'être* for the privilege. Stone and Wells go so far as to describe the privilege as existing not for protecting confidences, but for ensuring that confidences continue.⁴¹

As the administration of justice is the basis for the privilege, arguments based upon the notion that the delineation between the work of lawyers and that of other professionals is no longer as clear cut as it may once have been fail to address the central issue. While the original basis for the privilege was the maintenance of client confidences, the law now values the indirect role the privilege plays

³⁶ Policy Advice Division, Inland Revenue Department, *Tax and Privilege: A Proposed New Structure* (2002) para 2.15.

³⁷ C Brooks, "A Double-Edged Sword Cuts Both Ways: How Clients of Dual Capacity Legal Practitioners Often Lose Their Evidentiary Privileges" (2004) 35 *Texas Tech Law Review* 1069.

³⁸ M Italia, 'The History of Legal Professional Privilege and Its Role in Tax Advice by Tax Professionals' (Paper presented at 3rd Accounting History International Conference, Siena, 17-19 September 2003).

³⁹ Above n 9, 681-682.

⁴⁰ *Greenough v Gaskell v Gaskell* (1833) 1 My & K 98, 103; 39 ER 618, 621.

⁴¹ J Stone and W Wells, *Evidence: Its History and Policies* (1991) 585.

in upholding the integrity of the legal system as a whole.⁴² The maintenance of confidences is only a secondary consideration. The privilege is based upon the notion that a legal system, especially an adversarial system such as that operating within common law jurisdictions, is heavily dependent on the practising members of the legal profession. For these members to be able to operate effectively, it is necessary for them to be aware of all aspects of their client's circumstances. The absence of the privilege to ensure that these specific types of communication are kept confidential is considered to be detrimental to the trust relationship at the heart of the lawyer-client relationship. If clients are aware that their confidences may be broken through compulsory disclosure at a later point in time, the concern is that such clients will only provide favourable information to their legal representatives, impeding the effective administration of the legal system. Such considerations led McNicol to regard as dangerous, analogies between the lawyer-client relationship and other professional relationships, where those analogies are based in large part on the maintenance of confidences as justification for the extension of the privilege.⁴³ McNicol submitted⁴⁴ that Dixon J's reasoning that an inflexible rule had been "established that no obligation of honour, no duties of non-disclosure arising from the nature of a pursuit or calling, could stand in the way of the imperative necessity of revealing the truth in the witness box"⁴⁵ was to be preferred.

Such reasoning becomes weaker, however, when non-lawyers begin to play a role in the administration of justice (through participation in the legal system). For present purposes, it is acknowledged that a close similarity in the substance of the professional services supplied by lawyers vis-à-vis non-lawyers is not a basis in and of itself for extending privilege to non-lawyer relationships. However, once that "close similarity" is transformed into an identity, the restriction of the privilege becomes much more difficult to justify.

Under the Australian *Income Tax Assessment Act 1936*, s 251L(1) states:

Subject to this section, a person who is not a registered tax agent must not knowingly or recklessly demand or receive any fee for:

- (a) preparing or lodging on behalf of a taxpayer a return, notice, statement, application or other document about the taxpayer's liabilities under a taxation law; or
- (b) giving advice about a taxation law on behalf of a taxpayer; or
- (c) preparing or lodging on behalf of a taxpayer an objection ... against an assessment, determination, notice or decision under a taxation law; or
- (d) applying for a review of, or instituting an appeal against, a decision on such an objection; or
- (e) on behalf of a taxpayer, dealing with the Commissioner or a person who is exercising powers or performing functions under a taxation law.

Subsection 251L(8) provides an exception from the registration requirement for barristers and solicitors acting in the course of their profession.

⁴² Law Commission (NZ), *Evidence Law: Privilege – A Discussion Paper*, Preliminary Paper No 23 (1994) para 46.

⁴³ McNicol, above n 23, 5.

⁴⁴ *Ibid*, 4.

⁴⁵ *McGuinness v Attorney-General (Vic.)* (1940) 63 CLR 73, 102-103.

As a result of s 251L, it is not necessary to be a member of the legal profession to provide advice on a taxation law⁴⁶ (or other services commonly associated with the legal profession). While many tax agents will be members of either the legal or accounting professions, this is not a requirement either. Qualification for registration as a tax agent in Australia is determined primarily by the amount of experience obtained in applying tax laws (principally in the form of the preparation of income tax returns) and level of relevant education obtained (which determines the amount of work experience required before being qualified to apply for registration).⁴⁷

As it is not a prerequisite to be a member of the legal profession to provide advice to clients on matters involving the interpretation of tax legislation, as it is in most other areas of legal practice, extending legal professional privilege only to members of the legal profession and not other persons qualified to advise on taxation law, even where the advice would be identical, is anomalous. In being able to provide tax advice, tax agents that are not members of the legal profession play just as much of a role in the administration of justice as do lawyers. Any arguments in favour of legal professional privilege protecting communications with lawyers on tax related matters apply equally strongly to tax agents generally.

In recognition of the confidential nature of many communications that taxpayers have with their accounting advisors (who, more often than not, would be their sole source of taxation advice), the Australian Taxation Office (ATO) has produced some guidelines for its officers to follow when seeking access to accountant's documentation. The guidelines in relation to access to accounting advisors' papers are incorporated into Chapter 7 of the ATO's more general Access and Information Gathering Manual under the heading of "Guidelines to Accessing Professional Accounting Advisors' Papers" ("the Guidelines"). These Guidelines are essentially an internal document designed to guide the activities of the ATO's officers, but they are available to the general public as part of the ATO's requirement for transparency in its operations. Chapter 7 was compiled in consultation with the major professional accounting and taxation organisations in Australia.⁴⁸

The Guidelines make the distinction between three types of documents, being source documents, restricted source documents and non-source documents. Source documents are those documents that are "prepared in connection with the conception, implementation and formal recording of a transaction or arrangement and which explain the setting, context and purpose of the transaction or arrangement".⁴⁹ The ATO considers such documents as being freely available for inspection as part of the appropriate exercise of its access powers. Restricted source documents are those documents that fit the description of source documents but are prepared for the sole purpose of advising the client on taxation matters that call for a degree of candour. The ATO will only seek access to such documents in exceptional circumstances. Non-source documents are documents that do not relate to a transaction or arrangement entered into by the taxpayer. For example, advice relating to the application of the law to a transaction suggested to the client but not ultimately entered into would be a non-source document. These are treated in the same fashion as restricted source documents.

The Guidelines essentially act as an administrative restriction on the ATO to the effect of extending a privilege akin to legal professional privilege to the relevant documents (specifically, restricted

⁴⁶ The term "taxation law" is defined in s 995-1(1) of the *Income Tax Assessment Act 1997* as any "Act [or related regulations] of which the Commissioner has the general administration". As well as the two Income Tax Acts, this includes fringe benefits tax legislation and the goods and services tax legislation.

⁴⁷ Reg 156 *Income Tax Regulations 1936*.

⁴⁸ In particular, the Australian Society of Certified Practising Accountants, the Institute of Chartered Accountants in Australia, the National Institute of Accountants and the Taxation Institute of Australia.

⁴⁹ Australian Taxation Office, *Guidelines to Accessing Professional Accounting Advisors' Papers* para 2.1 (as updated to 17 December 2004).

source and non-source documents). For example, the restriction may be waived in circumstances similar to the waiver of legal professional privilege (such as through voluntary disclosure to an independent third party on a non-confidential basis).⁵⁰

However, while this administrative restriction is an admirable recognition by the ATO of the realities of business and accounting practice, it does not have the backing of either statute or common law behind it. Consequently, the Guidelines do not provide additional legal rights to taxpayers, although they do create a legitimate expectation that, in the exercise of the Commissioner's access and investigatory powers, ATO officers will adhere to their terms.⁵¹ This means that the ATO can still access restricted source and non-source documents in certain circumstances. For example, the Guidelines only protect the relevant documents if they were prepared for the sole purpose of advising on taxation matters. Legal professional privilege uses a dominant purpose test. Further, the Guidelines set out that if the Commissioner is unable to obtain sufficient factual information (which is not specifically defined) from other sources, this lack of information can form the basis of circumstances in which the ATO will seek access to restricted source and, possibly, non-source documents.⁵² As such, it can be appreciated that the administrative restriction set out by the Guidelines falls far short of the protection afforded by legal professional privilege to professional communications.

An interesting alternate perspective on the relationship between the Guidelines and common law legal professional privilege is put by Morfuni.⁵³ As noted, the Guidelines create a legitimate expectation for accountants. Morfuni claims that, as a result, accountants now enjoy a greater protection than lawyers. This is on the basis that the creation of a legitimate expectation makes the issue of a s 264 (and also, presumably, a s 263) notice by the Commissioner to be a reviewable decision, as the Commissioner has conceded that access to certain documents will only be made in exceptional circumstances. Lawyers have no right of review of the issuing of such notices. The availability of administrative review rights, for accountants, appears to confer additional avenues of redress for accountants.

Such arguments, however, do not take into account that, while at least two Federal Court decisions have found that the Guidelines do create a legitimate expectation with the resultant review rights, the legitimate expectation is only that the Guidelines will be given sufficient weight by the ATO officer in determining whether exceptional circumstances exist to access the relevant documents. In *Deloitte*, Goldberg J held that it was not for the court, but the ATO officer to determine whether the appropriate weight had been given to the terms of the Guidelines.⁵⁴ As such, so long as the ATO officer can demonstrate that regard was had for the Guidelines, it is difficult to conceive of circumstances in which an accountant will be successful in using the Guidelines as a vehicle to deny the ATO access to documents. As the Commissioner's access powers are subject to legal professional privilege, documents held by lawyers enjoy the greater protection as, once it is found legal professional privilege applies to the communication, access is denied regardless of the circumstances.

At the other end of the spectrum, suggestions have also been made to abolish legal professional privilege in respect of matters involving the genuine exercise of the relevant revenue authority's

⁵⁰ Ibid, para 4.

⁵¹ *Deloitte Touche Tohmatsu v Federal Commissioner of Taxation* 98 ATC 5192; *One.Tel Ltd v Federal Commissioner of Taxation* 2000 ATC 4229.

⁵² Australian Taxation Office, above n 49, para 6.

⁵³ Morfuni, above n 8.

⁵⁴ *Deloitte Touche Tohmatsu v Federal Commissioner of Taxation*, 98 ATC 5192, 5208.

investigatory powers. For example, in New Zealand, the Winebox Inquiry⁵⁵ and a majority of the Law Commission in 2000 (in relation to matters not involving litigation)⁵⁶ recommended that legal professional privilege be abolished in relation to tax matters. Such calls are often on the basis that taxation is a special case as the “existence of a solid tax base is essential to the efficient functioning of a developed state”.⁵⁷ Preventing the revenue authorities from accessing taxpayer’s communications (usually documents) hinders the efficient execution of their statutory powers and responsibilities. Further, some concerns have been raised that a number of claims to legal professional privilege are dubious,⁵⁸ thereby exacerbating the problems associated with reconciling a long established common law right with the more pragmatic task of ensuring appropriate compliance with taxation laws.

Kayle sets forth a number of additional arguments for legal professional privilege to not apply in taxation matters at all.⁵⁹ Kayle distinguishes taxation law from other areas of law, such as environmental and trade practices law, on the basis that tax law does not mandate or prohibit specific conduct, with a few trivial exceptions such as the filing of returns. Rather, tax law sets out the consequences of transactions under the law. As tax advice will be slanted more towards tax minimisation, rather than compliance with the law (as is the case in other areas of the law), justifications for the privilege on the basis that it promotes compliance with the law through the efficient administration of justice are substantially weakened. Further, tax law is more general and far reaching than almost any other area of law, as it affects virtually every individual and business in the economy. Consequently, there is the potential for many more claims of privilege than in other areas of the law. Kayle also argues that tax law is closer to accounting than the law per se, as “the ultimate objective [of tax law] is to correctly tally a taxpayer’s income tax liability, just the issue that has caused the courts to struggle for some time”.⁶⁰ Finally, in a self-assessment tax environment, which exists in both Australia and the United States, voluntary compliance is essential for the efficient operation of the system. To ensure that laws are complied with, assertions of legal professional privilege are likely to be particularly onerous for the revenue authorities, as it protects the most crucial information and is the hardest for the authorities to obtain.

While such concerns carry a great deal of weight, privileged communication with lawyers is now generally regarded as a fundamental common law right, at least in Australia.⁶¹ It is difficult to conceive of the Australian Government removing the precedence legal professional privilege has over the Commissioner of Taxation’s statutory investigatory powers, given the length of time the relevant provisions⁶² have featured in the legislation and been interpreted as being subject to legal professional privilege. In addition, such arguments, insofar as they look to the inability of the revenue authorities to access information, do not take into account the prospect that the only reason the communication was ever made was due to the fact that the communication would be protected by the privilege. As Saltzburg states:

⁵⁵ Commission of Inquiry into Certain Matters Relating to Taxation, *Report of the Winebox Inquiry* (1997).

⁵⁶ Law Commission (NZ), *Tax and Privilege – Legal Professional Privilege and the Commissioner of Inland Revenue’s Powers to Obtain Information*, Report No 67 (2000).

⁵⁷ *Ibid*, [11].

⁵⁸ Committee of Experts on Tax Compliance, *Tax Compliance: Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance*, (1998) [9.36]-[9.63].

⁵⁹ B Kayle, “The Tax Adviser’s Privilege in Transactional Matters: A Synopsis and a Suggestion” (2001) 54 *The Tax Lawyer* 509.

⁶⁰ *Ibid*, 551.

⁶¹ For example, *Commissioner of Australian Federal Police v Propend Finance Pty Ltd* (1997) 188 CLR 501.

⁶² Sections 263 and 264 of the *Income Tax Assessment Act 1936*.

In dealing with privilege claims the courts should focus on the ex ante issue: To what extent will the privilege promote the creation of information that might otherwise not exist? If the court focuses only on the ex post question – i.e., after information already has been created, what are the respective harms in a particular case of disclosure and nondisclosure – the court ignores the crucial aspect of privileges, which is the promotion of information-sharing and experimentation in the future, when others will think about whether to assist in the creation of information.⁶³

IV THE US EXPERIENCE – SECTION 7525

Until 1998, like most common law jurisdictions, the United States did not have a recognised privilege for communications with accountants.⁶⁴ Additionally, it had been held that lawyers performing activities that have been considered “accounting work”, such as the preparation of tax returns, did not enjoy legal professional privilege⁶⁵ in relation to that work.⁶⁶ This amounts to there being no “tax preparer’s privilege”, let alone no accountant’s privilege.⁶⁷ Further, communications made that would be disclosed in a tax return had been held to waive any privilege that attached.⁶⁸ However, it has been long established that accounting work will be covered by legal professional privilege if the accountant is acting under the direction of a lawyer,⁶⁹ although the requirements set out for protection have been interpreted strictly over the years.⁷⁰

A further form of privilege in the United States is referred to as the “work product doctrine”, a doctrine that is much more recent in its development, stemming from a 1947 decision.⁷¹ This doctrine protects communications made in relation to actual or anticipated litigation⁷² and also protects non-legal documentation, such as an accountant’s communications, so long as those materials were prepared for the purpose of a lawyer providing legal advice.⁷³ This is distinct from the privilege already described and is both wider and narrower than legal professional privilege⁷⁴ and bears somewhat of a resemblance to the second head of the privilege relating to litigation in Australia.⁷⁵ The work product doctrine is also incorporated into Federal law through Rule 26(3)(b) of the Federal Rules of Civil Procedure, requiring that, when requesting documentation prepared by counsel, opposing parties need to demonstrate a “substantial need” and that “undue hardship” would

⁶³ S Saltzburg, ‘Privileges and Professionals: Lawyers and Psychiatrists’ (1980) 66 *Virginia Law Review* 597, 600 (note 9).

⁶⁴ *Couch v United States* 409 US 322 (1973). See also *United States v KPMG LLP* No 02-0295 (DDC Dec 20, 2002) discussed in L Sheppard, “No Privilege for Tax Planning” (2003) 9 *Tax Notes Today* 159.

⁶⁵ In the United States, legal professional privilege is usually referred to as “attorney-client privilege”.

⁶⁶ *United States v Arthur Young & Co* 465 US 805 (1984). See F Magill, “The Account-Client Work Product Privilege: *United States v Arthur Young & Co*” (1985) 38 *The Tax Lawyer* 457; S Kline, “*United States v Arthur Young & Co*: Judicial Death Knell for Auditors’ Privilege and Suggested Congressional Resurrection” (1986) 71 *Cornell Law Review* 694 for a discussion of the ramifications emanating from this case prior to later legislative reform.

⁶⁷ *United States v Frederick* 182 F3d 496 (7th Cir, 1999), cert. denied 528 US 1154 (2000); A Mason, “Counsel as Tax Preparer, an Unprivileged Position: *United States v Frederick*, 182 F3d 496 (7th Cir, 1999)” (2000) 69 *University of Cincinnati Law Review* 411.

⁶⁸ *United States v Lawless* 709 F2d 485 (7th Cir, 1983).

⁶⁹ *United States v Kovel* 209 F2d 918 (2nd Cir, 1961).

⁷⁰ *United States v Adlman* 68 F3d 1495, 1500 (2nd Cir, 1995). See also K Gruetzmacher, “Privileged Communications with Accountants: The Demise of *United States v Kovel*” (2003) 86 *Marquette Law Review* 977.

⁷¹ *Hickman v Taylor* 329 US 495 (1947).

⁷² *United States v Nobles* 422 US 225, 238-239 (1975).

⁷³ *United States v Clark* 847 F2d 1467, 1471 (10th Cir, 1988).

⁷⁴ Gruetzmacher, above n 70, 989.

⁷⁵ C Tapper, *Cross & Tapper on Evidence* (8th ed., 1995) 483.

be experienced in attempting to acquire substantially the same information through other means. Even where these tests are met, many communications made by lawyers will remain protected.⁷⁶

As described by Petroni,⁷⁷ this inequality in the protection of communications in taxation matters came to a head in the 1990s, with the aggressive expansion of the larger accounting firms in the areas of taxation advice. This led to a “turf war” between the accounting and legal professions, in part played out in the courtroom.⁷⁸ The political climate was such that, eventually, in consultation with the American Institute of Certified Public Accountants (AICPA), when the United States Congress passed the *Internal Revenue Service Restructuring and Reform Act of 1998*⁷⁹ it incorporated IRC s 7525 into the Internal Revenue Code. IRC s 7525 reads as follows:

Confidentiality privileges relating to taxpayer communications

(a) Uniform application to taxpayer communications with federally authorized practitioners

(1) General rule

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

(2) Limitations

Paragraph (1) may only be asserted in –

- (A) any noncriminal tax matter before the Internal Revenue Service; and
- (B) any noncriminal tax proceeding in Federal court brought by or against the United States.

(3) Definitions

For the purposes of this subsection –

(A) Federally authorized tax practitioner

The term “federally authorized tax practitioner” means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to regulation under section 330 of Title 31, United States Code.

(B) Tax advice

⁷⁶ Kayle, above, n 59, 513.

⁷⁷ A Petroni, “Unpacking the Accountant-Client Privilege Under IRC Section 7525” (1999) 18 *Virginia Tax Review* 843.

⁷⁸ Ibid, describing lawsuits against large accounting firms Arthur Andersen and Deloitte & Touche. See also G Billhartz, “Can’t We All Just Get Along? Competing for Client Confidences: The Integration of the Accounting and Legal Professions” (1998) 17 *Saint Louis University Public Law Review* 427.

⁷⁹ Pub L No 105-206, 112 Stat 750.

The term “tax advice” means advice given by an individual with respect to a matter which is within the scope of the individual’s authority to practice described in subparagraph (A).

(b) Section not to apply to communications regarding corporate tax shelters

The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter

Almost as soon as IRC s 7525 was inserted into the Internal Revenue Code, commentators began expressing concerns as to the ambiguities relating to its content and scope.⁸⁰ For instance, the non-criminal requirement is problematic, as the Internal Revenue Service (IRS) has discretion over which matters are treated as civil and which are criminal. Questions also arise when proceedings are converted from civil into criminal once started.⁸¹

Also, as IRC s 7525 only applies to Federal matters, it does not protect communications from compulsory disclosure in state proceedings. Such disclosure may constitute a waiver of the privilege.⁸² Such waiver may come about also as a result of proceedings pursued by another government agency. IRC s 7525 only protects disclosure to the IRS. It does not extend to inquiries made by regulators such as the Securities and Exchange Commission or the Federal Trade Commission. Compulsory disclosure to such another government regulator may result in waiver of the privilege.

The definition of “tax advice” is also seen as problematic, due to its lack of clarity.⁸³ IRC s 7525 refers only to professionals that may represent taxpayers before the IRS and the privilege only protects matters falling within the advisor’s “authority to practice”. However, what constitute the appropriate responsibilities of such professionals is not set out anywhere. Such concerns continue to persist, although it is suggested that IRC s 7525 will protect communications only if they would have been protected by legal professional privilege if made to a lawyer.⁸⁴

Other concerns involve the limitation regarding advice relating to corporate tax shelters. As tax shelters are transactions that are predominantly, if not specifically, designed to minimise tax, it is difficult to see where taxpayers would be more likely to wish to assert the privilege. This has the potential to severely limit a substantial amount of the business of the intended beneficiaries of the privilege, as well as raising certain procedural issues.⁸⁵

These concerns continue to be expressed by various commentators, despite several interceding years in which these matters could have been resolved, by legislative amendment if not judicial decision. For example, Gillet raises many of the concerns listed above,⁸⁶ as does Gruetzmacher.⁸⁷

⁸⁰ See, for example, Petroni, above n 77, 857.

⁸¹ M Wilson, “Careful What You Wish For: The Tax Practitioner-Client Privilege Established by the *Internal Revenue Service Restructuring and Reform Act of 1998*” (1999) 51 *Florida Law Review* 319.

⁸² T LeBlanc, “Accountant-Client Privilege: The Effect of the *IRS Restructuring and Reform Act of 1998*” (1999) 67 *University of Missouri at Kansas City Law Review* 583, 594.

⁸³ *Ibid*, 595.

⁸⁴ Kayle, above n 59, 514.

⁸⁵ LeBlanc, above n 82, 596.

⁸⁶ P Gillet, “The Federal Tax Practitioner-Client Privilege (IRC Section 7525): A Shield to Cloak Confidential Communication or a Dagger for Both the Practitioner and the Client?” (2001) 70 *University of Missouri at Kansas City Law Review* 129.

Additional concerns have been raised more recently, such as the appropriateness of the procedural model adopted by the 1998 reforms in relation to the remainder of the Internal Revenue Code⁸⁸ and the application in the context of professionals practising as both accountants and lawyers.⁸⁹ Further, questions have been raised of the likely success the accounting profession will have in court in asserting the s 7525 privilege, given the reduced public respect for the accounting profession as a result of recent scandals and the types of transactions they are seeking to protect.⁹⁰ Such efforts may result in a reduction of the scope of the privilege as a consequence of the poor timing of the assertions. Whether IRC s 7525 also provides protection along the lines of the work product doctrine has also been called into question.⁹¹

While persisting uncertainty relating to new legislation is nothing new (Australians need look no further than Part IVA of the *Income Tax Assessment Act 1936* for an example closer to home), the continued existence of these concerns indicates that the introduction of IRC s 7525 may not be the solution that was intended by Congress. This is unfortunate, given the calls and lobbying for a tax-advisor's privilege prior to 1998, especially by the AICPA.

Petroni sets out that the objectives of the legislation were primarily to remove the "unfair penalty" imposed on taxpayers who have their tax affairs handled by a professional other than a lawyer, to curb some of the aggressive auditing practices exercised by the IRS and not advantaging taxpayers who were sufficiently well informed to run their affairs through a lawyer prior to approaching an accountant (or some other advisor) in order to access the privilege.⁹² If such objectives were to be achieved, one would expect certain changes to have taken place in accounting practice within the United States. In a survey of 1,072 practitioners and educators, Bauman and Fowler⁹³ found that there was some evidence that some practitioners had taken steps to educate clients and indicate on correspondence communications that would be potentially covered by the privilege. However, overall, the evidence gathered from the survey indicated that no major changes had been made to office practices or procedures as a result of the new privilege, nor was the privilege being asserted on a regular basis. Further, the majority of respondents did not believe that their practices would experience increased growth due to the removal of the perceived competitive advantage previously enjoyed by lawyers. In fact, other evidence would suggest that accountants continue to refer clients to lawyers when matters involving the application of privilege could potentially arise. For example, the following was taken off a publicly available website in November 2004:

But the biggest and most difficult restriction [on the availability of the s 7525 privilege] is the one in the tax code that specifically excludes the use of this privilege with respect to any "criminal tax mater (sic) or proceeding". Thus, if a taxpayer contacts me as a CPA and discloses that he or she has failed to file some tax returns or to pay some taxes that were due, that communication is not subject to the new accountant-client privilege.

...

⁸⁷ Gruetzmacher, above n 70, 981.

⁸⁸ B Camp, "Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the *IRS Restructuring and Reform Act of 1998*" (2004) 56 *Florida Law Review* 1.

⁸⁹ Brooks, above n 37.

⁹⁰ M Hindelang, "The Disappearing Tax-Advisor Privilege" (2003) 49 *The Wayne Law Review* 861.

⁹¹ Gruetzmacher, above n 70, 993.

⁹² Petroni, above n 77, 845.

⁹³ C Bauman and A Fowler, "The Expanded Taxpayer Confidentiality Privilege: A Review and Assessment of IRC Section 7525" (2002) 14 *Advances in Taxation* 37.

The greatest risk occurs if I should be retained to assist with the preparation of some delinquent tax returns and the information provided to me by the client causes me to recommend that the client seek counsel from a tax defense lawyer. Any information the client had previously given to me would not be protected and I could be required by law to disclose any discussions with that client.

It hasn't happened; it's not likely to happen but it could happen.

Therefore if a prospective client contacts me for assistance with the preparation of delinquent returns, I strongly suggest that the only inquiry should be for a referral to some lawyers who are specialists in criminal defense law.⁹⁴

This evidence, while limited, suggests that the tax advisor privilege in the Internal Revenue Code may not have had the desired effect of tax practices in the United States that was originally intended. While the ambit of IRC s 7525 has not been fully tested in the courts to date, the evidence available does indicate that accountants have not altered their practices in the manner that may have been envisaged by the framers of the legislation.

V THE NEW ZEALAND LEGISLATION

On 15 June 2005, the *Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005* was passed by the New Zealand Parliament.⁹⁵ Amongst other measures, it contains a new statutory privilege for professionals, such as chartered accountants, that will apply to "tax advice documents" in a similar fashion to common law legal professional privilege.⁹⁶ The main operative provision is s 20B of the *Tax Administration Act 1994 (NZ)*, which states:

No requirement to disclose tax advice document

- (1) A person (called in this section ... an information holder) who is required under 1 or more of sections 16 to 19 to disclose information in relation to a person is not required to disclose a document that is a tax advice document for that person.
- (2) A document is eligible to be a tax advice document for a person if the document—
 - (a) is created by—
 - (i) the person for the main purpose of instructing a tax advisor to act for the person by giving to the person advice about the operation and effect of tax laws;
 - (ii) by a tax advisor for the main purpose of giving to the person advice about the operation and effect of tax laws; and
 - (b) for purposes that do not include a purpose of committing, or promoting or assisting the committing of, an illegal or wrongful act.
- (3) A document is a **tax advice document** for a person if—

⁹⁴ V Jacobs, "Limits on Client Confidentiality and the Accountant-Client Privilege" <<http://www.offshorepress.com/vkjcpa/confidentiality.htm>> (accessed 1 November 2004) (copy on file with author).

