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## FOREWORD

The articles included in this edition of the Journal of the Australasian Tax Teachers' Association (JATTA) are derived principally from papers presented at the 27<sup>th</sup> Annual Conference of the Australasian Tax Teachers' Association (ATTA) held between Monday 19<sup>th</sup> January and Wednesday 21<sup>st</sup> January 2015 at the University of Adelaide in Adelaide, South Australia.

The theme of the 27<sup>th</sup> ATTA Conference was *Tax: 'It's time' for change* and the presenters were invited to submit papers that explored the way in which it was now time for serious tax reform in Australia. While not all papers published in this edition reflect the conference theme, the published papers certainly reflect the depth and breadth of Australasian tax research.

Each of the published articles presents readers with interesting and challenging material. Some highlights of this JATTA journal edition are five tax technical papers discussing such issues as tax change in the context of the GST in Australia and a proposed Capital Gains Tax in New Zealand. There is also an article on the changing role of the OECD in current international tax law and another which summarises Australia's mining resource tax and plans for reform in this area, as well as a paper canvassing issues related to the taxation of sovereign wealth funds in Australia. Three papers raise issues affecting tax teaching, such as reviewing online feedback provided to students studying tax and business law; the importance and usefulness of first year law students reading at least one tax appellate case; and the benefits of team-based learning of tax law.

I would like personally to thank Dale Pinto, the editor-in-Chief and also Domenic Carbone, the principal conference organiser for their invaluable support and helpful advice throughout the process of publishing this journal. I would also like to thank personally each of the authors for entrusting their papers for review and editing. A special thankyou goes to the anonymous peer reviewers without whose individual dedication and help a journal like this cannot be published. Last but not least a very big thankyou goes to the wonderful Trischa Mann, whose input as a professional editor was invaluable in publishing this edition.

John Tretola  
Lecturer, University of Adelaide  
November 2015

## **ONLINE FEEDBACK TO STUDENTS STUDYING TAXATION AND BUSINESS LAW – HOW DOES IT RATE?**

FIONA MARTIN AND KAYLEEN MANWARING<sup>1</sup>

### **ABSTRACT**

It is widely accepted that students value timely and targeted feedback on their assessment tasks; however, this is also the area where they are most critical when it comes to their teaching and learning evaluations. These criticisms can be grouped into three categories: first, where feedback is not easily accessible to the student; second, where the feedback is not targeted to the particular problems the student has demonstrated; and finally, where the feedback is hard for the student to understand (this may be due to the marker's poor expression, the student's difficulty in understanding, or a combination of both). In 2006, Nicol and Macfarlane-Dick set out seven principles of good feedback practice in their research based on their experiences as part of the Centre for Academic Practice, University of Strathclyde, Scotland. Those principles are based on a synthesis of the literature on assessment and feedback and provide a good model on which to benchmark feedback practices.

This article explains the use of online assessment and feedback in the School of Taxation and Business Law at UNSW, Australia, when teaching taxation law and business law to undergraduate and postgraduate students. It analyses the use of these assessment and feedback tools using educational theory and survey feedback from students and academics. In 2014 and 2015, students at UNSW were surveyed and their responses are evaluated in the article. Academics at UNSW were also surveyed and their responses are analysed. The article concludes with an evaluation of the advantages and disadvantages of online assessment and feedback.

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## I INTRODUCTION

Consideration of assessment issues in the 21<sup>st</sup> century, in the context of higher education, demonstrates a range of influences. Accreditation of student learning remains a key function of higher education; however, around the world this is now occurring in an environment of reduced government funding for higher education, and Australia is no exception.<sup>1</sup> This is putting pressure on existing staff, both academic and administrative, who are reputed to be working harder, often for longer hours, but in environments where budgets are reduced.<sup>2</sup> Infrastructure developments, including technology implementation and updating, are also threatened by these budgetary constraints.<sup>3</sup> There is additional pressure on Australian universities to admit more students, as some government caps on student numbers have been reduced,<sup>4</sup> and there is an increasingly diverse student body.<sup>5</sup> This diversity results in learning and teaching pressures on academics, who are required to interact with students who have different levels of English language skills and a range of cultural backgrounds, and may also have different levels of ability.<sup>6</sup> The issue of ability is particularly problematic in courses where international student numbers have been increased in order to raise additional university funds. A 2013 report states that international students, who come from more than 180 countries, comprise 29 per cent of the total higher education student load in Australia, having increased to 320,000 from just over 18,000 in 1988.<sup>7</sup>

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- <sup>1</sup> See for example Organisation for Economic Cooperation and Development 'Education at a Glance 2014' 227, 240; Susan R Hermer, 'Finding Time for Quality Teaching: An Ethnographic Study of Academic Workloads in the Social Sciences and their Impact on Teaching Practices' (2014) 33(3) *Higher Education Research & Development* 483, 483–4; David Boud and Elizabeth Molloy, 'Rethinking Models of Feedback for Learning: The Challenge of Design' (2013) 38(6) *Assessment & Evaluation in Higher Education* 698, 699; Douglas Belkin, 'How to Get College Tuition under Control' 8 October 2013, *The Wall Street Journal*.
  - <sup>2</sup> Susan R Hermer, 'Finding Time for Quality Teaching: An Ethnographic Study of Academic Workloads in the Social Sciences and their Impact on Teaching Practices' (2014) 33(3) *Higher Education Research & Development* 483, 483–4; Robert Allan and Steve Bentley (2012) 'Feedback mechanisms: Efficient and effective use of technology or a waste of time and effort?' Paper presented at STEM Annual Conference, 12–13 April 2012, Imperial College, London; Tom Lunt and John Curran, 'Are you listening please? The Advantages of Electronic Audio Feedback compared to Written Feedback' (2010) 35(7) *Assessment & Evaluation in Higher Education* 759; Helen J Forgasz and Gilah C Leder, 'Academics: How do they spend their time?' Paper presented at the Joint AARE/NZARE Conference, Auckland, 2003.
  - <sup>3</sup> Lisa Ann Petrides (ed), *Case Studies on Information Technology in Higher Education: Implications for Policy and Practice* (Ideas Group Publishing, USA, 2000).
  - <sup>4</sup> Universities Australia, (2013) 'An Agenda for Australian Higher Education 2013–2016' 1; Emma Griffiths, ABC News, 'Coalition denies change in position over caps on university places', 25 September 2013 <http://www.abc.net.au/news/2013-09-25/pyne-education-university-fees-student-unions/4979282>.
  - <sup>5</sup> Universities Australia, (2013) 'An Agenda for Australian Higher Education 2013–2016' 26.
  - <sup>6</sup> Susan R Hermer, 'Finding Time for Quality Teaching: An Ethnographic Study of Academic Workloads in the Social Sciences and their Impact on Teaching Practices' (2014) 33(3) *Higher Education Research & Development* 483, 483.
  - <sup>7</sup> Universities Australia, 'An Agenda For Australian Higher Education 2013–2016', 26.

These challenges arise in an environment where universities and governments require increasing levels of accountability from academics and university managers.<sup>8</sup> The challenges are also occurring at a time of proliferation of technology in our society, workplace and the educational environment,<sup>9</sup> which gives rise to student expectations: students now come to university with knowledge of technology and expectations that the university environment will be technologically up to date.<sup>10</sup>

The role of universities in accrediting student learning means there is an increased focus on the importance and role of assessment of students.<sup>11</sup> The increase in student numbers and the diversity of their backgrounds has also resulted in a greater focus on every aspect of assessment. However, higher education institutions in Australia and the United Kingdom are being criticised more for inadequacies in the feedback they provide to students than for almost any other aspect of their teaching and courses.<sup>12</sup> Yet it is recognised that feedback is important for student learning,<sup>13</sup> with some researchers stating that it is 'the most important aspect of the assessment process in raising achievement'.<sup>14</sup> One study of 137 university students found that individual learning that included feedback had significant positive effects on students' learning.<sup>15</sup> It is also agreed that good quality feedback and assessment must be timely and transparent; suitable for dealing with ever-increasing student numbers; and able to cater for a range of student learning needs and capabilities.<sup>16</sup>

The factors outlined above put the drivers of electronic assessment and feedback into context. In addition, electronic submission of assignments has been seen by academics in

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- <sup>8</sup> Rosemary Deem, 'The Knowledge Worker, the Manager-Academic and the Contemporary UK University: New and Old Forms of Public Management?' (2004) 20(2) *Financial Accountability & Management* 107; Susan R Hermer, 'Finding Time for Quality Teaching: An Ethnographic Study of Academic Workloads in the Social Sciences and their Impact on Teaching Practices' (2014) 33(3) *Higher Education Research & Development* 483, 484.
- <sup>9</sup> L Johnson, S Adams Becker and C Hall (2015) '2015 NMC Technology Outlook for Australian Tertiary Education: A Horizon Project Regional Report' (Austin, Texas: The New Media Consortium).
- <sup>10</sup> Camille B Kandiko and Matt Mawer, 'Student Expectations and Perceptions of Higher Education' (2013) King's College Learning Institute, London, 31.
- <sup>11</sup> Tom Lunt and John Curran, 'Are you listening please? The Advantages of Electronic Audio Feedback compared to Written Feedback' (2010) 35(7) *Assessment & Evaluation in Higher Education* 759, 759; National Union of Students, United Kingdom, 'The Great NUS Feedback Amnesty' (2008) 11; Geoff Scott, 'Accessing the Student Voice' (2006) A Higher Education Innovation Program Project, Department of Education, Science and Training, Canberra, Australia.
- <sup>12</sup> David Boud and Elizabeth Molloy, 'Rethinking Models of Feedback for Learning: The Challenge of Design' (2013) 38(6) *Assessment & Evaluation in Higher Education* 698, 698; Geoff Scott, 'Accessing the Student Voice' (2006) A Higher Education Innovation Program Project, Department of Education, Science and Training, Canberra Australia; National Union of Students, United Kingdom, 'The Great NUS Feedback Amnesty' (2008) 11.
- <sup>13</sup> P Ferguson, 'Student Perceptions of Quality Feedback in Teacher Education' (2011) 36(1) *Assessment & Evaluation in Higher Education* 51; Ni Chang et al, 'Electronic Feedback or Handwritten Feedback: What do Undergraduate Students Prefer and Why?' (2012) 1(1) *Journal of Teaching and Learning with Technology* 1, 1.
- <sup>14</sup> S Bloxham and P Boyd, *Developing Effective Assessment in Higher Education* (Open University Press, 2007) 20.
- <sup>15</sup> Ulrike-Marie Krause and Robin Stark, 'Reflection in Example- and Problem-Based Learning: Effects of Reflection Prompts, Feedback and Cooperative Learning' (2010) 23(4) *Evaluation & Research in Education* 255, 267-8.
- <sup>16</sup> Paul Ramsden, 'Context and Strategy: Situational Influences on Learning' in R R Schmeck (ed) *Learning Strategies and Learning Styles* (Springer, New York, 1988) 159, 160-1.

the School of Taxation and Business Law (TBL) at the University of New South Wales (UNSW) to have a number of practical advantages. A significant number of taxation law courses are taught in flexible delivery mode to off-campus students, and electronic submission is a practical way of handling the lodgment of assignments by students who are studying at a distance from the university campus.<sup>17</sup> Other taxation law courses, and all of the business law courses, at TBL are taught in face-to-face mode.

Electronic lodgment is also an efficient method for the on-campus business students, as this form of assignment submission ensures they can lodge their work from wherever is convenient. It also means that assignment submission time and date are accurately recorded, and that the assessment item is securely stored on the university system. This information is important for the student, academic and university administrator. The process of electronic assignment submission has been available to TBL students for several years. However, the ability to return assignments electronically, with comments, has only recently become available in a cost-effective, secure and reliable manner. This feature has the practical advantages that students assignments are returned safely: they cannot be lost in the mail; they are actually returned to the student so that academics are not left with unclaimed assignments at the end of semester;<sup>18</sup> and they are returned to the correct student, with no possibility of a student incorrectly claiming another student's work.

Good assessment practices require academic integrity in the process, as the academic should be accountable for their feedback and for the grade awarded. Educational theory tells us that assessment tasks should be reliable, in that the same assessment tool should produce stable and consistent results. It should also be valid, in that it is an appropriate test of what it purports to measure.<sup>19</sup> Furthermore, academics need to accurately record grades for accountability and accrediting purposes. Electronic assessment has the advantage of recording the academic's input into the assessment process and the mark awarded.

A significant driver in the assessment environment at TBL was therefore the importance of an efficient and accurate grade recording system for staff, both academic and administrative, while at the same time maintaining high-quality feedback. Electronic feedback was viewed as having the potential to improve readability (as long as the academic can type accurately), and also the value and quality of feedback to students.

This article discusses the use of online assessment and feedback in TBL when teaching taxation and business law. Part II introduces the educational theory that supports the use of assessment and feedback as part of the learning process and highlights the seven principles of good assessment suggested by Nicol and Macfarlane-Dick.<sup>20</sup> Part III describes the major online assessment and feedback tools that are used to teach courses at TBL.

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<sup>17</sup> Susan Miiller and Linda Smith, 'Distance Learning in the Visual Arts' (2009) 5(3) *Journal of Online Learning and Teaching* 496.

<sup>18</sup> Christopher Winter and Vanessa L Dye, *An Investigation into the reasons why students do not collect marked assignments and accompanying feedback* (2004) CELT Learning and Teaching Project 133.

<sup>19</sup> Barbara L Moskal and Jon A Leydens, 'Scoring Rubric Development: Validity and Reliability' (2000) 7(10) *Practical Assessment, Research & Evaluation* <http://pareonline.net/getvn.asp?v=7&n=10>.

<sup>20</sup> David Nicol and Debra Macfarlane-Dick (2006). 'Formative assessment and self-regulated learning: A model and seven principles of good feedback practice', *Studies in Higher Education* 31(2): 199-218.



Part IV evaluates the use of two of those tools: electronic lodgment of assessment, and the provision of online feedback via the GradeMark function on Turnitin. This evaluation proceeds from a perspective of educational theory, although academic and student views are also canvassed. In order to do this, students and academics were surveyed, and Part IV also analyses the results of those surveys and the experiences of students and academics with the lodgment and marking of online assessment. Part V draws together the themes that have arisen from this evaluation and reaches conclusions regarding the effectiveness, and future, of online assessment.

## II THE ROLE OF ASSESSMENT IN LEARNING

When academics and educators think of assessment, they often think of a range of activities including testing, rating of performances, observation and feedback.<sup>21</sup> However, when they think more deeply about assessment, they may perceive that assessment is an ongoing process. It involves a lot of input by the academic including planning, discussion, consensus building, and reflection, measuring, analysing and improving.<sup>22</sup> These activities revolve around a learning objective and the data gathered from and about this objective. However, as part of the process of assessment, it is important to remember that not only is assessment about measuring and testing student learning, it is also one of the key ways that students learn.<sup>23</sup> As Paul Ramsden said, 'the methods we use to assess students are one of the most crucial of all influences on their learning'.<sup>24</sup>

Although there will always be the necessity to grade students in some way, so that their progress in a certain area of learning can be summarised and articulated to them, to the university and to external stakeholders, assessment is more than this summary of results. Assessment can be viewed as a way of teaching more effectively through helping the educator and the student to understand what the students know and what they don't know. Quality feedback on assessment items should work as a guiding light to promote student learning.<sup>25</sup> So assessment has two major functions. It is about reporting on students' achievements and also about teaching them more effectively through expressing to them more clearly the learning goals of the curricula with which they are engaged.<sup>26</sup> This latter aspect will in turn aid the student in improving the quality of their learning.

Assessment has several important functions or aspects. It impacts on the affective processes of increased effort and motivation of learners. It also influences students' cognitive processes of restructuring knowledge. A further significant role of assessment is that learners (particular those studying at a distance) require reassurance that they are

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<sup>21</sup> Donald Orlich, Robert Harder, Richard Callahan and Harry Gibson, *Teaching strategies: A guide to better instruction* (Houghton Mifflin, New York, 2004).

<sup>22</sup> K Martell and T Calderon, 'Assessment of student learning in business schools: What it is, where we are, and where we need to go next' in K Martell and T Calderon, *Assessment of Student learning in business schools: Best practices each step of the way* ( Association for Institutional Research, Tallahassee, Florida, 2005) 1.

<sup>23</sup> Ni Chang et al, 'Electronic Feedback or Handwritten Feedback: What do Undergraduate students prefer and why?' (2012) 1(1) *Journal of Teaching and Learning with Technology* 1, 1.

<sup>24</sup> Paul Ramsden, *Learning to Teach in Higher Education* (Routledge, 1992) 67.

<sup>25</sup> Ni Chang, 'Pre-Service Teachers' Views: How did e-Feedback through Assessment Facilitate their Learning?' (2011) 11(2) *Journal of the Scholarship of Teaching and Learning* 16.

<sup>26</sup> Paul Ramsden, *Learning to Teach in Higher Education* (Routledge, 1992) 182.

heading in the right direction, and assessment coupled with quality feedback provides this guidance. Finally, constructive feedback often results in improved student performance.<sup>27</sup>

According to Nicol and Macfarlane-Dick, formative assessment and feedback should be used to empower students to become self-regulated learners.<sup>28</sup> When they refer to formative assessment, these authors mean assessment that is specifically intended to generate feedback on performance to improve and accelerate learning.<sup>29</sup> Their reference to self-regulated learners points to the degree to which students can regulate aspects of their thinking, motivation and behaviour during learning.<sup>30</sup> The capacity to be self-regulated learners will, they argue, improve student learning. Nicol and Macfarlane-Dick consider that students generate internal feedback as they monitor their engagement with learning activities and tasks, and assess their progress towards their learning goals. They argue that students who are more effective at self-regulation generate better-quality internal feedback when they complete an assessment task, or are more able to use the feedback they generate to achieve their desired goals. Self-regulated learners also actively interpret external feedback that they receive from educators and other students in relation to their internal goals.<sup>31</sup>

The seven principles of good feedback practice (by educators to learners on their work) as determined by Nicol and Macfarlane-Dick are:

- helps clarify what good performance is (goals, criteria, expected standards);
- facilitates the development of self-assessment (reflection) in learning;
- delivers high quality information to students about their learning;
- encourages educator and peer dialogue around learning;
- encourages positive motivational beliefs and self-esteem;
- provides opportunities to close the gap between current and desired performance; and
- provides information to educators that can be used to help shape the teaching.<sup>32</sup>

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<sup>27</sup> John Hattie and Helen Timperley, 'The Power of Feedback' (2007) 77 *Review of Educational Research* 81; J Veloski, J R Boex, M J Grasberger, A Evans and D B Wolfson, 'Systematic Review of the Literature on Assessment, Feedback and Physicians' Clinical Performance: BEME Guide No 7' (2006) 28 *Medical Teacher* 117.

<sup>28</sup> David J Nicol and Debra Macfarlane-Dick, 'Formative Assessment and Self-regulated learning: A model and Seven Principles of Good Feedback Practice' (2006) 31 *Studies in Higher Education* 199, 199.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid 200.

<sup>32</sup> Ibid.

### **III THE ONLINE TEACHING, ASSESSMENT AND FEEDBACK TOOLS USED TO TEACH TAXATION AND BUSINESS LAW COURSES AT UNSW**

Academics who teach TBL courses at UNSW predominantly use the Moodle software learning platform. Their students are generally undertaking a Bachelor of Commerce degree; however, some are doing a law degree and others are taking the Masters of Professional Accounting or Masters of Business Law (although enrolments from this latter course are very low). The Moodle platform allows academics to use a variety of online teaching and assessment practices. This article will confine itself to a discussion of the four major learning practices that the authors have engaged with over the last two years as full-time academics within TBL.

#### ***A. Moodle Online Webpage for Each Course***

First, every course has a Moodle website that provides a shell for the input of materials and information such as course notes and outlines, PowerPoint teaching slides, links to relevant WebPages, the webinar functions, quizzes and discussion forums and contact details for the academics involved in the course. This site provides the students with all the administrative information they need to complete the course.

The course webpage also provides all details of each assessment task, including the assessment question or problem and due date, the assessment criteria, and the link to the course objectives of each aspect of the assessment. Complete assessment details are provided at the beginning of each semester. This early advice and clear description of each assessment task, and the criteria for each task, helps learners clarify what good performance is. In addition, many academics post on the website examples of good work either prepared by them or from a good past student submission. For example, in several postgraduate courses where a research plan and lengthy research paper are the main forms of assessment, a prepared example of one research plan and paper (in a different course), and a good student example taken (with the student's permission) from another course, are uploaded to provide exemplars to students.

Down the left-hand side of the screen are function keys that open into the different spaces and enable students to access learning materials, their grades, the webinar forums and assignment lodgement. Each course has certain standard documentation icons, such as links to UNSW plagiarism information and notes on research and writing, together with links to webinars and discussion forums if the academic chooses to use these capabilities.

#### ***B. Webinars***

Because many of the taxation law courses are taught in flexible delivery mode (as opposed to face-to-face delivery), the academics use the webinar function enabled through the Blackboard Collaborate software platform in order to engage with students. Commencing in 2013, the standard postgraduate taxation law course offers six webinars timetabled at regular intervals throughout each semester. Each webinar is of one and a half hours duration. The webinar function enables the academic to upload PowerPoint slides or other materials so students can see this information while the educator speaks. Students can interact with the academic and other students verbally, by using the microphone, by typing into the chat box which appears on the screen, or by using the icon keys such as

smiley faces, green or red hands, and so on. Even though students are not in a face-to-face environment, they are still able to interact with the educator and with each other. They can all hear the academic and any student who speaks, and also see what each student types into the chat box. In this way, they interact dynamically with the other students, replying via the chat box even while the academic or another student is speaking. The comments in the chat box can also be downloaded and printed, thus enabling the educator to revise the students' learning during the class, and answer any questions after the class. Students log in into the webinar, and therefore a record of their attendance is maintained. This can assist the academic to follow student progress (or lack thereof), and enables the academic to answer student questions individually and privately where appropriate.

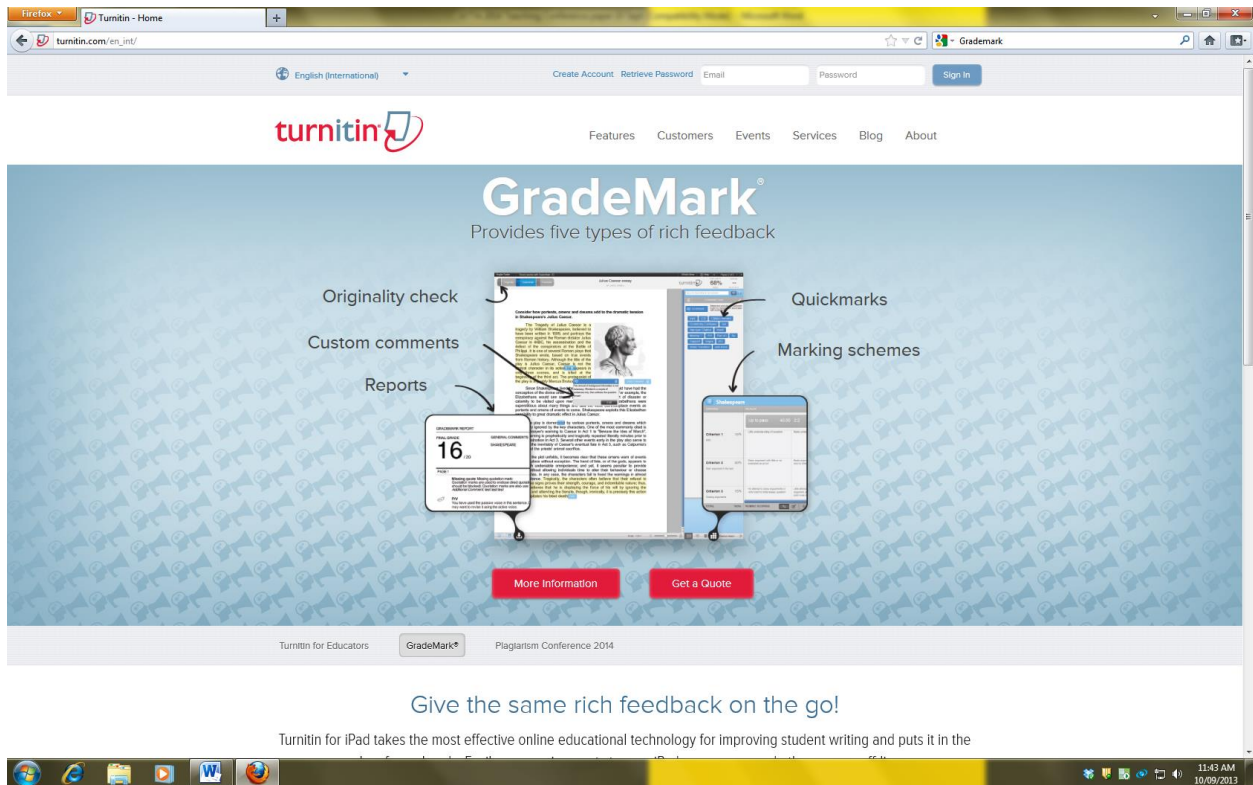
### ***C. Electronic Lodgement of Assignments Through Turnitin***

The third form of electronic learning and teaching is that all students (those on campus and those studying by flexible delivery) are required to lodge their written assignments via the Turnitin function of the Moodle site. They are able to reload their assignment into the Turnitin platform as many times as they wish prior to the due date of the assignment. Each time the assignment is lodged, the student can see an 'originality report' which advises them of the similarity between their assignment and other web based materials. The aim of Turnitin plagiarism detection is to promote student understanding of how to write without unintentional plagiarism. The ability of students to submit and resubmit to Turnitin encourages revising and rewriting which assists students to learn academic writing and generally produces better written assignments. The plagiarism function is also important because norms of referencing vary internationally, so it assists students to understand the Australian university standards.

### ***D. 'GradeMark' via Turnitin***

The fourth online tool evaluated here is 'GradeMark', the online feedback component of the Turnitin software package. Once a student's assignment has been electronically lodged, the academic can open it in GradeMark. The academic views the Turnitin originality report and can also see the percentage of similarity between the assignment and any other internet material. The academic can assess whether the similarities are merely due to appropriate quoting and referencing or whether there is a plagiarism issue. Once this is checked, the academic can undertake marking of the assignment online.

The GradeMark function allows for comments to be typed onto the screen which appear to the student as a speech bubble that opens up into the typed comments. These comments can be accurately placed on the assignment at relevant points. Comments can be customised to suit the individual student or issue, or saved as general comments (Quickmarks) so that they can be used repeatedly. The Quickmark function in GradeMark enables the academic to save commonly used comments and quotations so that marking is quicker and more efficient, and most importantly, of better quality. There is also the ability to incorporate marking schemes or rubrics. Figure 1 shows the GradeMark webpage which outlines its functions.



**Figure 1: Screenshot of GradeMark webpage**

GradeMark is also available for use on iPads, thus enabling academics to mark at whatever location they find most convenient.

#### **IV AN EVALUATION OF THE ONLINE TEACHING AND ASSESSMENT TOOLS THROUGH THE LENS OF THE SEVEN PRINCIPLES OF GOOD FEEDBACK PRACTICE**

Each of the four online teaching and assessment tools used at TBL will be evaluated using the seven principles suggested by Nicol and Macfarlane-Dick.

##### ***A. Clarification of Good Performance***

Good performance in an assessment task is usually easy to identify; however, it is not always easy to define. The educational literature provides a number of suggestions for making good performance clear to students prior to their engagement with the assessment task in order, hopefully, to improve the assessment outcome. The suggestions include use of assessment rubrics,<sup>33</sup> clear criteria, and providing examples of good performance.<sup>34</sup> But once the assessment task has been completed, it is important for students to understand how they might have fallen short of the ultimate goal of good performance. Comments such as 'poor effort' and 'could do better' are examples of unclear

<sup>33</sup> Nicole A Buzzetto-More and Ayodele Julius Alade, best Practices in Assessment' (2006) 5 *Journal of Information Technology Education* 251, 262-3.

<sup>34</sup> Mark Huxham, 'Fast and effective feedback: Are model answers the answer?' (2007) 32(6) *Assessment and Evaluation in Higher Education* 602.



feedback that do not offer anything substantive and do not assist students in understanding where they went wrong.<sup>35</sup> Vague feedback can lead to students having no true understanding of their limitations and how they can improve. This can result in the student being unable to apply their learning to their next assessment task.<sup>36</sup> Another frequent complaint is that 'handwritten feedback is illegible, rendering it almost useless'.<sup>37</sup>

A study of 664 undergraduate education students at an American university situated in the Midwest concluded that students prefer feedback sent to them electronically because this was easy for them to access,<sup>38</sup> since many of them have mobile phones, laptop computers and other mobile devices. Electronic feedback was faster than handwritten feedback returned to them in a face-to-face class, and typed feedback was more readable than most handwritten comments.<sup>39</sup>

There is some evidence that even where the majority of students are able to read and understand an instructor's handwritten comment, the online comments will be more legible. In a 2014 survey of 25 students who were undertaking a course in effective writing in the United States, 58 per cent stated that they found the instructor's handwritten comments legible.<sup>40</sup> For the same cohort, when the educator changed from handwritten to online comment via GradeMark later in the semester, the response was that 92 per cent found the comments legible.<sup>41</sup> Sixty three per cent of the cohort also responded that they preferred the online comments to the handwritten.<sup>42</sup>

GradeMark has the capacity to provide students with relevant information that should improve their performance. Marking schemes or rubrics are easily incorporated into the GradeMark system. Of additional importance is that detailed and sophisticated comments can be provided through the use of Quickmarks and that these and individual comments are, unlike handwriting, always legible. As one student commented on the use of GradeMark 'Quick ... constructive ... you actually had helpful comments and I could actually read them'.<sup>43</sup>

### ***B. Facilitates the Development of Self-assessment (Reflection) in Learning***

In 2005, Martell and Calderon highlighted the point that effective assessment involves a process. This process includes not only the assessment task but also identifying improvement opportunities and reflecting and making changes.<sup>44</sup> The assessment

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<sup>35</sup> National Union of Students, United Kingdom, 'The Great NUS Feedback Amnesty' (2008) 11.

<sup>36</sup> Mark Huxham, 'Fast and effective feedback: Are model answers the answer?' (2007) 32(6) *Assessment and Evaluation in Higher Education* 602.

<sup>37</sup> National Union of Students, United Kingdom, 'The Great NUS Feedback Amnesty' (2008) 11.

<sup>38</sup> Ni Chang et al, 'Electronic Feedback or Handwritten Feedback: What do Undergraduate students prefer and why?' (2012) 1(1) *Journal of Teaching and Learning with Technology* 1, 20.

<sup>39</sup> Ibid.

<sup>40</sup> Elizabeth Connell, 'Is the pen mightier than the pixel?' Webinar, Turnitin, 9 October 2014.

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> Student comments 'Principles of Australian Taxation Law' Webinar semester 1, 2013.

<sup>44</sup> K Martell and T Calderon, 'Assessment of student learning in business schools: What it is, where we are, and where we need to go next' in K Martell and T Calderon *Assessment of Student learning in*

process is often represented as a continuous cyclical process – or rather, a loop. ‘Closing the loop’, a phrase that is regularly used, has been defined by Martell and Calderon as an ongoing process that uses assessment data to improve student outcomes.<sup>45</sup> This data is not just for the academics and university administrators. The reflection process as part of the cycle of assessment can enhance student learning and lead to better assessment outcomes in the future. Students consider ‘that feedback needs to be an integral part of the learning experience not just a one-off exercise that assesses the student’.<sup>46</sup> Research indicates that students are generally interested in receiving feedback in order to improve their learning.<sup>47</sup> Through quality feedback, students are encouraged to reflect and develop in order to improve their academic achievements.<sup>48</sup> (However, other research demonstrates that students can be careless about feedback and do not always collect or properly read the feedback provided.)<sup>49</sup>

Electronic feedback may encourage student reflection in a number of ways. The most obvious is the use of the originality check in GradeMark. Students are able to lodge draft assignments as many times as they wish prior to the submission date and time. When they do this, they see a detailed originality report. This identifies any similarities between their own work and other sources that are available electronically. The sources include everything that is available on the university site, the World Wide Web and also the student’s own work or the work of other students. Students are thus afforded the opportunity to ensure that sources are properly referenced and quotes are identified. They are also encouraged to go back, revise their paper and resubmit in cases where there is a significant degree of overlap with other work. If students take advantage of this capability, then they are engaging in one form of self-assessment and making changes for the better. They are also reflecting on and revising the drafts of their assignments. Preparing, revising and resubmitting drafts are important ways of improving academic writing.<sup>50</sup> Furthermore, there is some research to suggest that students may also welcome the introduction of a way to reduce plagiarism via Turnitin.<sup>51</sup>

The use of structured assignments as part of electronic lodgement and feedback is another way to encourage reflection. It is common in the authors’ school to require postgraduate students to lodge a plan of their research paper prior to the final paper. Customised comments and Quickmarks available on GradeMark ensure that marking this assessment item is fast and the feedback informative and legible. Students are then in a position to reflect on timely and helpful feedback and incorporate it into their final paper. The

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*business schools: Best practices each step of the way* (2005, Association for Institutional Research, Tallahassee, Florida) 1.

<sup>45</sup> Ibid.

<sup>46</sup> National Union of Students, United Kingdom, ‘The Great NUS Feedback Amnesty’ (2008) 13.

<sup>47</sup> Ni Chang et al, ‘Electronic Feedback or Handwritten Feedback: What do Undergraduate students prefer and why?’ (2012) 1(1) *Journal of Teaching and Learning with Technology* 1, 13.

<sup>48</sup> National Union of Students, United Kingdom, ‘The Great NUS Feedback Amnesty’ (2008) 13.

<sup>49</sup> Christopher Winter and Vanessa L Dye, *An Investigation into the reasons why students do not collect marked assignments and accompanying feedback* (2004) CELT Learning and Teaching Project 133.

<sup>50</sup> Christina Hendricks, ‘Seven principles of effective feedback practice’ You’re the Teacher Blog, 31 October 2012 at <http://blogs.ubc.ca/chendricks/2012/10/31/>; David J Nicol and Debra Macfarlane-Dick, ‘Formative assessment and self-regulated learning: a model and seven principles of good feedback practice’ (2006) 31(2) *Studies in Higher Education* 199, 213.

<sup>51</sup> Stephen Dahl, ‘Turnitin: The Student Perspective on using Plagiarism Detection Software’ (2007) 8(2) *Active Learning in Higher Education* 173, 186.

academic can also see the research plan and their specific comments and compare them to the final research paper to ensure that feedback has been incorporated into the final research paper. This was not possible where comments were made on paper copies that were returned to the student, as, due to limited resources, it was not possible to photocopy these hard copies.

### ***C. Delivers High Quality Information to Students About Their Learning***

Good quality external feedback is information that helps students to identify problems in their own performance, and self-correct.<sup>52</sup> Lunsford argues that feedback that is effective in this way shows how the reader perceived the argument rather than providing a judgement.<sup>53</sup> Rowntree's 1987 seminal text about assessment claims that feedback 'is the life-blood of learning'.<sup>54</sup> The importance of assessment and quality feedback continues to dominate the thinking behind the design of appropriate and effective solutions to measure and support learning.<sup>55</sup>

As stated earlier, customised comments and Quickmarks available on GradeMark enable the educator to provide clear and detailed information to students about their assessment performance. The educator can draft and place comments in a way that is considered most appropriate and helpful. Quickmarks allow the academic to develop a bank of standard responses to recurring problems eg lack of appropriate headings, omission of an abstract or bibliography when required, incorrect citation of sources and problems with grammar. Other comments can be customised to be relevant and personal to a particular student or a particular issue. Comments can be specifically placed to focus attention on particular errors or issues.<sup>56</sup> Typed comments are ideal for highlighting specific errors.<sup>57</sup> As one student commented 'it was good you could put comments in the spot it related to'.<sup>58</sup> This can also benefit the academic. A colleague recently pointed out 'thanks for singing the praises of electronic marking – have just started and it is so much easier. Not just logistically, but conceptually – by now, my brain is more wired to think better when I type.'<sup>59</sup> Research by other academics also supports this view. One commentator stated

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<sup>52</sup> David J Nicol and Debra Macfarlane-Dick, 'Formative Assessment and Self-regulated learning: A model and Seven Principles of Good Feedback Practice' (2006) 31 *Studies in Higher Education* 199, 208.

<sup>53</sup> R Lunsford, 'When less is more: principles for responding in the disciplines' in M Sorcinelli and P Elbow (eds) *Writing to learn: Strategies for assigning and responding to writing across the disciplines* (Jossey-Bass, San Francisco, CA, 1997).

<sup>54</sup> Derek Rowntree, *Assessing students: How shall we know them?* (Taylor & Francis, 1987) 24.

<sup>55</sup> R Higgins, 'Be more critical! Rethinking assessment feedback' (Paper presented at the BERA conference, Cardiff University, 7–10 September 2000); P Black and D Wiliam, 'In praise of educational research: Formative assessment' (2003) 29 *British Educational Research Journal* 623; C Rust, M Price and B O'Donovan, 'Improving students' learning by developing their understanding of assessment criteria and processes' (2003) 28(2) *Assessment and Evaluation in Higher Education* 147.

<sup>56</sup> Robert Allan and Steve Bentley (2012) 'Feedback mechanisms: efficient and effective use of technology or a waste of time and effort?' Paper presented at STEM Annual Conference 2012, 12–13 April 2012, Imperial College, London.

<sup>57</sup> Ibid.

<sup>58</sup> Student comments 'Principles of Australian Taxation Law' Webinar semester 1, 2013.

<sup>59</sup> Email from [name withheld] dated 6 September 2013.



that, as she could type faster than she could write, she actually provided more detailed feedback through GradeMark.<sup>60</sup>

#### ***D. Encourages Educator and Peer Dialogue Around Learning***

Feedback is often given at the end of an assessment task simply to record a student's achievement. This approach doesn't always provide developmental advice that will allow a student to progress.<sup>61</sup> Dialogue about learning can be encouraged through educator and student interactions, both face-to-face and electronically. In the electronic environment webinars can be used effectively to encourage engagement with the assessment task while it is underway, and to discuss the quality of student performance at a general level. Webinars are not limited to the delivery of teaching materials and discussion can be facilitated through the chat room function, where students type in their comments and everyone can see them. This also facilitates conversations between students. Furthermore, general comments and feedback on assessment tasks can be posted by the academic on the Moodle site.

The Moodle site also enables educator–student dialogue through email and discussion forums. The authors regularly use the Moodle email and notification systems to, for example, remind students of the upcoming webinars, notify them of recently posted materials on the Moodle site, and make comments about assessment tasks.

To discuss their assessment tasks and feedback, students email, telephone or see the academic in their office. When online marking is used, the academic and the student can view the assessment task and comments simultaneously, and both know they are talking about the same issue and the same comment. They can both see these on the screen and engage in a meaningful discussion about the issues raised by the feedback. By contrast, where papers are marked in hardcopy, this is handed back to the student and copies are not kept at TBL.

#### ***E. Encourages Positive Motivational Beliefs and Self-esteem***

Criticism, when poorly expressed or delivered, can damage students' self-confidence and lead to a lack of motivation.<sup>62</sup> An important benefit of online feedback is that it can be viewed by the student wherever and whenever they choose. This provides them with privacy, avoiding comparisons and negative comments from other students, which can also damage self-esteem. In addition, customised feedback comments can be crafted so that they send the appropriate message, mixing criticism with encouragement by the educator. Quickmark comments can be designed by academics to encourage students in a way that is appropriate for the discipline and student cohort. The Quickmark function means the academic has time to draft and revise the comments to ensure they are helpful and expressed tactfully.

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<sup>60</sup> Elizabeth Connell, 'Is the pen mightier than the pixel?' Webinar, Turnitin, 9 October 2014.

<sup>61</sup> National Union of Students, United Kingdom, 'The Great NUS Feedback Amnesty' (2008) 13.

<sup>62</sup> Christopher Winter and Vanessa L Dye, *An Investigation into the reasons why students do not collect marked assignments and accompanying feedback* (2004) CELT Learning and Teaching Project 133, 137.

***F. Provides Opportunities to Close the Gap Between Current and Desired Performance***

Online technologies such as those described in this paper can be used to provide students with the opportunity to close the gap between their performance in the assessment task and their goal, just as traditional assessment can. These technologies however also have the additional benefits described earlier in this article such as timely, legible and targeted feedback which enables students to reflect on their performance and improve for the next assessment task.

The capacity of academics to use online technology to provide feedback in a timely manner ensures that students have the opportunity to quickly rectify their drawbacks and omissions and apply their new knowledge to the next task, while the feedback is still at the forefront of their minds. The ability to access this feedback wherever the students are located also means they are not waiting for the next class to obtain important information.

External feedback should, however, support two processes. It should help students to recognise the next steps in learning and also how to take them.<sup>63</sup> The electronic submission of research plans described earlier is one way of providing feedback on work-in-progress, thus encouraging students to plan various strategies that they might use to improve their final research paper. Furthermore, if students use the originality report offered through GradeMark, it will provide them with feedback on their level of originality, and correct use of references, prior to submission.

An additional enhancement of the learning process is the improvement of communication between the instructor and the student when they are in different locations. The instructor and student can both view the same assignment and the same feedback, even though they are communicating via the telephone or email. They can discuss the comments knowing they are both talking about the same material, and in this way have a meaningful dialogue about the assessment task.

***G. Provides Information to Educators That Can Be Used to Help Shape the Teaching***

Feedback is not only about providing relevant information to students, it is also about improving the quality of teaching. As one researcher points out, '[t]he act of assessing has an effect on the assessor as well as the student. Assessors learn about the extent to which they [students] have developed expertise and can tailor their teaching accordingly.'<sup>64</sup>

A range of reports can be generated by online technologies that enable academics to track student activities and performance. The originality check discussed earlier clearly shows the academic which sources have been commonly used by students, and how they have been used. This is important when setting research papers and other high-level essay assignments, as it helps the academic to identify important references that students are

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<sup>63</sup> David J Nicol and Debra Macfarlane-Dick, 'Formative Assessment and Self-regulated learning: A model and Seven Principles of Good Feedback Practice' (2006) 31 *Studies in Higher Education* 199, 213.

<sup>64</sup> Mantz Yorke, 'Formative assessment in higher education: moves towards theory and the enhancement of pedagogic practice' (2003) 45(4) *Higher Education* 477, 482.

accessing and also highlight whether students are overlooking other important reference materials.

For assessments that require submission of a research plan and subsequent research paper, since the website keeps a copy of the student's earlier work with annotations, the academic can assess whether the student has incorporated the feedback into their final paper.

The Moodle site can generate reports that identify not only the students who actually participate in webinars, but also those students who download and play the webinars subsequently. In this way, the academic can track which students, and how many, are engaged in the classroom activities. This can ultimately be compared to student performance to enable review of teaching and assessment activities to ensure that they are meeting the students' educational needs. Other reports can be generated that track how many (and how often) students access other material on the site, such as notes and reference materials. This assists academics in managing their uploading of materials, by indicating which materials are perceived as most worthwhile by the students.

An additional benefit is that where there are multiple markers, the academic in charge can access the Moodle site and determine how advanced the markers are in the marking process, and also assess the comments and marks that they have awarded. This enables moderation across markers to take place more easily.

### ***H. Student Surveys***

In 2014 and 2015, students in several TBL courses at UNSW were surveyed about the use of online marking of their assignments.

In total, four courses were surveyed. The students were in TABL5541 Corporations and Business Associations Law, taught in semester 2, 2014; TABL2751 Business Taxation taught over summer semester 2014–2015; and LAWS3751 Business Taxation and TABL5541 Corporations and Business Associations Law, both taught in semester 1, 2015. TABL2751 and LAWS3751 are both undergraduate courses, and TABL5541 is taught at postgraduate level. The latter course is targeted at students who already have a degree, but one that is not accountancy. It is designed to enable students to qualify for admission to the accounting profession. The surveys were administered to the students by a third party who is not part of the research team. They were administered face to face, either in lectures or consultation groups, and students were given the choice of whether or not to complete the surveys. All survey responses are anonymous and the total number of student responses is 182.

A large majority of students (72 per cent) either strongly agreed or moderately agreed that receiving online feedback was better than marking on paper.<sup>65</sup> Students agreed that it was easy to lodge their assignments electronically and that they preferred to lodge them

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<sup>65</sup> Question 10. Here 71 students answered 'strongly agree' and 60 answered 'moderately agree', while 35 students were neutral.

this way (84 per cent and 75.8 per cent respectively).<sup>66</sup> Seventy per cent either moderately agreed or strongly agreed that the markers' comments via online marking were easier to read than with paper marking,<sup>67</sup> and 71 per cent reported that feedback via the online system was available more quickly than feedback on paper submissions usually is.<sup>68</sup>

In response to one of the questions about how they used the online feedback, 62 per cent agreed that the makers' online comments were more helpful to assist them in understanding where they had gone wrong than comments on paper submissions for similar assignments,<sup>69</sup> with 23 per cent of students neutral on this issue.<sup>70</sup>

Other research into students' perceptions of electronic feedback has been undertaken in the last few years by Turnitin. In 2013, Turnitin embarked on a series of student surveys in order to better understand how students value and use feedback, and the type and timing of feedback that they prefer. The first online survey was launched on 4 March 2013 and a total of 1,000 students responded over three weeks.<sup>71</sup> The question design was a combination of multiple choice and scaled-response items. There was also a free response question at the end. The majority of respondents were students in graduate programs (47 per cent) followed by 36 per cent in Bachelors programs, 9 per cent in associates programs and 8 per cent in high schools.<sup>72</sup> In total, 80.2 per cent of students reported submitting assignments electronically.<sup>73</sup> Of these, 69 per cent typically submitted online, and the balance was by email. However, only 65.5 per cent of respondents advised that they typically received electronic feedback. So this survey indicated a gap of close to 15 per cent, where students are submitting electronically but receiving handwritten feedback.<sup>74</sup>

The most disturbing aspect of the survey results was, however, that 17.8 per cent of respondents advised that they typically waited 17 or more days to receive feedback on their assignments. A further 10.8 per cent stated that the time between assignment lodgement and feedback was between 13 and 16 days.<sup>75</sup> The additional comments by students largely focussed on this issue and how detrimental delays in feedback were to their learning. One student stated, 'I often receive feedback too late to incorporate it into the next assignment. This makes the feedback pretty much useless'.<sup>76</sup>

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<sup>66</sup> Questions 1 and 2 of the survey respectively. Regarding Q 1, 107 students 'strongly agreed' and 46 'moderately agreed'. Regarding Q2, 116 'strongly agreed' and 22 'moderately agreed', while 24 students were neutral in their response to Q 2.

<sup>67</sup> Question 7. Here 70 students 'strongly agreed' and 56 students 'moderately agreed', with 37 neutral and 2 stating that the question was not applicable as they did not access their comments.

<sup>68</sup> Question 6. Here 91 students strongly agreed, 37 moderately agreed and 30 students were neutral. Two students stated that the question was not applicable as they did not access their comments.

<sup>69</sup> Question 8. Here 54 students responded 'strongly agree' and 58 responded 'moderately agree'.

<sup>70</sup> That is, 42 student responses from a total of 180, as two students stated that the question was not applicable as they did not access their comments.

<sup>71</sup> Turnitin White Paper, 'Closing the Gap: What Students Say About Instructor Feedback' 2013, available at [http://turnitin.com/en\\_us/resources/white-papers](http://turnitin.com/en_us/resources/white-papers).

<sup>72</sup> Ibid 4.

<sup>73</sup> Ibid 5.

<sup>74</sup> Ibid 8.

<sup>75</sup> Ibid 10.

<sup>76</sup> Ibid 11.

In September 2014, Turnitin conducted another survey of over 2,000 students to investigate their perceptions on educator feedback.<sup>77</sup> The survey's purpose was to identify what students generally think about the feedback they receive on their assignments.<sup>78</sup> The respondents to this survey were even more skewed towards graduate programs, with 59 per cent being postgraduate, 38 per cent in Bachelor degrees, and only 3 per cent were high school students.<sup>79</sup> A significant percentage of students reported having received feedback via written comments on paper, very and extremely often (55.6 per cent). A similar percentage reported receiving typed comments electronically, with 25.52 per cent advising that they received this type of feedback very often and 33.63 per cent advising that they received this type of feedback extremely often.<sup>80</sup>

In answer to the question 'How effective has the feedback been in the following formats?', there was a clear split in responses between written comments on paper, 68.9 per cent stating that this feedback was 'very effective' or 'extremely effective' and 69.7 per cent saying the same about typed comments electronically.<sup>81</sup> Face-to-face feedback was considered the most effective (77 per cent) but this was not a form of feedback that was often received (30 per cent).<sup>82</sup>

The survey found that a high proportion of students reported receiving general comments 'very' or 'extremely often' (68 per cent). The majority of these students also advised that this type of feedback was 'very' or 'extremely effective' (67 per cent).<sup>83</sup> When examining the content of feedback, the most positive response was in respect of 'suggestions for improvement' while the least favourite form was 'praise or discouragement'.<sup>84</sup>

### ***I. Survey of Academics***

In late 2014, the UNSW Learning and Teaching Unit issued a survey to academics regarding the use of various assessment tools including Turnitin GradeMark.<sup>85</sup> The project was titled 'Using Technology for Assessment: a university-wide census'. Academics were advised that UNSW was exploring what assessment and feedback technologies it should be implementing over the next few years.<sup>86</sup> The survey asked all academic staff who were listed as having an instructor role in 2014 to advise why, or why not, they used any technologies to support assessment, and if so, what technologies they tried and how useful (or not) these had been.<sup>87</sup> The total number of academics invited to respond to the survey was 1500 and 800 answered the survey, a response rate of 53.3 per cent.

In response to the request to select all the UNSW services that academics had used in the last two years to support their assessment and feedback practices, 49.18 per cent of

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<sup>77</sup> Turnitin, White Paper, 'Instructor Feedback Writ Large: Students Perceptions on Effective Feedback' 2014.

<sup>78</sup> Ibid 3.

<sup>79</sup> Ibid 5.

<sup>80</sup> Ibid 12.

<sup>81</sup> Ibid 13.

<sup>82</sup> Ibid 12-13.

<sup>83</sup> Ibid 4.

<sup>84</sup> Ibid.

<sup>85</sup> UNSW, Qualtrics Public Report, Interim Report, 18 December 2014.

<sup>86</sup> UNSW Assessment Tools Census <http://moodle.telt.unsw.edu.au/course/view.php?id=11864>.

<sup>87</sup> Ibid.

respondents answered Turnitin GradeMark and 81.52 per cent answered Turnitin Originality Check.<sup>88</sup>

In answer to the subsequent question about whether this assessment tool was useful, 68.33 per cent stated that Turnitin GradeMark was 'very useful', 27.78 per cent that it was 'somewhat useful' and only 3.89 per cent that it was not useful.<sup>89</sup> In response to the same question regarding the Turnitin Originality Check, 74.4 per cent stated it was 'very useful', 25.6 per cent said 'somewhat useful' and no respondents stated that it was not useful.<sup>90</sup> Ninety two per cent of respondents who had used Turnitin GradeMark stated that they intended to use Turnitin GradeMark in the future, and 98 per cent stated that they intended to use the Originality Check in Turnitin in the future.<sup>91</sup>

It is clear from this survey that a significant number of academics at UNSW are using Turnitin GradeMark. Of the 800 respondents, 49.18 per cent or slightly fewer than 400 academics are using the assessment tool. Of these, the vast majority find it 'very useful' or 'somewhat useful'. The overwhelming majority (92 per cent) also intend to use the tool in the future.

## V CONCLUSION

This article has described how four different online strategies are used in teaching TBL. It has analysed lodgment and feedback strategies for online assessment through the lens of the seven principles of good assessment identified by Nicol and Macfarlane-Dick. Although it is not suggested that online assessment and feedback will cure all assessment defects, this article has demonstrated that the strategies described can be used effectively to provide high-quality feedback.

Furthermore, it has shown that there are certain unique advantages to the use of online assessment and feedback over more traditional formats. These advantages include the timeliness of online feedback, its legibility, and ease of access for students. This means that not only are the students able to view and interact with their feedback quickly but that it is certain to reach them, and they are able to view it privately without fear of comparison and criticism from their peers. The survey of academics has demonstrated that they are very positive about the use of online marking and feedback.

Of the seven principles of good assessment discussed in this article, encouraging the student to reflect on their feedback and use this new knowledge in the next stage of their learning has been highlighted as one of the most important aspects of effective assessment.<sup>92</sup> Online assessment enhances this. The article has provided two examples of ways in which this can be encouraged. First, electronic submission of research plans prior to the final research paper is one way of providing feedback on work-in-progress, thus

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<sup>88</sup> UNSW, Qualtrics Public Report, Interim Report, 18 December 2014, 5.

<sup>89</sup> Ibid 6.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

<sup>92</sup> David J Nicol and Debra Macfarlane-Dick, 'Formative Assessment and Self-regulated learning: A model and Seven Principles of Good Feedback Practice' (2006) 31 *Studies in Higher Education* 199, 213.

encouraging students to plan various strategies that they might use to improve their final paper. Because online feedback can be delivered quickly, it can be provided before submission of the second stage of assessment to enable students to apply the feedback to their final assignment. In addition, use of the originality report offered through GradeMark ensures that students have feedback on their level of originality and correct use of references, prior to submission. Encouragement to resubmit drafts also reinforces the idea of rewriting as a way of improving academic writing.



## **WHY FIRST-YEAR LAW STUDENTS SHOULD READ AT LEAST ONE APPELLATE TAX CASE!**

RACHEL TOOMA<sup>1</sup>

### **ABSTRACT**

An early understanding of issues of law and policy is important for a successful transition to law school. It is necessary to foster students' capacity to become independent and effective learners at the very early stages of law school, such as during a pre-semester induction program occurring prior to the commencement of studies.

This article uses a recent Australian High Court decision concerned with an overpayment of customs duty and Goods and Services Tax (GST) to demonstrate that appellate tax cases can teach first-year law students much about law and policy. It is argued by example that analysis of an appellate tax case, particularly in an engaging manner, such as through a moot occurring during a first-year induction program, ought to allow students to begin to understand how to approach the study of law. This is particularly so when the moot is followed by a reflective workshopping exercise, guided by pre-set questions.

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<sup>1</sup> Dr Rachel Tooma, Lecturer, Thomas More Law School, Australian Catholic University. Thank you to the anonymous referee who provided very helpful feedback on the initial submission of this article.



## I INTRODUCTION

Recent research on the first-year law student experience<sup>1</sup> has noted that first-year law students want what is required to learn law to be made more explicit.<sup>2</sup>

Students consider that they would benefit from 'more specific and structured guidance about how to think and write like a law student'.<sup>3</sup> This article begins, in Part II, with a brief examination of the first-year law school experience, and a literature review of 'transition pedagogy'. This section concludes that an important aim of successful transition to law school is to foster students' capacity to become independent and effective learners.<sup>4</sup>

In Part III, the question then arises as to how best to teach transitioning students how to study law. It is argued that first-year law students would benefit from examining at least one appellate tax case in detail during a law orientation or induction program. This article uses the case of *Thiess v Collector of Customs*<sup>5</sup> ('the *Thiess* case') as an example of a suitable appellate tax case for teaching in an induction program. The literature reviewed in Part II indicates that it is important for transitioning law students to be engaged. For this reason, it is suggested in Part III that the students should moot the appellate tax case. A moot teaches students that law can be adversarial, and parties must make their arguments by reference to authority – that is, statute and case law. After the moot, there should be a reflective exercise on the issues raised by the case.

Part IV of the article demonstrates the issues that could be workshopped in a reflective exercise following the moot of the appellate tax case, specifically using the example of the *Thiess* case. It demonstrates an approach to the following four questions in relation to the *Thiess* case:

- On what grounds can the Australian Federal Government charge customs duty and GST?
- How should the courts interpret legislation limiting the rights of taxpayers to recover customs duty and GST paid in error?
- Can the courts imply a duty requiring taxpayers to ensure that they pay the correct tax?
- What are the human rights issues in a case like *Thiess*?

