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FOREWORD

DIANE KRAAL AND KEN DEVOS

The articles included in this edition of the Journal of the Australasian Tax Teachers Association (JATTA) were presented at the 30th Annual Conference of the Australasian Tax Teachers Association (ATTA) in Melbourne, Australia. The 2018 ATTA conference was held 17–19 January 2018 and hosted by Monash University at our Caulfield campus.

The theme of the 2018 ATTA conference was ‘Sharing the Burden – Tax Reform’s Shifting Winners and Losers’, and many of the papers presented at the conference reflected the importance of what we do as both tax teachers and research academics. Several of the articles in this edition of JATTA relate to the conference theme and highlight the importance of our work in critiquing and challenging both national and international tax developments.

We were particularly pleased by the participation of academics from Indonesia, Malaysia, India, Botswana, Canada and the UK, as well as our New Zealand and Australian colleagues. We had a strong contingent of PhD student presenters, who are the future of our tax community.

Plenary presentations at the conference were given by The Honourable Justice Pagone (Federal Court of Australia), Paul Drum (Head of Policy, CPA Australia), Andrew Mills (Law Design and Practice, Australian Taxation Office) and Ali Noroozi, (Inspector-General of Taxation, Australian Government). We thank them for their contributions and insightful reflections and commentary on tax issues that affect us all.

We thank Editor-in-Chief Professor Dale Pinto for his generous offer of guidance and support. We also thank all the authors who submitted their articles to JATTA 2018. Thank you also to the reviewers of articles for their contribution and support of JATTA.

*Diane Kraal and Ken Devos
Monash Business School, Monash University
20 July 2018*

PROPERTY TAXES AS A POLICY RESPONSE TO FOREIGN INVESTMENT AS A PERCEIVED CAUSE OF HOUSING UNAFFORDABILITY

JONATHAN BARRETT*

ABSTRACT

Housing is commonly unaffordable in the world's most successful cities, including Auckland, Hong Kong, Melbourne, Singapore, Sydney and Vancouver. Both real property ownership and renting in these cities lies beyond the means of many residents, especially young adults working in metropolitan central business districts. In extreme, but not uncommon cases, unaffordability of accommodation leads to homelessness. Conversely, investment properties may be left vacant. Foreign investors are commonly blamed for exacerbating housing unaffordability, and taxes have been raised to remedy this perceived mischief. Drawing initiatives introduced by jurisdictions around the Pacific Rim, this article considers behaviour-modifying property taxes as a policy response to the perceived exacerbating effect of foreign investment on housing unaffordability.

* School of Accounting and Commercial Law, Victoria University of Wellington. Contact: Jonathan.Barrett@vuw.ac.nz. I would like to thank the anonymous reviewer whose recommendations greatly improved this article. Any remaining errors are mine alone.

I INTRODUCTION

The world's most successful cities 'face extraordinarily high and increasingly unaffordable housing prices'.¹ In analysing the conditions of this 'new urban crisis', Richard Florida specifically has United States cities in mind, but similar observations can be made about major Australasian cities, including Auckland, Melbourne and Sydney, and locations in the wider Pacific Rim, such as Hong Kong, Singapore and Vancouver. Residential property ownership in these, some of the world's most liveable cities,² has become unaffordable for many residents, especially the young.³ Furthermore, renting decent accommodation lies beyond the means of many working people.⁴ In extreme, but not uncommon, cases, unaffordability of accommodation leads to homelessness.⁵ Conversely, if foreign buyers and speculators treat housing as an investment asset, rather than a place to live, not only may prices increase but residential properties may be left vacant.

As homeownership rates fall because of housing unaffordability, increasing numbers of people are excluded from the benefits of owner-occupation. They do not enjoy the welfare advantages arising from the owned home as a shelter from the market.⁶ Due to relatively weak tenancy protections in Australia and New Zealand, they are denied the psychological benefits that security of tenure provides.⁷ Tenure insecurity is an element of multifactorial poverty,⁸ and is thought to have particularly deleterious effects on children.⁹ Furthermore, certain tax benefits, such as capital gains tax (CGT) concessions and local rates relief, can only be claimed by property owners.

Gentrification and pricing-out of long-term residents by well-paid new arrivals, as seen in the extreme example of San Francisco,¹⁰ are thought to stoke urban unaffordability. Furthermore, the emergence of the sharing economy, manifest in the Airbnb

¹ Richard Florida, *The New Urban Crisis: How Our Cities Are Increasing Inequality, Deepening Segregation, and Failing the Middle Class – And What We Can Do About It* (Basic Books, 2017) 6.

² See Economist Intelligence Unit, *The Global Liveability Report 2017* (2017) <https://www.eiu.com/public/topical_report.aspx?campaignid=liveability17>; Mercer, *2017 Quality of Living Rankings* (2017) <<https://mobilityexchange.mercer.com/Insights/quality-of-living-rankings>>.

³ See, for example, Shamubeel Eaqub and Selena Eaqub, *Generation Rent: Rethinking New Zealand's Priorities* (Bridget Williams Books, 2015).

⁴ When people in jobs as socially respected as nursing and teaching risk homelessness, Florida's claims for a new urban crisis seem pressingly plausible. See Barbara Ellen, 'If Our Nurses Are Homeless, We've Crossed the Line', *The Guardian* (United Kingdom), 17 December 2017, 15.

⁵ See, for example, Felicity Prance and Andrew Beer, 'Affordable Housing and Homelessness: The Link for Local Government' (2013) 26(9) *Parity* 26.

⁶ See Tony Fahey and Michelle Norris, 'Housing' in Herbert Obinger et al (eds), *The Oxford Handbook of the Welfare State* (Oxford University Press, 2010) 479, 491.

⁷ Dan Andrews and Aida Caldera Sánchez, 'The Ownership of Homeownership Rates in Selected OECD Countries: Demographic and Policy Influence' (2011) *OECD Journal: Economic Studies* 207, 210–11.

⁸ See Human Development Reports, United Nations Development Programme, *Multidimensional Poverty Index (MPI)* (2016) <<http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi>>; Ministry of Social Development, *The Social Report 2016* (2016) 15 <<http://socialreport.msd.govt.nz/documents/2016/msd-the-social-report-2016.pdf>>.

⁹ Andrews and Sánchez, above n 7, 210–11.

¹⁰ See Rebecca Solnit, *Hollow City: The Siege of San Francisco and the Crisis of American Urbanism* (Verso, 2002).

phenomenon, is commonly blamed for a shrinking supply of long-term tenancies in tourist-destination cities. But, in a globalised economy, investment in residential property by non-residents is widely perceived to be a principal cause of housing unaffordability for residents of the most desirable cities. This perception appears to attract most attention from tax policy and lawmakers. Taxes are commonly proposed as ‘silver bullet’ solutions to urban housing problems.¹¹ They are not, but may help to alleviate these problems in various ways. Property taxes, which were traditionally revenue-raising instruments, may be used to modify behaviour. For example, high levels of stamp duty may be introduced to discourage non-resident investors and speculators.

This article explores the use of property taxes, mostly at a subnational level, to influence the behaviour of foreign investors in order to promote housing affordability. These taxes may also seek to modify the behaviour of domestic speculators and property owners granting short-term Airbnb leases. Regulatory taxes do, of course, have a revenue element but are distinguished by an express purpose of modifying taxpayer behaviour. Windfall taxes, including traditional betterment taxes,¹² value capture levies,¹³ or tax increment financing,¹⁴ will not therefore be considered in this article, as they are principally revenue-raising instruments.¹⁵ After this introduction, the article identifies what housing unaffordability means, and considers its causes. The article then reviews property tax measures introduced around the Pacific Rim to cool residential housing markets and thereby promote affordability. The principal research aim of this article is to assess whether these taxes have been effective, and to consider whether other measures would be preferable.

II HOUSING UNAFFORDABILITY: ITS CAUSES AND CONSEQUENCES

This part of the article defines housing unaffordability, and considers its causes.

A What is housing unaffordability?

A universally shared vision, expressed in the United Nations *New Urban Agenda*, includes ‘just, safe, healthy, accessible, *affordable*, resilient and sustainable cities’.¹⁶ But, reflecting ‘the accelerating trend of housing-related household expenses rising faster than salary and wage increases in many urban centres around the world’, a global urban housing affordability crisis is evident.¹⁷ A broadly used measure of affordability is the ratio of

¹¹ See Jonathan Barrett, ‘A Property Transfer Tax is Not a “Silver Bullet” for Housing Affordability in Auckland’ (2016) 101 *Taxation Today* 4.

¹² See Patrick Fensham and Brendan Gleeson, ‘Capturing Value for Urban Management: A New Agenda for Betterment’ (2003) 21(1) *Urban Policy and Research* 93.

¹³ See Rob Dossor, Parliament of Australia, *Financing Infrastructure by Value Capture* <http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook45p/ValueCapture>.

¹⁴ See David Schleicher, ‘City Unplanning’ (2013) 122 *Yale Law Journal* 1670.

¹⁵ Andrew Coleman and Arthur Grimes, ‘Betterment Taxes, Capital Gains and Benefit Cost Ratios’ (2010) 109 *Economic Letters* 54.

¹⁶ See United Nations, *New Urban Agenda* (2016) 5 <<http://habitat3.org/wp-content/uploads/NUA-English.pdf>> (emphasis added).

¹⁷ Steffen Wetzstein, ‘The Global Urban Housing Affordability Crisis’ (2017) 54(14) *Urban Studies* 3159, 3159.

median house price to median income ('the Median Multiple'). This ratio is a 'driving force indicator' for states in terms of the United Nations Commission on Sustainable Development Agenda 21,¹⁸ and is considered by the World Bank to be '[p]ossibly the most important summary measure of housing market performance, indicating not only the degree to which housing is affordable by the population, but also the presence of market distortions.'¹⁹ Nevertheless, because methodological flaws in the Median Multiple have been shown, particularly as used by the widely cited Demographia surveys,²⁰ it should be considered illustrative, rather than authoritative.

According to the International Monetary Fund, New Zealand has the most extreme Median Multiple.²¹ Traditionally the country's ratio was around 3:1, but had risen in the major markets to a ratio of 8.8:1 by 2017.²² The corresponding ratio for Australia was 6.6:1.²³ (A Median Multiple of 3:1 indicates affordability, whereas a ratio in excess of 5:1 indicates severe unaffordability.²⁴) Even with a more favourable national ratio, domestic properties in major Australian cities are extremely unaffordable. Indeed, Sydney is reportedly second only to Hong Kong as the world's most unaffordable city.²⁵

Steffen Wetzstein observes 'a considerable number of homeowners, investors and speculators have materially benefited from these conditions'.²⁶ In Australia, despite a significant fall in the last decade, 'overall household ownership rates ... have not changed substantially since the 1960s, hovering around 70 per cent over the past 50 years'.²⁷ Indeed, for many older Australasians, homeownership has been a lucrative investment: for example, between 2014 and 2017, the average Auckland house price increased by 46 per cent.²⁸ However, for younger adults, ownership rates have fallen considerably. In

¹⁸ See Voula Mega, 'Urban Dimensions and Sustainable Development' in Saskia Sassen (ed), *Human Development* (Eoloss Publishers, 2009) vol 4, 1, 32.

¹⁹ Caroline Moser, Michael Gatehouse and Helen Garcia, *Urban Management and Poverty Reduction: Urban Poverty Research Sourcebook* (1996) <<http://documents.worldbank.org/curated/en/816091468331864427/text/484110WP0v20ur10Box338903B01PUBLIC1.txt>>.

²⁰ Peter Phibbs and Nicole Gurran, 'Demographia Housing Affordability Surveys: An Assessment of the Methodology' (Shelter Brief 35, Shelter NSW, Sydney, October 2008) <<https://shelternsw.org.au/sites/shelternsw.org.au/files/public/documents/rpt08demographia-sb35.pdf>>.

²¹ International Monetary Fund, *Global Housing Watch* (2017) <<http://www.imf.org/external/research/housing>>.

²² Demographia, *14th Annual Demographia International Housing Affordability Survey: 2018, Rating Middle-Income Housing Affordability* (2018) <<http://www.demographia.com/dhi.pdf>>.

²³ Ibid.

²⁴ Ibid.

²⁵ Melissa Davey, 'Housing "Severely Unaffordable" as Sydney Price to Income Ratio Worsens', *The Guardian* (online), 25 January 2016 <<https://www.theguardian.com/money/2016/jan/25/housing-severely-unaffordable-as-sydney-price-to-income-ratio-worsens>>.

²⁶ Wetzstein, above n 17, 3159.

²⁷ Parliament of Australia, Parliamentary Library, *Trends in Home Ownership in Australia: A Quick Guide* (28 June 2017) <https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1617/Quick_Guides/TrendsHomeOwnership> (emphasis added).

²⁸ See Auckland Council, *Updated Auckland Property Values Available* (2017) <<http://ourauckland.aucklandcouncil.govt.nz/articles/news/2017/11/45-per-cent-average-increase-for-auckland-properties>>.

Australia of the early 1960s, homeownership among the 35–44 age group was 72 per cent, the same as the rate for the overall population; by 2011, while the overall rate had fallen to 67 per cent, the rate for those aged 35–44 had fallen to 64 per cent.²⁹ In comparison, over the same period the rate for people older than 65 dropped only marginally from 81 per cent to 79 per cent, whereas the rate for those aged 25–34 fell dramatically from 60 per cent to 47 per cent.³⁰

In New Zealand, where owner-occupation has fallen in recent years, Māori and Pacific peoples experience exclusion more than others. In 1986, the overall homeownership rate was 75.2 per cent (78.9 per cent for Europeans, 53.9 per cent for Māori and 50.8 per cent for Pacific people) but had fallen to an overall rate of 63.7 per cent in 2013 (70.1 per cent for Europeans, 43.1 per cent for Māori, and 33.1 per cent for Pacific people).³¹

B Why is residential property unaffordable?

This section considers possible causes of housing unaffordability in Australasian cities.³²

1 Demand outstrips supply

An abnormally high Median Multiple may indicate ‘severe supply-side restrictions’.³³ Overall, Australia and New Zealand have fewer dwellings per capita relative to other Organisation for Economic Co-operation and Development (OECD) members.³⁴ However, since overall homeownership has been fairly stable for decades, it may be inferred that the market traditionally satisfies the demands of the majority of consumers of private housing. The current shortage of affordable housing is disproportionately experienced by the young and lower-income groups seeking accommodation in the inner and middle ring suburbs of the major cities.³⁵ This phenomenon can be seen as a consequence of the economic success of Auckland, Melbourne, Sydney, and other cities. Non-tax factors that cause demand to outstrip supply include prolonged economic growth and low interest rates; strong population growth led by immigration; and service jobs being created in metropolitan central business districts.³⁶ The obvious policy response, albeit one that is problematic and only fully realisable in the long-term,³⁷ is to build or encourage

²⁹ Parliamentary Library, above n 27.

³⁰ Ibid. Increasing levels of student debt may be a significant barrier to young people accumulating sufficient savings for a loan deposit. See Sarah Holder, ‘How Student Loans Are Killing Homeownership’, *CityLab* (25 January 2018) <https://www.citylab.com/equity/2018/01/student-loans-are-killing-homeownership/551300/?utm_source=citylab-daily&silverid=Mzc5OTAzNjk3NTA1S0>.

³¹ Alan Johnson, Philippa Howden-Chapman and Shamubeel Eaqub, *A Stocktake of New Zealand’s Housing* (New Zealand Government, 2018) 15.

³² For a discussion of the concept of affordable housing, specifically in an Australian context, see Peter Abelson, ‘Affordable Housing: Concepts and Policies’ (2009) 28(1) *Economic Papers* 27.

³³ Moser et al, above n 19.

³⁴ See OECD, *HM1.1 Housing Stock and Construction* (2017) <<http://www.oecd.org/els/family/HM1-1-Housing-stock-and-construction.pdf>>.

³⁵ John Daley, ‘Look to Sydney on Affordable Housing’, *The Age* (Melbourne), 5 March 2018, 19.

³⁶ Ibid.

³⁷ See, for example, New Zealand Productivity Commission, *Housing Affordability Inquiry* (March 2012) <https://www.productivity.govt.nz/sites/default/files/Final%20Housing%20Affordability%20Report_0_0.pdf>.

construction of denser housing in the urban areas where people need to live.³⁸ However, the model developed by Ben Phillips and Cukkoo Joseph indicates that Australia has a surplus of housing, even in the inner-cities.³⁹ Supply-solutions can only be effective, therefore, if people can afford the houses that are actually built.⁴⁰ In this regard, Steven Rowley et al argue:

The housing market is simply unable to deliver housing that is affordable to those on lower (and, increasingly, moderate) incomes because there is a minimum cost of delivering housing that meets minimum community standards. This is made up of the land price, the physical construction costs of the dwelling, and the profit required for taking on the development risk.⁴¹

2 Policy settings

The Henry Report noted that 'Government policies have traditionally treated owner-occupied housing as a preferred housing tenure.'⁴² John Daley et al identify four policy settings that for decades have stoked demand for homeownership in Australia. These are: exemption of the family home from the capital gains tax (CGT) net, and non-taxing of imputed rents; exclusion of the family home from Age Pension asset tests; exemption of residential property from state land taxes; and government assistance to first-home buyers.⁴³ As Peter Davidson and Ro Evans observe, negative gearing and CGT concessions 'encourage over-investment in existing properties and expensive inner city apartments which lift housing prices and does little to promote construction of affordable housing.'⁴⁴ These policy preferences do not only have deleterious social and economic effects, they

³⁸ For example, New Zealand's Labour-led government has undertaken to build 4000 houses in Mount Albert, a middle ring suburb of Auckland. See Phil Twyford, Minister of Housing and Urban Development, New Zealand Government, 'Unitec Deal Marks Major Kiwibuild Milestone' (Media Release, 25 March 2018) <<https://www.beehive.govt.nz/release/unitec-deal-marks-major-kiwibuild-milestone>>.

³⁹ B Phillips and C Joseph, 'Regional Housing Supply and Demand in Australia' (Working Paper No 1/2017, Centre for Social Research & Methods, Australia National University, 2017) 18.

⁴⁰ On meeting need, see generally, Steven Rowley, Chris Leishman, Emma Baker, Rebecca Bentley and Lawrence Lester, 'Modelling Housing Need in Australia to 2025' (AHURI Final Report 287, Australian Housing and Urban Research Institute, August 2017) <<https://www.ahuri.edu.au/research/final-reports/287>>.

⁴¹ Steven Rowley, Nicole Gurran and Peter Phibbs, 'Australia's Almost a World Leader in Home Building, So That Isn't a Fix for Affordability', *The Conversation* (online), 7 March 2017 <<http://theconversation.com/australias-almost-a-world-leader-in-home-building-so-that-isnt-a-fix-for-affordability-73514>>.

⁴² Ken Henry et al, Australian Government, *Australia's Future Tax System: Report to the Treasurer* (Australian Government Publishing Service, 2010) [6.2].

⁴³ J Daley, B Coates and T Wiltshire, *Housing Affordability: Re-imagining the Australian Dream* (Grattan Institute, 2018) 35-6. In New Zealand, no general CGT is levied and imputed rent is not taxable; New Zealand Superannuation is a universal benefit with no means testing; there are no land taxes, other than local authority rates; and, since stamp duty is not levied on transfers of land, no duty concessions can be given. However, local authorities, such as Wellington, may grant rates concessions for first-time homeowners: see Wellington City Council, *\$5000 Rates Discount for New First Homes Extended to Apartments* (14 March 2017) <[https://wellington.govt.nz/your-council/news/2017/03/\\$5000-rates-discount-for-new-first-homes-extended-to-apartments](https://wellington.govt.nz/your-council/news/2017/03/$5000-rates-discount-for-new-first-homes-extended-to-apartments)>.

⁴⁴ Peter Davidson and Ro Evans, *Fuel on the Fire: Negative Gearing, Capital Gains Tax & Housing Affordability* (Australian Council of Social Service, 2015) 4 <<https://search.informit.com.au/documentSummary;dn=518019364364949;res=IELHEA>>.

are also unnecessary. In the light of 'the non-financial benefits of home-ownership, it is highly likely that many people would buy a home even without these policies'.⁴⁵ The principal non-financial benefit owner-occupiers enjoy is 'ontological security', which Anthony Giddens defines as 'a sense of continuity and order in events'.⁴⁶

3 *Non-resident investors*

Non-resident investment is commonly perceived to be a principal cause of house price inflation and consequent unaffordability.⁴⁷ Thus Jack Favilukis and Stijn van Nieuwerburgh argue that capital inflows from non-resident investors 'affect housing affordability, the spatial distribution of residents, construction, labor income, wealth, and ultimately welfare'.⁴⁸ From their survey of 900 Sydney residents, Dallas Rogers et al found:

The most commonly identified factor [for rising house prices] was foreign investment, which twice as many survey participants selected compared to domestic factors such as negative gearing and the purchase of one's own home. The majority of participants did not believe foreign investment should be permitted in Sydney, and more than three in four agreed that foreign investment was driving up house prices in Sydney.⁴⁹

Despite this common perception, there is scant evidence that foreign investment really does have a significant impact on housing affordability in Australia.⁵⁰ Treasury researchers, Chris Wokker and John Swieringa conclude:⁵¹

⁴⁵ Daley et al, above n 43, 35.

⁴⁶ See Anthony Giddens, *Modernity and Self Identity: Self and Society in the Late Modern Age* (Stanford University Press, 1991) 243. On the debate whether homeownership is necessary for ontological security, see Rosemary Hiscock, Ade Kearns, Sally MacIntyre and Anne Ellaway, 'Ontological Security and Psycho-Social Benefits from the Home: Qualitative Evidence on Issues of Tenure' (2001) 18(1-2) *Housing, Theory and Society* 50, 51.

⁴⁷ In the absence of Australian-style investment restrictions, Canadian perceptions of overseas buyers fuelling, in particular, the Vancouver housing market may have more substance. See Joanne Lee-Young, 'Chinese Buyers Responsible for One-Third of Value of Vancouver Home Sales: National Bank', *Vancouver Sun* (online), 24 March 2016 <<http://www.vancouver.sun.com/business/chinese+buyers+responsible+third+value+vancouver+home+sales+national+bank/11804486/story.html>>.

⁴⁸ Jack Y Favilukis and Stijn van Nieuwerburgh, 'Out-of-Town Home Buyers and City Welfare' (1 August 2017) <<http://dx.doi.org/10.2139/ssrn.2922230>>. The authors specifically consider North American cities but their conclusion appears broadly generalisable.

⁴⁹ Dallas Rogers, Alexandra Wong and Jacqueline Nelson, 'Public Perceptions of Foreign and Chinese Real Estate Investment: Intercultural Relations in Global Sydney' (2017) 48(4) *Australian Geographer* 437, 451.

⁵⁰ The dearth of reliable data on the effects of foreign investment in the residential housing market is not restricted to Australia and New Zealand. Contemplating the United States, Emily Badger notes, 'the true extent of the phenomenon is maddeningly hard to measure'. See Emily Badger, 'When the (Empty) Apartment Next Door Is Owned by an Oligarch', *The New York Times* (online), 21 July 2017 <<https://www.nytimes.com/2017/07/21/upshot/when-the-empty-apartment-next-door-is-owned-by-an-oligarch.html>>.

⁵¹ Chris Wokker and John Swieringa, 'Foreign Investment and Residential Property Price Growth' (Treasury Working Paper 2016-03, Australian Treasury, December 2016) 25 <https://static.treasury.gov.au/uploads/sites/1/2017/06/TWP_FI_Residential_Property_Price_Growth.pdf>.

Only a small proportion of the strong property price growth over the study period [2010–15] can be attributed to foreign demand. It is also the case that the majority of foreign investment approvals are for new dwellings, consistent with Australia's foreign investment policy for residential real estate which, in part, aims to increase the total supply of dwellings.

Nevertheless, new housing built for foreign investors might not be of the type needed by aspiring homeowners with low incomes or may not be made available to renters.⁵²

At the time of writing, New Zealand was in the process of enacting Australian-style restrictions before the commencement of the Comprehensive and Progressive Trans Pacific Partnership Agreement.⁵³ Yet, there is little to suggest that foreign buyers have driven up house prices in New Zealand. Indeed, the first reliable data analysis shows that in the March 2018 quarter, only 3.3 per cent of home transfers were to people who were neither New Zealand citizens or resident-visa holders.⁵⁴ In the previous quarter, the corresponding figure was 2.9 per cent – the inter-period increase may have arisen from people seeking to invest before restrictions come into effect.

4 *Short-term leases*

Short-term leases, notably for Airbnb stays, are often blamed for having reduced the availability of affordable housing and rental stock in tourist-destination cities. Consequently, cities such as Berlin and New York have banned short-term leases, whereas Queenstown and Dunedin are considering ways of using their limited powers as local authorities to combat the perceived social costs of Airbnb.⁵⁵ However, the effect of Airbnb on housing affordability is unclear because of the lack of fully independent research. (Research tends to be sponsored either by Airbnb or the hotel industry.⁵⁶) Nevertheless, Kyle Barron et al plausibly conclude:

Home-sharing 1) raises local rental rates by causing a reallocation of the housing stock;
2) raises house prices through both the capitalization of rents and the increased ability

⁵² See R Ong et al, 'Housing Supply Responsiveness in Australia: Distribution, Drivers and Institutional Settings' (AHURI Final Report 281, Australian Housing and Urban Research Institute, 2017) <<https://www.ahuri.edu.au/research/final-reports/281>>.

⁵³ See Overseas Investment Amendment Bill 2017 (NZ) (5-1). The restrictions will not apply to investors from Australia or Singapore.

⁵⁴ Statistics NZ, *Property Transfer Statistics: March 2018* (7 June 2018) <<https://www.stats.govt.nz/information-releases/property-transfer-statistics-march-2018-quarter>>.

Land Information New Zealand previously collected data on the tax residency of house purchasers but did not keep a register of foreign ownership of residential property: see LINZ, *Property Transfers and Tax Residency Data* (2018) <<https://www.linz.govt.nz/land/land-registration/prepare-and-submit-your-dealing/property-tax-compliance-requirements/property-transfers-and-tax-residency-data>>.

⁵⁵ Queenstown has sought to prevent short-term leases through its resource consenting process. See Queenstown and Lakes District Council, *Further Clarification on Proposed Visitor Accommodation Rules* (9 November 2017) <<http://www.qldc.govt.nz/news/show/1871/further-clarification-on-proposed-visitor-accommodation-rules>>. Dunedin is contemplating a differentiated rate for short-lease properties. Tim Miller, 'Rates Rise for Short-Term Rentals Proposed', *Otago Daily Times* (online), 16 March 2018 <<https://www.odt.co.nz/news/dunedin/rates-rise-short-term-rentals-proposed>>.

⁵⁶ See, for example, Airbnb Citizen, *Economic Impact Report New York City* <<https://new-york-city.airbnb-citizen.com/economic-impact-reports/data-on-the-airbnb-community-in-nyc>>.

to use excess capacity; and 3) induces market entry by small suppliers of short-term housing who compete with traditional suppliers.⁵⁷

Even with these negative effects, Airbnb may provide broader benefits for tourist towns.⁵⁸

III PROPERTY TAXATION

This part of the article surveys taxes on residential property in selected Pacific Rim countries, which were introduced or amended to counter the perceived role of foreign investment, in particular, in exacerbating housing unaffordability.

A Local land taxes (rates)

Rating – a local tax on the value of real property – is the principal source of income for local government in British heritage jurisdictions.⁵⁹ The base adopted primarily distinguishes different rating systems.⁶⁰ While rates are designed to raise revenue, they have the capacity to modify behaviour. In particular, when rates are levied on the unimproved value of land, they might prompt its most efficient use.⁶¹ Unusually, Singapore differentially treats owner-occupied and rented residential dwellings. The policy purpose of this distinction is to encourage people to own and live in their own homes. Tax is levied at progressive rates on the annual value (estimated rental value) of the property. Rates range from 0 per cent for the first SGD8000 (AUD7575)⁶² to 16 per cent on the annual value exceeding SGD130 000 (AUD123 000).⁶³ For non-owner-occupied residential properties, property tax rates range from 10 per cent for the first SGD30 000 (AUD28 400) to 20 per cent on the annual value in excess of SGD90 000

⁵⁷ See Kyle Barron, Edward Kung and Davide Proserpio, 'The Sharing Economy and Housing Affordability: Evidence from Airbnb' (21 July 2017) 24 <<https://ssrn.com/abstract=3006832>>.

⁵⁸ See Louise Grimmer, Maria Massey and Oskaras Vorobjovas-Pinta, 'Airbnb Is Blamed for Tasmania's Housing Affordability Problems, But It's Actually Helping Small Businesses', *The Conversation* (16 February 2018) <<https://theconversation.com/airbnb-is-blamed-for-tasmanias-housing-affordability-problems-but-its-actually-helping-small-businesses-91566>>.

⁵⁹ See, for example, Australian Local Government Association, *Facts and Figures on Local Governments in Australia* <<https://alga.asn.au/?ID=59>>; Local Government New Zealand, *Local Government Funding Review: A Discussion Paper* (December 2015) <<http://www.lgnz.co.nz/assets/Uploads/Our-work/Local-Government-Funding-Review.pdf>>.

⁶⁰ For basic information on rating in Australia and New Zealand, respectively, see Australian Local Government Association, *Current Financial Arrangements* <<https://alga.asn.au/?ID=14855&Menu=44,60,611>> and Local Government New Zealand, *Local Government Finance* (2017) <<http://www.lgnz.co.nz/nzs-local-government/new-section-page>>.

⁶¹ See Rolland O'Regan, *Rating in New Zealand* (Baranduin Publishers, 2nd ed, 1985) 9. This proposition can be situated in broader Georgist land tax theory. See Henry George, *Progress and Poverty* (Hogarth Press, first published, 1879, 1953 condensed ed). See also Norman Gemmill, Arthur Grimes and Mark Skidmore, 'Do Local Property Taxes Affect New Building Development? Results from a Quasi-Natural Experiment in New Zealand' (Working Papers in Public Finance 08/2016, Victoria University of Wellington, 2016).

⁶² The exchange rates used in this article were accessed on 25 January 2018 from XE <<http://www.xe.com>>.

⁶³ Inland Revenue Authority of Singapore, *Lower Property Tax Rates for Owner-Occupied Residential Properties* (2017) <<https://www.iras.gov.sg/irashome/Property/Property-owners/Working-out-your-taxes/Property-Tax-Reliefs/Lower-Property-Tax-Rates-for-Owners-Occupied-Residential-Properties>>.

(AUD85 200).⁶⁴ Rating could be used to distinguish between foreign and locally owned properties as a behaviour-modifying instrument, but this is not a current practice.

B Stamp duty (property transfer duty)

With the notable exception of New Zealand,⁶⁵ British heritage countries typically raise a stamp or property transfer duty, often at a state level in federations.⁶⁶ Traditionally stamp duty has been viewed purely as a revenue-raising instrument, but more recently it has been used as a tool for modifying behaviour, specifically deterring non-resident and speculative investment in residential property. Traditionally, conveyance stamp duty has been levied at progressive but low rates. In contrast, behaviour-modifying surcharges are typically charged at relatively high, flat rates. For example, a foreign speculator investing in Hong Kong, would pay 30 per cent aggregate duty on purchasing a property and as much as 20 per cent if selling it shortly afterwards. Table 1 below summarises standard and deterrent stamp duty rates in various Pacific Rim jurisdictions.

Table 1: Comparison of duties on residential property transfers

Jurisdiction	Tax	Rate
British Columbia	Property transfer tax	1–3% ⁶⁷ 15% (foreign investors in Greater Vancouver Regional District) ⁶⁸ – to be increased to 20% ⁶⁹
Hong Kong ⁷⁰	Ad valorem stamp duty	<4.5% (HK residents for sole residential property) ⁷¹ 15% (others) ⁷²

⁶⁴ Ibid.

⁶⁵ Conveyance duty was abolished by s 6 of the *Stamp Duty Abolition Act 1999* (NZ).

⁶⁶ For a discussion of the scrapping of stamp duty by the Australian Capital Territory, see John A McLaren, 'The Australian Capital Territory Has Adopted Measures to Abolish Stamp Duty and Imposes a Land Tax on All Real Property: Will This Approach Be Adopted by Other States in Australia?' (2013) 8(1) *Journal of the Australasian Tax Teachers Association* 101.

⁶⁷ The tax currently applies to transfers of legal interests in land. The British Columbian government is considering extending the tax to transfers of beneficial interests in land. See Noah Sarna and Zheting Su, 'Subjecting Transfers of Beneficial Ownership to PTT Is Not as Simple as It Might Seem' (Thorsteinssons LLP, 19 February 2018) <<https://www.thor.ca/blog/2018/02/subjecting-transfers-of-beneficial-ownership-to-ptt-is-not-as-simple-as-it-might-seem>>.

⁶⁸ Government of British Columbia, *Additional Property Transfer Tax* <<https://www2.gov.bc.ca/gov/content/taxes/property-taxes/property-transfer-tax/understand/additional-property-transfer-tax>>.

⁶⁹ Government of British Columbia, *Budget 2018: Working for You* (2018) <http://bcbudget.gov.bc.ca/2018/highlights/2018_Highlights.pdf>.

⁷⁰ See *Stamp Duty Ordinance 1981* (HK), as amended.

⁷¹ *Stamp Duty (Amendment) (No 2) Ordinance 2014 (2014 (No 2) Amendment Ordinance)* (HK), gazetted on 25 July 2014; Hong Kong Government, *Stamp Duty Rates* (2016) <http://www.gov.hk/en/residents/taxes/stamp/stamp_duty_rates.htm>.

⁷² *Stamp Duty (Amendment) Ordinance 2018 (2018 Amendment Ordinance)* (HK), gazetted on 19 January 2018. Retroactive changes to stamp duty appear to be normal in Hong Kong. See Jianlin Chen, 'The Yet-to-be Effective but Effective Tax: Hong Kong's Buyer's Stamp Duty as a Critical Case Study of Legislation by Press Release' (2014) 10 *University of Pennsylvania East Asia Law Review* 1.

	Buyer's stamp duty	15% (non-residents) ⁷³
	Special stamp duty	10–20% (sellers of a property within three years) ⁷⁴
Singapore	Buyer's stamp duty	1–3% ⁷⁵
	Additional buyer's stamp duty ⁷⁶	15% (non-citizens who are not residents) 7% (citizens for a second property) 10% (citizens for a third and subsequent property) 5% (resident non-citizens) 10% (resident non-citizens for second and subsequent properties)
	Seller's stamp duty ⁷⁷	12% (property sold within 12 months) 8% (property sold between 1 and 2 years) 4% (property sold between 2 and 4 years)
New South Wales	Transfer duty	1.25–7% ⁷⁸
	Surcharge	8% (non-residents) ⁷⁹
Queensland	Transfer duty ⁸⁰	0–5.75% ⁸¹
	Additional foreign acquirer duty	3% ⁸²
South Australia	Stamp duty ⁸³	1–5.5%

⁷³ Inland Revenue Department of Hong Kong, *Buyer's Stamp Duty (BSD)* (2017) <<http://www.ird.gov.hk/eng/faq/bsd.htm>>.

⁷⁴ Inland Revenue Department of Hong Kong, *Special Stamp Duty (SSD)* (2017) <<http://www.ird.gov.hk/eng/faq/ssd.htm>>.

⁷⁵ Inland Revenue Authority of Singapore, *Buyer's Stamp Duty (BSD)* (2017) <<https://www.iras.gov.sg>>.

⁷⁶ Inland Revenue Authority of Singapore, *Additional Buyer's Stamp Duty (ABSD)* (2017) <<https://www.iras.gov.sg>>.

⁷⁷ Inland Revenue Authority of Singapore, *Seller's Stamp Duty (SSD) for Residential Property* (2017) <<https://www.iras.gov.sg>>.

⁷⁸ Revenue New South Wales, *Transfer Duty (Stamp Duty)* <<http://www.revenue.nsw.gov.au/taxes/transfer>>.

⁷⁹ Revenue New South Wales, *Surcharge Purchaser Duty* (2017) <<http://www.revenue.nsw.gov.au/taxes/spd>>.

⁸⁰ See *Duties Act 2001* (Qld).

⁸¹ Queensland Government, *Transfer Duty Rates* (2018) <<https://www.qld.gov.au/housing/buying-owning-home/transfer-duty-rates>>.

⁸² Business Queensland, *Additional Foreign Acquirer Duty Residential Land Interactive* (2018) <<https://www.business.qld.gov.au/industries/service-industries-professionals/professional-financial-services/transfer-duty/self-assessors/interactive-help/afad>>.

⁸³ *Stamp Duties Act 1923* (SA).

	Foreign ownership surcharge	7% ⁸⁴
Tasmania	Property transfer duty ⁸⁵	Minimum \$50 – 4.5% ⁸⁶
	Foreign investor duty surcharge	3% (from 1 July 2018) ⁸⁷
Victoria	Land transfer duty ⁸⁸	1.4–5.5% ⁸⁹
	Foreign purchaser additional duty	7% ⁹⁰
Western Australia	Transfer duty ⁹¹	1.9–5.15% ⁹²
	Foreign buyers surcharge ⁹³	7% (from 1 January 2019) ⁹⁴

C Land taxes

All Australian states levy a land tax.⁹⁵ (Western Australia also levies a related and supplementary Metropolitan Regional Improvement Tax.⁹⁶) The Northern Territory does not currently operate a land tax but consideration has been given to introducing such a tax to supplement or replace stamp duty.⁹⁷ Land taxes usually exempt a person's principal residence from the tax base. However, ACT, which is phasing out land transaction taxes,⁹⁸

⁸⁴ Revenue South Australia, *Foreign Ownership Surcharge* (2018) <<https://www.revenuesa.sa.gov.au/taxes-and-duties/foreign-ownership-surcharge>>.

⁸⁵ See *Duties Act 2011* (Tas).

⁸⁶ State Revenue Office of Tasmania, *Rates of Duty* (2018) <<http://www.sro.tas.gov.au/property-transfer-duties/rates-of-duty>>.

⁸⁷ State Revenue Office of Tasmania, *Property Transfer Duties* (2018) <<http://www.sro.tas.gov.au/property-transfer-duties>>.

⁸⁸ See *Duties Act 2000* (Vic).

⁸⁹ State Revenue Office of Victoria, *Land Transfer Duty* <<http://www.sro.vic.gov.au/land-transfer-duty>>.

⁹⁰ State Revenue Office of Victoria, *Foreign Purchasers of Property* <<http://www.sro.vic.gov.au/foreignpurchaser>>.

⁹¹ *Duties Act 2008* (WA).

⁹² *Ibid* sch 2 (general rate).

⁹³ The stated purpose of the Foreign Buyers Surcharge is 'to pay for a freeze on TAFE fees and assist in the difficult task of Budget repair', rather than discouraging foreign purchases. Ben Wyatt (Treasurer), Government of Western Australia, 'Foreign Buyers Surcharge another Component to Budget Repair' (Media Statement, 7 September 2017) <<https://www.mediastatements.wa.gov.au/Pages/McGowan/2017/09/Foreign-Buyers-Surcharge-another-component-to-Budget-repair.aspx>>.

⁹⁴ Gary Adshead, 'WA Budget 2018: Higher WA Property Surcharge to Hit Foreign Buyers', *The West Australian* (online), 10 May 2018 <<https://thewest.com.au/politics/budget/wa-budget-2018-higher-wa-property-surcharge-to-hit-foreign-buyers-ng-b88830337z>>.

⁹⁵ For a comprehensive survey and analysis of land taxes in Australia, see Vince Mangioni, *Land Tax in Australia: Fiscal Reform of Sub-national Government* (Routledge, 2015).

⁹⁶ Department of Finance Western Australia, *What Is Land Tax?* <https://www.finance.wa.gov.au/cms/State_Revenue/Land_Tax/What_is_Land_Tax_.aspx>.

⁹⁷ Ashley Manicaros, 'Land Tax May Be Introduced to Broaden NT's Revenue Base', *NT News* (online), 14 November 2017 <<http://www.ntnews.com.au/news/northern-territory/land-tax-may-be-introduced-to-broaden-nts-revenue-base/news-story/88e574afe3deeda0e1f1651f9d1c2ed7>>.

⁹⁸ Conveyancing duty, with a top marginal rate of 5.01 per cent for residential properties, is still payable but will be phased out. See 'Chapter 6 Revenue' in Treasury, ACT Government, *Australian Capital Territory*

includes residential property in its land tax base.⁹⁹ A foreign owner of residential land in New South Wales must pay a surcharge of 0.75 per cent for the 2017 land tax year and 2 per cent from the 2018 land tax year onwards.¹⁰⁰ ACT will introduce a 0.75 per cent surcharge to its land tax for foreign owners, with effect from 1 July 2018.¹⁰¹

D Vacant property taxes

The idea of taxing vacant land to encourage optimal development is not new.¹⁰² However, the phenomenon of optimally developed land being both unoccupied and withheld from the rental market may be a more recent phenomenon.¹⁰³ The first tax on vacant properties appears to be the 1998 French *taxe sur les logements vacants* (tax on empty apartments).¹⁰⁴ British Columbia has also enacted an Empty Homes Tax (also known as the Vacancy Tax) for metropolitan Vancouver with an aim of prompting owners to put their unoccupied properties on the rental market.¹⁰⁵ Net revenues from the Empty Homes Tax will be reinvested into affordable housing initiatives.¹⁰⁶ Most properties are exempt, notably principal residences, occupied for at least six months a year, and properties rented for at least six months of the year, in periods of 30 or more consecutive days. Short-term, Airbnb-style leases would not therefore be excluded.¹⁰⁷ In its 2018 Budget, the British Columbian government announced a so-called speculation tax, which will apply province-wide.¹⁰⁸ This tax will be similar to Vancouver's Vacancy Tax, inasmuch as property owners who do not pay provincial income tax, and do not reside in or rent out

Budget 2017–18: For a Better Canberra: Budget Paper 3: Budget Outlook (Pub No 17/0494, 2017) 219–46 <https://apps.treasury.act.gov.au/_data/assets/pdf_file/0010/1069921/08_BP3-2017-18-Budget-Chapter-6.pdf>.

⁹⁹ Prosper Australia, *The First Interval: Evaluating ACT's Land Value Tax Transition* (2016) <<https://www.prosper.org.au/wp-content/uploads/2016/09/The-First-interval-Evaluating-ACTs-Land-Valur-Tax-Transition.pdf>>.

¹⁰⁰ Revenue New South Wales, *Land Tax Surcharge* (2018) <<http://www.revenue.nsw.gov.au/taxes/land-tax-surcharge>>.

¹⁰¹ Treasury, ACT Government, *Australian Capital Territory Budget 2017–18: For a Better Canberra* (2017) 65 <https://apps.treasury.act.gov.au/_data/assets/pdf_file/0017/1163321/2017-18-Budget-Review.pdf>.

¹⁰² For example, in 1658, when New York was still New Amsterdam, taxes were levied on vacant plots until they were built upon. See John Christopher Schwab, 'History of the New York Property Tax' (1890) 5(5) *Publications of the American Economic Association* 17, 24.

¹⁰³ But see A J van der Walt, 'Property and Marginality' in Gregory S Alexander and Eduardo M Peñalver (eds), *Property and Community* (Oxford University Press, 2009) on squatting in vacant buildings in the Netherlands the 1970s.

¹⁰⁴ Sébastien Ménard, 'Should We Tax Vacant Dwellings? A Search Equilibrium Model Applied to the Rental Housing Market' (2012) 117(1) *Economics Letters* 88; Laura Kane, 'As Vancouver Grapples with Housing Crisis, How Europe Has Tackled Vacant Homes', *Vancouver Observer* (online), 14 December 2015 <<https://www.vancouverobserver.com/news/vancouver-grapples-housing-crisis-how-europe-has-tackled-vacant-homes>>.

¹⁰⁵ See 'City of Vancouver Approves Empty Homes Tax', *CBS News*, 16 November 2016 <<http://www.cbc.ca/news/canada/british-columbia/city-of-vancouver-approves-empty-homes-tax-1.3853542>>.

¹⁰⁶ City of Vancouver, *Will Your Home Be Taxed?* (2018) <<http://vancouver.ca/home-property-development/will-your-home-be-taxed.aspx>>.

¹⁰⁷ *Ibid.*

¹⁰⁸ British Columbia, *Budget 2018: Working for You* (2018) <http://bcbudget.gov.bc.ca/2018/highlights/2018_Highlights.pdf>.

the property, will have an annual liability of 0.5 per cent of the property's value in 2018, increasing to 2 per cent a year from 2019.

Australia has sought to control non-resident investment by restricting purchases of existing properties to residents. However, since overseas students may buy an existing property (provided they sell it within three months of completing their studies), the country's expanded tertiary education market has seen a significant increase in the number of students (presumably their families) purchasing existing houses and flats in the inner and middle ring suburbs of university cities.¹⁰⁹ On 9 May 2017, the Commonwealth Government announced the introduction of a fee on foreign owners of residential property where the property is not occupied or genuinely available on the rental market for at least six months of each year. However, the fee, which falls under the purview of the Foreign Investment Review Board, does not apply to properties bought before the date of the announcement. While the fee may be a petty measure, the government announced significant tax changes to promote housing affordability.¹¹⁰

Table 2: Comparison of selected vacant property taxes

Jurisdiction	Affected area	Vacancy period	Rates of tax
Australia	National (only applies to non-resident investments made after 9 May 2017) ¹¹¹	6 months	Fee equivalent to, e.g., 0.55% for property <\$1 million value; 1.12% for \$9–10 million value
British Columbia ¹¹²	Designated urban areas	9 months (2018) 6 months (2019)	0.5% (2018) 2% foreign investors; 1% non-BC Canadians; 0.5% BC Canadians (2019)
Victoria	Inner/middle ring Melbourne ¹¹³	6 months	1% 1.5% surcharge for absentees' unimproved land ¹¹⁴

¹⁰⁹ Stephen Anthony and Gary Lu, 'Discussion Paper: Assisting Housing Affordability' (Industry Super Australia, November 2017) 20 <<http://www.industrysuperaustralia.com/assets/Reports/Assisting-Housing-Affordability-ISA-Discussion-Paper-FINAL-2017.pdf>>.

¹¹⁰ Australian Government, *Budget 2017–18: Guaranteeing the Essentials for Australians* (2017) <<https://budget.gov.au/2017-18/content/glossies/essentials/download/Budget2017-18-Essentials.pdf>>.

¹¹¹ Australian Government, *Residential Real Estate – Annual Vacancy Fee (Guidance Note 48)* (20 December 2017) <<https://cdn.tspace.gov.au/uploads/sites/79/2017/12/171221-GN48-RRE-Annual-Charge.pdf>>.

¹¹² See *Vancouver Charter* [SBC 1953] ch 55 pt XXX: Vacancy Tax; Vacancy Tax By-law No 11674.

¹¹³ State Revenue Office of Victoria, *Vacant Residential Land Tax* (2017) <<http://www.sro.vic.gov.au/vacant-residential-land-tax>>.

¹¹⁴ State Revenue Office of Victoria, *Absentee Owner Surcharge* (2017) <<http://www.sro.vic.gov.au/node/1870>>; State Revenue Office of Victoria, *Vacant Residential Land Tax*, above n 113.

IV DISCUSSION

After noting reservations about comparisons, this part of the article considers the effectiveness of measures introduced, then sketches other tax measures that might be used as part of a multi-faceted approach to housing unaffordability.

Despite sharing a history of colonialism, the common law, and open economies, the British heritage states discussed in this article have substantively different tax systems. These differences suggest caution when drawing comparisons. (However, all use rating-like local taxation.) Hong Kong and Singapore are distinguished by minimalism. They have source-based, low-rate incomes taxes, and no CGT. Therefore, stamp duty may be the only extant tax instrument available for dampening demand for investment in housing. In contrast, Canada has a complex, multi-level tax system that incorporates income tax, CGT and value-added tax (VAT). At subnational levels, Canadian provinces raise income tax, sales tax (harmonised with federal VAT) and land transfer tax.¹¹⁵ Canada, therefore, has several existing tax instruments for engaging with housing problems. Nevertheless, the principal fiscal actions have been taken at a provincial level, in British Columbia (and later Ontario), although focus has been on specific metropolitan areas. Significantly, unlike Australia,¹¹⁶ Canada has not imposed direct restrictions on non-resident investment in residential property.¹¹⁷

The New Zealand tax system lies between the minimalism of Hong Kong and Singapore, and the complexity of Australia and Canada. As a unitary state, it has no state or provincial-level taxes.¹¹⁸ Neither a general CGT nor a stamp duty is levied. Speculative gains may constitute taxable revenue,¹¹⁹ but, of course, in the absence of a disposal, no income tax liability arises. New Zealand may therefore have the least scope, among the jurisdictions considered, for using taxes to combat foreign investment if it is thought to cause housing unaffordability. A property transfer tax could be introduced but is most unlikely since such taxes have previously been rejected as inefficient and unfair.¹²⁰ To reiterate, New Zealand intends to emulate Australia in requiring non-resident investors in residential property to build rather than purchase an existing property.¹²¹

¹¹⁵ See, generally, Geoffrey Loomer and David G Duff, *Taxation of Business Organizations in Canada* (LexisNexis, 2015).

¹¹⁶ See Australian Government, *Residential Real Estate – Foreign Non-Residents: Guidance Note 3* (1 July 2017) <https://cdn.tspace.gov.au/uploads/sites/79/2017/07/03_GN_FIRB.pdf>.

¹¹⁷ Richard Cullen, 'Real Estate Price Inflation: Lessons from Hong Kong' (TLRP Tax Comments No 3, Faculty of Law, University of Hong Kong, June 2016) 8 <http://www.law.hku.hk/aiifl/wp-content/uploads/file/TLRP-TaxComments-No_3.pdf>.

¹¹⁸ Subnational government taxes in New Zealand amount to only 2.2 per cent of GDP. See OECD, *Revenue Statistics – OECD Countries: Comparative Tables* (2016) <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>.

¹¹⁹ See *Income Tax Act 2007* (NZ) ss CB 6–CB15B.

¹²⁰ VUW 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, January 2010) 16.

¹²¹ In terms of the New Zealand-China Free Trade Agreement (NZCFTA), New Zealand can retain existing restrictions on foreign investment in real property under the *Overseas Investment Act 2005* (NZ). However, the restrictions at the time the NZCFTA was negotiated focused on farmland, rather than typically sized residential properties. Nevertheless, under the NZCFTA, New Zealand retains the right to introduce a land tax.

A Effectiveness of current measures

If we assume that foreign investment in residential property is a social mischief deserving government intervention, we may ask whether the taxes introduced have been effective in remedying that mischief. Furthermore, do these taxes have undesirable consequences? Focus in this section lies with stamp duty. Behaviour-modifying rating is a minor issue,¹²² and it is too early to tell whether vacant property taxes might be effective.¹²³ The latter taxes might have some impact on house prices,¹²⁴ but the reasons why properties are left empty can be complex, although speculation may be one of them,¹²⁵ particularly in times of uncertainty.¹²⁶ Besides, looking at the bigger picture of unaffordability, as Hal Pawson observes, 'empty homes represent just a small element of our increasingly inefficient and wasteful use of housing'.¹²⁷

1 High rates of stamp duty

While conceding that other factors could have been at play, Richard Cullen concludes that Hong Kong's stamp duty tax manipulation has been effective in dampening speculative demand in the territory, albeit after a time lag of four to five years for special stamp duty, and two to three years for buyer's stamp duty.¹²⁸ But, after Cullen drew this conclusion, Hong Kong found it necessary to make significant hikes to ad valorem duty in a further attempt to cool demand. This development raises several questions, including: will governments have the political nerve to keep raising the rates of stamp duty beyond their already exceptional levels; will investors simply factor in such increases into the already astronomical prices of property in the most desirable cities; and does control of foreign investment in residential property lie beyond the control of governments in open economies?¹²⁹

Some unintended if expectable effects were observed in Vancouver arising from the hikes in property transfer tax, notably a surge in non-resident investment before the date of implementation and, afterwards, possible collusion between residents and non-

¹²² New Zealand's restricted tax options may lead to differential rating (for example, in relation to Airbnb leases) becoming a more common policy choice in the future.

¹²³ A model constructed by Ménard, above n 104 indicates that a vacant property tax should reduce empty apartments but also has the long-term effect of reducing the supply of rentable properties.

¹²⁴ Cameron Murray estimates that if all vacant properties became occupied, the housing market would fall by no more than 2 per cent. See Cameron Murray, Domain Real Estate, *Empty Homes: The Economic Reasons behind Investors Keeping Properties Vacant* (4 April 2017) <<https://www.domain.com.au/news/empty-homes-the-economic-reasons-behind-investors-keeping-properties-vacant-20170404-gvdc7l>>.

¹²⁵ For calculations showing why a speculator may find it more advantageous to keep an apartment or plot of land empty, see *ibid*.

¹²⁶ See Sheridan Titman, 'Land Prices under Uncertainty' (1985) 75(3) *American Economic Review* 505.

¹²⁷ Hal Pawson, 'Taxing Empty Homes: A Step towards Affordable Housing, But Much More Can Be Done', *The Conversation* (online), 17 July 2017 <<https://theconversation.com/taxing-empty-homes-a-step-towards-affordable-housing-but-much-more-can-be-done-80742>>.

¹²⁸ Cullen, above n 117, 13.

¹²⁹ Truly effective control over mainland investment in the territory may lie with the Chinese government's policy on outbound investment. See Ben Bland, 'China Developers Retreat from Hong Kong Property Market', *Financial Times* (online), 7 February 2018 <<https://www.ft.com/content/f70b4c50-0bc5-11e8-8eb7-42f857ea9f09>>.

residents.¹³⁰ Toronto experienced a property boom immediately after the tax came into effect in Vancouver. In response, Ontario introduced its own non-resident speculation tax, a 15 per cent surcharge, payable in addition to standard land transfer tax.¹³¹ The British Columbian surcharge may have had no long-term impact on housing affordability in Vancouver. An article in *The Australian* reported that Vancouver's house prices fell by 18.9 per cent between January 2016 and January 2017.¹³² Indeed, prices do appear to have fallen sharply in the first year of the surcharge,¹³³ but, by March 2017, the market was booming once more.¹³⁴ And, as noted, the provincial government considered it necessary to increase property transfer tax for foreign purchases of residential property to 20 per cent in its 2018 budget. According to Juwai, a website aimed at Chinese property investors, this latest increase in stamp duty 'is likely to have minimal impact on wealthy Chinese buyers seeking to purchase in Vancouver or elsewhere in the B.C. province'.¹³⁵ In short, it seems that swingeing rates of stamp duty may have minimal long-term effect on foreign investment or, indeed, domestic speculation. State coffers may swell but government reliance on that revenue flow may have the effect of entrenching an inefficient and inequitable tax.

B Broad-based land tax as an alternative to stamp duty

According to the Henry Report, conveyance stamp duties, which are 'volatile and highly inefficient' and 'inequitable', discourage,

transactions of commercial and residential property and ... discourage people from changing their place of residence as their personal circumstances change or discourage people from making lifestyle change that involve a change in residence. It is also inequitable, as people who need to move more frequently bear more tax irrespective of their income or wealth.¹³⁶

Furthermore, because duty thresholds tend to be static, stamp duty is particularly prone to bracket creep (fiscal drag) in a rising market. Robert Carling and Michael Potter provide

¹³⁰ See Sam Cooper, 'Foreign Buyers Still Investing in Metro Vancouver Real Estate Despite B.C. Tax', *Vancouver Sun* (online), 28 June 2017 <<http://vancouver.sun.com/news/local-news/foreign-buyers-still-investing-in-metro-vancouver-real-estate-despite-b-c-tax>>.

¹³¹ Ministry of Finance, Government of Ontario, *Non-Resident Speculation Tax* (2017) <<https://www.fin.gov.on.ca/en/bulletins/nrst>>.

¹³² See Robert Montgomery, 'NSW and Victoria Foreign Buyer Taxes Come as House Prices Soften', *The Australian* (online), 10 June 2017 <<http://www.theaustralian.com.au/business/wealth/nsw-and-victoria-foreign-buyer-taxes-come-as-house-prices-soften/news-story/f2680b0a28c42483fa7f41f78878f2db>>.

¹³³ 'B.C. Real Estate Data Show Sharp Decline in Foreign Investment after Tax', *The Canadian Press* (online), 6 January 2017 <<https://globalnews.ca/news/3166198/sharp-decline-but-growth-in-bc-real-estate>>.

¹³⁴ See, for example, Joanne Lee-Young, 'Impact of B.C.'s Foreign Buyer Tax Wanes as March Sales Surge Almost 50 Per Cent', *Vancouver Sun* (online), 18 April 2017 <<http://vancouver.sun.com/business/local-business/impact-of-b-c-s-foreign-buyer-tax-wanes-as-march-sales-surge-almost-50-per-cent>>.

¹³⁵ Juwai, 'How Will B.C.'s New 20% Tax Sway Chinese Buyers in Canada?', 1 March 2018 <<https://list.juwai.com/news/2018/03/will-bc-new-20%25-tax-sway-chinese-buyers-in-canada>>.

¹³⁶ Henry et al, above n 42, [6.2].

the example of New South Wales, whose average rate of stamp duty doubled between 1986 and 2015.¹³⁷

The Henry Report and the Australian Productivity Commission,¹³⁸ among many others, have recommended the incremental replacement of stamp duties with a broad-based land tax. A massive body of literature exists on the effectiveness of land taxes.¹³⁹ For current purposes, it is sufficient to note that, notwithstanding the absence of conclusive evidence,¹⁴⁰ proponents of land taxes claim that they deliver the most efficient use of land. For example, they predict that a developer will not land bank; rather they will develop their land most efficiently, temporally and use-wise, provided the rate of tax is set sufficiently high.¹⁴¹ A land tax should apply to all land. 'Levying higher taxes on larger holdings discourages land-based investment by institutional investors, such as in rental housing. As owner-occupied housing is exempt, land tax on residential investment properties is probably passed through to renters as higher rent.'¹⁴²

ACT is widely considered to have made the 'right' policy choice in phasing out stamp duty in favour of a land tax. But the tax only applies to residential property,¹⁴³ and includes significant exemptions, notably parcels of rural land.¹⁴⁴ Rather than exemptions, relief should be provided through deferral options, for example for asset rich, income poor taxpayers, who are often elderly.¹⁴⁵ Nevertheless, the ACT experience indicates the political difficulties faced in implementing a pure land tax.

C Considerations for government

1 Multiple policy measures

As the Henry Report recognised, 'a range of non-tax policies have a more significant impact on housing supply and affordability' than do tax policies.¹⁴⁶ Vancouver's policy-makers did not envisage increases in property transfer tax as a silver bullet, more like one

¹³⁷ Robert Carling and Michael Potter, 'Exposing the Stealth Tax: The Bracket Creep Rip-off' (CIS Research Report 8, Centre for Independent Studies, 2015) 6 <<https://www.cis.org.au/app/uploads/2015/12/rr8.pdf>>.

¹³⁸ Productivity Commission, 'Shifting the Dial: 5 Year Productivity Review' (Report No 84, Productivity Commission, Government of Australia, 2017) <<https://www.pc.gov.au/inquiries/completed/productivity-review/report>>.

¹³⁹ For a potted review of issues in land taxation, see Richard F Dye and Richard W England, 'Assessing the Theory and Practice of Land Value Taxation' (Lincoln Institute of Land Policy, 2010).

¹⁴⁰ See A M Woodruff and L L Ecker-Racz, 'Property Taxes and Land-Use Patterns in Australia and New Zealand' in Arthur Becker (ed), *Land and Building Taxes: Their Economic Effect on Development* (University of Wisconsin Press, 1969) 147, cited by Mary E Edwards, 'Site Value Taxation in Australia: Where Land Is Taxed More and Improvements Less, Average Housing Values and Stocks Are Higher' (1984) *American Journal of Economics and Sociology* 481, 486.

¹⁴¹ Florida, above n 1, 194 notes: '[Henry] George in fact suggested that the less developed land is, the higher it is taxed. George in fact suggested that underdeveloped land be taxed at a rate of 100%, minus improvements to it. Absent such improvement, he argued, all of the land's value should return to the public commons.'

¹⁴² Henry et al, above n 42, [6.2].

¹⁴³ *Land Tax Act 2004* (ACT) s 9.

¹⁴⁴ *Ibid.*

¹⁴⁵ I am grateful to the reviewer who noted that such a deferral option may resemble in practice a CGT.

¹⁴⁶ Henry et al, above n 42, [6.2].

arrow in a quiver of policy options. The city's focus lies with protecting the existing rental stock and increasing the supply of affordable housing, especially condominiums. Technology, such as the use of modular housing, is expected to play a role, as are mass transit initiatives, government subsidies and land deals.¹⁴⁷ Similarly, the United Kingdom's Department for Communities and Local Government recommends a multi-pronged approach to vacant properties, including a potential 'empty homes premium', payable on the Council Tax.¹⁴⁸

2 Political attraction of taxing foreigners

Since foreign investors cannot vote and are unlikely to find a champion in their own governments, which have agreed to investment restrictions under free trade agreements,¹⁴⁹ imposing swingeing property taxes on non-residents may be politically attractive. Following Favilukis and van Nieuwerburgh, taxing non-resident investors 'can turn welfare losses into gains when tax revenues finance a local public good',¹⁵⁰ if, for example, stamp duty surcharges are hypothecated for public housing. Nevertheless, for Australia and New Zealand, which have histories of Sinophobia,¹⁵¹ taxes implicitly aimed at Chinese investors should give pause for thought.¹⁵² If foreign investment is not the major cause of housing unaffordability – as appears to be the case in Australia and New Zealand – increasingly heavy taxes on non-residents take on the appearance of scapegoating.

Focusing on foreign investors allows government to give the impression of combatting housing unaffordability, without taking measures that might alienate voters. Joannah Connolly observes of the latest British Columbian tax measures:¹⁵³

this tax affects all non-local-tax-paying home owners, not just speculators. But it has been cynically named a 'speculation tax' because the [governing New Democratic Party] knows tax-paying voters believe real estate speculation is a leading cause of high home prices, and this way the party is seen to be doing something about it.

Likewise, in Australia, Nicole Gurrán and Peter Phibbs consider,

¹⁴⁷ See an interview with Mukhtar Latif, Vancouver's then Chief Housing Officer: Radio New Zealand, *Interview with Mukhtar Latif: Do Taxes on Foreign Buyers Work?* (Radio Interview, 17 January 2017) <<http://www.radionz.co.nz/national/programmes/ninetonoon/audio/201831017/do-taxes-on-foreign-buyers-work>>.

¹⁴⁸ HM Government, *Laying Foundations: A Housing Strategy for England* (November 2011) 76 <<https://assets.publishing.service.gov.uk/government/uploads/system/.../2033676.pdf>>.

¹⁴⁹ See, for example, the *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China*, art 9.5.

¹⁵⁰ Favilukis and van Nieuwerburgh, above n 48.

¹⁵¹ On the notorious poll taxes payable by Chinese immigrants and sojourners, see 'Chinese' in AH McLintock (ed), *An Encyclopaedia of New Zealand* (Te Ara - the Encyclopedia of New Zealand, originally published 1966) <<http://www.TeAra.govt.nz/en/1966/national-groups/page-13>>.

¹⁵² See Laura Walters, 'Labour's "Half-Baked" Property Data Turns Chinese Buyers into "Scapegoats"', *Stuff* (online), 14 July 2015 <<https://www.stuff.co.nz/business/money/70155168/labours-halfbaked-property-data-turns-chinese-buyers-into-scapegoats>>.

¹⁵³ Joannah Connolly, 'Editorial: Why New Speculation Tax Is Not a Speculation Tax', *Vancouver Courier* (online), 26 February 2018 <<http://www.vancourier.com/real-estate/editorial-why-new-speculation-tax-is-not-a-speculation-tax-1.23185372>>.

the ways in which government responses to housing problems have come to resemble 'busy work', exhibiting and absorbing policy energy while at the same time constraining the suite of policy options and tools able to really address the housing affordability problems affecting low-income renters and aspiring owners in Australia.¹⁵⁴

Laurence Murphy makes similar observations about the Auckland housing crisis.¹⁵⁵ No government in a property-owning democracy would seek to engineer a crash in the residential housing market in order to promote housing affordability. As the global financial crisis demonstrated, '[a] major fall in house prices can create chaos across an economy ... [causing] widespread business failures, job losses and a broader economic recession.'¹⁵⁶ Conversely, a responsible government should not foster property speculation by either foreign or domestic speculators.

V CONCLUSION

A crisis in housing affordability is evident in the world's major cities, including those in Australasia. But the precise nature of the crisis and its causes are less clear. Paradoxically, Australia appears to have a surplus of housing, including vacant properties in the inner ring suburbs of Melbourne and Sydney where demand can be expected to be most intense. Foreign investment is commonly portrayed as a main driver of unaffordability, yet when reliable evidence exists, non-resident investment appears to contribute minimally to housing inflation. Notwithstanding uncertainty about the causes of housing unaffordability, ostensibly remedial taxes have been introduced to remedy what may be a nugatory social mischief. The article set out to assess whether these taxes have been effective, and to consider whether other measures would be preferable. It is concluded that these taxes are unlikely to have been effective in combatting foreign investment in residential property but this outcome is not fatal for housing affordability since its contribution is almost certainly minimal.

Stamp duties are commonly criticised for introducing frictions into the housing market, and for obviating augmentation or replenishment of the housing stock by discouraging investment. Wide consensus holds that a broad-based land tax, as a substitute for stamp duty, would be most effective – in the long-term, at least – in ensuring the most efficient use of land. ACT has shown that a broad-based land tax can include a surcharge for foreign-owned properties – even if that additional charge serves no real purpose other than to exact an additional charge for the privilege of investment. But the flow of revenue into State treasuries from thinly disguised xenophobia expressed in foreign purchaser surcharges may be too attractive for governments to surrender.

Australia's policy on foreign investment in residential property, which requires new accommodation to be built, if effectively enforced,¹⁵⁷ directly engages with the possibility

¹⁵⁴ Nicole Gurran and Peter Phibbs, 'Are Governments Really Interested in Fixing the Housing Problem? Policy Capture and Busy Work in Australia' (2015) 30(5) *Housing Studies* 711, 715.

¹⁵⁵ Laurence Murphy, 'The Politics of Land Supply and Affordable Housing: Auckland's Housing Accord and Special Housing Areas' (2016) 53(12) *Urban Studies* 2530.

¹⁵⁶ Shamubeel Eaqub, 'Property: A House of Cards?', *Sunday Star Times* (New Zealand), 6 August 2017, D12.

¹⁵⁷ Anthony and Lu, above n 109, 20 observe: 'there was significant rorting by non-residents purchasing existing real estate prior to 2016, with the tacit assistance of real estate agents, mortgage brokers and banks'.

of non-residents denying residents access to the stock of housing. Perhaps more direction could be given: for example, a person wishing to make a direct property investment of AUD1.5 million might be required to build two affordable units rather than one unit that might be unaffordable for potential tenants. Requiring foreign investors to build seems mutually beneficial for the investor, who obtains indefeasible ownership of real property in a common law jurisdiction, and the host state, whose housing stock is augmented or replenished. New Zealand seems well advised to follow Australia in this regard rather than seeking solutions in discriminatory taxes.

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IS THE LITERACY OF SMALL BUSINESS OWNERS IMPORTANT FOR CASH FLOW MANAGEMENT?: THE EXPERTS' PERSPECTIVE

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ABSTRACT

Small businesses play a crucial role in the Australian economy in terms of income and employment. Reliance on small business however can be concerning, as many small businesses fail to survive for a period of more than five years. This has been associated with the difficulty that small businesses face in maintaining a consistent cash flow. Research suggests that this may be related to financial and taxation literacy of the small business owner (SBO). Although SBOs have been identified as having a higher degree of financial literacy than individuals, it is unclear whether their level of literacy is adequate to support the management of the cash flow of their business. A continuing large research project investigates the required level of literacy that SBOs should possess to operate a successful business, with particular focus on cash flow management. This article reports expert perspectives of the degree of knowledge that is essential for SBOs in terms of professional financial literacy, computer accounting software (CAS) literacy and business taxation literacy in order to implement effective cash flow management practices.

Keywords: Small business; Cash flow; Tax literacy; Financial literacy; CAS literacy.

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I INTRODUCTION

The lifecycle of many small businesses in Australia and throughout the world is less than five years.¹ This has been attributed in part to their struggle to maintain consistent cash levels. Cash flow management appears to be difficult for many SBOs; however, it is unclear why SBOs find it so problematic. It appears that financial literacy of SBOs may have some impact on their ability to make sound financial decisions.²

Another concern for effective management of cash flow by SBOs relates to the obligation to collect and settle tax liabilities. It has been suggested that taxation may negatively impact the ability of SBOs to maintain consistent cash levels. The current research project seeks to gain a greater understanding as to whether cash flow difficulties are a direct result of taxation or whether there are other underlying issues that influence cash flow (and/or the taxation relationship).

Considering that research has identified that the relationship between small business cash flow and tax may be distorted by other business factors including individual characteristics of the SBO, it was deemed important to investigate areas of SBO characteristics not previously studied when analysing cash flow. In particular it was determined that some specific types of SBO literacy may have an effect on the tax and cash flow relationship.³ When identifying the appropriate areas of literacy, it was necessary to determine what influences a SBO's ability to understand cash flow and implement effective cash flow management strategies. These strategies can be linked to literacy of business tax systems as a number of business taxes require SBOs to understand the effects of incurring taxes today and planning for payment of the tax liability in the future.

Recent research suggests that to a large extent SBOs identify that increased literacy could be beneficial to their cash flow management.⁴ However, when investigating the level of literacy held it was found that only 12 per cent of SBOs implemented systematic cash flow management practices in their business, and only those educated in accounting made use of financial statements to help them to determine the liquidity of their business. Also, even though SBOs recognised managerial benefits from use of computer accounting software (CAS) in the form of accurate record keeping it was apparent that CAS was not being used to support cash flow management. More than half (56 per cent) of SBOs had limited knowledge on what financial reports could be produced in their CAS, and 12.5 per cent of SBOs were not aware that they could prepare any financial reports in their CAS. This suggests that SBOs were not realising any managerial benefits in the form of cash flow

¹ Australian Bureau of Statistics, *8165.0 – Counts of Australian Businesses, Including Entries and Exits, Jun 2012 to Jun 2016* (20 February 2017) <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0>>; Olawale Fatoki, 'The Financial Literacy of Micro Entrepreneurs in South Africa' (2014) 40(2) *Journal of Social Sciences* 151. The survival rate of small business increases as annual turnover increases. Those generating less than AU\$200 000 per annum have a lower chance of survival than those earning over AU\$200 000.

² Fatoki, above n 1, 153.

³ Melissa Belle Isle and Brett Freudenberg, 'Calm Waters: GST and Cash Flow Stability for Small Businesses in Australia' (2015) 13(2) *eJournal of Tax Research* 492.

⁴ Toni Chardon, Brett Freudenberg and Mark Brimble, 'Tax Literacy in Australia: Not Knowing Your Deduction from Your Offset' (2016) 31(2) *Australian Tax Forum* 321; Brett Freudenberg, Toni Chardon, Mark Brimble and Melissa Belle Isle, 'Tax Literacy of Australian Small Businesses' (2017) 18(2) *Journal of Australian Tax* 21.

management from use of CAS. It appears that literacy levels of SBOs in the research may not be at a level that supports cash flow of their business. Furthermore, from the findings it appears that 25 per cent of SBOs saw little benefit in being tax literate and instead saw taxation literacy to be the role of their accountant or advisor.

As a result of these findings the current research was designed to determine whether there is a required level of literacy that SBOs should possess in order to adequately support the cash flow management requirements of their business. Small business experts from varying professions in the small business landscape were engaged to explore their views on the level of literacy required by SBOs for effective cash flow management. In particular the areas of literacy that were examined when taking cash flow management and taxation into account for small business included two parts (of four) of professional financial literacy,⁵ CAS literacy and business taxation literacy.

This article presents the outcome of the data collected from 23 small business experts using the first stage of a Delphi technique.⁶ The structure of this article is as follows. First, relevant literature relating to cash flow concerns of Australian small businesses is discussed. Second, an overview of prior knowledge relating to SBO literacy in terms of professional financial literacy, CAS literacy and business taxation literacy is presented. Third, the methodology employed for the research is outlined followed by the findings of the research. The article is finalised with a concluding summary and recommendations for future research.

II SMALL BUSINESS CASH FLOW CONCERNS

A critical issue for all businesses is maintaining a consistent cash flow, which can be especially acute for small businesses due to restricted access to finance.⁷ Cash flow is the extent of cash or near cash assets available for use, along with any inflow or outflow of cash related to these assets.⁸ Therefore, cash flow is any business activity that alters the balance of the cash accounts. Previous research in Australia suggests that SBOs have recognised that cash flow is of particular importance to their ongoing survival,⁹ although it can be difficult for them to manage.¹⁰

Cash flow management has been identified as one of the most important problems for businesses in the United Kingdom, the United States of America and Australia.¹¹ Effective

⁵ See Andrew Worthington, 'The Distribution of Financial Literacy in Australia' (School of Economics and Finance Discussion Papers and Working Papers Series 185, School of Economics and Finance, Queensland University of Technology, 2004) 6.

⁶ The Delphi technique is discussed further in the Methodology section of this article.

⁷ Belle Isle and Freudenberg, above n 3, 519.

⁸ Shawn Carraher and Howard van Auken, 'The Use of Financial Statements for Decision Making by Small Firms' (2013) 26(3) *Journal of Small Business & Entrepreneurship* 323; Ignatius Ekanem, 'Liquidity Management in Small Firms: A Learning Perspective' (2010) 17(1) *Journal of Small Business and Enterprise Development* 123.

⁹ Melissa Belle Isle, Brett Freudenberg and Richard Copp, 'Cash Flow Benefit from GST: Is It Realised by Small Businesses in Australia?' (2014) 29(3) *Australian Tax Forum* 417; Ian Wallschutzky and Brian Gibson, 'Small Business Cost of Tax Compliance' (1993) 10(4) *Australian Tax Forum* 511, 527.

¹⁰ Belle Isle and Freudenberg, above n 3; Fatoki, above n 1.

¹¹ Scott Holmes and Des Nicholls, 'An Analysis of the Use of Accounting Information by Australian Small Business' (1998) 26(2) *Journal of Small Business Management* 57, 57; Michael Peel, Nicholas Wilson and

cash management is important to business survival irrespective of the size of the business.¹² When assessing small business liquidity it has been suggested that small businesses are less liquid and exhibit more volatility with cash flow and profit than their larger competitors.¹³ It has been observed that SBOs should try to avoid extended cash shortages, as supply constraints can affect the ongoing operations of the business and thereby make situations worse.¹⁴ In order to reduce cash constraints and achieve better control of cash flow, SBOs need to implement effective liquidity management practices.¹⁵

Effective liquidity management consists of keeping financial accounts, maintaining a business plan and cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and maintaining an inventory schedule.¹⁶ Previous research in Australia and the UK suggests that SBOs are not actively involved in systematic liquidity management practices.¹⁷ While day-to-day recording of activities involving cash inflow and outflow may be undertaken, the process involved in receiving and making payment for those activities or managing cash once received may not be actively conducted.¹⁸

The strengths of an SBO at commencement of their business revolve around the technical skill set of that owner.¹⁹ Research suggests that SBOs are lacking financial management skills at start-up of their business (with the exception of businesses related to finance or accounting).²⁰ Research proposes that liquidity management should be regarded as important at the start and throughout the growth of the business.²¹ Advances or procurement of new liquidity management skills are adopted with time and business development.²² This often occurs as a result of external events or stakeholders that force SBOs to learn new procedures and routines.²³ For instance, if a SBO has never been required to prepare a cash budget or business plan for an external party, they may never be aware of the role that these documents can play in assisting with effective cash flow management practices.²⁴

The level of proficiency of the SBO in relation to cash flow management is not solely reflective of the owner's abilities and capacity.²⁵ Cash flow management practices can be

Carole Howorth, 'Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence' (2000) 18(2) *International Small Business Journal* 17, 19.

¹² Arthur R DeThomas and William B Freudenberger, 'Accounting Needs of Very Small Business' (1985) 55(10) *The CPA Journal* 14; Fatoki, above n 1.

¹³ Peel, Wilson and Howorth, above n 11, 19.

¹⁴ Fatoki, above n 1; Ekanem, above n 8, 124–5.

¹⁵ Peel, Wilson and Howorth, above n 11, 19–24.

¹⁶ Alejandro Drexler, Greg Fischer and Antoinette Schoar, 'Keeping It Simple: Financial Literacy and Rules of Thumb' (2014) 6(2) *American Economic Journal: Applied Economics* 1, 13; Ekanem, above n 8, 125.

¹⁷ Belle Isle and Freudenberger, above n 3, 514; Freudenberger et al, above n 4, 34; Peel, Wilson and Howorth, above n 11, 19.

¹⁸ Belle Isle and Freudenberger, above n 3, 514; Peel, Wilson and Howorth, above n 11, 19.

¹⁹ DeThomas and Freudenberger, above n 12; Freudenberger et al, above n 4, 29.

²⁰ Freudenberger et al, above n 4, 30; Peel, Wilson and Howorth, above n 11, 19.

²¹ Peel, Wilson and Howorth, above n 11, 19.

²² David Deakins, Alana Morrison and Laura Galloway, 'Evolution, Financial Management and Learning in the Small Firm' (2002) 9(1) *Journal of Small Business and Enterprise Development* 7, 9.

²³ *Ibid* 15, 16.

²⁴ *Ibid*.

²⁵ Abdel K Halabi, Rowena Barrett and Robyn Dyt, 'Understanding Financial Information Used to Assess Small Firm Performance' (2010) 7(2) *Qualitative Research in Accounting & Management* 163, 169.

influenced by the SBO's attitude or the value they place on having effective procedures within their business.²⁶ Results from previous research advocates that a large number of SBOs undervalue the importance of cash flow management practices in their business decision-making, with more value placed on information gathered from market research.²⁷ Management of cash and credit was rated second last of all management functions, and only a minority of business owners identified any benefit from acquiring any form of cash management training.²⁸ SBOs appear to adopt a minimum standard rather than attempting to achieve a level of best practice when it comes to cash flow management.²⁹ This may be a result of SBOs having low levels of literacy and understanding about the benefits of having an effective cash flow management system in place and how it can be achieved.³⁰

III SMALL BUSINESS OWNER LITERACY

Of interest to the current study of cash flow are the concepts of SBO literacy in terms of professional financial literacy, CAS literacy and business taxation literacy. These areas of literacy are explored further throughout this section and the remaining sections of the article.

A Professional financial literacy

Financial literacy can be described as having the competence to successfully make efficacious decisions and cognitive judgements in financial circumstances that have the ability to influence an individual's financial status or position.³¹ Another term often used in place of financial literacy is 'financial capability'. Financial capability however, takes into consideration an individual's personal financial skills, attitudes and characteristics when attempting to determine their financial decision-making.³² For the purpose of this article financial literacy and financial capability will be viewed as one in the same.

Having financial literacy skills is an essential basis for both avoiding and solving financial problems.³³ Business owners have been identified as having greater financial literacy than other groups of individuals.³⁴ This includes SBOs, who have a higher level of financial

²⁶ Ibid.

²⁷ Holmes and Nicholls, above n 11, 59; Peel, Wilson and Howorth, above n 11, 24.

²⁸ Peel, Wilson and Howorth, above n 11, 31-2.

²⁹ Deakins, Morrison and Galloway, above n 22, 9; Ekanem, above n 8, 135.

³⁰ Deakins, Morrison and Galloway, above n 22, 11.

³¹ Sandra J Huston, 'Measuring Financial Literacy' (2010) 44(2) *Journal of Consumer Affairs* 296, 303; Freudenberg et al, above n 4, 23; Annamaria Lusardi and Olivia S Mitchell, 'The Economic Importance of Financial Literacy: Theory and Evidence' (2013) 52(1) *SSRN Electronic Journal* 5; Worthington, above n 5, 6.

³² Toni Brackin, *Taxation as a Component of Financial Literacy: How Literate Are Australians in Relation to Taxation* (PhD Thesis, Griffith University, 2014) 22; Freudenberg et al, above n 4, 23.

³³ Freudenberg et al, above n 4, 23; Sonia Marcolin and Anne Abraham, 'Financial Literacy Research: Current Literature and Future Opportunities' in P Basu, G O'Neill and A Travaglione (eds), *Proceedings of the 3rd International Conference on Contemporary Business* (Leura, NSW, Australia, 21-22 September 2006) 3.

³⁴ Reva Berman Brown, Mark N K Saunders and Richard Beresford, 'You Owe It to Yourself: The Financially Literate Manager' (2006) 30(2) *Accounting Forum* 171, 188; Freudenberg et al, above n 4, 25. Other

awareness than other individuals.³⁵ However, the financial literacy required to operate a small business is greater than that required for individual success.³⁶ Previous research suggests that SBOs lack the required level of financial literacy to make important financial decisions for their business.³⁷

The level of financial literacy required can depend upon someone's role. For example, the financial literacy expected of directors has been identified as professional financial literacy and includes having an understanding of financial statements, cash flow management, internal control mechanisms and corporate governance.³⁸ Financial statements that are of particular importance to professional financial literacy include the balance sheet, income statement, cash flow statements and the preparation of a cash budget.³⁹ This is due to their relevance to cash flow management and the influence that these statements can have on determination of business solvency by the SBO.⁴⁰

Solvency of small business is a critical part of small business management and is dependent on the level of professional financial literacy that the business owner possesses.⁴¹ Solvency is achieved through careful cash planning and control, which requires the owner to understand the financial position and activities of the organisation.⁴² SBO professional financial literacy can influence firm growth and productivity, and those with higher levels of financial literacy have been known to be more effective when using financial products and are more engaged in using and offering trade credit.⁴³ It has also been found that those with high levels of literacy are more likely to improve their literacy through using professional advisors whereas those with lower levels of literacy are more likely to rely on financial advice from friends and family, which could have negative effects on their improving their professional financial literacy in the long term.⁴⁴

Adequate financial literacy for SBOs can assist with everyday functions in the business. This can enable the SBO to evaluate financial information in order to make decisions while understanding the consequences of those decisions.⁴⁵ Preparation and use of financial statements can assist business owners to make more informed decisions and can facilitate improved performance. Information from financial statements can illustrate the

individuals with high levels of financial literacy include those with a tertiary education, professional occupation or a member of a couple with no children.

³⁵ Berman Brown, Saunders and Beresford, above n 34, 188.

³⁶ Freudenberg et al, above n 4, 25.

³⁷ Drexler, Fischer and Schoar, above n 16, 1–2; Fatoki, above n 1; Freudenberg et al, above n 4, 25.

³⁸ Worthington, above n 5, 5.

³⁹ Berman Brown, Saunders and Beresford, above n 34, 188.

⁴⁰ Fatoki, above n 1, 153.

⁴¹ Berman Brown, Saunders and Beresford, above n 34, 179–80.

⁴² DeThomas and Fredenberger, above n 12, 21; Fatoki, above n 1.

⁴³ Miriam Bruhn and Bilal Zia, 'Stimulating Managerial Capital in Emerging Markets: The Impact of Business Training for Young Entrepreneurs' (2013) 5(2) *Journal of Development Effectiveness* 232, 234 and 238; Fatoki, above n 1, 152.

⁴⁴ Tabea Bucher-Koenen, Annamaria Lusardi, Rob Alessie and Maarten van Rooji, 'How Financial Literate Are Women? An Overview and New Insights' (NBER Working Paper No 20793, National Bureau of Economic Research, December 2014) 13.

⁴⁵ Berman Brown, Saunders and Beresford, above n 34, 179–80; Fatoki, above n 1, 152.

consequences of the business operations.⁴⁶ Financial statements can also be used to measure profitability, perform ratio analysis, and assist with providing information to external stakeholders including financial institutions and banks.⁴⁷ An important advantage of small businesses using financial statements is that it can provide them with up-to-date cash flow information. Cash flow records can have greater usefulness to small businesses than accrual information when determining solvency, as preparation of reports relevant to cash flow provides a more accurate assessment of the present status of the business, and may assist with implementing strategies to overcome any cash flow problems.⁴⁸

Regardless of the abundance of research that suggests that use of financial statements is valuable to the ongoing success of small businesses, it appears that small businesses in Australia and overseas make limited use of financial statements to assist them in managing their business.⁴⁹ Although a large proportion of SBOs believe that evaluation and use of financial statements is their responsibility, previous research in Australia suggests that only 30 per cent use reports for decision-making, 20 per cent perform any form of ratio analysis, 11 per cent use the information to evaluate business performance and 10 per cent use current financial information for future plans or budgets.⁵⁰ Research both in Australia and overseas suggests that limited use of financial statements could be explained by education levels of the SBO.⁵¹ More educated SBOs are deemed better equipped at analysing and interpreting the figures presented in the statements.⁵²

In addition to literacy, SBOs indicate that the limited use of financial reports was a result of minimal significance placed on the information available in the statement, especially with regard to income statements and balance sheets.⁵³ SBOs believed that the main purpose of record keeping and producing reports was for tax compliance requirements, rather than being a worthwhile source of information and insight for management decisions.⁵⁴ That is, there is a lack of perception of any managerial benefit received from accounting records, other than for tax records/returns.⁵⁵ This confusion about the benefits of record keeping can be demonstrated in compliance cost research, where

⁴⁶ Bruhn and Zia, above n 43, 234 and 248.

⁴⁷ Robyn Dyt and Abdel K Halabi, 'Empirical Evidence Examining the Accounting Information Systems and Accounting Reports of Small and Micro Business in Australia' (2007) 15(2) *Small Enterprise Research* 1, 5; Fatoki, above n 1, 153; Halabi, Barrett and Dyt, above n 25, 167.

⁴⁸ Divesh S Sharma and Errol R Iselin, 'The Decision Usefulness of Reported Cash Flow and Accrual Information in a Behavioural Field Experiment' (2003) 33(2) *Accounting and Business Research* 123.

⁴⁹ Carraher and van Auken, above n 8; DeThomas and Fredenberger, above n 12; Dyt and Halabi, above n 47; Halabi, Barrett and Dyt, above n 25, 163; Peel, Wilson and Howorth, above n 11; Sharma and Iselin, above n 48.

⁵⁰ Dyt and Halabi, above n 47, 5; Halabi, Barrett and Dyt, above n 25, 167. A limitation of the Australian research is that the number of participants was 10.

⁵¹ Carraher and van Auken, above n 8, 333; DeThomas and Fredenberger, above n 12, 20; Halabi, Barrett and Dyt, above n 25, 171-4.

⁵² Carraher and van Auken, above n 8, 333; DeThomas and Fredenberger, above n 12, 20; Halabi, Barrett and Dyt, above n 25, 171-4.

⁵³ Halabi, Barrett and Dyt, above n 25, 171.

⁵⁴ *Ibid* 168.

⁵⁵ Nahida Faridy, Brett Freudenberg, Tapan Sarker and Richard Copp, 'The Hidden Compliance Cost of VAT: An Exploration of Psychological and Corruption Costs of VAT in a Developing Country' (2016) 14(1) *eJournal of Tax Research* 166.

compliance costs have been miscategorised as a tax cost when it is more a cost about basic record keeping for a business.⁵⁶ More importance can be placed on remaining up-to-date with the cash at bank balance, with this figure perceived to be a more accurate measure of performance.⁵⁷ Accordingly, while SBOs can identify that cash is essential for survival of their business, research suggests that they still do not see the importance of using financial reports, like a cash flow budget or cash flow statement, to assist them in managing their cash flow.⁵⁸ It appears that this may be a result of their inability to comprehend the information contained in the financial reports in order to improve the performance of their business.⁵⁹

B Computer accounting software literacy

CAS has been advocated as being of great importance to small business success. Since the introduction of the GST in 2000 and increases in the personal use of information technology, it is posited that a large number of small businesses in Australia use a CAS system for record keeping in their business.⁶⁰

For a CAS system to be effective to a small business it should be simple to maintain by the owner,⁶¹ as the SBO is likely to be active in record keeping rather than having a delegated employee. Potentially this allows the SBO to gain a greater understanding of the financial strengths and weaknesses of the business.⁶² A CAS system allows SBOs to collect and collate information from transactions for use in a timely manner, without having to request this information from accountants.⁶³

Australian research suggests that SBOs do not use their CAS to its full potential.⁶⁴ Indeed, the majority of SBOs do not produce financial reports from their CAS.⁶⁵ The reasoning for non-generation of reports was that SBOs do not understand accounting language, conventions or terms (that is, have low professional financial literacy), and therefore see limited value in generating a report that they do not understand.⁶⁶ Also, it appeared that

⁵⁶ Chris Evans, K Ritchie, Binh Tran-Nam and Michael Walpole, 'Taxation Compliance Costs: Some Recent Empirical Work and International Comparisons' (1997) 14 *Australian Tax Forum* 93; Philip Lignier and Chris Evans, 'The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia' (2012) 27(3) *Australian Tax Forum* 615.

⁵⁷ Halabi, Barrett and Dyt, above n 25, 167-74.

⁵⁸ DeThomas and Fredenberger, above n 12, 18-19; Fatoki, above n 1.

⁵⁹ Gerard Stone, 'Let's Talk: Adapting Accountants' Communications to Small Business Managers' Objectives and Preferences' (2011) 24(6) *Accounting, Auditing & Accountability Journal* 781, 785.

⁶⁰ Philip Lignier, *Identification and Evaluation of the Managerial Benefits Derived by Small Businesses as a Result of Complying with the Australian Tax System* (PhD Thesis, University of New South Wales, 2008) 25; Lignier and Evans, above n 56.

⁶¹ DeThomas and Fredenberger, above n 12, 21; Stone, above n 59.

⁶² Fatoki, above n 1, 156.

⁶³ Carraher and van Auken, above n 8; Halabi, Barrett and Dyt, above n 25, 166.

⁶⁴ Belle Isle and Freudenberg, above n 3; Melissa Belle Isle, Brett Freudenberg and Tapan Sarker, 'The Small Business Cash Flow Struggle: What Role Does Owner Literacy Play?' (Working Paper, Griffith University, 2017); Halabi, Barrett and Dyt, above n 25, 166.

⁶⁵ Ibid.

⁶⁶ DeThomas and Fredenberger, above n 12, 22-3; Halabi, Barrett and Dyt, above n 25, 168.

10 per cent of SBOs were unaware that they could even produce financial reports from their CAS.⁶⁷

Recent Australian research indicates that the CAS is not being used effectively to assist with management of cash flow, with low engagement in the use of CAS reporting options.⁶⁸ As a result, participants were spending considerable time arranging finances for payment of liabilities.⁶⁹ In contrast recent international research suggests that individuals who make regular use of tax software are more financially aware.⁷⁰ The difference could be explained by the existence of a position indicator in the tax software used in the United States of America.⁷¹ It could be argued that CAS systems available to SBOs in Australia are also capable of providing an indicator of cash flow position, however this would be reliant on timely recording of transactions.

As a result, it is argued that the low utilisation of CAS is in part the result of limited knowledge (literacy) about the functions of the CAS system and the benefits that can be realised from using the CAS for cash flow management in a small business.

C Business taxation literacy

Recent research by Chardon, Freudenberg and Brimble⁷² and Freudenberg, Chardon, Brimble and Belle Isle⁷³ suggest that understanding of tax systems is beneficial to a person's overall financial position. The level of knowledge that an individual possesses of tax systems is posited to have a relationship with their ability to communicate with advisors, budget, make decisions and understand their rights and obligations.⁷⁴ It was proposed that there is a base level of taxation and superannuation literacy or knowledge required in order to be financially literate.⁷⁵

Recent research conducted in Australia found that individuals that are involved in business are more literate in regard to individual taxation requirements than those who are not.⁷⁶ However, the level of tax literacy in relation to business tax systems does not appear to be adequate for management of their business tax requirements.⁷⁷

Research in the 1990's suggested that SBOs needed to spend more time improving their level of tax knowledge. McKerchar⁷⁸ proposed that SBOs experience difficulty with

⁶⁷ Halabi, Barrett and Dyt, above n 25, 171.

⁶⁸ Belle Isle and Freudenberg, above n 3; Belle Isle, Freudenberg and Sarker, above n 64.

⁶⁹ Belle Isle, Freudenberg and Copp, above n 9.

⁷⁰ Nicholas C Hunt and Govind S Iyer, 'The Effect of Tax Position and Personal Norms: An Analysis of Taxpayer Compliance Decisions Using Paper and Software' (2018) 41 *Advances in Accounting* 1.

⁷¹ Hunt and Iyer, above n 70.

⁷² Chardon, Freudenberg and Brimble, above n 4.

⁷³ Freudenberg et al, above n 4.

⁷⁴ Chardon, Freudenberg and Brimble, above n 4; Freudenberg et al, above n 4, 26.

⁷⁵ Toni Chardon, 'Weathering the Storm: Tax as a Component of Financial Capability' (2011) 5(2) *Australasian Accounting Business & Finance Journal* 53 <<http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1168&context=aabfj>>; Freudenberg et al, above n 4, 26.

⁷⁶ Chardon, Freudenberg and Brimble, above n 4; Freudenberg et al, above n 4, 45.

⁷⁷ Freudenberg et al, above n 4, 26; Margaret McKerchar, 'Understanding Small Business Taxpayers: Their Sources of Information and Level of Knowledge of Taxation' (1995) 12 *Australian Tax Forum* 25, 40.

⁷⁸ McKerchar, above n 77, 32-5.

understanding superannuation guarantee (SG), income tax, provisional tax⁷⁹ and fringe benefit tax. McKerchar found that SBOs experienced difficulty in determining which benefits were classified as a fringe benefit, which employees attracted SG and what deductions were allowable.⁸⁰ More recent research findings indicate that SBO tax literacy may have improved in regard to allowable deductions, as 69 per cent of GST business operators⁸¹ could differentiate between assets that were immediately deductible in comparison to those that would depreciate over time.⁸² This may be a similar outcome for determination of correct dates for lodgement and payment of the tax liability. SBOs experienced complexity in identifying the reporting and payment requirements of tax systems in the 1990s. In comparison, 71 per cent of SBOs were confident that they accurately meet their GST recording and reporting obligations in research conducted in 2017.⁸³

Also, a significant number of SBOs in the research by McKerchar⁸⁴ had a limited understanding of provisional tax, the forerunner to the PAYG (pay as you go) instalment. SBOs had difficulty comprehending that a payment of provisional tax decreased the overall amount of tax liability due at the end of the financial year.⁸⁵ The level of SBO literacy in terms of the current PAYG instalment system is unclear.

While research found that more than 90 per cent of SBOs suggested that they pursued tax information from various sources including advisors and the Australian Taxation Office (ATO), these practices were rarely undertaken by SBOs.⁸⁶ Also, evidence suggested that SBOs are not proactive in improving their tax knowledge, which was substantiated during prior studies when researchers provided respondents with information of taxes that were identified as being complex. The participants did not make use of the information during the time that the research was conducted.⁸⁷ It was suggested that there were two primary reasons for the lack of uptake of the tax information.

First, tax obligations were a low priority for SBOs, with greater importance placed on income earning activities.⁸⁸ A second possible reason was that SBOs perceived that they were knowledgeable about business tax matters,⁸⁹ and once business owners believed that they were well informed about a specific tax matter they did not review or revise their tax management practices at a later date. As a result, SBOs were oblivious to any changes to legislation or misrepresentations of tax law that occurred at a later time.⁹⁰ This is supported by findings of 'GST business operators' in a study conducted more recently

⁷⁹ Provisional tax was replaced and the new system is known as PAYG instalments, covered under *A New Tax System (Pay As You Go) Act 1999* (Cth).

⁸⁰ Freudenberg et al, above n 4, 27; McKerchar, above n 77, 34.

⁸¹ In Freudenberg et al, above n 4, SBOs were identified as 'GST Business Operators'.

⁸² Freudenberg et al, above n 4.

⁸³ Ibid 48.

⁸⁴ McKerchar, above n 77, 34.

⁸⁵ Provisional tax was essentially pre-payments of an estimated income tax liability. So once a tax return was lodged for the year, the overall tax liability owing would be reduced by the prior instalment (provisional tax) paid.

⁸⁶ McKerchar, above n 77, 30.

⁸⁷ Ibid 32; Wallschutzky and Gibson, above n 9, 528.

⁸⁸ McKerchar, above n 77, 36; Wallschutzky and Gibson, above n 9, 528.

⁸⁹ McKerchar, above n 77.

⁹⁰ Ibid 35.

on Australian business tax payers.⁹¹ It was purported that SBOs may struggle to stay up-to-date with continual changes in tax laws and the resultant outcome could be that they fail to maintain the required level of literacy to efficiently comply with the tax systems relevant to their business.⁹²

Further reasoning for limited tax literacy was determined to relate to expert advisors. SBOs placed great reliance on their accountant to carry out and understand all tax matters relevant to their business.⁹³ This is supported by more recent findings by Freudenberg et al, who suggested that those SBOs who had been in business for a substantial period of time had lower levels of tax literacy, as they relied heavily on advisors to carry out their business tax obligations.⁹⁴ McKerchar indicated that there was a need to improve tax literacy of SBOs, but noted that if SBOs did not perceive that being tax literate was important or if they did not recognise that there was a shortfall in the level of tax literacy they possessed, then any attempt at educating them would be futile.⁹⁵ Therefore, it appears that the personal perceptions of SBOs may be a critical motivator in whether they want to improve their tax literacy. Recent research into literacy of trustees of a self-managed super fund suggests that literacy has a positive association with fund compliance.⁹⁶ This could suggest that it would be advantageous for SBOs to remain at a level of taxation literacy to ensure that they are compliant with relevant tax systems.

Consequently, it can be appreciated that SBOs need literacy in a number of areas including professional financial, CAS and business taxation literacy. Although prior research suggests that SBOs may have higher literacy when compared to the broader public, it is questionable whether their literacy level is sufficient to operate a business and whether it influences their cash flow management practices.

IV METHODOLOGY

This article reports the findings of data collected from small business experts to greater understand the level of literacy required in terms of professional financial, CAS and business taxation⁹⁷ literacy in order for SBOs to successfully manage their business cash flow. The research question being addressed in this article is: *Are cash flow management practices in small businesses influenced by literacy of small business owners?*

It is important to acknowledge that this study forms part of a larger research project involving Australian small businesses. The views and opinions of SBOs are the primary focus in the larger project. The justification for including experts in the larger project was to validate and compare responses of SBOs due to the heterogeneity of the small business

⁹¹ Freudenberg et al, above n 4.

⁹² Ibid 50.

⁹³ McKerchar, above n 77, 36.

⁹⁴ Freudenberg et al, above n 4, 39.

⁹⁵ McKerchar, above n 77, 40.

⁹⁶ George Mihaylov, John Tretola, Alfred Yawson and Ralf Zurbruegg, 'Tax Compliance Behaviour in Australian Self-Managed Superannuation Funds' (2015) 13(3) *eJournal of Tax Research* 740.

⁹⁷ The PhD project for which the data related to this article was collected focuses on five tax obligations with which small businesses might comply, including: goods and services tax, fringe benefit tax, income tax, PAYG withholding and superannuation guarantee (not a tax system). It should be acknowledged that experts were not asked to talk specifically about these systems in the semi-structured interviews.

sector. Diversity of small businesses is particularly evident in terms of taxability, ownership, flexibility, industry, economies of scale, financial market access and level of information asymmetry. This diversity can make it difficult to ascertain any commonality between one small business and the next.

A The Delphi technique

The strategy of inquiry implemented for this part of the project and relevant to this article involved the first (of two) stages of a Delphi technique.⁹⁸ The Delphi technique is a systematic, repetitive process of collecting opinions or views from a group of experts.⁹⁹ Its objective is to clarify, explain or obtain consensus from experts in relation to an event or phenomenon.¹⁰⁰ The use of expert opinions as opposed to other individuals is justified on the basis that their opinions will be logical or sensible in comparison to having irrational judgement.¹⁰¹ Knowledge of experts in relation to a particular issue is independently collected and results are combined to give an overview of all expert responses.¹⁰² The collective results are used to vary or ratify the original data collection instrument, which is then redistributed to the same group of experts at a time in the future.¹⁰³ The purpose of altering the original instrument as a result of collective expert opinions is to reveal whether individual judgements are revised as a result of reviewing the collective expert feedback or whether experts are steadfast in their original responses.¹⁰⁴

The Delphi technique for this article was conducted in the qualitative phase immediately after the conclusion of a multiple case study of Australian small service-related businesses. Data collection instruments were created in the form of a semi-structured interview and a series of short survey questions from the collective findings from the multiple case study and prior literature in an attempt to substantiate the responses of SBOs. The design of the Delphi technique for the research was adapted to suit the validation role of experts in the project. That is, the responses of SBOs in the multiple case study shaped the interview questions and short survey questions posed to experts.¹⁰⁵

⁹⁸ It is anticipated that future publications for this research, once both Delphi stages are completed, will discuss the application of the Delphi to the research in more depth, including strengths and weaknesses that were recognised.

⁹⁹ Chris Evans, 'Unravelling the Mysteries of the Oracle: Using the Delphi Methodology to Inform the Personal Tax Reform Debate in Australia' (2007) 5(1) *eJournal of Tax Research* 105, 107; Jon Landeta, 'Current Validity of the Delphi Method in Social Sciences' (2006) 73(5) *Technological Forecasting and Social Change* 467, 468-9.

¹⁰⁰ Monica R Geist, 'Using the Delphi Method to Engage Stakeholders: A Comparison of Two Studies' (2010) 33(2) *Evaluation and Program Planning* 147, 148 and 152; Chitu Okoli and Suzanne D Pawlowski, 'The Delphi Method as a Research Tool: An Example, Design Considerations and Applications' (2004) 42(1) *Information & Management* 15.

¹⁰¹ Geist, above n 100, 148 and 152; Landeta, above n 99, 468-9.

¹⁰² Geist, above n 100, 148 and 152; Landeta, above n 99, 468-9.

¹⁰³ Okoli and Pawlowski, above n 100.

¹⁰⁴ Theodore Gordon and Adam Pease, 'RT Delphi: An Efficient, "Round-Less" Almost Real Time Delphi Method' (2006) 73(4) *Technological Forecasting and Social Change* 321, 322.