⁹⁵ Minister of Finance, New Zealand, *Major Tax Bill Passes*, Media Statement (16 June 2005).

⁹⁶ Minister of Finance, New Zealand, *Statutory Privilege for Legal Advice Extended*, Media Statement, (14 September 2004).

- (a) the document is eligible under subsection (2) to be a tax advice document for the person; and
 - (b) the person makes a claim, under section 20D, that the document is a tax advice document; and
 - (c) the person satisfies the requirements of sections 20E and 20F for the document.
- (4) A **tax advisor** is a natural person who–
- (a) is part of an approved advisor group; and
 - (b) has a significant function of giving advice on the operation and effect of tax laws; and
 - (c) is subject to the code of conduct and disciplinary processes referred to in subsection [(5)](a)(ii) and (iii).
- (5) An **approved advisor group** is a group that–
- (a) Includes natural persons–
 - (i) who have a significant function of giving advice on the operation and effect of tax law; and
 - (ii) are subject to a professional code of conduct in the giving the advice; and
 - (iii) are subject to a disciplinary process that enforces compliance with the code of conduct; and
 - (b) is approved by the Commissioner for the purposes of this definition.

The explanatory note to the Bill indicates that the objective behind the new privilege, like IRC s 7525, is to level the playing field for non-legal tax practitioners with lawyers by providing “a degree of consistency with the current privilege enjoyed by a lawyer’s client, who may refuse to disclose to Inland Revenue confidential communications with the lawyer”.⁹⁷ The new privilege is not intended to impact on the existing common law legal professional privilege.⁹⁸

A quick reading of s 20B reveals a number of similarities with IRC s 7525. Firstly, the privilege is aimed generally at tax advisors, not specifically at accountants (although the accounting profession is usually the example given of the class of professionals that is likely to make use of the privilege⁹⁹). Both provisions are aimed at the provision of tax advice and both are subject to similar limitations as for the common law legal professional privilege. Further, both provisions require that, as a prerequisite for an assertion of privilege to be successful, the tax advisor must be recognised as such by the relevant revenue authority.

As would be expected, there are a number of points of difference between these provisions. Most appear to be attempts by the framers of the New Zealand legislation to mitigate (if not avoid) some of the problems identified with the United States legislation. For example, s 20B does not appear to be explicitly limited to documents sought by the Inland Revenue Department (IRD). The language

⁹⁷ Explanatory Note, *Taxation (Base Maintenance and Miscellaneous Provisions) Bill (NZ)*, 10.

⁹⁸ *Ibid.*

⁹⁹ Minister of Finance, above n 95.

of the legislation does not indicate that it is intended to be restricted only to taxation matters, nor is there any equivalent to IRC s 7525(a)(2)(A), which explicitly limits the application of IRC s 7525 to non-criminal matters before the IRS. All that appears to be required under the New Zealand legislation is that the document in question is categorised as a “tax advice document” (within the meaning of s 20B(3)). Once this has been established, the treatment of the document is set out in s 20D, with items within the document that may still be required for disclosure set out in s 20F. While s 20D(4) indicates that a claim that the document is a tax advice document must be made if the IRD requires disclosure of the relevant information under one of a number of other provisions of the *Tax Administration Act 1994 (NZ)* (ss 16, 16B, 17, 17A, 18 and 19), the language used does not appear to limit the application of s 20B to the exercise of the Commissioner’s powers under only those provisions. Consequently, there does not appear to be the opportunity for involuntary waiver of the privilege through compulsory disclosure to another government agency, as there does appear to be under IRC s 7525.

Another difficulty with the United States legislation that appears to have been dealt with in the New Zealand legislation is the definition of “tax advice”. IRC s 7525(a)(3)(B) defines tax advice as being advice given by a federally authorised tax practitioner with respect to a matter within their authority to practice. As indicated earlier, there is some degree of uncertainty as to what is encompassed within a practitioner’s “authority to practice”. The New Zealand legislation does not explicitly set out a definition for “tax advice”, however, it does set out in s 20B(2) the requirements for a document to be a tax advice document (and, therefore, eligible for protection from compulsory disclosure). Specifically, to qualify as a tax advice document, either the client or the tax advisor must have created the document for the main purpose of formulating advice on the operation and effect of tax laws. Any other ancillary purpose, whether or not within the usual scope of the tax advisor’s profession, does not appear sufficient for the document to qualify for the privilege.

Another point of difference is the absence in the New Zealand legislation of an explicit restriction to civil proceedings. While there is an exclusion in s 20B(2)(b) for advice that includes a purpose of committing an illegal act, this is distinct from a proceeding for a criminal offence. This may be explained, in part, by differences in structure between the New Zealand income tax system and that in the United States. The majority of offences under New Zealand income tax law are civil offences, whereas criminal offences are much more numerous under the United States. Consequently, concerns regarding potential breaches of ancillary powers (such as the power to pursue a matter as either a criminal or civil offence) by the relevant revenue authority are much less relevant in New Zealand than in the United States. However, it would appear that, even in a criminal proceeding, the tax advice document would still be protected by the privilege so long as the advice did not have as a purpose the promotion or assisting of the commission of any illegal act.

Related to this area is the absence of a limitation in the New Zealand legislation excluding advice regarding tax minimisation schemes (tax shelters in the United States) from the scope of the privilege. Indeed, this limitation in the United States legislation was included only at the last minute just prior to its passage through Congress.¹⁰⁰ This, however, does raise an ambiguity in the New Zealand legislation. As identified above, s 20B excludes advice that has a purpose of the commission of an illegal act. While this exclusion is necessary, and is consistent with exclusions from the scope of common law legal professional privilege, it is not immediately clear where illegality begins and ends in this context, an issue shared with the common law privilege. In particular, would advice regarding the interpretation of New Zealand tax laws, especially an interpretation that is contrary to Parliament’s clear intention, be considered to be illegal if it were later rejected in court once challenged by the Commissioner? Would the illegality question be any

¹⁰⁰ Petroni, above n 77, 862.

clearer if the advice was covered by any anti-avoidance provisions within the New Zealand tax statutes? Australia provides an illustration for the foundation of such concerns, as Subdivision 284-C of the *Taxation Administration Act 1953* explicitly allows for the increase of penalties to be applied to taxpayers found to have wrongfully reduced their tax liability through the use of a tax minimisation scheme.¹⁰¹

Another point of divergence between s 20B and IRC s 7525 is the role of common law legal professional privilege. The United States legislation explicitly uses the common law rule as the basis for the statutory privilege, whereas there is no mention of legal professional privilege in the New Zealand legislation. It is apparent that s 20B is closely modelled on the common law privilege, for example, the exclusion of advice designed to promote illegal activities and the requirement to disclose certain factual information (referred to as “tax contextual information” and required to be disclosed under s 20F). Similar requirements are made under the common law privilege. However, certain requirements under the new statutory privilege depart from its common law counterpart. For instance, there is a prescribed procedure under s 20D for the assertion of the privilege, which has no equivalent under the common law. For example, s 20D(3) requires the following disclosures when an assertion for privilege is made over a document created by a tax advisor:

- (a) a brief description of the form and contents of the document; and
- (b) the name of the tax advisor who created the document; and
- (c) the approved advisor group to which the tax advisor belonged when creating the document; and
- (d) the areas of law about which the tax advisor was intending to give advice when creating the document; and
- (e) the date on which the document was created.

While the use of the common law doctrine in the United States legislation has not presented any problems with the application of the statutory privilege to date,¹⁰² the New Zealand approach to establish a procedure separate and independent from the common law may be explained as an attempt to maintain parliamentary control over the process. Developments in the common law privilege will not have an effect on the New Zealand statutory privilege, whereas such developments will impact on the application of the United States provision. Section 20B is unlikely to be an attempt by the New Zealand Parliament to influence the development of the common law privilege as the Explanatory Note indicates that it is not Parliament’s intention to affect the common law privilege.¹⁰³

While the benefit of separating the statutory privilege from the common law privilege, as indicated, would be to retain greater parliamentary control over the privilege’s development, this may also prove to be a burden. As identified earlier, one of the standard arguments for the establishment of a tax advisors’ privilege is to “level the playing field” with legal practitioners. If this is at least one of

¹⁰¹ Note that these Australian provisions also apply to tax legislation other than income tax legislation, such as the goods and services tax and fringe benefits tax statutes.

¹⁰² Although there have been some concerns expressed as to the correct procedure to assert the privilege conferred by IRC s 7525 in the United States; Gillet, above n 86, 143.

¹⁰³ Explanatory Note, *Taxation (Base Maintenance and Miscellaneous Provisions) Bill (NZ)*, 10.

the objectives of the legislation, as it is in New Zealand,¹⁰⁴ then such equivalency would be best achieved by applying exactly the same rules, as is the case in the United States (although this is undermined by the additional restrictions included in IRC s 7525). By providing for a separate privilege, the potential exists for either legal practitioners to enjoy a broader privilege than tax advisors generally, or vice versa. So long as the legal profession is approved by the Commissioner as an approved advisor group, the latter scenario is not likely to eventuate. However, it is difficult to reconcile the introduction of a completely separate statutory privilege with the objective of creating a consistent set of conditions for all tax professionals.

VI PROSPECTS FOR A TAX ADVISORS' PRIVILEGE IN AUSTRALIA¹⁰⁵

In identifying relationships that are suitable for protection by a privilege, commentators often refer to the writings of Wigmore.¹⁰⁶ Four criteria are set out as prerequisites for protection to be afforded by a privilege with respect to a particular form of relationship:

- (1) The communications must originate in a *confidence* that they will not be disclosed.
- (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties.
- (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.
- (4) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.¹⁰⁷

With respect to communications between accountants and clients, it is the fourth criterion that tends to be the centre of debate.¹⁰⁸ There is little question that communications are made in confidence, at least from the perspective of the client and that there would be a substantial incentive to withhold information if it were likely that much of that information would be disclosed to third parties, especially in taxation matters. The high degree of public shock at recent corporate scandals brought about by accounting irregularities, such as with Enron in the United States and HIH Insurance in Australia, serves as evidence of the high level of trust placed in the accounting profession by the community.

As is evident from the discussion of the case law earlier that rejected the extension of privilege to other professional relationships, the courts have come down on the side that the public interest served in having access to a greater amount of information in the resolution of disputes, including professional communications with non-lawyers, outweighs the public interest in upholding non-legal confidences. However, in the area of tax law, the distinction between legal and other professionals is very blurred, if it exists at all. As already noted, Australian legislation does not

¹⁰⁴ Explanatory Note, *Taxation (Base Maintenance and Miscellaneous Provisions) Bill (NZ)*, 10.

¹⁰⁵ It should be noted that a judicial discretion is conferred on courts in New South Wales by s 126B of the *Evidence Act 1995 (NSW)* to exclude communications made in confidence to a non-legal professional; see Heydon, above n 1, para 25340.

¹⁰⁶ For example, see J Sopinka, S Lederman and A Bryant, *The Law of Evidence in Canada* (1992) 629; Tapper, above n 75, 498; T Molony, "Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client Privilege in the Aftermath of *Jaffe v Redmond*" (1998) 55 *Washington & Lee Law Review* 247, 260; Italia, above n 38, 16.

¹⁰⁷ S J Wigmore *Evidence in Trials at Common Law* 2285 (McNaughten rev. 1961) reproduced in Sopinka et al, *ibid*, quoting *Slavutych v Baker* [1976] 1 SCR 254, 260 (Spence J).

¹⁰⁸ Molony, above n 106, 260-261.

require an advisor to be admitted to legal practice to be able to provide advice on taxation laws. Consequently, calls for an extension of privilege to tax practitioners generally are much more justified than in the context of, for example, accountants performing non-tax work (such as audits).

It is apparent, though, that any extension of legal professional privilege, if one is to eventuate, will need to be made through the legislature rather than the courts. In doing so, the Australian Parliament has a number of options that it may pursue if it were to change the status quo.

The first possibility is to abolish legal professional privilege completely with respect to taxation matters. As noted earlier, there are some strong arguments in favour of such a position, including the recognition that taxation law is much more pervasive throughout society than most laws, with the result that assertions of any privilege preventing access to relevant information represent a greater hindrance to the revenue authorities than regulators in other areas of the law. Related to this is the notion that taxes are the foundation upon which developed economies function, as they are the chief source of revenue through which the government is able to implement its economic (and often social) policies. Any avenue that prevents the revenue authority from ascertaining all relevant facts over a given matter may therefore be regarded as an impediment to the efficient and effective implementation and enforcement of government policy.

However, it is submitted that this option would be contrary to the position that legal professional privilege has come to hold in Australian law. The statement by McHugh J in *Propend Finance* that legal professional privilege is now regarded as a fundamental common law right, rather than merely a rule of evidence, is typical of the judicial view.¹⁰⁹ Consequently, there is negligible chance that Parliament will pass a statute abrogating legal professional privilege in taxation matters. In any event, the language used for such a provision to be effective would have to be very clear and unambiguous, as set out by Mason CJ, Brennan, Gaudron and McHugh JJ in *Coco v R*,¹¹⁰ requiring clear and unambiguous language to be used by Parliament when abrogating a fundamental common law right. The clarity required is demonstrated by the interpretation given to the Commissioner's access powers in ss 263 and 264 of the *Income Tax Assessment Act 1936* in recent decisions. Despite the very wide powers conferred on the Commissioner and the sweeping language used, the courts have found that these provisions do not abrogate legal professional privilege and, therefore, must be interpreted subject to the privilege. The fact that there has been no suggestion by Parliament in the light of these decisions for the provisions to be redrafted so as to remove the privilege as an impediment to the Commissioner's access is testimony to Parliament's reluctance to dilute the protection provided by the privilege.

The other option would be to follow the lead of the United States and New Zealand and introduce a statutory privilege to non-lawyer tax professionals. Such a privilege could draw upon the common law privilege directly, as is the case in the United States, or establish an independent statutory rule, as in New Zealand.

If Parliament were to extend the privilege, it should cover all tax practitioners. The chief argument presented by proponents of extension is of "levelling the playing field" with lawyers. It would be nonsensical to create a privilege for accountants practising tax, but not cover other tax agents. In Australia, as described earlier, it is not necessary to be formally admitted to either the legal or accounting professions to be qualified as a tax agent. Consequently, any statutory privilege should cover tax agents in general.

¹⁰⁹ *Commissioner of Australian Federal Police v Propend Finance Pty Ltd* (1997) 188 CLR 501.

¹¹⁰ (1994) 179 CLR 427, 436. See also *Baker v Campbell*, (1983) 153 CLR 52, 117 (Deane J) and 123 (Dawson J) discussing legal professional privilege.

Secondly, it is submitted that the basic United States approach is to be preferred to that of New Zealand. The primary function of any statutory privilege should be to allow clients of all tax practitioners the same protection of their communications as that currently enjoyed by the clients of legal practitioners. Essentially, this means ensuring that if a communication would be protected if made to a lawyer, then it should also be protected if made to a non-lawyer tax agent. This is in line with the advocate's argument of achieving parity between the professions. It is submitted that the most effective method of ensuring this result is to explicitly rely on the common law rule, as is done by IRC s 7525 in the United States. The alternative, which would be more akin to the New Zealand approach, is to attempt to replicate the effect of the common law privilege through the language adopted in statute. This would be a difficult task to begin with, as the rules of statutory interpretation may be applied in a manner unexpected by Parliament, creating differences between the common law privilege and the statutory rule. Even if parity were achieved initially, developments in the common law privilege would create a situation where the two rules are no longer equivalent (unless there was an immediate amendment of the statutory privilege to replicate the development). To maintain equivalency would necessitate regular reviews of the statute to accommodate common law developments.

It may be argued that creating an independent statutory rule allows Parliament to retain greater control over the privilege. However, this undermines the primary argument of achieving equal treatment of communications between tax agents. The only means by which parity could be guaranteed with an independent statutory rule is to ensure that the statutory rule is broader than the common law privilege. While such a position is feasible, there has been little suggestion that the common law privilege is insufficient in its coverage of which communications that it protects. Further, given the strong arguments presented earlier calling for a reduced application of legal professional privilege in taxation matters, especially the impediments that it represents to the revenue authorities, it is difficult to envisage the Australian Parliament introducing a privilege that protects an even broader range of communications than that covered by the common law privilege at the moment for lawyers.

However, while it has been submitted that the approach adopted by the United States at first instance is to be preferred, IRC s 7525 has been undermined by the additional restrictions introduced. In particular, the corporate tax shelter limitation represents a significant departure from the common law privilege. Such advice, from a lawyer, is likely to be privileged, yet the same advice from an accountant would not. While Congress may not be enamoured with the prospect of denying access to the IRS to communications relating to such tax minimisation arrangements, treating like communications differently depending on the professional affiliation of the advisor significantly detracts from the stated objective of creating parity between the professions.

Consequently, any efforts made by the Australian Parliament to introduce a tax advisor privilege should be explicitly based on the common law rule. An explicit feature of any such privilege should be that a communication, if it would be privileged if made by or to a lawyer, should also be privileged if made by or to another form of tax agent. Such an approach would mitigate many of the difficulties experienced with the United States legislation and the potential problems of the New Zealand legislation.

The question of what constitutes tax advice, or some similar question, may be answered with reference to established common law concepts. If the advice were to come from a lawyer, then it should also be privileged if comes from another tax agent. Questions such as whether information disclosed to an advisor that is intended to be utilised in the preparation of a tax return should be privileged may be resolved by the courts, as it is currently for common law legal professional privilege. Factual information would not be privileged, as this is not privileged with respect to

lawyers.¹¹¹ There would be no need to specify limitations, such as advice for illegal purposes, as this is not covered by the common law privilege either.¹¹²

There may be some residual questions over whether specific types of communications are covered by common law legal professional privilege and, hence, whether they would be covered by a statutory privilege in the form put forward here. However, this is not an argument against establishing the rule based on the common law privilege. Firstly, if there is doubt as to whether a lawyer's communications are protected, then this would also be the case for other forms of tax agent, and vice versa. Parity is still achieved. Secondly, there is likely to be some uncertainty in the application of any new rule. The advantage of basing the statutory privilege on the common law rule is that practitioners may attempt to anticipate a court's interpretation of the new rule based on several centuries of established doctrine. Any uncertainties emanating from an independent rule will be much more difficult to resolve in the absence of judicial interpretation. Consequently, any criticism of a statutory rule in this form is more of a criticism levelled at the common law system generally, rather than the statute specifically. Common law practitioners are well accustomed to providing advice in such grey areas and, therefore, arguments of this nature do not hold much weight.

Any such privilege should apply to extra-litigation matters. In particular, this would ensure that exercises of the ATO's access and investigatory powers, as well as discovery proceedings, would be covered. Otherwise, this would merely represent an extension of the limited client legal professional in the Commonwealth *Evidence Act* to other professionals.

An overriding concern, though, is whether any benefit is achieved by the introduction of such a privilege. The only jurisdiction to have an established rule, the United States, has had the rule in place for just over six years. As a result, there is little conclusive evidence either way of the effects of the statutory privilege. However, the results of the Baumann and Fowler survey¹¹³ appear to indicate that the privilege has not brought about the benefits that had originally been anticipated by Congress and the AICPA.

While it may be argued that these results represent a cautious approach being adopted by the accounting profession based on the inherent uncertainty that comes with any novel legislation, the additional limitations included in IRC s 7525 that do not apply to the common law privilege are also highly likely to have contributed to current practices. The limitations, particularly that relating to corporate tax shelters and restricting the application to non-criminal proceedings, appear to target the very areas where the benefits would be expected to accrue. Therefore, the result that the privilege has not had much of an impact on accounting practices in the United States should not come as a surprise. This evidence reaffirms the contention put forward earlier that any statutory rule to be introduced in Australia should simply apply the common law rules to tax agents generally, without modification.

Finally, in determining whether such an extension is appropriate for Australia, it is worth noting that another reason cited for the adoption of the tax advisors' privilege in the United States was concern over aggressive audit techniques used by the IRS to identify areas of non-compliance.¹¹⁴ The Commissioner of Taxation in Australia has announced initiatives to ensure compliance with taxation laws that cross over borders, including sharing information and experience with revenue

¹¹¹ For example, *Sharp v Federal Commissioner of Taxation* 88 ATC 4165.

¹¹² *R v Cox and Railton* (1884) 14 QBD 153; *Varawa v Howard Smith & Co* (1910) 10 CLR 382.

¹¹³ Baumann and Fowler, above n 93.

¹¹⁴ Petroni, above n 77, 845.

authorities in other jurisdictions, including the IRS.¹¹⁵ As a result, it is not hard to anticipate an environment in the future where aggressive audit techniques adopted by the IRS in the United States are also adopted by the ATO in Australia. If such concerns were sufficient to extend privilege to tax advisors generally in the United States, then the arguments for introducing a similar statutory rule in Australia gather further weight.

VII CONCLUSION

This article has assessed the prospects of extending a privilege based on the present common law legal professional privilege to tax practitioners in Australia by analysing the foundations and rationales for the common law rule and then looking to the attempts to implement such an extension in two other common law jurisdictions, specifically the United States and New Zealand. In particular, the United States has had a statutory privilege in place for over six years. This has provided ample opportunity for criticism and analysis by commentators, highlighting the strengths and problems with the legislation. Unfortunately, the timeframe involved is too short to enable the collection of much empirical evidence indicating the effect the new legislation has had in practice, nor have the courts had much opportunity to interpret the statute in the context of actual disputes. It should be noted, though, that early evidence suggests that the provision has not resulted in much change in the practices of accountants with respect to their tax advice.

It may be argued that the United States legislation has undermined the original objectives driving the introduction of the legislation, in particular, creating parity between tax advisors with legal qualifications and practitioners with another professional affiliation. The final version that was passed by Congress incorporated a number of restrictions, which do not apply under the common law privilege. Consequently, legal professionals are still able to protect their client communications in a number of circumstances where other professionals are unable to do so. Such circumstances are likely to arise quite frequently for tax advisors in larger practices, causing these restrictions to have a significant impact on the potential benefits originally offered to the professions.

The New Zealand Parliament has recently passed legislation of its own incorporating a similar provision in its own tax legislation. In its drafting, a number of the problems identified with the United States legislation have been avoided. However, the New Zealand legislation establishes a privilege completely separate from its common law counterpart, creating a number of potential issues itself.

In Australia, the arguments for establishing a general tax advisors' privilege are just as forceful as they are in the United States and New Zealand. These arguments include treating the same advice in the same fashion, regardless of the professional affiliation of the advisor and the confidential nature inherent in communications relating to clients' tax affairs. Such arguments have traditionally been rebutted by noting that the underlying rationale of common law legal professional privilege is not the maintenance of confidences per se, but rather the efficient administration of justice through the facilitation of the legal system, of which confidentiality is an essential part. However, such arguments lose weight in the context of taxation, as it is not necessary for a tax practitioner to be qualified as a lawyer to be able to provide advice on taxation laws in Australia in the same manner as tax lawyers.

If the Australian Parliament were to introduce a statutory tax practitioner privilege, this should be explicitly based on the common law legal professional privilege. This will ensure parity between

¹¹⁵ See, for example, M Carmody, Address to the Australian Institute of Company Directors Victoria Division, Melbourne, 28 May 2004.

the professions able to offer taxation advice, achieving the main goal of such legislation. Additional restrictions should be avoided, so as not to undermine this objective.

However, caution should be exercised prior to the introduction of such a privilege in Australia. The evidence from the United States is somewhat equivocal, with the peculiar features of the legislation likely to have caused the lack of impact on practice suggested by initial research. Consequently, the arguments in favour of introducing a new statutory privilege cannot be rebutted from these findings. While it is too early for any empirical evidence to have come from New Zealand, the differences between the New Zealand legislation and the model proposed here may provide grounds for concern as to the applicability of any such data to Australian conditions. As such, the evidence provided by these other jurisdictions may be of limited value in Australia, except to the extent that it may provide guidance as to the effects of a departure from the common law benchmark. Therefore, an assessment of the policy issues at hand prior to a position being adopted is required. It is submitted that the policy arguments in favour of treating like communications in the same manner should be considered paramount, not for any reason of lawyers otherwise holding a competitive advantage over other tax professionals, but in order to facilitate the appropriate administration of the legal system with respect to taxation. This will have the ultimate benefit of allowing the taxation profession to be more transparent and accessible from a client's perspective.

NON PAYMENT OF PAY AS YOU GO WITHHOLDING TAX AND THE IMPLICATIONS FOR COMPANY DIRECTORS

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I INTRODUCTION

On 1 July 2000, the Australian Federal Government replaced the Pay As You Earn system (PAYE) and various other tax systems with the Pay As You Go (PAYG) system. The PAYG legislation contains the PAYG withholding system and the PAYG instalment system. The PAYG withholding system is comprised of a single set of rules that applies to all withholding tax payments.

This article examines a number of recent Australian court decisions in which the Commissioner of Taxation (Commissioner) has taken legal action against directors in their personal capacity for non-payment of PAYG withholding tax. The case law demonstrates that the Courts narrowly interpret the relevant statutory defences with directors being held personally liable for their company's debts.

This article addresses the PAYG withholding tax providing an overview of the obligations placed on company directors to remit PAYG withholding tax on time. In sections II and III it provides an overview of the legislative provisions. Sections IV and V examine the penalty provisions which can be invoked by the Australian Taxation Office (ATO) when directors fail to comply with their obligations and also provides an overview of the approach taken by the courts when the ATO institutes proceedings against company directors who have breached the withholding tax provisions. Section VI sets out the conclusions.

II BACKGROUND TO THE STATUTORY SCHEME FOR COMPANY DIRECTORS

Section 222ANA (1) of the *Income Tax Assessment Act 1936* (ITAA36), set out below, provides that the purpose of Division 9 of the ITAA36 is to ensure that directors of companies comply with their withholding tax obligations:

222ANA Object and outline

- (1) The purpose of this Division is to ensure that a company either meets its obligations under Division 1AAA, 3B, 4 or 8 of this Act, or under Subdivision 16B in Schedule 1 to the *Taxation Administration Act 1953*, or goes promptly into voluntary administration under Part 5.3A of the *Corporations Act 2001* or into liquidation.

Failure to meet these requirements results in the imposition of penalties as set out in Section 222ANA (2):

222ANA (2) The Division imposes a duty on the directors to cause the company to do so. The duty is enforced by penalties. However, a penalty can be recovered only if the Commissioner gives written notice to the person concerned. The penalty is automatically remitted if the

¹ I wish to express my thanks to Shirley Murphy for her assistance with earlier versions of this article.

company meets its obligations, or goes into voluntary administration or liquidation, within 14 days after the notice is given.