The first question is designed to ensure that students can read a case. Specifically, it is concerned with whether students were able to understand, from a reading of the *Thiess* case, the grounds upon which the Australian Federal Government may impose customs

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<sup>1</sup> S Armstrong, M Campbell and M Brogan, 'Interventions to Enhance the Student Experience of a First-Year Law Degree: What they really wanted' (2009) 2 *Journal of the Australasian Law Teachers Association* (1 & 2) 135–48 and Susan Armstrong and Michelle Sanson, 'From Confusion to Confidence: Transitioning to Law School' (2012) 12(1) *QUT Law and Justice Journal* 21.

<sup>2</sup> Armstrong and Sanson, above n 1, 21–2.

<sup>3</sup> Ibid 22. The evaluation of a transition program for first-year law students at the University of Western Sydney found, when asked what more the law school could do to help first-year law students adjust, that the majority wanted 'more help about *how* to be a law student'. See Armstrong, Campbell and Brogan, above n 1, 139.

<sup>4</sup> Anthony and Sanson above n 1.

<sup>5</sup> *Thiess v Collector of Customs and Ors* [2013] QCA 54 and *Thiess v Collector of Customs* [2014] HCA 12.

duty and GST, and the issues that arose with that imposition in the *Thiess* case. The second question is designed to make students think about statutory interpretation, in this case, the interpretation is of legislation limiting the rights of taxpayers to recover erroneously paid tax. The third question introduces students to issues of policy and arguments for reform. It asks students to question whether taxpayers ought to be afforded greater warnings and education about the limitations that exist when seeking refunds of erroneously or overpaid tax. The fourth question raises the human rights issues in a case such as *Thiess*. Such issues would often arise in tax cases, where there is commonly an element of weighing the rights of the individual taxpayer against the interests of the collector of tax for the common good.

One important aim in asking these questions is to demonstrate the integration of different topics – from understanding the operation of a tax law, to statutory interpretation, to administrative law and human rights. This is significant for providing students with a framework of meaning in which to make sense of different parts of their degree.<sup>6</sup> Students transitioning to the first year of law school need to come to understand that material delivered in one law subject is linked to, and built upon in, other subjects.<sup>7</sup>

Finally, Part V offers some conclusions about what first-year law students might gain from analysis of an appellate tax case, such as the *Thiess* case, in light of the literature review on transition pedagogy in Part II.

## II THE FIRST-YEAR LAW SCHOOL EXPERIENCE AND TRANSITION PEDAGOGY

The University of Western Australia has reported on the transitioning experiences of first-year law students who find the experience ‘hostile, competitive, difficult and lonely’.<sup>8</sup> Importantly for the purposes of this article, one of the reasons for this is thought to be the difficulty of adjusting to an independent, self-directed learning style.<sup>9</sup>

Transition to the study of law has been identified as an issue both for school leavers entering an undergraduate law program, and for students beginning graduate-entry law programs.<sup>10</sup> This is because learning to learn at university involves learning how knowledge is constructed within a discipline.<sup>11</sup> Therefore all new law students,

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<sup>6</sup> Cassandra Sharp et al, ‘Taking Hints from Hogwarts: UOW’s First Year Law Immersion Program’ [2013] 1 *Journal of the Australasian Law Teachers Association* 134.

<sup>7</sup> Ibid.

<sup>8</sup> Tin Bunjevac, ‘Critical Reflection and the Practice of Teaching Law’ *Journal of the Australasian Law Teachers Association* 9 (2013) 1, 97. Studies have concluded that deterioration of law students’ well-being begins in the first year of study, with a statistically significant increase in symptoms of depression between the beginning and end of the first year of law school: see Rachael Field and James Duffy, ‘Better to Light a Single Candle Than to Curse the Darkness: Promoting Law Students Well-Being through a First Year Subject’ (2012) 12(1) *Queensland University of Technology Law and Justice Journal*, 133, 156.

<sup>9</sup> Ibid. Other cited reasons include: the burdensome workload, distanced methods of teaching, lack of understanding of academic expectations, and bell curved grading systems.

<sup>10</sup> Wendy Larcombe and Ian Malkin, ‘The JD First Year Experience: Design Issues and Strategies’ (2011) 21 *Legal Education Review* 1.

<sup>11</sup> Ibid, citing Wingate at footnote 38.

undergraduate<sup>12</sup> or post-graduate, are involved in a process of transition to the new disciplinary environment, its methods of inquiry and 'learning how knowledge is construed and communicated within law'.<sup>13</sup>

Consequently, much has been written about the responsibility of law schools to deploy 'transition pedagogy' within teaching programs.<sup>14</sup> This need arises primarily from the fact that first-year law students transitioning to law school require teaching that supports students' construction of meaning.<sup>15</sup> That is, first-year law students need help to devise strategies to learn to understand the content of their first year of legal studies.<sup>16</sup> Accordingly, some law schools have developed law induction programs.<sup>17</sup> Law induction programs tend to have multiple aims, including introducing students to the study of law and legal research, as well as fostering a cohesive cohort. The content of such programs, and more specifically, the way in which they introduce issues of law and policy, are the focus of this article.<sup>18</sup>

An introduction to issues of law and policy through students participating in a moot based on an appellate tax case should have two important aims. First, there must be engagement.<sup>19</sup> Kift and Nelson argue that effective programs for articulating transition pedagogy are those that support learning through engagement.<sup>20</sup> They argue that students need to be inspired and excited by the academic curriculum in order to work towards mastery of the discipline.<sup>21</sup> Second, the moot should build confidence through participation.<sup>22</sup> First-year law students should come to understand that there are not necessarily 'right' or 'wrong' answers, but rather, arguments which they must make and defend through analysis and reasoning.<sup>23</sup>

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<sup>12</sup> Not only are first-year undergraduate law students exposed to challenging new content, but scaffolding for first year students transitioning to law school is also necessary to help them 'attain self-mastery in reading skills, study and time management, and to reconcile themselves to the realities of the workload'. See Liesel Spencer, 'Motivating Law Students to 'Do the Reading' Before Class: Appropriate Extrinsic and Intrinsic Motivational Tools' (2012) 16 *Journal of the Australasian Law Teachers Association* 16 1–15, 5.

<sup>13</sup> Ibid.

<sup>14</sup> Sally Kift and Karen Nelson 'Beyond Curriculum Reform: Embedding the Transition Experience' in Brew and Asmer (eds) *Higher Education in a Changing World* (HERDSA 2005, 225–235).

<sup>15</sup> Sharp et al above n 6.

<sup>16</sup> Dominic Fitzsimmons, Simon Kozlina and Prue Vines, 'Optimising the First Year Experience in Law: The Law Peer Tutor Program at the University of New South Wales' (2006) 16 *Legal Education Review* 99.

<sup>17</sup> The pre-semester, two-week intensive foundation course at Melbourne Law School is described in Larcombe and Malkin, above n 10.

<sup>18</sup> The inclusion of Alternative Dispute Resolution programs during first year, designed to increase a student's sense of belonging to the law school and create higher levels of student engagement, is discussed in Field and Duffy, above n 8, 152.

<sup>19</sup> See above n 10.

<sup>20</sup> Sharp et al, above n 6, 129.

<sup>21</sup> Sally Kift, Karen Nelson and John Clarke, 'Transition pedagogy: A Third Generation Approach to FYE – A case study of policy and practice for the higher education sector' (2010) 1(1) *The International Journal of the First Year in Higher Education* 1–20, 3.

<sup>22</sup> Fitzsimmons, Kozlina and Vines, above n 16.

<sup>23</sup> Leon Wolff and Maria Nicolae, 'The first-year experience in law school' in Wolff and Nicolae (eds) *The first-year law experience: A new beginning* (Halstead Press, 2014) 8–18).

### III HOW BEST TO TEACH TRANSITIONING STUDENTS HOW TO STUDY LAW

It is argued that a moot recreating a recent appellate tax case is an effective teaching strategy for a law induction program.

Problem-based learning and experiential learning has been described as ‘the way people learn in real life’.<sup>24</sup> It is said to foster deep learning, as opposed to mere surface learning.<sup>25</sup> A moot achieves this by requiring students both to argue points of law before the bench and to answer questions from the bench relating to the arguments presented, or any other relevant law the students may not have considered.<sup>26</sup>

A moot of the *Thiess* case would involve one team mooting for Thiess and the other for the Collector of Customs. The students would pretend the appeal to the High Court had not occurred and act as though they were arguing the appeal before the High Court. The advantage of this approach is that it requires the students to read a High Court case, and based on that case, formulate arguments for the moot based on what was argued before the High Court.

At the conclusion of the moot during the induction program, it is important that first-year law students be able to answer some questions, such as the four questions posed in this article with respect to the *Thiess* case, designed to demonstrate to students a variety of law topics. This can be done by the bench during the moot, or workshopped in a reflective session occurring after the moot – or a combination of both. This is important for at least two reasons. First, to demonstrate an understanding of issues of law and policy raised by the moot, and second, to show students that they should not compartmentalise their studies, but rather be aware that law subjects are constantly built upon throughout the degree, and recognise that there are many issues to be discussed in relation to any one case.

The four questions raised by the *Thiess* case are now examined.

### IV QUESTIONS RAISED BY *THEISS*

#### ***A. On What Grounds Can the Australian Federal Government Charge Customs Duty and GST?***

Prior to commencing the moot it is necessary for students to read the case and understand the facts and the issues that the case raises. It may be useful to provide commencing first-year students with a brief that explains the material facts and issues raised by the case. However, in addition to an understanding of the issues of law arising from the set of facts in the case, an important aspect of the exercise is having the students read the case and come to an understanding of the avenues pursued by the taxpayer prior to the taxpayer seeking an appeal from the High Court of Australia, and the court hierarchy more generally.<sup>27</sup> The following discussion raises the points that could be included in both a

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<sup>24</sup> Keith Kendall, ‘Mooting in an undergraduate tax program’ *Journal of the Australasian Law Teachers Association* pp109–18, (2011) 10(1), citing Biggs and Tang 110.

<sup>25</sup> Ibid 111.

<sup>26</sup> Ibid 113.

<sup>27</sup> S White, ‘Teaching Novices How to Read Law Reports’, *Law Teacher* (1989) 23(2) 142–61, 145.

moot brief provided to commencing students, and in discussion notes for the workshopping exercise following the moot.

*(a) Facts of the Thiess case*

Mr Thiess engaged a customs broker to act for him in importing a yacht into Australia. The broker misclassified the yacht's weight, and Thiess paid \$494,471.74 customs duty, and \$49,447.17 GST on customs duty in December 2004.<sup>28</sup> In fact, no customs duty/GST should have arisen in respect of the yacht, if it were properly classified by its correct weight by the broker. Thiess was not aware of the broker's mistake, and that no customs duty or GST should have been paid, until October 2006, when he was alerted of the mistake in making plans to sell the yacht.<sup>29</sup>

In November 2006, Thiess wrote to the Department of Finance and Deregulation seeking an act of grace payment for a refund of monies overpaid.<sup>30</sup> This request was refused in May 2007.<sup>31</sup> Thiess then wrote to Queensland senators and members of Parliament requesting assistance in obtaining a refund. In October 2010, the Minister for Home Affairs and Justice wrote to the Queensland senators and members of Parliament from whom Thiess had requested assistance, advising that the Australian Customs and Border Protection Service was not authorised to make a refund in relation to the importation, but referring a potential reconsideration of an act of grace payment to the Minister for Finance and Deregulation.<sup>32</sup> On 12 January 2011, the delegate of the Minister for Finance and Deregulation notified Thiess's solicitors of the minister's refusal of a reconsideration.<sup>33</sup> Then on 15 December 2012, Thiess filed a claim in the Trial Division of the Supreme Court of Queensland.<sup>34</sup> On 19 June 2012, Fryberg J ordered referral of the matter to the Court of Appeal.<sup>35</sup>

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<sup>28</sup> Chronology of Case B57-2013 *Thiess v Collector of Customs and Ors*: see High Court website, [www.hcourt.gov.au/assets/cases/b57-2013/Thiess\\_Chrono.pdf](http://www.hcourt.gov.au/assets/cases/b57-2013/Thiess_Chrono.pdf), entry 14.

<sup>29</sup> Ibid 18 and 19.

<sup>30</sup> Ibid 20.

<sup>31</sup> Ibid 21.

<sup>32</sup> Ibid 31.

<sup>33</sup> Ibid 34.

<sup>34</sup> Ibid 36.

<sup>35</sup> Ibid 39.

The issues for determination by the Queensland Court of Appeal were as follows:

- Did s 167 (4) of the *Customs Act 1901* (Cth) prevent Thiess from recovering the customs duty?
- Did s 36 of the *Income Tax Assessment Act 1936* (Cth) exclude any common law action to recover an overpayment of GST as Thiess did not give notice to the Commissioner of Taxation within 4 years?
- (The plaintiff conceded that his claim to recovery of GST stood or fell upon the issue of whether he was entitled to recover the import duty. This was said to reflect the legislative scheme in relation to GST payable on customs duty, see: *Thiess v Collector of Customs & Ors* [2013] QCA 54 [42]).
- Were statutory time limits invalid under the Constitution's requirement (in s 51 (xxxii)) for just terms for any deprivation of property?

*(b) Relevant legislation*

The *Customs Act 1901* (Cth) provides for the refund of customs duty in s 163, and for disputes in s 167.

The refund provisions and dispute provisions are independent regimes, and subsection 167(5) states that 'nothing in this section shall effect any rights or powers under s 163'.<sup>36</sup> Relevantly, the *Customs Act 1901* (Cth) provides for a refund of customs duty paid by mistake under s 163. However, the problem for *Thiess* was that regulation 128A(5) requires an application for refund of duty under s 163(1)(b) to be made within 12 months of the duty being paid where, under regulation 126(1)(e), 'duty has been paid through manifest error of fact or patent misconception of the law'. *Thiess* realised the error of paying customs duty when it was not in fact payable, only after the expiration of 12 months from the date of paying duty. It is perhaps for this reason that *Thiess* did not argue that s 163 of the *Customs Act 1901* (Cth) provided for a refund of duty.<sup>37</sup>

Rather, *Thiess* argued that s 167(4)<sup>38</sup> of the *Customs Act 1901* (Cth) did not apply to prevent the application of common law restitution.

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<sup>36</sup> *Comptroller-General of Customs v Kawasaki Motors Pty Ltd* (1991) 103 ALR 63 found that s 167 excludes common law recovery and is an exclusive code.

<sup>37</sup> This occurred in *Table Eight Pty Ltd v Collector of Customs* (1993) 40 FCR 524. The issue in *Table Eight* was similarly one of incorrect classification of goods being entered, such that a concessional rate of duty was not applied. The question arose as to whether the case ought to be a refund case, so that the provisions of s 163 applied (and there was no need for a 'payment under protest') or whether the provisions in s 167 applied, that is a dispute as to classification, which meant that if the payment was not made under protest, the importer could not bring an action against Customs. Ultimately a refund under s 163 was available in that case, see G Fisher, 'Recovery of Customs Duty Paid Under Mistake' (1994) 15 Queensland Lawyer 34 and J Coelho, 'Customs Duty Refund Disputes: the current position in law' (1993) 31(5) *Law Society Journal* 60-2.

<sup>38</sup> Section 167, the dispute resolution provisions, relevantly provides:

- (1) If any dispute arises as to the amount or rate of duty payable in respect of any goods, or as to the liability of any goods to duty, under any Customs Tariff, or under any Customs Tariff or Customs Tariff alteration proposed in the Parliament (not being duty imposed under the *Customs Tariff (Anti-Dumping) Act 1975*), the owner of the goods may pay under protest the sum demanded by the Collector as the duty payable in respect of the goods, and thereupon the sum so paid shall, as against the owner of the goods, be deemed to be the proper duty payable in respect of the goods, unless the contrary is determined in an action brought in pursuance of this section.
- (2) The owner may, within the times limited in this section, bring an action against the Collector, in any Commonwealth or State Court of competent jurisdiction, for the recovery of the whole or any part of the sum so paid.
- ...
- (4) No action shall lie for the recovery of any sum paid to the Customs as the duty payable in respect of any goods, unless the payment is made under protest in pursuance of this section and the action is commenced within the following times:
  - (a) In case the sum is paid as the duty payable under any Customs Tariff, within 6 months after the date of the payment; or
  - (b) In case the sum is paid as the duty payable under a Customs Tariff or Customs Tariff alteration proposed in the Parliament, within 6 months after the Act, by which the Customs Tariff or Customs Tariff alteration proposed in the Parliament is made law, is assented to.
- (5) Nothing in this section shall affect any rights or powers under section 163.



Common law restitution allows for a longer period of time within which Thiess could seek to recover the mistakenly paid customs duty and GST. Thiess therefore needed to establish that s 167(4), which requires payment to have been made under protest, did not operate to prevent the bringing of an action for restitution under common law.

Section 167(3) and (3A) set out exhaustively when a payment is taken to be made under protest.<sup>39</sup> Thiess did not pay the customs duty under protest and within the prescribed timeframe (within 6 months of payment) as he was unaware of any mistake in paying the duty, and in practical terms, did not realise the need to pay under protest. Accordingly, Customs argued that, as the duty was not paid under protest, s 167(4) of the *Customs Act 1901* (Cth) prevented Thiess from taking any action against Customs.

Thiess argued that s 167(4) was limited to cases where there was a dispute at the time of payment. That is, if the importer is unaware that there is a dispute as they have mistakenly paid customs duty/ GST when it was not payable, then the importer cannot know to pay under protest. Counsel for Thiess argued that s 167 of the *Customs Act 1901* (Cth) was never designed to operate in the context of a self-assessment regime: s 167(1) makes it clear that Parliament had in contemplation a situation where officers of Customs determine the customs duty and 'demand' that sum. If the importer disagrees, they can pay under protest and commence proceedings within 6 months.<sup>40</sup>

Counsel for Thiess stated: 'None of this is readily transposed to a self-assessment regime, where there is no demand, no dispute, and no opportunity for payment under protest'.<sup>41</sup>

*(c) Issues of law raised by the Thiess case*

The Queensland Court of Appeal described the action brought by Thiess as being on a 'quasi contractual or restitutionary basis'.<sup>42</sup> That is, Thiess argues that it may bring a common law action as s 167(4) of the *Customs Act 1901* (Cth) does not prevent this. In *David Securities Pty Ltd and Others v Commonwealth Bank of Australia*,<sup>43</sup> the High Court found that money is prima facie recoverable if a mistaken belief has caused the payment. In *Woolwich Equitable Building Society v Inland Revenue Commissioners*<sup>44</sup> the majority of the English House of Lords held that 'money paid by a citizen to a public authority in the form of taxes or other levies paid pursuant to an ultra vires demand by the authority is prima facie recoverable by the citizen as of right'.<sup>45</sup> Under the common law, the time limitation for restitution is generally six years.

Thiess argued in the alternative before the Queensland Court of Appeal that if, contrary to his position, s 167(4) of the *Customs Act 1901* (Cth) did extinguish the right to recover

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<sup>39</sup> *Thiess v Collector of Customs* [2014] HCA 12 (2 April 2014) per French CJ, Hayne, Kiefel, Gageler and Keane JJ [9].

<sup>40</sup> Appellant's submission in the High Court of Australia Brisbane Registry on 20 November 2013 [26]: [www.hcourt.gov.au/assets/cases/b57-2013/Thiess\\_App.pdf](http://www.hcourt.gov.au/assets/cases/b57-2013/Thiess_App.pdf).

<sup>41</sup> *Ibid* [27].

<sup>42</sup> [2013] QCA 54 [14] 'mistake of fact meant Thiess was not legally obliged to make any payment by way of customs duty or GST and the Collector of Customs had no right to receive payment'.

<sup>43</sup> (1992) 175 CLR 353.

<sup>44</sup> [1992] WLR 366 at 396.

<sup>45</sup> M Chowdry, 'Recovery of overpaid GST and VAT and the "passing on" defence' (2005) 34 *Australian Tax Review* 229.

mistakenly paid customs duty at common law, it contravened s 51(xxxi) of the *Australian Constitution* because it amounted to an acquisition of property otherwise than on just terms.<sup>46</sup> Specifically, Thiess argued that s 167(4) of the *Customs Act 1901* (Cth) was not within the taxation power, nor incidental to that power, because the collection of tax due to the Commonwealth did not require a law to deprive a person who erroneously paid money to the Commonwealth of a chose in action to recover money, when there was no tax due and payable at any time.<sup>47</sup>

The Queensland Court of Appeal did not accept this constitutionality argument. It described s 167(4) of the *Customs Act 1901* (Cth) as a limitations law operating prospectively, within Federal power.<sup>48</sup> Whatever rights Thiess acquired to a refund of customs duty and GST depended upon the fulfilment of the conditions in s 167(4).<sup>49</sup>

The Court of Appeal unanimously decided the matter in favour of the Collector of Customs on 22 March 2013.<sup>50</sup> Thiess applied for Special Leave to Appeal to the High Court of Australia, which was granted on 11 October 2013.<sup>51</sup> Special leave was granted only as to the proper construction of s 167(4) of the *Customs Act 1901* (Cth) (not the constitutionality argument), in particular:

- the meaning of the expression ‘the payment is made under protest in pursuance of this section’ in subsection 167(4); and
- whether the procedure mandated by subsection 167(1) must be invoked before subsection 167(4) becomes operative.

Leave was granted, and the High Court dismissed the appeal by a judgement dated 2 April 2014.

### ***B. How Should the Courts Interpret Legislation Limiting the Rights of Taxpayers to Recover Customs Duty and GST Paid in Error?***

The moot itself requires students to familiarise themselves with various provisions of the customs duty legislation. However, the reflective workshop following the moot ought also to alert students to the importance of statutory interpretation. Legislation is often complex, and it can be difficult to determine its meaning, and for this reason, numerous appellate cases are concerned with issues of interpretation of legislation.<sup>52</sup>

Spigelman CJ has previously noted in his writing that:

The law of statutory interpretation has become the most important single aspect of legal practice. Significant areas of law are determined entirely by statute. No area of the law has escaped statutory modification.<sup>53</sup>

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<sup>46</sup> *Thiess v Collector of Customs and Ors* [2013] QCA 54, para 43.

<sup>47</sup> *Ibid.*

<sup>48</sup> *Ibid* 45.

<sup>49</sup> *Ibid.*

<sup>50</sup> Chronology of Case B57–2013 above n 28, entry 41.

<sup>51</sup> *Ibid*, entry 43.

<sup>52</sup> Catriona Cook et al, *Laying Down the Law* (LexisNexis Butterworths, 8th ed, 2012) 287.

<sup>53</sup> The Honourable James Jacob Spigelman, AC QC, former Chief Justice of the NSW Supreme Court ‘The Poet’s Rich Resource: Issues in Statutory Interpretation’ (2001) 21 *Australian Bar Review* 224.



Further, the Chief Justice of Victoria, the Honourable Marilyn Warren AC, has recently noted the importance of law programs teaching statutory interpretation.<sup>54</sup> Her Honour notes that legislation is becoming increasingly dense.<sup>55</sup> Since lawyers present the arguments and determine the appropriate evidence for the court (and judges cannot 'go on a frolic of their own'), it is critical for lawyers to understand how to interpret legislation.<sup>56</sup>

### Statutory interpretation generally

The principles of 'purpose' and 'context' for the interpretation of legislation have been in use for centuries<sup>57</sup> and it is widely considered that Australia shifted from a literal approach to statutory interpretation, to a purposive approach from the 1980s.<sup>58</sup> During the 1970s and early 1980s, the High Court was criticised for handing down decisions which strictly construed taxation legislation rather than interpreting the legislation to give effect to its underlying purpose.<sup>59</sup> This led to the enactment in 1981 of s 15AA of the *Acts Interpretation Act 1901* (Cth), requiring provisions in an Act to be interpreted in a way that promotes the purpose or

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<sup>54</sup> Remarks of the Honourable Marilyn Warren AC, Chief Justice of Victoria, Eleventh *Fiat Justitia* Lecture, 25 March 2014, Monash University Law Chambers, 'The Access to Justice Imperative: Rights, Rationalisation or Resolution', 2, available at: [www.supremecourt.vic.gov.au/find/publications/speeches+by+date](http://www.supremecourt.vic.gov.au/find/publications/speeches+by+date). Chief Justice Warren notes, in discussing law courses:

There are very important core areas which are taught in a way that is at least disappointing and in many respects unsatisfactory. Statutory interpretation is a prime example. The volume of statutes of which lawyers must have knowledge coupled with the ability to interpret them has changed. Whilst cases on statutory interpretation feature significantly in the High Court of Australia and intermediate appellate and superior courts' jurisprudence, statutory interpretation is not a compulsory subject. This is despite agitation from the highest levels for separate recognition in the curriculum. It may be readily assumed that most law schools find the curriculum so jam-packed there is a reluctance to expand the subjects that might be taught. Yet it is fundamental to legal education and, inevitably, the application of the rule of law for statutory interpretation to be taught. How can law graduates advise or act under, say, the *Migration Act*, the *Crimes Act*, the *Accident Compensation Act* and so forth, without a proper grounding in the interpretative craft? (at 14–15).

<sup>55</sup> Ibid.

<sup>56</sup> Ibid.

<sup>57</sup> R S Geddes, 'Purpose and Context in Statutory Interpretation' in *Statutory Interpretation: Principles and Pragmatism for a New Age*, Judicial Commission of New South Wales Education Monograph 4, June 2007, 128.

<sup>58</sup> '[T]he high water mark of the literalist approach to interpreting tax legislation was seen in the years of the Barwick High Court (1964–1981)': John Tretola, 'The Interpretation of Taxation Legislation by the Courts – A Reflection on the Views of Justice Graham Hill' [2006] 1(5) *Revenue Law Journal* 78.

<sup>59</sup> Cook et al, above n 52, 297.

object underlying the Act.<sup>60</sup> Following the addition of s 15AA, similar provisions were enacted in the Australian states and the territories.<sup>61</sup>

The question then arises as to the extent to which courts can consider extrinsic materials, such as parliamentary debates and explanatory memoranda, relating to the purpose of the legislation.<sup>62</sup> In 1983 the Commonwealth Attorney-General's department organised a seminar on the interpretation of legislation,<sup>63</sup> focusing on the use to be made of extrinsic materials.<sup>64</sup> This seminar led to the insertion of s 15AB in the *Acts Interpretation Act 1901* (Cth).<sup>65</sup> Section 15AB of the *Acts Interpretation Act 1901* (Cth) broadly provides that, in the interpretation of a provision of an Act, if any material (including, among other materials, an explanatory memorandum or any relevant report of a Royal Commission laid before either House of the Parliament before the time when the provision was enacted) can assist in the ascertainment of the meaning of the provision, consideration may be given to the material to: confirm the ordinary meaning of a provision; or determine the meaning of the provision when the provision is ambiguous or obscure; or determine the meaning of the provision when the ordinary meaning in context of the purpose of the Act leads to a result that is absurd or unreasonable. All states and territories, except for South Australia, have enacted provisions based on s 15AB of the *Acts Interpretation Act 1901* (Cth).<sup>66</sup>

#### Statutory interpretation of taxation laws

It has been questioned whether, in some areas of the law, there is a body of interpretative principles that are more or less specific to those areas.<sup>67</sup> In a taxation context, the 'special rule' for interpreting taxation legislation provides an example.

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<sup>60</sup> Section 15AA of the *Acts Interpretation Act 1901* (Cth) originally provided:

In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether thurpose or objective is expressly stated in the Act or not) shall be preferred to a construction that would not promote thurpose or object.

In 2011, s 15AA of the *Acts Interpretation Act 1901* (Cth) was amended (by the *Acts Interpretation Amendment Act 2011* (Cth)) and s 15AA now provides:

In interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not thurpose or object is expressly stated in the Act) is to be preferred to each other interpretation.

<sup>61</sup> State and territory provisions are as follows: *Legislation Act 2001* (ACT) s 139; *Interpretation Act 1987* (NSW) s 33; *Interpretation Act 1978* (NT) s 62A; *Acts Interpretation Act 1954* (Qld) s 14A; *Acts Interpretation Act 1915* (SA) s 22; *Acts Interpretation Act 1931* (Tas) s 8A; *Interpretation of Legislation Act 1984* (Vic) s 35(a); *Interpretation Act 1984* (WA) s 18.

<sup>62</sup> R S Geddes, above n 58, 132–3, notes: 'in *Commissioner for Prices and Consumer Affairs (SA) v Charles Moore (Aust) Ltd* (1977) 139 CLR 449 (at 457 per Barwick CJ, 462 per Gibbs J, 470 per Stephen J, 476–7 per Mason J), the High Court stated that courts should not refer to reports of parliamentary debates for any purpose to aid the construction of the statute. However, in *Wacando v Commonwealth* (1981) 148 CLR (at 1 25–26) in the High Court, Mason J said that an exception could be allowed if the Bill had been introduced to remedy a mischief.'

<sup>63</sup> Following the seminar it held prior to the enactment of s 15AA of the *Acts Interpretation Act 1901* (Cth).

<sup>64</sup> *Symposium on Statutory Interpretation* (AGPS, 1983). Discussed in: Cook et al, above n 52, 314.

<sup>65</sup> Inserted by s 7 of the *Acts Interpretation Amendment Act 1984* (Cth).

<sup>66</sup> *Legislation Act 2001* (ACT) ss141–143; *Interpretation Act 1987* (NSW) s 34; *Interpretation Act 1978* (NT) s 62B; *Acts Interpretation Act 1954* (Qld) s 14B; *Acts Interpretation Act 1931* (Tas) s 8B; *Interpretation of Legislation Act 1984* (Vic) s 35(b); *Interpretation Act 1984* (WA) s 19.

<sup>67</sup> Cook et al, above n 52, 287.

A choice between competing interpretations of legislation may ultimately involve a choice between favouring the revenue or the taxpayer.<sup>68</sup> The special rule regarded revenue law as 'special', so that there was a presumption against the construction urged by the tax collector.<sup>69</sup>

The special rule was rejected by Kirby J, who stated that the court's duty is to determine what Parliament meant when it enacted the provision.<sup>70</sup> Kirby J stated:

*'In earlier times it used to be said that legislation imposing taxation was subject to a strict construction, in favour of the taxpayer. However, in more recent times, this Court has departed from the narrow and literal interpretation of words appearing in legislation, including that imposing taxation, in favour of an interpretation that seeks to achieve the apparent purposes or objects of the enactment as expressed in its terms.'*<sup>71</sup>

Statutory Interpretation in Thiess

Counsel for Thiess argued:

Subsection 167(1) makes it clear that Parliament contemplated a situation where Customs officers: inspect goods (or the paperwork relating to goods); make a decision regarding whether duty is exigible, and, if so, determine the rate and amount of duty payable; demand payment of that sum; and are met with a contrary contention by the importer. If the issue cannot be resolved immediately, the importer is allowed to pay under protest, retain the goods, and commence proceedings within 6 months.

This is not readily transposed to a self-assessment regime, 'where there is no demand, no dispute, and no opportunity for payment under protest'.

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<sup>68</sup> Justice Hill, 'Some Thoughts on the Principles Applicable to the Interpretation of the GST', paper presented at the ATAX 15th Annual GST and Indirect Tax Conference, Noosa Queensland, 10–13 April 2003.

<sup>69</sup> The special rule was discussed and rejected by Kirby J in *Commissioner of Stamp Duties (NSW) v Commonwealth Funds Management Ltd* (1995) 31 ATR 457, 459.

<sup>70</sup> John Tretola, 'The Interpretation of Taxation Legislation by the Courts – A Reflection on the Views of Justice Graham Hill' *Revenue Law Journal* Volume 16 [2006] Iss. 1 Art. 5, 83.

<sup>71</sup> *Austin v The Commonwealth* (2003) 51 ATR 654, 723–4. Note also comments by The Honourable Murray Gleeson AC in 'Justice Hill Memorial Lecture Statutory Interpretation' 24<sup>th</sup> National Convention, Taxation Institute of Australia, Sydney, 11 March 2009:

Before referring to some principles of statutory interpretation and their relevance to revenue law, it is convenient to mention, in order to put it to one side, an approach that once was fashionable, but no longer commands judicial acceptance. It is possible to find in some judicial statements of former times, and even as recently as the third quarter of the 20th century, the proposition that a taxing Act interferes with rights of property, and therefore should be construed narrowly and in favour of the taxpayer. This proposition was normally qualified by a disavowal of some special rule for revenue laws, but it reflected what Lord Devlin, writing extra-judicially, described as a judicial philosophy that was 'highly suspicious of taxation' (Devlin, 'Judges and Lawmakers' (1976) 39 *Modern Law Review* 1 at 13–14). For example, in 1945, in *Scott v Russell* (1945) 3 T.C. 375 at 424, Viscount Simon in the House of Lords said that the language of a certain United Kingdom rule was obscure and difficult to expound and 'the taxpayer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected'. That passage was cited with approval by the Privy Council in a 1964 case (*Naranjee v Income Tax Commissioner* [1964] AC 1238 at 1250–1251).

If s 167(4) of the *Customs Act 1901* (Cth) was intended to apply in the context of a self-assessment regime, 'then the appropriate course is to legislate for it. Until such legislation is enacted, the clear duty of the courts is not to introduce specious concepts involving a duty ... on the part of the importer [to be careful and diligent]'

The process of entering goods for home consumption begins with an 'import entry', a communication of information to Customs.<sup>72</sup> In *Thiess*<sup>73</sup>, the import entry was transmitted to Customs by means of computer facilities known as the 'COMPILE computer system'.<sup>74</sup>

The COMPILE system operated to assess automatically the amounts of Customs duty and GST payable.<sup>75</sup> Customs then transmits an 'import entry advice' by means of the COMPILE computer system.<sup>76</sup> The advice would include a statement that the goods were cleared for home consumption.<sup>77</sup>

The Queensland Court of Appeal found that the legislation established a system of self-assessment under which the amount of duty and GST payable by an owner who imported goods ordinarily depended upon information entered in the COMPILE computer system by the owner.<sup>78</sup> The Court of Appeal cited Ormiston J in *A and G International Pty Ltd v Collector of Customs*<sup>79</sup> to establish that there was a 'demand' when the COMPILE system stated the total amount of duty payable – even where a protest was not possible because the importer was unaware of the mistake.<sup>80</sup> While in a practical sense, Thiess could not pay 'under protest' if unaware of the mistake, as a matter of construction, Customs had made a demand for payment and Thiess was entitled to pay under protest. The Queensland Court of Appeal cited Ormiston J in discussing the purpose of s 167(4):

*the clear purpose of s 167(4), as construed in the cases by which I am bound, is to prevent actions from being brought disputing customs duty unless the requirements of that section have been satisfied.*<sup>81</sup>

The Court further cited Rolfe J in *Matchbox Toys Pty Ltd v Chief Executive of Customs*<sup>82</sup> in finding that s 167(4) operates to encourage importers to take care and avoid mistakes favouring the revenues.<sup>83</sup>

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<sup>72</sup> *Thiess v Collector of Customs* [2014] HCA 12 [4], citing *Customs Act 1901* (Cth) s 71A(1)(d), as it applied in 2004.

<sup>73</sup> *Ibid*, citing the *Customs Act 1901* (Cth) s 71B, as it applied in 2004.

<sup>74</sup> *Ibid*, citing *Customs Act 1901* (Cth) s 71A.

<sup>75</sup> Submissions of the First and Second Respondents, on appeal from the Supreme Court of Queensland, Court of Appeal Division, dated 10 December 2013, in the High Court of Australia Brisbane Registry [18].

<sup>76</sup> *Thiess v Collector of Customs* [2014] HCA 12 [5], citing *Customs Act 1901* (Cth) s 71B, as it applied in 2004.

<sup>77</sup> Submissions of the First and Second Respondents, on appeal from the Supreme Court of Queensland, Court of Appeal Division, dated 10 December 2013, in the High Court of Australia Brisbane Registry [21].

<sup>78</sup> (2013) QCA 54, 18.

<sup>79</sup> (1995) 129 FLR 23.

<sup>80</sup> (2013) QCA 54, 25–8.

<sup>81</sup> *Ibid*, 26.

<sup>82</sup> (1997) NSWSC 494.

<sup>83</sup> (2013) QCA 54, p30–34.

*on a proper construction of s 167 there is an obligation on the owner, at the time of paying duty, to satisfy himself that the duty demanded is payable. If this were not so then, arguably, the provision of s 167 would be circumvented by an owner not bothering to consider or to consider properly whether such an obligation arose at the time of payment, but later concluding that the duty was not properly payable.*

The Queensland Court of Appeal agreed with the argument of Customs that, on Thiess' construction, the consequences would be 'odd' if taking care and paying duty under protest would mean an importer would only have 6 months to claim a refund – whereas the careless importer who does not pay under protest would not be bound by that limitation period.<sup>84</sup> The Court of Appeal noted:

*The High Court recently affirmed that, whilst context and legislative history may be significant in ascertaining the proper construction of a legislative provision, the exercise of construing legislation must begin and end with the statutory text (Commissioner of Taxation v Consolidated Media Holdings [2014] HCA 55 at [39]). The clarity of the language in s 167(4), the amelioration by s 163 and regulations made under it of what otherwise may be unjust consequences of a literal construction, and the odd consequences which would result from the plaintiff's construction, combine to require rejection of that construction. The plaintiff's claim for recovery of the import duty was barred by s 167(4).<sup>85</sup>*

The appeal to the High Court of Australia was limited to the construction of s 167(4) of the *Customs Act 1901* (Cth). Thiess again argued that s 167(4) cannot have application in the absence of a 'dispute' within the meaning of s 167(1). Thiess argued that if there were no 'dispute', then there could not be a payment under protest, and therefore s 167(4) of the *Customs Act 1901* (Cth) did not apply. Consequently, if s 167(4) did not apply, Thiess could commence a common law restitution action.<sup>86</sup>

The High Court cited *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd*<sup>87</sup> for the purpose of construing s 167(4) of the *Customs Act 1901* (Cth):

*This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and only in so far as, it assists in fixing the meaning of the statutory text.*

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<sup>84</sup> Ibid, 36.

<sup>85</sup> Ibid, 39.

<sup>86</sup> Thiess relied on Sackville J (in dissent) in *Comptroller-General of Customs v Kawasaki Motors Pty Ltd (No 2)* (1991) 32 FCR 243: 'Hill and Heery JJ appeared to have accepted that if no dispute had arisen as to the amount or rate of duty, or as to the liability of any goods to duty, the limitations imposed by s 167(4) did not apply'.

<sup>87</sup> (2012) 87 ALJR 98 107.



The High Court considered that the scheme of the *Customs Act 1901* (Cth) is clear.<sup>88</sup> That is: Customs has control over goods imported into Australia; goods are entered for home consumption via an import entry advice; and the payment of customs duty is a condition of Customs relinquishing control of the goods by giving an authority to take the goods into home consumption. The function of s 167 within that scheme is to provide, by s 167(1) a mechanism for payment under protest, so as to allow goods to be entered for home consumption.<sup>89</sup>

Section 167(4) of the *Customs Act 1901* (Cth) clearly states that no action shall lie for the recovery of any sum paid to customs, other than in two circumstances: first, if under s 167(2) the duty is paid under protest and the action is commenced within the prescribed timeframe; and second, if there are rights to a refund of duty under s 163 of the *Customs Act 1901* (Cth). The High Court concluded that s 167(4) of the *Customs Act 1901* (Cth) enhances the operation of the scheme of the Act by creating an incentive for the owner to be vigilant in the process of entering goods for home consumption, to identify what the owner of the goods considers to be the duty payable.<sup>90</sup>

The High Court further referred to s 15AA of the *Acts Interpretation Act 1901* (Cth) to note that statutes always have some purpose or objective to accomplish.<sup>91</sup> In 1910, individual members of the High Court answered differently the question of whether an action was available at common law for the recovery of customs duty outside the operation of s 167 of the *Customs Act 1901* (Cth).<sup>92</sup> Isaacs J<sup>93</sup> stated, on the operation of s 167 and the availability of a common law action for restitution, that a common law action was not available and would throw the revenue into chaos.<sup>94</sup> The High Court described the substitution of s 167(4) of the *Customs Act 1901* (Cth) three months after the statement of Isaacs in *Sargood*<sup>95</sup> as a 'preventative measure'. The High Court found:

*Those words as then enacted operated in combination with s 167(5) to ensure that, apart from the statutory action for recovery newly created by s 167(2) no action was to lie for the recovery of any sum paid to customs ... other than an action to enforce a right or to compel the exercise of a power under s 163'.<sup>96</sup>*

It can be seen that the *Thiess* case was mostly concerned with the proper interpretation of the customs duty statute. It is important for students to understand the process of construction that was followed in the *Thiess* case.

Can the courts imply a duty requiring taxpayers to ensure that they pay the correct tax?

The third issue to be workshopped following a moot based on the *Thiess* case follows on from the previous examination of statutory interpretation. It asks whether the courts can imply a duty requiring taxpayers to ensure that they pay the correct tax. Counsel for

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<sup>88</sup> *Thiess v Collector of Customs* [2014] HCA 12 [24] and [27–9].

<sup>89</sup> *Ibid* [28].

<sup>90</sup> *Ibid* [29].

<sup>91</sup> *Ibid* [23].

<sup>92</sup> *Sargood Bros v the Commonwealth* (1910) 11 CLR 258.

<sup>93</sup> In dissent.

<sup>94</sup> *Thiess v Collector of Customs* [2014] HCA 12 [31].

<sup>95</sup> Above n 92.

<sup>96</sup> *Thiess v Collector of Customs* [2014] HCA 12 [32].

Thiess argued that s 167 of the *Customs Act 1901* (Cth) was never designed to operate in the context of a self-assessment regime. If s 167(4) of the *Customs Act 1901* (Cth) was intended to apply in the context of a self-assessment regime, 'then the appropriate course is to legislate for it. Until such legislation is enacted, the clear duty of the courts is not to introduce specious concepts involving a duty ... on the part of the importer [to be careful and diligent]'.<sup>97</sup>

*(a) Self-assessment*

There is much academic commentary on self-assessment of income tax in Australia.<sup>98</sup> This is instructive in the customs duty context at issue in the *Thiess* case as it describes the rationale for, and operation of, self-assessment.

It particularly allows for analysis of the argument by Thiess that the courts cannot cite self-assessment as the basis of a duty being imposed upon the importer to ensure that the correct duty and GST are paid.

Self-assessment has been described as 'privatisation of the process of assessing and collecting the government's revenue'.<sup>99</sup> Self-assessment is generally regarded as a cost-effective means of administering a tax (or in Thiess' case, customs duty). Self-assessment of income tax in Australia replaced assessment by the government as it was considered by the Auditor General Report in 1984 that full assessment was not cost-effective and had little impact on taxpayer compliance with the law.<sup>100</sup>

In the context of self-assessment of income tax in Australia, self-assessment has been described as placing a heightened responsibility on taxpayers.<sup>101</sup> It places responsibility on taxpayers to protect themselves against penalties for incorrect assessment. The penalty provisions supporting the self-assessment regime apply a 'reasonable care' test. In discussing the penalty provisions, Nethercott and Stephen state: 'The main thrust of the new penalty provisions is to apply a penalty where a tax shortfall is caused by the taxpayer's failure to exercise reasonable care in carrying out his tax obligations'.<sup>102</sup> At the time of introduction of self-assessment of income tax in Australia, Nethercott and Stephen opined that the courts would, in the self-assessment of income tax context, interpret 'reasonable care' by imputing a standard, as has been done in the tort of negligence.<sup>103</sup>

*(b) Are taxpayers sufficiently educated about their obligations under self-assessment?*

At this point, it is important to consider some policy issues that arose with the *Thiess* case. It is often questioned, in the self-assessment of income tax context, whether the regime adequately

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<sup>97</sup> Appellant's submission to the High Court of Australia Brisbane Registry, '*The operation of s 167(4) in the context of a self-assessment regime*' discussed at [26-8], High Court website, above n 28.

<sup>98</sup> See for example R Fisher, 'An Assessment by Another name ... 'making an assessment' under self-assessment' (2005) 34 *Australian Tax Review* 7; and L Nethercott and Tony Stephen, 'Tax Management - A New Era Under Self-Assessment' (1993) 22 *Australian Tax Review* 7.

<sup>99</sup> Nethercott and Stephen, above n 98, 7.

<sup>100</sup> Auditor-General, *Report of the Auditor General on Efficiency Audits* (AGPS, 1984).

<sup>101</sup> Nethercott and Stephen, above n 98, 7.

<sup>102</sup> *Ibid* 10.

<sup>103</sup> *Ibid* 13.

protects taxpayers.<sup>104</sup> Self-assessment assumes that taxpayers have the knowledge and skill required to fulfil their obligations, when in fact they may not.<sup>105</sup> It is suggested that self-assessment requires that taxpayers be given support in determining the tax implications of certain courses of action, particularly through education programs and publications.<sup>106</sup> Arguably, in the case of self-assessment, revenue bodies have some responsibility to assist taxpayers' efforts to comply with relevant taxing statutes.<sup>107</sup> Such education programs and publications are useful in increasing taxpayer awareness of a revenue body's stance in administering a statute.<sup>108</sup>

The question then arises, in the customs duty context, whether importers are sufficiently educated about their rights to pay customs duty under protest under s 167(1) of the *Customs Act 1901* (Cth), and the time limits on application for a refund of overpaid or erroneously paid customs duty under s 163 of the *Customs Act 1901* (Cth).

The Australian Customs website currently provides information to importers on customs duty and tariff classification.<sup>109</sup>

It provides resources to assist importers with classifying the goods that they are importing. Under the heading 'How do I use the Tariff when importing goods?' the website currently states:

*Importers are required to self-assess their goods, including the tariff classification of their goods. Importers have a legal obligation to correctly assess their goods, and penalties may apply for incorrect or misleading information provided to the Australian Customs and Border Protection Service.*

*Importers are encouraged to use the services of a licensed customs broker if they are unsure how to classify their goods ... Customs brokers are licensed by the Australian Customs and Border Protection Service.*

The *Australian Customs and Border Protection Notice 2013/09: Continuing Professional Development Scheme for Licensed Customs Brokers – Update*, dated March 2013, notes in the background information that: 'Because of the complexity of the laws governing the importation of goods into Australia ... and the potential financial and other implications of lodging an incorrect entry, most importers of goods choose to engage a customs broker to act on their behalf'.<sup>110</sup> The Notice states that from 1 April 2014, Continuing Professional Development

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<sup>104</sup> S Villio, 'The legislative interface between the creation of a liability to tax and the right to challenge that liability' (2014) 29 *Australian Tax Forum* pp551–78.

<sup>105</sup> E Loo, M McKerchar, and A Hansford, 'Findings on the Impact of Self-Assessment on the Compliance Behaviour of Individual Taxpayers in Malaysia: A case Study Approach', (2010) 13 *Journal of Australian Taxation* 1–23, 10–11.

<sup>106</sup> F Zumbo, 'Educating taxpayers through seminars: a case study' *Australian Tax Review* (1996) 25 (Sept) 143–7, 143.

<sup>107</sup> *Ibid* 144.

<sup>108</sup> *Ibid* 144.

<sup>109</sup> [www.border.gov.au/](http://www.border.gov.au/).

<sup>110</sup> Former Customs website. Now [www.border.gov.au/](http://www.border.gov.au/).



obligations must be met by customs brokers annually, so that brokers are better able to provide their services with skill and expertise with regular participation in educational activities.<sup>111</sup>

It appears that the Department is operating on the assumption that most importers will use a customs broker,<sup>112</sup> and presumably the broker is aware of the limitation periods for seeking a refund under s 163 and the requirements of the dispute provisions under s 167 of the *Customs Act 1901* (Cth). However, it remains to be established whether the Department affords sufficient warnings to all importers of the operation of ss 163 and 167(4) of the *Customs Act 1901* (Cth). To this end, it is interesting to examine the recent requirement for warnings to guarantors providing a guarantee under the *National Consumer Credit Protection Regulations 2010* (Cth), and whether such a warning is a good lesson for customs duty.

To strengthen the position of guarantors, s 55 of the *National Credit Code*<sup>113</sup> ('the Code') prescribes the form that a written guarantee covered by the Code is required to take. It states in subsection 3 that the regulations may make provision for or with respect to the content of guarantees and the way that they are expressed. Under section 55(4) of the Code, a guarantee must comply with the regulations in order to be enforceable. Regulation 81 of the *National Consumer Credit Protection Regulations 2010* (Cth) states that, for section 55 of the Code, a guarantee must contain the warning set out in Form 8 of Schedule 1 of the Regulations. Form 8 contains a box of information under the heading 'IMPORTANT'. Under the subheading 'Before you Sign' it contains five short paragraphs, one of which recommends obtaining independent legal advice. Under the subheading 'Things you Must Know' there are four paragraphs, one stating: 'If the debtor does not pay you must pay. This could mean you lose everything you own including your home'. It is suggested that importers may benefit from a similar 'IMPORTANT' warning box when completing payment of customs duty and GST.

It is also necessary to consider the Australian Government Australian Customs and Border Protection Service *Client Service Charter 2014–2015*. The Charter does not note the time limits for seeking a refund of customs duty, nor the requirement to pay under protest if the importer seeks to take action against Customs. However, the Charter does note the self-management nature of customs duty.<sup>114</sup> The CEO's foreword to the Charter states: 'We use a range of services to help you self-manage your interaction with the border'. Under the heading 'How You Can Help Us' the Charter states: 'So We Can Provide High Quality Service, We Ask You To: Familiarise yourself and comply with Australian Government requirements relevant to your enquiry.'

### *(c) Conclusions on self-assessment*

Both the Queensland Court of Appeal and the High Court in *Thiess* considered that the self-assessment regime places a burden on the taxpayer/importer to ensure that they understand their

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<sup>111</sup> The Continuing Professional Development ('CPD') obligations of customs brokers was gradually introduced from 1 July 2012, with no mandatory CPD requirements from 1/7/12 to 31/3/13. From 1/4/13 to 31/3/14 the CPD obligations were at 50% of the full annual rate. The full annual rate of CPD obligations commenced from 1/4/14.

<sup>112</sup> Leaving aside the issue of whether this is a desirable position.

<sup>113</sup> Schedule 1 to the *National Consumer Credit Protection Act 2009* (Cth).

<sup>114</sup> Australian Government, Department of Immigration and Border Protection Service *Client Service Charter 2015*: <http://www.border.gov.au/AccessandAccountability/Documents/DIBP-Client-Service-Charter-2015.pdf#search=Client%20Service%20Charter>.

obligations and their rights, as is the case under Australian income tax legislation. This finding followed from the text of the Act, structure and history of the Act, and principles of statutory interpretation. Both courts considered that the text in s 167(4) of the *Customs Act 1901* (Cth) was clear. The harshness of s 167(4) of the *Customs Act 1901* (Cth) was ameliorated by s 163 (refund provisions). Further, Thiess' construction of s 167(4) would produce the odd result that an importer paying under protest would only have 6 months within which to commence an action, whereas an importer who does not pay under protest may not be similarly limited by time. From a policy point of view it would perhaps be beneficial, and consistent with other areas of Australian statutory law, for Customs to warn importers of the time limits for refunds and requirements for paying under protest if an action for the recovery of erroneously paid duty is to be made.

What are the human rights issues in a case like Thiess?

The fourth and final issue to be discussed in the *Thiess* example is a tension that is often at the centre of taxation cases: the balance between the rights of the individual taxpayer and the common good pursued by the tax collector. This position was observed by *The Hon J Daryl Davies AJA*:<sup>115</sup>

*A proper balance between the interests of the citizen and those of the Government is, as Sir Gerard Brennan said in his foreword to the 1977 Report of the Administrative Review Council, 'critical to a free society'. Yet the establishment and maintenance of such a balance can be a difficult, controversial and sometimes despairing task.*

Thiess argued before the Queensland Court of Appeal (but not the High Court) that, if s 167(4) of the *Customs Act 1901* (Cth) were effective to prevent Thiess recovering its mistaken payment, then s 167 contravened s 51(xxxi) of the *Australian Constitution* and was invalid as appropriations of the plaintiffs property otherwise than on just terms. Although this argument was not accepted by the Court nor allowed as a ground for appeal before the High Court, it does demonstrate the tension between the rights of the individual taxpayer and the collection of revenue for the common good. In the end, Thiess paid half a million dollars in customs duty and GST which was never due. However, there may be good reason for limiting the time within which a taxpayer can recover overpayments – such as protecting the certainty of the revenue base. That is, it is considered that if importers had unlimited time and opportunity to take action for the recovery of erroneously paid duty, the revenue base would be thrown into chaos.

This idea of the revenue being thrown into chaos raises interesting human rights issues. If the revenue base is uncertain, governments may be forced to adopt austerity measures that they otherwise might not adopt. Austerity measures may breach Australia's human rights obligations, as the Australian Government is required to use the 'maximum available resources' to secure the economic, social and cultural rights of its population.<sup>116</sup> Indeed, the United Nations General Assembly Special Rapporteur on extreme poverty and human rights dated 22 May 2014 presents fiscal policy, and particularly taxation policies,

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<sup>115</sup> *The Hon. J Daryl Davies AJA*, 'The Administrative Appeals Tribunal and the Rule of Law', (2001) 8 *Australian Journal of Administrative Law* 176–82.

<sup>116</sup> Magdalena Sepulveda, 'Taxation for Human Rights', (2014) 9(2) *Tax Justice Focus* at [www.taxjustice.net/wp-content/uploads/2013/04/TJF-June-2014-Human-Rights.pdf](http://www.taxjustice.net/wp-content/uploads/2013/04/TJF-June-2014-Human-Rights.pdf).

as a major determinant in the enjoyment of human rights.<sup>117</sup> Relevantly, the Special Rapporteur states in Part III 'Tax: a critical tool for realizing human rights and tackling inequality', that more 'stable revenues' result in increased sustainable investment in public services, infrastructure and other development needs.

Accordingly, while one may have sympathy for Thiess, who mistakenly paid customs duty and GST where it was not in fact due, and was barred by statute from seeking restitution that might otherwise have been available at common law – without such a limiting statute, if his argument had prevailed, the revenue would be less stable. A revenue base which is unstable might reasonably be linked to reduced government spending to benefit the poor – and this is now viewed as being contrary to a government's human rights obligations.

## V CONCLUSIONS

The engagement of new law students in a moot during a law induction program ought to enable the students to appreciate that case law is adversarial, and parties must make their arguments by reference to authority, that is, statutes and case law. It is important for law students to argue the law rather than their beliefs of what is fair and just.

Through discussion of the workshop exercise that would follow the moot of the appellate tax case, this article has demonstrated that analysis of a recent Australian High Court case on mistakenly paid customs duty and GST raises issues of: statutory interpretation; constitutional law; policy (as to the adequacy of warnings to importers on recovering overpaid customs duty); and even human rights.

Members of the judiciary have argued that it is essential for law students to understand the principles of statutory interpretation. Both the Queensland Court of Appeal and the High Court in *Thiess* considered that the self-assessment regime places a burden on the taxpayer/importer to ensure that they understand their obligations and their rights. This is due to the text of the Act (the requirements in s 163 and s 167(4) of the *Customs Act 1901* (Cth)), the structure and history of the statute, and the fact that on Thiess' construction, s 167(4) would have no effect.

First-year-law students should also consider the broader policy issues of a case, and even make recommendations as to appropriate law reform, following analysis of whether the law should operate as it does. This article has made one suggestion for law reform – that is, the use by Customs of greater warnings to importers of the time limits for seeking refunds of duty, and the need to pay under protest if the importer intends to dispute the duty paid.

The workshop exercise should demonstrate that there may be a human rights issue in an appellate tax case that may not appear obvious on the first reading of the case.

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<sup>117</sup> Sepulveda, C., 'Report of the Special Rapporteur on extreme poverty and human rights' Human Rights Council, UN General Assembly, 22 May 2014.

There is a newly emerging area of research examining whether government taxation policies adequately promote the achievement of basic human rights.<sup>118</sup> Arguably, there is a need to ensure stability of the revenue base, as the more 'stable' the revenue, the greater the sustainable investment in public services, infrastructure and other development needs.

Finally, in order to teach transitioning first-year law students the importance of the idea of currency (updated law), the appellate tax case studied during a law induction program ought to be a recent case that changes each year for each induction program. Presenting a recent case will also demonstrate to new law students the importance of keeping up with new developments in the law. There should not be a shortage of appellate tax cases suitable for a law induction program. Most cases will involve the interpretation of legislation and most cases will involve a dispute between a taxpayer and a tax collector, and therefore a weighing of the interests of an individual taxpayer as against the collection of revenue for the common good. This approach requires analysis of whether the law should operate as it does, and such analysis may, in turn, raise issues of policy.