¹⁰⁵ The findings from experts will then be used in conjunction with the multiple case study to create a large-scale survey that will be completed by Australian small service-related businesses. The findings of the large-scale survey will then be used to create a second survey that will form the second part of the Delphi technique and will be completed only by those experts that participated in the first part of the Delphi.

The purpose of the short survey was to address findings from the multiple case study that required validation and incorporate areas of literature that required further examination of literacy relevant to SBOs and cash flow management.¹⁰⁶ The short survey questions were administered verbally by the researcher, and participants were required to give a quick response on a Likert-type scale between ‘Strongly Disagree’ and ‘Strongly Agree’. The semi-structured interview questions in comparison were constructed from reviewing feedback from SBOs in the multiple case study, and identifying areas that required further exploration. The purpose of the interviews was to determine whether experts perceived that there were important concepts that SBOs should possess or whether there is a base level of knowledge that should be attained by SBOs in order to adequately manage the cash flow of their business.

B Participants

Experts represented four groups, including academia, government, advocacy and advisory. Twenty-three experts participated in the project, with five experts representing the groups of academia, government and advocacy, and eight experts involved in advisory positions with small businesses.

The data for both the semi-structured interviews and the short survey was collected from experts during the same session, with the semi-structured interviews preceding the short survey questions. The duration of the sessions with experts ranged from 11 minutes to 40 minutes in length and all sessions were conducted over the telephone. Voice recording technology was used in order to capture the responses of participants and the data was transcribed at a later time. Telephone interviews were chosen to allow the researcher to engage experts from different States and Territories throughout Australia.

An overview of participant years of experience and roles held can be found in Table 1. Twenty participants had been involved in the small business landscape for more than five years. The remaining three participants were involved in assisting small businesses for a period of three to five years (two participants) or fewer than three years (one participant). Sixteen of the participants had been involved in more than one expert role over their years of experience, and six participants had previously owned a small business.

Table 1: An overview of participant expertise in relation to small businesses

Expert	Years of experience	Field of expertise	Prior roles held as an expert
ACA1	Over 10 years	Academic	No other role held
ACA2	Over 10 years	Academic	Accountant
ACA4	Over 10 years	Academic	Accountant
ACA5	5–10 years	Academic	Government/ATO employee

¹⁰⁶ Drexler, Fischer and Schoar, above n 16.

ACA6	Over 10 years	Academic	Government/ATO employee
ACC4	3-5 years	Accountant	No other role held
ACC5	Over 10 years	Small business advisor other than an accountant	Accountant
ACC6	Over 10 years	Small business advisor other than an accountant	Small business owner
ACC8	Over 10 years	Small business advocate	Small business advisor other than an accountant Government/ATO employee Small business owner
ACC10	Over 10 years	Accountant	Small business owner Board member of not-for-profit agencies
ACC11	<3 years	Small business advisor other than an accountant	Involved in advising ASBFEO on cash flow management practices
ACC12	5-10 years	Accountant	Small business advisor other than an accountant Small business advocate
ACC13	Over 10 years	Accountant	Small business advisor other than an accountant Government/ATO employee Small business advocate
ADV1	Over 10 years	Small business advisor other than an accountant	Small business owner
ADV3	5-10 years	Small business advocate	Government/ATO employee
ADV4	Over 10 years	Small business advocate	Government/ATO employee
ADV5	Over 10 years	Small business advocate	Accountant Small business advisor other than an accountant
ADV6	Over 10 years	Small business advocate	Academic Small business owner
GOV1	Over 10 years	Government/ATO employee	No other role held
GOV2	5-10 years	Government/ATO employee	Small business advisor other than an accountant
GOV6	Over 10 years	Government/ATO employee	Accountant Small business advisor other than an accountant

			Government/ATO employee Small business advocate Small business owner
GOV7	Over 10 years	Government/ATO employee	No other role held
GOV8	3–5 years	Government/ATO employee	Accountant

Key: ACA: Academic; ACC: Accountant or Advisor; ADV: Small Business Advocate; GOV: Government or ATO employee.

V FINDINGS

Expert perception was explored to address two important questions for each of the areas of literacy addressed in this project. Expert feedback was sought on whether there are essential concepts or a base level of literacy that SBOs require in relation to use and understanding of financial statements, CAS and business taxation systems. The second question posed was whether the level of literacy that SBOs possess has an influence on their ability to manage cash flow in their business. The responses are discussed below under each literacy area.

A Professional financial literacy

As previously mentioned, professional financial literacy includes having an understanding of financial statements, cash flow management, internal control mechanisms and corporate governance.¹⁰⁷ Two components of professional financial literacy are investigated in this project: (i) the understanding of financial statements; and (ii) the ability to implement cash flow management processes within a business situation. Determining the ability of SBOs to implement cash flow management concepts for this article was adopted from the definition of Drexler, Fischer and Schoar of effective cash flow management.¹⁰⁸ Effective cash flow management includes the activities of keeping financial accounts, maintaining a business plan and cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and maintaining an inventory schedule.¹⁰⁹ Prior research suggests that SBOs are better equipped to operate their business if their literacy in these areas is adequate.¹¹⁰

1 Expert perception of cash flow management processes implemented by small business owners

Previous research suggests that effective cash flow management includes keeping financial accounts, maintaining a business plan and a cash budget, keeping records of revenue and expenses, creditor and debtor invoicing, and maintaining an inventory schedule.¹¹¹ The research explored opinions of expert participants and the importance

¹⁰⁷ Worthington, above n 5, 5.

¹⁰⁸ Drexler, Fischer and Schoar, above n 16, 13.

¹⁰⁹ Drexler, Fischer and Schoar, above n 16, 13; Ekanem, above n 8, 125.

¹¹⁰ Berman Brown, Saunders and Beresford, above n 34, 179–80.

¹¹¹ Drexler, Fischer and Schoar, above n 16, 13; Ekanem, above n 8, 125.

they place on the concepts of effective cash flow management. The semi-structured interviews identified that understanding of cash flow and liquidity would be meaningful for SBO literacy. The largest number of responses related to liquidity and cash flow. Examples of participant responses are detailed below and highlight concerns that experts have in terms of SBO cash flow literacy:

Definitely you need to understand the principles behind identifying debtors, identifying aged payables, identifying what's profit, what's a loss, identifying those indicators of liquidity. Having that planning ahead of what's coming up in terms of your business debts and what your cash flow's going to be (ADV3).

I think they need to do some education around cash flow management because it doesn't come naturally to those that aren't financially inclined. Therefore, it is important, if not critical, for them to get their mind around numbers and cash flow versus profit in particular because there is a significant difference and a lot of owners just don't understand it (ACC13).

Probably the difference between what's profit and what is actual cash inflow and outflow. We find that a lot of small business owners don't understand the interaction between the profit and loss and the actual cash flow (ACC12).

To investigate cash flow management literacy further, experts were asked to indicate their thoughts in response to the survey statement: 'Small business owners have a good understanding of their cash flow.' Seven participants (30.44 per cent) agreed, five participants were neutral in their response and eleven participants (47.83 per cent) disagreed that SBOs have a good understanding of their cash flow (see Table 2). This indicates that nearly 50 per cent of experts have concerns about SBO understanding of cash flow, which is consistent with the prior literature.¹¹²

Table 2: Expert survey responses relating to use of financial statements by SBOs (n=23)

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Not Sure	Not Applicable
a) Small business owners have a good understanding of their cash flow.	21.74	26.09	21.74	21.74	8.70	0	0
b) Small business owners have procedures in place to manage their cash flow.	13.04	43.48	26.09	13.04	4.35	0	0
c) Small business owners make use of financial statements to manage their cash flow.	17.39	52.17	21.74	8.7	0	0	0

¹¹² Belle Isle, Freudenberg and Copp, above n 9; Belle Isle and Freudenberg, above n 3.

d) Small business owners rely on the bank account to manage cash flow.	4.35	4.35	8.7	52.7	30.43	0	0
e) The cash flow statement should assist small business to manage their cash flow.	0	4.35	8.7	43.48	43.48	0	0
f) The Profit and Loss statement should assist small business to manage their cash flow.	4.35	26.09	13.04	21.74	30.43	4.35	0
g) The balance sheet should assist small business to manage their cash flow.	9.09	22.73	18.18	31.82	18.18	0	0
h) Small businesses should prepare a business plan to manage cash flow.	0	17.39	21.74	26.09	34.78	0	0
i) Small businesses should prepare a cash budget to manage cash.	0	0	8.7	30.43	60.78	0	0

Note: Results displayed as a percentage (%). Rounding may influence calculations as a per cent of 100.

In response to the survey statement ‘Small business owners have procedures in place to manage their cash flow’, the number of experts that disagreed increased from the prior question to three strongly disagreeing and ten disagreeing (see Table 2). Overall, this represents 56.52 per cent who believe that SBOs are not implementing procedures to manage cash flow. This would tend to suggest that experts have concerns as to whether SBOs are capable of managing their cash flow. The semi-structured interviews and survey questions then explored what concepts of effective cash flow management were considered important for small business success.

Relying on the definition of Drexler, Fischer and Schoar¹¹³ to determine effective cash flow management, participants were asked to express whether they believed that SBOs should prepare a business plan to assist with management of cash flow. Fourteen participants (60.8 per cent) agreed in the short survey questions that a business plan should be prepared for managing cash flow (see Table 2), and only four participants disagreed (five were neutral). This suggests that experts consider a business plan to be a worthy instrument for effective cash flow management. However, the responses in the semi-structured interviews did not accentuate a business plan as being important to effective

¹¹³ Drexler, Fischer and Schoar, above n 16.

cash flow management. None of the participating experts discussed a business plan when identifying necessary concepts that SBOs should maintain for management of cash flow. Consequently, the connection between a business plan and cash flow management is not clear. It may be the existence of a business plan itself will not assist cash flow unless it is regularly used and reused. Alternatively, experts may not consider that a business plan is as important as other cash flow management concepts and therefore did not discuss it in the interview. However, when prompted in the survey, they recognised it could be a worthy tool for managing cash flow.

There was a similar outcome when experts were asked to indicate whether they believed that preparation of a cash budget would assist SBOs to manage their cash flow. There was minimal discussion in the interviews about the usefulness of preparing a cash budget for cash flow management. However the short survey questions showed that 60.78 per cent strongly agreed (14 participants) and 30.43 per cent agreed (7 participants) that SBOs should prepare a cash budget in order to effectively manage cash (see Table 2**Table 3:**). The remaining two participants responded with a neutral answer. This demonstrates that, to some extent, experts believe that a cash budget is a worthy tool for effective cash flow management, but it is of concern that there was a lack of discussion of cash budgets in the interviews, especially when prior research suggests that absence of budgeting in small business is associated with business failure.¹¹⁴

The responses in the semi-structured interviews in relation to understanding of necessary concepts for professional financial literacy gave considerable support to SBOs having a thorough understanding of their debtors and creditors and what effect these concepts have on their cash flow. Collectively, there were 15 responses in the interviews relating to treatment of debtors and creditors (or aged payable or receivable). Predominantly this was discussed in concert with a misunderstanding of what these figures represent in the financial statements (this will be discussed further in the next section) and how credit transactions can give a false indication of the immediate cash flow situation of the business. That is because expenses may be purchased on credit, which does not immediately affect cash flow given that cash outflow is delayed.

The influence of credit vastly changes situations so that a person can go broke making a profit (ACA2).

Understanding of the concepts of debtor, creditors especially accounts payable and accounts receivable is probably another one that's really important (ACC8).

In terms of the requirement to keep financial accounts, including a record of revenue and expenses, minimal discussion (if any) was directed specifically at these concepts. However, the discussions in the interviews appeared to suggest that keeping these records are a necessary component of operating any business. This is particularly evident where experts believed there are specific financial statements that need to be maintained and understood. Without accurate and up-to-date records of transactions these financial statements would not be a true representation of the financial status of the business. That is, for records to be of any use to cash flow they need to be both accurate and up-to-date,

¹¹⁴ Fatoki, above n 1, 154.

because if records are accurate but old, or up-to-date but inaccurate, their usefulness is diminished.¹¹⁵

2 *Base level or concepts of financial statement literacy that should be acquired by small business owners*

In relation to financial statements, professional financial literacy includes reading and understanding balance sheets, income statements, statements of cash flow and preparing a cash budget.¹¹⁶ Preparation and use of financial statements has been advocated as being effective in helping SBOs to make more informed decisions. Information from financial statements can illustrate the consequences of the business operations and the impact of previous financial decisions.¹¹⁷ An important advantage of use of financial statements for small businesses is to provide up-to-date cash flow information. Regardless of the abundance of research that suggests that use of financial statements is valuable to the ongoing success of small businesses, it appears that SBOs in Australia and overseas make limited use of financial statements to assist them in managing their businesses.¹¹⁸ This may be related to SBO financial statement literacy, as Fatoki¹¹⁹ suggests that SBOs with higher levels of literacy produce and make use of financial statements more frequently than those with lower levels of literacy.

The survey response questions explored whether experts have witnessed SBOs making use of financial statements for cash flow management. Experts were first posed with the statement: 'Small business owners make use of financial statements to manage their cash flow' (see Table 2). Only two participants agreed with this statement. In comparison, 16 participants (69.56 per cent) disagreed/strongly disagreed (five participants gave a neutral response). This would suggest that experts do not think SBOs use financial statements to manage cash flow.

In comparison to the *use* of financial statements, the survey questions explored the reliance on the bank account balance. Experts were asked to give their thoughts on SBO use of the bank statement or bank account. In response to the statement: 'Small business owners rely on the bank account to manage their cash flow', 82.9 per cent of responses (19 participants) were in agreeance in comparison to 8.7 per cent disagreeing (Table 2). This suggests that experts believe that SBOs are relying heavily on their bank statement or bank balance as an indicator of cash flow.

In order to determine whether small business experts perceived that there are specific concepts of which SBOs should have understanding to have financial statement literacy, the semi-structured interviews addressed the question: 'In your opinion, what is the base level or concepts of literacy required by small business owners in relation to use and understanding of financial statements?' To facilitate discussion, participants were

¹¹⁵ Fatoki, above n 1, 154–5.

¹¹⁶ Berman Brown, Saunders and Beresford, above n 34, 188.

¹¹⁷ Bruhn and Zia, above n 43, 234 and 248; Fatoki, above n 1, 153.

¹¹⁸ DeThomas and Fredenberger, above n 12; Dyt and Halabi, above n 47; Halabi, Barrett and Dyt, above n 25; Peel, Wilson and Howorth, above n 11; Sharma and Iselin, above n 48.

¹¹⁹ Fatoki, above n 1, 153.

supplied with a list of possible concepts that might be considered when determining financial statement literacy (see Appendix 1).

As already discussed in the prior section, there was a large number of responses that related to aged payables and receivables and liquidity and cash flow. However, in terms of financial statement literacy, there were varying views on which concepts and financial statements were necessary for a SBO to be considered literate. Only one participant mentioned the need to understand accounting ratios. This suggests that accounting ratios may not be considered a necessary part of professional financial literacy for SBOs.

An attempt was made to determine whether experts believed that certain financial statements were better suited or gave more value to a SBO for cash flow management. The semi-structured interviews and the survey questions explored the importance experts placed on use of financial statements for cash flow management. The interviews gave varying feedback regarding the necessity to understand financial statements:

I think the base level concept is around, the difference between assets and liabilities. How much equity they have; fundamentally the difference between a balance sheet and a profit and loss statement, and what they can be used for. I suppose it's probably more about what financial statements can be used for in terms of running their business (ACA6).

The expert feedback in the interviews relating to the importance of specific financial statements was diverse. The largest number of responses in the interviews related to the profit and loss statement, followed by the balance sheet and the statement of cash flow receiving equal feedback. The outcome of the survey questions, however, placed the statement of cash flow as the most important financial statement to assist with management of cash flow. Feedback from the survey questions relating to the profit and loss statement suggested that just over half (52.17 per cent) of the expert participants believe it to be useful for cash flow management. Thirty per cent disagree that it is a cash flow management tool and the remaining experts were either unsure or gave a neutral response about its purpose for cash flow management (Table 2). The interview responses however were more supportive of the profit and loss statement. Participants gave the following feedback:

Well I think they need to understand where they're making a profit, so profit and loss, and they need to determine short and long term viability (ACA5).

So probably the base level of using financial statements should be the ability to read the profit and loss, and in terms of understanding, the big thing we try and get people to focus on is their gross profit margin (ACC10).

For a business starting out they should understand financial statements and difference between revenue and profit and loss (ACC12).

The balance sheet was determined the least useful statement to assist with management of cash flow in the survey questions (Table 2). Fifty per cent of participants agreed/strongly agreed that it was effective, whereas 31.82 per cent disagreed and 18.18 per cent gave a neutral response. These results are supported by the lack of responses on balance sheets from the interviews. Only two experts gave feedback about the necessity for SBOs to understand the balance sheet in order to have professional financial literacy. Those comments did not provide persuasive arguments to conclude that understanding of the balance sheet is important for professional financial literacy.

The survey questions expressed significant support for the understanding of the statement of cash flow as a tool for cash flow management (Table 2). Participants were asked to respond to the statement: 'The statement of cash flow should assist small business to manage their cash flow.' An overwhelming response of 87 per cent of participants (20 people) agreed that this is a useful statement for cash flow management. Only one participant disagreed and the remaining two experts gave a neutral response. As mentioned, the interview comments were not as supportive of the statement of cash flow as a necessary component of professional financial literacy. Comments relating to the statement of cash flow were:

So obviously the statement of cash flows would be probably the most important; and the profit and loss; and the balance sheet, I guess would be the next (ACA2).

We try and encourage clients to do annual forecasting but probably get them more to focus on a 12 week cash flow forecast, which is more probably dynamic and continuing. So in terms of using financial statements, the cash flow statement is the most important (ACC10).

Although understanding and use of the statement of cash flow was not well discussed in the interviews, cash inflow and outflow and the distinction between cash and profit was given substantial consideration overall in terms of cash flow literacy (see previous comments). This suggests that knowledge and understanding of liquidity is an essential part of professional financial literacy.

In summary, experts suggest that SBOs do not currently make use of or understand their financial statements. The results demonstrate that experts have observed that SBOs place more significance on the information obtained from the bank account as an indicator of cash flow stability than any other source. This is concerning, considering that unlike the statement of cash flows the bank account balance does not take liabilities into consideration.

In contrast, small business experts propose that the most influential financial statements that SBOs should make use of and understand in order to be literate include the statement of cash flow and the profit and loss statement. Preparing a cash budget and a business plan were also given strong support by experts as necessary components for cash flow management and professional financial literacy. Financial concepts that have been implied by experts as being essential for SBOs include identifying indicators of liquidity or recognising cash flow issues, such as understanding the effect of aged payables and receivables on cash flow, determining the difference between profit and cash, and having some ability to prepare and maintain a cash budget or forecast.

3 Does the level of small business owner professional financial literacy influence their ability to manage cash flow?

The views of experts were examined in relation to whether the level of professional financial literacy of SBOs has any impact on their ability to manage cash flow.¹²⁰ Only one participant suggested that literacy levels have no bearing on cash flow management from

¹²⁰ Berman Brown, Saunders and Beresford, above n 34, 179–80.

a financial statement literacy perspective, and this was because financial statements only provide SBOs with historical data and are of no use for cash flow management:

Most of them don't understand their financial statements and I don't think that influences their ability to manage cash flow. Basically, nobody uses financial statements produced by their accountant, you're onto the next financial year before you get them (ACC6).

However, this statement appears to be more in terms of end-of-year reporting including balance sheets and profit and loss statements. This participant argues that end-of-year reporting is redundant for cash flow management due to the statements by that time containing historical data. This suggests that the level of SBO literacy is irrelevant because these financial statements do not have currency to be useful for cash flow management.

The remaining feedback from experts all confirmed that the level of literacy has some impact on management of cash flow. The responses from participants revolved around four main themes. Experts suggested that literacy levels influence the SBO's ability to succeed by allowing them to understand the principles in the financial statements, to identify cash flow issues in advance, to illustrate the effects of previous decisions, and to have more informed conversations with external stakeholders. The expert feedback reinforces the existing literature suggesting that adequate professional financial literacy supports SBOs with everyday functions in the workplace and allows them to make more informed and strategic decisions.¹²¹

First, responses indicate that without adequate literacy SBOs are not equipped to interpret the important information contained in the financial statements in terms of cash flow. Misunderstanding of the concepts and principles required to read financial statements can leave SBOs in a vulnerable situation in terms of their cash flow.¹²² Experts expressed their concerns about inadequate ability to understand these concepts in the financial statements:

A lot of small businesses don't succeed because they don't understand the financial statements. If they don't create them or don't understand them, then that causes cash flow problems. So yes, a very strong relationship between the literacy and managing cash flow (ACA5).

The level of literacy that they hold in many ways can influence the success of the business because they need to understand how to manage their revenues and their expenses. They can pay an accountant to do that but it's expensive and they tend to shy away from that and they tend to do it themselves. Therefore, especially in those initial stages of owning a business, the higher their level of literacy around financial numbers the greater the chances of them succeeding in managing their business (ACC13).

Similar to research by Bruhn and Zia¹²³ and Fatoki,¹²⁴ experts expressed their views on how increased literacy of financial statements can improve the SBO's cash flow effectiveness, and their firm's performance and growth. It was stated that being more

¹²¹ Ibid.

¹²² Fatoki, above n 1, 156.

¹²³ Bruhn and Zia, above n 43, 234 and 238.

¹²⁴ Fatoki, above n 1, 179–80.

literate allows SBOs to be more informed in discussions with external stakeholders and reduces expenditure when engaging advisors:

A higher level of literacy also helps them to contain advisor costs because it means that they have the capability to put together briefs and statements and information in a way in which it saves advisors time in terms of getting on top of and understanding what their business is (ACC13).

Having adequate professional financial literacy has been advocated as being influential in helping SBOs to make more informed decisions, which in turn facilitates improved performance.¹²⁵ Expert responses support prior research, by implying that increased literacy in financial statements assists SBOs in identifying the consequences of previous financial decisions on business operations:

The higher the level of literacy, the better the understanding of financial statements. They can then see and recognise the early warnings including any variances and react and respond to make it favourable to them. If their literacy is low, then their understanding of it is low and therefore they may not even be able to read the signals even if they do get the information (ADV1).

Previous research indicates that cash flow understanding is critical in determining solvency and therefore limitations in literacy are likely to cause detrimental effects to ongoing business viability.¹²⁶ Higher levels of cash flow and profitability literacy has been advocated to allow SBOs to make a more accurate assessment of the present status of their business and assist with implementing strategies to overcome any cash flow problems.¹²⁷ Some experts expressed their concerns about SBOs misunderstanding profitability and cash flow, and the implications that can result from a lack of knowledge of these concepts:

It does influence their ability to manage their cash flow because if they don't understand how the cash that they spend impacts on their finances then they can have cash issues. We find that a lot of people say that they don't make a profit because they've got no money, which is not necessarily true. They just spend all of the money, they just don't realise how it's been flowing through the financial statements (ACC12).

Overall it appears that the majority of experts in the research perceive that the level of a SBO's literacy has an impact on their ability to manage their business cash flow. Concerns were expressed about limitations in professional financial literacy having a negative impact on the ability of SBOs to identify early warning signs of cash flow issues. Experts suggested that in order to support cash flow, SBOs should have a level of literacy that allows them to compare current financials with prior figures, determine the consequences of previous decisions in order to be more informed about decisions in the future, and have increased awareness of financial status in order to have more educated conversations with advisors and external parties.

¹²⁵ Bruhn and Zia, above n 43, 234 and 238.

¹²⁶ Sharma and Iselin, above n 48.

¹²⁷ Ibid.

B Computer accounting software literacy

Recent research by Belle Isle and Freudenberg¹²⁸ indicates that the CAS is not being used effectively to assist with management of cash flow, as there is low engagement in the use of CAS reporting options. Considering that CAS literacy is a relatively new concept, this project relies on two areas of professional financial literacy, cash flow management and understanding of financial statements, to determine CAS literacy. The research investigates the use of CAS for cash flow management activities including preparing a cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and generation and use of financial reports.

1 Base level or concepts of CAS literacy that should be acquired by small business owners

Experts were asked to determine if there are specific functions in CAS that SBOs should be capable of performing. First, the survey questions explored whether experts have observed that record keeping is accurate as a result of the use of CAS by SBOs. As illustrated in Table 3, 12 participants (52.18 per cent) agreed that small business records are more accurate as a result of CAS, in comparison to 17.39 per cent who disagreed and 30.43 per cent who gave a neutral response.

Table 3: Expert survey responses relating to use of CAS for cash flow management

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Not Sure	Not Applicable
a) Small businesses have reliable records as a result of their CAS.	4.35	13.04	30.43	47.83	4.35	0	0
b) The initial setup of CAS should be carried out by an accountant or adviser.	0	4.35	13.04	34.78	47.38	0	0

The large number of neutral responses might be explained by the responses given in the semi-structured interviews, where experts were asked to respond to the question: 'In your opinion, what is the base level or concepts in terms of operating CAS that is required by SBOs for cash flow management?' Participants were provided with a list of possible CAS concepts that they could refer to in order to determine CAS literacy requirements (see Appendix 1). One theme that presented a number of times related to the incorrect coding of transactions and how that could result in inaccurate processing of records. This concern can be seen in the following comments:

¹²⁸ Belle Isle and Freudenberg, above n 3.

As we all know, data output is only as good as the data in. If the data's been classified or incorrect, then it's not that useful to them. They have to have a base understanding of how to code the transactions themselves so that they can generate the output that they need (GOV1).

Half the time I think they're struggling because of errors that come up in the accounting software from incorrect entering of data (ADV3).

This argument is strengthened by the feedback given in the survey statement: 'The initial setup of CAS should be carried out by the accountant or advisor' (see Table 3). Nineteen of the twenty-three participant experts (82.61 per cent) agreed that the CAS initial setup should be the role of the accountant or advisor. This indicates that experts perceive that there may be a relationship between coding errors and incorrect setup of the software. Participant GOV1 discussed the requirement to have the initial setup carried out by an expert if the SBO's literacy is lacking in that area:

I think it depends on the software. I don't know that the business owner necessarily has to understand how it all works if they can set it up properly or they can get someone to set it up properly for them (GOV1).

The purpose of the semi-structured interviews was to determine what concepts and functions of the CAS the SBO should be able to complete in order to be considered CAS literate. The responses from the participants were varied. Some participants believed that CAS was not useful for cash flow management and could be detrimental to educating and increasing knowledge of accounting concepts for SBOs. One participant believed that CAS removes the requirement for SBOs to undertake basic accounting, which prevents them from undertaking fundamental accounting procedures on a regular basis:

The reliance on electronic data processing has overcome good basic sound accounting knowledge – everybody now is an expert because they can hit a key on the computer (ACA2).

This response contradicts prior research that suggests use of software and information systems increases financial awareness, efficiency and performance of small businesses.¹²⁹

Two of the participants suggested that SBOs should have a minimum level of literacy that allows them to produce and understand financial reports available in their CAS:

Definitely they do need to know which reports to print, how often to print them. So you want to keep your eye out on your cash flow regularly; profit and loss statement, you want to do at least monthly; and balance sheet that can be done on a less frequent basis (GOV6).

They should be using it as a management tool. I try to get my clients to do a monthly profit and loss, and aging debtors and aging creditors, because then you can see how their cash flow is going (ACC11).

The remaining experts believe that a thorough understanding of how CAS functions is necessary to be considered as having adequate CAS literacy. Participant GOV7 gave a detailed description of what SBOs should be capable of when operating their CAS:

¹²⁹ Fatoki, above n 1, 156; Hunt and Iyer, above n 70.

Ideally, they should be able to produce reports and understand what those reports are telling them. So they need basic digital literacy, then they need to understand their actual accounting software, what it will do and what it won't do for them. They need to know how to use it, and they need to know how to get value out of it relevant to running their business effectively. They don't need to be experts but they do need to have a level of ability to use the software to actually help them run the business (GOV7).

Overall, 19 of the 23 experts believed that CAS literacy of SBOs should at a minimum allow them to produce and understand financial reports. Three experts extended their ideas of the minimum level of literacy to suggest that a thorough understanding of how CAS functions is necessary in order to be considered CAS literate. In contrast, experts concur that the initial setup of a CAS system does not form part of SBO CAS literacy, and instead experts believe that the setup should be carried out by an accountant or advisor. This was seen as a necessary practice to prevent incorrect recording and coding of transactions in the future.

2 Does the level of SBO CAS literacy influence their ability to manage cash flow?

The semi-structured interviews explored whether experts believed that SBOs, CAS literacy influenced their ability to manage their cash flow. Three participants agreed that CAS literacy levels were important for cash flow management. Their responses suggest that without CAS knowledge the reports and data available will be worthless and serve little purpose for cash flow management:

Looking at your financial statements and having good accounting software and knowledge helps to analyse cash flow. It helps you to look forward, thinking about your tax liabilities and other debts and planning for those (ACC8).

The remaining comments from experts revolved around SBOs' knowledge of accounting concepts. It appears from the data analysis that participants perceive that management of cash flow using CAS is reliant on SBOs' understanding of basic accounting concepts:

It's not literacy of the computer accounting software, it's literacy of debits and credits or what's profit and loss, that influences their ability to manage cash flow when using their software (ACC12).

A review of the data suggests that it is not solely the level of understanding of the functions in CAS that influences SBOs' ability to manage cash flow. It appears that knowledge and understanding of basic accounting concepts complements or underlies SBOs' CAS literacy levels. This is concerning when taking into account the views of participant ACA2, who suggested that reliance on electronic data systems for recording of business transactions has eroded basic financial and accounting knowledge of SBOs. This is a result of SBOs never having to determine the treatment of the transactions that they process through the CAS system.

C Business taxation literacy

SBOs have been identified as being broadly tax literate in relation to individual tax systems, however this level of literacy may not be sufficient for business tax systems. Prior research suggests that the level of tax knowledge of SBOs is not sufficient for management

of their ongoing business tax obligations.¹³⁰ This research explores the perception of experts in regard to the level of business tax literacy required by SBOs in order to manage cash flow and in turn a successful business.

1 *Base level or concepts of business tax literacy that should be acquired by small business owners*

Prior literature suggests that a managerial benefit is available for businesses from recording transactions for tax compliance.¹³¹ This is attributed to the regularity of recording accounting transactions in order to satisfy tax reporting obligations. The survey questions were utilised to determine whether experts believed that record keeping for taxation purposes assisted SBOs in managing their cash flow, allowing them to recognise this benefit. Seventeen of the experts agreed/strongly agreed that tax recording is beneficial for cash flow management. Only two participants disagreed/strongly disagreed. Responses are displayed in Table 4. This would suggest that tax obligations are perceived as being beneficial to SBO cash flow management.

Table 4: Expert survey responses relating to business tax systems and cash flow of small business

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Not Sure	Not Applicable
a) The records and information generated by tax obligations assist small businesses with managing their cash flow.	4.35	4.35	13.04	47.83	26.09	0	4.35

The semi-structured interviews then explored the level of business tax literacy required for SBOs. Participants were asked: ‘In your opinion, what is the base level of literacy or concepts of business taxation required by SBOs to be considered literate?’ There were two common themes that emerged. The most prevalent responses were focused on being aware of their obligations and realising that the tax liability is a business expense. Research by McKerchar¹³² showed that determining correct payment and lodgement dates for taxation was a complex issue for SBOs. Experts today appear to suggest that awareness of lodgement and payment dates are still necessary components of business tax literacy:

They definitely need to have a good understanding of when those payments need to be made so they can manage their cash flow appropriately (ACC11).

¹³⁰ Freudenberg et al, above n 4; McKerchar, above n 77.

¹³¹ Lignier and Evans, above n 56.

¹³² McKerchar, above n 77, 34.

They should know how often they have to report in their tax returns and they should know what dates they have to pay the tax. They should know the dates that they have to fill in those reports and should be able to communicate with their advisers (ACA5).

Participants were also concerned that SBOs did not plan for the payment of the tax liability. This could be a result of SBOs not recognising that tax is a business expense or not being able to predict or forecast the amount of tax that will be due at the end of each reporting period. This can result in the tax liability owing to the ATO being classified as cash available for business spending.

A number of participants gave feedback about specific tax systems and necessary concepts in those tax systems of which SBOs should be aware. The most frequently discussed tax system was GST. The feedback from experts related to rules about taxable supplies and credits, understanding what goods are subject to GST, and determining if your business is required to be registered:

With GST, which goods or services have GST and which ones don't and how that affects cash flow. I think GST is more about cash flow (ACA 6).

GST on a base level, I think people understand there are taxable [supplies], and there are credits coming back. I think they need to have a base understanding of those concepts, and then how that fits into preparing a BAS (ACC10).

Minimal feedback was given in relation to literacy required for the other business tax systems relevant to this research. Experts made comments regarding income tax, PAYG instalments and fringe benefit tax – however, the feedback was scarce. Responses for income tax concentrated on understanding depreciation and determining the deductions available to the individual business:

My view is that there are basic concepts around what's deductible and what's not. What's a deduction and what's depreciation (ACA6).

Income tax is a bit different. Income tax, because of the way that it operates, you probably have to have less knowledge of it, but it is always good to understand what concessions are available to you so that you can make the best use of those that are available (GOV1).

One expert discussed the importance of SBO literacy for PAYG instalments,¹³³ particularly in the first year of trading. This participant suggested that without the required level of business tax literacy, SBOs could experience significant cash flow problems if they have not forecasted or set aside funds to satisfy their income tax liability for the first year. Subsequent years will incur a PAYG instalment that is required to be paid throughout the year based on the previous year's income.¹³⁴ However, considering that there is no prior trading in the first year, the income tax liability will be due as a lump sum once the return is lodged with the ATO:

Pay as you go instalments will, as a matter of course, be a negative to your cash flow because of what it does. Essentially, it's a provision towards your income tax liability for that particular year, so you're actually paying it earlier than you otherwise should have.

¹³³ *A New Tax System (Pay As You Go) Act 1999* (Cth).

¹³⁴ *Ibid* pt 2-10 sub-div 45-C.

Particularly for small businesses that are starting out, they can get themselves into quite a bit of trouble because they haven't actually been making provision for their income tax liability throughout the year, so when they lodge that first return that has a tax liability on it, there's nothing to offset that liability, with a lump sum amount that they have to then find the cash for. Unless they've actually been putting the money aside – we call it pay as you go instalment lag or pay as you go instalment shock because the return comes in, it's probably nine months after the end of the relevant income year, they're going okay (GOV1).

This feedback differs to the results of the research in 1995 relating to provisional tax. McKerchar¹³⁵ suggested that SBOs experienced complexity with the understanding that a provisional tax payment decreased the overall amount of tax liability owed at the end of the reporting period. Current expert feedback in comparison suggests that the most significant issue for cash flow is not identifying the implications of not paying an instalment in the first year of trade, and the possible restrictions to cash that SBOs could face when the tax liability is due in the subsequent year. This supports the responses in a recent related case study project of small business participants,¹³⁶ where business owners suggested that more education is required at the start-up of a business in relation to the likely tax liability that will be owed at the end of the first year of trade.

Expert ACC5 supported research by McKerchar,¹³⁷ suggesting that fringe benefit tax literacy needs to be improved. Lack of understanding by SBOs about what is classified as a fringe benefit is still prevalent in today's small business environment:

A lot of small businesses don't pay FBT. But they should. A lot of them have got exposures and they don't even know they've got an exposure (ACC5).

In summary, expert feedback indicates that record keeping for tax obligations is still regarded as being beneficial for cash flow management. Concepts identified as being essential for SBO literacy with respect to business tax systems include the need to be aware of ongoing tax obligations, and determining the correct lodgement and payment dates for the tax systems that are relevant to their business. SBOs should also be capable of identifying that tax liabilities are a business expense and should be able to differentiate between the money allocated to tax liabilities and cash available for business trade.

In regard to specific tax systems, the largest number of participants identified GST concepts as being necessary for SBO tax literacy. In particular, concepts highlighted as critical were rules relating to taxable supplies and credits, determination of goods subject to GST and understanding the GST registration requirements and thresholds. Other tax concepts that are considered crucial for SBO literacy include determination of what is considered a fringe benefit, identifying available deductions and concessions, understanding depreciation, and forecasting for income tax liability in the first year of trade before PAYG instalments become part of business tax obligations.

¹³⁵ McKerchar, above n 77.

¹³⁶ Belle Isle, Freudenberg and Sarker, above n 64.

¹³⁷ McKerchar, above n 77.

2 *Does the level of SBO business tax literacy influence their ability to manage cash flow?*

The collection of data then focused on the perception of experts about the effect of SBOs' business tax literacy on cash flow management. One expert expressed their concerns about SBOs' ability to manage cash flow. However, they suggested that the relationship between business tax literacy and cash flow management is irrelevant. They implied that SBOs should have simple understanding of tax where calculation of the tax liability as part of cash flow should be predicted as one-third of net profit:

I see cash flow management as a vastly superior problem to taxation. If a small business is making a good profit, tax is an irrelevance. Quite simply, all the business proprietor has to understand is that it's roughly a third of his net profit: that's his depreciation costs (ACA2).

In comparison the remaining participants suggested that the level of SBOs' business tax literacy would likely influence their ability to manage cash flow. One participant suggested that taxation was more complicated for SBOs than any of the other requirements of running a business, and therefore their business tax literacy would have some bearing on their ability to manage cash flow:

I think it probably is more in relation to the taxation, the GST, PAYG withholding and super guarantee side of things. Because the tax obligations, I think, do have an impact on their ability to manage cash flow. My view is that they probably have less literacy in relation to the taxation obligation, than they do in relation to their general business (ACA6).

Two participants highlighted the importance of business tax literacy and its relationship with cash management, particularly in relation to forecasting for the tax liability:

They absolutely need to understand taxation obligations because in my view it impacts cash flow directly. You have to have the cash flow to pay the tax when due (GOV2).

I mean just the basic issue of GST, to be able to account for that and budget for that, so that when it does become due, that it is there and can be paid on time without them spending it and having it included in their day to day cash. They think their cash flow is good but it's not because part of it is their tax liabilities (ADV1).

The remaining feedback proposed that the impact of business tax literacy on cash flow management revolved around the level of literacy held in financial statements and CAS. Experts indicated that insufficient literacy in the other two areas would have negative consequences on the level of business tax literacy held, and in turn the ability to manage cash flow. This suggests that in order to have business tax literacy SBOs need to be literate in financial statements and CAS. These outcomes broadly contradict the proposition by Chardon et al that a base level of literacy in taxation and superannuation is required in order to be financially literate.¹³⁸ Alternatively, the results may not oppose Chardon et al, but may suggest that taxation, superannuation, financial statement and CAS literacy work in concert with each other, and having a high level of literacy in any of these areas is in

¹³⁸ Chardon, Freudenberg and Brimble, above n 4.

turn beneficial to an individual's understanding of other concepts, especially their ability to manage cash flow.¹³⁹ Comments of experts are highlighted below:

Literacy has consequences on their cash flow. So, if they're not fully understanding tax, financial statements and computer accounting software then it will influence negatively if they're not sure how these interplay with their cash flow. If you don't know what the tax consequences are then you're not going to be able to project the cash correctly (ACC5).

What I would say is that there is a proportion, well less than half, of small businesses who start out with the required literacy and capability to actually effectively manage their finances, their business planning, and their tax and superannuation. Therefore, the remaining small business owners can't manage their cash flow because they don't have those capabilities. They simply can't do it. They don't understand basic things like the difference between their business income and their personal income. Business expenses, personal expenses. Their level of understanding is very low. Consequently, they get into financial strife or under financial stress very quickly (GOV7).

In summary, analysis of the data from the semi-structured interviews indicates that the level of business tax literacy held by SBOs could have some influence on their ability to perform effective cash flow management. Participant responses indicate that experts are mostly concerned that SBOs lack the capacity to determine the remaining cash available after taking the tax liability into consideration. Responses from the remaining six experts who discussed the influence of business tax literacy on cash flow management indicates that the level of SBO business tax literacy may have a relationship with their literacy in the other areas investigated in this research. Experts perceived that business tax literacy of SBOs is supported by their level of financial statement and CAS literacy when taking cash flow management into consideration.

VI CONCLUSION

This article detailed the findings of a study that sought to explore the critical issue of cash flow for small businesses. In particular, the article reported what business experts thought about SBO professional financial, CAS and business tax literacy and how these literacies may or may not influence cash flow management.

Overall, it appears that in order to have professional financial literacy, experts believe that SBOs should make use of a cash budget, business plan, profit and loss statement and cash flow statement. However, a critical part of using these documents in the management of cash flow is the ability to extract meaningful information in order to understand their cash flow situation. Essential information includes how to interpret the difference between cash and profit, and the effect of cash receipts in comparison to aged receivables and payables.

For CAS literacy, SBOs should ideally have a thorough understanding of how CAS functions, and at minimum be capable of producing financial reports and comprehending the information contained in those reports. With regard to the effect of CAS literacy on

¹³⁹ Ibid.

management of cash flow, experts consider comprehension of basic accounting concepts as a requisite to CAS literacy concepts.

When assessing business taxation literacy, experts suggest that SBOs should be aware of their ongoing tax obligations and determination of correct lodgement and payment dates for the tax systems that are relevant to their business. In regard to specific tax systems, identification of goods attracting GST and rules relating to registration, thresholds, taxable supplies and credits were considered essential for GST literacy. For income tax, necessary concepts highlighted were identification of allowable deductions and concessions, comprehension of depreciation rules and understanding the impact of the tax liability on cash flow after the first year of business trade.

Experts expressed concerns that SBO business tax literacy could impact cash flow management if SBOs were incapable of differentiating between the money allocated to tax liabilities and cash available for business trade. Experts propose that to effectively manage cash flow, SBO taxation literacy needs the support of adequate levels of professional financial literacy and CAS literacy.

VII RECOMMENDATIONS, LIMITATIONS AND FUTURE RESEARCH

If experts perceive that cash flow management in small businesses is related to the interaction of SBO literacy in terms of business taxation, CAS and professional financial literacy, then mechanisms should be adopted that seek to bring their literacy to an adequate level. Although there are mixed reviews in past research about the effectiveness of literacy education, there are a number of ways that education initiatives have been considered successful in other countries for SBO.¹⁴⁰

Tailoring advice to the individual user can be effective if delivered through the process of either just-in-time education or one-on-one coaching. Just-in-time education or one-on-one coaching allows advisors to satisfy the diverse characteristics of the individual SBO and provide education at a time that is relevant to the current situation of each individual small business.¹⁴¹ In order for the SBO to recognise any benefit from training the content should be delivered in descriptive language that is clear and straightforward.

The introduction of tax preparation software similar to systems used in the United States of America and Austria could also be useful, as these systems provide financial advice and indicators to users, which in effect improves their financial awareness.¹⁴²

One way of achieving or directing SBOs to undertake training could be through the ATO. As an alternative to imposing a shortfall interest charge on an amended assessment or a penalty for making a false or misleading statement, the Commissioner could, at their discretion, impose a training order on the SBO. This training order could be related to improving the literacy of the SBO and be required to be undertaken within a specific period of time. The order could also determine the duration that the SBO should be

¹⁴⁰ Daniel Fernandes, John G Lynch and Richard G Netemeyer, 'Financial Literacy, Financial Education, and Downstream Financial Behaviors' (2014) 60(8) *Management Science* 1861, 1875.

¹⁴¹ Fatoki, above n 1; Eleonora Johanna Kuiper and Marijn Janssen, 'Re-Using Taxpayer's Data: Scenarios for Wealth Management for the Public' (2018) 4(1) *Journal of Tax Administration* 88; Stone, above n 59.

¹⁴² Hunt and Iyer, above n 70; Kuiper and Janssen, above n 141.

involved in the training. The costs related to engaging in training under a training order imposed by the Commissioner would not be eligible as a tax deduction for the small business, as it should still be treated or related to fines and penalties under s 26-5 of the *Income Tax Assessment Act 1997*.

It is acknowledged that this article does not look in depth at individual demographics and characteristics of SBOs that could restrict the level of literacy that is achievable. The purpose of the article was to examine expert perception of what level of literacy is desirable to all SBOs. A limitation of the article is that it only reports one part of a larger research project and although there is considerable content discussed in terms of expert views on literacy, it is impracticable to review in depth the other stages of the project that have already been completed. A further constraint of the findings in this article is the small number of participating experts. Although it should be acknowledged that the intention of the research was to explore the findings from a multiple case study of SBOs that was carried out prior to this part of the research and to examine perception of a range of small business experts into what was considered the necessary level of literacy to support cash flow management.

Given the findings of this study, there are a number of relationships that could be explored in the future. Considering that there is conjecture regarding the usefulness of literacy training for SBO, it would be beneficial to explore on a larger scale the views of SBO into different forms of literacy education or to conduct experiments with SBO to determine what would be the best delivery option for retention of concepts required for literacy in support cash flow management. Particularly the use of tax preparation software used in other countries could be trialed throughout the small business sector. The research has also highlighted important concepts relating to professional financial literacy, CAS literacy and business tax literacy. Future studies could investigate on a larger scale SBO confidence, perceived importance, actual literacy and perceived literacy in relation to the concepts identified by small business experts.

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B Legislation

- A New Tax System (Pay As You Go) Act 1999* (Cth)
- Income Tax Assessment Act 1997*

APPENDIX 1

Base level literacy could include some or all of the following concepts.

Financial statements	Computer accounting software (CAS)	Small business taxation
Understand liquidity ratio	Perform original setup of accounts in CAS	Understand reporting and payment dates for taxes
Understand indicators of insolvency	Input data for creditor and debtor invoicing	Prepare income tax returns, business activity statements, instalment activity statements, superannuation reports
Determine profitability in income statement	Maintain bank reconciliation in CAS	Understand superannuation guarantee and superannuation contribution
Understand net value in balance sheet	Perform setup of employees, including tax and superannuation obligations	Understand fringe benefit determination
Understand the difference and effect of current and long-term debt	Prepare superannuation reporting and payment	Understand treatment of dividends, dividend imputation credit, factoring accounts
Analyse comparative data in: cash, accounts payable/receivable, equity, inventory and retained earnings	Prepare IAS and BAS in CAS	Understand: income; business income; revenue vs capital receipt; immediate deduction; small business capital gains tax; repairs; depreciation; small business immediate deductions; marginal tax rates; Medicare levy
Understand the difference between operational costs, asset investments and finance in the cash flow statement	Determine tax treatment of transactions in CAS	Effectively communicate with financial and tax advisers
Compare the income statement and cash flow statement to determine if there are non-essential expenses	Produce financial reports from CAS including balance sheet, income statement, statement of cash flow	Understand GST terminology: GST free; non-reportable; GST inclusive/exclusive; taxable supplies; input tax credits
Understand the concepts of debtors, creditors, assets, liabilities and equity	Prepare a financial budget in CAS	Understand capital gains tax, 50 per cent CGT discount, small business CGT concessions
Make use of information in financial statements to support preparation of a business plan or budget	Moderate level of proficiency in business-related software, including Excel	Understand treatment of offsets, deductions, write-offs, concessions, tax rates

Source: The concepts listed in this table have been collated from a variety of sources including: articles referred to in the literature review of this article; the findings of the multiple case study of SBOs that preceded the data collected for this article; and the researcher's own ideas.

PEER-ASSISTED LEARNING: PERSPECTIVES OF A FORMER STUDENT TUTOR

DONOVAN CASTELYN*

ABSTRACT

Peer-assisted learning (PAL) facilitates the reciprocal development of knowledge and skill between students of similar social groupings by disrupting the traditional student-teacher relationship. As an educational strategy, PAL strikes at the core of student collaboration, engagement and satisfaction. Given the ever-expanding digital landscape and push towards online course delivery, PAL's student-centred approach bridges gaps in course content delivery where conventional teaching practices would prove ineffective. PAL programmes are flexible and adaptable to change, thus providing an attractive accompaniment to orthodox teaching methods. This paper reflects on the author's experience as a PAL participant and facilitator, then draws on key perspectives gained through these experiences and compares them with the prevailing literature on this topic. This paper then advocates for the use of student tutors as additional resources to meet the needs of adapting student cohorts and to operate alongside traditional teaching practices. This paper concludes by recommending to educators, particularly those in higher education in the discipline of taxation, an implementation strategy to adopt and utilise PAL more effectively in the classroom and beyond.

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I INTRODUCTION

Peer-assisted learning (PAL), as a pedagogical framework, originates from the work of Dr Deanna Martin in the field of supplemental instruction (SI).¹ Intended as an academic support programme, SI promotes the use of regularly scheduled, peer-facilitated, out-of-class tutoring sessions, which offer students an opportunity to discuss, process and synthesise course content. Since then, universities have developed and implemented various forms of SI or PAL programmes. Great diversity in terminology and definitions of PAL methodologies exists, largely due to the variety of approaches, historical origins, academic disciplines and countries in which PAL has been developed and implemented.² A sufficiently inclusive and instructive working definition of PAL may be, '[p]eople from similar social groupings who are not professional teachers helping each other to learn and learning themselves by teaching'.³

Chiefly, the PAL framework encourages students to learn from peers in similar social groupings to the learner.⁴ PAL tutors, typically have less expansive knowledge in a particular subject compared with professional educators.⁵ An emphasis on working collaboratively with the view to reaching a common goal is fundamental to the success of a PAL programme.

Naturally, the adoption of any PAL initiative must be balanced against the envisioned educational benefits participants and stakeholders are likely to receive.⁶ The efficacy of various forms of PAL has been comprehensively assessed by a large volume of literature.⁷

¹ Deanna Martin and David Arendale, 'Supplemental Instruction: Improving First-Year Student Success in High-Risk Courses' (1992) 7 *The Freshman Year Experience* 1.

² Michael Ross and Helen Cameron, 'Peer Assisted Learning: A Planning and Implementation Framework: AMEE Guide No. 30' (2007) 29(6) *Medical Teacher* 527.

³ Keith Topping, 'The Effectiveness of Peer Tutoring in Further and Higher Education: A Typology and Review of the Literature' (1996) 32(3) *Higher Education* 321; Alexander Olaussen et al, 'Peer-Assisted Learning: Time for Nomenclature Clarification' (2016) 21(1) *Medical Education Online* 30974. For the purpose of this article, the term, peer-assisted learning (PAL) should be widely interpreted to include: 'Peer appraisal', 'Collaborative learning', 'Peer review', 'Learning, cells/Student dyads', 'Peer-assisted study', 'Peer assessment', 'Proctoring', 'Peer tutoring', 'Students helping students', 'Peer teaching', 'Student teaching assistant schemes', 'Peer counseling', 'Student teaching/tutoring/mentoring', 'Peer-assisted writing', 'Study advisory schemes', 'Peer-supported learning' and 'Supplemental instruction'. It should be noted, however, that these terms are not necessarily wholly interchangeable, and some have other non-PAL meanings. Where relevant and instructive, the author will try to distinguish these concepts.

⁴ William Damon and Erin Phelps, 'Critical Distinctions among Three Approaches to Peer Education' (1989) 13(1) *International Journal of Educational Research* 9.

⁵ Ibid; Ross and Cameron, above n 2.

⁶ Diane Dancer, Kellie Morrison and Murray Smith, 'Measuring the Impact of a Peer-Assisted Learning Program on Students' (2007) *Academic Performance in Econometrics* 23.

⁷ Brett Williams and Priya Reddy, 'Does Peer-Assisted Learning Improve Academic Performance? A Scoping Review' (2016) 42 *Nurse Education Today* 23; David Boud, Ruth Cohen and Jane Sampson, *Peer Learning in Higher Education: Learning from and with Each Other* (Routledge, 1st ed, 2001); Susan Edwards and Jane Bone, 'Integrating Peer Assisted Learning and ELearning: Using Innovative Pedagogies to Support Learning and Teaching in Higher Education Settings' (2012) 37(5) *Australian Journal of Teacher Education* 1; Phillip Dawson et al, 'On the Effectiveness of Supplemental Instruction: A Systematic Review of Supplemental Instruction and Peer-Assisted Study Sessions Literature between 2001 and 2010' (2014) 84(4) *Review of Educational Research* 609; Noreen Webb, 'Peer Interaction and Learning in Small Groups' (1989) 13(1) *International Journal of Educational Research* 21; Topping, above n 3; Maria Helena de Agrela, Gonçalves

The majority of studies report on course design, implementation procedures, participation and levels of student and staff satisfaction.⁸ An overwhelming majority of these studies relates to research conducted in the fields of nursing, medicine or degrees in relation to medicine.⁹ A range of studies have explored the relationship between a students' prior academic performance, their engagement in, or with, PAL initiatives and their final grade.¹⁰ As a corollary, a number of studies exploring the perspective of the student teacher and the inherent benefits and challenges engendered by facilitation of PAL experiences provides a useful and necessary point of comparison.¹¹ The studies indicate varying results in investigating these relationships. The general consensus, however, is that, when efficiently implemented, PAL initiatives have the potential to enhance student satisfaction, drive educational leadership and improve teaching quality.¹²

Against this background, the article will now explore the literature surrounding PAL pedagogies as they relate to teaching in the discipline of taxation. Given the scope and variation of PAL pedagogies, this article will focus primarily on peer mentoring and peer tutoring. The discussion will consider the investigated impacts of PAL from the perspective of both the student learner and student teacher. Further, the analysis will also canvass any limitations identified through the use of PAL initiatives. Where applicable, the author's own experience will be used for illustrative and comparative emphasis.

II LITERATURE REVIEW

PAL is an approach to supporting student learning that is used as a supplement to existing pedagogical practices.¹³ The basic concept is that experienced students mentor, or tutors support, incoming students in particular subjects. The use of PAL across a range of higher education settings has been found to significantly increase student understanding of course content, to contribute to cognitive understanding of course material and to contribute to students' interpersonal and social skills.¹⁴

Jardim, Geraldo Bezerra da Silva Junior and Márcia Lúcia Sousa Dias Alves, 'Values in Students of Higher Education' (2017) 8(10) *Creative Education* 1682.

⁸ Dancer, Morrison and Smith, above n 6.

⁹ Williams and Reddy, above n 7.

¹⁰ Diane Dancer, Kellie Morrison and Garth Tarr, 'Measuring the Effects of Peer Learning on Students' Academic Achievement in First-Year Business Statistics' (2015) 40(10) *Studies in Higher Education* 1808; Dancer, Morrison and Smith, above n 6.

¹¹ Elspeth Hill, Francesca Liuzzi and James Giles, 'Peer-Assisted Learning from Three Perspectives: Student, Tutor and Co-ordinator' (2010) 7(4) *The Clinical Teacher* 244.

¹² Bella Ross et al, 'Developing Educational Goals: Insights from a Peer Assisted Teaching Scheme' (2016) 21(4) *International Journal for Academic Development* 350.

¹³ Ashar Wadoodi and Joy R Crosby, 'Twelve Tips for Peer-Assisted Learning: A Classic Concept Revisited' (2002) 24(3) *Medical Teacher* 241.

¹⁴ Topping, above n 3; Keith Topping, *Peer Assisted Learning: A Practical Guide for Teachers* (Brookline Books, 1st ed, 2001); Keith J Topping, 'Trends in Peer Learning' (2005) 25(6) *Educational Psychology* 631; Wadoodi and Crosby, above n 13; Ross et al, above n 12.

Informed largely by the work of Topping et al¹⁵ in recent decades, considerable research and literature has been published reporting on the benefits of PAL initiatives for both instructor and participant.¹⁶

Colvin¹⁷ cites enhanced student and participant learning, economic savings and increased social and intellectual maturity as the primary objectives for introducing formal peer learning.¹⁸ Bandura¹⁹ notes that enhanced learning is seen as occurring on behalf of both the student and instructor as they engage in learning as a communal activity.²⁰ Astin²¹ suggests that the students learn from the modelling that takes place while the instructor learns from the opportunity to strengthen successful scholastic behaviours.²² Masters and Yelland²³ argue that modelling is successful because of the scaffolding of the learning process that takes place.²⁴ Scaffolding has been defined as, 'moving learners from their current level or zone of proximal development to a higher level of development'.²⁵ Additionally, formal peer learning has been shown to provide a structured and effective way of fostering relationships between students and instructors further supporting social and academic development.²⁶

Whilst literature concerning the impact of PAL within the discipline of taxation is fairly scarce, independent studies into complementary disciplines such as accounting, business statistics and economics have yielded some important findings concerning the effectiveness and viability of PAL initiatives. Sudhakar, Tyler and Wakefield,²⁷ Dancer et al,²⁸ and Xiang,²⁹ mirror the general benefits associated with peer learning methodologies as they relate to complementary disciplines and recognise the potential for effective implementation of PAL initiatives to enhance student satisfaction, performance and

¹⁵ Topping, *Peer Assisted Learning*, above n 14.

¹⁶ Jonathan Galbraith and Mark Winterbottom, 'Peer-Tutoring: What's in It for the Tutor?' (2011) 37(3) *Educational Studies* 321; Michael Parkinson, 'The Effect of Peer Assisted Learning Support (PALS) on Performance in Mathematics and Chemistry' (2009) 46(4) *Innovations in Education and Teaching International* 381; M Lisa Stout and Amelia J McDaniel, 'Benefits to Supplemental Instruction Leaders' (2006) 106 *New Directions for Teaching and Learning* 55.

¹⁷ Janet W Colvin, 'Peer Mentoring and Tutoring in Higher Education' in Mang Li and Yong Zhao (eds), *Exploring Learning & Teaching in Higher Education: New Frontiers of Educational Research* (Springer, 2015) 207–29.

¹⁸ *Ibid.*

¹⁹ Albert Bandura, *Social Learning Theory* (Prentice Hall, 1st ed, 1977).

²⁰ *Ibid.*

²¹ Alexander W Astin, 'Student Involvement: A Developmental Theory for Higher Education' (1984) 25(4) *Journal of College Student Personnel* 297.

²² *Ibid.*

²³ Jennifer Masters and Nicola Yelland, 'Teacher Scaffolding: An Exploration of Exemplary Practice' (2002) 7(4) *Education and Information Technologies* 313.

²⁴ *Ibid.*

²⁵ Colvin, above n 17, 209; Masters and Yelland, above n 23.

²⁶ Keith Topping and Stewart Ehly, *Peer-Assisted Learning* (Lawrence Erlbaum Associates, 1st ed, 1998); Colvin, above n 17.

²⁷ Adriel Sudhakar, Jonathan Tyler and James Wakefield, 'Enhancing Student Experience and Performance through Peer-Assisted Learning' (2016) 31(3) *Issues in Accounting Education* 321.

²⁸ Dancer, Morrison and Smith, above n 6; Dancer, Morrison and Tarr, above n 10.

²⁹ Meifang Xiang, 'Improving the Quality of Learning in Accounting through Advice and Learning Experiences from Former Students' in Timothy Rupert and Beth B Kern (eds), *Advances in Accounting Education: Teaching and Curriculum Innovations* (Emerald Group Publishing Limited, 2016) vol 18.

learning.³⁰ Notably, a study conducted by Kenny et al,³¹ exploring the efficacy of team-based learning (TBL) within the context of undergraduate taxation tutorials, displayed significantly higher levels of student preparation, engagement, participation, attendance and student satisfaction. Substantial benefits were also found for university law teachers in accounting schools.³²

Two of the most common traditional peer situations that involve students helping other students in PAL environments are peer tutoring and peer mentoring. Equally, in both these situations, studies have identified prevalent limitations to the effectiveness of PAL.³³ Topping provides a helpful distinction between the concepts of 'tutoring' and 'mentoring', stating:

Peer tutoring (PT) is characterised by specific role-taking as tutor or tutee, with high focus on curriculum content and usually also on clear procedures for interaction, in which participants receive generic and/or specific training ... Mentoring can be defined as an encouraging and supportive one-to-one relationship with a more experienced worker (who is not a line manager) in a joint area of interest. It is characterised by positive role modelling, promotion of raised aspirations, positive reinforcement, open-ended counselling, and joint problem-solving. It is often cross-age, always fixed-role, quite often cross-institution, and often targeted to disadvantaged groups.³⁴

Research conducted by Dunne and Rawlins,³⁵ using peer mentors to help students develop transferable life skills, suggests that 'one of the problems of introducing new processes of learning is that it tends to be difficult for both those that provide them and for those who should gain from them'.³⁶ Boud, Cohen and Sampson³⁷ note that limitations to PAL initiatives may be segregated into two general categories: power and differentiation. A third category, resistance, was further considered by Colvin in his study of peer tutoring situations.³⁸

Power and differentiation in the context of PAL are taken to mean the basis by which students and instructors see themselves as different from the other members of their group with respect to their perceived level of influence.³⁹ Boud, Cohen and Sampson⁴⁰ note that language, culture, gender and work experience are prominent differentiating

³⁰ Dawson et al, above n 7.

³¹ Paul Kenny et al, 'Improving the Students' Tax Experience: A Team-Based Learning Approach for Undergraduate Accounting Students' (2015) 10 *Journal of the Australasian Tax Teachers Association* 43.

³² See also, Larry K Michaelsen and Michael Sweet, 'The Essential Elements of Team-Based Learning' (2008) 116 *New Directions for Teaching and Learning* 7. Team-based learning involves independent out-of-class preparation for in-class interactive learning in small groups that is aimed to improve the application of learned material. The majority of face-to-face time is used for group work and group assignments, which aim to develop self-managed learning teams.

³³ Colvin, above n 17.

³⁴ Topping, 'Trends in Peer Learning', above n 14, 632.

³⁵ Elisabeth Dunne and Mike Rawlins, 'Bridging the Gap between Industry and Higher Education: Training Academics to Promote Student Teamwork' (2000) 37(4) *Innovations in Education & Training International* 361.

³⁶ *Ibid* 369.

³⁷ Boud, Cohen and Sampson, above n 7, 92.

³⁸ Colvin, above n 17.

³⁹ *Ibid*.

⁴⁰ Boud, Cohen and Sampson, above n 7.

factors that need to be carefully considered and managed prior to – and throughout – a PAL initiative.⁴¹

Resistance, as discussed by Colvin, argues that students are not passive recipients of power or culture – they have the power to accept or reject classroom practices, even if this occurs in practices that are largely hidden to the instructor or others in power.⁴² Further, Colvin notes that peer mentors and tutors cannot automatically expect peer interactions in the classrooms to be met without resistance.⁴³ To this end, Colvin's study suggests that instead, students wait to assign positional power to tutors or mentors until the mentor or tutor helps the student in a way the student wants to be helped. If this does not happen, students disregard the instructor.⁴⁴

Overreliance on the student tutor by the participants, and potentially ineffective teaching or delivery styles of the instructor, are additional concerns that have been flagged by the literature as risks or challenges to consider when introducing or engaging in a PAL initiative.⁴⁵ From the student perspective, the issue of the tutor not understanding the material, presenting it in a confusing way, or giving instructions other than what the lecturer had intended presented major risk. Concerns regarding the adequacy of delivery, relationship building and reputation were the primary risks voiced by instructors.

A majority of the literature addresses the risks or challenges associated with PAL by drawing the reader's attention to the importance of communication.⁴⁶ One of the most important elements of any peer situation is the relationship that comes from the interactions between peer mentors/tutors, students and lecturers.⁴⁷ Communication is key to fostering these relations and as such should form the focus of implementing any such programme.

Commensurate with the theme of communication, clarification for all parties could help establish and promote the role of peer tutors or mentors more clearly and alleviate confusion.⁴⁸ Clarification of instructor and student roles are likely to lead to further participation and continued success within a PAL programme. Hence, PAL programmes embedded with continued training can help increase the chances of success by pre-emptively addressing the challenges of power differentiation and resistance.

As illustrated above, traditional PAL strategies are well established and flourishing in higher education.⁴⁹ Nevertheless, the prevalence of eLearning and online PAL initiatives

⁴¹ Ibid.

⁴² Colvin, above n 17, 222.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Kenny et al, above n 32; Colvin, above n 17; Helen Watts, Makis Malliris and Olivia Billingham, 'Online Peer Assisted Learning: Reporting on Practice' (2015) 8(1) *Journal of Peer Learning* 85; Yvonne Hodgson, Robyn Benson and Charlotte Brack, 'Student Conceptions of Peer-Assisted Learning' (2015) 39(4) *Journal of Further and Higher Education* 579.

⁴⁷ Ibid.

⁴⁸ Ibid.

⁴⁹ Watts, Malliris and Billingham, above n 46.

is widely recognised, hosting additional opportunities, benefits and challenges for educators and students alike.⁵⁰

Turney et al⁵¹ advocate for the use of eLearning platforms that are said to offer students, teaching staff and institutions flexibility in terms of the times, places and pace at which learning and teaching may occur. Alexander's⁵² extensive study of the use of eLearning in Australian higher education settings suggested that the use of technology itself does not necessarily improve student learning. Rather, it was indicated that students were more likely to report engaging uses of the technology when it was associated with opportunities to interact with other students and lecturers.⁵³ Alexander's findings regarding the social use of technology to support learning, mirror those arguments emerging from the literature associated with face-to-face PAL, whereby the social aspects of peer learning are argued to support student participation, enhance social connections and increase learning.⁵⁴

Huijser et al⁵⁵ suggest that online PAL promotes a range of benefits for students such as providing a less intimidating learning environment, aiding motivation and enabling the provision of flexible and timely responses to questions.

Programmes selected for in-class PAL emphasise the importance of personal qualities, such as trustworthiness, sincerity, transparency, self-awareness, generosity, and authenticity.⁵⁶ Other programmes focus on the importance of nimbleness or being responsive and adaptable to needs, learning styles, and size of groups.⁵⁷ In the context of online PAL, there is no reason that these skills are less likely to be needed. The challenges of online PAL comparative to their in-class counterparts are therefore consistent. Therefore, it stands to reason that similar strategies to those described above may be employed to meet or erode pervasive risks.

A challenge unique to online PAL delivery stems from the use of technology. One prevalent issue was that of poor content coverage coupled with the impersonal nature of content delivery, which was identified as contradicting the philosophies of PAL programmes. Additionally, software, connection and lag issues may create a distraction for the participant, and were flagged among the major drawbacks associated with online PAL.⁵⁸

As noted by Huang et al, although more investigation needs to be conducted, the consensus within the literature is that online PAL programmes can be used as an instructive complement to existing in-class PAL and traditional teaching pedagogies,

⁵⁰ Edwards and Bone, above n 7.

⁵¹ C S M Turney et al, 'Using Technology to Direct Learning in Higher Education: The Way Forward?' (2009) 10(1) *Active Learning in Higher Education* 71.

⁵² Shirley Alexander, 'E-learning Developments and Experiences' (2001) 43(4/5) *Education + Training* 240.

⁵³ Ibid.

⁵⁴ Kellie Morrison, 'Peer Assisted Study Sessions: Supporting Quality Learning and Student Engagement in Economics and Business' (2006) 24 *Institute for Teaching and Learning* 3.

⁵⁵ Henk Huijser, Lindy Kimmins and Peter Evans, 'Peer Assisted Learning in Fleximode: Developing an Online Learning Community' (2008) 1(1) *Australasian Journal of Peer Learning* 7.

⁵⁶ Colvin, above n 17.

⁵⁷ Dawson et al, above n 7.

⁵⁸ Tairan Kevin Huang et al, 'Internet-Based Peer Assisted Learning: Current Models, Future Applications, and Potential' in Yu (Aimee) Zhang (ed), *Handbook of Mobile Teaching and Learning* (Springer, 2015) 811-826.

'further extending the benefits of student peer learning and social exchange with the convenience of technology'.⁵⁹

III DISCUSSION

A culture focused on enhancing the quality of the student learning experience whilst improving teaching quality is the goal of higher education.⁶⁰ From the literature, we can observe that traditional or online PAL initiatives provide an attractive vehicle for institutions to achieve these goals despite their limitations.

As a point of introspection, the article will now briefly discuss the author's experiences in PAL in an attempt to contrast and advocate for the use of these practices.

Having had the opportunity to work closely with students as a tutor in an undergraduate taxation law unit at the University of Western Australia and as part of the 'New to Curtin Mentoring Program',⁶¹ I mirror the benefits attached to the PAL literature as discussed above.

As a student tutor, I was given the opportunity to guide student discussion in relation to tutorial questions, and facilitate understanding through the use of examples and worked solutions. Class sizes ranged from 15 to 20 students and discussions were conducted over the course of an hour-long tutorial for the period of 13 weeks. Training in the form of online activities as well as a three-hour seminar at the beginning of the semester, prior to tutorials commencing, was offered to all new tutors.⁶² Of particular value was the seminar, which provided an opportunity to meet and connect with fellow student tutors and experienced educators. Tutors were expected to revise structured lesson plans, flag queries with the unit-controller and provide online assistance where applicable. In each of the activities, communication, trust, time-management and preparation were, in my reflection, key to success. Tutors received financial compensation for their efforts in addition to formal recognition by the employment contract and university staff status.

As a 'New to Curtin Mentor' within the discipline of business, I was tasked with assisting and advising a selection of 10 students new to Curtin Business School (CBS) with a variety of study-related and personal queries. The student cohort was diverse, which presented its own challenges with respect to delivering and adapting information. The programme spanned the course of one semester. The programme was largely conducted online, with minimal face-to-face interaction. Though intended to be more direct, scheduling complications and engagement seemed to necessitate an online approach. Time commitment was variable, but a minimum contact point of one email to the cohort per week was desirable. Mentors were offered a range of online courses to assist their performance and given the opportunity to attend a number of networking and

⁵⁹ Ibid 812.

⁶⁰ Ross et al, above n 12.

⁶¹ Curtin University, *Mentoring for New Students* (8 May 2015) <<http://life.curtin.edu.au/new-to-curtin/new-students-mentoring.htm>>.

⁶² The University of Western Australia, *Tutor Training Resources* <<http://www.business.uwa.edu.au/learning/tutoring>>.

information seminars. Participation in the programme afforded participants extracurricular recognition in the form of an annotation on their transcripts.⁶³

As a point of comparison, the below table represents the author's subjective recollections of his experience as both a mentor and a tutor and compares the results with the literature on this topic.

Table 1: Introspective comparison

	Benefits	Limitations	Literature
Tutoring	<p>Aptitude for teaching and learning.</p> <p>Sense of value and motivation to succeed.</p> <p>Increased understanding and appreciation of Australian taxation law.</p>	<p>Participation resistance and disengagement.</p> <p>Low class attendance.</p> <p>Class size.</p>	<p>Literature mirrors both benefits and limitations of tutoring. See Topping and Ehly;⁶⁴ Dunne and Rawlins;⁶⁵ Topping (1996, 2005);^{66,67} Boud, Cohen and Sampson;⁶⁸ Colvin;⁶⁹ and Huang et al.⁷⁰</p>
Mentoring	<p>Aptitude for personal growth and development.</p> <p>Sense of value and motivation to succeed.</p> <p>Multiculturalism: increased understanding and appreciation of various customs and traditions.</p>	<p>Participation resistance and disengagement.</p> <p>Low class attendance.</p> <p>Class size.</p>	<p>Literature mirrors both benefits and limitations of mentoring. See Topping and Ehly;⁷¹ Dunne and Rawlins;⁷² Topping (1996, 2005);^{73,74} Boud, Cohen and Sampson;⁷⁵ Alexander;⁷⁶ Huijser, Kimmins and Evans;⁷⁷</p>

⁶³ Curtin University, *Student eServices, Curtin Graduations – Curtin Extra Certificate* (9 April 2010) <<https://graduations.curtin.edu.au/graduate/curtinExtra.cfm>>.

⁶⁴ Topping and Ehly, above n 26.

⁶⁵ Dunne and Rawlins, above n 35.

⁶⁶ Topping, 'The Effectiveness of Peer Tutoring', above n 3.

⁶⁷ Topping, 'Trends in Peer Learning', above n 14.

⁶⁸ Boud, Cohen and Sampson, above n 7.

⁶⁹ Colvin, above n 17.

⁷⁰ Huang et al, above n 58.

⁷¹ Topping and Ehly, above n 26.

⁷² Dunne and Rawlins, above n 35.

⁷³ Topping, 'The Effectiveness of Peer Tutoring', above n 3.

⁷⁴ Topping, 'Trends in Peer Learning', above n 14.

⁷⁵ Boud, Cohen and Sampson, above n 7.

⁷⁶ Alexander, above n 52.

⁷⁷ Huijser, Kimmins and Evans, above n 55.

			Turney et al; ⁷⁸ Colvin; ⁷⁹ and Huang et al. ⁸⁰
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The above discussion demonstrates a clear correlation between the benefits and limitations of PAL, as examined earlier in this work, and the experiences of the author. Given the perceived strength of PAL to support traditional teaching pedagogies and the inherent benefits provided to all stakeholders, the article will now turn to recommending an implementation structure to incorporate PAL into – and beyond – the classroom.

IV IMPLEMENTATION STRATEGY

A large volume of literature exists in respect of preparing, orienting, implementing and evaluating PAL initiatives.⁸¹ The recommendation in this part is confined solely to the structure and implementation of PAL programmes to meet the needs of the adapting and technically savvy student. Further, the recommendation is largely based on the works of Huang et al⁸² and Watts et al,⁸³ and draws heavily on their findings.

The implementation of PAL programmes in higher education institutions can have a number of structural arrangements.⁸⁴ As an instructive point of reference, Huang et al (see Appendix 1)⁸⁵ illustrate some of the arrangements that can be made to utilise an internal and online-based PAL programme to support formal teaching pedagogies and enhance student learning.

A noticeable issue with on-campus PAL and teaching activities is that some students can find attending on-campus programmes difficult due to timetabling issues, or work or personal conflicts. To this end, including an online session will benefit these students, particularly those managing persistent work commitments.

For the institution, integrating on-campus and online PAL programmes offers learning potential for all stakeholders.⁸⁶ Informed by the work of Watt et al,⁸⁷ it is recommended that a number of steps are considered during the implementation phase. For ease, these steps have been tabled with a short description provided.

⁷⁸ Turney et al, above n 51.

⁷⁹ Colvin, above n 17.

⁸⁰ Huang et al, above n 58.

⁸¹ Boud, Cohen and Sampson, above n 7; Edwards and Bone, above n 7; Dancer, Morrison and Tarr, above n 10, 1808; Watts, Malliris and Billingham, above n 46; Masters and Yelland, above n 23; Parkinson, above n 16; Hodgson, Benson and Brack, above n 46; Astin, above n 21.

⁸² Huang et al, above n 58.

⁸³ Watts, Malliris and Billingham, above n 46.

⁸⁴ Huang et al, above n 58.

⁸⁵ Ibid 822.

⁸⁶ Ibid; Watts, Malliris and Billingham, above n 46.

⁸⁷ Watts, Malliris and Billingham, above n 46.

Table 2: PAL implementation tree

Implementation step	Description
Scope	The scope of on-campus and online PAL initiatives concerns the size and scalability of the service. Consideration should be given to the type of PAL service offered, ie, e-mentoring, group sessions, one-on-one online sessions. ⁸⁸
Planning and delivery	Extensive pre-planning of PAL courses is recommended. Directions as to content, structure and desired outcomes should be clearly articulated. ⁸⁹
Promotion, recruitment and attendance	Consideration should be given to the type of promotional activities that will need to be undertaken to inspire attendance and participation in the initiative. ⁹⁰
PAL leaders – recruitment, training and preparing	Recruitment methodology and ongoing training should also be thoroughly examined to ensure that PAL leaders have the required skill and knowledge base necessary for success in the programme. ⁹¹
Scheduling	Synchronous, asynchronous or multi-model offerings should be considered in light of student availability. ⁹²
Evaluation	An appropriate evaluation methodology should be adopted to measure the outcomes of the PAL initiative. ⁹³

By way of example, using the implementation tree above, the author has constructed a template of what a PAL programme in the context of a taxation law unit might look like. It is anticipated that this document will be used as a working model with a view to performing a pilot in this unit at a later date (see Appendix 2).

V LIMITATIONS

This article is limited by several factors. First, the article relies on the subjective perspective of the author and their experience. In this way, the lack of objectivity and supporting quantitative data calls in to question the authority of a great number of the propositions explored within the text. An opportunity exists to evaluate the effectiveness

⁸⁸ Ibid 95.

⁸⁹ Ibid 99.

⁹⁰ Ibid 95.

⁹¹ Ibid 96–8.

⁹² Ibid 97.

⁹³ Ibid 100.

of the implementation structure described above in an attempt to respond to many of the perceived biases in this work.

A second limitation is that the context of this article was confined to an exploration of one teaching discipline: taxation. Expanding the examination to other disciplines and institutions may be valuable in assessing the transferability and accuracy of the assertions made in this work. However, the literature could further benefit from future research that focuses more specifically on the outcomes of PAL relative to students, instructors, and mentors in the context of taxation.

Additionally, given a general predominance of research that examines the effect of PAL on academic performance only, there would be benefit in examining the process and dynamics that exist within the PAL sessions to support student growth and development. Further research in this area would be valuable as it may help explain why PAL may be more effective on a social level and is likely to contribute more broadly to those aspects of peer learning that assist the observed gains in academic performance.

VI CONCLUSION

Overall, employing PAL initiatives appears to be an effective strategy to meet the demands of various student cohorts. Additionally, the benefits of PAL can be seen to extend beyond academic performance. PAL's focus on developing learning strategies fosters critical thinking skills that form a foundation for life-long learning.⁹⁴

The literature shows that both the student and instructor are better placed towards grasping and applying the underlying concepts and ideas associated with course content when engaging with PAL. Notable benefits are also associated with the development of students' interpersonal and communication skills.

Although there are some shared findings – ie, increased student participation or academic performance – PAL experiences remain variable, and responses to these experiences differ depending on myriad social and psychological factors. The utility associated with the implementation strategy and other assertions proposed in this work remains to be seen and will certainly be faced with many challenges. What is true is that there currently exists no optimal solution to determine the effectiveness associated with PAL. Each initiative will face its own hurdles and continue to inform and advise on further and better PAL strategies. Such is the quest for innovation.

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⁹⁴ Topping and Ehly, above n 26.

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APPENDIX 1⁹⁵

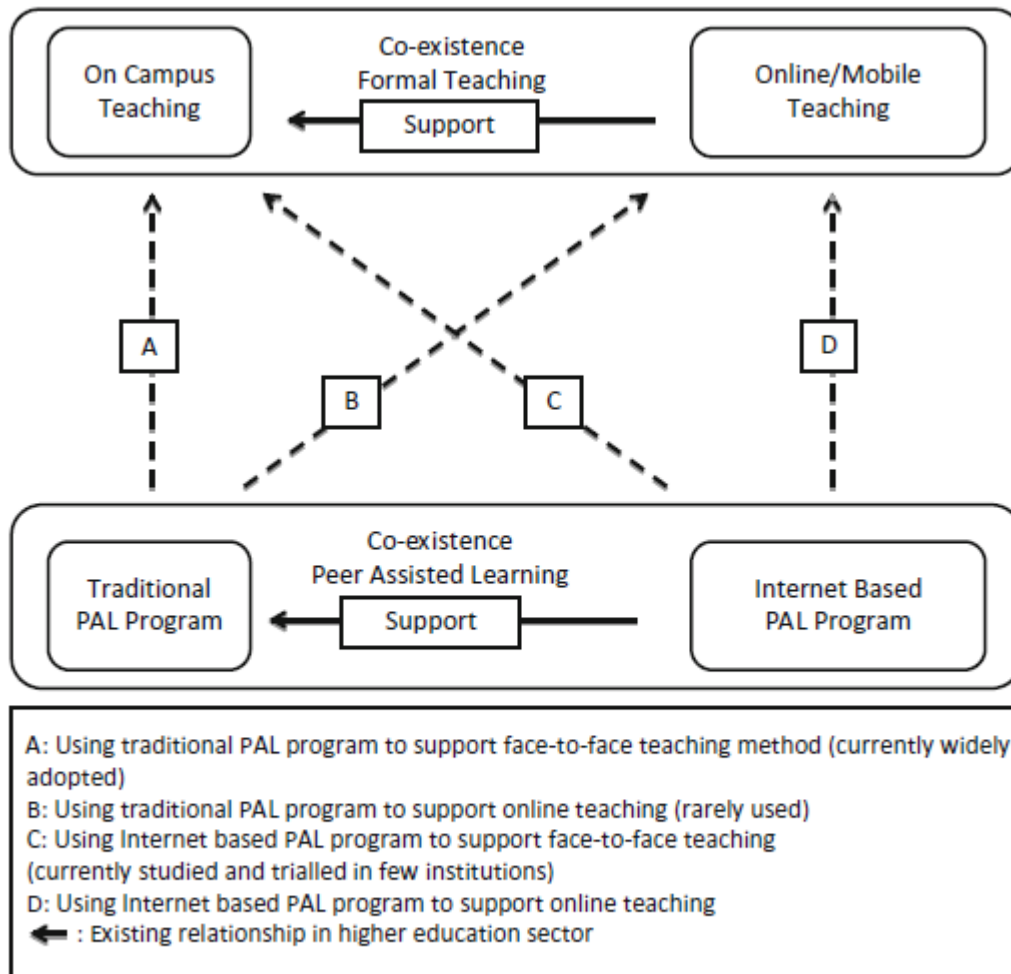


Fig. 1 Implementation structure

⁹⁵ Huang et al, above n 58, 822.

APPENDIX 2: PRINCIPLES OF AUSTRALIA TAXATION LAW – PAL IMPLEMENTATION TEMPLATE

Implementation step	Description
Unit details and description	<p>Intent: This introductory unit is intended to promote understanding of the Australian taxation system from a legal perspective.</p> <p>Years active: 3 (commenced 2016).</p> <p>FTSE: 13 (2018).</p> <p>Structure: 2-hour lecture, 2-hour tutorial – on-campus. No online availability.</p> <p>Assignments: Oral presentation, written assignment and exam.</p>
Scope	Introduce the use of on-campus and online PAL utilising the skill set of former students who have successfully completed the unit and display an aptitude for teaching and learning.
Planning and delivery	Preparation of PAL tutorial guide with suggested answers and worked examples. PAL leaders to schedule availability with students once per week prior to the lecture. Use of online delivery recommended. Forums such as Blackboard Collaborate or Skype may be attractive solutions.
Promotion, recruitment and attendance	Promotion, attendance and recruitment rely heavily on the relationship between former students and educator. Lecturer to facilitate introduction and confirm roles.
PAL leaders – recruitment, training and preparing	Online application followed by an interview. Training will be ongoing with lecturer as need be. Incentive may be monetary or participatory.
Scheduling	Variable pending availability of students.
Evaluation	Qualitative survey and eValuate.

CROWD-SOURCED FUNDING – WAS TAX CONSIDERED?

STEPHEN GRAW*

ABSTRACT

The *Corporations Amendment (Crowd-sourced Funding) Act 2017* (Cth) allows 'eligible CSF companies' to 'crowdfund', provided they meet the Act's threshold eligibility and other requirements. Unfortunately, as passed, the Act excludes all proprietary companies (and most public companies) from its operation, a defect that is being rectified, at least in part, by the *Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017* (Cth). Unlike other measures that have been introduced to assist innovative start-ups, however, neither the 2017 Act nor the present Bill provide any taxation incentives for either investors or the company. Nor do they address any of the possible tax problems that may arise because of the reform. This paper considers both the reforms and those possible issues.

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I INTRODUCTION

The *Corporations Amendment (Crowd-sourced Funding) Act 2017* (Cth) was passed on 22 March 2017, received Royal Assent on 28 March 2017, and commenced operation on 29 September 2017 (the practical effect of which was that crowd-sourced platforms were able to apply for a licence¹ to allow them to accept 'CSF [crowd-sourced funding] investments' from small investors from that date²).

Under the legislation, 'eligible CSF companies' are able to access crowd-sourced equity funding (CSF) provided they meet the threshold eligibility requirements, pass both the 'assets test' and the 'turnover test', the amount they seek falls within the 'issuer cap', the funds are raised through a CSF intermediary and their 'CSF offer document' (and, if it is not included in the 'CSF offer document', their 'CSF offer') meets the requirements of the Act.

The Act has its origins in a reference to the Corporations and Markets Advisory Committee (CAMAC) in June 2013. That reference required CAMAC to consider CSF and whether it could be facilitated in Australia. CAMAC reported in June 2014, noting that while CSF had potentially significant benefits for both fundraising companies and investors, there were major regulatory barriers to small businesses using it as an effective means of fundraising.

These barriers included the 50 non-employee member 'shareholder caps' that apply to proprietary companies, the *Corporations Act 2001* s 113(3)'s prohibition on proprietary companies making public offers of equity, and the reporting and corporate governance requirements that public companies have to meet that would, in many cases, make it uneconomic for small business to adopt a public company structure purely to fundraise.

The end result was that CAMAC recommended that CSF should be facilitated for small businesses in Australia, but that a modified regulatory regime should be introduced to allow it to occur in a cost-effective way.³

Treasury then issued a Discussion Paper in December 2014 seeking submissions on three identified 'Policy Options' (the CAMAC Model, a 'Regulatory Framework Based on the

¹ Persons intending to operate a CSF platform are required to hold an Australian Financial Services Licence and may be required to hold an Australian Markets Licence: Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 3.4.

² The first CSF intermediaries (through which all CSF investment applications must be channelled) were only licensed on 11 January 2018 – nearly three and a half months after the Act came into force. See Australian Securities and Investments Commission (ASIC), Australian Government, *18-004MRASIC Licenses First Crowd-Sourced Funding Intermediaries* (11 January 2018) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-004mr-asic-licenses-first-crowd-sourced-funding-intermediaries>>.

³ Reducing the regulatory impediments to crowdfunding was also a specific recommendation of the 'Murray Inquiry': Treasury, Australian Government, *Financial System Inquiry: Final Report* (November 2014) Recommendation 18, 177. It was also supported by the Productivity Commission: Productivity Commission, Australian Government, *Business Set-up, Transfer and Closure: Draft Report* (21 May 2015); Productivity Commission, Australian Government, *Business Set-up, Transfer and Closure: Final Report* (7 December 2015) Recommendation 6.1, 150. The government also included CSF as a FinTech priority: Australian Government, *FinTech Statement* (21 March 2016) 18–19.

New Zealand Model' and the 'Status Quo'). In August 2015, following submissions, the government released an outline of its proposed framework. Legislation based on that framework⁴ was introduced into Parliament in December 2015⁵ and passed the House of Representatives. However, as it had not passed the Senate before the 2016 Federal Election was called, it lapsed.

A new Bill, largely replicating the 2015 Bill, though with modifications to the 'assets and turnover' tests and an increase in the cooling-off period from 48 hours to 5 days, was introduced in 2016⁶ and passed in March 2017. It inserted a new pt 6D.3A into the *Corporations Act 2001* (Cth), the object of which, as detailed in the new s 738A, is 'to provide a disclosure regime that can be used for certain offers of securities for issue in small unlisted companies, instead of complying with the requirements of Part 6D.2'.⁷

That is, if their offers qualify for the modified disclosure regime, small unlisted public companies can access concessions in relation to not holding annual general meetings, only reporting to shareholders online, and not appointing auditors – concessions that are not generally available to public companies.

The aim of the new regime, as detailed in the Explanatory Memorandum, is to 'provide an additional funding option for small businesses and start-ups in particular, that may otherwise struggle to obtain affordable finance'.⁸ The Explanatory Memorandum also noted that '[f]acilitating CSF would also provide additional investment opportunities to retail investors, who are generally unable to gain direct access to early-stage financing activities'.⁹

II CROWD-SOURCED FUNDING

A What is crowd-sourced funding?

CSF typically involves raising funds from a (normally) large number of small contributors to finance some specific objective.¹⁰

One of the earliest modern examples of CSF was its use to finance the erection of the Statue of Liberty in New York. While the French donated the statue itself, the Americans

⁴ Corporations Amendment (Crowd-sourced Funding) Bill 2015 (Cth).

⁵ It was also included as one of the measures aimed at encouraging funding for start-ups that were announced in: Department of Education and Training, Australian Government, *National Innovation and Science Agenda* (7 December 2015); and included in: Australian Government, *Mid-Year Economic and Fiscal Outlook 2015–16* (15 December 2015). The others included providing tax breaks for early-stage investors in innovative start-ups (implemented in 2016 through the insertion of sub-div 360-A into the *Income Tax Assessment Act 1997* (Cth) (ITAA97)), and augmenting already-existing measures to encourage venture capital investment (implemented through the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* (Cth) and the *Treasury Laws Amendment (2017 Measures No 1) Act 2017* (Cth)).

⁶ Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth).

⁷ *Corporations Act 2001* (Cth) s 738A, inserted by *Corporations Amendment (Crowd-sourced Funding) Act 2017* (Cth) s 14.

⁸ Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 1.6.

⁹ *Ibid* para 1.8.

¹⁰ *Ibid* para 1.5.

were required to provide the site and build the pedestal on which it would be erected. In 1885 the statue had been delivered and was awaiting assembly, but New York City had not yet raised the entire US\$250 000 that was needed to pay for the pedestal. The then Governor, Grover Cleveland, refused to use city funds to meet the shortfall and the United States Congress was unable to agree on an alternative source of funds. Other cities (notably Boston, Philadelphia, Baltimore and San Francisco) were actively circling, offering themselves as alternative locations. To prevent that happening, Joseph Pulitzer, the publisher of the *New York World*, launched a fundraising campaign through his newspaper, publishing the names of every donor and the amounts they donated as a practical incentive. Within five months he raised US\$101 091 from over 160 000 donors, each of whom donated, on average, less than US\$1, but collectively that was more than enough to cover the shortfall.

A more recent well-known example was the Veronica Mars Movie Project, which was launched in March 2013 through 'Kickstarter' (a US 'Benefit Corporation' that runs a global crowdfunding platform 'to help bring creative projects to life'). It hoped to raise US\$2 million to fund a movie-length continuation of the Veronica Mars television series and offered potential contributors a range of 'rewards' varying from a digital pdf copy of the movie script for a US\$10 pledge to a small walk-on speaking part in the movie for a US\$10 000 pledge (an offer taken up by one backer). It was spectacularly successful and raised the entire US\$2 million that it had sought within 11 hours of opening. By the time it closed, exactly a month later, 91 585 fans had pledged a total of US\$5 702 153.

Crowd-sourcing has also recently been extensively (and successfully) used to raise substantial funds for (especially) blockchain start-ups,¹¹ for companies involved in hardware,¹² software¹³ and video game¹⁴ development and for a range of other innovation projects.¹⁵

B Types of CSF

There are four models for CSF:

- Donation-based (funds are raised from donors who receive nothing in return, apart from, perhaps, some acknowledgement of their donation – as was the case with Pulitzer's fundraising for the Statue of Liberty).
- Reward-based (funds are raised from contributors who receive some form of reward in the form of goods, services or rights – perhaps rights to a future discount – in exchange for their contribution. Typically, the rewards offered are graduated, with higher rewards for greater contributions – as with the Veronica Mars Movie

¹¹ See, for example, Filecoin (US\$257 million), EOS (US\$185 million), The DAO (US\$150 million), Polkadot (US\$144 million), TenX (US\$80 million) and BANKEX (US\$70.6 million).

¹² See, for example, Coolest Cooler (US\$13.3 million), Ubuntu Edge (US\$12.8 million), PonoMusic (US\$6.2 million), Micro Drone 3.0 (US\$3.6 million) and The Dash (US\$3.4 million).

¹³ See, for example, Firstblood Crowdsale (US\$6.3 million), Lisk (US\$5.7 million), The Grid (US\$5.5 million), and Mastercoin (US\$5 million).

¹⁴ See, for example, Star Citizen (US\$181 million), Prison Architect (US\$19 million), Shroud of the Avatar: Forsaken Virtues (US\$12.6 million), Ouya (US\$8.6 million) and Shanmue III (US\$6.3 million).

¹⁵ See, for example, ELIO Motors (US\$102 million), Glowforge (US\$28 million), Pebbletime (US\$20 million), BauBax (US\$10.3 million) and Exploding Kittens (US\$8.8 million).

Project. The rewards may also be contingent on the fundraising reaching identified minimum levels).

- Equity-based (funds are raised from contributors in exchange for a share – or other equity interest – in the fundraising entity. That gives those contributors the normal rights of share-ownership, including the right to participate in future dividends, the right to vote in company meetings and the right to participate in a distribution of surplus capital on winding-up).
- Debt-based (funds are raised from contributors who lend money to the promoters in exchange for agreed interest payments for the life of the loan and a promise of repayment on maturity – which can be with or without a premium for the risk).

III THE AUSTRALIAN PROVISIONS

A The background

Crowd-sourced equity funding schemes currently exist in a number of other countries including the US, the UK, Canada and New Zealand.¹⁶ In general, they seem to be less restrictive in their application than the new Australian model¹⁷ though at least some of the Australian provisions have been modelled on, in particular, the equivalent New Zealand provisions.

Crowd-sourced equity funding is less popular in the EU – though France, Germany and the Netherlands all have country-based regimes, none of which have yet been used successfully to raise large amounts of equity funding.¹⁸ Italy also introduced a new crowdfunding regime in 2013, which was initially restricted to ‘innovative start-ups’ but was extended to ‘innovative small to medium enterprises’ in 2015, a change that seems to have had a very limited (if any) effect on its success. On the evidence to date, it has not been particularly successful in allowing its targeted companies to raise significant sums.¹⁹

B CSF covered by the new legislation

The new Australian legislation only covers online equity-based CSF (though the Treasurer did note in his Second Reading Speech that it was simply ‘a new funding option for small businesses’ and that it was not intended to displace ‘other forms of

¹⁶ In 2014–15, the first 12 months of the New Zealand scheme, 21 innovation companies raised NZ\$12.3 million using CSF (a 78 per cent success rate), in 2015–16, 16 companies raised NZ\$10.8 million (a 57 per cent success rate) and, in 2016–17, 18 companies raised NZ\$13 million (a 64 per cent success rate).

¹⁷ In the US, the *Jumpstart Our Business Startups Act 2012* (US) provides two exceptions to the standard prohibition preventing issuers of private securities from ‘advertising their offerings or generally soliciting investors’. Rule 506(b) allows an unlimited number of ‘accredited investors’ and up to 35 ‘non-accredited investors’ to invest via CSF, though the prohibition on general solicitation still applies. Rule 506(c) removes the prohibition on general solicitation but, importantly, does so in relation to ‘accredited investors’ only.

¹⁸ Angelo Delivorias, ‘Crowdfunding in Europe – Introduction and State of Play’ (European Parliamentary Research Service, 2017) <[http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595882/EPRS_BRI\(2017\)595882_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595882/EPRS_BRI(2017)595882_EN.pdf)>.

¹⁹ Marina Nehme, ‘Australia Needs to Learn from Italy’s Mistakes’, *The Conversation*, 25 February 2016, <<https://theconversation.com/crowd-sourced-funding-australia-needs-to-learn-from-italys-mistakes-55130>>.

crowdfunding already available, such as rewards-based crowdfunding and peer-to-peer lending', which start-ups could already use to fund and finance their operations. It was also intended to 'serve as both a complement and a source of competition to more traditional funding options for small businesses, including bank debt products.'²⁰ Even then, though, the entities that can access funding by using the new regime are restricted.

IV HOW THE CSF REGIME WORKS

Provided the entity seeking to raise funds qualifies as an 'eligible CSF company' and its offer is a 'CSF offer' (ie, one that is 'eligible to be made' under the new provisions and is 'expressed to be made' under them²¹), it can access the regime²² – and *Corporations Act 2001* (Cth) pt 6D.2 (which contains the general rules regarding when disclosure is required for offers of securities) and Part 6D.3 (which deals with the prohibitions, liabilities and remedies that normally apply to offers of securities that require disclosure) do not apply to its 'CSF offers' (unless there is a specific provision under which they continue to apply to them).²³

A Qualifying as an 'eligible CSF company'

To qualify as an 'eligible CSF company' the entity must:²⁴

- be a public company limited by shares;²⁵
- have its principal place of business in Australia;
- have a majority of its directors resident in Australia;
- comply with the assets and turnover test;

²⁰ Australian Government, *Parliamentary Debates*, House of Representatives, 24 November 2016, 4306 (Scott Morrison, Treasurer).

²¹ *Corporations Act 2001* (Cth) s 738B.

²² *Ibid* s 738G.

²³ *Ibid* ss 703B, 704 and 706 (in relation to pt 6D.2) and s 725A (in relation to pt 6D.3). Section 738E does, however, also provide that the fact that a company makes a CSF offer of securities does not prevent it from also making an offer of securities of the same class in reliance on a provision of s 708. Consequently, a company could make a CSF offer to crowd investors and, at the same time, also make an offer to investors for whom disclosure is not required anyway – such as venture capital funds and angel investors: see Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 2.7.

²⁴ *Corporations Act 2001* (Cth) s 738H(1).

²⁵ To be eligible for the regime's limited governance requirements a company must, at present, either register as a public company limited by shares or convert from a proprietary company to a public company limited by shares: *Corporations Act 2001* (Cth) s 738ZI. While existing public companies (which are already covered by the *Corporations Act's* more stringent governance requirements) may be able to make a CSF offer, they are not eligible for the new concessions and, therefore, cannot, thereby, escape their existing corporate governance and reporting requirements: Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 7.20. Legislation currently before Parliament will extend the availability of CSF to proprietary companies: see Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth).

- not be a listed corporation²⁶ (a restriction that applies to both the company and any related party of the company²⁷); and
- not have a substantial purpose of investing in securities or interests in other entities or managed investment schemes (a restriction that applies not only to the company itself but also to any related party).

The 'assets and turnover test' is satisfied if, at the 'test time',²⁸ the value of the consolidated gross assets of the company and all of its related entities is less than AU\$25 million (or, if the regulations specify a different amount, that amount) – and the consolidated annual revenue of the company and all of its related parties for the 12-month period immediately prior to the company determining its eligibility to crowdfund,²⁹ is less than AU\$25 million (or, if the regulations specify a different amount, that amount).³⁰

Offers can also only be made by or on behalf of already existing companies; they cannot be made if they relate to 'a company that has not been formed or does not exist'.³¹

B Eligible offers

An offer will be 'eligible to be made under this Part' if and only if:

- it is an offer by the company for the issue of securities of the company;³²
- the company is an 'eligible CSF company' when the offer is made;
- the securities are of a class specified in the regulations (under the current provisions they must be fully paid ordinary shares³³ – but that requirement only appears in the regulations so it can readily be changed if it is found to be unnecessarily restrictive³⁴);
- the offer complies with the 'issuer cap'; and

²⁶ Listed companies are excluded because they have already 'demonstrated an ability to bear the costs of compliance requirements associated with listing on a public market' and because they 'generally have access to other forms of equity raisings because of their listing and continuously disclosing status, such as rights issues and share purchase plans': Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 2.27.

²⁷ 'Related party' is defined in *Corporations Act 2001* (Cth) s 738G(3) as 'a related body corporate of the company' or 'a person who controls the company or an associate of that person'.

²⁸ The time when the shares are issued and, therefore, the time at which the company must be an 'eligible CSF company': see *Corporations Act 2001* (Cth) s 738ZH(1).

²⁹ Companies that have been in existence for less than 12 months will still be able to crowdfund so long as their consolidated annual revenue for the period that they have been on foot is under AU\$25 million: Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 2.25.

³⁰ *Corporations Act 2001* (Cth) s 738H(2).

³¹ *Ibid* s 738ZF.

³² The offer can only be for an initial issue of securities, not for a subsequent sale: see Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 2.12.

³³ *Corporations Regulations 2001* (Cth) reg 6D.3A.01(1).

³⁴ Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) paras 2.31–2.34.

- the company does not intend that the funds raised will be used, either by itself or by a related party, to invest in securities or interests in other entities or schemes.³⁵

The 'issuer cap' is AU\$5 million or, if the regulations specify a different amount, that amount. The 'cap' is the maximum that the company can raise in a single year and includes not only the maximum amount that it intends to raise through its current offer but also any amounts that it, or a related party, raised through other CSF offers – together with all other amounts they raised within the immediately preceding 12 months in circumstances where *Corporations Act 2001* (Cth) ss 708(1) or (10) did not require disclosure.³⁶

A company (and its related parties) can also have only one CSF offer open at a time.³⁷

If an offer does not qualify as a CSF offer, it then generally defaults to being an offer that does require disclosure under *Corporations Act 2001* (Cth) pt 6D.2 – so failing to lodge the required disclosure documents with the Australian Securities and Investments Commission (ASIC) becomes an offence.³⁸

C The offer document

A 'CSF offer document' must be prepared and it *must* contain all of the information required by the regulations.³⁹ Perhaps surprisingly, that does not include full details of the 'CSF offer'⁴⁰ – though, if it does not, a separate CSF offer must be published together with the 'CSF offer document'.⁴¹ Among other things, the 'CSF offer document' must set out both the 'maximum subscription amount' and the 'minimum subscription amount' being sought through the offer.⁴²

It must also 'be worded and presented in a clear, concise and effective manner'⁴³ and it must be 'published'. It is here that the role of the 'CSF intermediary' comes into play. A CSF offer can only be made⁴⁴ by publishing a complying CSF offer document 'on a platform

³⁵ *Corporations Act 2001* (Cth) s 738G(1).

³⁶ *Ibid* s 738(2).

³⁷ *Ibid* s 738R. A company having more than one offer open at a time commits an offence: s 1311(1).

³⁸ *Ibid* s 727(1). See also Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) paras 2.53–2.54.

³⁹ *Corporations Act 2001* (Cth) ss 738J(1) and (2).

⁴⁰ The 'information required by the regulations' includes a Table of Contents, Risk Warnings, information about the offering company, information about the offer, and information about investor rights: *Corporations Regulations 2001* (Cth) regs 6D.3A.02–6D.3A.06. The CSF offer document *may* also set out the CSF offer itself: *Corporations Act 2001* (Cth) s 738J(2).

⁴¹ *Corporations Act 2001* (Cth) s 738L(1).

⁴² *Ibid* s 738L(7) and (8), respectively. Once the offer is fully subscribed to the maximum subscription amount, the responsible intermediary must close the offer: s 738N(4)(c). If the applications that are received (and not withdrawn) do not at least equal the minimum subscription amount, the responsible intermediary must refund all application money received: s 738ZB(3). Failure to comply is a strict liability offence: s 738ZB(5).

⁴³ *Ibid* s 738K.

⁴⁴ *Ibid* s 738L(3) provides that companies 'must not make the CSF offer otherwise than in accordance with [the requirement to make it through a CSF intermediary]'. If they do they commit an offence: s 1311(1).

of a single CSF intermediary⁴⁵ – an entity defined as ‘a financial services licensee whose licence expressly authorises the licensee to provide a crowdfunding service’.⁴⁶

D Role of the ‘CSF intermediary’

The CSF intermediary has a number of defined roles in the CSF process, all of which are aimed at protecting investors.