If withholding tax is not remitted the ATO will issue a penalty notice to a person under the provisions of s 222AOE. If at the end of 14 days after service of the notice the withholding tax is not remitted to the ATO, the Commissioner is entitled to issue proceedings against the person:

S 222AOE

The Commissioner is not entitled to recover from a person a penalty payable under this Subdivision until the end of 14 days after the Commissioner gives to the person a notice that:

- (a) sets out details of the unpaid amount of the liability referred to in subsection 222AOC(1), (1A) or (2) (whichever relates to the penalty); and
- (b) states that the person is liable to pay to the Commissioner, by way of penalty, an amount equal to that unpaid amount, but that the penalty will be remitted if, at the end of 14 days after the notice is given:
 - (i) the liability has been discharged; or
 - (ii) an agreement relating to the liability is in force under section 222ALA; or
 - (iii) the company is under administration within the meaning of the *Corporations Act 2001* ; or
 - (iv) the company is being wound up.

The penalty notice gives a person four alternative courses of action with which to comply within 14 days of service:

1. Discharge the liability in full or
2. Make an agreement to repay the debt to the (ATO) or
3. Take action so that the company is placed under administration
4. Take action so that the company is wound up

Section 222AOJ (2)-(4) provides defences for directors who are alleged to have breached their obligations:

(2) It is a defence if it is proved that, because of illness or for some other good reason, the person did not take part in the management of the company at any time when:

- (a) the person was a director; and
- (b) the directors were under the obligation to comply with subsection 222AOB (1) or 222AOBAA (1).

(3) It is also a defence if it is proved that:

- (a) the person took all reasonable steps to ensure that the directors complied with subsection 222AOB (1), 222AOBAA (1) or 222AOBA (1) (whichever is relevant); or
- (b) there were no such steps that the person could have taken.

(4) In subsection (3):

reasonable means reasonable having regard to:

- (a) when, and for how long, the person was a director and took part in the management of the company; and
- (b) all other relevant circumstances.

Failure by directors to remit PAYG withholding tax on time results in the imposition of a penalty equal to the unpaid amount. Directors therefore need to be aware of, and ensure compliance with, the legislation or face being held personally liable.

An examination of the case law in this area reveals that the courts adopt a narrow approach to the interpretation of the defences with the result that directors are finding it increasingly difficult to raise a successful defence.

The attitude of the courts is similar to that taken when proceedings are commenced against directors under s 588G (3) of the *Corporations Act 2001 (Cth)* for insolvent trading. This section holds directors personally liable where a company incurs a debt and there are reasonable grounds for suspecting that the company is insolvent at that time. Below are listed a number of warning signs for directors that a company is likely to be trading whilst insolvent:

- The unexplained resignations of co-directors;
- The withdrawal of support by the company's banker;
- The lack of other available avenues for raising finance;
- The inability to raise further equity capital;
- Mounting creditors who are not being paid in accordance with trading terms and the commencement of legal proceedings by some;
- Continuing liquidity problems including a mismatch in the timing of debt due to creditors and money owed by debtors;
- Relatively large and continuing trading losses;
- The issuing of post-dated cheques, some of which are dishonoured;
- Placement of orders by suppliers on COD terms;
- The inability of the company to issue accurate historical financial information or forecasts;
- Overdue payroll and withholding tax²

Young J makes it clear in *Manpac Industries Pty Ltd v Ceccattini*³ that courts require directors to demonstrate special circumstances before they can be protected:

² Allens Arthur Robinson file://C:\Documents and Settings\Desktop\AAR accessed 22/12/2004.

³ [2002] NSWSC 330.

‘The essence of the matter is that the law provides limited liability to people carrying on business using a corporate vehicle because it is to the community’s interest that people should venture and take commercial risks in their trade without the constant worry of being personally liable for any risk which happens to go wrong. However there is a limit to that protection and the limit is reached where directors have reasonable grounds to believe that the company is no longer solvent. When that point is reached, the field of limited liability to a degree evaporates unless the directors can demonstrate some special circumstances as to why they should still be protected.’⁴

The ITAA36 provisions are intended to achieve the same purpose as s 588G by imposing personal liability on the directors to ensure companies comply with their tax liabilities. It is crucial that before accepting directorships, people should be aware that the legislation in this area is potentially onerous and the courts are less than sympathetic when there has been a failure by a director to comply with these obligations.

Since the introduction of PAYG, the Deputy Commissioner of Taxation has brought numerous proceedings against directors who have not known or understood, or have ignored, their duties to remit withholding tax to the ATO. Even though there are statutory defences under s 222AOJ of the ITAA36, an examination of the case law demonstrates that the courts are reluctant to accept the wide variety of excuses that directors raise.

The *ATO Prosecution Policy*⁵ refers to circumstances in which it will prosecute company officers i.e.:

1. Where the officers appear to be deliberately trying to defeat tax laws by way of a company vehicle
2. Where there have been previous prosecutions in relation to tax laws
3. Where the company does not have sufficient sources to repay the penalty
4. Where instalments of PAYG have not been remitted and it is unlikely that the company will be able to make those payments, and
5. In particular, where it appears that officers of the company are misappropriating company assets or attempting to become insolvent so as to defeat its creditors.

The ATO Prosecution Policy further states that a prosecution should only be brought against an officer if it seems unlikely that the officer could prove on the balance of probabilities they *did not* aid, abet, counsel or procure the act or omission giving rise to the offence and *were not* knowingly concerned in or a party to it.

III THE PAYG LEGISLATIVE SCHEME

The Commissioner has extensive powers to prosecute company officers. Section 8Y of the *Tax Administration Act 1953 (Cth)* (TAA53) deals with any omission or action by a corporation for non-compliance with a taxation law. It states:

⁴ Ibid, para 78.

⁵ This is available at: <http://law.ato.gov.au/atolaw/view.htm?docid=RMP/PR0001>.

where a corporation does or omits to do an act or thing the doing or omission of which constitutes a taxation offence, a person (by whatever name called and whether or not the person is an officer of the corporation) who is concerned in, or takes part in the management of the corporation shall be deemed to have committed the taxation offence and is punishable accordingly.

The section refers to directors and 'an officer of the corporation', which encompasses a director, director, secretary, receiver, manager, administrator, official manager or deputy official manager, liquidator appointed in a voluntary winding up, trustee or other person administering a compromise or agreement made between a corporation and other persons. S8Y (2) provides a defence with two elements:

(a) the person did not aid, abet, counsel or procure the act or omission of the corporation

and

(b) was not in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the act or omission of the corporation.

Careless and other similar behaviour, and even well intentioned but mistaken behaviour, can still be caught. Therefore failure to exercise due care and attention to matters involving tax liabilities may be caught by the ITAA36.⁶

In the case of the non remittance of withholding tax, the Commissioner commonly issues proceedings against directors in the civil courts under the penalty notice provisions found in Division 9 of Part V1 the ITAA36.

Schedule 1 Subdivision 16-B of the TAA53 sets out when and how withheld amounts are to be paid to the Commissioner. Withholders are divided in 3 categories; small, medium and large.⁷ S 16-75 details when withheld amounts are due. A general interest charge applies to late payments.⁸

When a company fails to remit PAYG withholding tax, the Commissioner will issue a notice to the person under s 222AOE of the ITAA36. The section requires the Commissioner to give 14 days notice before proceeding to recover the penalty due. The notice must set out the details of the unpaid amount and requires a person to pay the Commissioner by way of penalty, an amount equal to the unpaid amount. At the end of the 14 days after service of the notice, the penalty is considered to be remitted in the following circumstances under s 222AOE (b):

1. The liability has been discharged; or
2. An agreement relating to the liability is in force under section 222ALA; or
3. The company is under administration within the meaning of the Corporations Act 2001; or
4. The company is being wound up.

Clearly if a company has problems in remitting its withholding tax it makes good sense to enter into a written agreement with the Commissioner under s 222ALA of the ITAA 36 to pay specified

⁶ *Buist v FCT, Ex Parte Buiste* 88 ATC 4376.

⁷ TAA53 16-85 - 16-105.

⁸ TAA53 16-80.

amounts on specified dates until the liability is discharged. Not taking advantage of this provision results in the activation of s 222ANA (2) which can result in a person being found personally liable to pay the outstanding withholding tax.

If a company makes the decision to wind up under s 222AOB (1)(d), a further danger can arise. A director must begin to undertake the procedure necessary to wind up a company within the 14-day period specified in the notice as failure to do so can result in the director being found personally liable.

*In Scobie & Anor Ex Parte Deputy Commissioner of Taxation*⁹ Cooper J held that the obligation imposed on directors arises from the first deduction day and continues until compliance with s 222AOB (2). Therefore the period prior to receiving the notice is relevant. The directors here argued that the phrase 'begins to be wound up', meant the filing of an application for an order to wind up so that their actions in this regard were 'reasonable'. Cooper J rejected this argument stating that a company only begins to be wound up when the Court issues an order, therefore the mere filing of an application does not comply with the notice requirements.

Should a matter proceed to litigation, s 222AOJ of the ITAA36 provides two main defences with the burden of proof resting on the defendant:

222AOJ (2) [Illness] It is a defence if it is proved that, because of illness or for some other good reason, the person did not take part in the management of the company at any time when:

- (a) the person was a director; and
- (b) the directors were under the obligation to comply with subsection 222AOB (1) or 222AOBAA (1).

222AOJ (3) [Reasonable steps]

- (a) the person took all reasonable steps to ensure that the directors complied with subsection s222AOB (1), s222AOBAA (1) or 222AOBA (1) whichever is relevant); or
- (b) there were no such steps that the person could have taken.

Under s222AOJ (4) '**reasonable**' means reasonable having regard to:

...

- (b) when and for how long the person was a director and took part in the management of the company; and
- (c) all other relevant circumstances.

As the case law below demonstrates, these defences are difficult to make out.

⁹ (1995) 95 ATC 4525.

IV CHALLENGING THE DEPUTY COMMISSIONER OF TAXATION'S NOTICE

A number of cases have been before the courts where directors have challenged the validity of the Deputy Commissioner of Taxation's Notice (DCN) but such challengers have met with little or no success.

As stated above, before the Deputy Commissioner can initiate proceedings, a notice must be served on the 'person' under s 222AOE of the ITAA36. The first purpose of the DCN is to inform the recipient of the unpaid amount of the company's liability under the remittance provisions, and the recipient's liability of a penalty in the same amount. The second purpose is to inform the recipient of the alternative courses available to them.

In *Deputy Commissioner of Taxation v Woodhams*,¹⁰ the High Court considered whether a DCN (or Penalty Notice) could be set aside because of its form. Mr Woodhams appealed to the High Court on the basis that the DCN was invalid under ss 222ANA, 222AOC, 222AOE, 222APE due to the absence of the naming of due dates for the remittance of withholding tax. It was argued this gave rise to uncertainty.

Gleeson CJ, McHugh, Gummow, Kirby and Callinan JJ held that the purpose of the DCN is to inform the directors of the unpaid amount of the company's liability for withholding tax and to inform the recipient of the penalty. It was also to inform the recipient of the options available under s 222AOE (b) and to encourage payment of the outstanding debt. The section did not require the Deputy Commissioner to supply details of the facts relevant to the liability as this is a function of the pleadings and particulars. The High Court overruled an earlier decision of the NSW Supreme Court in *DCT v Gruber*¹¹ where it was held that:

- A Director's Penalty Notice can be a composite document and give notice of more than one outstanding remittance providing it states the amount of each obligation
- If there is an error in the Penalty Notice it will be considered misleading and invalid.
- A director's Penalty Notice should be accurate in substance.

Mr Woodhams was successful in his appeal, the High Court holding that the Deputy Commissioner is not required to state the particular date on which the deduction made by a company are due.

In *Harpas v Deputy Commissioner of Taxation*¹² a director argued that the DCN was invalid as it referred to outstanding monies as a future rather than a present liability. Dunford J found this did not invalidate the notice because it was not a fundamental flaw as the legislative purpose was the giving of the notice. His Honour referred to the High Courts decision in *Woodhams*¹³ and held that the purpose of the DCN was to inform the recipient of the unpaid amount and the options available to resolve the matter without incurring a penalty.

¹⁰ (2000) 199 CLR 370.

¹¹ (1997-1998) 43 NSWLR 271.

¹² [2001] NSWSC 1064.

¹³ (2000) 199 CLR 370.

V EXAMINATION OF S 222ANA DEFENCES

A *Short directorships*

The case of *Fitzgerald v Deputy Commissioner of Taxation*¹⁴ provides a warning to persons who accept directorships of short duration for whatever reason. In this case, Mr Fitzgerald was a friend of a person who was involved in the running of a company. He accepted the position of director without making inquiries as to the financial state of the company. The company had not remitted group tax to the ATO and proceedings were initiated against Mr Fitzgerald. He argued that he did not take part in the management of the company and was not aware of the tax debt until he resigned as a director. He said he had not been in a position to take reasonable steps to facilitate payment of the debt to the ATO. The Court dismissed his appeal and held that prior to a new director taking up an appointment he/she must make enquires of the relevant company officers as to whether there are outstanding tax debts. Only if a director could prove that false information had been provided to him/her could a successful defence being made out. French J stated that if a company lies to a prospective director that the company is solvent and it is later discovered this was not the case, the director might be in a position to make out a defence.

B *De facto and Shadow Directors*

In *Deputy Commissioner of Taxation v Muriwai and Deputy Commissioner of Taxation v Solomon*¹⁵ three companies operated as a single business unit of which Mr Muriwai and Mr Solomon were directors. Mr Muriwai was appointed as a director of one of the subsidiaries on 23 June 2000 and remained in that position for only 5 days until 28 June 2000 when he resigned. The companies failed to remit PAYE deductions for April and May of that year. Dr Solomon was a director from September 1999 until March 2000 when he stepped down, but he was still involved after that time in the management of the company. He was re-appointed a director on 23 June 2000 and then resigned on 12 July 2000 though he continued to manage the companies until August 2000. The PAYE deductions for the period April May and June had not been remitted to the ATO. The Deputy Commissioner sought the outstanding payment for June from Mr Muriwai and the payments for April, May and June from Dr Solomon.

Dr Solomon argued that he was not responsible for the June payments as he had resigned and had not been re-appointed until 23 June. He argued that there were no reasonable steps he could have taken to ensure his fellow directors complied with section 222AOB. He stated he had been aware of the financial difficulties within the companies but only became aware of the outstanding tax liabilities after he joined the company. He argued that he had continually pressed the other directors for information regarding the financial state of the companies and was informed there would be an injection of cash into the business through the selling off of another entity which would result in the companies becoming solvent again. He also argued that he had little to do with the day to day activities of the company and was not a director of the company at the time of the failure to remit. During that time he underwent surgery for colon cancer and stated that on returning to work he was not permitted to see the accounting records of the company. Mr Muriwai argued that after he resigned from the company he was merely a senior officer.

The trial judge considered that there were no other steps Dr Solomon could have taken and took the view that he had inherited obligations in a company group which he believed to be financially sound. The trial judge accepted the defence raised under s 222AOJ (3) because it appeared to him

¹⁴ (1995) 95 ATC 4587.

¹⁵ [2003] NSWCA 62.

that Dr Solomon had taken all reasonable steps to ensure compliance with the ITAA36. Mr Muriwai also succeeded in his defence. The Commissioner appealed the decision.

Gzell J, with whom both Handley and Scheller JJ agreed, found that Dr Solomon could have entered into a written agreement with the ATO under s 222ALA and did not do so. It was held that the term reasonable meant 'having regard to when, and for how long, the person in question was a director and took part in the management of the company and all other relevant circumstances'.¹⁶ Even though Dr Solomon only held the position of director for such a short time and thereafter acted as a de facto director, Gzell J held that Dr Solomon was still responsible for ensuring that the tax liabilities of the company were met. As far as Mr Muriwai was concerned Gzell rejected the argument that he was only a senior employee as he had acted as the managing director of the group of companies and carried out the same tasks after his resignation.

C *S222AOJ (2) defence – the person 'for some other good reason ... did not take part in the management of the company at any time'*

The 'I was only the wife and became a director to assist my husband' defence is now difficult to raise because the courts take the view that when directors take on such a role they must ensure they are aware of the responsibilities involved.

In *Deputy Commissioner of Taxation v Clark*,¹⁷ the Court made it clear it was unsympathetic to Mrs Clark who argued she took on the role of a director in order to assist her husband. The liquidator of Southern Cross Interiors sued the Deputy Commissioner to recover what he alleged were unfair preference payments. The ATO applied to the court for a declaration that Mr and Mrs Clark, as the directors of Southern Cross Interiors, were required to indemnify the ATO under section 588FGA(2) of the *Corporations Act 2001 (Cth)*, which states:

588FGA (1) Each person who was a director of the company when the payment was made is liable to indemnify the Commissioner in respect of any loss or damage resulting from the order.

At first instance the Deputy Commissioner was successful in the claim against Mr Clark but failed against Mrs Clark. She relied on s 588FGB (5) of the *Corporations Act 2001 (Cth)* which provides that because of illness or some other good reason, the person did not take part in the management of the company. Mrs Clark stated that when one of the directors resigned her husband asked her to become a director because he believed that two directors were required to manage a company under the *Corporations Act 2001 (Cth)*.

She told the court she had no business experience and was just a housewife and mother. She signed company documents, which were not explained to her. She stated she 'would usually have a frying pan in one hand and be signing with the other'.

In her defence she relied on the judgment in *Garcia v National Australia Bank*.¹⁸ Palmer J held that the principle enunciated in *Garcia* recognised that married people might take on responsibilities or liabilities that they would not normally have undertaken because of the existence of a special relationship between husband and wife. His Honour also made reference to the concept of 'sexually transmitted debt' in support of the wife's argument and found in her favour.

¹⁶ Ibid, 69.

¹⁷ (2003) 57 NSWLR 113.

¹⁸ (1988) 194 CLR 395, 403.

The decision was overturned in the New South Wales Court of Appeal. Spigelman CJ in the leading judgment focused on the policy behind the amendments to the *Corporations Act 2001 (Cth)* which recognised that it is a fundamental structural feature of corporations legislation in Australia is that directors are expected to participate in the management of a company. His Honour held that every director is expected to actively participate in the management of a company and should be responsible for ensuring they understand what is involved in the role. Part of that requirement is to ensure that a company is solvent. The Court saw a risk in reinforcing gender stereotypes. In finding Mrs Clark liable, Spigelman CJ held that women who take on the role of a director cannot fall back on this type of defence because it is likely to undermine the confidence of potential creditors who deal with small companies in which women have increasingly become directors. The words 'good reason' must be read down so as not to conflict with the obligation of directors to participate in the management of a company.

This case can be contrasted with the earlier 'unconscionable conduct' cases where wives have been successful in arguing they were unduly influenced by their husbands to enter into business transactions which they did not understand.

In *Yerkey v Jones*¹⁹ Dixon J held that two situations could arise in a marriage when trust and confidence are displaced. One is where there is actual undue influence by a husband over his wife and the other where there had been a failure by the husband to explain adequately and accurately the surety transaction which he wanted his wife to enter into. Dixon J considered this type of situation resulted in a 'special equity' for wives because they did not understand the nature of the transaction. In the later case of *Garcia v National Australia Bank Ltd*²⁰ a married woman executed a mortgage with her husband over their home. She signed guarantees in favour of the bank which related to loans made to her husband's business. In later divorce proceedings she sought to have the guarantees set aside because she said she did not understand the transactions she had entered into. The High Court held that it would have been unconscionable to enforce the guarantees against her.

The case of *Clark*²¹ by contrast, indicates that there is an increasing focus by the courts on the necessity for good governance in the corporate arena and arguments by wives that they do not understand the obligations of accepting a directorship are no longer acceptable.

D *The 'reasonable steps' defence in general*

In general the courts are taking a tough stand on directors who fail to remit withholding tax as is demonstrated by the examples below.

In *Deputy Commissioner of Taxation v Saunig*²² proceedings were issued against a director, Mr Saunig for failure to remit withholding tax. He raised a defence under s 222AOJ (3) of the ITAA36 arguing that he had taken that all reasonable steps to ensure that fellow directors complied with s 222AOB (1) to pay the outstanding withholding tax. In the period March to June 1997 he realised that the company had not remitted withholding tax. He contacted the other directors and informed them of the situation but was met with non co-operation. He did nothing further.

He made some payments to the ATO and even had a meeting with ATO officers, though no specific outcome was achieved. A meeting was held with the other directors where discussions revolved around the company going into though that never occurred. In August 1999, Mr Saunig obtained

¹⁹ (1939) 63 CLR 649.

²⁰ (1998) 194 CLR 395.

²¹ (2003) 57 NSWLR 113.

²² (2002) 55 NSWLR 722.

professional advice and then placed the company in administration with the consent of one of the other directors.

The Deputy Commissioner served a statutory notice on the three directors but only proceeded against Mr Saunig. He argued he had taken all reasonable steps to ensure that the outstanding tax was paid.

Heydon JA considered the concept of 'reasonable' and held that the test under s 222AOJ (2) was an objective one. His Honour held that there was nothing to suggest that 'reasonable' went as far as encompassing the actual knowledge of a director or a director who is ignorant of law or of any fact.

In rejecting Mr Saunig's defence Heydon JA held:

While even in a relatively small organisation like the company in this case it may not be right to require each director to take personal steps to ensure compliance with s222AOB (1) (a), it was incumbent upon Mr Saunig to ascertain what the company's duties in relation to tax installments deducted from employees' wages were and to ensure that some system was in place which would produce compliance.' Mr Saunig's conduct must be judged not only by a reference to what he knew, but also by a reference to what he ought to have known²³

Heydon J further held that Mr Saunig could have entered into a written agreement with the ATO or put the company into liquidation when he knew it was insolvent. He could also have obtained early legal advice whereby he could have confronted the other directors with the various options available to the company in light of its financial problems. The defendant had to prove his defence on the balance of probabilities, which he failed to do and was found personally liable.²⁴

*In Deputy Commissioner of Taxation v Stenner and Stenner*²⁵ the Commissioner issued proceedings against a father and son. Many conversations had occurred between an officer at the ATO and Mr Stenner Sr with regard to settling the outstanding amount. An oral arrangement was entered into between the company and the ATO for a payment of \$1000 per month. A sum of \$45000 was paid and credited to the ATO but as there was never any written agreement. Ultimately the Deputy Commissioner issued a notice and then initiated proceedings to wind up the company.

Mr Stenner argued he had entered into an agreement with the ATO and had kept in contact with them advising them of his eagerness to settle the outstanding debt. He told the court that he advised that ATO that in order to keep the company afloat he was prepared to sell his personal property.

However, Brabazon J observed there was no written agreement as required under s 222ALA and in finding for the Commissioner stated that while Mr Stenner's personal disappointment can be readily understood, there is no legal foundation to deny or suspend the Deputy Commissioner's right to recover the directors' debts due to the ATO.

In Deputy Commissioner of Taxation v Moss,²⁶ a written agreement was entered into between the company and the ATO to pay off outstanding withholding tax. The company failed to fulfil its

²³ Ibid, 28 (cited at www.law.ato.gov.au).

²⁴ It is interesting to note that of the three directors the only one proceeded against by the Commissioner was the one who tried to do something to remedy the situation. Such an approach by the Commissioner brings very little credit on him and the ATO, and does nothing to engender confidence in the Commissioner's ability to approach his duties with any measure of fair-mindedness.

²⁵ [2003] QDC 53.

²⁶ [2003] VSC 294.

obligations under the agreement and the Commissioner issued proceedings against Mr Moss. In his defence Mr Moss argued that had been obtained a loan to pay off the outstanding debt. He argued that in these circumstances he had taken all reasonable steps to ensure compliance with the agreement. The court came to the conclusion that all Mr Moss had was a hope and not an expectation that the debt would be paid. In finding for the ATO, the Court held that insufficient financial information had been placed before the court to support Mr Moss's argument that his conduct was reasonable in the circumstances and the company could meet its obligations under the agreement.

In *Deputy Commissioner of Taxation v George*²⁷ Mr George, a director of a company, was appointed to the position of an acting District Court Judge between 1996 and 2000. He did not resign from his directorship during the appointment. At the end of his appointment on the bench he told the court he returned to take part in the management of the company. During the period he was on the bench, the company failed to pay withholding tax and the ATO issued proceedings against him. In the lower court Mr George succeeded in his defence by arguing that he had a reasonable excuse for not taking part in the management of the company during the period 1996 - 2000, due to his appointment as an acting District Court Judge. The ATO successfully appealed the court finding that at all times Mr George was a director and therefore involved in the management of the company.

E *Appointment of a Public Officer*

It is also important for directors to be aware that section 252 of the ITAA36 requires a company to appoint a public officer unless exempted by the Commissioner for Taxation. That person is responsible for ensuring compliance with the ITAA36 and its regulations. It is arguable that the public officer can be held personally responsible under s 252(i) for a company's failure to comply with any tax obligation. However in *Lean v Brady*²⁸ the High Court held the sections as a whole were not designed to impose personal liability on a public officer or other officer. The decision has not been overturned. At the same time s 252(j) gives the Commissioner the power to take action against any director or other officer of a non-compliant company. If a company is convicted for committing a tax offence, those involved in the management of the company are deemed to have committed the offence.

F *The defence of estoppel*

It is worth mentioning the successful outcome in the case of *Deputy Commissioner of Taxation v Winters*²⁹ where the Deputy Commissioner brought proceedings for summary judgment against Mr Winters who relied on the equitable doctrine of estoppel.

Two defendant directors had failed to remit withholding tax and were issued a penalty notice under s 222AOE of the ITAA36. When they received the penalty notice they were attempting to sell the company because of its financial problems. There was also in place arrangements with the ATO to discharge the remittance. Following service of the notice, the ATO took steps to wind up the company. Evidence was adduced that the directors had undertaken discussions with the company accountant to put the company into voluntary administration. They had also made arrangements with the ATO to pay the outstanding tax by installments. Following receipt of the notice, Mr Winters gave evidence that he arranged a meeting with an officer of the ATO where various options

²⁷ (2002) 55 NSWLR 510.

²⁸ (1937) 58 CLR 328.

²⁹ 1997 ATC 4967.

were discussed including selling the company, but the ATO officer suggested that the company keep trading to pay off the debt.

In this case the defence of estoppel was successful and the application by the ATO for summary judgment was set aside. However, this is a limited defence as the trial judge, Moynihan J, made clear by citing Mason CJ in *Maher and Commonwealth v Verwayen*:

The result is that it should be accepted that there is but one doctrine in estoppel which provides that a court of common law or equity may do what is required but not more, to prevent a person who has relied on an assumption as to a present, past or future state of affairs (including a legal state of affairs), which assumption the party estopped has induced him to hold, from suffering detriment in reliance upon the assumption as a result of the denial of its correctness. A central element of that doctrine is that there must be proportionality between the remedy and the detriment which is its purpose to avoid.³⁰

VI CONCLUSION

Every person should be aware that before accepting the position of director and in order to protect themselves from being found personally liable for the tax debts of a company; they should carefully examine the financial affairs of the company. Prospective directors should check with the ATO (in writing) to make sure that the company has a history of complying with its tax obligations.