While the benefits of studying an appellate tax case during law induction have been analysed here, one needs to be cautious about reaching conclusions based on limited experience. For this reason, student evaluations should follow the induction program.

Such evaluations should be designed to discern, among other things, whether students consider that the learning of an appellate tax case through a moot and workshop during an induction program has helped students learn the approach to studying the discipline of law. It has been argued that student evaluations have their limitations,<sup>119</sup> but even so, a properly drafted evaluation questionnaire should provide feedback to the architects of the law induction program. Useful feedback is perhaps best achieved by requiring students to give a narrative response, rather than a numerical one.<sup>120</sup>

A student evaluation of a law induction program could also achieve two further goals, if properly drafted. First, if properly framed, the questions in the student evaluation should lead the student to understand that learning is not a passive exercise in which teachers provide, and students receive, knowledge.<sup>121</sup> Rather, questions on an evaluation ought to 'orient students more to the collaborative nature of the teaching-learning process'.<sup>122</sup> This

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<sup>118</sup> See McGill University, Montreal's 'Tax Justice and Human Rights Research Collaboration Symposium' 18-20 June 2014 at: [www.mcgill.ca/tax-law/events/tax-justice-human-rights-symposium](http://www.mcgill.ca/tax-law/events/tax-justice-human-rights-symposium):

The Faculty of Law at McGill University invites you a conference on tax justice and human rights, that will bring together students, academic researchers, and tax justice advocates and activists to collaborate on the topic of tax justice: what is it, how is tax connected to human rights or how could it be, and what research needs to be done to further this emerging field?...

*Overview:* Until recently, tax policy was a technical speciality left to experts. Today, researchers, community groups and social justice activists are examining whether government tax policies lead to healthy communities and environments, support people in meeting their needs, and promote the achievement of basic human rights.

<sup>119</sup> See for example research by Deborah Merritt, discussed in Julia Glencer et al, 'The Fruits of Hope: Student Evaluations', (2010) 48 *Duquesne Law Review* 233-72.

<sup>120</sup> Arthur Best, 'Student Evaluation of Law Teaching Works Well: Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree' (2008) 38(1) *Southwestern Law Review* 1-36, 8.

<sup>121</sup> *Ibid* 2.

<sup>122</sup> *Ibid*.

may be achieved by an open-ended question asking students to explain how they consider that the moot exercise and following workshop allowed them to engage in the process of analysing the law at issue in the appellate tax case. Such a question should indicate that there is an expectation that students learn to be independent learners, as opposed to a question which states, for example: 'The moot during induction helped me to learn how to learn law: Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree'.

Second, the questionnaire should indicate that its purpose is for successful planning of future induction programs.

Such a sentiment may allow the students to feel valued as members of the law school whose opinions are being used to support the education of future members of their law school.

That being said, modelling how to learn law through a recent appellate tax case should not be the only aim of an induction program for new law students. Other important objectives – such as establishing pastoral care, and fostering a cohesive cohort – should also be addressed. It is important that students feel connected to their peers and their teachers from the time of the induction program.<sup>123</sup>

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<sup>123</sup> Susan Armstrong, Marnie Campbell and Michael Brogan, 'Interventions to Enhance the Student Experience of a First-Year Law Degree: What they really wanted', (2009) 2(1&2) *Journal of the Australasian Law Teachers Association* 135–48.

## **IMPROVING THE STUDENTS' TAX EXPERIENCE: A TEAM-BASED LEARNING APPROACH FOR UNDERGRADUATE ACCOUNTING STUDENTS**

PAUL KENNY, HELEN MCLAREN, MICHAEL BLISSENDEN AND SYLVIA VILLIOS<sup>1</sup>

### **ABSTRACT**

Traditionally, in Australia, law tutorials for accounting students are conducted by way of a class discussion led by the tutor, as was the case of the authors' students in the 2009 undergraduate taxation law class. This paper compares the impact using two different team learning approaches in the teaching of tutorials to undergraduate accounting students studying taxation law that were introduced in 2010, 2013 and 2014.

While research indicates that team learning aids students' ability to understand and apply content, the teaching experiment in 2010 was unable to provide clear evidence for this finding. However, when a team-based learning (TBL) approach was taken in 2013–14 using individual tests and team assignments with peer reviews, the benefits of TBL were evident. TBL was associated with significantly higher levels of student preparation, engagement, participation and attendance. Student satisfaction was high. TBL also encouraged student group development and generic skills, and this assists employers. Substantial benefits were also found for university law teachers in accounting schools.

Overall, we argue that the key benefit for accounting students from TBL stems from the demand by employers for employees with soft skills who can effectively work in teams. For universities, the strategic benefit from TBL is the improvement in the quality of university courses to better satisfy the requirements of the Tertiary Education Quality and Standards Agency.

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## I INTRODUCTION

A number of forces push towards innovation and the acceptance of new teaching methods in Australian university business schools. These include large class sizes and diversity of the student population, often characterised by a significant international student cohort, increasing complexity of topics (such as taxation law), growing pressures on school funding and teaching resources, and increasing focus to online teaching. The move towards greater accountability for research outputs also places added time pressure on academics to maintain teaching quality.

Additionally, with the rising use of teams in organisations there is a demand by employers for employees who can effectively work in teams.<sup>1</sup> This study compares the use of team-based learning (TBL) at an Australian university in 2013 and 2014 for undergraduate tax law tutorials with teaching used in 2009 and 2010.<sup>2</sup> After decades of building an evidence base of best teaching and learning practices in TBL, Michaelsen and Sweet<sup>3</sup> added that the permanent student teams enable interlocking synergies to form and, over the duration of an academic subject, students' generic skills and intellectual (academic thinking) capacities become amplified over that time. While the benefits of TBL have been tested and confirmed in other disciplines, little research has been undertaken on the benefits of TBL for accounting students, and even less in taxation law education.

Given that there is no known research into the use of TBL in teaching Australian taxation law to university accounting students, this study aims to assess its effectiveness. This TBL experiment was conducted with final-year accounting students studying an introductory taxation law topic covering taxation policy, goods and services tax and income tax.

First, this article explores the gaps in undergraduate accounting education. Second, the mooted benefits of TBL are examined and the theoretical underpinning for the TBL experiment is set out. The TBL experiment is then detailed, the findings analysed and conclusions drawn.

Research indicates that TBL aids educational outcomes and the students' ability to apply content. This was supported in observed and reported outcomes when applying TBL with undergraduate taxation law teaching, provided that students prepare and the scaffolding is sufficient. TBL was associated with significantly higher levels of student preparation, engagement, participation, attendance and performance. Student satisfaction was high. TBL encouraged student group development, generic skills, and leadership, and this

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<sup>1</sup> Robert Jeyakumar Nathan, Omar Shawkataly and Terence Siang, 'Universities at the crossroads: Industry or society driven?' (2013) 55(2) *Australian Universities' Review* 111; L Revere, P Decker and R Hill, 'Assessing Learning Outcomes Beyond Knowledge Attainment' (2012) 4(1) *Business Education Innovation Journal* 72.

<sup>2</sup> Larry K Michaelsen et al, 'Team Learning: A potential solution to the problems of large classes' (1982) 7(1) *Exchange: The Organizational Behaviour Teaching Journal* 13: defined TBL as 'extensive classroom use of permanent, heterogeneous, six or seven member student work teams to accomplish learning objectives'.

<sup>3</sup> Larry K Michaelsen and Michael Sweet, 'Team-based learning', in Larry K Michaelsen, Michael Sweet and Dean X Parmelee (eds), *Team-Based Learning: Small-Group Learning's Next Big Step* (Jossey-Bass, 2011) 41-51.

assists employers and helps address the gaps in undergraduate accounting information. There are substantial benefits for universities and teachers as TBL improves course quality and builds the joy of teaching.

## II EDUCATION NEEDS OF FUTURE ACCOUNTANTS

The key question for Australian business schools is the extent to which the curriculum and teaching in their accounting degrees satisfy the education needs of future accountants. While the acquisition of technical skills is important, generic skills are now of equal if not greater importance. 'Generic skills' is a somewhat vague concept,<sup>4</sup> but it has traditionally included writing, verbal and interpersonal skills. Previously, accountants' career success may have been centred on their proficiency at technical skills.<sup>5</sup> Today, generic skills have increased in importance, and now rank ahead of technical skills in their importance for career success.<sup>6</sup> These generic skills would also include graduates being work-ready.<sup>7</sup> When accounting students are prepared for the workplace, they quickly secure employment upon graduation and are successful as technicians and 'all-rounders'; this is a reflection of the quality of teaching and it impacts on reputation in the market place of the said university.

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<sup>4</sup> Neville Bennett, Elizabeth Dunne, and Clive Carre, *Skills Development in Higher Education and Employment*, (SRHE and Open University Press 2000); Ursula Lucas et al, 'Who writes this stuff?: students' perceptions of their skills development' (2004) 9(1) *Teaching in Higher Education* 55; Despina Whitefield and Louise Kloot, 'Skills? What skills? Personal and interpersonal skills: The process of prescribing definitions in an accounting degree' (2006) Proceedings of the Accounting Educators Forum 2005 (Wagga Wagga: Charles Sturt University).

<sup>5</sup> James E Rebele, 'An Examination of Accounting Students' Perceptions of the Importance of Communication Skills in Public Accounting' (1985) 3(1) *Issues in Accounting Education*, 41.

<sup>6</sup> R Mathews, M Jackson, and P Brown, 'Accounting in Higher Education: Report of the Review of the Accounting Discipline in Higher Education' Volume 1 (Australian Government Publishing Service, 1990); Helen A LaFrancois, 'The marketing of an accounting graduate: Characteristics most desired by CPA firms' (1992) 67(4) *Journal of Education for Business* 206; William P Birkett, 'Competency Based Standards for Professional Accountants in Australia and New Zealand' (Institute of Chartered Accountants in Australia and the New Zealand Society of Accountants, 1993); Teo Sock Kim, B C Ghosh and Low Aik Meng, 'Selection criteria: Perception gap between employers and accounting graduates' (1993), 9(4) *Singapore Accountant* 32; Reva Berman Brown and Sean McCartney, 'Competence is not enough: Meta-competence and accounting education', (1995) 4(1) *Accounting Education* 43; Gloria Agyemang and Jeffrey Unerman, 'Personal skills development and first year undergraduate accounting education: A teaching note', (1998) 7(1) *Accounting Education* 87; Catherine Usoff and Dorothy Feldmann, 'Accounting students' perceptions of important skills for career success' (1998) 73(4) *Journal of Education for Business* 215; Bob Gammie, Elizabeth Gammie and Erica Cargill, 'Personal skills development in the accounting curriculum' (2002) 11(1) *Accounting Education* 63; Paul D Hutchinson and Gary M Fleischman, 'Professional certification opportunities for accountants' (2003) 73(3) *The CPA Journal*, 48; T Hassall, J Joyce, J Montanto and J Anes 'Priorities for the Development of Vocational Skills in Management Accountants: A European Perspective' (2005) 29(4) *Accounting Forum* 379.

<sup>7</sup> Simon C Barrie, 'A research-based approach to generic graduate attributes policy' (2004) 23(3) *Higher Education Research & Development* 261; Bryan Howieson, 'Accounting practice in the new millennium: Is accounting education ready to meet the challenge?' (2003) 35(2) *British Accounting Review* 69.

Scott et al<sup>8</sup> developed a Professional Capability framework based on research on professional competence and expertise by Schön,<sup>9</sup> Morgan,<sup>10</sup> Gonczi and Hager,<sup>11</sup> Tennant,<sup>12</sup> Gardiner,<sup>13</sup> Goleman,<sup>14</sup> Scott,<sup>15</sup> Arthur Anderson et al,<sup>16</sup> Accounting Education Change Commission<sup>17</sup> and International Federation of Accountants.<sup>18</sup> This framework finds that generic or job-specific skills are necessary, and that the following skills are equally important:<sup>19</sup>

- a high level of social and personal emotional intelligence;
- a contingent way of thinking, an ability 'read' what is going on in each new situation and 'match';
- an appropriate course of action, and a capacity to deftly trace out and assess the consequences of alternative courses of action;
- a set of 'diagnostic maps' developed from handling previous practice problems in the unique work context.

Building upon these concepts, contemporary authors on the education of accountants have increasingly recognised the need to develop students' emotional intelligence as necessary for accounting practice in local and global markets, which are competitive.<sup>20</sup> As well, authors have noted the value of innovation, diagnostic ability and adaptability of students to the constantly evolving labour market demands of accountants across the globe.<sup>21</sup>

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<sup>8</sup> G Scott, W Yates and D Wilson, *Tracking and profiling successful graduates*, (2001) UTS, Sydney.

<sup>9</sup> Donald Schön, *The Reflective Practitioner* (Basic Books, 1983) 24, 25.

<sup>10</sup> Gareth Morgan, *Riding the Waves of Change: Managerial competencies for a turbulent world*, (1988) Jossey Bass, San Francisco.

<sup>11</sup> A Gonczi, P Hager and L Oliver, 'Establishing Competency Based Standards for the Professions' (National Office of Overseas Skills Recognition, Department of Education, Training and Youth Affairs, 1999).

<sup>12</sup> M A R K Tennant, 'Expertise as a dimension of adult development' (1991) 13(2) *New Education* 49.

<sup>13</sup> Howard Gardner, *Leading Minds* (Basic Books, 1995).

<sup>14</sup> Daniel Goleman, *Working with Emotional Intelligence* (1998) Bloomsbury, London.

<sup>15</sup> G Scott, 'Change, competence & education' in G Ryan (ed), *Learner Assessment & Program Evaluation* (APLN, 1996) 75.

<sup>16</sup> Arthur Andersen et al, 'Perspectives on Education: Capabilities for Success in the Accounting Profession' (1989).

<sup>17</sup> Accounting Education Change Commission, 'Objectives of Education for Accountants: Position Statement Number One' (1990) 5(2) *Issues in Accounting Education* 307.

<sup>18</sup> International Federation of Accountants, *Pre-qualification Education, Assessment of professional competence and experience of requirements of professional accountants*, (1996) New York IFAC.

<sup>19</sup> Scott, Yates and Wilson above n 8.

<sup>20</sup> Lyn Daff, Paul De Lange, and Beverley Jackling, 'A comparison of generic skills and emotional intelligence in accounting education' (2012) 27(3) *Issues in Accounting Education* 627; L Daff, Paul De Lange and Beverley Jackling, 'A closer look at how emotional intelligence may be used to enhance generic skills development in accounting education', *AFAANZ 2012*, Accounting and Finance Association of Australia and New Zealand (AFAANZ) 1; N A Aris et al, 'Assessment of critical success factors for accounting graduates employability' (2013), paper presented at the Business Engineering and Industrial Applications Colloquium (BEIAC), 2013 IEEE.

<sup>21</sup> R David Plumlee, Brett A Rixom and Andrew J Rosman, 'Training auditors to perform analytical procedures using metacognitive skills' (2014) 90(1) *The Accounting Review* 351; Javier Montoya-del-Corte and Gabriela M Farías-Martínez, 'Accounting Training Received in College vs. Labor Market Demands: The case of Mexico' (2014) *Stanisław Juszczak* 168; Dilrabo Jonbekova 'University Graduates' Skills Mismatches in Central Asia: Employers' Perspectives From Post-Soviet Tajikistan' (2015) 47(2) *European Education* 169.

### III EDUCATION GAPS IN UNDERGRADUATE ACCOUNTING EDUCATION

In Australia, professional accounting bodies and commentators have called for change in the manner in which accountants are educated.<sup>22</sup> Commentators have found that the accounting curriculum is dominated by specialised technical skills, and this does not provide leadership, generic, professional, ethical, and lifelong learning skills.<sup>23</sup> These commentators found that accounting educators have failed to provide appropriately qualified graduates for employers.<sup>24</sup> In 1990, Mathews reviewed the accounting education in 49 publicly funded institutions and assessed their ability to provide competent graduates.<sup>25</sup> Mathews recommended additional resources for accounting educations so as to reform the generic skills developed in accounting courses. However, governments declined to provide the additional support. A study by Jackling and De Lange suggests that employers regard technical skills as presumed in accounting graduates, and that it is the generic skill development in graduates that are the more valued quality for employability and career enhancement.<sup>26</sup> Tempone et al undertook research involving interviews with Australian employers of graduate accountants and representatives of accounting professional bodies, finding that interpersonal skills, team work and self-management were held in the highest regard.<sup>27</sup> This study highlighted the demands upon universities to deliver accounting graduates who have generic skills and are work-ready. And while much research and practice has gone into the development of educative programs in Australia aimed to ensure work readiness of graduates, particularly accounting graduates, via 'work integrated learning',<sup>28</sup> a recent study suggests that many university educators in academic subjects may continue to lack the motivation to change from traditional

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- <sup>22</sup> Mathews et al, above n 6; Chant Link and Associates, 'The future for Business' (Institute of Chartered Accountants in Australia, 1998); M Simister, P Roest and J Sheldon 'The CFO of the future' (1998) KPMG for the Chartered Accountants in Business Committee, Institute of Chartered Accountants in Australia, Sydney; CPA Australia, 'Guidelines for Joint Administration of Accreditation of Tertiary Courses by the professional Accounting Bodies, Accreditation Policy Guidelines' (1996); CPA Australia and The Institute of Chartered Accountants in Australia, 'Accreditation Guidelines for Universities' (2005); Scott Henderson, 'The education of accountants—comment' (2001) 25(4) *Accounting Forum*, 398; William P Birkett, 'Competency Based Standards for Professional Accountants in Australia and New Zealand' (NSW Institute of Chartered Accountants in Australia and the New Zealand Society of Accountants, 1993).
- <sup>23</sup> Wendy Crebbin, 'Teaching for Lifelong learning' in R Ballantyne, J Bain and J Packer (eds) *Reflecting on University Teaching Academics' Stories*, (1997) Canberra: CUTSD and Australian Government Publishing Service 139; R K Elliot and P D Jacobson, 'The evolution of the Knowledge Professional' (2002) 16(1) *Accounting Horizons* 69; Howieson, above n 7.
- <sup>24</sup> Ibid.
- <sup>25</sup> Mathews et al, above n 6.
- <sup>26</sup> Beverley Jackling and Paul De Lange, 'Do Accounting Graduates' Skills Meet The Expectations of Employers? A Matter of Convergence or Divergence' (2009) 18(4-5) *Accounting Education* 369, 381.
- <sup>27</sup> Irene Tempone et al, 'Desirable generic attributes for accounting graduates into the twenty-first century: The views of employers' (2012) 25(1) *Accounting Research Journal* 41.
- <sup>28</sup> Evangelina Elijido-Ten and Louise Kloot, 'Experiential learning in accounting Work-Integrated Learning: A three-way partnership' (2015) 57(2) *Education + Training* 204; Calvin Smith and Kate Worsfold, 'Unpacking the learning-work nexus: 'priming' as lever for high-quality learning outcomes in work-integrated learning curricula' (2015) 40(1) *Studies in Higher Education*, 22; Kirsten L MacDonald et al, 'The Professional Within: Effect of WIL' (2014) 15(2) *Asia-Pacific Journal of Cooperative Education* 159; Denise Jackson, 'Employability skill development in work-integrated learning: Barriers and best practice' (2015) 40(2) *Studies in Higher Education* 350.

lecture–tutorial modes to less-traditional forms of teaching and learning.<sup>29</sup> As a result, university educators in accounting may not be contributing to the development of ‘all-rounder’ accounting graduates.

Lack of student participation is a pervasive problem in university tutorials.<sup>30</sup> In particular, this is a real issue for accounting students.<sup>31</sup> In 1989, the Accounting Education Change Commission called for students to be active participants in classes rather than passive recipients of learning.<sup>32</sup> This is consistent with Australian higher education’s shift in preference towards teaching and learning models that achieve more than just knowledge acquisition via surface learning.<sup>33</sup> Since 1989, many tertiary educators in accounting have attempted to reform accounting education by implementing teaching methodologies that respond to the Commission’s identified graduates’ performance gaps, particularly via the implementation of non-traditional teaching and learning applications aimed to better engage accounting students in more relaxed atmosphere that are conducive to participatory and active learning, student engagement and heightened performance in the classroom, as well as critical thinking and deep learning.<sup>34</sup> More recently, educational research focused on accounting has indicated a nexus between teaching and learning strategies aimed to encourage student participation and higher student attendance and pass rates.<sup>35</sup>

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<sup>29</sup> Helen J McLaren and Paul L Kenny, ‘Motivating change from lecture-tutorial modes to less traditional forms of teaching’ (2015) 57(1) *Australian Universities Review* 26.

<sup>30</sup> Jean Keddie and Eileen Trotter, ‘Promoting participation – breathing new life into the old technology of a traditional tutorial (teaching note) (1998) 7(2) *Accounting Education* 171; Paul Ramsden, *Learning to teach in higher education* (Routledge Falmer, 2<sup>nd</sup> ed, 2003);, Elizabeth Stokoe, Bethan Benwell and Frederick Attenborough, ‘University students managing engagement, preparation, knowledge and achievement: Interactional evidence from institutional, domestic and virtual settings’ (2013) 2(2) *Learning, Culture and Social Interaction* 75; Paul Kenny, ‘Innovations in Teaching Tax Law to International Business Students’ (2012) *Global Business and Technology Association, Mapping the global future: evolution through innovation and excellence*, New York, 7 July 2012, 367.

<sup>31</sup> Pru Marriot and Neil Marriot, ‘Are we turning them on? A longitudinal study of undergraduate accounting students’ attitudes towards accounting as a profession’ (2003) 12(2) *Accounting Education* 113.

<sup>32</sup> Accounting Education Change Commission, above n 17, 307.

<sup>33</sup> McLaren and Kenny, above n 29.

<sup>34</sup> Doyle Z Williams, ‘Reforming accounting education’ (1993) 176(2) *Journal of Accountancy* 76; Ellen D Cook and Anita C Hazelwood, ‘An active learning strategy for the classroom—“who wants to win... some mini chips ahoy?”’ (2002) 20(4) *Journal of Accounting Education* 297; Paul Wells, Paul De Lange and Peter Fieger, ‘Integrating a virtual learning environment into a second-year accounting course: determinants of overall student perception’ (2008) 48(3) *Accounting & Finance* 503; William B Pollard, ‘An Active Learning Approach to Teaching Variance Analysis to Accounting Students’ (2014): 8(2) *e-Journal of Business Education and Scholarship Teaching*, 69; Sidney Weil et al, ‘Using asynchronous discussion forums to create social communities of practice in financial accounting’ (2013) 25(1) *Pacific Accounting Review* 30; Syed Zulfiqar Ali Shah, ‘The use of group activities in developing personal transferable skills’ (2013) 50(3) *Innovations in Education and Teaching International* 297; Mary E Phillips and Timothy R Graeff, ‘Using an in-class simulation in the first accounting class: moving from surface to deep learning’ (2014) 89(5) *Journal of Education for Business* 241; Curtis L DeBerg and Kenneth J Chapman, ‘Assessing student performance and attitudes based on common learning goals and alternative pedagogies: The case of principles of financial accounting’ (2012) 16 *Academy of Educational Leadership Journal* 63.

<sup>35</sup> Conor O’Leary and Jenny Stewart, ‘The interaction of learning styles and teaching methodologies in accounting ethical instruction’ (2013) 113(2) *Journal of business ethics* 225.



Similarly, in the United States,<sup>36</sup> accounting bodies and commentators have argued for a change in the way in which accountants are educated. Ravenscroft and Williams, in their discussion about accounting education post-Enron in the United States, have argued that:<sup>37</sup>

*there are currently serious omissions from the accounting curriculum that need to be rectified, and that accounting students are miss-educated in certain critical areas. In these areas the tendency is to inculcate students with a convenient mythology rather than to educate.*

Schwartz and Stout found that American practitioners had a greater preference for more practically based teaching methods than did tax educators.<sup>38</sup> Stara et al reported practitioners' preferences as being for the development of tax technical and written communication skills within university programs.<sup>39</sup> Notwithstanding acknowledgement that active learning approaches are more likely to stimulate the development of accounting students' generic skills, in contrast to traditional lecture-tutorial modes, recent research highlights that the lack of teaching skills, technologies, resources and perceptions of educators is likewise a barrier in the USA.<sup>40</sup>

In New Zealand, Tan and Veal found that educators and practitioners both indicated a higher level of conceptual understanding for students of most of the taxation topics, compared with technical proficiency.<sup>41</sup> Tan and Veal praised tax educators who focus on generic skills by way of case studies, group learning, problem solving, written assignments and oral presentations.<sup>42</sup>

In the United Kingdom, Simon and Kedsle<sup>43</sup> analysed responses from a survey of recruiters of trainee chartered accountants to rank the important attributes of applicants. Irrespective of the gender of applicant or size of firm, they found that oral and written communication skills and team work featured in the top five attributes. Interpersonal

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<sup>36</sup> Accounting Education Change Commission, above n 17; American Accounting Association Committee on the Future Structure, Content and Scope of Accounting Education (the Bedford Committee), 'Future Accounting Education: Preparing for the Expanding Profession' (1986) 1(1) *Issues in Accounting Education*, 168; American Institute of Certified Public Accountants, *Core Competency Framework for Entry into the Accounting Profession* (AICPA 1999); W Steve Albrecht and Robert J Sack, 'Accounting Education: Charting the Course through a Perilous Future' (American Accounting Association, 2000).

<sup>37</sup> Sue Ravenscroft and Paul F Williams, 'Accounting Education in the US post-Enron' (2004) 13 (S1) *Accounting Education* 7, 8, 12.

<sup>38</sup> Bill N Schwartz and David E Stout, 'A comparison of practitioner and educator opinions on tax education requirements for undergraduate accounting majors' (1987) 2 *Issues in Accounting Education* 112.

<sup>39</sup> Nancy Stara, Paul Shoemaker and James Brown, 'The curriculum required to develop a tax specialist: a comparison of practitioner opinions with current programs' (1991) 9 *Journal of Accounting Education* 79.

<sup>40</sup> Aldys Tan, Bickram Chatterjee and Susan Bolt, 'The Rigour of IFRS Education in the USA: Analysis, Reflection and Innovativeness' (2014) 23 (1) *Accounting Education* 54.

<sup>41</sup> Lin Mei Tan and John Veal, 'Tax Knowledge for Undergraduate Accounting Majors: Conceptual v Technical' (2005) 3(1) *eJournal of Tax Research* 28.

<sup>42</sup> *Ibid.*

<sup>43</sup> Jon Simon and Moira Kedsle, 'Factors affecting selection of trainee Chartered Accountants' (1997) Paper presented at British Accounting Association Annual Conference, Birmingham, 24-26 March 1997.



skills were ranked sixth, and problem-solving skills around tenth. Ranked almost at the bottom of the list of 36 possible attributes was the possession of a relevant degree. This implies that the topics studied at university are not of central importance to prospective employers. Miller and Woods found that 'in terms of transferable ability from the university taxation course to the employment situation, the universities are not succeeding.'<sup>44</sup> Notably, the UK's university education system is very different from that of other common law countries with respect to accounting education.

While universities work to develop graduate attributes and qualities of good communication skills, team work and inter personal skills,<sup>45</sup> the accounting profession is often critical of graduates' skills in these areas, indicating that this is an area warranting further improvement.

#### IV BENEFITS OF TBL

Michaelsen et al defined TBL as 'extensive classroom use of permanent, heterogeneous, six or seven member student work teams to accomplish learning objectives'.<sup>46</sup> Work teams dominate industry due to long-standing and contemporary research indicators that team work leads to better decision making.<sup>47</sup> Business and government employers rely on work teams to achieve organisational goals, and these employers seek employees who can effectively work in teams. This is particularly the case when team players have good interpersonal and problem-solving skills.<sup>48</sup> Business leaders have concerns about new recruits who are technically proficient but who are socially ill equipped to solve organisational problems.<sup>49</sup> When employees are unwilling, unable or ill equipped to share with others this inhibits problem identification, task achievement, employee interactions and the achievement of organisational goals.<sup>50</sup> Other research suggests that for tasks requiring significant intentional depth, the performance of high-level individuals is

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<sup>44</sup> Angharad M Miller and Christine M Woods, 'Undergraduate tax education: a comparison of educators' and employers' perceptions in the UK' (2000) 9(3) *Accounting Education* 223, 238-9.

<sup>45</sup> Tertiary Education Quality and Standards Agency, 'Process guide: applying for renewal of registration' Version 1.1 Effective from 2 June 2014, 2 To renew registration, TEQSA will need evidence from the provider of "outputs and outcomes that: demonstrate how effective your operations are in delivering positive student outcomes and experiences, while maintaining academic standards and reinforce student and public confidence in your organisation..." [www.teqsa.gov.au/sites/default/files/RenewalofRegistrationProcessGuidev1.1170215.pdf](http://www.teqsa.gov.au/sites/default/files/RenewalofRegistrationProcessGuidev1.1170215.pdf).

<sup>46</sup> Larry K Michaelsen et al, 'Team Learning: A potential solution to the problems of large classes' (1982) 7(1) *Exchange: The Organizational Behaviour Teaching Journal* 13.

<sup>47</sup> Richard A Guzzo and Gregory P Shea, 'Group performance and inter-group relations in organizations' (MD Dunnette and LM Hough eds), *Handbook of industrial and organizational psychology* Vol 3 (2<sup>nd</sup> ed 1992); Maneula Pardo-del-Val, Clara Martínez-Fuentes, and Salvador Roig-Dobón, 'Participative management and its influence on organizational change' (2012) 50(10) *Management Decision* 1843.

<sup>48</sup> E Michael Bamber, Richard T Watson and Mary Callahan Hill, 'The effects of group decision support systems technology on audit group decision making' (1996) 15(1) *Auditing, a Journal of Theory and Practice* 122.

<sup>49</sup> James RBaily et al, 'A model for reflective pedagogy' (1997) 21 *Journal of Management Education* 155; D G Holt and C Willard-Holt, 'Let's get real: Students solving authentic corporate problems' (2000) 82 *Phi Kappa Deltan* 243.

<sup>50</sup> John R Turner, Tekeisha Zimmerman and Jeff M Allen, 'Teams as a sub-process for knowledge management' (2012) 16(6) *Journal of Knowledge Management* 963.

superior to that of groups.<sup>51</sup> Groups compromise in their decisions, and while this may result in better than average performance, it is performance at a lower level than that of the best individual performance. Hancock et al found that team work and good communication skills were highly sought after in accounting graduates by employers, and made a difference in their advancement in the workplace.<sup>52</sup>

TBL has been found to increase student participation, aid educational outcomes and result in high satisfaction levels for students.<sup>53</sup> TBL assists students understanding of content and their ability to apply content.<sup>54</sup> There are also benefits from TBL in improving the effectiveness of teaching large class sizes.<sup>55</sup> Further, TBL is helpful in other challenging teaching situations such as diverse student groups, courses with extended class durations, and courses that require analytical thinking skills.<sup>56</sup> There are also benefits for university teachers as TBL improves the enjoyment of teaching.<sup>57</sup>

TBL has enjoyed success in a number of disciplines such as medicine, nursing, health sciences, general embryology,<sup>58</sup> but there is no known Australian study of the use of TBL for undergraduate accounting students studying taxation law, although TBL has also been used in accounting education at the University of Sydney and the University of Western Australia.

Research in Belgium by Opdecam and Everaert found that TBL, applied to teaching financial accounting with first year students, resulted in the students engaged in TBL reporting higher levels of satisfaction and positive course experience when compared with a traditional lecture-based control group.<sup>59</sup>

In the USA, Reinig et al applied TBL with accounting students in taxation law education and found that some level of team disparity among team members stimulated the development of teamwork skills, team cohesiveness, team accountability, and individual performance and improved student learning outcomes.<sup>60</sup> Further, Reinig et al found that a process-centred curriculum, such as that achieved via TBL, provided accounting students with an educational experience that was broader and more consistent with both the accounting profession's expectations of new graduates and modern business

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- <sup>51</sup> Ernest J Hall, Jane S Mouton and Robert R Blake, 'Group problem solving effectiveness under conditions of pooling vs interaction' (1963) 59 *Journal of Social Physiology* 14; Charles R Holloman and Hal W Hendrick, 'Problem solving in different sized groups' (1971) 24 *Personnel Psychology* 489.
- <sup>52</sup> Phil Hancock et al, *Accounting for the future: more than numbers* Vol 1 Final Report (Australian Learning and Teaching Council 2009), 18.
- <sup>53</sup> Larry K Michaelsen, 'Three keys to using learning groups effectively' (1998) 9(5) *Teaching Excellence: Towards the best in the academy*, Ames IA: POD Network, <http://teaching.uchicago.edu/ete/97-98/Michaelsen.html>.
- <sup>54</sup> L Dee Fink, 'Team learning: Putting "Team" into learning groups' (2007) <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.138.8502&rep=rep1&type=pdf>.
- <sup>55</sup> Michaelsen et al, above n 2.
- <sup>56</sup> Fink, above n 54.
- <sup>57</sup> Ibid; Michaelsen, above n 53.
- <sup>58</sup> Hancock et al, above n 52, 18.
- <sup>59</sup> Evelien Opdecam and Patricia Everaert, 'Improving student satisfaction in a first-year undergraduate accounting course by team learning' (2012) 27(1) *Issues in accounting education* 532.
- <sup>60</sup> Bruce A Reinig, G E Whittenburg and Ira Horowitz, 'Modelling performance improvement and switching behaviour in team learning' (2009) 18(4-5) *Accounting Education* 487.

practices.<sup>61</sup> Additionally, Reinig et al found that students' attitudes towards TBL, and particularly to team assessment, were developed in the first weeks of teaching based more on their satisfaction with group members than on the teaching method.<sup>62</sup> Thus, while students are assimilating to TBL, it is vital to develop team formation, the learning content and the nature of assessment for the first weeks.

A number of studies have determined the criteria used by students to determine whether a higher education course is of a higher quality than another.<sup>63</sup> Scott, Yates and Wilson found that students are most impressed when their university courses:<sup>64</sup>

- Are immediately relevant to their particular background, abilities, needs and experiences;
- Provide more opportunities for active learning than they do for passive learning;
- Consistently link theory with practice;
- Effectively manage students' expectations right from the outset;
- Ensure that learning proceeds in a clear direction and is 'digestible';
- Use a valid graduate capability profile to specifically generate appropriate assessment tasks;
- Provide them with opportunities to pursue flexible learning pathways;
- Ensure that feedback on assessment tasks is both timely and detailed;
- Not only include opportunities for self-managed learning using both digital and paper-based resources but actively coach students on how to undertake it;
- Provide support and administrative services which are easily accessed, responsive to students needs and which specifically work together to optimise the total experience which a student has of the university or college;
- Acknowledge prior learning and make provision for its recognition in both learning and assessment.

The above criteria suggest that TBL can improve course quality and the student experience by: providing more opportunities for active learning than passive learning; using a valid graduate capability profile to specifically generate appropriate assessment tasks; ensuring that feedback on assessment tasks is both timely and detailed; and developing teams that provide support to students will improve the student experience.

Overall, we argue that the key benefit for accounting students from TBL stems from the demand by employers for employees with soft skills who can effectively work in teams. It is important that the assessment utilises reflections assignments and ongoing individual tests to dissuade free riders and ensure the integrity of TBL. For universities, the key benefit from TBL is the improvement in the quality of university topics and courses as well as student and teacher satisfaction.

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<sup>61</sup> Bruce A Reinig, Ira Horowitz and G E Whittenburg, 'Does attitude towards one's group impact student performance in a team-exam environment? A longitudinal analysis.' (2012) 5(1) *International Journal of Applied Decision Sciences* 77-96.

<sup>62</sup> Bruce A Reinig, Ira Horowitz and Gene Whittenburg, 'Determinants of Student Attitudes toward Team Exams' (2014) 23(3) *Accounting Education* 244.

<sup>63</sup> G Foley, 'Understanding Adult Education and Training' (2000), Sydney, Allen & Unwin, 2nd Ed, 7.

<sup>64</sup> Scott et al, above n 8.

## V THEORETICAL GUIDELINES FOR TBL EXPERIMENT

This experiment is based on the TBL model pioneered by Michaelsen.<sup>65</sup> Under this model, small-group or TBL methods can aid educational goals where the teachers motivate the students to prepare and engage in 'give and take' discussions.<sup>66</sup> The following three keys are considered to be important to the effectiveness of such group learning.

First, promoting ongoing accountability is vital to prevent under-preparation by students and the group work becoming a social event.<sup>67</sup> Thus individuals and groups should be set tasks and assessed on their success.<sup>68</sup> Individuals can be set individual tests, and verbal discussions for each individual can be assessed by way of peer evaluations. Groups can be tasked with assignments that require an output that can be assessed so as to facilitate an inter group comparison.

The second key involved using linked and mutually reinforcing assignments at the individual work stage, the TBL stage, and the total class discussion stage of the teaching process.<sup>69</sup> To optimise the impact on learning, assignments should be characterised by three S's: *same problem*; *specific choice* and *simultaneously report*.<sup>70</sup> Under the 'same problem', individual groups should work on the same issue. For 'specific choice', individual groups should use topic concepts to make a specific choice. Finally, groups should be required to report simultaneously.

Thirdly, practices that stimulate an exchange of ideas should be adopted.<sup>71</sup> For assignments, this can be achieved by providing tasks that require group interaction – for example, requiring students to use course concepts to make difficult choices. Barriers to participation can be alleviated by using permanent groups, assignments, and a grading system that encourages group development.<sup>72</sup> Work in the classroom is preferred, given the time constraints and difficulty for students of meeting outside class, which can limit any serious group work.<sup>73</sup> Creating diverse groups of between 5 and 7 individuals exposes students to new ideas.<sup>74</sup>

Additionally, TBL was incorporated into a scaffolding approach to teaching. This experiment broadly follows the definition of scaffolding provided by Dickson, Chard and Simmons as 'the sequencing of prompted content, materials, tasks and teacher and peer support to optimise learning'.<sup>75</sup> In this experiment, scaffolding is transitory, as student

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<sup>65</sup> Michaelsen, above n 53.

<sup>66</sup> Ibid.

<sup>67</sup> Ibid.

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

<sup>72</sup> Larry K Michaelsen, Robert H Black and L Dee Fink, 'What every faculty developer needs to know about learning groups' in Richlin (ed), *To improve the Academy: resources for faculty instructional and organizational development* (New Forums Press, 1996) 31.

<sup>73</sup> Michaelsen, above n 53.

<sup>74</sup> Ibid.

<sup>75</sup> S V Dickson, D J Chard and D C Simmons, 'An integrated reading/writing curriculum: A focus on scaffolding' (1993) 18(4) *LD Forum* 12, 12.

support from teachers is withdrawn for [OR: during?] the case study to facilitate deeper student learning and research skills.

As suggested by Michaelsen, student peer reviews of each other were also incorporated into the TBL so students could reflect on their own performance and that of their team members. McAlpine, Reidsema and Allen found such feedback enhanced students' awareness of team processes and aided their understanding that they needed to contribute to the team.<sup>76</sup> Abraham also established that such a student-centred blended learning approach enhanced student motivation and student grades.<sup>77</sup> The teams comprised randomly selected groups of students to ensure diversity as required by TBL.

## **VI THE TBL TAXATION LAW EXPERIMENT**

Over the comparison years (2009, 2010, 2013 and 2014) the taxation law tutorials to undergraduate accounting students involved a diverse cohort of domestic and international (primarily Asian) students. The 50 minute tutorials for the introductory taxation topic ran over 12 weeks (1 tute per week) during semester one of both years. The author and other tutors presented these tutorials.

### ***A. The 2009–10 Taxation Law TBL Experiment***

In 2009, the taxation law tutorials were conducted without TBL and student participation was not assessed. The tutorials were largely tutor based, with the tutor didactically providing answers and with some prompting of students for answers and class discussion. The tutors' explanations dominated the discussion.

In 2010 some team-based assessment was introduced involving teams of 4–5 students in tutorials (usually four teams per tute group). The team work departed from Michaelsen's three keys, since weekly individual based tests were not used and team size of four was below the ideal of between five and seven. The team exercise involved approximately four multiple choice questions (MCQ). The team tutorial work was worth 10% of the assessment. Other assessment consisted of: 10% mid semester test; 30% individually based tax research assignment and 50% final exam.

### ***B. The 2013–14 Taxation Law TBL Experiment***

In 2013–14 the TBL experiment was aligned with Michaelsen's three keys by introducing assessed weekly individual based tests, a team research assignment, a reflections assignment and increasing the team size to 6–7.

In 2013 this involved a TBL tutorial exercise which constituted 5% of the assessment as well as a 5% ten-minute unseen individual tutorial test. Additionally, team work was

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<sup>76</sup> Iain McAlpine, Carla Reidsema and Belinda 'Allen, Educational design and online support for an innovative project-based course in engineering design', in L Markauskaite, P Goodyear and P Reimann (eds), *Proceedings of the 23rd Annual ASCILITE Conference: Who's learning? Whose technology?* (Sydney University Press, 2006) 497.

<sup>77</sup> A Abraham, 'Teaching accounting using student-centred pedagogy: A blended learning versus a traditional approach', *AFAANZ Conference Proceedings*. 7–9 July 2008, Sydney, Australia, 1–27.

further supported by moving to a 23% team-based tax research assignment and a 2% peer review reflections assignment. The reflections assignment was designed to encourage students to reflect on their own performance and that of their team members. Other assessment included a 10% mid-semester test, 5% tutorial participation and a 50% final exam. The team-based assessment of free riders identified in the reflections assignment was adjusted down by the lecturer in accordance with the feedback provided by team members. Free riders were also identified in the weekly individual tests.

Similarly, in 2014 a TBL tutorial exercise constituted 7.5% of the assessment as well as a 7.5% ten-minute unseen individual tutorial test. Team work was again aided by a 25% team-based tax research assignment and a 5% peer review reflections assignment. Other assessment included a 10% mid-semester test and a 45% final exam.

The group members remained unchanged during the teaching semesters in 2013–14. MCQ sheets were handed out to each team at the beginning of each tutorial and the group was given about 15–20 minutes to ascertain answers. Over the ten weeks of these tests, 37 MCQ questions were provided to teams. Teams simultaneously reported their answers in the tutorials. The provision of extensive and timely feedback was a key feature of TBL. After each question, the tutor provided an explanation for the correct answer and invited discussion. The teams' weekly results (without individual member names) were published on the topic's intranet site and were accessible by all taxation law students. The grading system was designed to encourage group development and competition.

The 2013–14 experiment promoted ongoing accountability for teams (by the MCQ tests and a research assignment) and individuals (individual tests and reflections assignment). Also, the experiment involved linked and mutually reinforcing assignments at the individual work stage, the TBL stage and the total class discussion stage of the teaching process. Further, the use of the MCQs meant that the '3 S' protocol was followed. Teams were given the same MCQ tests, which involved groups using topic concepts to make a specific choice. The groups were required to report simultaneously. Students needed to use course concepts to make difficult choices. The experiment used permanent groups, MCQ tests and a grading system. All of the work was conducted in the classroom and with diverse groups of between 6 and 7 students.

Note that the university standardised the unit value of all topics offered to 4.5 units,<sup>78</sup> equating to 25% of fulltime workload (previously a six-unit topic, being one-third of a full-time student workload) from 2011. Thus, full-time students had to study another three topics, rather than two topics, in 2013–14, implying a higher student workload for tax law to meet the professional bodies' requirements, compared with 2009–10.

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<sup>78</sup> To ensure consistency with other universities to facilitate improved articulation and credit.



## VII TBL AND THE IMPACT ON STUDENT PERFORMANCE

### A. Scaffolding

The differences in the scaffolding for student support during the 2009–10 and 2013–14 years are set out below in Table 1.

**Table 1: Scaffolding Assessment Stages 2009, 2010 and 2014**

2009	2010	2013–14
5. Teacher feedback to individuals	5. Teacher feedback to individuals	6. Teacher feedback to individuals and teams
		5. Individual students submit Reflections Assignment
4. Individuals analyse, research, provide written submission for case study	4. Individuals analyse, research, provide written submission for case study	4. Teams analyse, research and discuss, provide written submission for case study
3. Planning by individuals for case study	3. Planning by individuals for case study	3. Planning by teams for case study
2. Individual case study problem allocated, explained by teacher	2. Individual case study problem allocated, explained by teacher	2. TBL case study problem allocated, explained by teacher
1. Weekly tutorials with no participation marks	1. Weekly tutorial team quizzes and instant feedback provided by teacher; and participation marks	1. Weekly tutorial TBL and individual quizzes and instant feedback provided by teacher

The above table describes the scaffolding process from the beginning of the semester (level 1) to the end of semester (level 5 or 6). This shows how scaffolding increased over the period 2009–2014. In 2010, the scaffolding improved with the introduction of weekly team tests. In 2013–14, with the introduction of TBL, the scaffolding improved significantly upon the addition of individual tests, team research assignments and peer review assignments.

### ***B. Student Performance in Tax Research Assignments***

The tax research assignments<sup>1</sup> in the three experiment years used similar formats and levels of complexity, and identical weightings for its component parts. The student performance in tax research assignments over the experiment years is set out in the table below.

**Table 2: Analysis of research assignment performance 2009, 2010, 2013 and 2014**

	<b>Fail</b>	<b>Pass</b>	<b>Credit</b>	<b>Distinction</b>	<b>High Distinction</b>
<b>2009</b> <b>(158 students)</b>	4 (2%)	27 (17%)	58 (37%)	38 (24%)	31 (20%)
<b>2010</b> <b>(147 students)</b>	7 (5%)	31 (21%)	59 (40%)	32 (22%)	18 (12%)
<b>2013</b> <b>(100 students)</b>	0 (0%)	12 (12%)	39 (39%)	45 (45%)	4 (4%)
<b>2014</b> <b>(87 students)</b>	0 (0%)	5 (6%)	14 (16%)	47 (54%)	21 (24%)

The above table compares research assignment performance. This shows a slight drop in performance in individual research assignments in 2010 compared with 2009, with 2009 having considerably more high distinctions and a lower number of fails. In 2013–14, the move to TBL tax research assignments resulted in a significantly higher standard of assignments compared with 2009 and 2010. There were 49% (2013) and 78% (2014) of distinction and higher grade assignments compared with 44% in 2009 and 34% in 2010. There were also no fails in 2013–14, unlike 2009 and 2010. This appears indicative of generally higher quality team-based assignments in 2013–14 as opposed to individual assignments in 2009–10. This result is even more impressive given the relatively higher student workload in 2013–14 compared with 2009–10, when, as noted, the unit structure changed. This finding is consistent with the literature, which shows that TBL aids educational outcomes and improves students' ability to understand and apply content.<sup>2</sup>

<sup>1</sup> Paul Kenny, Michael Blissenden and Sylvia Villios, *Australian Tax 2015* (Lexis Nexis Butterworths 2015), 730–4.

<sup>2</sup> Michaelsen, above n 53.

### C. Student Performance in Final Year Exam

The final exam in 2009, 2010, 2013 and 2014 involved a 2.5 hour exam paper with similar levels of complexity and formats, and identical weightings for the component parts. The following table outlines student performance in the four experiment years.

**Table 3: Analysis of final exam performance 2009, 2010, 2013 and 2014 years<sup>3</sup>**

	<b>Fail (Did not sit exam)</b>	<b>Fail</b>	<b>Pass</b>	<b>Credit</b>	<b>Distinction</b>	<b>High Distinction</b>
<b>2009 (190 students)</b>	19 (10%)	29 (15%)	55 (29%)	53 (28%)	30 (16%)	4 (2%)
<b>2010 (160 students)</b>	21 (13%)	30 (19%)	42 (26%)	38 (24%)	26 (16%)	3 (2%)
<b>2013 (102 students)</b>	7 (7%)	14 (14%)	51 (50%)	19 (18%)	9 (9%)	0 (0%)
<b>2014 (96 students)</b>	13 (13%)	18 (19%)	30 (32%)	22 (23%)	11 (12%)	1 (1%)

The above table compares final exam performance. This shows that the introduction of team work in 2010 resulted in minimal differences, without any positive impact on exam performance compared with 2009. The introduction of TBL in 2013–14 also was not associated with any improvement in exam performance compared with 2009–10. The exam performance appears to have declined since 2013. The number of fails remained at similar levels in all four years. However, credit and above grade students were only 27% (2013) and 36% (2014) compared with 46% in 2009 and 42% in 2010. This does not suggest that TBL works to improve individual student performance – in contrast to the finding by Reinig et al that individual performance is enhanced.<sup>4</sup> However, as noted above, in 2011 the university standardised the unit value of all topics to 4.5 units, implying a

<sup>3</sup> It is noted that fewer students completed the research assignment than completed the assessed exam performance in each of the years. This difference arose from students who did not take part in the research paper but remained enrolled in the topic (the 'did not sit exam' fails) or who negotiated a change in assessment that excluded the research paper.

<sup>4</sup> Reinig et al, above n 60.

relatively higher workload in 2013–14. This finding is very tentative, given the differences in student workload, student numbers and potential differences in student quality over the four years. Given that this small sample set is confined to one topic, these findings are not considered generalisable for detailed statistical analysis.

#### ***D. Student Reflections Assignment***

The assessed 2014 reflections assignment<sup>5</sup> enabled students to reflect on their own performance and that of their team members. This provided important feedback for the teachers and students. Student feedback from the peer review exercise identifies team members who freeride, since students have to assess each team member out of a score of one to ten on their contribution, and support this with details of the individuals input. Answers to the following key questions on TBL are set out in the table below.

**Table 4: Key Data TBL Survey Results in 2014**

Number (percentage) of students who had no prior group work experience	1 out 96 of students (1%)
Average number of meetings	4.7
Average duration of meetings	1 hour 38 Minutes
Total average time in meetings	7 hours 18 minutes
Percentage of teams that had a leader	41%

The survey shows that almost all students had prior group work experience. A significant number of teams (41 per cent) developed leaders. This is consistent with the literature that TBL improves student leadership.<sup>6</sup> A strong work ethic and an onerous research task is suggested by the average of 4.7 team meetings that totalled an average time of 7 hours 18 minutes. This provides an insight into how students work. Perhaps, greater efficiency could be achieved outside of meetings – for example, by the use of shared documents, internet and email. This also suggests that the size of the team research assignment be reduced to accommodate a more appropriate workload for a 4.5 unit topic.

Additionally, the students rated each aspect of the questions below about team harmony and performance by placing an “X” in the most appropriate box.

<sup>5</sup> The reflections assignment was based on an assignment provided in 2011 by A Abraham, School of Accounting, College of Business and Law, University of Western Sydney.

<sup>6</sup> Reinig above n 60.

**Table 5: Average Student Responses to Likert Scale Questions on Team Harmony and Performance**

	1	2	3	4	
1.Members were suspicious of each other				x	High degree of mutual trust in the group
2.Everyone worked for themselves				x	Genuine support for each other
3.Communication was guarded and cautious				x	Communication was authentic and open
4,One member dominated the group			x		All members participated equally
5.The project was clearly understood		x			The project was not clearly understood
6.Group was negative towards project				x	Group was committed to project
7.Group denied, avoided or suppressed conflict				x	Group brought out conflicts and worked through them
8.My ideas, abilities, knowledge and experience were not properly drawn out and not properly used				x	My ideas, abilities, knowledge and experience were properly drawn out and used
9.Group had no set strategies for the task				x	Group had set strategies for the task
10.Strategies were not successful				x	Strategies were successful
11.Time management was a problem for the group			x		Time was not a problem for the group
12,We had the same ideas about the questions			x		We had different approaches to

								answering the questions
13. Other people's ideas did not help my understanding						x		Other people's ideas helped me to understand the material better
14. One person could have done the assignment best						x		2 or 3 minds are more effective than one
15. The sharing of ideas and the discussions did not lead to better understanding						x		The sharing of ideas and the discussions lead to better understanding
16. It did not teach us to cooperate within a team						x		It taught us how to cooperate within a team
17. We always agreed about what to do					x			We compromised to form a united decision
18. We did not explain information to each other						x		We explained information to each other
19. I did not help my team members learn						x		I helped my team members learn
20. Individual knowledge was sufficient						x		Collective knowledge was greater than individual knowledge
21. I did not feel any accountability to my group						x		I felt accountability to my group
22. The group process did not promote learning						x		The process enabled members to learn from each other

Again, given that this small sample set is confined to one topic, these findings are not considered generalisable for detailed statistical analysis. However, the reflection



feedback indicates that the teams worked in harmony and performed well in the MCQs and the research assignment, as seen by the average 3.5 out of four ratings given for 17 out of the 22 questions. There were also good ratings (average 3 out of 4) for: members participating equally; time management; and the ability to compromise. These findings are consistent with the literature that TBL provides high levels of satisfaction and positive course experience<sup>7</sup> and develops team cohesiveness, team accountability and team work skills, individual performance and improves student learning outcomes.<sup>8</sup>

There was a mixed response (average 2.5 out of 4) about whether or not the team members had the same ideas in answering questions. This appears to be indicative of the complexity of the TBL tutorial questions and the research assignment.

The survey also provided valuable feedback for teachers on the level of student support, as the rating for understanding the case study was relatively moderate. This appears to reflect (at least in part) the deliberate removal of scaffolding and the complexity of the case study research tasks. A number of students have difficulty in learning how to use the Australian Taxation Office legal data base and law publisher's database and/or do not appreciate the time-intensive nature of this task. This response may reflect a student overload in the topic (in particular the team research paper) compared with the standard student workload of 9 hours per week at this university for 4.5 unit topic (that represents 25% of a full-time student workload).<sup>9</sup> This result is institution-specific, since other universities may employ topics that have different student workloads. For example, the workload at another institution maybe based on a 40 hour week.<sup>10</sup>

Students were also asked in the reflections assignment how they preferred to be taught in tutorials. They were provided with the three options, the student responses were as in Table 6.

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<sup>7</sup> Opdecam and Everaert, above n 59.

<sup>8</sup> Reinig et al, above n 60.

<sup>9</sup> A recommended full-time student workload consists of four topics of 9 hours workload per week each, therefore 36 hours overall study commitment per week. The impact of variation in weekly workloads within and across four topics is indeterminate.

<sup>10</sup> For example, at the University of Sydney, for a full-time enrolled student, the normal workload, averaged across the 16 weeks of teaching, study and examination periods, is about 37.5 hours per week: <https://student.unsw.edu.au/uoc>.

**Table 6: Tutorial preferences**

Which teaching method do you prefer for tutorials:	2014 Student responses
A. Active learning consisting of weekly TBL tests (10% of assessment; 15 minutes of tute) weekly individual tests (10% of assessment, 15 minutes of tute) also with some tutor led tute questions (20 minutes of tute) [as used in 2014 tax law tutes]	72 (99%)
B. Passive Tutor led tute discussion questions supported by face to face lectures and text book (traditional method)	
C. Other method (students to specify) .....  online quizzes	1
Total responses	73
Survey response rate (total 96 students)	76%

This shows an overwhelming preference for active TBL-based tutorials over traditional passive teaching methods.

Other student feedback gave further insights into the skills obtained through face-to-face team work. One student noted:

*Sometimes I just cannot consider questions comprehensively and my group members help me. Every member explains their options while we discuss, this really helps a lot.*

Another student stated:

*The particular group worked well together and were committed to the project, so meetings and discussions were fruitful, constructive and everyone respected each other's commitment. The shared ideas and the prospect of not working alone that there is someone else to bounce ideas off and share the load. Sometimes working alone is a bit narrow and having other people to give ideas makes you expand your thinking.*

### ***E. Teachers' Impressions***

As noted above, in 2009, the teaching was passive, with the tutors didactically providing answers and with limited class discussion. In 2010, teachers observed that the students enjoyed working in teams. Initially the level of team verbal class participation and discussion was rather low, but this improved significantly over the semester. Tutorial attendance was significantly higher than in 2009. A tutor in the topic in 2010 observed:<sup>11</sup>

*The impact on students was a positive one because the competitive nature of the team approach generated more enthusiasm and interest in the tutorial class. It provide[s] a 'light' and entertaining relief from the normal procedure which the students enjoyed and looked forward to each week. Students were more likely to attend the tute because the team questions formed part of the overall assessment. Also [this is] a good practical learning experience for the students as they have to work as a team and make decisions by discussion and consensus.*

From the teachers' impressions, in 2013–14, the introduction of TBL significantly raised the level of participation and student preparation compared with 2009. TBL facilitates a more enjoyable learning experience for students. Stress and boredom for teachers and students are greatly reduced by the high levels of student engagement. These impressions were supported by the findings of improved team research assignment performance over individual assignments and in the students' responses to the likert survey noted previously. This is also supported by the literature, which shows that TBL improves the enjoyment of teaching,<sup>12</sup> and results in higher levels of student satisfaction and positive course experience compared to a traditional lecture.<sup>13</sup>

## **VIII CONCLUSION**

In keeping with the literature, this analysis of introducing TBL research assignments, the reflections assignment and teacher impressions shows that TBL was associated with significantly higher levels of student tutorial preparation, engagement, participation and attendance. Student satisfaction was high. TBL encouraged student group development, generic skills and this assists employers. Further, there are substantial benefits for university teachers as TBL adds to the joy of teaching.