First, it has a defined statutory ‘gatekeeper’ role.⁴⁷ It must not publish a CSF offer document unless it has first conducted the checks required by the regulations⁴⁸ and is satisfied as to the identity and bona fides of both the company making the offer and its directors and officers. It must also be satisfied that the offer is eligible to be made under pt 6D.3A and is not misleading or deceptive.⁴⁹ If it fails to conduct those checks (or to conduct them to a reasonable standard) it commits a strict liability offence with a penalty of up to 50 penalty units.⁵⁰

Second, the responsible intermediary must ensure that ‘the general CSF risk warning’ appears prominently on the offer platform at all times while the offer is open or suspended.⁵¹ The general risk warning is a statement in terms that are prescribed by the regulations.⁵²

Third, the responsible entity must ensure that an ‘application facility’ (a facility for investors to make an application under the offer) is available at all times when the offer is open;⁵³ that any application made other than through that facility is rejected;⁵⁴ and that a ‘communication facility’ is provided through which potential investors can make posts related to the offer, see posts made by others and ask questions about the offer – and through which it or the company can make posts or respond to questions or posts.⁵⁵

⁴⁵ Ibid s 738L(1). While advertising a CSF offer or intended CSF offer is generally prohibited (s 738ZG(1)), that prohibition does not apply to publishing a CSF offer or a CSF offer document on a responsible intermediary’s platform: s 738ZG(2).

⁴⁶ Ibid s 738C. CSF intermediaries are therefore required to hold an Australian Financial Services Licence. Depending on the nature of the activities in which the CSF intermediary engages it ‘could also be considered to be operating a financial market and therefore be required to hold an Australian Market Licence’: Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 3.8. The Minister has power under *ibid* s 791C to exempt operators from the requirement to hold an Australian Market Licence.

⁴⁷ *Corporations Act 2001* (Cth) s 738Q.

⁴⁸ *Ibid* s 738Q(1).

⁴⁹ *Ibid* s 738Q(5).

⁵⁰ *Ibid* ss 738Q(3) and 1311(1).

⁵¹ *Ibid* s 738ZA(1). The detailed wording of the risk warning is set out in *Corporations Regulations 2001* (Cth) reg 6D.3A.03.

⁵² *Corporations Act 2001* (Cth) s 738ZA(2). See also *Corporations Regulations 2001* (Cth) reg 6D.3A.03.

⁵³ *Corporations Act 2001* (Cth) s 738ZA(3).

⁵⁴ *Ibid* s 738ZA(4).

⁵⁵ *Ibid* s 738ZA(5). The intent is that investors will be able to ‘rely on the collective wisdom of the “crowd” in making their investment decision’: Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 3.64.

Fourth, it must ensure that statements drawing investors' attention to their rights to withdraw their applications during the cooling off period⁵⁶ and the process by which that can be done, appear prominently on the platform.⁵⁷

Fifth, the fees the intermediary charges the company and details of any pecuniary interest that the intermediary has or expects to acquire in either the company or a related party must also appear prominently on the platform.⁵⁸

Failing to comply with any of those obligations is also an offence and renders the CSF intermediary liable to a penalty of up to 60 penalty units and/or one year's imprisonment.⁵⁹

Finally, the arrangement between the company and the CSF intermediary (the 'hosting arrangement') must require that all applications made in response to the offer, and all application money in respect of those applications, be sent or paid to the intermediary and be then dealt with by the intermediary in accordance with the provisions of *Corporations Act 2001* (Cth) pt 6D.3A.⁶⁰

E Opening and closing a CSF offer

A CSF offer remains 'open' until it is 'closed'.⁶¹ It opens when it is first published on the responsible intermediary's platform and it closes when the responsible intermediary closes it – which must be as soon as practicable after the first of: a period of three months since the offer opens; the specified end date for the offer; the intermediary considers that the offer is fully subscribed; the company notifies the responsible intermediary that it wants the offer withdrawn; or the Act prohibits the continued publication of the CSF offer document.⁶²

F Accepting a CSF offer

Investors can only accept a CSF offer by making an application through the responsible intermediary (using the 'application facility' provided). 'Retail clients' must also first complete an 'acknowledgement' that complies with the requirements of the regulations.⁶³

The responsible entity must reject any application that is made otherwise than through the application facility (and, as retail clients *cannot* make an application without completing the required acknowledgement, that also effectively means that the

⁵⁶ Investors may withdraw their application within five business days: *Corporations Act 2001* (Cth) s 738ZD.

⁵⁷ *Ibid* s 738ZA(8).

⁵⁸ *Ibid* s 738ZA(9).

⁵⁹ *Ibid* s 1311(1). See also Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 3.56.

⁶⁰ *Corporations Act 2001* (Cth) s 738L(2). The responsible entities' obligations in relation to application money are set out in s 738ZB. It provides that the general obligations in pt 7.8 div 2 sub-div A continue to apply, with some modifications provided for in that section.

⁶¹ *Ibid* s 738N(1), (2) and (3).

⁶² *Ibid* s 738N(4). Failing to close the offer when required is an offence: s 1311(1).

⁶³ *Ibid* s 738ZA(3)(b). The detailed wording of the 'acknowledgement' (which acknowledges that the retail client has read the offer document, understands the risk warning and is aware of the availability and operation of the communication facility) is set out in *Corporations Regulations 2001* (Cth) reg 6D.3A.07(2).

responsible entity must reject any application that is not accompanied by a completed acknowledgment).⁶⁴

In addition, the legislation provides a number of other protections for investors. First, individual 'retail clients'⁶⁵ are limited to investing a maximum of AU\$10 000 in CSF offers by the same company in any 12-month period and the responsible intermediary must reject applications that exceed that amount.⁶⁶

Further, neither the company, nor any related party, nor the responsible intermediary, may provide financial assistance to allow that investor to make the investment.⁶⁷

G The regulatory concessions

For companies whose offers qualify under the CSF rules there are a number of regulatory concessions that are intended to remove what the Treasurer referred to in his Second Reading Speech for the 2016 Bill as 'unnecessary regulatory barriers ... [to] Australia's innovative early-stage businesses to obtain the capital they need to turn good ideas into commercial successes'.⁶⁸ These include, for a concession period of up to a maximum of five years:

- modified disclosure obligations in the CSF offer document;
- an exemption from the requirement to hold an AGM;
- an option to provide reports to shareholders merely by making them available online; and
- an exemption from the requirement to appoint an auditor until the company has raised at least AU\$1 million⁶⁹ from CSF offers.

V AVAILABILITY OF THE CSF REGIME

A Initially limited to a select group of public companies

As indicated above, as the CSF regime was originally intended to operate, it was only available to unlisted public companies limited by shares, with less than AU\$25 million in both gross assets and annual revenue. Consequently, all proprietary and many public

⁶⁴ *Corporations Act 2001* (Cth) s 738ZA(4).

⁶⁵ Defined in *ibid* s 738D as 'a person who is a retail client for the purposes of Chapter 7 in relation to a crowdfunding service that relates to a particular CSF offer'. Chapter 7 provides that financial services or products will be provided to a person as a retail client unless the exclusions in sub-ss 761G(5)–(7) ('wholesale clients') or s 761GA ('sophisticated investors') apply to them.

⁶⁶ *Ibid* s 738ZC(1). An intermediary who fails to reject an application that exceeds the retail investor cap commits an offence: s 1311(1). There are, however, no penalties for investors who make, or purport to make, applications that exceed that cap: see Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) paras 6.15–6.17.

⁶⁷ *Corporations Act 2001* (Cth) s 738ZE. Failure to comply with this prohibition is an offence: s 1311(1).

⁶⁸ Australian Government (Morrison), above n 20.

⁶⁹ Under the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) the audit threshold is to be raised from AU\$1 million to AU\$3 million to align it with the audit threshold being proposed for proprietary companies once they are permitted to raise funds through CSF.

companies were automatically excluded. This meant that the option of raising funds through crowd-sourcing was denied to about 99.7 per cent of all Australian companies.⁷⁰

However, even for companies that did qualify, the available concessions had a limited lifespan (and therefore conferred a limited benefit).

B Problems with eligibility and the limited 'concession period'

While unlisted public companies can raise funds through crowd-sourcing, and are granted a number of exemptions from the *Corporations Act's* standard public company regulatory obligations to allow them to do so (reduced disclosure obligations, exemptions from the requirement to hold an AGM, ability to provide reports to shareholders simply by making them available online, and exemptions from the requirement to appoint an auditor until the company had raised at least AU\$1 million from its CSF offers), those exemptions only apply for a maximum five-year concession period (starting once 'a successful CSF round' has been completed).⁷¹

The facts that CSF is only available to that limited group of companies and that the available concessions are 'time-limited' both have a number of negative effects:

1. If a small business (including a start-up) wants to raise capital through CSF it has either to register as, or, if it was already registered as a proprietary company, convert to, a public company to be eligible to do so.
2. As the concessions only last for a maximum of five years, the small business (especially if it is a start-up) needs to consider, carefully, where it would be at the end of the concession period before deciding to register or convert. The risk is that, having registered as (or converted to) a public company to attract initial capital, it could be stranded with a structure that, because of the 'standard' compliance burdens that will apply to it once the concession period ends, is not really appropriate for its business (especially if it does not achieve the sort of scale that would justify such a structure).⁷²
3. Because 'investors (especially venture capital) generally consider public companies a less attractive target due to the complexities and shareholder consent associated with takeover laws',⁷³ the requirement to register as, or convert to, a public company could also adversely affect companies if they intend to exit their business via a trade sale after it matures.
4. Because the type (and therefore the number) of companies that can use the new rules is limited, the number of CSF intermediaries that can expect to operate

⁷⁰ Marina Nehme, 'Australia Finally Has Crowd-Sourced Equity Funding, But There's More to Do', *The Conversation*, 22 March 2017 <<https://theconversation.com/australia-finally-has-crowd-sourced-equity-funding-but-theres-more-to-do-74921>>.

⁷¹ See Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) paras 7.8, 7.25 and 7.31.

⁷² This problem is expressly recognised in the Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) para 2.41.

⁷³ *Ibid* para 2.38. See also paras 2.6 and 2.16.

profitably as commercially successful businesses is also limited. That, in turn, can lead to reduced competition and increased costs for capital-raising companies.⁷⁴

5. To some extent, the available concessions also limit investors' ability to control their risk. In particular, the absence of audit and AGM requirements means that investors may find it difficult to identify and react to problems (by, for example, changing the board, changing the company's direction or even, in extreme cases, winding it up).
6. The fact that the company must be unlisted raises an additional problem in that 'bailing out' can be difficult and shareholders wanting or needing to extract their investment may find it difficult (or even impossible) to sell their shares.⁷⁵

C Problems with excluding proprietary companies

About 98 per cent of all companies in Australia are proprietary companies.⁷⁶ The proprietary company structure is also the one that is most favoured by start-ups and early-stage companies.⁷⁷ Therefore, excluding proprietary companies from the CSF regime was always going to be problematic – and that has long been known.

For example, even in his Second Reading Speech for the 2016 Bill the Treasurer referred to the possibility of extending the availability of CSF to proprietary companies – noting that a consultation paper on that possibility had been released in 2015 and that the government was continuing to consult on how it might work.⁷⁸

The problem was, of course, that proprietary companies are generally prohibited from offering shares to the public⁷⁹ – so allowing them to crowdfund immediately raised a number of basic issues with the very concepts under which they are allowed to operate.

D Solving the 'proprietary company problem'

Despite that, in the 2017 Budget the Treasurer announced that the availability of crowd-sourced equity funding would be extended to proprietary companies. The reason, he said, was to make it possible for a greater number of innovative companies and start-ups to access that option.

⁷⁴ Ibid para 2.41. In Italy, where the availability of CSF is restricted, only one CSF intermediary equivalent currently exists. Similarly, in New Zealand a number of intermediaries were established initially, and some have already withdrawn from the field: see Nehme, above n 70.

⁷⁵ The Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) para 2.37 does suggest, though, that, 'as public companies maintain a more consistent flow of information to the public, it is more likely that a secondary market in shares in public CSF companies could be developed in time.'

⁷⁶ Ibid para 2.38.

⁷⁷ Ibid paras 2.38 and 2.40.

⁷⁸ Australian Government (Morrison), above n 20.

⁷⁹ *Corporations Act 2001* (Cth) s 113(3) effectively prohibits a proprietary company from offering its shares to other than its existing shareholders or employees of itself or of a subsidiary.

Draft legislation to give effect to that announcement was released in May 2017 and was introduced into Parliament on 14 September 2017.⁸⁰ It passed the House of Representatives on 26 February 2018.

Under the proposed legislation, proprietary companies that meet the Act's requirements will be permitted an unlimited number of CSF shareholders but, in exchange, will have to meet higher governance and reporting obligations.

In particular, they will have to have a minimum of two directors (at least one of whom must reside in Australia), will have to prepare financial reports in accordance with accounting standards (whether or not they are 'large proprietary companies' – the only proprietary companies that are currently subject to that requirement), will be required to have those statements audited (at least after they raise more than AU\$3 million from CSF offers), will have additional reporting obligations (they will have to record details of their CSF offers and CSF shareholders and report any changes to those details to ASIC) and, to protect investors, will be subject to restrictions on related party transactions.

If proprietary companies do qualify to undertake CSF, the process under which they can raise capital using CSF offers is very similar to that which presently applies to public companies. In particular, the location, assets and turnover tests, issuer cap, investor cap, offer requirements, CSF intermediary requirements (and obligations), communication facility requirements, cooling off rights, prohibitions on financial assistance and advertising restrictions will all be the same for them as they are for eligible public companies.

One change that will be made to the existing CSF regime is that, once the new legislation is passed, the temporary concessions (those applicable to AGMs, reporting and audit) that currently apply will be removed – subject to a grandfathering of those arrangements for companies that registered or converted to public companies prior to the regime being extended to proprietary companies.⁸¹ This is a direct consequence of the proposed change because those concessions 'were initially only granted on the assumption that proprietary companies would not have the opportunity to access crowd-sourced funding'.⁸²

E Taxation considerations

Making CSF available is merely one of many measures that have been introduced, especially in the last 20 years, to assist innovation-based enterprises, especially in their start-up phase.

Those measures really began with the tax incentives for 'early venture capital investments' (EVCIs) that investors made through Venture Capital Limited Partnerships (VCLPs), Early Stage Venture Capital Limited Partnerships (ESVCLPs) or Australian Venture Capital Funds of Funds (AFOFs).

⁸⁰ Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth).

⁸¹ See proposed amendments to *Corporations Act 2001* (Cth) s 738ZI: Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) sch 1 pt 1 items 42, 43 and 44.

⁸² Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) para 2.27. See also para 2.34

Those incentives, which were provided through a combination of the *Venture Capital Act 2002* (Cth) and amendments to both the Australian Government's taxation legislation and the individual state and territory Partnership Acts,⁸³ were intended to facilitate non-resident investment in the Australian venture capital industry. They did that by providing those investors with an exemption from capital gains tax (CGT) on their EVCLs (provided they had held them for at least 12 months) and an exemption from income tax on their share of the profits that were made by the businesses in which they had invested.⁸⁴

In addition, under the *Income Tax Assessment Act 1997* (Cth) (ITAA97) div 355, businesses can access a research and development (R&D) tax offset, which is jointly administered by AusIndustry and the Australian Taxation Office (ATO).⁸⁵ It replaced the formerly available 'R&D Tax Concession' and allows eligible R&D entities that incur eligible R&D expenditure on defined 'core' or 'supporting' R&D activities to a self-assessed tax offset, the nature and extent of which depends on the size of the R&D entity's turnover and the amount of its eligible expenditure.

R&D entities with an aggregated turnover of less than AU\$20 million, on a worldwide basis, are entitled to a *refundable* tax offset equal to 43.5 per cent of their total eligible R&D expenditure for the year of income; those with an aggregated turnover of AU\$20 million or more on the same worldwide basis are entitled to a *non-refundable* tax offset equal to 38.5 per cent of their total eligible R&D expenditure for that year – in both cases, provided they have notional deductions of at least AU\$20 000.⁸⁶ Since 2014, however, those offsets have been limited to the first AU\$100 million of the affected R&D entity's eligible R&D expenditure for that year. A separate offset equal to the company tax rate is available for expenditure over AU\$100 million.

Those offsets are in lieu of a tax deduction, so their net effect is that entities under the AU\$20 million threshold receive a minimum net benefit of 13.5¢ in the dollar and those over the threshold receive a minimum net benefit of 8.5¢ in the dollar – at least up to a notional R&D expenditure of AU\$100 million. After that, the net effect of the then-available lesser offset is, effectively, to provide an immediate write-off for that additional expenditure.

To assist start-ups to attract staff, the ITAA97 div 83A was also amended in 2015, in line with the government's *Industry Innovation and Competitiveness Agenda*,⁸⁷ to provide, *inter alia*, a 'start-up' concession for shares and options that eligible small start-up

⁸³ In Western Australia, the required partnership law changes are contained in the *Limited Partnerships Act 2016* (WA). In New Zealand the same considerations led to both the passage of the *Limited Partnerships Act 2008* (NZ) and changes to taxation legislation to encourage venture capital investment into New Zealand.

⁸⁴ On the downside, losses on both capital and revenue account are also disregarded.

⁸⁵ AusIndustry has responsibility for registration and administration of programme activities under pt III of the *Industry Research and Development Act 1986* (Cth); the ATO has responsibility for administration of expenditure on what might be eligible R&D activities under the ITAA97 div 355.

⁸⁶ The offsets were originally 45 per cent and 40 per cent, respectively but they were reduced by the *Budget Savings (Omnibus) Act 2016* (Cth). The new rates apply for income years commencing on or after 1 July 2016.

⁸⁷ Australian Government, *Industry Innovation and Competitiveness Agenda: An Action Plan for a Stronger Australia* (2014).

companies issue to their employees in lieu of the higher salaries that they might otherwise have to pay to attract appropriate talent to their businesses.

In addition, since 1 July 2015 start-up companies, partnerships and trusts have been able to access an immediate write-off under ITAA97 s 40-880(2A) for any capital expenditure that they, as 'small business entities' (defined in ITAA97 s 328-110), incur either in obtaining advice or services relating to the proposed structure or proposed operation of the business or in paying government agency fees, taxes or charges relating to establishing either the business itself or its operating structure. This does not allow them to immediately write-off all set-up expenditure⁸⁸ but many of those other expenses may be deductible over five years under other provisions in s 40-880.

More recently, in 2016, the *Tax Laws (Tax Incentives for Innovation) Act 2016* (Cth) introduced a range of 'tax incentives for early-stage investors', by inserting a new sub-div 360-A into the ITAA97 to augment the other, already existing, measures – especially those applicable to the venture capital industry.

Subdivision 360-A provides tax incentives to encourage 'angel investors' to invest in innovative Australian start-up companies at a stage earlier than that at which venture capital funds are typically willing to invest.⁸⁹ In particular, the tax incentives were intended to make it easier for 'early-stage innovation companies' (ESICs) 'to attract seed and pre-commercialisation equity at an earlier stage of their development',⁹⁰ particularly to get their innovations from the concept to the commercialisation stage⁹¹ – an interim period commonly known as 'the valley of death'.

The tax incentives that 'angel investors' can access under sub-div 360-A are a non-refundable carry-forward tax offset of 20 per cent of the value of the investment up to a maximum 'tax offset cap' of AU\$200 000 (with, to protect 'non-sophisticated' investors, a total annual investment limit of AU\$50 000 for retail investors), and a 'modified CGT treatment' that allows early-stage investors to disregard any capital gains they make on their shares in eligible ESICs, provided the shares have been held for between one and ten years⁹² – a tax treatment that is similar to that which is already accorded Early Stage

⁸⁸ In particular, the cost of acquiring assets that may be used by the business, the direct costs of acquiring start-up capital itself (such as interest, dividends or capital repayments), expenses the business may incur for the operation of a proposed business (such as travel costs to assess locations for a business), and expenditure relating to taxes of general application (such as income tax) are not included.

⁸⁹ Paragraph 1.4 of the Explanatory Memorandum to the Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016 (Cth) noted, in particular, that '[venture capital funds] typically focus on companies that have already developed a concept that is anticipated to attract capital and the company is generally seeking higher amounts of capital to grow'.

⁹⁰ *Ibid.*

⁹¹ The 'tax incentives for early-stage investors' do not apply at the concept stage because, before a company can be classified as an ESIC under ITAA97 s 360-40 it must, *inter alia*, be 'genuinely focused on developing for commercialisation one or more new, or significantly improved, products, processes, services or marketing or organisational methods': s 360-40(1)(e)(i).

⁹² Though, to ensure that investments are not made (to gain the offset) and then withdrawn before the company can benefit from them, any capital losses on shares held for less than 10 years are also disregarded.

Venture Capital Limited Partnerships, Venture Capital Limited Partnerships and Australian Venture Capital Funds of Funds under sub-div 118-F.⁹³

There are a number of problems with the application of sub-div 360-A in a practical sense⁹⁴ but some of those have already been addressed⁹⁵ and others are in the process of being addressed.⁹⁶ In general, though, the Subdivision does seem to be a good start point to address (and redress) the problems that ESICs have in attracting early-stage investment.

VI 'RISK' AND TAX INCENTIVES

Compensating for 'risk' has been a significant factor in making tax incentives available for investment in innovation and that was particularly so with the 2016 'tax incentives for early-stage investors'. As the Treasurer noted in his Second Reading Speech, the aim of the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* (Cth) was, specifically, to 'foster a shift towards a culture of innovation, whereby entrepreneurial risk-taking is encouraged and rewarded'.⁹⁷

That approach was eminently justified because providing finance to innovative start-ups is inherently risky. Data shows that somewhere in excess of 50 per cent of all small businesses fail in the first four years of their operation.⁹⁸ For innovative start-ups the figures, sitting at about 60 per cent,⁹⁹ are worse. The figures are worse again for first-time entrepreneurs, for whom there is only an 18 per cent chance of success.¹⁰⁰

Potential investors are therefore understandably selective, both in the innovations they are prepared to back, especially in the very early stages of the business's existence, and in the amount of capital they are prepared to risk.

In fact, investor reluctance to invest in innovation, and the resulting difficulty that innovative small businesses in particular encounter when trying to access adequate capital, has been identified as 'a major contributor to poor innovation outcomes in Australia'.¹⁰¹ That problem is also confirmed by the results of the Australian Bureau of

⁹³ Provided the conditions in sub-div 360A are met, any capital gains or losses that result from CGT events relating to 'eligible venture capital investments' (EVCI) that partners in ESVCLPs, 'eligible venture capital partners' in VCLPs or 'eligible venture capital partners' in AFOFs have owned for at least 12 months are disregarded: ITAA97 ss 118-405, 118-407 and 118-410. Those investors are also exempt from income tax on their share of any profits (ss 51-54 and 51-55) and are denied a deduction for any losses that arise from disposal of those interests: ss 26-68 and 26-69.

⁹⁴ Those problems are dealt with in detail in Stephen Graw, 'Encouraging Innovation – The Tax Laws Amendment (Tax Incentives for Innovation) Act 2016' (Paper presented at the ATTA Conference, Masterton, New Zealand, 18–20 January 2017).

⁹⁵ See *Treasury Laws Amendment (2017 Measures No 1) Act 2017* (Cth) sch 1.

⁹⁶ See *Treasury Laws Amendment (2018 Measures No 2) Bill 2018* (Cth).

⁹⁷ Australian Government (Morrison), above n 20.

⁹⁸ Matt Mansfield, Small Business Trends, *Startup Statistics – The Numbers You Need to Know* (1 November 2016) <<https://smallbiztrends.com/2016/11/startup-statistics-small-business.html>>.

⁹⁹ Erin Griffith, 'Conventional Wisdom Says 90% of Startups Fail. Data Says Otherwise', *Fortune* (online), 27 June 2017 <<http://fortune.com/2017/06/27/startup-advice-data-failure>>.

¹⁰⁰ Mansfield, above n 98.

¹⁰¹ G Withers, N Gupta, L Curtis and N Larkins, 'Australia's Comparative Advantage: Final Report' (Australian Council of Learned Academies, Melbourne, August 2015) 120.

Statistics *Business Characteristics Surveys*, which have consistently rated 'lack of access to additional funds' as the greatest barrier to innovation in Australian businesses.¹⁰²

The seriousness of the problem is also clearly reflected in data in the *Startup Muster* Annual Reports. The 2017 report, for example, noted that, while success rates for fundraising by start-ups had improved over time, in the previous year only 34.2 per cent of start-ups had equity investors.¹⁰³ The difficulties that start-ups encounter when trying to raise funds was also illustrated by the fact that, in that year, only 27.5 per cent of start-ups had tried to fundraise and had either raised as much as they wanted or been oversubscribed. Ten per cent had tried but had not raised as much as they had sought and 5.8 per cent had tried but had not been able to raise any funding at all. More significantly, of all start-ups, 42.8 per cent had never tried to fundraise at all.¹⁰⁴

Therefore, anything that encourages investors to support innovation is to be welcomed – particularly in the period between the initial stage of the business's lifecycle (where finance is normally provided through self-funding, family, friends and, perhaps, through government support and/or tax incentives – such as those outlined above)¹⁰⁵ and the commercialisation stage where funding is more likely to be available through the established ESVCLP and VCLP regimes, as well as from banks and other sources of commercial finance.

VII WHERE CROWD-SOURCED FUNDING FITS IN

A Recognition of risk

The government's declared intent in legislating to make CSF available was to facilitate fundraising in the initial stages of a company's existence.¹⁰⁶ That is well evidenced by the fact that, to qualify for the governance and reporting concessions, a company registering as, or converting to, a public company in order to use the CSF regime has to state in its application that it intends to make a CSF offer after registration or conversion *and* it must then also complete a CSF offer within 12 months.¹⁰⁷

¹⁰² See, for example, Australian Bureau of Statistics, Australian Government, *Selected Characteristics of Australian Business, 2015-16* (17 August 2017) para 8167.0 <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8167.02015-16?OpenDocument>>. It reported that for 2015/16, as for previous years, both innovative-active businesses and businesses overall identified lack of access to additional funds as the most common barrier to innovation: 21.3 per cent of all innovation-active businesses rating it as their greatest barrier to innovation (with an even higher percentage among SMEs). For the purposes of those surveys, 'barriers to innovation' are defined as 'those barriers that significantly hampered the development or introduction of any new or significantly improved goods, services, processes and/or methods'.

¹⁰³ Startup Muster, *2017 Annual Report* (2017) <<https://www.startupmuster.com/reports/Startup-Muster-2017-Report.pdf>>. These figures were an improvement on results from earlier years where start-ups had reported much worse outcomes.

¹⁰⁴ *Ibid.*

¹⁰⁵ See, *ibid.*, for figures on the availability and sources of funding for start-ups in 2016/17.

¹⁰⁶ Explanatory Memorandum to Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) paras 1.4-1.6.

¹⁰⁷ *Corporations Act 2001* (Cth) s 738ZL.

It is also clear that the government recognised and took steps to bring the substantial risks that can be involved with such investments to the attention of potential investors.

The Explanatory Memorandum to Corporations Amendment (Crowd-sourced Funding) Bill 2016, for example, specifically notes that 'start-ups generally present higher risks for investors compared to larger, more established companies [and] CSF investments may be largely illiquid, reducing the ability of investors to exit their investment'.¹⁰⁸

The legislation itself also expressly provides for a 'risk statement',¹⁰⁹ which must be made available to potential investors – and which CSF intermediaries must publish *prominently* on their offer platform for each offer with which they are involved.¹¹⁰ 'Retail clients' must also complete an acknowledgement that, *inter alia*, they have read and understood that risk statement¹¹¹ – and responsible entities are required to reject any application from a retail client that is not accompanied by a completed acknowledgement.¹¹²

ASIC also specifically warns on its website that, because businesses that raise money through CSF 'are new or in the early stages of development ... there's more risk that the business will be unsuccessful and you may lose all the money you invested'.¹¹³ It also specifically notes that because of the nature of the company structures that are involved '[y]our investment is also unlikely to be 'liquid', so if you decide you need the money you've invested, you may not be able to sell your shares quickly, or at all'.¹¹⁴

Therefore, as with the venture capital incentives and, in particular, the more recent ESIC tax regimes, it might have been expected that significant tax incentives would have been attached to CSF offers to compensate for the risks associated with them and to enhance their attractiveness to investors.

B Taxation and the CSF regime

Surprisingly, there are no taxation incentives attached to the CSF regime. Investment transactions under it will be taxed exactly as if the funds were raised by a normal issue of

¹⁰⁸ Explanatory Memorandum to Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 1.8.

¹⁰⁹ The detailed wording of the risk statement is set out in *Corporations Regulations 2001* (Cth) reg 6D.3A.03. It reads in part: Crowd-sourced funding is risky. Issuers using this facility include new or rapidly growing ventures. Investment in these types of ventures is speculative and carries high risks; You may lose your entire investment, and you should be in a position to bear this risk without undue hardship; Even if the company is successful, the value of your investment and any return on the investment could be reduced if the company issues more shares; Your investment is unlikely to be liquid. This means you are unlikely to be able to sell your shares quickly or at all if you need the money or decide that this investment is not right for you; Even though you have remedies for misleading statements in the offer document or misconduct by the company, you may have difficulty recovering your money.

¹¹⁰ *Corporations Act 2001* (Cth) s 738ZA(1). Failure to comply with that subsection is an offence: s 1311(1).

¹¹¹ *Ibid* s 738ZA(3)(b). The detailed wording of the acknowledgement is set out in *Corporations Regulations 2001* (Cth) reg 6D.3A.07(2).

¹¹² *Corporations Act 2001* (Cth) sub-ss 738ZA(3)(b) and (4). Not doing so is also an offence: s 1311(1).

¹¹³ ASIC, Australian Government, *Moneysmart: Crowd-Sourced Funding* (10 November 2017) <<https://www.moneysmart.gov.au/investing/crowd-sourced-funding>>.

¹¹⁴ *Ibid*.

shares.¹¹⁵ That has a number of consequences. For companies raising funds through CSF offers, the money they raise will not be income but simply part of the company's share capital. There are therefore no income tax consequences for the receiving company at that stage. Subsequent use of those funds for non-capital business purposes will give rise to deductions that they can then offset against current or future income and, if the funds are used for capital expenditure, an immediate or accelerated write-off under ITAA97 s 40-880 may be available. If the funds are used for eligible R&D expenditure then a self-assessed tax offset may be available under ITAA97 div 355, in lieu of a deduction.

For CSF intermediaries, the fees that they receive will be income from carrying on a business and will therefore be taxable in full. The fees that they pay to acquire and maintain their Australian Financial Services Licence and, if required, their Australian Markets Licence, so they can provide CSF services, will of course be deductible, as will all other non-capital expenses they incur in carrying on their CSF intermediary business. Capital expenses may give rise to depreciation deductions under ITAA97 div 40 (including, if they are 'small business entities', the immediate or accelerated write-offs that are available under ITAA97 s 40-880).

For investors, their investments will not be deductible expenses (being outgoings of capital or of a capital nature), but, if the shares they receive are subsequently disposed of, any profit will be taxable (as either a capital gain, as a gain on disposal of a revenue asset or as ordinary income, depending on how the shares were acquired and held). Any loss will also be treated as either a capital loss to be dealt with under ITAA97 s 102-10 or as a loss on revenue account to be deducted under ITAA97 s 8-1 (again depending on how the shares were acquired and held). Any return that they get on their investment in the way of dividends will, of course, be taxable as ordinary income under ITAA36 s 44.

There may also be GST consequences.¹¹⁶ The supply of shares itself is an input-taxed financial supply and is therefore not subject to GST (so the investor receives no input credits). The services that the CSF intermediary supplies to the company are, however, a taxable supply and, provided the intermediary is carrying on an enterprise, is registered or required to be registered for GST, provides the services for consideration, and the services are connected to Australia (as they will be because of the eligibility requirements for CSF offers), they will be subject to GST.

Input tax credits are not normally available for acquisitions that relate to the making of input taxed supplies unless certain prescribed circumstances exist, so whether the company will be entitled to input credits for the GST on the fees that it pays the CSF intermediary will therefore depend on whether the provision of the intermediary's services fall within those circumstances (mainly the *de minimis* exception under *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 11-15(4) or the 'reduced credit

¹¹⁵ For the ATO view, see Australian Taxation Office, Australian Government, *Crowdfunding* (2017) <<https://www.ato.gov.au/individuals/income-and-deductions/income-you-must-declare/crowdfunding>>.

¹¹⁶ For the ATO view, see Australian Taxation Office, Australian Government, *GST and Crowdfunding* (2017) <<https://www.ato.gov.au/Business/GST/In-detail/Rules-for-specific-transactions/GST-and-crowdfunding>>.

acquisitions' detailed in the *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) reg 70-5.02).

C Will the absence of tax concessions be a 'deal breaker'?

Clearly, providing tax incentives for early-stage investing has been an integral part of how governments have approached the issue in the past, so what is different this time?

The most obvious difference is in relation to the types of investors and the amounts that they are likely to invest. There is no legislated minimum investment for CSF offers but there is an 'issuer cap' that limits the total amount that individual companies (and any related parties) can raise under the CSF regime in any 12-month period to a maximum of AU\$5 million.¹¹⁷ There is also a AU\$10 000 'investor cap' on the amount that an individual retail client can invest in all CSF offers made by the same company in any 12-month period (and, under *Corporations Act 2001* (Cth) s 738ZC(1), a responsible intermediary *must reject* an application made by a retail client if it would breach that cap).

The AU\$10 000 'investor cap' does not apply to sophisticated and/or professional investors – though offers to them are already exempt from disclosure under *Corporations Act 2001* (Cth) ss 708(8) and 708(11) and it is more likely that companies would seek investments from those investors under the general fundraising provisions rather than the CSF regime, especially as those other investments do not count towards the AU\$5 million issuer cap,¹¹⁸ which can then remain intact for bona fide small retail 'mum and dad' investors.¹¹⁹

Individual investments are therefore likely to be small and the people who make them are less likely to be greatly concerned about possible tax incentives than with the potential for significant possible gains on the occurrence of an expected exit event¹²⁰ (such as a trade sale, initial public offering or other disposal of their shares). Alternatively, they may be mainly motivated by a desire to assist family or friends who are behind the company seeking the funds – albeit also wanting to protect their investment, to some extent, by acquiring equity rather than simply providing 'loan' funds.¹²¹

¹¹⁷ *Corporations Act 2001* (Cth) s 738G(2).

¹¹⁸ The offers that are exempt from disclosure under *Corporations Act 2001* (Cth) s 708, and which therefore do count towards the AU\$5 million issuer cap, are 'small scale personal offers' under s 708(1) and offers made under s 708(10) via an Australian Financial Services licensee where the licensee is satisfied on reasonable grounds that the person to whom the offer is made has previous experience in investing that allows them to assess the merits and risks of the current offer.

¹¹⁹ A small number of small 'mum and dad' investors can also be catered for under the 'small scale offering' provisions in *Corporations Act 2001* (Cth) s 708(1). It exempts companies from the disclosure requirements for 'personal offers' (defined in s 708(2)) where both the number of people to whom securities are issued does not exceed 20 and the amount raised does not exceed AU\$2 million in any 12-month period. Companies might therefore also elect to use s 708(1) to raise funds from such 'known' investors (if they exist) to avoid the effect of the AU\$10 000 CSF 'investor cap'.

¹²⁰ See Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) para 1.61.

¹²¹ By exercising their rights as shareholders. For start-up companies equity may also be preferable to debt given that equity 'does not require immediate repayments and equity investors generally accept that returns are contingent on profits': *ibid* para 2.11.

Because of the probable small scale (and, concomitantly large number) of individual CSF investments that are likely to result from the AU\$5 million 'issuer cap', providing (and administering) tax incentives for CSF investors (which could be similar to the incentives that are available for investments in ESICs) is also likely to involve a disproportionate administrative burden for both the fundraising company and, possibly, the ATO.

However, whatever the reason for the absence of tax 'incentives', that may, in fact, operate in the CSF investors' favour. One of the problems with the ESIC incentives is that, in some instances, they do not apply or, if they do, they can operate against the interests of the investors they were intended to benefit.

First, there is the requirement that the company must qualify as an ESIC immediately after the shares are issued. A particular problem with this requirement is that the company has to be genuinely involved in innovation – something that it has to self-assess using either a highly subjective 'principles-based test' or a more objective '100-point innovation test'. If the company errs for some reason the investors lose their anticipated entitlement to both the tax offset and the modified CGT treatment.¹²²

There is no such risk for either investors or the issuing company under the CSF regime. The requirements for a company to be eligible for the limited governance requirements, as they are stated in *Corporations Act 2001* (Cth) s 738ZI, are straightforward, and compliance (or non-compliance) can be simply determined. If the company makes an error, the only risk for investors is the indirect risk that the company may then have to expend part of the funds it raised on the compliance activities from which it had thought it was exempt – and that may affect the financial viability of its ongoing operations (and perhaps necessitate further fundraising).

Second, shares issued by the company must be eligible for the tax incentives. Technically though, it is not the shares that qualify for the tax incentives, it is the investor; and the investor only qualifies if the relevant issue meets each of the criteria in ITAA97 s 360-15(1)(b)–(f). However, the onus of ensuring that the company qualifies rests with the investor, who, if the company does not qualify as an ESIC, is not entitled to the tax incentives. The problem is that each of the s 360-15(1) matters relate to things that are not within the shareholders' control – and they therefore have to rely entirely on the issuing company 'getting them right'.

Third, 'non-sophisticated' investors are limited in the amounts they can invest in ESICs.¹²³ If they exceed that limit, they lose not only the tax offset they might have received for the amount that exceeds the limit, they lose the entire offset – including for that part of their investment that did not exceed the limit.¹²⁴ Worse, because they lose the entitlement to the tax offset, they also lose their entitlement to the 'modified CGT treatment' – again, for their entire investment.¹²⁵ Given that they are 'non-sophisticated' investors (a group likely to be largely co-extensive with the 'retail clients' in CSF issues) it is possible that

¹²² ITAA97 ss 360-15(1)(c) and 360-50(1).

¹²³ Ibid s 360-20(1)(b). The limit is AU\$50 000, which includes all investments in *all* ESICs in any year.

¹²⁴ By investing more than AU\$50 000 in any income year, they are deemed not to satisfy the ITAA97 s 360-15(1)(b) requirement that they have been issued with 'equity interests that are shares in the company'.

¹²⁵ The modified CGT treatment only applies if the issuing of the share 'gives rise to an entitlement to a tax offset under this Subdivision': see *ibid* s 360-50(1).

they might not fully appreciate the consequences of exceeding the cap, and might, therefore, inadvertently breach it.

Finally, the modified CGT treatment to which ESIC investors are entitled depends entirely on how long the shares have been held:

- if the shares have been ‘continuously held’ for less than 12 months from the date of issue, any capital gain on the occurrence of a CGT event is assessed under normal principles¹²⁶ but any capital loss must be disregarded;¹²⁷
- if the shares have been ‘continuously held’ for at least 12 months and less than 10 years from the date of issue, any capital gain arising on the occurrence of the relevant CGT event is disregarded¹²⁸ – as is any capital loss;¹²⁹ or
- if the shares are ‘continuously held’ for 10 years or more from the date of issue, the normal CGT rules apply, so any gains or losses that are realised on any after-occurring CGT event will be determined, and dealt with, under s 102-5 (for gains) or s 102-10 (for losses) – but with the modification that the first element of the shares’ cost base, or reduced cost, becomes the market value of the shares on the 10th anniversary of their issue instead of their actual cost at issue.¹³⁰

The major problem with the ‘concessional’ modified CGT treatment, especially given the statistics on the likelihood of start-ups failing, is the fact that investors lose the potential benefit of any capital loss if the company fails (or if they sell out to limit their possible losses) within the first 10 years of the company’s life. This can have potentially draconian consequences, especially where the disposal is involuntary – as would be the case on death.

Crowd-sourced funding investors do, therefore, have some advantages over investors in ESICs in that, while they may be subject to CGT on their potential gains, their capital losses are not mandatorily disregarded.

D Investing under both ESIC and CSF regimes concurrently

From the legislation, it appears that there is nothing to stop investors investing in the same company under both the ESIC rules (to get the tax concessions) and the CSF rules.¹³¹ It also seems that they could do so in respect of the same investment, provided the company meets both the requirements to qualify as an ESIC,¹³² immediately after the relevant share issue, and the requirements to be an ‘eligible CSF company’ (which, at the

¹²⁶ This is because the investor is taken to hold the share on capital account under *ibid* s 360-50(2) but the modified tax treatment of any capital gain does not come into effect under s 360-50(4) unless the relevant CGT event occurs ‘on or after the first anniversary ... of the issue’: s 360-50(4)(b).

¹²⁷ *Ibid* s 360-50(3).

¹²⁸ *Ibid* s 360-50(4).

¹²⁹ *Ibid* s 360-50(3).

¹³⁰ *Ibid* s 360-50(5).

¹³¹ That possibility also seems to be indirectly suggested by the Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (Cth) para 2.42.

¹³² Which it would be so long as it was ‘early-stage’ (ie, if it satisfied the requirements in ITAA97 sub-ss 360-40(1)(a)–(d)) and was genuinely involved in innovation (something that it self-assesses under either a principles-based test under s 360-40(1)(e) or the ‘100 point innovation test’ in s 360-45).

latest, must be 'at the time when the offer is made'¹³³). The offer would also have to be both 'eligible to be made' and 'expressed to be made' under the CSF rules,¹³⁴ and the shares issued under that offer would have to be eligible for the tax incentives under the ESIC rules.

None of that would seem to involve insurmountable hurdles. In broad terms, to be 'early-stage', the potential ESIC must either have been incorporated in Australia or registered in the Australian Business Register within the last three income years (the latest being the current year) or, if not, it must have been incorporated in Australia within the last six years. In addition, it and its subsidiaries must have incurred *total* expenses of AU\$1 million or less across the last three years *and* it and its 100 per cent subsidiaries must have had a total income of AU\$200 000 or less – excluding any amount of Accelerating Commercialisation Grant it may have received – in the income year before the current year; and none of the company's equity interests must be listed for quotation in the official list of any stock exchange, in Australia or overseas.

These requirements all align neatly with the requirements that 'eligible CSF companies' not be foreign companies and must satisfy their own, somewhat more liberal, gross assets and revenue tests.

The major differences between the two sets of requirements are that there is no requirement for an ESIC to be a public company (a requirement that is in the process of being removed for CSF companies anyway¹³⁵), it has no principal place of business or resident director requirement to satisfy, it has a less liberal 'assets and turnover' test to meet and, unlike 'eligible CSF companies', it is not subject to any specific requirement that it not have a substantial purpose of investing in securities and interests in other entities (though the same practical effect is likely to be achieved through the requirement that ESICs be 'genuinely involved in innovation').

Similarly, there would appear to be no insurmountable hurdles to a single offer being able to meet both the requirements for it to be 'eligible to be made' under the CSF rules and eligible for the ESIC tax incentives. In both cases the offer must be for 'shares in the company' (though the ESIC requirements do allow for the concessions to apply if convertible notes are later converted to shares) – and, with ESICs, there is no express requirement that they be fully paid on issue (as is the case with CSF offers).

One major difference is that ESIC offers are not subject to an 'issuer cap' (as opposed to CSF offers, under which companies, including related parties, are limited to raising a maximum of AU\$5 million in a single year from CSF and other offers where disclosure is not required).

Another difference is the 'investor' cap that applies in each case¹³⁶ – and the different consequences of breaching those caps. Companies that want their offers to meet both CSF and ESIC requirements would have to structure those offers so that they met both sets of requirements (including limited maximum acceptance to AU\$10 000 for each 'retail

¹³³ *Corporations Act 2001* (Cth) s 738G(1)(b).

¹³⁴ *Ibid* s 738B.

¹³⁵ See *Corporations Amendment (Crowd-Sourced Funding for Proprietary Companies) Bill 2017* (Cth).

¹³⁶ A maximum AU\$50 000 for 'non-sophisticated' investors in ESICs (in total in any one year) as opposed to a AU\$10 000 cap for retail clients applying for shares under a CSF offer in any one company in any year.

client’/’non-sophisticated’ investor) – but that would not seem to be too onerous (depending on the level of funds that the company wanted to raise).

1 *Was the possibility of meeting both regimes intended?*

The problem seems to be that neither the CSF nor the ESIC legislation appears to have identified the potential for the two regimes to operate in tandem – or to make provision for that to occur.

In theory, there is no reason why the two regimes should not coexist. In fact, as was noted earlier, the Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 specifically stated that the aim of the new regime was to ‘provide an *additional funding option* for small businesses and start-ups in particular, that may otherwise struggle to obtain affordable finance’¹³⁷ (emphasis added).

The Treasurer also expressly stated in his Second Reading Speech for that Bill that the CSF option was simply ‘a new funding option for small businesses’, that it was not intended to displace ‘other forms of crowdfunding already available, such as rewards-based crowdfunding and peer-to-peer lending’ and that it was also intended to ‘serve as both a complement and a source of competition to more traditional funding options for small businesses, including bank debt products’.¹³⁸

However, the CSF legislation does specifically make it clear that eligible CSF companies can also only have one CSF offer open at a time¹³⁹ – so allowing them to raise funds through a concurrent capital raising under the ESIC rules could be regarded as both inappropriate and, at least, at odds with the spirit of the new law.

2 *Potentially ‘unintended’ tax consequences*

There are a number of potentially unintended tax consequences flowing from the possibility that a single offer might qualify under both the ESIC and CSF rules. They arise mainly because of uncertainty about how the ESIC tax incentives are activated.

An issuing company is required to report any issues of new shares that could give rise to an entitlement to the ESIC tax incentives to the ATO within 31 days after the end of the financial year in which the shares were issued (ie, normally by 31 July of that income year). The stated reason is to allow the ATO to assess whether investors are entitled to those tax incentives.¹⁴⁰

However, if the issue of shares does create an entitlement to the tax offset (and through it, to the modified CGT treatment), does that mean that investors are then, immediately,

¹³⁷ Explanatory Memorandum to the Corporations Amendment (Crowd-sourced Funding) Bill 2016 (Cth) para 1.6.

¹³⁸ Australian Government (Morrison), above n 20.

¹³⁹ *Corporations Act 2001* (Cth) s 738R.

¹⁴⁰ Explanatory Memorandum to the Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016 (Cth) para 1.15. *Taxation Administration Act 1953* (Cth) sch 1 s 396-55 Item 10 in the Table and sch 1 s 396-60(1)(a) note that, if a company is aware that a particular investor is not entitled to those incentives (for example, because the investor is an affiliate or because their interest in the company then exceeds 30 per cent or because the shares were acquired through an employee share scheme – all express prohibitions under the ESIC legislation), that issue of shares need not be reported.

and simply by virtue of the issue of shares to them, automatically covered by the ESIC rules, or does it mean that the issue of shares to them simply raises a possible entitlement that the shareholder must choose to activate (by claiming the tax offset) before the ESIC rules can apply. That is not clear from the legislation and that lack of clarity gives rise to at least two problems.

First, if accepting a 'CSF offer' does also qualify as an ESIC investment (because the company has aligned the terms of its offer to achieve that effect), 'retail clients' who accept the CSF offer could inadvertently lose their entitlement to claim a capital loss if their investment later fails (or if they dispose of those shares at a loss for any other reason – including through an involuntary disposal, such as might occur on death) within the first 10 years of their investment. This is because, under the ESIC rules, capital losses within that period must be disregarded.¹⁴¹ That outcome is technically possible, even though those investors may not have invested with the ESIC incentives in mind – and may not even have been aware of them, or of the potential problem.

Second (and perhaps more worrying from the ATO's point of view), the uncertainty could give rise to a situation where knowledgeable investors (including 'sophisticated investors' who can invest significant sums under both regimes) might not immediately claim the tax offset to which the ESIC rules would entitle them (thereby preserving the option of claiming a capital loss if the company fails or if they otherwise dispose of their shares at a loss shortly after investment), but then seek to amend their returns subsequently (after it appears that the company might succeed) to gain both a (backdated) tax offset and, consequently, the benefits of the modified CGT treatment as well.

As a minimum, if a single issue of shares was to qualify under both the CSF and the ESIC rules, there would appear to be some justification for amending the legislation to require investors to elect to claim (or not to claim) the ESIC tax incentives, and to do so (preferably) in the first tax return that they lodge after the issuing company reports that issue to the ATO.

VIII CONCLUSION

The introduction of the CSF regime is a laudable addition to the already existing channels of funding that are available to small start-up innovation companies. However, whether the temporary corporate governance, reporting and compliance concessions (which are really to assist the company rather than the investors) will be enough to make such investments attractive to the small 'mum and dad' investors at whom the new provisions are notionally aimed, or whether further tax or other incentives will be needed, is yet to be seen. Other refinements, especially to eliminate possible taxation complications resulting from the new rules, would also seem to be desirable.

However, the fact that the government has already demonstrated its willingness to be flexible, by introducing legislation to extend the CSF regime to proprietary companies, is

¹⁴¹ ITAA97 s 360-50(3).

a positive sign that may also see the introduction of appropriate taxation or other incentives if the take-up of CSF investment proves to be limited without them.

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ASSESSING THE TAXATION OF SUPERANNUATION IN TERMS OF HORIZONTAL AND VERTICAL EQUITY

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ABSTRACT

This paper discusses whether the taxation of the current superannuation system is equitable, by reference to the principles of horizontal and vertical equity and highlights that high-income earners are clearly advantaged. The research has reviewed the taxation treatment of more than 30 of the main taxing rules regarding superannuation. Although, the design of the taxation of superannuation has substantial horizontal and vertical equity, vertical inequity in the taxation of superannuation remains significant for various components of Australia's superannuation system, concerning taxation on contributions, fund income, and benefits. Age discrimination that is unfair in terms of horizontal equity remains restrictive in some components and should be abolished. Finally, the value of using horizontal and vertical equity concepts as lenses of fairness has deduced novel recommendations in particular regarding supporting lower income earners through increased levels of Superannuation Guarantee and fairer taxation treatment of benefits to all retirees (not favouring those over 60).

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I INTRODUCTION

This paper seeks to answer the question, 'Is the taxation of superannuation equitable by reference to taxation design principles of horizontal equity and vertical equity?' After consideration of these principles to more than 30 components in the superannuation system, this paper identifies that there remain important areas of reform that Parliament must address.

II TAXATION THEORIES REGARDING HORIZONTAL AND VERTICAL EQUITY

A Horizontal and vertical equity

The 1975 Asprey Taxation Review Committee identified three principles of a well-designed tax system that guide revenue-raising objectives; equity, efficiency and simplicity.¹ The Asprey Taxation Review Committee saw that equity meant fairness in the distribution of the tax burden.² Although one of its chapters focused on superannuation, that chapter did not discuss equity as an issue at all.

Similarly, the more recent and very comprehensive review of the taxation and superannuation systems (the Australia's Future Tax System, informally referred to as the Henry Review),³ also did not address horizontal and vertical equity in the superannuation system. The Henry Review's objectives for the taxation system included horizontal and vertical equity as taxation design features, but when discussing the superannuation system, it outlined five objectives: broad and adequate, acceptable, robust, simple and approachable, and sustainable.⁴ The objective of acceptable was on a foundation of equity, but this was on the basis of examining the superannuation system with respect to the broader retirement income system, taking into account the tax-transfer system and assessing impacts in terms of intergenerational equity. Therefore, both the Asprey and Henry reviews did not take the opportunity to review the superannuation system by specifically addressing horizontal and vertical equity.

¹ Asprey Taxation Review Committee (Justice K W Asprey (Chairman), Sir Peter Lloyd, Ross Parsons and K Wood), *Full Committee Report 31 January 1975* (Treasury, Australian Government, 1975) paras 3.7–3.26 <<http://adc.library.usyd.edu.au/view?docId=law/xml-main-texts/p00087.xml;collection=;database=;query=;brand=anderson>>.

² *Ibid* 12–15.

³ The Henry Review produced various published reports, including a preliminary paper on the architecture of Australia's future tax system (August 2008), a consultation paper on the taxation system (December 2008), a consultation paper on the retirement income system (December 2008), a strategic issues paper on the retirement income system (May 2009), and a final report in May 2010. See <https://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm>.

⁴ Ken Henry et al, Treasury, Australian Government, *Australia's Future Tax System: The Retirement Income System: Report on Strategic Issues* (May 2009) 23–34 <https://taxreview.treasury.gov.au/content/downloads/retirement_income_report_strategic_issues/retirement_income_report_20090515.pdf>.

Horizontal equity involves taxpayers in like economic circumstances being taxed the same or as Elkins puts it, 'similarly situated individuals face similar tax burdens'.⁵ On the other hand, vertical equity is where higher income earners pay more tax in comparison to low-income earners because higher income earners have greater capacity to pay more to support the government.⁶ Elkins expresses that, 'vertical equity is concerned with the distribution of the tax burden along society's economic spectrum'.⁷ Accordingly, vertical equity is broadly inherent in the design of the progressive income taxation system, which provides for increasing rates of taxation as income levels rise, and 'has been a long-standing design feature of the Australian tax system'.⁸

Horizontal and vertical equity are therefore distinguished in their concepts as 'the notions that it is fair that persons in the same situation should be equally treated, and those in different situations being differently treated, with those more favourably placed being required to pay more.'⁹ Given the inherent fairness of the progressive taxation system, it is possible to overlook the importance of horizontal equity.

However, Elkins strongly puts it that 'Violation of horizontal equity, while not necessarily fatal, is nevertheless considered a serious flaw in any proposed tax arrangement.'¹⁰ He points out that theorists have taken for granted the notion of horizontal equity (that the tax system should tax similarly situated taxpayers), and have focused their attention on how to measure wellbeing or examine where horizontal equity has been violated. Elkins¹¹ advises there is a vast level of literature regarding vertical equity and economic efficiency in comparison to the literature regarding horizontal equity.

Musgrave¹² views that horizontal equity is not a subset of vertical equity and that both have standing as primary norms. Kaplow¹³ disagrees and doesn't see that horizontal equity has any significant independence. After considering the Musgrave/Kaplow debate, it is interesting that Repetti and McDaniel refute the value of horizontal equity and vertical equity in evaluating changes in tax policy objectives.¹⁴ However, this paper finds

⁵ David Elkins, 'Horizontal Equity as a Principle of Tax Theory' (2006) 24(3) *Yale Law & Policy Review* 43 <<http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1515&context=ylpr>>.

⁶ Ken Henry et al, Treasury, Australian Government, *Australia's Future Tax System: Part 2: Detailed Analysis* (December 2009) 11 <https://taxreview.treasury.gov.au/content/downloads/final_report_part_2/AFTS_Final_Report_Part_2_Vol_1_Consolidated.pdf>.

⁷ Elkins, above n 5, 51.

⁸ Miranda Stewart et al, 'A Stocktake of the Tax System and Directions for Reform, Five Years after the Henry Review' (Policy Research Paper, Tax and Transfer Policy Institute, February 2015) 7 <https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies_crawford_anu_edu_au/2015-03/stocktake_report_27_feb_2015_final_web_version.pdf>.

⁹ Asprey Taxation Review Committee, above n 1, para 3.7.

¹⁰ *Ibid*.

¹¹ Elkins, above n 5, 44.

¹² Richard Musgrave, 'Horizontal Equity, Once More' (1990) 43(2) *National Tax Journal* 113-22 <<https://www.ntanet.org/NTJ/43/2/ntj-v43n02p113-22-horizontal-equity-once-more.pdf>>.

¹³ Louis Kaplow, 'Horizontal Equity: Measures in Search of a Principle' (1989) 42(2) *National Tax Journal* 139-54 <<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.318.610&rep=rep1&type=pdf>>.

¹⁴ James Repetti and Paul McDaniel, 'Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange' (1993) 1(10) *Florida Tax Review* 607-22

that relying on the notion of vertical equity alone in considering fairness is flawed because different findings resulted when applying horizontal equity (refer discussion following). Accordingly, the impacts of both horizontal and vertical equity are addressed.

Also, in assessing the equity of the superannuation system, this is better done by comparing those within the system, not by comparing superannuation members against taxpayers generally. For example, when a 61-year-old retiree receives a pension from a taxed fund, such earnings are tax-free. In comparison, a 61-year-old who works and receives the same level of earnings pays tax on that income. These two taxpayers are in similar or equivalent situations, not identical situations. Although gross income (essentially the economic circumstances or economic wellbeing) is the same, their circumstances are very different given the retiree's earnings flow from the superannuation system, and the worker's earnings do not. However, horizontal equity requires that equal tax burdens apply, despite these different circumstances, and regardless of whether they choose to consume or save.¹⁵

The above example, which relied upon income as the basis of 'economic wellbeing' in application to taxation, is considered defensible and has been adopted throughout the analysis in this paper, because, in a practical sense, it is the only feasible basis on which horizontal and vertical equity can be applied. The Asprey Taxation Review Committee commented that the best measure of a person's economic wellbeing was in regard to their income,¹⁶ so when comparing both taxpayers with the same income, they would pay the same taxes.¹⁷

However, there are various other points of debate when applying horizontal and vertical equity. For example, in Australia, the taxation system taxes the individual while the welfare system assesses the family unit. This strikes the essential chord of what is fair in terms of the taxing unit. For example, if a single, middle-income earner receives AU\$60 000, should the individual be taxed the same as a family of two adults and two children that has greater consumption needs but the same level of income? Further, what about the legal but arguably unfair practice of income splitting through partnerships (and trust arrangements). A plumber and his spouse in a family pay less tax because of income splitting in comparison to a single earner family of the same income level. Wouldn't it be fairer if all families were able to income split? Piggott and Whalley¹⁸ argue the household unit should be the appropriate taxable unit contrary to the wider held belief that the individual is the appropriate taxable unit (largely on the basis of efficiency).

Another significant issue to consider is whether individuals should be taxed at a point in time (the income year) or over an entire lifetime that contemplates averaging or income

<<https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1706&context=lsfp>>.

¹⁵ Elkins, above n 5, 45.

¹⁶ Asprey Taxation Review Committee, above n 1, para 3.9.

¹⁷ *Ibid*.

¹⁸ John Piggott and John Whalley, 'The Tax Unit and Household Production' (April 1996) 104(2) *Journal of Political Economy* 398-418 <<http://www.journals.uchicago.edu/doi/abs/10.1086/262028>>.

smoothing. Kudrna and Woodland¹⁹ explore the lifecycle framework as it applies to the superannuation system and use modelling to assess the impact of vertical equity on superannuation taxation concessions. This was researched pursuant to the Henry Review that reported in 2008 the top 5 per cent of income earners received 37 per cent of taxation concessions. Kudrna and Woodland's findings based on hypothetical tax reforms reveal, in the short, medium and long term, that lower income households improved in terms of vertical equity because of larger welfare gains and income improvements. The arbitrary notion of the income year can be a source of vertical inequity in comparison to the lifecycle framework.

Another important issue for equity concerns whether taxation should be imposed on an income base or consumption base, both of which can be viewed as a reflection of an individual's wellbeing. Currently, Australia adopts a 'hybrid' comprehensive income tax (a TTE design) in relation to superannuation where contributions are Taxed, fund income Taxed and earnings are Exempt. It is hybrid because the tax on contributions and fund income are low, and so in comparison has a ttE tax design. Prior to the Keating reforms of 1998 that introduced a concessional tax on both contributions and fund income, and subsequent Costello reforms that made benefits exempt, Australia had a cash flow expenditure or consumption taxation system on superannuation (EET design) where contributions were Exempt, fund income was Exempt, and benefits were Taxed. Today, the expenditure or consumption approach is the most commonly adopted tax regime taxing retirement income.²⁰

In regard to horizontal equity, over a lifetime, an individual's total income would equate to their consumption (and net savings), so the issue becomes in terms of wellbeing – which is a fairer tax base: equal earners or equal consumers? Weisbach and Bankman²¹ consider these opposing positions in terms of searching for an optimal tax theory, the focus of which is on reducing inefficiency. They dispute the arguments that a consumption tax is regressive to low-income earners and spares those who are savers given there is no tax on interest. After due consideration and basing their positions of ideal tax regimes, they conclude that a properly designed consumption or expenditure tax design (EET) is superior to a comprehensive income tax approach (TTE). Weisbach and Bankman admit the main 'Achilles heel' to their position lies with implementation.

¹⁹ George Kudrna and Alan Woodland, 'Progressive Tax Changes to Private Pension in a Life-Cycle Framework' (Research Paper No CE110001029, Australian Research Council Centre of Excellence in Population Ageing and Research, April 2002) 1–27 <https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=CEF2012&paper_id=23>.

²⁰ OECD, 'Stocktaking of the Tax Treatment of Funded Private Pension Plans in OECD and EU Countries' (OECD Publishing, 2015) <<http://www.oecd.org/daf/fin/private-pensions/Stocktaking-Tax-Treatment-Pensions-OECD-EU.pdf>>.

²¹ David Weisbach and Joseph Bankman, 'The Superiority of an Ideal Consumption Tax over an Ideal Income Tax' (2006) 58 *Stanford Law Review* 1413 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=3035&context=journal_articles>.

More recently, Ingles and Stewart²² supported a prepaid consumption tax design (TEE) on the basis that they calculated it would save AU\$10 billion in terms of Australian superannuation tax concessions. They argue this tax design would be fairer given that the comprehensive income system is a highly concessional system that favours the wealthy. In contrast, the Committee for Sustainable Retirement Incomes consider that the current superannuation system viewed against an EET benchmark may not be so concessional or unfair when taking into account the 2016 Turnbull government superannuation reforms. After modelling, their results showed that the post-2016 superannuation system is approximate in outcomes to an EET system.²³

Changing from a comprehensive income tax system to an expenditure-based taxing system in superannuation may therefore be debatable on economic grounds, but given the length of time that Australia's tax design of superannuation (tE) has been in place, Podger considers this is not 'feasible'.²⁴ It is submitted there would be a real reluctance by the major Australian political parties to tax pensioners on superannuation benefits. For example, this sensitivity was demonstrated by the Labor Party's recent policy backdown on its franking credit policy that pursuant to public sentiment exempted 300 000 pensioners.²⁵

In light of the above discussion, the Asprey Taxation Review Committee also raised various considerations that complicated the meaning or measurement of horizontal and vertical equity and viewed these considerations could not be easily applied. For example, the Asprey Taxation Review Committee considered when assessing equity whether the appropriate unit should be the family or the individual, the health and size of the family, the arbitrary nature of the income year, the lifetime view of equity, the comparison of tax to consumption, and the issue of inflation, all of which the Asprey Taxation Review Committee concluded would be too difficult to administer.²⁶ It is asserted similar considerations are difficult to apply for this paper too.

Finally, it is unnecessary to evaluate the fairness of the superannuation system if it was only on the basis of a comparison of those in the superannuation system to those outside of the superannuation system. Under this comparison, the superannuation system is inherently inequitable to taxpayers not in the superannuation system and unable to

²² David Ingles and Miranda Stewart, 'Reforming Australia's Superannuation Tax System and the Age Pension to Improve Work and Savings Incentives' (2017) 4(3) *Asia & the Pacific Policy Studies* 417–36, 432 <<https://onlinelibrary.wiley.com/doi/abs/10.1002/app5.184>>.

²³ Committee for Sustainable Retirement Incomes, 'Encouraging Sustainability and Self-Provision in Retirement Incomes: Policy Conclusions' (CSRI Sustainability Policy Position Paper, CSRI Leadership Forum, 12–13 October 2016) <<https://cfsri.files.wordpress.com/2015/09/csri-sustainability-and-self-provision-position-paper-final.pdf>>.

²⁴ Andrew Podger, 'A Fair, Effective and Sustainable Retirement Income System' in Michael Keating and John Menadue (eds), *Fairness, Opportunity and Security Policy Series* (John Menadue: Pearls and Irritations, 23 May 2015) <<https://johnmenadue.com/andrew-podger-a-fair-effective-and-sustainable-retirement-incomes-system>>.

²⁵ Phillip Coorey, 'Labor Spares 300,000 Pensioners in AU\$3.3bn Franking Policy Back Down', *Australian Financial Review* (online), 26 March 2018 <<http://www.afr.com/news/labor-spare-300000-pensioners-in-33b-policy-backdown-20180325-h0xy8t>>.

²⁶ Asprey Taxation Review Committee, above n 1, paras 3.10–3.16.

benefit from the tax concessions, because they are not part of the superannuation system. Accordingly, the appropriate point of evaluation in this paper is comparing the equitable relationship of members with other members within the superannuation system.

The focus of this paper is not on equity in the taxation system but whether taxation in the superannuation system is equitable. The measures discussed following are in relation to the taxing rules of the main components of the superannuation system, which are reviewed in terms of their horizontal and vertical equity.

These concepts of horizontal and vertical equity are relevant to the superannuation system where tax is levied – on contributions, on fund income and on benefits. It is shown in the following discussion and Appendix A, that many of the components of the superannuation system are equitable, but some components are inequitable, requiring further reform.

Given the breadth of issues in this paper, it is highly recommended that the reader turn now to the end of this paper and review ‘Appendix A – Snapshot re Horizontal and Vertical Equity’. This appendix is a quick reference guide that neatly summarises the outcomes of the following discussion, in just two pages.

III OVERVIEW OF THE TAXATION OF SUPERANNUATION

A How superannuation is complex

Determining whether the taxation of Australia’s superannuation system is equitable, is a complex issue because it takes many circumstances into account.²⁷ As an overview, these factors include:

- **Contributions** – whether a concessional or non-concessional contribution, differing cap levels or limits to contributing, income levels, whether employed or self-employed, the rate of Superannuation Guarantee (SG), the age of the member or member’s spouse, or whether the contributions is paid by the member, the member’s spouse, employer or government.
- **Fund income** – nature of the fund, nature of the income, whether the income is at the accumulation phase or retirement phase, whether the fund is taxed concessional at 15 per cent or the penal rate of 45 per cent.
- **Taxation of benefits** – varies depending upon age and preservation age, the condition of release, whether a taxable component has been taxed or untaxed, whether benefit is from a taxed or untaxed fund, whether the benefit is in pension

²⁷ For an excellent summary of the taxation of superannuation rules, see CPA Australia, ‘CPA Australia Superannuation Guide: 2017-18’ (1 July 2017) <<https://www.cpaaustralia.com.au/~ /media/corporate/allfiles/document/professional-resources/financial-planning/superannuation-guide-2017-18.pdf?la=en>>.

or lump sum form, or for minimum income stream percentages whether account based or non-account based, or paid to dependents because of death of a member.

For the purposes of this paper, only the main taxation issues in superannuation are discussed.

B Horizontal and vertical equity regarding taxation of superannuation at a glance

Appendix A provides a 'Snapshot of horizontal and vertical equity'; the details of which are discussed below. As discussed above, taxation of superannuation applies at the three stages and the main issues pertain to more than 30 components of the system where horizontal and vertical equity are reviewed. It can be seen at a glance that vertical inequity is the main concern with the taxation of superannuation, although there are some (lesser) concerns applying to horizontal equity.

IV IS THE TAXATION OF CONTRIBUTIONS EQUITABLE?

Contributions to superannuation funds can be made by employers, the self-employed, employees, spouses and the government. Different rules apply to employer contributions, individual contributions and government contributions. Broadly the superannuation system is equitable in relation to contributions except where high-income earners benefit through tax deductions because of their high marginal tax rate and where there is unnecessary age-based discrimination in relation to various contributions. In addition, low-income earners could be favoured in terms of a higher SG rate.

A Equity regarding employer contributions

1 A more equitable superannuation system because of universal SG

The Keating Government established the SG scheme²⁸ of the superannuation system based on a platform of equity. In his second reading speech, the then Treasurer John Dawkins advised that the introduction of the SG would 'provide a coherent and equitable framework to progress retirement income objectives'.²⁹ In addition, Dawkins stated access to superannuation would now be much more equitable and the system would move from a concessionally taxed system for high-income earners to a national retirement savings for most Australians.³⁰ Accordingly, SG can be viewed as horizontally equitable in that the mandated minimum contributions paid by employers apply to all employees.

²⁸ *Superannuation Guarantee (Administration) Act 1992* (Cth) and *Superannuation Guarantee Charge Act 1992* (Cth).

²⁹ Australian Government, *Parliamentary Debates*, House of Representatives, 2 April 1992, 1763 (John Dawkins, Treasurer) <http://parlinfo.aph.gov.au/parlInfo/download/chamber/hansardr/1992-04-02/toc_pdf/H_per_cent201992-04-02.pdf>.

³⁰ *Ibid.*

The SG system is broadly universal, although there are some exemptions. These exemptions were introduced mainly for compliance and administration reasons, including international considerations. For example, no SG applies to an employee paid less than AU\$450 in a month,³¹ or to part-time employees less than 18 years of age working 30 hours or less each week,³² or for private arrangements for work paid for domestic duties such as nannies who work less than 30 hours each week.³³ Also, no SG is payable for various foreign executives under certain visas,³⁴ or for resident employees paid by non-resident employers when work is performed outside Australia,³⁵ or for foreign resident employees paid for work undertaken outside Australia.³⁶ The most objectionable equity concern regarding exemptions related to the age barrier, where employees were not paid if they were 70 or more years of age. The age limit for SG³⁷ was abolished from 1 July 2013 by the Gillard Government. The SG system is considered to be horizontally equitable.

2 *SG rate: vertical inequity*

However, middle-income earners have the best deal in terms of SG, and this leads to vertical inequity, given the flat rate of 9.5 per cent. For example, a wage earner who is paid AU\$50 000 gets AU\$4750 in SG compared to a wage earner receiving AU\$150 000 that gets AU\$14 250 SG, which is considerably more. One possible reform is the introduction of a higher rate of SG for lower income earners to promote vertical equity. It can also be noted that high-income earners still benefit from the SG system, although these benefits are subject to a maximum limit. The employer is only obligated to pay up to the maximum superannuation contribution base³⁸ limit. For the 2017/18 income year, the maximum contribution level is AU\$52 760 for a quarter, equivalent to AU\$211 040 a year (indexed annually).³⁹ This is fair in terms of vertical equity, given high-income earners have less need to rely upon SG for their retirement.

3 *Salary sacrifice contributions and additional contributions by employer*

Employers can make contributions beyond the minimum required under the SG regime through additional voluntary contributions or via salary sacrifice contributions⁴⁰ (on

³¹ *Superannuation Guarantee Administration Act* (Cth) s 27(2).

³² *Ibid* s 28.

³³ *Ibid* s 12(11).

³⁴ *Ibid* s 27(1)(d).

³⁵ *Ibid* s 27(1)(c).

³⁶ *Ibid* s 27(1)(b).

³⁷ *Ibids* 27(1)(a).

³⁸ *Ibids* 15.

³⁹ Australian Taxation Office, Australian Government, *Maximum Super Contribution Base* (24 July 2018) <<https://www.ato.gov.au/rates/key-superannuation-rates-and-thresholds/?anchor=Maximumsupercontributionbase#Maximumsupercontributionbase>>.

⁴⁰ Natasha Cortis and Christine Eastman, 'Salary Sacrificing in Australia: Are Patterns of Uptake and Benefit Different in the Not-For-Profit Sector?' (2015) 53(3) *Asia Pacific Journal of Human Resources* 311-30 <<http://onlinelibrary.wiley.com/doi/10.1111/1744-7941.12054/abstract>>. This paper advises that only

behalf of the employee using the employee's before-tax earnings), subject to certain limits.⁴¹ Employment arrangements are a private matter, and additional contributions such as these is not really a matter of concern in regard to equity, and such amounts are simply considered as part of the SG contributions component.

4 Conclusion regarding SG

Overall, SG satisfies horizontal equity as it is a national employer-sponsored superannuation scheme, broadly accessible to all Australians. It significantly improves equity for low-income earners, and middle-income earners who fare very well, and it does not unduly favour high-income earners. However, a reform measure to redress the vertical inequity would be to increase the SG rate for low-income earners.

B Individual contributions: concessional and non-concessional; excess contributions tax

To further boost superannuation savings, individuals can make private contributions to their superannuation funds. In general, high-income earners have greater capacity to make contributions compared to low-income earners, given they have greater disposable income, and there is an inherent vertical inequity because of the differing income levels. This could be overcome by the government making contributions for low-income earners. Contributions are made during the accumulation phase where the member's account increases, not the retirement phase when a member has met a condition of release,⁴² such as reaching retirement age, financial hardship, disability etc, and generally draws down on their accumulated savings.

There are two types of contributions; concessional and non-concessional. Broadly speaking, a concessional contribution⁴³ is one that can be claimed by an individual or employer as a tax deduction whereas a non-concessional contribution⁴⁴ is not tax deductible to the individual. Previously, these terms were referred to in the *Income Tax Assessment Act 1936* as 'deductible' and 'non-deductible' contributions.

Concessional contributions are limited to AU\$25 000 for the 2017/18 income year.⁴⁵ These contributions are available to all Australians of all ages, and contributions above the cap are subject to an excess contributions tax. In contrast, non-concessional contributions (made from after-tax earnings) are limited to a maximum of AU\$100 000⁴⁶

high-income earners take up salary sacrificing within the not-for-profit sector and across the workforce generally.

⁴¹ Employers need to be careful with the total contributions made to an employee's superannuation account, as if there is an excess to the cap, then an excess concessional contributions tax is payable by the employee. The contributions cap for 2017 is AU\$25 000 under *Income Tax Assessment Act 1997* (Cth) s 291-20(2).

⁴² Superannuation Industry (Supervision) Regulations 1994 (Cth) sch 1 pt 6.

⁴³ Defined in *Income Tax Assessment Act 1997* (Cth) s 291-25.

⁴⁴ Defined in *ibid* s 292-90.

⁴⁵ *Ibid* s 292-20(2).

⁴⁶ *Ibid* ss 292-85(2)-(4).

per annum for the 2017/18 income year, or AU\$300 000⁴⁷ using carry-forward provisions over a three-year period. Any excess above either of these limits is subject to an excess contributions tax.⁴⁸

1 *Equity of excess contributions taxes (ECT): concessional and non-concessional*

As discussed, contributions made to superannuation funds are limited for both concessional and non-concessional contributions. These limits were primarily introduced to make the superannuation system sustainable for the government.

Excess concessional contributions are added to the assessable income and taxed at marginal rates of tax less 15 per cent tax offset for contributions. The rules were relaxed so that a taxpayer could withdraw their excess concessional contributions to pay the ECT.⁴⁹ Any excess concessional contributions not withdrawn count towards the non-concessional contributions cap, and excess non-concessional contributions are taxed as above. However, if the excess non-concessional contributions are not withdrawn from the fund, they will be subject to the top marginal rate of tax.⁵⁰ These rules apply equally to all superannuation, and there is horizontal equity in relation to the contribution limits and ECT.

C Equity regarding concessional contributions

1 *Concessional contributions by employers*

The contributions discussed above are available to the employer as a tax deduction, which is why they are a concessional deduction. There is horizontal equity in that all employers can claim a tax deduction for both SG payments made on time and other concessional superannuation contributions.⁵¹ Some employers are companies and benefit from the tax deduction at only the company rate of 27.5 per cent for small companies and 30 per cent for other companies. Some employers are individuals and their benefit could be as high as the top marginal tax rates. However, this is not an example of horizontal inequity in the superannuation system, but horizontal inequity within the design of the taxation system itself, because different entities are taxed differently. This matter is considered by principals when setting up their business structure (eg, sole trader, trust, partnership or company).

⁴⁷ Ibid ss 292-85(2)-(4).

⁴⁸ *Superannuation (Excess Concessional Contributions Charge) Act 2013* (Cth) and *Superannuation (Excess Non-Concessional Contributions Tax) Act 2007* (Cth).

⁴⁹ Kai Swoboda and Les Nielson, *Tax and Superannuation Laws Amendment (2014 Measures No. 7) Bill 2014 [and] Excess Exploration Credit Tax Bill 2014* (Bills Digest No 75 2014/15, Parliamentary Library, 23 February 2015) 14
<http://parlinfo.aph.gov.au/parlInfo/download/legislation/billsdgs/3676055/upload_binary/3676055.pdf;fileType=application/pdf>.

⁵⁰ Ibid.

⁵¹ *Income Tax Assessment Act 1997* (Cth) sub-div 290-B.

2 *Horizontal equity for self-employed, non-employed investors and employees: access to concessional contributions*

Until the November 2016 Turnbull Government reforms,⁵² there was not horizontal equity for contributions made by non-employed investors, employees and the self-employed. All self-employed members could broadly claim a tax deduction as an appropriate business expense.⁵³ The self-employed were able to make deductible (before-tax) contributions since the Menzies Government,⁵⁴ and were financially advantaged compared to employees that were only able to make non-deductible (after-tax) contributions. This advantage remained also for self-employed and non-employed until the November 2016 Turnbull superannuation reforms.

Further, concessional contributions apply to employers who pay SG contributions, salary sacrifice and additional contributions, and these deductions historically have been seen as an appropriate business expense.⁵⁵ However, there was horizontal inequity given some employees were advantaged through salary sacrifice arrangements for superannuation from their employer. Employers that offered salary sacrifice arrangements benefitted their employees because the employer contributed to superannuation from their pre-tax income and their taxable income was reduced by that contribution. Employees that are offered salary sacrifice are advantaged in comparison to those employees not offered salary sacrifice arrangements. In comparison, the latter could only make non-concessional contributions from after-tax income and received no tax deduction.

The recent Turnbull reforms redressed the above inequities by abolishing the 10 per cent rule,⁵⁶ putting the self-employed, non-employed and employees on the same footing because now all Australian members of superannuation funds can claim the same levels of concessional and non-concessional contributions. The elimination of the 10 per cent rule means that concessional deductions can be accessed by a wider class of members. This results in an allowable deduction to those self-employed and non-employed whose earnings from wages are more than 10 per cent of their assessable income and for those employees whose employers do not offer salary sacrifice arrangements.

In summary, the superannuation system for contributions has removed the horizontal inequity allowing concessional deductions to employees unable to participate in salary

⁵² Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 (Cth) (Act 80 of 2016) and Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) (Act 81 of 2016).

⁵³ *Income Tax Assessment Act 1997* (Cth) s 290-150.

⁵⁴ The Menzies Government introduced a deduction for superannuation for the self-employed pursuant to the Ligertwood Committee's recommendation.

⁵⁵ Employers have been allowed deductions since 1915 for superannuation contributions for employees: *Income Tax Assessment Act 1915* (Cth) s 18(j).

⁵⁶ To enable a concessional contribution as a deduction, the 10 per cent rule required a self-employed person to be substantially self-employed by having less than 10 per cent of their income in wages. This applied similarly to non-employed persons (investors) to also have less than 10 per cent assessable income from wages. See *Income Tax Assessment Act 1997* (Cth) former s 290-160.

sacrificing privileges and also permitted further concessional deductions for self-employed and non-employed groups, by abolishing the 10 per cent rule.

3 *Vertical inequity for high-income earner concessional contributions and Div 293 Tax*

Vertical inequity remains an issue in relation to concessional contributions. For all concessional contributions within certain limits, the tax applied is a 15 per cent flat rate, and arguably, this tax imposition would appear to be fair. However, this arrangement is inequitable because individuals can subsequently claim a tax deduction for concessional contributions and the consequent benefit of the tax deduction applies at their marginal rate of tax. This means that higher income earners receive a greater tax benefit in reducing their tax burden in comparison to lower income earners. For example, a high-income earner that contributes AU\$10 000, pays tax on the contribution of AU\$1500, but given they also claim a tax deduction of AU\$10 000, subsequently receive a tax reduction of their tax liability of AU\$4500 assuming the highest marginal rate of tax applies. Essentially the government gives a generous 30 per cent return to high-income earners to encourage investment into superannuation when making a concessional contribution. Contrast this scenario to a low-income earner (who would be very fortunate indeed to be able to afford the same investment), but if they did, given their marginal rate of tax is only 19 per cent or 0 per cent, the reduction in tax is only AU\$400 for 19 per cent marginal rate of tax, and for those below the tax-free threshold a very unfavourable increase of tax of AU\$1500 if the marginal rate of tax is 0 per cent.

Essentially, on this basis, there is no motivation for low-income earners to invest in concessional contributions to superannuation funds, in comparison to high-income earners who are positively encouraged to invest if they have the means. Middle-income earners are also encouraged to invest but with a lower benefit in comparison to high-income earners, given their lower marginal rates of tax.

However, this inequity favouring high-income earners was addressed in part by the Gillard Government reforms that imposed an additional contributions tax of 15 per cent on those members with adjusted taxable incomes (including any employer SG contributions) that were above AU\$300 000.⁵⁷ This threshold was reduced to AU\$250 000⁵⁸ by the Turnbull Government as part of the November 2016 reforms. This additional 15 per cent tax under Division 293 of the *Income Tax Assessment Act 1997*, commonly known as Div 293 Tax, was introduced to ensure those on higher incomes who received the tax concessions would be aligned more closely to low- and middle-income earners.

In summary, vertical inequity remains given members with higher incomes receive larger tax deductions at marginal rates, although this benefit to high-income earners has been reduced by the Div 293 Tax (an additional 15 per cent tax). One reform measure that could be implemented to improve vertical equity, is to lower the threshold for the Div

⁵⁷ *Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other Measures) Act 2013* (Cth) and also *Superannuation (Sustaining the Superannuation Contributions Concession) Imposition Act 2013* (Cth).

⁵⁸ *Income Tax Assessment Act 1997* (Cth) div 293, and other sections.

293 Tax, say to AU\$180 000. Alternatively, the taxation of contributions could be imposed at an individual's marginal rate of tax.

However, if contributions were taxed at an individual member's marginal rates of tax, the net effect of allowing the tax deduction, which would also be at the member's marginal rate of tax, is to effectively cancel the tax on contributions. It could be argued that a simple method therefore to promote vertical equity to individuals in the system would be to withdraw the tax on concessional contributions for individuals and subsequent tax deductions, and to deny salary sacrificing arrangements for superannuation. However, while this proposal may meet the objective of promoting equity, it would fail to meet the government's underlying policy to encourage Australians to invest in superannuation.⁵⁹

Finally, another option could be to adopt the Greens approach campaigned in the last election, to apply a progressive contributions tax, so that concessional contributions would be taxed at marginal rates of tax, less 15 per cent. In this way greater vertical equity will result.⁶⁰

4 *Concessional contributions on behalf of a spouse: contributions splitting*

In 2006, the Howard Government introduced spouse contributions splitting that may be made using concessional contributions (before tax).⁶¹ Non-concessional contributions cannot be split but concessional contributions can be split between spouses, providing the superannuation fund of the spouse that splits their contributions permits the contributions splitting. The advantage of contributions splitting is that the higher-income-earning spouse salary sacrifices their contributions and receives the tax benefits, while the lower-income spouse receives a greater superannuation benefit. The main condition is that the receiving spouse must be under preservation age, or, if older, must be younger than 65 and not retired.⁶² A spouse includes a partner of either a same-sex couple or heterosexual couple, and this similar treatment of couples promotes horizontal equity in the superannuation system.⁶³ It is considered contributions' splitting raises no major issues for horizontal equity as all couples have equal rights to make contributions. However, it could be argued that high-income earners will take up this option, and so favour the high-income earners. But, a counter argument is that the real benefit is to the lower-income spouse, and the other focus of the policy is an adequacy measure that promotes superannuation savings for low-income earners contributed from a higher taxed spouse. On balance it is considered that this policy achieves vertical equity.

⁵⁹ Asprey Taxation Review Committee, above n 1, para 21.6. The Asprey Taxation Review Committee observed that the superannuation concessions were aimed to correct the bias against savings (that is the tax on savings) and also promote long-term savings in the private sector.

⁶⁰ Australian Greens, *Progressive Superannuation: Ending Unfair Tax Breaks and Booting Super for Low-Income Earners* (2016).

⁶¹ Superannuation Industry (Supervision) Amendment Regulations 2005 (No.8) (Cth).

⁶² Australian Taxation Office, Australian Government, *Contributions Splitting for Members* (8 September 2015) <<https://www.ato.gov.au/Super/APRA-regulated-funds/Managing-member-benefits/Contributions-splitting-for-members>>.

⁶³ *Same-sex Relationships (Equal Treatment in Commonwealth Laws – Superannuation) Act 2008* (Cth).

5 *Catch up concessional contributions: flexibility and equity measure*

The Turnbull Government's November 2016 reforms introduced catch-up concessional contributions allowed to members who have small superannuation fund account balances less than AU\$500 000. Some members in the community have irregular work patterns, such as women who take time off from the workforce for family reasons, or because of only contract or casual work being available. For a period of up to five years and on a rolling basis, unused portions of the concessional cap can be carried forward.⁶⁴ This was reported as a flexibility measure, but it is also an equity measure that assists all Australians, but in particular low-income earners whose financial circumstances have improved. Although 90 per cent of Australians have low account balances, it is expected only 230 000 members will take up the opportunity to top up their superannuation when they can afford to.⁶⁵ This is considered a timing issue, that provides flexibility, and given it is accessible to all with less than AU\$500 000 account balances, it achieves horizontal equity.

D Equity regarding non-concessional contributions

1 *Non-concessional contributions: general*

Individuals that make non-concessional contributions from post-tax income receive no tax deduction at the contributions stage, irrespective of the size of their contribution. There is no tax deduction advantage to individuals in relation to non-concessional contributions, and therefore no impact on vertical equity given differing marginal tax rates. Non-concessional contributions are equally available to all subject to limits discussed, and therefore there is no adverse impact on horizontal equity.

2 *Non-concessional contributions on behalf of a spouse: spouse tax offset*

Prior to the Turnbull Government superannuation reforms, a person who made non-concessional superannuation contributions to a complying superannuation fund of AU\$3000 or more from after-tax income for their spouse received a maximum tax offset of AU\$540,⁶⁶ providing both spouses were Australian residents, and the benefitting spouse's assessable income was less than AU\$10 800 (including amounts from reportable fringe benefits and reportable superannuation contributions).⁶⁷ The tax offset was phased out altogether if the eligible spouse's income was greater than AU\$13 800. The Turnbull Government 2016 reforms increased the income threshold of the spouse to

⁶⁴ *Income Tax Assessment Act 1997* (Cth) sub-ss 291-20(3)-(7).

⁶⁵ Australian Government, *Parliamentary Debates*, House of Representatives, 9 November 2016, 3382 (Scott Morrison, Treasurer)
<<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;db=CHAMBER;id=chamber%2Fhansardr%2Fe089c8c3-75b7-4858-80ac-58b4e4c6e749%2F0161;query=Id%3A%22chamber%2Fhansardr%2Fe089c8c3-75b7-4858-80ac-58b4e4c6e749%2F0160%22>>.

⁶⁶ *Income Tax Assessment Act 1997* (Cth) s 290-235.

⁶⁷ *Ibid* s 290-230.

AU\$37 000, to phase out at AU\$40 000.⁶⁸ This is a horizontal equity measure that again assists spouses of low-income earners to make contributions to support the other partner's retirement savings measure.⁶⁹

3 *Non-concessional contributions over 65: work test requirements*

In order to make a non-concessional contribution, superannuation members must consider whether they are required to meet the 'work test'.⁷⁰ The work test essentially requires that members are working full time or part time, but the specified minimum is 40 hours in 30 days,⁷¹ which is achieved working full time, and also fairly easily achieved working part time. In 2004, the Howard Government abolished the work test requirements for Australians under 65 years of age, but retained them for persons over 65 years of age.⁷² Given the aged pension was available to all at 65, the objective of the work test was to ensure that senior Australians were still working for their future retirement needs. This test was intended to counter abuse of the superannuation system by senior Australians putting money into superannuation as an investment vehicle that attracted a low rate of earnings tax. However, this work test breaches horizontal equity and can be easily circumvented, and it is discriminating on the basis of age; it should simply be abolished. The Australian Law Reform Commission also supports removing age-based restrictions on accumulation, given these limits are not appropriate for today's retirement expectations.⁷³

E Equity regarding government contributions

1 *Equity for low-income earners: LISC and LISTO*

The low-income super contribution (LISC) was a maximum of AU\$500 co-contribution provided by the Gillard Government from the 2012/13 income year that applied to low-income earners whose adjusted taxable income was less than AU\$37 000.⁷⁴ (The marginal rate of tax at that time was 15 per cent, but today is 19 per cent.) This co-contribution was paid by the government directly into an employee's superannuation account where concessional contributions had been made (by the employer through SG or through additional contributions by the employee) and then taxed at 15 per cent.⁷⁵ Essentially the LISC refunded the 15 per cent contributions tax. This was an example of an equity measure to support low-income earners, because low-income earners who did

⁶⁸ Ibid para 290-230(2)(c).

⁶⁹ Australian Government, *Parliamentary Debates* (Morrison), above n 65.

⁷⁰ Contributions are prohibited by the Superannuation Industry (Supervision) Regulations 1994 (Cth) 7.01(3), from members aged 65–74, unless the member meets the work test.

⁷¹ Ibid.

⁷² Superannuation Industry (Supervision) Amendment Regulations 2004 (No.4) (Cth).

⁷³ Australian Law Reform Commission, Australian Government, *The Superannuation System – An Overview* para 8.1 <<https://www.alrc.gov.au/publications/8-superannuation/superannuation-system>>.

⁷⁴ *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012* (Cth).

⁷⁵ Australian Taxation Office, Australian Government, *Low Income Super Contribution* (17 May 2017) <<https://www.ato.gov.au/Individuals/Super/In-detail/Growing/Low-income-super-contribution>>.

not pay tax on their income in the personal taxation system were penalised in the superannuation system when tax was levied on their superannuation contributions paid by their employers, and also when income tax was levied on their fund income. This measure promotes vertical equity in the system.

The LISC was abolished by the Abbott Government commencing from 1 July 2017. This added to the inequity in the superannuation system. However, the Turnbull Government November 2016 reforms subsequently introduced a low-income superannuation tax offset (LISTO) of up to AU\$500⁷⁶ available to superannuation funds to replace the LISC, which results in the same outcome and supports vertical equity. The Treasurer stated this is to improve the fairness of the tax system because low-income earners lose 15 per cent of their contribution, which is higher than their marginal rate of tax.⁷⁷

2 *Government co-contribution: equity for low- and middle-income earners*

In 2003, the Howard Government introduced government co-contributions,⁷⁸ to benefit low- and middle-income earners that made non-concessional contributions, and this was increased to AU\$1500 in 2004.⁷⁹ This was a vertical equity measure that in particular, supported low-income earners. This was a generous motivation by the government of providing a dollar-for-dollar investment return that would be channeled into superannuation. This benefit was, however, reduced in the 2008/09 income year to AU\$1000 by the Rudd Government on the basis of sustainable pension reform.⁸⁰ The Gillard Government subsequently reduced government co-contributions to AU\$500⁸¹ in the 2012/13 income year given the LISC was introduced, which also provided a maximum of AU\$500 benefit.

The co-contributions scheme requires four tests to be met,⁸² and for the 2017/18 income year these tests are:

- The **work test**, as discussed above, working full time or part time, but a minimum of 40 hours in 30 days.
- The **income test** is if an individual earns less than AU\$36 813 they can receive support of 50 cents for every after-tax dollar the individual contributes to a superfund up to a maximum of AU\$1000 contribution, resulting in a maximum of AU\$500 government benefit that is tax-free and paid into the individual's superfund. This benefit shades out for individuals who earn more than AU\$36 813, and the upper income threshold cuts out at AU\$51 813.
- The **age test** is that the individual must be younger than 71 at the end of the financial year.

⁷⁶ *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth) pt 2A ss 12B–12G.

⁷⁷ Australian Government, *Parliamentary Debates* (Morrison), above n 65.

⁷⁸ *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth).

⁷⁹ *Ibid.*

⁸⁰ *Tax Laws Amendment (2009 Budget Measures No. 1) Act 2009* (Cth).

⁸¹ *Tax Law Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012* (Cth).

⁸² Australian Taxation Office, Australian Government, *Super Co-contribution* (1 June 2018) <<https://www.ato.gov.au/individuals/super/in-detail/growing/super-co-contribution>>.

- The **superannuation balance test** is that the individual must have less than AU\$1.6 million in the balance of their account.

The tests are reasonable in terms of equity considerations. Individuals need to be working, have low incomes, and must have less than AU\$1.6 million in their superannuation account. In a similar manner to the non-concessional contributions test for members aged over 65, the age test⁸³ for making co-contributions is inequitable in terms of horizontal equity and should be abolished. This is especially so given similar reforms abolished the age test for SG.⁸⁴ The Australian Law Reform Commission also questions whether such a test is appropriate to foster mature age workforce participation.⁸⁵

V IS THE TAXATION OF FUND INCOME EQUITABLE?

The main issue with fund income is that its level of concession is unsurpassed by any other form of investment, given it is taxed at only 15 per cent, meaning that it becomes very attractive to high-income earners seeking tax advantages, and there is virtually no benefit to low-income earners. In addition, despite new laws setting a limit to the superannuation balance cap of AU\$1.6 million, this cap is limited to new assets and grandfathering rules apply to existing assets prior to 1 July 2017. Grandfathering permits the excess superannuation balance to simply move to another account that is still concessional tax at 15 per cent, favouring high-income earners. Although non-concessional contributions cannot be added to an account once the AU\$1.6 million balance cap has been reached, concessional contributions can still be added, again favouring high-income earners. In this regard, both horizontal and vertical inequity apply to taxation on fund income.

A Horizontal and vertical inequity regarding tax on fund income

Income of a superannuation fund was historically tax exempt.⁸⁶ The Hawke Government introduced a low concessional 15 per cent tax⁸⁷ on fund income, and this rate has remained unchanged.⁸⁸ It was seen that abolishing the exemption and the taxation of superannuation funds would raise revenue and improve efficiency and equity in a growth market.⁸⁹

⁸³ *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth) s 6(1)(e).

⁸⁴ The Gillard Government originally proposed to increase the age from 70 to 75, and then decided to abolish the age test altogether. See *Superannuation Guarantee (Administration) Amendment Act 2012* (Cth).

⁸⁵ Australian Law Reform Commission, above n 73.

⁸⁶ *Income Tax Assessment Act 1915* (Cth) s 11(f) and *Income Tax Assessment Act 1936* (Cth) s 23F.

⁸⁷ *Taxation Laws Amendment Act (No 6) 1988* (Cth).

⁸⁸ Note that superfunds are eligible for a capital gains tax discount of 33 1/3 per cent (*Income Tax Assessment Act 1997* (Cth) s 115-100(b)), and therefore only pay tax of 10 per cent on a capital gain.

⁸⁹ Australian Government, *Parliamentary Debates*, House of Representatives, 30 November 1988, 3568 (Peter Morris) <http://parlinfo.aph.gov.au/parlInfo/download/chamber/hansardr/1988-11-30/toc_pdf/H_per_cent201988-11-30.pdf;fileType=application_per_cent2Fpdf#search=per_cent221980s_per_cent201988_per_cent2011_per_cent2030_per_cent22>.

1 *Complying vs non-complying fund: different tax rates*

The concessional rate of 15 per cent tax⁹⁰ is available to complying funds⁹¹ providing they comply with certain legal requirements.⁹² When a fund registers, the complying status is awarded providing the fund meets certain minimum requirements. However, should the fund breach legal requirements it can be made a non-complying fund by the Australian Taxation Office or Australian Prudential Regulation Authority.

In the taxation system, income of a complying fund that is only taxed at 15 per cent is horizontally inequitable in comparison to tax paid by others, such as companies at 27.5 per cent or 30 per cent and individuals who are taxed at their marginal rate of tax ranging from 0 per cent to 45 per cent.

Within the superannuation system, this is vertical inequity, as high-income earners who have a 45 per cent tax rate are advantaged by investing into the fund in comparison to low- and middle-income earners. Low-income earner contributions that have a 0 per cent tax rate are significantly disadvantaged, and there is very little support for those on a 19 per cent tax rate. However, as discussed, this vertical inequity has been countered by the LISTO.

Middle-income earners remain disadvantaged in comparison to high-income earners. One reform measure that could address this inequity, is to apply an additional tax to high-income earners, or alternatively middle-income earners could receive something like the LISTO.

In contrast, if a fund is non-complying, then the taxation rate that applies to a non-complying fund⁹³ income is 45 per cent.⁹⁴ All non-complying funds are taxed at this rate, and this is considered to be horizontally equitable.

2 *Transfer of excess funds over the AU\$1.6 million cap*

Pursuant to the November 2016 superannuation reforms, the maximum account balance of an accumulation account that receives concessional tax treatment on returns from investment is AU\$1.6 million. Funds for retirement capped at AU\$1.6 million are taxed at 15 per cent on fund income in the accumulation phase. With the new AU\$1.6 million cap applying, existing pension accounts at the time in excess of that amount were required to transfer the excess, prior to 1 July 2017, to an accumulation account in the fund or withdraw the excess from the superannuation fund. The new account containing the excess over AU\$1.6 million is treated as an accumulation account, and earnings are taxed

⁹⁰ *Income Tax Rates Act 1986* (Cth) s 26(1)(a).

⁹¹ For the definition of a complying and non-complying superannuation fund, see *Income Tax Assessment Act 1997* (Cth) s 995.

⁹² There are many compliance requirements involving different superannuation laws. For example, to ensure a self-managed super fund is properly regulated, see Australian Taxation Office, Australian Government, *How Your SMSF is Regulated* (16 June 2015) <<https://www.ato.gov.au/Super/Self-managed-super-funds/Administering-and-reporting/How-we-help-and-regulate-SMSFs/How-your-SMSF-is-regulated>>.

⁹³ Defined in *Income Tax Assessment Act 1997* (Cth) s 995.

⁹⁴ *Income Tax Rates Act 1986* (Cth) s 26(2).

at 15 per cent.⁹⁵ This is because if the funds were withdrawn and subsequently reinvested to another investment, those funds would be taxed at the individual's marginal rate of tax, or if invested into a company, would be taxed at 27.5 per cent or 30 per cent. Accordingly, funds that remain in the superannuation fund above the AU\$1.6 million are being generously treated for tax purposes.

3 *Accumulation phase (15 per cent tax) vs retirement phase (tax-free)*

(a) Accumulation phase

Superannuation funds that are in the accumulation phase are taxed at 15 per cent provided they meet the requirements of a complying regulated superannuation fund.

(b) Retirement phase

The earnings from pension asset accounts are tax-free when they are transferred from the accumulation phase into retirement phase, providing the assets are less than the AU\$1.6 million cap.⁹⁶ This allocation occurs when a person meets a condition of release⁹⁷ and can therefore access their pension benefits. These earnings finance the pension income stream on retirement. This is not considered an example of horizontal inequity, despite other taxpayers who have not retired and who have their investments in a superfund pay 15 per cent tax on their investment returns. This is because the circumstances are not considered similar. The retired taxpayers use their balance to meet retirement needs, whereas the other members are accumulating their wealth for future retirement. Given earnings are tax-free from a retirement phase account and that this applies to all retirees, horizontal equity is achieved.

4 *Transition to retirement (TRIP): back to accumulation phase*

The Howard Government introduced transition to retirement pensions in 2005 to allow workers flexibility to gradually move to retirement.⁹⁸ Workers could work less but receive similar earnings from a combination of their job and pension. Under these provisions, members could access pensions early on and enable a gradual retirement. This meant members could access their retirement funds while still working, and also have the benefits of the superannuation system. Superannuation funds in a TRIP account were previously exempted from tax given the transition to retirement.

However, the main use of TRIP has been made by full-time workers as a tax minimisation strategy.⁹⁹ The problem with the TRIP provisions was that members could make contributions and withdrawals almost simultaneously and use the fund to create tax-free

⁹⁵ Australian Government, *Parliamentary Debates* (Morrison), above n 65.

⁹⁶ *Income Tax Assessment Act 1997* (Cth) s 294-35.

⁹⁷ Superannuation Industry (Supervision) Regulations 1994 (Cth) sch 1 pt 6.

⁹⁸ Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 2) (Cth).

⁹⁹ Explanatory Memorandum, Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) 10.12.

benefits. The 2016 Turnbull Government reforms sought to curb this abuse and improve the integrity of transition to retirement pensions. TRIP accounts are no longer granted the tax exemption in the retirement phase and earnings will now be taxed at 15 per cent.¹⁰⁰ However, the taxation of individuals who are over 60 years of age that receive transition to retirement pensions remains unchanged, and so this will result in paying no tax or, if they have reached preservation age they will pay tax at their marginal rate albeit with a 15 per cent tax offset. This integrity measure is seeking to prevent abuse of the superannuation system. From a wider system perspective, and as with all superannuation accounts that are concessional taxed at 15 per cent, this would appear to raise the issue of horizontal inequity. However, in focusing only on the superannuation system as the relevant measure, the tax treatment of TRIP accounts applies equally to all members, and is considered horizontally equitable.

5 *Non-arm's length income: self-managed superannuation funds*

Given the concessional taxation treatment of superfunds, taxpayers could be enticed to transfer income into the fund in order to save on taxation. Self-managed superannuation funds must operate on an arm's length basis,¹⁰¹ and if found not to because of a scheme or arrangement between close parties that results in more income being transferred into the fund than would have been if they were operating at arm's length, then that income is taxed at the highest marginal rate of 45 per cent.¹⁰² This is consistent with other anti-avoidance taxation penalties that apply the highest marginal rate of tax in the taxation system and is considered horizontally equitable. Given this measure applies equally to all superannuation members, it is considered horizontally equitable.

VI IS THE TAXATION OF BENEFITS EQUITABLE?

A Superannuation benefits and taxation

The policy to promote working longer in the work force is in itself not an issue of equity but one of sustainability for the government. Concessions are provided to motivate employees to retire at age 60 and there is vertical inequity in that high-income earners pay no tax (despite their capacity) just as middle-income earners and low-income earners pay no tax. In line with the policy of working longer in the workforce, greater concessions are provided to those who receive a benefit after age 60, in comparison to those between preservation age and age 60. The least concession is provided to those members who receive benefits before preservation age. The taxing of benefits is considered fair and

¹⁰⁰ Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) (Act 81 of 2016) sch 8.

¹⁰¹ Australian Taxation Office, Australian Government, *Non-Arm's Length Income* (16 June 2015) <<https://www.ato.gov.au/Super/Self-managed-super-funds/Investing/Tax-on-income/Non-arm-s-length-income>>.

¹⁰² *Income Tax Rates Act 1986* (Cth) s 26(1)(b).

equitable in comparison between members of taxed and untaxed funds, for both pensions and lump sums.

1 *Taxing benefits is complex*

The taxation of benefits is a complex area but, fortunately for most Australians, the personnel section/superfund advises, calculates and withholds taxation obligations based on the various superannuation components.