If those inquiries produce a positive result, and the directorship is accepted, the person is then put in the position of being bound to participate in the financial affairs of the company. If there are any signs of insolvency, a director should immediately consult with other directors to ascertain whether there is a cash flow problem and if there is, ascertain what can be done about it sooner rather than later.

Having accepted the position of director, a person must participate in the financial affairs of the company. There is absolutely no excuse under the legislation not to do so. If there are any signs of insolvency, a director should immediately consult with other directors to ascertain whether there is a cash flow problem and if there is, ascertain what can be done about it sooner rather than later.

The obligations placed on directors by the Commissioner are onerous and the Commissioner made that clear when on 29 January 2004 he wrote to the boards of all listed companies in Australia stating that corporate governance in relation to taxation is extremely important. He advised that boards of directors need to take a direct and active role in managing the risks associated with a company's tax affairs and the need to ensure the correct amount of tax is paid. The warning applies equally to smaller companies as is evident from the cases referred to above.

If problems arise which cause non-payment of withholding tax, a written agreement should be entered into with the ATO (if available) or one of the other options under s 222AOE of the ITAA36 should be exercised. If a director decides to enter into an agreement with the ATO, this should be done at an early stage, particularly if there is any chance that the company will remain solvent. If there are insufficient assets and there are never likely to be sufficient assets to meet the outstanding debt, the company should go into administration or liquidation as soon as possible so that directors avoid personal liability and possible bankruptcy.

³⁰ *Commonwealth v Verwayen* (1990) 170 CLR 395, 413.

The judgment of Heydon JA in *Deputy Commissioner of Taxation v Saunig*³¹ provides sound advice to directors when faced with possible insolvency problems:

The harshness [of the legislation] is to some extent ameliorated by the fact that the directors cannot be sued until a s 222AOE notice is served, by the time it has been served and a further fourteen days have passed the director will have had a period sufficient to procure the company to take one of the four steps referred to in s 222AOB (1). If one of the steps is taken the director ceases to be liable. Harsh or not, however, the legislative scheme in this respect is clear.

Voluntary compliance requires efficient systems being put in place by companies to ensure that tax debts are paid on time to the ATO. The above cases make it clear that non-compliance may lead to harsh results once a penalty notice has been issued by the ATO. 'Avoidance' of the onerous consequences that can result from court proceedings should be at the forefront of a person's mind when they accept a directorship.

³¹ (2002) 55 NSWLR 722, 731.

TARGETING AMNESTIES AT INGRAINED EVASION – A NEW ZEALAND INITIATIVE WARRANTING WIDER CONSIDERATION?

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I INTRODUCTION

A most intriguing development in New Zealand from a behavioural tax compliance perspective was the announcement on August 17, 2004 (along with the associated discussion document) concerning the possibility of limited scope (or targeted) tax amnesties in an effort to reduce the level of ingrained tax evasion in targeted industries. *Options For Dealing With Industry-Wide Tax Evasion*¹ sets out the NZ Government's proposals for cracking down on the hidden economy through targeted tax measures.

The proposals described in the discussion document would allow the IRD to offer limited amnesties to targeted industries or other groups, giving businesses within those industries a last chance to "clean up their act" and begin complying with the law. Income tax evasion is proposed as the main subject of the amnesties but these amnesties could also extend to other taxes, such as GST, depending upon the circumstances (as determined by the IRD). The limited amnesties would be backed up by intensive enforcement activity against those who did not take up the offer. Submissions on the proposals closed on 1 October 2004. If the NZ Government determines it will go ahead with the proposal, legislation was intended to be introduced early in 2005. As at 1 December 2005, with changes in the Government's policy and legislative priorities, and the new Government arrangement put in place following the September 2005 General Election, there has been no progress on the proposals, publicly at least.

The NZ Government within days of the announcement was on the back foot given the immediate and frequently emotional reactions to the proposal. In response Ministers were at pains to emphasise that the proposal is not about simply letting tax evaders "off the hook". Rather, David Cunliffe, Associate Minister of Finance and Revenue, argued that the proposals are intended to improve the incentives to come forward for those who are willing to begin complying with the law, allowing the IRD to focus more resources on those who continue to evade tax.

However, several commentators are of the view that the proposal is a non-starter and unlikely to be effective, and they may in fact cause more negative reaction than positive. In fact, a *New Zealand Herald* Editorial shortly after the announcement suggests that using an amnesty for businesses that have been evading taxes as a weapon of choice "is hopelessly naïve".²

It is important to understand that a limited or targeted tax amnesty can only be justified if it reduces the level of evasion within a specific industry or area of the economy where evasion is rife, eases the competitive pressure to evade tax in the future, and does not adversely affect the behaviour of compliant taxpayers and attitudes towards the tax system. This is a big 'if'! It is contended by the

¹ New Zealand Government, *Options For Dealing With Industry-Wide Tax Evasion: a government discussion document* (August 2004); a copy is available from the Tax Policy Division's website at: <http://www.taxpolicy.ird.govt.nz> under "news".

² Editorial, 'Amnesty for Tax Cheats is Naïve and Futile', *The New Zealand Herald*, (19 August 2004).

NZ Government that such problems can be overcome through ensuring that each amnesty would be offered only for a limited time to a specific industry that had been identified as displaying ingrained evasion.

In the next section of this article, I provide an overview of the international and Australasian compliance literature on tax amnesties, which is followed by a review of the major proposals contained in the discussion document in section III, along with a review of the submissions received on the proposals. Section IV of the article contains some comment on, and analysis of, the proposal. Concluding thoughts and implications for consideration by the ATO and Australian tax policymakers are set out in section V of the paper, prior to an appendix that sets out a substantial number of studies examining tax amnesties forming part of the tax compliance literature. It should be noted that the analysis in this paper builds upon an earlier comment on the proposals by Sawyer and Tan.³

II LITERATURE ON TAX AMNESTIES

A *International tax compliance literature*

Richardson and Sawyer⁴ note that a tax amnesty generally involves providing previously noncompliant taxpayers with the opportunity to pay back-taxes on undisclosed income, without fear of penalties or prosecution.

The main types of tax amnesties are as follows:

1. *Filing amnesty*: this involves the waiving of penalties for non-filers who commence filing;
2. *Record-keeping amnesty*: this involves the waiving of penalties for past failure to maintain statutorily required records, provided such records are now kept;
3. *Revision amnesty*: this is an opportunity to revise past tax returns without penalty or with a reduced penalty. This enables taxpayers to correct past returns (upwards) and pay any taxes that are missing or outstanding. Taxpayers will not normally be immune from investigation and auditing activities. Possible rationales for revision amnesties have been analysed by Andreoni⁵ and Malik and Schwab;⁶
4. *Investigation amnesty*: This involves a promise not to investigate the source of incomes disclosed for specific years and may require the payment of an 'amnesty fee'. It will also involve a promise in effect not to investigate the real amount or origin of the income. Such

³ AJ Sawyer and LM Tan, 'Limited Tax Amnesties: Are they the Answer?' (2004) 10(3) *New Zealand Journal of Taxation Law and Policy* 202-211; and AJ Sawyer and LM Tan, 'New Zealand Government proposes targeted tax amnesties to combat evasion - is this the answer?' (2004) 34 *Tax Notes International* (October 18) 217-223.

⁴ M Richardson and AJ Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16(2) *Australian Tax Forum* 137-320, 219-221. The authors do not include economic modelling studies in their review, such as I Macho-Stadler, P Olivella and D Perez-Castrillo, 'Tax Amnesties in a Dynamic Model of Tax Evasion' (1999) 1 *Journal of Public Economic Theory* 439-463, and A Das-Gupta and D Mookherjee, 'Tax Amnesties as Asset Laundering Devices' (1996) 12 *The Journal of Law, Economics and Organisation* 407-429; nor simulation experiments, such as G Violette, 'The Impact of a Simulated Tax Amnesty: A Classroom Exercise' (1995) 6(2) *Accounting Educators' Journal* 147-158.

⁵ J Andreoni, 'The Desirability of a Permanent Tax Amnesty' (1991) 45 *Journal of Public Economics* 143-159.

⁶ AS Malik, and RM Schwab, 'The Economics of Tax Amnesties' (1991) 46 *Journal of Public Economics* 29-49.

amnesties may often be in the form of a “laundering amnesty”; see Das-Gupta and Mookherjee.⁷

5. *Prosecution amnesty*: This will involve immunity from prosecution for detected offenders, usually a waiver of the penalty on pleading guilty, with the penalty waived on the basis of the payment of some compensation. These amnesties are discussed further in Franzoni.⁸

The main benefits and costs of a tax amnesty can be summarised as follows. The benefits of amnesties include:⁹

- Generating an immediate increase in tax revenues;
- Reducing administrative costs;
- Improving post-amnesty voluntary compliance through better record-keeping and monitoring of individuals who were previously non-filers or did not declare all of their income; and
- Improving post-amnesty voluntary compliance if the amnesty is part of a larger effort directed at reforming the tax system, such as through improved enforcement efforts, reasonable and equitable civil and criminal penalties, and more extensive and improved taxpayer services and education.

The costs of amnesties include:¹⁰

- Producing small and overstated amnesty revenues (in relation to revenues arising from normal audit activities); and
- Reducing post-amnesty voluntary compliance from:
 - previously honest individuals who view the amnesty as unfair,
 - individuals who are now less motivated by guilt to pay their taxes,
 - individuals who are now aware of the presence of non-compliance,
 - individuals who now realise that the government is unable to enforce the tax laws, and
 - individuals who anticipate that another amnesty may be given in the future.

As will be seen later in this paper when the current amnesty proposal is discussed, these benefits and costs are applicable in evaluating the proposal but need to be slightly modified to reflect the fact that the proposal is really a series of targeted amnesties at particular industries with ingrained evasion, not a general amnesty. Hence, future amnesties will be anticipated but in *different* industries – an amnesty will not be repeated for any industry.

Tax amnesties in the United States (“US”) (and in countries such as Australia and New Zealand) have primarily been revision and prosecution amnesties. Stella¹¹ argues that the bulk of amnesty

⁷ Das-Gupta, and Mookherjee, above n 4.

⁸ LA Franzoni, ‘Costly Prosecution, Tax Evasion and Amnesties’ (1994) 23(2) *Economic Notes* 248-265.

⁹ This discussion is based on a paper by J Alm, ‘Tax Policy Analysis: The Introduction of a Russian Tax Amnesty’ (Working Paper No 98/6, International Studies Program, Georgia State University, 1998), 4.

¹⁰ *Ibid*, 4.

revenues from the amnesties held in different states in the US have been from prosecution amnesties. In contrast, amnesty programs in India, the Philippines and Colombia have usually been investigation amnesties.

An important aspect of amnesties is their psychological features. These features are often crucial in determining participation and the direct and indirect revenue effect of amnesties. These various features are now discussed in turn. An unanticipated amnesty can affect tax revenue both during and after the amnesty. An anticipated amnesty can have a positive effect on revenue prior to the amnesty in the absence of other concomitant changes to the tax system. This occurs because taxpayers can be induced to alter their tax reporting behaviour prior to the amnesty merely because they expect a future tax policy change. If their reporting behaviour, in the absence of this change in their expectations, was 'optimal', any change in behaviour is no longer "optimal" since nothing has really changed.¹² Furthermore, the total effect of the amnesty may not be positive when evaluated in the context of all three phases of an amnesty; that is, before, during and after the amnesty.

Does an amnesty signal anything about future levels of enforcement? Without a clear and credible commitment to administrative reform, an amnesty may serve as a signal of weak enforcement capacity of the tax administration, with adverse revenue consequences during and after the amnesty. Two identical amnesties in different political environments may therefore induce very different participation levels. Furthermore, an often neglected signalling effect of an amnesty is via its effect on the workload of the administration, given limited administrative resources. For example, a successful amnesty with widespread participation that increases the workload of the administration massively may prevent the administration from devoting sufficient resources to enforcement in years *after* the amnesty. This would imply, therefore, that a 'highly successful' amnesty may be at the cost of future revenue on account of the workload effect.

What information does an amnesty convey to future tax enforcers? A successful tax evader may be unwilling to participate in an amnesty if the information that his or her participation in the amnesty conveys to the tax administration leads the tax administration to pay greater attention to the tax evader's future tax disclosures. Consequently, without other simultaneous changes in the environment, the most 'successful' or hard core tax evaders are unlikely to participate in an amnesty.

Many of the criteria discussed above for evaluating the structure of amnesty are related. For example, intermittent amnesties will sooner or later be anticipated by taxpayers, thereby providing a signal of future enforcement.

The effect of tax amnesties on taxpayer compliance was excluded from Jackson and Milliron's¹³ earlier review of the tax compliance literature in 1986. The growing popularity of amnesty programs since the early 1980s¹⁴ has seen a turn-around in this area, with increasingly more

¹¹ P Stella, 'An Economic Analysis of Tax Amnesties' (1991) 46 *Journal of Public Economics* 383-400.

¹² Das-Gupta and Mookherjee, above n 4.

¹³ BR Jackson and VC Milliron, 'Tax compliance research: findings, problems and prospects' (1986) 5 *Journal of Accounting Literature* 125-165.

¹⁴ National tax amnesties have been conducted in countries such as Australia, Belgium, France, India, Italy, New Zealand, and Sri Lanka, while a number of states within the United States have run similar programs. A brief comment on South African amnesties is offered by M Kolitz and S Killman, *The SARS approach to Income Tax Evasion: a theoretical perspective* (2004), 9-10. Alm provides an analysis for consideration of a tax amnesty in Russia; see Alm, above n 9. An analysis in contemplation of an amnesty in Hong Kong is provided by D Southwood and A Chan (of

researchers publishing work on the topic, evident in the extensive but non-exhaustive list of publications in the appendix to this paper.

Although research into tax amnesties has developed significantly since Jackson and Milliron's review, Richardson and Sawyer observe that relatively few studies have examined the issue of how amnesties affect the long-term compliance of taxpayers.¹⁵ This aspect of tax amnesties was identified by Mikesell¹⁶ as the most critical factor needing investigation. However, most of the research has been concerned with other issues, such as identifying the ingredients of a successful tax amnesty¹⁷ and describing the characteristics of amnesty participants.¹⁸ Richardson and Sawyer note that this limited attention directed at the long-term compliance implications of tax amnesties means that much uncertainty still exists about the relationship between this variable and taxpayer compliance.¹⁹

Of those studies which have examined the long-term impact of tax amnesties on compliance behaviour, Richardson and Sawyer identify only three have sought to empirically test the nature of the relationship.²⁰ Of these three studies, only Alm, McKee and Beck,²¹ and Alm and Beck²² are of general applicability, with the results of Das-Gupta, Lahiri and Mookherjee²³ being affected by

Grant Thornton), 'Is it time for a tax amnesty in Hong Kong?' (Paper available from: <http://www.gthk.com.hk/Upload/insight/Spring04/GT%20Insight/08.htm>).

¹⁵ Richardson and Sawyer, above n 4, 219.

¹⁶ JL Mikesell, 'Amnesties for state tax evaders: the nature of and response to recent programs' (1986) 39 *National Tax Journal* 507-525.

¹⁷ See for example, DJ Hasseldine, 'Increasing voluntary compliance: the case of tax amnesties' (1989) 6 *Australian Tax Forum* 509-523; and DJ Hasseldine, 'The use of tax amnesties in tax reform', in CT Sandford, (ed) *More key issues in tax reform* (1995), 105-118.

¹⁸ See for example, R Fisher, JH Goddeeris and JC Young, 'Participation in tax amnesties: the individual income tax' (1989) 42 *National Tax Journal* 15-27; JH Goddeeris, SW Martin and JC Young, 'Tax amnesty in Michigan: characteristics of individual income tax participants' (1989) 7 *Journal of State Taxation* 373-395; J Alm and W Beck, 'Wiping the slate clean: individual response to state tax amnesties' (1991) 57 *Southern Economic Journal* 1043-1053; MJ Graetz and LL Wilde, 'The decision by strategic nonfilers to participate in income tax amnesties' (1993) 13 *International Review of Law and Economics* 271-283; and JC Young, 'Factors associated with non-compliance: evidence from the Michigan tax amnesty program' (1994) 16 *Journal of the American Taxation Association* 82-105.

¹⁹ Richardson and Sawyer, above n 4, 220.

²⁰ Richardson and Sawyer, above n 4, 220. In addition to these empirical studies, Alm and Beck, and Malik and Schwab developed economic models to determine the long-term compliance implications of a tax amnesty. The models failed to produce any clear predictions about the long-term effect on compliance, with the results generally dependent on the type of amnesty program adopted; see J Alm and W Beck, 'Tax amnesties and tax revenues' (1990) 18 *Public Finance Quarterly* 433-453; and Malik, and Schwab, 'above n 6.

²¹ J Alm, M McKee and W Beck, 'Amazing grace: tax amnesties and compliance' (1990) 43 *National Tax Journal* 23-37.

²² J Alm and W Beck, 'Tax amnesties and compliance in the long run: a time series analysis' (1993) 46 *National Tax Journal* 53-60.

²³ A Das-Gupta, R Lahiri and D Mookherjee, 'Income tax compliance in India: an empirical analysis' (1995) 23 *World Development* 2051-2064. Das-Gupta, Lahiri and Mookherjee performed regression analysis using compliance data from India, and found that tax amnesties lowered compliance significantly in the long-term. This result, however, is not generalisable to other countries, as a consequence of the unique nature of India's tax regime. Five amnesties were conducted in the Indian tax system during the period of analysis, which represents a significant departure from other tax systems where the once-off use of an amnesty program is the norm. This difference undoubtedly contributed to the direction of the result found by Das-Gupta, Lahiri and Mookherjee, and highlights the need for care when interpreting results from different tax jurisdictions.

factors unique to the Indian tax system. The following analysis is drawn from Richardson and Sawyer.²⁴

Alm, McKee and Beck²⁵ conducted a comprehensive experiment to assess the long-term effect of tax amnesties on compliance behaviour, with the results indicating that the exact effect of an amnesty on compliance depends on the type of amnesty program adopted. The authors found that where an amnesty was conducted without any accompanying changes to the tax system, the level of taxpayer compliance post-amnesty was significantly lower than the pre-amnesty level. Conversely, where an amnesty was used to pave the way for a harsher enforcement regime, post-amnesty compliance was found to be significantly higher than the pre-amnesty level, with results even showing this compliance level to be higher than where increased enforcement efforts were adopted without such an amnesty. The authors' experimental results also indicated that a tax amnesty raises the hope of future amnesties, and thereby lowers subsequent compliance, even in the presence of express assurances that the amnesty is a once-off occurrence. This finding supports the preceding discussion regarding the results of Das-Gupta, Lahiri and Mookherjee²⁶ being a consequence of the frequent use of amnesties in the Indian tax system.

While the results of Alm, McKee and Beck are intuitively appealing, Alm and Beck²⁷ failed to find supporting evidence using data from Colorado's state amnesty run in 1985. Alm and Beck performed various time-series analyses using this data, and the results indicated that Colorado's amnesty had no long-term effect on compliance levels in the state, even though a harsher enforcement regime was introduced at the conclusion of the amnesty. Alm and Beck suggest that this 'no effect' finding may reflect the small size of the Colorado amnesty, or alternatively may be the result of competing amnesty effects offsetting each other. The authors' second explanation appears to have particular merit, with some features of an amnesty program likely to aid compliance (for example, getting previously noncompliant taxpayers on the revenue authority's files, and the introduction of a harsher enforcement regime), while others could arguably hinder it (for example, honest taxpayers may respond negatively to such a program, and expectations may be raised of another amnesty in the future).

Consequently, it may be that the exact effect of an amnesty program on subsequent taxpayer compliance depends upon the relative size of these competing effects, which may differ on a case-by-case basis. Time-series analysis of data from other tax amnesties should help shed some light on this issue, and should be undertaken by future researchers.

Richardson and Sawyer conclude with respect to tax amnesties:

"It is clear that research into the relationship between amnesties and tax compliance has progressed during the decade or so since Jackson and Milliron's (1986) earlier review of the tax compliance literature. Several studies analysing the relationship have been published, where none existed before. However, advancement on the issue has been minimal, with only a handful of researchers displaying an interest in this compliance variable. Future researchers therefore have much work to do in terms of advancing knowledge on this issue,

²⁴ Richardson and Sawyer, above n 4, 220-221.

²⁵ Alm, McKee and Beck, above n 21.

²⁶ Das-Gupta, Lahiri and Mookherjee, above n 23.

²⁷ Alm and Beck, above n 22.

although it is acknowledged that amnesties are traditionally a rare occurrence, thereby severely restricting the potential source of available data.”²⁸

Importantly, as Richardson and Sawyer²⁹ observe, tax officials also have a role to play in developing knowledge in this area, with improved data collection during amnesty programs imperative for increased understanding of the implications of an amnesty on tax compliance behaviour. In this regard, Lerman³⁰ and Martin³¹ both commented on the poor state of data collection by amnesty officials, especially in the US. It seems that amnesty officials generally collect the minimum amount of information necessary for running the program, with little consideration given to long-term compliance issues, or for that matter, academic research that would utilise the data. The data collection carried out during the Michigan tax amnesty was, however, identified by Martin as an exception to this trend, and was cited as an example for subsequent amnesty officials to follow.

An excellent overview of tax amnesties conducted internationally was undertaken by Hasseldine in the mid 1990s.³² Hasseldine provides a summary of the advantages and disadvantages of tax amnesties, reviews prior research on tax amnesties, including empirical research, followed by an analysis of the success or otherwise of various US state³³ and national tax amnesties in other countries.³⁴ It is clear from the review that amnesties tend to cover a particular tax type or types, rather than be limited to specific industries.

Hasseldine’s review of tax amnesties offers a template for issues to be resolved prior to conducting an amnesty. Specifically this summary provides an excellent template for the process of contemplating the possibility of an amnesty, its design and subsequent implementation (should an amnesty be considered necessary and advantageous to improving compliance), and the process of evaluation after the amnesty is complete. Hasseldine’s decision parameters are reproduced in Table 1:³⁵

²⁸ Richardson and Sawyer, above n 4, 221 (emphasis added). As the appendix to this paper reveals, the interest in amnesties has continued to grow since Richardson and Sawyer’s 2001 review.

²⁹ Ibid, 221.

³⁰ AH Lerman, ‘Tax amnesty: the Federal perspective’ (1986) 39 *National Tax Journal* 325-332.

³¹ SW Martin, ‘Using amnesty data to detect tax cheats and improve taxpayer service: lessons from Michigan’ (1988) 4 *Government Finance Review* (October) 23-27.

³² DJ Hasseldine, ‘Tax Amnesties: An International Review’ (1998) 52(7) *Bulletin for International Fiscal Documentation* 303-310.

³³ For an early study of various US state amnesties, see VL Fisher, ‘Recent Innovations in State Tax Compliance Programs’ (1985) 38 *National Tax Journal* 365-371, and SE Crane and F Nourzad, ‘Tax Rates and Tax Evasion: Evidence from the California Amnesty Data’ (1990) 43 *National Tax Journal* 189-199. For a comment from a United States’ State Commissioner of Revenue, see IA Jackson, ‘Amnesty and Creative Tax Administration’ (1986) 39 *National Tax Journal* 317-323. An interesting analysis of the influence of a change in governor and an amnesty is considered by EA Posner, ‘Law and Social Norms: The Case of Tax Compliance’ (2000) 86 *Virginia Tax Review* 1781-1819, 1808-1810.

³⁴ There has not been any US Federal tax amnesty, although commentators have considered the merits of such; see for example, LP Martinez, ‘Federal tax amnesty: Crime and Punishment Revisited’ (1991) 10 *Virginia Tax Review* 535-585; and GP Moran, ‘Tax Amnesty: An Old Debate as Viewed from Current Public Choices’ (1992) 1 *Florida Tax Review* 307-331.

³⁵ Hasseldine, above n 32, 308-309.

Table 1: Amnesty decision parameters for tax agencies – based on Hasseldine (1998)

A.	<i>Prior to the decision to offer a tax amnesty</i>
1.	
2.	
3.	
4.	Assess level of voluntary compliance.
5.	
6.	Assess taxpayer attitudes to paying taxes and to tax amnesties.
7.	Assess severity of current penalty provisions. Is any strengthening required?
8.	What is the current policy on voluntary disclosure? How well known is this policy? Is any change desirable?
	Assess adequacy of audit

coverage.
Do
citizens
perceive
that they
could be
caught
(and
punished
) for
evading
tax? Can
greater
funding
be
allocated
to
enforcem
ent
activities
?
Examine
the
results of
previous
tax
amnestie
s, in
particular
those
conducte
d in
similar
jurisdicti
ons.
Assess
the
amount
of
revenue
expected
under a
tax
amnesty.
Is
legislativ
e
authorisa
tion
necessary

for an amnesty to take place? Is there a better alternative to a tax amnesty to encourage compliance, for example, the non-filer programme of the US?

- B.*
- 1.
- 2.
- 3.
- 4.
- 5.
- 6.

The design and administration of a tax amnesty
What taxes (or offences) are to be included? Who will the amnesty apply to? Most likely, non-filers can participate, but what about known delinquents? Are there any other eligibility

issues
needing
considera
tion?
Over
what
time
period
will the
amnesty
run?
Will any
extension
be
required?
Which
officers
will be
responsib
le for
staffing
the
amnesty?
What
sort of
media
campaign
will be
run to
encourag
e
amnesty
participat
ion?
Should
assurance
s be
given
that this
is a
“once-
only”
amnesty?
Other
operation
aspects
of the
amnesty
– eg form
design,

	<p>toll-free numbers, liaison with tax practitioners, will instalment arrangements be permitted, etc?</p>
<p>C. 1. 2. 3. 4. 5.</p>	<p><i>After a tax amnesty has finished</i> Compute gross and net amnesty revenue. Construct a database of amnesty participants. Examine the characteristics of amnesty participants and isolate common trends and features. Use this information in future enforcement activities. Assess level of</p>

voluntary compliance and taxpayer sentiment .
Make appropriate media releases. Compare results to those of previous amnesties.

While these parameters are presented in the context of general amnesties (the most common types utilised in national and state amnesties to date - whether or not they are limited to particular tax types), in my view they can be adapted for application to the current proposal, namely amnesties targeted at particular industries. In his review study, Hasseldine reminds the reader that amnesties are not a panacea but should be considered as an optional tool that can be used in association with changes to penalty provisions and policing procedures.³⁶ Furthermore, consideration of an amnesty needs to be undertaken with an assessment of taxpayers' current attitudes and levels of voluntary compliance.