However, while the literature suggests that TBL improves individual performance, the individual student exam results did not improve with the introduction of TBL in 2013–14. The exam results in 2013–14 though were impacted by the change from a 6 unit to 4.5 unit topic as well as differences in student cohorts, and thus do not facilitate a good comparison.

Overall, as the teaching team and students found, there are clear benefits to using TBL that follows Michaelsen's three keys in the teaching of taxation law. It is submitted that the key benefit for accounting students from TBL stems from the demand by the

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<sup>11</sup> T Trimboli, Feedback on TBL for taxation law tutorials, email dated 22 March 2011.

<sup>12</sup> Fink, above n 54, Michaelsen, above n 53.

<sup>13</sup> Opdecam and Everaert, above n 59.

accounting profession and other employers for employees with soft skills and that can effectively work in teams. For universities the strategic benefit from TBL is the improvement in the quality of university courses so as to better satisfy the requirements of the Tertiary Education Quality and Standards Agency.

This study has a number of limitations. The results may be tentative given the differences in students' cohorts in the comparison years. There was a significant variance (decline) in total student numbers in the four years and there may have been some variation in student quality. Further, the transition from a 6 unit tax law topic to a 4.5 unit topic during the comparison period and the apparent higher student workloads in 2013–14 also hindered assessing the impact of TBL. The sample size was too small to allow for statistical analysis.

**A PUBLIC POLICY CASE STUDY OF THE INTRODUCTION OF THE GOODS AND SERVICES TAX: TAX REFORM CAN BE SUCCESSFULLY ACHIEVED<sup>†</sup>**

JOHN ALVEY\* AND AMANDA ROAN\*\*

**ABSTRACT**

The introduction of the Goods and Services Tax (GST) which took more than 30 years to implement in Australia is examined in this paper. We aim to address the enduring public policy question of the extent to which policies can be formulated on the basis of rational evidence-based decision making. The three landmarks for the introduction of the GST: (1) the National Tax Summit (1985); (2) *Fightback!* (1991, 1992); and (3) *ANTS* (1998, 1999) are used to demonstrate that rationality in decision making of policy makers re-emerged with each new attempt at policy formulation, despite being interwoven with complex political processes.

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<sup>†</sup> This paper is an extension of the research undertaken by John Alvey for his PhD thesis (2014) at UQ Business School at The University of Queensland and a revised version of a paper presented at the Australasian Tax Teachers Association (ATTA) Conference at the Adelaide Law School, The University of Adelaide on 19 January 2015.

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## I INTRODUCTION

The year 2015 marks the 40<sup>th</sup> anniversary of the release of the Asprey Report (1975),<sup>1</sup> which was the first report to recommend a value added tax (VAT). It paved the way for future tax reform and eventually led to the Howard Government's *ANTS* (1998) and the GST. The theme of the ATTA Conference 2015 – 'Tax: It's time for change' – is reminiscent of the 1972 federal Australian Labor Party (ALP) election campaign, 'Its time'. It is also the 30<sup>th</sup> anniversary of The Draft White Paper – *RATS* (1985),<sup>2</sup> which recommended a broad-based consumption tax (BBCT). Also, and most significantly, it is the 15<sup>th</sup> anniversary of the introduction of the GST in Australia in 2000. It is timely therefore to look again at the GST as tax reform successfully achieved in Australia.

The possibility of rationality in policy making, which has dominated the public policy literature in the 1960 and has re-emerged in other guises such as evidence-based policy,<sup>3</sup> is the key focus adopted here in an effort to understand the long timeframe involved in the acceptance of the GST in Australia. Rationality is the starting point in policy making, and one of the principles of advice in the public sector – that is, rationality in the sense of neutrality. However the focus of the literature in recent years has been to explain the effect of the many other influences to be considered in the policy-making process.

Based on the assumption that sound economic and social analysis of the benefits and costs of tax reform must form the basis of such a policy, three major landmarks are examined to determine how rational and evidence-based decision making informed the introduction of the GST. The first landmark was the Hawke Government's National Tax Summit (1985) and Draft White Paper (1985), which was the first attempt by an Australian government to introduce a consumption tax called a BBCT. The second landmark was the *Fightback!* (1991) policy, which was an unsuccessful attempt by the then Liberal Party–National Party Coalition to oppose the introduction of a GST. The third landmark was the successful attempt by the Coalition Government, in the late 1990s, to negotiate with various groups. Before examining these landmarks, a brief review of the policy processes literature is provided. The article concludes with a discussion of the implications of the research.

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<sup>1</sup> Kenneth Asprey, Taxation Review Committee, Commonwealth of Australia Parliament, *Full Report* (AGPS, 1975).

<sup>2</sup> Treasury, Commonwealth of Australia, *Reform of the Australian Tax System: Draft White Paper* (AGPS, 1985).

<sup>3</sup> Huw Davies, Sandra Nutley and Peter Smith, *What Works? Evidence-based policy and practice in public services* (The Policy Press, Bristol 2000); Sandra Nutley, Isabel Walter and Huw Davies, *Using Evidence: How research can inform public services* (The Policy Press, 2007); Ray Pawson, *Evidence-based Policy: A Realist Perspective* (Sage, 2006); Brian Head, 'Three lenses of evidence-based policy', (2008) 67 *Australian Journal of Public Administration* 1–11; Brian Head, 'Reconsidering evidence-based policy: Key issues and challenges' (2010) 29 *Policy and Society*, 77–94.



## II THE STUDY OF POLICY PROCESSES

Howlett states that policies are complex entities composed of policy goals and means arranged in several layers ranging from the general to the specific.<sup>4</sup> He describes views of policy making in the mid-twentieth century as instrumental problem solving and a conscious matter of attempting to match the means of policy implementation to formulated policy goals.<sup>5</sup> This approach is known as the 'rational comprehensive model'<sup>6</sup> –rational because it follows a logical, ordered sequence, and comprehensive because it canvasses, assesses and compares all [or most] options.<sup>7</sup> This rational model, used by Herbert Simon, has provided a starting point for many of the theoretical approaches to policy making, such as stage models and policy cycles.<sup>8</sup> However, in practice, policy decision making is rarely rational (not every step in the policy process is undertaken) and rarely comprehensive (political realities, budgets and time limit possible options).<sup>9</sup> Regardless of its problems, rationally-derived-evidence-based policy remains one of the principles of advice in the public sector. Since the early descriptions of the rational model, various authors have developed more complex and detailed approaches and come up with other influences and types of policy analysis. In the late 1950s Charles Lindblom outlined policy making as a set of incremental adjustments which he described as 'muddling through',<sup>10</sup> while a combination of rational and incremental approaches resulted in the mixed approach used by Amitai Etzioni.<sup>11</sup>

Head claims that the emergence of evidence-based policy in recent times has been an attempt to retain some of the fundamentals of rationality. Head states:

*For public managers and political leaders, the opportunity is apparent for continuous improvement in policy settings and program performance, on the basis of rational evaluation and well-informed debate of options.<sup>12</sup>*

Head links the growth in popularity of evidence-based policy to the growth in the social sciences in recent decades and the need for political culture that can allow substantial

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<sup>4</sup> Michael Howlett and M. Ramesh, *Studying Public Policy: Policy Cycles and Policy Subsystems* (Oxford University Press, Don Mills, Ontario 1995), 81; Michael Howlett, *Designing Public Policies: Principles and Instruments* (Routledge, 2011), 16.

<sup>5</sup> Ibid.

<sup>6</sup> Howlett, above n 4, 18.

<sup>7</sup> Glyn. Davis et al, *Public Policy in Australia* (Allen & Unwin, 1993), 160–1.

<sup>8</sup> Herbert Simon, *Administrative Behaviour* (Plenum, 1957); David Easton, *The Political System* (Knopf, 1953); David Easton, *A Systems Analysis of Political Life* (Wiley, 1965a); David Easton, *A Framework for Political Analysis* (Prentice Hall, 1965b); William Jenkins, *Policy Analysis: A Political and Organizational Perspective* (Martin Robertson, 1978), 17; Brian Hogwood and Lewis Gunn, *Policy Analysis for the Real World* (Oxford University Press, 1984), 4; James Anderson, *Public Policy-Making* (Holt, Rinehart and Winston, 1984), 19; W. Parsons, *Public Policy* (Edward Elgar, 1995), 79–81.

<sup>9</sup> Peter Bridgman and Glyn Davis, *The Australian policy handbook* (Allen & Unwin, 2004), 48–9.

<sup>10</sup> Charles Lindblom, 'The Science of "Muddling Through"' (1959) 19 *Public Administration Review*, 78–88.

<sup>11</sup> Amitai Etzioni, 'Mixed Scanning: A "Third" Approach to Decision Making' (1967) 27 *Public Administration Review*, 385–92; Amitai Etzioni, 'Mixed Scanning Revisited' (1986) 46 *Public Administration Review*, 8–14.

<sup>12</sup> Brian Head, 'Three lenses of evidence-based policy' (2008) 67 *Australian Journal of Public Administration*, 1–11.

elements of transparency and rationality in the policy process.<sup>13</sup> He states, ‘This in turn may facilitate a preference by decision-makers for increased utilization of policy-relevant knowledge’ and because ‘the associated research culture will encourage and foster an analytical commitment to rigorous methodologies for generating a range of policy-relevant evidence.’<sup>14</sup>

Howlett reminds us that it is fundamental to government that public servants use resources and expertise to formulate effective policy;<sup>15</sup> however, more recent literature on policy process takes a broader view, aiming to address the context and incorporating a range of policy influences and actors. These include the ‘policy networks’ and ‘policy communities’ approach used by David Marsh and Rod Rhodes,<sup>16</sup> the ‘advocacy coalition’ approach used by Paul Sabatier and Hank Jenkins-Smith,<sup>17</sup> and institutional analysis used by James March and Johan Olsen.<sup>18</sup>

The policy network approach offers a way to analyse the clustering of interests in the policy process.<sup>19</sup> Rhodes described policy networks as based on central-local locations and involving and exchange relationships where participants manoeuvre using their available resources to maximize their influence over outcomes.<sup>20</sup> Marsh and Rhodes claim that the policy network is closely associated with pluralism and emerge out of the complex interdependencies of decentralised government structures and the limits to rational policy making and the factorizing and professionalization of policy systems but noting that policy networks are only a component part of any explanations of the process and outcomes of policy making.<sup>21</sup>

The advocacy coalition approach sees the policy process from formulation to implementation as involving an ‘advocacy coalition’ comprising of actors from all parts of the policy system.<sup>22</sup> This framework considers the role of policy orientated learning and

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<sup>13</sup> Brian Head, ‘Evidence-based policy: principles and requirements’ (2010) 1 *Strengthening evidence-based policy in Australian federation*, 13–26.

<sup>14</sup> Ibid 79.

<sup>15</sup> Michael Howlett, *Designing Public Policies: Principles and Instruments* (Routledge, 2011), 63.

<sup>16</sup> David Marsh and Rod Rhodes, *Policy Networks in British Government* (Oxford University Press, 1992); Rod Rhodes, *Beyond Westminster and Whitehall* (Unwin Hyman, 1988); Rod Rhodes, *Understanding Governance: Policy Networks, Governance, Reflexivity and Accountability*, (Open University Press, Buckingham 1997).

<sup>17</sup> Paul Sabatier and Hank Jenkins-Smith, *Policy Change and Learning: An Advocacy Coalition Approach*, (Westview Press, 1993); Paul Sabatier and Hank Jenkins-Smith, ‘The advocacy coalition framework: An assessment’, in Paul Sabatier, *Theories of the Policy Process* (Westview Press, 1999), 117–66.

<sup>18</sup> James March and Johan Olsen, ‘The new institutionalism: Organisational factors in political life’ (1984) 78 *American Political Science Review*, 738; James March and Johan Olsen, *Rediscovering Institutions: the organizational basis of politics* (Free Press, New York 1989); James March and Johan Olsen, ‘Institutional perspectives on political institutions’ (1996) 9 *Governance*, 248–64.

<sup>19</sup> Michael Hill, *The Public Policy Process*, (Pearson Longman, 2005), 74.

<sup>20</sup> Rod Rhodes and David Marsh, ‘New directions in the study of policy networks’ (1992) 21 *European Journal of Political Research*, 181–205.

<sup>21</sup> Ibid.

<sup>22</sup> Paul Sabatier ‘The need for better theories’, in Paul Sabatier, *Theories of the Policy Process* (Westview Press, 1999), 3–17, 9.

aiming to take in the role of the major actors and other casual factors in policy formulation often stretching over an extended time period.<sup>23</sup>

The re-emergence of institutional theory has seen the analysis of governments and their organisational forms to explain the formulation of policy and policy outcomes. The new approaches to institutional analysis stress policy learning and policy entrepreneurs (leaders often situated at the intersection of policy networks). Eccleston<sup>24</sup> argues that new institutional analysis can help understand policy change and the roles of economic forces, policy ideas and political actors. Examining tax reform in Australia, he argues that in Australia political institutions and practices, which were historically entrenched, hampered the tax reform process. He sums up the obstructions faced by tax reformers as including, a short electoral cycle (less than three years), a doctrinaire and autocratic bureaucracy, constitutional constraints, fragmented and parochial interest groups, potentially antagonistic state governments and an obstructive Senate and political opponents who actively promoted community opposition to tax reform.<sup>25</sup>

Eccleston also highlights the concept of 'policy learning' by key interest groups and others, arguing that interest group mobilisation and coalition building were important factors in bringing acceptance of taxation reform in Australia.<sup>26</sup> He states that by 1996 there was awareness among business groups and welfare groups that Australia's indirect tax base was in need of reform, and that this opened up possibilities for reform, particularly with the advocacy of important actors from the welfare lobby, whom he termed 'policy entrepreneurs'.<sup>27</sup>

In an analysis of preferences and reasons for tax reform shifts, James<sup>28</sup> adapted the analytical approach of Canadian political scientist, Simeon, whose framework attributes policy reform outcomes to the socio-economic environment, relative power of participants, community cultural traits and institutions that progress reforms.<sup>29</sup> Identifying Australia as a 'slow burner' approach she notes the power of the major interest groups in Australia in resisting reform and Australia's political conservatism and scepticism of political elites.<sup>30</sup> James stresses that tax reforms outcomes are highly contingent on the social and political environment and calls into question accounts that present tax reform outcomes as inevitable or as mere technical advances.<sup>31</sup>

This brief overview of approaches to policy making indicates policy making in an advanced democracy such as Australia is a complex and multi-layered phenomena. A

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<sup>23</sup> Hank Jenkins-Smith and Paul Sabatier, 'Evaluating the advocacy coalition framework' (1994) 14 *Journal of Public Policy*, 175.

<sup>24</sup> Richard Eccleston, *The Thirty Year Problem: The Politics of Australian Tax Reform* (Australian Tax Research Foundation, 2004); Richard Eccleston, *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia* (Edward Elgar, 2007).

<sup>25</sup> Ibid 116.

<sup>26</sup> Richard Eccleston, 'The thirty year problem' Political Entrepreneurs, Policy Learning and the Institutional Dynamics of Australian Consumption Tax Reform (2006) 24, no. 2 *Law in Context*, 117.

<sup>27</sup> Ibid 78.

<sup>28</sup> Kathryn James, 'An Examination of Convergence and Resistance in Global Tax Trends' (2010) 11 *Theoretical Inquiries in Law*, 496.

<sup>29</sup> Ibid. 486. James cites Richard Simeon, 'Studying Public Policy' (1976) 9, no. 4 *Canadian Journal of Political Science*.

<sup>30</sup> James, above n 28, 488.

<sup>31</sup> James, above n 28.

common theme is the need to satisfy policy aims that have been formulated for the benefit of society but what constitutes this benefit is hotly disputed and influenced by interest groups and stakeholders and that solutions must be palatable to a broad electoral base. Returning to the question of rationality in policy making, Head identifies that knowledge forms the basis of policy making as arising from three sources: political knowhow; rigorous scientific and technical analysis; and practical and professional experience – all of which involve a range of influences and policy actors.<sup>32</sup> In this article we aim to examine the role of rationally-derived-evidence-based processes at key turning points in the introduction of the GST in Australia to determine whether rationality can still play a part in the changing political landscape.

### III BACKGROUND AND JOURNEY OF THE GST

The issue of a consumption tax was first raised in Australia in the 1970s in the form of a VAT, which was recommended in the *Asprey Report* (1975). The report had had been commissioned by the Coalition to review the Commonwealth taxation system. The *Asprey Report* concluded that the taxation system should place greater reliance on taxes on goods and services by a broad-based tax (a VAT), and recommended that Australia adopt a VAT or a BBCT in place of the then wholesale sales tax (WST). It took almost twenty years before the legislature had adopted virtually all the *Asprey* recommendations, and thirty years to adopt and implement the GST.

The 1980s saw the issue of a consumption tax raised again. In February 1981, Coalition Treasurer John Howard made a submission to the Fraser Cabinet, proposing a Retail Sales Tax (RST) (another version of a consumption tax) with a number of options, but Cabinet rejected the proposal. Three years later, Labor Prime Minister Hawke announced in October 1984 that a National Tax Summit (NTS) would be held to bring about consensus for tax reform. The issue was revived again in the early 1990s by the Liberal Party as part of an unsuccessful election platform. On 13 August 1998, prior to the election in October of that year, the Coalition released its tax package, *Not A New Tax: A New Tax System (ANTS)* (1998) – *ANTS*, which included a 10% GST, and a GST was introduced by the Coalition Government on 1 July 2000.

In assessing the broader political and economic environment, Morse (2011)<sup>33</sup> notes that Australia enacted GST legislation through ordinary political channels, without external pressure from a multinational organisation, without the pressure of an extreme national fiscal crisis, and without an unusual exercise of executive authority. Morse further notes that in Australia the GST-enacting centre-right Liberal National Party Government retained control for seven years after the reform. Morse outlines the Australian VAT (GST) story in four parts: (1) framing the GST as a relatively efficient tax; (2) building a coalition between business and social welfare interest groups particularly the Australian Chamber of Commerce and Industry (ACCI) and the Australian Council of Social Security (ACOSS); (3) emphasizing efficiency while addressing regressivity in the political and legislative process; and (4) the federalism solution included in the reform, which provided for the

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<sup>32</sup> Brian Head, 'Three lenses of evidence-based policy' (2008) 67 *Australian Journal of Public Administration*, 1-11, 5.

<sup>33</sup> Susan Morse, How Australia Got a VAT, *The VAT Reader*, Tax Analysts, 2011.

transfer of GST revenue to the Australian states and territories. All this took place through a complex and longitudinal process. Three major attempts to introduce a GST in Australia have been chosen for examination. The documents and events involved in the three major landmarks are summarised in Table 1 and will now be discussed in detail.

#### IV THE THREE GST LANDMARKS

The three landmarks are: (1) National Tax Summit (1985); (2) *Fightback!* (1991, 1992); and (3) *ANTS* (1998, 1999). Table 1 outlines key dates documents and events used to each landmark.

**Table.1 GST Landmarks and their major documents**

GST Landmark	Document/Event/Date
<p><b>Landmark 1:</b></p> <p>National Tax Summit (1985);</p> <p>Draft White Paper (1985):</p>	<p><i>Reform of the Australian Taxation System</i> (Draft White Paper) 1985, AGPS, Canberra. (June 1985).</p> <p><i>National Tax Summit: Record of Proceedings</i>, 1985, AGPS, Canberra. (1–4 July 1985).</p> <p>Hawke deal with ACTU (3 July 1985).</p>
<p><b>Landmark 2:</b></p> <p><i>Fightback!</i> Policy (1991–2);</p> <p><i>One Nation Statement</i> (1992):</p> <p><i>Fightback!</i> Policy Mark II (1992):</p> <p>Federal election: 1993:</p>	<p>Hewson, J. and Fischer, T. 1991. <i>Fightback!: Taxation and expenditure reform for jobs and growth</i>. Panther Publishing, Canberra. (<i>Fightback! Mark I</i>), (21 November 1991).</p> <p>Hewson, J. and Fischer, T. 1991. <i>Fightback!: It's your Australia</i>, (21 November 1991).</p> <p>Keating, P. 1992. <i>One Nation Statement</i>. AGPS, Canberra. (26 February 1992).</p> <p>Hewson announced <i>Fightback! Fairness And Jobs (Fightback! Mark II)</i> (9 December 1992).</p> <p>13 March 1993.</p>
<p><b>Landmark 3:</b></p> <p>Howard Government's tax package, <i>ANTS</i> (1998–9);</p> <p>Federal election:</p> <p>Senate Inquiry into <i>ANTS</i> (1998–9):</p>	<p>Treasury Department 1998, <i>Tax reform: not a new tax, a new tax system. (ANTS)</i> 1998. (Circulated by the Hon Peter Costello) 1998. AGPS, Canberra. (Released on 13 August 1998).</p> <p>3 October 1998.</p>

<p><i>Intergovernmental Agreement (IGA) Mark I (1998):</i></p> <p>Howard Government's negotiation with the Democrats (1999):</p> <p><i>A New Tax System (ANTS) legislation (1999) ANTS Mark II:</i></p> <p><i>ANTS and GST Agreement (1999):</i></p>	<p>Senate Select Committee on a New Tax System, First report, February 1999. (18 February 1999).</p> <p><i>Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.</i> 1998.</p> <p>(Australian Democrats' rejected the Government's initial offer on 26 May) (Negotiation for seven days).</p> <p><i>A New Tax System (Commonwealth-State Financial Arrangement) Act.</i> 1999.</p> <p>(On 28 May 1999 Howard, Costello and Lees announced an 'in principle' agreement on tax reform).</p> <p>28 June 1999, the Senate passed <i>ANTS</i> bills with amendments.</p> <p>30 June 1999, the House of Representatives passed the <i>ANTS</i> legislative changes.</p> <p>30 June 2000, the <i>ANTS</i> legislation and GST was implemented.</p>
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### **A. Landmark 1 – National Tax Summit (1985)**

The economic recession from two successive quarters of negative growth in real GDP and the economic slowness between 1981 and 1983 were a major factor leading up to the calling of a National Economic Summit in April 1983 following the election of the Hawke Government.<sup>34</sup> Taking a pluralist approach the summit brought together major interest groups and represented an attempt at a corporatist style of government. In July 1985 the Hawke Government's National Tax Summit with representatives from government, trade unions, business, and consumer and welfare groups was held to discuss tax reform. In contrast to the National Economic Summit, little was achieved. Treasurer Keating failed in his attempt to gain support for moving the Australian tax system away from direct tax towards a consumption tax. This will now be explored in more detail.

<sup>34</sup> Michael Keating and G. Dixon, *Making economic policy in Australia* (Longman Cheshire, Sydney 1989) pp. 11–12; Eccleston (2004), above n 24, 77.



(1) 1 *The Draft White Paper (1985) – An Attempt at Rational Policy Making*

The National Tax Summit (1985) was built on The Draft White Paper – *Reform of the Australian Tax System* (1985) (DWP), which presented three options,<sup>35</sup> including the Government and Treasury's preferred option [Option C], detailed below. The Government wanted support from business, unions and welfare groups, and importantly the support from the Australian Council of Trade Unions (ACTU) for the BBCT, but consensus could not be achieved.

In terms of approaches to policy making, the DWP has elements of a rational approach as it attempted to gather sound evidence and set clear objectives and end goals, and was prepared by the professionals from the Treasury Department. The DWP was evidence-based, drawing on sources including research reports from the Organization for Economic Cooperation and Development (OECD) and its member country reports, taxation reports, parliamentary reports and papers, Australian Bureau of Statistics reports and court cases. It outlined the Government's primary objectives and end goals which were to make the tax system 'fairer' overall and more conducive to 'economic growth'. The document DWP (1985) emphasised the need to:

- Significantly reduce marginal personal tax rates;
- Improve the equity of the tax system, not least by increasing the tax burden on those engaged in avoidance and evasion;
- Rationalise the consumption tax regime; and
- Ensure that arrangements can be made to compensate the needy for the effects of any increase in consumption tax.<sup>36</sup>

It then presented three alternatives for tax reform<sup>37</sup> accompanied by a detailed analysis. Option A essentially consisted of broadening the indirect tax base. Option B consisted of Option A with additional measures to broaden the indirect tax base through the introduction of a 5% RST and levying the existing WST at 10% on selected goods. The Government's-preferred 'Option C' entailed Option A tax base broadening plus a shift in the tax mix from income to consumption, with the introduction of a BBCT (or RST) of 12.5% (replacing the WST). Treasury predicted the revenue gains would allow a 30% reduction in income tax rates and additional compensation measures for low-income earners and pensioners.<sup>38</sup>

(2) 2 *The National Tax Summit (1985) – What Actually Happened?*

**Day one** – The die was cast. The National Tax Summit (NTS) was held 1–4 July 1985 in old Parliament House in the House of Representatives Chamber. There were 160 delegates in attendance from the three major groups including: government, business and unions. The Liberal–National Coalition did not attend, as the federal Liberal Party had decided to boycott the event. The Shadow Treasurer, John Howard, who was instrumental

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<sup>35</sup> Draft White Paper (1985), Approach A: see p 242, Approach B: see p 246, Approach C: see p 247.

<sup>36</sup> Treasury, Commonwealth of Australia, *Reform of the Australian Tax System: Draft White Paper*, 240.

<sup>37</sup> Ibid Ch 22.

<sup>38</sup> Ibid 242–5; Kathryn James, 'Taxing Power: consumption tax reform in Australia and the United States' (Paper presented at the ATTA Conference, University of Tasmania, 24 January 2008), 5.

in the Coalition's decision to boycott the NTS, believed that to have attended would have risked the appearance of irrelevance<sup>39</sup> for the federal Coalition. An important position in opposing the BBCT was taken by the Opposition when Opposition Leader Andrew Peacock said 'the consumer tax would harm families'.<sup>40</sup>

On the first day of the NTS, the tone was set by the first delegate (the President of the Business Council of Australia (BCA), Bob White) who, on behalf of the peak business association, rejected all three approaches set out in the DWP (1985).<sup>41</sup> Also on the first day, ACOSS President Bruce McKenzie rejected Approach C on behalf of the welfare sector. The Prime Minister then raised the stakes with the unions by warning that he would proceed with the proposed tax reforms without ACTU support if necessary.<sup>42</sup> However, on the first day the Secretary of the ACTU, Bill Kelty, called Hawke's bluff. Kelty, who was concerned about the regressive nature of a BBCT and feared the inflationary risks posed by Approach C, argued that the proposed income tax cuts were skewed to high income earners.<sup>43</sup>

**Day two** – No Consensus. Due to the absence of any middle ground between business and the ACTU/welfare lobby on tax reform, Hawke and Keating would be forced to concede to one side or the other. Political pragmatism prevailed and the second day of the NTS private negotiations took place between the Government and the ACTU leadership. As a result of Bob White's speech, business effectively dealt itself out of the negotiations.

**Day three** – The Deal. On the third day of the NTS, the death knell for the BBCT was the Morgan Gallup poll published in *The Bulletin* on the morning of 3 July which revealed that the Government trailed the Coalition by 41% to 49%.<sup>44</sup> Hawke acted to limit the political damage. On the evening of 3 July 1985, he met privately with Kelty and Crean (Senior Vice-President, ACTU) and accepted the ACTU's position (Approach A), leading into the NTS.<sup>45</sup>

The ambitious Approach C had been defeated, but Keating had gained support for substantial reforms to the income tax base. At a post-NTS press conference Keating claimed that his tax cart had crossed the finishing line, albeit with one wheel off – like the chariot in *Ben Hur*.<sup>46</sup> As numerous commentators indicated, the irreconcilable differences between business interests and the welfare lobby forced Hawke to intervene by

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<sup>39</sup> Andrew Peacock, in Deborah Snow, 'Consumer tax will harm families, says Peacock', *The Australian Financial Review*, 1 July 1985, 4.

<sup>40</sup> Ibid 5.

<sup>41</sup> Commonwealth of Australia, *National Taxation Summit: Record of Proceedings*, Summit 1–4 July 1985, Parliament House, Canberra, (AGPS, 1985), 5.

<sup>42</sup> R Bowden, 'Consumption tax set for a change after private talks', *The Australian*, 3 July 1985, 1.

<sup>43</sup> Paul Kelly, *The end of certainty: Power, politics and business in Australia* (Allen and Unwin, Sydney 1994), 169.

<sup>44</sup> Edna Carew, *Keating: A Biography* (Allen and Unwin, 1988), 125.

<sup>45</sup> John Edwards, *Keating: The Inside Story* (Penguin Books, 1996), 171.

<sup>46</sup> Ibid 277; Peter Groenewegen, *Everyone's guide to taxation in Australia* (Allen and Unwin, 1985), 12; Russell Mathews, 1985. Federal – State fiscal arrangements in Australia. In Peter Drysdale and Hirofumi Shibata, *Federalism and Resource Development: The Australian Case* (George Allen and Unwin, 1985); Eccleston (2004), above n 24, 91–2.

abandoning plans to introduce a BBCT.<sup>47</sup> However, the evidence base gathered through policy development was not entirely lost.

After the NTS, in September 1985, Treasurer Keating announced the Government's tax reform proposals which involved some 22 measures to reform the Australian taxation system.<sup>48</sup> No provision was made for a BBCT. The decade after the NTS was characterised by substantial income tax changes pursuant to the ALP Government's taxation reform program. These tax reforms were mainly due to the efforts of Treasurer Keating. After the 1990 federal election, the Opposition Leader Andrew Peacock resigned and in April 1990 John Hewson was elected leader of the Liberal Party and Leader of the Opposition. In October 1990, the Coalition parties endorsed a GST, and Opposition Leader Hewson (1990–94), Shadow Treasurer Peter Reith (1990–93), and Access Economics began work on *Fightback!*

### **B. Landmark 2 – *Fightback!* (1991, 1992)**

Australia had suffered a share market crash in 1987 and a property crash in 1990, which contributed to economic recession. At this time, the Liberal Party, under John Hewson, considered an electoral win almost certain, and it was considered necessary to 'go for broke' and introduce a complete program for the implementation of economic rationalism and economic liberalism in Australia.<sup>49</sup> *Fightback!* and its series of reforms were interpreted by the electorate as a significant attack on government services and the welfare state.<sup>50</sup>

#### **(1) 1 *Fightback!* (1991, 1992)**

The *Fightback!* (1991)<sup>51</sup> Policy revisited the issues raised at the NTS (1985) and a revised consumption tax or GST proposal. Developing a policy in opposition meant that despite its attempts at extensive research, the Coalition parties' policies were not subject to the rigors of analysis and debate possible through government policy mechanisms. The research was provided mainly by Access Economics (an economic analysis consultancy firm), as well as a compilation and analysis of previous studies, from government, academics, business and John Hewson, who was an experienced economist with a doctorate in economics, Peter Reith and their staff.<sup>52</sup> The references (reports) used by *Fightback!* were varied, and many were from previous inquiries.

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<sup>47</sup> Paul Kelly, *The End of Certainty: Power, Politics and Business in Australia* (Allen & Unwin, Sydney, 1994), 171; John Edwards, Keating: *The Inside Story*, (Penguin Books, Melbourne, 1996), 276–77; Eccleston (2007), *above n 24*, 76.

<sup>48</sup> Paul Keating, 1985. *Reform of the Australian taxation system: statement by the Treasurer The Hon Paul Keating, MP*, September 1985, (AGPS, 1985).

<sup>49</sup> Pru Goward, *Labor in Power* (ABC Productions, 1994); Clinton de Bruyn, *Australia's Position in the World: The Historical Adoption of Corporatist Public Policy and Australia's Subsequent Movement between the Core and Semi-Periphery*, PhD Thesis (Griffith University, 2004), 57.

<sup>50</sup> de Bruyn, *above n 49*, 57.

<sup>51</sup> Liberal Party of Australia, *Fightback! It's your Australia: the way to rebuild and reward Australia* (Liberal and National Parties, 1991).

<sup>52</sup> John Hewson and Tim Fischer, *Fightback! Taxation and expenditure reform for jobs and growth* (Panther Publishing, 1991).

In terms of rational policy making, the *Fightback!* (1991) Policy did set out the objectives (goals) of tax and expenditure reform. Five guiding principles underlie the tax reform proposals outlined in the document. They were: first, to produce lower taxes and a 'simpler' and 'fairer' tax system which would boost the incentives to work, save, and invest; second, to produce a tax system that would make the Australian economy more internationally competitive and productive; third, to make the operation of the tax system more transparent and simpler for the taxpayer; fourth, to establish a tax system that raised the revenue necessary to finance government programs in the most efficient and effective way; and fifth, to establish a tax system that built a stable and reliable base for public expenditure programs in both Commonwealth and state sectors of responsibility. Also there were important objectives underpinning the reform of government expenditure in all areas of government, expressed as the need to target programs more effectively, to deliver programs and services more effectively, and to reduce or abolish programs that were no longer cost-effective or appropriate.<sup>53</sup>

(2) *2 One Nation (1992) (ALP Government's Response to Fightback!)*

Faced with a policy challenge, Prime Minister Keating consulted various groups in the community, asking their opinion on what changes were needed to the Government's policies. In February 1992, Keating delivered the *One Nation*<sup>54</sup> (*ON*) Statement. It promised that a re-elected Labor Government could deliver the same personal income tax cuts as the Coalition's *Fightback!* Policy to middle-class voters, but without the need for a GST. Much of the *ON* was determined by staff in the PM's (Keating's) office and not by the technical experts in Treasury.<sup>55</sup> The Canberra Press Gallery was sceptical of the motives behind *ON* and financial markets doubted Treasury's growth projections and affordability of the package.<sup>56</sup> Hendy argues that the economic forecasts upon which the *ON* Statement depended were highly manipulated to justify the package as affordable.<sup>57</sup> In November 1992, Keating declared that the ALP Opposition would not oppose a GST in the Senate.<sup>58</sup> Keating also declared that: 'If you don't understand the GST, don't vote for it [in the approaching federal election]. And if you do understand it, I know you will never vote for it'.<sup>59</sup>

(3) *3 Fightback! Mark II Policy and GST (1992) – Response to Public Pressure*

As a response to public pressure, a change resulted in the *Fightback!* and GST policy. In December 1992, Dr Hewson reconsidered *Fightback!* and relaunched it to make the GST more acceptable to the community. The major provisions were to remove the GST on food and childcare through zero rating and provision for a Rebuild Australia fund for new public works. This policy targeted support from particular groups, such as welfare groups.

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<sup>53</sup> Ibid 4.

<sup>54</sup> Paul Keating, *One Nation*, Statement by the Prime Minister (AGPS, Canberra, 1992), (Announced 26 February 1992).

<sup>55</sup> Peter Hendy, *The Politics of a Goods and Services Tax: The Liberal Party and the GST, and the GST's future in Australia*, (Unpublished Paper, 1997), 111.

<sup>56</sup> Richard Eccleston, *The Capacity for Reform: Australian taxation policy and the state, 1970–2000*, PhD Thesis (University of Queensland, 2002), 167.

<sup>57</sup> Hendy, above n 55, 111.

<sup>58</sup> Don Watson, *Recollections of a Bleeding Heart* (Random House, 2011), 272.

<sup>59</sup> *Australian*, 3 March 1994; Paul Kelly, *The March of Patriots* (Melbourne University Press, 2011), 84.

The announcement of *Fightback! Mark II* was obviously motivated by the Liberal Party's declining electoral fortunes<sup>60</sup> and the consequent threat to Hewson's leadership of the Liberal Party.<sup>61</sup> The institutional knowledge and experience from Treasury and the NTS in 1985 was used by the Keating Government against Hewson's *Fightback! Policy* and the GST in 1992.<sup>62</sup>

What had started as a radical but ostensibly rational policy profile had been modified to make it more acceptable to pressure groups and the broader community. Welfare groups such as the Society of St Vincent de Paul, the Brotherhood of St Laurence, ACOSS, the Australian Council of the Aged, and the Australian Catholic Social Welfare Commission expressed support for zero rating of food and child care, as well as bringing forward increases in pensions and changes to the taxable threshold of superannuation. The BCA, the Australian Chamber of Commerce and the NSW Farmers Association favoured accelerated depreciation, and bringing forward of tax cuts. Car makers and other manufacturers criticized the continuation of the policy of the original *Fightback!* package to significantly reduce tariffs by the year 2000.<sup>63</sup>

The Keating ALP media campaign focused on the electorate's perceived fear of the GST, its permanence and its broader implications for the national lifestyle. The ALP campaign was supplemented by a union campaign against the GST which was estimated at \$2 million.<sup>64</sup> An advertising campaign in support of the GST by peak business groups the BCA and the ACCI, under the banner 'Australians for Tax Reform', couldn't save the Hewson-led Coalition.<sup>65</sup>

The 1993 federal election was an overtly policy-driven contest between Labor Prime Minister Keating and Liberal leader of the Opposition, Hewson. Few election platforms have been as detailed in their policy prescriptions as was the LP's *Fightback!* (1991) manifesto, and the introduction of the GST was central to this. The end result was that Keating relished 'the sweetest victory of all' while Hewson lost the seemingly 'unlosable' election – a loss attributed specifically to the GST.

John Howard was re-elected leader of the Liberal Party in January 1995. However, political pragmatism forced him to publicly abandon his career-long commitment to consumption tax reform. Howard declared, 'there's no way the GST will be part of our policy. It's dead. Never ever. It's dead.'<sup>66</sup> Regardless, the GST was now in the public's consciousness; it had been extensively debated and even deemed acceptable by a range of interest groups.

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<sup>60</sup> *Bulletin*, 22 December 1992, 11.

<sup>61</sup> *Sydney Morning Herald*, 19 December 1992; *Bulletin*, 29 December 1992, 14; Blount 1999, 23.

<sup>62</sup> Liberal Party of Australia, *Fightback! Fairness and Jobs* (Liberal and National Parties, Canberra, 1992). (Announced on 9 December 1992 by Dr John Hewson, who launched *Fightback! Mark II* at the National Press Club on 18 December 1992.)

<sup>63</sup> *Sydney Morning Herald*, 19 December 1992.

<sup>64</sup> John Harrison and Marilyn Stretton, *The GST Debate* (Originally published as *The GST Debate – A Chronology: Background Paper No. 1 1997–1998*; updated by Marilyn Stretton to February 1999), (AGPS, 1999).

<sup>65</sup> James, above n 38, 8.

<sup>66</sup> Michelle Grattan, 'Howard Bans GST "forever"', *The Age*, 3 May 1995, 5.



The 'small target' approach<sup>67</sup> succeeded in securing the Howard-led Coalition victory at the 1996 federal election.<sup>68</sup> In response to the economic and political situation, interest groups mobilised and advocated for indirect tax reform. This led to the charge that an unprecedented and 'unholy' alliance had formed between the peak business association, (the ACCI) and the peak welfare body (ACOSS). They were traditional adversaries on consumption tax reform, but they united to promote dialogue on a GST. Partly due to the ACCI/ACOSS campaign, public support for the GST peaked in 1997, with supporters almost doubling the number of opponents.<sup>69</sup> On 18 May 1997, Prime Minister Howard indicated that he would seek a mandate for tax reform at the next election. The public face of consultation took the form of the Tax Consultation Task Force, but the report was not released publicly. Business was consulted, but ACOSS was excluded.<sup>70</sup>

#### (4) 4 High Court Decision 1997

In 1997 an important High Court case concerning states taxes created a problem for state governments and Australian taxation policy, and encouraged further debate about tax reform and the GST. The High Court of Australia in *Ha v New South Wales* (1997) 189 CLR 465 (the *Ha* case) dealt with s 90 of the Australian Constitution, which prohibits the states from levying excise. The High Court decision viewed the NSW scheme (requiring a licence to sell tobacco in NSW) under the NSW Act (*Business Franchise Licences (Tobacco) Act 1987* (NSW)) as purely about revenue raising without a discernible regulatory element, giving it the appearance of a tax. Under the High Court's broad interpretation of s 90, the 'licence fee' imposed by the NSW State Government was in fact an excise – which, under the Australian Constitution, states are barred from imposing. This had a significant impact on the states' revenue base.<sup>71</sup>

On 11 and 12 August 1997, Prime Minister Howard took his initial tax reform proposals to a special Cabinet meeting and, partly as a result of the High Court decision in the *Ha* case, in August 1997 the Cabinet agreed to pursue tax reform.

### **C. Landmark 3 – Tax Reform: Not A New Tax, A New Tax System (1998, 1999)**

There was no national fiscal crisis or recession for the Howard Government, but there was, according to Treasurer Peter Costello, a 'black hole' of \$8 billion left by Labor. The Howard Government came under heavy attack from business for lack of vision in May

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<sup>67</sup> A 'small target' approach is a clever way to win power for an opposition, but poor preparation for it to become a government. A 'small target' is a political party that offers the voter a bare minimum – a minimal agenda, a minimal set of policies, and as little detail as possible. Peter Hartcher, 'Small target, big letdown', *Sydney Morning Herald*, 28 April 2012. After the Hewson experiment, the Liberal Party was scarred, and under the leadership of John Howard went into the 1996 election with the modest aim of making Australians feel 'relaxed and comfortable'. Robert Simms, 'Abbott's uncertain legacy beyond warring opposition', *The Drum*, 20 June 2012.

<sup>68</sup> James, above n 38, 9.

<sup>69</sup> Simon Blount, 'Public Opinion and Tax Aversion in Australia' (2000) 36(3) *Journal of Sociology* 275–90, 279.

<sup>70</sup> James, above n 38, 10.

<sup>71</sup> James notes that the High Court decision in the *Ha* case on 5 August 1997 prevented the states levying indirect consumption taxes at a loss of approximately \$5 billion or 17 per cent of their revenue: Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 247.



1997;<sup>72</sup> Howard responded, without reference to senior colleagues, by putting the whole tax question on the agenda. By August, a task force was appointed to prepare a report.<sup>73</sup> A year later, the Howard Government produced the *ANTS* (1998) package, with its 10% GST and big income tax cuts. Howard's tax strategy may be seen as a reaction to pressure, but the problems he faced provided an opportunity to revive a policy that, given his long commitment to tax reform, he would have brought forward eventually. Economic rationalism was the dominant philosophy under John Howard's leadership of the Liberals; the party had moved away from its traditional theoretical base of conservatism and was geared towards unchallenged free-market reform. The Liberal–National Coalition of 1996 aggressively pursued monetarist contractionary policy and neo-liberal philosophy.<sup>74</sup>

(1) *1 ANTS Mark I and GST (1998)*

On 28 July 1998, the Cabinet, amid tight security, endorsed the 208-page *ANTS* document, followed by the conservative premiers and finally by the parliamentary Liberal and National Parties. On 13 August 1998, the Howard Coalition Government released its tax package, *Tax Reform: Not A New Tax, A New Tax System (ANTS)*. The *ANTS* 1998 package proposed a 10% GST with very few exceptions:<sup>75</sup> the proposed GST was to be paid on all food and clothing.<sup>76</sup> The public was given less detail (in a document a third of the size of the *Fightback!* document) and less time to respond. An election was called within two weeks of the release of *ANTS*.<sup>77</sup> Howard sought a mandate from the Australian people for BBCT reform.

The Australian Catholic Social Welfare Committee campaigned strongly that food should be excluded from the GST. The Howard Government's plan was to legislate the tax reform program by mid-1999.<sup>78</sup> This would allow businesses a year to get ready before the GST took effect on 1 July 2000. The Sydney Olympics (2000) were to be held later that year (15 September – 1 October 2000), and the Government wanted foreign tourists to pay the GST just as Australians paid VAT as tourists in other countries. The Government also wanted the new tax system in place before the next election, due in 2001.<sup>79</sup> PM John Howard hailed his new *ANTS* tax system as the most significant overhaul in almost 100 years. The proposed reforms included a 10% GST and the promise of income tax cuts.<sup>80</sup>

(2) *2 ALP Opposition's Response to ANTS (1998)*

To counter the *ANTS* proposal, under the leadership of Kim Beazley the main feature of the ALP's tax package was the absence of a GST. Kim Beazley said 'the [*ANTS*] package was

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<sup>72</sup> Eccleston (2004), above n 24, 131.

<sup>73</sup> Ibid 134.

<sup>74</sup> Kelly argues that Prime Minister John Howard, in office, sought to marry economic liberalism and social conservatism: Paul Kelly, *The March of the Patriots: The Struggle for Modern Australia*, (Melbourne University Press, 2011), 289.

<sup>75</sup> Exemptions, or products which were to be 'zero rated' included health, education, childcare and local government rates.

<sup>76</sup> *ANTS*, Ch 2.

<sup>77</sup> James, above n 38, 10.

<sup>78</sup> Peter Costello and Peter Coleman, *The Costello Memoirs* (Melbourne University Press, 2008), 134.

<sup>79</sup> Ibid.

<sup>80</sup> John Howard, *The Age*, 14 August 1998, 8.

a massive tax switch that handed far greater benefits to the wealthy at the expense of lower and middle income earners'.<sup>81</sup> On 27 August 1998, Beazley released the ALP's tax package: *A Fairer Tax System – With No GST*, which offered carefully targeted income tax credits for low- to middle-income earners which would taper out once family income exceeded \$60,000 per year. The response to the ALP tax package from the press, business and welfare groups was scathing. ACOSS president Michael Raper labeled the ALP tax package 'fair enough, but not good enough' and stated 'ACOSS does not accept Labor's argument that the tax system is not "broken"'.<sup>82</sup> Overall, the ALP's tax reform package was influenced more by political imperatives than economic goals.<sup>83</sup> The Beazley ALP Opposition tax package could be considered to be a limited political response or an incremental approach to the Howard Government's *ANTS* tax package, perhaps because of the limited time available to respond.

(3) *3 Post-Federal Election (1998)*

On 3 October 1998, the Howard led Coalition was returned with an increased majority in the House of Representatives. For the Howard Government, crucially the 1998 federal election campaign had convinced the electorate of the need for tax reform. Within one week of the 1998 federal election, the Senate emerged as an institutional constraint on the Howard Government's ability to progress its GST. The 1998 federal election also resulted in a clash of mandates between the Liberal–National Coalition Government (which proposed *ANTS* and the GST) in the House of Representatives and the Australian Democrats (who originally opposed the introduction of the GST and who held the balance of power) in the Senate.

In October 1998, the leader of the Australian Democrats, Senator Meg Lees, sought greater compensation for low-income earners on the introduction of *ANTS* & the GST.<sup>84</sup> On 30 October 1998, Senator Mal Colston (Independent) indicated that he would be inclined to support the Government's *ANTS* tax package. In March 1999 Treasurer Costello held talks with the Australian Democrats when they had given him a list of their demands.<sup>85</sup>

On May 14<sup>th</sup> 1999, after independent Senator Brian Harradine (who had the pivotal vote in the Senate) gave his 'I cannot support the GST' speech in the Senate, Howard and Costello turned to the Australian Democrats. The only alternative was to negotiate with the Australian Democrats and that would mean agreeing to exempt food. The Coalition could settle for 85 per cent of what the Australian people had supported or accept that tax reform was dead indefinitely.<sup>86</sup> Howard conducted negotiations with the Australian Democrats in the Senate over tax reform and the GST concessions. These negotiations went on for several weeks, shifting from Melbourne back to Canberra, and gradually areas of difference were whittled away.<sup>87</sup>

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<sup>81</sup> Kim Beazley, in Brendan Nicholson, *The Age*, 14 August 1998, 11.

<sup>82</sup> ACOSS, Media Release, 3 September 1998.

<sup>83</sup> Paul Kelly, *The Australian*, 28 August 1998; Eccleston (2002), above n 56, 218; Eccleston (2004), above n 24, 141.

<sup>84</sup> Ian Davis, *Australian Financial Review*, 16 October 1998, 4.

<sup>85</sup> Costello and Coleman, above n 78, 138.

<sup>86</sup> John Howard, *Lazarus Rising: A Personal and Political Autobiography* (Harper Collins, 2010), 313.

<sup>87</sup> *Ibid* 315.

***D. ANTS Mark II Policy and GST (1999):  
Response to Australian Democrats and public pressure***

As a response to the Australian Democrats' demands and public pressure, a change was made to the ANTS and GST policy. On May 26th 1999, the Australian Democrats rejected the Government's initial offer on the ground that too much of the projected budget surplus was being used to fund tax cuts for high income earners. On May 28<sup>th</sup> 1999, an 'in-principle' agreement between PM Howard, Treasurer Costello and Senator Lees was publicly announced by PM Howard on tax reform that closely reflected the Australian Democrats position prior to negotiations. Basic food was to be exempt from the GST and also a restructuring of proposals concerning diesel fuel and a few other matters. On June 29<sup>th</sup> 1999, the ANTS (ANTS Mark II) legislation with the GST was passed by the Senate; the next day, the House of Representatives passed the tax plan into law. At long last major tax reform, built around the principles outlined in the Asprey Report almost 25 years earlier, had been legislated.<sup>88</sup>

***E. Discussion***

Taken longitudinally, the GST can be seen as an example of successful tax reform. From the perspective of a traditional rational comprehensive approach to policy making, each landmark demonstrates the initial adoption of the rational approach in that policy goals were set, information and data collected and options weighed. This was most evident in the first landmark, where professional public servants formulated a set of options aimed at bringing consensus. The NTS (1985) graphically illustrated the importance of stake holder groups with the rejection of all or some of the options by the leaders of the major groups leaving little chance for success.

An evidence- and goals-based document was the starting point for the Liberal–National attempt to introduce a GST through the *Fightback* manifesto, this time driven by economic rationalism and prepared with the help of consultants. This period saw a sequence of policy adjustments and revisions in order to gain public support and again demonstrated the importance of interest groups such as the trade unions, welfare groups and business but this time and with an election looming, the press and public sentiment also played a vital role. Blatantly ideology based, the incremental policy adjustments made by Hewson appeared to undermine his evidence base. This period also saw the widening of the advice base as both sides of government recognised the decentralisation of the formulation options.

The ANTS period saw an alliance between the strong interest groups representing business and the welfare lobby. It appeared that time and public debate had led to an acceptance – or at least recognition of the inevitability – of the introduction of the GST. Although extensive documents were formulated, these were less available for broad debate, and the ALP Opposition did not appear to mount a sound evidence-based defense.

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<sup>88</sup> Ibid 316.

As Rhodes,<sup>89</sup> Head<sup>90</sup> and others have noted, and as demonstrated in the second and third landmark, the growth in influence of important actors in the formulation of policy pushes technical advice further beyond the boundaries that a professional public service can achieve. Post-dating the period under discussion PM Kevin Rudd, when addressing the heads of agencies and senior executives of the Commonwealth Public Service stated, 'Policy design and policy evaluation should be driven by analysis of all the available options and not by ideology'.<sup>91</sup> The passage of the GST demonstrates the changing position of the public sector in policy formulation. If this sort of rationally-derived decision making is to remain the standard for the public sector then its position in powerful policy networks needs to be better understood.

The long journey of the GST demonstrates an educative process and can be seen as a form of policy learning. Initially, the multiple options of the NTS and the complexity of the *Fightback!* Policy diverted attention from the issue of tax reform to fear an Australian tax regime which was not fully understood by the public. These periods did, however, lay the foundations for further reform.

Despite the abandonment and adjustment of the platform at each landmark, an evidence-based approach did form the base of each attempt. From a policy process perspective this could be represented as a 'learning spiral' that starts from a rational-evidence base then – under the heat and pressure of numerous political events and criticisms from interest groups, opposition parties and groups, the media, opinion polls and inquiries – moves to adopt a compromise position. However, while the original policy positions were ultimately not successful, knowledge gained from that policy formulation resurfaced in subsequent attempts.

The introduction of the GST emphasised the 'iterative' nature of public policy. It is often the case that policies are introduced and fail, and it takes several more attempts to get them accepted. There are various reasons for this. It can be because people do not understand them, or fear them, first time around. Attitudes change due to the educative effect of previous attempts to introduce different public policy.<sup>92</sup> Of importance to this discussion was that the rational evidence-based approach remained the starting point at each iteration.

In terms of tax reform in the historical context in Australia from *Asprey* (1972–5) onwards, the first step in all consumption tax reform proposals was to diagnose crisis

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<sup>89</sup> Rod Rhodes, *Beyond Westminster and Whitehall* (Unwin Hyman, London 1988); Rod Rhodes, *Understanding Governance* (Open University Press, 1997).

<sup>90</sup> Brian Head, 'Three lenses of evidence-based policy' (2008) 67 *Australian Journal of Public Administration*, 1–11; Brian Head, 'Evidence-based policy: principles and requirements' (2010) 1 *Strengthening evidence-based policy in Australian federation*, 13–26.

<sup>91</sup> Kevin Rudd, Prime Minister: Address to heads of agencies and members of senior executive service, (April 30, 2008) Canberra, Australia, Cited in Head, 2014. Brian Head, 'Public Administration and the promise of evidence-based policy: experience in and beyond Australia' (2014) 36 *Asia Pacific Journal of Public Administration*, 48–59.

<sup>92</sup> The three highlighted GST landmarks illustrate this point. Also it is important to note, as Aubin indicates, that the indirect tax increases introduced in 1993 by Treasurer Keating were even more regressive in their impact than the proposed GST that the LP/NP Coalition took to the 1993 election; T. Aubin, *Peter Costello: A biography* (Harper Collins, 1999), 197.

before prescribing reform.<sup>93</sup> By 1972, rising inflation and increasing real taxation burdens, along with the growing public awareness of the deficiencies and unfairness of the existing taxation system, pressured the McMahon Government to appoint the *Asprey Inquiry* (1972–75).<sup>94</sup> In the 1984 election campaign, major tax reform resurfaced as an issue. The tax reform agenda was in part due to economic recession and the public exposure of rampant tax avoidance and evasion by the *Costigan Royal Commission* (1982). The Hawke Labor Government engaged in a two-stage process of tax reform: Stage 1 involved the release by Treasury of the DWP (Option C recommended a 12.5% BBCT), which canvassed three alternatives for reform; Stage 2 involved a unique attempt at consensus-building at the NTS (1985).<sup>95</sup> In 1991 the Australian economy was in deep recession.<sup>96</sup> It was in this environment of economic crisis that Hewson released *Fightback!* (1991) a neo-liberal economic manifesto (with a 15% GST). However in Australia, the Howard Government's *ANTS* (and 10% GST) (1998–89) was not borne of the crises common to previous major tax reforms. Instead, it rode the waves of economic expansion and budget surpluses to flush money into voters' pockets.<sup>97</sup>

The Hewson (1991, 1992) and Howard (1998, 1999) GST experiments verify much of the conventional thinking in the tax politics literature: first, the political sense of not releasing detailed and drastic tax policy long before an election campaign; second, the need for an interdependent tax package whereby losses are offset by clear gains; third, the public appearance of consultation; and finally, the necessity of the political sell for tax policy specifically by individual political party leaders and increasingly through media campaigns.<sup>98</sup> Hewson from opposition and Howard in government both pursued a 'big bang' approach to tax reform.<sup>99</sup> For Sandford,<sup>100</sup> these individual leaders, in positions of power and influence, are 'the essence of the theory or model of successful tax reform'. In Australia such an individual was John Howard, whose career-long commitment to a GST was a key factor in bringing about change.<sup>101</sup>

## V CONCLUSION

The public policy goal of the introduction of the GST involved a broad range of policy processes and instruments. Evidence and analysis were reworked and adjusted through an educative process for the real-world political circumstances of the time. This generalisation may not be confined to taxation policy, although tax policy brings out a nation's values, political influences, and conflicts like no other arena of public policy. The

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<sup>93</sup> James, above n 38, 25.