There are many factors affecting how taxation impacts on superannuation benefits, but broadly these include age and preservation age, the condition of release, whether the amounts are tax-free or taxable and involve taxed elements or untaxed elements (based on type of contribution and whether tax has already been paid), whether paid as a lump sum or income, and the level of the balance of the account.

As a general approach, amounts paid to members over 60 years of age from taxed funds are tax-free, while amounts paid to members under 60 years of age involve some tax, and more tax if a benefit is received less than the preservation age. Monies received from a taxed fund are treated more concessionally in comparison to untaxed funds. Death benefits are tax-free when passed on to dependents and are concessionally taxed when passed on to adult non-dependents, although age considerations of both the deceased and dependents vary this somewhat.

Amounts are tax-free or taxable based on the type of contribution and whether tax has already been paid. Non-concessional contributions paid from after-tax income will be non-taxable when received as a benefit, whereas concessional contributions made from pre-tax income and where a tax deduction has been previously sought will be taxable. A tax-free component is always tax-free, while a taxable component from a taxed fund is tax-free and from an untaxed fund is taxed at 15 per cent.

2 *Conditions of release*

A condition of release¹⁰³ is the requirement that must be met under legislation before a member can access their superannuation entitlements. Superannuation benefits can be accessed when a member meets the following conditions of release:

- 65 years of age (regardless whether retired or not);¹⁰⁴
- Preservation age and retired;¹⁰⁵
- Preservation age¹⁰⁶ and takes a transition to retirement income stream while working.¹⁰⁷

Accessing superannuation before a condition of release constitutes an illegal early release. Members need to be careful of unscrupulous scheme promoters that make

¹⁰³ Superannuation Industry (Supervision) Regulations 1994 (Cth) sch 1.

¹⁰⁴ Ibid sch 1 item 106.

¹⁰⁵ Ibid sch 1 items 101, 110.

¹⁰⁶ Ibid sch 1 item 110.

¹⁰⁷ Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 2) (Cth).

financial gain from encouraging early release. Promoters untruthfully advise members they can transfer their retirement funds into a newly created self-managed super fund and subsequently access them for personal purposes, which is illegal. In this process, the promoters receive a large commission.¹⁰⁸

However, there are special circumstances or conditions of release where superannuation entitlements can be accessed, and are considered equitable, and apply to a minority of members. These exceptional circumstances involve conditions of release on compassionate grounds,¹⁰⁹ severe financial hardship,¹¹⁰ permanent¹¹¹ or temporary incapacity,¹¹² and death benefits.¹¹³ Entitlements can also be accessed if less than AU\$200¹¹⁴ for administrative expedience and also in relation to temporary residents departing Australia.¹¹⁵

3 Preservation age

Preservation age is the age at which a member can access their superannuation providing they meet a condition of release. This was initially 55 years of age under the Hawke Government¹¹⁶ but was raised by the Howard Government incrementally to 60 years of age¹¹⁷ and narrows the gap between preservation age and pension age (currently 65.5 years for the 2017/18 income year, increasing to 67 years of age in 2023/24). By 2024/25 the preservation age will be 60 years of age for all members.¹¹⁸ Table 1 refers to preservation ages.

Table 1: Preservation ages

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57

¹⁰⁸ Australian Taxation Office, Australian Government, *Illegal Super Schemes – Beware of Offers to Withdraw Your Super Early* (11 January 2016) <<https://www.ato.gov.au/General/Other-languages/In-detail/Information-in-other-languages/Illegal-super-schemes---beware-of-offers-to-withdraw-your-super-early>>.

¹⁰⁹ Superannuation Industry (Supervision) Regulations 1994 (Cth) sch 1 item 107.

¹¹⁰ Ibid sch 1 item 105.

¹¹¹ Ibid sch 1 item 103.

¹¹² Ibid sch 1 item 109.

¹¹³ Ibid sch 1 item 102.

¹¹⁴ Ibid sch 1 item 104.

¹¹⁵ Ibid sch 1 item 103A.

¹¹⁶ *Occupational Superannuation Standards Act 1987* (Cth).

¹¹⁷ Superannuation Industry (Supervision) Regulations Amendment 1999 (Cth).

¹¹⁸ Mercer says Australia could improve its superannuation system if there were only five years between retirement age and pension age. However, in 2025 there is scheduled to be seven years difference. Mercer, *Melbourne Mercer Global Pension Index 2017* (Australian Centre for Financial Studies, October 2017) <<https://australiancentre.com.au/projects/melbourne-mercer-global-pension-index>>.

1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
From 1 July 1964	60

4 *Most concessional taxation: retiring after 60; taxed vs untaxed funds; income vs lump sums*

(a) Pensions: taxed funds

The *SimplerSuper* legislation¹¹⁹ intended that the taxation of benefits from taxed funds for retirees who were over 60 years of age would be tax-free.¹²⁰ The then Treasurer, Peter Costello, announced, ‘Cutting taxes will increase retirement incomes, improve incentives to save and strengthen incentives for older Australians to remain in the workforce’.¹²¹ While these may be viewed as admirable objectives, the tax-free policy fails the test for vertical equity in regard to taxation of the superannuation system. Although high-income, middle-income and low-income earners all pay no tax on pensions and lump sums, this is vertically inequitable given that high-income earners have the capacity to pay more.

Further, equity about this tax-free policy at 60 years of age should also be compared to members who receive benefits from untaxed funds.

(b) Pensions: untaxed funds and 10 per cent tax offset

Members from untaxed funds also receive concessional treatment, but when comparing benefits from taxed and untaxed funds, there is horizontal equity.

Pensions received from untaxed funds (public service pensions) by those members who turn 60 years of age receive a 10 per cent tax offset based on the pension amount.¹²² For a person who received a AU\$100 000 pension, the tax payable¹²³ would be AU\$26 632 in the 2017/18 income year, and reduced by a AU\$10 000 tax offset (the maximum offset allowable), the tax would only be AU\$16 632 or 17 per cent of the pension in round terms. For a person who receives AU\$50 000, the tax payable is AU\$7797 less a AU\$5000 tax offset, leaving tax payable of only AU\$2797 or 6 per cent in round terms. For a person who receives income of AU\$25 000 from a pension, who would also receive an aged pension of approximately AU\$13 000, a total taxable income of AU\$38 000, the tax liability would be AU\$5307 less a AU\$2500 tax offset, leaving AU\$2807 tax payable or 7

¹¹⁹ For further details regarding the *SimplerSuper* policy, see Treasury, Australian Government, *Simplified Superannuation* <<https://simplersuper.treasury.gov.au/documents>>.

¹²⁰ *Income Tax Assessment Act 1997* (Cth) ss 280-30(2) 301-10.

¹²¹ Peter Costello (Treasurer), ‘Simplified Superannuation Legislation Introduced into Parliament’ (Press Release, Treasury, Australian Government, 7 December 2006) <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2006/131.htm&pageID=003&in=phc&Year=2006&DocType=0>>.

¹²² *Income Tax Assessment Act 1997* (Cth) ss 280-30(3), s 301-100.

¹²³ To calculate tax payable, see TaxCalc, *The Australian Tax Calculator* (2018/19) <<https://www.taxcalc.com.au>>.

per cent rounded. There is vertical equity in relation to public service pensions in that the higher income earner pensioners pay higher rates of tax in comparison to the lower income earners.

The above examples also show that lower income earners are very much supported by the aged pension in addition to their superannuation, and have increased benefits, which also assists in terms of vertical equity.

From a horizontal equity perspective, public servants over 60 years of age pay tax in comparison to those who receive a pension from taxed funds that pay no tax. However, with a closer view, this is not inequitable. Taxed fund members have paid tax of 15 per cent on the fund income every year – accordingly, there is a horizontal equity as the untaxed fund members above pay between 7 per cent and 17 per cent tax. Therefore, it is a roughly fair deal that the taxed fund members receive their pensions tax-free as they had already paid tax in deriving those pensions (15 per cent for concessional contributions and 15 per cent on fund income) in comparison to untaxed fund members who gave non-concessional contributions from after-tax monies but never paid tax on fund income, and therefore pay tax at the benefits stage on the taxable benefits after offsetting 10 per cent. This roughly achieves horizontal equity.

In addition, it should be noted that, in terms of equity, the tax offset of 10 per cent afforded to public servants of untaxed funds, cuts out at AU\$100 000¹²⁴ so that it broadly and fairly equates to the AU\$1.6 million cap limitations. This also is a fair measure in terms of both horizontal equity in comparing members of taxed and untaxed funds, and vertical equity in comparing high-income and low-income members of untaxed funds.

(c) Lump sums

Lump sums received from taxed funds paid to retirees over 60 years of age are tax-free.¹²⁵ Lump sums received from untaxed funds for retirees over 60 years of age still receive some concessional treatment. Tax is payable at the marginal rate of tax or 15 per cent, whichever is the lower, unless the lump sum exceeds the untaxed plan cap (\$1.445m in the 2017/18 income year), whereby the excess is taxed at the highest marginal rate of tax (45 per cent).¹²⁶ For the same reasons as discussed above this is broadly equitable in terms of horizontal equity.

5 Less concessional taxation: age between preservation age and 60; taxed vs untaxed funds; income vs lump sums

If a member meets a condition of release and retires between their preservation age and 60 years of age, the taxation impact is more costly than if over the age of 60. This is an

¹²⁴ *Income Tax Assessment Act 1997* (Cth) s 294-30(1). See also Australian Taxation Office, Australian Government, LCR 2017/1: *Superannuation Reform: Capped Defined Benefit Income Streams: Pensions or Annuities Paid from Non-Commutable, Life Expectancy or Market-Linked Products* (19 February 2018) s 32(c) <<https://www.ato.gov.au/law/view/document?DocID=COG/LCR20171/NAT/ATO/00001>>.

¹²⁵ *Income Tax Assessment Act 1997* (Cth) ss 280-30(2), s 301-10.

¹²⁶ *Ibid* s 301-95.

example of vertical inequity. This is a policy choice encouraging Australians to work until 60 years of age, and provides a less concessional arrangement than those who retire at 60 years of age onwards. The rules apply commonly to all who choose to leave the workforce prior to age 60 and therefore there is horizontal equity. As discussed above, greater concessions are applied to those from taxed funds compared to untaxed funds and this is equitable as discussed above because taxed fund members paid tax on their fund income, while untaxed members did not.

However, these arrangements are vertically inequitable in comparison to the tax-free income and lump sums if paid out after 60 years of age.

No tax is paid on the tax-free component.¹²⁷

(a) Pensions

In taxed funds, members under 60 years of age as retirees from taxed funds pay tax on their marginal rates of tax, and receive a 15 per cent tax offset to compensate them for earlier years where they paid 15 per cent tax on their contributions.¹²⁸ In contrast, those public servants who are less than 60 years of age pay marginal rates of tax on pension income, until they reach age 60 and then are eligible for the 10 per cent tax offset.¹²⁹ This is broadly fair in terms of horizontal equity given that there is no tax paid on income of the public service fund.

(b) Lump sums

For a taxed fund member, the tax payable for a lump sum from a taxed fund is tax-free unless the low rate cap (AU\$200 000 in the 2017/18 income year) has been exceeded and, if so, only the excess above the cap will be taxed at the marginal rate of tax or 15 per cent, whichever is lower.¹³⁰

For an untaxed fund member, the tax is more costly. The tax on the lump sum will be the marginal rate or 15 per cent, whichever is lower. If the lump sum is above the low rate cap (AU\$200 000 in the 2017/18 income year) the excess above the cap will be taxed at the marginal rate of tax or 30 per cent, whichever is the lower. If the lump sum is above the untaxed plan cap (\$1.445m in the 2017/18 income year), the excess will be taxed at the top marginal rate of 45 per cent.¹³¹

6 Least concessional taxation: age below preservation age; taxed vs untaxed funds; income vs lump sums

If a member meets a condition of release and retires before their preservation age, the taxation impact is the most costly option to the member. This is a policy choice around encouraging members to retire at age 60. However, these arrangements are vertically

¹²⁷ Ibid s 301-15.

¹²⁸ Ibid s 301-25.

¹²⁹ Ibid s 301-100.

¹³⁰ Ibid s 301-20.

¹³¹ Ibid s 301-105.

inequitable in comparison to tax-free income and lump sums paid out after 60 years of age.

No tax is paid on the tax-free component.¹³²

(a) Pensions

In relation to the taxable component, the income stream will be taxed at the member's marginal rate of tax, whether received from a taxed fund or untaxed fund.¹³³ This is horizontal equity as no tax concession has been provided. These arrangements are vertically inequitable in comparison to the tax-free benefits at age 60.

(b) Lump sums

In relation to a taxed fund, the lump sum will be taxed at 20 per cent or at the marginal rate, whichever is the lower.¹³⁴ In relation to an untaxed fund, the lump sum will be taxed at 30 per cent or at the marginal rate, whichever is the lower, unless the lump sum is more than the untaxed plan cap (\$1.445m in the 2017/18 income year), in which case the excess is taxed at the top marginal tax rate.¹³⁵ This is broadly equitable in terms of horizontal equity. These arrangements are vertically inequitable in comparison to tax-free benefits at age 60.

7 Death benefits paid to family members and AU\$1.6 million cap

All death benefits paid to dependents in a lump sum are tax-free.¹³⁶

Benefits paid in a pension depend on age of the deceased and dependents. Dependents include spouse, children under 18 or those children financially dependent upon the member, or any persons who are interdependent in their relationship with the member, or any permanently disabled child regardless of age.¹³⁷

The tax-free component of a death pension is tax-free.¹³⁸ This applies whether from a taxed or untaxed fund.

Where a death pension is paid from a taxed fund and either the deceased or dependent were 60 years of age or over, the income is tax-free.¹³⁹ Where in a taxed fund both the deceased and the dependent were under 60 years of age, the income is taxed at marginal rates less a 15 per cent tax offset.¹⁴⁰

¹³² Ibid s 301-30.

¹³³ General rates of tax apply.

¹³⁴ *Income Tax Assessment Act 1997* (Cth) s 301-30.

¹³⁵ Ibid s 301-115.

¹³⁶ Ibid s 302-60.

¹³⁷ Ibid ss 302-195–200.

¹³⁸ Ibid ss 302-70–80.

¹³⁹ Ibid s 302-65.

¹⁴⁰ Ibid s 302-70.

Where a death pension is paid from an untaxed fund and either the deceased or dependent were 60 years of age or over, the dependent is entitled to a 10 per cent tax offset.¹⁴¹ Where in an untaxed fund both the deceased and the dependent were under 60 years of age, the income is included in assessable income and taxed at marginal rates.¹⁴²

Death benefits paid to non-dependents can only be in the form of a lump sum and involve a benefits tax. Non-dependents include adult children, who are not dependents and have no dependency relationship.¹⁴³ No tax is paid on the tax-free component.¹⁴⁴ A tax of 15 per cent is payable from taxed funds and a tax of 30 per cent from untaxed funds applies.¹⁴⁵

The AU\$1.6 million balance cap needs to be considered in situations with death of a member. If one partner dies, and if their balance is transferred to the surviving partner, this amount will be included in the surviving partner's new balance. If this results in the surviving partner's cap being exceeded, the excess will need to be transferred to an accumulation account.¹⁴⁶

The policy regarding death benefits is broadly consistent with the taxation of benefits above that highlights vertical inequity, but is considered equitable from a compassionate perspective.

B Other benefits

As previously mentioned various benefits are provided in other exceptional circumstances. Different taxing rates apply in relation to different conditions of release such as medical condition, permanent incapacity, temporary residents, etc – but these uncommon cases are not discussed here.

VII FUTURE REFORM

A Summarising horizontal and vertical equity

In reviewing the components of the taxation of superannuation contributions, fund income and benefits, a summary of the findings concerning horizontal and vertical equity are summarised in Appendix A.

Appendix A identifies that the majority of the taxing components are broadly equitable in terms of horizontal and vertical equity, and the Turnbull Government November 2016 reforms have assisted in improving the equity in the taxation system.

However, there remains vertical inequity across the superannuation system:

¹⁴¹ Ibid s 302-85.

¹⁴² Ibid s 302-90.

¹⁴³ Non-dependents are those who are not dependents nor have a dependency relationship.

¹⁴⁴ *Income Tax Assessment Act 1997* (Cth) s 302-140.

¹⁴⁵ Ibid s 302-145.

¹⁴⁶ Ibid s 294-35.

- SG advantages high- and middle-income earners compared to low-income earners, because of its flat rate.
- Concessional contributions give high-income earners an advantage compared to middle and low-income earners. This remains so despite the additional tax of 15 per cent under the Div 293 Tax.
- The low taxation of funds (15 per cent) advantages high-income earners.
- High-income earners aged 60 and over are advantaged significantly as they pay no tax but have the capacity to pay compared to middle and lower income earners. In addition, high-income earners over 60 years of age are advantaged compared to those who have retired after their preservation age but before 60 years of age, or have retired prior to their preservation age.

In terms of horizontal equity, the grandfathering of assets that are excess to the AU\$1.6 million cap, which are taxed at 15 per cent only, should be taxed at the marginal rate of tax. Finally, there is horizontal inequity given various age discriminations in the concessional contributions work test over 65 years of age, and the government co-contributions to those over 71 years of age. Both requirements should be removed.

B Future reform options

Based on the preceding discussion and as outlined in Attachment A, the following reforms address horizontal and vertical inequity in the taxation of superannuation.

1 Contributions

1. Introduce a higher rate of SG for low-income earners.
2. Lower the threshold for the Div 293 Tax (say to AU\$180 000) to promote further equity or, alternatively, impose the taxation of concessional contributions at an individual's marginal rate of tax less 15 per cent.
3. Abolish the work test for people over 65 making contributions.
4. Abolish the age test in relation to government co-contributions.

2 Fund income

5. For fund accounts less than AU\$1.6 million, increase the tax for high-income earners say to 27.5 per cent (the lowest tax paid by small business companies). Alternatively, to match the benefits of high-income earners regarding fund income, provide middle-income earners with something akin to the LISTO afforded to low-income earners.
6. Also, for fund accounts that existed prior to 1 July 2017 and were greater than AU\$1.6 million, increase the tax to 27.5 per cent.

3 Benefits

7. To put all retirees at the same level as those who turn 60 years of age, provide all retirees from a taxed fund who have met a condition of release with benefits tax-free. (Being less than 60 years of age and less than preservation age should be disregarded.) To promote horizontal equity under this arrangement, subject retirees benefits from an untaxed fund to a 10 per cent tax, or marginal tax, whichever is the lower.

VIII CONCLUSION

The taxation of superannuation has most components that are equitable in terms of horizontal and vertical equity.

However, some are inequitable, in particular regarding vertical equity in the contributions stage, fund income stage and benefits stage. The grandfathering of accounts in excess of AU\$1.6 million breaches horizontal equity as does the work test for concessional contributions and the age test for government co-contributions.

In addition, by using the perspective of horizontal and vertical equity as a filter of fairness, novel recommendations have been deduced such as increasing the SG rate for low-income earners and proposing similar tax treatment on benefits for all retirees, regardless of conditions such as age 60.

Accordingly, further legislative reform should be made to make the treatment of these concessional taxation advantages fairer to all Australians.

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APPENDIX A: SNAPSHOT REGARDING HORIZONTAL AND VERTICAL EQUITY

Contribution, fund income or benefits	Specific component issue	Horizontal	Vertical	Equitable (yes/no)
4.1 Employer contributions for employees	SG – almost universal access	Horizontal		Yes
	SG – flat rate		Vertical	No
4.3 Concessional contributions	Employer	Horizontal		Yes
	Self-employed, non-employed and employees – equally claim	Horizontal		Yes
	Higher income earners (compared to low-income earners), redressed in part by Div 293 Tax		Vertical	No
	Contributions splitting – equal rights	Horizontal	Vertical	Yes
	Catch up – flexibility	Horizontal		Yes
	4.2 ECT	Excess contributions tax	Horizontal	
4.4 Non-concessional contributions	Individuals – high–low income	Horizontal	Vertical	Yes
	Spouse tax offset	Horizontal		Yes
	Work test for over 65	Horizontal		No
	4.2 ECT	Excess contributions tax	Horizontal	Yes
4.5 Government contributions	LISC/LISTO		Vertical	Yes
	Government co-contributions – age test	Horizontal		No

	Government co-contributions		Vertical	Yes
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5.1 Fund income				
	Complying fund income < AU\$1.6 million cap		Vertical	No
	Non-complying fund	Horizontal		Yes
	Grandfathered accounts > AU\$1.6 million cap	Horizontal		No
	Retirement phase – income tax-free	Horizontal		Yes
	Transition to retirement pensions	Horizontal		Yes
	Non-arm’s length income for self-managed super funds	Horizontal		Yes

6.1 Taxing of benefits				
	Retiring after 60 – income – taxed fund is tax-free and untaxed fund receives 10 per cent tax offset applied to income – greatest advantage to over 60 – unfair as high-income earners benefit more than low-income earner		Vertical	No
	AU\$100 000 cap for untaxed fund receive 10 per cent tax offset – high-income pensions pay more tax than middle and low-income pensions	Horizontal	Vertical	Yes
	Retiring after 60 – income – taxed funds vs untaxed funds – comparing taxing benefits of income	Horizontal		Yes
	Retiring after 60 – lump sums – tax-free for taxed funds compared to untaxed funds, lump sums incur 15 per cent tax or marginal tax rate (whichever is lower) and excess over untaxed plan cap is taxed at 45 per cent	Horizontal		Yes

	Retiring after preservation age but before 60 – compared to retiring after 60 – middle disadvantage		Vertical	No
	Retiring after preservation age but before 60 – income – taxed fund taxed at marginal rates less 15 per cent offset, untaxed funds taxed at marginal rates	Horizontal		Yes
	Retiring after preservation age but before 60 – lump sums – taxed fund lump sum tax-free unless exceeded the low rate cap (AU\$200 000), excess only taxed at marginal rate or 15 per cent, whichever is lower, and untaxed fund lump sums are taxed at marginal rate or 15 per cent, whichever is lower, excess above low rate cap is taxed at marginal rate or 30 per cent, whichever is lower	Horizontal		Yes
	Retiring before preservation age – compared to retiring after 60 – greatest disadvantage		Vertical	No
	Retiring before preservation age – income – taxed at marginal rate whether received from taxed fund or untaxed fund	Horizontal		Yes
	Retiring before preservation age – lump sums – taxed fund lump sums are taxed at 20 per cent or marginal rate whichever is the lower – untaxed fund lump sums taxed at 30 per cent or marginal rate, whichever is the lower, unless lump sum exceeds the untaxed plan cap where the excess is taxed at marginal rates.	Horizontal		Yes
	Death benefits – complex – broadly similar to above concessions – but on compassionate grounds considered fair	Horizontal		Yes

ROLE OF TAX KNOWLEDGE AND SKILLS: WHAT ARE THE GRADUATE SKILLS REQUIRED BY SMALL TO MEDIUM ACCOUNTING FIRMS

SHARON HAYES, BRETT FREUDENBERG AND DEBORAH DELANEY*

ABSTRACT

Small and medium accounting (SMA) firms can account for approximately 40 per cent of graduate recruitment in Australia. Does the context of obtaining employment with a SMA firm require graduates to have certain knowledge and skills? This article reports the findings of a study into the technical and generic skills required by graduates commencing employment within an Australian SMA firm. The findings suggest that together with financial statement and reporting, tax knowledge is highly valued for graduates to a SMA firm. In terms of tax, this also includes the ability to use tax software. Also, the generic skills of communication, teamwork and ethics are highly regarded. This raises the question as to whether current university degrees are providing adequate technical and generic skill development for those graduates seeking employment with a SMA firm.

Keywords: Accounting; Graduates; Technical skills; Generic skills; Small to medium accounting; Employment; Work-ready.

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I INTRODUCTION

It has been argued that undergraduate degrees are currently unable to completely prepare Commerce graduates, because the learning outcomes of most accredited undergraduate degrees in Australia do not align with the profession's requirements or expectations.¹ This in part is due to the role of the professional accountant continuing to undergo significant change, adapting from its traditional role of information provider and record-keeper, to the role of business advisor and information analyst.² Freeman and Wells suggest these changes are attributable to business globalisation and task automation due to technological advancements.³

These changes require critical reflection of the graduate skills of students entering into the accounting profession. The literature demonstrates an element of uncertainty as to which skills are required for newly prepared graduates entering the profession.⁴ This is compounded by the fact that graduates may gain employment in a wide variety of employment contexts, including public accounting practices of different sizes, or corporate or government environments. Greater challenges are also predicted as the trend of outsourcing basic accounting services continues, as these entry level tasks commonly provide a source of skill enhancement and development for new accounting employees.⁵

Small to medium accounting (SMA) firms are responsible for a significant portion of graduate employment. Figure 1 illustrates the destination in 2015 of 1830 domestic Australian accounting graduates, and demonstrates that more than 40 per cent of graduates attained employment within either a small (2–19 employees) or medium (20–99 employees) accounting firm.⁶ Consequently, SMA firms are a significant employer of

¹ Leopold Bayerlein and Mel Timpson, 'Do Accredited Undergraduate Accounting Programmes in Australia Meet the Needs and Expectations of the Accounting Profession?' (2017) 59(3) *Education + Training* 305.

² W Steve Albrecht and Robert Sack, *Accounting Education: Charting the Course through a Perilous Future* (AAA, 2000); Nas Ahadiat and Rose M Martin, 'Attributes, Preparations and Skills Accounting Professionals Seek in College Graduates for Entry-Level Positions vs. Promotion' (2015) 8(1) *Journal of Business and Accounting* 179.

³ Mark Freeman and Paul Wells, 'Reducing the Expectation Gap: Using Successful Early Career Graduates to Identify the Capabilities that Count' in Elaine Evans, Roger Burritt and James Guthrie (eds), *Future Proofing the Profession: Preparing Business Leaders and Finance Professionals for 2025* (RMIT and Chartered Accountants ANZ, 2015) 67–78.

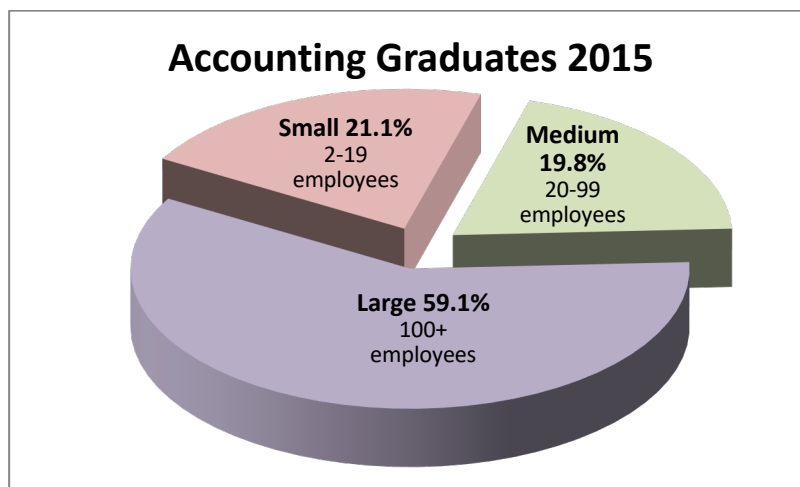
⁴ Bryan Howieson, Phil Hancock, Naomi Segal, Marie Kavanagh, Irene Tempone and Jenny Kent, 'Who Should Teach What? Australian Perceptions of the Roles of Universities and Practice in the Education of Professional Accountants' (2014) 32 *Journal of Accounting Education* 259–75; Irene Tempone, Marie Kavanagh, Naomi Segal, Phil Hancock, Bryan Howieson and Jenny Kent, 'Desirable Generic Attributes for Accounting Graduates into the Twenty-First Century: The Views of Employers' (2012) 25(1) *Accounting Research Journal* 41; Seedwell T M Sithole, 'Quality in Accounting Graduates: Employer Expectations of the Graduate Skills in the Bachelor of Accounting Degree' (2015) 11(22) *European Scientific Journal* 165.

⁵ Sally Chaplin, 'Accounting Education and the Prerequisite Skills of Accounting Graduates: Are Accounting Firms Moving the Boundaries?' (2017) 27(1) *Australian Accounting Review* 61.

⁶ The scope of this study is restricted to SMA firm employers. The definition of a 'large' employer, according to the Australian Bureau of Statistics (ABS), is one with more than 200 full-time employees, whilst Graduate Careers Australia (GCA) identifies 'large' employers as having 100 or more employees. Whilst this creates a conflicting definition, this research study accords with the GCA definition and focuses upon SMA firm employers with 2–99 employees.

Australian accounting graduates, and it is important to consider their perspective as to the skills required by graduates.

Figure 1: Accounting undergraduate employment destination by employer size⁷



Current literature indicates that accounting employers require both technical and generic skills for accounting graduates commencing employment.⁸ However, most studies have investigated the skills of accounting graduates in accounting firms of all sizes, government employers, private corporations, public corporations, and other non-accounting industry employers. Prior research has not adequately considered graduate attributes specific to SMA firms, and it is recognised that the skill emphasis for SMA firms may not be compatible with other employment contexts due to the differences in graduate duties.⁹

Howieson identifies that the expectations for graduates will differ dramatically across different employer groups, reinforcing the view that the required skills to make a graduate work-ready will depend upon the employment role.¹⁰ A recent comparison of accounting practices confirmed that smaller firms usually have a larger number of small business clients across various industries, exposing graduates to a broader range of tasks and skill requirements.¹¹ The expansion by SMA firms to provide more complex and

⁷ Graduate Careers Australia, 'Graduate Outlook 2015' in *The Report of the 2015 Graduate Outlook Survey: Perspectives on Graduate Recruitment* (2014) Graduate Destinations Report Table T24 <www.graduatecareers.com.au>.

⁸ John Bowden, Gail Hart, Bruce King, Keith Trigwell and Owen Watts, 'Generic Capabilities of ATN University Graduates' (Department of Education, Australian Government, Training and Youth Affairs, 2000); Beverley Jackling and Kim Watty, 'Generic Skills' (2010) 19(1-2) *Accounting Education* 1; Tempone et al, above n 4.

⁹ Binh Bui and Brenda Porter, 'The Expectation-Performance Gap in Accounting Education: An Exploratory Study' (2010) 19(1-2) *Accounting Education: An International Journal* 23; Mary Low, Vida Botes, David De La Rue and Jackie Allen, 'Accounting Employers' Expectations – The Ideal Accounting Graduates' (2016) 10(1) *e-Journal of Business Education & Scholarship of Teaching* 36.

¹⁰ Howieson et al, above n 4.

¹¹ Daniel Bishop, 'Context, Agency and Professional Workplace Learning: Trainee Accountants in Large and Small Practices' (2017) 59(5) *Education + Training* 516.

commercially oriented accounting services is also leading to changes in the skills and attributes a work-ready accounting graduate should exhibit.¹²

In aiming to provide work-ready accounting graduates to SMA firms, an improved understanding of the required skills for the SMA employment context is needed. Given the proportion of graduates securing employment within SMA firms, it is important to ensure that graduates develop the necessary skills. This is significant, as SMA firms may have limited financial resources to support and train graduates during the initial stages of employment as they transition from graduate to professional. A continued failure to provide sufficiently skilled work-ready graduates to SMA firm employers may lead to further decreases in graduate employment.¹³

A 'work-ready' graduate is seen as a graduate who has obtained the desired skills upon completion of their tertiary education to competently commence employment.¹⁴ These consist of both generic and technical skills, with Bui and Porter arguing that the necessity for each attribute requires consideration to be given to the specific employment context, and suggesting that SMA firms place relatively more importance on technical skills.¹⁵ However, in a small study by Low et al from New Zealand with employers of various sizes, they found no evidence upon which to infer that SMA firms place more importance on particular skills when compared to larger firms.¹⁶ In contrast, Tempone et al in their 2012 study did find the size of accounting firm employer and associated employment context was significant.¹⁷ This study seeks to investigate the technical and generic skills required for a work-ready graduate commencing specifically within a SMA accounting firm. The overarching research question that this article seeks to address is: 'What are the technical and generic graduate skills required in an Australian SMA firm?' The findings suggest that, unlike larger firms, tax knowledge and the ability to use tax software is a desired graduate skill for a majority of SMA firms.

Section II of this article will provide a discussion of graduate skills and their classification as technical or generic skills, followed by a broad summary of recent graduate trends. Section III will provide the research methodology undertaken and the demographics of the participants, which will be followed by the results in Section IV. Through the analysis of the results recommendations will be proposed in Section V, with future research being outlined in the Section VI of the article before concluding.

¹² Samantha Sin and Nicholas McGuigan, 'Fit for Purpose: A Framework for Developing and Assessing Complex Graduate Attributes in a Changing Higher Education Environment' (2013) 22(6) *Accounting Education* 522.

¹³ Department of Employment, Australian Government, *Labour Market Research – Accountants Australia June Quarter 2017* (Labour Market Research and Analysis Branch, 2017) <https://docs.employment.gov.au/system/files/doc/other/ausaccountants_1.pdf>.

¹⁴ Tempone et al, above n 4.

¹⁵ Bui and Porter, above n 9.

¹⁶ Low et al, above n 9.

¹⁷ Tempone et al, above n 4.

II GRADUATE SKILLS

Graduate attributes are defined as the qualities, skills and understandings that students should develop during their time with a university.¹⁸ The literature demonstrates graduate attributes as diversely understood by a cross-section of academics,¹⁹ consisting of a broad range of skills and attributes acquired through completion of an undergraduate degree. De la Harpe and David argue that they are a critical outcome of a modern tertiary education, and graduates need to be capable of demonstrating the necessary skills when seeking graduate employment.²⁰ These skills go beyond just the disciplinary expertise and technical knowledge that have traditionally been a focus for university courses, and extend to particular human behaviours, dispositions and capabilities.²¹

Graduate skills can be classified as either generic or technical skills, with various employment duties and responsibilities ultimately requiring different graduate attributes. Technical skills have been described as context-specific and practical,²² and represent for accounting such things as debits and credits, taxation knowledge and preparing financial accounts, as well as book-keeping skills, information technology, and the ability to understand accounting concepts.²³ Technical skills are considered necessary to perform the tasks that are specific to accountants and should be developed from the knowledge of content areas as prescribed. In comparison, generic attributes include those non-accounting skills that may be used across a variety of industries and include communication, teamwork and problem-solving. A more detailed discussion of these concepts follows.

A Technical attributes

Bayerlein and Timpson argue that whilst tertiary accounting education is bound by clear standards through the use of accreditation, graduates can continue to lack adequate knowledge and skills.²⁴ Technical skills such as book-keeping, information technology, analysis, and basic accounting concepts, are recognised as desirable.²⁵ Dale argues, however, that the role for graduates is becoming more complex because they are expected to apply judgement and problem-solve across a whole range of areas, and

¹⁸ Bowden et al, above n 8.

¹⁹ Simon Barrie, 'A Conceptual Framework for the Teaching and Learning of Generic Graduate Attributes' (2006) 32(4) *Studies in Higher Education* 439; Sin and McGuigan, above n 12; Calvin Smith, Sonia Ferns and Leoni S Russell, 'Conceptualising and Measuring "Employability" – Lessons from a National OLT Project' (ACEN National Conference, Australian Collaborative Education Network Limited, Gold Coast, 2014) 1.

²⁰ Barbara De La Harpe and Christina David, 'Major Influences on the Teaching and Assessment of Graduate Attributes' (2012) 31(4) *Higher Education Research & Development* 493.

²¹ Sin and McGuigan, above n 12.

²² Marie Kavanagh and Lyndal Drennan, 'What Skills and Attributes Does an Accounting Graduate Need?' (2008) 48 *Accounting and Finance* 279.

²³ 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; Bui and Porter, above n 9; Low et al, above n 9.

²⁴ Bayerlein and Timpson, above n 1.

²⁵ Bui and Porter, above n 9.

simply reporting data is no longer sufficient for the desired solutions and insight.²⁶ Others have confirmed that the ability to use accounting software is necessary due to the recent introduction of advanced hardware and software technology into accounting practices, and the dramatic changes to data processing.²⁷ Chaplin concludes that SMA firms typically identify that future graduates will require more specialised skills as a result of outsourcing trends, with analytic skills deemed as the most important.²⁸ Sithole surveys of the technical skills required of graduates across a broad range of accounting employers in Swaziland found that of the technical skills listed, employers rated computing techniques, reporting skills, functional competencies and measurement skills as important.²⁹

Pan and Perera contend that simply aligning the accounting programmes with existing accreditation guidelines will not ensure graduates are work-ready, due to a lack of consensus between typical employer requirements and current accounting programmes.³⁰ A growing gap between accounting education and the requirements of practitioners, particularly in relation to preparing graduates and accounting knowledge, was identified by Rebele and St Pierre when analysing accounting education literature ranging from 1991 to 2015.³¹

It appears that until recently tax as discipline knowledge has to an extent reduced in its importance with accounting professional bodies. Juchau and Neale traced the history of tax in Australian accounting degrees from 1945 to 1995.³² Their observations noted that during these 50 years, tax varied from being initially external to degrees to then being a 'regular feature' in the late 1950s.³³ Tax was present in most commerce degrees in the 1960s even if not a separate course and instead intermingled with other law or accounting courses.³⁴ This developed from the 1970s to the late 1980s with tax generally part of the curriculum due to accreditation requirements.³⁵ However, by the end of the 1980s there was some reconsideration about what extent was tax coverage in accounting degrees required, with a Task Force Report suggesting a weighting of 11 per cent to 15 per cent in degrees to cover legal structures and processes, as well as revenue laws.³⁶ It

²⁶ Jason Dale, 'Preparing Business Leaders and Accountants for Future Financial Leadership' in Elaine Evans, Roger Burritt and James Guthrie (eds), *Future Proofing the Profession: Preparing Business Leaders and Finance Professionals for 2025* (RMIT and Chartered Accountants ANZ, 2015) 88.

²⁷ Ali Yaftian, Sohelia Mirshekary and Dessalegn Mihret, 'Learning Commercial Computerised Accounting Programmes: Perceptions and Motivations' (2017) 30(3) *Accounting Research Journal* 312.

²⁸ Chaplin, above n 5.

²⁹ Sithole, above n 4.

³⁰ Peipei Pan and Hector Perera, 'Market Relevance of University Accounting Programs: Evidence from Australia' (2012) 36 *Accounting Forum* 91.

³¹ James Rebele and E Kent St Pierre, 'Stagnation in Accounting Education Research' (2015) 33(2) *Journal of Accounting Education* 128.

³² Roger Juchau and Ray Neale, 'Taxation in Australian Undergraduate Accounting Courses: A Review and Case Note' (2001) 10(1) *Accounting Education* 27.

³³ *Ibid.*

³⁴ *Ibid.*, citing F Devonport, 'The Place of Taxation in a Commerce Degree' (Proceedings of the AAUTA Convention, University of Newcastle, August 1968).

³⁵ *Ibid.* 29.

³⁶ William P Birkett, 'The Demand for, and Supply of Taxation Education: A Delphi Study' (Task Force for Accounting Education in Australia, sponsored by the Australian Society of Accountants, the Institute of

appears that this may have been the impetus for some tertiary institutions to reduce their tax courses from a full-year course (consisting of two units) to a half-year course (of one unit). Curiously, this was occurring at a point in time when Australia was experiencing extensive tax reform including the introduction of capital gains tax, fringe benefits tax and the imputation system for corporations. The threat of the reduced length of tax courses in accounting degrees was in part the impetus for the formation of the Australasian Tax Teachers Association (ATTA), with the first ATTA Conference held at the University of NSW in 1989.³⁷ Nevertheless, by the end of 1995 tax was a specified area of which accounting accreditation required a demonstrated understanding and knowledge, although not necessarily covered over 12 months.³⁸

However, by the end of the first decade of the third millennium this was further threatened as CPA Australia (Certified Practising Accountants) removed the requirement for tax (and audit) as a required course in an undergraduate degree to seek membership. The current university curriculum requires 13 knowledge areas to be covered to ensure that an Australian accounting degree will be eligible for professional accreditation as prescribed by CPA Australia and Chartered Accountants Australia and New Zealand (CAANZ).³⁹ Table 1 provides a brief explanation of each content area to be included for accreditation, with the most recent amendment to the curriculum occurring in 2012 (which was relevant at the time of this study). It is noted that at the time of this study for CPA Australia audit and taxation were not required as a compulsory inclusion (as indicated with a cross in Table 1), instead requiring that a non-compulsory course is made available for students. However, starting from mid-2018 CPA Australia has changed its accreditation requirements so that now it once again requires an undergraduate tax course.⁴⁰ This change appears largely to be in response to the educational requirements of the Tax Practitioner Board that includes requiring two courses in tax law for registration as a Tax Agent.⁴¹

It should be noted that Table 1 on the whole includes only the technical knowledge areas, except for the generic skill requirement for 'ethics'.

Chartered Accountants in Australia with the Accounting Association of Australia and New Zealand, Melbourne, 1989).

³⁷ Fiona Martin, 'A History of the Australasian Tax Teachers Association' (2013) 8(1) *Journal of the Australasian Tax Teachers Association* 31; Brett Freudenberg, 'Conference Dinner Address' (Presented at the Annual ATTA Conference, ATTA Newsletter, February 2018) <<https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/AttaNews/ATTA-News-Feb-2018.pdf>>.

³⁸ Juchau and Neale, above n 32, 29.

³⁹ CPA Australia and Institute of Chartered Accountants in Australia, 'Professional Accreditation Guidelines for Australian Accounting Degrees' (2012) <<http://www.cpaaustralia.com.au/cps/rde/xbcr/cpa-site/international-accreditation-guidelines.pdf>>.

⁴⁰ See CPA Australia, *Changes to Advanced Taxation* <<https://www.cpaaustralia.com.au/cpa-program/cpa-program-candidates/your-enrolment/advanced-taxation/changes-to-advanced-taxation>>.

⁴¹ The education requirements for a tax agent include one accounting course, three commercial law courses, and two tax law courses. See Tax Practitioners Board, Australian Government, *Qualifications and Experience for Tax Agents* (5 March 2018) <<https://www.tpb.gov.au/qualifications-and-experience-tax-agents>>.

Table 1: Core knowledge areas required for accreditation of a Bachelor's degree with CPA Australia or CAANZ (up to 30 June 2018)

Knowledge area	Description and/or examples	CPA	CAANZ
Accounting information systems	Productivity software; file and database management systems; accounting information systems in business; systems development and maintenance; e-commerce	✓	✓
Accounting systems and processes	Understanding financial statements and recording financial transactions, including different types of financial statements; using accounting software to record and report business transactions	✓	✓
Accounting theory	Theoretical issues and concepts underlying the practice of accounting, finance and related disciplines; role of the conceptual framework in contemporary accounting	✓	✓
Audit and assurance	Nature and process of auditing; regulatory and professional environment; auditing standards and audit process	✗	✓
Commercial law	General legal knowledge relating to the business environment; understanding risks and responsibilities that impact that environment	✓	✓
Corporations law	National corporate law framework as legislated; its commercial application to the business environment	✓	✓
Economics	Micro – demand and supply; markets and pricing; factor markets; income distribution and market failure. Macro – performance structure; behaviour of the financial economy	✓	✓
Ethics across the curriculum	Ethical decision-making models, principles and values across the curriculum; encouraging debate on ethical issues using practical cases where possible	✓	✓
Finance	Business finance and treasury function; analysis and measurement of an entity's financial position; current treasury developments and relevant issues	✓	✓
Financial accounting	Recording and reporting financial transactions including groups and companies; theoretical issues and concepts underlying accounting practice; current financial accounting and analysis issues for international accounting	✓	✓
Management accounting	Budgeting; product and service costing; control and performance evaluation; strategic management accounting; relevant numerical and analytical skills and current theoretical knowledge	✓	✓
Quantitative methods	Descriptive statistics; frequency and probability distributions; hypothesis testing; simple linear regression and correlation	✓	✓
Taxation	Australian taxation knowledge and administration	✗	✓

Osmani et al conducted an extensive literature review on graduate attributes and employability across accounting, business and management, and computer science.⁴² Thirty-nine studies were considered, with many recognising the concern of graduates' skills failing to meet employer expectations and requirements, and noting the exacerbation due to lack of communication between education and industry. The most

⁴² Mohamad Osmani, Vishanth Weerakkody, Nitham Hindi, Rajab Al-Esmail, Tilla Eldabi, Kawaljeet Kapoor and Zahir Irani, 'Identifying the Trends and Impact of Graduate Attributes on Employability: A Literature Review' (2015) 21(4) *Tertiary Education and Management* 367.

commonly cited technical graduate skills included: technical expertise; financial skills; analytical skills; practical and professional skills; technological skills; knowledge of business functions; general knowledge; and accounting research skills.⁴³ Yap, Ryan and Yong recognise that academic research focus has tended to shift to generic skills due to a presumption that technical skills will already be adequate.⁴⁴ The definition and identification of generic attributes is detailed next.

B Generic attributes

Generic skills can be referred to as non-technical skills,⁴⁵ soft skills⁴⁶ or employability skills,⁴⁷ and have been described as the non-accounting skills necessary to advance or apply the technical skills within the accounting employment context.⁴⁸ Examples of generic skills include: teamwork, written and oral communication, self-management, critical thinking, interpersonal skills and problem-solving.⁴⁹ Research about generic skills has typically highlighted concerns with the generic skills obtained by accounting graduates, whilst reaffirming the 'expectation gap' between the skill levels attained and employer expectations.⁵⁰

Hancock et al recognised the sought-after generic skills for graduates as including 'written and verbal communication, self-management, teamwork, initiative and enterprise, problem-solving, technological competence and planning and organising skills'.⁵¹ Critical thinking, problem-solving and communications,⁵² as well as team skills, interpersonal skills and verbal communication have also been identified as lacking amongst accounting graduates.⁵³ Tempone et al used a frequency analysis to rate the importance of non-technical skills amongst employers for the twenty-first century,

⁴³ Ibid 371, Table 6.

⁴⁴ Christine Yap, Suzanne Ryan and Jackie Yong, 'Challenges Facing Professional Accounting Education in a Commercialised Education Sector' (2014) 23 *Accounting Education* 562.

⁴⁵ Low et al, above n 9.

⁴⁶ R De Villiers, 'The Incorporation of Soft Skills into Accounting Curricula: Preparing Accounting Graduates for Their Unpredictable Futures' (2010) 18(2) *Meditari Accountancy Research* 1.

⁴⁷ Denise Jackson, Ruth Sibson and Linda Riebe, 'Delivering Work-Ready Business Graduates – Keeping Our Promises and Evaluating Our Performance' (2013) 4(1) *Journal of Teaching and Learning for Graduate Employability* 2.

⁴⁸ Ibid.

⁴⁹ Denise Jackson and Elaine Chapman, 'Non-Technical Competencies in Undergraduate Business Degree Programs: Australian and UK Perspectives' (2012) 37(5) *Studies in Higher Education* 541; Phil Hancock, Bryan Howieson, Marie Kavanagh, Jenny Kent, Irene Tempone and Naomi Segal, 'Accounting for the Future: More Than Numbers' (Final Report, Australian Learning and Teaching Council, 2009) vol 1; Jackling and Watty, above n 8.

⁵⁰ Kavanagh and Drennan, above n 22; Jackling and De Lange, above n 23; Lyn Daff, Paul De Lange and Beverley Jackling, 'A Comparison of Generic Skills and Emotional Intelligence in Accounting Education' (2012) 27(3) *American Accounting Association* 627; Tempone et al, above n 4. Diane Bunney, Elaine Sharplin and Christine Howitt, 'Generic Skills for Graduate Accountants: The Bigger Picture, a Social and Economic Imperative in the New Knowledge Economy' (2015) 34(2) *Higher Education Research & Development* 256.

⁵¹ Hancock et al, above n 49.

⁵² Jackling and Watty, above n 8.

⁵³ Jackling and De Lange, above n 23.

identifying communication, teamwork and interpersonal skills, and self-management as the most critical for accounting graduates.⁵⁴

C Recent graduate trends

The recent Graduate Outlook Report identifies over one-quarter of surveyed graduate employers (26.8 per cent) as experiencing trouble sourcing graduates, with accounting listed as the third highest disciplinary area causing concern.⁵⁵ In addition, a recent report on accountants demonstrated that whilst a surplus of accounting graduates exists, only 76.2 per cent obtained full-time employment in 2016 (down from 88.6 per cent in 2008), of which only 52.3 per cent were employed as accountants.⁵⁶ According to industry commentary, this could be due to the insufficiency of tertiary training and the misalignment of accounting graduates with the needs of modern accounting practice.⁵⁷ A recent study, in which 97 per cent of survey participants fall within the SMA category, noted that 21 per cent of all firms currently outsource, with an additional 35 per cent looking to outsource in the future, a factor that may further contribute to declining graduate employment.⁵⁸

Previous research thus far has not focused on identifying the required graduate attributes for Australian SMA firm employers. Instead, research has been conducted across all employment environments including SMA firms and Big Four accounting firms, corporations, government and private employers, with little or no consideration or distinction of the employment contexts.⁵⁹ This means that there is a gap that remains to be investigated, so that specific technical and generic attributes can be identified as being preferable for an accounting graduate who seeks to commence employment within a SMA firm. The purpose of the research reported in this article is to address the literature gap.

III RESEARCH METHODOLOGY

The literature demonstrates that the attributes obtained by graduates are critical to their successful employment, and employers require a mix of skills that are either technical or generic. The research question to be addressed therefore is: 'What are the technical and generic skills required by an Australian SMA firm?'

A mixed methods investigation of the desired graduate attributes with respect to SMA firm employers was used, involving the completion of an online survey, followed by semi-structured interviews to answer the research question. The mixed methods design was considered appropriate as it can investigate the phenomenon in its real-life context,⁶⁰ as

⁵⁴ Tempone et al, above n 4.

⁵⁵ Graduate Careers Australia, above n 7, 6.

⁵⁶ Department of Employment, Australian Government, above n 13.

⁵⁷ Ibid 6.

⁵⁸ Chaplin, above n 5.

⁵⁹ Kavanagh and Drennan, above n 22; Hancock et al, above n 49; Jackling and De Lange, above n 23; Tempone et al, above n 4.

⁶⁰ Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomas Reuters, 2010) 103.

well as provide rich and detailed information through a variety of data collection methods.⁶¹

A Sample selection

The sample includes SMA firms listed within online membership directories of the three Australian professional accounting bodies: CAANZ; CPA Australia; and the Institute of Public Accountants (IPA). The sampling frame includes SMA firms employing between 1 and 99 full-time (or equivalent) employees, aligning with the GCA definition of both small and medium accounting firm employers, having a range between 2 and 99 employees. Convenience sampling was used to select firms located within 100 km of the Gold Coast (Australia) region,⁶² which was considered to be sufficient to provide a broad viewpoint of required graduate skills, and included employers within the Gold Coast and Brisbane regions of Queensland. Selection was further limited by the requirement that the SMA firm had previously hired a commerce graduate within the past 10 years.

Prospective participants were contacted via email. The unit of analysis to be sampled was identified as a senior staff member within the SMA firm who is actively involved with graduate recruitment decision-making.⁶³ Thirty-four suitable participants were invited to attend an interview within the timeframe of the study, with 12 participants ultimately participating in the project. Whilst the number of participants is small, it equates to a response rate of 35.2 per cent, and provided a rich and detailed interview information to be supported by survey findings.⁶⁴

Semi-structured interviews were used and included open-ended questions to address the overarching research question. An interview guide was used at each interview for consistency, and including scripted interview questions along with an introduction, explanatory notes, and pre-interview checklist. Examples were also listed to be used to ensure the participant understood the questions in context, with care taken by the interviewer not to lead the participant with their responses. The data generated by the semi-structured interview questions was eclectically coded amongst a number of developing themes to enable reflection and analysis,⁶⁵ and used to identify key themes and patterns to draw conclusions from them.⁶⁶ Data was also collected from the interview participants via an online survey, including demographic information, followed by the desirability of 20 commonly identified commerce graduate skills. To provide support for the qualitative responses, survey participants were asked to use Likert-type responses to provide information in relation to the desirable attributes that make an accounting graduate work-ready in a SMA firm.

⁶¹ Shan L Pan and Barney Tan, 'Demystifying Case Research: A Structured – Pragmatic – Situational (SPS) Approach to Conducting Case Studies' (2011) 21 *Information and Organisation* 161.

⁶² Rosalind Edwards and Janet Holland, *What Is Qualitative Interviewing?* (A&C Black, 2013).

⁶³ Melvin Ember and Carol R Ember, 'Testing Theory and Why the "Units of Analysis" Problem Is Not a Problem' (2000) 39(4) *Ethnology* 349.

⁶⁴ Unfortunately, due to the random sampling technique over an extended period of time, it is not possible to test for a non-response bias. Accordingly, the results need to be considered with this limitation in mind.

⁶⁵ Jane Towers-Clarke, 'Undergraduate Accounting Students: Prepared for the Workplace?' (2015) 8(1) *Journal of International Education in Business* 37.

⁶⁶ Mark N K Saunders, Philip Lewis and Adrian Thornhill, *Research Methods for Business Students* (Pearson, 7th ed, 2015).

The survey data is used for comparative analysis between the two sources to facilitate a deeper understanding, and can be used to further support the interview findings as part of the mixed methods research.

B Descriptive statistics

Table 2 presents the demographic details of the 12 participants, including the location of their firm, the size of the firm by reference to full-time employees, the position they hold within the firm, and the number of graduates employed within the past 10 years. The data in Table 2 indicates that all participants have an office within the greater Gold Coast or Brisbane regions, with firms classified as either small (n=3), very small (n=3), or medium (n=6).

Table 2: Demographic information

Participant	Firm location	Firm size	Job title	Number of graduates (past 10 years)
1	Southern Gold Coast/ Northern NSW Mid/ Central Gold Coast and Hinterland	Very small (<5)	Owner/Sole practitioner	1–2 graduates
2	Mid/ Central Gold Coast and Hinterland Northern Gold Coast/ Logan	Small to medium (21–100)	Other: HR Business partner	10+ graduates
3	Brisbane City and Surrounds	Small to medium (21–100)	Chief Operations Officer (CEO)	10+ graduates
4	Brisbane City and Surrounds	Small to medium (21–100)	Partner	6–10 graduates
5	Brisbane City and Surrounds	Small to medium (21–100)	Accountant	6–10 graduates
6	Brisbane City and Surrounds	Small to medium (21–100)	Senior management	10+ graduates
7	Mid/ Central Gold Coast and Hinterland	Small to medium (21–100)	Partner	6–10 graduates
8	Mid/ Central Gold Coast and Hinterland	Small (6–20)	Owner/Sole practitioner	6–10 graduates
9	Mid/ Central Gold Coast and Hinterland	Small (6–20)	Owner/Sole practitioner	3–5 graduates
10	Mid/ Central Gold Coast and Hinterland	Small (6–20)	Partner	10+ graduates

11	Brisbane City and Surrounds	Very small (<5)	Owner/Sole practitioner	1–2 graduates
12	Mid/ Central Gold Coast and Hinterland	Very small (<5)	Owner/Sole practitioner	10+ graduates

Table 3 illustrates the services provided by each participating firm. Participants selected all applicable services from the 10 categories listed, and provided details of any additional services offered by selecting ‘Other’. This demonstrates most of the firms involved with financial statements, tax compliance, business set-up and book-keeping services. A number of firms were more specialised, such as firm #3 that focused on forensic accounting and insolvency. This highlights that not all SMA firms are homogenous, with some SMA firms being boutique firms with key specialisations rather than a broad practice base. It can be expected that those specialised firms could have different graduate needs compared with those firms with a broader practice. Consequently, this needs to be considered when analysing the results.

Table 3: Services provided by the accounting firm

Services provided	Participant number											
	1	2	3	4	5	6	7	8	9	10	11	12
Financial statement and reporting	x	x	-	x	x	x	x	x	x	x	x	x
Tax compliance and GST	x	x	-	x	x	x	x	x	x	x	x	x
Business setup and structuring	x	x	-	x	x	x	x	x	x	x	x	x
Book-keeping	x	x	-	x	x	x	-	x	x	x	x	x
Cash flow and budgeting	-	x	-	x	x	x	x	x	x	-	x	-
Registered Office services	x	x	-	x	x	x	x	x	x	x	x	-
Due diligence reports	-	x	-	-	-	x	x	-	-	-	x	-
Forensic accounting	-	-	x	-	-	-	x	-	-	-	-	-
Financial planning	-	x	-	-	x	x	-	x	x	-	x	-
Auditing	x	x	-	-	-	x	x	-	x	-	-	-
Other – SMSF	-	x	-	x	-	-	x	-	-	-	-	-
Other – Finance and legal	-	-	-	-	-	-	-	-	-	-	x	-
Other – Management and KPI	-	-	-	-	x	-	-	-	-	-	-	-
Other – Insolvency and restructure	-	-	x	-	-	-	-	-	-	-	-	-

Indicates the service is provided by the respondent

A discussion of the detailed survey and interview results as they relate to the technical and generic skills required by an Australian SMA firm is next.

IV RESULTS

A Desired technical graduate attributes

1 Interview: Technical skills

SMA firm participants were interviewed to discuss the technical attributes they desire for a graduate accountant commencing with their firm. Whilst many themes emerged, participants typically indicated financial statements, accounting software, and taxation skills (each of which is discussed below) as important for graduates.

(a) Financial statements

Over 91 per cent (n=11) of participants discussed the ability to prepare and interpret financial statements, making financial statements as the most prominent technical attribute identified, in front of taxation (n=10, 83 per cent). Participants commonly referred to the main services their firm provides in referring to what technical skills are required, and included discussions surrounding the preparation of financial statements, which also referred to the understanding of 'basic accounting' or 'debits and credits' necessary to achieve this:

The core knowledge in a lot of firms in business services is doing people's financial statements and tax returns (P4).

Definitely a deep understanding of accounting principles, so the debits and credits, the nature of the transactions, and the underlying transactions that take place in accounting systems (P5).

The ability to interpret the financial information contained in the financial statements was noted as significant, including the capacity to understand and break down the financials of a company, and to understand how they are comprised in terms of accounting treatment, including debits and credits. Participants commonly referred to the main services their firm provides in referring to what technical skills are required:

We expect if you are calling yourself an accountant then you should at least understand how to work the financial statements of a business and also reverse engineer that process (P3).

Interpreting financial statements and having a more thorough understanding of profit and loss, balance sheet, general journal entries (P2).

(b) Accounting package software

Given the desirability of financial statement preparation skills, familiarity with the accounting software used by many clients to record their financial information is also required. Accounting software is often used to obtain the client's financial information for use in preparing or interpreting financial statements and information due to the

popularity of business accounting software, as well as the proposed Australian Taxation Office (ATO) electronic small business reporting (SBR) requirements:

Xero is very popular software now ... MYOB desktop software is definitely still rampant in the SME business arena (P5).

However, it was stated that knowing one accounting software package will assist in understanding and learning another one, with participants identifying 'small business accounting software like Xero, MYOB, or Quickbooks' (P6) as commonly used. Two-thirds of participants included knowledge of accounting software packages as a required skill (n=8), listing MYOB, Xero and Quickbooks as currently used accounting software packages. The popularity of accounting software used by small business typically requires one 'to be able to get on there and print profit and loss reports, look into a general ledger and see what's happened' (P1) in using the information to prepare financial statements.

(c) Taxation and taxation software

Over 83 per cent of participants identified basic taxation knowledge as required with the emphasis on 'people being able to actually do a tax return' (P8) or 'confidently fill out a tax return' (P2), along with focusing on the skills for 'current software that the industry uses, particularly for tax' (P10), so that they can 'complete a very basic tax return' (P11) or are 'able to complete a tax return from day one' (P4). It was also acknowledged that 'technical skills such as knowing the basics of the tax system' (P12) are desirable.

It was noted that 'graduates start with individual tax returns and concepts' (P5) before advancing to more complex situations, and that 'being able to use the software would be a plus', so that graduates can 'go into various tax programs and complete a basic tax return' (P12). The tax software was identified as another technical skill that is 'very important, which we don't get anyone out of university having it, is the current software that the industry uses, particularly for tax' (P10), as well as desirable: 'to have some sort of working knowledge of that is certainly advantageous' (P1).

(d) Additional technical attributes

Minor themes that were raised included the desirability for graduates to possess skills for preparing spreadsheets in Excel, along with double-entry book-keeping. This overlaps with the previous requirements relating to financial statements and accounting software (including debits and credits). Whilst a graduate is unlikely to be responsible for data entry and book-keeping as such, they may still be required to 'use programs like MYOB and Quickbooks and be able to process transactions in those' (P12). One participant explained this as:

If a business doesn't have financial statements, they (the graduate) can go through the double-entry book-keeping, so they need to understand how that works to be able to break it down (P3).

It is argued that book-keeping knowledge is useful for interpretation purposes, as it will be important for the graduate to understand what happens in the background to be able to interpret the resulting data:

Spreadsheets were recognised as a useful tool in data analysis and commonly used by accounting firms, and it was noted that it is important that business software like Excel is understood (P3).

One technical attribute identified as not critical for a work-ready graduate was the knowledge of accounting standards, indicating that this will not be part of the graduate's immediate employment within a typical SMA firm, and may only be needed for a graduate in a more specialised role:

A highly advanced knowledge of the accounting standards is probably not all that necessary in a firm with a client base such as ours, with the kind of reports that need to be produced (P5).

You don't need to know that much about financial accounting standards ... as long as you disclose them for special purpose accounts ... Where you've got an audit practice, even though the partner usually handles it, unless you have an audit section we won't need to be reading the AASB's to find out if we are keeping up with the regulations for reporting (P4).

It was recognised that for most SME accounting firms preparing financial statements, 'our software already produces the reports that we provide to our clients' (P1), and that:

We are not preparing accounts for audit or anything, all we do are basic note disclosures which are already programmed into the accounting software so the standards aren't really necessary ... If you were doing auditing they would be, but an SME where you are doing tax preparation, and financial statements that are management accounts, you wouldn't need the standards (P12).

This highlights how the specific nature of SMA firms means that the technical skills required can be different to a large firm.

2 Survey: Technical skills

Participants undertaking the survey were informed that each question refers to a specific graduate attribute and requires the statement to be considered in the context of a graduate commencing within their SMA firm. A summary of responses pertaining to technical skills is shown in Table 4, and generic skills in Table 5 in the following section. Each column includes the number of responses for each selection and skill, with the final column including a weighted average score (WA), which is calculated by allocating the values to each participant's response in relation to each skill.⁶⁷ Due to the small sample size it cannot be definitively concluded that a skill showing a higher WA score will be preferred over one with a lower score.⁶⁸

⁶⁷ The values shown are used to determine the WA score for each skill: a WA score of 7.0 would indicate all respondents very strongly agree with the statement, whilst a score of 1.0 would show all respondents very strongly disagree (Very Strongly Disagree (1); Strongly Disagree (2); Disagree (3); Neutral (4); Agree (5); Strongly Agree (6); Very Strongly Agree (7)).

⁶⁸ L Douglas Ried, 'Using Likert-type and Ipsative/Forced Choice Items in Sequence to Generate a Preference' (2014) 10 *Research in Social and Administrative Pharmacy* 598.

Table 4: Survey: Technical skills

Technical skill	Very Strongly Disagree	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Very Strongly Agree	WA score (1–7)
Financial statement preparation	0	0	0	2	1	3	6	6.08
Spreadsheets/book-keeping	0	0	0	1	2	3	6	6.08
Taxation	0	0	0	2	2	2	6	6.00
Accounting industry software	0	0	0	1	2	6	3	5.92
Accounting intern/work experience	0	0	0	3	5	2	2	5.25
Business law	0	0	1	2	6	2	1	5.00
Accounting research	1	0	0	3	4	2	2	4.92
Taxation planning	0	0	2	5	1	2	2	4.75
Accounting standards and IFRS	1	0	0	3	7	0	1	4.58
Audit	0	0	0	8	3	0	1	4.50
Weighted average all responses								5.31

Consistent with the interviews, the top technical skills required by a work-ready graduate of a SMA firm were financial statement preparation (6.08), spreadsheets/book-keeping (6.08), taxation (6.0), and accounting industry software (5.92). This supports that a core understanding of tax principles is highly desirable for a graduate to be work-ready when commencing with a SMA firm (although it should be noted there were two neutral responses). Interestingly, the more advanced concept of ‘Tax Planning’ was not as desired for a work-ready graduate (4.75). This could reflect that a graduate at the commencement of their career is more likely to be involved in ‘compliance’ work rather than strategic tax ‘advisory’ work. It may be that as their career advances then more advanced tax planning knowledge could be required.

The second group of skills involved accounting intern/work experience (5.25), business law (5.0), accounting research (4.92), and taxation planning (4.75), and the third group of skills were accounting standards and International Financial Reporting Standards (IFRS) (4.58) and audit (4.50).

The survey data supports the interview findings, with financial statement preparation achieving the equal highest WA score of 6.08, confirming that it is a skill most participants strongly agree is required for graduates. The significance of Excel and spreadsheets is also noted, also achieving an equal highest WA score of 6.08.

Survey results support the interview findings, with a WA of 6.00 for taxation, which is also in the highest scoring group, indicating a strong agreement overall that taxation is a required skill for a graduate.

Accounting software received a high scoring WA of 5.92. Taxation software was not separately noted; however the interview showed that participants presumed this as a component of taxation skills due to the prominence of electronic preparation and reporting.

Accounting standards and IFRS were indicated as one of the less critical technical attributes, receiving a WA score of 4.58. Along with audit (WA = 4.50), this was in the lowest scoring group. This supports the argument that SMA firms do not consider accounting standards a requisite technical skill for a commencing graduate, noting also that accounting standard application will typically be linked to audit skill.

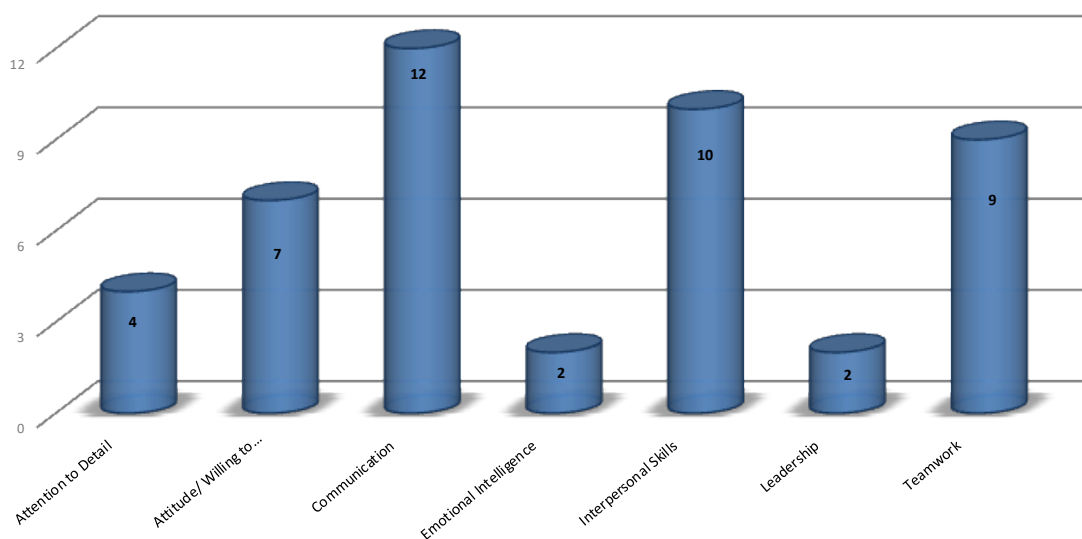
Overall, it appears that tax, financial statement preparation and software knowledge are the top technical skills required for work-ready SMA graduates. The generic skill requirements of a graduate commencing at a SMA firm are considered next.

B Desired generic graduate attributes

1 Interview: Generic skills

Participants were also asked to consider the generic attributes they find desirable for a graduate accountant. Generic skills include communication skills, leadership, teamwork and interpersonal skills. Figure 2 shows the seven most frequently noted generic attributes discussed by participants during the interview process. The responses highlighted the different methods, and contexts for the overwhelmingly desirable communication skills, with some discussions notably overlapping with other generic skills. The attributes shown in Figure 2 are considered below.

Figure 2: Desirable generic attributes for an ideal SMA firm graduate accountant



(a) Communication

Communication skills were found to be perceptively broad, including verbal and written communication as well as listening skills. The desired communication skills may relate to interactions with clients, as well as colleagues and senior staff within the firm. When interview participants were asked what specific generic attributes, they desire in an ideal graduate within their SMA firm, 100 per cent of participants (n=12) included communication skills.

Written communication skills were identified as important for the drafting emails or letters to clients, with participants clarifying their concerns regarding spelling, grammar and general coherency, noting that 'if the spelling and grammar are wrong, it is embarrassing' (P12). Employers want a graduate who can 'draft coherent emails and advice ... because some people just don't have the skills' (P4). It is noted that graduates are typically only drafting communications upon commencing employment, with the email usually forwarded to a 'manager for checking' (P12) so the more experienced person can make sure 'they have got those business communication skills and can write things to clients well, and be very clear in what they are asking for' (P7).

Whether clients meet with graduates in a face-to-face situation upon commencement is a practice that is particular to each SMA firm. One participant noted that client meetings and oral communications with clients wouldn't be occurring yet because 'at that level you wouldn't need face-to-face client communication' (P12). However, a different SMA firm participant stated that they 'expect the graduate to be able to talk to clients straight away, so communication skills are really important' (P7). It was also emphasised that the role of the accountant remains very service-focused, requiring graduates to not only be knowledgeable but to be able to communicate that knowledge, noting that 'communication is becoming far more essential, there aren't many roles for people who are just smart' (P4).

Written and oral communication skills also include effective communication, which must be 'worthwhile and useful, so that people don't have to then keep asking questions ... being able to ask an effective question of the client' (P5). Effective communication may require simplicity, where graduates use jargon instead of 'simple English ... explain things clearly and slowly so that the client understands' (P9). Communicating critical information is also essential, being mindful of time management for compliance deadlines, including 'communicating where there is a shift with regards to deadlines or with regards to time, budgets, etc' (P5):

Communication is a really important thing in our game because ultimately we are in the people game, most people can do the stuff we do, most firms can do things and obviously at different standards, but the great skill is communicating what you are doing to the population because they have zero idea and unless you do that, you can't go very far (P7).

(b) Interpersonal skills

Interpersonal skills can include effective listening, knowledge transfer, understanding group dynamics and collaborating with colleagues.⁶⁹ Much of the discussion surrounding interpersonal skills provides overlap with the communication findings, however it was considered separately to highlight the significance of communicating with colleagues in the workplace:

They need to be able to communicate with other people and ask questions (P12).

The administration staff, you need to know how to get along with them very well because they are critical to what you do (P7).

Interpersonal skills were considered critical in relation to a specialist SMA insolvency practice, 'because of the volatility of this type of work, really high communication skills including empathy and the ability to listen' (P3). Another participant highlighted the personal nature of long-standing client relationships within a smaller firm, identifying the desire to uphold their customer interaction ideals, 'we need someone that has patience and respect and passion, because accountancy is something that is very personal' (P9).

(c) Teamwork

Teamwork has been described as contributing expertise to a team of colleagues so that a solution may be collectively ascertained for a common problem within a typical context.⁷⁰ Communication with colleagues was previously discussed within the realm of interpersonal skills, yet contributes to the generic skill of teamwork as it involves 'working in a team and having the right attitude to get along with everyone else' (P12). It is argued that 'if you've got communication skills, you've generally also got the ability to develop teamwork skills because you can communicate' (P8).

Nine participants (75 per cent) acknowledged teamwork as a desirable skill. The major theme arising regarding teamwork is working as a team to achieve client goals, as well as the goals of the SMA firm. As part of a team, a graduate may 'have to answer the phone, or fill the photocopy paper ... there will be mundane, routine, boring tasks that they will have to do as part of learning the ropes' (P2), but everybody needs to work together. In achieving the best possible outcome, it was noted 'we've got thirty people here with thirty different perspectives and knowledge levels' (P7) to assist with efficiency. Similarly:

In terms of being efficient, in terms of sharing knowledge, in terms of finding better ways to do things, it is important that people are willing to be open and share where they've had troubles or be able to share where they've had wins so that everyone can learn or win from it (P5).

Teamwork is extremely important, we don't have people who are all about themselves, we just have teamwork and everyone works together ... our little firm is like a family,

⁶⁹ Daff, De Lange and Jackling, above n 50.

⁷⁰ Bayerlein and Timpson, above n 1.

we're not family but we work together ... common goal to do well for the client and everybody contributes (P9).

(d) Attitude and willingness to learn

A good attitude, a willingness to learn, and career enthusiasm and motivation were considered together for this study. A desire for graduates to exhibit the right attitude, motivation or enthusiasm toward their career, or willingness to learn was discussed by seven participants. Comments included a desire for respectful and professional graduates in the early stage of their career, by 'having that attitude and keeping in perspective as to where they sit as far as their career goes and their development' (P2); 'they need to be respectful of others, and realise that they need to learn and need to be patient before moving forward' (P12). In conjunction, the willingness to learn can be revealed with the correct attitude:

You need someone that is willing to do the work and start at a lower level and not have attitude about it. They are on the lower income and they are going to do the lower type of work, and they need to suck it up (P12).

It is important that graduates respect their position, but this does not mean they should be stagnant in progressing. A motivated graduate who is enthusiastic about developing their career is also desirable, 'if you've got the self-drive to learn in a short period of time then you'll go places' (P7). One participant explains, 'we look for someone that has the ability and enthusiasm to bring their career forward' (P8) so that the graduate may be developed into a future senior employee. Additionally, it is recognised that 'aptitude, like initiative, in general is huge and as an employer you appreciate it when they have it' (P1).

(e) Emotional intelligence

Emotional intelligence (EI) was discussed as being desirable for a SMA firm graduate, with one participant stating, 'emotional intelligence is just as critical if not slightly more important than technical ability' (P2). It was claimed that 'it is very difficult to teach emotional intelligence' (P8), arguably because it is so broadly defined. Daff et al, describes EI as comprising four broad competencies: self-awareness, self-management, social awareness, and relationship management, each of which consists of further skills including (but not limited to) self-confidence, adaptability, initiative, empathy, leadership and teamwork.⁷¹ However, only two interview participants (n=2) recognised EI as desirable, a comparatively low response given the prominence of EI in the literature.⁷²

The low discussion rate of EI by participants during interviews may be attributed to its broad definition, which encompasses other skills that have already received attention. Self-management, teamwork and adaptability have been discussed in previous sections, along with interpersonal skills, which are recognised as another broad skill with overlapping features.⁷³ Despite limited discussions under these broad headings, this demonstrates support for graduates to display EI as:

⁷¹ Daff, De Lange and Jackling, above n 50, 632, Figure 2.

⁷² Ibid; De Villiers, above n 46; Samantha Sin, Anna Reid and Alan Jones, 'An Exploration of Students' Conceptions of Accounting Work' (2012) 21(4) *Accounting Education* 323.

⁷³ Sin and McGuigan, above n 12.

They tend to develop more quickly because they are able to get deeper relationships with their workmates and their clients earlier, and that then allows them to explore opportunities and develop and move up the career chain (P8).

(f) Leadership

Leadership was also identified; however, it was discussed in terms of not being required early within a graduate’s career:

Leadership is something that is developed through watching other people and through an understanding of where you want to go in your career, which generally is just too early for graduates to have a good understanding of (P8).

2 Survey: Generic skills

Part 3 of the survey explained ‘generic attributes’ as those that can apply across a broad range of contexts and may be obtained by completing any degree. Participants were asked to select the extent to which they agree or disagree that each skill is needed by a graduate commencing within their SMA firm. The results are set out in Table 5 – the final column includes a WA score, calculated as above and using a single response from all 12 participants.

Table 5: Survey: Generic skills

Generic skill	Very Strongly Disagree	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Very Strongly Agree	WA score (1–7)
Oral and written communication	0	0	0	0	3	4	5	6.17
Teamwork	0	0	0	0	3	5	4	6.08
Ethics and professionalism	0	0	0	0	3	6	3	6.00
Self-management	0	0	0	0	4	5	3	5.92
Interpersonal skills	0	0	0	1	2	7	2	5.83
Information technology	0	0	0	0	5	6	1	5.67
Motivation and enthusiasm	0	0	0	1	4	5	2	5.67
Flexibility and adaptability	0	0	0	1	5	4	2	5.58
Creative problem-solving	0	0	0	2	3	6	1	5.50
Leadership	0	1	2	5	4	0	0	4.00
Weighted average all responses								5.64

The analysis indicates that most participants agreed the listed generic attributes are required for a graduate, with leadership skills (4.0) scoring the lowest WA score. Oral and written communication (6.17), teamwork (6.08), and ethics and professionalism (6.00) received the highest group of WA scores. The second group included self-management

(5.92), interpersonal skills (5.83), information technology and motivation and enthusiasm (5.67), flexibility and adaptability (5.58) and creative problem-solving (5.50).

Survey data demonstrates support for oral and written communication as a desired generic attribute, with the highest WA score of 6.17 from a possible 7.00. The discussions demonstrate that communication remains important for many aspects of the graduate's role, however, oral communication is not restricted to just clients, with the skill also important for 'communicating with other staff' (P1), which may be better described as an interpersonal skill.

The survey data supports the notion that 'teamwork is important' (P10), with all responses in agreement, leading to a very high WA score of 6.08. This shows that although 75 per cent of interview participants identified teamwork as a desirable generic attribute, 100 per cent of survey responses support it as a requisite quality in a work-ready graduate.

Interpersonal skills also received a high level of support, scoring a WA of 5.83. This provides support for concluding that interpersonal skills are also considered one of the most desirable generic attributes for graduates within a SMA firm.

Self-management, ethics and professionalism, motivation and enthusiasm, and flexibility and adaptability, were listed separately within the survey to enable participants to give individual responses for each. Ethics and professionalism received a WA score of 6.0, followed closely by self-management with 5.92. Motivation and enthusiasm also received a reasonably high score with 5.67, whilst flexibility and adaptability had a WA of 5.58. The weighted average scores ranging from 5.58 to 6.0 indicate that these are generally perceived as skills required by a work-ready graduate in a SMA firm.

Leadership received the lowest WA score across all 20 technical and generic skills listed in the survey with 4.0. This corresponds with the statement noting that 'leadership doesn't matter because that can be developed along the way' (P6), where it is recognised as a good skill to have but it is not required in the early career stages.

C Technical or generic: Which is more important to SMA firms?

1 Interview: Comparison

Upon recognising the desirable technical and generic skills for a graduate within their SMA firm, participants were asked to compare the two sets of skills to identify if one is generally considered more important. Two-thirds (66.6 per cent) identified both groups of skills as essential, noting equal importance:

They are both as important as each other, I think you need the whole combination of having the technical skills but also being able to communicate and get along with other people is as important (P12).

They are equally important, you can be the most lovely, hard-working, good communicator but if you don't know accounting and tax then you are not useful to us (P7).

It was argued that whilst both are important, emphasising one group over the other will depend upon the employment role: 'it is really 50-50, I mean the best result is a broad range of skills across both of those areas but it depends on the role' (P5). A lack of

graduate employment opportunities may also highlight the symbiotic nature of the two types of skills and why it can be artificial to discern between them:

I think it is very important for a graduate to demonstrate both, generic skills are more important for a graduate but the technical skills will give them an advantage in getting employed (P6).

If somebody has completed a degree, I would expect that they have completed it very well ... I can't teach traits but I can teach knowledge, so for me the personal attributes are much more important than the academic ones (P9).

Yap et al identified a shifting focus on generic skills due to a presumption that technical skills will already be adequate.⁷⁴ Whilst both are necessary, participants identified that generic skills would take priority if skills were lacking due to the difficulty of teaching generic skills compared to teaching technical skills:

If I had to choose one it would be the interpersonal skills because I can always teach them how to read a balance sheet (P3).

I can teach them software but I cannot teach them how to work in a team and how to communicate (P10).

This raises an interesting question of how generic skills can be developed if it is perceived by some SMA firms that it is easier to teach technical skills compared to generic skills. This could represent a skill or confidence (or time) constraint with the SMA participants themselves. This could support the notion that, for SMA firms (compared to larger firms), generic skills may be more important than technical skills, due to the capacity and resource constraints on being able to develop generic skills.

2 Survey: Comparison

The survey data presented in Table 6 provides an overall comparison between generic skills and technical skills required by SMA firms. The median values of the weighted averages are calculated for each attribute across all 12 survey responses, resulting in a technical median WA score of 5.13, and a generic median WA score of 5.75. This observation may be used to demonstrate a higher level of agreement across the entire class of generic skills when compared to the class of technical skills.

Table 6: Comparison of technical vs generic skills

Technical skills	WA	Generic skills	WA
Financial statement preparation	6.08	Oral and written communication	6.17
Spreadsheets/book-keeping	6.08	Teamwork	6.08
Taxation	6.00	Ethics and professionalism	6.00
Accounting industry software	5.92	Self-management	5.92

⁷⁴ Yap, Ryan and Yong, above n 44.

Accounting internship/work experience	5.25	Interpersonal skills	5.83
Median WA technical skills	5.13	Median WA generic skills	5.75
Business law	5.00	Information technology	5.67
Accounting research	4.92	Motivation and enthusiasm	5.67
Taxation planning	4.75	Flexibility and adaptability	5.58
Accounting standards and IFRS	4.58	Creative problem-solving	5.50
Audit	4.50	Leadership	4.00
Mean of individual weighted averages	5.31	Mean of individual weighted averages	5.64

The mean WA for technical skills was calculated as 5.31, which demonstrates a reasonable level of agreement when considered against the scoring range of 1.0 (very strongly disagree) up to 7.0 (very strongly agree). In comparison, the mean WA score of the generic skills was higher at 5.64, which may indicate that there is a higher overall level of agreement for SMA firms for the need for generic skills. However, it is argued that employers may already assume the presence of technical skills as a result of completing the accounting undergraduate degree, and subsequently place more emphasis on the generic skills, which may be reflected here and could be the difference in the graduate succeeding in the workplace.

D Technical or generic: Does firm size really matter?

After discussing whether technical or generic skills are more important for a graduate commencing within a SMA firm, an additional question was posed to establish the significance of the working environment context. Participants were asked if they believe a large firm would provide a different preference for desirable skills compared to their SMA firm. Responses varied; however, common themes developed with some arguing a different outcome would arise whilst others suggested no difference.

1 Generalist or specialist employment role

Several participants distinguished the technical skill requirements for SMA firms, noting the broader range of knowledge and technical skills that are needed for a broader range of work typically conducted by the SMA firm. Alternatively, it was stated by the participants that a larger firm may involve a narrower range of technical skills but a more in-depth knowledge may be required: 'the bigger the firm, the more emphasis is put on their academic record, and technical skills and technical expertise' (P1); such that a higher level of technical skills and knowledge may be preferred when compared to the SMA firm conducting a wide array of non-specialist services:

A firm our size we are exposed to a lot broader range of work and it's important that we are able to wear a bunch of different hats ... We are filling more general positions so we would need more generally skilled candidates (P5).

It was also recognised that certain technical attributes will not be required for non-SMA firm graduates, highlighting the different opportunities presented by large accounting firms that will 'look to fill specific technical roles' (P5):

If you go and work at KPMG then you will probably need to know the accounting standards ... you'll do a lot of study around consolidations and tax effect accounting (P7).

Large firms are looking for someone to work in a specific area and they would be more interested in the technical skills (P11).

When you are bigger you can put someone in a specialist area and they can deal with repetitive tasks, but when you're smaller, you need more of a generalist that's good at everything (P3).

Overall, this would tend to suggest that graduates of a SMA firm need a broader knowledge base compared to those who commence with a larger firm.

2 *Office environment*

It is suggested that a large firm will not require graduates to interact as closely with colleagues, whereas in the office environment of a 'smaller firm you've got a huge emphasis on the cultural aspect. Will they fit in? Are they the right person for the job?' (P1). Further concerns may develop where a SMA firm provides graduates with the opportunity for interaction with clients sooner than in a large firm that includes more senior staff. The query, 'am I going to be able to let them talk to people?' (P1) will arise where the smaller number of staff requires the graduate to commence seeing clients earlier, recognising:

A major thing is people skills so they just kind of fit ... with the smaller firm, they need to be a bit more interactive with clients (P10).

When you are in a larger firm you are less likely to speak to the client base within the first three years, whereas with us, we need you to be speaking to people. We basically give you a list of clients to look after and expect you to do everything for those clients so you really need to communicate from day one (P7).

Given that client interaction could occur at an earlier date for a graduate at a SMA firm this would tend to support the notion that communication skills could be more critical (or at least the context different) for them compared to a graduate commencing with a larger firm.

3 *No distinction*

Several participants stated that a consistent desire for interpersonal skills is expected, 'in a large firm you still have small groups of people in teams, but there are just more teams' (P12). It was also suggested that the graduate requirements will be comparable, as 'they are pretty much going to want a 50-50 combination of technical and generic skills and for them being job-ready would be the same as the smaller firms' (P2). In relation to generic skill requirements, it was suggested there is no difference for these:

I don't believe size will really affect the expectation ... maybe large firms will require higher performance or more work experience on their resume but they will still come back to the basics and be expecting those generic skills (P6).

Overall it does appear there is some difference in the skills required by graduates if commencing with a SMA firm compared to a large one. This particularly appears with the notions of needing a broader knowledge base (including a greater need to understand tax and to be able to use tax software), with less importance on accounting standards. Also, a graduate at a SMA firm is more likely to need to be able to effectively communicate at an earlier stage with clients rather than just colleagues. Additionally, SMA firms may give a greater preference to generic skills compared to technical skills, if for no other reason than having less capacity and confidence in being able to improve graduates' generic skills. Of course, given the sample size, these initial observations could be the basis of a larger survey.

E Should graduates be work-ready?

In addressing the possible insufficiency of skills in graduates, interview participants were asked whether graduates should be work-ready or whether on-the-job training is sufficient. Whilst most participants recognised that there is a necessary element of on-the-job training, they agreed that it usually pertains to the systems and processes of the firm. Three-quarters (75 per cent) of participants noted the university as responsible for preparing a graduate as work-ready, although the employer and the graduate are also considered responsible to a varying extent.

The training provided to graduates upon commencement was also investigated, with all participants noting the immediate provision of a taxation training programme (internal or external) with the exception of one participant whose specialist insolvency firm does not provide taxation services. Participant firms without an internal training programme typically use services provided by the National Taxation and Accountants Association, the Tax Institute, or a new employee programme run by the CAANZ or CPA Australia to give their graduates the taxation skills necessary to perform in their roles. This training cost is incurred by the employer, and demonstrates a requirement for more suitable taxation skills for graduates seeking employment within SMA firms. This practice of providing additional 'tax' training to SMA graduates as they commence would provide further support of how important technical tax knowledge is for graduates commencing with a SMA firm. Additionally, it raises concerns about the current adequacy of the tertiary education accounting graduates are receiving in their undergraduate accounting degrees.

Given the findings and the current challenges facing the accounting industry (such as outsourcing and technology), recommendations are provided in the next section.

V RECOMMENDATIONS

As observed by Juchau and Neale:

Designers, mindful of the economic significance of tax and the growth of work for tax practitioners, have incentives to keep their accounting degrees relevant to a major domain of accounting work and therefore attractive to career-oriented under-graduates.

This, in part, gives designers an economic and competitive justification for ensuring taxation is available in their degree courses.⁷⁵

We argue that universities should be particularly proactive if they consider that their accounting graduates are more likely to gain employment with SMA firms. As Pan and Perera argue accounting degrees can't just simply align with accreditation guidelines,⁷⁶ universities must be proactive to ensure the appropriate skill and knowledge development of graduates given their likely employment outcomes. With this in mind a number of recommendations are formulated given the results.

Participants identified a lack of technical skills in current graduates, which are usually implemented after employment is commenced, consuming the resources of the SMA firm employer. In order to address this, the university curricula could be investigated and adapted to provide graduates with the opportunity to develop these skills where they seek to pursue employment with a SMA firm. Particularly, accounting software and taxation software skills are recognised as desirable yet lacking from graduates, even though they are identified as necessary for the typical introductory graduate work performed. It is argued that the desirability for software knowledge is implied as part of taxation skills due to the prominence of electronic preparation and lodgements for accounting firms, SME or other taxpayers. Interview participants noted that immediate taxation training was typically necessary for graduates, with some questioning why this couldn't be implemented at the undergraduate stage. With the high proportion of domestic undergraduates being employed by SMA firms, consideration should be given to offering non-compulsory courses that address the inadequacy of taxation skills in the SMA firm context. This may ultimately increase employability and decrease the incentive for SMA firms to find alternative and more cost-effective solutions, such as outsourcing.

Accounting accreditation may need to be altered to encourage universities to change the course offerings for taxation, as accreditation is a large driver for curriculum change.⁷⁷ CAANZ currently requires the completion of a compulsory taxation course for accreditation. Until recently, CPA Australia only required that a taxation course is made available to students, but from mid-2018 CPA Australia now requires a tax course to be completed as part of an undergraduate accounting degree. It can be argued that two tax courses should be required, mirroring an accreditation requirement from some 30 years ago.⁷⁸ Alternatively, it is suggested that content within the taxation course be adjusted to reflect the inclusion of current taxation software and the possible introduction of case study assessment requirements involving authentic assessment.⁷⁹

Communication and interpersonal skills were also identified as required, yet the levels of these skills are typically identified as not sufficient. It appears that the practical application has not been entrenched, with graduates lacking the ability to draft

⁷⁵ Juchau and Neale, above n 32, 33.

⁷⁶ Pan and Perera, above n 30.

⁷⁷ Brett Freudenberg and Dale Boccabella, 'Changing Use of Business Structures: Have University Business Law Teachers Failed to Reflect This in Their Teaching?' (2014) 9(1) *Journal of the Australasian Tax Teachers Association* 80.

⁷⁸ Freudenberg, above n 37.

⁷⁹ Liz van Acker and Janis Bailey, 'Embedding Graduate Skills in Capstone Courses' (2011) 7(4) *Asian Social Science* 69.

appropriately written client communications, or effectively engage with clients and colleagues. In addition, the generic skills of teamwork, good attitude, and willingness to learn were acknowledged as necessary for a work-ready graduate. Whilst these generic skills may be within the university curricula, it is recommended that their current presence is investigated to determine a more effective means of enhancing these skills. It is acknowledged that Work Integrated Learning (WIL) can improve written and oral communication skills, interpersonal skills, and teamwork⁸⁰ and any proposed recommendation could incorporate a form of WIL, which can assist in improving these skills.

It is suggested that there should be greater awareness of the importance of all communication skills to both academics and students in the accounting industry. Academics should be encouraged to provide more opportunities for students to develop their written and verbal communication skills, with ample opportunity to enhance these skills throughout their degree. The adoption of authentic assessment pieces such as client interviews, business letters of advice and presentations could provide many opportunities on campus during the undergraduate degree to enhance these critical skills. By remaining aware of the central role that communication plays, students may be encouraged to take greater opportunity to develop these skills.

Suggestions by participants included the implementation of more practical course work within the curricula, or a WIL programme, referring to on-campus or workplace learning experiences that combine theory with practice, and require collaboration between the accounting firm participants and educational institutions.⁸¹ However, typical WIL programmes can prove very resource intensive for the employer,⁸² and are often undertaken by only a minority of students. Due to the high resources typically incurred by participants, it is suggested that a viable WIL alternative should be offered to graduates during the final stages of the undergraduate programme such that it can be undertaken by students tending toward SMA firm employment.

In consultation with SMA firm employers, it is suggested that an on-campus workplace simulation may be developed that teaches and enhances the technical skills for business software, taxation and taxation software, whilst also providing the opportunity to develop the generic skills of communication, teamwork and interpersonal skills.⁸³ The introduction of a simulated WIL programme could reduce the overall SMA firm resources expended, which in turn may see graduate employment rates maintained. It could involve authentic assessment using constructed client case studies, which is shown to facilitate higher order thinking, improve communication and critical thinking, and promote

⁸⁰ Brett Freudenberg, Mark Brimble and Craig Cameron, 'WIL and Generic Skill Development: The Development of Business Students' Generic Skills through Work-Integrated Learning' (2011) 12(2) *Asia-Pacific Journal of Cooperative Education* 79.

⁸¹ Denise Jackson, 'The Contribution of Work-Integrated Learning to Undergraduate Employability Skill Outcomes' (2013) 14(2) *Asia-Pacific Journal of Cooperative Education* 99.

⁸² Riccardo Natoli, Beverley Jackling, Friederika Kaider and Colin Clark, 'Mapping WIL Activities in the Curriculum to Develop Graduate Capabilities: A Case Study in Accounting' (2013) 14(2) *Asia-Pacific Journal of Cooperative Education* 75.

⁸³ Nava Subramaniam and Brett Freudenberg, 'Preparing Accounting Students for Success in the Professional Environment: Enhancing Self-efficacy through a Work Integrated Learning Programme' (2007) 8(1) *Asia-Pacific Journal of Cooperative Education* 77.

knowledge transfer to the workplace setting.⁸⁴ The workplace simulation could be added as an elective course toward the end of an undergraduate accounting degree, or offered as a full-fee four-week intensive course after completion of the final university semester and prior to commencing graduate employment. It is argued that this may alleviate employer concerns by providing improved work-ready graduates to SMA firms.

VI LIMITATIONS OF RESEARCH AND FUTURE RESEARCH

The scope of this study is limited to SMA firm employers with no comparative research being undertaken concerning larger or government accounting employment contexts. A restricted geographical scope exists due to the preference of face-to-face interview strategies, involving willing participants operating within the Gold Coast–Brisbane region (Queensland). Additionally, it was not possible to test for a non-response bias.

Regard must also be had to the potential biases of the researcher, in ensuring that the design protocol does not allow any bias to influence the face-to-face interview data obtained. This was addressed by ensuring the researcher was conscious of maintaining an open mind and remaining receptive to all information presented,⁸⁵ along with compiling verbatim transcriptions upon completion of each interview.

The research indicates that SMA firm employers are not willing to employ graduates without some level of the desired generic skills such as communication, teamwork, and interpersonal skills. Further research could be used to investigate how well these are embedded during the accounting undergraduate degree, and to provide alternative ways to enhance these skills through practical application to a SMA firm environment. Additionally, future research could consider effective ways of integrating software knowledge and skills into the accounting curriculum.

VII CONCLUSION

The required skill for a graduate to obtain employment is a vexed question. In the accounting context a number of prior studies have analysed what accounting graduates need. However, many of these prior studies did not focus on these attributes from the perspective of SMA firms, even though they can account for 40 per cent of graduate employment. It was argued that the SMA firm perspective could be different to other sectors. First, this article outlined the literature in terms of technical and generic skills, what this means and their desirability for graduates. Then the research design and method was provided, which included interviews and a short survey of SMA firms. The results indicated that the desired technical skills of accounting software, taxation knowledge and taxation software, and double-entry book-keeping are lacking or insufficient in graduates. Indeed, it seemed that tax knowledge was an important part of the technical skills required by graduates of SMA firms. In addition, the generic skills of

⁸⁴ Susan Kossman, 'Authentic Assessment for RN Students: Writing Case Studies and Teaching Projects' (2005) 44(2) *Journal of Nursing Education* 96.

⁸⁵ Anthony J Berry and David T Otley, 'Case-Based Research in Accounting' in C Humphrey and B Lee (eds), *The Real Life Guide to Accounting Research: A Behind-the-Scenes View of Using Qualitative Research Methods* (Elsevier Science, 2004) 231–55.

communication, teamwork, good attitude and interpersonal skills are also recognised as assisting to make the graduate work-ready in the SMA firm environment. In a competitive tertiary sector a number of suggestions were proposed to develop these skills, which included the introduction of a simulated WIL programme for graduates seeking employment within a SMA firm, or further development of current university curricula.

Given the importance of SMA firms with graduate recruitment it is critical that regard is given to the requirements of employers if the issue of employability is to be addressed. The increasing incidence of outsourcing typical graduate work, together with the decline in sufficiently skilled graduates, is a serious issue that must be addressed by change. With a better understanding we can better equip accounting graduates, which can assist the sector to address the challenges that it faces, and make the most of the opportunities it presents.

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INLAND REVENUE'S NEW CIRCULAR COMPLIANCE MODEL – AN OVERVIEW

ALISTAIR HODSON*

ABSTRACT

New Zealand Inland Revenue adopted the Braithwaite Compliance Model in 2001. It was regarded as transformational at the time it was introduced. More recently Inland Revenue have developed and adopted a new circular compliance model. At the centre of the new model is the 'Customer'. The new model builds upon the Braithwaite Compliance Model and was released in late 2015. This paper examines why the Braithwaite Compliance Model was replaced and provides an overview of the new circular compliance model with its One, Three, Five, and Seven aesthetic. It considers whether the various wheels of the new compliance model will lead to an improved tax compliance environment for New Zealand. The conclusion is that the new compliance model is a thinking tool with positive sentiment and recognises that compliance decisions and the interface between a revenue authority and its customers remains multifaceted.

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I INTRODUCTION

The Wind and the Sun were contemplating who was the greatest. One day they saw a man walking along a road and decided to settle their dispute by way of a challenge. 'Whoever can remove the man's coat will be the strongest' they decided. The Wind blew and blew, only to cause the man to hold on more tightly to his coat. The Wind eventually gave up in despair. The Sun then radiantly shone upon the man, who in a short while voluntarily removed his coat.¹

Improving taxpayers' voluntary compliance is an important goal of tax authorities worldwide. However, this goal is not always easy to achieve as not all taxpayers respond to their tax obligations in the same way.² There have been myriad studies³ examining tax compliance over the last few decades. In the early days of empirical tax compliance research, the work of Schmolders,⁴ Spicer and Lundstedt,⁵ Vogel⁶ and others challenged the confines of economic self-interest models in the tradition of Allingham and Sandmo⁷ and stressed that non-economic social factors such as social norms and individual morality could have a significant impact on taxpaying behaviour.⁸ In 2015, Inland Revenue adopted a new circular compliance model that visually recognises the importance of focusing on the customer (taxpayer) first, the importance of influencing norms, and the importance of 'upstream' prevention. Rather than reacting to non-compliant behaviour, the emphasis is placed on how it can be stopped (or reduced) from happening in the first instance.

Plato is noted as saying 'when there is an income tax, the just man will pay more and the unjust less on the same amount of income'⁹ indicating attitudes, personal morals, social norms, opportunity, values, as well as trust in the institution are important. Taxation is recognised as a two-way relationship between the payer (customer) and the collector and this intersection of the two parties is very important. The attitude of the tax collector/revenue official can also play a relevant part in this context. The compliance

¹ Adapted from Aesop, 'The Sun and the North Wind' (500BC): University of Massachusetts Amherst, *Aesop's Fables: The Wind and the Sun* <<https://www.umass.edu/aesop/content.php?n=31&i=2>>.

² Lin Mei Tan and Valerie Braithwaite, 'Agreement with Tax Practitioners' Advice under Tax Law Ambiguity' (2011) 17 *New Zealand Journal of Taxation Law and Policy* 267.

³ See, eg, Betty R Jackson and Valerie C Milliron, 'Tax Compliance Research: Findings, Problems and Prospects' (1986) 5 *Journal of Accounting Literature* 125; Maryann Richardson and Adrian J Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137; Ken Devos, *Factors Influencing Individual Taxpayer Compliance Behaviour* (Springer, 2014).

⁴ Gunter Schmolders, 'Survey Research into Public Finance: A Behavioural Approach to Fiscal Theory' (1970) 25(2) *Public Finance* 300.

⁵ Michael W Spicer and Sven B Lundstedt, 'Understanding Tax Evasion' (1976) 21(2) *Public Finance* 295.

⁶ J Vogel, 'Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data' (1974) 27(1) *National Tax Journal* 499.

⁷ M Allingham and A Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1(3-4) *Journal of Public Economics* 323.

⁸ M Wenzel, 'An Analysis of Norm Processes in Tax Compliance' (2004) 25 *Journal of Economic Psychology* 213.

⁹ Goodreads, *Plato* <<https://www.goodreads.com/quotes/93726-when-there-is-an-income-tax-the-just-man-will>>.

model's interface is at the junction of where the taxpayer (customer) and the revenue authority meet.

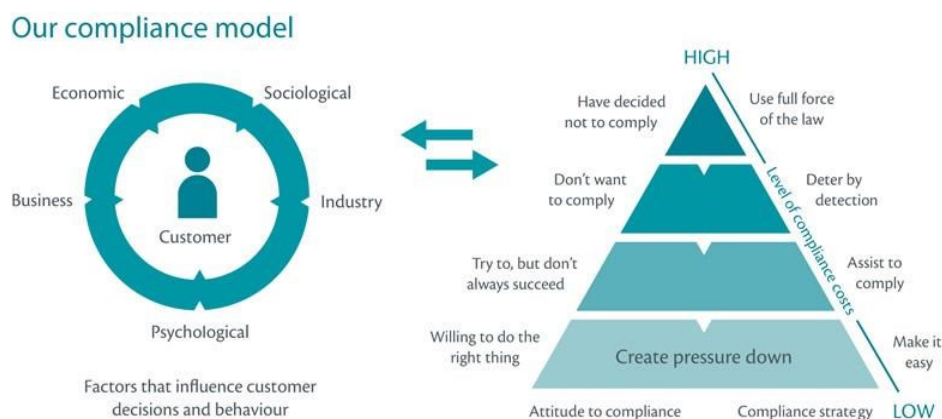
Section II of the paper provides a brief history and background to the Braithwaite Compliance Model. The Braithwaite Compliance Model was used by Inland Revenue from 2001 until late 2015. Section III introduces the new circular compliance model, a 'thinking tool', adopted in 2015 from a health care context. This section provides a conceptual background to the new model. Section IV provides an overview of the three moveable wheels around the 'Customer' centre, the 'Behaviour Wheel', the 'Principles Wheel', and the 'Activity Wheel' contributing to the model's One, Three, Five, Seven aesthetic. It also considers Inland Revenue's customer and the customer lifecycle as well as the importance of personal, social and societal norms. Section V provides a brief discussion, limitations and conclusion.