A recent contribution to the analysis of amnesties was conducted by Ritsema, Manly and Thomas³⁷ using data from the Arkansas amnesty. In their review of Arkansas amnesty participants, the authors conclude:

“[that] the comments made by participants in the 1997 Arkansas Tax Penalty Amnesty Program [identify] four general excuses for the failure to file state tax returns: (1) Forgetfulness (unintentional evaders); (2) Personal choice due to individual circumstances or opinion (intentional evaders); (3) Error, either by the taxpayer, his representation, or the state; and (4) Confusion, primarily due to the complexity of the tax rules.”

These comments indicate that major reasons for non-compliance are not necessarily intentional tax evasion but may include forgetfulness, mistakes and confusion. This point should not be lost on policymakers.

Outside of the predominantly US literature, a recent analysis of a Spanish amnesty held in 1991 was provided by Lopez-Laborda and Rodrigo.³⁸ The authors conclude that this amnesty had no effect on either the short or long term levels of tax collection, which is in line with most previous studies.

³⁶ Ibid, 309.

³⁷ C Ritsema, TS Manly and DW Thomas, 'Why Taxpayers are Non-compliant: Comments from 1997 Arkansas Tax Penalty Amnesty Participants' (2003) 27(4) *State Tax Notes* (January 27) 1-16.

³⁸ J Lopez-Laborda and F Roderigo, 'Tax Amnesties and Income Tax Compliance: The Case of Spain' (2003) 24 *Fiscal Studies* 73-96.

The literature and empirical analysis outlined above indicates that amnesties are widespread. What may be the reason(s) for this?³⁹

1 *Inability to commit to a long-term enforcement policy*

The optimal tax enforcement literature recognises that governments may have a short term incentive to scale back enforcement levels to reduce monitoring costs. Similarly, once an audit or prosecution is in progress, the ex-post revenue effects of pursuing taxpayers to the end may not be considered to be worthwhile. Taxpayers currently under investigation may be induced to 'settle' their dues voluntarily via an amnesty program. A third example of inability to commit is when a government lowers the tax rate through lenient taxation in an amnesty. Such amnesties, if utilised frequently, causes taxpayers to rationally anticipate such amnesties which adversely affecting ex ante deterrence. Thus in the long run it is desirable for the government to commit to a given enforcement policy, and forego the use of such amnesties.

2 *Flexibility*

Can amnesties conceivably form part of a long term enforcement policy to which the government commits? A possible reason why this may not be the case is that amnesties permit greater flexibility in enforcing tax compliance than is otherwise the case.

First, optimal audit policies generally require that high income disclosures be investigated less frequently than low disclosures. The tax administration may, however, be constrained (for example, by legislation or government policy) to over-auditing taxpayers who make high income disclosures. Consequently it may be revenue and welfare enhancing if such taxpayers are offered an investigation amnesty. However, instead of an amnesty, direct reform of investigation policy could also remove these restrictions.

Second, with the limited information possessed by a tax administration about the heterogeneity of taxpayers with respect to risk-aversion or to the costs of concealing income, taxpayers may make it revenue and welfare enhancing for the government to offer a menu of enforcement policies between which these taxpayers self-select.

3 *Insurance*

Andreoni⁴⁰ and Franzoni⁴¹ also point to the insurance value to risk-averse citizens of an amnesty for past tax evasion, combined with the saving in audit costs to the government. In fact Andreoni argues that amnesties tend to be revenue neutral since the revenue loss from earlier cheating is offset by amnesty receipts.⁴²

4 *Equity*

³⁹ This discussion draws upon comments from the World Bank's discussion on amnesties; see the following link to its website: <http://www1.worldbank.org/publicsector/tax/amnesties.html>.

⁴⁰ Andreoni, above n 5.

⁴¹ LA Franzoni, above n 8; and LA Franzoni, 'Punishment and Grace: On the Economics of Tax Amnesties' (1996) 51(3) *Public Finance* 353-368.

⁴² Related arguments are offered by A Cassone and C Marchese, 'Tax Amnesties as Special Sales Offers: The Italian Experience' (1995) 50(1) *Public Finance* 51-66; L Kaplow and S Shavell, 'Optimal Law Enforcement with Self-Reporting of Behavior' (1994) 102 *Journal of Political Economy* 583-606; and Malik, and Schwab, above n 6.

A justification sometimes offered by governments is that an amnesty is an equitable transition measure to a period of stepped up enforcement. This argument is far from conclusive since an amnesty inequitably allows lenient treatment of amnesty participants, contrasted to offenders convicted either before or after the period of the amnesty. Nevertheless, it has some merit.

5 *Avoiding costly prosecution*

Amnesties may allow the tax administration to economise on prosecution costs. This has an obvious resemblance to the rationale for out-of-court settlements, and has special importance in countries where the court system is overburdened.⁴³

6 *Asset laundering*

Amnesties targeted at inducing taxpayers to declare hidden assets have been important in, for example, India, and in other countries where significant assets are held offshore. Declaration of assets can enhance taxpayer compliance subsequent to an amnesty since these assets are now known to tax authorities. On the other hand, if such an amnesty is anticipated, taxpayers may strategically evade taxes prior to the amnesty, owing to the projected dilution of penalties for tax evasion which could, as discussed in the context of anticipated amnesties, actually increase revenue prior to the amnesty.

Nevertheless, the long run revenue effects of such amnesties are likely to be negative.⁴⁴ This result may not be the case with economic reforms leading to greater investment opportunities. In such a case, former tax evaders may wish to disclose assets in order to take advantage of the higher rates of return on assets outside of the black or underground economy.

B *Australasian study(ies)*

There has been almost a dearth of studies on amnesties conducted in Australasia, which largely reflects the minimal usage of tax amnesties in Australia and New Zealand. The only major study is the review by Hasseldine⁴⁵ in 1989 of both the Australian and New Zealand general tax amnesties conducted in 1988. After reviewing the characteristics of tax amnesties in general terms (including their advantages and disadvantages), Hasseldine outlines the two Australasian general tax amnesties. There is minimal comment on the Australian amnesty other than to note that the ATO regarded the amnesty to be successful in terms of the number of responses received and publicity received. In contrast, the New Zealand amnesty is discussed in depth, including the responses and tax collected. Hasseldine, in his conclusion,⁴⁶ observes that many taxpayers may still be ignorant of their reporting requirements and need further help (notwithstanding the amnesty), and furthermore, some taxpayers may need to receive additional audit attention or be encouraged via some other method to comply – the amnesty is not a stand-alone method to remedy non-compliance.

III MAJOR PROPOSALS IN THE DISCUSSION DOCUMENT AND CONSULTATION

A *Modifying the major proposals*

⁴³ Ex ante incentive effects have been discussed by CYC Chu, 'Plea Bargaining with the IRS' (1990) 41 *Journal of Public Economics* 319-333; Kaplow and Shavell, above n 42; Franzoni, above n 8 and Franzoni, above n 41.

⁴⁴ See Das-Gupta, and Mookherjee, above n 4; and A Das-Gupta, and D Mookherjee, *Incentives and Institutional Reform in Tax Enforcement* (1998).

⁴⁵ Hasseldine, above n 17.

⁴⁶ *Ibid*, 522.

The discussion document⁴⁷ proposes that limited amnesties would be offered to operators in some industries in which tax evasion presents a particular set of problems that could be unnecessarily costly for the tax administration to tackle using traditional tax education and audit systems. Essentially these limited amnesties would:

1. Be a one-off opportunity for people in a targeted industry to come forward and disclose their past evasion;
2. Allow the IRD to offer amnesties to some industries or other groups, at its discretion;
3. Offer an attractive advantage for evaders to disclose undeclared income under the terms of an amnesty by limiting the number of years for which income would have to be disclosed; and
4. Be backed up by intensive audit activity focused on those who within the industry in question do not come forward under an amnesty offer.

In launching the discussion document, the NZ Government identifies that there are severe penalties for tax evasion with reduced penalties for voluntary disclosure of tax evasion to the IRD.⁴⁸ These rules reflect the NZ Government's view that there should be no tolerance of people who are determined not to pay tax and will do so only if they are forced to do so.

One key issue is that the amnesty proposal is aimed at 'entrenched' or 'ingrained' evasion. It recognises that it can be difficult for people who have evaded tax in the past, and who want to begin complying with the law, to come forward and sort out their tax affairs. This is particularly so when tax evasion is prevalent across a whole industry. The reassessment of previous years can result in large debts made worse by the addition of penalties and interest, even if reduced for voluntary disclosure, and lead to bankruptcy or liquidation.

1 *The IRD's thinking*

New Zealand's existing tax rules are designed to apply to individual businesses and the IRD considers that this approach is inadequate to deal with the industry-wide tax evasion problem that underlies the impetus for the proposal. The IRD proposes an industry-wide approach to promote compliance (rather than business by business approach) when evasion common place within an industry.

The IRD's (and the Government's) proposal would allow the IRD to offer limited amnesties to target industries or other groups, giving businesses within those industries a last chance to "clean up their act" and begin complying with the law. Evasion of income tax is the main amnesty target but could also extend to other taxes, such as GST. The IRD intends to back up a limited amnesty with intensive enforcement activity against those in the industry who did not take up the offer.

A major concern is that the limited tax amnesty proposal would be simply "letting evaders off the hook". The IRD, however, sees this matter of concern from the other side, in that the proposal is directed at improving the incentive for tax evaders to come forward through offering a concession by limiting the number of past years for which tax would be assessed under an amnesty.

⁴⁷ New Zealand Government, above n 1.

⁴⁸ See *Tax Administration Act 1994* ("TAA 1994") Part IX Penalties, including provision for a reduction in civil penalties through voluntary disclosure under s 141G TAA 1994.

Furthermore, the underlying justification for offering a limited tax amnesty would necessitate a reduction in the level of evasion within a specific industry or area of the economy where evasion is rife, as well as an easing of the competitive pressure to evade tax in the future. Therefore, each amnesty offer would be only for a limited time to a specific industry (identified with entrenched/ingrained evasion). Importantly, there would be no guarantee that any given industry would ever be offered an amnesty, and importantly there will be no general amnesty for all taxpayers.

After the amnesty period is over, the IRD's audit and enforcement activity would increase, and those taxpayers caught evading tax would incur full penalties and other enforcement measures, although no mention is made in the proposal of the possible nature of the increased enforcement measures that will be applied to those targeted industries following the amnesty. The IRD does not propose to extend the amnesty eligibility to those people already being audited when an amnesty is announced.

2 *How would these limited amnesties work?*

The IRD proposes that the amnesty offer would specify who was eligible to participate, the start and end date between which eligible people could come forward, and the terms and conditions that would have to be met to qualify for the benefits of the amnesty. Eligibility could be specified in a number of ways, depending on the circumstances of the amnesty; hence this component is left rather vague.

In order to participate, taxpayers would need to contact the IRD and provide information about their evasion as required by the terms of the amnesty offer. Subsequently the IRD would check that information against other information it held, which could well be sourced from third parties and others participating in the amnesty.

The IRD proposes that the incentive to come forward will be that in making a voluntary disclosure of evasion, the extent to which core tax amounts can be assessed will be limited, but the normal penalties and interest will be applied to the assessed (disclosed) amounts. Furthermore, most of the usual rules would apply from the moment someone comes forward under an amnesty.

Taxpayers qualifying under the terms of an amnesty would be those who earn income from a particular industry. Although more than one industry might be targeted over time, those who worked in more than one industry would be eligible to make use of one amnesty only. Once a person has come forward they will be known to the IRD as an amnesty participant, and will be expected to disclose all income, including that arising in the target industry and in any other industry that they may be operating. In all cases, persons already being audited by the IRD would not be eligible to participate.

The IRD is contemplating requiring additional information in addition to the (revised) tax returns and would monitor participants closely to ensure they did continue to pay tax correctly – that is, there will be some analysis of longer term compliance trends. Concessions offered by the IRD under an amnesty would be contingent on both full disclosure and future compliance. Importantly, instalment arrangements could be entered into for the payment of tax debt assessed under an amnesty in the same way that other tax debts can be paid by instalment.

3 *The size of the amnesty coverage period - how many back-years should be assessed?*

It is proposed that no tax relief could be provided in respect of the most recent year for which tax is due, which is a reasonable proposition. The IRD's current preference is for a two year period with the most recent and second most recent year assessed being fully liable for tax. The discussion document also contains three and four year options for assessment. The IRD considers that a two-year period would provide a greater incentive than would a three or four-year period (which is logical), and would be relatively easier to administer, although not everyone may perceive shorter disclosure periods as fair, particularly compliant taxpayers.

Currently there is no limit in NZ's tax legislation as to the number of back years that can be reassessed when evasion is involved - hence any limit on back years would provide some incentive to disclose income. There may be practical limitations on how far back reassessments may go in terms of the IRD proving and quantifying the level of evasion, as the onus of proof for tax evasion rests with the IRD. The further back reassessments are permitted to be made by the IRD, the more the proposal resembles the 'normal' rules and the lower will be the incentive to come forward.

One concern recognised by the IRD concerning the requirement for full disclosure over a long period of back years is that the taxpayers involved might have difficulty providing the information required, or fear that the IRD would not be satisfied with the information they provide. As noted above, the further back the information goes, the harder it will also be for the IRD to verify its accuracy. Consequently, there is some logic in requiring only a relatively short period for disclosure, as this would alleviate these concerns.

4 *Criminal penalties and prosecution*

The terms of a limited amnesty would prevent criminal penalties under the *Tax Administration Act 1994* (TAA 1994) being imposed for:

- absolute liability and knowledge offences (ss 143 and 143A TAA 1994);
- evasion or similar offences (other than the offence of pretending to be another person) (s 143B TAA 1994);
- an offence committed by an employee or officer to the extent that it would be an offence if committed by the taxpayer and the taxpayer would qualify for the amnesty (s 147 TAA 1994); and
- aiding or abetting someone to commit an offence to the extent it would be an offence if committed by the taxpayer and the taxpayer would qualify for the amnesty (s 148 TAA 1994).

Interestingly, immunity would not extend to offences under other enactments, such as the *Crimes Act 1961* or *Serious Fraud Act 1990*. On occasions the IRD has involved or sought the assistance of the Solicitor General or Director of the Serious Fraud Office to invoke these provisions for case of alleged tax fraud.

5 *Tax law changes*

In what appears to be more of an after thought than a thoroughly considered possibility, the IRD considers that amnesties may also be beneficial when a change in tax law highlights previous, possibly unintentional, non-compliance. This should not be underestimated as an important mechanism to allow non-intentional non-compliance to be remedied through reduced cost to taxpayers.

In its release of the discussion document, the Associate Minister of Finance and Revenue, David Cunliffe offered some answers to key questions regarding the proposal.⁴⁹

The first question is: “Why is the government releasing this discussion document?” The key reason is that some industries have entrenched tax evasion, which affects every person, as those who evade tax contribute less than their fair share to services. It also disadvantages those in the industry who comply with the law as they bear costs that those not paying tax do not. Importantly it is recognised that a barrier to cleaning up tax evasion is that those who have evaded tax in the past and who want to begin complying with the law can face back taxes and penalties that are so high they may be forced out of business (and into bankruptcy/liquidation).

Thus the IRD and NZ Government argue that tax rules that focus solely on individuals may not deal most effectively with industry-wide evasion, necessitating more innovative ways of dealing with the problem. It is suggested that there may be an overall benefit to New Zealand that industries can be cleaned up by offering limited amnesties to businesses to allow them to ‘clean up their acts’ so they can continue trading and start contributing their fair share to society. Importantly, since the proposal represents what is considered by the NZ Government to be ‘innovative thinking’, any

⁴⁹ Refer to comments on the Executive Branch of the NZ Government’s website, at <http://www.behive.govt.nz>, under “Cunliffe”.

action arising from the discussion document will be trialled and very closely monitored by the IRD to ensure the proposal achieves its aims.

The second question is: “Why would some industries be targeted and not others?” The NZ Government, states Cunliffe, is concerned about the pressures being placed on honest, hard-working taxpayers in some industries because they have to compete with other, less scrupulous business persons who do not pay tax and so can charge less – commonly done at a ‘cash’ price. In some industries, the NZ Government believes this is making it hard for legitimate businesses to stay afloat without adopting the same practices – even though they might not want to. However, as noted in the submissions on the proposals (and discussed later in this paper), the NZ Government has done little in this regard and is not proposing any initiatives of real substance to make it easier for compliant taxpayers and businesses to meet their obligations.

The third question is: “What industries would be targeted?” Since the discussion document represents an idea that is “just a proposal at this stage”, industries have not been identified publicly. However, Cunliffe states that “if” the proposal goes ahead, the IRD would identify groups for whom amnesties would be effective as part of a broader strategy to ‘clean up’ problem industries, from a tax compliance point of view. Whether this includes those industries under the current IRD-business partnership scheme is unclear. This strategy would include intensive follow-up audit and investigation in the targeted industry.

Cunliffe states that no potential candidate industries have been determined (or more correctly, no public announcement has been made concerning these industries, although one would expect that the IRD had industries in mind when it was developing the proposal). The first announcement as to an industry will be when a limited amnesty is offered. This approach is designed to prevent people changing their current taxpaying habits in anticipation of an amnesty in the future. Furthermore, Cunliffe states that no industry could be certain it would be offered an amnesty, so it would be much wiser to continue paying taxes rather than gamble on perhaps having one. However, it is naïve of the NZ Government to believe that certain industries are not expecting to be targets compared than others, given their perceived level of non-compliance.

The fourth question is: “How would the limited amnesties work?” The response to this question has been discussed in detail above with regard to the discussion document, but essentially limited amnesties would allow tax evaders the opportunity to get back on track by coming forward and paying only a certain number of years of back-taxes.

A major concern is raised through the fifth question: “Wouldn’t tax evaders just be let off the hook?” Cunliffe states that taxpayers coming forward under an amnesty will be assessed with penalties for whatever period is determined following consultation on the discussion document and the (generic tax) policy process (and eventually set out in legislation). Evaders may not end up paying their full tax liability but this is also likely to be the case if they were bankrupted or put into liquidation by a large tax assessment so it is a matter of finding the appropriate balance. The limits of the incentive to come forward aim to prevent those arrears from being overwhelming, such that they can be managed, say, by instalment arrangements, while the taxpayer involved also has to meet their current and future tax obligations.

Cunliffe observes that this may appear unfair in some respects but it might be more unfair not to try to do something about the evasion problem in some industries – hence it is a matter of balance. This position is also because the NZ Government believes that there are groups of people who are not hard-core evaders but have been pressured into, and subsequently trapped in, ‘dodgy’ tax practices by having to try and compete with hard-core evaders.

Furthermore, legislation in NZ currently treats all evaders in essentially the same way. Cunliffe observes that pursuing the full force of the law in a lot of cases could result in large numbers of bankruptcies, which could disrupt the industries involved, meaning that no-one will gain in the long run. It appears to be lost on the NZ Government that this does not appear to have stopped the IRD in the past as being the most frequent creditor seeking bankruptcy of taxpayers.⁵⁰ The NZ Government is considering offering a concession now to evaders in order to improve the long-term picture for everyone.

The sixth question is: “Why wouldn’t a limited amnesty be offered to everyone?” Cunliffe asserts that general amnesties normally do not provide any positive benefits and they risk encouraging future non-compliance, especially if people think another one is going to be offered in the future. This is a valid observation in the light of many of the empirical studies reported in the literature but it is not necessarily true of all amnesties that have been reviewed.

Cunliffe observes that a key part of the proposal is the ability to ensure that follow-up investigations and audits can be conducted intensively by the IRD. From a practical standpoint, there is no way a limited amnesty could be credibly proposed if it is spread too thinly over large numbers of people or the whole economy. This argument is more about the level of resourcing the IRD will dedicate to following up on the amnesty rather than necessarily a limitation of a general amnesty.

The seventh question: “Wouldn’t it be unfair to offer limited amnesties to some people and not others?”, is one that has some validity to it. The aim of the NZ Government, states Cunliffe, is to increase fairness by making sure that businesses are operating on a level playing field. The targeted amnesty is an opportunity for industries with ingrained evasion to come clean and start to contribute their fair share to society. Limited amnesties may be a way to shift the aggregate behaviour of an industry in which evasion has become a deeply ingrained problem. Thus the aim is to get a whole group of people back on track in the most manageable way, giving them a chance to come forward first, so that the IRD is able to focus its attention on those who choose not to come forward under the amnesty. This is a last chance before the full force of the law is exercised. The response that compliant taxpayers would be expected to make to this point is why not apply the full force of the law in the absence of an amnesty, since there is to be no increase in penalties following the amnesty, just greater enforcement of existing penalties? Supporting this position is the findings of the amnesty literature, although with appropriate terms and conditions an amnesty may be beneficial overall.

The eighth and final question is: “How would things like child support be affected?” Cunliffe’s response is that social policy programmes like child support, student loans and family assistance will be affected to the extent that income is disclosed and assessed for tax when someone comes forward under an amnesty. In the case of child support this may have a flow-on effect of providing more financial support for children.

B *Recommended changes to the proposal*

Returning to the discussion document proposals, as noted above, under the conditions of the limited amnesties that have been proposed, the amount of core tax that would be assessed for past periods of evasion would be limited. This is illustrated in Figure 2 from the discussion document (reproduced as Figure 1) although it is suggested that possibly consideration could be given to

⁵⁰ See AJ Sawyer, ‘Report from New Zealand: Reprioritising Priorities- IRD the big loser?’ (2000) 8(2) *Insolvency Law Journal* 116-123, where details of the IRD’s role as the major petitioning creditor in bankruptcy is considered in the context of the high priority in repayment that various taxes are provided by statute.

reducing the level of tax assessed for the second most recent year, under the two year option, to 50 percent and thereby providing more consistent comparatives:⁵¹

FIGURE 1: Proportion of tax assessed under the three options

The period for which income must be fully disclosed	Most recent year assessed	Second most recent year assessed	Third most recent year assessed	Fourth most recent year assessed
2 years	100%	100%	-	-
3 years	100%	50%	50%	-
4 years	100%	50%	50%	50%

Incorporating the suggested change would see Figure 2 in the discussion document appear as follows:

FIGURE 2: Proportion of tax assessed under the three options

Most recent year assessed	Second most recent year assessed
100%	50%
100%	50%
100%	50%

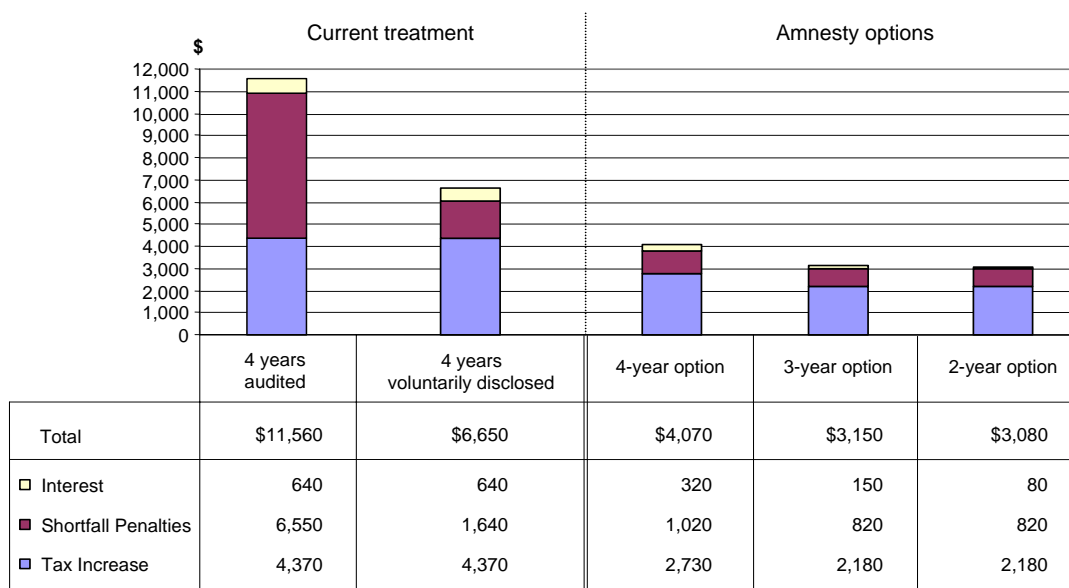
However, penalties and interest would still apply to the tax that was assessed and any repayments of family assistance or back payments of child support and student loans for the disclosure period would still have to be made. An example of the changes is set out in Figure 3 in the discussion document (which appears as Figure 3 below), indicating that the two and three years options are more attractive than the four year option to tax evaders that come forward under the amnesty (with

⁵¹ New Zealand Government, above n 1, 20.

the two year option possible more attractive if the 2-year option is reduced to 50 percent for the second year were included):⁵²

⁵² Ibid, 23.

FIGURE 3: The resulting tax bill under current and proposed treatments for someone who has undeclared income of \$100 a week, \$5,200 a year



Amounts rounded to the nearest \$10

Incorporating the suggested change would see Figure 3 in the discussion document appear as follows (emphasis added):

FIGURE 4: The resulting tax bill under current and proposed treatments for someone who has undeclared income of \$100 a week, \$5,200 a year

	4 years audited	4 years voluntarily disclosed	4-year option	3-year option	2-year option
Total	\$11,560	\$6,650	\$4,070	\$3,150	\$2,090
Interest	640	640	320	150	40
Shortfall Penalties	6,550	1,640	1,020	820	410
Tax Increase	4,370	4,370	2,730	2,180	1,640

Amounts rounded to the nearest \$10

As stated previously, the purpose of offering a limited amnesty to a targeted industry would be to provide tax evaders with an incentive to stop evading tax permanently. Limited amnesties would be considered in conjunction with changes in tax law on a case-by-case basis. Given that it is uncertain whether limited amnesties would prove to be effective, the NZ Government proposes that the IRD would be required to monitor the results of amnesties and report to the relevant Ministers as well as to Parliament on the success or otherwise of any amnesty. If these amnesties were not successful, the IRD's power to offer them would be removed via Order in Council, although at this point serious damage to the NZ tax compliance environment may already have been inflicted.

While only receiving brief mention in the discussion document⁵³ and without any supporting references, the NZ Government makes assertions through the discussion document concerning how tax amnesties should be planned and conducted. The tax compliance literature on amnesties suggests that it is possible to develop and conduct a tax amnesty that successfully improves overall tax compliance in the long run, without being seen as unfair to those who have complied with their tax obligations, *provided* it is designed appropriately.

Following an unexpected telephone conversation on 1 September 2004 with a senior policy official within the IRD, I was advised that the relevant tax compliance literature concerning tax amnesties was reviewed extensively prior to releasing the discussion document (although this is not evident from the discussion document). However, in the interests of making the discussion document readable to as wide an audience as possible, IRD officials determined that references to the literature would be omitted. Furthermore, given the sensitive nature of tax amnesties, the IRD was not prepared to consult outside a small group within the Department prior to releasing the discussion document, since there was genuine concern that information could become public prior to the release of the discussion document.

While this approach is understandable, it would still have been preferable to have included citations to several of the leading amnesty studies, along with the main literature review studies and the State of Michigan study within the main body, with a more detailed list integrated as an appendix to the discussion document. This approach, I would argue, would provide assurance to readers and the general public that the IRD had undertaken extensive research prior to releasing the proposal. The list of studies in the appendix to this paper is testament to the extensive size and variety of studies forming a substantial component of the known tax compliance on tax amnesties. Furthermore, the IRD's research phase could have been undertaken in conjunction with appropriate experts through confidential means.