<sup>94</sup> Eccleston, above n 56, 83.

<sup>95</sup> James, above n 38, 5–6.

<sup>96</sup> Alan Fenna, *Australian public policy* (Pearson Education Australia, 2<sup>nd</sup> ed, Frenchs Forest, 2004), 207–8.

<sup>97</sup> James, above n 38, 2008, 33.

<sup>98</sup> Cedric Sandford, *Successful Tax Reform: Lessons from an Analysis of Tax Reform in Six Countries* (Fiscal, Bath, 1993); A E Prest, 'The Political Economy of Tax Reform' (1971) 37 *Economic Papers* 11; Brian J Arnold, 'The Process of Tax Policy Formulation in Australia, Canada and New Zealand' (1990) 7(4) *ATF* 379; Peter Groenewegen, *Australian Taxation Policy* (Longman Cheshire, 2<sup>nd</sup> ed, Melbourne, 1987), 168–174; James, above n 38, 32.

<sup>99</sup> Hendy, above n 55, 111; Kathryn James, above n 38, 32.

<sup>100</sup> Sandford, above n 98.

<sup>101</sup> James, above n 38, 2008, 33.

long and difficult journey of the GST demonstrates not only the difficulty in introducing a new tax in Australia but also demonstrates that it can be successfully achieved, given enough time and effort.



## THE MINERAL RESOURCE RENT TAX HAS BEEN REPEALED: IS IT NOW TIME FOR A BETTER-DESIGNED RESOURCE RENT TAX ON ALL EXTRACTED MINERALS AND GAS?

JOHN MCLAREN<sup>1</sup> AND JOHN PASSANT<sup>\*\*</sup>

### ABSTRACT

The Mineral Resource Rent Tax (MRRT) was repealed by the *Mineral Resource Rent Tax Repeal and Other Measures Act 2014* (Cth) in September 2014. The Abbott Coalition Government had promised to abolish the mining tax in the lead-up to the election in 2013, and it was able to achieve this in 2014. The MRRT had its faults, and was created with the help of the mining industry and the biggest mining companies in Australia. There is an overriding philosophical basis for the imposition of a super profits tax on mining resources. It is simply that these resources are finite, and future generations of Australians have a vested interest in knowing where their share of the wealth from taxing the mining companies has been invested by the government or spent by the government. What infrastructure has been developed as a result of collecting a super profits tax from the mining companies or sovereign wealth fund? What is left for future generations when the minerals have run out and the mining companies have moved on to exploit the mining resources of other countries? On the other hand, the Petroleum Resource Rent Tax (PRRT) is still in existence and it has been collecting revenue for the Commonwealth government since 1987. This article examines what was wrong with the recent MRRT. First it briefly considers the political issues raised by both sides of politics in Australia. It then discusses the rationale for taxing the super profits of mining companies when the price of minerals is high. This includes an examination of the taxation of economic rent and the recommendations of the Henry Tax Review. The final part of the article proposes a new and better mining tax that would overcome many of the criticisms the old MRRT faced from politicians, economists and mining companies.

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## I INTRODUCTION

The philosophical basis for a super profits tax is simply that these resources are finite. Once all of the iron ore, coal, coal seam gas and other minerals have been extracted from the ground, nothing further can be mined in the future, and there will be no employment from the mining industry. The mining industry has been a large employer of Australian and international workers, but without a further contribution to the wealth of Australia by the mining industry, future generations will question the role of national governments in what has been developed as a result of the exploitation of the finite resources to which they were given access. The mining companies can move on, exploiting the mining resources in other countries. But what of the wealth of the sovereign nation whose resources have been depleted? What infrastructure has been developed as a result of collecting a super profits tax from the mining companies? What is left for future generations when the minerals have run out?

The MRRT was repealed in September 2014. The Coalition Government abolished the MRRT by passing the *MRRT Repeal and Other Measures Act 2014* (Cth). The Leader of the Opposition, later Prime Minister, Tony Abbott, had campaigned at the election in 2013 that his government would repeal the MRRT along with the Carbon Tax. That was achieved by his government in fulfilment of its election promise. By contrast, the Petroleum Resource Rent Tax was not repealed, and has been collecting revenue for the Commonwealth government since 1987.

Part II of this article considers the weaknesses of the recent MRRT, briefly examining the political issues raised by both sides of politics in Australia along with the opinions of economists and other commentators.

Part III discusses the rationale for taxing the super profits of mining companies when the price of minerals is high. This includes an examination of the taxation of economic rent and the recommendations of the Henry Tax Review. Part III goes on to examine the philosophical basis for a tax on the super profits generated from the sale of mineral resources. It is contended that there are sound reasons for a rent tax on the super profits of mining companies, and that this points to the need for a template of what a 'good' mining tax should look like.

Part IV discusses the options for a better-designed mining tax. What would it look like, and how would it overcome many of the criticisms the old MRRT faced from politicians, economists and mining companies?

Part V concludes that a properly designed resource rent tax, based on the recommendations of the Henry Tax Review, should be implemented in Australia

## II WHAT WAS WRONG WITH THE MRRT?

There are many reasons why the MRRT introduced by the Gillard Labor government was faulty. One of the main reasons was that it was designed by the three major mining companies operating in Australia at that time.<sup>1</sup> Prime Minister Julia Gillard, Treasurer Wayne Swan and Minister for Resources Martin Ferguson met with the senior managers of BHP Billiton, Rio Tinto and Xstrata to design the MRRT that was subsequently repealed in September 2014. To make matters worse, the then Labor government had locked in spending, such as the 'schoolkids bonus', against projected revenue from the MRRT, so that when the actual revenue fell short of the projections, the government lost credibility concerning the MRRT.

Originally, the MRRT was expected to raise \$22.5 billion over four years, of which \$3 billion would be raised in the 2012–13 financial year.<sup>2</sup> It raised only \$200 million.<sup>3</sup> It was supposed to raise \$4 billion in 2013–14. It raised \$100 million.<sup>4</sup> The estimated revenue failed to materialise because the mining boom was coming to an end and the world price of coal and iron ore was starting to decline. The level of demand for these resources, especially by China, had slowed. Coupled with this problem was the fact that mining companies valued their existing mining assets at current market value rather than historical cost, and state royalties had increased; this produced a greater deduction against sales for mining companies when calculating the amount of MRRT to be paid. These issues are discussed later in this article.

A super profits tax such as a MRRT should be designed to capture only additional revenue from mining companies when they make a profit over and above a reasonable rate of return on labour and capital, and this will only happen in an environment in which the price of minerals is high and there is an extraordinary demand for the particular minerals. This was the situation in Australia over the past ten years, but it is not the situation now.

### A. *Opposition to the MRRT*

Professor Henry Ergas was opposed to the MRRT on the basis that it was an inefficient tax and might raise much less revenue than claimed by the government.<sup>5</sup> He was correct. He also contended that future investment in iron ore and coal projects might become less attractive because of the MRRT, and that investment might shift to other resources not subject to the tax.<sup>6</sup> Clearly one of the shortcomings of the former MRRT was the fact that it did not apply to all minerals being extracted in Australia. For example, the price of gold has been at record highs over the past five years and might well have produced super profits in the hands of the gold mining companies. Professor Ergas et al also contended that the MRRT retained the inefficiencies of the royalty system and the inefficiencies of a

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<sup>1</sup> Julia Gillard, Wayne Swan and Martin Ferguson, 'Breakthrough agreement with industry on improvements to resource taxation', (Joint Press Release, 2 July 2010).

<sup>2</sup> Stephen Bartholomeusz, 'Time to move on from MRRT mistakes, Swan', *Business Spectator* (online), 2 September 2014 <http://www.businessspectator.com.au/print/865136>.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> Henry Ergas, 'Taxation of the mining industry', Economics Society of the ACT, 8 September 2010.

<sup>6</sup> Ibid.

rent tax.<sup>7</sup> He contended that the MRRT was inefficient because it might discourage investment in high-risk projects while leaving unchanged the viability of low-risk projects.<sup>8</sup> Professor Ergas and others explain this contention on the basis that high-risk projects require a higher rate of return on investment, and if they are successful they will be subject to a greater amount of MRRT, whereas the low-risk projects are financed at an expected lower rate of return and hence less tax is to be paid on them.<sup>9</sup> The MRRT would distort investment away from high-risk projects.<sup>10</sup>

Professor Guj contended that the MRRT was not competitively neutral, in that existing large mining companies would pay less MRRT compared with small to mid-tiered producers. The reason for this was that the existing mining companies were able to value projects commenced before 2 May 2010 at market value for their starting base allowance, which increased their deductions from the sale price of their minerals and gas.<sup>11</sup> This proved to be the case, and was one of the main reasons why the tax did not raise the expected amount of revenue. Surprisingly, the taxing provisions of the repealed MRRT were similar to those of the existing PRRT, and that system has appeared to be quite acceptable for oil companies over the past 15 years.

The former Leader of the Opposition, later Prime Minister, Tony Abbott, claimed that imposing a MRRT on mining companies was 'an economic version of the tall poppy syndrome'.<sup>12</sup> He maintained that it was sufficient for mining companies to pay income tax, that their employees pay personal income tax, and that, as miners, they pay state royalties.<sup>13</sup> He was therefore of the view that no additional taxes should be imposed on mining unless there was some unique feature.<sup>14</sup> This attitude to a proposed MRRT at that time was quite remarkable, given that many foreign countries impose additional taxes on mining companies on the basis that their mineral resources are finite and that the additional revenue may provide benefits for future generations. It was even more remarkable given that the Howard Government was in power in Australia for 14 years and at no time considered repealing the PRRT, which had been adding at least one billion dollars to government revenue each year for the past 15 years.

Mining companies naturally opposed the MRRT because they would be required to contribute a greater share of their taxable profit to the Australian government if they were involved in the sale of iron ore, coal or petroleum products. The MRRT was imposed on a mining company's mining profit, less its MRRT allowances, at a rate of 22.5 per cent. That is, at a nominal rate of 30 per cent, less a one-quarter extraction allowance to recognise the miner's employment of specialist skills. The mining company would also pay company tax on the taxable income at the company tax rate. The three largest mining companies, namely BHP, Rio Tinto and Xstrata accepted the MRRT that they helped to design in

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<sup>7</sup> Henry Ergas, Mark Harrison and Jonathan Pincus, 'Some Economics of Mining Taxation' (2010), 29(4) *Economic Papers* 369, 378.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

<sup>11</sup> Pietro Guj, 'Is MRRT competitively neutral', (2010) Association of Mining and Exploration Companies (AMEC, 2010), 2. [www.amec.com.au](http://www.amec.com.au) 14 November 2011.

<sup>12</sup> Matthew Franklin and David Uren, 'Abbott mines resources sector', *The Australian* 24 December 2010.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

consultation with the Labor government, and were prepared to pay the tax.<sup>15</sup> At that time the executive chairman of the Fortescue Metals Group, Andrew Forrest, opposed the MRRT, but contended that his company would avoid paying the MRRT for at least five years due to the starting base allowances reducing their profits.<sup>16</sup> He also contended that the big mining companies such as BHP, Rio Tinto and Xstrata were in a similar position and would not pay the MRRT for many years.<sup>17</sup> This proved to be the case. Mr Forrest also contended that the Government had overestimated the amount of revenue that would be collected.<sup>18</sup> Again he was proved correct. There were at least three main design faults with the MRRT which allowed the big mining companies to eliminate any liability to pay the MRRT. These were: allowing the mining companies to deduct the state and territory royalties that they paid; being able to choose the market value of their mines rather than their historical cost for the tax's starting base; and the downstreaming of profits to avoid the application of the MRRT.<sup>19</sup> These faults are discussed in detail in Part III of this article.

### III THE CONCEPT OF AN ECONOMIC RENT TAX

The renewed interest in a resource rent tax on mining was the initiative of Dr Ken Henry and the members of the review of 'Australia's Future Tax System', now commonly referred to as the 'Henry Review'.<sup>20</sup> The review recommended the introduction of a resource rent tax for all mineral and petroleum resources except brown coal.<sup>21</sup> In the final report, Dr Henry contended that the royalty system, which allows the states to collect revenue based on the value of the resource being sold and the volume of output, should be replaced by a resource rent tax.<sup>22</sup> As a result of this review, the then Labor Government announced on 2 May 2010 that it would introduce a 'Resource Super Profits Tax' on mining, not only to generate additional revenue but to compensate for a reduction in the rate of company tax to 28 per cent. The super profits tax was set at a rate of 40 per cent and was to apply from 1 July 2011.<sup>23</sup> However, as a result of a campaign against the tax – by the mining industry, the Opposition in Parliament and public opinion – the incumbent Prime Minister, Kevin Rudd, was replaced by Julia Gillard on 24 June 2010.

The then new Prime Minister, Julia Gillard, negotiated a new form of resource rent tax to be applied to mining companies extracting iron ore, coal and coal seam gas only. The end result was a new 'Minerals Resource Rent Tax Bill' (MRRT) and Exposure Draft that was released for public comment on 18 September 2011. Prior to this happening, the Australian Government had formed a 'Policy Transition Group' made up of resource sector, government and taxation experts to provide advice on the design and

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<sup>15</sup> For a detailed examination of this process see John Passant, 'The Minerals Resource Rent Tax: The Australian Labor Party and the continuity of change', (2014) 27(1) *Accounting Research Journal* 19.

<sup>16</sup> Andrew Burrell and Siobhain Ryan, 'Levy writeoffs "shield" Fortescue', *The Australian*, 8 November 2011, 6.

<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

<sup>19</sup> D. Uren, 'Treasury exposes mining tax flaws as Martin Parkinson blames Labor's concessions', *The Australian*, 15 February 2013.

<sup>20</sup> Australia's Future Tax System Review Panel (Ken Henry (Chair), J Harmer, J Piggott, H Ridout and G Smith), *Australia's Future Tax System: Report to the Treasurer* (December 2009) (AFTS Report).

<sup>21</sup> Ibid 217.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

implementation of an MRRT.<sup>24</sup> On 24 March 2011, the Policy Transition Group reported to the Government on its findings. The Government accepted all 98 recommendations of the Policy Transition Group, led by Resources Minister Martin Ferguson and Don Argus AC, relating to the new resource tax arrangements. The recommendations formed the basis of the second draft of the MRRT legislation.

### ***A. The Basis for a Tax on Super Profits from Mining***

The Henry Tax Review advanced arguments for cash flow business taxes as a replacement for business income tax, and for bequest duties, both of which are arguably further examples of the taxation of economic rents – or in the latter case, at least of the taxation of unearned gain. This is an important part of the thinking underpinning economic rent. Indeed, it has been argued that the Henry Tax Review has as one cornerstone of its vision for the Australian tax system the taxation of economic rents rather than income and capital. The then Labor government adopted one small part of such a tax, namely an MRRT, and rejected two other aspects of such a tax, a land tax and a bequest duty.

Economic rent is that return over and above the return necessary for the activity to take place.<sup>25</sup> For example, what does it take to get a supermodel to work? Linda Evangelista told *Vogue* that ‘we don’t wake up for less than \$10,000 a day.’<sup>26</sup> While that example is hardly scientific, it suffices for the purposes of explanation: if a supermodel is paid anything more than that (and they are), the excess over \$10,000 is economic rent. So a Government could tax almost all of that excess without affecting a supermodel’s work decisions at all. The model would still go to work even if the economic rent tax reduced the return to ‘just’ \$10,000 a day. This explanation is similar to the example provided in the Henry Tax Review in defining ‘economic rent’.<sup>27</sup> In that example, if a worker is paid \$100,000 but would still be willing to work at the same job if the salary was \$75,000, the economic rent would be \$25,000.

The following comment from Robin Broadway and Michael Keen provide a good description of economic rent, and an argument in favour of taxing it.

Economic rent is the amount by which the payment received in return for some action – bringing to market a barrel of oil, for instance – exceeds the minimum required for it to be undertaken. The attraction of such rents for tax design is clear: they can be taxed at up to (just less than) 100 per cent without causing any change of behaviour, providing the economist’s ideal of a non-distorting tax.<sup>28</sup>

The Henry Tax Review echoes this and applies the general logic of economic rent to the specifics of minerals. The following passage provides an excellent explanation.

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<sup>24</sup> Australian Government Policy Transitions Group, *Issues Paper: Technical Design of the minerals Resource Rent Tax, Transitioning Existing Petroleum Projects to the Petroleum Resource Rent Tax and policies to Promote Exploration Expenditure*, 1 October 2010.

<sup>25</sup> W H Wessel ‘A note on economic rent’, (1967) 57(4) *American Economic Review* 873, 885.

<sup>26</sup> J Van Meter, ‘Pretty Women’ in *Vogue* (October 1990).

<sup>27</sup> Commonwealth of Australia, above n 18, 737.

<sup>28</sup> Robin Broadway and Michael Keen, ‘Theoretical Perspectives on Resource Design’ in Philip Dean, Michael Broadway and Charles McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (Routledge, 2010), 9.



*The finite supply of non-renewable resources allows their owners to earn above-normal profits (economic rents) from exploitation. Rents exist where the proceeds from the sale of resources exceed the cost of exploration and extraction, including a required rate of return to compensate factors of production (labour and capital). In most other sectors of the economy, the existence of economic rents would attract new firms, increasing supply and decreasing prices and reducing the value of the rent. However, economic rents can persist in the resource sector because of the finite supply of non-renewable resources. These rents are referred to as resource rent.<sup>29</sup>*

However, as the Henry Tax Review recognised,<sup>30</sup> it is not just the minerals sector which profits from economic rents. There appears no reason in logic to limit the economic rent analysis to resources since the overriding consideration is above-normal profits. As Garnaut and Clunies Ross put it, the term 'rent' can be applied to any profits of any kind of enterprise that exceed those whose prospect the investor would have required to induce him to invest in the enterprise.<sup>31</sup> For resources, the reason for that above-normal rate of return is, according to the Henry Tax Review, the finite supply of non-renewable resources.<sup>32</sup> Yet monopoly or oligopoly can create the same above-average rates of return,<sup>33</sup> and arguably should be taxed in a similar fashion. Indeed, these conditions might actually reflect something even deeper: arguably economic rent arises not from monopoly per se but from monopolised property relations –that is, private property. Thus Garnaut and Clunies Ross say that most discussion of economic rent talks about windfall profits, barriers to entry and transfer rents, but these terms are inadequate. For them, windfall profits do not necessarily come as a surprise.<sup>34</sup>

A simple way of demonstrating the way in which economic rent is calculated is found in the following formula:

$$\text{Economic Rent} = \text{Total Revenue} \text{ Minus } \text{Total Economic Cost}^{35}$$

A tax is then imposed on the amount of economic rent derived from the resource at a specific rate. It is in effect a tax on the free cash flow from a resource project. It also takes into account in determining the costs of a project the 'opportunity costs of capital' by incorporating an uplift factor such as a long-term bond rate plus a further component.<sup>36</sup> For example, the PRRT in Australia has a carry-forward rate for undeducted general

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<sup>29</sup> Henry Tax Review, Final Report, Detailed Analysis Chapter C: Land and resources taxes C1. Charging for non-renewable resources C1-1 The community's return from the exploitation of its resources. Viewed 3 December 2014.

<sup>30</sup> Ibid.

<sup>31</sup> Ross Garnaut and Anthony Clunies Ross, *Taxation of Mineral Rents* (1983) 33.

<sup>32</sup> Ibid 76.

<sup>33</sup> This is at the expense of other business, since what is happening is actually a reallocation of value from all sectors of capital to the monopoly or resource sectors.

<sup>34</sup> Garnaut and Clunies Ross, above n 31, 34.

<sup>35</sup> G C Watkins, 'Atlantic Petroleum Royalties: Fair Deal or Raw Deal?', (2001) *Atlantic Institute for Market Studies*, The AIMS Oil and Gas Papers (2), 5.

<sup>36</sup> Martin Van Brauman and Clifford Mangano, 'Resource Rent Taxation as a Basis for Petroleum Tax Policy by Foreign Governments and its Relationship to US Foreign Tax Credit Policy and Tax Law', (2000) 18(1) *Journal of Energy & Natural Resources Law* 19, 20.

project costs of the long-term bond rate plus 5 per cent. The now-repealed MRRT had a mining loss allowance of the long-term bond rate plus 7 per cent.

It must be noted that economic rents would not persist under standard competitive conditions.<sup>37</sup> In other words, if other mining companies entered the market because of the attraction of the size of the economic rent, then the rates of return and supply of minerals would drive the commodity price down, or the market would bid up the cost of fixed assets until economic rents were eliminated.<sup>38</sup> The economic rent is eliminated when commodity prices fall or the extraction costs are too high. This is exactly the current situation in Australia with iron ore: the price has fallen to historic lows due to an oversupply by the big mining companies and a slowdown in economic activity in China, the largest buyer of iron ore from Australia.

The philosophical justification for the imposition of a rent tax has three premises: first, that the minerals belong to the state and the rent tax is the price for extracting the state-owned assets; second, that the collection of economic rents may result in a large amount of revenue being collected without distorting production; and third, that mining companies are very large and usually foreign-owned, and from an equity perspective a higher rate of tax could be justified.<sup>39</sup> This view was reinforced by the objective for the former MRRT as contained in the Act. The objective also reinforced the fact that the mineral resources are non-renewable and the state has only one opportunity to maximise its return for the Australian community.

### ***B. Resource Rent Taxes Imposed in Other Countries***

Australia was not the first country to impose a resource rent tax on mining companies. Many countries impose additional taxes on mining companies selling petroleum and mineral resources that have been extracted from their land. The following examination is limited in its scope, giving merely a brief overview of the resource rent regimes adopted in other countries, but it does show that this form of taxation of mineral resources has been used elsewhere, thus supporting the argument that it should be considered by a future Australian government.

Many countries have imposed a resource rent tax on petroleum and mineral extraction projects. Australia was one of the first countries to introduce a PRRT in 1984, but Papua New Guinea (PNG) had already introduced a resource rent tax (RRT) in 1977 on petroleum projects and then, in 1978, on mining projects. PNG subsequently removed the RRT in 2002 on mining and introduced a progressive profits tax.<sup>40</sup> In 1984, Ghana and Tanzania also introduced a RRT.<sup>41</sup> Since then, many countries have either contracted with mining companies to impose an RRT on profit or legislated to impose an RRT. Russia introduced an RRT in 1994; Kazakhstan in the mid-1990s; Angola in 1996; British

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<sup>37</sup> Michael Hinchy, Brian Fisher and Nancy Wallace, 'Mineral Taxation and Risk in Australia', Discussion Paper 89.8 (Australian Bureau of Agricultural and Resource Economics, 1989) 6.

<sup>38</sup> Ibid.

<sup>39</sup> Garnault and Clunies Ross, above n 31, 18.

<sup>40</sup> J. Sarma and G Naresh, 'Mineral Taxation around the World: Trends and Issues' (2001) January, *Asia-Pacific Tax Bulletin* 2, 7.

<sup>41</sup> Bryan Land, 'Resources rent taxes', in Daniel, Keen and McPherson, above n 28.

Columbia, Canada in 1990; Namibia in 1993; and Timor-Leste in 2006 – to name just a few.<sup>42</sup>

Both the United Kingdom (UK) and Norway impose an RRT on petroleum profits derived from the North Sea on the Continental Shelf. The UK first introduced a petroleum resource tax when the North Shelf was developed in 1975. Since then the tax has been amended and altered a number of times.<sup>43</sup> The UK and Norway abolished royalties based on the value of oil and gas extracted in 2002 and 1986 respectively.<sup>44</sup> The reason given for abolishing royalties was that it was a regressive tax, as it applied to gross revenue and acted as a disincentive to exploration and production.<sup>45</sup> The UK applies a petroleum rent tax (PRT) at the rate of 50 per cent as well as the normal company income tax. Norway applies a special petroleum tax (SPT) at 50 per cent as well as the normal company tax on income.<sup>46</sup> The UK government imposed a supplementary charge of a further 10 per cent in 2002, and in 2005 increased the rate to 20 per cent on the company income. However, the PRT is deductible for income tax purposes. Norway does not allow the SPT to be deducted for income tax purposes, and the effective marginal tax rate on the income of the company is 78 per cent.<sup>47</sup>

The UK system is complicated by the fact that the PRT is based on the development of the oil fields and different regimes apply to fields given development consent before 1993 and those given consent after 1993. Fields approved before 1993 are taxed on their income at a company tax rate of 50 per cent and a PRT at the rate of 50 per cent, whereas the later fields are subject only to a company tax rate of 50 per cent.<sup>48</sup> In 2002, the UK government introduced a 10 per cent supplementary charge on the same basis as company tax, but there was no deduction for financing costs against the supplementary charge.<sup>49</sup> The royalty was abolished on older fields that had received development consent before 1983 in an attempt to encourage fuller exploitation of reserves from those fields.<sup>50</sup> In 2005, in light of an increase in oil prices, the UK government doubled the supplementary charge to 20 per cent.<sup>51</sup> This means that in the UK, oil and gas is taxed at the highest rate of any industry: for fields given approval after 1983, a company tax rate of 30 per cent and the supplementary charge of 20 per cent. For fields given approval prior to 1983, the marginal rate of tax is 75 per cent, and they are also liable to company tax at the rate of 50 per cent.<sup>52</sup>

Zambia nationalised its copper industry in 1964, but the legislation effecting nationalisation was repealed in 1985. Since then, the government has imposed a royalty rate of 3 per cent, a variable income tax rate and a windfall tax applied to the value of

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<sup>42</sup> Ibid 243.

<sup>43</sup> Carole Nakhle, 'Can the North Sea still save Europe?' (2008) *OPEC Energy Review* 123, 134.

<sup>44</sup> Ibid 133.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid 134.

<sup>48</sup> Ibid.

<sup>49</sup> Carole Nakhle, 'Petroleum fiscal regimes: evolution and challenges,' in Daniel, Keen and McPherson, above n 28.

<sup>50</sup> Ibid 111.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

production. However, in 2009 the windfall tax was discontinued.<sup>53</sup> A similar situation occurred in Chile, Bolivia, Peru, Democratic Republic of the Congo, Ghana and Jamaica – countries where the mining industry has been nationalised.<sup>54</sup> Some countries have subsequently privatised parts of their mining industry, but the sovereign risk still remains. Chile now has a mixture of state participation and private investment in the mining industry, and has imposed a sliding scale of rates of royalties based on the value of sales.<sup>55</sup> Kazakhstan and Liberia have introduced a rent-based tax on the exploitation of their mineral resources.<sup>56</sup>

Given the range of extra taxes that are imposed on mining and petroleum projects by different nations, the introduction of a MRRT in Australia should not have created the hostility that it did. The fact that a PRRT has been in existence in Australia since 1987 should have provided comfort for the then Labor Government that an RRT would gain acceptance by the mining companies and by the then federal Opposition, led by Tony Abbott. For the purpose of clarity, it is useful to briefly discuss the PRRT that has been operating in Australia.

### ***C. The Australian PRRT***

While the Abbott Coalition Government was committed to repealing the MRRT, the PRRT was allowed to continue to raise a rent tax from offshore petroleum operations in Australia. In 1984, the federal government announced the introduction of an RRT for new offshore petroleum projects and indicated that that the projects would be exempt from imposition of royalties and the crude oil levy.<sup>57</sup> It was a further three years before the legislation was finally passed by parliament. The federal government was not able to extend the rent tax to onshore petroleum production in lieu of state royalties because the state governments of Western Australian and Queensland objected.<sup>58</sup> In 1990, Bass Strait petroleum projects became subject to the PRRT.<sup>59</sup> The North West Shelf projects are subject to a federal royalty and the crude oil levy.<sup>60</sup>

The Hawke Labor Government of 1984 introduced a resource rent tax, based on the Garnaut and Clunies Ross model, in order to remedy the state-based taxation system of imposing royalties on resource production output.<sup>61</sup> The PRRT was imposed on oil companies with the enactment of *Petroleum Resource Rent Tax Act 1987* (Cth) and the *Petroleum Resource Rent Tax Assessment Act 1987* (Cth). The regime was effective from 15 January 1984, even though the legislation was not passed by Parliament until 1987. The Act applied retrospectively to exploration permits awarded on or after 1 July 1984, and recognised expenditure incurred on or after 1 July 1979. It was originally imposed on

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<sup>53</sup> Lindsay Hogan and Brenton Goldsworthy, 'International mineral taxation', in Daniel, Keen and McPherson, above n 28, 122, 126.

<sup>54</sup> Ibid 127.

<sup>55</sup> Ibid 125.

<sup>56</sup> Carole Nakhle, above n 49, 149.

<sup>57</sup> Michael Crommelin, 'Governance of Oil and Gas Resources in the Australian Federation', (2009) *University of Melbourne Law School, Research Series 8*, 12.

<sup>58</sup> Ibid 13.

<sup>59</sup> Ibid.

<sup>60</sup> Ibid.

<sup>61</sup> Rob Fraser, 'The state of resource taxation in Australia: "An inexcusable folly for the nation"?', (1999) *Australian Journal of Agricultural and Resources Economics* 259, 260.

offshore petroleum projects other than Bass Strait and the North West Shelf. However, oil and gas production in Bass Strait moved from a royalty and excise regime to the PRRT regime in the fiscal year 1990–91. The PRRT is imposed on the taxable profit of a petroleum project that is located ‘offshore’ in Australia. The *Petroleum Resource Rent Tax Act 1987* (Cth) is imposed on the profit at the rate of 40 per cent. The *Petroleum Resource Rent Tax Assessment Act 1987* (Cth) contains the provisions relating to the calculation of the profit subject to the rent tax. The PRRT raises in excess of an additional \$1 billion a year in revenue over and above the normal company tax on income.<sup>62</sup> It might reasonably be assumed that the current federal government is content to allow a resource rent tax to be imposed on offshore petroleum projects, since it has not repealed the PRRT, although the change of leadership from Tony Abbott to the more centre-right Malcolm Turnbull in mid-2015 could bring a change of perspective. In addition, the Labor Opposition has stated that if re-elected, it will consider the reintroduction of a MRRT. It is therefore timely to set out a template for a future MRRT in Australia.

#### IV WHAT A RESOURCE RENT TAX SHOULD CONTAIN

It is contended in this paper that Australia needs a new MRRT, and this section outlines the previous flaws in the repealed MRRT and the most desirable characteristics that a new resource tax should contain. There are a number of matters that any future Australian government should consider when examining the merits of an MRRT. These matters are discussed in detail below.

##### A. Replicate the Existing PRRT

A good starting point might be to simply replicate the design of the PRRT, which still successfully collects a resource rent tax in Australia. This means that the super profit or economic rent generated in any year from each project will be taxed at an extra rate of 40 per cent over and above the normal company tax at the rate of 30 per cent paid by the oil and gas company. The PRRT only applies to super profits generated from offshore petroleum projects after the uplift factor of 5 per cent on development expenditure plus the long-term bond rate and a higher uplift factor on exploration expenditure. According to Professor Garnaut, the structure of the PRRT is widely understood and accepted within the oil and gas industry.<sup>63</sup> Professor Garnaut goes on to say that the PRRT is a stable tax, in that there have been no changes since it was introduced in 1985.<sup>64</sup> It clearly demonstrates the flexibility of the tax, in that when the projects are profitable more tax is paid and when less profitable, less tax is paid.<sup>65</sup> It must be noted that the PRRT taxes super profits generated by the oil and gas industries from offshore resources. This means that no state or territory royalties are paid by the exploration companies. This is a major

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<sup>62</sup> Australian Taxation Office statistics: 2002–03 = \$1.2 billion; 2003–04 = \$1.5 billion; 2004–05 = \$2.0 billion; 2005–06 = \$1.8 billion; 2006–07 = \$1.9 billion, 2007–08 = \$ 1.6 billion, 2008–09 = 2.18 billion, 2009–10 = 1.25 billion, 2010–11 = 0.80 billion, 2011–12 = 1.46 billion and 2012–13 = 1.82 billion, but this figure also includes the MRRT collection.

<sup>63</sup> Ross Garnaut, ‘Development and operation of the minerals resource rent tax’, *Senate Economics Reference Committee Public Hearings, No.1, 1*, <http://parlinfo.aph.gov.au/parlInfo/download/committees>.

<sup>64</sup> *Ibid* 5.

<sup>65</sup> *Ibid*.

advantage of this particular tax, as there are no royalties which would be deductible against the PRRT and no potential disputes with state governments on the level of royalties to be paid.

### ***B. Potential State and Territory Conflict – Royalties***

One of the major problems that faced the repealed MRRT was the fact that the payment of royalties to state and territory governments was a deductible expense when calculating the amount of tax payable under the MRRT. In the later year of the MRRT certain state governments increased the royalty rates, which only added to the reduction in tax that was likely to be paid under the MRRT to the federal government.

Any future MRRT must have state and territory input so that there is an equitable sharing of the tax revenue. Ideally, royalties would be reduced or abolished, to be replaced by a share of the MRRT. Because royalties are an inefficient system of taxation they should if possible be replaced with an RRT. This view is supported by professors Garnaut and Ergas. Professor Garnaut contends that in order to bring about efficiencies in resource developments in the States, there needs to be a comprehensive revision of fundamental aspects of federal financial relations.<sup>66</sup> He pointed to the fact that the distribution arrangements for the GST between states has created large disincentives for efficiencies in resource development.<sup>67</sup> Ergas et al recommend that before any new MRRT is introduced, agreement be reached between the state governments and the federal government on distribution of mineral taxes between the states and the impact that this will have on Current Commonwealth Grants.<sup>68</sup>

### ***C. All Mining Should Be Subject to an MRRT***

An MRRT should be directed at all mining companies engaged in the business of extracting any particular mineral or collection of minerals. It should not be restricted to just iron ore, coal and coal seam gas. In this way, if the price of gold remains at very high levels but iron ore remains at historically low levels, at least some mining companies will be paying the MRRT. Ergas et al contend that the former MRRT had the potential to produce undesirable consequences, with mining companies investing in mining operations which did not involve iron ore, coal or coal seam gas.<sup>69</sup> Mining companies wanting to avoid the MRRT would potentially move investment into projects that did not attract the tax. This would distort all investment in mining in Australia.

### ***D. Restrict the Deductions Associated With Write-downs of the Value of the Mines***

One of the most significant design flaws with the former MRRT was the ability of mining companies to claim a depreciation deduction against the MRRT for the cost of their mining assets. The problem was that instead of using historical cost as the basis of valuation, they were able to use market value as the starting cost base. This resulted in higher than

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<sup>66</sup> Ibid 1.

<sup>67</sup> Ibid.

<sup>68</sup> Ergas, Harrison and Pincus, above n 7, 382.

<sup>69</sup> Henry Ergas and Alex Robson, 'Revenue allocation under the MRRT: Economic aspects' (2012) 14(2) *Journal of Australian Taxation* 183, 185.



expected depreciation deductions against the MRRT. Mining companies were able to claim an additional deduction on mining assets that had been written down to zero many years earlier by now attributing market value to the assets for the purposes of the MRRT, but not for income tax purposes.<sup>70</sup> In addition, the depreciation was calculated on the basis of the life of the mine, and many companies lower their estimates of mine life in order to increase the depreciation deduction. Professor Garnaut makes the point that a resource rent tax is not designed to collect tax until the mining company has recouped its investment with a reasonable rate of return, and in the case of the former MRRT it was 5 per cent plus the long-term bond rate.<sup>71</sup> This would result in the market value of the mine being written down over the life of the mine – not, as occurred with mines with a zero value, being written down at current value rather than at historical cost. According to Professor Garnaut, by allowing mining companies to depreciate established mines at market value, the government was giving away the value of the untaxed rent.<sup>72</sup> This was the case with the former MRRT, and the main reason why a very small amount of tax was raised. One solution to this problem is to introduce an MRRT on new projects that commence after the law is introduced and then allow the mining companies a number of years to obtain a return on their initial investment before expecting any tax to be paid. Ergas et al are of the view that a MRRT should apply to new ventures, and that the tax should be levied at a modest and internationally competitive rate.<sup>73</sup>

### ***E. Problems With Allocating Revenue to Vertically Integrated Mining Companies***

Ergas et al identified a major flaw in the MRRT legislation in relation to the allocation of income between downstream activities and upstream activities within the mining process.<sup>74</sup> Vertically integrated mining companies not only extract minerals but also blend, load and transport the minerals to ships for export. The tax was imposed on income generated from upstream activities, but the mining company itself determined to what extent expenses and income were allocated to the separate upstream extraction and downstream processing activities. Ergas et al examined the problem of allocation in detail and concluded that the former MRRT legislation would produce considerable uncertainty and ultimately lead to litigation.<sup>75</sup> As a result of the repeal of the MRRT this issue will not eventuate. However, this potential problem of cost allocation must be taken into consideration when designing a new MRRT. The now-repealed MRRT Act set out a number of statutory assumptions to be made in determining the correct allocation of income generated from upstream and downstream activities. The main thrust of these assumptions was to treat the upstream and downstream activities as separate entities operating at arm's length and independently from one another.<sup>76</sup> Ergas et al highlighted the problems with this approach, but concluded that similar problems currently exist with the PRRT, and that after 25 years of operation of the PRRT some of the problems with allocating income are now being considered by the Federal Court of Australia.<sup>77</sup> Perhaps

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<sup>70</sup> David Uren and Lauren Wilson, 'Flaw to blame for tax shortfall as Treasury miscalculates write downs', *The Australian*, 11 February 2013.

<sup>71</sup> Ross Garnaut, above n 63, 6.

<sup>72</sup> *Ibid.*

<sup>73</sup> Ergas, Harrison and Pincus, above n 7, 382.

<sup>74</sup> Ergas and Robson, above n 69, 186.

<sup>75</sup> *Ibid.* 199.

<sup>76</sup> Section 30–25, MRRT Act.

<sup>77</sup> Ergas, Harrison and Pincus, above n 7, 379.

the courts will find a lasting solution to this problem in relation to the PRTT, which in turn can be applied to a new MRRT.

### ***F. Government Approach to a New MRRT***

While it is accepted that governments have the sole discretion in determining how and where taxation revenue will be spent, any future Australian government examining the potential introduction of a MRRT should take into account two of the major errors that occurred with the approach to the former MRRT. First, the government should not invite mining companies to assist in the design of the resource rent tax. The industry will not then be in a position to 'capture' the regulatory process and implement its own agenda, as was the case with the former MRRT.<sup>78</sup>

The second error in the approach to the former MRRT was to commit the potential revenue from the tax to specific expenditure programs. This is directly contrary to the essence of the concept of a rent tax on super profits. Any government that re-introduces an MRRT must not allocate set tax expenditures against possible tax revenue from mining companies. It must be recognised at the outset that a MRRT only provides revenue when the price of mineral commodities is high and the mining companies are making abnormal profits. These super profits are then calculated only after allowing the mining companies to generate a return on capital and labour plus an uplift factor such as the long-term bond rate plus a percentage. Moreover, the rate at which the tax is set should be reasonable.

### ***G. A new version of an MRRT***

A new MRRT should have as its core objective fairness to both the mining company and to the people of Australia, who have a vested interest in the finite mineral resources that are being extracted. A well designed mineral resource tax should contain the following features, based on the above analysis of the problems identified in the now-repealed MRRT:

- The tax rate should be reasonable and comparable with other countries. It should be no higher than the current PRRT rate of 40 per cent.
- The tax should be easy to understand, and in this respect the PRRT legislation should be used as a guide. It has been collecting a resource rent tax from oil and gas producers in Australia for more than 25 years.
- The Commonwealth Government should discuss the question of royalties on mining with the state governments in order to resolve a number of outstanding issues. The main issue is the deductibility of state royalties from mining income when calculating the profit from the mining project. If the royalties are to be deductible, the states must agree not to increase the rate of the royalty for a set period, otherwise the amount of MRRT to be collected will be at risk. Ideally, royalties should be abolished by the states and a share of the MRRT should be paid to the individual states in compensation.
- All projects involved in the extraction of finite mineral resources in Australia should be subject to an MRRT. When the price of certain minerals is high and a

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<sup>78</sup> John Passant, *The Minerals Resource Rent Tax: The Australian Labor Party and the continuity of change*, (2014) 27(1) *Accounting Research Journal* 19.

super profit is being generated by the mining company, the MRRT will be paid. If that particular resource is at a low price, then no tax will be paid.

- A new MRRT should only be applied to new mining projects, and the value of the mining assets will be at their historical cost for depreciation purposes. There will be no need for mining companies to revalue their existing assets because the tax is only applied to new projects from the date the new law is introduced.
- The potential problems in the allocation of income and expenses associated with vertically integrated mining companies ought to have been resolved in relation to the PRRT before a new MRRT is introduced. The now-repealed MRRT provisions contained in the former Act and based on the PRRT should be reintroduced in new MRRT legislation.

The previous Australian Government made mistakes in the initial design and promotion of the now repealed MRRT, as discussed above. Nevertheless, it is contended that super profits generated from mining activities in Australia should be subject to a rent tax. The tax itself was a good idea, and it was one of the few taxation reforms that was implemented based on the Henry Tax Review recommendations.

## V CONCLUSION

The MRRT should ideally be used to invest in projects that will benefit future generations of Australians over the next hundred or so years, on the basis that mining will not be the employer or generator of substantial wealth for the Australian economy. Future governments owe future generations a duty to provide potential wealth and prosperity by investing in projects that have a long-term potential for increasing or maintain at least the current living standards.

The federal government has repealed the MRRT but left the PRRT in place so that it collects revenue for the government on offshore petroleum exploration. The Labor Opposition has publically stated that if re-elected it will introduce a new MRRT. This article acknowledges that there were design faults in the former MRRT. But it moves beyond that analysis to provide the philosophical basis for the introduction of a super profits tax on the economic rent generated by mining companies.

A new MRRT must overcome the shortcomings of the now-repealed MRRT. As discussed in Part IV, a good starting point for a new MRRT is to tax all minerals extracted by mining companies. The tax should be fair and at a reasonable rate. It should be based on the PRRT and adopt many of the provisions relating to the allocation of income and expenses where vertically integrated mining companies are involved in a project. The new MRRT must only apply to new mining projects, so that the valuation of the assets will be at current market values. The most difficult problem to be overcome with a new MRRT is how to obtain the support of state and territory governments and move to the reduction or abolition of state-based royalties. This problem must be overcome by any future government wanting to reintroduce an MRRT.

The idea of a resource rent tax on the super profits from mining projects is based on the recommendations of the Henry Tax Review and should be implemented in Australia. While the concept is sound and a new MRRT is justified, any future Australian government must not make the mistakes of the previous Labor Government that introduced the now

repealed MRRT. That future government must not link spending programs to an expected level of revenue from a MRRT, and it must not involve the biggest mining companies in its design.

## TAXING CAPITAL IN THE TWENTIETH-FIRST CENTURY: A NEW ZEALAND PERSPECTIVE

JONATHAN BARRETT<sup>1</sup>

### ABSTRACT

Thomas Piketty's *Capital in the Twentieth-First Century* ('Capital') has been a remarkable publishing success. His thesis is that inequality is worsening to a point of crisis because the rate of return on investment exceeds that of general economic growth has attracted significant attention. Conversely, his remedial prescription for a progressive global tax on capital has been widely dismissed as unworkable. How relevant is Piketty's thesis and remedy for New Zealand? Domestic commentators generally believe that his findings in relation to major economies, notably the United States, are not directly relevant to New Zealand, a small and open economy. Furthermore, in contrast to Piketty's accessing and processing comprehensive data, there is a dearth of information about wealth in New Zealand. Nevertheless, as in all developed economies, inequality is a pressing concern, and Piketty's proposal for taxing capital usefully focuses attention on this area of tax policy which has been greatly neglected in New Zealand.

In this article, an overview of *Capital* is given and issues of inequality in New Zealand are sketched. A review of local commentaries on *Capital* is also provided. Consideration is given to appropriate policy responses to New Zealand's inequality issues. Arguments are then presented for a capital acquisitions tax, and conclusions are drawn.

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## I CAPITAL IN THE TWENTY-FIRST CENTURY

Thomas Piketty's *Capital in the Twentieth-First Century* ('*Capital*'),<sup>1</sup> a dense and widely unread examination of wealth accumulation,<sup>2</sup> is a publishing phenomenon which has attracted significant attention from politicians and policymakers.<sup>3</sup> Indeed, Geoff Bertram argues that Piketty's theory of capital promises 'a Kuhnian scientific revolution' in fiscal policy.<sup>4</sup> Bertram further predicts that 'there is a sea-change coming in the global intellectual climate, and New Zealand will as usual be swept along with it',<sup>5</sup> although Brian Easton suggests that '[w]hat is going on overseas will impact here intellectually – albeit with a lag, of perhaps a decade or so.'<sup>6</sup>

Piketty sums up his thesis as follows:<sup>7</sup>

*This fundamental inequality which I will write as  $r > g$  (where  $r$  stands for the average annual rate of return on capital, including profits, dividends, interest, rents and other income from capital, expressed as a percentage of its total value, and  $g$  stands for the rate of growth in the economy, that is the annual increase in income or output) ... it sums up the overall logical of my conclusions.*

Demonstrating that those who possess more capital are able to accumulate and compound their wealth is not new, and in 2000, physicists Jean-Philippe Bouchaud and Marc Mézard constructed a model which demonstrated how wealth could condense into the hands of a small number of capital holders.<sup>8</sup> James Meade and his one-time students, Anthony Atkinson and Joseph Stiglitz,<sup>9</sup> have analysed inequality, its causes and

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<sup>1</sup> Thomas Piketty, *Capital in the Twentieth-First Century* (Arthur Goldhammer trans, The Belknap Press of Harvard University Press, 2014) [trans of: *Le capital en XXI siècle* (first published 2013)].

<sup>2</sup> See, for example, Jordan Ellenberg, 'The Summer's Most Unread Book Is ...', *The Wall Street Journal* (online), 3 July 2014 <<http://www.wsj.com/articles/the-summers-most-unread-book-is-1404417569>>.

<sup>3</sup> For example, Andrew Little, leader of the New Zealand Labour Party, has visited Paris to consult with Piketty: see Richard Harman, 'Labour Talking about Taxing Wealth' on *Politik* (29 April 2015) <<http://politik.co.nz/en/content/economy/224/LABOUR-TALKING-ABOUT-TAXING-WEALTH-Grant-Robertson-Thomas-Piketty-Andrew-LittleMichael-Cullen-peter-Harris-capital-gains-tax.htm>>.

<sup>4</sup> Geoff Bertram, 'Has Capital in the Twentieth-First Century Changed Anything?' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 15, 16.

<sup>5</sup> *Ibid*, 28.

<sup>6</sup> Brian Easton, 'How Economists Might View the Piketty Thesis' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 50, 50.

<sup>7</sup> Piketty, above n 1, 25.

<sup>8</sup> Jean-Philippe Bouchaud and Marc Mézard, 'Wealth Condensation in a Simple Model of Economy' (2000) 282 *Physica A* 536. See also Ofer Malcai, Ofer Biham, and Sorin Solomon, 'Power-Law Distributions and Lévy-Stable Intermittent Fluctuations in Stochastic Systems of Many Autocatalytic Elements' (1999) 60 *Physical Review E* 1299. Commenting on the research, Mark Buchanan observes that 'the richest 40 people in Mexico have nearly 30% of the wealth': see Mark Buchanan, 'Wealth Happens' (2002) 80(4) *Harvard Business Review* 49, 53. Rather than wealth condensation, Piketty, above n 1, 336 uses the term 'hyperconcentration' of wealth.

<sup>9</sup> See, for example, Joseph E Stiglitz, *The Price of Inequality* (Allen Lane, 2012).



consequences, since the 1960s.<sup>10</sup> Indeed, Meade and Atkinson have presented more nuanced explanations of inequality than Piketty: they focus on the quality of investments which the less wealthy are able to make. Atkinson says 'it is less the relationship between  $r$  and  $g$ , and more differences in  $r$  and the differences in the savings rate,  $s$ ' that matter.<sup>11</sup> Even when the average rate of return on investment is low, as it has been since the Global Financial Crisis, the wealthy obtain better returns because their larger investments are not consumed by management fees and they have access, for instance, to the spectacular returns that hedge funds may provide.<sup>12</sup> And, even when people pursue less exotic forms of investment, as Meade observes, 'the rate of return on property is much lower for small properties than for large properties'.<sup>13</sup> Despite these antecedents and refinements of his theory, Piketty's thesis is particularly persuasive because his extensive accessing and analysing of data present plausible evidence of the tendency towards wealth condensation in developed economies. His remedy for this mischief is a progressive global tax on capital.

This article takes advantage of the popularity of *Capital* to consider inequality in New Zealand and the potential for taxing wealth as Piketty prescribes. The article is structured as follows: an overview of *Capital* is first given and issues of inequality in New Zealand are sketched. A review of local commentaries on *Capital* is also provided. Consideration is given to appropriate policy responses to New Zealand's inequality issues. Arguments are then presented for a capital acquisitions tax, and conclusions are drawn.

## II INEQUALITY IN NEW ZEALAND

Fundamental inequality issues are common across the developed world, whereas other problems are more pronounced in different countries.<sup>14</sup> Along with other Organisation for Economic Cooperation and Development (OECD) members, New Zealand's growth has been hindered by increasing income inequality over the past 30 years. But the unequal position of Māori and Pacific peoples in New Zealand adds a unique dimension to inequality concerns. These and related issues will be considered in this part of the article.

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<sup>10</sup> Meade himself cites the philosopher John Rawls and the economists Henry Phelps Brown, David Champernowne, Amartya Sen and John Stone as influences on his work: see J E Meade, *The Just Economy* (George Allen & Unwin, 1976) 10.

<sup>11</sup> Anthony B Atkinson, 'Can We Reduce Income Inequality in OECD Countries' (2015) 42 *Empirica* 211, 220.

<sup>12</sup> *Ibid*, 221.

<sup>13</sup> J E Meade, *Efficiency, Equality and the Ownership of Property* (Allen & Unwin, 1964) 44.

<sup>14</sup> The United States is an exception among developed countries. While it has a very high United Nations Development Program ('UNDP') human development index ('HDI') rank of 5<sup>th</sup>, its inequality-adjusted HDI ('IHDI') is ranked 28<sup>th</sup>. Generally, the top-ranked countries have similar HDIs and IHDI. Thus the HDIs are for Norway (1<sup>st</sup>); Australia (2<sup>nd</sup>); New Zealand (7<sup>th</sup>); Canada (8<sup>th</sup>); Ireland (11<sup>th</sup>); Sweden (12<sup>th</sup>); Iceland (13<sup>th</sup>); United Kingdom (14<sup>th</sup>); Finland (24<sup>th</sup>) whereas the IHDI rankings are: Norway (1<sup>st</sup>); Australia (2<sup>nd</sup>); New Zealand (no data); Canada (9<sup>th</sup>); Ireland (10<sup>th</sup>); Sweden (7<sup>th</sup>); Iceland (6<sup>th</sup>); United Kingdom (16<sup>th</sup>); Finland (11<sup>th</sup>). See UNDP, *Human Development Report 2014, Sustaining Human Progress: Reducing Vulnerabilities and Building Resilience* (UNDP, 2014).

### A. *Inequality in Income*

*Capital* helps New Zealanders to recognise they are ‘part of the Anglo-Saxon pattern of steeply rising inequality since 1980’.<sup>15</sup> New Zealand was once considered an exceptionally egalitarian society,<sup>16</sup> but income equality fell dramatically following the neoliberal reforms of the 1980s and 1990s.<sup>17</sup> Thus, in 1984, at 0.27,<sup>18</sup> New Zealand’s Gini coefficient was similar to the income distributions of contemporary Scandinavian societies.<sup>19</sup> Nevertheless, having fallen, income distribution has been fairly stable for the past two decades.<sup>20</sup> Indeed, Bertram claims with some plausibility that New Zealand is ‘one of the less unequal Anglo economies’.<sup>21</sup> However, different income distribution measures can lead to conflicting conclusions and complacency. Thus Donald Curtin argues that both Australia and New Zealand ‘have a slightly smaller share going to the top 1 per cent than France does, and both of us are comparable to the egalitarian Swedes’.<sup>22</sup> But, according to the OECD, New Zealand has a Gini coefficient of 0.32, compared with 0.3 for France, and Sweden’s significantly lower coefficient of 0.27.<sup>23</sup> Besides, despite the attention the wealthiest one per cent receives,<sup>24</sup> from a practical inequality perspective, the position of the bottom 40 per cent matters more.<sup>25</sup>

Working for Families (WfF), a limited negative income tax, is credited with improving poverty rates and staving off greater income inequality.<sup>26</sup> As Bernard Hickey observes, WfF closes the gap between  $r$  and  $g$ .<sup>27</sup> Furthermore, increases in the national minimum wage pursued by the Labour-led government (1999–2008) have contributed to a stabilisation of income inequality. The current National-led government has maintained WfF, increased the minimum wage and announced plans to raise benefits in real terms for

<sup>15</sup> Bertram, above n 4, 28.

<sup>16</sup> See Michael King, *The Penguin History of New Zealand* (Penguin Books, 2003) 282.

<sup>17</sup> See Brian Easton, ‘Economic Inequality in New Zealand: A User’s Guide’ (2013) 28(3) *New Zealand Sociology* 19–66.

<sup>18</sup> See Bryan Perry, *Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982 to 2013* (Ministry of Social Development, 2014) 18.

<sup>19</sup> See, generally, UNDP, above n 14. ‘The Gini coefficient, which compares cumulative proportions of the population against cumulative proportions of income they receive. It ranges between 0 in the case of perfect equality and 1 in the case of perfect inequality.’ See Statistics New Zealand, ‘Income Inequality’ <[http://www.stats.govt.nz/browse\\_for\\_stats/snapshots-of-nz/nz-social-indicators/Home/Standard%20of%20living/income-inequality.aspx#anchor26](http://www.stats.govt.nz/browse_for_stats/snapshots-of-nz/nz-social-indicators/Home/Standard%20of%20living/income-inequality.aspx#anchor26)>.

<sup>20</sup> See Bryan Perry, *Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982 to 2013* (Ministry of Social Development, 2014) 90.

<sup>21</sup> Bertram, above n 4, 28. Certainly, using comparative Gini coefficients, New Zealand is markedly less unequal than the United States (0.38) but, at 0.32, the same as Canada and similar to Australia and Ireland (0.33) and the United Kingdom (0.34). See ‘Income Inequality’ Statistics New Zealand <[http://www.stats.govt.nz/browse\\_for\\_stats/snapshots-of-nz/nz-social-indicators/Home/Standard%20of%20living/income-inequality.aspx](http://www.stats.govt.nz/browse_for_stats/snapshots-of-nz/nz-social-indicators/Home/Standard%20of%20living/income-inequality.aspx)>.

<sup>22</sup> Donald Curtin, ‘Why the Fuss?’ in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 40, 47.

<sup>23</sup> See Statistics New Zealand, above n 21.

<sup>24</sup> See, for example, Stiglitz, above n 9.

<sup>25</sup> See OECD, *In It Together: Why Less Inequality Benefits All* (OECD Publishing, 2015) <<http://dx.doi.org/10.1787/9789264235120-en>>.

<sup>26</sup> See, for example, Tony Blakely, ‘Social Injustice is Killing People on a Grand Scale’ (2008) 121(1281) *New Zealand Medical Journal* 7, 8.

<sup>27</sup> Bernard Hickey, ‘What Piketty Means for Us’ in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 75, 79.

the first time since 1972.<sup>28</sup> These measures have prevented income inequality deteriorating further but, as Lisa Marriott and Dalice Sim observe, such transfers are not a long-term solution to inequality.<sup>29</sup>

### **B. Inequality in Wealth**

If income inequality in New Zealand is marginally less severe than other Anglophone countries, what of wealth inequality? The simple answer is that we do not know. As Peter Skilling observes, '[a]vailable data in New Zealand is sadly lacking on the distribution of wealth, with most commentators still relying on [a 2007 analysis]'.<sup>30</sup> In Easton's view, 'there is no good quality data about top wealth' in New Zealand.<sup>31</sup> Max Rashbrooke concedes there is a lack of relevant data but infers that Piketty's thesis does, indeed, apply in New Zealand. He points to tangential evidence – for example, the *National Business Review's* Wealth List has increased from NZD12 billion to NZD30 billion in thirty years.<sup>32</sup> But, as Matt Nolan says, 'we need to research – not assume'.<sup>33</sup> Piketty's lesson for New Zealand is, then, perhaps, as much about the collection and processing of data as it is about taxing capital.