II BACKGROUND

A The Braithwaite Compliance Model

The Braithwaite Compliance Model (Figure 1) was first introduced in New Zealand in 2001 and was transformational as it changed the way Inland Revenue looked at customers and how they thought about their compliance approach. The Braithwaite Compliance Model was formally introduced in Australia by the Australian Taxation Office (ATO) in November 2000 to improve compliance. In Australia there had been some opposition to the model being introduced with some staff seeing it as a threat to the validity of their roles. Others saw the cooperative compliance model as bringing some compassion to their work. One of the ATO challenges in promoting the Braithwaite Compliance Model was to convince auditors that the model enhanced their role rather than diminished it.¹⁰

Figure 1: The Braithwaite Compliance Model¹¹



¹⁰ Robert B Whait, *The Conception and Promulgation of Cooperative Compliance in Australian Taxation Policy: A Historical Study* (PhD Thesis, University of South Australia, 2013) 186.

¹¹ Source: Inland Revenue, New Zealand Government.

Inland Revenue had been enforcement focused and bringing in the Braithwaite Compliance Model helped the transformation of Inland Revenue to more of a service organisation.¹² The Model's key message was that most people 'wanted to comply' and only a small proportion did not. Inland Revenue could help these customers by 'making it easy' for them to comply.

The author understands the Braithwaite Compliance Model was very well regarded within Inland Revenue and popular amongst Inland Revenue staff. They liked the simplicity, and staff possibly created further simplicity to the model in the way they used it.

Whether Inland Revenue staff fully understood the Braithwaite Compliance Model is a matter for debate. Staff understood key messages from it with the 'make it easy' message appearing to resonate well with staff. One reason for considering the compliance model 'refresh' or change was that Inland Revenue considered they had moved beyond the Braithwaite Compliance Model and that it had not kept pace with changes in compliance thinking both within Inland Revenue and across the world. There was nothing wrong or 'broken' with the model, it was more about where Inland Revenue wanted to go with its compliance approach. One of the major issues considered by Inland Revenue was, instead of reacting to non-compliant behaviour, how could they stop it from happening in the first place. Nowhere in the Braithwaite Compliance Model was 'prevention', a 'top of the cliff approach', explicitly stated.

Linked with the prevention goal was clearly wanting customers to get it 'right from the start'. The 'Right from the Start' approach is very evident in the Organisation for Economic Co-operation and Development (OECD) literature¹³ and their approach to tax compliance. The 'Right from the Start' approach was first developed by the Swedish Tax Agency. The Braithwaite Compliance Model was very much a model to change how Inland Revenue staff *thought* about customers, whereas the new circular compliance model is designed to help focus Inland Revenue staff to think about how they should *help* customers.

New Zealand Inland Revenue, following the Australian Taxation Office (ATO), adopted the Braithwaite¹⁴ Compliance Model in 2001. In 2015 the Braithwaite Compliance Model was superseded by a new circular model adapted from a healthcare context. The proposal to develop a new model was signed off by Inland Revenue in November 2014. A person instrumental in the adoption of the new compliance model was on secondment to Inland Revenue having come from the Netherlands Tax and Customs Agency and was at the time one of the Co-chairs of the Small/Medium Enterprise Compliance Subgroup of the OECD.

¹² For discussion on the 'service' paradigm of tax administration, see James Alm et al, 'Taxpayer Information Assistance Services and Tax Compliance Behavior' (2010) 31 *Journal of Economic Psychology* 577.

¹³ See Organisation for Economic Co-operation and Development (OECD), 'Forum on Tax Administration: Small/Medium Enterprise (SME) Compliance Subgroup: Information Note: Understanding and Influencing Taxpayers' Compliance Behaviour' (OECD Publishing, November 2010); OECD, 'Tax Compliance by Design: Achieving Improved SME Tax Compliance by Adopting a System Perspective' (OECD Publishing, 2014); OECD, 'Right from the Start: Influencing the Compliance Environment for SMEs' (OECD Publishing, 2012).

¹⁴ Also referred to as the Ayres-Braithwaite model. See New Zealand Productivity Commission, *Regulatory Institutions and Practices* (June 2014) <<https://www.productivity.govt.nz/sites/default/files/regulatory-institutions-and-practices-final-report-ch3.pdf>> ch 3.

In 2014 Inland Revenue's Customer Strategy Team, based in Head Office, Wellington, introduced what they considered a more customer-centric focus, and a 'Right from the Start' approach, which is a fundamental part of the new compliance model. The 'Right from the Start' approach has four dimensions: acting in real time and up front; focusing on end-to-end processes from a customer viewpoint; making it easy to comply and difficult not to; and actively involving and engaging customers and stakeholders. A question sometimes considered is why do taxpayers (customers) comply with their obligations? Institutional theory¹⁵ posits that institutions themselves do not determine behaviour. Instead they provide a context that helps in understanding why actors make the choices they do.¹⁶ In late 2015 the new circular compliance model was integrated into Inland Revenue.

The author interviewed an Inland Revenue senior staff member to gather a background for this paper. A general observation of the Braithwaite Compliance Model was that some Inland Revenue staff understood it in its entirety; some people understood the model in full in terms of how the BISEP¹⁷ aspect on the left (Figure 1) interacted with the 'pyramid' on the right; but a lot of people found it difficult to apply (the BISEP side) and what they ended up doing was ignoring it and focusing on the 'pyramid' side of the model. A common experience of the Inland Revenue senior staff member¹⁸ as she would travel around Inland Revenue offices during the new circular model's integration phase would occur when she asked staff if they knew what the 'old model' was. There were many comments describing the old model similar to this one as follows:¹⁹

... Quite curious – they would all go 'I know what it is, it is a pyramid' and they would form a pyramid with their thumb and index finger. That is part of the model, it's only half of it, and one of the things we found is that people found the pyramid really easy to understand – (at the bottom of the pyramid) willing to do the right thing ... make it easy, (at the top of the pyramid) they don't want to comply, use the full force of the law ... they would ignore the five factors that went into determining the customer's attitude in the BISEP.

The two middle segments of the pyramid model ('Don't want to comply' and 'Try to, but don't always succeed') would also often be ignored. The staff understood some of the key messages but not the depth of the model. Part of what Inland Revenue were trying to do with implementing a new compliance model was to bring back the BISEP so that the depth around it is recognised.

¹⁵ Institutional theory has been described as a focus on the effects of institutions in society on political outcomes, including policy formation. M McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2009) 81, [4.200].

¹⁶ L Marriott, *The Politics of Retirement Savings Taxation: A Trans-Tasman Comparison* (CCH Australia, 2010).

¹⁷ The BISEP model addresses the different attitudes to compliance. It shows that there are a range of attitudes and they often differ depending on the situation. 'Business, Industry, Sociological, Economic and Psychological' (BISEP) are factors that influence taxpayer decisions and behaviour.

¹⁸ The Inland Revenue senior staff member was instrumental in the new circular compliance model's integration into Inland Revenue.

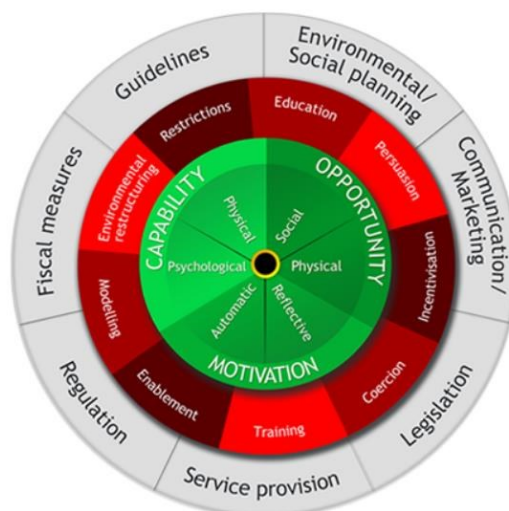
¹⁹ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

III THE NEW CIRCULAR MODEL – IT IS NOT A MODEL, IT’S A THINKING TOOL

A Conceptual background

The new Inland Revenue circular compliance model has ancestral links to the University College of London Centre for Behaviour Change and its Behaviour Change Wheel (Figure 2). This model was developed for a healthcare context and Inland Revenue thought it translated well to their enforcement-based approach.

Figure 2: Behaviour Change Wheel, University College of London Centre for Behaviour Change²⁰



B An overview of the design – The ‘moveable wheels’ aesthetic

The design of Inland Revenue’s new compliance model (Figure 3) and the deliberate ‘spinning wheels’ is very symbolic, it is a more conceptual flexible, changeable approach. The cardboard version of the circular Compliance Model has moveable ‘wheels’ that allow Inland Revenue staff using the model to vary their compliance approach to suit.

The new circular model is more customer-centric, and this was addressed very literally having the ‘Customer’ in the centre of the circular model. The compliance approach varies depending on the customer, allowing Inland Revenue to pivot and change their compliance approach to suit. The model is also applicable in a strategy context, for example, Inland Revenue may be wanting to develop an industry approach for a particular type of taxpayer.

One of Inland Revenue’s design decisions was that the wheels would not align to give an ‘answer’. Starting at the centre with the one element, the ‘Customer’, the model then goes outwards with a Three, Five, and Seven aesthetic. Inland Revenue also did not want the model to be prescriptive, instead it is a thinking tool, its elements are interconnected, and

²⁰ Source: Susan Michie, Lou Atkins and Robert West, *The Behaviour Change Wheel: A Guide to Designing Interventions* (Silverback, 2014) 18 <www.behaviourchangewheel.com>.

it is symbolic in the sense that the 'Customer' is in the centre. It is a thinking tool to help staff come up with innovative approaches.

Figure 3: Inland Revenue's new circular compliance model (2015) – a thinking tool²¹



The new circular compliance model in some ways brings together both the BISEP aspect and the 'pyramid' aspects of the Braithwaite Compliance Model into the one platform. This was a deliberate design decision by Inland Revenue and although it does make the new circular compliance model more complicated visually, it was important to have a model that staff could not simplify and therefore only concentrate on a part of it, essentially losing its effectiveness.

The digital collateral for the new model could be delineated to just look at the grey 'Customer' centre, or look at the 'Customer' centre with 'Capability, Opportunity and Motivation', or look at the 'Principles' wheel listed around the outside of the 'Capability, Opportunity and Motivation' wheel. In other words, the new model has holistic 'layers' that could be built on but the priority was to have the new model looked at as a complete model, rather than as sometimes happened with the Braithwaite Compliance Model where only half of the model was generally looked at (usually only the 'pyramid' side). Inland Revenue wanted to make sure that the overall Behaviour Change Wheel was always in view because that was one of the main things Inland Revenue were wanting to bring in, a deeper understanding of the factors that form customer behaviour.

²¹ Source: Inland Revenue, New Zealand Government.

1 The 'Customer'

(a) Social policy organisation

Inland Revenue's customer base includes 84 per cent 'individuals', with many of this group having very little direct contact with the revenue authority. New Zealand is culturally diverse and any compliance model would have to recognise the diversity of taxpayers. While some taxpayers may have minimal contact with Inland Revenue, the contact they have can have an effect on their future compliance attitudes. For example, in an audit context a 'good' audit experience, perhaps where the taxpayer has had some education in response to a tax issue, may leave the customer with an impression that Inland Revenue are approachable and 'making it easy' for them to comply. Likewise, an audit where there has been tensions between a tax investigator (now called Customer Compliance Specialists), might set a negative stance towards Inland Revenue for the future. Inland Revenue regard every contact with a customer as an opportunity to influence norms towards better compliance. Over half of the contacts Inland Revenue has with its customers are in relation to social policy such as child support, Working for Families, KiwiSaver and paid parental leave. In designing the new compliance model, it needed to reflect how Inland Revenue deals with that social policy/individual customer group, although the model is equally applicable to other customer groups (refer to Figure 4 below).²²

Figure 4: Inland Revenue customer groups²³



Inland Revenue does not see itself solely as a tax collector: they are actually self-described as a tax and social policy organisation. Inland Revenue's responsibilities are to ensure

²² The circular compliance model in a physical form was given to Inland Revenue staff with adhesive stickers to represent the different taxpayers – individuals; microbusiness/self-employed; small- and medium-sized enterprise; high-wealth individuals; significant enterprise; and not-for-profits – thereby demonstrating that all customers are at the centre of Inland Revenue's compliance thinking.

²³ Source: Inland Revenue, New Zealand Government.

that customers get their entitlements as well as pay their required tax. The Braithwaite Compliance Model did not fully reflect these dual responsibilities.

The circular compliance model works by starting at its centre with a customer-centric approach to facilitating compliance. The grey shadowy figures around the outside of the 'Customer' are not 'shadowy Inland Revenue staff keeping a look out over the customer',²⁴ instead they reflect what and who is in the customer's environment. A taxpayer's peers have been loosely defined as a taxpayer's associates, including friends, relatives, acquaintances, and co-workers.²⁵ Also, those peers who influence the taxpayer are more likely to be those held in esteem by the taxpayer.

A customer's environment is important in determining whether the customer complies or not. If a customer is surrounded by non-compliant peers, this can influence their behaviour. Likewise, if a customer is surrounded by people who are generally compliant and 'doing the right thing', this too can influence their behaviour.

(b) The customer 'lifecycle'

Inland Revenue's approach predicated itself on a customer 'lifecycle'. It begins with the birth of a person and ends with death, and everything in between. This translates well with their self-description of being a tax and social policy organisation. The customer is born, starts school, gets married, has a baby, starts a business, goes overseas, may have a relationship breakdown and eventually dies. Of course, not necessarily in that order, apart from the birth and death aspects:²⁶

We are thinking about seeing our customer lifecycle and how we can best respond to that. ... looking at their past behaviour might influence what we do. Not necessarily that they have had a tax debt once so they are always in a certain camp. But it might be we know that this person is a 'repeat new business establisher' and their new businesses tend to go into liquidation so what actually can we do to make sure they are setting up right, properly. That might be working more across government in terms of this particular company, this particular business person might need some help on boosting their financial literacy and understanding how they get good business processes in place.

Inland Revenue's view is that quite often business success (as opposed to failure) is due to its early stages. Although not initially tax focused, how well a customer establishes and puts in place processes to manage its cash flow will actually ultimately end up flowing through to their tax position. If the customer has good systems and processes in place then accurate data flows out from that and goes into their tax return. They tend to also be better about paying tax and filing on time. Inland Revenue will try to identify key events with inherent compliance risk in a customer lifecycle to target them proactively with tailored interventions.

²⁴ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

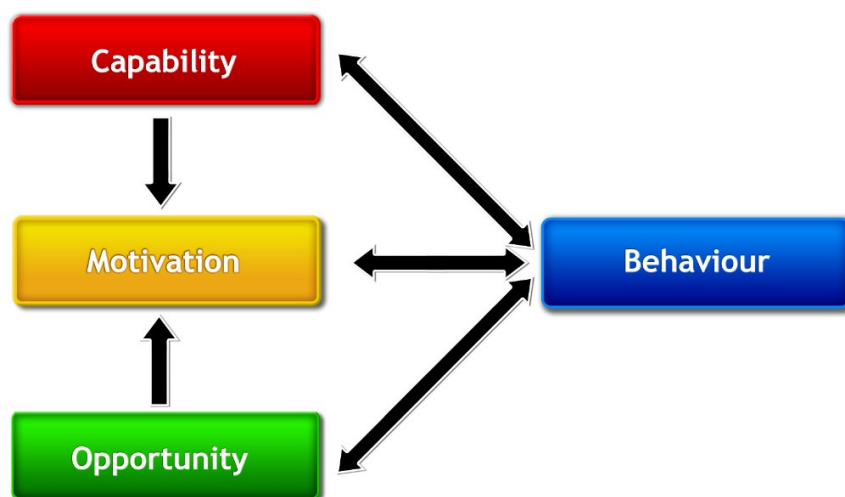
²⁵ Jackson and Milliron, above n 3, 136.

²⁶ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

IV THE BEHAVIOUR CHANGE WHEEL

The new circular Inland Revenue compliance model uses the Behaviour Change Wheel, a synthesis of 19 frameworks of behaviour change found in the research literature.²⁷ None of these frameworks were found to be comprehensive in themselves. In addition, few of them were conceptually coherent or clearly linked to a model of behaviour change. Some of the frameworks assumed that behaviour was primarily driven by beliefs and perceptions, while others placed greater emphasis on unconscious biases and yet still others focused on the social environment. All of these were recognised as being important and needed to be brought together in a coherent manner. The Behaviour Change Wheel aimed to address these limitations by synthesising the common features of the frameworks and linking them to a model of behaviour that was sufficiently broad that it could be applied to any behaviour in any setting,²⁸ including tax administration. The Behaviour Change Wheel consists of three layers. The hub of the wheel identifies the sources of the behaviour that could prove fruitful targets for intervention. Once the 'Customer' and their environment and personal situation are understood, the focus then shifts to the outer layers of the model. The Behaviour Change Wheel has as its first 'layer' a model of behaviour known as COM-B (Figure 5).²⁹

Figure 5: COM-B component of the circular compliance model³⁰



The COM-B initials stand for 'Capability', 'Opportunity', 'Motivation' and 'Behaviour'. The model recognises that 'Behaviour' is part of an interacting system involving all these components.³¹ The central tenet of the model is that for any behaviour to occur there must be capability, opportunity, and motivation. Briefly, 'Capability' is about how well a

²⁷ Susan Michie, Maartje van Stralen and Robert West, 'The Behaviour Change Wheel: A New Method for Characterising and Designing Behaviour Change Interventions' (2011) 6 *Implementation Science* 42.

²⁸ Michie, Atkins and West, above n 20, 17.

²⁹ When the author first saw the COM-B model he thought of the fraud 'triangle'. When the new circular compliance model is discussed internally within Inland Revenue, 'Means, Motive and Opportunity' is referred to because it helps understanding, particularly with an enforcement-based organisation. It is something that makes sense in an enforcement framework.

³⁰ Michie, Atkins and West, above n 20, 11.

³¹ *Ibid* 11.

customer can meet their obligations and access their entitlements. It includes their knowledge of the rules applicable to them and their access to tools and assistance. Factors that will impact on a customer's capability include whether they are aware of the tax and social policy rules relevant to them, their ability to access Inland Revenue assistance and resources (their ability to access the internet or phone services), their access to specialist advice or tools, their ability to speak and read English, and their level of education. 'Opportunity' includes whether the customer earns income not taxed at source, if they are in an industry where cash payments are common, and if they are overseas. Motivation comprises the factors that create both the desire to comply and to follow through. Factors may include whether the customer is under financial pressure, their personal beliefs on tax and social policy, and the social norms that impact on the customer.

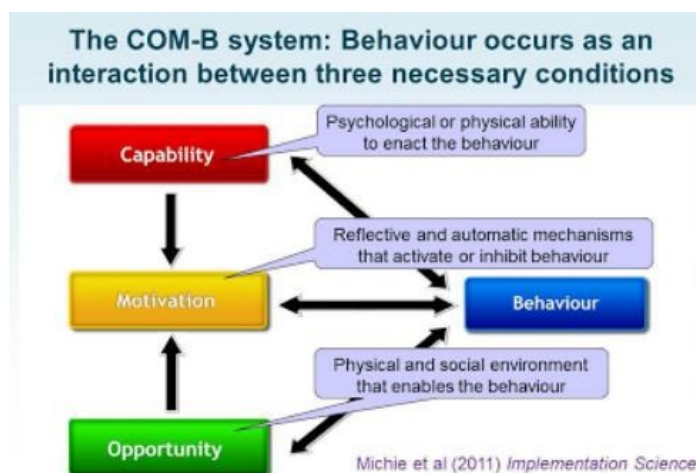
Each of these components can be divided heuristically into two types. 'Capability' can be either 'physical' (having the physical skills, strength or stamina to perform the behaviour), or 'psychological' (having the knowledge, psychological skills, strength or stamina to perform the behaviour). 'Opportunity' can be 'physical' (what the environment allows or facilitates in terms of time, triggers, resources, locations, physical barriers, etc), or 'social' (including interpersonal influences, social cues and cultural norms). 'Motivation' may be 'reflective' (involving self-conscious planning and evaluations, ie, beliefs about what is good or bad), or 'automatic' (processes involving wants and needs, desires, impulses and reflective responses).³² These components interact as illustrated in Figure 6 by the interlinking arrows so that, for example, increasing opportunity or capability can increase motivation. Increased motivation can lead people to do things that will increase their capability or opportunity by changing behaviour.³³ By way of example, owning a bicycle (opportunity) or being able to ride a bicycle (capability) might increase motivation to ride a bicycle but motivation alone will not improve the riding skills or afford access to a bicycle unless the individual acts (behaviour) on this motivation to buy a bicycle or to practice bicycle riding.³⁴ Care must be taken regarding assumptions, for example it would be easy to assume that young drivers crash frequently because of a lack of driving experience. However, the issue might be not so much a lack of skill but of motivation. Young drivers are motivated to drive in ways that increase the risk of crashing, particularly driving too fast and not paying sufficient care and attention.³⁵

³² Ibid 59–60.

³³ Ibid 59–61.

³⁴ Ibid 61.

³⁵ Ibid 58.

Figure 6: The COM-B system – behaviour occurs as an interaction³⁶

According to Michie, Atkins and West the components can be construed at any level from individual or group through sub-populations and even populations,³⁷ allowing Inland Revenue in the tax context to develop an approach for a particular type of taxpayer.

Inland Revenue recognised that 'Capability, Opportunity and Motivation' from the COM-B system related well in a tax context for their staff because of the 'Means, Motive and Opportunity' aspects to it, and in addition the model is simpler than the BISEP. It is easier to recall than reciting the 'Business, Industry, Sociological, Economic and Psychological' factors. Advanced users of the circular compliance model would understand how the arrows interplay, for example how 'Capability' and 'Opportunity' can influence 'Motivation', but for most Inland Revenue staff all they needed to know was that there are the three factors. The goal is to determine what is driving the customer's behaviour.³⁸

A taxpayer may 'want to comply' and are normally compliant, but in a particular period in their life they might become non-compliant and paying their tax bill drops low down on the list because they are struggling to pay their food or power bills. Or they might actually want to comply and have the money and capability to comply but life is a bit too difficult at the moment – they might be suffering a bereavement or have a significant health issue such as depression, cancer or something equally serious. So, it is about wanting to do the right thing but it is also about having physical and emotional resources to carry through and do it. Understanding the context in which non-compliance occurs will guide Inland Revenue's intervention. So, it might be:³⁹

Yes, we know this person will ultimately pay, we just need to give them an extension of time because there's a valid reason why. They will file, we just need to give them a

³⁶ Ibid.

³⁷ Ibid 61.

³⁸ A tax avoider, for example, has high capability because they understand the rules inside out, and that is how they are able to work around them. They have the motivation not to comply and obviously their social/personal norms are such that they are willing to not comply. They have some opportunity not to comply, because there is a grey area within the rules.

³⁹ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

breather ... or it's a financial pressure situation in which case let's enter into an instalment arrangement etc. ... they might be eligible for hardship relief ... depends on the situation. Basically let's understand what is going on with the customer and what's driving their behaviour.

Neither the Braithwaite Compliance Model nor the new compliance model are expected to be an operational guideline. The new circular compliance model is more of a 'this is why we do things and how we want you to think' tool. The new model's message for their staff is that it 'pervades everything we do'.⁴⁰ Inland Revenue's desire is that the new compliance model would influence how Inland Revenue design their approach towards taxpayers. Rather than having a prescriptive compliance model Inland Revenue also realise their role may change in the future as it has in recent years having increasingly become a tax and social policy organisation:⁴¹ 'Things change, our customers change, and our role changes. We respond to something, it guides us rather than tells us what to do.'

A The 'Principles Wheel'

The 'Principles Wheel' shows the five key principles to Inland Revenue's compliance approach briefly discussed in sub-sections 1 to 5 below. Of the five Principles, the top three⁴² come from the 'Right from the Start' approach.⁴³ There are actually four elements in the 'Right from the Start' approach and a decision was made by Inland Revenue to combine two of the elements⁴⁴ to remain consistent with the One, Three, Five, and Seven aesthetic of the model.

1 Build compliance right from the start

This is the most obvious reference to the 'Right from the Start', OECD-inspired approach, and in a way is almost like a Mission Statement because that is Inland Revenue's end goal: to help people to do the right thing up front, get their entitlements, and pay their taxes. The goal is to get people to 'do the right thing' before they actually take the step of taking a tax position, with Inland Revenue working in real time to help customers comply. Examples might include: direct educational messages to customers at the time they need it in their lifecycle; performing systems audits and record keeping checks; working with private providers to imbed tax compliance into accounting software packages; and interventions that encourage good systems and processes and support continued compliance. Their work is not limited to simply correcting individual transactions. With regard to Inland Revenue Community Compliance Officers, Inland Revenue is taking a

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² 'Build compliance right from the start', 'Understand and involve the customers and stakeholders', 'Make it easy to comply and difficult not to'.

⁴³ Inland Revenue, New Zealand Government, *Making Tax Simpler - Proposals for Modernising the Tax Administration Act: A Government Discussion Document* (December 2016) ch 4.

⁴⁴ The 'Right from the Start' approach is defined in terms of four dimensions that are considered central to the compliance environment: (1) Acting in real time and up-front, so that problems are prevented or addressed when they occur; (2) Focusing on end-to-end processes rather than only on the revenue body processes and trying to make taxpayers' processes fit into them; (3) Making it easy to comply (and difficult not to comply); and (4) Actively involving and engaging taxpayers, their representatives and other stakeholders, in order to achieve a better understanding of taxpayers' perspectives and to cooperate with third parties.

proactive compliance stance. The people in this role are now starting to run seminars in the weekends and at night for customers as they realise that many of their customers are small business owners and weekends and nights are the only free times they have to attend. In addition, there are a number of online Inland Revenue videos⁴⁵ explaining the basics of income tax, expenses, depreciation, Goods and Services Tax (GST) obligations, and so forth. Inland Revenue also recognise that there are some people who do not have the time to come out at night, such as business owners who are also single parents. As they have to look after their children, they can sit down at home and watch a short video.

2 *Making it easy to comply and difficult not to*

One of the myths that Inland Revenue wanted to dispel was the perception that 'making it easy' was just providing educational material. There is actually a lot more to 'making it easy', such as simplifying processes (ie, making processes both fraud-proof and fool-proof) so people do not unintentionally make mistakes. Data analytics significantly help Inland Revenue in designing their systems, based on an increased understanding of their customers and their behaviour, and might shape the way Inland Revenue deploy their proactive actions. Where appropriate, Inland Revenue would automatically share information with other government agencies.

A deliberate addition to the new compliance model, which was not in the Braithwaite Compliance Model, is adding the 'and difficult not to' wording to the principle of 'make it easy' to comply. It is natural to look at a compliance model and predominantly think about the audit function. One aspect Inland Revenue have been trying to change for a long time is about changing people's perceptions of compliance and whose responsibility it was. The view that compliance was only a function of audit was one perception Inland Revenue were trying to change and make it clear that everyone within Inland Revenue has a contribution to make in terms of facilitating compliance. For example, it is important for the role of Inland Revenue policy staff because they draft the legislation with which customers have to comply. The legislation drafter's role is also important in terms of making it easy to comply, and they also have a role as a 'lever' in terms of reducing opportunities to not comply.

3 *Provide certainty*

One of Adam Smith's maxims in his 1776 treatise *The Wealth of Nations* was that the tax each individual is bound to pay ought to be certain and not arbitrary.⁴⁶ Simplicity and certainty are desirable features of a good tax system. If these criteria are not met, taxpayers will find it difficult to comply with the tax laws and to apply them to their specific circumstances.⁴⁷ 'Provide certainty' is making sure that customers know what they have to do and how they should do it. One aspect that is incredibly important to customers is that they have confidence knowing what they have filed is correct. Inland Revenue compliance model design staff listened to some of the call centre calls and calls

⁴⁵ See, eg, Inland Revenue, New Zealand Government, *Introduction to Business Videos* (30 June 2015) <<http://www.ird.govt.nz/help/demo/intro-bus-vids>>.

⁴⁶ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) ch 2, part 2, 892.

⁴⁷ Stephen Barkoczy, *Foundations of Taxation Law* (CCH Australia, 2013) [1.7].

made to Inland Revenue Complaints Management.⁴⁸ A large volume of calls came from customers who just wanted to know if what they had filed or prepared was correct.⁴⁹ Inland Revenue want to provide knowledge certainty to customers as well as process certainty, confirming that returns have been filed or payments have been received. Inland Revenue will confirm the accuracy of a tax or social policy position where appropriate.

4 *Influencing norms*

There had been considerable research into how the determinant 'attitude' affects behaviour.⁵⁰ Psychologists define attitudes as a learned tendency to evaluate things in a certain way.⁵¹ This can include evaluations of a particular object, person, thing, or event. Attitudes are often the result of experience or upbringing, and they can have a powerful influence over behaviour. Inland Revenue consider 'attitude' is an overrated determinant of behaviour.⁵² The Braithwaite Compliance Model was an attitude-based model where the application would be to first look at the BISEP, determine the factors that make up a customer's attitudes, and then consider the Inland Revenue response. As conceptualised by Azjen's 1991 theory of planned behaviour, behaviour is only partly predicted by attitudes.⁵³ Braithwaite states that attitudes and behaviour need to be treated as separate dimensions with some relationship to each other.⁵⁴

Fishbein and Ajzen perceive attitudes as an individual's disposition to respond favourably or unfavourably to an object, person, institution or event, or to any discernible aspect of the individual's world.⁵⁵

The OECD Small/Medium Enterprise (SME) Compliance Subgroup⁵⁶ undertook research into the role of norms and tax compliance behaviour. They recognised that influencing taxpayer norms is not an activity in which most revenue bodies have a great deal of experience, instead tending to focus on short-term, output-driven indicators of performance. 'Influencing norms' is one of the five 'Principles' in the new circular compliance model and was not specifically shown in the Braithwaite Compliance Model. Inland Revenue have stated that everything they do influences norms and Inland Revenue staff must understand the importance of their role in this respect. There is an idea that influencing norms is all about marketing but every contact Inland Revenue has with customers will influence norms.

It is also not just about what Inland Revenue do overtly – for example, through media campaigns aimed at tradespeople who perform undeclared cash jobs – but it comes from everything Inland Revenue do: the publications they send out, the way they design the

⁴⁸ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

⁴⁹ Ibid.

⁵⁰ Erich Kirchler, *The Economic Psychology of Tax Behavior* (Cambridge University Press, 2007) 49.

⁵¹ Kendra Cherry, 'Attitudes and Behavior in Psychology', *verywellmind* (online), 26 April 2018 <<http://www.verywellmind.com/attitudes-how-they-form-change-shape-behavior-2795897>>.

⁵² Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

⁵³ Kirchler, above n 50, 49.

⁵⁴ Ibid 57.

⁵⁵ M Fishbein and I Ajzen, *Belief, Attitude, Intention and Behaviour: An Introduction to Theory and Research* (Addison-Wesley, 1975), as cited in Kirchler, above n 50, 49.

⁵⁶ OECD, 'Forum on Tax Administration', above n 13.

website, the 'Making Tax Simpler' series of publications. All of those things will influence norms.

Norms can be of a personal, social, or societal nature. The way norms are operationalised and measured in research can at times heavily overlap with taxpayer's personality characteristics, value orientation, personal versus social norms and commitment to them, as well as societal norms, trust in institutions and cultural standards. Conceptualisations vary from internalised individual standards of what is correct behaviour, over awareness and acknowledgement of socially approved standards of correct behaviour, to societal and cultural standards resulting in imposing rules and laws.⁵⁷ Kirchler states that the lack of clearly distinctive measures makes it difficult to aggregate results from different investigations and to draw clear conclusions. It is, however, generally assumed that higher moral standards correlate positively with tax compliance, but the relationship is complex.⁵⁸

(a) Personal norms

A person's tax ethic is related to personality factors, such as moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency, and values.⁵⁹ Various studies have demonstrated the role of personal norms for taxpaying behaviour. Schwartz and Orleans⁶⁰ provided early experimental evidence that appeals to a taxpayer's personal conscience could increase their tax compliance.⁶¹ There are also a number of studies by way of survey showing that general honesty, ethical convictions concerning taxpaying, or the anticipation of experienced guilt due to non-compliance were significantly related to tax compliance.⁶² Studies on effects of personal taxpaying norms, ethics, and morality rarely ask for the origin of these personal norms. Personal tax norms are, to a large extent, based on the process of social learning and absorption from the environment and thus have a social basis.⁶³ Personal norms need not be understood as stable and enduring personality characteristics, but rather, because they are largely of a social nature, as depending on and varying with the groups and social norms to which one refers at any given point in time.⁶⁴ Studies that test and thus control for the effects of personal norms may underestimate the role of social norms for tax compliance.⁶⁵

(b) Social norms

There is evidence that social norms impact on taxpaying behaviour. The OECD SME Compliance Subgroup holds the view that influencing social norms is one of the most effective ways of ensuring a community pays its required taxes. Social norms are defined as representing a pattern of behaviour that is judged in a similar way by relevant others

⁵⁷ Kirchler, above n 50, 59.

⁵⁸ Ibid.

⁵⁹ See *ibid* for further discussion.

⁶⁰ R Schwartz and S Orleans, 'On Legal Sanctions' (1967) 34 *University of Chicago Law Review* 274.

⁶¹ See also Marsha Blumenthal, Charles W Christian and Joel Slemrod, 'Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota' (2001) 54(1) *National Tax Journal* 125.

⁶² Wenzel, above n 8, 214.

⁶³ Ibid.

⁶⁴ Ibid.

⁶⁵ Ibid.

and therefore is sustained by social approval or disapproval.⁶⁶ Taxpayers who perceive others as behaving according to socially accepted rules and who communicate with others about appropriate behaviour will adopt the socially shared norms and behave appropriately. If the reference group signals that non-compliance will be tolerated, then compliance will decrease.⁶⁷ A number of studies found that people with more non-compliant attitudes or behaviours perceived tax non-compliance to be more prevalent among people known to them.⁶⁸ The direction of causality underlying this finding is ambiguous.⁶⁹ The findings seem more consistent with taxpayers' perceptions of tax compliance among friends and people known to them, but there have been negative findings for the perceived prevalence of tax non-compliance among taxpayers in general.⁷⁰ Peer influence was recognised in the seminal work of Jackson and Milliron.⁷¹ Wenzel concludes that this would suggest that social norms are not a promising channel for regulation attempts, because campaigns could hardly address the norms of each taxpayer's more immediate peer groups, while broader societal norms could be targeted but seem less relevant to people. Social norms do not exist in an unstructured social field, rather others' beliefs and behaviours become normative when people refer to these others as a relevant reference group. Wenzel considered that a better appreciation of the role of social norms requires an understanding of how people structure their social field, whereby they consider some social norms as relevant to themselves while they reject other social norms. Wenzel concludes that we need to recognise the significance of social norms even where they become an invisible part of our personal ethical views. The simple polarity between personal and social norms of tax compliance needs to be overcome and the process whereby external social norms become part of a person's own norms and values should be addressed.

Taylor argued that social identity is an important factor and that attitudes and fairness perceptions depend on the group with which a person identifies (eg, friends, occupational group or the nation).⁷² Taylor suggests that identification at the superordinate level (eg, the nation) is more relevant than identification at the subgroup level (eg, occupational group). From this Taylor concludes that communication of behaviour and, thus, social norms, should focus on the superordinate level of identification. Kirchler states that by combining Taylor's and Wenzel's arguments, tax authorities should communicate social norms on the collective level, which may enhance a feeling of civic duty as a societal norm that is likely to enforce compliance.⁷³

Kirchler concludes with the statement by Taylor that:

the appeal to civic virtue is associated with a qualitative shift in self-perception from 'me' to 'us', a corresponding shift in who is included in the frame of reference, and a

⁶⁶ James Alm, Gary H McClelland and William D Schulze, 'Changing the Social Norm of Tax Compliance by Voting' (1999) 52(2) *Kyklos* 141.

⁶⁷ Kirchler, above n 50, 65.

⁶⁸ Wenzel, above n 8, 215.

⁶⁹ *Ibid.*

⁷⁰ *Ibid.*

⁷¹ Jackson and Milliron, above n 3, 136.

⁷² N Taylor, 'Understanding Taxpayer Attitudes through Understanding Taxpayer Identities' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate, 2003) 71.

⁷³ Kirchler, above n 50, 70.

corresponding decrease in personal self-interest and more concern about outcomes for all.⁷⁴

(c) Societal norms

Norms are conceived as behaviour standards on three levels: the individual; the social; and the collective. On the individual level, norms define internalised standards of how to behave. On the social level, norms determine the behaviour of a social group (for example, friends, acquaintances and vocational group), based on shared standards. On a collective or national level, norms become cultural standards, often mirrored in the actual law.⁷⁵ On the cultural level, norms have been addressed mainly under the terms tax morale⁷⁶ and civic duty, and also under the term cultural norms.⁷⁷ Research on tax compliance has focused on personal ethics and subjective perception of behavioural habits in taxpayers' reference groups.⁷⁸ Kirchler writes that cultural norms and societal institutions are perceived as important in determining tax compliance and suggest that the success of taxes depends on cooperation.⁷⁹

5 Understand and involve the customer and stakeholder

This key principle is about understanding the customer and their environment by way of using data and research, and 'involving' refers to how Inland Revenue want to use a co-design approach – part of their drive to be more customer-centric. It recognises that Inland Revenue must actually talk to customers and the people around them. Inland Revenue state they seek to understand the customer's needs more and can design solutions that will actually work for them. It also shows how Inland Revenue can work with others to facilitate compliance. Further, it is part of creating a more cohesive and connected public service. It also involves Inland Revenue working with industry bodies such as Chartered Accountants Australia and New Zealand (CAANZ), CPA Australia, the Bankers Association and a wide range of people that can help Inland Revenue in facilitating compliance.

With regard to data analytics and the Business Transformation of Inland Revenue,⁸⁰ this should improve the ability for Inland Revenue to analyse information more effectively and use that data to shape what they do. It can significantly contribute to Inland Revenue's understanding of their customers and shape how Inland Revenue design their systems based on the increased understanding of customers and their behaviour.

⁷⁴ Ibid.

⁷⁵ Kirchler, above n 50, 71.

⁷⁶ M E Kornhauser, 'Tax Morale Approach to Compliance: Recommendations for the IRS' (2007) 8(6) *Florida Tax Review* 599. See also J Alm and B Torgler, 'Culture Differences and Tax Morale in the United States and in Europe' (2006) 27(2) *Journal of Economic Psychology* 224.

⁷⁷ Kirchler, above n 50, 71.

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Business Transformation is a multi-stage transformation of Inland Revenue. By 2021 it will modernise Inland Revenue's tax systems. It involves streamlining processes, policies, and online services. For further information on Business Transformation, see Inland Revenue, New Zealand Government, *Our Business Transformation Programme* (29 January 2018) <<http://www.ird.govt.nz/transformation/bt-programme/bt-programme-section-contents.html>>.

Understanding on an individual level of the motivation to pay taxes is a question often considered by researchers.⁸¹ Motivation as an element of behaviour can change over time. People's desire to comply and actually follow through can vary at different points in their life. It could be quite different between taxes/payments such as Child Support and Student Loan. Many customers are more compliant in relation to Child Support but there are also some who think their Child Support deductions are inherently unfair. Anecdotally individual cases within Inland Revenue show that people have been very motivated to pay their Child Support because they see that as benefitting their child, and less motivated on other taxes or social policy obligations.

Does the new circular compliance model capture societal differences amongst different taxpayers? With the 'Customer' in the centre of the new model this includes understanding of their environment, which could be religious, industry, whānau⁸² and so forth.

The circular compliance model should be a model to apply to all taxpayers, including large corporates. Inland Revenue already works closely with larger taxpayers in an ongoing risk review relationship. Many New Zealand customers are small to medium (SME) enterprises.⁸³ To seek to understand and involve the SME more is a great sentiment, but in practice, how do Inland Revenue measure this in a tangible way.

B The 'Activity Wheel'

The final wheel of the model is the 'Activity Wheel'. It has seven key approaches (which are not the only ones) that can be used to implement strategy for a customer or a customer group. The approaches are: Enforce, Educate, Design, Legislate, Collaborate, Analyse, and Service. The 'wheel' was strictly not necessary for the circular compliance model to work but when Inland Revenue ran user testing with front line staff before the model was finalised literally all of those using the model in testing indicated that they wanted the 'Activity Wheel' to remain because it gave them direct visibility between their role and the circular compliance model. It actually helped reinforce the fact that everyone in the organisation has a role to play in facilitating compliance. In many respects the 'Activity Wheel' is very important as it sets in motion the action to be taken by Inland Revenue.

⁸¹ M McKerchar, 'Why Do Taxpayer's Comply? Past Lessons and Future Directions in Developing a Model of Compliance Behaviour' (2001) 16 *Australian Tax Forum* 99-137.

⁸² An extended family or community of related families who live together in the same area. The primary economic unit of traditional Māori society. In the modern context the term is sometimes used to include friends who may not have any kinship ties to other members.

⁸³ While there are various definitions for SMEs, Inland Revenue define SMEs in New Zealand as enterprises that 'have an annual turnover more than \$30,000 or PAYE deductions more than \$4,000 and an annual turnover less than \$80 million and employ less than 50 employees'. Inland Revenue, New Zealand Government, *Better for Customers: SME's Compliance Costs in 2016* (November 2016) 19. Large enterprises are defined by Inland Revenue as 'A non-individual entity which by itself or as a part of a business group has an annual turnover exceeding \$100 million (calculated based on GST101 returns)'. Inland Revenue, New Zealand Government, *Registered Customers by Group 2008 to 2017* (27 November 2017) <<http://www.ird.govt.nz/aboutir/external-stats/customers/reg-by-customer-group>>.

1 *Layout and components of the wheel*

The Western world reading patterns are from top to bottom and left to right. 'Enforce' is fixed at the top left with someone outside of Inland Revenue perhaps thinking that 'Enforce' was shown as an 'eleventh hour' response. Enforcement is very important as it actually helps with 'influencing norms'. Enforcement is useful for compliant taxpayers because it reassures them that, if they are 'doing the right thing', Inland Revenue is going to make it fair by responding to the people who are not doing the right thing. It does have a deterrent effect for some customers but actually it is mainly about reassuring the vast majority of taxpayers who are compliant that actually the system is fair.⁸⁴ Briefly, 'Enforce' is the law, 'Educate' is trying to inform taxpayers more. An example of this would be by way of guides but also Community Compliance Officers who can sit down with a customer and show them the 'how'. They will talk to the customer about a process. 'Design' refers to the Inland Revenue Service Design and Implementation staff designing the processes and systems. When a legislative change comes in these staff will help develop the processes and systems to integrate the change.

'Legislate' refers to the work of policy, 'Collaborate' refers to a lot of people within Inland Revenue, including the Software Development Liaison Unit, people working directly with industry groups and the Large Enterprises group. 'Analyse' refers to the Insight and Intelligence Unit who develop the profiles of customers, and the 'Service' staff are the Customer Service Officers.

2 *No 'road show'*

A lot of communication material was released within Inland Revenue around the circular compliance model upon its introduction. Inland Revenue set up a compliance intranet site, which contains a lot of resource material, and developed an E-Learning module. A digital version of the model was developed and is available on the intranet.

An Inland Revenue team 'conversation guide' was also developed for use in teams where it could either use a scenario from one of their own cases or environment, or use several pre-set scenarios that had been developed.

A staff member can interactively apply the circular compliance model to different scenarios and customer groups. Users would have to work through their 'Capability, Motivation and Opportunity' to determine which of the principles apply and which activities apply to the 'Customer' in the given scenario.

Scenarios were chosen for an Investigations, Large Enterprises, Hidden Economy, Design, Call Centre and Collections environment. Scenarios are for each of the six customer groups defined on the model (individual, sole trader, micro business, etc). Videos were produced as well as featured news articles and posters. In addition, when being integrated into Inland Revenue, a staff competition was held where staff answered several questions and went into a prize draw.

There was a deliberate decision not to have a 'roadshow' to promote the new compliance model to practitioners and customers. Customers do not need to know all the law in relation to tax and likewise they did not need to necessarily know what Inland Revenue's

⁸⁴ Interview with Inland Revenue senior staff member (Wellington, 9 February 2017).

approach was to compliance. By comparison, the Braithwaite Compliance Model was heavily communicated when introduced. Many customers and tax agents really were not that interested in understanding the compliance model because they thought that Inland Revenue will 'do what they do' anyway. The circular compliance model and Inland Revenue's compliance focus is not secret. If a person wants to find out about the new compliance model and compliance focus they can do so if they wish.

V DISCUSSION, LIMITATIONS AND CONCLUSION

It is self-evident that judgement pervades human experience.⁸⁵ Inland Revenue consider the person best placed to make a decision in relation to a customer is the front-line staff member. Internal delegations have been extended to match this change. Inland Revenue take the view that staff are trained and trusted in relation to interacting with their customer base. There has been extensive investment to train staff with a range of tools and scenarios available on the Inland Revenue intranet to assist staff develop their skills and judgement in relation to a customer. The customer under the new circular compliance model is considered from a whole of life viewpoint, from birth to death, and everything in between.

Although the BISEP actually had the customer in its centre, it appears that the BISEP component of the Braithwaite Compliance Model could sometimes be ignored by Inland Revenue staff. The focus was more on the 'pyramid' side of the model with staff predominantly identifying taxpayers at the top (have decided not to comply and therefore use the full force of the law) or the bottom part of the pyramid (willing to do the right thing, therefore let's make it easy). Inland Revenue staff were less likely to see customers more in the middle two sections of the model. The 'Customer' is in the centre of the new compliance model and their characteristics will be assessed by an Inland Revenue staff member. The new compliance model is a 'thinking tool', not a prescriptive platform. The basis of the model is flexibility, the goal being a model to help Inland Revenue staff understand their customers and allow them to work proactively and tailor approaches to make compliance easier.

Inland Revenue staff have to apply the law fairly and impartially. Section 6 of the *Tax Administration Act 1994* refers to the responsibilities on Ministers and officials to protect the integrity of the tax system. Section 6(2) defines the 'integrity of the tax system' to include taxpayer perceptions of that integrity and the rights of taxpayers to have their liability determined fairly, impartially, and according to the law. The onus is on the tax administrators to perform in a manner that upholds the integrity of the tax system.

New Zealand is a multicultural country, and the diversity is reflected in the taxpayer's backgrounds. Likewise, Inland Revenue staff are from diverse backgrounds and care must be taken in relation to unconscious bias. Although emotions and perception may have basic similarities across cultures there are significant differences as well.⁸⁶ The

⁸⁵ Thomas Gilovich, Dale Griffin and Daniel Kahneman (eds), *Heuristics and Biases: The Psychology of Intuitive Judgment* (Cambridge University Press, 2002).

⁸⁶ Interpersonal accuracy in relation to culture and ethnicity: Hillary Anger Elfenbein and Elizabeth A Luckman, 'Interpersonal Accuracy in Relation to Culture and Ethnicity' in Judith A Hall, Marianne Schmid

boundaries between cultures are becoming more porous as interaction between people across distinct cultures is increasingly common and necessary. The ability to read non-verbal cues is an important element of social interaction.⁸⁷

The influence of the OECD can be seen in the new Inland Revenue circular compliance model. In 2010 the OECD Forum on Tax Administration (FTA) report 'Understanding and Influencing Taxpayers' Compliance Behaviour' was building on the compliance pyramid by introducing a model of five drivers of taxpayer behaviour: economy, norms, deterrence, opportunity and fairness. The view was that while enforcement responses would always be required for the deliberately non-compliant, a supporting, educating or enabling approach is likely to be more efficient and effective for taxpayers that want to comply. It is through a better understanding of taxpayer behaviour that revenue authorities can make more effective use of their resources to develop strategies that will have a sustainable impact on taxpayer compliance.⁸⁸

A 2012 report released by the OECD FTA entitled 'Right from the Start: Influencing the Compliance Environment of Small and Medium Enterprises'⁸⁹ stated that 'prevention and cure are, in this way, complementary aspects of any balanced regulatory strategy'. The Braithwaite Compliance Model did not emphasise prevention. Inland Revenue recognise the importance of prevention and the benefits it brings.

There are several limitations with this paper. First, only one senior Inland Revenue staff member was interviewed to gather background. However, the person interviewed was active in the development of the current Inland Revenue compliance strategy. This paper has sought to provide an overview of the new circular compliance model. How is the change in compliance model assessed? For an effect to be attributed, there must be a clear counterfactual. Clearly a comparison between the two compliance models and their effectiveness would not produce a usable result.

Inland Revenue did not seek external feedback in relation to the proposed new compliance model in its early stage of development. Unlike a discussion document that may impact on tax policy or procedure, the circular compliance model is a thinking tool for Inland Revenue staff, with consultation sought and feedback provided internally. A feasibility study of the proposed new circular model was not conducted.

No taxpayers were interviewed in this paper, to add a so-called balanced view. In part this is due to many taxpayers not even being aware that Inland Revenue have a compliance model, let alone aware of the change to a new circular model. The circular compliance model was groundbreaking in a tax context by being adopted and modified by Inland Revenue for their purposes, therefore no comparisons have been made with overseas jurisdictions that may use other compliance models.

In reality the new compliance model is a thinking tool, designed to get all staff, especially the front-line staff, to consider the customer in the centre of their analysis. Inland Revenue consider they have moved from being a tax collector and enforcement

Mast and Tessa V West (eds), *The Social Psychology of Perceiving Others Accurately* (Cambridge University Press, 2016).

⁸⁷ Ibid 344.

⁸⁸ OECD, 'Forum on Tax Administration', above n 13.

⁸⁹ OECD, 'Right from the Start', above n 13.

organisation to more of a tax and social policy organisation. Inland Revenue's social policy role and the new compliance model reflects this wider ambit of 'Customer'.

Inland Revenue have moved like most revenue authorities to a position of having the 'wind and sun' aspects in their tax administration environment. The 'sun' of understanding the taxpayer is a proactive action in the modern tax administration environment. Does the new circular compliance model really make a difference to Inland Revenue or their compliance activities? Connecting with the customer to understand them should be a part of any revenue compliance strategy. The new circular model is a pictorial representation of a compliance strategy. Understanding the customer, designing a customer experience where it is easy to comply, influencing norms and focusing on building compliance right from the start. It is primarily a thinking tool.

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RHETORIC AND PANDERING: AN EXAMINATION OF TAX POLICY ANNOUNCEMENTS IN THE HARPER-TRUDEAU ERA

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ABSTRACT

This paper examines the tax policy announcements in Canada made by the current and immediately previous governments. The paper rests on the premise that democracy is strengthened where governments provide useful, complete and timely information to the public. The author evaluates the extent to which the tax policy announcements meet this standard, and finds them deficient in multiple respects. The communications are clearly persuasive in nature, involving strategic choices in language used and information provided. At best, the information provided is incomplete, and, at worst, the announcements are intentionally misleading. The author argues that governments should be more transparent in their reasons for, and the effects of, tax policy changes. Further, they should use annual budgets as an opportunity to educate citizens about the tax system instead of tools to manipulate the public. This would better equip the populace to evaluate policy choices and hold governments accountable, thus promoting democracy.

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I INTRODUCTION

This paper examines the Canadian budgets and other tax policy announcements during the time former Prime Minister Stephen Harper and now Prime Minister Justin Trudeau have held office. The analysis exposes various tactics used, explains possible motivations for their use, and makes arguments about their appropriateness in light of the likely effects of the policy. Thus, the paper contains elements of both discourse and policy analysis. Underlying the discussion and analysis is an argument that democracy is better served through a more informed and engaged populace. This leads to a conclusion here that the Canadian government can play a role in strengthening democracy through its tax policy announcements.

This paper proceeds by first summarising the Canadian income tax system and fiscal politics, and then describing the major tax policy changes during the Harper-Trudeau era. In Part III, I consider the role of transparency in democracy, and what transparent tax policy announcements would look like. Then, in Part IV, I identify and analyse the persuasive tactics used in tax announcements during this period. The first set of tactics relate to the careful choice of language. The second set relates to the strategic delivery of rationales behind the policy choices. Winners and losers of tax policy reform, the theme of this conference, are discussed in this section, among other matters. The remaining sections show an absence of a link between taxes and spending, a lack of educational content in tax policy budgets, and the use of tax advantages to gain the political favour of certain groups. Overall, it is clear that the tax policy announcements lacked transparency.

In the final part of this paper, I recommend that tax policy announcements should be scrutinized with the identified persuasive tactics in mind. Further, the government should be compelled to formulate policy announcements that are more candid, include more complete disclosure around the nature and impact of the tax policy choices, and educate citizens on the tax system and its goals. These initiatives have the potential to increase government accountability, and, thus, strengthen democracy.

II CANADIAN INCOME TAX SYSTEM AND POLITICS

In this part, I provide an overview of the Canadian tax system, fiscal politics, and tax policy changes during the period of study to set the stage for the analysis later in the paper.

A The Canadian income tax system and fiscal politics

Both federal and provincial governments have the power to raise income taxes under Canada's Constitution.¹ With some exceptions, provincial taxes are collected by the federal government on behalf of the provinces, and provincial governments generally use income calculated under the federal *Income Tax Act*² as their tax base, with some adjustments. In addition to spending tax revenues on its own services, the federal

¹ *Income Tax Act*, RSC 1985, c 1 (5th Supp).

² *Constitution Act 1982* (UK), 30 & 31 Vict, c 3.

government also provides significant equalisation payments to the 'have not' provinces, using an allocation formula.

Since 1940, the only two parties in power federally in Canada have been the Liberal and Progressive Conservative parties. The federal government enacts income tax legislation through the parliamentary system, with most major changes announced in the annual federal budget, which is presented by the Minister of the Department of Finance.

Going back in history for a moment, in their introduction to the book *Tax is Not a Four Letter Word*,³ Alex and Jordan Himelfarb recount the rise in neo-liberalism in Canada beginning around 25 years ago, and its free-market solution to economic stagnation and inflation, and the resulting prescription of low taxes and smaller government.⁴ They explain how governments sold this to a public accustomed to public goods and services: 'The sales pitch was simple, and it was perfect politics: tax cuts would be so beneficial to economic growth that they would pay for themselves. Tax cuts were free – the last free lunch.'⁵ They also observe, at the time of the writing of the book, published in 2013: 'that taxes are somehow separate from services they buy is now a part of political culture.'⁶ The other contributors to the book continue along this theme of exploring the tax-cutting phenomenon, and it is notable that in this period there were both more right wing Progressive Conservative and more centralist Liberal federal governments in power.

The Harper-Trudeau period reviewed here begins in 2006, with the election of Steven Harper's Progressive Conservative minority government. This followed 13 years of Liberal reign, under the leadership of Jean Chrétien and Paul Martin. While some previous Progressive Conservative leaders have been considered moderate conservatives, Harper's Reform Party roots are indicative of his fiscal conservatism. As will be revealed shortly, his government continued the 'tax cut mania'⁷ of those in power the decade before him. Harper's government retained a minority government in the 2008 election, and then formed a majority government after the 2011 election, but fell to Prime Minister Justin Trudeau's Liberal government in 2015. Trudeau successfully campaigned on strengthening the middle class at the expense of the wealthy, and his tax policy changes purport to reflect this. While it is clear that there is at least a softening of the tax-cut frenzy, remnants of the low-tax mentality are certainly still present, as evidenced by the significant net government cost of lowering middle-income bracket rates and adding a new highest tax bracket.

B A summary of major tax policy changes in the Harper-Trudeau era

In its first post-election budget speech, and during a time of economic growth, the Conservative Minister of Finance Jim Flaherty opened by announcing its focus on tax

³ Alex Himelfarb and Jordon Himelfarb, 'Introduction: Tax is Not a Four-Letter Word' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 1.

⁴ Ibid 3.

⁵ Ibid.

⁶ Ibid.

⁷ Eugene Lang and Philip DeMont, 'A Brief Potted History of Ottawa's Tax Cut Mania' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 119.

relief.⁸ Despite forming only a minority government, the 2006 Budget⁹ included a plethora of significant tax changes, including a 1 per cent GST reduction, a decrease in the lowest income tax rate, and an increase of the basic personal amount.¹⁰ More targeted tax credits included one for all employees, low-income earners entering the workforce, tradespeople's tools, students' textbooks, children's fitness activities, and public transit. There were also significant tax reductions for corporations: both the general corporate rate and the small business rate would be gradually reduced over the next few years. In the fall of 2006, Minister Flaherty announced changes that would eliminate tax advantages income trusts had over corporations, but dampened the impact with a further corporate tax reduction and favourable policies aimed at seniors.¹¹

The 2007 Budget¹² again focused on tax reduction, concentrating on families (through a child tax credit and an increase of the spousal/dependent credit for single-earner families) and manufacturers (through accelerated depreciation). Later that same year, additional corporate tax decreases – from 22.1 to 15 per cent by 2012 – were announced, and small business deduction rate reductions were accelerated by one year, such that the rate would decline from 16 per cent to 11 per cent by 2008.¹³

By the time of the February 2008 Budget,¹⁴ recession was looming. Nonetheless, the government introduced more tax relief, most notably in the form of a tax-free savings account, in which savings could grow tax-free. If it wasn't already clear in 2008, the 2009 Budget,¹⁵ which followed the Conservatives winning another minority government, showed a full commitment to a plan to spend to stimulate the economy during an economic crisis. The Conservatives increased the basic personal amount and raised the upper limit of the lowest two tax brackets. It also offered more targeted relief through measures including expansion of the credit for low-income earners entering employment and the age credit for seniors, as well as offering new credits for first-time homebuyers and home renovators. The 2010 Budget,¹⁶ in contrast, contained only minor tweaks to income tax policies.

The following year, 2011, was an election year, and by then the government's goal was to focus on low taxes as opposed to stimulus spending as it had been during the recession. Several 'boutique' credits were offered: the family caregiver credit, the arts tax credit, and

⁸ Department of Finance, Government of Canada, *The Budget Speech 2006: Focusing on Priorities* (2006).

⁹ Government of Canada, The Honourable James M Flaherty, *The Budget Plan 2006: Focusing on Priorities* (2006).

¹⁰ This amount is a non-refundable credit available to all individual taxpayers and essentially operates to create a 0 per cent tax bracket.

¹¹ Department of Finance, Government of Canada, 'Canada's New Government Announces Tax Fairness Plan' (News Release, 31 October 2006) <<https://www.fin.gc.ca/n06/06-061-eng.asp>>.

¹² Government of Canada, The Honourable James M Flaherty, *The Budget Plan 2007: Aspire to a Stronger, Safer, Better Canada* (2007).

¹³ Department of Finance, Government of Canada, *Strong Leadership. A Better Canada: Economic Statement* (2007).

¹⁴ Government of Canada, The Honourable James M Flaherty, *The Budget Plan 2008: Responsible Leadership* (2008).

¹⁵ Government of Canada, The Honourable James M Flaherty, *Canada's Economic Action Plan: Budget 2009* (2009).

¹⁶ Government of Canada, The Honourable James M Flaherty, *Budget 2010: Leading the Way on Jobs and Growth* (2010).

the volunteer firefighters tax credit.¹⁷ Tax policy changes in the 2012 Budget¹⁸ were relatively minor, but included reducing the research and development credit in favour of direct spending.

Highlights of the 2013 tax policy changes included expanding the lifetime capital gains exemption for small business owners and farmers and fisherpersons, expanding the adoption tax credit, and introducing a super-credit to encourage new donors to make charitable donations.¹⁹ There were only minor income tax changes in the 2014 Budget,²⁰ with more notable changes announced later in the fall as the Conservatives geared up for the election the following year.²¹ The fall announcements included enhancements to the children's fitness tax credit, and the announcement of a 'Family Tax Cut' package offering a more generous benefit for parents, an increase in the child care deduction, and income splitting for parents of minor children.

In 2015 the Conservatives announced plans to reduce the small business tax rate to 9 per cent by 2019, and to double the tax-free savings account limit. Yet another boutique tax credit was offered, this time a 'Home Accessibility Tax Credit'. Also, donors would no longer be taxed on the gains from selling private shares if the proceeds were donated to charity.²²

When Prime Minister Justin Trudeau's Liberal Party government took over late in 2015, it wasted no time in effecting tax changes to deliver on some campaign promises. In December, it announced a 'Tax Cut to Strengthen the Middle Class',²³ which involved a reduction in the tax rate for the second lowest tax bracket, and the creation of a new highest tax bracket for the wealthy. The announcement also included a new income-tested Canada Child Benefit to replace the Conservative's Universal Child Care Benefit, and the repeal of income splitting for parents. In its first budget, released in 2016,²⁴ additional tax policy changes included eliminating the children's art and fitness credits, cancelling further phase-in of small business tax cuts as had been planned by the Conservatives, eliminating textbook and education credits, and introducing a teachers' credit for school supplies.

In 2017, the budget²⁵ announcements continued the trend of shrinking personal tax expenditures, consolidating the caregiver credits into a single credit and eliminating the public transit credit. The budget also signaled changes to close down loopholes used by

¹⁷ Government of Canada, The Honourable James M Flaherty, *A Low-Tax Plan for Jobs and Growth* (2011).

¹⁸ Government of Canada, The Honourable James M Flaherty, *Jobs, Growth and Long-Term Prosperity: Economic Action Plan 2012* (2012).

¹⁹ Government of Canada, The Honourable James M Flaherty, *Jobs, Growth and Long-Term Prosperity: Economic Action Plan 2013* (2013).

²⁰ Government of Canada, The Honourable James M Flaherty, *The Road to Balance: Creating Jobs and Opportunities* (2014).

²¹ Department of Finance, Government of Canada, 'PM Announces Tax Cuts, Increased Benefits for Families' (News Release, 20 October 2014) <<http://www.fin.gc.ca/n14/14-155-eng.asp>>.

²² Government of Canada, The Honourable Joe Oliver, *Strong Leadership: A Balanced-Budget, Low Tax Plan for Jobs, Growth and Security* (2015).

²³ Department of Finance, Government of Canada, 'Government of Canada Announces Tax Cut to Strengthen the Middle Class' (News Release, 7 December 2015) <<https://www.fin.gc.ca/n15/15-086-eng.asp>>.

²⁴ Government of Canada, The Honourable William Francis Morneau, *Growing the Middle Class* (2016).

²⁵ Government of Canada, The Honourable William Francis Morneau, *Building A Strong Middle Class: Budget 2017* (2017).

small businesses. Those changes were announced in the fall after public consultation,²⁶ a day after a promise to reduce small business taxation rates.²⁷ The most recent budget, released 27 February 2018,²⁸ did not heavily feature tax changes. More details on the changes to small business taxation, as had been signaled the preceding year, were announced. Also, the Working Income Tax Benefit was replaced with a more generous Canada Workers Benefit, which would be automatically applied to qualifying individuals in order to increase take-up.

To sum up the tax policy changes in the past dozen or so years, Harper's time as Prime Minister was an era of tax cuts and boutique credits,²⁹ followed by now Prime Minister Trudeau's quest to recalibrate income distribution to favour the middle class, at the expense of the upper class.

III TRANSPARENCY IN TAX POLICY-MAKING AS A NECESSARY ELEMENT OF GOOD DEMOCRATIC GOVERNANCE

A strong democracy requires an engaged and informed public to hold governments accountable for its actions through rational and informed consideration and debate.³⁰ One important element of this is that citizens need to have the necessary information to enable them to evaluate government actions, including, of particular relevance here, tax policy decisions. This understanding has led to a push in democracies for government transparency. As Michael Halberstam puts it, 'Government transparency has become a measure of democratization and a goal of good government reform'³¹ through 'afford[ing] citizens the means to hold their elected and unelected government officials accountable.'³²

It is thus argued in this paper that democracy will be strengthened where governments provide useful, complete, and timely information to the public. Tax policy announcements are one way in which this information can be provided. In this Part, I consider what optimal transparency in tax policy announcements would look like. Later in the paper, this will be used as a baseline to determine how the Harper and Trudeau governments measured up.

²⁶ Department of Finance, Government of Canada, 'Government Thanks Canadians for Helping Get Tax Fairness Right' (News Release, 17 October 2017) <<http://www.fin.gc.ca/n17/17-098-eng.asp>>.

²⁷ Department of Finance, Government of Canada, 'Government Moves to Reduce Small Business Tax Rate and Support Fairness for the Middle Class' (News Release, 16 October 2017) <<http://www.fin.gc.ca/n17/17-097-eng.asp>>.

²⁸ Government of Canada, The Honourable William Francis Morneau, *Equality and Growth: A Strong Middle Class* (2018).

²⁹ For more discussion on the use of boutique credits, see Neil Brooks, 'Policy Forum: The Case Against Boutique Tax Credits and Similar Tax Expenditures' (2016) 64 *Canadian Tax Journal* 65.

³⁰ See Mark Fenster, 'The Opacity of Transparency' (2006) 91 *Iowa Law Review* 885, 897, 949.

³¹ Michael Halberstam, 'Beyond Transparency: Rethinking Election Reform from an Open Government Perspective' (2015) 38 *Seattle University Law Review* 1007, 1107-8.

³² *Ibid* 1008. See also Fenster, above n 30, 900.

A Ideal characteristics of tax policy announcements

It is argued here that there are at least six aspects of an ideal tax policy announcement: it should (1) not mislead, (2) explain the content, (3) explain the impact, (4) reveal the rationale, (5) be accessible, and (6) be timely. Each of these six aspects is briefly elaborated on below.

1 Not mislead the reader

The point of transparency is to inform citizens so that they can hold governments accountable. Misleading communication, whether intentional or not, is detrimental to achieving this goal.

2 Explain the content of the policy change

Some explanation of the content of the rule change is necessary to alert citizens to its substance. This has been referred to as ‘obligation transparency’, or revealing what is required by the rule.³³ While describing every minutia will often not be necessary, or even helpful, enough detail should be revealed that the audience would be able to understand the essence of the new rule.

3 Explain the impact of the policy change

Without knowledge of the *impact* of the policy change, it cannot be properly evaluated. A meaningful evaluation requires knowledge of who will be impacted, in what way, and to what extent. In the case of tax policy, the impact will normally be financial in nature, and this leaves the issues of who will be impacted financially, and to what extent. As will be explained in more detail below in Part IV.C below, there will be ‘winners’ and ‘losers’ with each tax policy change, and it is thus important for governments to identify these groups and, to the extent possible, give readers an indication of the degree of impact that is likely to be experienced by the various groups and sub-groups.

As part of its explanation of the impact of a policy change, governments should also connect taxes with spending. If citizens do not understand that the policy change will result in an increase or decrease in tax revenue, and that this, in turn will have repercussions for government services, the impact of a particular policy will not be appreciated. Kornhauser (in the American context) frames the argument for greater links between taxes and services as a government obligation:

Leaders have an obligation to lead. As Justice Frankfurter once said ‘the responsibility of those who exercise power in a democratic government is not to reflect inflamed public feeling but to help form its understanding[.]’ In the tax area, many officials and candidates for office have sorely neglected this responsibility. Indeed, they have not only reflected inflamed public feeling, they have consciously sought to ignite the public’s constantly simmering anti-tax sentiment. It is time for them to shoulder their responsibility by rationally discussing tax policy. They should help preserve the balance

³³ Andrew Keane Woods, ‘The Transparency Tax’ (2018) 71 *Vanderbilt Law Review* 1, 6.

between the positive and negative aspects of tax protest, not destroy it in their efforts to achieve or maintain office. It is time for them to lead.³⁴

As an added benefit, so long as taxpayers see value in public spending, a consequence of linking taxes and spending may be that taxes will be elevated in status from a burden to a responsibility. This should help to motivate tax compliance.³⁵ It should also help governments to gain public support for maintaining or even increasing tax rates.

4 *Reveal the rationale behind the policy change*

One type of transparency that is particularly relevant here has been labelled 'justification transparency'.³⁶ Providing justifications for the policy change will help citizens to understand the problem the policy was meant to address and therefore the need for the policy change. They then will be better able to evaluate the measure and, in turn, hold governments accountable where citizens feel it necessary.

5 *Be accessible to citizens*

Policy announcements should be accessible. There are two aspects to accessibility: it should be widely available,³⁷ and comprehensible. Comprehensibility requires that the content not be so highly technical that it is not understandable to the public,³⁸ yet not so general that it is devoid of meaning.

Comprehensibility will be improved if disclosure is paired with public education about the income tax system. Citizens need to have the requisite broader understanding of how our tax system works to fully evaluate the policy change. As Edward McCaffery has stated, '[p]eople just do not think very much, or very well, about taxes', and tend to '[look] only to one salient dimension of a public policy issue, ignoring or underweighting all else.'³⁹ While he is likely referring to Americans, it applies to Canadians as well. Media and tax experts also play a role in educating the public on both the specific tax provisions and general tax principles, but they, too, need the information and, particularly in the case of the media, may also need education.

While expecting all citizens to become tax experts is not a realistic goal, most adults, or even teenagers, could achieve basic understanding of the goals of a tax system (such as equity, neutrality, and simplicity) and the concepts of tax expenditures. As an additional benefit, the literature suggests that greater knowledge of the tax system may increase tax compliance.⁴⁰

³⁴ Marjorie E Kornhauser, 'Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America' (2002) 50 *Buffalo Law Review* 810, 929–30 [footnotes omitted].

³⁵ Marjorie E Kornhauser, 'A Tax Morale Approach to Compliance: Recommendations for the IRS' (2007) 8 *Florida Tax Review* 599, 638.

³⁶ Woods, above n 33, 19.

³⁷ Woods refers to this as the 'publicity' aspect of transparency: *ibid* 20–2.

³⁸ Fenster, above n 30, 942.

³⁹ Edward J McCaffery, 'Commentary – Are We Asking the Right Questions?' (2014) 67 *New York University Tax Law Review* 669, 674.

⁴⁰ Kornhauser, 'Tax Morale', above n 35, 633; Antoine Genest-Grégoire, Luc Godbout and Jean-Herman Guay, 'The Knowledge Deficit about Taxes: Who It Affects and What to Do about It' (Commentary No 484, C D Howe Institute, 2017) 3–4.

6 *Be timely*

Finally, the information should be disclosed at a time that enables citizens to hold governments accountable in a meaningful sense, and should not, for example, delay disclosure until after an election.⁴¹

B Constraints on transparency

Scholars have recognised that there are costs to transparency.⁴² These costs are both monetary, in terms of the time and effort to provide information to the public,⁴³ and political, in terms of the negative effects on government reputation (and, ultimately, voter support) where the policy choice is unpopular.⁴⁴ While there may valid reasons for closed deliberations because of the candor it requires,⁴⁵ in the case of disclosing policy changes already enacted, these reasons are not pertinent.⁴⁶

Another constraint, which is often tied to cost, is the availability of information. In the context of tax policy decisions, it may be impossible, or potentially very costly, to calculate exact costs and impacts. This point is demonstrated by the number of tax expenditures for which the government is unable to estimate the cost in its tax expenditure budget.⁴⁷

It would be unfair, and, in fact, not in the best interests of the country as a whole, for governments to be expected to demonstrate full transparency at all costs. Thus, in measuring the announcements against the ideal, monetary costs and lack of available information should be taken into account. On the other hand, governments should not be excused from transparency where the costs are political.

IV TAX ANNOUNCEMENTS AS PERSUASIVE DOCUMENTS

Others have, not surprisingly, recognised that tax policy is political.⁴⁸ The delivery of government communications, and the receipt, evaluation, and response by members of the public, are part of the political process.⁴⁹ In this Part, I examine one aspect of this process: the government communication of tax policy changes.

The scope of analysis here is limited to income tax policy discussion in budgets and the budget speeches, as well as other written announcements of income tax policy changes. These sources were chosen as they are the most broadly available and intended for general audiences, as opposed to other communications aimed at tax experts. These communications, in particular the annual budgets, are also very well covered by the

⁴¹ Fenster, above n 30, 942.

⁴² See, eg, Fenster, above n 30, 937; Woods, above n 33.

⁴³ Halberstam, above n 31, 1028.

⁴⁴ See, eg, Fenster, above n 30; Woods, above n 33, 29–30.

⁴⁵ Woods, above n 33, 4.

⁴⁶ Fenster, above n 30, 940.

⁴⁷ Department of Finance, Government of Canada, *2018 Report on Federal Tax Expenditures* (2018).

⁴⁸ See, eg, Jonathan R Kessleman, 'Economics versus Politics in Canadian Payroll Tax Policies' (1998) 24 *Canadian Public Policy* 381; Paul Boothe, 'The Art of Tax Reform' (2002) 50 *Canadian Tax Journal* 2038, 2044.

⁴⁹ Gia B Lee, 'Persuasion, Transparency, and Government Speech' (2005) 56 *Hastings Law Journal* 983, 994.

media,⁵⁰ and thus are likely have the highest public profile of any of the government's tax communications in Canada.

It is clear that these tax announcements were used to persuade. Why is this the case? Governments must gain legitimacy, must have revenue, and must look forward to the next election. As Marjorie Kornhauser states: 'Legitimacy and a steady source of revenue provide the twin foundations of any enduring government.'⁵¹ The high profile of budgets means that they have an audience, and thus provide an opportunity to gain legitimacy.

Gia B Lee writes that, in its communications, 'a government seeks to shape public awareness, influence public opinion, or secure popular support.'⁵² Thus, 'government communications generally entail an element of persuasion.'⁵³ Paul Boothe, on reviewing Geoffrey Hale's book *The Politics of Taxation in Canada*,⁵⁴ describes the political ambitions of governments in the context of tax reform:

The political goal of tax reform is not to reward particular groups for past support, but to capture the hearts and minds of the ever-moving, elusive, median voters by causing them to feel that they will be made better off immediately, in the medium term, or both.⁵⁵

In the discussion below, I argue that multiple tactics are used to persuade, some of which are likely to mislead the reader. This is based on an assumption that the observed communications and policy decisions were deliberate tactics. While it would be very difficult to obtain explicit confirmation that they were done mindfully with the view to persuade, their consistent use and the political environment in which they operate make it likely.

Others have presumed deliberate tactics used in government communications, and some have even argued that it is proper for politicians to take advantage of public misperceptions through 'spin'.⁵⁶ Leo P Martinez describes a couple of goals that may underlie this behaviour: 'Some might call this trickery, others might call it paternalism: if the child does not understand what is good for her, it might be necessary to dress the truth up a little.'⁵⁷ Martinez then goes on to suggest that the goals may be even more sinister: 'The trouble with these approaches is that they depend on an assumption that politicians, executives, and legislators are in fact interested in sound tax policy and a fiscal system that is capable of responsibly raising revenue.'⁵⁸

In this paper, I argue for a route that does not infantilise citizens, but includes educating and informing citizens. Further, while I do not share Martinez' degree of cynicism about

⁵⁰ While it is acknowledged that the media play an important role in tax policy communications, they are not the focus of this paper. My recommendations, while aimed at the general population, should also result in a better-informed media, and, thus, result in a better-quality policy debate.

⁵¹ Kornhauser, 'Legitimacy', above n 34, 84.

⁵² Lee, above n 49, 992.

⁵³ *Ibid.*

⁵⁴ Geoffrey Hale, *The Politics of Taxation in Canada* (University of Toronto Press, 2001).

⁵⁵ Boothe, above n 48, 2039.

⁵⁶ Leo P Martinez, 'Tax Legislation and Democratic Discourse: The Rhetoric of Revenue and Politics' (2004) 4 *Nevada Law Journal* 510, 516, mentioning the work of Steven Sheffrin.

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

the motives of government, it becomes clear throughout the discussion in this Part that political motivations may often prevail over sound decision-making.

In the discussion below, along with identifying the persuasive tactics and their likely motivation, I also analyse the degree to which the documents exemplify the transparency necessary for a strong democratic process, as was set out in Part III.

A Language was chosen carefully

The term 'rhetoric' is often associated with the language used in government communications. The use of rhetoric in tax debates is not surprising. Nor is it necessarily objectionable. Kornhauser, who has written multiple articles on rhetoric and taxes, points out that the term 'rhetoric', or communicating persuasively, need not be viewed negatively and, in fact, is embedded in all written and spoken communication.⁵⁹ However, Kornhauser also writes that the term is sometimes used 'to mean insincere or flowery language used to mislead and emotionally sway an audience'.⁶⁰ She further points out that rhetoric can be used to either mask lack of change or proposed changes.⁶¹

Kornhauser concludes that the tax debate in the United States during a particular period of study was 'rhetorical in the pejorative sense' as its assumptions were unstated, unnoticed, and hidden, and, thus, resulted in confusion rather than illumination.⁶² I argue here that much of the same could be said about the government's tax policy announcements in Canada over the past decade: they were intended to persuade, contained hidden assumptions, left a lot unsaid, and were even misleading at times. To the extent that this is the case, transparency is impeded.⁶³

It is clear from examining the tax announcements that language was used to persuade. Of the themes that can be seen in the use of language, two of the most notable are setting a deliberate tone and presenting taxes in a negative light.

1 Tone was deliberately set

The tone of a budget can set the stage for the announced policy changes. Given the less formal style of a budget speech, there is even more freedom to deliberately set a tone. For example, in 2007, when economic times were good and the focus was on cutting taxes, the budget speech tone was aspirational and proud. The writing was poetic at times, and this poem could be named 'That's Our Canada', a refrain appearing 11 times in the budget speech.⁶⁴

The following year, in the face of the economic downturn, the tone of the budget speech was much more subdued, conveying a message that government was 'holding down the

⁵⁹Marjorie E Kornhauser, 'The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction' (1987) 86 *Michigan Law Review* 465, 469.

⁶⁰ *Ibid.*

⁶¹ Marjorie E Kornhauser, 'The Rise of Rhetoric in Tax Reform Debate: An Example' (1996) 70 *Tulane Law Review* 2345, 2347.

⁶² *Ibid* 469–70.

⁶³ Recall, one of the ideal characteristics of transparent policies is that it not mislead: see Part III.A.1, above.

⁶⁴ Government of Canada, The Honourable James M Flaherty, *The Budget Speech 2007: Aspire to a Stronger, Safer, Better Canada* (2007).

fort'. By 2009, the government aimed to 'weather the current storm'.⁶⁵ This was a time of 'crisis', and the tone was sombre. The government had 'passed through some steep and rocky terrain' but its 'compass ha[d] not failed',⁶⁶ and by 2009 there was a tone of cautious self-congratulation and optimism. The 2011 budget speech was particularly boastful of the Conservative tax record to date, likely due to it being an election year. And after winning a majority, the tone in 2012 returned to an aspirational one. Once again, it was a time to dream:

We see young Canadians, confident in their future; retired Canadians, secure in their senior years; Aboriginal Canadians, realizing their vast potential; new Canadians, strengthening our country as they have done in every generation. We see every region of the country, more prosperous than ever in our history. We see Canadian businesses and universities coming up with things no one has thought of before, leading to new opportunities and a better life for Canadians and for people around the world.

...

We see Canada for what it is and what it can be—a great, good nation, on top of the world, the True North strong and free. Our government has been inspired by this vision from the beginning. Today we step forward boldly, to realize it fully—hope for our children and grandchildren; opportunity for all Canadians; a prosperous future for our beloved country.⁶⁷

The government reverted back to a more cautious tone in 2013, advising that there was 'significant risk ahead' given the 'fragile state' of the global economy.⁶⁸ The boastful tone re-emerged in 2014 and 2015 – not surprisingly, given the impending 2015 election.

The 2016 Liberal budget speech was hopeful and aspirational, with the tone of their second and third budgets being seemingly more forceful, perhaps as the government gained confidence over time.

2 *Taxes were presented in a negative light*

Canadians pay too much tax. This is a constant story told through the tax announcements in the period of study. For example, Finance Minister Flaherty made the following statements regarding high taxes in his 2006 budget speech: 'It's holding families back. It makes it harder for small businesses to create jobs and opportunities. It discourages innovation and investment. It is limiting our productivity.'⁶⁹

⁶⁵ Government of Canada, The Honourable James M Flaherty, *Canada's Economic Action Plan: The Budget Speech 2009* (2009) 4.

⁶⁶ Ibid 3.

⁶⁷ Government of Canada, The Honourable James M Flaherty, *Jobs Growth and Long-Term Prosperity, Economic Action Plan 2012: The Budget Speech* (2012) 9.

⁶⁸ Government of Canada, The Honourable James M Flaherty, *Jobs Growth and Long-Term Prosperity, Economic Action Plan 2013: The Budget Speech* (2013) 2.

⁶⁹ Government of Canada, The Honourable James M Flaherty, *The Budget Speech 2006: Focusing on Priorities* (2006) 5.

Consistent with this message was the presentation of taxes as a 'burden' from which to be 'relieved'.⁷⁰ This language may have been used for a few reasons. First, it is presumed that tax cuts are popular with voters. As Kornhauser explains: 'Because the purpose of rhetoric is to persuade, the particular form the rhetoric takes is important. It must reflect deeply and widely held views or else it will lack the power it needs to persuade.'⁷¹ Second, this language had permeated Canadian tax discourse so deeply that it is used without much thought.⁷²

Third, in the case of the Conservatives, it aligns with their ideology of small government and low taxes. In fact, one of Harper's primary policy goals was to reduce taxes, and presenting taxes as a 'burden' and reductions as 'relief' was a subtle way to convince voters that this was the best course of action. However, the fact that the Liberal government's first tax announcement was a 'Tax Cut to Strengthen the Middle Class'⁷³ indicates the pervasiveness of the tax cut mentality, though it is notable that the terms tax 'burden' and 'relief' were not used nearly as often by the current government (and, in fact, were absent in the latest budget document).⁷⁴

In some announcements, tax expenditures were presented as tax cuts, as opposed to spending programs that happen to be located in the tax act. For example, the 2017 caregiver credit granted 'tax relief for caregivers'.⁷⁵ In addition to getting political benefit from the popular notion of a tax cut, this strategy may have been applied because it may be subject to less scrutiny than a direct spending programme.⁷⁶

B Rationales (or lack thereof) were delivered strategically

A government could choose to rationalise its position by identifying opposing arguments and addressing them head on, in order to head off counterpoints the reader might come up with. However, if the audience is not considered to be interested or knowledgeable enough to detect the counterpoints, omitting to mention them may be a savvy strategy. In fact, a trickster may go one step further and mislead the audience to believe that a position is even stronger than it actually is. These latter strategies appear to have been used in the tax policy announcements studied, as it was rare for a full and candid rationale to be given for a tax policy change. Thus, governments are not as transparent as they should be.⁷⁷ The ways in which the government has rationalised policy choices are described below.

⁷⁰ The use of this terminology in Canadian discourse is also observed by Hugh Mackenzie, 'Taxes and Public Services' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 55, 57.

⁷¹ Marjorie E Kornhauser, 'The Morality of Money: American Attitudes toward Wealth and the Income Tax' (1995) 70 *Indiana Law Journal* 119, 138.

⁷² Paul Saurette and Shane Gunster, 'Canada's Conservative Ideological Infrastructure: Brewing a Cup of Cappuccino Conservatism' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 227, 227.

⁷³ Department of Finance, 'Government of Canada Announces Tax Cut', above n 23 [emphasis added].

⁷⁴ Government of Canada, Morneau, *Equality and Growth*, above n 28.

⁷⁵ Government of Canada, Morneau, *Budget 2017*, above n 25, 160 [emphasis added].

⁷⁶ Brooks, above n 29, 78–9.

⁷⁷ Recall, transparency demands that governments reveal their rationale for their decisions: see Part III.A.4, above.

1 'Fairness' was used as a rationale

The appeal to 'fairness' as a rationale is a common occurrence in the tax announcements. The reality that there is no agreement on tax fairness⁷⁸ may actually work to the advantage of the government; this way, readers may agree with the fairness argument for different reasons.

The term 'fairness' is used in a few ways, referred to here as content, compliance, and administrative fairness. 'Content fairness' refers to the substantive rules of tax and is primarily concerned with distribution of the total taxes paid to government. There are various theories about the optimal distribution,⁷⁹ and ideas about optimal distribution may be tied to political ideology. For example, the Trudeau government used it to describe its middle-class tax cuts, which would provide 'greater tax fairness for the people who need it most – the middle class'.⁸⁰

'Compliance fairness' refers to citizens abiding by tax laws.⁸¹ Both the Harper and Trudeau governments used the term 'fairness' to justify rules to clamp down on tax avoidance and evasion.⁸² Referring to the need to stop those who do not follow tax laws and pay their 'fair share' could be used as a strategy to evoke feelings of solidarity as between the compliers and governments, in their crusade against the enemy evaders/avoiders.

It is interesting that aggressive tax avoidance, which often is 'legal' until the announced tax changes are put into effect, seems to have been put in the same category as evasion.⁸³ Two examples of policy changes to combat aggressive tax avoidance that were justified, at least in part, on the grounds of fairness were the Conservative changes to eliminate income trust tax advantages vis-a-vis corporations,⁸⁴ and the Liberal announcements to eliminate 'loopholes' being used by small businesses.⁸⁵ In both cases, the appeals to fairness may have been successful within the general population, but those affected negatively were vehemently opposed and brought up fairness counter-points in both

⁷⁸ Trish Hennessey, 'Tax Cuts and Other Cheap Parlour Tricks' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 137, 142.

⁷⁹ For example, David Kamin identifies four theories of distributive justice: '(1) equality of resources, under which a fair tax system would reduce income disparity; (2) the "difference principle," under which a fair tax system would seek to minimize income inequality but would give priority to maximizing the welfare of the least well-off in society; (3) equal sacrifice, under which a fair tax system would impose the same sacrifice, in terms of utility, upon each taxpayer; and (4) utilitarianism, under which the optimal tax system would maximize the summed value of everyone's utility.' (David Kamin, 'What Is a Progressive Tax Change? Unmasking Hidden Values in Distributional Debates' (2008) 83 *New York University Law Review* 241, 266).

⁸⁰ Department of Finance, Government of Canada, *Speech on Measures to Strengthen the Middle Class* (7 December 2015) <http://www.fin.gc.ca/n15/15-086_1-eng.asp>.

⁸¹ Kornhauser, refers to this as 'fair collection' in 'Legitimacy', above n 34, 873: 'Fair collection means that everyone pays the appropriate amount of tax that the law assesses.'

⁸² See, eg, Department of Finance, 'Government Announces Tax Fairness Plan', above n 11; Government of Canada, Morneau, *Budget 2017*, above n 25.

⁸³ See, eg, Government of Canada, Flaherty, *Budget 2007*, above n 12, 239; Government of Canada, Flaherty, *Budget 2010*, above n 16, 101.

⁸⁴ Department of Finance, 'Government Announces Tax Fairness Plan', above n 11.

⁸⁵ Government of Canada, Morneau, *Budget 2017*, above n 25, 199–200.

examples.⁸⁶ So, while the flexible meaning of fairness can perhaps work in the government's favour in some instances, it has the downfall of being openly challenged by self-interested parties who would be negatively affected by the policy change.

'Administrative tax fairness' refers to the government fairly administering the income tax act, and is not likely to attract hostility as generally citizens will not experience negative tax consequences. It also can be used to foster confidence in government. The Harper government appealed to administrative tax fairness in the 2011 Budget.⁸⁷

2 *Ideology was sometimes used to rationalise*

Not surprisingly, one can identify ideological underpinnings in tax policy reforms. Turning first to Harper's government, the primary message was that taxes should be low. This is clearly consistent with conservative ideology. Underlying this is the belief that pre-tax income is the property of the taxpayer, not government,⁸⁸ and this is reflected in terminology such as the 'Tax Back Guarantee'⁸⁹ and the reference to 'taxpayer dollars'.⁹⁰

Small government is another conservative ideology, and it can be detected in messaging that individuals can better meet their needs through markets and other mechanisms. For example, the Conservatives suggested that charities can better meet community needs: '[t]hese charities now have a powerful set of tools for raising the funds they need to meet the needs of Canadians'.⁹¹ The policy choice to support private (rather than public) caregiving is also consistent with this belief.⁹²

Messaging in the budget also supports the belief that hard work is to be rewarded by offering benefits going to 'families working hard',⁹³ tax changes that will 'make work more attractive'⁹⁴ and a budget described as 'reward[ing] effort'.⁹⁵ The conservative virtue of wealth accumulation⁹⁶ can be seen in the creation of the tax-free saving account, and can be contrasted with the more progressive goal to reduce income inequality,⁹⁷ which can be seen in the Liberal government's steepening of the rate structure.

Some of the Liberal government's tax policy changes also reflect other ideological beliefs. For example, the redistribution of wealth is a goal implicit in the trade-off of education

⁸⁶ See, eg, Canadian Association of Income Trust Investors, 'Angus Reid Poll on Tax Fairness Plan- Indicates Canadians Overwhelmingly Believe it to be Unfair' (News Release, 17 March 2007) <<https://www.newswire.ca/news-releases/angus-reid-poll-on-tax-fairness-plan---indicates-canadians-overwhelmingly-believe-it-to-be-unfair-533548971.html>>; David J Rotfleisch, 'Morneau's Tax Changes Are So Complex and Unfair, They'll Turn Accountants Bald – and Rich', *Financial Post* (Canada), 13 September 2017 <<http://business.financialpost.com/opinion/morneaus-tax-changes-are-so-complex-and-unfair-theyll-turn-accountants-bald-and-rich>>.

⁸⁷ Government of Canada, Flaherty, *A Low-Tax Plan*, above n 17, 74.

⁸⁸ Kornhauser, 'Rise of Rhetoric', above n 61, 2349.

⁸⁹ Department of Finance, 'Government Announces Tax Fairness Plan', above n 11.

⁹⁰ See, eg, Government of Canada, Flaherty, *Budget 2006*, above n 9, 51.

⁹¹ *Ibid* 121.

⁹² Government of Canada, Flaherty, *A Low-Tax Plan*, above n 17, 114.

⁹³ Government of Canada, Flaherty, *Budget 2006*, above n 9, 64.

⁹⁴ *Ibid* 70.

⁹⁵ *Ibid* 63.

⁹⁶ Kornhauser, 'Rise of Rhetoric', above n 61, 2349–50.

⁹⁷ *Ibid* 2349.

credits in favour of direct government-funded programmes, the universal ‘cash’ system in favour of an income tested child benefit, and higher taxes for the upper class in favour of lower taxes for the middle class.⁹⁸ So, while the Liberal budgets also reflected a value of hard work,⁹⁹ the ideological differences between the conservative value of equality of opportunity versus the liberal value of equality of need¹⁰⁰ can be detected in the parties’ policy choices. (This is not to say that equality of opportunity is not also a value present in the Liberal budgets, however.¹⁰¹)

What is somewhat perplexing is that, aside from the constant tax cut refrain, governments rarely overtly tie tax policies to ideology or values, and instead allow policies to speak for themselves, or use more subtle terminology, as discussed above. Further, in some instances, the government appears avoid tying itself too closely to a particular set of values. For example, both governments targeted families, but it seems that Harper’s government had a particular vision for families where one parent stayed home to raise the children. However, in announcing policies that tended to support this vision, the Conservative government appeared careful to make it known that they would not exclude other versions of families. In the case of the Universal Child Care Benefit, not only would it ‘help parents choose the child care option that best suits their families’ needs’ including ‘a parent staying at home’, but it would also help those using formal and informal care.¹⁰² Similarly, while the expansion of the spousal and dependent credits would help those with a ‘low-income spouse’¹⁰³ (providing an example of what could be referred to as ‘traditional’ family, with one spouse staying home to take care of the children),¹⁰⁴ the government was quick to point out that this would also help single parents.¹⁰⁵ Spousal income splitting was packaged together with other measures that would ‘benefit every Canadian family with children’,¹⁰⁶ (although, in reality, spousal income splitting would only benefit spouses in different tax brackets, with greatest benefit to high-income earners with a much lower-income spouse, for example, a spouse staying home to raise children).

Why wouldn’t governments try to appease their party supporters by justifying tax policy changes using ideological beliefs or values? First, there can be costs to this type of transparency, including damage to reputation.¹⁰⁷ The two winningest parties in Canadian federal politics, the Progressive Conservative and Liberal parties, are both considered to be brokerage parties, meaning that they have, historically, ‘adapt[ed] their own positions

⁹⁸ Femke Roosma, Wim van Oorschot and John Gelissen, ‘A Just Distribution of Burdens? Attitudes Toward the Social Distribution of Taxes in 26 Welfare States’ (2015) 28 *International Journal of Public Opinion Research* 376, 380.

⁹⁹ See, eg, Government of Canada, Morneau, *Budget 2017*, above n 25, 11; Government of Canada, Morneau, *Equality and Growth*, above n 28, 17.

¹⁰⁰ Kornhauser, ‘Rise of Rhetoric’, above n 61, 2348–9

¹⁰¹ See, eg, Government of Canada, Morneau, *Equality and Growth*, above n 28, 30.

¹⁰² Government of Canada, Flaherty, *Budget 2007*, above n 12, 227.

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid* 228

¹⁰⁵ *Ibid* 227–8.

¹⁰⁶ Department of Finance, Government of Canada, ‘Harper Government Tables Notice of Ways and Means Motion to Implement Tax Cuts for Families’ (News Release, 24 March 2015) <<http://www.fin.gc.ca/n15/15-027-eng.asp>>.

¹⁰⁷ Woods, above n 33, 29–34.

and policies to attract the maximum number of votes ... at times even alternating policy stances.¹⁰⁸ Thus, the parties have historically made weaker ideological commitments and would risk losing potential supporters with opposing ideologies and values if the party makes firm commitments. Second, in the two terms that it was a minority government, the Conservatives would have been sensitive to the need to appease Members of Parliament of opposing parties in order to gain their votes. It would be more difficult to form alliances if it was spouting ideology that was unpalatable to other parties and their supporters.

It is interesting that, in his 2015 budget speech, Finance Minister Joe Oliver made a fairly clear commitment to 'family values' when he stated that '[r]aising a family is hard work, and unlike our opponents, we prefer to leave it to the experts: Mom and Dad.'¹⁰⁹ Was this perhaps because, for the first time, there was a new Finance Minister, who used a different strategic approach? Had the government reached a new level of confidence in its final year of a majority government? Or was it an election year tactic used to distinguish themselves from the Liberals?

The Liberal government had the confidence to overtly tout its values in its decision to release its gender statement: 'an assessment that ensures all budget measures—not just those aimed specifically at women—help us advance the goals of fairness, stronger workforce participation, and gender equality.'¹¹⁰ In the budget plan, tax policy changes were evaluated based on their effects on women.¹¹¹ While this is a laudable advancement, it is easy to see a political motivation considering the significant presence of women among the Liberal base.¹¹² This strategy was continued in the 2018 Budget, where it was heavily featured in the budget speech,¹¹³ though it has not been apparent yet that the gender lens has actually influenced tax policy.

3 *Rationales were insufficient in most instances*

Justifications for tax policy changes were absent, misleading, or vague. For example, when farmers and fishing business owners were given an increased exemption for capital gains on the sale of their property, this was explained in the budget plan as a way to provide an incentive to invest in these businesses and to allow owners to 'maintain more of their capital for retirement'.¹¹⁴ The obvious question is, why wasn't the limit for other small business owners, who were also entitled to a capital gains exemption, bumped up at the same time? Why wouldn't governments provide a justification for the differentiation?

¹⁰⁸ Éric Bélanger and Laura B Stephenson, 'Parties and Partisans: The Influence of Ideology and Brokerage on the Durability of Partisanship in Canada' in Cameron D Anderson and Laura B Stephenson (eds), *Voting Behaviour in Canada* (UBC Press, 2010) 107, 115.

¹⁰⁹ Government of Canada, The Honourable Joe Oliver, *Strong Leadership – The Budget Speech* (2015) 9.

¹¹⁰ *Ibid* 7.

¹¹¹ Government of Canada, Morneau, *Budget 2017*, above n 25, 217–42.

¹¹² See, eg, Forum Research Inc, 'Liberals Widen Gap, Conservatives Stall in Final Poll' (News Release, 18 October 2015) <[http://poll.forumresearch.com/data/dc2e85ea-624f-4377-b2f1-928dc876fef3Federal%20Horserace%20News%20Release%20\(2015%2010%2018\)%20Forum%20Research.pdf](http://poll.forumresearch.com/data/dc2e85ea-624f-4377-b2f1-928dc876fef3Federal%20Horserace%20News%20Release%20(2015%2010%2018)%20Forum%20Research.pdf)>.

¹¹³ Government of Canada, The Honourable William Francis Morneau, *Budget 2018: Equality and Growth for a Strong Middle Class – Remarks by the Honourable Bill Morneau* (2018) 4–8, 13–14.

¹¹⁴ Government of Canada, Oliver, *Strong Leadership*, above n 22, 122.

One possibility is that omitting details is an attempt to cover up a lack of good policy rationale and avoid the reputational damage¹¹⁵ that comes along with admitting that this was simply done to gain the political favour of the preferred groups (a tactic described below).

C 'Winners' and 'losers' were identified when politically expedient

It is clear that any tax policy change comes with a trade-off. That is, there will be winners and losers in the case of any tax policy. As David Kamin explains (in the American context):

The federal government faces a budget constraint ... This has important implications for the permanence of a non-revenue-neutral tax change; any such tax change will be budget neutral over the long term. Tax cuts will be paid for via eventual spending reductions or tax increases; similarly, tax increases will, in the future, finance either lower taxes or greater spending. Thus, if a tax cut creates only winners today by reducing tax revenues, then it must generate losers tomorrow through some combination of increased taxes and reduced spending. This truth comes from the 'iron laws of arithmetic and fiscal solvency.' ... As analysts have noted with regard to the Bush tax cuts, 'Someone, somewhere, at some time will have to pay for them.'¹¹⁶

Good tax policy decision-making requires identifying the costs and benefits to various groups, and considering them in light of government goals. If the government does not make citizens privy to this analysis by revealing costs and benefits and winners and losers, it is difficult for the public to assess whether the policy choices were sound. The tax announcements examined in this paper appear to show a common theme of drawing attention to winners and losers only when it would be politically expedient, and, thus, they are only selectively transparent.

There may be *overall* winners in a budget who are the clear targets for tax changes. In terms of each particular tax policy change, there may be a clear group of direct winners, in the case of a tax cut or advantage, or a clear group of losers, in the case of a tax increase or removal of a tax advantage. However, it must be noted that members of the groups of winners and losers usually do not share equally in the winnings or losses. Finally, there will be indirect winners and losers of policy changes. These points are elaborated on below.

1 The overall winners were well advertised and fairly consistent

The targeted beneficiaries under Stephen Harper's tax policies were consistent over the years, with businesses, families, and, perhaps, older Canadians, being the most touted. While the wealthy frequently benefited from the tax policy changes, this was not explicitly made known in the policy announcements.¹¹⁷ The Liberal government, on the other hand, has vocally targeted the 'middle class and those working hard to join it'¹¹⁸ as the intended

¹¹⁵ See the discussion of reputational costs of transparency in Part III.B, above.

¹¹⁶ Kamin, above n 79, 263–4 [footnotes excluded].

¹¹⁷ See Part IV.C.2, below.

¹¹⁸ See, eg, Government of Canada, Morneau, *Growing the Middle Class*, above n 24, 14, 55, 86.

beneficiaries of its tax policy changes thus far. The latest budget also placed women at the forefront, as was particularly evident in the budget speech.¹¹⁹

2 *The share in winnings was ignored*

The direct winners of most tax expenditures and tax rate reductions appear obvious in most cases. Anyone meeting the qualification criteria for tax expenditures or who would apply the lower rate would benefit (ignoring, for this moment, questions of corporate tax incidence).

However, among those who would benefit, the demographic or other traits of those who would benefit the most and least were seldom identified. One example of failing to mention those who would benefit the most and least can be seen in the instance of income splitting. The gender and class impacts of income splitting have been discussed thoroughly in the literature.¹²⁰ However, when introduced, the Conservative government did not highlight potential negative impacts on lower-class families and women. The class-based impacts were raised by the Liberals in their election campaign in the case of income splitting of parents, but not pensioners¹²¹ (likely because of the political backlash that might result in the case of the latter). It is interesting that the Liberals did not highlight the gender aspects of income splitting, despite their gender focus in the most recent budgets.

The most obvious omission in terms of the share of winnings was the Conservatives' omission to point out that the wealthy were likely to benefit most from the vast majority of their tax policy changes, including introducing the children's fitness tax credit,¹²² increasing the small business tax deduction, increasing the lifetime capital gains exemption, introducing spousal income splitting, and introducing exemptions of gains on sale of property where proceeds are donated to charity. While obvious to many tax policy experts and likely the advisors to the wealthy, the Conservatives were very likely counting on their non-wealthy voting base not noticing.

3 *Indirect winners were sometimes identified*

Narrow groups of indirect winners of policies were often not revealed in budget announcements, likely because governments wanted to appear to be targeting the more apparent, direct beneficiaries. For example, in the case, of student tax credits, it was not pointed out that parents of those students may indirectly benefit if they were otherwise assisting in covering the cost of education. In the case of corporate tax reductions or expenditures, governments did not point out that the incidence of corporate taxes is unclear and may fall to employees, all holders of capital, consumers, or labour, as opposed

¹¹⁹ Government of Canada, Morneau, *Budget 2018 – Remarks*, above n 113, 4–8, 13–14.

¹²⁰ Frances Woolley, 'Liability Without Control – The Curious Case of Pension Income Splitting' (2007) 55 *Canadian Tax Journal* 603, 607–12.

¹²¹ Liberal Party of Canada, *Ending Unfair Tax Breaks* <<https://www.liberal.ca/realchange/ending-unfair-tax-breaks>>.

¹²² Koren L Fisher et al, 'Awareness and Use of Canada's Children's Fitness Tax Credit' (2013) *Canadian Tax Journal* 599, 628–9.

to only shareholders.¹²³ Why wouldn't governments point out that many groups potentially bear the corporate tax, which might help to gain favour among the many who bear it and thus benefit from reduced taxes? One reason might be that if the incidence questions were raised, the public might start to question the corporate tax in its entirety. This would be a very real threat to government revenues. Further, if decisions were made to raise corporate taxes in the future, there could be larger resistance.

Broader groups of indirect winners of a tax policy were more often identified, however. For example, Harper's government pointed out that tax evaders and avoiders would leave 'working Canadians and small businesses, among others' paying more taxes,¹²⁴ who would therefore benefit from a crackdown. In the case of the tax expenditures eliminated by the Liberal government (the Child Tax Benefit, tuition and textbook tax credits and the children's fitness and art tax credits), the government identified the middle class as the overall, indirect 'winners', because the tax savings could be used to implement programmes that were 'better targeted'.¹²⁵ Also, both parties in power during the period under study, but especially the Conservatives, were quick to justify policy changes by referring to the economic growth that would result,¹²⁶ vaguely suggesting that all Canadians would benefit.

4 *Indirect losers were rarely identified*

Governments tend not to identify the non-obvious losers of a particular expenditure or tax reduction, likely with the hopes that those negatively affected will not otherwise figure it out. In this case, there are special circumstances that make it more likely that the losers will not protest loudly.