It is well established in the literature that tax amnesties tend to discriminate against those that comply with their obligations and may in fact send the message: "evade tax and wait until an amnesty come along and then declare your income". Consequently any proposal for an amnesty should be considered within the broader picture of overall fairness, such that all taxpayers meet their correct tax obligations in the least painful manner. The current NZ tax system largely operates with a 'stick' approach to encourage compliance (via penalties and use of money interest), and if a taxpayer is operating outside the tax system, the consequences of coming back may be dire, thereby encouraging them to remain outside the system. An amnesty needs to be constructed to overcome or at least reduce this disincentive, while concurrently avoiding any negative impact on existing compliant taxpayers – a better balance through a 'carrot and stick' approach.

In this regard, KPMG identifies that the proposal does not encompass the situation of a person that is operating outside the tax system, but is not part of an industry per se, such as someone that 'wheels and deals' in various goods or undertakes work that is paid for 'under the table'.⁵⁴ This situation is not the intention of the proposal as it is directed at specific industries; rather KPMG's issue is more relevant to a general amnesty.

⁵³ Ibid, 12-13.

⁵⁴ KPMG, *Taxmail* Issue 3 (August 17, 2004), available at: <http://www.kpmg.co.nz/download/102278/105680/Aug%2004%203.pdf>.

C Consultation and submissions on the proposal

1 Institute of Chartered Accountants of New Zealand

The Institute of Chartered Accountants of New Zealand (ICANZ) provided a detailed submission on the proposals.⁵⁵ ICANZ is in agreement with the IRD that tax evasion should be reduced – this is hardly a controversial stance to take. However, it is ICANZ’s preference that a wider amnesty than that proposed be offered. In conjunction with this expansion of the scope of the amnesty, ICANZ considers that the amnesty changes should be accompanied by a relaxation of the voluntary disclosure rules (through removal of penalties in the case of voluntary disclosure subject to appropriate safeguards being put in place).

The ICANZ submission observes that the proposal is designed with a view to sorting out ‘tax evaders’ who have deliberately not paid tax. Concern is raised that taxpayers who are not ‘tax evaders’, but nevertheless have not complied with their obligations, such as through a mistake they have made in relation to their tax position, are faced with the ramifications and penalty costs of voluntary disclosure. Correctly, ICANZ argue that it is important that such non-complying taxpayers are not discouraged from voluntary compliance by the operation of the penalties regime. A similar situation arises when taxpayers have historically dealt incorrectly with their tax affairs and are afraid to come forward due to the significant financial consequences of accumulating use of money interest and shortfall penalties.

ICANZ then submits that amending the voluntary disclosure rules to eliminate penalties would enhance the likelihood of success of any amnesty. It is suggested that amending the voluntary disclosure rules in this way should provide a permanent environment that encourages and provides incentives for voluntary disclosure that apply to everyone, not just tax evaders. This position has some merit but as revealed in the compliance literature, this has risks in that the complete elimination of penalties in these circumstances may cause undesirable reactions from existing compliant taxpayers.⁵⁶ ICANZ acknowledges that there would need to be safeguards and that any such amendment would need robust rules to ensure its effective operation. Developing such rules would necessitate a delay in introducing the first targeted amnesty.

ICANZ identifies the nub of the issue when stating that:

“those involved in the cash economy need to be given a strong signal that such behaviour is not appropriate. The success of any amnesty will depend on its ability to encourage people to come forward and sort out their tax position. *An important aspect is convincing these people that the benefits of sorting out their tax position will outweigh the costs, and there is a strong likelihood that they will eventually get caught, and that is a high risk to take.* People that need to sort out their tax position should not be discouraged from coming forward because of a harsh penalties regime.”⁵⁷

⁵⁵ ICANZ, *Submission on Options for Dealing with Industry-wide Tax Evasion*, (22 October 2004). Available from ICANZ’s website at: <http://www.icanz.co.nz> under “submissions”. I was involved in preparing this submission, particularly in terms of providing an overview of aspects of the relevant amnesty literature.

⁵⁶ See Richardson and Sawyer, above n 4, 219-221.

⁵⁷ ICANZ, above n 55, 2 (emphasis added).

ICANZ states that should their recommended approach to a wider amnesty with the voluntary disclosure approach not prove acceptable to the IRD, then they would like a wider amnesty in scope than that proposed in the discussion document, with follow up action targeted at tax evaders.

ICANZ then accepts that if the limited amnesty approach is considered the most appropriate tool by the NZ Government and IRD to deal with the tax evasion problem, then it accepts that this will go part-way to addressing the problem, but not to the full extent. As the amnesty literature indicates, amnesties are a tool that can have some positive effect in improving compliance but not significantly, and they require extremely careful planning and implementation.

ICANZ notes that that it is difficult to develop and conduct a tax amnesty that successfully improves overall tax compliance in the long run without it being seen by some parties as unfair to those who have complied with their tax obligations – this is also one of the major concerns arising in the literature. Consequently a limited amnesty proposal must be appropriately designed to maximise the prospects of success. ICANZ understands, on the basis of advice received from policy officials, that the relevant tax literature on tax amnesties was reviewed extensively before preparation of the discussion document. The lessons on best practice that can be learnt from this research should be useful in the implementation of the limited amnesty proposal.

According to the discussion document, the IRD's proposal has been developed on the premise that it will strike a fair balance between the concession offered to past tax evaders and the increased future compliance that will result in exchange. As part of the consultation process, the IRD asked specifically for comments on whether the balance is right, and on how the proposals might be made fairer in the eyes of the general public and taxpayers who already comply with the law.

ICANZ states that most of its comments in the submission would be unnecessary if a wide amnesty adopting voluntary disclosure rules is introduced. The IRD is not prepared to entertain this possibility. ICANZ then raises important matters for consideration as part of the design of a limited tax amnesty.

(a) Boundary issues – inherent design issues

ICANZ notes that an important aspect will be the definition of the boundaries of the industry and eligibility to participate in the amnesty. Communicating clearly the boundaries of an industry is vital. ICANZ states that although it is difficult to have sympathy for a tax evader, it is important that those tax evaders who do come forward under the amnesty were able to ascertain that the limited amnesty applies to them. If tax evaders do come forward and discover that the amnesty does not cover them, this may be perceived as unfair by such tax evaders as they will not be able to benefit from the amnesty.

One of the boundary issues that will need to be made clear is the situation when a tax evader is involved in more than one industry. ICANZ ask of the IRD: "If an amnesty is announced in one of those industries what is the position? Is that person able to bring all undisclosed income within the ambit of the amnesty?" If all undisclosed income may be included, tax evaders may take the opportunity to use the situation to claim some recent involvement in that industry and benefit from the amnesty. This may be difficult to verify since records will often be scarce in this type of situation.

ICANZ plays 'devils advocate' when stating that if the amnesty umbrella only covers undisclosed income from the nominated industry, it will not be attractive to a person evading tax in a variety of industries. On the other hand, unless the amnesty is restricted to the nominated industry, there is a

chance that tax evaders who are not significantly involved in the industry will find a way to take advantage and obtain exemption for many years of undisclosed income from dealings in other industries. A balance needs to be struck, and this requires considerable thought and weighing up of the risks and benefits of a narrow targeted amnesty or a broader scope amnesty.

Limited amnesties should include all taxes over the given period – a view espoused by ICANZ that is contrary to that proposed by the IRD. Taxes are often interrelated (for example, income tax and GST). This should also apply to the social policy measures that are determined by income and administered through the tax system (for example, family assistance, child support and student loans). ICANZ agrees that the limited amnesty should not extend to programmes administered by other Government agencies (for example, ACC) and that the tax evader should be required to face up to the consequences from exchange of information on taxable income.

ICANZ believes that the proposal is drafted such that anyone already being audited by the IRD will not be eligible to participate. Although ICANZ understands that it is important to provide a clear boundary of eligibility this may result in an unfair result in some circumstances, and there may be merit in widening the scope to include those under audit to come forward and disclose income. ICANZ suggests that it may be worth considering whether limited amnesties should extend to those taxpayers who belong to the targeted industry and make a voluntary disclosure purely of their own accord prior to a limited amnesty commencing for their industry. A time frame would need to be considered to ensure this is not perceived as something closer to a general amnesty.

ICANZ suggests that limited amnesties will favour tax evaders who are about to or have recently retired. This is because people often wind down close to retirement and the tax that will be disclosed under the amnesty will be lower in the most recent years. Whether this is an accurate prediction will only be revealed following an analysis of amnesty participants. Additionally, I would suggest that as the tax compliance literature indicates,⁵⁸ older people are generally more compliant as they wish to tidy up their tax affairs, particularly if they are ceasing to run a business. If that person has been a tax evader for many years then there will a high proportion of tax that will escape the net. ICANZ also notes that there will be minimum payback in tax in the future because the person is in retirement.

(b) Incentives – part of the design process

The proposal provides for an incentive for tax evaders to make a voluntary disclosure by limiting the extent to which core tax amounts can be assessed, but applying the normal penalty and use of money interest amounts to the assessed amounts. ICANZ agrees that this is a preferable approach to suspending the application of rules that would normally impose penalties and use of money interest, and assessing just the core tax amounts. As the amnesty literature suggests, it is important that tax evaders under an amnesty are required to meet the same requirements as other taxpayers once the undisclosed tax has been assessed. No concessions should be provided to tax evaders in this situation, unless they are available to other taxpayers. Otherwise, compliant taxpayers will perceive the treatment as unfair, and some may retaliate through undertaking some noncompliant activities themselves.

ICANZ also agrees that the most recent year would have to be fully assessed. In most situations there will be a lack of records available and for this reason it makes sense to provide for a shorter disclosure period.

⁵⁸ See generally Jackson and Milliron, above n 13; and Richardson and Sawyer, above n 4.

An important aspect of providing an incentive for evaders to disclose will be the communication of the amnesty to industry participants. As the amnesty literature suggests, the more real the (perceived) threat of audit is, the more likely that an evader will come forward under an amnesty. ICANZ makes a useful suggestion that it is more likely for the threat to be effectively conveyed to evaders if industry participants are identified and sent a personal letter setting out that the industry has been targeted for audit, and that an amnesty has been offered on certain terms, with the implications for evaders not disclosing income provided. In some industries this may be difficult to achieve so other means of getting the message to industry participants will need to be considered. This will require closely working with the targeted industries, perhaps adapting the techniques used through the IRD's Industry Partnership model.

The key purpose of the amnesty proposal, ICANZ suggests, is to get people to comply in the long term and the concessions offered under the amnesty would be contingent on full disclosure and future compliance. The amnesty literature suggests this is the most difficult part of an amnesty program to achieve. The IRD may require further information than just tax returns, and would monitor participants closely to ensure they continue to pay tax correctly. As a result, tax evaders who come clean under an amnesty could expect to be subject to greater scrutiny in future than other taxpayers, and any statements from the IRD to the contrary are unlikely to be believed.

ICANZ suggests that given a person's previous tax evasion activities it may be difficult for a person to meet the initial disclosure requirements and the ongoing tax compliance standards without some form of assistance. Many may find trying to determine the extent of their tax obligations extremely difficult given the lapse of time and poor state of their records. ICANZ raises the notion of the provision of assistance to ensure an evader is able to successfully meet these requirements and become a "reformed taxpayer" – that is, a fully compliant taxpayer meeting their obligations voluntarily. To this end ICANZ suggests that an incentive should be provided to tax evaders who obtain professional assistance with getting their tax affairs into order and to achieve ongoing tax compliance. Alternatively, it may be that a special team be made available within the IRD to respond to queries and enable the taxpayer to have some continuity of IRD personnel to resolve issues.

The ability to pay the debt assessed under amnesty conditions is an important consideration for a tax evader in deciding whether or not to come forward. The IRD's proposal is that instalment arrangements could be entered into for the payment of tax debt assessed under an amnesty in the same way that other tax debts can be paid by instalment. ICANZ makes the useful suggestion that a debt repayment programme should be offered as part of the amnesty, so that it is clear to the tax evader at the outset what the payment arrangement will be. This is likely to be more conducive to tax evaders coming forward under the amnesty.

(c) *Managing changes in the tax system – the cause of considerable unintentional non-compliance*

An amnesty could be developed to provide extra flexibility to deal with problems that arise when tax law changes. The example provided in the discussion document is the legislative clarification of a tax issue which might highlight that interpretations applied previously were not consistent with policy, thereby increasing the risks of penalties. ICANZ considers that this concept has considerable merit and could be applied with much more justification, fairness and success than the proposed industry-specific amnesties. That is, this form of amnesty should operate regardless of targeted amnesties.

ICANZ further states that it supports the availability of such amnesties and agrees with the view in the discussion document that Ministers should consider the application to any legislative tax reform on a case-by-case basis. ICANZ considers that there may be interpretation and policy issues that do not result in legislative change, but still justify an amnesty, and such non-legislative change situations should also be within the scope of the Minister's authority to declare an amnesty. The main concern here is the relative frequency of such amnesties –there may need to be a form of standing amnesty provided for within the legislation, with the exact application of the amnesty to be determined as required.

(d) Safeguards

As noted above, before offering an amnesty, the IRD would be required to report to the relevant Ministers on the reasons for the implementation in the context of a targeted industry or group, its monitoring of the results, and in addition to the relevant Ministers report to Parliament on the success or otherwise of any amnesty conducted. If these amnesties were not successful, the IRD's power to offer them would be removed by Order in Council.

Given the uncertainty whether limited amnesties would be effective, ICANZ considers that the selection of the first two or three target industries is important, a view with which I agree. If tax amnesties are not successful, then serious harm could be inflicted on the general tax compliance environment. Any proposal for a limited amnesty should, as ICANZ suggests, outline the boundaries' issues that may exist, the way these will be treated, and the communication strategy.

It appears from the discussion document that to ensure that the objectives of an amnesty were being achieved, the IRD would also be required to report specifically on the effectiveness of the first two or three amnesties. The amnesties initially offered would be treated as piloting the proposal. ICANZ surmises that this means that there would be more extensive reporting requirements in relation to the pilot amnesties, as compared to any subsequent amnesties.

ICANZ also considers that it is appropriate as part of the amnesty to prevent criminal penalties under the TAA 1994 being imposed on tax evaders, and agrees with the proposal that this immunity should not extend to offences under other enactments.

2 Business New Zealand submission

Business New Zealand ("BusinessNZ"), which encompasses four regional business organisations and affiliated industry groups, also put in a submission.⁵⁹ Overall BusinessNZ states that it welcomes the NZ Government's willingness to consider ways to increase voluntary compliance with the tax system. However, it is not convinced that offering limited/targeted amnesties to those in certain problem industries would be either the fairest or most effective way to increase voluntary compliance. Nevertheless, BusinessNZ agrees, not surprisingly, that tax evasion should be reduced, that tax evaders pay less than their fair share of tax revenue and honest taxpayers have to pay more to cover the shortfall. BusinessNZ considers a better approach would be to address the underlying reasons for tax evasion.

BusinessNZ then spends a considerable portion of its submission arguing that most NZ businesses pay more than their fair share of tax, that ongoing complexity and changes to the legislation has made compliance more difficult, diverting its focus from the essence of the proposals in the

⁵⁹ A copy of this submission is available from Business NZ's website, at <http://www.businessnz.org.nz/file/790/040820TaxEvasion.pdf>.

discussion document. The reason for this diversion seems to be as a form of explanation, but not an excuse for tax evasion. The high and growing tax burden and increasing complexity of the tax system should not be underestimated when considering issues around tax evasion, particularly for those businesses that are otherwise operating lawfully. BusinessNZ correctly identifies that the discussion document largely ignores these issues and instead focuses more narrowly on the current approach to enforcement and penalties. BusinessNZ appears to miss the point since this is the intended focus of the proposal.

The submission correctly recognises that New Zealand currently uses the ‘stick’ approach for ensuring that businesses and individuals pay their ‘fair share’ of tax, involving strict enforcement by the IRD and the use of what by international standards are very punitive penalties provisions. Conversely, there is very little use of the ‘carrot’ approach.⁶⁰ Although this approach is designed to protect the revenue base, it is likely that it also has unintended consequences.

Most importantly for the vast majority of taxpayers, the penalty provisions are too punitive against those who make innocent mistakes and as a result they generate a climate of fear and result in high compliance costs – a view endorsed by many tax preparers. Moreover, it is also likely that the penalty provisions discourage tax evaders from complying – once they are outside the tax system, the penalty provisions ensure that there are dire consequences if they were to want to come back inside the system.

BusinessNZ see the amnesty proposal as effectively suggesting that a ‘carrot’ approach is also needed for tax evaders in certain industries – this is a useful way to view an amnesty from the perspective of a potential amnesty recipient. BusinessNZ is pleased that the NZ Government has acknowledged that the current regime discourages voluntary compliance for those outside the tax system. BusinessNZ is not convinced that an amnesty approach would either be fair for the vast majority of those who do pay their fair share or would even succeed in achieving a higher degree of voluntary compliance from those that currently do not – this concern is frequently stated in the tax compliance literature.

The NZ Government acknowledges that its proposals would raise concerns with those who do voluntarily comply. BusinessNZ correctly identify that this is an equity issue, the importance of which should not be underestimated. Anecdotal information is offered, with BusinessNZ stating that it:

“... received strong feedback from both businesses and individuals concerned about fairness and equity, with the majority instinctively negative about the proposal, particularly when they see IRD imposing punitive penalties on honest taxpayers making innocent mistakes.”⁶¹

On the issue of effectiveness, BusinessNZ comments that the discussion document notes that overseas experience with amnesties has been mixed, with a number of risks associated with them (this must be seen within the very limited comment on the literature in the discussion document). An important point, that is in accord with the amnesty literature, is that amnesties are likely to be more effective when they are used sparingly and for a special purpose, for example implementing significant changes to the tax system that would disadvantage taxpayers. To this end, BusinessNZ

⁶⁰ S James and C Alley, ‘Tax Compliance, Self-assessment, and Tax Administration in New Zealand - Is the Carrot or the Stick More Appropriate to Encourage Compliance?’ (1999) 5(1) *New Zealand Journal of Taxation Law and Policy* 3-14.

⁶¹ BusinessNZ, above n 59, 4 (para 3.4).

agrees that the credibility of an amnesty would rely upon enhanced detection and enforcement efforts to build an expectation that tax evaders will actually be caught.

In this context, BusinessNZ reveals its underlying view on the proposal, stating that with overseas experience on amnesties mixed at best, a fairer and more effective approach would be for IRD to accept that honest taxpayers should not be punished for making innocent mistakes, but ensure that those who deliberately evade feel the full force of the law. This view follows the compliance pyramid⁶² that the IRD applies, implying that the IRD agrees that it should concentrate its enforcement efforts on those who have consciously decided to evade paying their fair share of tax, while making it easier for those that do voluntarily comply. BusinessNZ strongly supports the IRD's Compliance Model, but it is aware that a perception remains that IRD is still going after those that make innocent mistakes. Consequently, BusinessNZ believes that more could be done to transform the Compliance Model into reality by providing greater leniency to honest taxpayers and discretion to IRD officials on the action taken against taxpayers. This approach, it suggests, would help address some of the fairness issues around providing amnesties for tax evaders.

BusinessNZ then provides a response to the various questions raised in the discussion document, but unlike ICANZ, it does not comment on the questions regarding the design of an amnesty regime as it does not feel sufficiently able to comment on the questions of detail. Given BusinessNZ's membership and expertise, this is an entirely justified decision.

BusinessNZ, in response to the question: "Would it be acceptable to offer limited amnesties to tax evaders?", does not agree, unless the issue of fairness for honest taxpayers and reasonable certainty that an amnesty would be effective in increasing voluntary compliance are satisfactorily addressed. In its view, neither of these conditions would appear to be a 'given' at present.

In response to the question: "Would limited amnesties help evaders to begin complying with the tax laws?", BusinessNZ considers that the international experience would suggest that the case does not appear to be strong. In considering the question: "Would it be fair to offer amnesties, even limited ones, as a last chance for tax evaders to get their tax affairs in order?", its view is probably not, but a possible exception may be if an amnesty were offered as part of implementation of a significant change in the tax system that would disadvantage taxpayers. This latter statement is in accord with the amnesty literature as a valid reason for consideration of implementing a tax amnesty. Such an amnesty would need to be open to all taxpayers, not just those in certain 'problem' industries – BusinessNZ is thus showing its preference for a general amnesty, which in these particular circumstances has some credence.

In response to: "Are there other options instead that would deal with industries or areas of the economy where there is ingrained evasion?", BusinessNZ believes that the NZ Government should make greater efforts to reduce the overall tax burden (including lower tax rates), simplify the tax system, and take a less punitive approach to taxpayers who make honest mistakes (as opposed to deliberate evaders who should feel the full force of the law). To buttress their view, BusinessNZ is of the view that policymakers need better information about the scale of the problem. BusinessNZ then appears to stray from its area of expertise when it contends that the frequently quoted figure of the 'black economy' being around 10-12% of GDP in NZ is "implausibly high".⁶³ Such research has been undertaken by experts and BusinessNZ does not possess such expertise to counter these estimates.

⁶² New Zealand Government, above n 1, 7 (Figure 1).

⁶³ See the discussion in section IV of this article below referring to the work of Professor David Giles.

With regard to specific industries or areas of the economy, BusinessNZ states that it is aware that the IRD has been working constructively with several industry groups on improving compliance with tax requirements. In its view, this should be extended to other ‘problem’ industries in the first instance, with positive incentives for the ‘clean’ operators/taxpayers that are compliant and better efforts at detecting and catching those that are not. This recommendation is a useful one that can be adopted regardless of whether the amnesty proposal proceeds.

BusinessNZ see some scope for a public education campaign to raise awareness about the economic and societal costs of ‘cash jobs’ and the wider issue of tax evasion. This, I would argue is a useful contribution to the discussion, and could be incorporated within the amnesty program or considered alongside it, or possibly even in isolation of the proposal.

3 *Other submissions*

A request was made under the *Official Information Act 1992* for a copy of the submissions made on the proposal. A total of 14 submissions were made, including that of ICANZ and Business NZ discussed above. Three submissions (21 percent) were substantial in size, including ICANZ, BusinessNZ and KPMG. Five (36 percent) were medium in size and six (43 percent) were small (often less than a page). Five submissions came from industry and professional groups (Collision Repair Association, NZ Tourist Industry, NZ Retailers Association, BusinessNZ and ICANZ), four from private individuals, three from CA firms (KPMG, PWC, and NSA Ltd), and one each from an academic (not the author!) and a Member of Parliament.

On an analysis, five (36 percent) were strongly or mildly in support of the proposals, four (29 percent) offered weak support or other ideas that could be developed, and two (14 percent) expressed no view on the proposals (that is, they were largely irrelevant). In terms of the contribution made by the content of the submissions, seven (50 percent) provided useful ideas and analysis, four (29 percent) some ideas, with three (21 percent) were not at all relevant to the proposals.

The large submissions commented on issues of structural problems within the New Zealand tax system and the penalties regime, and tended to prefer the offering of a general amnesty over the targeted amnesty proposal. With specific relevance to the proposal itself, issues of the boundaries, incentives to come forward, managing changes and safeguards were raised as potential concerns. Most submissions, from an academic analysis, were devoid of reasoning that was informed from the content of the tax amnesty literature and associated research, and offered comments that were largely anecdotal. It will be interesting to see what the IRD makes of the submissions when it publicly announces whether the proposal will proceed to the next stage.

IV DISCUSSION AND ANALYSIS

A *The amnesty literature and reaction to the proposal*

A key reason why the proposed targeted amnesty is ‘up against the odds’ of working effectively is outlined in the discussion document. It notes that a study of an amnesty in the US State of Michigan in 2002 found that most of the tax evaders who came forward had failed to comply for just a single year⁶⁴ – it did not attract the “hard-core” evaders.

⁶⁴ Michigan Department of Treasury, *State of Michigan Tax Amnesty Program 2002*, (Michigan Department of Treasury, Office of Revenue and Tax Analysis, February 2003). Available at: www.michigan.gov/documents/AmnestyReport_59671_7.pdf.

Christian, Gupta and Young,⁶⁵ in their analysis of the Michigan amnesty data, find that two-thirds of the new filers and ninety percent of the previous filers' amended returns under the amnesty subsequently filed tax returns. This suggests there is considerable value in increasing compliance via an amnesty for previous non-compliers. The associated threat of enhanced enforcement also appears to have been successful. Many (about two-thirds) of the nonfilers that came into the system with the amnesty were already known to the revenue authority, which raises the issue of whether an amnesty was needed to make these taxpayers compliant. This outcome may make identifying other nonfilers more difficult for the revenue authority. The amount of revenue brought in was about 0.1 percent of the total revenue. Nevertheless, increasing revenue is usually only a secondary target of an amnesty, with changing noncompliant behaviour permanently the most important matter. The overall impact of this amnesty on compliance is hence minimal but it is at least positive.

Disappointingly, there is no citation to the Michigan amnesty studies in the discussion document, a common theme through the entire text of this discussion document. Consequently, only those researchers that are familiar with the literature will be able to verify or comment authoritatively on these statements. Nevertheless, through having an awareness of key studies on amnesties, such as those summarised by Richardson and Sawyer,⁶⁶ and subsequent studies⁶⁷ (see also the appendix to this paper), informed comment can be made on the assertions contained in the discussion document.

What is even more surprising is that there is no specific reference in the discussion document to a study of the previous general New Zealand tax amnesty conducted by the IRD in 1988, which was reviewed by Hasseldine.⁶⁸ Not only does his analysis provide useful background but the 1988 general amnesty provides a benchmark for developing any future amnesties, such as those proposed in the discussion document, along with details of the key issues that need to be considered in such an analysis. The NZ Government would also be served well to consider other studies, such as the comparative analysis and template provided by Hasseldine.⁶⁹

Amnesties can also send out the wrong message about compliance and non-compliance, as indicated in previous studies. Amnesties can lead to those who have complied with their obligations feeling aggrieved by a write-off of tax evaders' obligations. These taxpayers have already been placed at a competitive disadvantage by tax evaders who have not accounted for taxation in their pricing and costs, and would now have to suffer this additional insult. Furthermore, as the amnesty literature indicates, the operation of an amnesty gives rise to expectations of future amnesties and reason to relax and wait until this occurs. While an amnesty may reduce the stress among people who want to become compliant with the system but were afraid

⁶⁵ CW Christian, S Gupta and JC Young, 'Evidence on Subsequent Filing from the State of Michigan Income Tax Amnesty' (2002) 55(4) *National Tax Journal* 703-721.

⁶⁶ Richardson and Sawyer, above n 4.