Any research into individual wealth in New Zealand is hampered by the common use of trusts. No one knows how many trusts currently exist in the country: estimates vary from 300 000 to 500 000. Thus the New Zealand Law Commission observes that 'it is difficult to develop a comprehensive view of the trust landscape, particularly since there is no record of the number of trusts in New Zealand'.<sup>34</sup> The Inland Revenue Department ('IRD') has made some in road into the use of trusts for splitting active income to avoid income tax,<sup>35</sup> but trusts remain popular 'to shelter income from various social taxes (e.g. child

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<sup>28</sup> Bill English, 'Budget Speech' (media release) 21 May 2015. It is likely that the Māori Party and United Future, National's coalition partners have exerted a moderating influence on social policy. New Zealand's mixed member proportional voting system is designed to create compromises. As David Runciman notes, in contrast to the United Kingdom, in continental Europe 'there are barriers in the way of vastly unequal distributions of wealth and power and where there also happen to be proportional representational systems that force multiple parties to negotiate': see David Runciman, 'Notes on the Election' (2015) 37(10) *London Review of Books* 5.

<sup>29</sup> Lisa Marriott and Dalice Sim, 'Indicators of Inequality for Māori and Pacific People' (Working Papers in Public Finance No 09/2004, Victoria University of Wellington, 2014) 27.

<sup>30</sup> Peter Skilling, 'Attitudes to Inequality in 2014: Results from a 2014 Survey' (2014) 29(3) *New Zealand Sociology* 38, 38. The analysis relied upon is Jit Cheung, *Wealth Disparities in New Zealand* (Statistics New Zealand, 2007). However, the data appears to have been gathered in 2003–04: see Perry, above n 20, 39, n 14.

<sup>31</sup> Easton, above n 6, 50. See also Simon Chapple, 'Piketty's Book is the Real Article' in Geoff Bertram et al *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 30, 39 on the lack of income and wealth data in New Zealand.

<sup>32</sup> Max Rashbrooke, 'Bringing Wealth into the Spotlight' in Geoff Bertram et al *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 132, 138.

<sup>33</sup> Matt Nolan, 'What Is the Piketty Model, and Does It Fit New Zealand?' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 116, 131.

<sup>34</sup> New Zealand Law Commission, *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts Second Issues Paper* (IP 20, 2010) [1.4].

<sup>35</sup> See *Penny & Hooper v CIR* [2011] NZSC 95. Before then, IRD estimated that \$300 million annual income tax was lost by taxpayers using trusts to split active income: see Grahame Armstrong, 'Spotlight to Fall on Tax-Dodgers' *Stuff* (online) 25 October 2009 <<http://www.stuff.co.nz/national/2998145/Spotlight-to-fall-on-tax-dodgers>>.

support and student loan repayments) or to enable people to receive social support'.<sup>36</sup> Generally, avoidance of resident status, use of trusts and private companies ensure a fuller understanding of wealth distribution is obfuscated.<sup>37</sup>

Despite the lack of accurate data, inferences can be drawn. Henry Phelps Brown tells us that [t]he degree of concentration of wealth is everywhere far higher than that of income'.<sup>38</sup> Indeed, Bryan Perry concludes that '[f]or both Australia and New Zealand the Gini for wealth is roughly double the income Gini. The ratio of top quintile share to bottom quintile share (S5:S1) is 5 for income for both Australia and New Zealand, whereas the same share ratio for wealth is "off the scale" – around 70 for Australia [and unknown for New Zealand]'.<sup>39</sup>

### ***C. Inequality Among Ethnic Groups***

Poverty is a different issue from inequality but, as Marriott and Sim observe, 'to the extent that greater inequalities exist among certain ethnic groups, the result is higher levels of poverty among these ethnic groups'.<sup>40</sup> Their investigation updated Ministry of Social Development research into health; knowledge and skills; paid work; economic standard of living; cultural identity; and social connectedness. Māori and Pacific people scored significantly worse than European and Asian populations across all categories.<sup>41</sup> These findings are of particular significance, since the wealthier European population is ageing and its fertility rate is falling. In contrast, '[t]he Pacific population has the highest growth rate of any ethnic group, with 38 per cent of the population under the age fifteen'.<sup>42</sup> They are, in Karlo Mila's words, 'significant arteries in New Zealand's future lifeline'.<sup>43</sup> It is critical, then, for future society and the economy that Māori and Pacific people are enabled to reach their full potential and are not held back by inequality of opportunities: investment in human capital must be made to 'promote skills development and learning across people's lives'.<sup>44</sup>

### ***D. Inequality Among and Between Generations***

On a day-to-day basis, intergenerational inequality is greatly associated with ownership of real property and the unequal opportunities among the young to gain the welfare

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<sup>36</sup> Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group') 28.

<sup>37</sup> Easton, above n 6, 56.

<sup>38</sup> Henry Phelps Brown, *Egalitarianism and the Generation of Inequality* (Oxford University Press, 1988) 361. See also Piketty, above n 1, 336

<sup>39</sup> Perry, above n 20, 39.

<sup>40</sup> Marriott and Sim, above n 29, 4.

<sup>41</sup> *Ibid.*, 26.

<sup>42</sup> Karlo Mila, 'Only One Deck' in Max Rashbrooke (ed), *Inequality: A New Zealand Crisis* (Bridget Williams Books, 2013) 91, 99.

<sup>43</sup> *Ibid.*

<sup>44</sup> OECD, 'Focus on Inequality and Growth' (2014) <<http://www.oecd.org/els/soc/Focus-Inequality-and-Growth-2014.pdf>>.

benefits of homeownership.<sup>45</sup> Thus, according to David Seymour, '[f]or the first time in New Zealand's history, house ownership has become the privilege of the wealthy' and 'property ownership is heritable'.<sup>46</sup> But, even when people do have access to private home ownership, since debt is a critical determinant of wealth inequality,<sup>47</sup> young families with large mortgages are unfavourably positioned relative to older people with mortgage-free homes. More generally, New Zealand has commendably tackled elder poverty by linking basic superannuation to the median wage, whereas other non-superannuitant beneficiaries have become relatively poorer because their benefits have been linked to the consumer price index.<sup>48</sup> Education is another significant cause of debt for younger people. Indeed, Atkinson observes that '[i]ncreased reliance on parental funding [for tertiary education] means that inequality of income in one generation is to a greater extent associated with inequality of opportunity in the next generation.'<sup>49</sup>

### ***E. Inequality Among Regions***

Shamubeel Eaqub observes that 'the lower bounds of household income are similar across all regions, but the opportunity for high household income is confined to Auckland and Wellington. The economic prospects across – and often within – our regions are vastly unequal'.<sup>50</sup> The median household income in Auckland, for example, is similar to France, and that of Wellington to Finland, but the household median income in Northland is on a par with Timor-Leste.<sup>51</sup>

### ***F. Lived Inequality***

Tim Hazledene asks where in *Capital* is a discussion of the problems caused by inequality?<sup>52</sup> Thus Piketty's data analysis fails to take into account the consequences and nuances of inequality, the real, quotidian experience of being denied dignity and excluded from the benefits of social existence. These are amply evident and recorded in New Zealand<sup>53</sup> and are the types of social problems documented in *The Spirit Level*.<sup>54</sup> Life

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<sup>45</sup> See Tony Fahey and Michelle Norris, 'Housing' in Herbert Obinger, Chris Pierson, Francis G Castles, Stephan Liebfried and Jane Lewis (eds), *The Oxford Handbook of the Welfare State* (Oxford University Press, 2010) 479, 491.

<sup>46</sup> Quoted by Rob Stock, 'ACT Warns on Home Ownership' *The Dominion Post* (Wellington) 13 May 2015, B4. The comment is significant because Seymour is the sole Member of Parliament and leader of ACT, a party of economic libertarians.

<sup>47</sup> OECD, *In It Together: Why Less Inequality Benefits All* (OECD Publishing, 2015) 20 <<http://dx.doi.org/10.1787/9789264235120-en>>.

<sup>48</sup> Stacey Kirk and Andy Fyers, 'Pensions Rise Way Ahead of Benefits' *The Dominion Post* (18 May 2015) A2. See English, above n 28 on plans to increase benefits in real terms.

<sup>49</sup> Atkinson, above n 11, 219.

<sup>50</sup> Shamubeel Eaqub, *Growing Apart: Regional Prosperity in New Zealand* (Bridget Williams Books, 2014) 10.

<sup>51</sup> *Ibid.*, 10. See also Susan Jacobs, 'Developing a Regional Social Progress Index' (Institute for Governance and Policy Studies, Victoria University of Wellington, 2015).

<sup>52</sup> Tim Hazledene, 'Pickings from Piketty' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 67, 74.

<sup>53</sup> See, generally, Max Rashbrooke (ed), *Inequality: A New Zealand Crisis* (Bridget Williams Books, 2013).

<sup>54</sup> Richard Wilkinson and Kate Pickett, *The Spirit Level: Why Equality Is Better for Everyone* (Penguin, 2010).



expectancy and income are strongly correlated,<sup>55</sup> as are poverty and childhood morbidity.<sup>56</sup> Inequality in life expectancy has increased with worsening income inequality,<sup>57</sup> and, in New Zealand, regressive tax reforms have been linked to increased differences in mortality rates.<sup>58</sup> It is appropriate that Richard Wilkinson and Kate Pickett are epidemiologists, since the metaphor of disease more aptly communicates the individual and social harm of inequality than a comparison of national Gini coefficients. But, beyond compassion, why should the well-off be concerned about inequality?

### G. Economic Efficiency

Among the Bretton Woods institutions which formulated the 10 neoliberal policies of the Washington Consensus,<sup>59</sup> the idea that inequality is an unfortunate but necessary trade-off for economic growth has become greatly disbelieved. Summing up a post-Washington Consensus, Jonathan Ostry and his fellow researchers from the International Monetary Fund conclude:<sup>60</sup>

*Extreme caution about redistribution – and thus inaction – is unlikely to be appropriate in many cases. On average, across countries and over time, the things that governments have typically done to redistribute do not seem to have led to bad growth outcomes, unless they were extreme. And the resulting narrowing of inequality helped support faster and more durable growth, apart from ethical, political, or broader social considerations.*

The World Bank has been more forthcoming, and argues that ‘for countries and local communities, extreme inequalities in assets, power, and voice are corrosive, linked and self-perpetuating’.<sup>61</sup> These effects are not limited to those who suffer poverty and inequality directly; society as a whole suffers, ‘stability is undermined, and the ability to solve economic, social, and environmental problems (that require collective action) dissipates’.<sup>62</sup> In more equal societies, ‘people are more likely to trust each other, measures of social capital and social cohesion show that community life is stronger, and homicide rates and levels of violence are consistently lower’.<sup>63</sup> There is no reason why New Zealand should be immune from such social malaise.<sup>64</sup>

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<sup>55</sup> Richard G Wilkinson, *The Impact of Inequality: How to Make Sick Societies Healthier* (Routledge, 2005) 102.

<sup>56</sup> Susan St John and Donna Wynd, *Left Behind: How Social and Income Inequalities Damage NZ Children* (Child Poverty Action Group, 2008).

<sup>57</sup> Gopal K Singh and Mohammad Siahpush, ‘Widening Socioeconomic Inequalities in US Life Expectancy, 1980–2000’ (2006) 35 *International Journal of Epidemiology* 969.

<sup>58</sup> Tony Blakely, Shilpi Ajwani, Bridget Robson, Martin Tobias and Martin Bonné, ‘Decades of Disparity: Widening Ethnic Mortality Gaps from 1980 to 1999’ (2004) 117:1199 *New Zealand Medical Journal* <<http://www.nzma.org.nz/journal/117-1199/995/content.pdf>>.

<sup>59</sup> See World Health Organization, ‘Washington Consensus’ <<http://www.who.int/trade/glossary/story094/en/>>.

<sup>60</sup> Jonathan D Ostry, Andrew Berg Charalambos G Tsangarides, ‘Redistribution, Inequality, and Growth’ (IMF Staff Discussion Note, SDN/14/020) 26.

<sup>61</sup> World Bank, *World Development Report 2003: Dynamic Development in a Sustainable World*, (Washington, World Bank, 2003) 184.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid, 33.

<sup>64</sup> Eaquib, above n 50, 23 notes that these risks are real for a regionally unequal New Zealand.



The gap between rich and poor has been deteriorating for 30 years and is now at its highest level across the OECD. This phenomenon has significant impact on economic growth. For example, it is estimated that New Zealand (the worst affected country, along with Mexico) lost 10 per cent of its potential economic growth because of its increasing income inequality since the 1980s. This is greatly attributable to the lowest 40 per cent of income earners, who tend to invest less than others in education, falling behind the rest.<sup>65</sup> As noted, in New Zealand, this disadvantaged group are over-represented by Māori and Pacific people, whose population is increasing. Ganesh Nana sums the issue up: 'inequality of opportunity leads inevitably to a workforce that is less skilled (and is thus less productive)' than it could be; 'there is a very real economic loss incurred by the existence of unemployed, underemployed, untrained, disenchanted, disconnected, disenfranchised and, indeed, disruptive resources'.<sup>66</sup>

### III WHAT SHOULD BE DONE?

Bouchaud and Mézard, the physicists whose model of wealth condensation anticipated Piketty's  $r < g$ , conclude that increased taxation 'seems to be an efficient way to reduce inequalities'.<sup>67</sup> Likewise, for Wilkinson, 'redistributing income from rich to poor improves health no matter what mechanism' is employed.<sup>68</sup> Indeed, funding public needs, effecting transfers from the wealthy to the needy, and obviating wealth condensation are all functions to which taxes can contribute. But they are not a panacea. Taxes may add to equality but access to tertiary education, decent work opportunities, stronger legal support for trade unions, higher minimum wages and the general provision of public goods and services are also necessary drivers of a more equal society.<sup>69</sup> Atkinson attributes the significant reduction of inequality in post-war Europe to 'redistribution via the welfare state and progressive taxes, a reduced share of capital income and a marked decline in the concentration of wealth, and equalizing labour market policy'.<sup>70</sup> And so, we should not think that taxes alone can remedy the mischief of inequality but they can contribute, and the remainder of this article focuses on that potential contribution.

#### A. More-Progressive Income Tax

Symmetry lies in seeking to combat income inequality through more-progressive income taxation.<sup>71</sup> In the post-War period, when developed countries were most equal (and economic growth was highest), income taxes were at their most progressive. In that context, Atkinson's recommendation of restoring progressive income tax with 10 per cent steps to a top marginal rate of 65 per cent does not seem excessive.<sup>72</sup> A degree of income

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<sup>65</sup> OECD, 'Focus on Inequality and Growth' (2014) <<http://www.oecd.org/els/soc/Focus-Inequality-and-Growth-2014.pdf>>.

<sup>66</sup> Ganesh Nana, 'The Cost of Inequality' in Max Rashbrooke (ed) *Inequality: A New Zealand Crisis* (Bridget Williams Books, 2013) 55, 60.

<sup>67</sup> Bouchaud and Mézard, above n 8, 544.

<sup>68</sup> Wilkinson, above n 55, 143.

<sup>69</sup> See JE Meade, 'Poverty in the Welfare State' (1972) 24(3) *Oxford Economic Papers* 289, 322.

<sup>70</sup> Atkinson, above n 11, 217.

<sup>71</sup> See, for example, Nana, above n 66, 65.

<sup>72</sup> Atkinson, above n 11, 221.

inequality may incentivise workers and entrepreneurs in a capitalist economy<sup>73</sup> but it is difficult to see retaining 45 per cent at the margin as a disincentive.

Warnings are commonly encountered in New Zealand about the income tax burden borne by high income earners. (Krugman identifies reiteration of a similar message in the United States.<sup>74</sup>) Thomas Pippos, for example, observes that '2 per cent of the population ... already pay 22 per cent of personal income tax – the most tax per capita in absolute and relative terms.'<sup>75</sup> Under an income tax system with any degree of progressivity, those who earn the most income will pay an apparently disproportionate amount of income tax. But Pippos notes that the highest income tax earners are 'not the wealthiest New Zealanders, just those who can't fall outside of the rules – a segment of the upper middle class'.<sup>76</sup> The pressing issue is then whether community members with a similar ability to pay taxes as high salary earners do not do so because their income is crystallised and distributed as tax-free capital or otherwise sheltered from income tax. And so, without being distracted from the vertical equity of progressivity in income tax, serious attention should be paid to horizontal equity among the wealthy.

### **B. Taxing Capital**

New Zealand has an approaching fiscal crisis. Treasury predicts a tax yield deficit, by 2060, of six per cent of gross domestic product<sup>77</sup> – the equivalent in today's terms of the annual health budget.<sup>78</sup> How should this gap be filled? As noted, the belief is widely held in New Zealand that no more income tax should be levied against a small number of high salary earners. A comprehensive capital gains tax ('CGT') is broadly considered unattractive because of its perceived complexity.<sup>79</sup> Increases in goods and services tax (GST) will be self-defeating. Since GST is regressive, particularly in its pure form in New Zealand,<sup>80</sup> income transfers will be needed if rates continue to be increased.<sup>81</sup> Therefore the deficit can only be made good by taxes on capital in some form.

Book balancing is somewhat of a distraction from the key issue: the critical motivation for taxing capital is ideological. This article has sought to adduce supra-political reasons for interfering in wealth outcomes but, ultimately wealth distribution is a matter of political

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<sup>73</sup> See, for example, Richard A Miller, 'From Macro to Micro: the Re-emergence of Efficiency Considerations in Economic Policy' in Alan Bollard (ed) *The Influence of United States Economics on New Zealand: The Fulbright Anniversary Seminars* (NZ-US Educational Foundation and New Zealand Institute of Economic Research, 1988) 34.

<sup>74</sup> See Paul Krugman, 'Our Invisible Rich' *The New York Times* (online) 28 September 2014) <[http://www.nytimes.com/2014/09/29/opinion/paul-krugman-our-invisible-rich.html?emc=edit\\_th\\_20140929&nl=todaysheadlines&nid=52727791&r=0](http://www.nytimes.com/2014/09/29/opinion/paul-krugman-our-invisible-rich.html?emc=edit_th_20140929&nl=todaysheadlines&nid=52727791&r=0)>.

<sup>75</sup> Thomas Pippos, 'Taxation as Political Football Ends in Own Goal', *Sunday Star Times* (New Zealand) 24 August 2014, p D11.

<sup>76</sup> Ibid.

<sup>77</sup> The Treasury, *Affording Our Future: Statement on New Zealand's Long-term Fiscal Position* (2013) <<http://www.treasury.govt.nz/government/longterm/fiscalposition/2013/affordingourfuture/lfts-13-aof.pdf>>.

<sup>78</sup> Geof Nightingale, 'A Tax on Capital is Coming', *Sunday Star Times* (New Zealand) 21 September 2014, p D11.

<sup>79</sup> See Tax Working Group, above n 36, 67.

<sup>80</sup> See David White and Richard Krever, 'Preface' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (2007) vii, viii.

<sup>81</sup> Tax Working Group, above n 36, 66.

values. As Nolan observes: 'Piketty is clear that he finds the idea of a future with large inherited wealth, and a clearer class-based grouping between individuals, to be morally abhorrent – and this is the real driver of his policy suggestion.'<sup>82</sup> Like Piketty, the current author supports a society based not only on substantive equal opportunities but also on equitable outcomes. This view is, of course, not universally shared. Thus Jonathan Boston observes that 'there is almost universal acceptance that equality matters. Yet there is no consensus on what *kind* of equality should be championed.'<sup>83</sup> For him, 'a strong commitment to substantive equality of opportunity raises important questions about how far these large inequalities of income and wealth should be tolerated'<sup>84</sup> and he concludes 'a relatively egalitarian distribution of resources ... will help ensure that all citizens are able to enjoy their basic rights and liberties, it will also lead to greater equality of opportunity and stronger sense of social equality.'<sup>85</sup> To reiterate, this author recognises that such a progressive vision is not universally held, but it does inform this article.

### C. Taxing Capital in New Zealand

The Liberal government (1890–1912) and the Labour government (1935–49) took significant strides against inequality (for European males, at least) through policies that included the levying of 'hefty' death duties.<sup>86</sup> But capital taxes have since been abolished: estate duty in 1992,<sup>87</sup> stamp duty in 1999,<sup>88</sup> and gift duty in 2011.<sup>89</sup> Furthermore, no general CGT is levied.<sup>90</sup> The only tax on capital in New Zealand is local rating.<sup>91</sup> However, as an equitable capital tax, rating is deeply flawed, since residential landlords bundle rates charges into rentals and pass the tax burden on to their tenants who may be the poorest members of society.

Simon Chapple argues that, because New Zealand is 'a small open economy that is not part of any functional supra-national entity ... we have severe policy limitations in terms of dealing with inequality at the top end, both of capital and income'.<sup>92</sup> Bertram also notes that the 'large component of the rent secured within New Zealand actually flow overseas, which limits the rate at which wealth accumulates within New Zealand' and 'taxation of rents and wealth, and other moves to expropriate rentiers, therefore, have an international dimension that policy even more difficult than in the core capitalist

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<sup>82</sup> Nolan, above n 33, 126.

<sup>83</sup> Jonathan Boston, 'What Kind of Equality Matters?' in Max Rashbrooke (ed), *Inequality: A New Zealand Crisis* (Bridget Williams Books, 2013) 70, 84.

<sup>84</sup> Ibid, 85.

<sup>85</sup> Ibid.

<sup>86</sup> See Max Rashbrooke, 'Inequality in New Zealand' in Max Rashbrooke (ed) *Inequality: A New Zealand Crisis* (Bridget Williams Books, 2013) 20, 25. The first major national tax was an income and land tax: see *Land and Income Tax Assessment Act 1891* (NZ).

<sup>87</sup> See *Estate Duty Abolition Act 1993* (NZ).

<sup>88</sup> See *Stamp Duty Abolition Act 1999* (NZ).

<sup>89</sup> See *Taxation (Tax Administration and Remedial Matters) Act 2011* (NZ).

<sup>90</sup> At the time of writing, the government has announced proposals for taxing gains on sales of houses within two years of purchase: see English, above n 28. Rather than a specific CGT, this measure can be seen as an objective benchmark for speculation. Compare with the *Property Speculation Tax 1973* (NZ).

<sup>91</sup> Rates are either raised against the value of land or its improved value. The possible base of annual rental value is no longer used in practice. See *Local Government (Rating) Act 2002* (NZ), s 13(3).

<sup>92</sup> Chapple, above n 31, 37.

economies'.<sup>93</sup> These views seem unduly fatalistic. Piketty's global capital tax has been similarly dismissed as unworkable,<sup>94</sup> but, as he observes, '[a] global tax on capital is a utopian idea' but is one that may be attainable – '[s]tep by step, region by region, towards a progressive tax on capital'.<sup>95</sup> Robert Wade notes that the United States seeks to tax its citizens wherever they live and uses measures such as FATCA<sup>96</sup> to promote this.<sup>97</sup> Tax information exchange agreements can also assist with tracking citizens' offshore wealth. More generally, international agreement has been reached on various issues: human rights and free trade are, perhaps, the most unlikely and yet most broadly achieved areas of international cooperation. But in the current absence of a global capital tax, what should be done to tax capital?

The McLeod Report championed a risk-free return method (RFRM), calculated as follows: net asset value at the start of the year x statutory risk-free real rate of return x the investor's tax rate.<sup>98</sup> Susan St John has reiterated support for this proposal.<sup>99</sup> Gareth Morgan and Susan Guthrie propose a 'comprehensive capital income tax'.<sup>100</sup> Representing mainstream policy opinion, the Tax Working Group rejected both an RFRM and an annual capital charge; instead, the majority of members supported an annual land tax,<sup>101</sup> a proposal that was ignored by government. Certainly a low rate, annual land or wealth tax deserves greater consideration but the more pressing issue is the reinstatement of some form of wealth transfer tax.<sup>102</sup>

#### ***D. A Note on Radicalism and Political Plausibility***

Before turning to arguments for a capital acquisitions tax ('CAT') in the next part, some points on radicalism and political plausibility may be noted.

##### **1 Radicalism**

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<sup>93</sup> Bertram, above n 4, 29.

<sup>94</sup> See, for example, Tyler Cowen, 'Capital Punishment: Why a Global Tax on Wealth Won't End Inequality' *Foreign Affairs* (online) May/June 2014 <<https://www.foreignaffairs.com/reviews/review-essay/capital-punishment>>; Allister Heath, 'Thomas Piketty's Bestselling Post-Crisis Manifesto Is Horrendously Flawed' *The Telegraph* (online) 29 April 2014 <<http://www.telegraph.co.uk/finance/economics/10796532/Thomas-Pikettys-bestselling-post-crisis-manifesto-is-horrendously-flawed.html>>.

<sup>95</sup> Piketty, above n 1, 515–6.

<sup>96</sup> Foreign Account Tax Compliance Act 26 USC §§ 1471–1474, § 6038D.

<sup>97</sup> Robert H Wade, 'Inequality and the West' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 155, 169.

<sup>98</sup> *Tax Review 2001* (Treasury, 2001) (Chair Robert McLeod) <<http://www.treasury.govt.nz/publications/reviews-consultation/taxreview2001/taxreview2001-report.pdf>>.

<sup>99</sup> Susan St John, 'Recalibrating New Zealand' in Geoff Bertram et al, *The Piketty Phenomenon: New Zealand Perspectives* (Bridget Williams Books, 2014) 144, 153

<sup>100</sup> See, generally, Gareth Morgan and Susan Guthrie, *The Big Kahuna: Tax and Welfare* (Public Interest Publishing, 2011).

<sup>101</sup> The Tax Working Group estimated that a 0.5 per cent annual land tax that would raise up to NZD2.3 billion or 10 per cent of income tax revenue: see Tax Working Group, above n 36, 45.

<sup>102</sup> For arguments in favour of a wealth transfer tax, see Jonathan Barrett, 'Wealth Transfer Tax Redux?' (2011) 17(3) *New Zealand Journal of Taxation Law and Policy* 389, 289–308.

The *Manifesto of the Communist Party* understandably called for the abolition of all rights of inheritance.<sup>103</sup> But Christian socialists, notably Richard Tawney,<sup>104</sup> also reasoned that a tolerably equal society could only be achieved by abolishing intergenerational transfers. Roberto Unger argued for the establishment of a rotating capital fund with a constant flow of new entrants and no consolidation of market position.<sup>105</sup> Before them, Thomas Paine argued that, on the one hand, substantial estates should be heavily taxed but, on the other hand, provision of a minimum inheritance should be made for everyone.<sup>106</sup> Likewise, Atkinson tells us that Cedric Sandford proposed a negative capital tax payable on attainment of adulthood, an idea taken further by Julian Le Grand.<sup>107</sup> Atkinson now floats the idea of the state acquiring 'beneficial ownership (not control) of productive capital and [using] the profits to share the benefits among all citizens ... Entitlement could be based on... participation in the society'.<sup>108</sup> The point made here is that a CAT is not a radical proposal, indeed, it may be considered timid and unambitious in the light of these other, possibly more effective ways of countering wealth inequality.

## 2 Political Plausibility

Skilling demonstrates that New Zealanders 'generally underestimate how much top income earners actually earn, and that they believe that those top earners *should* receive less than their erroneously low estimation'.<sup>109</sup> Similar perceptions and expectations have been observed elsewhere.<sup>110</sup> Because the poor do not socialise with the wealthy, comparisons are difficult to make. If you are wealthier or poorer than members of your social group, you might assume you are wealthy or poor in absolute terms. Such misunderstandings lead to political inertia.<sup>111</sup> Thus Paul Krugman observes that '[T]oday's political balance rests on a foundation of ignorance, in which the public has no

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<sup>103</sup> See, Karl Marx and Frederick Engels, 'Manifesto of the Communist Party' in *Select Works* (Lawrence and Wishart, 1968) 35, 52.

<sup>104</sup> See, generally, RH Tawney, *Equality* (G Allen & Unwin, 1931).

<sup>105</sup> Roberto Mangabeira Unger, *The Critical Legal Studies Movement* (Harvard University Press, 1986) 35.

<sup>106</sup> Thomas Paine, 'Agrarian Justice' Social Security Agency <<http://www.ssa.gov/history/paine4.html>> cited by Atkinson, above n 11, 219. Paine also proposed a top income tax rate of 100 per cent: see Martha C Nussbaum, *Creating Capabilities: the Human Development Approach* (The Belknap Press of Harvard University Press, 2011) 139.

<sup>107</sup> Anthony B Atkinson, *Inequality: What Can Be Done?* (Harvard University Press, 2015) 169. See also Patrick Diamond and Anthony Giddens, 'The New Egalitarianism: Economic Inequality in the United Kingdom' in Anthony Giddens and Patrick Diamond (eds), *The New Egalitarianism* (Polity Press, 2005) 101, 117 on hypothecating revenues from a capital accretions tax 'to the funding of a universal capital grant scheme ... [which] would strengthen the perceived legitimacy of taxing concentrations of wealth'.

<sup>108</sup> Atkinson, above n 11, 220.

<sup>109</sup> Skilling, above n 30, 39.

<sup>110</sup> 'More than 80 percent of the wealth in the United States belongs to 20 percent of the population; respondents estimated that this group held less than 60 percent of the wealth, and would in an ideal world hold about a third.' See Elizabeth Gudrais, 'What We Know about Wealth' *Harvard Magazine* (November-December 2011) <<http://harvardmagazine.com/2011/11/what-we-know-about-wealth>>.

<sup>111</sup> In its United Kingdom survey, the Fabian Society's Commission on Taxation and Citizenship found that 51 per cent of respondents thought that inheritance tax should be abolished and only two per cent supported taxing all inheritances; cited in Will Hutton, *Them and Us: Changing Britain – Why We Need a Fair Society* (Little, Brown, 2010) 302–3.



idea what our society is really like.<sup>112</sup> Concluding his analysis of the United Kingdom's Labour government's retreat from a proposed wealth tax in the 1970s, Howard Glennerster cautions: 'If any new move to tax wealth is to be successful it will only be so if the public, many of whom are now holders of modest wealth, are convinced that its unequal distribution is 'a problem'.<sup>113</sup> *Capital* has made a significant contribution to inequality being recognised as 'a problem'.

#### IV FOR A CAT

Current equality concerns are motivated by a desire to ensure everyone might enjoy opportunities to fulfil their promise as human beings. Martha Nussbaum encapsulates this capacities approach thus: 'What is each person able to do and to be'.<sup>114</sup> The critical question is, then, which type of tax on capital transfers is most consistent with promotion of full human flourishing.

Robert Wade quotes Margaret Thatcher's paean to inequality: 'It is our job to glory in inequality and see that talents and abilities are given vent and expression for the benefit of us all.'<sup>115</sup> A society which enables people with, say, extraordinary entrepreneurial skill to realise their potential does not have to be a society that grants those people full liberty to pass their wealth to their chosen beneficiaries if negative consequences arise for the rest of society. Neither Marx nor Tawney sought equalisation of incomes;<sup>116</sup> it was undeserving inheritance by the next generation which was unacceptable to them.

Inheritances have historically constituted the principal determinant of wealth accumulation,<sup>117</sup> with between 35 and 45 per cent of wealth being inherited.<sup>118</sup> It is implausible, then, that wealth inequality might be countered 'without some limitation on the intergenerational transmission of wealth'.<sup>119</sup> However, as Nolan observes, '[T]he question of inheritance, and what is a fair kick-start for children is an emotive one'.<sup>120</sup> In the conservative view, a person has 'unqualified rights over their own property' and amassing heritable wealth 'is a powerful incentive and a natural right'.<sup>121</sup> Conversely, some very wealthy people believe that excessive bequests benefit neither the inheritors nor society. The steely, republican resolve of self-made American moguls, such as Bill

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<sup>112</sup> Krugman, above n 74.

<sup>113</sup> Howard Glennerster, 'Why Was a Wealth Tax for the UK Abandoned? Lessons for Policy Process and Tackling Wealth Inequality' (2012) 41(2) *Journal of Social Policy* 233, 247.

<sup>114</sup> Nussbaum, above n 106, 18.

<sup>115</sup> Wade, above n 97, 39.

<sup>116</sup> See Brown, above n 38, 342 for a discussion.

<sup>117</sup> Laurence J Kotlikoff and Lawrence H Summers, 'The Role of Intergenerational Transfers in Aggregate Capital Accumulation' (1981) 89 *Journal of Political Economy* 706, 730.

<sup>118</sup> Tomer Blumkin and Efraim Sadka, 'Estate Taxation, with Intended and Accidental Bequests' (2004) 88 *Journal of Public Economics* 1, 2.

<sup>119</sup> Cedric Sandford, 'Taxing Wealth' in Cedric Sandford (ed), *More Key Issues in Tax Reform* (Fiscal Publications, 1995) 58.

<sup>120</sup> Nolan, above n 33, 130.

<sup>121</sup> Hutton, above n 111, 302.



Gates and Warren Buffett,<sup>122</sup> not to give their children exceptional financial inheritances above other members of the republic may, however, be considered unusual.

Transfer of excessive wealth to the next generation is 'morally indefensible' because it is arbitrary and disproportionately impacts on opportunities.<sup>123</sup> Some people are fortunate to be endowed with extraordinary genetic inheritance but they still need to put their own effort into leveraging their gifts into wealth.<sup>124</sup> Inherited wealth is different: it is a manifestation of 'brute luck',<sup>125</sup> an unmerited advantage which distorts equality of opportunity among community members. It also interferes with Thatcherite meritocracy, since it privileges qualities other than unequal talents and abilities. Transfer of wealth may also be economically inefficient. Thus Randall Morck and his co-authors conclude:<sup>126</sup>

*the ownership structure of a country's capital matters. Economic growth depends, not just on the stock of physical capital, but also on who controls it. We find that entrenched family control of a nation's capital is correlated with lower rates of economic growth while billionaire entrepreneurs' control of capital is correlated with higher rates of economic growth.*

Being 'normally unrelated to the merit, effort or enterprise of the recipient',<sup>127</sup> inheritances are eminently taxable. A tax on inheritances 'strikes at the heart of the problem of inequality, for it is large inheritances, not large estates as such, that perpetuate inequality'.<sup>128</sup> As Robin Boadway and his co-authors conclude, the transferee of wealth and not the transferor is the proper subject of taxation.<sup>129</sup>

If Robert Haig's definition of income as the 'money value of the net accretion to one's economic power between two points of time'<sup>130</sup> is followed, bequests should be included in a person's annual income.<sup>131</sup> Indeed, the United States income tax of 1894 did include

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<sup>122</sup> See, for example, Michelle Nichols, 'Warren Buffett, Bill Gates Ask Billionaires to Give Away Wealth' *Reuters* (online) 16 June 2010 <<http://www.reuters.com/article/2010/06/16/us-philanthropy-buffett-gates-idUSTRE65F5CC20100616>>.

<sup>123</sup> David G Duff, 'Taxing Inherited Wealth: A Philosophical Argument' (1993) 6 *Canadian Journal of Law and Jurisprudence* 3, 50.

<sup>124</sup> Hutton, above n 111, at 75 refers to making one's own luck or taking advantage of good fortune as 'circumstantial or option luck'.

<sup>125</sup> Patrick Diamond and Anthony Giddens, 'The New Egalitarianism: Economic Inequality in the United Kingdom' in Anthony Giddens and Patrick Diamond (eds) *The New Egalitarianism* (Polity Press, 2005) 117.

<sup>126</sup> Randall K Morck, David A Strangeland and Bernard Yeung, 'Inherited Wealth, Corporate Control, and Economic Growth: The Canadian Disease?' in Randall K Morck (ed) *Concentrated Corporate Ownership* (University of Chicago Press, 2000) 319, 362.

<sup>127</sup> Sandford, above n 119, 58.

<sup>128</sup> *Ibid*, 65.

<sup>129</sup> Robin Boadway, Emma Chamberlain and Carl Emmerson, 'Taxation of Wealth and Wealth Transfers' in James Mirrlees et al (eds) *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, 2010) 790. Compare with the Henry Report, while refraining from recommending a bequest tax (essentially an estate tax), concluded that such a tax would meet the Panel's requisite criteria of efficiency, equity, simplicity and sustainability. See *Australia's Future Tax System Review Panel Australia's future tax system: Report to the Treasurer – Part One: Overview* (2009) 37.

<sup>130</sup> Robert Murray Haig, 'The Concept of Income' in Robert Murray Haig, Thomas Sewall Adams and Thomas Reed Powell (eds) *The Federal Income Tax* (first published 1921, BiblioBazaar, 2009) 7.

<sup>131</sup> Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2005) 159.

inheritances as taxable income.<sup>132</sup> However, as Nicholas Kaldor notes, it is intuitively unfair to tax 'the man who once in a life time receives £10,000 in the same way as the man who receives £10,000 every year'.<sup>133</sup> So, rather than including bequests as income, a CAT seems preferable. In *Inequality: What Can Be Done?*, his response to Piketty, Atkinson makes ten policy recommendations, including a lifetime capital receipts tax that is, 'the taxation at progressive rates of the total received over a person's lifetime in bequests and gifts'. Ireland already has such a tax. Its capital accession tax applies a single rate of 33 per cent to accumulated gifts and inheritances over the relevant class threshold.<sup>134</sup> Such a tax both limits a person's right to acquire unmerited wealth by bequests and achieves a more equal distribution of wealth.<sup>135</sup> As Meade observes, a CAT 'penalises wealth received by gift or inheritances but not wealth accumulation by the recipient from his own effort and savings'.<sup>136</sup>

## V CONCLUSION

This article has considered *Capital* in the New Zealand context. The book's precise applicability to a small, open economy and the technical accuracy of Piketty's method are irrelevant. The great virtue of *Capital* lies in its highlighting the issue of inequality and capital taxation for politicians and policymakers. Rather than eclipsing the decades of inequality research of people such as Meade and Atkinson, it has ideally created a greater 'market' for their ideas. In New Zealand, as in other OECD countries, we do not need deep data analysis to demonstrate to us that inequality is rife among generations, ethnic groups and regions; the evidence is in our midst.

Equalisation of wealth is neither consistent with human nature nor a capitalist economic system.<sup>137</sup> But, if everyone is to enjoy full opportunities to experience full human flourishing, wealth needs to be distributed more fairly and the sensible way to deal with disproportionate wealth is to limit inheritance through taxation, not to unduly discourage effort and enterprise.<sup>138</sup> Thus Atkinson tells us that:<sup>139</sup>

*progressive taxation of capital income, or of wealth, or of the transfer of wealth all contribute, through reducing the effective savings rate of the rich, to narrowing the gap between the rich and the less wealthy. They may or may not reduce the amount of inheritance but they definitely reduce the inequality of inheritance. The taxation of wealth and its transfer are central to this aspect of redistribution.*

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<sup>132</sup> Gerald R Jantscher, 'Death and Gift Taxation in the United States after the Report of the Royal Commission' (1969) 22 *National Tax Journal* 121, 126 n 23.

<sup>133</sup> Nicholas Kaldor, *An Expenditure Tax* (George Allen & Unwin, 1955) 203.

<sup>134</sup> Significantly, the rate was increased from 20 per cent in 2012: see *Capital Acquisitions Tax Consolidation Act 2003* (Ireland) and Irish Tax and Customs, 'Capital Acquisitions Tax' <<http://www.revenue.ie/en/tax/cat/>>.

<sup>135</sup> Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice* (2nd ed, McGraw-Hill, 1976) 359-360; see also Richard A Musgrave, 'Growth with Equity' (1963) 53(2) *American Economic Review* 323, 327 on equality and accretion.

<sup>136</sup> Meade, above n 7, 202 n 5.

<sup>137</sup> JK Galbraith, *The Good Society: The Humane Agenda* (Sinclair-Stevenson, 1996) 59.

<sup>138</sup> Kaldor, above n 133, 100.

<sup>139</sup> Atkinson, above n 11, 220.

## TAXATION OF SOVEREIGN WEALTH FUNDS – A SUGGESTED APPROACH

SALLY-ANN JOSEPH,<sup>1</sup> MICHAEL WALPOLE<sup>2</sup> AND ROBERT DEUTSCH<sup>3</sup>

### ABSTRACT

Sovereign wealth funds (SWFs) are used for large-scale offshore investment of government funds. In accordance with the sovereign immunity doctrine, a SWF is generally immune from the jurisdiction of another sovereign State – including tax laws. There has been little research on the application of tax to SWFs. Yet it is an issue of vital importance to Australia and to its international competitiveness and security. In 2009, the Australian Government announced its intention to codify its practices in dealing with SWFs and an Options Paper was released in 2011.

This article reviews the practices adopted by Australia and selected countries in relation to taxing SWFs. It considers best practice principles, which Australia should adopt in developing policy for taxing these foreign investment vehicles. Australia's current taxation regime and the model proposed in 2011, are discussed, and a model suggested for Australia.

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## I INTRODUCTION

Governments around the world use Sovereign wealth funds (SWFs) as the investment vehicle for large-scale offshore investment of government funds. These funds have assumed new political significance through increased participation of nations considered to be more capitalist authoritarian states than democracies.<sup>1</sup>

In accordance with the doctrine of sovereign immunity, which is customary in international law, a sovereign State and its agents are generally immune from the jurisdiction of another sovereign State – including its tax laws.<sup>2</sup> Australia has largely observed this principle over the years since Federation in 1901. In August 2009 the Australian Government announced its intention to codify its practices in dealing with SWFs.

A set of voluntary, internationally agreed principles and practices, generally known as the Santiago Principles, establish best practices for SWFs. They cover legal, institutional and management frameworks.<sup>3</sup> Tax, however, is excluded.

The application of tax to SWFs has seen limited research. Yet this is an issue of vital importance to Australia and to its international competitiveness and security. This article proposes a set of best practice principles which Australia could adopt for taxing the foreign investment vehicles of the world's governments.

Part II provides an overview of SWFs. This includes their importance globally, the application of the doctrine of sovereign immunity and their different legal forms and governance structures. This is followed in Part III by a review of the practices adopted by Australia and nine selected countries in relation to taxing SWFs. These are Australia's top five trading partners, being the United States (US), Japan, Republic of Korea, Singapore and China. Also included are the United Kingdom (UK), Canada and New Zealand as other common law countries whose approaches are a helpful guide to how SWFs might be treated in Australia. Norway is also assessed as it is the home country of the largest SWF. Australia's taxation regime, in both its current form and that proposed in 2011 (hereafter the 2011 proposed model), is discussed in Part IV. Part V discusses framework principles for world best tax practice. These are applied in Part VI, which also assesses the 2011 proposed model rules and suggests a model for Australia that embraces best practice in an important area for Australia's international competitiveness as an investment destination.

A detailed discussion of regulatory controls is beyond the scope of this paper. Nevertheless, to illustrate their effect and implications, an overview of the requirements of Australia and China are provided. In Australia, prior approval is required under the

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<sup>1</sup> Daniel W Drezner, 'BRIC by BRIC: The Emergent Regime for Sovereign Wealth Funds' (Princeton University Summer Workshop 'Rising States and Rising Institutions', 2008).

<sup>2</sup> David R Tillinghast, 'Sovereign Immunity from the Tax Collector: United States Income Taxation of Foreign Governments and International Organisations' (1978) 10 *Law and Policy of International Business* 495.

<sup>3</sup> IWG, 'Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles"' (International Working Group of Sovereign Wealth Funds, October 2008).

federal government's foreign investment policy before a foreign government investor can make any direct investment in Australia, regardless of its value.<sup>4</sup> China introduced the Qualified Foreign Institutional Investor (QFII) in 2002, which allows foreign investors access to the A-share market and to other types of Chinese investments which foreign investors are otherwise prohibited from owning and trading.<sup>5</sup> It is a dual-approval scheme requiring the SWF first to apply for QFII designation and then to obtain an investment quota.

## II SOVEREIGN WEALTH FUNDS

### A. Overview

SWFs are major players in international financial markets and in the global economy.<sup>6</sup> They are unique and special investment vehicles primarily for three reasons:

- They are beneficially owned by a government or government related agencies;
- They generally adopt investment strategies which are based on very long-term perspectives; and
- They focus on investment with a broader perspective than profit making (for example, looking for strategic advantages for a sovereign nation as a whole, such as food security in purchasing agricultural land).

In other respects they tend to differ (for example, in policy objectives or in structure), creating complex legal and economic issues associated with such matters as governance, regulation and security.

SWFs have been increasing in popularity but are by no means a uniquely twenty-first century phenomenon. Two of the earliest SWFs are the Texas Permanent School Fund and Texas Permanent University Fund, established in 1854 and 1876 respectively.<sup>7</sup> Many have been established in the last 15 years, however. In 2007, China initiated three: the China Investment Corporation (currently the 4<sup>th</sup> largest SWF with US\$652.7 billion in assets); the National Social Security Fund; and the China-Africa Development Fund.<sup>8</sup> Countries establishing SWFs in the 2000s include Australia, Republic of Korea, Qatar, Russia, United Arab Emirates, Libya, France, Indonesia, Vietnam, Chile and Brazil.<sup>9</sup>

The number of funds and their total holdings vary depending on how a SWF is defined. Preqin, a UK-based research and consultancy firm operating globally in the financial services industry, asserts that the value of total assets under management as at October

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<sup>4</sup> Treasurer, *Australia's Foreign Investment Policy* (2015) <[www.firb.gov.au/content/\\_downloads/AFIP\\_2013.pdf](http://www.firb.gov.au/content/_downloads/AFIP_2013.pdf)>.

<sup>5</sup> Keith Robinson, Karl Egbert, Jingzhou Tao and Gregory Louvel, 'The Qualified Foreign Institutional Investor Program in China – Recent Developments, New Opportunities and Ongoing Challenges' (2013) 20(2) *The Investment Lawyer* 21; PricewaterhouseCoopers China, *Qualified Foreign Institutional Investors (QFII) Brochure, Special Edition* (PwC, 2012).

<sup>6</sup> Simon Johnson, 'The Rise of Sovereign Wealth Funds' (2007) 44(3) *Finance and Development* 56.

<sup>7</sup> SWF Institute, *Sovereign Wealth Fund Rankings* (2013) <[www.swfinstitute.org/fund-rankings/](http://www.swfinstitute.org/fund-rankings/)>.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

2013 was US\$5.38 trillion.<sup>10</sup> Of this, 47 per cent of the assets are held by Asia-based SWFs, notwithstanding that these represent less than a quarter of the number of SWFs.<sup>11</sup> According to the SWF Institute, total assets under management at December 2013 amounted to US\$6.05 trillion<sup>12</sup> and at November 2014 this had grown to US\$6.98 trillion.<sup>13</sup> Of this, over two-thirds are attributable to SWFs of developing countries.

SWFs were important during the global financial crisis of 2008 onwards. It has been argued that their injections of capital into financial institutions had a stabilising effect 'because they came at a critical time when risk-taking capital was scarce and market sentiment was pessimistic'.<sup>14</sup> Indeed, the China Investment Corporation, a SWF of the Chinese Government, provided the equity that investment bank Morgan Stanley required after posting a US\$5.7 billion subprime mortgage write-down.<sup>15</sup> Singapore's Temasek Holdings, the largest shareholder in Merrill Lynch, further increased its stake during the subprime crisis.<sup>16</sup> Because SWFs are long-term investors, they are better positioned to withstand financial upheaval.

The increase in both number and size of SWFs has heightened public attention. This has generated an ongoing policy debate about the proper role of foreign government regulation and the taxation of these funds.<sup>17</sup> Around 2008 there was a flurry of activity regarding developing guidelines and 'best practice' for SWFs. These include the Organisation for Economic Cooperation and Development (OECD) Investment Committee report commissioned by the G7 Finance Ministers,<sup>18</sup> International Monetary Fund (IMF) reviews,<sup>19</sup> a report prepared by the United States Congress Joint Committee on Taxation<sup>20</sup> and a policy brief from the Peterson Institute for International Economics.<sup>21</sup> These

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<sup>10</sup> Preqin, 'Sovereign Wealth Funds Assets Surpass \$5tn' (Press Release, 10 October 2013) <[www.preqin.com/docs/press/Sovereign\\_Wealth\\_13.pdf](http://www.preqin.com/docs/press/Sovereign_Wealth_13.pdf)>.

<sup>11</sup> Ibid

<sup>12</sup> SWF Institute, above n 7.

<sup>13</sup> SWF Institute, *Sovereign Wealth Fund Rankings* (2014) <[www.swfinstitute.org/fund-rankings/](http://www.swfinstitute.org/fund-rankings/)>.

<sup>14</sup> OECD Investment Committee, *Sovereign Wealth Funds (SWFs) and Recipient Country Policies* (OECD, 2008) 2. See also Nick Sherry, 'International Forum of Sovereign Wealth Funds' Press Release No 014 Assistant Treasurer, Sydney, 6 May 2010).

<sup>15</sup> Victor Fleischer, 'A Theory of Taxing Sovereign Wealth' (2009) 84 *New York University Law Review* 440.

<sup>16</sup> Ian Timberlake, 'Singapore's Temasek confirms Merrill Lynch stake' *Sydney Morning Herald* 29 July 2008.

<sup>17</sup> Leonard Schneidman (ed), *Sovereign Wealth Funds: A Legal, Tax and Economic Perspective* (Practising Law Institute, 2010).

<sup>18</sup> OECD Investment Committee, above n 14.

<sup>19</sup> Cornelia Hammer, Peter Kunzel and Iva Petrova, 'Sovereign Wealth Funds: Current Institutional and Operational Practices' (IMF Working Paper WP/08/254, IMF, November 2008); The Monetary and Capital Markets and Policy Development and Review Departments, *Sovereign Wealth Funds – A Work Agenda* (IMF, February 2008).

<sup>20</sup> Joint Committee on Taxation, 'Economic and U.S. Income Tax Issues Raised by Sovereign Wealth Fund Investment in the United States' (JCX-49-08, Joint Committee on Taxation, 2008). Members of the Joint Committee on Taxation are from the Senate Finance Committee and the House Ways and Means Committee.

<sup>21</sup> Edwin M Truman, 'A Blueprint for Sovereign Wealth Fund Best Practices' (Policy Brief, No PB08-3, Peterson Institute for International Economics, 2008).



resulted from concerns that the increased activity and resulting influence of SWFs may have distorting effects on capital markets<sup>22</sup> or threaten national security.<sup>23</sup>

In October 2008, generally accepted principles and practices of SWFs, known as the Santiago Principles, were agreed and published.<sup>24</sup> This was followed in 2010 by a comprehensive review of foreign state immunity and foreign government controlled investors by the OECD<sup>25</sup> as well as a discussion paper on the application of tax treaties to state-owned entities, including SWFs.<sup>26</sup> In November 2013 the IMF released a paper regarding the governance structures and investment management of SWFs.<sup>27</sup>

SWFs provide economic benefits to both home and host countries. For home countries these include tempering volatility in commodity markets, while for host countries they stimulate business activity and the creation of jobs – benefits normally associated with foreign investment.<sup>28</sup> As a result of these benefits, countries actively compete for these investments. One way this can be achieved is through taxation policy.

### ***B. Sovereign Immunity***

Briefly, the doctrine of foreign state or sovereign immunity asserts that one State is not subject to the full range of rules applicable in the other State.<sup>29</sup> A more restrictive approach to immunity, however, has been developed at a global level, although not universally adopted. This is in reference to the type of activity carried out by the State. For example, courts recognise immunity for acts carried out by a State in the exercise of its sovereign authority but will deny immunity for acts of a commercial or private nature.<sup>30</sup> For sovereign immunity purposes, an investment activity is considered commercial if it is related to commerce, as opposed to diplomatic or humanitarian goals.<sup>31</sup>

The restrictive theory of sovereign immunity focuses primarily on the nature of the transaction at issue, rather than on the status or structure of the foreign entity. In a 2005 UK case, *AIG Capital Partners Inc. and Another v Kazakhstan*<sup>32</sup> (AIG), the court took the view that a SWF that invests in securities is engaged in immune sovereign activity by virtue of its general purpose of accumulating assets in the public interest. The transaction was analysed on the basis of its purpose: the nature of the activity as engagement in

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<sup>22</sup> Charles R Irish, 'Income Taxation of Sovereign Wealth Funds' (East Asian Legal Studies Centre, 2008).

<sup>23</sup> Edwin M Truman, *Sovereign Wealth Funds: Threat or Salvation* (Petersen Institute, 2011); Philip Whyte and Katinka Barysch, 'What should Europe do about sovereign wealth funds' (Centre for European Reform, 2007).

<sup>24</sup> IWG, above n 3.

<sup>25</sup> David Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investors' (OECD Working Papers on International Investment 2010/02, 2010).

<sup>26</sup> OECD, 'Discussion Draft on the Application of Tax Treaties to State-Owned Entities, Including Sovereign Wealth Funds' (OECD, 2009).

<sup>27</sup> Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke and Cheng Chih Sung, 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management' (IMF Working paper, WP/13/231, 2013).

<sup>28</sup> Ibid; OECD Investment Committee, above n 14; Gaukrodger, above n 25.

<sup>29</sup> Gaukrodger, above n 25.

<sup>30</sup> Ibid; OECD, Model Tax Convention on Income and Capital (OECD, 2010) [6.38].

<sup>31</sup> Fleischer, above n 15.

<sup>32</sup> [2005] EWHC 2239 (Comm.), 129 ILR 589.

financial transactions was irrelevant in light of the overall purpose of earning money for the State (ie 'commercial').<sup>33</sup> The invested assets were accordingly immune from action.

Countries adopting the restrictive approach include Australia, United States (US), United Kingdom (UK), Canada, Singapore and Japan. The restrictive approach appears not to be universally accepted with China and Hong Kong providing examples of contrary practices.

The implication of this, if broadly adopted, is that SWFs are likely to benefit from immunity regardless of their structure. This also causes the treatment of sovereign debtors and creditors to be different: a State that raises funds in the sovereign market is now generally considered to engage in private or commercial activity (immunity denied) even if the funds are destined for immediate public purpose.<sup>34</sup> In contrast, following the reasoning in *AIG*, investment activity by a SWF would benefit from immunity. The issue of whether the investment activities of a SWF are commercial/private acts or sovereign acts is not settled, which may lead to considerable uncertainty.

National laws also define foreign States differently. Of relevance to SWFs are the varying approaches taken to state-owned enterprises, state-controlled enterprises and central banks.<sup>35</sup> One aspect of state immunity laws is to maintain jurisdictional attractiveness as a financial and banking centre. Central banks often gain special treatment to protect their positions as investment centres for foreign state reserves. With more central banks playing a role in SWFs, the competitive issues have expanded beyond attracting reserves, to issues affecting investment more generally.<sup>36</sup> Rules on immunity from execution of central banks vary significantly. While no special immunity is provided by Australia or Canada, the UK, US and China all provide some form of special protection.<sup>37</sup>

### ***C. Legal Forms and Governance Structures***

As noted above, SWFs can have different legal forms and governance structures and this affects their degree or level of sovereign immunity. As separate legal entities SWFs may be governed by a specific constitutive law or they may be state-owned corporations. Alternatively, as pools of assets without separate legal standing, they may be controlled either by a central bank or by a separate statutory agency. Examples of SWFs are shown in Table 1. While the UK and Japan are included in the commentary, they are absent from Table 1, as neither has a SWF.

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<sup>33</sup> Discussed in Gaukrodger, above n 25.

<sup>34</sup> Ibid.

<sup>35</sup> See generally Al-Hassan et al, above n 27.

<sup>36</sup> Gaukrodger, above n 25.

<sup>37</sup> Ibid.

**Table 1: Legal forms and governance structures of selected SWFs**

As separate legal entities		As pools of assets	
Governed by a specific constitutive law	State-owned corporation	Controlled by central bank	Controlled by separate statutory agency
Future Fund (Australia)	Temasek Holdings (Singapore)	Government Pension Fund Global (Norway)	Alberta Heritage Fund (Canada)
New Zealand Superannuation Fund	GIC Private Ltd <sup>38</sup> (Singapore)		Alabama Trust Fund (USA)
Korea Investment Corporation	China Investment Corporation		Texas Permanent University Fund (USA)

The different legal forms and governance structures have implications both for immunity of investments and for taxation. For example, the UK exempts SWFs from tax on passive investment income, but only if it is an integral part of the government of a foreign state. The exemption is denied if it is an entity that is separate from the government although owned by it, such as a state-owned corporation. Thus, for example, the UK would exempt the Norway Pension Fund Global earnings on passive investment but not those of China Investment Corporation.