One could assume that the losers of a tax preference include anyone who does not get to use the lowered rate or other tax preference. However, rate reductions are often justified as helping the economy, suggesting wider positive implications. For example, reduced corporate taxes would 'create new and better jobs and increase living standards for Canadians.'¹²⁷ Where tax preferences were granted to a particular industry – for example, the home construction and businesses – it was suggested that many would benefit, as the industries were 'major sources of jobs and growth'.¹²⁸ It is nearly impossible for citizens themselves to determine if, and to what extent, they will benefit in these circumstances.

Although all tax policy choices involve a trade-off, the losers of tax advantages are widely disbursed, and the extent of the loss would be nearly impossible to calculate. While we could say that 'the rest of society' will pay, at some point, this does not identify which members of society pay how much, and when. What tax policy would have been in place

¹²³ Kenneth J McKenzie and Egrete Ferede, 'The Incidence of the Corporate Income Tax on Wages: Evidence from Canadian Provinces' (2017) 10(7) *The University of Calgary School of Public Policy Technical Paper* 1.

¹²⁴ Government of Canada, Flaherty, *Budget 2007*, above n 12, 239. And, later in 2011, a similar message was sent: measures to close loopholes would 'protect the Government's revenue base – which helps keep tax rates low.' (Government of Canada, Flaherty, *A Low-Tax Plan*, above n 17). See also a similar message in the 2012 Budget: Government of Canada, Flaherty, *Action Plan 2012*, above n 18, 203.

¹²⁵ Government of Canada, Morneau, *Growing the Middle Class*, above n 24, 68.

¹²⁶ See, eg, Department of Finance, 'Speech on Measures', above n 80; Government of Canada, Flaherty, *Budget 2010*, above n 16, 76; Government of Canada, Flaherty, *Budget Speech 2009*, above n 65, 10.

¹²⁷ Government of Canada, Flaherty, *Budget 2010*, above n 16, 76.

¹²⁸ Government of Canada, Flaherty, *Budget Speech 2009*, above n 65, 10.

if that tax advantage was not implemented? Would there have been a different tax or direct spending measure in its place? Would certain other public programmes have grown or not been cut back? Would there have been broad-based tax reductions? Since the implications are so unknown, the best that can be said is some members of society will eventually pay for this cost. Because of the vague nature of this statement, there is no identifiable group to mobilise around this issue and question the government on the policy.¹²⁹

5 *Winners and losers were at times misrepresented*

Yet again presuming some degree of taxpayer ignorance, the winners and losers of tax policy changes were sometimes misrepresented. While omitting to identify the winners and losers might lead to misinformation, in the instances discussed here in this section, the government more overtly misled readers.

In the case of the Harper government lowering the lowest marginal personal rate and increasing the basic personal amount, the government stated that 'the majority of personal income tax relief ... goes to Canadians with incomes in the two lowest tax brackets.'¹³⁰ This statement suggests that these tax reductions favour low- to middle-income earners. However, from a careful read of the document, it appears that the dollar value of the tax measures would be greatest for the highest income earners.¹³¹ Along the same lines, in 2009 the Conservative government claimed to provide 'additional tax relief, especially for lower- and middle-income Canadians.'¹³² The increase of the basic personal amount and raising of the upper limit of the lowest two tax brackets were supposedly aimed at this group,¹³³ but of course would have maximum dollar value to anyone whose income fell above the former upper limit of the second highest tax bracket.

When the 'family tax cut' package was announced leading up to the 2015 election, the Conservative government suggested that low and middle income earners were the big 'winners' as they 'will receive two-thirds of the overall benefits provided by the package'.¹³⁴ However, this is misleading as the income splitting would have the greatest impact for families with an earner in the highest income bracket, particularly where one spouse had a very low income.

The Liberal's 'middle class tax cut' asked 'the wealthiest ... to contribute a little more'.¹³⁵ While it is true that the very wealthiest would pay more because of the introduction of a new highest tax bracket, the greatest tax benefits would go to those earning between the upper limit of the reduced income bracket (CA\$90 000) and the lower limit of the new

¹²⁹ Richard Eccleston and Ian Marsh, 'The Henry Tax Review, Cartel Parties and the Reform Capacity of the Australian State' (2011) *46 Australian Journal of Political Science* 437, 441: 'organised economic interests will lobby for self serving tax concessions resulting in a policy debate dominated by concentrated and politically powerful groups which tend to drown out the disorganized and politically ineffective majority' [citations omitted].

¹³⁰ Department of Finance, *Strong Leadership*, above n 13, 85.

¹³¹ *Ibid* 87.

¹³² Government of Canada, Flaherty, *Budget Speech 2009*, above n 65, 4.

¹³³ *Ibid* 9.

¹³⁴ Department of Finance, 'PM Announces Tax Cuts', above n 21.

¹³⁵ Department of Finance, 'Strengthen the Middle Class', above n 73.

highest bracket (CA\$200 000). Many people would not identify those people as 'middle class', particularly on the higher end.

Another example of misleading taxpayers was where the arts and cultural community was singled out as benefiting from new charitable donation rules,¹³⁶ where it was equally likely that other types of charities would benefit. In this case, the government clearly wanted to appear to place importance on the arts.

Although perhaps 'misrepresentation' would be too strong a word in the following examples, it does appear that by failing to give prominence to some issues, taxpayers were likely to be misled about the winners and losers of some other tax changes. For example, the Conservative government could be accused of 'burying' the tax rate changes for testamentary trusts in 2014 when the graduated rates were replaced with the top marginal rate. This change was very quietly put in the Budget paper, and was only explained in detail in the tax annex.¹³⁷ The government may have been counting on the public not noticing this, perhaps aided by the fact that the repercussions would only be experienced upon death.

A second example of an omission can be seen in the 2017 Budget, where the Liberal government removed the tax exemption on non-accountable allowances for provincial and territorial legislative assemblies and some municipal bodies in order to 'improve consistency' and fairness.¹³⁸ The government explained: 'certain tax measures allow some individuals to pay less than their fair share of taxes on such benefits. These measures are unfair and they lack a strong policy rationale ... This exemption [on expense allowances] ... provides an advantage that other Canadians do not enjoy.'¹³⁹ Since the government neglected to mention it, most readers would be surprised to find out that this move to greater consistency and fairness did not involve removing the equivalent tax advantage for federal Members of Parliament. To call this omission self-serving may be an understatement.

D Only infrequent and often vague links were made between tax revenues and spending

Taxes have two functions: public provision and redistribution.¹⁴⁰ Himelfarb and Himelfarb explain that we have had a more 'benign' view of taxes in Canada as compared to our American neighbours, and traditionally:

[W]e have understood that taxes, however irksome, are the price we pay for civilization and a better future, for the privilege of living in Canada and the opportunities that provides. While there are legitimate disputes regarding how much tax and of what sort, we have generally accepted higher taxes as a way of funding valued public goods and

¹³⁶ Flaherty, *Budget 2006*, above n 9, 123.

¹³⁷ Government of Canada, Flaherty, *The Road to Balance*, above n 20, 259.

¹³⁸ Government of Canada, Morneau, *Building a Strong Middle Class*, above n 25, 206.

¹³⁹ *Ibid* 208.

¹⁴⁰ Liam B Murphy and Thomas Nagal, 'Taxes, Redistribution, and Public Provision' (2001) 30 *Philosophy & Public Affairs* 53.

services, redistributing income to avoid the worst excesses of inequality, and shaping the future to the extent we can.¹⁴¹

So, while collection of taxes can be linked to redistribution and government spending on public services, and Canadians know this is the case, over the past decade the governments have not made this link explicit.¹⁴² This is rather curious, as budgets are replete with spending measures, and it would seem logical to link the collection mechanism – taxes – to the spending. However, there are ideological and tactical reasons that may motivate this omission.

Where governments are ideologically opposed to high taxes, as Harper's Conservatives certainly were, failing to connect taxes and spending is consistent with the message of taxes as a burden. As Hugh Mackenzie points out, '[i]t is easier to sell the idea of taxes as a 'burden' if they are presented as disconnected from any of the purposes for which they are raised.'¹⁴³ Hennesy, quoting Penn the Magician, puts it this way: 'Nothing fools you better than the lie you tell yourself', and then explains: 'Part of the magic of tax cuts is that we want to believe we can have them without any great sacrifice on our part.'¹⁴⁴

Mackenzie explains why governments get away with failing to link tax cuts to public spending. He points out that public services are so pervasive that they become practically invisible, particularly when governments have not shone a spotlight on them, as has been the case in recent decades.¹⁴⁵ He argues that this can lead to underinvestment in public services and provides a 'smokescreen to obscure the fact that while tax cuts go disproportionately to those with high incomes, the costs of the public expenditure restraint needed to pay for them are born disproportionately by lower- and middle-income Canadians.'¹⁴⁶

Hugh Mackenzie chastises the tax cutting advocates for their short sightedness through this tongue-in-cheek analogy:

Conversations that separate actions from consequences are familiar to any parent. They are the kinds of conversations you have with a four-year-old at the supermarket checkout as you try to explain he can't just grab that back of Smarties [candy]; the kinds of conversations that any toddler understands.¹⁴⁷

Himelfarb and Himelfarb also criticise the debate in recent times on similar grounds: 'Gone is the language of the citizen, replaced by the atomizing language of consumer and taxpayer. These taxpayers, we are told, know far better than some distant bureaucrat how

¹⁴¹Himelfarb and Himelfarb, 'Introduction', above n 3, 1–2.

¹⁴² Mackenzie, 'Taxes and Public Services', above n 70. At best, it is possible to find some insinuation that the two are linked. For example, at one point in the 2014 Budget, the Minister of Finance states that reducing government debt will '[e]nsure taxpayer dollars are used to support important social services – such as health care – rather than paying interest costs' (Government of Canada, Flaherty, *The Road to Balance*, above n 20, 243).

¹⁴³ Mackenzie, 'Taxes and Public Services', above n 70, 57.

¹⁴⁴ Kornhauser, 'Rise of Rhetoric', above n 61, 2371.

¹⁴⁵ Hugh Mackenzie, 'Benefits from Public Services' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 69, 81.

¹⁴⁶ Ibid.

¹⁴⁷ Ibid 55.

to spend their money – as if roads, bridges, public schools, hospitals, and the like arise spontaneously.¹⁴⁸ More generally, others have noted that the conversation of taxes, particularly the conversation around cutting taxes, has been devoid of ‘any serious reference to the reason we have taxes in the first place – to pay for public services’.¹⁴⁹ This debate could be transformed from a tax bashing affair to talk about obligations, benefits, how taxes ‘tie us to one another and the common good’.¹⁵⁰

The long-term tax cuts cannot be sustained without the public noticing reductions in public services, and implementing or even maintaining current tax rates can be made easier if, as Leo P Martinez puts it, ‘more attention were given to the many benefits and necessities of daily life (for rich, poor, and everyone in between) that depend on tax revenue (including roads, schools, police and fire services)’.¹⁵¹ Mackenzie’s proposed solution is to be more attentive to the value Canadians receive from public service.¹⁵²

So long as taxpayers see value in public spending, a consequence of linking taxes and spending may be that taxes will be elevated in status from a burden to a responsibility. This should help to motivate tax compliance.¹⁵³ The government’s anti-tax and tax-cutting rhetoric of late can threaten legitimacy,¹⁵⁴ and presenting taxes in a more positive light through tying taxes to the provision of government goods and services could help to reduce this threat.

Hugh Mackenzie suggests that there can be political value in greater government focus on public investment, as ‘public opinion surveys report repeatedly that respondents indicate a preparedness to pay more in tax in return for better public services in a wide range of areas.’¹⁵⁵ On the other hand, Frank Graves point out that sorting out public opinion is complex. For example, Graves points to surveys showing that the public would rather governments cut spending than increase taxes to address a deficit,¹⁵⁶ but, somewhat contradictorily, they have a strong preference for a government priority of investing in social areas as opposed to keeping taxes as low as possible.¹⁵⁷ Not surprisingly, non-Conservative supporters show stronger support for investment in services.¹⁵⁸ Along similar lines, while Conservative and Green party supporters prefer a smaller government with lower taxes and fewer services, NDP, Liberal and Bloc supporters prefer a larger government with higher taxes and more services. Thus, the Conservative government’s focus on small government and lower taxes, while ignoring effects on public service, likely play to its voter base. The Liberal government, on the other

¹⁴⁸ Alex Himelfarb and Jordon Himelfarb, ‘The Conversation Today’ in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 15, 15.

¹⁴⁹ Mackenzie, ‘Taxes and Public Services’, above n 70, 55.

¹⁵⁰ Himelfarb and Himelfarb, ‘The Conversation Today’, above n 148, 15.

¹⁵¹ Martinez, above n 56, 510, 517. See also Mackenzie, ‘Benefits from Public Services’, above n 145, 81.

¹⁵² Mackenzie, ‘Benefits from Public Services’, above n 145, 81.

¹⁵³ Kornhauser, ‘Tax Morale’, above n 35, 638.

¹⁵⁴ Kornhauser, ‘Legitimacy’, above n 34, 906.

¹⁵⁵ Mackenzie, ‘Taxes and Public Services’, above n 70, 66.

¹⁵⁶ Frank Graves, ‘Canadian Public Opinion on Taxes’ in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 82, 84–5.

¹⁵⁷ *Ibid* 85–6.

¹⁵⁸ *Ibid* 86.

hand, might be better off concentrating more on the linkage between taxes and public services, particularly if it can convince the public of a less wasteful, accountable and transparent use of funds.¹⁵⁹

Neglecting the link between taxes and spending impedes fulsome policy discussions, and leaves governments less accountable. The potential for being subject to less scrutiny concerning the taxing/spending trade-offs could motivate governments to stay silent.¹⁶⁰ However, there is some indication in the most recent budget that the conversation may change as the Liberal government has linked taxes to public services. In the context of targeting those not paying their 'fair share', the 2018 Budget plan reads:

After all, the taxes we pay as Canadians build the infrastructure that gets our goods to market, and helps create good, well-paying jobs ... The taxes we pay help to set broken bones, and push cancer into remission. And the taxes we pay mean that if a hard-working Canadian loses her job, she might not have to lose her house.¹⁶¹

While this message was not prominent in the budget materials, it is likely a welcome change in the discourse to those promoting a robust welfare state. It is notable, however, that the current government still seems to subscribe to a 'have our cake and eat it too' attitude, as demonstrated in the following statement: '[d]elivering the programs and services that Canadians need, while keeping taxes low for small businesses and middle-class families, is important to this Government, and to all Canadians'.¹⁶² And even though the current Liberal government does not appear to share the same unyielding disdain for taxes, it must be cognisant of the political pitfalls of raising taxes after decades of anti-tax messaging.¹⁶³

E Little attempt was made to educate citizens about the tax system

Education can complement transparency in that citizens with greater background knowledge will be able to more intelligently use government-provided information to hold governments accountable.¹⁶⁴ However, it is clear that the tax policy announcements studied rarely included general background information about the tax system. This is rather unfortunate as, other than tax returns themselves, budget documents are the best publicised government documents. Unlike other tax-related government documents targeted at researchers and tax specialists (such as tax expenditures, backgrounders, technical documents), budgets, and especially budget speeches, are directed at general citizens and media. This presents an opportunity to help citizens understand our tax system.

There are multiple examples of how the budget could be used to educate readers about the tax system. Tax credits could be presented as choices about public spending.

¹⁵⁹ Ibid 97–8.

¹⁶⁰ Mackenzie, 'Taxes and Public Services', above n 70, 57–8.

¹⁶¹ Government of Canada, Morneau, *Equality and Growth*, above n 28, 68.

¹⁶² Ibid 68.

¹⁶³ See, eg, Himelfarb and Himelfarb, 'Introduction', above n 3, 2. For a historical account of anti-tax sentiments in the 1960s and 1970s in Canada, see Shirley Tillotson, 'The Politics of Carter-era Tax Reform: A Revisionist Account' in Kim Brooks (ed), *The Quest of Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Carswell, 2013).

¹⁶⁴ See Part III.A.5, above.

'Fairness' rationales could lead to an explanation about tax equity. However, just as is the case with details about the justification for tax policy changes, governments choose less content and more rhetoric and strategic messaging.

Although governments may find taxpayer ignorance convenient when implementing unsound policies, they actually may find that a better educated populace makes it easier to gain political support for increases in taxes and increasing tax equity. For example, the government could have perhaps gained more support from the general population for the recent changes to close loopholes used by small businesses or to eradicate the tax advantages of income trusts. Perhaps those negatively affected may have objected out of self-interest anyway, but a better educated populace would have been more equipped to join the government and academics in arguing that, for the most part, these were good policy choices.

F Tax advantages were offered to appeal to self-interest

The foregoing discussion of language, rationales, winners and losers, and education were centered on how things were communicated in the policy announcements. The discussion now shifts to focus on the content of the tax policy changes.

1 Small groups were given advantages to gain political favour

The governments studied here often hoped to gain the favour of particular groups by offering them tax advantages, thus capitalising on self-interested behaviour.¹⁶⁵ For example, the 'Home Accessibility Tax Credit' was offered as part of a commitment to 'supporting seniors, whose efforts have helped make Canada the strong and prosperous country that it is today.'¹⁶⁶ Harper's 'boutique tax cuts', including the children's fitness tax credit and income splitting for pensioners have been described as 'little more than backdoor tax cuts aimed at winning middle-income voters over to the Conservative Party'¹⁶⁷ (although researchers have shown that most of the benefits went to higher-income earners¹⁶⁸).

The Liberals eliminated a number of credits and promised further review of tax expenditures in order to promote simplicity, efficiency, fairness, and better targeted support.¹⁶⁹ This would suggest that the era of boutique credits was over. However, offering a classroom supplies tax credit to teachers in that very same budget shows just

¹⁶⁵ This assumption of self-interest has complex and mixed support in empirical studies: see, eg, Takornori Sumino, 'Level or Concentration? A Cross-national Analysis of Public Attitudes towards Taxation Policies' (2016) 129 *Social Indicators Research* 115.

¹⁶⁶ Government of Canada, Oliver, *Strong Leadership*, above n 22, 241.

¹⁶⁷ Matt Fodor, 'Taxation and the Neo-Liberal Counter-Revolution: The Canadian Case' in Alex Himelfarb and Jordon Himelfarb (eds), *Tax Is Not a Four-Letter Word: A Different Take on Taxes in Canada* (Wilfred Laurier University Press, 2013) 101, 113.

¹⁶⁸ *Ibid* 114.

¹⁶⁹ Government of Canada, Morneau, *Growing the Middle Class*, above n 24, 64, 68.

how irresistible this tactic of capitalising on self-interest can be, even where its use is blatant hypocrisy.¹⁷⁰

Governments may be able to get away with targeted policies without backlash by combining them with the strategy of not mentioning trade-offs or giving full rationales, and counting on a lack of citizen knowledge or interest. Governments can also rely on a sort of 'puppy dog effect',¹⁷¹ recognising that there are certain causes or recipients that evoke an emotional response such that others, including critics, cannot oppose for emotional, political, or tactical reasons. This emotional response may be linked to reverence, sympathy, respect, appreciation, or even, as with the case of puppy dogs, adoration. This has allowed governments to introduce targeted policies advantaging groups such as firefighters, persons with disabilities and their caregivers, and perhaps even teachers, with relatively low risk of criticism.

2 Tax advantages were offered to appease losers

The reason for offering tax advantages could be to appease those negatively affected by other tax policy changes. For example, when Harper's government announced its plan to eliminate the tax advantages previously afforded to income trusts, it surely knew very well that it was breaking an election promise they had made earlier that year.¹⁷² To help to soften the blow, these changes were announced along with measures to lower the corporate rate (which would now apply to the income trusts) and extend greater tax benefits to seniors through an enhanced age credit and pension income splitting. The focus on pensioners was undoubtedly due to the negative impact of the income trust changes on their pension or personal investment portfolios.¹⁷³

The Liberals have also used this strategy. When there was vocal opposition to the proposals to tighten up the small business taxation rules, the government quietly announced a reduction of the small business tax rate.¹⁷⁴ Although it was presented as a previous commitment, it was actually commitment by the previous Conservative government, and the Liberals had previously declared it would not reduce the small business tax as promised by its opponents.¹⁷⁵ Quite possibly this was done to appease small business owners without drawing attention to potential supporters who would oppose it.

Compensating the losers of a change in tax policy might not always be purely political. That is, there could be good policy reasons for doing this where direct spending was considered superior to tax expenditures, such as in the case of the elimination of textbook

¹⁷⁰ Leslie Young, 'Federal Budget 2016: Trudeau Eliminates Harper-era Tax Credits', *Global News*, 22 March 2016 <<https://globalnews.ca/news/2594044/federal-budget-2016-trudeau-eliminates-harper-era-tax-credits>>.

¹⁷¹ See, eg, Joanne Sauder, *Canada's Experiment with Children's Fitness and Activity Tax Credits* (LLM Thesis, University of Saskatchewan, 2014) 69, 124.

¹⁷² 'Sensible Move on Income Trusts', *Edmonton Journal* (Canada), 2 November 2006, A16.

¹⁷³ *Ibid.*

¹⁷⁴ Department of Finance, 'Government Moves to Reduce Small Business Tax Rate', above n 27 and accompanying text.

¹⁷⁵ Government of Canada, Morneau, *Growing the Middle Class*, above n 24, 220; 'Liberals Pledge to Cut Small Business Tax Rate to 9% Amid Backlash over Proposed Tax Reforms', *CBC News* (Canada), 16 October 2017 <<http://www.cbc.ca/news/politics/small-business-tax-1.4356229>>.

and education tax credits in favour of direct spending programmes to assist low- and middle-class students.¹⁷⁶ Similarly, when the research and development credit was reduced in the 2012 Budget, it was tied to an increase in direct spending.¹⁷⁷

G Direct losers were often easy targets

In some cases, policy changes with direct losses may have been implemented because the losers were easy targets. Both the Liberals and the Conservatives likely viewed avoiders and evaders as easy targets¹⁷⁸ because most of the general population would loathe them for shirking their obligations. However, although the general public might agree with these policy changes, governments do take some political risk in doing so as those targeted may not appreciate being portrayed as avoiders, or ‘cheats’, which appears to have been the case during the recent crackdown on small business owners using aggressive tax planning.¹⁷⁹

Also, the wealthy appear to have been viewed as easy targets. The Conservatives often mentioned in their tax announcements that the avoiders and evaders were usually also wealthy,¹⁸⁰ suggesting that wealthy tax cheats and free riders were particularly reprehensible. In the case of the Liberals, the wealthy were deliberate targets in the case of their middle-class tax cuts. They had successfully campaigned on the issue of redistribution,¹⁸¹ and therefore they had the political authority to work towards eliminating the tax advantages of the wealthy.

H Rhetoric abounds and other conclusions

Rhetoric is prevalent in annual budgets and other tax announcements. As Kornhauser points out, good rhetoric clarifies issues, while bad rhetoric obscures them.¹⁸² The tax announcements studied here demonstrate an unwillingness for governments to reveal the reasons for and effects of their policy choices. The assumption that readers can be persuaded through ‘flowery language’, misleading statements, and blatant pandering carries with it a dim view of the readers’ capacity.

In Part III, I put forth these six aspects of an ideal tax policy announcement: the announcement should (1) not mislead, (2) explain the content, (3) explain the impact, (4) reveal the rationale, (5) be accessible, and (6) be timely. The final aspect, timeliness, is not typically an issue with budget announcements. As for the other five aspects, the discussion in the previous Part shows that the announcements are often lacking. The announcements do, in fact, mislead at times, and they do not adequately explain the

¹⁷⁶ Government of Canada, Morneau, *Growing the Middle Class*, above n 24, 68.

¹⁷⁷ Government of Canada, Flaherty, *Action Plan 2012*, above n 18, 15–16.

¹⁷⁸ See the discussion in Part IV.B.1, above.

¹⁷⁹ Joahn Ivison, ‘Surprise! Doctors Don’t Like Being Branded Tax Cheats’, *The National Post* (Canada), 29 August 2017 <<http://nationalpost.com/news/politics/john-ivison-surprise-doctors-dont-like-being-branded-tax-cheats>>; CBC News, above n 175.

¹⁸⁰ Government of Canada, Flaherty, *Budget 2007*, above n 12, 239.

¹⁸¹ Liberal Party of Canada, *Real Change – A New Plan for a Strong Middle Class* (2015) 4 <<https://www.liberal.ca/wp-content/uploads/2015/10/New-plan-for-a-strong-middle-class.pdf>>.

¹⁸² Kornhauser, ‘Rise of Rhetoric’, above n 61, 2346–7.

content, impact, or rationale. Clearly, much could be done to improve the announcements in terms of providing information to the public.

Throughout this part, I have speculated about the reasons that governments may be less than transparent. It would seem that these reasons are politically motivated. Thus, tension between the government's quest for political favor and democracy's reliance on transparency is apparent. However, if citizens insist upon it, political motivations may shift towards greater transparency.

Governments should not view these calls to action as a threat. In fact, clear communication about the need for the tax law changes, the possible options for reform, and the reasons for selecting one particular option, has been described as a recipe for successful tax reform.¹⁸³

V CONCLUSION

Tax policy announcements over the past dozen or so years reveal a number of tactics to gain political favour. The main themes are an intentional use of language; strategic, sparse, and sometimes misleading communication of rationales and effects of the policies; failure to educate citizens about the tax system; and a blatant use of tax policies to buy votes. There is no way to know if all of the examples identified were intentional tactics, but the frequency with which these were used suggests that they were often deliberate.

Kornhauser's description of government rhetoric in the US is fitting here in the Canadian context as well: 'current rhetoric seeks only to evoke knee-jerk reaction rather than reflection. It is cheerleading, not thought. What we need, however, is a debate, not a sports competition.'¹⁸⁴ Our democratic system requires healthy debate. This, though, depends on appropriate information from the government.

Canadians should, first, recognise the nature of tax policy announcements as persuasive and politically motivated, and they should scrutinise them with this in mind. Second, they should pressure the federal government to increase transparency in tax policy announcements with the goal of strengthening democracy. This requires the government to provide more complete rationales for the policy change, describe the effects of the changes, and connect taxes with spending. Further, governments should use budgets and other high-profile tax policy announcements to educate the public about the tax system. With greater knowledge and information, citizens would be better equipped to hold governments accountable.

Politics, rhetoric, and taxes may indeed all go hand in hand. However, it is possible for citizens to eschew smoke and mirrors and demand governments place more trust in their ability to properly evaluate policy choices, rather than being treated as self-interested, ignorant, and naive. If successful in their calls for more transparent, respectful, and meaningful communication from governments, or if the current government makes a

¹⁸³ Boothe, above n 48, 2040.

¹⁸⁴ Kornhauser, 'Rise of Rhetoric', above n 61, 2371.

decision to take this more morally responsible route on its own, all members of our society would be 'winners'.

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TAXPAYER ATTITUDES, COMPLIANCE BENEFITS PERCEPTIONS AND COMPLIANCE COSTS OF THE VALUE ADDED TAX SYSTEM IN BOTSWANA

TSHEPISO MAKARA* AND NTHATI RAMETSE†

ABSTRACT

This research is an original study of the taxpayer attitudes, compliance benefits perceptions and compliance costs of the value added tax (VAT) system in Botswana. In 2009/10 and 2010/11, 600 and 100 businesses, respectively, were surveyed. Respondents were presented with attitudinal statements and asked to express their attitudes and benefits perceptions concerning VAT, using a questionnaire that utilised a five-point Likert scale. Internal consistent reliability of responses to the attitudinal statements is measured using Cronbach's alpha, while responses are analysed using SPSS software.

The findings suggest that businesses in Botswana find VAT requirements to be burdensome and VAT compliance costs high. Further investigation reveals that the businesses that find VAT to be burdensome have higher VAT compliance costs. The respondents who perceive the VAT system to be unreasonably complicated report higher average VAT compliance costs. However, these costs are mitigated by the benefits that accrue to taxpayers in the form of improved record keeping, as indicated by 69 per cent of the respondents. The study concludes with policy implications for government, business taxpayers and researchers. This study is significant as it is original and also contributes to the scarce literature on taxpayer attitudes.

Keywords: Value added tax; Compliance costs; Attitudes; Perceptions; Taxpayers.

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I INTRODUCTION

This study is the first of its kind to investigate taxpayer attitudes, compliance benefits perceptions and compliance costs of the value added tax (VAT) system in Botswana. Compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in complying with a given tax structure, over and above payment of the tax itself.¹ The VAT system in Botswana, like in many other countries, requires taxpayers to collect, account for and remit the VAT proceeds to the government. VAT-registered businesses incur a heavy compliance burden, which comes from being used by the government as unpaid tax collectors.² A complex VAT system makes this task onerous and elevates VAT compliance costs. As Pope notes, 'compliance costs are one measure of the complexity of any tax, with high costs implying a complex tax regime and vice versa.'³

Attitudes towards a taxation system may be either positive or negative. On the one hand, positive business attitudes may arise where the tax system is not complex to comply with and where enterprises support governments' tax reform due to benefits of compliance.⁴ Benefits of compliance may arise due to better record keeping arising from VAT compliance requirements. On the other hand, high VAT compliance costs may evoke negative attitudes from business taxpayers, which in turn can hamper compliance. This is particularly evident where they see a tax system to be complicated and where there is an initial negative reaction towards a newly legislated tax requirement.⁵ In a study by Coleman and Freeman, small business owners were critical of a rather too complex taxation law and resented time and money devoted to compliance.⁶ Essentially, small businesses that resent their tax compliance costs may engage in tax evasion acts.⁷ Indeed, taxpayers who feel that their compliance costs are unfairly high may be reluctant to comply with the tax regulations. In particular, they may deliberately understate their sales in order to reduce the VAT due to the government. Some may even falsely classify their goods and services as zero-rated or exempt.⁸ Evidence suggests that the failure of taxpayers to comply with tax law results in loss of revenue by governments. As such, an empirical investigation on taxpayers' attitudes is essential.

¹ Cedric Sandford, Michael Godwin and Peter Hardwick, *Administrative and Compliance Costs of Taxation* (Institute for Fiscal Studies, 1989).

² Jeff Pope, 'Estimating and Alleviating the Goods and Services Tax Compliance Cost Burden Upon Small Business' (2001) 11(1) *Revenue Law Journal* 6, 1.

³ Jeff Pope, 'The Compliance Costs of Taxation in Australia and Tax Simplification: The Issues' (1993) 18(1) *Australian Journal of Management* 69, 70.

⁴ Nthathi Rametse and Jeff Pope, 'Start-Up Tax Compliance Costs of the GST: Empirical Evidence from Western Australian Small Businesses' (2002) 17(4) *Australian Tax Forum* 407.

⁵ Nthathi Rametse and Sue Yong, 'Small Business Taxpayers' Attitudes to Complying with a Tax System: Lessons and Experiences from Australia and New Zealand' (2009) 1(1) *Journal of Applied Law and Policy* 83, 102.

⁶ Cynthia Coleman and Lynn Freeman, 'Changing Attitudes of Small Business Owners to the ATO in a Tax Reform Environment' (Paper presented for the Australian Tax Teachers Conference, University of Canberra, Canberra, 5-7 February 1999) 13.

⁷ Sandford, Godwin and Hardwick, above n 1.

⁸ United States Government Accountability Office, *Value Added Tax. Lessons Learned from Other Countries on Compliance Risks, Administrative Costs, Compliance Burden and Transition: Report to Congressional Requesters* (2008).

In light of this, this study explores the attitudes of taxpayers and their perceptions of compliance benefits concerning the VAT in Botswana. In addition, the study briefly reports on the findings of attitudes and perception of taxpayers relative to their VAT compliance costs. A detailed investigation of the VAT compliance costs in Botswana has already been reported by Makara and Pope,⁹ and will not be repeated here. However, the overall findings suggest that the VAT compliance costs in Botswana are high and regressive upon small businesses.

The rest of the paper is organised as follows: Section 2 provides theoretical and conceptual issues adopted in this study; Section 3 discusses a review of the literature on taxpayer attitudes and perception in tax compliance with an emphasis on tax complexity; Section 4 focuses on the methodology used; Section 5 summarises the results; and finally, Section 6 provides a discussion of the findings.

II THEORETICAL/CONCEPTUAL ISSUES

This study adopts the following discussed theory and concepts. Richardson and Sawyer categorise the factors that broadly affect taxpayer compliance as economic, structural, demographic/personal and attitudinal.¹⁰ Economic factors include utility maximization, where taxpayers will undertake a cost/benefit analysis, and will comply if the benefit exceeds the cost of compliance.¹¹ Moreover, factors such as the size, location and legal structure of the business influence tax compliance costs. Structural factors, such as tax administration, tax complexity, tax rate structures and audit possibility¹² are beyond the taxpayer's control, hence exogenously determined. Where it is not possible to incorporate all factors into the measurement of compliance costs, taxpayer attitudes may serve as a proxy for many factors.¹³ This is because negative attitudes to taxes can overstate the perceptions of the compliance costs involved,¹⁴ and overshadow the benefits of taxation.¹⁵ Moreover, a direct relationship between the compliance behaviour of taxpayers and that of their peers explains that taxpayers whose peers evade tax tend to follow a similar approach.¹⁶

⁹ Tshepiso Makara and Jeff Pope, 'Estimates of the Compliance Costs of Value Added Tax in Botswana' (2013) 19(3) *New Zealand Journal of Taxation Law and Policy* 183, 212–21.

¹⁰ Maryann Richardson and Adrian Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137. See also, referred to in Richardson and Sawyer, Betty Jackson and Valerie Milliron, 'Tax Compliance Research: Findings, Problems and Prospects' (1986) 5 *Journal of Accounting Literature* 125–65.

¹¹ Cynthia Coleman and Chris Evans, 'Tax Compliance Issues for Small Business in Australia' in Neil Warren (ed), *Taxing Small Business: Developing Good Tax Policies* (Australian Tax Research Foundation, Conference Series 23, 2003) 147; Richardson and Sawyer, above n 10.

¹² James Alm, Betty Jackson and Michael McKee, 'Estimating the Determinants of Taxpayer Compliance with Experimental Data' (1992) 45 *National Tax Journal* 107.

¹³ Cedric Sandford et al, *Costs and Benefits of VAT* (Heinemann Educational Books, 1981).

¹⁴ Ian Wallschutzky and Brian Gibson, 'Small Business Cost of Tax Compliance' (1993) 10(4) *Australian Tax Forum* 511, 541.

¹⁵ Rametse and Yong, above n 5.

¹⁶ Julie Collins, Valerie Milliron and Daniel Toy, 'Determinants of Tax Compliance: A Contingency Approach' (1992) 14 *The Journal of the American Taxation Association* 1.

More specifically, using the Responsive Regulation Theory (RRT)¹⁷ and Theory of Reasoned Action (TRA),¹⁸ taxpayers' attitudes can be a significant reflection of the complexity/simplicity of the tax system and the intention to comply. The RRT is based on influencing the community to pay tax through reforming complex processes and simplifying regulations,¹⁹ while TRA postulates that the intention to behave in a certain way is a good predictor of whether or not a person actually engages in that behaviour.²⁰ Hence, the knowledge of the attitudes of taxpayers towards tax is crucial and should be integrated in tax policy decision-making. In Australia, anecdotal and empirical evidence suggests that the Australian tax system is complex. Moreover, Tran-Nam, a renowned advocate for tax simplification, sees it remaining as elusive as ever.²¹ Earlier on, Tran-Nam and Glover have discussed conceptual issues on complexity, which for tax agents entails 'legal complexity' on the difficulty in reading and understanding the income tax law.²² Additionally, Tran-Nam explains that there is 'effective/economic complexity' for small businesses, referring to the difficulty in determining the correct tax liability in terms of their effort in raising tax revenue.²³ Contrary to this distinction, Tran-Nam and Glover elaborate on legal simplicity vs economic simplicity and assert that these concepts may or may not be consistent, for example:

A GST law may be legally simpler than a Wholesales Tax law (WST), whilst compliance with a WST is less costly in aggregate terms – because it affects a far smaller number of taxpayers.... Legal simplicity assesses taxes by the concepts which are internal to the system and economic simplicity assesses taxes by their wider social effects.²⁴

In addition to Tran-Nam and Glover's identification of these types of complexity, McCaffery adds one other element of complexity, which is 'compliance complexity'.²⁵ Compliance complexity relates to complex procedures in complying with tax requirements such as completing forms by a taxpayer as well as record keeping.²⁶

III STUDIES OF BUSINESS TAXPAYER ATTITUDES TOWARDS TAXATION

The review of the literature reveals that studies of business taxpayer attitudes towards taxation are sparse. Only a few studies investigating the attitudes of business taxpayers

¹⁷ Valerie Braithwaite, 'Responsive Regulation and Taxation: Introduction' (2007) 29(1) *Law & Policy* 3.

¹⁸ L Ajzen and M Fishbein, *Understanding Attitudes and Predicting Social Behaviour* (Prentice Hall, 1980); Zainol Bidin, Faridahwati Mohd-Shamsudin and Zainudin Othman, 'Using Theory of Reasoned Action to Explain Taxpayer Intention to Comply with Goods and Services Tax' (2014) 5(1) *International Journal of Business and Social Science* 131.

¹⁹ Braithwaite, above n 17.

²⁰ Bidin et al, above n 18.

²¹ Binh Tran-Nam, Chris Evans, Richard Krever and Philip Lignier, 'Managing Tax Complexity: The State of Play after Henry' (2016) 35(4) *Economic Papers* 347.

²² Binh Tran-Nam and John Glover, 'Tax Reform in Australia: Impacts of Tax Compliance Costs on Small Business' (2002) 5(3) *Journal of Australian Taxation* 338.

²³ Binh Tran-Nam, 'Tax Simplification and the Operating Costs of the Australian Federal Tax System' (Paper presented for the Australian Tax Teachers Conference, University of Canberra, Canberra, 5–7 February 1999).

²⁴ Tran-Nam and Glover, above n 22, 344.

²⁵ Edward McCaffrey, 'The Holy Grail of Tax Simplification' (1990) *Wisconsin Law Review* 1267.

²⁶ Coleman and Evans, above n 11, 171.

towards tax systems have been published since the 1980s. Three of these studies were carried out in Africa. Thus, the contribution of this study towards closing this significant gap in the literature is emphasised. Overall, the majority of the studies report that taxpayers find their country's VAT system to be unfair, costly and unreasonably complicated.²⁷ Botswana taxpayers, as reported in this research, are no exception as their VAT system has also evolved into complex structures. Thus, globally, taxpayers resent doing their VAT work.

Sandford et al, in their study of the administrative and compliance costs of taxation in the UK, also investigate the attitudes of the taxpayers towards VAT. They report that about 51 per cent of the respondents indicate that they mind doing VAT work while roughly 54 per cent feel that VAT is unreasonably complicated.²⁸ Another UK study on the attitudes of small business owners towards VAT compliance was undertaken by Adams and Webley. They highlight the possibility of the influence of the different ways of mental accounting for VAT money on compliance, as some businesses believe that the VAT money they collect is theirs and, thus, resent remitting it to the tax authorities.²⁹ Additionally, Adams and Webley find that taxpayers resent having to do unpaid work for the government, which leads to negative attitudes as far as tax compliance is concerned.³⁰

A study by Rametse shows that the majority of small businesses in Australia (53 per cent) find GST to be unreasonably complicated. This may be an explanation of why most of them (45 per cent) disagree and strongly disagree with the statement 'I do not mind doing GST work'. However, even though many Australian small businesses believe that GST is unreasonably complicated, the majority of them support the government tax reform.³¹ An extension of this study was undertaken by Rametse and Yong in order to compare the attitudes of Australian small businesses towards the Australian tax reform and New Zealand's small businesses and tax agents' perceptions to tax compliance. Their study indicates that small businesses in Australia and New Zealand have similar views concerning their tax obligations and tax complexity.³²

Oberholzer investigated the attitudes of South African individual taxpayers towards taxation. He reports that the majority of the respondents do not feel that it is unfair to pay tax, with only 25 per cent agreeing with the statement 'It is unfair to pay tax'. However, 56 per cent of the respondents indicate that tax is very complicated and that they do not know how to calculate their own tax liability. In addition, all of the respondents feel that there is high wastage and corruption in the government. The majority of these respondents believe that a large proportion of tax is used by the government for

²⁷ The findings that contradict this are reported in an Ethiopian study: see Wollela Abehodie Yesegat, *Value Added Tax in Ethiopia: A Study of Operating Costs and Compliance* (PhD Thesis, University of New South Wales, 2009) 149–52.

²⁸ Sandford, Godwin and Hardwick, above n 1.

²⁹ Caroline Adams and Paul Webley, 'Small Business Owners' Attitudes on VAT Compliance in the UK' (2001) 22(2) *Journal of Economic Psychology* 195, 208.

³⁰ *Ibid* 206.

³¹ Nthathi Rametse, *Start-up Compliance Costs of the Goods and Services Tax (GST) for Small Businesses in Australia* (PhD Thesis, Curtin University of Technology, 2006) 151–2.

³² Rametse and Yong, above n 5, 102.

worthless purposes. Moreover, taxpayers indicate that there is a lack of information concerning how the government uses the tax revenue.³³

In Ethiopia, the attitudes of taxpayers towards VAT are investigated by Yesegat. Yesegat reports that the majority of the respondents perceive VAT to be a simple method of collecting tax (58 per cent) and not unreasonably complicated (53 per cent). This may explain why most of the respondents (74 per cent) indicate that they do not mind doing VAT work. Furthermore, the surveyed taxpayers feel that, based on how much VAT they pay, they do not spend too much time on VAT affairs. In terms of compliance costs, the respondents are almost equally distributed with regards to whether they perceive their VAT compliance costs to be significant (41 per cent) or insignificant (49 per cent).³⁴

Another African study that investigates the attitudes and tax compliance behaviour of taxpayers was undertaken by Marti, Wanjohi and Magutu in Kenya. Their findings indicate that 66 per cent of the respondents are of the opinion that the Kenyan tax system is unfair. In particular, respondents feel that they are not paying a fair share of tax, that others are not reporting and paying tax honestly and also that tax laws are difficult to understand. In addition, the survey participants disagree with the statements that: taxpayers make high business profits by operating illegal businesses; taxpayers are given rewards; and there is use of informants by the Kenya Revenue Authority (KRA) to report tax evaders.³⁵

Yong and Rametse used case studies to explore how New Zealand small business taxpayers are treated when audited by the tax authority and also their perception of the tax authority. Their findings indicate that most taxpayers and tax agents do not welcome audits as they can be stressful, time consuming and an intrusion into their business affairs. In addition, taxpayers perceive the Inland Revenue Department (IRD) to be working against them. They perceive the IRD as always wanting to collect more taxes from them, while they prefer to pay the least amount of taxes.³⁶

More recently, the compliance attitudes of small business owners towards the GST system in New Zealand were researched by Woodward and Tan. In particular, the study explores perceptions of deterrence, tax morale, social norms, perception of the tax system and tax administration. The findings indicate that most small business owners perceive the New Zealand GST system to be unfair and burdensome, while evidence of mental accounting is also reported.³⁷

³³ Ruanda Oberholzer, 'Attitudes of South African Taxpayers towards Taxation: A Pilot Study' (2008) 7(1) *Accountancy Business and the Public Interest* 44, 62.

³⁴ Yesegat, above n 27, 149–52.

³⁵ Lumumba Omweri Marti, Migwi Wanjohi and Obara Magutu, 'Taxpayers' Attitudes and Tax Compliance Behaviour in Kenya' (2010) 1 *African Journal of Business & Management* 112, 116.

³⁶ Sue Yong and Nthathi Rametse, 'The Influence of Procedural Fairness on the Small Business Entrepreneurs and their Perception of the Tax Authority: A Case Study Approach' (2010) *International Review of Business Research Papers* 487, 498–505.

³⁷ Lynley Woodward and Lin Mei Tan, 'Small Business Owners' Attitudes toward GST Compliance: A Preliminary Study' (2015) 30 *Australian Tax Forum* 517, 534.

IV METHODOLOGY

A Sample, response rate and analysis procedure

The data was collected using structured questionnaires.³⁸ In 2009/10, 600 questionnaires were hand delivered to the businesses in the city of Gaborone as well as surrounding towns and villages. A total of 137 usable responses were obtained, giving a response rate of 23 per cent. During the year 2010/11, 100 structured questionnaires were hand delivered to businesses in Gaborone and surrounding towns. Fifty usable questionnaires were collected from the businesses, resulting in a response rate of 50 per cent. The majority of the respondents have been operating and also VAT registered for longer than five years. In terms of legal structure, most of the respondents are companies. Small businesses, measured in terms of turnover, constitute a greater portion of the respondents for the year 2009/10, while for the year 2010/11, the number of large business respondents is greater. A majority are from business/financial services, followed by retail trade/restaurants sectors. The Statistical Package for Social Sciences (SPSS) software was used to compute cross-tabulations and descriptive statistics.

B Measurement of attitudinal statements

The attitudes of taxpayers towards VAT in Botswana are investigated using a five-point Likert attitude scale. The Likert attitude scale 'is based upon the assumption that each statement/item on the scale has equal "attitudinal value", "importance" or "weight" in terms of reflecting an attitude towards the issue in question'.³⁹ Building upon the literature,⁴⁰ the respondents were presented with various statements and asked to express their perceptions by ticking the box that best describes their opinion of VAT. The attitudes and perceptions of the taxpayers are captured by their level of 'agreement' or 'disagreement', which are assigned values as follows: strongly agree (1), agree (2), neutral (3), disagree (4) and strongly disagree (5).⁴¹ The attitudes and compliance benefits perceptions of the VAT taxpayers in Botswana are measured by Question 23 of the 2009/10 questionnaire and Question 22 of the 2010/11 questionnaire.⁴²

The statements that have been used in this study to investigate the attitudes of taxpayers in Botswana towards VAT are delineated in Table 1. Overall, the statements seek to find out how the taxpayers perceive the VAT requirements laid upon them by the government as well as their opinion of the possible benefits of complying with the VAT system.

³⁸ Ibid.

³⁹ Ranjit Kumar, *Research Methodology: A Step-by-Step Guide for Beginners* (Longman Australia, 1996) 129.

⁴⁰ For example, Sandford, Godwin and Hardwick, above n 1; Jeff Pope, *The Compliance Costs of Major Commonwealth Taxes in Australia* (Unpublished PhD Thesis, Curtin University of Technology, Perth, 1993); Adams and Webley, above n 29; Rametse, above n 31; Rametse and Yong, above n 5; Oberholzer, above n 33; Yesegat, above n 27; Marti et al, above n 35; Yong and Rametse, above n 36; Woodward and Tan, above n 37.

⁴¹ 'Strongly agree' and 'agree' will hereafter be combined and termed 'agree'. Likewise, 'strongly disagree' and 'disagree' will be joined and termed 'disagree'.

⁴² See Appendices A and B.

Table 1: Attitudinal statements

No.	Attitudinal statements	Item measured
1	VAT is unreasonably complicated.	Burdensome 1
2	My VAT compliance costs are very high.	Burdensome 2
3	Other business duties are affected because I spend too much time on VAT.	Burdensome 3
4	The burden of VAT discourages me from fulfilling my VAT obligations.	Burdensome 4
5	Other taxes are easier than VAT.	Burdensome 5
6	VAT requirements are easy to fulfill.	Simple 1
7	I do not mind doing my VAT work.	Simple 2
8	My VAT compliance costs are insignificant.	Simple 3
9	VAT helps improve my business record keeping.	Benefit 1
10	VAT helps to improve my business management.	Benefit 2

Note: Although statements 1–8 collectively investigate whether the VAT system in Botswana is complex, they were separated into two categories, namely ‘burdensome’ and ‘simple’ in order to enhance the internal consistency of the responses.

C Assessment of reliability

The internal consistent reliability of the responses to the attitudinal statements in Table 1 is measured using Cronbach’s alpha. The alpha coefficient ranges and their strengths of association are displayed in Table 2. An alpha coefficient that falls within the acceptable range indicates that the respondents answered the questions in a consistent manner.⁴³

Table 2: Rules of thumb about Cronbach’s alpha coefficient size⁴⁴

Alpha coefficient range	Strength of association
Less than 0.6	Poor
0.6–0.7	Moderate
0.7–0.8	Good
0.8–0.9	Very good
0.9 and above	Excellent

Note: If alpha is greater than 0.95, the items should be inspected to ensure that they measure different aspects of the concept.

The results of Cronbach’s alpha test for the attitudinal aspects of taxation in Botswana are set out in Table 3. The internal consistency of the responses in this study is considered

⁴³ Joseph Hair, Arthur Money, Phillip Samouel and Mike Page, *Research Methods for Business* (John Wiley and Sons Ltd, 2007) 245.

⁴⁴ *Ibid* 244.

satisfactory because it falls within the acceptable ranges. The highest mean scores of 6.23 and 5.70 in the financial years 2009/10 and 2010/11, respectively, are obtained under the VAT burden item. This implies that the majority of the respondents in both years find the VAT regime to be burdensome. The mean score of those who perceive VAT in Botswana to be simple are fairly close for both years. With regard to the benefits of complying with the VAT requirements, the mean scores of 2.87 for 2009/10 and 3.04 for 2010/11 indicate that gains in the form of improvement in record keeping and management gained by some taxpayers.

The attitudinal statement 'The burden of VAT discourages me from fulfilling my VAT obligations' was deleted when computing the coefficient alpha in both years, as it is negatively correlated with other attitudinal statements. It is possible that the respondents are not truthful about their attitudes regarding this statement in fear of exposing some likely non-compliance behaviour, hence the inconsistency in responses.

Table 3: Internal reliability of responses to the attitudinal statements

Attitudinal item	No of items measured		Cronbach's alpha		Mean score	
	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11
Tax burden*	4	4	0.835	0.825	6.23	5.70
Tax simplicity	3	3	0.821	0.755	4.94	4.62
Benefit	2	2	0.778	0.768	2.87	3.04

*One item was deleted in order to obtain an acceptable alpha.

V RESULTS

A Overview

This study investigates the perceptions of businesses, over and above compliance costs, towards the VAT system in Botswana. In Tables 5 to 9, 'N' represents the number of respondents who provided answers to attitudinal statements presented in the questionnaires. Some businesses, especially in 2009/10, did not answer this particular section of the questionnaire, hence the missing numbers. The missing numbers represent only around 7 per cent of the total 2009/10 respondents, and, thus, they do not affect the overall findings.

B Taxpayer attitudes to Botswana VAT

The survey results suggest that the majority of taxpayers in Botswana perceive VAT to be burdensome, an issue that is prevalent in most compliance costs research,⁴⁵ as illustrated in Table 4. In fact, most of the respondents, in both financial years, indicate that they resent doing their VAT work, as shown in Table 5. The respondents also point out that their VAT compliance costs are high, with many disagreeing with the statement that their compliance costs are insignificant. In addition, the majority of the 2009/10 survey

⁴⁵ Sandford, Godwin and Hardwick, above n 1.

participants agree that other business duties suffer because they spend too much time on VAT compliance tasks. Furthermore, VAT taxpayers in Botswana seem to be of the opinion that other taxes are easier than VAT. Overall, the findings appear to suggest that most VAT taxpayers in Botswana perceive the VAT to be complex and costly.

Table 4: Taxpayer attitudes towards VAT in Botswana (Burden Aspect)

	2009/10		2010/11	
	N	%	N	%
VAT is unreasonably complicated				
Agree	68	54	30	60
Neutral	5	4	0	0
Disagree	54	42	20	40
Overall	127	100	50	100
My VAT compliance costs are very high				
Agree	69	55	31	62
Neutral	5	4	0	0
Disagree	52	41	19	38
Overall	126	100	50	100
Other taxes are easier than VAT				
Agree	66	52	30	60
Neutral	5	4	0	0
Disagree	55	44	20	40
Overall	126	100	50	100
Other business duties are affected because I spend too much time on VAT				
Agree	59	47	23	46
Neutral	13	10	0	0
Disagree	54	43	27	54
Overall	126	100	50	100
The burden of VAT discourages me from fulfilling my VAT obligations				
Agree	35	28	7	14
Neutral	24	20	4	8
Disagree	65	52	39	78
Overall	124	100	50	100

Note: Some businesses in the year 2009/10 did not provide their attitudes towards VAT compliance, hence the missing responses.

Table 5: Taxpayer attitudes towards VAT in Botswana (Simplicity Aspect)

	2009/10		2010/11	
	N	%	N	%
VAT requirements are easy to fulfil				
Agree	59	47	27	54
Neutral	3	3	0	0
Disagree	63	50	23	46
Overall	125	100	50	100
My VAT compliance costs are insignificant				
Agree	46	36	19	38
Neutral	6	5	0	0
Disagree	75	59	31	62
Overall	127	100	50	100
I do not mind doing my VAT work				
Agree	41	32	23	46
Neutral	4	3	0	0
Disagree	82	65	27	54
Overall	127	100	50	100

Note: Some businesses in the year 2009/10 did not provide their attitudes towards VAT compliance, hence the missing responses.

Although most of the respondents feel that VAT is burdensome, its associated costs are, to some extent, mitigated by the benefits gained by the taxpayers in the form of better management and record keeping. In 2009/10, 64 per cent of the survey participants indicate that they benefit from improved management as a result of VAT, while 69 per cent gain from better record keeping, as displayed in Table 6.

Table 6: Taxpayer perceptions of VAT compliance benefits

	2009/10		2010/11	
	N	%	N	%
VAT helps to improve my business management				
Agree	81	64	27	54
Neutral	12	9	0	0
Disagree	34	27	23	46
Overall	127	100	50	100
VAT helps to improve my business record keeping				
Agree	87	69	21	42
Neutral	13	10	0	0

Disagree	27	21	29	58
Overall	127	100	50	100

Note: Some businesses in the year 2009/10 did not provide their attitudes towards VAT compliance, hence the missing responses.

C Taxpayer attitudes in relation to VAT compliance costs

The compliance costs of the taxpayers in relation to their the attitudes towards VAT are presented in Table 7. The overall figures provided in the following tables are the absolute average compliance costs for the businesses that provided their attitudes towards tax compliance work. The explanations of compliance costs by the different attitudes of the businesses are provided in the body above the tables. The attitudinal statements 'My compliance costs are high' and 'VAT requirements are easy to fulfill' are not included in the analysis, from this point forward, as they are similar to the statements 'My VAT compliance costs are insignificant' and 'VAT is unreasonably complicated'.

As could be expected, the respondents who agree with the statement that 'VAT is unreasonably complicated', and those who disagreed that their VAT compliance costs are insignificant, had higher average and median VAT compliance costs. In the same way, the respondents who agree with the statement 'Other business duties are affected because I spend too much time on VAT' report higher compliance costs for 2009/10. In both years, the respondents who agree that 'Other taxes are easier than VAT' report higher compliance costs.

Table 7: VAT compliance costs by taxpayer attitudes

	2009/10			2010/11		
	N	Mean (P, Pula)	Median (P)	N	Mean (P)	Median (P)
VAT is unreasonably complicated						
Agree	68	8231	7362	30	8099	7128
Neutral	5	8734	8180	0	0	0
Disagree	54	5190	3876	20	5855	5400
Overall	127	6958	5760	50	7201	6225
My VAT compliance costs are insignificant						
Agree	46	5314	3943	19	5200	5000
Neutral	6	10 502	8904	0	0	0
Disagree	75	7682	6000	31	8428	7308
Overall	127	6958	5760	50	7201	6225
I do not mind doing my VAT work						
Agree	41	5831	4080	23	7322	5820
Neutral	4	8104	8904	0	0	0
Disagree	82	7465	5760	27	7099	6875
Overall	127	6958	5760	50	7201	6225

Other business duties are affected because I spend too much time on VAT						
Agree	59	8198	7364	23	6821	6875
Neutral	13	6229	4701	0	0	0
Disagree	54	5842	4206	27	7525	5820
Overall	126	6985	5760	50	7201	6225
Other taxes are easier than VAT						
Agree	66	8591	8208	30	8085	6843
Neutral	5	8521	9627	0	0	0
Disagree	55	5558	3974	20	5877	5020
Overall	126	6999	5760	50	7201	6225
The burden of VAT discourages me from fulfilling my VAT obligations						
Agree	22	8705	7549	7	7976	6000
Neutral	25	7799	6240	4	7842	7797
Disagree	75	5910	4091	39	6997	5820
Overall	126	6999	5760	50	7201	6225

Note: Around 10 respondents, in 2009/10, did not provide their attitudes towards VAT compliance work, hence, the missing responses.

Contrary to expectation, the taxpayers that agree to benefitting from the VAT system in the form of improved business management report higher average and median VAT compliance costs, as outlined in Table 8. This shows that the VAT compliance costs have little or nothing to do with the business management, as the bulk of the costs are incurred through other tasks such as record keeping,

VAT return filing, travelling and queuing at the Botswana Unified Revenue Service (BURS) office. As anticipated, the respondents who indicate benefitting from improvements in record keeping have lower VAT compliance costs. Stringent record keeping enables the business to have all their invoices at hand, which saves them time and money when filing their VAT returns.

Table 8: VAT compliance costs by perceptions of benefits

	2009/10			2010/11		
	N	Mean (P, Pula)	Median (P)	N	Mean (P)	Median (P)
VAT helps to improve my business management						
Agree	81	6884	5760	27	7583	6810
Neutral	12	9077	7570	0	0	0
Disagree	34	6385	5512	23	6754	5534
Overall	127	6958	5760	50	7201	6225
VAT helps improve my business record keeping						

Agree	87	6473	5040	21	7161	6810
Neutral	13	9350	8180	0	0	0
Disagree	27	7366	7364	29	7231	5820
Overall	127	6958	5760	50	7201	6225

Note: 10 businesses, in the year 2009/10, did not provide their attitudes towards VAT compliance, hence the missing responses.

D Taxpayer attitudes by size

The attitudes of the taxpayers by the size of the business are presented in Table 9.⁴⁶ In line with evidence provided in prior literature,⁴⁷ the majority of small businesses in Botswana find VAT to be unreasonably complicated. With regard to the statement 'My VAT compliance costs are insignificant', most of the businesses across all sizes disagree, implying that they perceive their VAT compliance costs to be significant. Most businesses have indicated that they find other taxes to be easier than VAT, which may explain why they do mind doing their VAT work.

Table 9: Taxpayer attitudes by the size of the business

Business size	Less than P1.5 million (Pula)		P1.5 million–P5 million		Over P5 million	
	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11
VAT is unreasonably complicated						
Agree	54 (65)	14 (93)	8 (35)	7 (58)	6 (40)	9 (39)
Disagree	29 (35)	1 (7)	15 (65)	5 (42)	9 (60)	14 (61)
Overall	83 (100)	15 (100)	23 (100)	12 (100)	15 (100)	23 (100)
My VAT compliance costs are insignificant						
Agree	29 (35)	1 (7)	13 (57)	5 (42)	4 (27)	13 (57)
Disagree	53 (65)	14 (93)	10 (43)	7 (58)	11 (73)	10 (43)
Overall	82 (100)	15 (100)	23 (100)	12 (100)	15 (100)	23 (100)
I do not mind doing my VAT work						
Agree	26 (31)	2 (13)	12 (52)	7 (58)	3 (20)	14 (61)
Disagree	58 (69)	13 (87)	11 (48)	5 (42)	12 (80)	9 (39)
Overall	84 (100)	15 (100)	23 (100)	12 (100)	15 (100)	23 (100)
Other business duties are affected because I spend too much time on VAT						
Agree	47 (59)	12 (80)	7 (41)	3 (25)	5 (31)	8 (35)

⁴⁶ The 'neutral' column and associated figures have been excluded from the ensuing tables due to very low numbers and also, to enhance the presentation of the results.

⁴⁷ For example, Sandford, Godwin and Hardwick, above n 1; Rametse, above n 31; and Oberholzer, above n 33.

Disagree	32 (41)	3 (20)	10 (59)	9 (75)	11 (69)	15 (65)
Overall	79 (100)	15 (100)	17 (100)	12 (100)	16 (100)	23 (100)
Other taxes are easier than VAT						
Agree	42 (50)	14 (93)	14 (64)	6 (50)	10 (67)	10 (43)
Disagree	42 (50)	1 (7)	8 (36)	6 (50)	5 (33)	13 (57)
Overall	84 (100)	15 (100)	22 (100)	12 (100)	15 (100)	23 (100)
The burden of VAT discourages me from fulfilling my VAT obligations						
Agree	28 (42)	4 (31)	5 (25)	1 (8)	2 (17)	2 (10)
Disagree	39 (58)	9 (69)	15 (75)	11 (92)	10 (83)	19 (90)
Overall	67 (100)	13 (100)	20 (100)	12 (100)	12 (100)	21 (100)

Note: Percentages are in parentheses.

Many small businesses and some medium ones often lack sophisticated business management and record keeping systems. While this makes tax compliance more onerous for these sectors, many of them benefit from the rigorous VAT requirements. Thus, it is not surprising that the majority of the businesses in this study that agree that they gain improvements in business management and record keeping are small- and medium-sized enterprises, as shown in Table 10.

Table 10: Taxpayer perceptions of the benefits by the size of the business

Business size	Less than P1.5 million (Pula)		P1.5 million–P5 million		Over P5 million	
	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11
VAT helps to improve my business management						
Agree	58 (72)	13 (87)	15 (65)	9 (75)	8 (73)	5 (22)
Disagree	23 (28)	2 (13)	8 (35)	3 (25)	3 (27)	18 (78)
Overall	81 (100)	15 (100)	23 (100)	12 (100)	11 (100)	23 (100)
VAT helps improve my business record keeping						
Agree	63 (77)	13 (87)	20 (91)	7 (58)	4 (40)	1 (4)
Disagree	19 (23)	2 (13)	2 (9)	5 (42)	6 (60)	22 (96)
Overall	82 (100)	15 (100)	22 (100)	12 (100)	10 (100)	23 (100)

Note: Percentages are in parentheses.

E Taxpayer attitudes by the sale of standard-rated, zero-rated and exempt goods and services

The VAT system in Botswana zero-rates and exempts some goods and services. It has long been argued that exemptions and zero-rates complicate the VAT.⁴⁸ As expected, most (77 per cent in 2009/10) of the businesses that trade in exempt and zero-rated goods and services agree that VAT is unreasonably complicated, while 81 per cent disagree that their VAT compliance costs are insignificant, as displayed in Table 11. The majority (76 per cent) also report that they mind doing their VAT work while 64 per cent are of the opinion that other taxes are easier than VAT.

Table 11: Taxpayer attitudes by VAT and VAT-free sales

Years	Standard-rated sales		VAT-free sales	
	2009/10	2010/11	2009/10	2010/11
VAT is unreasonably complicated				
Agree	51 (50)	26 (60)	27 (77)	3 (43)
Disagree	50 (50)	17 (40)	8 (23)	4 (57)
Overall	101 (100)	43 (100)	35 (100)	7 (100)
My VAT compliance costs are insignificant				
Agree	43 (43)	16 (37)	6 (19)	4 (57)
Disagree	58 (57)	27 (63)	26 (81)	3 (43)
Overall	101 (100)	43 (100)	32 (100)	7 (100)
I do not mind doing my VAT work				
Agree	36 (35)	20 (47)	8 (24)	4 (57)
Disagree	66 (65)	23 (53)	26 (76)	3 (43)
Overall	102 (100)	43 (100)	34 (100)	7 (100)
Other business duties are affected because I spend too much time on VAT				
Agree	45 (48)	19 (44)	20 (74)	5 (71)
Disagree	49 (52)	24 (56)	7 (26)	2 (29)
Overall	94 (100)	43 (100)	27 (100)	7 (100)
Other taxes are easier than VAT				
Agree	58 (59)	26 (60)	13 (36)	4 (57)

⁴⁸ For example, Milka Casanegra de Jantscher, 'Problems of Administering a Value Added Tax in Developing Countries' (IMF Working Paper WP/86/15, International Monetary Fund, 1986) 3; Alan Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 50; Sijbren Cnossen, 'Design of the Value Added Tax: Lessons from Experience' in Javad Khalilzadeh-Shirazi and Anwar Shah (eds), *Tax Policy in Developing Countries* (World Bank, 1991) 82; Rick Krever, *VAT in Africa* (Pretoria University Law Press, 2008) 19; Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007) 108; and United States Government Accountability Office, above n 8, 12.

Disagree	41 (41)	17 (40)	23 (64)	3 (43)
Overall	99 (100)	43 (100)	36 (100)	7 (100)
The burden of VAT discourages me from fulfilling my VAT obligations				
Agree	29 (34)	3 (8)	7 (32)	1 (14)
Disagree	56 (66)	33 (92)	15 (68)	6 (86)
Overall	85 (100)	36 (100)	22 (100)	7 (100)

Note: Percentages are in parentheses.

F Taxpayer attitudes by VAT registration

The businesses that are newly VAT-registered spend valuable time and money learning the VAT regulations or employing tax experts. It is thus not surprising that over 60 per cent of the businesses that have been VAT-registered for less than five years agree that VAT is unreasonably complicated, as presented in Table 12. In principle, compliance with the VAT requirements should become easier over time if there are no major changes to the VAT regulations. In this study, around 50 per cent of the businesses that have been VAT-registered for more than five years agree that VAT is unreasonably complicated. This implies that, for some taxpayers in Botswana, the VAT regulations do not get easier with time, which is possibly why most of the businesses that have been operating for over five years indicate that they mind doing their VAT work.

Table 12: Taxpayer attitudes by the number of VAT registration years

Years	0-5 years		Over 5 years	
	2009/10	2010/11	2009/10	2010/11
VAT is unreasonably complicated				
Agree	36 (63)	8 (67)	32 (50)	22 (58)
Disagree	21 (37)	4 (33)	32 (50)	16 (42)
Overall	57 (100)	12 (100)	64 (100)	38 (100)
My VAT compliance costs are insignificant				
Agree	22 (39)	3 (25)	24 (38)	16 (42)
Disagree	34 (61)	9 (75)	40 (62)	22 (58)
Overall	56 (100)	12 (100)	64 (100)	38 (100)
I do not mind doing my VAT work				
Agree	18 (31)	5 (42)	23 (36)	18 (47)
Disagree	40 (69)	7 (58)	41 (64)	20 (53)
Overall	58 (100)	12 (100)	64 (100)	38 (100)
Other business duties are affected because I spend too much time on VAT				
Agree	29 (54)	7 (58)	30 (52)	16 (42)
Disagree	25 (46)	5 (42)	28 (48)	22 (58)
Overall	54 (100)	12 (100)	58 (100)	38 (100)

Other taxes are easier than VAT				
Agree	30 (53)	10 (83)	36 (56)	20 (53)
Disagree	27 (47)	2 (17)	28 (44)	18 (47)
Overall	57 (100)	12 (100)	64 (100)	38 (100)
The burden of VAT discourages me from fulfilling my VAT obligations				
Agree	21 (43)	5 (45)	14 (28)	2 (6)
Disagree	28 (57)	6 (54)	36 (72)	33 (94)
Overall	49 (100)	11 (100)	50 (100)	35 (100)

Note: Percentages are in parentheses.

VI DISCUSSION

A Overview of key findings

This study investigates taxpayers' attitudes, compliance benefits perceptions and compliance costs of the VAT in Botswana. The reliability of the responses towards the attitudinal statements in this study is tested using Cronbach's alpha. Most of the responses fall within the acceptable alpha range, indicating that the internal consistency of the answers is reliable. The findings indicate that the majority of the respondents perceive the VAT system in Botswana to be unreasonably complicated. Most also feel that their VAT compliance costs are not insignificant. Thus, the majority of the survey participants resent doing their VAT work. The results also show that some VAT taxpayers are of the opinion that other taxes are easier than VAT. However, the burden of VAT is mitigated by the benefits that accrue to most VAT taxpayers, especially small businesses, in the form of improvements in their record keeping.

The assessment of taxpayers' attitudes by their compliance costs reveals that taxpayers who perceive the VAT to be burdensome have higher VAT compliance costs than those who do not. The respondents who agree with the statement 'VAT is unreasonably complicated' and those who disagree that their VAT compliance costs are insignificant incur higher average and median VAT compliance costs. Similarly, the compliance costs of the businesses that disagree with the statement 'I do not mind doing my VAT work', and those that agree with the statement 'other business duties are affected because I spend too much time on VAT', are higher. This is probably due to the high frequency of VAT filing, the presence of various zero-rated and exempt goods and services as well as the tedious process of travelling to, and queuing at, the BURS office to file the VAT returns.

Some taxpayers agreed that they benefit from the VAT system in the form of improved business management. However, these taxpayers, counter-intuitively, report higher average and median VAT compliance costs, implying that VAT compliance costs have little or nothing to do with the business management, as the bulk of the costs are incurred through other tasks such as record keeping, VAT returns filing, and travelling and queuing at the BURS office. As expected, the respondents who indicate benefitting from improvements in record keeping report lower VAT compliance costs. Stringent record keeping enables businesses to have all their invoices ready, which enables them to save time and money when filing their VAT returns.

B International comparisons

Comparing this study with international findings is questionable, owing to the disparities in the countries' levels of development, socio-economic environments, as well as taxpayer populations and tax systems. Caution needs to be exercised, as 'any such attempt would be more likely to mislead than enlighten'.⁴⁹ Moreover, differences in definitions, methodologies, as well as areas of focus can lead to a comparison of 'apples and oranges'.⁵⁰ Nevertheless, a comparison of this study with other studies is cautiously made.⁵¹ When placed on an international platform, the findings of this study confirm the results of most of the literature, that taxpayers find VAT to be unreasonably complicated.⁵²

In addition, the finding that taxpayers in Botswana resent doing their VAT work supports earlier findings reported by Adams and Webley in the UK and Rametse in Australia.⁵³ The study by Rametse also reports that small businesses who found GST to be unreasonably complicated had higher GST compliance costs than those who did not find GST complicated. A similar result is obtained in Botswana.

These findings, however, contradict the results by Yesegat. Yesegat reports that the majority of the Ethiopian VAT taxpayers perceive VAT to be a simple method of collecting tax and not unreasonably complicated. Thus, most of the taxpayers do not mind doing their VAT work. In addition, taxpayers feel that they do not spend too much time on VAT affairs.⁵⁴ This contrast could be explained by Ethiopia's weak VAT administration.⁵⁵ A weak VAT administration could imply that there is no stringent regulation and, consequently, that VAT compliance is low. It is possible that businesses in Ethiopia do not spend much time on record keeping for VAT and other burdensome VAT-related activities, as they know that enforcement efforts by the revenue authority are weak.

C Perceived benefits

The findings in this study, concerning perceived record keeping benefits, contradict the results of the study by Rametse and Pope. While businesses in Botswana agreed that they benefitted from record keeping practices for VAT purposes, Rametse and Pope report that a majority of small businesses in Australia indicate that they would not benefit from keeping records for GST purposes.⁵⁶ This was probably because this was a start-up compliance cost study, hence the businesses could not, at that stage, see the benefit of keeping records as they were still unfamiliar with the GST system.

⁴⁹ Cedric Sandford, 'The Next Steps' in C Sandford (ed), *Tax Compliance Costs: Measurement and Policy* (Institute for Fiscal Studies, 1995) 405.

⁵⁰ International Finance Corporation, 'The Costs of Tax Compliance in Ukraine' (Washington DC, 2009) 95 <www.ifc.org/Ukraine/IC>.

⁵¹ Some studies, such as those conducted in the 1980s and 1990s, are dated. Thus, a comparison with these studies necessitates extreme caution.

⁵² See Sandford, Godwin and Hardwick, above n 1; Rametse, above n 31; and Oberholzer, above n 33.

⁵³ Adams and Webley, above n 29; and Rametse, above n 31. Rametse reported that small businesses in Australia indicated that they resent doing their GST work.

⁵⁴ Yesegat, above n 27.

⁵⁵ *Ibid* iii.

⁵⁶ Rametse and Pope, above n 4, 434.

D Summary

This paper has discussed the attitudes, compliance benefits, perceptions and compliance costs of the Botswana VAT system. The findings in this study are significant for policy-makers in Botswana. In addition, this study provides comparative findings, which will contribute towards the sparse literature in this area. Further research is needed to determine whether or not the attitudes of VAT taxpayers in Botswana can lead to non-compliance.

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APPENDIX A: 2009/10 QUESTIONNAIRE



Survey of the Compliance Costs of Value Added Tax for Businesses in Botswana for the financial year 2009/2010

Note:

- All questions relate to the year of assessment 2009/2010
- All responses will be kept strictly confidential and anonymous
- Please tick one box or fill in the appropriate details as requested
- BURS refers to Botswana Unified Revenue Service

SECTION A: GENERAL INFORMATION

1. Please indicate the legal structure of your business.

- Sole trader ₁ Company ₂
 Partnership ₃ Trust ₄
 Non-profit organisation ₅ Public sector ₆

2. How long has your business been operating?

- Under 2 years ₁ 2-5 years ₂ Over 5 years ₃

3. What is your main business activity?

- Accommodation ₁ Business Services ₂
 Construction ₃ Farming ₄
 Manufacturing ₅ Property ₆
 Restaurants ₇ Retail Trade ₈
 Transport ₉ Finance and Insurance ₁₀
 Other ₁₁

(Please specify) _____

4. In what year was your enterprise's main business activity registered for VAT?

5. Is the main place(s) of your business in the

- Village ₁ Town ₂ City ₃

6. What was your business's last accounting year?
(Please state **month**)

From to

7. What was your business turnover for the year 2009/2010?

- Less than P500,000 ₁ P500,000–P749,999 ₂
 P750,000–P999,999 ₃ P1,000,000–P5,000,000 ₄
 Over P5,000,000 ₅

SECTION B: TAX COMPLIANCE COSTS

8. In the 2009/2010 financial year, approximately what percentage of your **sales** is classified in each of the following VAT categories?

- a. Standard rated (12 per cent) ₁
 b. Zero rated (0 per cent) ₂
 c. Exempt from VAT ₃
 Total 100%

9. In the 2009/2010 financial year, approximately what percentage of your **purchases** is classified in each of the following VAT categories?

- a. Standard rated (12 per cent) ₁
 b. Zero rated (0 per cent) ₂
 c. Exempt from VAT ₃
 Total 100%

10. Are your VAT return forms completed:

- a. Entirely within the firm? ₁
 b. Partly by the firm and partly by outside assistance? ₂
 c. Entirely by outside assistance? ₃

11. If you have ticked answer (b) or (c),

a. For the 2009/2010 financial year, what was your tax adviser/accountant's fees for ALL tax work?

P

b. If the above fee includes work on VAT, please estimate in percentages:

VAT % ₁ Other Taxes % ₂

12a. Did you employ a tax adviser/accountant for your VAT work in the financial year 2009/2010?

YES ₁ NO ₂ Go to question 13

12b. If 'YES', why do you need the assistance of a tax adviser/accountant for your VAT work?
(Multiple answers possible)

- The VAT return is too complicated ₁
- I do not have time to do VAT related activities ₂
- Hiring a VAT adviser saves my business more time and money than if I did the VAT work myself ₃
- I think it will reduce the chance of a VAT audit ₄
- To ensure compliance with the business' VAT obligations ₅
- Other (Please specify) ₆

12c. In which area(s) do you seek paid advice?
(Multiple answers possible)

- VAT returns preparation ₁ VAT audits ₂
- Record keeping for VAT ₃ VAT on sales ₄
- Legal aspects of VAT ₅ VAT on purchases ₆
- Other (Please specify) ₇

13. If 'NO' to question 12a, which of the following statements apply to you? (Multiple answers possible)

- Our VAT affairs are very simple ₁
- We get help from books/leaflets/guides ₂
- We cannot afford to pay VAT advisers ₃
- We receive help from friends/relatives ₄
- We receive help from BURS ₅
- We think VAT advisers charge more than their advice is worth ₆
- We have employees who are qualified to handle our VAT affairs ₇
- Other (Please specify) ₈

14a. In the financial year 2009/2010, how many hours did the following people spend working solely on VAT (exclude usual book keeping and overhead costs)? Please estimate the MONTHLY hours.

- Owner ₁
- Managers ₂
- Accounting staff ₃
- Administrative staff ₄
- Other (Please specify) ₅

14b. Please estimate MONTHLY wage rates of the following people.

- Owner P ₁
- Manager/Accountants P ₂
- Accounting staff P ₃
- Administrative staff P ₄
- Other (Please specify) P ₅

15. Please estimate your MONTHLY cost of complying with the VAT requirements other than personnel / tax adviser costs in the financial year 2009/2010.

- P ₁
- Computer /data processing P ₁
- Stationery P ₂
- Copying and faxes P ₃
- Postage and telephone P ₄
- Travel P ₅
- Other (Please specify) P ₆

16. Please estimate the number of VAT invoices you process in a month.

Sales ₁ Purchases ₂

17. How often do you submit VAT returns?

- Monthly ₁ Every two months ₂
- Other (Please specify) ₃

18. Excluding bad debts, approximately what percentage of your 2009/2010 sales and purchases (by value) was settled within each of the following periods after invoicing?

Settlement made:	% value of:	
	Purchases	Sales
For cash	<input type="text"/>	<input type="text"/> ₁
Within 1 week	<input type="text"/>	<input type="text"/> ₂
Between 1 week and 1 month	<input type="text"/>	<input type="text"/> ₃
Between the 1 st and 2 nd month	<input type="text"/>	<input type="text"/> ₄
More than 2 months after invoicing	<input type="text"/>	<input type="text"/> ₅
Total	100%	100%

19a. How much did you remit to BURS as VAT for the financial year 2009/2010 (Please exclude penalties)? P

19b. How much did you receive from BURS as input tax for the financial year 2009/2010?

P

19c. How much, if any, have you paid in late payment penalties for the financial year 2009/2010?

P

20. How do you keep your accounting records?

- a. In a paper filing system ₁
- b. In a fully computerised system ₂
- c. In a partially computerised system ₃
- d. My tax adviser keeps my tax records ₄
- e. Other (Please specify) ₅

21a. Does record keeping for VAT give you any benefits e.g. saving money by doing more of your own accounts and giving less work to outside advisers?

YES ₁ NO ₂ Go to question 22a

If 'YES', please describe

21b. If 'YES' to question 21a, please estimate the value of the benefit: P

22a. Have you been visited by a VAT officer?

YES ₁ NO ₂ Go to question 25

22b. If 'YES', when was the last time you were visited by a VAT officer?

22c. How long did the visit last? hours

22d. Please write your comments on the visit below

(Please continue on a separate page if necessary)

SECTION C: PERCEPTIONS AND OPINIONS

23. Kindly indicate with a tick your opinion regarding the statements below:

Strongly agree (1) Agree (2) Neutral (3) Disagree (4)

Strongly Disagree (5)

- a. VAT is unreasonably complicated ₁ ₂ ₃ ₄ ₅
- b. My VAT compliance costs are insignificant ₁ ₂ ₃ ₄ ₅
- c. I do not mind doing my VAT work ₁ ₂ ₃ ₄ ₅
- d. VAT requirements are easy to fulfil ₁ ₂ ₃ ₄ ₅
- e. VAT helps to improve my business management ₁ ₂ ₃ ₄ ₅
- f. Other business duties are affected because I spend too much time on VAT ₁ ₂ ₃ ₄ ₅
- g. Other taxes are easier than VAT ₁ ₂ ₃ ₄ ₅
- h. My VAT compliance costs are very high ₁ ₂ ₃ ₄ ₅
- i. VAT helps improve my business record keeping ₁ ₂ ₃ ₄ ₅
- j. The burden of VAT discourages me from fulfilling my VAT obligations ₁ ₂ ₃ ₄ ₅

24. Has the increase in the VAT rate affected your compliance costs?

YES ₁ NEGLIGIBLE ₂ NO ₃

If 'YES', please explain

25. Has the increase in the VAT registration threshold affected your registration for VAT?

YES ₁ NO ₂

If 'YES' please explain

26. As a taxpayer in a developing country, do you find the resources provided by your government to support Value Added Taxpayers adequate?

YES ₁ NO ₂

APPENDIX B: 2010/11 QUESTIONNAIRE



UNIVERSITY OF BOTSWANA
FACULTY OF BUSINESS

Survey of the Compliance Costs of Value Added Tax for Businesses in Botswana for the Financial Year 2010/2011

Note:

- All questions relate to the year of assessment 2010/2011
- All responses will be kept strictly confidential and anonymous
- Please tick one box or fill in the appropriate details as requested
- BURS refers to Botswana Unified Revenue Service

SECTION A: GENERAL INFORMATION

1. Please indicate the legal structure of your business.

- Sole trader ₁ Company ₂
 Partnership ₃ Trust ₄
 Public sector ₅ Non-profit organisation ₆

2. How long has your business been operating?

- Under 2 years ₁ 2-5 years ₂ Over 5 years ₃

3. What is your main business activity?

- Mining ₁ Business/financial Services ₂
 Farming ₃ Construction/Property ₄
 Manufacturing ₅ Restaurants ₆
 Retail Trade ₇ Other ₈
 (Please specify)

4. The main place of your business is in the

- Village ₁ Town ₂ City ₃

5. What was the last accounting year of your business? (Please state **MONTH**)

From: To:

6. What was your business turnover for the year 2010/2011?

- Less than P500,000 ₁ P500,000–P749,999 ₂
 P750,000–P999,999 ₃ P1,000,000–P5,000,000 ₄
 Over P5,000,000 ₅

If your turnover was more than P5,000,000 in 2010/2011, please estimate below

P

7. How many employees did you have in 2010/2011?

8. In what year was your business registered for VAT?

- 2002/03 ₁ 2003/04 ₂ 2004/05 ₃
 2005/06 ₄ 2006/07 ₅ 2007/08 ₆
 2008/09 ₇ 2009/2010 ₈ 2010/2011 ₉

SECTION B: TAX COMPLIANCE COSTS

9. In the 2010/2011 financial year, approximately what percentages of your sales & purchases are classified in each of the following VAT categories?

	Sales	Purchases
a. Standard rated (12 per cent)	<input type="text"/>	<input type="text"/>
b. Zero rated (0 per cent)	<input type="text"/>	<input type="text"/>
c. Exempt from VAT	<input type="text"/>	<input type="text"/>
Total	100%	100%

10. How are your VAT return forms completed?

- a. Entirely within the firm? ₁
 b. Partly within and partly outside the firm ₂
 c. Entirely by outside assistance? ₃

11. If you have ticked answer (10b) or (10c):

a. For the 2010/2011 financial year, what was your tax adviser/accountant's fees for ALL tax work?

P

b. If the above fee includes work on VAT, please estimate in percentages:

VAT %₁ Other Taxes %₂

12. Please estimate the time spent by the following people entirely on VAT (exclude usual book-keeping and overhead costs).

Number of hours	<u>Hourly</u> wage rate / value of this time
--------------------	---

a. By the owner and family or by partners in the business.

hours/year	P per hour
------------	------------

b. By the directors and managers of the company.

hours/year	P per hour
------------	------------

c. By accounting staff.

hours/year	P per hour
------------	------------

d. By administrative staff.

hours/year	P per hour
------------	------------

e. By other staff.

hours/year	P per hour
------------	------------

13a. Did you incur any other REGULAR costs in complying with the VAT system in 2010/2011 not previously mentioned?

Yes ₁ No ₂ Go to question 14a

13b. If 'YES', please describe them briefly

13c. Please give an estimate of these costs:

P

14a. Have you had any SPECIAL problems with the VAT in the financial year 2010/2011?

YES ₁ NO ₂ Go to question 15

14b. If 'YES', please describe them briefly

14c. Please estimate the MONETARY COST of these special problems

P

15. Excluding bad debts, approximately what percentage of your 2010/2011 sales (by value) was settled within each of the following periods after invoicing?

Settlement made:	% value of Sales
For cash	<input type="text"/> % ₁
Within 1 week	<input type="text"/> % ₂
Between 1 week and 1 month	<input type="text"/> % ₃
Between the 1 st and 2 nd month	<input type="text"/> % ₄
More than 2 months after invoicing	<input type="text"/> % ₅
Total	100%

16a. How much did you remit to BURS as VAT for the financial year 2010/2011 (Please exclude penalties)?

P

16b. How much did you receive from BURS as input tax for the financial year 2010/2011?

P

16c. How much, if any, have you paid in late payment penalties for the financial year 2010/2011?

P

17. Please estimate the number of VAT invoices you process in a month.

Sales ₁ Purchases ₂

18. How often do you submit VAT returns?

Monthly ₁ Every two months ₂
Other (Please specify) ₃

19a. How do you keep your accounting records?

- a. In a paper filing system ₁
- b. In a fully computerised system ₂
- c. In a partially computerised system ₃
- d. My tax adviser keeps my tax records ₄
- e. Other (Please specify) ₅

19b. Does record keeping for VAT give you any benefits e.g. saving money by doing more of your own accounts and giving less work to outside advisers?

YES ₁ NO ₂ Go to question 20a

If 'YES', please describe

19c. If 'YES' to question 19b, please estimate the MONETARY value of the benefit:

P

20a. Did you employ a tax adviser/accountant for your VAT work in the financial year 2010/2011?

YES ₁ NO ₂ Go to question 21

20b. If 'YES', why do you need the assistance of a tax adviser/accountant for your VAT work? (Multiple answers possible)

- The VAT return is too complicated ₁
 - I do not have time to do VAT related activities ₂
 - Hiring a VAT adviser saves my business time and money than if I did the VAT work myself ₃
 - I think it will reduce the chance of a VAT audit ₄
 - To ensure compliance with the business' VAT obligations ₅
 - Other (Please specify) ₆
-

20c. In which area(s) do you seek paid advice? (Multiple answers possible)

- VAT returns preparation ₁ VAT audits ₂
 - Record keeping for VAT ₃ VAT on sales ₄
 - Legal aspects of VAT ₅ VAT on purchases ₆
 - Other (Please specify) ₇
-

21. If 'NO' to question 20a, which of the following statements apply to you? (Multiple answers possible)

- Our VAT affairs are very simple ₁
 - We get help from books/leaflets/guides ₂
 - We cannot afford to pay VAT advisers ₃
 - We receive help from friends/relatives ₄
 - We receive help from BURS ₅
 - Our employees are qualified to do our VAT work ₆
 - Other (Please specify) ₇
-

SECTION C: PERCEPTIONS AND OPINIONS

22. Kindly indicate with a tick your opinion regarding the statements below:

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	N/A
	1	2	3	4	5	6
VAT is too complicated	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
My VAT compliance costs are insignificant	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
I do not mind doing my VAT work	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
VAT requirements are easy to fulfil	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
VAT helps to improve my business management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other business duties are affected because I spend too much time on VAT	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other taxes are easier than VAT	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
My VAT compliance costs are very high	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
VAT helps improve my business record keeping	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
The burden of VAT discourages me from fulfilling my VAT obligations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

23. As a taxpayer in a developing country, do you find the resources provided by your government to support Value Added Tax adequate?

YES ₁ NO ₂

If 'NO', what is lacking?

24. Developing countries have been said to have poor VAT administration. Do you think this is the case with Botswana? YES ₁ NO ₂

Please comment

25. If your business could claim from the government as compensation for the time and money spent on VAT affairs, how much would you claim for the financial year 2010/2011?

P

SECTION D: COMMENTS AND SUGGESTIONS

26. Compared with other businesses in your industry, the estimated level of VAT compliance burden for your business is: (Please tick one box)

Very high ₁ High ₂
Similar ₃ Low ₄
Very low ₅

27. Please state any comments/suggestions that you may have for improving VAT.

(Please continue on a separate page if necessary)

If you are willing to answer additional questions arising from this questionnaire, please provide your contact details. Your answers will be treated with strict confidentiality and will only be used for the purpose of this study.

Name _____

Company Name _____

Telephone _____

E-mail Address _____

Thank you for using your valuable time to complete this questionnaire. Please post the completed questionnaire in the enclosed reply paid envelope to:

**Tshepiso Ketsoeletse Makara
University of Botswana
Faculty of Business
Accounting and Finance Dept.
Private Bag UB 00701
Gaborone**

TAX, DEBT, FINE AND PENALTY COLLECTION IN NEW ZEALAND: EQUITABLE TREATMENT OR INEQUITABLE OUTCOMES?

LISA MARRIOTT*

ABSTRACT

This article examines the different approaches to collecting debts owed to the New Zealand Government. The study compares Inland Revenue's approach to debt collection with debt collection approaches in other government departments, including the Ministries of Justice, Environment, Primary Industries, Social Development, and Business, Innovation and Employment. Data is collected from government department annual reports and supplemented with information collected under the *Official Information Act 1982*. Alber's framework for comparative social service provision is used for analytical purposes.

The first, and primary, objective of this study is to measure and report on different approaches to debt management across government agencies, with the aim of highlighting how different approaches contribute to inequitable outcomes for different debtors. The study finds that approaches to collecting funds owed to the Crown are inconsistent across government agencies, both in their intent and in their application. The current approaches result in large sums of funds remaining uncollected. This is particularly evident in relation to tax debt and student loan debt.

There is some suggestion from overseas literature that white-collar fines and penalties lack strong enforcement. Thus, a secondary aim of the study is to examine whether there is any relationship between the types of monies owed and debt collection approaches in New Zealand. Data collected shows that tax debt and student loan debt are more likely to be remitted than other forms of debt. The article makes a case for adopting a standardised, and potentially centralised, approach to debt collection in New Zealand, in order to improve transparency and equity across government debt collection.

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I INTRODUCTION

This article examines debt collection across a number of government agencies in New Zealand, with a particular focus on tax debt. Typically, negative consequences follow when debts are not settled. However, this is not the case in relation to some debts in New Zealand, where there are a range of situations where debts will not be recovered. The issue that this study sets out to explore is the different approaches to debt management that are adopted across different government departments.

Receivables reported in the Crown financial statements for the year ended 30 June 2017 are outlined in Table 1.

Table 1: New Zealand Government receivables (30 June 2017)¹

Receivable type	Amount (NZ\$)
Tax receivables	\$10 313 million ²
ACC levy receivables	\$2225 million
Social benefit receivables	\$736 million
Other levies, fines and penalties receivable	\$350 million
Total sovereign receivables	\$13 624 million

Other receivables that are categorised as advances are outlined in Table 2.

Table 2: Additional receivables (30 June 2017)³

Receivable type	Amount (NZ\$)
Kiwibank loans and advances	\$17 795 million
Student loans	\$9197 million
Other advances	\$1591 million
Total other receivables	\$28 583 million

The primary receivables of the New Zealand Government total NZ\$24.4 billion. This amount includes all receivables with the exception of Kiwibank advances as, unlike other debts to the Crown, these are likely to be entered into on commercial terms. For the purposes of context, total tax revenue for the 2016/17 financial year was NZ\$75.6 billion.⁴

¹ New Zealand Government, Financial Statements of the Government of New Zealand for the Year Ended 30 June 2017 (2017).

² The tax receivables figure reported in the New Zealand Government financial statements differs from the receivables reported in the Inland Revenue financial statements. This is due to a number of factors, including expected timing of collection of debt.

³ New Zealand Government, above n 1, Note 12 Receivables.

⁴ Treasury, New Zealand Government, *Revenue* (5 October 2017) <<http://www.treasury.govt.nz/government/revenue>>.

Data is collected for this study from annual reports of government departments and supplemented with information gathered under the *Official Information Act 1982* (OIA). The study has two objectives. The first, and primary, objective is to highlight the different approaches adopted to debt collection across government agencies in New Zealand and the inequities that result from different approaches. The second objective is to examine whether different 'types' of debt are treated differently, that is, whether 'white-collar' debt is less likely to be collected.

The research concludes that approaches to Crown debt are inconsistent, both in their intent and in their application, and result in large sums of funds remaining uncollected. The majority of Crown debt that is not collected is tax debt and student loan debt, both of which are administered by the Inland Revenue. The article suggests that Inland Revenue's attempts to be more customer-centred have resulted in a lenient approach to tax collection that impacts negatively on revenue collection. Moreover, different approaches between government departments to debt collection result in inequitable outcomes for holders of government debt.

The study suggests that there may be benefit from adopting a standardised approach to debt collection across New Zealand government departments to reduce extant inequities. Further benefit may be gained from establishing a centralised debt management office to specialise in debt collection.

The study commences in section two with a discussion on tax debt administration. Section three outlines the method and theoretical framework adopted in the study. Section four follows with a review of debt collection across a range of government agencies in New Zealand. Section five provides an analysis of the range of debt collection approaches, with concluding comments drawn in section six.

II BACKGROUND

This section provides the context to the topic of debt collection, with a primary focus on tax debt and tax penalties. Fines, penalties and other sanctions exist in order to encourage compliance with rules and laws. They also have a deterrent objective – to deter specific individuals from repeating events of non-compliance and to deter individuals in general from engaging in non-compliant behaviour. They may also include an element of reparation: to make amends for wrongdoing. However, in order to achieve these aims, the financial fines and penalties imposed need to be collected.

In 1999 the Finance and Expenditure Committee completed an *Inquiry into the Powers and Operations of the Inland Revenue Department* (the Inquiry).⁵ The Terms of Reference of the Inquiry included reviewing the powers of the Commissioner of Inland Revenue to assess and collect income tax and to assess whether the powers were justified; to review Inland Revenue's application of the compliance and penalties regime; and to review debt management practices and the adequacy of Inland Revenue's powers to remit or defer payment of tax liabilities.

⁵ Inland Revenue, New Zealand Government, *Inquiry into the Powers and Operations of the Inland Revenue Department* (Presented to the New Zealand House of Representatives, October 1999).

Terms of Reference C to the Inquiry are relevant to this study. This outlines the debt management practices and adequacy of the powers of Inland Revenue to remit or defer payment of tax liabilities. The Terms of Reference note that Inland Revenue has a 'difficult job to perform when dealing with taxpayers who are in debt to the department'.⁶ Three reasons are provided in support of this statement. First, unlike other creditors, Inland Revenue has no control over the individuals and entities that generate tax debts. Second, Inland Revenue (at the time) had no general discretion on payment of tax liabilities. Third, some forms of debt (such as child support) were given priority in distributions when a taxpayer was insolvent.

The Inquiry also observed the potential for debts to escalate quickly as use-of-money interest and penalties accrue. This is a situation that is receiving further attention at the present time, some 20 years later.

The Inquiry also commented on the Commissioner's discretion to remit income tax if the taxpayer was experiencing serious hardship, noting that the serious hardship provision was used where taxpayers did not have the ability to pay tax in arrears but did have the ability to account for future taxation payments. The Inquiry notes the equity issues associated with remission of debt and that it 'erodes the ethos that all taxpayers have an obligation to pay their tax'. This equity has not been addressed and creates a situation where employees, whose tax obligations are deducted at source, do not have the same ability to claim serious hardship.

A theme that emerged from the Inquiry was that 'the department takes a heavy handed approach to debt collection, and pursues debt rigorously and without tact'.⁷ The Inquiry reported that in the period 1 July 1998 to 30 June 1999, the department referred 1000 individuals for bankruptcy and 995 companies for liquidation. In 44 per cent of these cases, the proceedings were withdrawn as the debt was either paid or arrangements to pay the debt were made. Liquidations and bankruptcies are discussed further in section four of this article. However, for the purposes of comparison, the numbers of individuals and companies entering into liquidations and bankruptcies in 2015/16 were approximately double those reported for 1998/99.⁸

Tax revenue authorities throughout the OECD have invested considerable resource in improving tax compliance and collection. As noted by the OECD, there is little to be gained from sophisticated strategies for enhancing or enforcing compliance, if the tax owed is not actually collected.⁹ In 2011, Ross and Pritikin wrote an article suggesting that corporate and white-collar fines and penalties lacked strong enforcement.¹⁰ The authors report a 'massive gap between penalties imposed "on the books" and penalties collected in reality'.¹¹ However, this is not a new revelation. Over 30 years ago, Kagan suggested

⁶ Inland Revenue, above n 5, Terms of Reference C.

⁷ Ibid.

⁸ Information received under the *Official Information Act 1982* (OIA), 29 November 2017, Inland Revenue, New Zealand Government.

⁹ OECD, 'Forum on Tax Administration. Scoping Document: Working Smarter in Tax Debt Management' (OECD Publishing, 2013).

¹⁰ Ezra Ross and Martin Pritikin, 'The Collection Gap: Underenforcement of Corporate and White-Collar Fines and Penalties' (2011) 29 *Yale Law & Policy Review* 453.

¹¹ Ibid 454.

that costly mechanisms to collect debt were being foregone for alternative approaches that included negotiation of payment terms, bankruptcy or writing off unpaid debt.¹²

In the United States of America an 'Excessive Fines Clause' exists in the Eighth Amendment.¹³ The result of this clause is that penalties may be barred where they are disproportionate in relation to their associated offending. However, the ability of the defendant to pay the fine has not been a relevant consideration in the context of the Eighth Amendment and it is only in the event that the fine or forfeiture would be sufficiently severe as to 'destroy a defendant's livelihood' that the clause would be imposed.¹⁴ No similar clauses exist in New Zealand, although some government departments may take advantage of legislated debt write-offs where serious hardship will result to the debtor if repayment of the debt is pursued.¹⁵

Governments are becoming more innovative in the methods used to assist with debt collection. For example, the Netherlands Tax and Customs Administration uses Automatic Number Plate Recognition to assist with collecting tax debt. Motorists with outstanding debts are stopped during 'stop-and-pay' operations with police and other authorities. If motorists are identified as tax debtors during these operations, they are required to settle the tax debt or their car will be seized. In 2010, the tax administration seized 2000 vehicles and collected €5 million during these operations.¹⁶ Other examples include publishing the names of taxpayers with debts (Finland) or using specialist debt collection agencies (the United Kingdom).¹⁷ The United Kingdom approach was reported as collecting an additional 77 per cent more cash than if the debt collection agencies had not been used.¹⁸

In 2011, the OECD published a document comparing debt collection mechanisms across OECD countries, among other topics.¹⁹ While this information dates back to 2009, it provides an historical perspective on resources invested in the debt collection mechanism in a range of countries. Across the 34 OECD member states reported, New Zealand has one of the lowest proportions of staff usage on debt collection and related functions at 9.4 per cent.²⁰

New Zealand has a low cost of collection ratio for tax debt, which the OECD observe is used as a measure of efficiency and effectiveness of the administration.²¹ New Zealand's

¹² Robert A Kagan, 'The Routinization of Debt Collection: An Essay on Social Change and Conflict in the Courts' (1984) 18 *Law and Society Review* 323.

¹³ Nicholas M McLean, 'Livelihood, Ability to Pay, and the Original Meaning of the Excessive Fines Clause' (2013) 40 *Hastings Constitutional Law Quarterly* 833.

¹⁴ *Ibid* 835.

¹⁵ For example, *Tax Administration Act 1994* (NZ) (TAA) s 177A.

¹⁶ OECD, 'Forum on Tax Administration. Information Note: Working Smarter in Structuring the Administration, in Compliance, and through Legislation' (OECD Publishing, 2012) 39.

¹⁷ *Ibid*.

¹⁸ OECD, 'Scoping Document', above n 9, 40.

¹⁹ OECD, 'Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series' (OECD Publishing, 2011).

²⁰ *Ibid* Table 23. Countries reporting lower proportions are: the Czech Republic (6.3 per cent); Norway (5.1 per cent); the Slovak Republic (5.5 per cent); Switzerland (6.1 per cent); and Turkey (7.8 per cent).

²¹ OECD, 'Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies' (OECD Publishing, 2015).

cost of collection ratio ((administration cost/net revenue collection)/1) is 0.85.²² While this would appear to be a positive sign, other countries that have low cost of collection ratios typically have a low tax burden. In the case of New Zealand the low cost of collection may reflect a high level of efficiency or it may also reflect non-collection of debt that will incur higher costs to collect. It is acknowledged that a range of factors can impact on these measures resulting in difficulties in engaging in cross-country comparisons. These factors include when the tax authority has other roles such as collecting social insurance contributions or excise taxes, the legislated tax burden or economic conditions.²³

A range of factors have been identified as contributing to positive debt collection outcomes, including: the existence of extensive debt collection powers; the ability to collect taxes from third parties, close businesses and cancel licences; the ability to obtain liens over assets; requiring tax clearance prior to being awarded government contracts; withholding government payments where tax debt is outstanding; and imposing tax debts on company directors.²⁴ Additional factors include investment in information technology and effectively resourced tax authorities. The OECD note the importance of having a well-staffed debt collection function, which is organised within a dedicated unit.²⁵

III METHOD AND THEORETICAL FRAMEWORK

This study adopts a comparative method. It is often argued that comparative study is potentially the most important of all.²⁶ This claim results from the potential for one country, institution or department to improve its own processes by observing how other countries, institutions or departments have responded to similar problems. The research uses a case study approach, notwithstanding the acknowledged limitations of comparative case studies: the use of a small number of cases, with many variables, results in limited ability to generalise from the findings.²⁷

The comparative method is used to explore debt collection approaches across a range of government departments in New Zealand. As such, the study is largely positive in nature, focusing on extant practice and the potential for inequities to arise from current approaches to debt collection.

For analytical purposes, the study uses the framework proposed by Alber for comparative study of social services.²⁸ The framework uses a 'checklist' of variables to facilitate analysis of state service provision. For the purposes of this study, the service

²² Ibid 181, Table 5.4. Data reported as at 2013.

²³ Ibid.

²⁴ OECD, 'Scoping Document', above n 9, 56.

²⁵ Ibid.

²⁶ Christopher Nobes and Robert Parker, *Comparative International Accounting* (Financial Times/Prentice Hall, 7th ed, 2002) 8.

²⁷ Arend Lijphart, 'Comparative Politics and the Comparative Method' (1971) 65 *The American Political Science Review* 682.

²⁸ Jens Alber, 'A Framework for the Comparative Study of Social Services' (1995) 5 *Journal of European Social Policy* 131.

considered is the debt collection mechanism. The analytical framework proposes four variables, which are outlined below in Figure 1.

Figure 1: Analytical framework applied to debt collection in New Zealand²⁹

<p>Regulatory structure Determined by legislation and applied by individual government departments</p>	<p>Financing structure Funded by central government through appropriations to individual government departments</p>
<p>Delivery structure Delivery approaches determined by individual government departments</p>	<p>Customer power Different power held by different debtor types</p>

Figure 1 further shows the application of the four variables to the case study herein: debt collection. The regulatory structure refers to who regulates and at what level of government. In the case study examined in this research, the government departments operate under different legislation. For example, Inland Revenue debt collection is largely determined by the *Tax Administration Act 1994* (TAA) while debt collection for the Ministry of Social Development (MSD) is in the *Social Security Act 1964*.