⁶⁷ See for instance, J Alm, J Martinez-Vazquez and S Wallace, 'Do Tax Amnesties Work? (Working Paper, International Studies Program, Andrew Young School of Policy Studies, Georgia State University, 2001); Ritsema, Manly and Thomas, above n 37; López-Laborda and Rodrigo, above n 38; B Torgler, CA Schaltegger and M Schaffner, 'Is Forgiveness Divine? A Cross-Culture Comparison of Tax Amnesties' (2003) *Swiss Journal of Economics and Statistics*, 375-396; and M Kellner, 'Tax Amnesty 2004/2005 – An Appropriate Revenue Tool?' (2004) 5(4) *German Law Journal*, which is available at: <http://www.germanlawjournal.com/article.php?id=409>. A useful summary of tax amnesty studies is available at the World Bank's website, at: <http://www1.worldbank.org/publicsector/tax/amnesties.html>.

⁶⁸ Hasseldine (1989), above n 17. See also Hasseldine (1995), above n 17.

⁶⁹ Hasseldine, above n 32.

they could not afford to (the non-hardcore non-compliers), it will rarely be effective against the hardcore non-compliers.

The literature suggests, however, that there may be justification for an amnesty particularly if there is to be a more harsh penalties regime to come in immediately after the amnesty, not merely greater enforcement of existing penalties, which could be achieved without the use of an amnesty.⁷⁰

Research published by economist Professor David Giles estimated the New Zealand hidden or “black” economy to be about \$9 for every \$100 worth of goods and services produced in the official economy.⁷¹ That would amount to around \$12 billion a year in 1998 dollars. Thus the lost tax revenue could be as large as \$3-4 billion p.a. While some of this would come from illegal activities such as the drug trade, and is likely to remain outside the tax net even with an amnesty, substantial gains in revenue could be made from capturing even a small percentage of the underground economy, which in itself could be seen as a good reason to support the NZ Government’s amnesty proposal.

There is a growing argument that the IRD’s current approach to gaining greater voluntary compliance through partnerships with trade associations in industries in which cash jobs are common is not achieving the level of success desired. Maintaining such a ‘softly-softly’ or ‘carrot’ approach is questionable if it is not being successful, indicating that a much harsher approach may be required through greater enforcement of existing law and penalties. Nevertheless, it is a matter of finding the appropriate balance of ‘carrot and stick’ measures to improve level of compliance.

Importantly the IRD has argued that any benefits from an amnesty would need to be weighed against adverse reaction from taxpayers who had done the right thing. The IRD is also concerned that an amnesty would set a dangerous precedent - if taxpayers thought there would be amnesties, they could afford to relax. Such concerns are valid and should be considered.

PriceWaterhouseCoopers (PWC) tax partner John Shewan is reported as stating that:

“... this would be the first amnesty in 30 [sic] years, and there is a very clear signal than this is a one-off and that if you don’t come forward and continue to evade you can expect to be dealt with very harshly. In my experience there is huge emotional stress associated with people who realise they have done wrong and want to get back in the system but don’t want to get hung, drawn and quartered for so doing - and that is what the current rules tend to do.”⁷²

New Zealand’s previous general tax amnesty was held in 1988, some 16 years ago, although this is still a significant time in the past, and prior to more recent changes to the tax system, including the current penalties regime. An opportunity when an amnesty could have been held was prior to the 1997 introduction of the new comprehensive penalties regime, although this would have been less than 10 years after the previous general amnesty.

The New Zealand Herald’s Editorial on 19 August 2004 is particularly scathing of the proposal. It states in relation to the finding of the Michigan amnesty that “[c]hronic tax dodgers showed no

⁷⁰ Richardson and Sawyer, above n 4, 220-221.

⁷¹ This is referred to in a study by P Caragata, *The economic and compliance consequences of taxation: a report on the health of the tax system in New Zealand*, (1998). See also, for example, DEA Giles, ‘Modelling the hidden economy and the tax-gap in New Zealand’ (1999) 24 *Empirical Economics* 621-640.

⁷² See B Fellow, ‘Tax amnesty plan to beat tax cheats’ (2004) *New Zealand Herald* (August 18).

interest in the amnesty. They carried on regardless. The same, almost certainly, would happen in this country.”

Further on, this Editorial comments:

“...in the words of a tax specialist, ‘there is a huge emotional stress associated with people who realise they have done wrong and want to get back in the system, but don’t want to get hung, drawn and quartered for so doing’. Really? No stress is associated with the commonplace. And those who evade taxes because they lack a sense of social responsibility feel no guilt?”⁷³

The Employers and Manufacturers’ Association (Northern) (EMA), not surprisingly has been extremely critical of the proposal, stating through their CEO, Alasdair Thompson, that: “Government’s largesse in granting the tax amnesty is no medal winner for over 90 percent of businesses.”⁷⁴ Rather, the EMA would prefer that the Government establish a business compliance environment that does not tempt small business people to cheat on taxes in the first place.

By way of an example of what could be done to reduce the likelihood of tax cheating, EMA’s CEO Alasdair Thompson pointed to a tax strategy adopted by the United Kingdom where the first £10,000 of business income is tax free and the next £300,000 is taxed at only 19 pence in the pound. Currently in NZ all company profit is taxed at the high rate of 33 cents plus FBT rates up to 64 per cent. A small business in the UK earning \$30,000 per year pays little or no tax. In NZ it would pay at least \$9,900 tax. In the view of EMA’s CEO, if NZ’s business environment was fixed, tax amnesties would not even need to be considered, although there appears to be no realistic likelihood that such a proposal or anything similar would ever occur under the current NZ Government.

PriceWaterhouseCoopers, in their newsletter,⁷⁵ observe that an amnesty will not eliminate the black economy but acknowledge that the Government is not suggesting that this is the aim of the proposal. As PWC note, the Government is also not suggesting that tax evaders be ‘let off the hook’ entirely. To the contrary, evaders that come forward under the amnesty would be required to pay interest and some of the core tax and penalties, as discussed above. PWC conclude their positive perspective on this proposal with the following comment:

“The Government has put forward a constructive proposal which deserves much more careful consideration than that demonstrated by most commentators to date.”⁷⁶

In the *National Business Review*’s Editorial of 20 August 2004, it concludes aptly in part with the statement: “A more lateral approach would be to establish why there is not more widespread voluntary compliance, reduced barriers and penalties to assist this, and relying less on ‘income’ and more on spending to raise revenue.” However, while this approach is worth considering, the issue of tax mix is a separate area that is beyond the scope of this amnesty proposal.

⁷³ Ibid.

⁷⁴ See Anon, ‘EMA pans amnesty proposal’ (2004) *National Business Review* (August 18). This is also reflected in BusinessNZ’s submission, since EMA is a member of this organisation; see section III(C)(2) of the article above.

⁷⁵ PriceWaterhouseCoopers, *Tax Tips*, No. 15, (25 August 2004).

⁷⁶ Ibid, 1.

B *Issues for Australian policymakers*

Recently the ATO indicated part of its process for combating tax evasion in 2004. Specifically in a media release on 31 March 2004, the ATO states:

“We have a very active compliance program to ensure that everyone complies with their tax obligations. Part of this program deals with tax evasion in the cash economy. We also have an increased presence in the community as part of our expanded cash economy strategy, with about 660 field staff dedicated to investigating those who do not declare their correct income and identifying businesses which operate outside the tax system.

We will contact around 70,000 businesses over the coming year as part of this strategy to investigate undeclared income. About 30,000 of these businesses will be visited by one of these field staff.

Tax evasion can occur in any industry, but the industries we are now focusing on include building and construction; taxis; cafes, restaurants and takeaway food outlets; hairdressing and beauty salons; cleaning services; clothing and textiles; and pubs, clubs and taverns.

Other industries we are looking at closely this year include tobacco growing; liquor wholesaling and manufacturing; motor vehicle retailing; gold bullion; art and antique dealing; the sex industry; and the tourism and hospitality industry.”⁷⁷

This statement provides an indication of areas where potentially a tax amnesty could be targeted to some of the industries identified, should such an approach be considered justifiable based on a thorough review of the industry, and an understanding of the relevant literature and previous empirical experience with amnesties. Furthermore, both Australia and New Zealand have similar tax systems (founded on voluntary compliance through self-assessment and enforcement mechanisms), and similar amnesty experiences, with the last known general amnesty in Australia in 1988, the same year as New Zealand.⁷⁸ A current focus for improving compliance in both nations is directed at reducing tax evasion via targeting industries, including the use of some form of industry partnership.⁷⁹

Importantly, through this discussion document, NZ tax policymakers have proposed a new and unique approach to tax amnesties, through targeting amnesties to specific industries (although these industries at the time of writing are unknown). Australian tax policymakers, if not so already, should pay close attention to the development, and possible implementation, of targeted amnesties in NZ. Other jurisdictions are expected to show an interest in these proposals as well, since ingrained tax evasion is an international phenomenon.

⁷⁷ ATO, *How we combat tax evasion* (31 March 2004) (emphasis added), available at: <http://www.ato.gov.au/corporate/content.asp?doc=/content/30337.htm&pc=001/001/008/003&mnu=&mfp=&st=&cy=1>

⁷⁸ See Hasseldine, above n 17.

⁷⁹ This should not be a surprise since the New Zealand Commissioner of Inland Revenue is formerly from the ATO and has introduced ideas that have been successfully applied in Australia, and both the NZ Commissioner and his Australian counterpart are conducive to considering research and analysis from the tax compliance literature.

V CONCLUSIONS AND LIMITATIONS

The NZ Government's targeted tax amnesty proposal may have been developed with the best intentions but the proposal, as disseminated in the discussion document, falls short of the mark for a well-reasoned and research-informed policy document. Not only does the proposal fail to provide any references from the extensive literature on tax amnesties, but it neglects to make any reference to the previous general amnesty conducted in New Zealand in 1988. The IRD's response as to why it took the approach of nondisclosure and lack of detail is understandable but not acceptable if it was really seeking to obtain informed comment by way of submissions and provide evidence to convince taxpayers that the IRD had "done its homework". Nevertheless, in my view the proposal should be advanced to the next stage, namely publicly disseminating draft legislation for consultation which one would hope is based on relevant research-informed policy.

The initial reaction to the proposal by commentators has been swift and frequently scathing – few appear to support this initiative, although the submission from ICANZ is well-reasoned and generally supportive. In my view the NZ Government would have been better advised had it given more careful consideration to the existing literature, possibly requiring that it sought expert assistance prior to releasing the proposal for public comment (within the necessary level of secrecy), and provided an analysis, even if by way of appendix, to the discussion document.

After all, this debate leaves an important question to be answered – "When should an amnesty be declared in practice?" The best advice that can be given is: unless an excellent and inarguable reason can be found for an amnesty, then it is best not to declare one. The level of ingrained evasion in some industries in New Zealand suggests that consideration of an amnesty is warranted, and to this end the IRD's initiative is to be applauded. However, the amnesty literature indicates that future revenue effects of an amnesty are almost sure to be negative (or at best just positive), either because of a negative signalling effect or due to the reduced fear of the consequences of further evasion once taxpayers have had their 'slates wiped clean'. Nevertheless, the effect on compliance behaviour of a suitably designed amnesty may be positive in the long-run.

Possible reasons for "one-shot" (general) amnesties (or possibly even for targeted amnesties) discussed above include self selection (flexibility), insurance effects (insurance), economising on prosecution costs (avoiding costly prosecution), asset laundering during economic liberalisation (asset laundering), and reducing workload arrears (transitional amnesties via 'cleaning the slate'). Nevertheless, since the literature indicates that most amnesties will have negative compliance and revenue costs, projected benefits should be carefully weighed against costs before they are instituted. Costs also include the equity costs of all amnesties including, especially, amnesties that are designed to offer a self-selection menu of options to tax evaders.

The major limitation of this article is that the subject matter is under review at the time of writing and in fact there is no clear indication whether the IRD will be pursuing this proposal to the next stage – drafting legislation originally due for tabling in Parliament in the first part of 2005. As of 1 December 2005 draft legislation has not as yet emerged. The concept may be 'killed' at this early consultation phase if the overwhelming view in submissions is negative⁸⁰ and the yet to be complete analysis of the literature causes the IRD to lose its early optimism for the proposal. Should the proposal proceed, the draft legislation may differ to that in the proposal as a result of content of the fourteen submissions on the proposals and further review of the relevant literature.

⁸⁰ Of the fourteen submissions reviewed, a slim majority is supportive of the proposals or at least some form of general amnesty.

Thus future analysis should be conducted to review the detailed legislation, if it eventuates, or the reasons given for withdrawing the proposal, depending upon which alternative eventuates. If these amnesties become a reality, then independent as well as IRD analysis should be undertaken to review their success (or otherwise), and identify any changes that can be made to further targeted amnesties, should they be contemplated. Other jurisdictions, including Australia, should closely follow these developments with this innovative New Zealand proposal for targeted industry tax amnesties.

VI APPENDIX

Tax Amnesty Studies from the World Bank's website:
<http://www1.worldbank.org/publicsector/tax/amnesties.html>.

As this paper has illustrated, even the list below is far from exhaustive of amnesty studies.

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BUSINESS START-UP COMPLIANCE COSTS: POLICY PERSPECTIVES

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I INTRODUCTION

It is nearly half a decade since the Goods and Services Tax (GST)¹ was introduced in Australia on 1 July 2000. Since then, most of the Australian tax reform issues still continue to be a “political play”. The government presented tax simplification as one of the related objectives of the tax reform. However, much of the concern from businesses, in particular, small business community, was on both GST start-up and recurrent compliance costs. Presently, start-up tax compliance costs of the GST may no longer be an important issue since they are mostly regarded as “sunk costs” that can never be recovered. Moreover, businesses are now focusing on GST recurrent compliance costs. Nonetheless, start-up compliance costs of any taxation system/regulation cannot be ignored as they are important for policy makers. Empirical evidence suggests that overall start-up tax compliance costs are significant and regressive.² Furthermore, international findings also indicate that start-up compliance costs represent a significant amount of recurrent compliance costs.³ The taxation literature on start-up compliance costs is very limited, although non-taxation studies on start-up compliance costs do shed some light on the topic. The major objective of this article is to discuss the possible relationship between start-up compliance costs and recurrent compliance costs of the GST. It also seeks to present an evaluation of the importance of business start-up compliance costs.

The rest of the article is organised in four parts as follows. Section II reviews the terminology and the context of business start-up and recurrent compliance costs. Section III discusses the very limited literature on both the Australian and international business start-up compliance costs. Section IV presents some empirical evidence on start-up tax compliance costs of the GST for small businesses. Furthermore, studies on both GST start-up compliance costs and transitional compliance costs and their relationship to recurrent compliance costs are explored. Section V concludes the article with a focus on policy perspectives.

II CONCEPTUAL ISSUES

A *An Overview of Compliance Costs*

Compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirement laid upon them in complying with a given tax structure, over and above payment of the tax itself.⁴ Similarly, business start-up costs are those costs incurred by businesses in preparing to comply with legislative prescriptions.⁵ Compliance costs of business taxation include professional fees, especially accounting and legal fees; “the value of time spent by business

¹ The Goods and Services Tax (GST) is also known as Value Added Tax (VAT) in other countries.

² N Rametse and J Pope, ‘Start-up Tax Compliance Costs of the GST: Empirical Evidence from Western Australian Small Businesses’ (2002) 17(4) *Australian Tax Form* 407-442, 418-419.

³ See for example, B Tran-Nam, ‘The Implementation Costs of the GST in Australia: Concepts, Estimates and Implications’ (2000) 3(5) *Journal of Australian Taxation* 331-343.

⁴ CT Sandford, MR Godwin and PJW Hardwick, *Administrative and Compliance Costs of Taxation* (1989).

⁵ Tran-Nam, above n 3; J Pope and N Rametse, ‘Small Business and the Goods and Services Tax: Compliance Cost Issues’ (Working Paper, School of Economics and Finance, Curtin University, 2000); Rametse and Pope, above n 2.

taxpayers (including owner/partner/director, paid staff and unpaid helpers⁶) to learn about and become thoroughly familiar with the new tax and its implications⁷; computer hardware and software, and other physical resources.⁸

Two concepts of tax compliance costs are normally distinguished in the literature, namely gross and net compliance costs. Gross compliance costs of particular concern to tax policy makers, represent the total resource cost to the economy before any offsetting benefits to taxpayers are taken into account. These offsets include the tax deductibility of the various costs incurred and the value of any cash flow benefits enjoyed by taxpayers. Cash flow benefits arise from the lawful delay in payment of tax to the tax authorities, and in the delay in remittance of tax revenue collected by them on behalf of the government.⁹ Managerial benefits to taxpayers arising from improved accounting procedures, together with tax deductibility, cash grants from government¹⁰ and cash flow benefits may also be an important offset, though for managerial benefit, quantification is very difficult.¹¹ Thus net compliance costs are the actual or real costs imposed on the business sector after allowing for offsets, and what business focuses upon. A distinction is also made between start-up compliance costs and recurrent (or ongoing annual) costs.

B *Business start-up versus recurrent compliance costs*

Start-up costs are distinct from recurrent (or ongoing annual) costs. Whilst business start-up compliance costs “arise with the introduction of a new tax or a major change in tax”,¹² recurrent costs are continuing costs. Recurrent/regular costs are incurred in running a tax system and do not include temporary costs, which are incurred by the tax officers and taxpayers in learning about the new tax system “over a period extending after a change commences”.¹³ Tran-Nam and Glover further clarify that aggregation of start-up costs and temporary costs is necessary because, although the two concepts are theoretically distinct, separating them with precision is very difficult.

Even when a particular tax has been well established to regard the compliance costs as regular/recurrent costs, some businesses will be starting to operate, hence experiencing tax start-up costs as they prepare to comply with the tax legislation for the first time. Thus, within the recurrent costs, there will be elements of start-up costs associated with changes in the taxpayer population.¹⁴ This may occur where either a new business is established or an existing business registers for GST for the first time.

III INTERNATIONAL AND AUSTRALIAN BUSINESS START-UP COMPLIANCE COST STUDIES

A *Overview*

To the best of our knowledge, the major start-up compliance cost studies undertaken before the Australian GST implementation date of 1 July, 2000 are two Canadian, one Mauritian, one

⁶ Tran-Nam, above n 3.

⁷ B Tran-Nam and J Glover, ‘Estimating the Transitional Compliance Costs of the GST: A Case Study Approach’ (2002) 17(4) *Australian Tax Form* 499-536, 502.

⁸ J Pope, ‘Factors affecting the Compliance Costs of the Goods and Services Tax in Australia’, in C Evans, J Pope and J Hasseldine (eds), *Tax Compliance Costs: A Festschrift for Cedric Sandford*, (2001), 139-157.

⁹ J Pope, ‘Tax Compliance Costs: The Value of Cash Flow Benefits to Business and the Effect of the Pay-As-You-Go System’, in M Walpole and C Evans (eds.), *Tax Administration in the Third Millennium* (2001) 303-311.

¹⁰ Tran-Nam, above n 3.

¹¹ Rametse and Pope, above n 2, 410.

¹² Sandford, Godwin and Hardwick, above n 4, 16.

¹³ Tran-Nam and Glover, above n 7, 502.

¹⁴ CT Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand* (1992), 7.

Australian and one British. Other United States studies¹⁵, although not relevant to start-up tax compliance, are on start-up compliance costs of consumer financial regulations. Studies that are more relevant to start-up tax compliance costs of the GST are the Canadian Federation of Independent Business (CFIB),¹⁶ the Australian study¹⁷ and the Mauritian study.¹⁸ These studies, together with Gunz et al.¹⁹ (1995a, 1995b) are discussed briefly in this section.

The CFIB²⁰ estimated small business GST start-up costs, Clare and Connor's study²¹ was on start-up compliance costs of the superannuation surcharge tax (SST) and Pillai²² researched the Mauritian GST start-up costs in the hotel industry. Amongst the various studies conducted by Sandford et al.²³ was the UK VAT recurrent compliance cost. Sandford et al.²⁴ further outline 33 major compliance costs studies. In Australia, most business start-up compliance cost studies relate to surveys that were undertaken before and after the GST was introduced.²⁵

B *International literature on business start-up compliance costs*

Research by Rametse and Pope²⁶ is a major contribution to the international literature on (any) tax start-up costs, of which there is a surprising dearth of information. The development of Tax Impact Statements in various OECD countries in the 1990s is recognised.²⁷ However, their depth in forecasting tax compliance costs is open to criticism, at least in the case of Australia,²⁸ which omitted to recognise the regressivity of compliance costs. The Regulatory Impact Statement (RIS) is the early government impact statement that focuses on how the new tax law would impact on the taxpayer compliance costs as far as operating costs are concerned. The RIS²⁹ did not provide any breakdown of its aggregate gross compliance cost estimate of \$1.9 million for the year 2001-02 by size of business (small, medium and large).

Evans and Walpole researched the extent to which OECD members use taxation impact statements in the development of tax policies and legislation and found that:

¹⁵ As reviewed by G Elliehausen and BR Lowery, 'The Cost of Implementing Consumer Financial Regulations: An Analysis of Experience with the Truth in Savings Act' (Governors of the Federal Reserve System Staff Studies 170, 1997); available at: <http://www.federalreserve.gov>.

¹⁶ Canadian Federation of Independent Business, *The GST: A National Tax Tragedy* (1991).

¹⁷ R Clare and D Connor, 'The Cost of the Surcharge – more bad news' (ASFA Research Centre, Association of Superannuation Funds of Australia, Sydney, 1998).

¹⁸ KV Pillai, 'The Compliance Costs of VAT in the Hotel Industry in Mauritius, Social Sciences and Humanities and Law & Management', (2000) 3(7) *Research Journal* 52-66.

¹⁹ S Gunz, A Macnaughton and K Wensley, 'Measuring the Compliance Cost of Tax Expenditures: The Case of Research and Development Incentives' (1995) 43(6) *Canadian Tax Journal* 2008-2034; and S Gunz, A Macnaughton and K Wensley, 'Measuring the Compliance Cost of Tax Expenditures: The Case of Research and Development Incentives' (Working Paper No 6, Industry Canada, 1996).

²⁰ CFIB, above n 16.

²¹ Clare and Connor, above n 17.

²² Pillai, above n 18.

²³ Sandford, Godwin and Hardwick, above n 4.

²⁴ *Ibid.*, 224-230.

²⁵ These studies are discussed in section III(E).

²⁶ Rametse and Pope, above n 2, 407-442.

²⁷ C Evans and M Walpole, *Compliance Cost Control: A Review of Tax Impact Statements in the OECD* (1999). See also AJ Sawyer, 'Compliance Cost Impact Statements in New Zealand – How far have we come?: Tribute to Cedric Sandford' (2002) 17(4) *Australian Tax Forum* 441-494

²⁸ *Regulation Impact Statement for the Introduction of a Goods and Services Tax*, accompanying *A New Tax System (Goods and Services Tax) Bill 1998*, presented to the Federal Parliament, December 1998.

²⁹ *Ibid.*

Despite its commitment to the completion of taxation impacts statements, Australia compares poorly with other OECD countries in certain important respects. There is inadequate quantification of the likely costs of compliance for taxpayers (often inexplicably so), and there is inadequate consultation with business and other stakeholders outside the revenue authorities on the issues of taxpayer compliance costs.³⁰

Thus for any regulation, policy makers must recognise the regressivity of compliance costs. Pope and Rametse³¹ have identified around eleven international start-up compliance costs studies undertaken prior the Australian GST implementation on 1 July 2000, as shown in Table 1 in the Appendix. It must be noted that there is a wide variation of the figures from other studies, for example, the United States studies. However, applying the rule of thumb, start-up compliance costs could be equivalent to one year's recurrent compliance costs.

C *The Canadian Studies*

The CFIB³² undertook a survey of their members in the first year of the GST's operation in Canada and received 25,362 responses. They estimated start-up costs of C\$3.0 billion, representing 45 percent recurrent costs of C\$6.6 billion, which was around 30 percent of tax revenue at that time.

Though one of the CFIB's survey merits was its large sample size, their figures were widely criticized on the basis of selection bias and overestimation because they were a lobby group. Brooks,³³ in particular, cautions that "these estimates may be influenced by selection bias and other threats to validity and reliability". Plamondon and Associates,³⁴ by contrast, found that Canadian GST recurrent compliance costs, expressed as a percentage of business turnover, were lower than those in New Zealand.

Economies of scale, which is revealed by most compliance costs studies, was also evident in the CFIB³⁵ study as shown in Table 2.

³⁰ Evans and Walpole, above n 27, 7.

³¹ Pope and Rametse, above n 2.

³² CFIB, above n 16.

³³ N Brooks, *The Canadian Goods and Services Tax: History, Policy and Politics* (1992), 137.

³⁴ Plamondon and Associates Inc, *GST Compliance Costs for Small Business in Canada*, (1993); as summarised by B Wurts in C Sandford (ed) *Tax Compliance Costs Measurement and Policy* (1995), 299-320.

³⁵ CFIB, above n 16, 8-9.

TABLE 2

GST START-UP COSTS IN CANADA BY SIZE OF FIRM - 1991³⁶

Number of employees	Average cost per firm C\$	Estimated total cost C\$Million	Percentage of total Costs
0-4	2,421	1,153	38
5-19	4,023	1,069	36
20-49	6,546	412	14
50-99	8,674	177	6
100+	10,389	179	6
Overall	3,964	2,990	100

Small businesses, defined in terms of employment size, comprising businesses with less than 20 employees, incurred 74 percent of the total cost compared to 6 percent for larger firms (more than 100 employees). It must be noted that the former account for 30 percent of total Canadian production.

Another Canadian study, though not related to GST, was on start-up compliance costs of Canadian research and development tax incentives.³⁷ This study found that average start-up costs of 33 firms with a start-up year were \$3,550. These comprised 84 percent of recurrent compliance costs, yet only represented 0.4 percent of the total research and development credit claimed. A further interpretation was that a firm has a “double year” of compliance costs in its start-up year, one of start-up costs and an almost equal amount of recurrent costs. Approximately, half of the start-up costs represented costs relating to external adviser’s costs. This confirms that start-up costs are higher than recurrent costs because businesses may have gone to consultants to get them started. Thus at a later stage, businesses did not require assistance from these consultants once the firms became familiar with the program.

D *The Mauritian study*

In Mauritius, research on start-up costs and recurrent costs of VAT in the Mauritius hotel industry was undertaken.³⁸ The estimated measurable compliance costs in 1998/99 for hotels in Mauritius was Rs 14.3 million, comprising of start-up costs of Rs 9.8 million and recurrent costs of Rs 4.5 million. Start-up tax compliance costs of VAT were around 69 percent of the total compliance costs, while the recurrent costs accounted for 31 percent. Thus start-up costs were more than twice as high as recurrent costs, representing around 223 percent of recurrent compliance costs. Part of the start-up costs were equipment costs and training costs, estimated at 28 percent and 18 percent respectively.

These figures however, are exclusive of time costs as apparently respondents had difficulty with the estimation of opportunity costs, hence omitted from the analysis.³⁹ This study also confirmed the economies of scale and regressivity of compliance costs. Compliance costs expressed as percentage of turnover for less than Rs 12 million was estimated at sixteen times that of businesses

³⁶ Source: Ibid, 9.

³⁷ Gunz, Macnaughton and Wensley (1996), above n 19.

³⁸ Pillai, above n 18.