The form and structure may also have implications for SWFs that have sovereign wealth enterprises (SWE). SWEs are investment vehicles owned and controlled by a SWF.<sup>39</sup>

It can therefore be concluded that, because the scope and application of sovereign immunity differs between countries, SWFs can affect their degree of sovereign immunity through the structure they use for their investments as well as their choice of jurisdictions in which to operate. The international law of sovereign immunity is not, however, definitive. It does not preclude countries from offering additional immunities such as via bilateral tax treaties.

<sup>38</sup> Previously Government of Singapore Investment Corporation.

<sup>39</sup> Sovereign Wealth Fund Institute, *Sovereign Wealth Enterprise* <[www.swfinstitute.org/statistics-research/sovereign-wealth-enterprise-swe/](http://www.swfinstitute.org/statistics-research/sovereign-wealth-enterprise-swe/)>.

### III TAXATION OF SWFs

#### A. *Ways of taxing*

The OECD notes that '[t]here is no international consensus ... on the precise limits of the sovereign immunity principle'.<sup>40</sup> Just as many countries do not recognise the principle as applying to commercial activities, so there are differences between countries as to the extent, if any, to which the principle applies to tax matters. Even where it is recognised, its application differs depending on whether it has been incorporated into domestic law or is applied as customary international law with or without limitations. Accordingly, a diverse range of practices exists and a diverse set of options is open to Australia and other countries.

As the taxation of SWFs is not standardised, each country follows its own policies and practices. Indeed, both the United Nations Convention on Jurisdictional Immunities of States and the European Convention on State Immunity exclude taxation from the scope of their conventions.<sup>41</sup> Nevertheless, there are essentially two mechanisms employed: the sovereign immunity doctrine and tax treaties.

Commonwealth countries and Japan generally base their practice of exempting foreign governments and their agencies from taxation on the international law concept of sovereign immunity. This may be codified through domestic legislative provisions or applied administratively. European and Asian countries generally treat foreign governments as they do other foreign entities, with any exemptions generally resulting from double tax treaties.

The source of the authority differs. This is shown in Table 2 for the 10 countries under review.

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<sup>40</sup> OECD, above n 26, [6.11].

<sup>41</sup> Gaukrodger, above n 25.

**Table 2: Authority for taxing SWFs**

<b>Principle of Sovereign Immunity</b>	<b>Legislation: Domestic Tax Law</b>	<b>Administrative</b>	<b>Reciprocal Income Tax Treaty Arrangements</b>
UK (if SWF beneficially owned)	US	Australia – private ruling	China – application required
		Canada – information circular	Republic of Korea
		Japan – customary practice	Singapore
			New Zealand
			Norway
			UK (if separate entity)

Various factors are generally taken into consideration when determining whether, and to what extent, tax exemptions should be granted for SWFs. These factors include: whether the income is derived from ‘government’ as opposed to commercial activities; the purpose of the assets and/or income; whether there is reciprocity; and whether the income is derived from a portfolio or direct investment.<sup>42</sup>

Similarly to the discussions in 2008, as noted in section IIA above regarding the practices of SWFs, their tax treatment was also examined. A combined committee of the House of Representatives and Senate of the US Congress issued a report on SWFs and associated income tax issues.<sup>43</sup> One of the discussions initiated by the OECD concerned the application of tax treaties to state-owned entities, including SWFs.<sup>44</sup> A number of changes to the Commentary on the OECD Model Tax Convention were proposed. While the report acknowledges that the international law doctrine of sovereign immunity underpins most exemptions for SWFs, it does not deal with the doctrine. Rather the focus is more on the definition of what is deemed a ‘resident’ and therefore liable to tax. In Australia there is useful research on the investment and management practices of SWFs,<sup>45</sup> there is little available on the application and potential application of tax rules to such funds.

<sup>42</sup> OECD, above n 30, [6.39].

<sup>43</sup> US Joint Committee on Taxation, above n 20.

<sup>44</sup> OECD, above n 26.

<sup>45</sup> Olivia S Mitchell, John Piggott and Cagri Kumru, ‘Managing public investments funds: best practices and new challenges’ (Working Paper No 14078, National Bureau of Economic Research, 2008).

## **B. Country Analysis**

### *(1) Domestic Law*

A broad categorisation based on the domestic law and practice for the 10 countries under review is given in Table 3. Note that these may be subject to provisions in tax treaties.

**Table 3: Taxation categorisation of selected countries**

<b>Exemption For All Investments</b>	<b>Exemption For Non-commercial Investments</b>	<b>No Exemption (but see below)</b>
Own domestic	Australia	China
	Canada	Japan
	UK (if SWF beneficially owned)	New Zealand
	United States	Norway
		Republic of Korea
		Singapore
		UK (if separate entity)

As noted above, the governance of the SWF may determine the tax treatment. For example, the UK provides an exemption to all investments (both portfolio and controlling) provided the income and gains are beneficially owned by the foreign state. This exemption does not extend to entities separate from their government although wholly owned by the government.

The purpose of the SWF may also be determinative of the tax treatment. For example, in Australia the SWF must establish that the generated passive investment income results from the performance of a governmental function in Australia;<sup>46</sup> in Canada the focus is on the public/humanitarian or commercial purpose of the fund – Chinese banks have been denied exempt status whereas the New Zealand Earthquake Relief Fund qualified.<sup>47</sup>

<sup>46</sup> ATO Interpretative Decision, ATO ID 2002/45, Withholding Tax: Sovereign Immunity, 24 January 2002.

<sup>47</sup> Joint Committee on Taxation, above n 20, A-27-A-28; The Law Library of Congress, 'Taxation of the Passive Income of Foreign Governments and Sovereign Wealth Funds in Selected Foreign Countries' (LL file No 2008-00763, Directorate of Legal Research, Report for Congress, May 2008).



### *Full exemption*

It would appear that no country provides a tax exemption for all income derived by a foreign SWF. However, the literature suggests that jurisdictions exempt their own domestic SWFs from their tax regimes.<sup>48</sup>

### *Partial exemption*

The international doctrine of sovereign immunity does not formally nor specifically impose any restrictions on a country's ability to tax SWFs.<sup>49</sup> Nevertheless, many countries originally exempted all income derived by SWFs from tax. Historically, SWFs were established from excess funds generated by oil or trade surpluses and invested in Treasury bonds and foreign exchange in order to further governmental purposes.<sup>50</sup> This exemption was originally grounded in the international law principle of sovereign immunity.<sup>51</sup> However, adoption of the restrictive view of sovereign immunity dispenses with the notion that all income received by a foreign government should be immune from taxation. Many countries therefore narrowed the tax exemption to exclude income arising from commercial activities. That commercial and governmental functions are mutually exclusive is consistent with the decision of the British House of Lords in the case *I Congreso del Partido*,<sup>52</sup> which held that activities of a trading, commercial or other private law character were not governmental functions.<sup>53</sup>

An example of a jurisdiction that has narrowed the tax exemption is the US, which has codified the restrictive view of sovereign immunity. Whether an activity is commercial is determined on the basis of the nature of the transaction rather than the purpose of the transaction.<sup>54</sup> Similarly, for tax purposes, it is the nature of the activity conducted by the foreign sovereign that is determinative rather than the organisation conducting the activity.<sup>55</sup> As such, the tax exemption was similarly narrowed to exclude income from commercial activities. However, for tax purposes, the commercial activities do not have to occur in the US.<sup>56</sup>

What is deemed 'non-commercial' differs between jurisdictions. For example, in Australia an equity holding of 10 per cent or more is considered commercial (or 'non-portfolio');<sup>57</sup>

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<sup>48</sup> Michael N Kande, 'Sovereign Wealth Funds: Are They Welcome in Canada?' (2010) 64(12) *Bulletin for International Taxation* 649.

<sup>49</sup> See, for example, *Qantas Airways Ltd v United States*, 62 F.3d 385, 388-90 (Fed.Cir 1995) where the Court upheld the regulatory authority to tax income derived from commercial activities by government-owned enterprises.

<sup>50</sup> Fleischer, above n 15.

<sup>51</sup> Ibid; Wm. W. Bishop, Jr, 'Immunity from Taxation for Foreign State-Owned Property' (1952) 46(2) *The American Journal of International Law* 239.

<sup>52</sup> [1981] 2 All ER 1064.

<sup>53</sup> Ibid.

<sup>54</sup> Foreign Sovereign Immunities Act 1976: 28 USC s 1603(d).

<sup>55</sup> Revenue Ruling 87-6, 1987-1 C.B. 179 defining commercial activity for the purposes of exemption under s 892.

<sup>56</sup> US Internal Revenue Code s 892(a)(2)(A)(i).

<sup>57</sup> ITAA 1997 s 960-195 'Non-portfolio interest test'; ITAA 1936 s 317 definition of 'non-portfolio dividend'.

in the US the equity holding must be 50 per cent or more,<sup>58</sup> and trust interests and certain commodity derivatives are also considered commercial.<sup>59</sup> The US also makes a distinction between portfolio and direct investment with income from portfolio investment (being portfolio income and capital gains) being exempt.<sup>60</sup> Income that is fixed or determinable periodically such as interest, dividends, rents and royalties are subject to withholding tax (subject to any treaty).<sup>61</sup> However, SWFs are exempt from: all US-sourced dividends paid by non-controlled corporations; from interest paid by a corporation where the SWF owns at least 10 percent (that is, above the 'portfolio interest' exemption) but less than 50 per cent (that is, less than a controlling interest) of it; and exempt from tax on certain gains from real estate transactions.<sup>62</sup> This, therefore, broadens the scope of the exemption. The different treatment of portfolio and direct investment is reflective of the qualified immunity policy established in the Foreign Sovereign Immunities Act of 1976<sup>63</sup> and contributes to the international complexity faced by SWFs.<sup>64</sup>

Some countries, instead of specifically taxing income related to commercial activities, provide exemptions for specific income. For example, the Hong Kong<sup>65</sup> tax legislation provides a tax exemption for income derived by non-residents from certain specified transactions, broadly defined to cover most types of transactions typically engaged in by investment funds.<sup>66</sup> These include transactions involving securities, commodities and future and currency contracts and transactions incidental to those transactions. There is also no tax payable on dividends paid to either domestic or foreign shareholders<sup>67</sup> nor is there a capital gains tax.<sup>68</sup>

Yet other jurisdictions apply additional constraints to merely differentiate between commercial and governmental activities. An example is Canada, which sets out the tax treatment of foreign SWFs in an Information Circular.<sup>69</sup> (Note, however, that Information Circulars do not have the force of law and are merely the Canadian tax authority's interpretation of the legislation.)<sup>70</sup> Here, a foreign government or its central bank is required to request authorisation for tax exemption provided three conditions have been met.<sup>71</sup> First, the applying country must provide a reciprocal exemption to the Canadian

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<sup>58</sup> Philip Sutton et al, 'US tax implications for sovereign wealth funds of financial derivative investments' (PricewaterhouseCoopers, December 2010).

<sup>59</sup> Ibid.

<sup>60</sup> US Internal Revenue Code ss 871(h) and 881(c).

<sup>61</sup> Sutton et al, above n 58; Matthew A Melone, 'Should the United States Tax Sovereign Wealth Funds?' (2008) 26 *Boston University International Law Journal* 143.

<sup>62</sup> Joint Committee on Taxation, above n 20.

<sup>63</sup> Foreign Sovereign Immunities Act 1976, Pub. L. No. 94-583, 90 Stat. 2891.

<sup>64</sup> See further US Joint Committee on Taxation Report note 20 above.

<sup>65</sup> Included here as a 'Special Administrative Region' of China.

<sup>66</sup> Inland Revenue Ordinance Cap 112 s 20AC. Hong Kong legislation to impose a tax on property, earnings and profits.

<sup>67</sup> Inland Revenue Ordinance Cap 112 s 26.

<sup>68</sup> Ernst & Young, 'Hong Kong Special Administrative Region (SAR) of China' *Worldwide Corporate Tax Guide* (EYGM Limited, 2013).

<sup>69</sup> See Information Circular IC77-16R4 'Non-Resident Income Tax'.

<sup>70</sup> Inspector-General of Taxation, 'Review of the Tax Office's administration of public binding advice' (A report to the Assistant Treasurer, Australian Government, 7 April 2009) Appendix 4.

<sup>71</sup> Information Circular IC77-16R4 'Non-Resident Income Tax' 11 May 1992 s 50. See also Vijay Jog and Jack Mintz, 'Sovereign Wealth and Pension Funds Controlling Canadian Businesses: Tax-Policy Implications' (2013) 6(5) *The School of Public Policy Research Papers* 1; Stijn Janssen, 'How to

Government or its agencies. Second, the income to be exempted must be derived from non-commercial activities. Finally, the exemption is limited to interest 'on an arm's length' debt or portfolio dividends on listed company shares. What constitutes 'commercial activity' is not defined in the tax legislation and has not been considered by any tax court 'with significant precedential authority'.<sup>72</sup> It is generally agreed to mean that the SWF pursues activities with a governmental or humanitarian objective.<sup>73</sup> Further, 'arm's length investments' have been held to mean 'portfolio investments' to differentiate them from 'non-arm's length or direct investments'.<sup>74</sup>

The tax treatment is yet again different in the UK where investment income (that is, of a non-commercial nature) is exempt from tax but only if it is an integral part of the activities of the foreign government.<sup>75</sup> That is, a fund that is an entity separate from the government, although owned by it, would not qualify.

### *No exemption*

It was noted in Table 3 that some countries do not provide any specific exemption. However, this does not necessarily mean that an exemption does not apply. In some jurisdictions the law does not tax interest, dividends and/or capital gains. Thus, while SWFs are not exempt, they are also not taxable on much of their income. For example, Norway does not impose withholding tax on interest and royalties;<sup>76</sup> dividends paid by domestic UK companies are not subject to withholding tax.<sup>77</sup>

Singapore also does not tax capital gains. However, in certain circumstances transactions involving the acquisition and disposal of real estate, stocks or shares are considered to be the carrying on of a trade. Consequently, such gains may be taxable with each decision about whether the exemption applies based on a consideration of the facts and circumstances of the particular case.<sup>78</sup>

In Japan, foreign companies without a permanent establishment are required to file a corporate tax return when income arises from the transfer of assets in Japan notwithstanding that withholding tax does not apply.<sup>79</sup> Such assets include marketable securities or financial assets and real estate.<sup>80</sup>

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Treat(y) Sovereign Wealth Funds? The Application of Tax Treaties to State-owned Entities, Including Sovereign Wealth Funds' in Dennis Weber and S van Weeghel (Eds) *The 2010 OECD Updates: Model Tax Convention and Transfer Pricing Guidelines* (Kluwer Law International 2011), ch 13.

<sup>72</sup> Kandev, above n 48, 653.

<sup>73</sup> Jog and Mintz, above n 71; Michael Podolny, 'the Limits of Sovereign Immunity: A Study and Analysis of the Canadian Income Taxation of Sovereign Wealth Funds' (2012) 70(Spring) *University of Toronto Faculty of Law Review* 90.

<sup>74</sup> Jinyan Li, Arthur Cockfield and Scott Wilkie, *International Taxation in Canada* (2<sup>nd</sup> ed, LexisNexis Canada, 2011) 115.

<sup>75</sup> The Law Library of Congress, above n 47.

<sup>76</sup> Joint Committee on Taxation, above n 20; Ernst & Young, 'Norway' *Worldwide Corporate Tax Guide* (EYGM Limited, 2015).

<sup>77</sup> Ernst & Young, 'United Kingdom' *Worldwide Corporate Tax Guide* (EYGM Limited, 2015).

<sup>78</sup> Ernst & Young, 'Singapore' *Worldwide Corporate Tax Guide* (EYGM Limited, 2013).

<sup>79</sup> Japan *Corporate Tax Law* Article 138-1.

<sup>80</sup> Ibid.

(2) *Tax Treaties*

The OECD Model Tax Convention does not expressly address state or sovereign immunity from tax. Nevertheless a number of articles are worth noting. Article 4 provides that the definition of a 'resident of a Contracting State' extends to the Contracting States themselves, their political subdivisions and their local authorities. Thus, Article 4 generally extends to a foreign State the benefits that tax conventions grant to private residents of that State and recognises the foreign State as a potential taxpayer in the other State. Where foreign governments are not afforded specific treatment under Article 4, they are subject to the income tax treatment of foreign persons generally.

However, whether a SWF qualifies as a 'resident of a Contracting State' depends on the facts and circumstances of each case. Whether a SWF is considered to come within the scope of the State and any political subdivision or local authority would depend on its legal form and governance structure. For example, a SWF that is a statutory body or incorporated company is unlikely to be so classified. In order to clarify the tax treatment of SWFs, the definition of 'resident of a Contracting State' may be modified under the OECD Model treaty to include a statutory body, an agency or instrumentality.<sup>81</sup>

Alternatively, specific provisions may grant an exemption to other States or to specific state-owned entities such as central banks with respect to specific items of income. In particular, interest or dividends derived from activities of a governmental nature may be made exempt from tax.<sup>82</sup> For example, certain tax treaties provide an exemption where the government, authority, institution or central bank, of the other Contracting State, beneficially owns the interest. Article 11 in each of the Australia-New Zealand, United States-Singapore and the Japan-UK tax treaties are examples of this.

Treaty tax exemptions may be for a specific entity. For example, the Japan–Singapore tax treaty exempts the Government of Singapore Investment Corporation (now GIC Private Limited) from tax on interest income earned in Japan.<sup>83</sup> In the Japan–Australia tax treaty interest derived by 'a public authority that manages the investments of the Future Fund' is exempt from tax on interest income derived in Japan.<sup>84</sup>

Thus, a tax treaty may provide an outright exemption from tax such as under Article 4, or may exempt some income items only – such as for interest income under Article 11. If neither of these applies, treaties usually provide for a lower withholding rate relative to what would arise were no treaty in place. For example in the Republic of Korea interest (other than on bonds), dividends and royalties are taxed at 20 per cent whereas treaty rates vary between 5 and 15 per cent.<sup>85</sup> In Australia, SWFs have access to the Managed Investment Trust withholding tax regime. Prior to 1 July 2012,<sup>86</sup> this concessional rate of 7.5 per cent was generally lower than treaty rates which range between 5 and 15 per cent

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<sup>81</sup> OECD, above n 30, [6.36].

<sup>82</sup> Ibid, [7.4] and [13.2], respectively.

<sup>83</sup> Singapore-Japan Tax Treaty Article 11.

<sup>84</sup> Japan-Australia Tax Treaty Article 11 paragraph 3(c)(ii).

<sup>85</sup> PricewaterhouseCoopers, *Sovereign Wealth Funds: Investment trends and global tax risks – Asia* (PwC, 2010).

<sup>86</sup> From 1 July 2012 the MIT withholding tax rate is 15 per cent.

for dividends and are 10 per cent for interest.<sup>87</sup> Where there is no tax treaty in place, the withholding tax rate is 30 per cent.<sup>88</sup>

Notwithstanding that a tax treaty may provide for the reduction or exemption of tax payable, some countries require an application to be made to claim these. Failure to comply with the formalities will result in the denial of treaty benefits. In China, treaty relief is subject to an approval application procedure for passive income or record-filing procedure for active income. Guidance is provided in 'Administrative Measures on Tax Treaty Treatment of Nonresidents' (Circular 124).<sup>89</sup> Japan has separate forms and instructions for exemption for each income type, entitled 'Application Form for Income Tax Convention'.

#### IV AUSTRALIA'S TAXATION REGIME

##### A. Current Approach

The Australian approach has followed the tradition of others and it has been to exempt certain income derived by foreign governments from Australian tax pursuant to the doctrine of sovereign immunity. The practice is, however, somewhat discretionary and uncertain. Currently, SWFs seeking an exemption under Australian tax have to request a private ruling from the Australian Taxation Office (ATO).<sup>90</sup> These are binding in that the taxpayer is protected from further liability if they have followed the advice in the ruling which later turns out to be incorrect.<sup>91</sup>

The application of the law can be gleaned from administrative documents, particularly Interpretative Decision ID 2002/45 (ID)<sup>92</sup> Here the ATO, as Australia's tax authority, recognises the doctrine of sovereign immunity and indicates that

*An activity undertaken by a foreign Government Agency will generally be accepted as the performance of governmental functions provided that it is functions of government, provided that the agency is owned and controlled by the government and does not engage in commercial activities.*<sup>93</sup>

It is evident from this that the meaning of 'commercial activities' is a key concern in determining the extent of the immunity in a particular case. Unsurprisingly the ID explains that the question whether or not an operation or activity is commercial is

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<sup>87</sup> See for example Australia–New Zealand, Australia–United Kingdom and Australia–Norway tax treaties Articles 10 and 11.

<sup>88</sup> ATO, 'Withholding Tax Arrangements for Managed Investment Trust Fund Payments' (International Tax, Australian Taxation Office, 2013).

<sup>89</sup> Deloitte, *World Tax Advisor* (Deloitte, 2009); Ye Zhou, 'Qualifying for Tax Treaty Benefits for Passive Income' (2013) 17(13) *Practical International Tax Strategies* 11–12.

<sup>90</sup> The Law Library of Congress, above n 47.

<sup>91</sup> Inspector-General of Taxation, above n 70.

<sup>92</sup> See ATO ID 2002/45, above n 46. This records, for purposes of the Freedom of Information law, a decision made by the ATO concerning whether an exemption from dividend withholding tax was justified in the case of a foreign government agency's fund that received dividends on investments held in Australian securities

<sup>93</sup> *Ibid.*

dependent on the facts in each case. The ID suggests that ‘...a commercial activity is generally an activity concerned with the trading of goods and services, such as buying, selling, bartering and transportation, and includes the carrying on of a business’.<sup>94</sup>

Thus:

*Income derived by a foreign government or by any other body exercising governmental functions from interest bearing investments or investments in equities is generally not considered to be income derived from a commercial operation or activity. Accordingly, provided the funds used to make such investments are and remain government moneys, the income is accepted as being exempt from tax under the common law doctrine of sovereign immunity.*<sup>95</sup>

Notwithstanding this, the facts of the specific situation may affect whether it can be said that a holding in an investment is of such scale as to amount to the carrying on of a business rather than passive investment.

The ID sets up three tests to be applied, viz whether: the person deriving the income is a foreign government or an agency of a foreign government; the moneys being invested are and will remain government moneys; and whether the income is derived from a non-commercial activity.

For example, in ATO ID 2002/45 the foreign government agency fund was eligible for an exemption from Australian withholding tax on dividends received, while in ATO ID 2005/355 a German state-owned bank was denied such an exemption on interest income on the basis that it was not the central bank of Germany (notwithstanding the fact that the State bank performed some central banking activities).<sup>96</sup>

### ***B. The 2011 Proposed Model Approach***

It is noted that the process of determining the eligibility of the income of a sovereign fund for the exemption is one that involves a degree of judgment and therefore some uncertainty for the fund until a decision has been made. Presumably this was a cause for disquiet because the then government had set about trying to reduce the uncertainty. The current government has subsequently made the decision not to proceed with this measure.<sup>97</sup>

On 20 April 2011 the (Federal) Assistant Treasurer of the day released a consultation paper, *Options to Codify the Tax Treatment of Sovereign Investments*, (the Options to Codify paper) setting out the 2011 proposed model options to legislate for tax treatment of sovereign investments. It was said that this would clarify and provide certainty concerning the tax consequences in Australia for investments made by foreign

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<sup>94</sup> Ibid.

<sup>95</sup> Ibid.

<sup>96</sup> ATO Interpretative Decision, ATO ID 2005/355 Income Tax Withholding Tax: Exemption from interest withholding tax for a German bank undertaking central bank activities, 23 December 2005.

<sup>97</sup> Arthur Sinodinos, Assistant Treasurer, ‘Integrity restored to Australia’s taxation system’ (Media Release, 14 December 2013).



governments, as well as the withholding obligations for Australian residents.<sup>98</sup> That set of proposals came in the wake of an earlier consultation (*Greater Certainty for Sovereign Investments*)<sup>99</sup> and eleven submissions made in response to it.<sup>100</sup>

The Options to Codify paper identified two possibilities for codifying the exemption of certain income earned by foreign governments and sovereign funds. It is to be noted that the sole purpose of this project was to codify the current administrative practice and not to change existing law and practice.<sup>101</sup> Notwithstanding this, it suggested adopting the rules applicable in the US.<sup>102</sup>

The first of these options established rules according to which eligible entities that derived income from eligible interests would be taxed on that income – including eligibility requirements (both for the entity and the relevant interests) and ‘safe harbour’ rules for the equity interests of these entities. That option also set out the treatment to be accorded arrangements under existing private rulings and advanced opinions.<sup>103</sup>

The second option extended the first one by adding a test that may have been applied to equity interests that failed the safe harbour test in option 1. This test was termed the ‘commercial activity test’. The option discussed details of the limitations of the ‘commercial activity test’.<sup>104</sup>

The options are rule-based rather than principles based. That had the effect that they are detailed and complex to read. But they had the advantage of being clear, certain, and thus, arguably, simple. Briefly, the rules were as follows. Rules 1 to 4 described the tax treatment which rendered the income or gains ‘non-assessable non-exempt’ provided the other rules were satisfied. While rule 5 set out the eligibility requirements for entities, rules 6 and 7 set out the eligibility requirements for debt and equity interests, respectively. The equity interest test was described as the ‘safe harbour’ test. Rule 8 provided that existing private rulings and advance opinions could be relied upon for the duration of their term, notwithstanding that they may have been inconsistent with the 2011 proposed model rules. The additional ‘commercial activity’ test was provided for in rule 9, followed by the application of its limitations with respect to indirect Australian real property interests in rules 10 and 11. The Options to Codify paper had also helpfully set these rules out diagrammatically as shown in Figure 1.

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<sup>98</sup> Australian Federal Treasury, ‘Options to codify the tax treatment of sovereign investments’ (Proposal Paper, April 2011) available at <[archive.treasury.gov.au/documents/2017/PDF/Proposals\\_Paper.pdf](http://archive.treasury.gov.au/documents/2017/PDF/Proposals_Paper.pdf)>..

<sup>99</sup> Australian Federal Treasury, ‘Greater certainty for Sovereign Investments’ (Consultation Paper, November 2009).

<sup>100</sup> Of which five are public and six are confidential <[archive.treasury.gov.au/contentitem.asp?ContentID=2017](http://archive.treasury.gov.au/contentitem.asp?ContentID=2017)>.

<sup>101</sup> Australian Federal Treasury, above n 99, [3.2].

<sup>102</sup> Ibid, [3.3].

<sup>103</sup> Australian Federal Treasury, above n 98, 2.

<sup>104</sup> Ibid, 2.

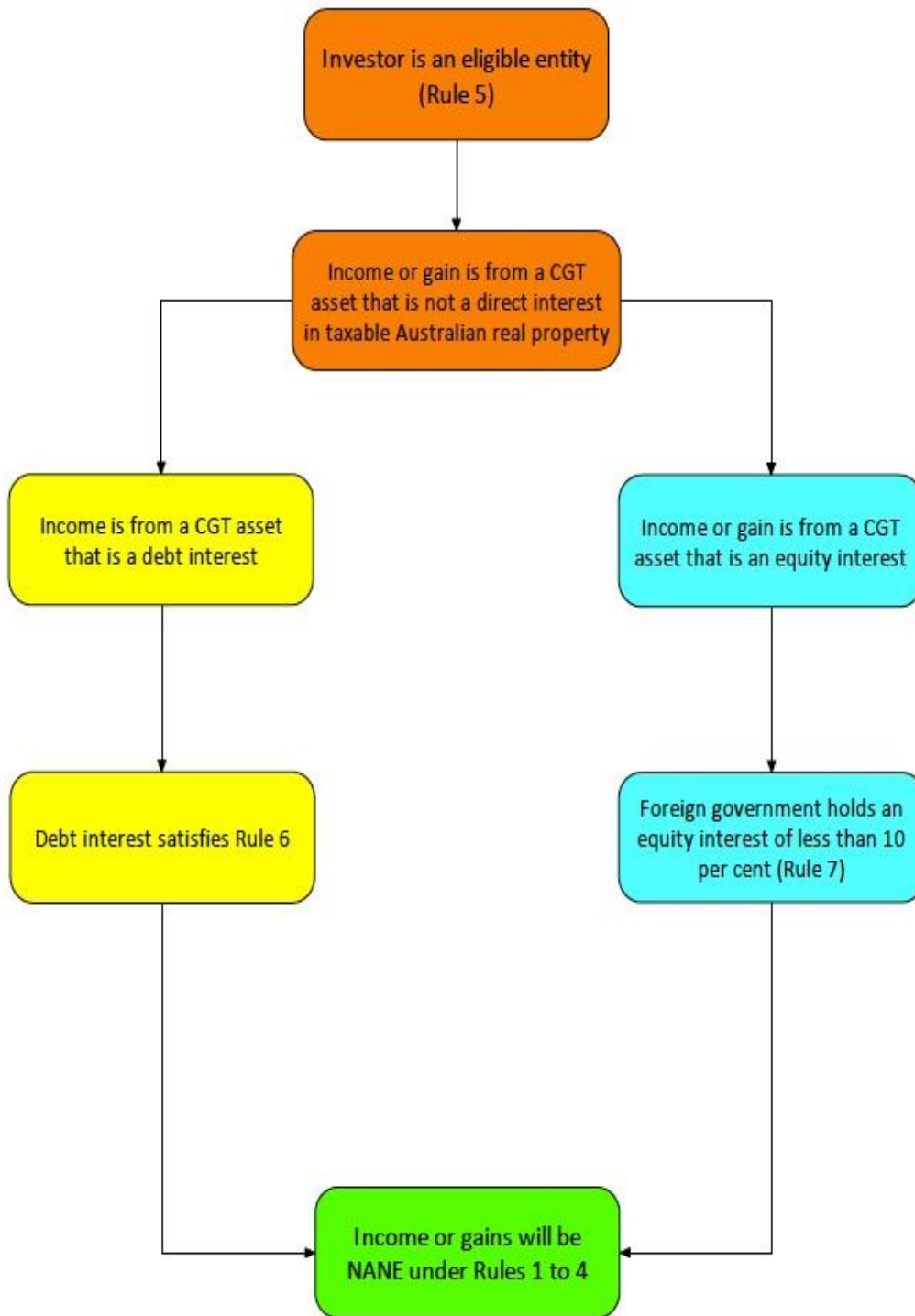
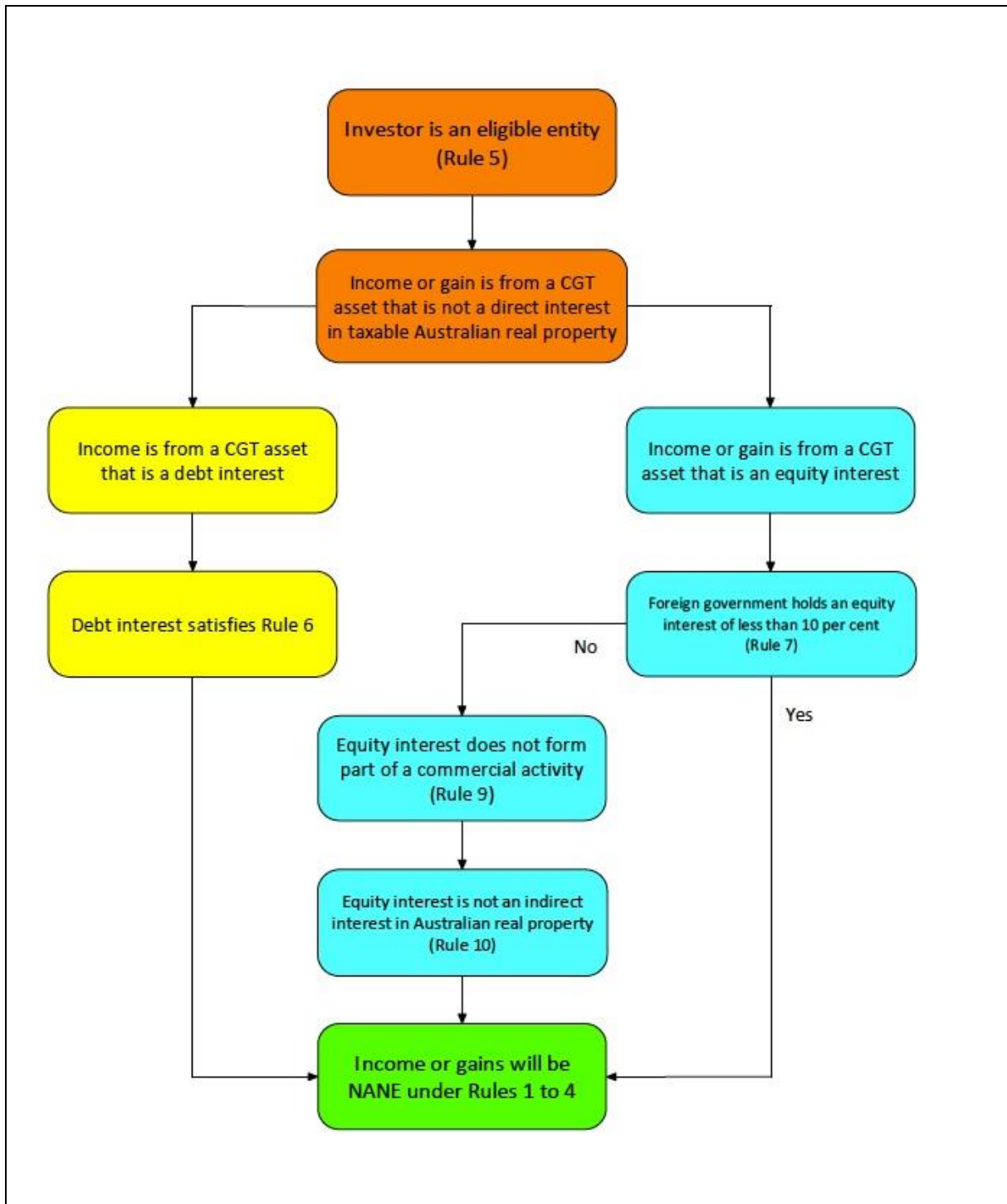


Figure 1: Option 1 to codify<sup>105</sup>

<sup>105</sup> Ibid, 4 and 20. “CGT” means capital gains tax; “NANE” means non-assessable not exempt.



**Figure 2: Option 2 to codify**

An ‘eligible entity’ was defined to be restricted to ‘foreign government agencies’<sup>106</sup> and to their wholly owned entities. Determining what is an ‘equity interest’ was more complex, being based on the debt/equity tax rules currently applying. The ‘safe harbour’ test was essentially the application of the current non-portfolio interest test.<sup>107</sup> That is, the safe

<sup>106</sup> As defined in the tax legislation. See ITAA 1997 s 995-1 ‘foreign government agency’.

<sup>107</sup> ITAA 1997 s 960-195.

harbour encompassed passive or portfolio income; a non-portfolio interest would breach the safe harbour. The 'commercial activity' test was more prescriptive, taking into account the size of the SWF's voting rights in the entity, the degree of influence that was, or could potentially have been, exercised in respect of the financial, operating and policy decisions as well as the overall activities of the SWF. That test was to apply on an interest-by-interest basis. That is, each interest was to be assessed individually and separately.

While there are some differences in the application of the 2011 proposed codification of the current practice, the principles remain the same. That is, the person deriving the income is a foreign government or an agency of a foreign government; the moneys being invested are and will remain government moneys; and whether the income is derived from a non-commercial activity.

### ***C. Application of Approach***

This section applies the approach proposed in the 2011 Options Paper to four specific funds to determine whether they would qualify for tax relief under the 2011 proposed model Australian law. These four funds are the New Zealand Superannuation Fund, Singapore's Temasek Holdings, the Government Pension Fund Global of Norway and Canada's Alberta Heritage Fund.

#### *(1) Criteria*

The types of entities that are eligible for relief from Australian tax are prescribed under 'Rule 5: Entities to which these rules apply'.<sup>108</sup> There are criteria with respect to ownership, funding and receipt of benefit.

#### *Ownership*

Only foreign government agencies and the wholly owned entities through which they invest in Australia are eligible for relief from Australian tax. The term 'foreign government agency' is defined in s 995-1 *Income Tax Assessment Act 1997* ("ITAA") to mean:

- the government of a foreign country or of part of a foreign country; or
- the authority of the government of a foreign country or of part of a foreign country.

A broad interpretation is provided in the *Acts Interpretation Act 1901* s 2B. In addition, the ITAA covers all levels of a government such as national, regional and local governments. The class of eligible entities is extended to include wholly owned entities of foreign government agencies such as wholly owned companies and investment vehicles. The Options Paper refers to these entities as 'sovereign funds'.

It is important to note that, while indirect ownership of a sovereign fund is permitted, ultimately all membership interests must be wholly beneficially owned by a foreign government agency. To avoid any doubt, the test is whether the foreign government

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<sup>108</sup> Ibid, 8-13.

agency beneficially owns the membership interests<sup>109</sup> in the entity. In determining this, control or influence over the entity is not considered to be a directly relevant consideration.

Further, sole ownership is not required. A sovereign fund will exist where an entity is jointly owned:

- by two or more wholly owned entities of a foreign government agency;
- by a foreign government agency and one or more of its wholly owned entities; or
- by two or more foreign government agencies.

However, a sovereign fund will not exist where it is jointly owned by a foreign government agency and another entity that is not wholly owned by a foreign government agency. This does not extend to arm's-length commercial services provided to the sovereign fund. For example, where it is normal commercial practice to remunerate contracted fund management services through an entity holding, this will not preclude the entity from being a sovereign fund.

The requirement of owning all membership interests means that superannuation and pension funds will not be classified as sovereign funds as the superannuants or pensioners actually hold the membership interests. This also goes to the internationally accepted definition of a 'sovereign wealth fund'.<sup>110</sup>

### *Funding*

A further requirement is that the sovereign fund must be funded solely with public money or property. Such funding will meet this requirement if it is in the custody or under the control of a foreign government agency, or of a person acting for or on behalf of the foreign government agency. Sources include fiscal surpluses, balance of payment surpluses, the proceeds of privatisations, the proceeds of commodity exports, mineral royalties or official foreign currency operations.

If an entity is acquired by a foreign government agency or its wholly owned entity, it will be considered to be 'financed' by that acquiring entity. However, it still needs to be wholly owned. That is, any entity acquired must be 100 per cent acquired in order for it to become a sovereign fund.

### *Receipt of benefit*

Any asset, income or gain generated by the foreign government agency or sovereign fund must be for the benefit only of that foreign government agency or sovereign fund. This is an integrity measure designed to prevent any individual (including foreign sovereigns,

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<sup>109</sup> 'Membership interest' is defined in ITAA 1997 s 960–135 to mean an interest, or set of interests, or a right, or set of rights, in an entity of which one is a member.

<sup>110</sup> See for example Simon Johnson, 'The Rise of Sovereign Wealth Funds' (2007) 44(3) *Finance & Development* 56; Leonard Schneidman (ed), *Sovereign Wealth Funds: A Legal, Tax and Economic Perspective* (Practising Law Institute, 2010); OECD, *Sovereign Wealth Funds (SWFs) and Recipient Country Policies* (OECD, 2008).

officials or administrators acting in a private capacity) or ineligible entity receiving a tax benefit designed solely for a foreign government agency or sovereign fund.

A limited number of exceptions apply. One exception is where there is a commercial arm’s-length agreement with an investment manager. Incentive-based consideration is permitted provided the arrangements relate directly to remuneration for the investment manager’s role as a service provider.

(2) *Assessment*

The SWFs identified for assessment are the Future Fund (Australia), Temasek Holdings (Singapore), the Government Pension Fund Global (Norway), the Alberta Heritage Fund (Canada) and New Zealand’s Superannuation Fund (as Australia’s Future Fund is exempt from Australian tax,<sup>111</sup> and cannot be properly tested for the purposes of this exercise).

These selected SWFs represent examples of different fund arrangements. Their legal forms and governance structures were given in Table 1 and replicated in Table 4.

**Table 4: Legal forms and governance structures of selected SWFs**

As separate legal entities		As pools of assets	
Governed by a specific constitutive law	State-owned corporation	Controlled by central bank	Controlled by separate statutory agency
New Zealand Superannuation Fund	Temasek Holdings (Singapore)	Government Pension Fund Global (Norway)	Alberta Heritage Fund (Canada)

*The New Zealand Superannuation Fund*

The New Zealand Superannuation Fund (“NZ Fund”) is a pension reserve fund managed and administered by a Crown entity called Guardians of New Zealand Superannuation (“Guardians”). It was established in 2003 with NZ\$2.4 billion cash, for the purpose of partially providing for the future cost of funding superannuation payments for all eligible New Zealanders. That is, it seeks to reduce the tax burden on future taxpayers of the cost of New Zealand superannuation.

Both the NZ Fund and the Guardians were established under the *New Zealand Superannuation and Retirement Income Act 2001*. This Act also provides for the amount of required annual capital contribution, based on a formula that includes projected GDP.<sup>112</sup> However, provided certain conditions are met, a lesser amount is permissible.<sup>113</sup> There is

<sup>111</sup> ITAA s 50–25 read with *Future Fund Act 2006* s 84A.

<sup>112</sup> Sections 42 and 43.

<sup>113</sup> Section 44.



an additional requirement to top-up the fund annually to meet entitlements payable during that year.<sup>114</sup> Additional contributions are also provided for.<sup>115</sup> The New Zealand Government suspended annual capital contributions to the Guardians in July 2009, having made one additional contribution to the Fund of \$250 million.<sup>116</sup>

The Guardians is a Crown entity. Crown entities are bodies established by law in which the government has a controlling interest.<sup>117</sup> The *Crown Entities Act 2004* is administered by the Treasury and the State Services Commission. However, it is membership interest that is more of a determining factor than controlling interest. The legislation states that the 'Fund is the property of the Crown'.<sup>118</sup>

The function of the Guardians is '... to manage and administer the Fund in accordance with this Act'.<sup>119</sup> This covers the investment, management and custodianship of the NZ Fund and ensures the Fund receives any benefit generated.<sup>120</sup>

In summary, the New Zealand Superannuation Fund is a separate legal entity governed by a specific constitutive law and funded by the New Zealand Government. It meets the criteria of ownership, funding and receipt of benefit. As a result, this SWF would qualify for tax relief under the 2011 proposed Australian law.

### *Temasek Holdings*

Temasek Holdings is an investment company wholly owned by the Singapore Ministry of Finance and governed by the *Singapore Companies Act*. In the early 1960s the Singapore Government acquired stakes in a wide range of companies in the manufacturing, financial, trading, transportation, shipbuilding and services sectors to jump-start the economy. Many of these companies were joint ventures with foreign investors. These companies included the Development Bank of Singapore Ltd and Singapore Airlines Ltd. Temasek Holdings was incorporated in 1974 to hold and manage investments and assets previously held by the Singapore Government.<sup>121</sup>

With an initial portfolio of S\$354 million, Temasek Holdings now funds its investments using dividends and other cash distributions it receives from its portfolio companies and other investments, divestment proceeds from sale of its investments, and borrowings and debt financing sources such as Temasek Bonds.

In summary, Temasek Holdings is a state-owned corporation, funded with public money and reinvestments of any asset, income or gain generated. It meets the criteria of

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<sup>114</sup> Section 45.

<sup>115</sup> Section 46.

<sup>116</sup> NZSuperfund, 'FAQs' <<http://www.nzsuperfund.co.nz/index.asp?pageID=2145831988>> accessed 22 May 2014.

<sup>117</sup> The Treasury, 'Crown Entities' 8 May 2013 <<http://www.treasury.govt.nz/statesector/crownentities>> accessed 22 May 2014.

<sup>118</sup> New Zealand Superannuation and Retirement Income Act 2001 s 40.

<sup>119</sup> New Zealand Superannuation and Retirement Income Act 2001 s 51.

<sup>120</sup> New Zealand Superannuation and Retirement Income Act 2001 ss 58–63.

<sup>121</sup> Temasek, 'Why was Temasek established?' <<http://www.temasek.com.sg/abouttemasek/faqs>> accessed 22 May 2014.

ownership, funding and receipt of benefit. As a result, this SWF would qualify for tax relief under the 2011 proposed Australian law.

#### *The Government Pension Fund Global*

The Norwegian Government Pension Fund Global (“GPF”) was established in 1990 ‘as a fiscal policy tool to underpin long-term considerations in the phasing-in of petroleum revenues into the Norwegian economy’.<sup>122</sup> It was also to serve as a tool to manage the financial challenges of an ageing population and an expected decrease in petroleum revenue.<sup>123</sup> Prior to 2006 it was called the Petroleum Fund.

The GPF is managed by Norges Bank Investment Management (“NBIM”) on behalf of the Ministry of Finance. NBIM is a division of the Norwegian Central Bank. That the Norwegian Government has sole ownership is inferred from the *Government Pension Fund Act 2005* that states the capital ‘may only be used for transfers to the central government budget pursuant to a resolution by the Storting (Norwegian parliament)’.<sup>124</sup>

Funding is integrated with the government’s annual budget. All petroleum revenue (net of financial transactions related to petroleum activities) and any budget surplus make up the capital inflows.<sup>125</sup> All income generated by the GPF is reinvested.<sup>126</sup>

In summary, the GPF is under the control of the government’s central bank, funded with public money and reinvestments. It meets the criteria of ownership, funding and receipt of benefit. As a result, this SWF would qualify for tax relief under the 2011 proposed Australian law.

#### *The Alberta Heritage Fund*

The Alberta Heritage Fund (“AH Fund”) is a savings fund governed by Alberta’s Treasury Board and Finance. Alberta is a province of Canada. The AH Fund was established in 1976 with 30 per cent of Alberta’s non-renewable resource royalties. This funding ceased in 1987. It now generates revenue from its investment activities.

The assets are managed by the Alberta Investment Management Co, formerly part of the Ministry of Finance of Alberta before being converted to a provincial Crown corporation in 2008. It provides investment management to a variety of public sector funds. However, the Crown is the legal and beneficial owner of the AH Fund.<sup>127</sup>

Originally designed for economic development, it is now primarily a long-term savings and investment fund. In the 1980s the AH Fund made loans to other provincial

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<sup>122</sup> Norway, ‘Norway’s Government Pension Fund Global (GPF)’ <[http://www.norway.org.au/Norway\\_and\\_Oceania/Latest-News/Norways-Government-Pension-Fund-Global-GPF/#.U32gnC\\_-OHk](http://www.norway.org.au/Norway_and_Oceania/Latest-News/Norways-Government-Pension-Fund-Global-GPF/#.U32gnC_-OHk)> accessed 23 May 2014.

<sup>123</sup> Norges Bank Investment Management, ‘About the Fund’ 4 April 2014 <<http://www.nbim.no/en/the-fund/about-the-fund/>> accessed 23 May 2014.

<sup>124</sup> Section 5.

<sup>125</sup> Government Pension Fund Act 2005 s 3.

<sup>126</sup> Government Pension Fund Act 2005 s 4.

<sup>127</sup> Alberta Heritage Savings Trust Fund Act s 2.

governments. Since then funds have been used for capital infrastructure projects and to support government programs such as health care and education. Legislation requires that a portion of its income be retained for inflation-proofing.<sup>128</sup> Currently the earned investment income, less the inflation-proofing amount, is transferred to Alberta's General Revenue Fund to support program spending. A new savings plan introduced as part of the 2013 Budget will see the fund retain all its income by 2016–17.<sup>129</sup> However, the *Fiscal Management Act* allows for amounts to be transferred to the AH Fund.<sup>130</sup>

The AH Fund is a fund owned by the Crown, controlled by a provincial government agency and funded by the Alberta government. It meets the criteria of ownership, funding and receipt of benefit. As a result, this SWF would qualify for tax relief under the 2011 proposed Australian law.

#### ***D. Concluding Remarks***

Currently a SWF is required to obtain a private ruling before being able to access relief from Australian tax. The proposal contained in the Options Paper is an attempt to codify what is currently an administrative practice. By meeting the prescribed criteria, all four SWFs assessed are types of entities that are eligible for relief from Australian tax under the 2011 proposed scheme. The outcome is therefore identical to what would result currently (assuming a favourable outcome to a private ruling request) but with more certainty and with lower compliance and administrative costs.

### **V PRINCIPLES FOR 'GOOD' TAXATION**

Over two hundred years ago Adam Smith set out four principles of good taxation – taxes should be simple, certain, efficient in terms of collection cost and fair.<sup>131</sup> Since then these principles have been distilled into 'efficiency', 'equity' and 'simplicity' to which variants of these have been added. The purpose reviewing the principles here is to distil from the literature a set of principles concerning the tax system that can be applied to taxation of SWFs and thus be used as a means to evaluate the Australian approach.

The Asprey Committee discussed the principles under the three headings of efficiency, fairness and simplicity.<sup>132</sup> This was, by their own admission, for the sake of brevity, noting that 'each of these three when one seeks to define it closely proves to embrace several distinct qualities'.<sup>133</sup> Economic management, encompassing revenue integrity and flexibility, and economic growth were singled out as 'other objectives'.<sup>134</sup> On the other hand, the Henry Review added the principles of sustainability and policy consistency to

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<sup>128</sup> Alberta Heritage Savings Trust Fund Act ss 8, 11.

<sup>129</sup> Treasury Board and Finance, 'Heritage Fund' <<http://www.finance.alberta.ca/business/ahstf/faqs.html>> accessed 22 May 2014.

<sup>130</sup> *Fiscal Management Act* Section 3.

<sup>131</sup> Adam Smith in K Sutherland (ed), *An Inquiry Into the Nature and Causes of the Wealth of Nations* (A select edition) (1993) book V, ch II, pt II 'Of Taxes'.

<sup>132</sup> Taxation Review Committee, 'Full Report' (Report by Taxation Review Committee Asprey, K. W. Parsons, Ross, Waite, 31 January 1975) paragraphs 3.6–3.26.

<sup>133</sup> *Ibid*, paragraph 3.6.

<sup>134</sup> *Ibid*, paragraphs 3.27 and 3.28.

equity, efficiency and simplicity.<sup>135</sup> The Meade Committee, reviewing the UK tax structure, considered six principles to be ‘the most important’ as ‘desirable characteristics of a tax structure’.<sup>136</sup> These are (1) incentives and economic efficiency, (2) distributional effects, (3) international effects, (4) simplicity and costs of administration and compliance, (5) flexibility and stability and (6) transitional problems.<sup>137</sup> Similarly, a review of the New Zealand tax system determined that six principles were considered ‘important for a sound tax system’.<sup>138</sup> These are (1) efficiency and growth, (2) equity and fairness, (3) revenue integrity, (4) fiscal cost, (5) compliance and administration cost and (6) coherence.<sup>139</sup> Thus it is becoming increasingly evident that merely assessing a tax model under the three principles of equity, efficiency and simplicity is not sufficient. A broader range of principles is required.

As a result it is suggested that the approach to taxation of SWFs should conform to a number of principles. Many lists and sub lists could be drawn, each emphasising major or lesser features, and the ranking of these would be subject to the values and perceptions of the list’s compiler. For practical purposes, and because little is to be gained from endless refinement of principles that will in any event have to be adapted to the exigencies of dealing with a particular fund, this analysis will consider the taxation of SWFs from the perspective of the following generally accepted principles (in no particular order):

- Simplicity;
- Low compliance costs;
- Economic incidence and encouragement of growth;
- Neutrality (to the extent this is consistent with the point above);
- Consistency;
- Revenue integrity;
- Desirable international relations;
- Flexibility;
- Stability; and
- Ease of transition to a new model.

We think that these represent desirable principles for taxing SWFs. Each point requires some elaboration.

### *A. Simplicity*

The question to be asked is whether the approach to taxation of SWFs in Australia is simple, both in regard to the processes required to exempt SWFs from tax, and in regard to the conceptual framework for the chosen taxation approach. Simplicity may be found in an alignment with other processes undertaken by SWFs or with a separate form of

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<sup>135</sup> Australia’s Future Tax System, ‘Report to the Treasurer’ Part One Overview (Commonwealth of Australia, December 2009) 17.

<sup>136</sup> The Institute for Fiscal Studies, ‘The Structure and Reform of Direct Taxation. Report of a Committee chaired by Professor J. E. Meade’ (London: George Allen & Unwin, 1978) 7.

<sup>137</sup> Ibid.

<sup>138</sup> Victoria University of Wellington Tax Working Group, ‘A Tax System for New Zealand’s Future’ (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, January 2010) 15.

<sup>139</sup> Ibid.

compliance activity which is different but nevertheless is simple. Simplicity may also be found in the concepts underpinning the taxation of SWFs. There is a need for simple clear rules that, inter alia, identify what is an SWF and identify precisely what income, from what activities, is exempt.

### ***B. Low Compliance Costs***

Related to simplicity, low compliance costs would be found in the ease and simplicity of processes involved in complying with tax rules for dealing with SWFs. In light of comments of the Meade Committee,<sup>140</sup> it is submitted that it may be preferable, where it is possible to choose, for the burden of compliance costs to be borne by the administration rather than the taxpayer so that costs may be shared through the community. The latter outcome may be difficult to achieve in a self-assessment environment, but a clearer process for SWFs ought not to be difficult to achieve and would result in lower compliance costs.

### ***C. Economic Incidence and Encouragement of Growth***

For various reasons, including international competitiveness and general economic growth, the treatment of SWFs in the tax system should provide incentives for creation of employment, investment in business and for general growth in the economy. If SWFs are becoming more important in the modern economy the tax incentives provided should both recognise this and promote the use of Australia for investment as a means to encourage growth. This must, nevertheless, be tempered with containment of fiscal costs. The balance here will usually be a question of (political) judgment.

### ***D. Neutrality***

The principle of neutrality generally competes with the principle of encouraging growth, requiring a compromise. It can be forgotten that distortion, the opposite of neutrality, can be found in an approach to taxation of SWFs that encourages tax avoidance, thus resulting in unintended revenue shortfalls and economically irrational (except for the tax consequences) taxpayer behaviour. A form of neutrality should therefore be sought, which achieves appropriate revenue targets, which avoids placing stress on which investment vehicles are used. A narrow set of definitions and clear terms ought to address this challenge.

### ***E. Consistency***

Consistency is intricately linked with neutrality, and aims to treat all SWFs the same under the tax rules. Particularly important, consistency of treatment is desirable also in relation to the manner in which different parts of the tax system impact on SWFs so that there is consistency between, for example, the ordinary income tax treatment and the capital gains tax treatment of their dealings. In particular, qualifications for exemptions should be consistent within the taxation system. This can also be considered as 'coherence' where individual reforms conform to, or complement, the tax system as a whole. The principle

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<sup>140</sup> The Institute for Fiscal Studies, above n 136.

of consistency also extends to consistency of policy. This delivers certainty and is tied to the concept of simplicity.

### ***F. Revenue Integrity***

Revenue integrity is a basic requirement of any tax system given that the principle purpose of taxation is to raise revenue to fund government activities. The tax system should therefore be sustainable over time as well as providing a sustainable revenue base to meet the changing revenue needs of government on an ongoing basis. As the Henry Review noted, '[t]o be sustainable the tax system ... must contribute to a fair and equitable society'.<sup>141</sup> Opportunities for tax avoidance and arbitrage must necessarily be minimised. This could be an argument for not exempting SWFs from tax at all. It is certainly an argument for clear drafting and tightly circumscribed access to exemptions as discussed under the topic of neutrality.

### ***G. Desirable International Relations***

It is desirable that Australia have a system of taxing SWFs that conforms to some degree with the treatment that it is accorded in jurisdictions with which Australia trades. On the other hand, in some cases, the encouragement of economic growth in Australia may dictate that a degree of competition with other jurisdictions would be desirable. In order to be sustainable, such competition would obviously need to fall short of classification as a harmful tax practice or similar unfair competition. Australia's leading role in the G20 initiatives to contain tax avoidance is relevant here as it should not be seen to criticize tax minimisation while simultaneously encouraging it.

### ***H. Flexibility***

The tax treatment accorded SWFs in Australia should also be capable of easy change in response to developments in worldwide government and investment behaviour and should not become rigid and calcified. The tax system should be responsive to the needs of the economy and to SWF investor practices, as well as flexible enough to allow the government to respond as required. It would be undesirable to establish a framework in Australia that is not flexible enough to be easily changed should the need arise.