Financing for the debt collection functions, as well as write-off provisions, come through the appropriation process to individual government departments. For example, MSD have an output expense for ‘investigation of overpayments and fraudulent payments and collection of overpayments’³⁰ and Inland Revenue have an output expense for ‘management of debt and outstanding returns’.³¹

The third variable, the delivery structure, determines how debt collection approaches are applied in practice. These will, in part, be influenced by the regulatory and financing structure, but will also be influenced by historical practice.

Customer (debtor) power will differ between different debtor types and will also be influenced by the regulatory structure. By way of example, the Inland Revenue have a statutory revenue collection function to maximise tax revenue collection. However, this must be achieved in an efficient manner, ie, it must not be an inefficient use of resources. This generates a situation where taxpayer debtors have the power to negotiate an agreed outcome, as it is preferable for Inland Revenue to collect some revenue, as opposed to no revenue. However, other debtors, such as those holding fines payable to the Ministry of Justice, do not have similar powers. These different approaches are discussed in more detail in the next section. These variables will be returned to in the Discussion, in order to frame the analysis.

²⁹ Ibid 142.

³⁰ Ministry of Social Development, New Zealand Government, *Annual Report 2016/17* (2017) 66.

³¹ Treasury, New Zealand Government, *Supplementary Estimates of Appropriations 2016/17 B.7* (2017) 588.

IV DEBT COLLECTION APPROACHES IN NEW ZEALAND

The primary debt of interest in this study is tax debt. Thus, this section commences with a discussion of current tax debt and debt collection approaches used by Inland Revenue. This is followed with discussion of another government department that also holds a significant level of debt: the government department responsible for the welfare system, MSD. Subsequently, student loan debt is discussed. The student loan scheme is administered by MSD in connection with the Ministry of Education and Inland Revenue. MSD is responsible for the payment of the student loans, while Inland Revenue is responsible for the collection. A number of brief sub-sections follow, outlining debts held by a range of additional government departments, together with amounts collected and remitted over the most recently reported period.

A Inland Revenue

Under the TAA the Commissioner of Inland Revenue must maximise the recovery of outstanding tax from a taxpayer.³² However, the Commissioner may not recover outstanding tax where it would either be an inefficient use of Inland Revenue resources or would place the taxpayer, who is a natural person, in a position of serious hardship.³³ The duty to maximise revenue collection is subject to an overriding obligation to protect the integrity of the tax system as per s 6A(3) of the TAA, where the Commissioner of Inland Revenue is charged with collecting:

over time the highest net revenue that is practicable within the law having regard to

- (a) the resources available to the Commissioner; and
- (b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and
- (c) the compliance costs incurred by taxpayers.

In 2015/16, 87 per cent of tax payments made by taxpayers were on time.³⁴ The corollary is 13 per cent of tax payments were not made on time, generating tax debts. As at 30 June 2016, tax debt reported by the Inland Revenue was NZ\$4.7 billion. This debt includes unpaid goods and services tax (GST); income tax; KiwiSaver contributions; pay-as-you-earn; Working for Families tax credits; and other taxes, but does not include student loans. Student loans are discussed in sub-section C.

There are 234 462 Inland Revenue debtors with overdue debts in 2015/16.³⁵ A large component of tax debt is made up of penalties and interest: 48.8 per cent in 2015/16, including student loan debt.³⁶ Table 3 outlines tax debt reported by Inland Revenue over the period 2012–16, together with student loan debt. The amount described as non-

³² TAA s 176(1).

³³ *Ibid* s 176(2).

³⁴ Inland Revenue, New Zealand Government, *Annual Report – 2016* (2016) 48.

³⁵ Calculated from the 339 192 debtors reported in the Inland Revenue annual report, less 104 730 student loan debtors (information received under the OIA, 12 September 2017, Inland Revenue, New Zealand Government).

³⁶ It is not possible to get this figure broken down into different borrowing types.

collectable is debt where Inland Revenue is unable to proceed with collection activity at the present time.³⁷ Amounts shown as non-collectable also include amounts classified as tax evasion³⁸ and therefore cannot be written off.³⁹ The debt-under-instalment figure of NZ\$996.6 million in 2015/16 includes NZ\$239.4 million of student loan default.⁴⁰

Table 3: Tax debt and debt portfolio as at 30 June 2012 to 30 June 2016 (NZ\$ million)⁴¹

	2012	2013	2014	2015	2016	% change 2015-16
Total tax debt	5404.1	5342.3	5470.7	5153.1	4680.0	-9.2%
Student loan debt	512.3	635.9	769.4	933.0	1074.8	15.2%
Total	5916.4	5978.2	6240.1	6086.1	5754.8	
Debt-under- instalment	1176.3	1230.2	1228.2	1085.4	996.6	-8.2%
Other collectable debt	2582.7	2561.5	2621.6	2367.0	2198.0	-7.1%
Non-collectable debt	2157.4	2186.4	2390.3	2633.8	2560.2	-2.8%
Total debt	5916.4	5978.2	6240.1	6086.1	5754.8	-5.4%

Across the OECD, tax administrations report that around 45 per cent of tax debt is considered collectable.⁴² Based on the figures shown in Table 3, New Zealand's potential collectable debt is higher than this at 55 per cent. However, of the NZ\$5754.8 million debt reported in 2016, the majority is older than two years.⁴³ Of the total, NZ\$1219.9 million (21 per cent) is older than one year; NZ\$822.8 million (14 per cent) is between one and two years; NZ\$1752.5 million (30 per cent) is between two and five years; NZ\$987.9 million (17 per cent) is between five and ten years; and NZ\$971.7 million (17 per cent) is older than ten years.⁴⁴ Thus, 65 per cent of the debt reported is older than two years. As aged debt is more likely to be non-collectable, it may be that a higher proportion than suggested in Table 3 is not collected in practice.

The Inland Revenue has a range of tools to assist with debt recovery and enforcement. These tools include allowing taxpayers to enter into instalment arrangements, whereby tax debts can be paid off over time. As shown in Table 3, debt-under-instalment in 2016

³⁷ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 134.

³⁸ TAA s 177C(3) restricts the Commissioner of Inland Revenue from writing off outstanding tax where it relates to taking an abusive tax position or tax evasion.

³⁹ Information received under the OIA, 12 September 2017, Inland Revenue, New Zealand Government.

⁴⁰ *Ibid.*

⁴¹ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 30/134.

⁴² OECD, 'Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies' (OECD Publishing, 2017) 18.

⁴³ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 134.

⁴⁴ *Ibid.*

was NZ\$997 million. In the 2015/16 tax year, 110 920 taxpayers entered into an instalment arrangement, of which 10 897 were still current at the end of the year.⁴⁵

An OIA request was made to Inland Revenue requesting:

1. The value of penalties applied on tax debt;
2. The value of penalties collected;
3. The value of penalties written off;
4. The value of interest applied on tax debt;
5. The value of interest collected;
6. The value of interest written off; and
7. The value of tax debt written off (excluding penalties and interest).

Inland Revenue advised in their response to the OIA request that the information requested under point 7 was not available as an amount excluding penalties and interest, and advised that the figures reported in the department's annual report outline total tax debt written off and impaired during the year. In 2015/16, Inland Revenue report 'impairment of debt and debt write-offs' at NZ\$680.343 million and NZ\$1.1 billion written off as uncollectable.⁴⁶ However, this amount includes debt and debt written off relating to general tax, Working for Families tax credits and KiwiSaver debt. A further OIA request was made requesting a breakdown of the three categories. In response to this request, Inland Revenue provided the information outlined in Table 4.

Table 4: Debt category breakdown (2015/16)⁴⁷

Debt type	NZ\$ million
General tax	\$936.414
Working for Families tax credits	\$187.168
KiwiSaver	\$3.026
Total debt write-offs	\$1126.608
Less impairment reversal	(\$446.265)
Total impairment of debt and debt write-offs 2016	\$680.343

Table 4 shows the NZ\$1.1 billion that was written off as uncollectable, while the NZ\$680 million amount is the adjusted figure taking into account the previous impairment of the debt. For the purposes of the discussion in this article, it is the \$1.1 billion amount that is of primary interest. Case law has shown that the requirement to maximise recovery of

⁴⁵ Information received under the OIA, 24 February 2017, Inland Revenue, New Zealand Government.

⁴⁶ Inland Revenue, New Zealand Government, above n 34, 110. This debt figure includes general tax, Working for Families tax credits and KiwiSaver debt.

⁴⁷ Information received under the OIA, 29 November 2017, Inland Revenue, New Zealand Government.

outstanding debt is not an absolute obligation. Inland Revenue report that ‘the Commissioner’s duty is to be approached on “a pragmatic basis with proper regard to the likely benefits and the costs of achieving them”’.⁴⁸

Of relevance, is that penalties and interest accrue on unpaid tax obligations. At the time of writing, the initial late payment penalty is 1 per cent of unpaid tax on the day after the tax is due. This increases by a further 4 per cent at the end of the sixth day the tax is unpaid and a further 1 per cent is added for each additional month the debt remains outstanding. In addition, interest is applied. As at May 2018 the interest rate is 8.22 per cent.⁴⁹ A taxpayer who enters into an instalment arrangement will benefit as the monthly additional penalties are not charged when a debt is under an instalment arrangement, but interest charges remain.⁵⁰

Information provided by Inland Revenue in relation to points 1–6 above is outlined in Table 5. As shown in Table 5, a high proportion of penalties and interest are written off each year. In the three most recent years shown, over 60 per cent of penalties were written off. It is acknowledged that this figure will not accurately reflect the actual collection of penalties applied in that year, as some penalties will be collected, or written off, in a different year to when they are applied.

Collection of penalties ranged from a low of 18 per cent (in 2012/13) to a high of 36 per cent (in 2015/16). Thus, relatively low proportions of penalties applied are collected. A similar picture is visible with interest, but with higher proportions of collection rates. Collection rates of interest ranged from 42 per cent (in 2012/13) to 63 per cent (in 2015/16). Interest values written off were close to 50 per cent in the past three years.

Table 5: Penalties applied, collected and written off (2012/13–2015/16)⁵¹

	2012/13	2013/14	2014/15	2015/16
Penalties applied (\$ m)	850	563	552	484
Penalties collected (\$ m)	151	179	175	172
Penalties written off (\$ m)	281	342	341	319
<i>Penalties collected (%)</i>	<i>18%</i>	<i>32%</i>	<i>32%</i>	<i>36%</i>
<i>Penalties written off (%)</i>	<i>33%</i>	<i>61%</i>	<i>62%</i>	<i>66%</i>
Interest applied (\$ m)	420	366	354	336
Interest collected (\$ m)	176	190	185	213
Interest written off (\$ m)	143	153	194	179

⁴⁸ Inland Revenue, New Zealand Government, *Standard Practice Statement 11/01: Instalment Arrangements for Payment of Tax* (2011) 19.

⁴⁹ Inland Revenue, New Zealand Government, *Current and Past Interest Rates* (2 May 2018) <<http://www.ird.govt.nz/how-to/debt/penalties/interest/interest-overview/interest-rates.html>>.

⁵⁰ Inland Revenue, New Zealand Government, *Standard Practice Statement 11/01*, above n 48, 22.

⁵¹ Information received under the OIA, 23 May 2018, Inland Revenue, New Zealand Government. Inland Revenue advise that these amounts exclude social policy amounts, such as student loans; the time period is from July to June, rather than the tax year (April to March); the amounts are based on the year in which a resolution to an outstanding debt case is achieved (paid, written off, or a combination of both); and the amounts reflect the amount accrued over the life of the debt.

<i>Interest collected (%)</i>	42%	52%	52%	63%
<i>Interest written off (%)</i>	34%	42%	55%	53%

Under s 177 of the TAA a taxpayer can request for all or some of the tax debt to be written off. The Commissioner of Inland Revenue cannot enter into an instalment arrangement, where the recovery of the debt would place the taxpayer in a position of serious hardship.⁵² Serious hardship is defined in s 177A of the TAA as meaning that the taxpayer would have significant financial difficulties as: their dependant has a serious illness; the taxpayer would be unable to meet minimum living expenses estimated according to normal community standards of cost and quality, medical treatment for the taxpayer or their dependant, or the cost of education for their dependant; or other factors that the Commissioner thinks relevant. 'Normal community standards of cost and quality' must take into account the individual circumstances of the taxpayer, such as which part of the country the taxpayer resides.⁵³ As noted above, inequity arises as individuals who earn wages or salaries, or earn other income where tax is deducted at source, do not have the same opportunity to negotiate with the Inland Revenue if they are in a similar position of serious hardship.

An OIA request was made to Inland Revenue asking for the following information:

- The value of tax written off due to bankruptcy of the debtor in 2015/16 (excluding student loans);
- The number of individuals, companies or other entities that received tax write-offs due to bankruptcy, liquidation or no asset procedures in 2015/16 (excluding student loan write-offs); and
- How many bankruptcy, liquidation or no asset procedures were initiated by Inland Revenue in 2015/16 (excluding student loans).

Inland Revenue provided the information outlined in Table 6.

Table 6: Inland Revenue liquidations and bankruptcies (2015/16)⁵⁴

Entity type	Client status	Number of entities	Amount of tax written off (NZ\$ million)
Company	Liquidation	1956	\$210.8
Individual	Bankruptcy	2070	\$191.2
Partnership	Liquidation	1	\$0
Society/Club	Liquidation	2	\$0.3
Trust	Liquidation	46	\$6.7
Total		4075	\$408.9

⁵² TAA s 177B.

⁵³ Inland Revenue, New Zealand Government, *Standard Practice Statement SPS 15/03: Writing Off Outstanding Tax* (2013) 56.

⁵⁴ Information received under the OIA, 29 November 2017, Inland Revenue, New Zealand Government.

The Inland Revenue advised that no tax write-offs were received as a result of no asset procedures for the 2015/16 tax year. Inland Revenue were not able to provide information on how many bankruptcy or liquidation procedures were initiated by Inland Revenue, advising that this information is considered part of court records and is therefore not included within the OIA.

Inland Revenue provide a *Standard Practice Statement* to outline how the Commissioner will exercise statutory discretion in relation to writing off outstanding tax debt.⁵⁵ Certain debts must be written off, such as tax debt that cannot be recovered due to bankruptcy, liquidation or when a taxpayer's estate has been distributed.⁵⁶ There are also some tax debts that cannot be written off, such as debt generated from shortfall penalties for taking an abusive tax position⁵⁷ or tax evasion.⁵⁸ In addition, there are provisions for small tax debts to be written off.⁵⁹ Some situations will require a trade-off between maximising revenue and protecting integrity of the tax system, for example, when a negotiated agreement for payment of part of outstanding debt will generate a greater return than bankruptcy.⁶⁰

As well as remission of debt, taxpayers may request remission of penalties applied to debt. Remission will be granted where the debt was created by an event outside the control of the taxpayer⁶¹ or where there is an emergency event.⁶² Remission will also be granted where it is consistent with the duty of the Commissioner to collect the highest revenue over time.⁶³ Interest will also be remitted where it is consistent with the Commissioner's duty to collect the highest amount of revenue over time.⁶⁴ Where tax debt is remitted, any interest on that debt is also remitted.⁶⁵ As with tax debt and penalties, applications for remission of interest will be considered on the merits of each case.

Inland Revenue can issue statutory notices (more commonly referred to as deduction notices) to banks or other third parties, which require them to make deductions from their customers' accounts.⁶⁶ This is, in effect, a debt collection tool for the Inland Revenue. Deduction notices can be for lump sum amounts or instalments.⁶⁷ Guidance is provided in the TAA on limits to the amounts that can be claimed through a deduction notice.⁶⁸ In 2015/16, Inland Revenue issued 73 013 deduction notices.⁶⁹

⁵⁵ Inland Revenue, New Zealand Government, *Standard Practice Statement SPS 15/03*, above n 53.

⁵⁶ TAA s 177C(2).

⁵⁷ *Ibid* s 141D(2).

⁵⁸ *Ibid* s 141E(1). Some of the debt classified as non-collectable in Table 3 includes this type of debt.

⁵⁹ *Ibid* s 174AA allows for balances less than NZ\$20 to be written off.

⁶⁰ Inland Revenue, New Zealand Government, *Standard Practice Statement SPS 15/03*, above n 53, 37.

⁶¹ TAA s 183A.

⁶² *Ibid* s 183ABA.

⁶³ *Ibid* s 183D.

⁶⁴ *Ibid* s 183D(2).

⁶⁵ *Ibid* s 183E.

⁶⁶ Inland Revenue, New Zealand Government, *Standard Practice Statement SPS 11/04: Compulsory Deductions from Bank Accounts* (2011) 1.

⁶⁷ TAA s 157.

⁶⁸ *Ibid* s 157(3).

⁶⁹ Information received under the OIA, 29 November 2017, Inland Revenue, New Zealand Government.

In 2017, Inland Revenue was given the power to share 'reportable unpaid tax' with approved credit reporting agencies.⁷⁰ The stated purpose of this power is to protect other creditors by allowing visibility of tax debt. At the present time, only companies and not individuals will have their debt information shared with the credit reporting agencies. Inland Revenue advise that information will only be shared when the debt has been overdue for at least a year, it is 30 per cent or more of the company's assessable income, the debt is not disputed, and it is not under a formal instalment arrangement. To date, only one case exists where Inland Revenue have reported a firm under this power.⁷¹ The name of the company is not made publicly available and is only available through the credit reporting agency when a credit check is requested for a specific company.

B Ministry of Social Development

Welfare debts are generated in a number of ways. The primary methods by which debt is generated are fraud, overpayments, advances on benefits and recoverable special needs grants (also known as recoverable assistance loans). Interest is not usually charged on these debts. Similar debt recovery approaches apply to all debts, although current welfare beneficiaries are likely to be repaying debts in instalment from current benefits received.

The nominal value of MSD receivables as at 30 June 2016 was NZ\$1377 million. However, when the provision for impairment was taken into account, this reduces to NZ\$703 million.⁷² The impairment does not reflect non-collection of debt. Instead, it reflects the fair value of the debt, which is calculated by discounting the expected future cash flows by the interest rate at the year-end (2.12–4.31 per cent).⁷³ As welfare debt is unlike traditional debt, there are no contractual repayment terms and therefore future cash flows are adjusted for possible future events such as death of the debtor before repayment.

It is noticeable that, unlike other debt such as student loan debt, default on payment is not a factor taken into account in the discounting process. This is because default on the debt will not result in the debt being written off, as the MSD approach to debt recovery is that 'all monies owed to the Crown are actively pursued and debts remain with each individual until all avenues to recover have been exhausted'.⁷⁴

MSD report benefit recoveries of NZ\$319 million for the year ended 30 June 2016.⁷⁵ Benefit recoveries are amounts collected from a current or former welfare recipient by way of a regular deduction from a current benefit or other source.⁷⁶

⁷⁰ TAA s 85N.

⁷¹ Tom Pullar-Strecker, 'Inland Revenue Dobs in Auckland Firm to Credit Ratings Agencies over Unpaid Tax Bill', *The Dominion Post* (online), 24 October 2017, <<https://www.stuff.co.nz/business/industries/98168461/inland-revenue-dobs-in-auckland-firm-to-credit-ratings-agencies-over-unpaid-tax-bill>>.

⁷² Ministry of Social Development, New Zealand Government, *Annual Report 2015/16* (2016) 131.

⁷³ *Ibid* 130.

⁷⁴ Office of the Associate Minister for Social Development, New Zealand Government, *Welfare Debt Recovery* (15 May 2013).

⁷⁵ Ministry of Social Development, above n 72, 123. Current debt is NZ\$224 million and non-current debt is \$95 million.

⁷⁶ *Ibid* 123.

MSD have a high proportion of clients repaying by instalment at 70 per cent.⁷⁷ As well as current instalment options, MSD also have the potential to eventually recover debts when people turn 65 and become eligible for New Zealand Superannuation, at which point the debt can be recovered through deductions from pension payments.⁷⁸

Other tools that may be used for debt collection include deduction notices made directly from beneficiaries' bank accounts or wages, where voluntary instalments or repayments are not made.⁷⁹ In 2015/16, MSD served deduction notices on 36 269 beneficiaries.⁸⁰ In addition, civil action may be taken, including placing caveats over property. MSD report that NZ\$1.6 million in debt was recovered through asset seizures and reparation orders in 2015/16.⁸¹

The MSD approach to writing off debt is 'where all reasonable and practicable avenues of recovery have been exhausted the Ministry may consider writing off the debt'.⁸² Examples provided by MSD include where a debtor has died and the estate is insolvent or distributed prior to the Crown notifying its claim; where the debtor is insolvent and has been adjudicated bankrupt; or the Official Assignee has recognised under the No Asset Procedure that the debtor is insolvent with no realisable assets.⁸³

Different approaches to serious hardship exist for tax debtors and welfare debtors. Where Inland Revenue may remit or write-off penalties and interest in cases of serious hardship, MSD will generally take hardship into account by 'negotiating realistic repayment rates with debtors so that significant hardship is not caused'.⁸⁴

An OIA request was made to MSD requesting the amount of welfare debt that was written off in the 2015/16 year and, where possible, for a breakdown of the debt into the categories of debt from loans, debt from overpayments and debt from fraud. Information provided is outlined in Table 7.

Table 7: Ministry of Social Development debt written off (2015/16)

Debt type	Amount (NZ\$)
Recoverable assistance (loans)	\$3 512 935
Fraud	\$1 057 137
Overpayment	\$8 698 572
Total	\$13 268 644

⁷⁷ Ibid 60.

⁷⁸ Controller and Auditor-General, Ministry of Social Development, New Zealand Government, *Managing the Recovery of Debt* (Office of the Auditor-General, 2011). New Zealand Superannuation is a universal pension payment paid to all New Zealand residents aged over 65 who meet a residency test.

⁷⁹ *Social Security Act 1964* (NZ) s 86(A)(D).

⁸⁰ Information received under the OIA, 30 November 2017, Ministry of Social Development, New Zealand Government.

⁸¹ Ministry of Social Development, above n 72, 33.

⁸² Information received under the OIA, 9 May 2013, Ministry of Social Development, New Zealand Government.

⁸³ Information received under the OIA, 30 November 2017, Ministry of Social Development, New Zealand Government.

⁸⁴ Office of the Associate Minister for Social Development, above n 74.

As the value written off from fraudulent activity has been provided separately by MSD, the overpayment amounts are those that will result from error, which may be error by MSD or error by the recipient of the welfare benefit. It is not possible to know from the information, as it is currently provided, how much of this is the result of MSD error. Therefore, the value for overpayment debt in Table 7 may be overstated.

C Student loans

In New Zealand, student loans are available to New Zealand citizens or residents who are studying an approved course operated by an approved education provider. Depending on the circumstances of the student, a loan may be available for course-related fees and living costs. As noted above, Inland Revenue is responsible for collecting student loan repayments.⁸⁵

Under the *Student Loan Scheme Act 2011*, a student loan borrower has an obligation to repay the loan balance in accordance with the contract and the Act.⁸⁶ Loan repayments must start when the loan holder has annual earnings in excess of NZ\$19 136 before tax. The amount of the repayment will depend on earnings of the individual debt holder. Interest is not applied to student loans, as long as the debtor is not overseas for more than 183 days.⁸⁷ However, a late payment interest charge is made when student loan repayments are not made on time.⁸⁸ This late payment interest charge is currently 8.3 per cent per annum.⁸⁹ The rate reduces by 2 per cent if an instalment arrangement is entered into.⁹⁰

When debt holders travel overseas, the debt repayment arrangements do not change unless the debt holder is overseas for more than six months. When debt holders are outside New Zealand for more than six months, repayments are no longer assessed on earned income, instead, the repayments are calculated on the loan balance.⁹¹ In addition, interest becomes payable for loan holders who are overseas for longer than 183 days. The interest rate for the period from 1 April 2018 to 31 March 2019 is 4.3 per cent.⁹² Inland Revenue advise that loan interest on overseas-based borrowing is NZ\$135.4 million and late payment interest on both New Zealand and overseas borrower default is NZ\$63.8 million.⁹³ Overseas-based debtors may apply for a repayment holiday.⁹⁴

⁸⁵ A second form of government student support is the student allowances scheme. This provides eligible students with a weekly payment to assist with living expenses. The allowance is income-tested on the student and the student's family. This assistance does not have to be repaid.

⁸⁶ *Student Loan Scheme Act 2011* (NZ) (SLSA) s 30.

⁸⁷ Interest is applied to the loan in the first instance, but this is written off as the loan is repaid on time.

⁸⁸ SLSA s 113.

⁸⁹ Calculated as the interest rate of 4.3 per cent plus a 4 per cent penalty.

⁹⁰ SLSA s 141.

⁹¹ By way of example, an overseas-based student loan holder with a student loan between NZ\$1000 and NZ\$15 000 is expected to make biannual payments of NZ\$500. If the same loan holder had a loan between NZ\$15 000 and NZ\$30 000, biannual loan payments are NZ\$1000. Inland Revenue, New Zealand Government, *Paying Off Your Student Loan When You're Overseas* (23 March 2017) <<http://www.ird.govt.nz/studentloans/overseas/managing/student-loan-paying-off-overseas.html>>.

⁹² Inland Revenue, New Zealand Government, *Student Loan Interest Rates* (2 April 2018) <<http://www.ird.govt.nz/studentloans/manage/interest/student-loan-interest-rates.html>>.

⁹³ Information received under the OIA, 12 September 2017, Inland Revenue, New Zealand Government.

⁹⁴ SLSA s 107.

Most New Zealand-based student loan debtors will have their loan repayments made automatically by their employer, as when an employer knows of the student loan, they have an obligation to make standard deductions for the student loan.⁹⁵ Inland Revenue have an Approved Information Sharing Agreement with the Department of Internal Affairs.⁹⁶ This agreement with the Department of Internal Affairs allows for passport information to be shared on student loan defaulters.

Table 8: Student loan debt as at 30 June: 2012–16 (NZ\$)⁹⁷

	2011/12	2012/13	2013/14	2014/15	2015/16	% change 2014/15– 2015/16
Overdue debt	\$512.3 million	\$635.9 million	\$769.4 million	\$933.0 million	\$1074.8 million	+15.2%
Nominal balance	\$12 969 million	\$13 562 million	\$14 235 million	\$14 837 million	\$15 340 million	+3.4%
Average balance/student	\$18 507	\$19 092	\$19 756	\$20 386	\$20 983	+2.9%
Median balance/student	\$12 849	\$13 307	\$13 882	\$14 421	\$14 904	+3.3%

Table 8 shows student loan debt. The first row shows overdue debt of NZ\$1.1 billion in 2015/16, while the second row shows the nominal balance of all debt NZ\$15 billion in 2015/16. The reason for the significant differences is that debt does not become repayable until individuals earn above the specified threshold.

As shown in Table 8, the overdue student loan debt of NZ\$1.1 billion as at 30 June 2016 increased 15.2 per cent over the previous year. The majority of this overdue debt is held by overseas borrowers at 91.5 per cent.⁹⁸ Only 20.4 per cent of overseas taxpayers with New Zealand student loans are making repayments.⁹⁹ Moreover, only 26.7 per cent of overseas-based borrowers in debt are in contact with Inland Revenue (this figure includes those making repayments).¹⁰⁰ Total annual repayments from taxpayers with student loans who are overseas was NZ\$216 million in 2015/16. Overseas debtors hold higher debt balances than New Zealand debtors, with an average amount outstanding of NZ\$12 188, as compared to New Zealand debtors at NZ\$3782 in 2016.¹⁰¹ Borrowing numbers by activity are outlined in Table 9, which shows that the majority of borrowers are in New Zealand and repaying their debt. Only a small proportion overall (14 per cent in 2015/16) are overseas. Overseas debtors are forecast to take twice as long to repay

⁹⁵ Ibid s 36. Around 70 per cent of student loan debt is collected through the PAYE system. Ministry of Education, New Zealand Government, *Student Loan Scheme Annual Report 2015/16* (2016).

⁹⁶ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 19.

⁹⁷ Ibid 29.

⁹⁸ Ibid 30.

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Ministry of Education, *Annual Report 2015/16*, above n 95, 30.

their debt as New Zealand debtors.¹⁰² Some of the overseas debtors may never return to New Zealand and there is the risk that some of the debt held by overseas borrowers will not be repaid.

Table 9: Borrowing activity¹⁰³

		2013/14	%	2014/15	%	2015/16	%
New Zealand-based borrowers	Borrowing and repaying	86 975	11%	89 372	12%	88 766	11%
	Borrowing	117 643	15%	110 542	14%	104 848	13%
	Repaying	280 865	36%	291 764	38%	301 189	39%
	Inactive	185 145	24%	170 315	22%	171 847	22%
Overseas-based borrowers	Repaying	39 997	5%	43 486	6%	48 242	6%
	Inactive	69 966	9%	67 822	9%	63 660	8%
Total		780 591		773 301		778 552	

The non-current asset value of student loans reported in the Inland Revenue annual report was NZ\$7.8 billion, with current asset value of an additional NZ\$1.2 billion.¹⁰⁴ This reflects the initial write-down of the value of the loan, together with the timing delay in collecting much of the student debt. Table 10 shows the initial write-down on new borrowing and the average cost of lending in cents per dollar. As is visible in Table 10, significant write-downs on new borrowing are reflected in the carrying amounts of student loan debt.

Table 10: Lending and initial write-down on borrowing¹⁰⁵

	2011/12	2012/13	2013/14	2014/15	2015/16
New lending (NZ\$ million)	\$1489	\$1481	\$1522	\$1529	\$1522
Initial write-down on new borrowing (NZ\$ million)	\$702	\$536	\$629	\$602	\$659
Average cost of lending (NZ\$)	\$47.15	\$36.19	\$41.33	\$39.37	\$43.3

As shown in Table 10, the key measure of the cost of the student loan scheme is the initial write-down on the new borrowing. By way of illustration, in 2015/16, the write-down was NZ\$659 million on the lending of NZ\$1522 million (43.3 cents in the dollar).¹⁰⁶ This write-down provides an estimation of the long-term economic cost of the lending and

¹⁰² Ministry of Education, New Zealand Government, *Student Loan Scheme Annual Report 2016/17* (2017) 41.

¹⁰³ Ministry of Education, *Annual Report 2015/16*, above n 95.

¹⁰⁴ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 123.

¹⁰⁵ Ministry of Education, *Annual Report 2015/16*, above n 95.

¹⁰⁶ Ibid 41.

ensures that the asset of the loan is recognised in the Crown financial statements at fair value. This takes into account the time value of money, lending policies, and economic factors such as interest rates, income and changes in employment, eg, if incomes and/or employment are increasing, then repayments will also increase.¹⁰⁷

There is relatively high risk associated with student loan lending and therefore the value of new loans are discounted to reflect that loans may not be repaid. For example, borrowers may die before the loan is repaid; borrowers may default on repayment and as no security is provided against the loan, this will result in non-payment of the debt; and borrowers may never earn above the minimum earnings that will trigger repayment obligations. These factors are all reflected in the differences between the amount loaned and the carrying value of the loan. By way of illustration, in 2015/16, Inland Revenue report that \$32 million of student loan debt was written off due to death and bankruptcies.¹⁰⁸ Of this figure, \$18 million was written off due to bankruptcy with 483 individuals declaring bankruptcy (averaging NZ\$37 000/individual).¹⁰⁹ After the initial fair value write-down, student loans are measured at amortised cost, which includes any annual impairment.¹¹⁰

Inland Revenue engage in data-matching with the Department of Internal Affairs in order to determine whether a taxpayer is entitled to an interest-free loan and to provide insight into the border movements of some student loan customers.¹¹¹ In 2015/16, Inland Revenue report that 559 921 student loan customers had their records updated as a result of data-matching.¹¹² Other initiatives to assist with collecting student loans include: an Overseas Based Borrower Compliance Initiative, introduced in 2015/16; working with private sector collection agencies in Australia and the United Kingdom to track and collect debt; and progressing an information exchange initiative with the Australian Taxation Office.

Inland Revenue provide a Standard Practice Statement that outlines when relief may be available from student loan repayment obligations.¹¹³ There are limited situations in which relief is available for student loan debtors. These include:

- Quick repayment of loan balance, made by an overseas debtor. In these cases, where repayment is made before the end of the 183-day consecutive period, then interest will be written off; and¹¹⁴
- Small amounts (less than NZ\$20).¹¹⁵

¹⁰⁷ Ibid.

¹⁰⁸ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 123.

¹⁰⁹ Ministry of Education, *Annual Report 2015/16*, above n 95.

¹¹⁰ Ibid Note 15.

¹¹¹ Inland Revenue, New Zealand Government, *Annual Report*, above n 34, 31.

¹¹² Ibid.

¹¹³ Inland Revenue, New Zealand Government, *Standard Practice Statement SPS 11/03: Student Loans – Relief from Repayment Obligations* (2011).

¹¹⁴ SLSA s 138.

¹¹⁵ Ibid s 144.

Relief may be granted from late payment interest or penalties on application from the debtor.¹¹⁶ Under the *Student Loan Scheme Act 2011*, the Commissioner may grant this relief, taking into account the circumstances of each case, if it is 'equitable to do so'.¹¹⁷ Hardship relief may decrease a student loan debtor's repayment obligation where it is likely to cause serious hardship to the borrower, or where the Commissioner considers there are other reasons that make it fair and reasonable to provide relief.¹¹⁸ Relief, in the case of student loans, does not result in the loan being written off: the debt remains as part of the borrower's loan balance.¹¹⁹

Recently, Inland Revenue have been given the power to obtain an arrest warrant to prevent an overseas-based borrower who has a debt that is in default from leaving the country (if they are visiting New Zealand). Inland Revenue advise that this is used only for the most serious defaulters. Furthermore, in 2016 information-sharing provisions were implemented between Inland Revenue and the Australian Taxation Office that allow for exchange of information on contact details of student loan borrowers who are in default.¹²⁰

As at 30 June 2016, 731 754 people had a student loan.¹²¹ Inland Revenue advise that the total number of student loan debtors as at 30 June 2016 was 104 730, comprising 80 622 overseas-based borrowers and 24 108 New Zealand-based borrowers.¹²² The differences in these numbers represent the different status of those holding student loans. Those held by Inland Revenue are those classified as overdue, whereas the higher figure of 731 754 includes all those holding student loans, a large component of which are not classified as overdue.

In 2015/16, there were 182 537 new loan arrangements. Of students who are eligible for a student loan, 71 per cent did take up a student loan in this period.¹²³ The average amount borrowed was NZ\$8888 in the year. As noted in Table 8, the average loan balance per person is NZ\$20 983, and the median is NZ\$14 904 in 2016.¹²⁴ Median repayment times for all borrowers (who finished study in 2014) is forecast to be 8.4 years, although significant differences are visible for those who reside in or outside New Zealand. Median repayment times for those in New Zealand is forecast to be 6.5 years and for those outside New Zealand is forecast to be 17 years.¹²⁵

Nearly two-thirds of the student loan debt that is overdue is older than two years. Less than 20 per cent of student loan debt is 12 months or less overdue, 15.5 per cent is

¹¹⁶ Ibid s 146.

¹¹⁷ Ibid ss 146(2) and 146A.

¹¹⁸ Ibid s 147.

¹¹⁹ Ibid s 151.

¹²⁰ Ministry of Education, *Annual Report 2015/16*, above n 95.

¹²¹ Ibid. The differences in student loan numbers reported by Inland Revenue (778 552, as shown in Table 9) and the Ministry of Education (731 754) are noted.

¹²² Information received under the OIA, 12 September 2017, Inland Revenue, New Zealand Government.

¹²³ Ministry of Education, *Annual Report 2015/16*, above n 95, 24.

¹²⁴ Ibid 3.

¹²⁵ Ibid 3.

overdue by 1–2 years; 30.8 per cent is overdue by 2–5 years; and 35.1 per cent is overdue by more than 5 years.¹²⁶

Student loans are not only provided for education fees, they can also be applied to living costs and course-related costs. While some students may also be entitled to a student allowance, which is not repayable, living cost payments that are provided under the student loan scheme are repayable. In the 2015/16 year, students could borrow up to NZ\$176.86 per week for living costs from the student loan scheme. Average amounts borrowed for course fees, course-related fees and living costs for the past five years are outlined in Table 11.

Table 11: Course fees, living costs and course-related costs borrowed under the student loan scheme (2011–15, NZ\$)¹²⁷

	2011/12	2012/13	2013/14	2014/15	2015/16
Average course fees	\$5441	\$5571	\$5850	\$6074	\$6323
Average living costs	\$3710	\$3774	\$3944	\$4036	\$4179
Average course-related costs	\$990	\$988	\$988	\$987	\$988

D Ministry of Justice

The Ministry of Justice (MoJ) is responsible for the justice sector. The key responsibilities of the agency are administration of the court system, the legal aid system and the Public Defence Service. The agency is also responsible for the collection and enforcement of fines and civil debts, including reparation.¹²⁸

In their *Annual Report*, MoJ note that effective collection of fines and reparations is important in ensuring the credibility of fines as a sentencing option.¹²⁹ MoJ also claim to follow up on non-payment of court-imposed fines and reparations, and will enforce civil debts on behalf of credits where payments have been ordered by the courts.¹³⁰

MoJ debt information is outlined in Table 12. Debt as at 30 June 2016 was NZ\$593 million, of which 42.5 per cent was under a repayment arrangement. MoJ report that 77–80 per cent of court imposed fines and infringement fines are collected or have a repayment arrangement entered into within four months of the fine being imposed. However, MoJ also report that 56 per cent of people have not paid or made an arrangement to pay their fine, infringement or reparation.

¹²⁶ Ibid 30, Table 15.

¹²⁷ Ibid 25, Table 5.

¹²⁸ Ministry of Justice, New Zealand Government, *About the Ministry* (27 October 2017) <<https://www.justice.govt.nz/about>>.

¹²⁹ Ministry of Justice, New Zealand Government, *Annual Report 2015/16* (2016) 29.

¹³⁰ Ibid.

Table 12: Ministry of Justice collection of fines and reparations¹³¹

	2014/15	2015/16	% change 2014/15- 2015/16
Total debt owing (as at 30 June)	NZ\$576 million	NZ\$593 million	+3%
Total fines and reparations collected	NZ\$212 million	NZ\$191 million	-11%
Debt-under-arrangement	46.6%	42.5%	-10%
% of court imposed fines collected or placed under arrangement within four months	84.2%	80%	-5%
% of infringement fines collected or placed under arrangement within four months	86.8%	77%	-13%
% of people who have not paid or made an arrangement to pay their fine, infringement or reparation	56%	56%	Unchanged

An OIA request was made to MoJ asking for information on fines and reparation that was written off. MoJ advised that:

Registrars will, in the first instance, seek payment in full or negotiate sustainable payment arrangements where possible. If these are unsuccessful, the registrar may take measures to enforce overdue amounts which can include clamping vehicles, seizing and selling property, making compulsory deductions from a person's income or bank account, suspending drivers' licences and preventing a person's international travel.¹³²

A further OIA request was made asking for detail on how many deduction notices were served; how many seizures of property there were; how many drivers' licences were suspended; and how frequently people had been prevented from travelling internationally. MoJ advised that 24 280 deduction notices were issued to financial institutions, 31 989 attachment orders were issued to employers, and 30 672 attachment orders were issued to MSD.¹³³

During the 2015/16 financial year, 109 driver's licences were suspended as a result of non-payment of fines. There were 199 intercepts on either departure or arrival from airports in this period. However, MoJ can only advise that the debtor was stopped and this does not necessarily result in the debtor being restricted from travelling. Either paying the debt in full or negotiating repayment arrangements would allow the debtor to continue with their travel.¹³⁴

¹³¹ Ibid 29, 70.

¹³² Information received under the OIA, 18 July 2017, Ministry of Justice, New Zealand Government.

¹³³ Information received under the OIA, 31 August 2017, Ministry of Justice, New Zealand Government.

¹³⁴ Information received under the OIA, 31 August 2017, Ministry of Justice, New Zealand Government.

The OIA response also advised that in some circumstances, remittal of a fine is considered the most appropriate action, such as when a person dies, a company is put into liquidation, or when a registrar remits small outstanding balances. In other circumstances, where enforcement action has been unsuccessful or further action is not considered appropriate, fines may be remitted by a judge and an alternative sentence imposed, such as imprisonment, home detention, community detention or community work. Registrars have the discretion to remit court costs and enforcement fees in order to encourage payment of the original fine.¹³⁵ A total of NZ\$28 976 746 was remitted in the 2015/16 financial year, made up of NZ\$27 554 692 in remitted fines and NZ\$1 422 054 in remitted reparation.¹³⁶

Some of the debts outlined herein relate to Legal Aid debt. Legal Aid debt as at 30 June 2016 is NZ\$126 million, with an impairment provision of NZ\$71 million, and a carrying value of NZ\$55 million.¹³⁷ Under the *Legal Services Act 2011*, the Commissioner of Legal Services may write off repayments or other debt payable to the Commissioner of Legal Services in circumstances that are similar to tax write-off provisions. These include:

1. Where the enforcement of the debt would cause serious hardship to the aided person;
2. Where the cost of enforcing the debt is likely to exceed the amount of the debt likely to be repaid; or
3. If the Commissioner considers that it would be just and equitable to write off the debt.¹³⁸

Serious hardship is defined in a similar way to tax collection, which is:

significant financial difficulties that arise because of:

- the aided person's inability to meet minimum living expenses according to normal community standards; or
- the cost of medical treatment of an illness or injury of the aided person or the aided person's dependant; or
- a serious illness suffered by the aided person or the aided person's dependant.¹³⁹

E Ministry for the Environment

Total receivables reported in the 2015/16 Ministry for the Environment (MfE) annual report were \$13 million, of which the majority was amounts receivable from the

¹³⁵ Information received under the OIA, 18 July 2017, Ministry of Justice, New Zealand Government.

¹³⁶ Ibid.

¹³⁷ Ministry of Justice, *Annual Report 2015/16*, above n 129.

¹³⁸ *Legal Services Act 2011* (NZ) s 42(1).

¹³⁹ Ibid s 42(4).

Crown.¹⁴⁰ MfE report fines and penalties receivable of NZ\$120 000 in the 2015/16 year with a further NZ\$34 000 due from Emissions Trading Scheme penalty revenue.¹⁴¹

A request was made to MfE on 15 August 2017 for the value of fines and penalties receivable that were written off during the 2015/16 period. MfE advised under the OIA that the amount written off was NZ\$55 042.84, which is made up of several smaller amounts from different participants, all of which relates to the New Zealand Emissions Trading Scheme.¹⁴² The penalties were imposed by the Environmental Protection Agency due to non-compliance by Emissions Trading Scheme participants.

F Ministry for Primary Industries

The Ministry for Primary Industries (MPI) is responsible for supporting primary sector growth in New Zealand. MPI can issue infringement notices (more commonly referred to as instant fines) for situations where people fail to declare biosecurity risk goods when arriving in New Zealand; when people commit an offence under the *Fisheries Act 1996* (NZ); or for breaking animal welfare laws.¹⁴³ Biosecurity fines are due within 14 days. Recreational fishing fines and animal welfare fines are due within 28 days. For all of these offences, a waiver may be requested, but not for reasons such as not knowing the law or forgetting.

MPI's 2015/16 *Annual Report* reports revenue of NZ\$31 360 000 from fines, penalties and levies.¹⁴⁴ The majority of this sum is from cost recovery levies from the fishing industry (NZ\$25 381 000 – 81 per cent).¹⁴⁵ The *Annual Report* also reports debtor receivables from fines, penalties and levies of NZ\$20 988 000.

An OIA request was made to MPI in relation to fines, penalties and levies that were written off in the 2015/16 period. MPI advised that no fines, penalties or levies were written off during this time.¹⁴⁶

G Ministry for Business, Innovation and Employment

The Ministry for Business, Innovation and Employment (MBIE) report collection of fines and penalties totalling NZ\$108 000 in 2015/16, and other penalties of NZ\$6 434 000.¹⁴⁷ The receivables amount is calculated at NZ\$58 791 000, but this includes levies as well as fines and penalties. An OIA request was made for a breakdown of the amount that was fines and penalties, together with the amount of fines and penalties written off during the period.

¹⁴⁰ Ministry for the Environment, New Zealand Government, *Annual Report 2015–16* (2016).

¹⁴¹ Ibid.

¹⁴² Information received under the OIA, 12 September 2017, Ministry for the Environment, New Zealand Government.

¹⁴³ Ministry for Primary Industries, New Zealand Government, *Paying Your Fine* (10 January 2018) <<https://www.mpi.govt.nz/law-and-policy/paying-your-fine>>.

¹⁴⁴ Ministry for Primary Industries, New Zealand Government, *2015/16 Annual Report* (2016).

¹⁴⁵ Ibid 118.

¹⁴⁶ Information received under the OIA, 4 August 2017, Ministry for Primary Industries, New Zealand Government.

¹⁴⁷ Ministry for Business, Innovation and Employment, New Zealand Government, *Annual Report 2015–16* (2016).

The response received from MBIE advised that the majority of the receivables amount was levies (NZ\$58 659 000) with only NZ\$132 000 comprising fines and penalties. The amount of fines and penalties written off during the year was NZ\$396 000. MBIE also advised that the majority of this write-off related to penalties issued to Immigration Advisers.¹⁴⁸

V DISCUSSION

Section four outlined the outcomes of the debt collection process across a number of government departments. While not all departments are included in section four, the primary departments that hold and collect debt from the general population are included. The debt held by Inland Revenue is significantly higher than other agencies. This is because Inland Revenue is responsible for both outstanding tax debt and overdue student loan debt.

The different amounts written off across each of the agencies is outlined in Table 13, together with the number of deduction notices served by each agency and whether the relevant legislation has a provision to alleviate debt when the debtor is in a situation of serious hardship. The final row shows the proportion of write-offs against year-end debt held by the respective agency.

Table 13: Comparative information across government departments and loan types

	Inland Revenue	MSD	Student loans	MoJ	MfE	MPI	MBIE
Write-offs (2015/16, NZ\$)	\$1.1 billion	\$13 million	\$18 million ¹⁴⁹	\$29 million	\$55 042	Nil	\$396 000
Write-downs (NZ\$)	\$680 million	N/A	\$659 million	N/A	N/A	N/A	N/A
Serious hardship provision	Yes	No	Yes	Yes	N/A	Waiver request	N/A
Deduction notices	73 013	36 269	Unknown ¹⁵⁰	86 941	N/A	N/A	N/A
Write-offs as % of debt	19.1% ¹⁵¹	1.9%	See footnote 151	4.7%	36%	0%	N/A ¹⁵²

¹⁴⁸ Information received under the OIA, 27 November 2017, Ministry for Business, Innovation and Employment, New Zealand Government.

¹⁴⁹ Due to bankruptcy.

¹⁵⁰ The SLSA provides for the use of deduction notices, but it is not known if they have been used to help collect student loans.

¹⁵¹ This amount combines Inland Revenue and student loan debt, as Inland Revenue cannot provide a breakdown between student loan write-offs, with the exception of that written off due to bankruptcy.

¹⁵² The write-off amount for MBIE is greater than the year-end receivables held.

Table 13 shows that Inland Revenue writes off significant amounts of tax – 85 times the amount written off by MSD. All the other government departments write off relatively low amounts when compared to Inland Revenue. While the amount of student loan debt written off is low, the amount of write-downs of the debt are high and comparable to the write-downs of Inland Revenue. As noted in the previous section, the student loan write-downs are due to the high cost to the government of providing student debt facilities. While it appears that the MfE write-off a high proportion of their debt, the actual amount written off is low at NZ\$55 042 (or around 1/20 000 of that written off by Inland Revenue). These different approaches to writing off debt result from a combination of all the variables highlighted in Alber's framework: the regulatory structure provides for different approaches; the financing structure and appropriations allow for writing off debt by some, but not all, government departments; the delivery structure facilitates different approaches; and customer power is visible when some debtors have greater power to negotiate more favourable outcomes.

It is also worth observing that of all the large government debts, it is tax debt, student loan debt and debts held by the Ministry of Justice that have legislated serious hardship provisions to protect debtors who are in a position of financial hardship. MSD, where, arguably, debtors are the most likely to be in financial hardship notwithstanding the presence of debt to the government, does not have legislated serious hardship provisions in the *Social Security Act 1964*. Thus, the regulatory structure and delivery structure facilitate the different approaches adopted to serious hardship and the inequity that results from the different approaches.

Differences in debt collection are visible across the agencies discussed in the previous sub-section. Some agencies, such as the MPI, collect all fines, penalties and levies imposed. Others, such as the student loan scheme, administered by Inland Revenue, collect around 55 per cent of debt. While the tax debt appears high, this is accumulated debt and therefore it is reference to 'new debt' that is perhaps the most accurate to assess current collection procedures. However, it must also be acknowledged that 87 per cent of tax is paid on time and another proportion is paid, albeit late. Thus, the regulatory structure and delivery structure are, to some extent, effective for some government departments, but there is inconsistency in the debt collection outcomes. This, at least in part, results from the regulatory structure and the power of the particular debtors.

The different approaches adopted to debt collection are highlighted in Table 13 and throughout the prior section. These different approaches lead to inequitable outcomes: different debtor types have access to different approaches to debt collection. Welfare debtors are less likely to have their debt written off than other debtor types. Welfare debtors also do not have access to the same ability to request remission of their debt when they are suffering from serious hardship. In addition, welfare debtors are more likely to have deduction notices or asset seizures applied to assist with debt collection than, for example, tax debtors.

Extant provisions also create inequities within similar groups of people, for example, not all taxpayers have the same ability to request tax relief when they are suffering from serious hardship. Remission of debt where there is serious hardship is only available to taxpayers who are not taxed at source. All of these inequities result from the current regulatory structure.

There is an argument to be made that in a small country such as New Zealand, there are efficiency gains and more effective outcomes to be had from a standardised approach to

debt collection across all government debt. This would extend to collection of debt, penalties, interest or fines, as well as write-off provisions. Such an approach would increase transparency and equity, as all debtors would be treated equally. Currently, some debt, such as student loan debt or fines, may be remitted where it is 'just and equitable' to do so. However, this is not the case for all debt. There is a case to be made that all debtors are entitled to 'just and equitable' treatment in relation to debt repayment. This could be achieved by amendments to the regulatory structures to improve consistency between agencies, and to the delivery structure to improve consistency of application of the regulation.

Focusing on the delivery structure, there is a further argument to be made that there is benefit to be gained from adopting a centralised debt collection mechanism or agency. At the present time, multiple debt collection activity occurs across government departments. Not only does this result in duplication of resources, it minimises the extent to which best practice adopted in larger government departments can be passed through to smaller government departments. Extant practice also does not ensure consistency of treatment among debtors. Tools and techniques used by government agencies, and the Inland Revenue in particular, to assist with collecting outstanding tax payments continue to evolve. The OECD note increased use of advanced analytics for targeting debtors with accompanying targeted intervention strategies.¹⁵³ Such tools could be appropriately shared across all debtors if debt management was the role of a coordinated agency.

Prior research has observed the different debt collection approaches adopted by Inland Revenue and MSD.¹⁵⁴ However, what is visible from the above discussion is the difference in collection rates between Inland Revenue and all the other government agencies investigated in this study. Student loan debt is greater than all tax debt and significant amounts are written down at the point of initial recognition to reflect, among other things, the cost to the Crown of providing the finance, together with the likelihood that some of the loans will not be repaid.

When debts are not settled, consequences typically follow. This is the usual manner when other debts are not fulfilled, such as bank borrowings, where property provided by way of guarantee is usually forfeited. However, in New Zealand it is largely the debtors with the least power - welfare beneficiaries - who are most likely to be held to account to settle debts. Meanwhile, debtors who are, arguably, in a better position to repay debts such as student loan debtors or tax debtors, are more likely to receive debt write-offs than those who hold debt generated from the welfare system.

VI CONCLUSION

The primary objective of this research is to report on approaches to debt management across government departments in New Zealand, with the aim of highlighting differences that contribute to inequitable outcomes. The study finds differences in approaches to collecting debt across government departments, ranging from total collection of debt to just over half of due debt collection. Overseas research suggests that white-collar debt is

¹⁵³ OECD, 'Tax Administration 2017', above n 42.

¹⁵⁴ Lisa Marriott, 'Unpaid Tax and Overpaid Welfare: A Comparison of Debt Recovery Approaches in New Zealand' (2014) 20 *New Zealand Journal of Taxation Law and Policy* 46.

less likely to be enforced than other forms of debt. This exploratory research indicates that a similar situation may apply in New Zealand, with collection of tax debt and student loan debts being collected at a significantly lower rate than other forms of debt. Arguably, tax debt and student loan debtors are among the groups that are, over time, most able to settle these debts.

Where differences exist in the collection approaches of different debt types, but where the creditor is the same, the potential exists for preferential treatment of certain types of debtors. With the exploratory analysis undertaken above it is not possible to suggest with any certainty that this exists in New Zealand. However, the adoption of a centralised debt collection agency that can apply best practice tools and techniques across all overdue debt would alleviate any suggestion of preferential treatment of certain debtors. Moreover, it is likely to improve efficiency of operations and collections across all debt types.

The study highlights the inequities that arise from extant practice. Inequities arise as not all debtors can apply for special consideration when they are suffering from serious hardship. They also arise when different debtors are subject to different debt write-off criteria. Debt collection produces further inequities: some government departments make greater use of tools such as deduction notices and asset seizures. In addition, taxpayers who earn their income from wages and salaries will not have access to the same ability to apply for debt write-offs or serious hardship provisions as other taxpayers who do not have their tax deducted at source.

The results of this study suggest there is future research needed to examine in more detail the types of tax debts and student loan debts that are written off. These represent significant losses to the New Zealand taxpayer, at over \$2 billion combined per annum, and therefore warrant further investigation.

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TAXATION EDUCATION IN SECONDARY SCHOOLS

ANNETTE MORGAN AND DONOVAN CASTELYN*

ABSTRACT

This study aims to understand the existing levels of taxation knowledge evident amongst a sample size of tertiary students. Eligible participants were asked to complete an online survey in an attempt to ascertain the degree to which their secondary school curriculum engaged with elements of Australia's taxation regime. A further component of the study required participants to consider whether tax education should be adopted into Australia's secondary school curriculum, and sought to ascertain whether formal taxation education – whilst at secondary school – would have proved useful or applicable to their future taxpayer obligations. The results of the study indicate that a majority of the participants agree with the proposition that formal tax education should be introduced into secondary school curriculum and, as a corollary, would assist taxpayers in their interactions with Australia's taxation system. In light of the outcomes of this study, it is recommended that the Department of Education and Training, in collaboration with the Australian Taxation Office and other relevant agencies, devise a strategy for the development and introduction of a compulsory taxation education programme within all Australian secondary schools to support and inform future generations of Australian taxpayers.

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I INTRODUCTION

The secondary school curriculum has been at the forefront of national and global scrutiny for some time now.¹ Relevantly, the level of financial literacy among students and citizens alike has become an area of increasing concern.²

Financial literacy is an essential life skill, affording individuals the ability to navigate financial decisions whilst simultaneously strengthening their financial well-being.³ As a consequence, sound financial literacy in a population also promotes inclusive growth, and resilient financial systems and economies.⁴

In recognition of the need for improved and sustained financial literacy, the Australian National Financial Literacy Strategy (ANFLS) was first developed in 2011 – later revised in 2014 – to impact upon perceived educational deficiencies in this area.⁵ One of the key strategic priorities for the period 2014–17 was to ‘[e]ducate the next generation, particularly through the formal education system’.⁶ The core actions proposed in respect of this priority included: a curriculum-based approach to teaching financial literacy in primary and secondary schools;⁷ building teachers’ capabilities;⁸ developing resources for teachers and students linked to the Australian Curriculum website;⁹ extending opportunities to engage students in completing the post-compulsory years of education, with a particular emphasis on students in the Vocational Education and Training sector;¹⁰ and, engaging parents and families to help amplify the core messages students and young people learn through formal education.¹¹

¹ See, eg, Ministerial Council for Education, Early Childhood Development and Youth Affairs, *National Consumer and Financial Literacy Framework* (2009) <http://www.curriculum.edu.au/verve/_resources/Financial_Literacy_Framework_revised2009.pdf>; Organisation for Economic Co-operation and Development (OECD), *PISA 2012 Assessment and Analytical Framework: Mathematics, Reading, Science, Problem Solving and Financial Literacy* (11 February 2013) <https://www.oecd-ilibrary.org/education/pisa-2012-assessment-and-analytical-framework_9789264190511-en>.

² OECD, *PISA 2015 Results (Volume IV): Students’ Financial Literacy* (24 May 2017) <<https://www.oecd-ilibrary.org/docserver/9789264270282-en.pdf?expires=1523245128&id=id&accname=guest&checksum=BE1235FB5DB60EB4816DAFECC8C87B4A>>.

³ Ibid 3.

⁴ Ibid 40; OECD, *PISA 2012*, above n 2.

⁵ Australian Securities and Investment Commission (ASIC), *Report 229: National Financial Literacy Strategy* (March 2011) <<http://www.financialliteracy.gov.au/media/218312/national-financial-literacy-strategy.pdf>>; ASIC, *Report 403: National Financial Literacy Strategy 2014–2017* (August 2014) <<https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-403-national-financial-literacy-strategy-2014-17>>.

⁶ ASIC, *Report 229*, above n 5; ASIC, *Report 403*, above n 5, 18–21.

⁷ ASIC, *Report 403*, above n 5, 18, [1.1].

⁸ Ibid [1.2].

⁹ Ibid [1.3]. See also, Australian Curriculum, *Home* (24 May 2017) <<https://www.australiancurriculum.edu.au>>.

¹⁰ Ibid 19.

¹¹ Ibid.

While the ANFLS initiative has shown signs of improving the financial literacy of the Australian community,¹² attempts to facilitate taxation education as a fundamental aspect of the financial landscape remained ambiguous at the time this study was conducted.¹³

However, in recent years a strategic collaboration between the Australian Securities and Investment Commission (ASIC), the Australian Taxation Office (ATO) and the Australian Curriculum, Assessment and Reporting Authority has led to the development and introduction of a consumer and financial literacy 'curriculum connections' resource featured on the Australian Curriculum website.¹⁴ This resource showcases where financial literacy sits within the Australian curriculum learning areas, provides interactive activities to assist teachers in planning and delivering their learning programmes,¹⁵ and features links to ASIC's 'MoneySmart Teaching'¹⁶ and the ATO's 'Tax, Super and You'¹⁷ initiatives.

While these resources identify the need for, and importance of, developing financial literacy – and attempt to address the issue in an informal, non-invasive and supportive manner – it is the opinion of the authors, supported by the findings in this study,¹⁸ that financial literacy and, ideally, taxation education form an integral component of Australia's secondary school curriculum as either an independent subject or integrated into other strands of the broader curriculum.¹⁹

II RESEARCH OBJECTIVES

A general lack of academic literature in the field of taxation education and secondary schools, as will be discussed later, motivates this study. Against this background, this study aimed to: i) identify the type of taxation education that a sample size of undergraduate students studying at Curtin University (target group) received whilst they attended secondary school; ii) ascertain whether the target group desired a compulsory form of taxation education be provided to students in secondary schools; iii) evaluate the

¹² ASIC, *NFLS Annual Highlights Report 2016-17* (2017) <<http://www.financialliteracy.gov.au/media/560953/nfls-annual-highlights-report-16-17.pdf>>.

¹³ ASIC, *NFLS Annual Highlights Report 2015-16* (2016) <<https://www.moneysmart.gov.au/media/560313/nfls-annual-highlights-report-2016-web-version.pdf>>.

¹⁴ Australian Curriculum, *Curriculum Connector: Consumer and Financial Literacy* (2018) <<https://www.australiancurriculum.edu.au/resources/curriculum-connections/portfolios/consumer-and-financial-literacy/?searchTerm=taxation#dimension-content>>.

¹⁵ Ibid.

¹⁶ ASIC, *MoneySmart Teaching* <<https://www.moneysmart.gov.au/teaching>>: a dedicated educational resource aimed at developing consumer and financial literacy capabilities in young Australians.

¹⁷ ATO, *Tax, Super and You* <<https://www.taxsuperandyou.gov.au>>: a free online educational resource aimed at secondary school students, but available to anyone. It explains how the taxation and superannuation systems work, the benefits to the community and the role Australians play in supporting these systems.

¹⁸ This position is further supported by the pervading literature on the topic. See, eg, OECD, *National Strategies for Financial Education: OECD/INFE Policy Handbook* (16 November 2015) <<http://www.oecd.org/daf/fin/financial-education/National-Strategies-Financial-Education-Policy-Handbook.pdf>>; OECD, *Financial Education in Schools* (2012) <https://www.oecd.org/finance/financial-education/FinEdSchool_web.pdf>.

¹⁹ OECD, *Financial Education in Schools*, above n 18, 6.

confidence levels of the target group when completing their first income tax return; and, iv) ascertain which areas of financial literacy were of most importance to the target group.

III LITERATURE REVIEW

This section describes a selection of past studies on taxation education and complementary literature.

A Australia's self-assessment framework

Australia has operated a system for self-assessment of income tax since 1986/87.²⁰ Under this system, the onus to assess tax liability vests with the taxpayer.²¹ This shift in responsibility from the tax authority to the taxpayer raises concerns with respect to voluntary compliance and associated non-compliance behaviours.

Hence, in order to comply with Australia's taxation laws, taxpayers need to possess some degree of basic knowledge and understanding of personal taxation matters. In particular, individual taxpayers need to have a rudimentary understanding of the concepts of income, deductions, offsets, and exemptions, in order to accurately compute their tax liability.²² This is especially crucial as the taxpayers remain answerable to the tax authority in the case of a tax audit.

B Taxation education, knowledge and compliance

Kasippilai²³ argues that taxation knowledge, which may be defined as 'the level of awareness or sensitivity of the taxpayer to taxation legislation and the processes, by which taxpayers become aware of taxation legislation and other tax-related information',²⁴ is an essential element in a self-assessment tax system,²⁵ particularly in determining accurate tax liability and encouraging taxpayers to voluntarily comply with

²⁰ See, Treasury, *Report on Aspects of Income Tax Self Assessment* (August 2004) <http://selfassessment.treasury.gov.au/content/_download/report/final_report.pdf>.

²¹ *Income Tax Assessment Act 1936* (Cth) s 161.

²² *Income Tax Assessment Act 1997* (Cth) s 4-15.

²³ Jeyapalan Kasippilai, 'Taxpayer Knowledge Index as a Clue for Non-Compliance' (2000) 81(3) *Journal on Pakistan's Taxation Laws* 1.

²⁴ Adesina Olugoke Oladipupo and Uyioghosa Obazee, 'Tax Knowledge, Penalties and Tax Compliance in Small and Medium Scale Enterprises in Nigeria' (2016) 8 *iBusiness* 1-9, 2; see also, John Hasseldine, Kevin Holland and Pernill van der Rijt, 'The Market for Corporate Tax Knowledge' (2011) 22(1) *Critical Perspectives on Accounting* 39.

²⁵ Kasippilai, above n 23.

the tax regime.²⁶ Similarly, the studies of Loo²⁷ and Loo et al²⁸ suggest that tax knowledge is the most influential factor when assessing taxpayers' compliance behaviour under a self-assessment system.²⁹

The correlation between taxation knowledge and tax compliance is empirically established by several other studies,³⁰ which documented that possessing tax knowledge would lead to higher compliance rates. Conversely, it has been argued that the absence of tax knowledge may lead to non-compliance. This is postulated by McKerchar,³¹ who studied small business taxpayers in Australia. In her study, McKerchar suggested that small business taxpayers may not be aware of their tax knowledge shortfall and this may lead to unintentional non-compliant behaviour.

The level of taxation education received by taxpayers is therefore an important factor that contributes to the understanding of taxation requirements, especially as they relate to compliance, computation and reporting of tax liability. Taxation education has broadly been defined, with consensus, as 'a general introduction to concepts and principles of taxation covering personal, business and corporation taxation, tax administration, assessment and appeal and basic tax planning for individuals and businesses'.³²

In their study, Lai et al³³ sought to understand whether an appetite for taxation education existed among a sample of Malaysian undergraduate students from non-accounting disciplines. Whilst the primary focus of this study was to ascertain whether the sample shared an enthusiasm for the introduction of taxation education into their curriculum, their analysis was grounded, in part, on the notion that an understanding of the basic principles of taxation law could lend itself to enhanced tax compliance. Indeed, in drawing their conclusions, Lai et al argued that taxation education is paramount to developing tax

²⁶ See also, Mohd Rizal Palil, 'Does Tax Knowledge Matter in Self-Assessment System? Evidence from the Malaysian Tax Administration' (2005) 6(2) *Journal of American Academy of Business* 80; Natrah Saad Muzainah Mansor and Idawati Ibrahim, 'The Self-Assessment System and Its Compliance Costs' (2004) 2(1) *National Accounting Research Journal* 1.

²⁷ Ern Chen Loo, 'Tax Knowledge, Tax Structure and Compliance: A Report on a Quasi-Experiment' (2006) 12(2) *New Zealand Journal of Taxation Law and Policy* 117.

²⁸ Ern Chen Loo, Margaret McKerchar and Ann Hansford, 'Understanding the Compliance Behavior of Malaysian Individual Taxpayers Using a Mixed Method Approach' (2009) 4(1) *Journal of the Australasian Tax Teachers Association* 181.

²⁹ For the purposes of this study, the definition of tax compliance, offered by James and Alley, which considers tax compliance in terms of the difference between the person's legal tax liability and the amount of tax finally collected on a voluntary basis or by enforcement action, has been adopted. See, Simon James and Clinton Alley, 'Tax Compliance, Self-Assessment and Tax Administration in New Zealand – Is the Carrot or Stick More Appropriate to Encourage Compliance?' (1999) 5(1) *New Zealand Journal of Taxation Law and Policy* 3, 11.

³⁰ See, eg, Erich Kirchler, Apolonia Niemirowski and Alexander Wearing, 'Shared Subjective Views, Intent to Cooperate and Tax Compliance: Similarities between Australian Taxpayers and Tax Officers' (2006) 27(4) *Journal of Economic Psychology* 502; Jeyapalan Kasipillai and Hijattulah Abdul Jabbar 'Gender and Ethical Differences in Tax Compliance' (2006) 11(2) *Asian Academy of Management Journal* 73.

³¹ Margaret McKerchar, 'Understanding Small Business Taxpayers: Their Sources of Information and Level of Knowledge of Taxation' (1995) 12(1) *Australian Tax Forum* 25.

³² This definition was adopted throughout the conduct of this study. See, eg, Ming Ling Lai, Yaacob Zalilawati, Mahat Mohd Amran and Kwai Fatt Choong, 'Quest for Tax Education in Non-Accounting Curriculum: A Malaysian Study' (2013) 9(2) *Asian Social Science* 154, 155.

³³ *Ibid.*

knowledge and a compliant tax culture.³⁴ This view is echoed by the prior studies of Eriksen and Fallan,³⁵ Kasipillai et al³⁶ and Sarker,³⁷ which found that with a reasonable understanding of the tax laws, individuals are more willing to respect the tax system and, thus, become more tax compliant. The presupposition is therefore: with basic taxation education, a person is better equipped to understand and comply with taxation laws.

C Tax education and secondary schools

With the exception of studies conducted by Eriksen and Fallan,³⁸ Craner and Lymer,³⁹ Miller and Woods,⁴⁰ Juchau and Neale,⁴¹ Schwartz and Stout,⁴² Hite and Hasseldine,⁴³ Kasipillai et al,⁴⁴ Furnham,⁴⁵ Tan and Veal,⁴⁶ Lai,⁴⁷ and Lai et al,⁴⁸ there is limited academic literature generally available on the topic of taxation education.

Notably, however, the limited academic literature available on this topic is divided on the appropriate phase in the education cycle to introduce taxation education. In South Africa, Oberholzer and Nel⁴⁹ argued that implementing tax education in primary school or at an earlier secondary level would have the best chance of success, and ensure that a large percentage of future taxpayers have the opportunity to receive some form of tax education.⁵⁰ However, Furnham⁵¹ – through examining children ranging from 10 to 15 years old – found the participants unable to fully comprehend the nature and purpose of

³⁴ Ibid 155.

³⁵ Knut Eriksen and Lars Fallan, 'Tax Knowledge and Attitudes Towards Taxation: A Report on Quasi-Experiment' (1996) 17(3) *Journal of Economic Psychology* 387.

³⁶ Jeyapalan Kasipillai, Norhani Aripin and Noor Afiza Amran, 'The Influence of Education on Tax Avoidance and Tax Evasion' (2003) 1(2) *eJournal of Tax Research* 134.

³⁷ Tapan Sarker, 'Improving Tax Compliance in Developing Countries via Self-Assessment Systems – What Could Bangladesh Learn from Japan' (2003) 9(6) *Asia-Pacific Tax Bulletin* 1.

³⁸ Eriksen and Fallan, above n 35.

³⁹ John Craner and Andrew Lymer, 'Tax Education in the UK: A Survey of Tax Courses in Undergraduate Accounting Degrees' (1999) 8(2) *Accounting Education* 127.

⁴⁰ Angharad Miller and Christine Woods, 'Undergraduate Tax Education: A Comparison of Educators' and Employers' Perceptions in the UK' (2000) 9(3) *Accounting Education* 223.

⁴¹ Roger Juchau and Ray Neale, 'Taxation in Australian Undergraduate Accounting Courses: A Review and Case Note' (2001) 10(1) *Accounting Education* 27. This study sought to identify the presence of the subject of taxation in undergraduate accounting courses in Australia for the period 1945–95.

⁴² Bill Schwartz and David Stout, 'A Comparison of Practitioner and Educator Opinions on Tax Education Requirement for Undergraduate Accounting Major' (1987) 2 *Issues in Accounting Education* 112.

⁴³ Peggy Hite and John Hasseldine, 'Tax Practitioner Credentials and the Incidence of IRS Audit Adjustments' (2003) 17(1) *Accounting Horizon* 1.

⁴⁴ Kasipillai, Aripin and Amran, above n 36.

⁴⁵ Adrian Furnham, 'Understanding the Meaning of Tax: Young Peoples' Knowledge of the Principles of Taxation' (2005) 34(5) *Journal of Behavioral and Experimental Economics* 703.

⁴⁶ Lin Mei Tan and John Veal, 'Tax Knowledge for Undergraduate Accounting Majors: Conceptual v Technical' (2005) 3(1) *eJournal of Tax Research* 28.

⁴⁷ Ming Ling Lai, 'Introducing Tax Education in Non-Accounting Curriculum in Higher Education: Survey Evidence' (2009) 7(1) *Journal of Financial Reporting and Accounting* 37.

⁴⁸ Lai et al, above n 32.

⁴⁹ Ruanda Oberholzer and Martelize Nel, 'The Road to an Improved Tax Curriculum in South African Schools' (2006) 10(1) *Education as Change* 105–20.

⁵⁰ Ibid 109.

⁵¹ Furnham, above n 45.

taxation. This, in turn, led Furnham to argue that taxation education should be offered at a tertiary level, when students were more able to comprehend the subject matter.⁵²

In the Australian context, the authors of this paper are unaware of any study that has been conducted to examine the existing level of taxation education in Australian primary or secondary schooling phases. Traditionally, taxation education has primarily been delivered at a tertiary level, which is consistent with the evaluated literature. However, a recurring theme in many Organisation for Economic Co-operation and Development (OECD) countries is working with school children (both primary and secondary) to develop a fundamental understanding of the importance and operation of taxation laws and rules.⁵³ The rationale, consistent with the findings of Oberholzer and Nel,⁵⁴ is that this segment of the population is key to effecting a long-term cultural shift and improving tax compliance.⁵⁵ Notable initiatives include: Jamaica's 'Schools Tax Education Programme';⁵⁶ Kenya's 'Schools Outreach Programme';⁵⁷ Mauritius's 'Tax Education and Communication Department';⁵⁸ the mandate on Morocco's General Directorate of Taxes to educate children about taxes;⁵⁹ and Australia's 'Tax, Super and You' programme, as discussed above.

Whilst each of these initiatives has produced successful results, and indicated positive trends towards improving taxpayer compliance through the use of taxation education,⁶⁰ none of the evaluated jurisdictions have implemented taxation education as a core component of the school curriculum, despite recognition of the relative benefits associated with this measure.⁶¹

The primary limitations foreshadowed in the literature with respect to the introduction of taxation education as a core component of the curriculum, include: i) educators feeling ill-prepared or incapable of delivering the information;⁶² and, ii) poorly constructed content and resourcing barriers.⁶³

It is beyond the scope of this study to address these limitations; however, the authors of this paper have earmarked this issue to be discussed in subsequent publications. Notwithstanding the limitations noted above, the findings of this study support the introduction of taxation education into the secondary school curriculum.

⁵² See also, Lai, above n 47.

⁵³ OECD, *Building Tax Culture, Compliance and Citizenship* (2015) <<http://ifuturo.org/documentacion/Building%20tax%20culture.pdf>>.

⁵⁴ Oberholzer and Nel, above n 49.

⁵⁵ OECD, *Building Tax Culture*, above n 53, 18.

⁵⁶ *Ibid* 89–94.

⁵⁷ *Ibid* 95–8.

⁵⁸ *Ibid* 117–21.

⁵⁹ *Ibid* 129–34.

⁶⁰ *Ibid*.

⁶¹ OECD, *Financial Education in Schools*, above n 18.

⁶² See Gladson Nwanna and Darlington Richards, 'The Imperative of Basic Tax Education for Citizens' (2010) 3(9) *American Journal of Business Education* 61–6; Furnham, above n 45; Oberholzer and Nel, above n 49.

⁶³ See Gladson Nwanna and Darlington Richards, 'The Imperative of Basic Tax Education for Citizens' (2010) 3(9) *American Journal of Business Education* 61–6; Furnham, above n 45; Oberholzer and Nel, above n 49.

With respect to the literature examined (academic and otherwise), there appears to be in-principle support towards the introduction of taxation education in secondary schools; the merits of which are well documented.

Against this background, discussion in this article will now turn to the research study conducted.

IV RESEARCH METHODOLOGY

A self-administered, mixed method survey was designed to collect the data. The purpose of the survey was to broadly assess the participants' exposure to and corresponding attitude towards the Australian taxation regime. In doing so, the survey also sought to ascertain whether participants would have found formal taxation education – whilst at secondary school – useful or applicable to their future taxpayer obligations.

The use of a survey to collect the data was selected as the appropriate methodology for this study based on the relative efficiencies associated with questionnaire construction, administration and data collection.⁶⁴ This methodology was also consistent with the prior literature examined in this article.⁶⁵

The survey comprised 26 questions. The questions were chosen based on their ability to address the following components:

1. Personal and demographic information;
2. Previous exposure to taxation education as provided during the participants' secondary schooling;
3. Knowledge of taxation and associated attitude towards tax compliance, commensurate with assessing confidence levels in fulfilling personal tax obligations;
4. Perception towards the introduction of compulsory taxation education into Australia's secondary school curriculum; and
5. Perceived areas of importance in financial literacy.

The survey was administered via email and through online social media platforms. The survey was primarily targeted at Curtin University undergraduate students enrolled in the introductory taxation unit, 'Introduction to Australian Taxation Law' (the unit). This unit forms part of the core curriculum for the award of Bachelor of Commerce or Bachelor of Laws/Bachelor of Commerce (Taxation) (double degree), and is usually undertaken by a student in their first or second year of study.⁶⁶ This unit is offered internally and

⁶⁴ Laura Aaron, 'Survey Research' (2012) 84(2) *Radiologic Technology* 190–2; Patricia Moy and Joe Murphy, 'Problems and Prospects in Survey Research' (2016) 93(1) *Journalism & Mass Communication Quarterly* 16.

⁶⁵ See, eg, Lai et al, above n 32.

⁶⁶ Curtin University, *TAXA2000 (v.1) Introduction to Australian Tax Law* (2018) <<http://handbook.curtin.edu.au/units/31/316246.html>>.

externally through Curtin University across four campus locations,⁶⁷ and wholly online through Open Universities Australia.

The survey was distributed to a total of 457 students who were enrolled in the unit, via email and Blackboard announcement. In addition, the survey was also distributed online through the Curtin Tax Team's social media profile to reach a broader audience. Responses were voluntary, and 211 questionnaires were collected and analysed. The responses were collated by the lead investigator, through the mediums of SurveyMonkey and Excel. Observational analysis was then undertaken by the research team to identify emergent patterns not explicitly stated in the survey. The theoretical framework for this analytical methodology is based on identifying, analysing, and reporting themes within the data to better illustrate the relationship between the research questions and the results.⁶⁸

V FINDINGS

This section reports on the participants' responses and characteristics as identified in the study.

Q1: What is your gender?		
Answer options	Response (%)	Response (n)
Female	61.4%	129
Male	38.6%	81
	<i>answered question</i>	210
	<i>skipped question</i>	1

Principally, this question sought to ascertain if the participant group was representative of the broader university community.

This question was attempted by 99.5 per cent of the participants in the survey. It found that 61.43 per cent of the respondents identified as female and 38.57 per cent of the respondents identified as male. Interestingly, these results were within 5–6 per cent of the reported gender mix statistics for both male (44.07 per cent) and female (55.91 per cent) students attending Curtin University for the 2016 academic year.⁶⁹

⁶⁷ TAXA2000 is available at the following Curtin University locations: Bentley Campus, Charles Telfair Institute Mauritius, Miri Sarawak Campus and Singapore Campus.

⁶⁸ Virginia Braun and Victoria Clarke, 'Using Thematic Analysis in Psychology' (2006) 3(2) *Qualitative Research in Psychology* 77.

⁶⁹ Curtin University, *Curtin University Student Statistics 2012–2016* (23 February 2017) <<https://planning.curtin.edu.au/stats/students2012-2016.cfm>>.

Q2: What is your age?		
Answer options	Response (%)	Response (n)
18 to 24	52.1%	110
25 to 34	30.8%	65
35 to 44	10.4%	22
45 to 54	5.2%	11
55 to 64	1.4%	3
65 to 74	0.0%	0
75 or older	0.0%	0
<i>answered question</i>		211
<i>skipped question</i>		0

This question aimed to determine the age range of the respondents. This question was attempted by 100 per cent of the participants in the survey. The results show that a majority of the respondents were aged between 18 and 24, making up 52.13 per cent of the participant group. Sequentially, the other age groups were: 25 to 34 (30.81 per cent); 35 to 44 (10.43 per cent); 45 to 55 (5.21 per cent); and 55 to 64 (1.42 per cent).

These results were anticipated and preferable for the research study. As the study aimed to identify the level of taxation education experienced by a participant through their secondary education, targeting students enrolled in a unit offered at an early stage in their course was suspected by the researchers to yield reliable and comparable results.

Recent school leavers, those born between 1992 and 1998, would be in a more suitable position to describe their experience with the secondary school curriculum, having recently concluded this phase of their education. Those born prior to 1992 provide an interesting point of comparison in respect of the consistency or availability of taxation education over time.

Q3: Are you an Australian citizen?		
Answer options	Response (%)	Response (n)
Yes	81.0%	171
No	19.0%	40
<i>answered question</i>		211
<i>skipped question</i>		0

The assumption in this question is that an Australian citizen is likely to participate in the Australian tax regime on a resident basis and may have attended secondary school in Australia. Whilst the researchers acknowledge that Australian citizenship is not a

requirement to participate in Australian secondary schooling, this question nonetheless provides useful context in respect of the mix of nationalities present in the participant group.

This question was attempted by 100 per cent of the participants in the survey. The results show that 81 per cent of the participants identify as Australian citizens. Question 4 further investigates the participants who supplied a 'No' response to this question.

Q4: If you answered 'No' to Question 3, what is your country of citizenship? (If you have dual citizenship, please provide details of all countries.)		
Answer options	Response (%)	Response (n)
	21.8%	46
	<i>answered question</i>	46
	<i>skipped question</i>	165

This question was attempted by 21.8 per cent of the participants in the survey. Interestingly, six more participants responded to this question than anticipated. It is suspected that a misinterpretation of the instructions relative to this question lead to this anomalous result.

Of the respondents to this question, 58.7 per cent were between the ages of 18 and 24, 85.2 per cent of whom were either enrolled full or part time at university; 26.1 per cent were between 25 and 34, 91.6 per cent of whom were enrolled at university; 10.8 per cent were between 35 and 44, 100 per cent of whom were enrolled at university; and 4.4 per cent were between 45 and 55, 100 per cent of whom were enrolled at university.

Further analysis revealed that respondents to this question hailed from 21 different countries,⁷⁰ with 4 per cent reporting dual citizenship with Australia and an additional 4 per cent listing as Australian Permanent Residents.

Q5: Are you currently enrolled as a student at an Australian university?		
Answer options	Response (%)	Response (n)
Yes, full time	55.7%	117
Yes, part time	22.9%	48
No, I am not currently enrolled	21.4%	45
	<i>answered question</i>	210

⁷⁰ These included, Sri Lanka, Mauritius, India, Zimbabwe, China, Malaysia, Iran, Nepal, Singapore, Hong Kong, Russia, Pakistan, Thailand, Philippines, South Africa, Ireland, New Zealand, Indonesia, Tanzania, Taiwan and United Kingdom.

<i>skipped question</i>	1
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The results of this question were contrary to the researchers' hypotheses. Whilst some responses were anticipated for the 'No, I am not currently enrolled' field, a result of 21.4 per cent was beyond expectation. Given the variety of ways in which the survey was distributed – particularly in the form of social media – it is speculated that past students or recent graduates may have taken it upon themselves to contribute responses. This analysis is informed by the fact that 62.2 per cent of those who responded in this field fell in the age range of 18–24, and 24.4 per cent fell in the age range of 25–34.

Whilst this seems anomalous in light of the direction of the study, the broad data remains robust enough to yield valuable results. For this reason, the data has continued to be examined with these participants included.

Q6: What is your current employment situation?		
Answer options	Response (%)	Response (n)
Full-time employment	39.3%	83
Part-time employment	18.5%	39
Casual employment	23.7%	50
Not currently employed	18.5%	39
<i>answered question</i>		211
<i>skipped question</i>		0

A necessary component of the research study was to understand the current employment status of the participant group. The rationale being that those respondents who were – or had been – engaged in employment would be capable of addressing their ability, and confidence levels, in fulfilling their tax obligations.

Notably, 81.52 per cent of the participant group were engaged in some form of employment. Full-time employment accounted for 39.34 per cent, which was the largest group and populated predominantly (47 per cent) by those not currently enrolled as students.

These results were expected given the analysis conducted in the preceding questions and, although not ideal, remain valuable and instructive given the research questions to be answered.

Q7: What year did you leave secondary school?		
Answer options	Response (%)	Response (n)
2014	3.4%	7

2013	13.5%	28
2012	10.1%	21
2011	9.6%	20
2010	4.3%	9
2009	9.1%	19
2008	6.7%	14
2007	1.9%	4
2006	4.8%	10
2005	4.3%	9
Other (please specify)	32.2%	67
<i>answered question</i>		208
<i>skipped question</i>		3

The research study relied on the assumption that recent school leavers, those who completed their secondary education between 2009 and 2014, would be in a more suitable position to describe their exposure to tax education, having recently concluded this phase of their education. Those who completed their secondary schooling before 2010 provide an interesting point of comparison in respect of the availability of taxation education over time.

The results were comparable to the assumptions and shared a strong correlation with the dominate age range of 18–24. One hundred per cent of secondary school leavers fell within this field.

Q8: In relation to your secondary education please indicate the type of educational institution you attended.		
Answer options	Response (%)	Response (n)
Independent boys' school	5.3%	11
Independent girls' school	12.1%	25
Independent co-education school	27.7%	57
State government school	49.0%	101
Other (please specify)	5.8%	12
<i>answered question</i>		206
<i>skipped question</i>		5

Q9: If you attended an independent educational institution, please indicate which one.		
Answer options	Response (%)	Response (n)
Catholic	36.8%	46
Anglican	8.8%	11
Christian	6.4%	8
Adventist	0.0%	0
Uniting	6.4%	8
Baptist	2.4%	3
Non-denominational	28.8%	36
Other (please specify)	10.4%	13
<i>answered question</i>		125
<i>skipped question</i>		86

Q10: Where was your educational institution located?		
Answer options	Response (%)	Response (n)
Perth and surrounding areas	11.7%	24
South of the river	18.9%	39
North of the river	17.5%	36
Hills district	3.4%	7
Goldfields region	1.0%	2
Northwest region	1.9%	4
Southwest region	5.3%	11
Other (please specify)	40.3%	83
<i>answered question</i>		206
<i>skipped question</i>		5

Questions 8, 9 and 10 were intended to be used as a baseline for comparison with Questions 11 and 12. The researchers sought to understand whether the type or location of an educational institution impacted on the delivery of tax education.

Q11: Looking back to your secondary schooling, did you receive any information on taxation from your school?		
Answer options	Response (%)	Response (n)
Yes	23.4%	45
No	76.6%	147
<i>answered question</i>		192
<i>skipped question</i>		19

It is worth noting, prior to proceeding with further analysis, that from this point of the study forward, the sample size of the participant group and response rate fell into decline. The researchers suspect survey fatigue, time management or lack of interest may have impacted on the participant group. The researchers do not anticipate that this decline materially affects the quality of the results obtained in the survey.

The results in this question were expected, with 23.44 per cent of the participant group reportedly receiving some form of taxation education, and 76.56 per cent not.

This question was crucial to the research study and availed the first of several high-level themes. Whilst these results showcase a dearth of taxation education within the secondary school curriculum, generally, it is interesting to note that of the 23.4 per cent who received some form of taxation education, 53.3 per cent of those respondents attended a state government school, and a further 26.6 per cent attended an independent co-education school.

Whilst these results share a direct correlation to the responses in Questions 8, 9 and 10, and are representative of the participant group's personal and demographic information, it may be said that participants who undertook their secondary education through either a state government or independent co-education school received more exposure to taxation education and are arguably more confident in meeting – or complying with – their tax obligations. These observations and emerging themes were further assessed in the analysis of later questions.

Q12: Did your school provide any structured lessons that explained to students the purpose of taxation?		
Answer options	Response (%)	Response (n)
Yes	13.0%	25
No	87.0%	167
<i>answered question</i>		192
<i>skipped question</i>		19

Whilst 87 per cent of the participant group reportedly received no structured form of taxation education, of the 13 per cent that did, 76 per cent attended either a state government or independent co-education school, thus reinforcing the theme.

Q13: If you answered 'Yes' to Questions 11 or 12, please indicate from the list below the types of information or lessons provided.		
Answer options	Response (%)	Response (n)
The role of taxation in society	32.1%	17
The organisations involved within the taxation system	0.0%	0
How to complete a taxation return	1.9%	1
What types of income are assessable	5.7%	3
What types of deductions are claimable	0.0%	0
Where to obtain information to assist you to find out more information about the taxation system	0.0%	0
How taxes are used in society	22.6%	12
Types of different business structures and, in particular, the tax that applies to them	9.4%	5
Other (please specify)	28.3%	15
	<i>answered question</i>	53
	<i>skipped question</i>	158

The purpose of this question was to evaluate the type and quality of the information delivered to the participant group in receipt of taxation education. As noted, taxation education, has broadly been defined, with consensus, as 'a general introduction to concepts and principles of taxation covering personal, business and corporation taxation, tax administration, assessment and appeal and basic tax planning for individuals and businesses'.⁷¹ Hence, it was important to understand whether the information delivered to the participant group met the definition of 'taxation education' and what form this may have taken.

These results were anticipated and illustrate a fundamental gap in the dissemination of taxation education to secondary students. Whilst the majority of participants reported

⁷¹ This definition was adopted throughout the conduct of this study. See, Ling et al, above n 32.

learning about the role of taxation in society (32.1 per cent), and the purpose to which those taxes are applied (22.6 per cent), information related to the principles of personal, business or corporate taxation, and tax administration, were limited or non-existent.

These results are striking as they reveal an immense opportunity for improvement and reform associated with the secondary school curriculum.

Q14: If you answered 'Yes' to Questions 11 or 12, please indicate from the list below the subject classes that contained discussions on taxation.		
Answer options	Response (%)	Response (n)
Mathematics	5.7%	3
Humanities and Social Sciences	17.0%	9
Commerce	32.1%	17
Technologies	0.0%	0
History	3.8%	2
Other (please specify)	41.5%	22
<i>answered question</i>		53
<i>skipped question</i>		158

Prior to proceeding with this analysis, it should be noted that the 'Commerce' category, which generally involves subjects such as Economics or Business, is largely subsumed by the learning area of Humanities and Social Science in the Australian curriculum.⁷² These subjects are however, mostly elective and do not necessarily form part of the core curriculum of all students.⁷³

Notwithstanding the above, the results forecast that while some form of taxation education exists throughout the secondary school curriculum, dissemination of this information is predominantly conducted through the use of elective subjects – ie, Commerce (32.1 per cent) or Other (41.5 per cent), which included subjects such as Accounting, Politics and Law. As such, only a sample size of a given secondary school population would have access to fundamental and necessary information in respect of taxation. This, in turn, supports our concluding arguments that, if introduced, taxation education should form part of the compulsory secondary school curriculum.

⁷² Australian Curriculum, *Humanities and Social Sciences* (2018) <<https://www.australiancurriculum.edu.au/f-10-curriculum/humanities-and-social-sciences>>.

⁷³ See Australian Curriculum, *Structure* (2018) <<https://www.australiancurriculum.edu.au/f-10-curriculum/structure>> and Australian Curriculum, *Senior Secondary Curriculum* (2018) <<https://www.australiancurriculum.edu.au/senior-secondary-curriculum>>.

Q15: When you left secondary school, please rate your knowledge level on the following areas.							
Answer options	Very Poor	Poor	Average	Good	Excellent	Rating Average	Response (n)
Purpose of taxation in society	43	39	63	39	7	2.62	191
General understanding of taxation responsibilities	39	60	58	30	4	2.48	191
Where to obtain assistance regarding taxation responsibilities	49	79	40	20	3	2.21	191
Which organisations are part of the taxation system	57	72	47	14	1	2.11	191
How to complete a taxation return	95	56	22	15	3	1.82	191
How to understand a taxation assessment	90	62	24	11	3	1.82	190
How to complete a Tax File Number Declaration	53	37	45	39	17	2.63	191
How to apply for a Tax File Number	47	31	46	40	27	2.84	191
<i>answered question</i>							191
<i>skipped question</i>							20

This table is fundamental to the research study as it reflects the current attitudes and confidence levels of the participant group in complying with or meeting their taxation obligations.

As expected, responses of 'Poor' to 'Very Poor' were dominant over all fields. Perhaps most revealing, however, were the results in the fields of 'How to complete a taxation return' and 'How to understand a taxation assessment', where the response of 'Poor' to 'Very Poor' equated to 79.05 per cent and 82.19 per cent, respectively.

This result causes concern, given the reliance on taxpayers to assess and accurately report their tax liability.⁷⁴ A degree of basic knowledge and understanding of personal taxation matters is therefore fundamental to compliance with Australia's taxation laws, and these results further illustrate the need for robust and compulsory mechanisms to address this lack of taxation knowledge and education.

Q16: Looking back to when you lodged your first income tax return, please indicate from the list below who completed the return or assisted you.		
Answer options	Response (%)	Response (n)
Completed it myself	28.2%	53
Family member	33.0%	62
Friend	5.9%	11
Tax agent/accountant	27.7%	52
Tax help service	1.1%	2
Other (please specify)	4.3%	8
<i>answered question</i>		188
<i>skipped question</i>		23

Given the level of confidence the participant group expressed previously with respect to completing or meeting their tax obligations, these results were unexpected and caused some concern.

On average, during the period of this study, the ATO reported that 72.4 per cent of returns were logged by taxation agents.⁷⁵ It is interesting therefore that the data did not report a higher proportion of participants using the services of taxation agents.

Q17: If in the previous question you answered 'Completed it myself', were you confident that you had completed it correctly?		
Answer options	Response (%)	Response (n)
Yes	44.4%	28
No	55.6%	35
<i>answered question</i>		63
<i>skipped question</i>		148

⁷⁴ *Income Tax Assessment Act 1936* (Cth) s 161. See also Treasury, above n 20.

⁷⁵ See Australian Taxation Office, *Taxation Statistics 2015-16* (27 April 2018) <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2015-16>>.

Following the analysis in Question 16, of greater concern is the proportion of respondents that completed their tax return without assistance and with arguably low levels of confidence. More telling still is the reported rate at which tax help services were underutilised.

The analysis reflected in Questions 15–18 reveals yet another concerning theme, which may be articulated as follows: taxpayers, despite their lack of confidence and understanding in respect of their taxation obligations, are still participating in Australia's taxation system without assistance. Arguably, this may result in incomplete returns, misappropriation of tax liability and a litany of other unfavourable and administratively burdensome outcomes.

Interestingly, and complementary to the analysis conducted in respect of Question 11, of the 28 respondents to confirm that they felt confident completing their tax return, 64.28 per cent undertook their secondary education through a state government or independent co-education school.

Q18: Have you completed or are you currently undertaking a taxation course at university or a TAFE institution since leaving secondary school?		
Answer options	Response (%)	Response (n)
Yes	86.4%	165
No	13.6%	26
<i>answered question</i>		191
<i>skipped question</i>		20

Q19: If you answered 'Yes' to Question 18: Since undertaking or completing the taxation course are you more confident in submitting your own taxation return?		
Answer options	Response (%)	Response (n)
Yes	89.6%	147
No	10.4%	17
<i>answered question</i>		164
<i>skipped question</i>		47

The comments with respect to the anomalies identified in Question 5 (ie, the high proportion of non-students in the participant group) resonate in Questions 18 and 19. The results in these questions were expected and mirror much of the academic literature considered in this study.⁷⁶

⁷⁶ See, eg, Kasipillai et al, above n 36; Sarker, above n 37.

These responses in turn avail the penultimate, and perhaps axiomatic, theme that an increased understanding of the taxation laws promotes higher degrees of confidence and compliance in meeting associated taxation obligations.

Q20: Do you feel that it would have been beneficial to you to have studied taxation when you were in secondary school?		
Answer options	Response (%)	Response (n)
Yes	93.1%	175
No	6.9%	13
<i>answered question</i>		188
<i>skipped question</i>		23

Q21: Do you feel that students should know about the Australian taxation system so that when they start working they understand their rights as taxpayers?		
Answer options	Response (%)	Response (n)
Yes	96.8%	183
No	3.2%	6
<i>answered question</i>		189
<i>skipped question</i>		22

Q22: Do you feel that students should know about the Australian taxation system so that they understand what their taxes do for the community?		
Answer options	Response (%)	Response (n)
Yes	96.3%	182
No	3.7%	7
<i>answered question</i>		189
<i>skipped question</i>		22

Questions 20–22 assist in concreting the argument for the introduction of a compulsory taxation education regime into Australia's secondary school curriculum.

The overwhelming affirmative response to these questions is representative of the participant group's view towards the value associated with taxation education, and further illustrates the collective appetite for formal taxation education.

Q23: Of the following, please indicate which is the most important to least important to help you have a good financial understanding for making decisions about your future (with 1 being least important and 5 being most important).							
Answer options	1	2	3	4	5	Rating Average	Response (n)
Superannuation/retirement benefits	20	31	41	47	48	3.39	187
Budgeting	10	8	22	39	109	4.22	188
Banking	21	21	43	59	41	3.42	185
Financial contracts	37	29	39	36	45	3.12	186
Taxation	1	24	42	55	66	3.86	188
<i>answered question</i>							188
<i>skipped question</i>							23

This question sought to ascertain which areas of financial literacy were of most importance to the participant group, and in doing so, represented the last theme associated with this study.

Whilst it is clear from the results that the participant group share a collective appreciation for the importance of 'Taxation' in the context of financial literacy (second to 'Budgeting' by rating average), there exists little by way of formal education to address these realities.

Q24: How do you feel about the Australian taxation system?		
Answer options	Response (%)	Response (n)
It's extremely complex	25.0%	47
It's complex	54.8%	103
It's understandable	19.7%	37
It's simple	0.5%	1
It's extremely simple	0.0%	0
<i>answered question</i>		188
<i>skipped question</i>		23

Q25: How do you rate the Australian Government's management of the Australian taxation system (with 1 being poor and 5 being excellent).						
Very Poor	Poor	Average	Good	Excellent	Rating Average	Response (n)
12	34	92	42	5	2.62	185
answered question						185
skipped question						26

Questions 24 and 25 assess the attitudes of the participant group in the context of the perceived complexity of Australia's taxation regime and the Australian Government's management of the Australian taxation system.

The majority of the participant group considered Australia's taxation system 'Complex' or 'Extremely complex', with consensus that the management of the system was 'Average'. Given the limited exposure to taxation education, and the general consensus that Australia's taxation system is among the most complex in the developed world,⁷⁷ these results were unsurprising and further confirm the value associated with formal taxation education.

Q26: Oliver Wendell Homes Jr once said 'Taxes are what we pay for a civilized society' – do you agree with this?		
Answer options	Response (%)	Response (n)
Yes	86.7%	163
No	13.3%	25
answered question		188
skipped question		23

The words of Former Associate Justice of the Supreme Court of the United States, Oliver Wendell Holmes Jr, are representative of the importance associated with the collection of taxes. In this way, taxes may be viewed as not only a revenue collection mechanism, but rather as a fundamental component in the development and progress of a nation.

This interpretation appears to resonate with 86.7 per cent of the participants and testifies to the collective attitude harboured by this group. This view, in turn, supports the

⁷⁷ See Francis Chittenden and Hilary Foster, 'Discussion Paper: Perspectives on Fair Tax' (Association of Chartered Certified Accountants, 2008) <<https://www.accaglobal.com/content/dam/acca/global/PDF-technical/tax-publications/tech-tp-ft.pdf>>.

position that an understanding of fundamental elements of taxation, or a basic level of taxation education, creates increased compliance and a more robust taxation regime.

VI LIMITATIONS

The study is principally limited in its utility due to the relatively small sample size of the participant group, and further by the fact that the raw data produced some anomalous results as a consequence of recruitment and distribution of the survey on social media. As such, the observations reported in this study are confined to raw data evaluated. It is, therefore, not appropriate to generalise that all Australians would share a desire to have studied taxation within their secondary education phase. Further, it is not appropriate to generalise that the study of taxation during the secondary education phase would benefit a larger population in completing or understanding their personal taxation affairs, despite academic literature indicating that this view is likely correct.⁷⁸ These limitations present an opportunity for further comparative research where a larger sample size may be used to examine the accuracy of the assertions made in this study.

VII CONCLUSIONS

In reference to the research questions identified in the earlier part of this study, the following conclusions can be drawn.

A Taxation education received whilst attending secondary school

General exposure to taxation education was low, with 23.44 per cent of the participant group reportedly receiving some form of taxation education. Interestingly, respondents that attended state government or independent co-education schools received more exposure to taxation education and felt more confident in meeting their taxation obligations.

The type of tax education received by participants varied greatly. Whilst the majority of participants reported learning about the role of taxation in society (32.1 per cent) and how those taxes are applied (22.6 per cent), information related to the principles of personal, business or corporate taxation, and tax administration, was limited or non-existent.

These results illustrate a fundamental gap in the dissemination of taxation education to secondary students, presenting an opportunity for future reform.

B Desire for compulsory taxation education in secondary schools

The results of this study are wholly in favour of the introduction of a compulsory taxation education regime into the secondary school curriculum, with 93.1 per cent of the participation group indicating that the study of taxation whilst at school would have been beneficial.

⁷⁸ See, eg, Kasipillai et al, above n 36; Sarker, above n 37.

In an Australian context, taxation education could arguably fit within the remit of the Australian Curriculum's Humanities and Social Sciences: Economics and Business strand – the central aim of which is to ensure that students develop 'enterprising behaviours and capabilities that can be transferable into life, work and business opportunities and will contribute to the development and prosperity of individuals and society'.⁷⁹ A limitation of this approach, which has been earmarked by the authors to address in future research, relates to both resourcing and ability.

It stands, however, that the success of taxation education in the secondary school curriculum will depend on an educator's ability to identify, construct and disseminate relevant taxation information to their students, and their level competency in the subject matter. In this way, adopting taxation education into a pre-existing subject, such as Accounting or Economics and Business may avail its own challenges and fail to optimise the benefits associated with broadening a student's understanding of Australia's taxation laws and regulations. Therefore, it is the authors' opinion that taxation education, if formally adopted into the secondary school curriculum, should be taught as an independent subject,⁸⁰ perhaps under the broad discipline of either Mathematics⁸¹ or Humanities and Social Sciences.⁸²

This strategy poses its own unique resourcing and recruitment challenges, both of which will be explored in subsequent publications. However, this approach readily addresses the limitations associated with educator competency and content development.

C Confidence levels associated with taxation administration and compliance

The attitudes and confidence levels of the participant group in complying with or meeting their taxation obligations were reportedly low. Perhaps most revealing however, were the results in the fields of 'How to complete a taxation return' and 'How to understand a taxation assessment', where the response of 'Poor' to 'Very Poor' equated to 79.05 per cent and 82.19 per cent, respectively.

The analysis conducted to address this research question further revealed that participants, despite their lack of confidence and understanding in respect of their taxation obligations, are still participating in Australia's taxation system without assistance. Arguably, this may result in incomplete returns, misappropriations of tax liability and a litany of other unfavourable and administratively burdensome outcomes.

Given the reliance on taxpayers to assess and accurately report their tax liability,⁸³ a degree of basic knowledge and understanding of personal taxation matters is fundamental to compliance with Australia's taxation laws and these results further illustrate the need for robust and compulsory mechanisms to address this lack of taxation knowledge and education.

⁷⁹ Australian Curriculum, *Economics and Business* (2018) <<https://www.australiancurriculum.edu.au/f-10-curriculum/humanities-and-social-sciences/economics-and-business>>.

⁸⁰ Perhaps entitled 'Introduction to Australian Taxation Law'.

⁸¹ Australian Curriculum, *Mathematics* (2018) <<https://www.australiancurriculum.edu.au/f-10-curriculum/mathematics>>.

⁸² Australian Curriculum, *Humanities and Social Sciences*, above n 72.

⁸³ *Income Tax Assessment Act 1936* (Cth) s 161. See also, Treasury, above n 20.

D Importance of taxation in the context of financial literacy

Whilst it is clear from the results that the participant group share a collective appreciation for the importance of 'Taxation' in the context of financial literacy (second to 'Budgeting' by rating average), there exists little by way of formal education to address these realities.