³⁹ Ibid, 56.

with over Rs 180 million. Thus the very small hotels, with a turnover of Rs 7.2 million incurred the highest compliance costs of 1.78 percent compared with large hotels with turnover of Rs 310.3 million that incurred 0.11 percent. Furthermore, compliance costs for all hotels combined at turnover of Rs 103 million were 0.02 percent.

Segregation of these costs showed that start-up costs, as percentage of turnover were 1.39 percent for very small hotels and for large hotels, 0.07 percent. Recurrent costs for very small hotels were ten times that of large hotels with 0.40 percent as compared to 0.04 percent respectively.⁴⁰ Thus in line with findings of other compliance costs studies, Pillai's study found that both start-up and recurrent costs of VAT in Mauritius were regressive.

It is worth noting the importance of guiding respondents properly to segregate start-up costs from the recurrent costs. The joint cost issue must also be addressed, where equipment acquired for any tax under investigation could also be used for other normal business activities. This study does not reveal how respondents were guided to separate these costs. Since the study was conducted ten months after the introduction of the GST, it is possible that some elements of recurrent costs could have been included in start-up costs and vice versa if there was no proper guidance on the segregation of costs. Information on this can only be obtained from the questionnaire, which unfortunately was not provided with the report.

E *Australian business start-up compliance cost studies*

Apart from Clare and Connor's study,⁴¹ which estimated start-up compliance cost of the SST, most Australian business start-up compliance costs studies relate to the GST and were estimated around 1998-2001. The GST compliance cost estimates for Australia were stipulated in the RIS.⁴² The Australian GST estimates were based on recurrent costs of the GST of other countries, in particular, New Zealand. However, the government acknowledged that start-up costs might be of a similar magnitude to annual recurrent costs.

The pre-implementation debate on the GST attracted a variety of surveys on small business start-up compliance costs. Rametse and Pope⁴³ are aware of around ten major studies that have been published to date concerning the GST implementation costs for small businesses (see Table 3 in the Appendix). However, due to differing methodologies such as survey technique, sample sizes, wording of questions and ensuing reliability, the findings of these surveys must be treated with caution. These studies show a fairly wide range of cost estimates, in terms of direct costs and opportunity costs. Other differing factors are the number of businesses surveyed. Where there are a small number of respondents, this then raises a concern on the studies' reliability and representativeness of the whole population of around 1.2 million small businesses in Australia in 2000.

These studies used different research methods (mainly telephone, questionnaire survey and case study) and particularly the varied treatment of time costs and joint cost issue.⁴⁴ However, as it can be seen (Table 3), apart from Ernst and Young,⁴⁵ RSM Bird Cameron⁴⁶ and NARGA,⁴⁷ there is

⁴⁰ Ibid, 58.

⁴¹ Clare and Connor, above n 17.

⁴² RIS, above n 28.

⁴³ Rametse and Pope, above n 2.

⁴⁴ Pope and Rametse, above n 5.

⁴⁵ Ernst & Young, *The Impact of the Goods and Services Tax on Small Business in New South Wales - A report to the New South Wales Department of State and Regional Development* (1999).

evidence of similarity in terms of costs incurred. The most authoritative study by the Economic Development Committee, Parliament of Victoria,⁴⁸ which used a synthesis of other studies, estimated GST start-up costs of \$6,000 per small business. It must be noted that this study did not take into account the opportunity costs. If time spent was included, at an opportunity cost of \$20, using Evans et al⁴⁹ estimate, this figure would possibly increase by \$2,000, resulting in the increased estimate of \$8,000.

Furthermore, analysis of the 1999 estimates show figures that are much lower than the post-1999 estimates. This could be due to the fact that these surveys may have been based on expectations rather than actual experience. Thus, after the 1 July, 2000, small businesses would have known the actual implementation costs, hence provided fairly accurate figures. Furthermore, costs may have been overstated, for example, the Victoria University of Technology's study,⁵⁰ the time period of the study was from early June to mid November 2000. Thus costs may be inclusive of both start-up costs and recurrent costs.

The National Association of Retail Grocers of Australia Pty Ltd (NARGA) commissioned a study on both start-up and recurrent costs of the GST for independent grocers.⁵¹ Small businesses were measured in terms of annual turnover of \$5 million, whilst medium-sized businesses annual turnover was between \$5 million and \$20 million. Start-up compliance costs for small businesses were estimated at \$18,622 and for medium sized businesses at \$44,704. It must be noted that careful comparative analysis must be treated with caution because of differing turnover measurement with other studies, particularly those that use the ATO measurement of small businesses with annual turnover of less than \$10 million. Small independent retailers, as percentage of turnover, incurred start-up costs of 1.63 percent, while medium sized and large independent retailers incurred 0.58 and 0.17 percent respectively.⁵² This confirms the regressivity of the GST start-up compliance costs.

Another study, by Queensland Council of Social Services (QCSS)⁵³ has been excluded from Table 3 because it is more of a recurrent compliance cost than a start-up compliance cost study since it covered a period of twelve months from July 2000 to July 2001⁵⁴. The QCSS study reveals that "the implementation of the GST and other parts of the New Tax System has cost this sector over \$39 million and will cost a similar amount each year thereafter for ongoing (recurrent) costs...."⁵⁵ However, the findings are similar to those of small businesses, high compliance costs, with a proportionately greater impact on smaller organisations.

⁴⁶ RSM Bird Cameron, *Survey on Compliance Costs* (2000); commissioned by and cited in the Economic Development Committee, Parliament of Victoria, *Inquiry into the Impact of the Goods and Services Tax on Small and Medium Sized Business in Victoria: GST Report No. 1* (2000) 40-45.

⁴⁷ National Association of Retail Grocers of Australia Pty Ltd (NARGA), *Report on the GST Compliance Costs for Independent Grocers: Prepared for the National Association of Retail Grocers of Australia*, (Submission No. 83, Small Business Employment, 2001).

⁴⁸ Economic Development Committee, Parliament of Victoria, *Inquiry into the Impact of the Goods and Services Tax on Small and Medium Sized Business in Victoria: GST Report No. 1* (2000).

⁴⁹ C Evans, K Ritchie, B Tran-Nam and M Walpole, *Taxpayer Costs of Compliance*, (Australian Taxation Office, 1997), 11-12.

⁵⁰ Victoria University of Technology, *Goods and Services Tax Implementation and Victorian Small Businesses: Final Report*, (Small Business Research Unit, 2001).

⁵¹ NARGA, above n 58.

⁵² *Ibid*, 15.

⁵³ Queensland Council of Social Services, *Taxing Goodwill, Final Report of the GST Impact Research Project* (2001); available at: <http://www.qcss.org.au>.

⁵⁴ An Australian GST start-up compliance cost study, for example, Rametse and Pope, would cover the period up until 30 June, 2000.

⁵⁵ QCSS, above n 75, 4.

Tran-Nam and Glover⁵⁶ provide a critique of the QCSS study and assert the difficulty in assessing its reliability since the final questionnaire form was not included in the QCSS study. Thus information on guiding respondents to exclude recurrent costs from start-up costs was not available. Furthermore, the very well known problem identified by literature, of “accounting-taxation overlap” and disentangling equipment costs relating to the GST implementation and other normal business activities is normally scrutinised from the questionnaire.

A wide variation of GST start-up compliance costs reported by most of these studies could be attributable to expensive upgrades of computer equipment not related to the GST. This interpretation tends to be confirmed by the median estimates that are often below the mean estimates. Estimates also vary widely by type of industry, with retail/wholesale reporting the highest costs and entertainment, recreation, restaurants and personal services reporting the lowest.⁵⁷

It must be noted that these studies did not attempt to estimate temporary compliance costs of the GST. The only academic study that we are aware of and has estimated temporary compliance costs of the GST is by Tran-Nam and Glover.⁵⁸ In estimating transitional costs, Tran-Nam and Glover included both commencement (start-up) and temporary (learning) costs. Their study was more of a quantitative focus and had a smaller number of small business participants.

The estimated transitional costs of tax reforms included GST related costs and other aspects of the tax reform such as the Business Activity Statement (BAS) and Pay-As-You-Go (PAYG). The mean gross transitional costs were estimated at \$5,442 per small businesses and after considering tax deductibility benefits and the \$200 direct subsidy, the estimated net transitional costs of tax reforms were \$3,815 per business. Net costs expressed as percentage of average annual turnover in 1999-2000 and 2000-01 were 1.34 percent (gross) and 0.86 percent (net).

Petzke and Murphy⁵⁹ conducted a GST compliance cost study. This study surveyed small businesses in Albury Wodonga during September and October 2001. The research attempted to ascertain small business owners’ perception of the impact of the GST in the first twelve months of its implementation. Petzke and Murphy estimated average implementation costs estimated at \$4,545 (without time costs) per business, comprising of additional staff costs of \$2,019 and additional professional fees of \$2,525 per business. Average time spent per business was 133 hours. This study, however, neither valued these hours in dollar terms nor addressed the common “joint cost” problem. If time was valued using an opportunity cost of \$20,⁶⁰ time costs would be \$2,660, giving the total implementation compliance costs would be \$7,205.

IV AUSTRALIAN GST EMPIRICAL EVIDENCE

Apart from Tran-Nam et al,⁶¹ to date, there is no academic GST recurrent compliance study in Australia that can be analysed to show the relationship between GST start-up compliance costs and recurrent compliance costs. In this section, an overview of the major GST start-up compliance cost for Western Australia small businesses⁶² and GST transitional compliance cost study⁶³ is presented.

⁵⁶ Tran-Nam and Glover, above n 7, 352.

⁵⁷ VECCI, above n 67, Table 4.

⁵⁸ Tran-Nam and Glover, above n 7.

⁵⁹ S Petzke and D Murphy, ‘A Survey of Small Regional Businesses and the Impact of the Goods and Services Tax’ (Working paper, Charles Stuart University, 2001).

⁶⁰ Evans, Ritchie, Tran-Nam and Walpole, above n 60, 11-12.

⁶¹ B Tran-Nam, J Glover and S Wilkin, ‘The GST Recurrent Compliance Costs/Benefits of Small Business in Australia: A Case Study Approach’ (Paper presented at the Australasian Tax Teachers Association Conference, Flinders University, 29-31 January, 2004).

⁶² Rametse and Pope, above n 2.

These studies are analysed within the context of small business GST recurrent compliance cost research by Tran-Nam et al.⁶⁴

A *The West Australian GST Start-up Compliance Cost Study*

Business start-up compliance estimates in Western Australia focused on small business and the GST. As reported in Rametse and Pope,⁶⁵ small businesses incurred high costs in preparation for complying with the GST requirements. On average, small businesses incurred GST start-up costs (excluding their time costs) of \$5,006. The costs were an average of 131 hours per firm in seeking professional accounting and information technology advice to introduce new systems and procedures. Time spent valued in dollars amounted to \$2,620 (at an opportunity cost of \$20 per hour), or 34 percent of total start-up costs of \$7,626. Gross GST start-up costs, that is, before considering any offsets, were estimated at \$7,626. This estimate comprises the cost of equipment, particularly computers and software, costs such as professional accounting and IT consultancy fees, training course fees, stationery and phone calls, and also (opportunity) time costs.

It must be noted that the opportunity cost of \$20⁶⁶ has since been reviewed to reflect the inflation of 8 per cent as at the period ending GST start-up compliance cost estimate (June 2000). Time costs increased to \$2,882 amounting to total estimated mean gross GST start-up compliance costs of \$7,888. Most of this study's results have been reported elsewhere⁶⁷ and will not be repeated here.

B *Relationship of Business start-up compliance costs to recurrent compliance costs*

The GST formed part of the Australian new tax system and, it was expected that start-up compliance costs would be higher than the recurrent compliance costs. Furthermore, recurrent compliance costs would be lower as small businesses become familiar with the GST. Thus there is no doubt that a strong relationship of business start-up compliance costs to recurrent compliance costs exists. Analysis reveals the extent to which small business gross mean start-up compliance costs (with time) relates to recurrent GST compliance cost. Based on the study by Tran-Nam et al.⁶⁸ on the recurrent cost of the GST, the start-up tax compliance costs of the GST represent a significant amount of GST recurrent compliance costs. After two years of the implementation of the Australian GST, Tran-Nam et al.⁶⁹ estimated the recurrent GST compliance costs, covering the financial years 2000-2001 and 2001-2002.

Using a case study methodology, the researchers collected data from thirty one participants, predominantly from rural Victoria, NSW, Tasmania, Queensland, the ACT and the Northern Territory. The preliminary results of this study estimated the mean gross GST recurrent compliance costs per small business at \$2,481. After considering offsets such as tax deductibility and cash flow benefits, the net recurrent GST compliance costs were estimated at \$1,244 per small business.

⁶³ Tran-Nam and Glover, above n 7.

⁶⁴ Tran-Nam, Glover and Wilkin, above n 83.

⁶⁵ Rametse and Pope, above n 2.

⁶⁶ Evans, Ritchie, Tran-Nam and Walpole, above n 60.

⁶⁷ Pope and Rametse (2001), above n 62; Pope and Rametse (2002), above n 62; Rametse and Pope, above n 2; N Rametse and J Pope, 'Start-up Tax Compliance Costs of the GST: Empirical Evidence from Western Australian Small Businesses' (Paper presented at the Annual Australasian Tax Teachers Association Conference, University of Wollongong, 30 January – 1 February, 2003).

⁶⁸ Tran-Nam, Glover and Wilkin, above n 83.

⁶⁹ Ibid.

Earlier on, for the period 1999-2000, the gross transitional costs of the GST were estimated at \$7,673, a figure which is in line with Rametse and Pope study's⁷⁰ gross mean GST start-up compliance costs of \$7,888. However, Tran-Nam et al⁷¹ believed that the mean gross GST recurrent compliance costs were still higher and as such, the figure could be inclusive of some elements of transitional costs. Thus transitional difficulties are still evident for small businesses.

It is clear that start-up compliance costs of \$7,888 estimated by Rametse and Pope⁷² and transitional costs of \$7,673 estimated by Tran-Nam and Glover⁷³ are around six times higher than the Tran-Nam et al⁷⁴ recurrent compliance costs estimate of \$1,244 per small business. It must be noted that both start-up compliance costs and transitional compliance cost figures do not include a deduction of government's \$200 voucher subsidy.

As compared to Rametse and Pope study,⁷⁵ which covers only start-up compliance costs, Tran-Nam and Glover⁷⁶ transitional costs include both start-up compliance costs and temporary compliance costs.⁷⁷ These authors define temporary compliance cost as "the value of additional time required by staff over a period extending after a change commences in order for them to comply and familiarise themselves with new regulations".⁷⁸ Thus their slightly lower transitional cost figure as compared to Rametse and Pope's⁷⁹ start-up compliance cost figure may justify that small businesses were beginning to be familiar with the GST requirements.

Another potential relationship of start-up compliance costs to recurrent compliance costs, though may be weaker, relates to managerial benefits arising from the use of computers. The increased level of small businesses, using computers, not only for record-keeping and GST compliance, but for their business generally is significant. Rametse and Pope's study⁸⁰ also covers acquisition of computers for GST compliance (as start-up compliance costs) and its relationship to recurrent costs. It is expected that acquiring computers for GST compliance would result in lower recurrent compliance costs due to benefits from the use of technology in other business areas and better management. The authors are in the process of finalising interviews and data analysis on managerial benefits and are keen to disseminate their findings as soon as possible.

C *GST Start-up Compliance Aggregation Difficulties*

The estimation of aggregate start-up compliance cost of the GST for the Australian small businesses is a dicey situation. It requires stratified small business data by either annual turnover or employment size for grossing up purposes. However, for comparability intention, Rametse and Pope's study⁸¹ requires stratification data by annual turnover rather than employment size since it follows the ATO's definition of small business.⁸² This data can only be obtained from the ATO, which "for confidentiality purposes" is unwilling to provide it.

⁷⁰ Rametse and Pope, above n 2.

⁷¹ Tran-Nam, Glover and Wilkin, above n 83.

⁷² Rametse and Pope, above n 2.

⁷³ Tran-Nam and Glover, above n 7.

⁷⁴ Tran-Nam, Glover and Wilkin, above n 83.

⁷⁵ Rametse and Pope, above n 2.

⁷⁶ Tran-Nam and Glover, above n 7.

⁷⁷ Ibid, 502.

⁷⁸ Ibid, 502.

⁷⁹ Rametse and Pope, above n 2.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Rametse and Pope, Ibid, 413 discuss the definition of small business. The Australian Bureau of Statistics definition is small business in non-manufacturing those employing less than 100 people (see Bell, *Time for Business, Report of the*

In order to gross-up, it is appropriate to use the number of small businesses registered for GST before the GST implementation date on 1 July 2000. However, this has the potential of inflating aggregate GST start-up compliance costs because it is evident that many businesses may operate several firms as one business.⁸³ If extrapolation of gross GST start-up compliance costs was based on an estimate of around 1.2 million Australian small businesses in 2000, GST start-up compliance costs would be around \$9 billion. However, to obtain a more reliable estimation, small business aggregate gross GST start-up compliance costs can be calculated by extrapolating on the basis of the number of small businesses in Australia and weighted against Australian small business GST registrants. Rametse and Pope⁸⁴ are in the process of estimating a more reliable aggregate gross GST start-up compliance costs figure for Australian small businesses.

V CONCLUSIONS AND POLICY PERSPECTIVES

Though business start-up compliance costs are “sunk costs” and can never be recovered they are important to policy makers. Countries yet to introduce their new taxes need to know about the magnitude of start-up compliance costs. Though the United States start-up compliance costs studies do not relate to tax whatsoever, their contribution to literature is acknowledged.

It is evident that business start-up compliance costs relative to recurrent compliance costs are significant. Gross mean GST start-up compliance costs estimated by Rametse and Pope⁸⁵ and Tran-Nam and Glover⁸⁶ transitional compliance cost study are around six times more than Tran-Nam *et al* recurrent compliance cost study. This contradicts Government prediction that start-up compliance costs may be of a similar magnitude to recurrent compliance costs.⁸⁷

The government had estimated start-up compliance costs for all businesses at around \$2 billion. If extrapolation of gross GST start-up compliance costs was based on an estimate of around 1.2 million Australian small businesses in 2000, small business GST start-up compliance costs would be around \$9 billion. Pillai⁸⁸ found that start-up compliance costs were more than twice as high as recurrent costs, at 223 percent. Gunz et al⁸⁹ estimated start-up costs at 84 percent of recurrent costs while National Audit Office⁹⁰ found start-up costs to represent 72 percent of recurrent costs.

Estimation of managerial benefits relative to GST start-up compliance costs is a challenging task. Higher start-up costs may represent an investment in the latest technology yielding lower recurrent compliance costs. This relationship is analysed in the context of start-up costs. The longer-term benefits may justify the Government’s policy of a low GST registration threshold and offset to high initial costs.

Policy makers should recognize the significance of compliance costs and without their cooperation (making data available to researchers) researchers may experience estimation difficulties. As such,

Small Business Deregulation Task Force, (Department of Industry, Science and Technology, 037 (1996), 13). The ATO measures small business by turnover, that is, \$10 million or less (see C Evans and A Ryan, *Tax Reform Issues for Small Business* (1999), 1-62; available at: <http://www.cpaonline.com.au>).

⁸³ B Tran-Nam, C Evans and M Walpole, ‘Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia’ (2002) 53(2) *National Tax Journal* 229-252.

⁸⁴ Rametse and Pope, above n 2.

⁸⁵ *Ibid.*

⁸⁶ Tran-Nam and Glover, above n 7.

⁸⁷ RIS, above n 28.

⁸⁸ Pillai, above n 18.

⁸⁹ Gunz, Macnaughton and Wensley (1995), above n 19.

⁹⁰ National Audit Office, above n 36.

unless careful analysis is applied, various parties may question the reliability as well as the credibility of the research in question.

Appendix 1

TABLE 1

MAJOR STUDIES ON BUSINESS START-UP COMPLIANCE COSTS, 1977-2000: Part 1

Country	Researcher	Regulation Researched	Research Method/Sample size/ Business Researched	Key Findings
Canada	Canadian Federation of Independent Business ¹	Canadian start-up compliance costs of the GST.	Survey of 25,362 small businesses.	Start-up costs represented 45 percent of recurrent costs.
Canada	Gunz, Macnaughton and Wensley ²	Start-up compliance costs of Canadian Research and Development tax incentives.	Survey of 51 companies.	Start-up costs represented 84 percent of recurrent costs.
Mauritius	Pillai ³	Start-up compliance costs of the GST in the Mauritius hotel industry.	Survey of 82 small and large hotels.	Start-up costs represented 223 percent of recurrent compliance costs.
Australia	Clare and Connor ⁴	The Costs of the Superannuation Surcharge Tax (SST).	Survey methodology and estimation analysis not reviewed.	Regressivity of start-up costs of SST.
Britain	National Audit Office ⁵	Large business start-up costs for the GST component of the impact of the Single European Market.	Visits to Customs and Excise headquarters and 14 local offices.	Start-up costs were estimated at 72 percent of recurrent costs.

¹ CFIB, above n 16.

² Gunz, Macnaughton and Wensley (1995), above n 19.

³ Pillai, above n 18.

⁴ Clare and Connor, above n 17.

⁵ National Audit Office, *HM Customs and Excise: Cost to Business of Complying with VAT Requirements* (1994).

Country	Researcher	Regulation Researched	Research Method/Sample size/ Business Researched	Key Findings
USA	Murphy ⁶	Start-up compliance costs of the Equal Credit Opportunity Act.	Survey of 37 large commercial banks.	Economies of scale in legal and other compliance costs.
USA	Boyle ⁷	Start-up compliance costs of the Revised Truth Lending Act.	201 mortgage banks.	Start-up costs were 45 percent of the revised Act.
USA	Schroeder ⁸	Start-up compliance costs of implementing the Electronic Fund Transfer Act.	Used data from the Federal Reserve survey of 67 commercial banks.	18 percent of start-up costs were on management costs.
USA	Elliehausen and Lowery ⁹	Start-up compliance costs of the Truth in Savings Act.	Survey of 4,000 savings institutions.	Reported economies of scale of start-up compliance costs.
USA	Smith ¹⁰	Creditors' aggregate start-up compliance costs of the Equal Credit Opportunity Act.	Synthesis of evidence from several sources.	Aggregate start-up costs of around \$US132 million.
USA	Elliehausen and Lowery ¹¹ (2000)	The effect of the required changes on start-up compliance costs.	Not reviewed.	Start-up costs for the Truth in Savings were insensitive to the extent of changes required to implement the regulation.

⁶ NB Murphy, 'Economies of Scale in the Cost of Compliance with Consumer Credit Protection Laws: The Case of the Implementation of the Equal Credit Opportunity Act of 1974' (1980) 10 *Journal of Bank Research*, (Winter), 248-50, available at: <http://www.federalreserve.gov>.

⁷ JM Boyle, 'A Survey of the Mortgage Banking Industry Concerning Costs and Benefits of Regulation' (Report prepared for the Federal Trade Commission, 1982).

⁸ FJ Schroeder, 'Compliance Costs and Consumer Benefits of the Electronic Funds Transfer Act: Recent Survey Evidence' (Board of Governors of the Federal Reserve System Staff Studies 143, 1985); available at <http://www.federalreserve.gov>.

⁹ Elliehausen and Lowery, above n 15.

¹⁰ FJ Smith, 'The Equal Credit Opportunity Act of 1974: A Cost/Benefit Analysis' (1977) 32(5) *Journal of Finance* 609-22.

¹¹ G Elliehausen and BR Lowery, 'The Cost of Implementing Regulatory Changes: The Truth in Savings Act' (2000) 17(2) *Journal of Financial Services Research* 165-179.

TABLE 3:

SUMMARY OF SMALL BUSINESS GST START-UP COMPLIANCE COST ESTIMATES FROM MAJOR STUDIES, 1999-2001¹

	Ernst & Young ²	AC Nielsen ³	Pope et al ⁴	VECCI ⁵	VECCI ⁶ 2 000	RSM Bird Cameron ⁷	EDC, Victorian Parliament ⁸	Victoria University of Technology ⁹	Patterson ¹⁰	NARGA ¹¹ 2001
Average start-up costs (\$)	17,016	2,618	3,500	3,500	6,814	5,000-20,000	6,000	12,380*	5,587	18,622
Average time spent (hours)	64	64	n/a	80	142	100-300	n/a	included above**	n/a	n/a
Number of respondents	4	602	129	328	70	170	-	6	264	285

Notes: * Time period was from early June to mid November 2000, that is, up to the lodgement of the first quarterly BAS (GST) return. Costs are \$6,012 excluding time costs.

** 170 hours, giving a cost of \$6,368 at an average opportunity cost of \$37.46 per hour (derived from the 'employer hourly rate'). Time costs thus account for 51% of the average start-up costs of \$12,380.

¹ Source: developed from J Pope and N Rametse 'Small Business and the Goods and Services Tax: Compliance Cost Issues', (2001) 9(2) *Small Enterprise Research* 42-54; and J Pope and N Rametse, 'Small Business Start-up Compliance Costs of the GST: Estimates and lessons' (Paper presented at the Fifth International Conference on Tax Administration, Sydney, April 2002).

² Ernst and Young, above n 56.

³ AC Nielsen, 'CPA Small Business Survey', (Survey Conducted by AC Nielsen for ASCP, August 1999).

⁴ J Pope, P Fernandez and A Hawke, 'GST and Small Business: A Preliminary Study' (Mimeo, Curtin Business School, Curtin University, 1999).

⁵ Victorian Employers' Chamber of Commerce and Industry (VECCI), 'Special Questions - GST Compliance Burden, Survey of Business Trends and Prospects, September Quarter Performance and December Quarter 1999', (1999) *Outlook* (No 20).

⁶ Victorian Employers' Chamber of Commerce and Industry (VECCI), *Impact of the GST on Victorian Business* (September 2000); as cited in Economic Development Committee, Parliament of Victoria (2000), above n 59, 186-196.

⁷ RSM Bird Cameron, above n 57.

⁸ Economic Development Committee, Parliament of Victoria (2000), above n 59.

⁹ Victoria University of Technology, above n 61.

¹⁰ Patterson, *Market Research Survey* (2001), cited in: *The West Australian*, 'GST hit hard: businesses', (Perth) 28 June, 2001.

¹¹ NARGA, above n 58.

N/A indicates either not estimated or not cited. Implicitly time costs would be included in the monetary estimate.

1 Number of respondents refers to small business respondents only, and excludes respondents in other categories in some surveys, with the exception of the VECCI 1999 survey where a breakdown was not given. Cost and time estimates refer to small business only (and are mutually exclusive unless stated).

2 The Economic Development Committee, Parliament of Victoria, estimate was based on a synthesis of evidence from other studies and submissions. A high reliance appears to have been placed on the VECCI2000 survey findings, albeit with a conservative estimate cited.

3 There may be other smaller and/or unpublished studies not known to the authors.

4 A few studies have focused on large business or have not distinguished between large and small business, for example, PricewaterhouseCoopers (2001), and these are not included in this table but are discussed below