### ***I. Stability***

On the other hand, the approach to taxation of SWFs should be certain and stable and should not be prone to sudden change without notice, nor at the whim of the administration. It should be possible for SWF investors to predict that the method of taxation of their income will remain the same for the foreseeable future, or if there are to be changes, it should be possible for them to know precisely what the changes are, when they will occur, and, if necessary, there should be an ability to move to the changed method without unreasonable adverse tax consequences.

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<sup>141</sup> Australia's Future Tax System, above n 135, 17.



### *J. Ease of Transition*

As has been suggested above, in order to avoid major disruption within the investment community and in order to avoid inequitable consequences of change in the manner of taxing SWFs, it should be possible for the SWF community to adapt to any tax change without unreasonable adverse tax consequences and a minimum of additional compliance costs. Similarly it should be possible for the tax administration to adapt and change in conformity with any change in policy.

## VI AUSTRALIA'S POSSIBLE FUTURE RULES

### *A. SWFs and the Future*

SWFs will become more prominent in capital markets and, with pressure to increase financial returns, investment strategies are becoming increasingly aggressive.<sup>142</sup> Attraction as an investment destination will become progressively more competitive at an international level. Foreign investment in the Australian economy is a key element in Australia's future economic growth.<sup>143</sup>

SWFs act as both financial institutions and political institutions. From a tax perspective, they could be treated like private financial investors subject to corporate and banking laws, or like sovereigns acting to further political or humanitarian agendas or a combination of these. Alternatively, a new model could be devised solely for the taxing of SWFs.

### *B. Alternative Approaches to Taxation of SWFs*

From the above discussion, alternative approaches can be suggested.<sup>144</sup>

First, Australia provides a '**unilateral exemption**' from tax on the passive (that is, non-commercial) investment income of SWFs. In this it joins the UK (provided the SWF is beneficially owned) and the US. Applying the principles above, this approach does engender simplicity, low compliance costs, economic incidence and encouragement of growth and flexibility while promoting desirable international relations. It meets the ease of transition requirement. This approach, however, offends the principles of neutrality, revenue integrity and stability. As to how it meets the principle of consistency, this is considered to be beyond the scope of this study but an investigation of this would be an opportunity for further research.

A second approach might be a '**reciprocal exemption**' such as that granted in Canada after application and substantiation. Such an exemption is made subject to conditions

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<sup>142</sup> Al-Hassan et al, above n 27; Fleischer, above n 15; Melone, above n 61.

<sup>143</sup> Business Council of Australia, 'Submission to the Review on Export Policies and Programs '2008; ITS Global, 'Foreign Direct Investment in Australia – the increasing cost of regulations' (Report by ITS Global, 9 September 2008); Committee for Economic Development of Australia, 'The contribution of foreign direct investment and the mining industry to the welfare of Australians' (CEDA Information Paper 92, November 2008).

<sup>144</sup> See also Irish, above n 22.

which might include similar principles to the Australian approach (for example income of a non-commercial nature). What distinguishes this from the 'unilateral exemption' is that the other country provides a reciprocal exemption to Australian SWFs. Reciprocal exemptions are commonly established under tax treaties and are particularly common amongst countries with significant SWFs.<sup>145</sup> Australia has only recently created a SWF and there has therefore been limited opportunity to introduce such clauses in its tax treaties.

With the reciprocal approach, the principle of simplicity (although not to the same extent as under the unilateral approach), desirable international relations, stability and ease of transition are all met. The principle of economic incidence and encouragement of growth is also met but, as preference is given to Australia in foreign jurisdictions, this may be higher than under the unilateral approach. Again, consistency is considered to be out of frame.

A third approach to taxing SWFs is to provide **no exemptions** on the basis that all taxpayers should be taxed alike on the benefits derived as a result of the host country's infrastructure.<sup>146</sup> Examples of countries with such approaches include China, Japan, New Zealand, Norway, Republic of Korea, Singapore and the UK where the SWF is a separate entity from the government.

This is the simplest of all three approaches as no special rules are required. It does, however, have higher compliance costs, falls short in economic incidence and encouragement of growth, as well as failing in creating desirable international investment relations and in ease of transition. Its advantages are that it is neutral, consistent, flexible, and stable and provides revenue integrity.

The application of the principles to the three alternative approaches is shown in Table 6.

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<sup>145</sup> Ibid.

<sup>146</sup> Ibid.

**Table 2: Application of principles to alternative approaches**

Principle	Unilateral	Reciprocal	No Exemption
Simplicity	Meets	Meets	Meets
Low compliance costs	Meets	Offends	Offends
Economic incidence, growth	Meets	Meets	Offends
Neutrality	Offends	Offends	Meets
Consistency	N/A	N/A	Meets
Revenue integrity	Offends	Offends	Meets
International relations	Meets	Meets	Offends
Flexibility	Meets	Offends	Meets
Stability	Offends	Meets	Meets
Transition	Meets	Meets	Offends

It will be evident from this that the principles thus applied are somewhat inconclusive (both the Unilateral and No Exemption approach address six principles, the reciprocal approach is close behind meeting five of them) without trying to weight the principles in some way. This inconclusiveness highlights the fine balance between the three approaches and therefore the different policy options these present.

It has been suggested that, theoretically, the most desirable approach is to provide no exemptions.<sup>147</sup> This would achieve equity of treatment between all foreign investors (whether government or private) and would maximize revenue. On the other hand, were it in Australia's best interests it might obtain the optimal outcome for the tax treatment of the Australian Future Fund in other jurisdictions and attract the foreign investment it wants by establishing a reciprocal regime. This gives it the added advantage of being able to attract foreign investment on a case-by-case basis by negotiation.<sup>148</sup> Thus, if outcomes for the Future Fund were seen as overriding, the reciprocal approach would be best.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid.

### ***C. The 2011 Proposed Model Approach***

Applying the principles established in section 5, it would appear that the Option to Codify, being a unilateral approach, meets the requirements of simplicity because although it is detailed and complex, it is clear and imposes low compliance costs to a degree. It does score favourably with respect to economic incidence and encouragement of growth, as it should attract investment, and it addresses revenue integrity and stability because its detail quarantines the concession. The suggestion offends neutrality – but that is the point of concessions for special categories of investor. It does seem to offend the principle of flexibility, and the model would be difficult to transition to. It seems it would be indifferent towards international relations, as this model does not permit individual negotiations. Consistency, as a principle, is not applicable here.

These misgivings having been expressed, however, the earlier analysis has highlighted the difficulty encountered when trying to reach a conclusion on the various models, and is somewhat inconclusive. The Australian approach that was under consideration does seem to be preferable to the lack of transparency we now have, and perhaps for that reason might be regarded as a viable option. Based on the best practice principles proposed in this paper, all approaches are equally problematic.

Further in-depth analysis of the experiences of other countries by expanding the study beyond the 10 discussed here may assist in devising a model for Australia that could be considered to emulate and embrace best practice. Reduced compliance costs and greater certainty would be in Australia's best interests. On the other hand, it may be that in an area of tax policy as difficult as this it would be advisable to simply settle on an approach, afford it as much transparency as possible, and allow economic behaviour to demonstrate the efficacy or otherwise of the approach adopted.

## THE ROLE OF THE OECD IN THE CURRENT INTERNATIONAL TAX LAW: VOLUNTARY OR 'OBLIGATORY'?

ALIREZA SALEHIFAR<sup>1</sup>

### ABSTRACT

Whereas currently the OECD's Model Tax Convention, Commentaries and Guidelines are being broadly utilised by many countries, there is no legal certainty regarding the extent to which they can constitute part of international tax law. It might be argued that despite the widespread practice by both the OECD Member states and non-member states conforming to the OECD's Model Tax Convention, Commentaries and Guidelines, the *opinio juris* is still difficult to prove. This means that the legal status of the OECD's Model Tax Convention, Commentaries and Guidelines has not necessarily evolved into binding customary international law.

However, this widespread practice by both the OECD member states and non-member states might still have a legitimising effect if the issue is considered from different perspectives. By recourse to general principles of international law and according to the settled case law of the International Court of Justice, this paper seeks to prove that *opinio juris* exists under certain circumstances. Countries which have voluntarily implemented or practised a norm regularly over time can be held to have acquiesced in those norms and practices (*acquiescence*) and therefore are bound to these rules. Even if there are some uncertainties regarding the parties' tacit acceptance of the OECD's Model Tax Convention, Commentaries and Guidelines, they are deemed to be estopped or precluded from denying such acceptance due to their regular practices (*estoppel*).

In international law these principles have specifically evolved to govern situations in which countries reasonably rely on the regular practices of each other. By scrutinising the relevance of these general principles of international law to cross-border tax matters, this article intends to clarify the extent to which legitimising international tax norms can emerge outside of the OECD Model Tax Convention, Commentaries, and Guidelines. It will discuss whether under current international tax law the OECD's pronouncements potentially constitute a part of international tax law or whether they should be regarded as mere guidance.

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<sup>1</sup> PhD Candidate, University of Canterbury, New Zealand. Special thanks are due to my supervisors, Professor Adrian Sawyer and Associate Professor Andrew Maples, and the participants in the 27<sup>th</sup> Australasian Tax Teachers' Association (ATTA) Conference 2015, for their valuable feedback and useful comments on the earlier versions of this draft.

## I INTRODUCTION

All international organisations are authorised to issue non-binding recommendations and guidelines to their members within their area of competence.<sup>1</sup> However, if practised comprehensively, these norms and standards may over time come to represent accepted international norms. In this context, the OECD's Model Tax Convention, Commentaries and Guidelines<sup>2</sup> are broadly observed by OECD countries and even many non-OECD countries. For example, many countries generally grant either an exemption for foreign-source income or a credit for foreign taxes paid, according to the OECD's Model Tax Convention. Nearly every country in the world claims to follow the arm's length transfer pricing guidelines of the OECD (Brazil being the only noticeable exception).<sup>3</sup> The non-discrimination norm embodied in Article 24 OECD Model Tax Convention, which provides that non-residents from a treaty country should not be treated worse than residents, is represented in almost all tax treaties. As a result, these cross-border tax norms have been quickly extended beyond the OECD member states' jurisdictions.

The OECD is a multilateral economic organisation of 34 countries, founded in 1961 to stimulate economic development and world trade.<sup>4</sup> According to the official website of the OECD, this organisation is a forum of developed countries which provides a platform for comparing policy experiences, looking for solutions for common economic problems, identifying good practices and coordinating domestic and international policies of its members.<sup>5</sup> The mission of the OECD is to develop policies which may enhance the economic and social well-being of nations around the world.<sup>6</sup> In addition, the OECD also works with governments to identify what drives economic, social and environmental change.<sup>7</sup> It establishes international standards in a variety of areas, from agriculture and tax, to the safety of chemicals.<sup>8</sup> It is accepted that similar to many international organisations, the early stages of the OECD were based on voluntary adherence of the member countries to its pronouncements.<sup>9</sup> However, this did not necessarily mean that the OECD had to remain as a "voluntary" organisation forever. For this reason, this article seeks to scrutinise the role of the OECD from the perspective of international law.

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<sup>1</sup> Henry G. Schermers and Niels M. Blokker, *International Institutional Law* (Martinus Nijhoff Publishers, 3rd ed, 2001) 1218.

<sup>2</sup> The OECD Guidelines are recommendations that address different tax or trade issues, including, for example, the OECD Guidelines for Multinational Enterprises, the OECD Guidelines on Transfer Pricing Guidelines, the OECD Guidelines for the Testing of Chemicals, etc.

<sup>3</sup> Reuven Avi-Yonah, 'Tax Convergence and Globalisation' (2010) 6 *University of Michigan* 1, 7. Electronic copy available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1636299](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1636299), last visited 5 December 2014.

<sup>4</sup> The website of the OECD, available from <http://www.oecd.org/about/history/>, last visited 1 June 2015.

<sup>5</sup> The website of the OECD, available from <http://www.oecd.org/about/>, last visited 1 June 2015.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Yariv Brauner, 'An International Tax Regime in Crystallization' (2003) 56 *Tax Law Review* 259. Electronic copy available at: <http://scholarship.law.ufl.edu/facultypub/9>, last visited 1 December 2014.



International law is said to emerge from a variety of sources. International law commentators commonly define it as “a set of rules generally regarded and accepted as binding in relations between states and between nations”.<sup>10</sup> This definition is in conformity with a positivistic legal tradition which establishes that the legal validity of any legal system depends on its sources, not its merits.<sup>11</sup> According to legal positivism a sovereign State exists to posit laws governing subjects, and those sovereign States would shape international law, provided that there were some enforcement mechanisms.<sup>12</sup>

However, it is misleading to say that international law is shaped by States, through treaties and customs, both because this definition overlooks the increasing contribution of global or multilateral organisations to the process of international law-making and because a variety of non-State institutions increasingly play a role in international law-making.<sup>13</sup> Thus, other scholars argue that international law includes not only state law and practices but also it covers a rich tradition of societal and cultural customs, statements and pronouncements produced by States and their representatives, universal rights and duties, and other sources such as judicial declarations and commentaries.<sup>14</sup> This raises two questions: (1) whether the OECD’s Model Tax Convention, Commentaries and Guidelines may constitute a part of international law and have a legitimising effect, and (2) to what extent these pronouncements should be binding.

To answer the question raised above the methodology adopted for the present research is based on traditional legal analysis involving different areas of law, including international law, public law and tax law. In order to shed light on the international law status of the OECD in current international tax law, different sources of law and materials, such as the OECD’s documentation, general principles of international law, international case law and scholarly articles, have been analysed. The elements of international law, including customary international law, acquiescence and estoppel, play a significant role in clarifying the current legal status of the OECD in the international tax law. The article is structured as follows: Section 2 is dedicated to defining international law and the process through which international norms are created. Section 3 provides a general overview of the legal status of the OECD pronouncements. Section 4 considers the characteristics of customary international law and investigates the relationship between the OECD Model Tax Convention, Commentaries and Guidelines and customary international law. Section 5 investigates how estoppel and acquiescence (as two concepts of customary international law) are applicable to cross-border tax situations and against tax authorities. Section 6 examines the enforcement of customary international law and Section 7 provides a summary of this whole paper.

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<sup>10</sup> Jeremy Sarkin, *Colonial Genocide and Reparations Claims in the 21st Century: The Socio-Legal Context of Claims under International Law by the Herero against Germany for Genocide in Namibia, 1904–1908*, (Greenwood Publishing Group, 1<sup>st</sup> ed, 2009) 68.

<sup>11</sup> Legal positivism is a school of thought of philosophy of law and jurisprudence, largely established by eighteenth and nineteenth-century legal theorists, most prominently, by works of Jeremy Bentham and John Austin.

<sup>12</sup> Sarkin, above n 10, 68.

<sup>13</sup> Samantha Besson and John Tasioulas (eds), *The Philosophy of International Law* (Oxford University Press, 1<sup>st</sup> ed, 2010) 87.

<sup>14</sup> Ibid.

## II INTERNATIONAL LAW AND THE CREATION OF INTERNATIONAL NORMS

Before illustrating the transformation of international norms in the body of international law in the form of customs, which occurs through the frequent practices of norms by countries, the article presents an overview of the creation of norms at a global level. International law<sup>15</sup> is a system of law which regulates the interrelationship of sovereign States and their rights and duties with regard to one another.<sup>16</sup> In the context of international law, there is no international parliament, similar to that in domestic law systems, for legislating binding rules. In addition, there is no international body, such as an international police force, in charge of sanctioning breaches of international law.<sup>17</sup> Instead, the international law originates from a variety of sources: (1) conventions and treaties; (2) international custom, in so far as this is evidence of a general practice of behaviour accepted as legally binding; and (3) the general principles of law recognised by civilised nations.<sup>18</sup>

A norm, in the context of international law, can be defined as “the shared expectations or standards of appropriate behaviour accepted by States and intergovernmental organisations that can be applied to States, intergovernmental organisations, and/or non-State actors of various kinds”.<sup>19</sup> Certain types of norms may become binding through the common practice of States which have accepted that practice as law. According to Lauterpacht:<sup>20</sup>

*This dependence on State practise is both the source and the reflection of the legal relevance of divergence from the normal ... Where there is a repeated divergence - a divergence is either widely accepted or, at any rate, is not widely disapproved of, then that deviation itself tends to become the norm and, therefore, the law.*

Generally speaking, norms are incorporated in the international community in four possible ways:

- *Legal norm setting*—International organisations and governments form norms through conventions, declarations, treaties, and so forth.
- *Multi-stakeholder initiatives*—Stakeholders from government, the private sector, international organisations, and civil society form norms through inclusive and deliberative processes.

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<sup>15</sup> International law is also known as public international law to distinguish it from private international law, which does not deal with relationships between states. See: Jonathan Law, *Oxford Dictionary of Law* (Oxford University Press, 8<sup>th</sup> ed, 2015) 333.

<sup>16</sup> Ibid.

<sup>17</sup> John McLaren, ‘The OECD’s ‘harmful tax competition’ project: Is it international tax law?’ (2009) 24 *Australian Tax Forum* 421, 430.

<sup>18</sup> Law, above n 15, 333.

<sup>19</sup> Johanna Martinsson, ‘Global Norms: Creation, Diffusion, and Limits’ (2011) *CommGAP Discussion Papers: the World Bank*, 2.

<sup>20</sup> Eric Lauterpacht, ‘The Inevitability of Change in International Law and the Need for Adjustment of Interests’ (1977) 51 *Australian Law Journal* 83, 84.

- *Global policy networks*—State and non-State actors jointly bring new issues and ideas into public discourse and complement policy making and international cooperation.
- *Transnational advocacy coalitions*—Non-State actors advocate norms through transnational campaigns and monitoring implementation.<sup>21</sup>

In the context of the OECD, legal norms are established through its pronouncements (legal norms setting). The following section will elaborate on how the process of legal norm setting takes place through the OECD pronouncements and how a legal norm can take the form of a custom and become legally binding.

### III GENERAL OBSERVATIONS REGARDING THE LEGAL STATUS OF THE OECD'S PRONOUNCEMENTS

According to the *Oxford Dictionary of Law* the term 'soft' law refers to:

*Guidelines of behaviours such as those provided by treaties not yet in force, resolutions of United Nations or international conferences, that are not binding in themselves but are more than statements of political aspirations. Soft law contrasts with hard law, i.e. those legal obligations, found either in treaties or customary international law that are binding in and of themselves.*<sup>22</sup>

*Black's Law Dictionary* refers to 'soft law' in similar terms:

1. *Collectively, rules that are neither strictly binding nor completely lacking in legal significance.*
2. *Guidelines, policy declarations or codes of conduct that set standards of conduct but are not legally binding.*<sup>23</sup>

Accordingly, 'soft law' refers to legal instruments which are not legally binding, or their binding force is weaker than the binding force of traditional law, often distinguished from 'hard law' because of its non-binding nature. Against this backdrop, the OECD Model Tax Convention, Commentaries and Guidelines can be considered to be soft law. These pronouncements are not meant to bind their members, let alone non-members which have not contributed to the formation of the contents of these pronouncements and do not have convention-based ties with this organisation. According to Article 5 of the Convention on the OECD:<sup>24</sup>

In order to achieve its aims, the organisation may:

- (a) Take decisions which, except as otherwise provided, shall be binding on all the Members;

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<sup>21</sup> Martinsson, above n 19, 3.

<sup>22</sup> Law, above n 15, 582.

<sup>23</sup> Bryan A. Garner (ed.), *Black's Law Dictionary*, (West Group Press, 8<sup>th</sup> ed, 2004), 1426.

<sup>24</sup> The Convention on the OECD (Paris, 14<sup>th</sup> December 1960) is, in fact, the constitution of the OECD and it should not be confused with the OECD Model Tax Convention.

- (b) Make recommendations to Members; and
- (c) Enter into agreements with Members, non-member States and international organisations.

Based on Article 5 of the Convention of the OECD it is clear that if the OECD seeks to require its members to be bound to follow a particular matter the OECD Council<sup>25</sup> may resort to a formal decision which is then obligatory on all member countries. However, this does not mean that the OECD's Model Tax Convention, Commentaries and Guidelines are totally without any legal weight for its Member States.<sup>26</sup> In other words, the fact that a particular measure or instrument is in itself not legally mandatory to its addressees does not mean it is without any legal consequence. When a State member thus refutes any import at all to each and every pronouncement issued by the OECD, it violates the legitimate expectations principle which is the basis of the international principles of estoppel and acquiescence.<sup>27</sup>

In this context, other Member States at least expect that a Member State shall give these pronouncements serious consideration.<sup>28</sup> In addition, the effectiveness of the international organisation is directly associated with the object and purpose of the convention founding it, as well as with the maxim *ut res magis valeat quam pereat*,<sup>29</sup> which is linked to the principle of good faith. This is to say that even the non-binding parts of the OECD pronouncements should not be ignored entirely.

In an article entitled "*The OECD's 'harmful tax competition' project: Is it international tax law?*", McLaren contends that the OECD makes soft international law and the norms made by this organisation are generally accepted by its member countries and even non-members as being part of the international tax law.<sup>30</sup> McLaren provides examples of a variety of the OECD policies and norms which have found their way into the Australian tax law and become part of the Australian domestic law, including: the OECD Model Double Taxation Agreement (DTA), Taxpayers Charter, Transfer Pricing Rules, Controlled Foreign Corporations (CFC), Foreign Investment Funds (FIF) and Transferor Trust Rules, the Non-deduction for bribes of foreign officials and Anti-Money Laundering and Counter Terrorist Financing Act 2007(Cth) and the Financial Action Task Force.<sup>31</sup> McLaren holds while these policies and norms are considered to be 'soft' international law, most of the OECD member countries are willing to follow many of the policies and norms developed by the OECD.<sup>32</sup>

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<sup>25</sup> Article 7 of the Convention on the OECD articulates: 'A Council composed of all the Members shall be the body from which all acts of the Organisation derive. The Council may meet in sessions of Ministers or of Permanent Representatives'.

<sup>26</sup> Edwin Van der Bruggen, 'The Power of Persuasion: Notes on the Sources of International Law and the OECD Commentary' (2003) 8/9 *Intertax* 229, 236. Available at: [http://www.dfdl.com/images/stories/The\\_Legal\\_Effects\\_of\\_the\\_OECD\\_Commentary\\_as\\_a\\_Non-Binding\\_Recommendation\\_Intertax\\_2003.pdf](http://www.dfdl.com/images/stories/The_Legal_Effects_of_the_OECD_Commentary_as_a_Non-Binding_Recommendation_Intertax_2003.pdf), last visited 3 December 2014.

<sup>27</sup> Estoppel and acquiescence, as two principles of international customary law, have emerged from the doctrine of legitimate expectation, which itself originates from English law.

<sup>28</sup> Van der Bruggen, above n 26, 242.

<sup>29</sup> Latin, meaning it is better for a thing to have effect than to be made void.

<sup>30</sup> McLaren, above n 17, 452.

<sup>31</sup> *Ibid* 439-45.

<sup>32</sup> *Ibid* 445.

The OECD member countries, in particular, are happy to adopt the OECD's pronouncements where these soft international laws directly assist them to be able to collect more revenue or safeguard existing revenue.<sup>33</sup> In the same vein, Christians maintains that although the OECD is not a supranational organisation, the harmful tax practice initiative demonstrates an area in which it has successfully formulated and disseminated tax norms that became law, within, and among, a number of States.<sup>34</sup>

The author, however, argues that in spite of its non-legally binding nature the contents of the OECD's Model Tax Convention, Commentaries and Guidelines might be, or become, binding either for member or non-member countries in several ways. In other words, there are some international law principles according to which the OECD pronouncements can be considered to have legitimising effects. In these cases the unilaterally practised norms by a country would not derive their binding force from the OECD pronouncement itself but, depending on particular conditions, they might be regarded as evidence of customary international law, estoppel or acquiescence. The following section will explain how the contents of some of the OECD pronouncements can be considered to be legally binding.

#### IV CUSTOMARY INTERNATIONAL LAW

Rules set out in the OECD's Model Tax Convention, Commentaries and Guidelines may be legally binding if they feature or are evidence of customary rules of international law. Customary international law can be defined as law that "results from a general and consistent practice of States followed by them from a sense of legal obligation".<sup>35</sup> In practice, some of the norms implied by the OECD's Model Tax Convention, Commentaries and Guidelines are consistently practised by many countries to such extent that it seems they are binding. However, whether one can term these norms as "customary international law" is a quite different issue. Some authors believe that these norms should be considered as customary international law.<sup>36</sup>

The founders of the International Court of Justice describe customary international law to be "international custom, as evidence of a general practice accepted as law."<sup>37</sup> Based on this definition, there are two prerequisites for a rule of customary international law:<sup>38</sup>

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<sup>33</sup> Ibid.

<sup>34</sup> Allison Christians, 'Hard Law and Soft Law in International Taxation' (2007) *University of Wisconsin Legal Studies Research Paper Series*, Paper No. 1049, 9.

<sup>35</sup> American Law Institute, *Restatement of the Law Third: The Foreign Relations Law of the United States* (1987), Sec. 102(2).

<sup>36</sup> See generally; Reuven S. Avi-Yonah, 'Tax Competition, Tax Arbitrage and the International Tax Regime' (2007) 61.4 *Bulletin for International Taxation* 130; Brian D. Lepard, 'Is the United States Obligated to Drive on the Right' (1999) 10 *Duke Journal of Comparative & International Law* 4.

<sup>37</sup> The Statute of the International Court of Justice, Article 38.

<sup>38</sup> Chantal Thomas, 'Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method' (1996) 14.99 *Berkeley Journal International Law* 99, 117. Electronic copy available at: <http://scholarship.law.berkeley.edu/bjil/vol14/iss1/2>, last visited 23 November 2014.

- 1 Practice requirement: The international law must be consistently practised by nations whose interests it clearly affects, with the tacit consent or acquiescence by those nations whose interests it does not;
- 2 Force of law requirement: The international law must carry the force of law. That is:
  - (a) States must clearly acknowledge an obligation to adhere to it; and
  - (b) A high probability of punitive action - which may include a wide range of negative responses - must attach to its violation by any State.

Practice shapes the foundation of customary international law, as without it the most highly practised legal norms cannot gain recognition as a binding rule of law. It is clear that a State's practice must be consistent and continuous in order to satisfy this constituent of customary international law. However, the other essential aspects of the "force of law requirement" remain ambiguous. In particular, much ambiguity concerns the required punitive action for non-compliance.

With regard to *opinio juris*, the International Court of Justice Statute defines customary international law in Article 38(1) (b) as "evidence of a general practice accepted as law".<sup>39</sup> There is no evidence to prove that these norms are "accepted as law". In addition, an essential element of custom, one of the four sources of international law as outlined in "the Statute of the International Court of Justice",<sup>40</sup> is that the custom should be regarded as State practice leading to a legal obligation, which distinguishes it from mere usage.<sup>41</sup>

Based on the above, it seems unconvincing to conclude that the force of law or *opinio juris* exists behind the OECD's pronouncements. It is comprehensively recognised that *opinio juris* refers to the sense of obligation that countries have towards an international rule which converts the rule into a law, as opposed to some other types of obligation such as motives of courtesy, fairness, or morality.<sup>42</sup> It is not true to say such an obligation exists for each and every country in the world. What is clear is that, to date, the universal sense of obligation to apply these norms as law is missing. This view is supported by Christians who observes that "the OECD's guidance seems to lack the general legal obligation (*opinion juris*) associated with customary law, because the guidance is by its terms commendatory rather than obligatory".<sup>43</sup>

The author is of the view that it is inaccurate to make a general comment regarding the legal status of the OECD. It is not true to say that the OECD pronouncements are entirely voluntary or they are entirely binding. In other words, while the OECD's Model Tax Convention, Commentaries and Guidelines lack the integral element for being termed as international customary law per se (that is *opinio juris*), under some particular situations, and in a case-by-case basis, the *opinio juris* or force of law is evident for certain countries. In these cases the norm in question will take the form of international customary law.

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<sup>39</sup> Website of International Court of justice, available at: <http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0>, last visited 25 November 2014.

<sup>40</sup> As stipulated by Chapter XIV of the United Nations Charter, 'The Statute of the International Court of Justice' is an important part of the United Nations Charter, which establishes the International Court of Justice.

<sup>41</sup> Law, above n 15, 435.

<sup>42</sup> Thomas, above n 38, 118.

<sup>43</sup> Christians, above n 34, 6.



Finally, in terms of punitive actions it is worth noting that some commentators believe that a common perception in international law is that the inclusion of punitive action into a definition of customary international law will destabilise much of what is now accepted as such.<sup>44</sup> The absence of punitive actions appears to stem mostly from the lack of effective enforcement of pronouncements that are regarded as international law.<sup>45</sup> Therefore, even though punishment of the transgressor is a well-established and an essential component in national legal systems, it is hardly articulated as an essential element of international law.<sup>46</sup>

In summary, from the perspective of customary international law it is difficult to prove that all countries are bound to follow the OECD's pronouncements in exactly the same way. But does it necessarily follow that these pronouncements should be considered as voluntary? In the following discussion, the author considers whether these norms might have binding effects on countries based on the principles of estoppel and acquiescence which are theoretically at least concepts of customary international law.<sup>47</sup>

## V ESTOPPEL AND ACQUIESCENCE

In some particular cases and over time some non-binding recommendations and norms can be regarded as a new source of international law. In this context, based on the general principles of international law and according to the settled case law of the International Court of Justice, countries which have voluntarily implemented or practised a norm over time can be held to have acquiesced to those norms and practices (*acquiescence*) and therefore, are legally bound to them. Actions inconsistent with acquiescence or tacit consent, in effect, can constitute the basis for legal claims. The Encyclopaedia of Public International Law describes acquiescence as: "... the far-reaching effect of creating legal obligation by silence and inaction which is an essential element in the promotion of stability in international relations, and is intended to prevent States from playing 'fast and loose' with situations affecting other States....".<sup>48</sup>

Yet, the important issue is that even though most authorities recognise that a country is not required to have explicitly consented to being bound by a rule of international law, almost all authorities agree that nations which object to one (or more) evolving rule of general customary international law can be exempted from its obligations.<sup>49</sup> This tolerance is known as the "persistent objector" exemption. The acceptance of the

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<sup>44</sup> Thomas, above n 38; Fernando Teson, *A Philosophy of International Law (New Perspectives on Law, Culture, and Society)* (Westview Press, 1<sup>st</sup> ed., 1998) 90. Teson believes that a customary norm is binding because it is the 'right, fair, or best rule'; J. L. Brierly, *The Basis of Obligation in International Law*, (Oxford, Clarendon Press, 1958). Brierly proposed that the obedience to a law is a moral matter: 'the ultimate basis of the obligation to obey the law cannot be anything but moral.' *Ibid*, 65.

<sup>45</sup> Thomas, above n 38, 120.

<sup>46</sup> *Ibid* 118.

<sup>47</sup> Sjoerd Douma and Frank A. Engelen, *Conflict of Norms in International Tax Law; the Legal Status of the OECD Commentaries* (IBFD, 1<sup>st</sup> ed., 2008) 29.

<sup>48</sup> Encyclopaedia of public international law, (Elsevier Science Publishers B.V 1981) 5. Electronic copy available from:

[http://samples.sainsburysebooks.co.uk/9781483257013\\_sample\\_815463.pdf](http://samples.sainsburysebooks.co.uk/9781483257013_sample_815463.pdf), last visited 20 November 2014.

<sup>49</sup> Thomas, above n 38, 118.

persistent objector is specifically due to the fact that custom eventually is contingent upon the consent of nations.<sup>50</sup> This principle is based on the fact that States are bound to a certain norm of international law through custom and action showing their obligation to be bound (*opinio juris*).

In contrast, while acquiescence is manifested by unilateral and voluntary conduct, estoppel (preclusion) is manifested by precluding the party which keeps silent towards a particular treatment of another party. In the context of cross-border taxation, estoppel can occur when one State keeps silent and does not protest against a regularly practised tax principle of another country. By tacitly recognising those practices, States are prevented (estopped) from later denying the legitimacy of such tax norm. This principle, which supplements *pacta sunt servanda*,<sup>51</sup> the keystone of international law obliging all States to maintain contractual obligations,<sup>52</sup> is known as estoppel. Estoppel is rising to the rank of one of the key general principles of law recognised by civilised nations.<sup>53</sup> It establishes one of the sources of international law under Article 38(l) (c) of the Statute of the International Court of Justice.

In terms of estoppel, there are two main categories of estoppel: equitable estoppel and legal estoppel. Each category of estoppel has different sub-categories.<sup>54</sup> The author will only focus on equitable estoppel, which protects one party from being harmed by another party's voluntary conduct. Voluntary conduct may include an action, silence, acquiescence, or concealment of material facts.

Equitable estoppel occurs when a State gives the impression of going along with a particular practice or rule (possibly by not protesting against it when it was convenient for the State to do so).<sup>55</sup> This State should not be permitted later to disavow the practice or the rule. The main question is whether equitable estoppel can be applied against the tax authorities of a State in a cross-border tax situation? In the literature there is little discussion on the application of estoppel in international taxation. However, there are a few arguments regarding the application of estoppel against governments in purely domestic cases, which are also helpful for the purpose of this study.<sup>56</sup> Generally, there are two main approaches towards this matter.

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<sup>50</sup> Ibid 116.

<sup>51</sup> Latin for 'agreements must be kept.'

<sup>52</sup> Phil C.W. Chan, 'Acquiescence/Estoppel in International Boundaries: Temple of Preah Vihear Revisited' (2004) 3 *Chinese Journal of International Law* 421, 424.

<sup>53</sup> Ibid.

<sup>54</sup> Franco Ferrari and Stefan Kröll (eds.), *Conflict of Laws in International Arbitration*, (European Law Publishers, 1<sup>st</sup> ed, 2011), 166.

<sup>55</sup> Anthony, D' Amato, 'Consent, Estoppel, and Reasonableness: Three Challenges to Universal International Law' (2010) *Northwestern University School of Law, Faculty Working Papers No. 102*, 8. Electronic copy available at: <http://scholarlycommons.law.northwestern.edu/facultyworkingpapers/102>, last visited 2 December 2014.

<sup>56</sup> E.g.: Dean R. Knight, *Estoppel (principles?) in public law: the substantive protection of legitimate expectations*, (Master Thesis in Law, the University of British Columbia, 2004); Alexandra O'Mara, 'Estoppel against public authorities: is Australian public law ready to stand upon its own two feet?' (2004) 42 *Australian Institute of Administrative Law Forum* 1; Renata Petrylaite, 'Can the doctrine of equitable estoppel be applied against a government?' (2004) 1.2 *International Journal of Baltic Law* 97.

### **A. THE TRADITIONAL APPROACH**

The traditional approach considers that the doctrine of equitable estoppel does not have any place in the areas of governments' relations with private entities due to three major factors, namely:

#### Protection of public interests

Governments act for the benefit of the public. The interests of the public will be served better if responsibilities and duties in areas such as taxation or police power are granted to the government. As a result, a government must benefit from certain immunities, one of which is immunity against estoppel, to make sure that public interests will not be damaged.<sup>57</sup>

#### Performance of governmental functions

Governments represent the State and its people. So that society can function properly certain duties and responsibilities have been assigned to the discretion of government. Only the government is responsible to impose additional taxes or cancel some of them, to develop infrastructure of the State and to exercise the police powers. Such spheres of social life are considered to be of vital significance. For that reason, governmental functions and the doctrine of sovereign immunity<sup>58</sup> are linked together, and when acting in governmental or sovereign capacity, the government should be immune from estoppel.<sup>59</sup>

#### Ultra vires conduct of governmental officers

When governmental agents act wholly beyond their power and authority, a government cannot be estopped. This is because the government cannot be able to secure perfect performance from all its numerous employees. It would be unfair to consider the government responsible for every misstatement of its agents as to do otherwise will waste public funds.<sup>60</sup>

### **B. The Modern Approach**

This approach tends to estop a government and maintains that one should not differentiate between private and governmental bodies in application of estoppel rules. According to this approach, estoppel as an equitable doctrine may concern itself with elemental fairness to the private citizens dealing with their governments. The arguments in favour of the application of the doctrine of equitable estoppel against governmental authorities are based upon some key factors, for instance:

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<sup>57</sup> Petrylaite, above n 57, 103–4.

<sup>58</sup> The doctrine of sovereign immunity is a legal doctrine which holds that a State or nation, as the case may be, possessed of its own independent powers, cannot be sued and therefore be made accountable to others for exercising those powers in an allegedly unlawful manner. See: State Sovereign Immunity: Melvyn R. Durchslag, A Reference Guide to the United States Constitution, (Praeger, 1<sup>st</sup> edn, 2002), 3.

<sup>59</sup> Petrylaite, above n 57, 101–3.

<sup>60</sup> Ibid 104–6.

(1) *Protection of private interests*

The interests of individuals dealing with the governmental agencies should be protected. The rule of no estoppel where public interests are concerned cannot protect the rights of individuals because sometimes the public interest itself requires estopping the government. Although, the public and private interests are closely interconnected, it is not always easy to make a distinction between them. Instead of striving to precisely draw the line between public and private interests it is more efficient to consider carefully what would be a fair and just solution to a particular problem and then employ the doctrine of equitable estoppel where justice demands it.<sup>61</sup>

(2) *Justice and fairness*

Another important consideration favouring estoppel against the government is justice and fairness. The very concepts of justice, equity and fairness are by themselves sufficient to balance the interests of public and private sectors.<sup>62</sup> Equitable estoppel, when applied to a particular situation, will ensure that both private and public interests are balanced and unnecessary harm to any of them is avoided.<sup>63</sup> Yet, the issue of estoppel against governments should be decided on a case-by-case basis involving investigating the circumstances precisely and applying only one test, a test of justice and fairness.<sup>64</sup>

(3) *Governmental agents acting intra vires*

There is a general rule in private law that a principal is bound by the acts of its agent. The same rule applies to the government. If its agents and officers act within the scope of their authority, the government is bound by such acts and representations and, consequently, it is estopped from denying the validity of such conduct.<sup>65</sup>

In Anglo-American domestic case law, particularly by studying the case law of Australia, New Zealand, the United Kingdom and the United States, it is difficult to arrive at a single answer to the dilemma posed by the question of whether estoppel should lie against public authorities in domestic cases. In brief, there is considerable inconsistency in looking at English and Australian courts and how they have dealt with estoppel against public authorities.<sup>66</sup> A proper balance needs to be struck between the rights of individuals and the free exercise of discretion by public authorities.<sup>67</sup> The overall approach in New Zealand has tended to place a greater emphasis on public bodies' obligations to protect expectations.<sup>68</sup> However, this approach has not been consistent or coherent through the range of cases.<sup>69</sup> The US case law seems to be more receptive towards the application of equitable estoppel to governmental authorities since the US courts are increasingly

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<sup>61</sup> Ibid 108–10.

<sup>62</sup> Ibid 112–13.

<sup>63</sup> Ibid 111–13.

<sup>64</sup> Ibid 113.

<sup>65</sup> Ibid 110–11.

<sup>66</sup> O'Mara, above n 57, 18.

<sup>67</sup> Ibid.

<sup>68</sup> Knight, above n 57, 55–63.

<sup>69</sup> Ibid.

willing to apply this doctrine to relations in which one party is a governmental entity.<sup>70</sup> Nevertheless, still many courts in the US, including the Supreme Court, are influenced by the traditional view<sup>71</sup> favouring the doctrine of sovereign immunity.

However, with regard to the application of estoppel against States at the international level, there is a little doubt. The International Court of Justice has clearly illustrated the fundamental elements required by estoppel in cross-border issues as "... a statement or representation made by one party to another and reliance upon it by that other party to his detriment or to the advantage of the party making it".<sup>72</sup> It is internationally accepted that estoppel is a general principle of international law leaning on principles of good faith and consistency.<sup>73</sup> The essence of estoppel is the element of conduct which leads to the reliance of the other party on that conduct, to detrimentally change its position or to bear some prejudice.<sup>74</sup> According to the Encyclopaedia of Public International Law, estoppel requires that:<sup>75</sup>

*The party invoking estoppel must have been induced to undertake legally relevant action or abstain from it by relying in... good faith upon clear and unambiguous representations by the other State. Reliance must prejudice the addressee, i.e., subsequent deviation from the original representation must cause damage to the relying State, or result in advantages for the representing State. The typical effect of the doctrine is that, under such requirements, a representing party is barred ("estopped" or "precluded") – without regard to truth or accuracy – from adopting successfully different subsequent statements on the same issue.<sup>76</sup> Clear and unequivocal representation, prejudice and detriment are not simply addenda; they trigger the very justification for specific protection of settled expectations.*

In cross-border tax matters, this principle of international law signifies that a State may be precluded from applying an act to taxpayers once it has exercised its determination as to how the taxing statute should be applied to a particular set of facts, so it can be precluded from doing so a second time and in a different manner. In other words, generally, where a State has made a misrepresentation of fact upon which taxpayers have detrimentally relied, the State will be precluded from acting differently in the future according to these principles of international law. So, in this context, either the OECD Member States or non-member States are bound to those comprehensively practised rules of the OECD.

Nevertheless, it should be noted that estoppel and acquiescence are two different notions. The International Court of Justice in the *Gulf of Maine Area (Canada v. United States)*<sup>77</sup>

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<sup>70</sup> Petrylaite, above n 57, 113.

<sup>71</sup> Ibid.

<sup>72</sup> International Court of Justice Reports 1990, 118.

<sup>73</sup> Megan L. Wagner, 'Jurisdiction by Estoppel in the International Court of Justice' (1986) 74 *California Law Review* 1777, 1778.

<sup>74</sup> Ian Brownlie, *Principles of Public International Law* (Clarendon Press, 5<sup>th</sup> ed, 1998) 646.

<sup>75</sup> Encyclopaedia of Public International Law, above n 23, 116.

<sup>76</sup> Ibid 117.

<sup>77</sup> Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada v. United States of America), International Court of Justice Reports 1984, 246.

clearly distinguished between acquiescence and estoppel. According to the International Court of Justice:

*The concepts of acquiescence and estoppel, irrespective of the status accorded to them by international law, both follow from the fundamental principles of good faith and equity. They are, however, based on different legal reasoning, since acquiescence is equivalent to tacit recognition manifested by unilateral conduct which the other party may interpret as consent, while estoppel is linked to the idea of preclusion.*<sup>78</sup>

Article 38(1) of the Statute of the International Court of Justice identifies the typical sources of international law. Among them, the Court acknowledges the applicability of general principles of law and equity. In equity, one of those principles is estoppel. Estoppel pervades the international law system through the use of the general principles of law to solve international conflicts.<sup>79</sup> Estoppel seeks to give substantive protection to people's expectations arising from their dealings with public bodies and officials.<sup>80</sup> Today there can be no doubt that the doctrines of acquiescence and estoppel are significantly operating in international law.<sup>81</sup>

Whether or not countries accept estoppel and acquiescence in their domestic law, many international authorities have already considered acquiescence and estoppel as general principles of international law originating from the principles of good faith and equity in general and the related conception of protection of legitimate expectations in particular. For instance, the World Trade Organisation (WTO) Panel, in *Guatemala — Cement II*,<sup>82</sup> appears to have recognised the notion of international estoppel and dealt with it accordingly. In this case, Guatemala claimed that Mexico was estopped from alleging certain violations of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (Anti-Dumping Agreement),<sup>83</sup> because Mexico had not made these allegations at the earliest opportunity. In defining estoppel, the WTO Panel stated that 'where one party has been induced to act in reliance on the assurances of another party, in such a way that it would be prejudiced were the other party later to change its position, such a change in position is "estopped", that is precluded.'<sup>84</sup>

In addition, the International Court of Justice has applied these notions where States have voluntarily made a clear and unambiguous statement upon which another State has detrimentally relied.<sup>85</sup> The doctrine has historically been reflected in the jurisprudence of

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<sup>78</sup> International Court of Justice Reports 1984, 305.

<sup>79</sup> Jessica M. Guevara, 'Equity in MERCOSUR: The use of Estoppel in a Customs Union Created for and by Countries of the Civil System of Law' (2014) 20 *Law and Business Review of the Americas* 303, 303.

<sup>80</sup> Knight, above n 57, ii.

<sup>81</sup> Frank Engelen, 'Some Observations on the Legal Status of the Commentaries on the OECD Model' (2006) *Tax Treaty Monitor* 105, 106.

<sup>82</sup> *Guatemala — Definitive Anti-Dumping Measures on Grey Portland Cement from Mexico*, WTO Doc WT/DS156/R (24 October 2000) (Report of the Panel) ('*Guatemala — Cement II*').

<sup>83</sup> Marrakesh Agreement Establishing the World Trade Organization, opened for signature 15 April 1994, 1876 UNTS 3 (entered into force 1 January 1995), annex 1A (Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994) 1868 UNTS 201.

<sup>84</sup> However, the WTO Panel rejected Guatemala's claim of estoppel since Mexico was under no obligation to object immediately to the violations.

<sup>85</sup> Wagner, above n 75, 1803–4.



the Court,<sup>86</sup> for instance, in *Eastern Greenland*,<sup>87</sup> the *Fisheries Case*,<sup>88</sup> the *Temple Case*<sup>89</sup> and the *Nuclear Tests Case*.<sup>90</sup>

## VI HOW CAN CUSTOMARY INTERNATIONAL TAX LAW BE ENFORCED?

One may question whether international tax law is a fully-fledged concept. If so, how national tax authorities can, in practice, be compelled to comply with these unwritten international tax rules where they are not explicitly set out in any treaty. This important question is not only peculiar to the enforcement of international tax law. It is “an old and rather tiresome matter in international law”,<sup>91</sup> not only because it is asked so frequently, but also because of the crucial assumption it contains; the assumption that international law cannot be enforced.<sup>92</sup> This problem becomes more serious, especially for a country with a dualistic method. It is worth noting that the enforcement of international tax law is a broad area of study which involves different areas of law including international law, tax law and administrative law, among others. However, I will briefly consider the main issues surrounding the implementation of customary international tax law.

At this point, it needs to be explained that from the perspective of domestic law, international law only becomes mandatory within its own national legal order under the rules and circumstances it determines, such as, a State’s constitution. In this respect, a distinction is usually made between *monism* and *dualism*. These terms are meant to describe two different theories of the relationship between international law and domestic law. There are two ways in which international law can become part of a State’s national law: either due to the operation of incorporation, a monist approach, or by transformation, a dualist approach.<sup>93</sup> In a monist system treaties can become law without incorporation, given their provisions are regarded to be adequately self-explanatory.<sup>94</sup> This approach holds that international law is part of a nation's law and that international law has priority.<sup>95</sup> The theory of monism is based on the doctrine of incorporation of international law.<sup>96</sup> According to this doctrine a specific rule of international law becomes part of the domestic law without the need for express adoption of that rule.<sup>97</sup> In other words, the international law is said to be self-executing.<sup>98</sup> Consequently, the national

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<sup>86</sup> Ibid.

<sup>87</sup> Denmark v. Norway, 1933 P.C.I.J. (ser. A/B) No. 53 (April 5).

<sup>88</sup> UK v. Norway, 1951 I.C.J. 116 (Dec. 18).

<sup>89</sup> Cambodia v. Thailand, 1962 I.C.J. 6 (June 15).

<sup>90</sup> Australia v. France, 1974 I.C.J. 253 (Dec. 20).

<sup>91</sup> Frederic L. Kirgis, ‘Enforcing International Law’ (1996) 1 American Society of International Law Newsletter (ASIL), 165. Electronic Copy available from: <http://www.asil.org/insights/volume/1/issue/1/enforcing-international-law> last visited 6 December 2014

<sup>92</sup> Ibid.

<sup>93</sup> John McLaren, above n 17, 437.

<sup>94</sup> Anthony Aust, *Modern Treaty Law and Practice*, (Cambridge University Press, 3<sup>rd</sup> ed., 2007) 147.

<sup>95</sup> John McLaren, above n 17, 437.

<sup>96</sup> John Gillespie and Pip Nicholson, *Asian Socialism and Legal Change: The Dynamics of Vietnamese and Chinese Reform*, (the Australian National University (ANU) Press, 1<sup>st</sup> ed, 2005) 299.

<sup>97</sup> Ibid 300.

<sup>98</sup> Ibid.

courts are required to apply a certain rule of international law even if there is no explicit contradicting piece of law or judgment.

Differently from monism, dualism is based on the theory of transformation. The doctrine of transformation states that, rules of international law do not become part of national law until they have been expressly adopted by the State.<sup>99</sup> The difference between the incorporation and transformation doctrines is that the incorporation doctrine suggests adoption of international law into national law because it is international law, while the transformation theory necessitates an express act on the part of the State concerned. It is to be determined by the national law of concerned countries, usually their constitutions, whether to adopt the incorporation or transformation doctrine. Dualists emphasise the distinction between national and international law, and require the translation of international law into domestic law. International law does not exist as law if this transformation does not take place. International law must be national law too; otherwise, it is not law. In some countries, such as the Netherlands and France the monist approach prevails. In a minority of nations led by the United Kingdom, and most nations of the Commonwealth, a transformation approach is adopted and the dualist view is prevalent.<sup>100</sup> In this context, international law can be considered as national law only when it is translated in their national law. In Australia, for instance, international agreements only become part of the Australian domestic law once the Australian Parliament has 'transformed' the international law into Australian law.<sup>101</sup> There is no automatic incorporation of international law into Australian domestic law.<sup>102</sup> A mixed monist-dualist mechanism is being used in the United States. International law applies directly in United States courts in some cases. In implementing international law in national law, most States are to some extent monist and somewhat dualist.<sup>103</sup>

I return to the question posed at the beginning of this discussion as to how national tax authorities can be forced to follow the customary international tax rules. Practically, according to the general rules of international law, whenever there is no overarching authoritative law enforcer, such as an International Tax Organisation (ITO),<sup>104</sup> to enforce particular international rules, consequences for non-compliance will operate in different

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<sup>99</sup> Ibid 301-2.

<sup>100</sup> Ibid 301.

<sup>101</sup> John McLaren, above n 17, 437.

<sup>102</sup> Ibid.

<sup>103</sup> Lanre Adedeji, 'the Application of International Law in Domestic Courts', available online from: <http://thelawyerschronicle.com/the-application-of-international-law-in-domestic-courts/>, last visited 27 November 2014.

<sup>104</sup> See; e.g. Adrian Sawyer, *Developing a World Tax Organisation: The Way Forward* (Fiscal Publication, 1<sup>st</sup> ed. 2009); Dale Pinto, 'A Proposal to Create a World Tax Organisation' (2003) 9 *New Zealand Journal of Tax Law and Policy* 145; Vito Tanzi, *Taxation in an Integrating World, Integrating National Economies Series* (Washington, DC: Brookings Institution, 1<sup>st</sup> ed, 1995).

ways. In this situation common legal tactics that can be used include reciprocity,<sup>105</sup> collective action,<sup>106</sup> and shaming,<sup>107</sup> by other States against a Transgressor State.<sup>108</sup>

Apart from these general punitive mechanisms, regional trade organisations may also play a significant role to ensure the effective compliance of customary international law. For instance, the European Union (EU) law strictly requires all the EU Member States to adhere to customary international law. Customary international law is considered as a limit on State jurisdiction and powers. No derogation from a customary international rule on the ground of the public policy is permitted.<sup>109</sup> The European Court of Justice has for many years taken rules of customary international law into account.<sup>110</sup> Provisions of EU legislation have to be interpreted, and their scope limited, in accordance to the relevant rules of customary international law.<sup>111</sup> The national courts within the EU jurisdiction have explicitly relied on customary international law to test the validity of national law actions and even the rules of EU institutions.<sup>112</sup>

Some authors have argued that existing organisations are able to enforce and monitor the application of cross-border tax rules. Slemrod and Avi-Yonah suggest that the WTO is probably an appropriate organisation to rely upon for this task especially because it has a developed decision making mechanism.<sup>113</sup> Avi-Yonah considers the WTO as an appealing candidate for ITO since it has a much broader membership than any other organisation and because developing countries are much better represented.<sup>114</sup> Brauner believes that the OECD is the best organisation for this as it has proven expertise in tax.<sup>115</sup> Some other scholars have advocated for a stand-alone international tax body, since the OECD and the WTO, among other international organisations, do not have the necessary attributes, expertise or core objectives that would enable incorporation of an ITO within themselves.<sup>116</sup>

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<sup>105</sup> Reciprocity is a type of enforcement by which states are assured that if they violate a rule in detriment of another State; the other State will react by returning the same conduct.

<sup>106</sup> Through collective action, some countries act collectively to produce a punitive outcome against the Transgressor State.

<sup>107</sup> The risk of shaming a State with public statements concerning their violating conduct is an effective enforcement mechanism.

<sup>108</sup> International Law and Organizations (Carnegie Project, University of North Carolina Wilmington), at 4–5. An electronic Copy is also available from: <http://www.csb.uncw.edu/people/eversp/classes/BLA361/Intl%20Law/Required%20Readings/1.International%20Law%20&%20Organizations.Globalization%20101.Carnegie%20Project.pdf>, last visited 20 December 2014.

<sup>109</sup> Jan Wouters and Dries Van Eeckhoutte, 'Giving Effect to Customary International law through European Community Law', *Institute for International Law*, Working Paper No 25 (2002) 7–11.  
<sup>110</sup> Ibid 3–6.

<sup>111</sup> Case C-286/90, *Anklagemyndigheden v. Peter Michael Poulsen and Diva Navigation Corp.* [1992] European Court Reports (hereinafter ECR) I-6019. In this case, the European Court of Justice for the first time clearly maintains that 'the European Community must respect international law in the exercise of its powers'.

<sup>112</sup> Case T-115/94 *Opel Austria GmbH v Council* [1997] ECR II-39; Case C-162/96 *Racke v Hauptzollamt Mainz* [1998] ECR I-3655.

<sup>113</sup> See; Joel Slemrod and Reuven Avi-Yonah, '(How) Should Trade Agreements deal with Income Tax Issues?' (2002) 55 *Tax Law Review* 533.

<sup>114</sup> See; Reuven Avi-Yonah, 'Bridging the North-South Divide, International Redistribution and Tax Competition', (2004). 26 *Michigan Journal of International Law* 371.

<sup>115</sup> Brauner, above n 9, 316.

<sup>116</sup> See Wouters and Dries Van Eeckhoutte (2002) above n 109.

## VII CONCLUSIONS AND THOUGHTS FOR THE FUTURE

On the foregoing analysis, the OECD's Model Tax Convention, Commentaries and Guidelines do not bind their members, let alone non-members. In the context of international taxation, some commentators, such as McLaren and Christians, have contended the OECD policies and norms may constitute parts of international soft law. However, it was argued in this article that the unilateral practice of the OECD norms by countries may have binding effects on them. This legitimising effect would not derive its force from the OECD's pronouncements themselves but, based on particular conditions, they might be regarded as evidence of customary international law (estoppel or acquiescence). In addition, the traditional view which suggests that the OECD's pronouncements are entirely voluntary is an inaccurate perception. In other words, on a case-by-case basis, the *opinio juris* or force of law might be evident for certain countries following the OECD's Model Tax Convention, Commentaries and Guidelines. Nevertheless, the main concern is over the effective enforcement of customary international law in the area of taxation. It is doubtful if the power of customary international law is truly adequate to compel national tax authorities, especially in dualistic countries, to comply.

As observed, there is no doubt that the OECD pronouncements in certain situations can rise to the level of "custom", which is recognised as one of the main sources of international law. However, to effectively enforce these customs, it seems that new measures should be offered, whether in the form of creation of a new enforcement body such as an ITO, or in the form of giving the required mandate to one of the existing organisations such, as the OECD or the WTO. Another effective way to successfully enforce cross border customary tax rules enshrined in the OECD pronouncements is to draw attention to the significant role of regional trade organisations.<sup>117</sup>

In order to see how the enforcement of customary international rules can be handled effectively, a good place to start looking for ideas could be the legal systems of regional trade organisations, especially, the EU. Application of estoppel and acquiescence in domestic law is also another interesting topic for future research. In addition, the same investigations made in this study as regards the legal status of the OECD can be performed in respect to the United Nations Model Tax Convention. But all of these areas are topics for future research.

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<sup>117</sup> E.g. the ASEAN Free Trade Agreement (AFTA), European Union (EU), and North American Free Trade Agreement (NAFTA).