Hence, in light of the findings obtained in this research study, and to address the educational gap that exists in respect of taxation education, it is recommended that the Department of Education and Training, in collaboration with the Australian Taxation Office and other relevant agencies, devise a strategy for the development and introduction of a compulsory taxation education programme, within all Australian secondary schools, to support and inform future generations of Australian taxpayers.

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IS THERE A VIABLE WAY TO TAX THE CONSUMPTION OF IMMOVABLE PROPERTY THAT IS MORE CONSISTENT WITH THE ECONOMIC OBJECTIVE OF THE VAT?

CHRISTINE PEACOCK*

ABSTRACT

The design of value added tax (VAT)[†] systems is generally based on an assumption known as the 'prepaid method'. Under this method, it is assumed that the value of goods at the time of purchase (the first transaction) is equal to the value of the use and enjoyment (consumption) by the owner of the goods. VAT is imposed on the first purchase of goods, and later sales of goods from consumer to consumer are not subject to VAT. This generally produces the correct result. However, the general appreciation in the value of immovable property may result in the value of total consumption of owner-occupied housing being greater than the value that was taxed at the time of first purchase. This is inconsistent with the economic objective of VAT, which is to tax the flow of consumption. A possible alternative would be to subject imputed rent (the net value of services rendered by a house to its owner-occupier for which they would otherwise pay cash rent to a landlord) to VAT. Imputed rent has been regarded as part of the tax base for income tax purposes in many countries. However, no country includes imputed rent in its VAT base. This article outlines some of the practical considerations that would be involved in including imputed rent in the VAT base.

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[†] Whilst VAT was the traditional name for the broad-based consumption tax that was implemented in the European Union (EU), some Anglo countries such as Australia, Canada, Malaysia, New Zealand and Singapore, which have more recently introduced this system of consumption tax, have called the tax a goods and services tax (GST). As VAT is the traditional name used for this type of consumption tax, and it is the term most commonly used in the international sphere, it will be the term that will be used throughout this article, except when any GST system is referred to (for example, the GST system in New Zealand).

I INTRODUCTION

The research question to be answered in this article is whether there is a viable way to tax the consumption of immovable property that is more consistent with the economic objective of VAT (which is to tax the flow of consumption) as compared to the current approach. The current approach to the VAT treatment of immovable property will first be considered in Section II of this article. It will be noted in this section that the design of VAT systems is generally based on an assumption that is known as the 'prepaid method'. It is assumed that the value of goods at the time that they are first purchased is equal to the total value of the use and enjoyment (consumption) of those goods.¹ Therefore, VAT is generally imposed on the first purchase of goods, and later sales of goods from consumer to consumer are not subject to VAT.

In Section III, the particular challenge posed by the VAT treatment of owner-occupied housing under the prepaid method will be discussed. The general appreciation in the value of immovable property² may result in the value of total consumption of owner-occupied housing being greater than the value that was taxed at the time of first purchase. This is inconsistent with the economic objective of VAT, as it may produce a result where there are flows of consumption of owner-occupied housing that are not subject to VAT.

It has been recognised in the VAT literature that the theoretically correct approach for VAT purposes would be to include the imputed rent of a house or apartment in the VAT base.³ Section IV of this article will discuss the concept of imputed rent. This is the hypothetical rent that an owner-occupier would pay to him or herself for living in his or her own home.⁴ Imputed rent has been regarded as part of the tax base for income tax purposes in many countries.⁵ However, it has generally been considered that including imputed rent in the VAT base would be too difficult. This has primarily been because of concerns about how to value imputed rent, and concerns as to how such a proposal would

¹ David F Bradford, *Blueprints for Basic Tax Reform* (Tax Analysts, 2nd ed, 1984) 108; Wei Cui, 'Objections to Taxing Resale of Residential Property under a VAT' (November 2012) *Tax Notes* 777, 779; and Robert F van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International, 2009) 183.

² The term 'immovable property' is generally understood in the tax literature to mean land, buildings and fixtures, both residential and commercial: Satya Poddar, 'Taxation of Housing Under a VAT' (2009) 63 *Tax Law Review* 443, 445-6. In Anglo countries, including Australia, immovable property is known as real property. However, owing to the international importance of this article, immovable property is referred to by its most common name.

³ See, for example, Robert Albon, 'The Appropriate Tax Treatment of Owner-Occupiers' (1984) 1(4) *Australian Tax Forum* 391, and Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards a Post-Modern VAT' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013). In relation to the purest theoretical VAT treatment of goods more generally, see Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 24.

⁴ Marsh provides a similar explanation. See Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514.

⁵ See Steven C Bourassa and William G Grigsby, 'Income Tax Concessions for Owner-Occupied Housing' (2000) 11(3) *Housing Policy Debate* 521; Paul E Merz, 'Foreign Income Tax Treatment of the Imputed Rental Value of Owner-Occupied Housing: Synopsis and Commentary' (1977) XXX(4) *National Tax Journal* 435; and Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003).

affect low-income earners and those who do not earn income. As there is no example of any country including imputed rent within its VAT base, this article will consider two historic examples of imputed rent being included within the income tax base (see Section V). These examples will demonstrate some of the problems that have arisen from such an approach. Section VI will then consider whether the concerns that have arisen regarding including imputed rent within the VAT base are still realistic concerns today.

II VAT TREATMENT UNDER THE PREPAID METHOD

In order to answer the research question, this article first considers the current approach. Under the prepaid method, VAT is currently imposed on the original purchase price of goods as a measurement of the present value of all future consumption.⁶ Later sales of goods from consumer to consumer are not subject to VAT, although theoretically later consumers pay VAT as future consumption is assumed to be built into the price at which second-hand goods are sold.

The current use of the prepaid method yields an appropriate result where goods provide immediate gratification to a consumer, such as a cup of coffee.⁷ In this case, the value of goods at the time that they are first purchased is the present value of their future use, and the VAT on the initial purchase corresponds with all future consumption. Use of the prepaid method also generally yields an appropriate result where goods are sold partway through their useful lives.⁸ The owner of a washing machine, for example, who sells it for, say, half the purchase price when it is halfway through its life recovers half the VAT that he or she originally paid to the revenue authority. The purchaser of a second-hand washing machine bears an effective burden equal to the present value of the VAT on the remaining consumption that is yielded by the washing machine. The market value of used goods such as second-hand washing machines is the VAT-inclusive value. This includes a portion of the VAT paid by the first purchaser.⁹

The purchase of a good is a form of savings, not consumption.¹⁰ Expenditure is recognised as goods waste through usage or the effluxion of time. Cui has recognised this where he has written that '[t]he act of purchase is not itself an act of consumption. Instead,

⁶ The following sources provide similar explanations: Bradford, above n 1; Sijbren Cnossen, 'VAT Treatment of Immovable Property' in Victor T Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 233–4; Cui, above n 1, 799; Rebecca Millar, 'Echoes of Source and Residence in VAT Jurisdictional Rules' in Michael Lang, Peter Melz et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009); Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013) 253; Christine Peacock, 'Taxing the Consumption of Owner-Occupied Residential Property' (2013) 5 *International VAT Monitor* 299, 299; and van Brederode, above n 1, 183.

⁷ This has been recognised by van Brederode: Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) vol 37, 1.

⁸ Krever has recognised this: Krever, above n 3, 24.

⁹ This was earlier recognised in Peacock, above n 6.

¹⁰ *Ibid.*

consumption happens when a durable good is used.¹¹ Many consumer durables are goods that waste in value over time.¹² Therefore, for many consumer durables the VAT on the initial sale price will generally be approximately equal to the present value of all future consumption.

However, where a durable good appreciates, upfront taxation does not correspond to the present value of all future consumption. If the market value of a durable good increases over time, the value of savings will rise, and yield more consumption. Final consumption will therefore be greater than the original present value that was ascribed to the good. Owners who retain appreciating goods therefore bear less VAT than the amount that corresponds with the increased consumption value of the good. This is problematic, as it is inconsistent with the economic objective of VAT, which is to tax the flow of consumption.¹³ It presents a situation where the legal design of VAT as a tax on transactions does not achieve this economic objective. For simplicity reasons, expenditure is generally currently used as a proxy for consumption. In effectively describing the operation of the prepaid method, Millar has explained that:

while the objective of a VAT is to tax consumption, in its legal design it is a tax on transactions, in which future consumption is predicted. Consumption is measured by reference to consumption expenditure (the price paid to acquire goods or services for the purpose of consuming them, whether immediately or in the future).¹⁴

Generally, there are time of supply rules that are imposed in countries that have a VAT, which have the effect that VAT is accounted for at the time that ownership of a good is transferred.¹⁵ This will generally be regarded as the time that a transaction takes place. For example, in New Zealand there is a general 'time of supply' rule that states that GST should be accounted for at 'the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier in respect of the supply.'¹⁶ Similarly, in the European Directive (EU) Directive 2006/112 it is written that 'on each transaction, value added tax ... shall be chargeable'.¹⁷

¹¹ Cui, above n 1. See also Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015), and van Brederode, 'Theory and Practice of VAT', above n 7.

¹² Krever, above n 3.

¹³ The economic objective of the VAT is recognised by Millar. See Millar, 'VAT and Immovable Property', above n 6. See also Robert F Conrad, 'Value Added Taxation and Real Estate' (Discussion Paper DRD224, Development Research Department Economics and Research Staff World Bank, February 1987); Alan A Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988) 80; and van Brederode, 'Theory and Practice of VAT', above n 7.

¹⁴ Millar, 'Echoes of Source', above n 6. See also OECD, *Consumption Tax Trends 2016: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing, 2016).

¹⁵ Millar describes the time of supply rules in more detail: Millar, 'Echoes of Source', above n 6.

¹⁶ *Goods and Services Tax Act 1985 (NZ)* s 9.

¹⁷ European Union Directive 2006/112 Article 1. New Zealand and the EU are mentioned here as the VAT/GST systems in these countries are considered international models of VAT design: John F Due, 'The New Zealand Goods and Services (Value-Added) Tax - A Model for Other Countries' (January-February 1988) 36(1) *Canadian Tax Journal* 125; Andrew Maples and Adrian Sawyer, 'The New Zealand GST and its Global Impact: 30 Years On' (2017) 23(1) *New Zealand Journal of Taxation Law and Policy* 9, 25; Christine Peacock, 'Why Simple GST Treatment of Real Property Is Important' (2010) 13(4) *The Tax Specialist* 216; Adrian Sawyer, 'GST Reform: Can New Zealand Offer Constructive Guidance to Inform the Australian

James has observed that using 'expenditure on consumption as a proxy for consumption' is considered best practice design.¹⁸ She has written that it is generally thought 'necessary to identify some taxable transactions ... such as the supply of a good or service, that triggers the expenditure on consumption and therefore the liability to pay VAT'.¹⁹ According to Ecker, '[c]onsumption itself is not directly observable but what we can hope to observe is ... spending'.²⁰

However, this article suggests that it is no longer necessary to identify taxable transactions in order to subject the consumption of immovable property to VAT. This article therefore fits within the increasing body of literature where the current general design of VAT systems is being questioned, and where it is being suggested that it is now possible to tax some consumption that has generally not been subject to VAT in the past. In particular, there is an increasing body of literature where the rationale for the use of standard exemptions from VAT, are being questioned.²¹ This is particularly in light of the experience in VAT jurisdictions with the problems caused by the use of exemptions, such as the often-difficult issue of determining which supplies of goods and services are taxable and which are exempt. Further, as noted by the European Commission, there is a need to review standard exemptions 'in the light of economic and technological changes'.²² The focus of this article is on the VAT treatment of residential premises. Currently sales and leases of residential premises are generally regarded as exempt from VAT, or outside the scope of VAT when a vendor is not registered for VAT (see Section III).

III THE PROBLEM WITH THE VAT TREATMENT OF OWNER-OCCUPIED HOUSING

The particular challenge posed by the VAT treatment of owner-occupied housing under the prepaid method will be discussed in this section, after consideration of the VAT treatment of immovable property more generally. Unlike most consumer durables that depreciate over time, the value of immovable property generally appreciates.²³ Cui has attributed this appreciation to '[u]rbanization, the building of new transportation pathways and amenities, unexpected rises in income in the local population, and so forth'.²⁴ Other factors affecting the general appreciation in the value of immovable property may include population growth, particularly in jurisdictions with immigration.²⁵

Debate?' (Paper presented at the Visiting Professor Seminar Series, QUT Business School, Brisbane, Queensland, Australia, November 2014); and Thuronyi, above n 5, 313.

¹⁸ Kathryn James, *The Rise of the Value-Added Tax* (Cambridge University Press, 2015) 41.

¹⁹ *Ibid* 41–2.

²⁰ Thomas Ecker, *A VAT/GST Model Convention* (IBFD, 2013) 100.

²¹ Liam Ebril et al, *The Modern VAT* (International Monetary Fund, 2001) 100.

²² European Commission, 'Green Paper on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System' (2010) <http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/consultations/tax/future_vat/com%282010%29695_en.pdf>.

²³ This has been recognised by Cui: Wei Cui, 'Learning to Keep the Consumption Tax Base Broad: Australian and Chinese VAT Design for the Housing Sector' in Christine Peacock (ed), *GST in Australia: Looking Forward from the First Decade* (Thomson Reuters, 2011). See also Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁴ Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁵ This was recognised in Peacock, 'Taxing the Consumption', above n 6, 300.

Appreciation in the value of immovable property can also arise due to other circumstances relating to the property, such as a change of zoning.²⁶

Van Brederode has noted that other than immovable property 'art, antiques and some other collectibles'²⁷ can also appreciate. To achieve consistency, the VAT treatment of these other durable items that may also experience a change in real values should also be considered. However, this is beyond the scope of this article, which focuses on the VAT treatment of immovable property. This is because it is more common for people to purchase immovable property than these other items, as this form of property is considered more of a necessity, and immovable property is the most frequently consumed asset to appreciate. The importance of the VAT treatment of immovable property also lies in the fact that expenditure on housing services often comprise a large percentage of an individual's total consumption.²⁸ In this regard, Millar has written that '[i]mmoveable property is the most widely held and traded appreciating asset and a purchase of immovable property is more often than not the single most important acquisition a person will make in his/her lifetime.'²⁹

The general appreciation in the value of immovable property is not so problematic when it comes to supplies of commercial property, as business consumers are entitled to deduct VAT on the purchase or lease of commercial property, as the property is used as an input into the purchaser's production.³⁰ Therefore, there is no VAT net effect for revenue authorities as a result of supplies of commercial property being subject to VAT. The general appreciation in the value of immovable property is also not a problem that affects the VAT treatment of residential rents, as residential rents are generally exempt from VAT.³¹

The VAT treatment of owner-occupied housing is, however, problematic. Under the prepaid method, the first sale of residential premises from a developer to a consumer is subject to VAT. Subsequent sales of residential premises from consumer to consumer are generally regarded as exempt from VAT, or outside the scope of VAT when a vendor is not registered for VAT.³² In theory, it is assumed that the initial sale price of residential premises will include the present value of all future consumption of the residential

²⁶ Cui, 'Objections to Taxing Resale', above n 1, 779.

²⁷ van Brederode, 'Theory and Practice of VAT', above n 7.

²⁸ Ibid 1.

²⁹ Millar, 'VAT and Immovable Property', above n 6. See also Institute for Fiscal Studies, *The Structure and Reform of Direct Taxation: Report of a Committee Chaired by Professor J.E. Meade* (George Allen & Unwin, 1978) 54, and Poddar, above n 2.

³⁰ See Krever, above n 3, 24; Ine Lejeune, Jeanine Daou-Azzi and Mark Powell, 'The Balance Has Shifted to Consumption Taxes – Lessons Learned and Best Practices for VAT' in Michael Lang, Peter Melz et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD, 2009); and van Brederode, 'Theory and Practice of VAT', above n 7.

³¹ This is so as to achieve tenure neutrality between homeownership and residential rents, as sales of used residential premises are not subject to VAT: Sijbren Cnossen, 'Improving the VAT Treatment of Exempt Immovable Property in the European Union' (Working Paper 10/19, Oxford University Centre for Business Taxation, 2010) 1; Lejeune, Daou-Azzi and Powell, above n 30; Millar, 'VAT and Immovable Property', above n 6; and M Stewart, 'Taxation Policy and Housing' (2012) 7 *International Encyclopedia of Housing and Home* 152.

³² van Brederode, 'Theory and Practice of VAT', above n 7.

premises.³³ However, Cnossen has described the current VAT treatment under the prepaid method as a 'second-best approach' as changes in the value of residential premises are not included in the VAT base.³⁴ Over time, the value of a house or apartment generally rises above the consumer price index. Applying the prepaid method to the VAT treatment of owner-occupied housing may therefore mean that the value of total consumption of owner-occupied housing may be greater than the value that was taxed at the time of first purchase.³⁵ Future purchasers of a used residence will have an effective tax burden equal to the present value of the VAT at the time of acquisition, not the new value of future consumption.

IV THE CONCEPT OF 'IMPUTED RENT'

It has been recognised in the VAT literature that the theoretically correct approach for VAT purposes would be to include the imputed rent of a house or apartment in the VAT base.³⁶ Marsh has described imputed rent as 'the net value of the services rendered by a house to its owner (occupier) for which he would otherwise pay cash rent to a landlord.'³⁷ Imputed rent falls within the broader taxation concept of imputed income, which Marsh has defined as a 'flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf.'³⁸ If imputed rent were included within the VAT base, then it would not be subject to VAT at the time that transactions between parties take place, but instead, a value would be placed on the imputed rent of a home for a specific period, such as a month or year, and this value could be updated as the immovable property appreciates.

Cnossen has observed that subjecting imputed rent to VAT would involve regarding the owner-occupier of a home as making a self-supply of the services in a home to him or herself.³⁹ He has explained that by purchasing a home, an owner would become a producer of housing services. The owner could sell the housing services to a tenant who would act as a consumer of the housing services. A theoretically correct approach would be for the tenant to pay VAT on the rental charge. Alternatively, the owner could put the home to his or her own disposal.⁴⁰ This would be equivalent, Cnossen has argued, to making a self-supply of housing services. He has recommended that VAT should be

³³ de la Feria and Krever, above n 3.

³⁴ Sijbren Cnossen, 'A Proposal to Improve the VAT Treatment of Housing in the European Union' in Rita de la Feria (ed), *VAT Exemptions Consequences and Design Alternatives* (Wolters Kluwer, 2013) 225; Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399; and Sijbren Cnossen, 'Is the VAT's Sixth Directive Becoming an Anachronism?' (2003) 43(12) *European Taxation* 434. See also de la Feria and Krever, above n 3.

³⁵ This was recognised in: Cnossen, 'A Proposal to Improve the VAT Treatment', above n 34; Cui, 'Learning to Keep the Consumption Tax Base Broad', above n 23; de la Feria and Krever, above n 3, 453; and Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011) 380.

³⁶ See, for example, Albon, above n 3, 391, and de la Feria and Krever, above n 3. In relation to the purest theoretical VAT treatment of goods more generally, see Krever, above n 3, 24.

³⁷ Marsh, above n 4, 514.

³⁸ *Ibid.*

³⁹ Cnossen, 'Improving the VAT Treatment of Exempt Immovable Property', above n 31, 1.

⁴⁰ *Ibid.*

charged on the consideration for this self-supply.⁴¹ Such an approach would involve widening the VAT base, to include residential rent and imputed rent.

While imputed rent has been regarded as part of the tax base for income tax purposes in many countries including Australia, Austria, Belgium, Denmark, Finland, Germany, Greece, Israel, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey and the United Kingdom,⁴² there is no country that includes or has included imputed rent in its VAT base.⁴³ The next section considers two historic examples of when imputed rent was included within the income tax base. These examples will illustrate some of the problems that have arisen from such an approach.

V HISTORICAL EXAMPLES OF IMPUTED RENT BEING SUBJECT TO INCOME TAX

Imputed rent was assessed for income tax purposes at a national level in Australia, from 1915 until 1923.⁴⁴ Where applicable, the income of any person included:

five per centum of the capital value of land and improvements thereon owned and used or used rent free by the taxpayer for the purpose of residence or enjoyment and not for the purpose of profit or gain, less the interest paid on a mortgage of that land.⁴⁵

Simons wrote in particularly positive terms about this experience in 1938 in the course of discussing the 'comprehensive concept of income' and 'income in kind'.⁴⁶ However, it appears that he mistakenly viewed this as a simple system under which imputed rent was calculated on a net basis, without further deductions allowed for depreciation or repairs.⁴⁷ For example, he wrote that '[a] conspicuous advantage of this method lies in the avoidance of the depreciation problem – which ... is very inadequately handled under rules of the kind prescribed in Schedule A of the English law'⁴⁸ (the operation of Schedule A in the United Kingdom will be discussed below). Albon has explained that the Australian system was, however, more complex than this. He has written that, '[f]rom the "five per centum of the capital value", owner-occupiers could deduct for repairs, rates, land taxes and mortgage interest.'⁴⁹

⁴¹ Ibid.

⁴² See Bourassa and Grigsby, above n 5; Merz, above n 5, 435; New Zealand Treasury, New Zealand Government, *Issues Paper – Tax Review 2001* (2001) 39; and Thuronyi, above n 5.

⁴³ Richard M Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007), and Cnossen, 'VAT Treatment of Immovable Property', above n 6.

⁴⁴ South Australia included imputed rent in its income tax base from 1885 until 1930, Victoria from 1895 until 1936, and Queensland from 1920 until 1923: B F Reece, 'Taxing Imputed Rent: Australian Precedents' (1975) *Community* 6.

⁴⁵ *Income Tax Act 1915* (Cth) s 14(e).

⁴⁶ Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938).

⁴⁷ This is noted in Robert Albon, 'Housing and Taxation – Commonwealth Issues' (1990) 7(3) *Australian Tax Forum* 337 and Barry Reece, 'Simons' Account of Australian Taxation of Imputed Rental Income' (1985) 2(2) *Australian Tax Forum* 239.

⁴⁸ Simons, above n 46.

⁴⁹ Albon, above n 47, 337. See also Reece, 'Simons' Account', above n 47.

The previous system of including imputed rent in the income tax base in the United Kingdom, which existed from the beginning of its income tax system in 1799 until 1963,⁵⁰ has been cited in the tax literature as an example of the administrative difficulties that can arise in assessing imputed rent for income tax purposes.⁵¹ Income tax was levied on the annual value of the property that was owner-occupied.⁵² The annual value of owner-occupied property was regarded as the amount that it was 'worth to be let by the year'.⁵³ Revaluation of owner-occupied property was to occur every five years.⁵⁴ However, no revaluations took place in the United Kingdom between 1936 and 1963 due to war conditions and post-war difficulties.⁵⁵ Merz has written that, '[t]he fear of significant increases in income tax liability following establishment of realistic values by reassessment was the major factor in the cessation of income tax on this form of income'.⁵⁶

VI INCLUDING IMPUTED RENT WITHIN THE VAT BASE

Following on from the historical experiences of Australia and the United Kingdom in including imputed rent in the income tax base, administrative concerns have also arisen in the more recent theoretical VAT literature that has discussed whether imputed rent could be included in the VAT base (see Section V above). For example, in 1996 Cnossen wrote that 'the computation of all rental values, would present formidable administrative problems that a VAT should not take on'.⁵⁷ However, while valuing assets in general may have been problematic historically (for instance, for income tax purposes in the United Kingdom, as discussed above), this does not appear to be the case today. In 2011, Holmes wrote that, from an income tax perspective,

[t]here seems to be little justification for omitting imputed rent from owner occupied housing on the basis of measurement difficulties in a climate of increasingly sophisticated valuation methodology for local authority rating (and other) purposes.⁵⁸

Tax administrations have become more capable over time of administering increasingly more complex tax laws. These administrations have more sophisticated technology now compared to what they have had in the past. Further, real values of residential property are utilised for other taxation purposes (including local council rating) in many jurisdictions and these systems of valuation could potentially be adapted so that they could be used to determine how to value imputed rent.

⁵⁰ Kevin Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD, 2001).

⁵¹ See Government of Canada, *Report of the Royal Commission on Taxation* (1966) vol 3, 48; Richard Goode, *The Individual Income Tax* (The Brookings Institution, revised ed, 1976) 118; and Merz, above n 5.

⁵² Government of Great Britain, 'Royal Commission on the Taxation of Profits and Income: Final Report: Presented to Parliament by Command of Her Majesty' (Her Majesty's Stationery Office, 1955) 246.

⁵³ *Ibid* para 8.11.

⁵⁴ *Ibid* para 8.12.

⁵⁵ Merz, above n 5, 7.

⁵⁶ *Ibid*.

⁵⁷ Cnossen, 'VAT Treatment of Immovable Property', above n 6, 233–4. See also Cnossen, 'Global Trends and Issues in Value Added Taxation', above n 34.

⁵⁸ Holmes, above n 50.

In the Australian state of Victoria, a Net Annual value is stated on the Notice of Valuation, Rates and Charges that is issued to property owners by local councils. This Net Annual value is 5 per cent of the capital-improved value, which is the value of the land and any capital improvements, including buildings. For the purpose of including imputed rent within the VAT base, the Net Annual value on this Notice of Valuation could be regarded as the value of imputed rent that would be subject to VAT on an annual basis. However, a potential problem with such an approach is that the values of residential property that are currently utilised for tax purposes are sometimes not revised regularly, and hence become outdated (as happened in the United Kingdom when imputed rent was subject to income tax).

Alternatively, VAT could be charged based on the average market rental in different regions, and these figures could be adjusted over time for inflation, and in accordance with the features of a home. For example, two-bedroom homes could be valued more than one-bedroom homes; and the standard valuation allocated to a home could be adjusted based on the size of the property. However, such a system would be far more complex to administer than the proposal mentioned above relating to regarding the capital-improved value as the value of imputed rent. A potential problem with both of these potential ways to calculate imputed rent is that sometimes the values that are used in valuation systems even in year one do not reflect the actual value of the property, given the broad valuation metric that is used. There would therefore be compliance and administrative costs associated with any system of valuation that may be used to value imputed rent.

Another concern that has been raised in the tax literature is that if the consumption of housing were taxed on an annual basis then people on lower incomes or no income may be at a disadvantage financially. For example, in considering the possibility of an annual tax levied on housing services, the authors of the Mirrlees Review Report wrote that '[t]here would clearly be a large number of losers from a reform of this kind. The losers would include those, often older people, on low incomes who live in expensive houses.'⁵⁹ Likewise, when discussing the possibility of including imputed rent within the income tax base, Bourassa and Grigsby wrote that,

[t]he tax bears little relationship to capacity to pay, weighing more heavily on lower-income, elderly homeowners ... Substantial exclusions would be required to protect retired homeowners being taxed out of their own homes.⁶⁰

However, older people living in expensive houses are often exercising a choice to enjoy a high-imputed rent rather than cash flow or investing in other assets such as shares. If their imputed rent were subject to VAT, they may not necessarily experience hardship, given their capacity to use the equity in their home (the difference between the value of the property and how much is owed on any mortgage) to obtain a loan that could be used to pay VAT on the imputed rent.

Taxing imputed rent for VAT purposes may, however, have the potential to impact negatively on first home buyers in particular. This may especially be the case during a time of declining homeownership rates due to inflation in house prices. Perhaps there

⁵⁹ Institute for Fiscal Studies, *Tax by Design*, above n 35, 390.

⁶⁰ Bourassa and Grigsby, above n 5, 528.

could be ways to deal with this issue. For example, accompanying social assistance could be considered for those who could genuinely claim that they would be unreasonably disadvantaged (as occurred in New Zealand, when the very comprehensive GST was introduced – in that case to combat regressivity).⁶¹ The authors of the Mirrlees Review Report have suggested that ‘it would be possible to allow people, in specified circumstances, to roll up liabilities (with interest) either until the property is sold or until death, in order to alleviate cash-flow problems.’⁶² If governments collected the additional revenue from including imputed rent within the VAT base and redistributed some of this, then people disadvantaged by such a proposal could be compensated. For example, in Australia the first homeowner’s grant was introduced to offset the effect of the VAT on homeownership.

VII CONCLUSION

Given that housing is so frequently consumed, the appropriate VAT treatment of immovable property is particularly important. In the past, using expenditure on consumption as a proxy for consumption, as occurs under the prepaid method (discussed in Section II) has been considered best practice design. However, the current VAT treatment of immovable property under the prepaid method produces a result that is inconsistent with the economic objective of VAT (which is to tax all consumption). Under the prepaid method, the consumption of immovable property is only taxed once, at the time that the property is first sold to a consumer. Therefore, any appreciation in the value of immovable property is not captured within the VAT base. This produces a result where there may be a flow of consumption that is not subject to VAT. The research question that this article therefore set out to answer was whether there is a viable way to tax the consumption of immovable property that is more consistent with the economic objective of VAT.

In this article, the current VAT treatment of immovable property under the prepaid method was compared to the result that would be achieved if imputed rent were subject to VAT. Including the imputed rent of owner-occupied housing within the VAT base, along with rentals of housing to tenants, would produce a result that is more consistent with the economic objective of VAT. Subjecting imputed rent to VAT would involve subjecting the consumption of immovable property to VAT on a more regular basis. The value of immovable property that is subject to VAT as part of this process could be updated regularly to reflect its appreciation.

In the VAT literature, the idea of including imputed rent in the VAT base has been considered the theoretically correct approach. However, it has generally been considered that this might result in measurement difficulties in determining the value of imputed rent (as occurred when imputed rent was considered part of the income tax base in the United Kingdom: see Section V). It has also been considered that low-income earners and those with no income would be at a financial disadvantage if they were required to pay VAT on their imputed rent (see Section VI).

⁶¹ Jeff Todd, ‘Implementing GST – Information, Education, Co-ordination’ in David White and Richard Krever (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 30.

⁶² Institute for Fiscal Studies, *Tax by Design*, above n 35, 390.

In considering the measurement difficulties that may arise, it was conceded that there would be compliance and administrative costs associated with any system of valuation that may be used to value imputed rent. However, the availability of sophisticated technology and existing systems of valuing property suggests that these costs would be lower than they may have been in the past. The ability today to achieve an outcome closer to the economic objective of VAT may outweigh these costs.

In considering the potential financial disadvantage that may be experienced by low income earners and those who do not earn an income, it was suggested that some people who fall within this category may be able to take out loans to fund the potential VAT liability on imputed rent. It was also suggested that social assistance could be provided to those who may be genuinely disadvantaged. It was concluded that the potential problems that may arise from including imputed rent within the VAT base may not be insurmountable. Referring back to the research question that this article set out to answer, including imputed rent in the VAT base may be a viable way to tax the consumption of immovable property that may produce a result that is more consistent with the economic objective of VAT.

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B Legislation

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- Income Tax Act 1915* (Cth)

**THE IMPLEMENTATION OF THE GOODS AND SERVICES TAX IN MALAYSIA: POTENTIAL ISSUES
PERCEIVED BY BUSINESS TAXPAYERS**

APPADU SANTHARIAH, BINH TRAN-NAM, DALE BOCCABELLA AND NTHATI RAMETSE*

ABSTRACT

The implementation of the goods and services tax (GST) in Malaysia on 1 April 2015 was part of the Malaysian government's taxation reforms aimed at improving the collection of revenue and reducing the country's budget deficit. This study presents some of the major issues and concerns that Malaysian business taxpayers perceived as key challenges in preparing for GST implementation. A survey was conducted April to June 2013, in which 426 business taxpayers responded from various small- and medium-sized enterprises (SMEs). The results confirmed that, overall, business taxpayers were poorly prepared for GST implementation, with only 9 per cent claiming to be substantially ready. Around 22 per cent of the respondents stated that they were well equipped with computer systems for GST purposes. Over 25 per cent of eligible potential GST registrants stated that they would not register. Over 74 per cent of respondents felt that GST would place an additional compliance burden on them. Only 24 per cent of respondents were confident that they would get the required help and assistance from the Royal Malaysian Customs Department, the GST tax authority. Additionally, whilst larger businesses confirmed that they were well prepared for GST, smaller businesses experienced greater stress in their preparation. This article concludes with a discussion of policy implications for the Malaysian GST system, particularly those that would alleviate businesses' compliance burdens.

Keywords: Malaysian goods and services tax; Compliance issues; Business taxpayers; Royal Malaysian Customs Department.

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I INTRODUCTION

This paper examines some of the major challenges business taxpayers¹ perceived in preparing for the goods and services tax (GST)² in Malaysia. More specifically, four broad issues were investigated: (i) business readiness to implement GST; (ii) the GST compliance burden imposed on businesses; (iii) perceptions of the Royal Malaysian Customs Department (RMCD, the body that administers GST in Malaysia) and their capacity to provide financial and non-financial assistance; and (iv) determination of whether business perceptions are related to business characteristics.

After two failed attempts, which spread over seven years, the Malaysian *Goods and Services Tax Act 2014*, based on a broad-based consumption tax, was finally passed, with effect from 1 April 2015. Kraal and Kasipillai³ argued that the key factors for Malaysia's delayed GST were public opposition in 2007, and the reduction of income tax rates, which were pre-emptively lowered in 2009 in anticipation of the second failed attempt at passing the GST Bill through the Malaysian Parliament. During the long preparation period from 2005, the private sector and the Malaysian government conducted various GST information sessions and seminars to educate Malaysian business taxpayers. However, not much is known about business taxpayers' concerns and their readiness on pre-GST implementation issues, since there is a dearth of Malaysian literature in this area. No tax impact statement was published by the tax authorities for the introduction of GST in Malaysia. To address this gap, this study aims to explore pre-GST compliance implementation issues faced by business taxpayers in Malaysia, and attempts to put forward some policy recommendations for the reduction of compliance issues.

This study focuses on business taxpayers representing small- and medium-sized enterprises (SMEs), since they make a significant contribution to the economy in terms of employment and output in Malaysia.⁴ This study is also crucial and relevant for developing countries' economies particularly in relation to the 2030 United Nations' Agenda for Sustainable Development goals. The goals of the agenda include strengthening domestic revenue mobilisation and improving domestic capacity for tax revenue collection. It is considered a key driver of these goals⁵ that public revenue from trade taxes should be gradually reduced and there should be a shift of tax burden to consumers in the form of consumption taxes.

¹ Business taxpayers include sole traders, partnerships, private companies and public companies who are eligible to register for the Malaysian GST.

² GST is also known as value added tax (VAT) in other countries, eg, Japan and the European Union. They both refer to a multi-stage consumption tax where tax on value added is imposed through the different stages of the supply chain.

³ D Kraal and J Kasipillai, 'Finally, a Goods and Services Tax for Malaysia: A Comparison to Australia's GST Experience' (2016) 31(2) *Australian Tax Forum* 257.

⁴ A S Saleh and N O Ndubisi, 'An Evaluation of SME Development in Malaysia' (2006) 2(1) *International Review of Business Research Papers* 1-14; T Ramayah and K P Ling, 'An Exploratory Study of Internet Banking in Malaysia' in *Proceedings of the 3rd International Conference on Management of Innovation and Technology* (Zhejiang University Press, 2002) 25-7.

⁵ U V Nam, *Transforming Our World: The 2030 Agenda for Sustainable Development* (United Nations, 2015).

A Background of the study

The rationale for this study was to explore the perceptions and challenges faced by SMEs regarding the introduction of GST in Malaysia on 1 April 2015. This survey was conducted from April to June 2013, two years before the introduction of GST, comprising 1500 business taxpayers from various SMEs. A total of 426 responses were received, resulting in a response rate of over 28 per cent. The findings show that Malaysia was not well placed for the implementation of GST, which was interesting given that GST was first announced for implementation in 2005. Many in the business community, both large and small, did not take the implementation date seriously, due to the earlier postponements of GST and their 'laissez-faire' attitude in hoping that GST would not be implemented at all.

B Objective of the study

There were four parties involved in successfully implementing GST in Malaysia. They were business taxpayers from various SMEs, the RMCD, the tax agents and the public. Since SMEs and tax authorities were at the forefront for the implementation of GST, this study has confined its scope to these two parties and excludes the perceptions of the tax agents and the Malaysian public.

Based on a literature review of GST implementation in other countries and Malaysia, the following four broad objectives were designed for this study.

1. To investigate the perceptions of Malaysian business taxpayers in terms of their overall readiness to implement GST, their computer system readiness, and their intention to register for GST when turnover is above or below the RM500 000 registration threshold.
2. To gain an insight into business taxpayers' perceptions on the potential compliance burden, stress levels,⁶ and the offsetting of cash flow⁷ and managerial benefits⁸ that may have eventuated due to compliance to GST rules and regulations.
3. To gather information about business taxpayers' perceptions of the RMCD, and the monetary and non-monetary assistance they sought for the reduction of their compliance burden.
4. To determine whether business perceptions were related to business characteristics.

⁶ Sandford et al stated non-economic costs (such as psychic or mental costs) are caused by the stress and anxiety of having to comply with a set of rules that a taxpayer does not fully understand, induced by the operation of a new tax system: C T Sandford, M R Godwin, P J W Hardwick and M I Butterworth, *Costs and Benefits of VAT* (Heinemann Educational Books, 1981).

⁷ Businesses normally collect more output tax than they pay in input tax during each return period. Businesses are then allowed to retain this excess for a 'grace period' before handing it over to the tax office. This gives them a cash flow benefit.

⁸ Managerial benefits may accrue to business taxpayers because of record-keeping requirements imposed by tax compliance obligations. These benefits come in the form of improved financial information to owners and managers and improved managerial decision-making for increasing cash flow and profitability of the business.

At the end of this paper, some recommendations are put forward to policy-makers for the reduction of the compliance issues based on the wish list submitted by SMEs.

Next, we look at the Malaysian economy, which gives the background for the introduction of GST.

C Malaysian economy

Malaysia is a developing country in Asia that in the last decade has successfully transformed from an exporter of raw materials into a diversified economy. Mohd⁹ notes that Malaysia has sustained a strong economy with a gross domestic product (GDP) growth average of 5 per cent per year, mainly supported by robust investment and domestic consumption. The economy continues to perform strongly at 5.9 per cent growth in 2017, driven by strong global demand for electronics and improved terms of trade for commodities such as oil and gas. A slower growth of 5.3 per cent is forecasted in 2018, due to lower petroleum prices.

Due to strong economic growth, the International Monetary Fund (IMF)¹⁰ has forecasted a low inflation of 3 per cent and a low unemployment rate at around 3.4 per cent for 2018. Thus, Malaysia is well poised for achieving a high-income status by 2020. However, the government needs to step up reforms to boost productivity and control public expenditure. As Malaysia's public debt continues to decline, the IMF recommended that the government shift towards raising revenue, rather than cutting public spending. Table 1 provides some data on Malaysia's key economic indicators such as population, inflation, unemployment and debt to GDP ratio.

Table 1: Overview of the Malaysian economy, 2015 to 2017¹¹

Indicators	2015	2016	2017
Population	31.2 million	31.7 million	32.3 million
Labour force	14.4 million	14.7 million	14.9 million
Real GDP annual growth	5.0%	4.2%	5.9%
Inflation rate	2.1%	2.1%	3.8%
Unemployment rate	3.2%	3.5%	3.4%
Income – per capita	USD5004	USD5421	USD5800

⁹ E A M Mohd, 'An Economic Outlook for Malaysia' (Paper presented at the National Tax Conference, Malaysia, 17 July 2012) <<http://www.ibfd.org/IBFD-Tax-Portal/Events/2012-National-Tax-ConferenceMalaysia>>.

¹⁰ International Monetary Fund, 'Malaysia's Economy: Getting Closer to High-Income Status' (IMF News, 7 March 2018) <<https://www.imf.org/en/News/Articles/2018/03/07/NA030718-Malaysias-Economy-Getting-Closer-to-High-Income-Status>>.

¹¹ Treasury, Malaysian Government, *Malaysia Key Data and Forecast 2017/18* <http://www.treasury.gov.my/pdf/economy/er/1718/keydata_forecast.pdf>; Treasury, Malaysian Government, *Malaysia Key Data and Forecast 2016/17* <http://www.treasury.gov.my/pdf/economy/er/1617/keydata_forecast.pdf>.

GDP – per capita	USD9505	USD9374	USD9813
Current account % of GDP	3.0%	2.4%	3.0%
Debt to GDP	57.9%	56.2%	54.2%

A review of the structure of SMEs shows that they can be defined by several characteristics based on economic size or value. Around the world, the most common measures used are turnover/revenue and number of employees, and these criteria are also used for Malaysian SMEs. Table 2 shows that, in 2011, the total number of business enterprises was 662 939, of which SMEs represented 97.3 per cent (645 136), with the remaining 2.7 per cent being large firms. The number of SMEs increased in 2012 and they constituted 99.2 per cent of total businesses (670 000 establishments). The majority of businesses are micro firms (75 per cent), followed by small firms (19 per cent), medium firms (3 per cent) and large firms (3 per cent). SMEs contribute about 37 per cent of Malaysia's GDP, 65 per cent of employment and 18 per cent of exports, making them very significant to the economy.¹²

Table 2: Businesses by annual turnover and percentage of total businesses, 2010–11¹³

Annual turnover (Ringgit Malaysia, RM)	Number of establishments	Percentage of total establishments
Micro firms: ≤ RM250 000	496 458	74.9%
Small firms: RM250 000 to RM10 million	128 787	19.4%
Medium firms: RM10 million to RM25 million	19 891	3.0%
Total SMEs	645 136	97.3%
Large firms: ≥ RM25 million	17 803	2.7%
Total establishments	662 939	100%

¹² 'Malaysia's SME GDP Contribution to Exceed 40%', *The Star* (online), 13 July 2017 <<https://www.thestar.com.my/business/business-news/2017/07/13/malysias-sme-gdp-contribution-to-exceed-40pct>>.

¹³ Department of Statistics, Malaysian Government, *Economic Census 2011 – SME Annual Report* (2014).

Table 3: Distribution of establishments by business sector, by population and by samples¹⁴

Sector	Population of firms	Population percentage of firms	Total employment by business sector	Percentage of employment by business sector	Sample of firms	Percentage sample of firms
Services	591 883	89.3%	2 610 373	71%	310	73%
Manufacturing	39 669	6.0%	698 713	19%	59	14%
Construction	22 140	3.3%	275 631	8%	44	10%
Agriculture	8829	1.3%	78 777	2%	12	3%
Mining and quarrying	418	0.1%	5765	0%	1	0%
Total	662 939	100%	3 669 259	100%	426	100%

As shown in Table 3, the services sector has grown to be a leading contributor of businesses, accounting for 89.3 per cent, followed by the manufacturing sector at 6 per cent and construction at 3.3 per cent. In terms of employment, the services sector provides about 71 per cent, followed by manufacturing (19 per cent) and construction (8 per cent). The large services and manufacturing sectors will provide a good tax base for collection of GST.

Table 4: SME GDP and overall GDP share by key economic activity, 2014¹⁵

Sector	Percentage share of total	
	SMEs GDP	Total GDP
Services	58.6%	53.5%
Manufacturing	21.7%	23.0%
Agriculture	12.4%	9.2%
Construction	5.7%	4.3%
Mining and quarrying	0.4%	9.0%
Plus: import duties	1.1%	1.1%

¹⁴ Department of Statistics, Malaysian Government, *Economic Census 2011 – Profile of SMEs* (2011).

¹⁵ SME Corporation Malaysia, *SME Annual Report 2014/2015* (2015) 22
<http://www.smecorp.gov.my/images/Publication/Annual-report/BI/Annual-report-2014.pdf>.

Total	100%	100%
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Table 4 shows that the services sector contributes 58.6 per cent of SME GDP, followed by manufacturing at 21.7 per cent and agriculture at 12.4 per cent. SMEs in the services sector recorded a growth of 8.7 per cent compared with overall services value-added growth of 6.5 per cent. SME value-added growth across all economic sectors was higher than overall value-added GDP growth in all sectors. Thus, SMEs are a major contributor of GDP in Malaysia.

D GST studies in Malaysia

This section focuses on GST studies in Malaysia, and highlights some of the issues that have arisen since the introduction of GST. In 2010, when the government first postponed the introduction of GST, the Associated Chinese Chambers of Commerce & Industry of Malaysia (ACCCIM) conducted a survey of SMEs in Malaysia. They found that businesses were clearly not prepared for GST. Thirty-eight per cent of the respondents stated they had not yet prepared for the implementation of GST. Only 4 per cent indicated that their readiness for GST was above 75 per cent, while 33 per cent were 1–25 per cent ready, and 25 per cent were 26–75 per cent ready.¹⁶

Many businesses, particularly in the SME community, were concerned that GST would have a profound impact on financial reporting and strategic decision-making such as pricing.¹⁷ Apart from the political considerations, the deferment of GST was due to readiness issues faced by business taxpayers in Malaysia. A survey by the Federation of Malaysian Manufacturers in 2013 showed that over 60 per cent of businesses were not ready for GST.¹⁸

Similarly, a study by SME Corporation Malaysia in July to November 2014, based on 2063 respondents, found that many SMEs were not ready to comply with GST.¹⁹ Small firms were leading the group with 53 per cent being ready to comply, followed by medium firms with 45 per cent and micro firms with 38 per cent. Only a small portion of SMEs indicated having full confidence and understanding of GST: micro firms at 6 per cent; small firms at 8 per cent; and medium firms at 8 per cent. The main challenges for SMEs included the establishment of an internal GST team, training of staff on GST, purchase of GST hardware and setting up the GST compliant accounting system.²⁰

Other GST studies undertaken included three before the introduction of GST and three after its implementation are discussed below.

¹⁶ The Associated Chinese Chambers of Commerce & Industry of Malaysia (ACCCIM), *Surveys Questionnaires/Reports: Report of 2010 SMEs Survey* (16 July 2010) <<http://www.accim.org.my/blog/topic/26/1/14/Report+of+2010+SMEs+Survey>>.

¹⁷ N H Mansor and A Ilias, 'Goods and Services Tax (GST): A New Tax Reform in Malaysia' (2013) 2(1) *International Journal of Economics Business and Management Studies* 12–19.

¹⁸ P Jayaraman, 'Majority of Malaysian Businesses Not GST-Ready', *The Sun Daily* (online), 17 September 2013 <<http://www.thesundaily.my/news/831481>>.

¹⁹ SME Corporation Malaysia, above n 15.

²⁰ M Hanif Tamin, *Analysing Financial Challenges of SMEs on the Implementation of Goods and Services Tax (GST) in Malaysia* (Unpublished Master's Thesis, University of Waikato, New Zealand, 2015).

The following studies were conducted before GST implementation. Marimuthu et al²¹ found that tax agents had a positive attitude and were well prepared for GST, but their issues included a lack of GST knowledge, the burden of record keeping, and the need to upgrade their computer systems. Palil et al²² examined Malaysian SMEs before the introduction of GST and found that their GST compliance costs amounted to RM28 000 (USD7000), and most of them were still not prepared for the implementation. Mansor and Ilias²³ stated that GST would boost revenue, but the RMCD needed to rectify initial problems and reduce income tax rates.

The following studies were conducted after implementation. Ishak, Othman and Omar²⁴ found that students were not supportive of GST, the majority perceiving it as a burden, and they wanted GST collection to be managed well for the benefit of citizens. Ramli and Ibrahim²⁵ found that the average start-up cost for a SME in Malaysia in 2013 was estimated at RM15 730 (USD4000). Ching et al²⁶ found that three factors influenced GST implementation for SMEs: GST taxpayers' perceptions of fairness; GST compliance readiness of businesses; and external factors that affect the businesses. The factors that affect a GST taxpayer's perception of fairness are high compliance costs, tax complexity, the extent of government support, and the stress costs of the business. The degree of readiness depends on the firm's resources and the business taxpayer's ability to cope with the change. External factors include sector-specific developments and political-economic developments that dampen the overall attitude of a business taxpayer towards GST implementation.

None of the above studies specifically focused on the main issues faced by SMEs prior to the introduction of GST, which is a gap in the literature. Next, we look at the structure and design of the proposed GST implementation and the reasons for its introduction.

E Background and context to GST reform in Malaysia

GST/VAT was first introduced in France in the 1950s, and it spread quickly around the world. The number of countries adopting GST/VAT rose from 10 in 1965 to 160 by 2013.²⁷ Cnossen²⁸ noted that though the specific reasons for adopting GST differ from country to country, the main argument put forward was that a properly designed GST

²¹ M Marimuthu, Z Bidin and H Abdul-Jabbar, 'Perceptions of Tax Agents towards the Proposed Goods and Services Tax in Malaysia' (SIBR-UniKL 2013 Conference on Interdisciplinary Business & Economics Research, Kuala Lumpur, 2012).

²² M R Palil, R Ramli, A F Mustapha and N S A Hassan, 'Elements of Compliance Costs: Lesson from Malaysian Companies towards Goods and Services Tax (GST)' (2013) 9(11) *Asian Social Science* 135.

²³ Mansor and Ilias, above n 17.

²⁴ N I Ishak, M H Othman and M F Omar, 'Students' Perception towards the Newly Implemented Goods and Services Tax (GST) in Malaysia' (2015) 2(6) *International Journal of Contemporary Applied Sciences* 80–99.

²⁵ R Ramli and M A Ibrahim, 'GST Non-Compliance Behaviour of SMEs in Malaysia: Determinants and Start-Up Compliance Costs' (8th Asia Pacific Interdisciplinary Research in Accounting Conference, 2016).

²⁶ Y M Ching, J Kasipillai and A Sarker, 'GST Compliance and Challenges for SMEs in Malaysia' (2017) 15(3) *eJournal of Tax Research* 457–89.

²⁷ Royal Malaysian Customs Department, *Countries Implementing GST or VAT* (24 January 2014) <http://gst.customs.gov.my/en/gst/Pages/gst_ci.aspx>.

²⁸ S Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5 *International Tax and Public Finances* 399–428.

raises more revenue than any other broad-based consumption tax. Sandford et al²⁹ estimated VAT compliance costs of between 3.7 per cent and 9 per cent of VAT collections in the UK. Based on 320 of Australia's largest corporations, Ernst & Young³⁰ estimated GST implementation costs at between 0.075 per cent and 1 per cent of turnover.

Due to changes in the world economy, Malaysia needed to boldly execute a tax policy that could raise a stable revenue stream to maintain a competitive edge in the world market. Given this background, the rationale for introducing GST in Malaysia seemed logical and timely. There are four strong arguments for the introduction of GST: it broadened the tax base to reduce budget deficit; it raised a stable revenue; there was pressure from the IMF and the World Bank to introduce a consumption tax; it replaced sales and services tax (SST).

1 *Reduce budget deficit*

Narayanan³¹ stated that Malaysia had been facing a chronic budget deficit problem. Over the 43-year period from 1970 to 2012, the federal government budget was in deficit, except for the five years between 1993 and 1997. Not only were these deficits unrelated to economic cycles, but they consistently exceeded forecasts since 1999. The government wanted to broaden the tax revenue base to reduce the deficit, and thus GST was a good option.

Kasipillai,³² quoting Musgrave, argued that Malaysia, like most developing countries, relied heavily on indirect taxes during the early stages of its development. However, in more recent years, Malaysia moved from the normal tax features found in developing countries and shifted its focus to direct taxes. In 1970, for example, direct taxes comprised 27.3 per cent of Malaysia's revenue, with indirect taxes comprising 50 per cent. By 2011, however, direct taxes increased to 55.3 per cent of revenue and indirect taxes took a dramatic dive to 17.5 per cent. Thus, there was a need to shift tax collection from direct taxes (such as income taxes for individuals and corporations) to consumption-based GST.

2 *Raise stable revenue*

Narayanan³³ added that GST in Malaysia is a tax on the value added to the output: it is a multi-stage tax and has inbuilt controls based on a paper trail of all transactions. First, the multi-point collection and invoice trail minimises tax avoidance and evasion. Second, GST is better able to protect revenue from tax evasion by retailers as compared to a single-stage sales tax, since there is a paper trail of the transactions. This is supported by Jala,³⁴ who argued that Malaysia may not have been taxing all those who are legally liable.

²⁹ C Sandford, M Godwin and P Hardwick, *Administrative and Compliance Costs of Taxation* (Fiscal Publications, 1989).

³⁰ Ernst & Young, 'Preparing for the GST: An Australian Survey' (1999) 1 *Journal of Australian Taxation* 331-43.

³¹ S Narayanan, 'The Impact of the Goods and Services Tax in Malaysia: Lessons from Experiences Elsewhere' (2014) 59 *The Singapore Economic Review* 2.

³² J Kasipillai, *A Guide to Advanced Malaysian Taxation* (McGraw-Hill, 2010).

³³ Narayanan, above n 31.

³⁴ I Jala, 'Conversation with a Malaysian Angry with the Government', *The Star* (online), 2013.

Malaysia has a population of 29 million, and in 2012 the working population was 12.8 million. Out of this, only 1.7 million paid income taxes, that is, about 6 per cent of the population. Further, Bedi³⁵ reported that there were 6.4 million registered taxpayers for all taxes in Malaysia, but with only 2.4 million paying their due taxes. Hence, GST would bring more taxpayers into the tax net, since even though they were not paying income taxes, they would be paying GST when they consumed goods and services, even when there was a downturn in the economy.

3 *Pressure from the IMF and the World Bank*

Bird³⁶ argued that many developing countries adopted VAT due to the perceived success of VAT implementation in the European Union, and the 'pressure' exerted by the IMF and the World Bank. The IMF and the World Bank encouraged developing countries to adopt some form of consumption tax, using finance assistance and access to expert advice.

PricewaterhouseCoopers³⁷ reported that the IMF, the Organisation for Economic Co-operation and Development (OECD) and the European Commission all promoted the shift from direct to indirect taxes to help solve the financial crisis, by reducing costs on businesses to make them more competitive. After the financial crisis there was pressure from the IMF for Malaysia to adopt an indirect consumption tax as a method to increase the efficiency of the tax system, rather than relying on trade and income taxes. Now, the IMF has recently recommended Malaysia's implementation of GST as a case study to Middle Eastern countries that are looking to adopt a consumption tax regime.³⁸

4 *Replace sales and services tax*

Kasipillai³⁹ stated that SST has a narrow base, since currently there are about 4700 types of goods, representing approximately 78 per cent of the goods manufactured locally, that are exempted from sales tax. It is cumbersome to administer due to several exemptions and the different rates applied to some specified goods (5 per cent on non-basic foodstuff, 20 per cent on cigarettes and liquor, and 10 per cent on all other goods). This complexity imposes extra compliance costs on businesses.

SST is ineffective, inefficient and inequitable (whereby the rich pay more and the poor pay less). In addition, the government has argued that goods and services are costlier for consumers due to their cascading effect, since there is no credit for tax paid on business

³⁵ R S Bedi, 'Silver Lining Behind GST', *The Star* (online), 10 July 2011 <<http://www.thestar.com.my/story.aspx>>.

³⁶ R M Bird, 'Value Added Taxes in Developing and Transitional Countries: Lessons and Questions' (Paper presented at the First Global International Tax Dialogue Conference on GST, Rome, Italy, 2005).

³⁷ PricewaterhouseCoopers, 'Shifting the Balance from Direct to Indirect Taxes: Bringing New Challenges' (*Tax Policy and Administration – Global Perspectives* series, June 2013) <<https://www.pwc.com/gx/en/tax/assets/pwc-shifting-the-balance-from-direct-to-indirect-taxes-bringing-new-challenges.pdf>>.

³⁸ Kamarul Anwar, 'IMF Endorses Malaysia's GST Implementation as Case Study – Customs', *The Edge Financial Daily*, 11 March 2016 <<http://www.theedgemarkets.com/my/article/imf-endorses-malaysia%E2%80%99s-gst-implementation-case-study-%E2%80%94-customs>>.

³⁹ J Kasipillai, 'Taxpayer's Knowledge Index as a Clue for Non-Compliance (2000) 81(3) *Journal on Pakistan's Taxation Laws*.

input. Also, Narayanan⁴⁰ argued that revenue generated by SST in Malaysia compares unfavourably to that raised by GST in neighbouring countries. For example, with a standard rate of 10 per cent, GST produced about 22 per cent of total revenue in the Philippines, 21 per cent in Thailand, and 19 per cent in Indonesia. In contrast, SST contributed about 10 per cent of total revenue in Malaysia in 2012. Therefore, GST would be an improvement for Malaysia in raising a more stable revenue.

Malaysia introduced GST at 6 per cent, compared with other ASEAN (Association of Southeast Asian Nations) countries where the rates varied (for example, 7 per cent in Thailand and Singapore, and 10 per cent in the Philippines, Cambodia, Vietnam, Laos and Indonesia). There was a need for Malaysia to keep exports zero-rated to be competitive in the ASEAN and other world markets. The fiscal reform package is aimed at long-term structural reform for Malaysia, so that its economy can integrate further into the global economy and become a high-income economy by 2020.

The proposed GST of 6 per cent was expected to replace the sales tax of 10 per cent and the services tax of 6 per cent from 1 April 2015, and the threshold was set at RM500 000 (USD125 000). It was expected to collect about RM30 billion in revenue. Around 122 000 businesses were expected to register for GST, but as of February 2015, 345 939 businesses had registered.⁴¹

This GST model, broadly speaking, provided for three different types of supplies, and a credit system would be given to businesses to claim the input tax on purchases of goods and services. The GST treatment varied according to the type of supply:

- a) **Standard-rated supplies** are goods and services subject to GST at the standard rate (currently 6 per cent). A supplier is able to claim input tax credits on purchases related to making these supplies.
- b) **Zero-rated supplies** carry a zero rate of tax. Thus, no GST will need to be levied on their supply. Suppliers of zero-rated supplies are required to register for GST and can claim input tax credits for the GST paid on business purchases related to making the supplies, such as raw materials. The supply of the following goods and services were expected to be zero-rated: agricultural products; foodstuffs, such as fresh vegetables, rice, sugar, cooking oil, etc; livestock, including live animals and unprocessed meat (fresh or frozen meat).
- c) **Exempt supplies** are not subject to GST. However, unlike zero-rated supplies, no input tax credit can be claimed by the supplier on related purchases. A supplier of exempt supplies is therefore unable to claim input tax incurred on raw materials/services that relate to making exempt supplies. The supply of the following goods and services were expected to be exempt: highway tolls; private health and education; domestic transportation of passengers.

⁴⁰ Narayanan, above n 31.

⁴¹ Bernama, 'Highest GST Registration Rate Recorded on Feb 27', *New Straits Times*, 2 March 2015 <<https://www.nst.com.my/news/2015/09/highest-gst-registration-rate-recorded-feb-27>>.

- d) **Multiple rates** are applicable in some industries. For example, mining, plantation and forestry businesses need to register for GST and are not exempt. The sales can be subject to the standard rate depending on how their output is made up. They can claim input taxes for purchases incurred for the business. If the goods are exported, the sales are zero-rated and the business can claim the input tax.
- e) Most of the **financial services** provided by banks and financial institutions are not subject to GST, but fee-based services, such as loan processing fees, safe keeping and custodial services, are subject to GST at a standard rate. Zero rates apply if the services supplied to the business are charged when the business owner is outside the country. If the supply is tax exempt the business taxpayer is not entitled to claim the input tax. Exempt supply covers provision of loans, exchange of currency and traveller's cheques.

Saira et al⁴² stated that the introduction of GST in Malaysia might strengthen cash flow by providing a steady source of funding for budget spending. However, GST would come with greater administrative and compliance costs. Wan⁴³ found that SMEs deemed GST to be a major burden, considering the cost of software adaptation and staff training, especially when they were already grappling with the high cost of doing business, and complying with other government regulations.

Ching et al⁴⁴ further noted that GST was successfully implemented in Singapore and New Zealand due to well-planned implementation strategies and easy-to-administer structures and designs. Tran-Nam⁴⁵ stated that the implementation of GST in Australia could be considered a success, despite some early teething problems. This success can be attributed to broad-based community support, simple design, direct compensation, income tax cuts, and a long lead-in time, allowing ample time for taxpayer and tax practitioner education and assistance programmes, conducted by the Australian Taxation Office.

In 2017, GST revenue collected in Malaysia was RM45 billion. However, recently, despite the success of GST in other countries, the Mahathir Mohamad-led government (which won the election on 9 May 2018) revised the GST legislation introduced on 1 April 2015. With effect from 1 June 2018 all standard-rated goods of 6 per cent will be zero-rated to alleviate the hardship faced by the public, who had voiced their concern at price increases due to the imposition of GST. The Ministry of Finance⁴⁶ stated that in September 2018 SST will be reintroduced and expected to raise RM25 billion. There will be a shortfall in

⁴² K Saira, M A Saraswathi and L Yoke-May, 'An Exploratory Study of Goods and Services Tax Awareness in Malaysia' (Seminar on National Resilience, Political Management and Policies, Langkawi, Malaysia, 13–15 July 2010) 265–76.

⁴³ H C Wan, 'GST and Anti-Profiteering: Tackling the Pricing Issue', *The Edge Malaysia*, 22 September 2014 <<https://www.pwc.com/my/en/assets/press/140922-theedge-gst-n-anti-profiteering.pdf>>.

⁴⁴ Ching, Kasipillai and Sarker, above n 26.

⁴⁵ B Tran-Nam, 'Recent Tax Reform in Australia: An Examination from a Tax Policy Perspective' (Paper prepared for the Korea and the World Economy VII Conference, Korean Institute of Public Finance, Seoul, South Korea, 2008).

⁴⁶ Martha Soezean, 'Netizens Support Malaysia Replacing the GST with SST, Voicing Benefit of the Latter', *The Online Citizen*, 6 June 2018, <<https://www.theonlinecitizen.com/2018/06/06/netizens-support-malaysia-replacing-the-gst-with-sst-voicing-benefit-of-the-latter>>.

revenue of RM20 billion that will be supported by specific revenue measures and expenditure reduction including rationalisation, efficiency measures and reduction in wastages.

F GST studies in the context of GST reform in Malaysia

Based on the literature review of SMEs in developing and developed countries, the following issues were identified when countries prepare for the implementation of GST/VAT.⁴⁷ The main issues identified were the compliance burden, the complexity of GST legislation, computerisation for GST, and the lack of assistance from tax authorities to reduce SMEs' compliance burden.

1 Compliance burden

The GST tax compliance burden is defined for this study as the time and money that taxpayers expend each year to comply with GST rules and regulations. Chittenden et al⁴⁸ stated that SMEs face substantial issues in managing documentation pertaining to proper tax records. Ehrich and Billett⁴⁹ found that the task of learning to implement GST is often stressful and lacks certainty for businesses. Smulders and Stiglingh⁵⁰ concluded that time and effort spent on preparing for GST was responsible for the largest part of a business's compliance cost. Lignier et al⁵¹ found that GST compliance costs were high and regressive on smaller businesses. PricewaterhouseCoopers studied the data collected by the World Bank Group on 'the ease of paying taxes in different economies around the world' as part of the Paying Taxes 2010 project.⁵² They observed that it takes businesses around the world longer to comply with VAT than with corporate income tax. In addition, it takes less time to comply in countries where businesses use online filing and payment for VAT.

2 Complexity of tax legislation

Evans and Tran-Nam⁵³ noted the difficulty of defining or measuring tax complexity, since it is regarded as a multi-faceted concept. However, some authors attempted to broadly

⁴⁷ Value added tax (VAT) is known as goods and services tax (GST) in other countries. Although GST and VAT have different names, they are both broad-based, multi-stage consumption taxes where tax is imposed through the different stages of the supply chain. The term GST will be used in lieu of VAT in some cases in this paper.

⁴⁸ F Chittenden, S Kauser and P Poutziouris, 'Tax Regulation and Small Business in the USA, UK, Australia and New Zealand' (2003) 21(1) *International Small Business Journal* 93–115.

⁴⁹ L C Ehrich and S Billett, 'How Australian Small Business Operators Learned About the Goods and Services Tax' (2006) 14(2) *Small Enterprise Research* 59–73.

⁵⁰ S Smulders and M Stiglingh, 'Annual Tax Compliance Costs for Small Businesses: A Survey of Tax Practitioners in South Africa' (2008) 11(3) *South African Journal of Economic and Management Sciences* 354–71.

⁵¹ P Lignier, C Evans and B Tran-Nam, 'Tangled Up in Tape: The Continuing Tax Compliance Plight of the Small and Medium Enterprise Business Sector' (2014) 29 *Australian Tax Forum* 217.

⁵² PricewaterhouseCoopers and World Bank Group, 'Paying Taxes 2010 – The Global Picture' (2010) <<https://www.pwc.com/gx/en/paying-taxes/assets/paying-taxes-2010.pdf>>.

⁵³ C Evans and B Tran-Nam, 'Managing Tax System Complexity: Building Bridges through Pre-Filled Tax Returns' (2010) 25 *Australian Tax Forum* 245.

define tax complexity. Slemrod⁵⁴ identified four fundamental attributes of tax complexity: predictability, enforceability, difficulty and manipulability. McCaffery⁵⁵ identified three types of tax complexity: technical, structural and compliance.

Tran-Nam⁵⁶ made a distinction between legal and effective complexity. Legal complexity refers to the ease with which a tax law can be read, understood and applied. Effective complexity can be measured in terms of the operating costs required to raise a certain level of tax revenue. For simplicity purposes, we used Tran-Nam's legal complexity definition for this study.

Conceptually, a simple GST will comprise a single-rate threshold, which is inclusive of all goods and services, except for exports, which are zero-rated. However, tax law becomes complex with increased sophistication of GST design and structure, including an increased number of rates and tax codes applicable to standard-rated, zero-rated and exemption items. Ebrill et al⁵⁷ argued that VAT is an intrinsically complex tax, cumbersome to both authorities and the taxpayer. Complexity may also increase the uncertainty of tax laws and thereby frustrate taxpayers and reduce their willingness to comply.⁵⁸

McKerchar⁵⁹ found that in Australia the main cause of complexity was uncertainty in tax law and the level of detailed information provided to the taxpayer to meet their tax obligations. In addition, tax complexity can generate significant economic costs. It is generally accepted that tax systems should be simple, but tax policy principles of simplicity and equity cause conflict and trade-offs, which can add complexity to tax legislation.

Bird and Gendron⁶⁰ found that only a few countries within developing or transitional economies offer taxpayers assistance in coping with tax complexity, or pay attention to the impact of compliance costs imposed on taxpayers. Richardson,⁶¹ in his study of 45 countries, found complexity is the largest determinant of non-compliance, apart from education, income source, fairness and tax morale. He adds that complexity of the tax system affects the level of taxpayers' compliance costs.

According to Kasipillai,⁶² there is a direct relationship between complexity of the tax system and the level of the compliance costs incurred by taxpayers. Any increase in the

⁵⁴ J Slemrod, 'Complexity, Compliance Costs, and Tax Evasion' in J A Roth and J T Scholz, *Taxpayer Compliance: Volume 1: An Agenda for Research* (University of Pennsylvania Press, 1989).

⁵⁵ E J McCaffery, 'The Holy Grail of Tax Simplification' (1990) *Wisconsin Law Review* 1267.

⁵⁶ B Tran-Nam, 'Tax Reform and Tax Simplification: Some Conceptual Issues and a Preliminary Assessment' (1999) 21(3) *Sydney Law Review* 500.

⁵⁷ L Ebrill, M Keen, J-P Bodin and V Summers (eds), *The Modern VAT* (International Monetary Fund, 2001).

⁵⁸ G A Carnes and A D Cuccia, 'An Analysis of the Effect of Tax Complexity and Its Perceived Justification on Equity Judgments' (1996) 18(2) *The Journal of the American Taxation Association* 40.

⁵⁹ M McKerchar, 'The Effects of Complexity on Unintentional Noncompliance for Personal Taxpayers in Australia' (2002) 17 *Australian Tax Forum* 3.

⁶⁰ R M Bird and P Gendron, 'Is VAT the Best Way to Impose a General Consumption Tax in Developing Countries?' (2006) 60(7) *Bulletin for International Taxation* 287.

⁶¹ G Richardson, 'Determinants of Tax Evasion: A Cross-Country Investigation' (2006) 15(2) *Journal of International Accounting, Auditing and Taxation* 150-69.

⁶² J Kasipillai, *A Comprehensive Guide to Malaysian Taxation: Under Self-Assessment System* (McGraw-Hill, 2009).

complexity of the tax system will escalate the compliance burden for taxpayers. Rising complexity in the tax system also leads to burdensome administrative costs for the tax authorities.

In Malaysia, a study by Mustafa and Hanefah⁶³ found that, due to self-assessment of income taxes, taxpayers perceived the legislation to be very complex and ambiguous, particularly in terms of record keeping. According to Kasipillai,⁶⁴ the newly enacted *Goods and Services Tax Act 2014* is a complex document with 165 pages and 197 sections, and must be read together with GST orders and regulations.

Finally, based on a study by Saad,⁶⁵ there are six potential causes for complexity: ambiguity, frequent changes, calculations, details, forms and record keeping.

3 Computerisation for GST

The use of technology to enhance the effectiveness of tax administration and compliance attracts increasing attention in both developed and developing countries, as asserted by Edwards-Dowe.⁶⁶ Bernier and Suire⁶⁷ postulated that data is the key for GST/VAT reporting. Mohd Daud and Mohamed⁶⁸ posited that information technology (IT) usage will enable the improvement of both individual and organisational performance.

Plamondon⁶⁹ in a Canadian study, and Hasseldine and Hansford in a UK study,⁷⁰ found that GST/VAT taxpayers who used computers in their accounting routines had lower compliance costs than those who used manual accounting systems. On the other hand, Hansford et al⁷¹ found that SMEs using computers for GST record keeping incurred higher compliance costs than those working manually, implying that initial costs could be high due to the purchase of new hardware.

Lim⁷² found that most SMEs in Malaysia are family businesses and operate on a cash basis with very little computerisation. Low computer use was also due to high staff turnover

⁶³ H Mustafa and M Hanefah, *An Evaluation of the Malaysian Tax Administrative System and Taxpayers Perceptions towards Assessment Systems, Tax Law Fairness and Tax Law Complexity* (Unpublished PhD Dissertation, University Utara Malaysia, 1996).

⁶⁴ J Kasipillai, *A Guide to Malaysian Taxation* (McGraw-Hill, 2015).

⁶⁵ N Saad, 'Tax Knowledge, Tax Complexity and Tax Compliance: Taxpayers' View' (2014) 109 *Procedia - Social and Behavioural Sciences* 1069-75.

⁶⁶ D Edwards-Dowe, 'E-Filing and E-Payments - The Way Forward' (Paper presented at the Caribbean Organization of Tax Administration, Caribbean Regional Technical Assistance Centre, 2008).

⁶⁷ G Bernier and J Suire, 'Meeting the VAT E-audit Challenge' (Indirect Tax Briefing: Issue 11, EYGM Limited, December 2014).

⁶⁸ N Mohd Daud and I S Mohamed, 'Evaluating the Intranet Acceptance with the Extended Task-Technology Fit Model: Empirical Evidence in Malaysian Maritime Industry' (2010) 3 *International Journal of Arts and Sciences* 294-306.

⁶⁹ R Plamondon, Department of Finance, Government of Canada, *GST Compliance Costs for Small Business in Canada* (1993).

⁷⁰ J Hasseldine and A Hansford, 'The Compliance Burden of VAT: Further Evidence from the UK' (2002) 17 *Australian Tax Forum* 369.

⁷¹ A Hansford, J Hasseldine and C Howorth, 'Factors Affecting the Costs of UK VAT Compliance for Small and Medium-Sized Enterprises' (2003) 21(4) *Environment and Planning C: Government and Policy* 479-92.

⁷² T M Lim, 'Outsourcing to Ensure Successful ICT Systems Implementation and Maintenance' (Monash University, 24 August 2006).

and a lack of IT expertise. Seow⁷³ found that only 30 per cent of SMEs in Malaysia have a web presence and use IT in their daily operations, and found that SMEs seem more concerned with appearance in the marketplace than getting into new technology to increase the efficiency of their business. Tan⁷⁴ also noted that SMEs in Malaysia are slow in adapting to IT to increase their global competitiveness.

4 *GST tax authorities*

The tax authorities play an important role for the reduction of compliance costs. Apart from the simplification process of the tax legislation, they can provide friendly and prompt services to taxpayers' queries at no cost. Alm et al⁷⁵ argued that supporting private taxpayers through services provided by tax authorities reduces their compliance burden, since there is no need for the taxpayer to seek help from costly external tax experts.

Zumbo⁷⁶ argued that authorities do have a responsibility in assisting taxpayers to comply with tax requirements. Franzoni⁷⁷ argued that tax authorities should avoid the vicious circle of countering evasion by introducing complex tax legislation, which increases compliance costs and fosters non-compliance. Frey⁷⁸ stated negative experiences with tax officials lead to taxpayers losing faith in the system.

Berhan and Jenkins⁷⁹ argued that whilst governments of developing countries are eager to create modern tax systems, they are often saddled with weak tax administrations. These governments normally experiment with tax administration mechanisms that result in large compliance costs for taxpayers. Faridy, quoting Franzoni,⁸⁰ argued that businesses may resent tax authorities for creating high levies and a very complex tax system. Eichfelder and Kegels⁸¹ found evidence that customer-friendly Belgian tax authorities established ways to reduce the compliance burden of their business customers by about 20 per cent on average.

Some of the above studies have highlighted the issues faced by businesses from some developed and developing countries prior to the introduction of GST, which have the capacity to prevail in Malaysia. However, Sandford⁸² warned that international

⁷³ T C Seow, 'SMEs Need to Embrace ICT', *Computerworld Malaysia* (online), 2006.

⁷⁴ C Tan, 'Towards Progress', *Computerworld Malaysia* (online), July 2006.

⁷⁵ J Alm, T Cherry, M Jones and M McKee, 'Taxpayer Information Assistance Services and Tax Compliance Behavior' (2010) 31(4) *Journal of Economic Psychology* 577–86.

⁷⁶ F Zumbo, 'Tax Assessments and Judicial Review: Do the Courts Have a Supervisory Role?' (1996) 79 *Canberra Bulletin of Public Administration* 97.

⁷⁷ L Franzoni, 'Tax Compliance' in B Bouckaert and G De Geest (eds), *Encyclopedia of Law & Economics* (Edward Elgar, 1999).

⁷⁸ B S Frey, 'Deterrence and Tax Morale in the European Union' (2003) 11(3) *European Review* 385–406.

⁷⁹ B A Berhan and G P Jenkins, 'The High Costs of Controlling GST and VAT Evasion' (2005) 53(3) *Canadian Tax Journal* 720.

⁸⁰ N Faridy, 'VAT Compliance Costs and VAT Evasion of Small and Medium Enterprises (SMEs) Sectors in Bangladesh: Is There a Link' (Paper presented at the 25th Annual Australasian Tax Teachers Association Conference, Auckland, New Zealand, 23–25 January 2013); see also Franzoni, above n 77.

⁸¹ S Eichfelder and C Kegels, 'Compliance Costs Caused by Agency Action? Empirical Evidence and Implications for Tax Compliance' (2014) 40 *Journal of Economic Psychology* 200–19.

⁸² C Sandford (ed), *Tax Compliance Costs: Measurement and Policy* (Fiscal Publications, 1995).

comparisons are more likely to mislead than enlighten, because there are differences in the time periods, quality of data, definitions used and units of measurement.

II RESEARCH METHODOLOGY

Sandford et al⁸³ conducted various studies into compliance costs of VAT in the UK using extensive mail surveys. Sandford and Hasseldine⁸⁴ also investigated the compliance costs of New Zealand's GST using a mail survey. Postal surveys feature most prominently in taxation studies, with two-thirds of studies wholly or partly using this method. For this study, a quantitative method was adopted: to determine the legal form, size, industry sector and year of establishment for each business; to analyse and generalise about the issues; and to determine the relationship between business perceptions and business characteristics.

The research questions were made simple to encompass a broad range of topics on GST matters. Some were selected from Evans et al's 'A Report into Incremental Costs of Tax Compliance'.⁸⁵ A focused survey of business taxpayers was undertaken using a structured questionnaire, with 36 questions. Questionnaires were distributed to 1500 business taxpayers in a sample of business enterprises throughout Malaysia, covering various business sectors.

A Survey sample selection, design and piloting

The design of the survey instrument comprised three sequential steps involving data selection, questionnaire design and the piloting of the survey questionnaire.

1 *Data selection*

Instead of postal surveys, this survey was administered through a face-to-face approach at GST seminars, to participants from three major business organisations.⁸⁶ Survey forms were given to lecturers to distribute to participants. This method was adopted because previous Malaysian survey experiences have proved it difficult to get responses through postal/email surveys. Mohdali⁸⁷ stated that for most tax surveys in Malaysia the response rate is poor, at around 14–22 per cent. There is a fear amongst respondents that data provided may be forwarded to revenue authorities.

⁸³ Sandford, Godwin and Hardwick, above n 29.

⁸⁴ C T Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand* (The Institute of Policy Studies, Wellington, 1992).

⁸⁵ C Evans, K Ritchie, B Tran-Nam and M Walpole, 'A Report into Incremental Costs of Tax Compliance' (Revenue Analysis Branch, Australian Taxation Office, 21 November 1996).

⁸⁶ (1) Associated Chinese Chamber of Commerce and Industry of Malaysia; (2) Kuala Lumpur Malay Chamber of Commerce; (3) Malaysian Associated Indian Chamber of Commerce and Industry.

⁸⁷ R Mohdali, 'The Effects of Religiosity and Taxpayer's Perception towards Government on Voluntary Compliance' (Paper presented at School of Economics and Finance, Curtin University, 2010).

2 Questionnaire design

The survey questionnaires were designed to be user-friendly, simple and comprehensive. Mohd-Sani⁸⁸ stated that it is well known that the government controls the press in Malaysia. Media freedom and the right to express opinions is limited, and public debates on government decisions and policy matters are nearly non-existent, limiting public debates on GST issues. Thus, to make the survey more meaningful and realistic, most of the material for the questionnaire was fine-tuned to capture various reactions in newspapers articles and blogs. (Blogs are an important channel of communication in Malaysia, as they are unauthorised, and their authors cannot be held liable for criticising the government.)

3 Pilot testing

The proposed questionnaire was pilot-tested using six participants, including one practising accountant, two lecturers and three revenue officials. Using their feedback, the questionnaire was refined and finalised. Please refer to Appendix 1: Survey Questionnaire.

B Survey implementation

Fowler⁸⁹ stated that a random sample of 150 would describe a population of 15 000 or 15 million with the same degree of accuracy. Assuming a plausible response rate of 20 per cent, a survey sample of 1500 was selected to generate an effective sample size of at least 300 respondents. In this study the effective sample was 426 – a response rate of 28 per cent, which is a good rate for statistical sampling. A further test was applied, using the Raosoft⁹⁰ sample size selector, and showed that for a population of 662 939 Malaysian businesses a sample size of 384 would be a reasonable minimum (assuming a response distribution of 50 per cent, at a 95 per cent level of confidence with a 5 per cent margin of error). Thus, the sample size of 426 in this study more than meets the requirement.

Table 5: Distribution and collection of survey forms

Associated Chinese Chamber of Commerce and Industry of Malaysia	300
Kuala Lumpur Malay Chamber of Commerce	300
Malaysian Associated Indian Chamber of Commerce and Industry	200
Kuala Lumpur Indian Chamber of Commerce	100
GST seminar lecturers	600
Total	1500
Responses received	426
Response rate	28%

⁸⁸ M A Mohd-Sani, 'Media Freedom in Malaysia' (2005) 35(3) *Journal of Contemporary Asia* 341–67.

⁸⁹ F J Fowler, *Survey Research Methods* (Sage Publications, 2nd ed, 1993).

⁹⁰ Raosoft, *Sample Size Calculator* (2004) <<http://www.raosoft.com/samplesize.html>>.

As shown in Table 5, the survey forms were evenly distributed amongst the three major business organisations.

The effective sample of 426, a response rate of 28 per cent, is a good number for statistical sampling. It also compares favourably to other surveys conducted in Malaysia: Mohdali⁹¹ found that, based on tax research carried out in Malaysia by Abdul and Pope⁹² and Hanefah, Ariff and Kasipillai,⁹³ response rates to surveys of this nature in Malaysia tend to be low, usually between 14 per cent and 22 per cent; Abdul and Pope⁹⁴ stated that business surveys targeting SMEs or large firms in Malaysia often yield a poor response rate of between 10 per cent and 20 per cent.

C Representativeness of observed sample

As Miles and Huberman⁹⁵ argued, the ability to draw statistical inferences from samples to reference populations is largely dependent on how well the attributes of observed samples represent the attributes of the population. To establish if the survey sample was representative of the population, three attributes – namely, turnover, sector and location by region – were included in the survey questionnaire.

The sample for this study included 55 per cent of respondents with a turnover above the RM500 000 (USD125 000) compulsory registration turnover threshold, and the rest (45 per cent) were below the threshold. This is a good representation of business taxpayers who would compulsorily and optionally register for GST.

Regarding the length of operation of business, 14 per cent of the sample were new businesses that had been operating for fewer than three years, with 86 per cent being established businesses operating for more than three years. Thus, a good percentage of established and new businesses have been included in the survey.

The survey responses will now be summarised in more detail, starting with a profile of the respondents' legal form, turnover, industry sector and other major variables.

Table 6: Respondents by legal form (from Survey Questionnaire, Question 1)

Legal form	Number	Percentage
Sole Trader	133	31%
Partnership	63	15%
Company – Private	177	42%
Company – Public	53	12%
Total	426	100%

⁹¹ Mohdali, above n 87.

⁹² J H Abdul and J Pope, 'Exploring the Relationship between Tax Compliance Issues in Malaysia' (2008) 1(1) *Journal of Applied Law and Policy*.

⁹³ M Hanefah, M Ariff and J Kasipillai, 'Compliance Costs of Small and Medium Enterprises' (2002) 4 *Journal of Australian Taxation* 73.

⁹⁴ Abdul and Pope, above n 92.

⁹⁵ M Miles and A M Huberman, 'Qualitative Data Analysis: A Sourcebook of New Methods' (1984) 56(2) *Qualitative Research Journal* 2.

Table 6 shows the respondents by legal form of business. The largest category was private companies, which accounted for 177 (42 per cent) of respondents, followed by sole traders at 133 (31 per cent), partnerships at 63 (15 per cent), and publicly listed companies at 53 (12 per cent). This represented a good mix of the various legal forms of business.

Table 7: Respondents by legal form and industry sector (from Survey Questionnaire, Questions 1 & 3)

Industry sector	Legal form								Total sample		Total population	
	Sole Trader		Partnership		Private Company		Public Company		N	%	N ('000)	%
	*N	*%	N	%	N	%	N	%	N	%	N ('000)	%
Manufacturing	6	5	3	5	43	24	7	13	59	14	40	7
Construction	8	6	9	14	23	13	4	8	44	10	22	3
Agriculture	7	5	1	2	3	2	1	2	12	3	9	1
Mining	0	0	0	0	1	1	0	0	1	0	0	0
Services	112	84	50	79	107	60	41	77	310	73	591	89
Total	133	100	63	100	177	100	53	100	426	100	662	100

* N denotes number of respondents; % denotes percentage.

Table 7 shows the respondents by legal form and industry sector. The total samples were grouped into 15 industry categories, based on the Malaysian Statistics Department's Standard Industrial Classification 2008. Further, the total sample was summarised into sectors, with services at 73 per cent, manufacturing at 14 per cent, construction at 10 per cent, and agriculture at 3 per cent.

The services sector represented 73 per cent of the businesses in the sample, compared with 89 per cent of the total population of SMEs. The manufacturing sector represented 14 per cent of the sample, compared with 7 per cent of the total population. Thus, the sample well represented the distribution of sectors in the total population.

Table 8: Respondents by legal form and turnover (from Survey Questionnaire, Questions 1 & 4)

	Sole Trader		Partnership		Private Company		Public Company		Total	
	N	%	N	%	N	%	N	%	N	%
Up to RM200 000	65	49	12	19	20	11	3	6	100	23
RM200 001–249 999	16	12	8	13	13	7	3	6	40	9

RM250 000–499 999	22	17	14	22	17	10	2	4	55	13
RM500 000–4 999 999	19	14	26	41	54	31	9	17	108	25
RM5 000 000–9 999 999	1	1	1	2	13	7	2	4	17	4
RM10 000 000–24 999 999	5	4	1	2	14	8	5	9	25	6
RM25 000 000–49 999 999	2	2	0	0	8	5	2	4	12	3
RM50 000 000 or more	3	2	1	2	38	21	27	51	69	16
Total	133	100	63	100	177	100	53	100	426	100

Table 8 shows 195 businesses (45 per cent) with turnover below the compulsory registration threshold of RM500 000, with the rest (231; 55 per cent) above the threshold and therefore required to register for GST. The sample selected was therefore a good representation of businesses with different turnovers that would register for GST. It is worth noting at this stage that the 45 per cent of respondents who operated below the threshold would prefer to stay out of the GST net to avoid the compliance burden associated with registration.

In conclusion, the sample responses from the survey findings were a good representation of the population in Malaysia, in terms of legal form, industry sector and turnover. Thus, the study findings provided a reliable set of data for further analysis.

III FINDINGS AND ANALYSIS

The findings of this study are discussed in relation to the four study objectives: (i) to analyse business readiness to implement GST; (ii) to analyse the GST compliance burden imposed on businesses; (iii) to gather the perceptions of the capacity of RMCD to provide financial and non-financial assistance; and (iv) to determine whether business perceptions are related to business characteristics. Several specific conclusions can be drawn for each of the objectives, as explained below.

A Objective 1: Business readiness to implement GST, comprising overall readiness, computerisation readiness, and readiness to register for GST if turnover exceeds threshold

1 Overall readiness for the implementation of GST

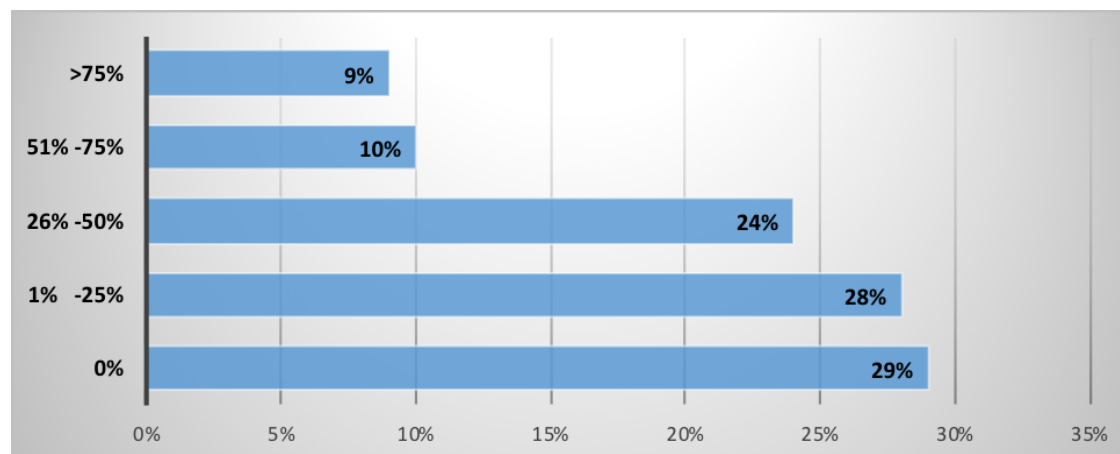
Overall readiness is generally made up of the business taxpayer's ability to cope with the change, the firm's resources and the availability of support from external tax agents and the RMCD.

Figure 1 below shows overall readiness for the implementation of GST. Only 9 per cent of respondents stated they were at least 75 per cent ready, while about 19 per cent considered themselves more than 50 per cent ready, and 81 per cent were less than 50 per cent ready. The poor preparation for GST was mainly due to the businesses'

perception that GST may not be implemented, since it was postponed twice and the starting date was unknown (at the time of this survey). This made it more difficult for businesses to properly prepare for GST, and this was reflected in the survey findings.

The findings of this study are confirmed by a similar study by ACCCIM.⁹⁶ Their study found only 4 per cent perceived that they were more than 75 per cent ready for GST. In this study, three years later (in 2013), there had been a marginal increase from 4 per cent to 9 per cent.

Figure 1: Overall readiness for the implementation of GST



Larger businesses with a turnover of over RM50 million seemed to be more ready than smaller businesses. This study further discovered that the manufacturing sector and the accounting profession were more ready than other industry sectors. Large businesses have international connections, more resources, better trained staff and in most cases a separate tax department, thus they are better equipped for GST preparation.

Persons responsible for implementing GST comprised internal accountants (46 per cent), external tax agents (26 per cent), owners/directors (22 per cent), and internal bookkeepers (6 per cent). This is positive, since it is better to utilise internal staff, who are less costly and can, at the same time, train other supporting staff internally.

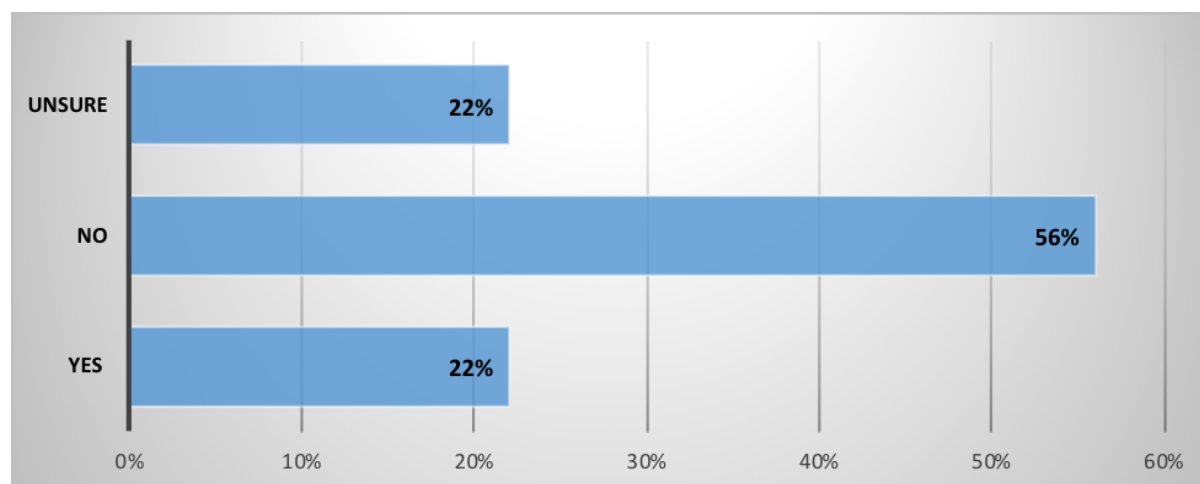
2 Computer hardware and software readiness for GST implementation

Figure 2 below indicates that overall only 22 per cent of business taxpayers believed that they were ready with their computer hardware and software for GST implementation. Again, larger businesses (with a turnover of over RM50 million), the manufacturing sector, as well as accounting firms, had their computer systems readier compared with smaller businesses and other sectors. Since the manufacturing sector had their accounting systems already set up for reporting sales tax, it was easier for them to update

⁹⁶ Tan Sri William Cheng, President of ACCCIM, 'President Speech: Media Conference on the Report of ACCCIM 2010 SMEs Survey' (Speech delivered at the Media Conference on the Report of ACCCIM 2010 SMEs Survey, ACCCIM Conference Room, 16 July 2010) <<http://www.acccim.org.my/blog/topic/27/1/36/Media+Conference+on+the+Report+of+ACCCIM+2010+SMEs+Survey>>.

their systems for GST. Similarly, since the accounting profession was already acting as advisors for the new GST, their computer systems were more ready than other sectors. It is a concerning issue that 78 per cent of businesses, mainly SMEs, believed their computer systems were not ready. Low computer usage suggests that a large proportion of SMEs still operate on a cash basis. This is in line with the findings of Kasipillai and Liew,⁹⁷ who pointed out that many small businesses operate on a cash basis and do not use computerised accounting or cash registers to maintain records.

Figure 2: Computer hardware and software readiness



An earlier study by ACCCIM⁹⁸ highlighted the same issue, where 80 per cent of respondents indicated that their computer systems were not ready to meet their compliance obligations. In addition, 71 per cent of the respondents indicated that they would not electronically file GST returns. Only 42 per cent of business taxpayers indicated they would use electronic filing to submit GST returns to the RMCD, with 21 per cent using external tax advisers, 17 per cent filing manual returns, and 20 per cent undecided.

Even though 42 per cent was a good start, the remaining 58 per cent of business taxpayers seemed to be uncomfortable using computers to submit returns, even with the knowledge that manual filing was costlier than electronic filing. The lack of confidence in using electronic filing leads to less investment in computer systems and a shortage of IT staff to run the software. This is an area of concern, as SMEs may not meet the reporting obligations, and thus may incur heavy RMCD penalties.

3 Compulsory registration for GST turnover above threshold of RM500 000

Figure 3 shows that 58 per cent of businesses stated they would register for GST. However, one of the most worrying results of this research was that 25 per cent of respondents with a turnover above the RM500 000 threshold stated they would not register for GST, which is a clear breach of the law. Another 17 per cent said they were not sure if they would register. One hopes that these respondents simply made a mistake

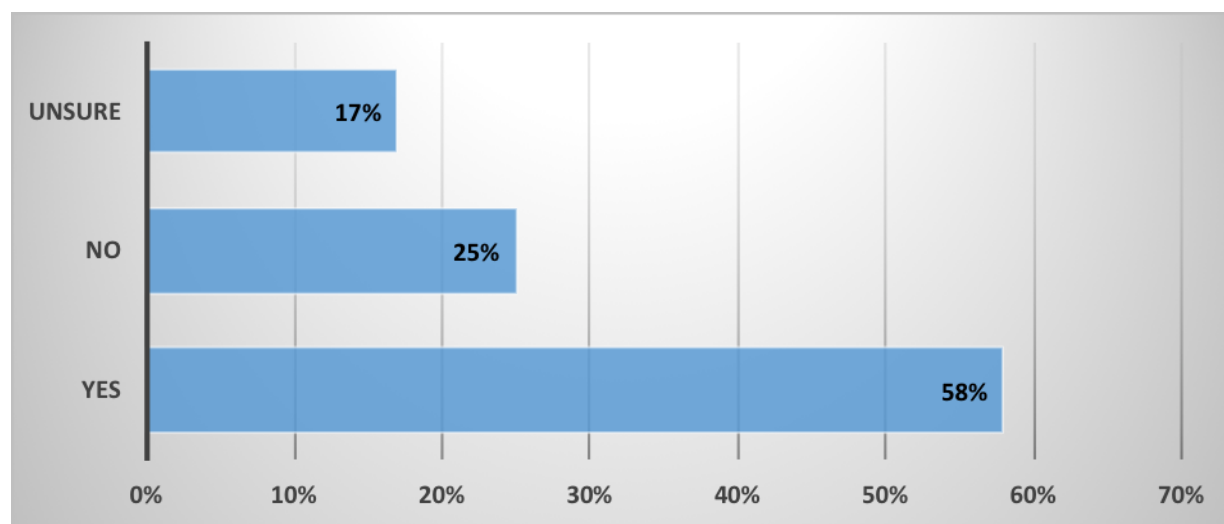
⁹⁷ J Kasipillai and R Liew, 'The Small and Medium Enterprises under a GST Regime' (2004) 17 *Accountants Today* 10–13.

⁹⁸ Cheng, ACCCIM, above n 96.

and were not aware of the compulsory registration threshold, but given that the registration threshold under SST was below that for GST, this is unlikely.

No matter what the reason, the RMCD should be concerned. A significant level of non-compliance with the compulsory registration requirement of GST would be incredibly damaging to its ongoing success. It seems some business taxpayers were adopting a 'wait and see' approach, and were willing to take the chance in not registering and face the consequences arising from RMCD action through their audit processes.

Figure 3: Compulsory registration for GST turnover above threshold of RM500 000



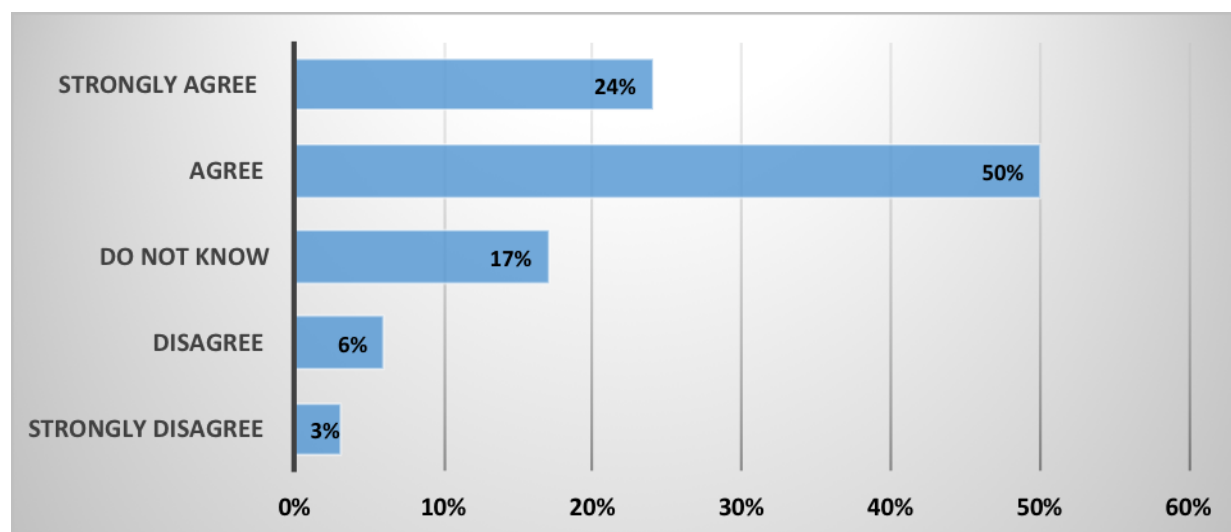
The RMCD had previously been using a persuasive approach, advocating collaboration with business taxpayers to register for GST, but, due to business taxpayers' continued non-compliance, and they changed to a deterrence approach and started imposing tax penalties after December 2014 (deadline for registration for GST).

B Objective 2: Compliance burden, stress levels, managerial and cash flow benefits

1 Compliance burden

Figure 4 summarises the compliance burden of business taxpayers, with 74 per cent of respondents agreeing that GST placed an additional compliance burden on their businesses. In this regard, it should be remembered that international research found that a high compliance burden leads to high costs, which fall more heavily on small enterprises.⁹⁹

⁹⁹ C Evans, 'Taxation Compliance and Administrative Costs: An Overview' in M Lang, C Obermair, J Struch, C Staringer and P Weninger (eds), *Tax Compliance Costs for Companies in an Enlarged European Community* (Kluwer Law International, 2008) 447-70.

Figure 4: Compliance burden of business taxpayers

2 *GST-induced stress levels*

Fifty per cent of respondents stated that their stress levels would increase, and 36 per cent were not sure, due to the increased compliance burden, the lack of general information and the specific training required for GST. Another concern is that, due to stress levels, business taxpayers could voluntarily defer registration and be non-compliant with GST law.

In 2010, ACCCIM¹⁰⁰ found that 33 per cent of the respondents to their study expressed high stress in getting ready for GST, due to a lack of information. Another 22 per cent stated that the GST Bill was too technical and complicated. It seems stress levels had increased as the date of introduction of GST was getting closer, given the response of 50 per cent in this study. Businesses may have been hiring external advisers to set up the GST systems and train staff, and, thus, stress levels would have increased when the responsibility of reporting obligations fell back to the internal accountants and owners of businesses. However, it should be noted that this study and that by ACCCIM reflect a fairly rudimentary measure of stress levels, since GST had not been implemented at the time, and therefore businesses had not experienced the 'real' stress of GST compliance.

3 *Managerial benefits*

Managerial benefits refer to the potential for better and more informed business decision-making. These benefits can be maximised when record keeping is of a high quality. GST compliance forces taxpayers to keep better and timelier records of business transactions. Managerial benefits exist but are difficult to quantify. Accordingly, as Tran-Nam and Glover¹⁰¹ pointed out, these benefits are normally omitted in empirical

¹⁰⁰ Cheng, ACCCIM, above n 96.

¹⁰¹ B Tran-Nam and J Glover, 'The GST Recurrent Compliance Costs/Benefits of Small Business in Australia' (2005) 1(2) *Journal of the Australasian Tax Teachers Association* 237.

compliance cost studies. However, Lignier¹⁰² uncovered that some business taxpayers were deriving managerial benefits in the form of improved knowledge of financial affairs, mainly through increased use of computer accounting.

The survey results indicated only 44 per cent of respondents believed they may enjoy some managerial benefits, while 30 per cent were not sure and 26 per cent felt there would be no managerial benefit for them. It would be difficult to measure the impact of managerial benefits enjoyed by business taxpayers, since GST was not implemented at the time of the survey. Therefore, these findings may not be used to draw any credible conclusions.

4 Positive cash flow benefits

The business taxpayer enjoys a short-term cash flow benefit due to the time lag between when GST is collected from customers and when it is remitted over to revenue authorities. Only 28 per cent of respondents believed they would enjoy some short-term cash flow benefits, while 33 per cent were not sure, and 40 per cent believed they would not enjoy any cash flow benefits. From an accounting point of view, positive cash flows are very important for businesses, but respondents felt that, overall, GST would not contribute positive cash flow benefits for their organisation. Again, since the survey was carried out before GST implementation, it would be difficult to forecast any cash flow benefits.

C Objective 3: Business taxpayers' perceptions of the RMCD

Chow¹⁰³ stated that the OECD considers increasing responsiveness in solving taxpayer issues as one of the major challenges for revenue authorities. Increasing the responsiveness can include consistently delivering quality information to taxpayers, and dealing with inquiries and appeals from taxpayers in a timely fashion. Singh¹⁰⁴ stated that some of the public are still lacking knowledge and information regarding taxation, which leads to low awareness of their responsibility to pay taxes. So, taxpayers need to have sufficient knowledge of the current taxation system to comply with laws and regulations, as there seems to be a close relationship between knowledge and compliance. Also, a good positive relationship between taxpayers and revenue authorities is vital for the dissemination of knowledge and information to taxpayers.

¹⁰² P Lignier, 'The Managerial Benefits of Tax Compliance: An Empirical Study of Small Businesses in Regional Australia' (Paper presented at the 8th International Tax Administration Conference, University of New South Wales, Sydney, 2008).

¹⁰³ W S Chow, 'Tax Administration in the Hong Kong Special Administrative Region: Benchmarking against International Standards' in *ATAX Tax Administration Series, Vol 3: Tax Administration: Safe Harbours and New Horizons* (Fiscal Publications, 2008).

¹⁰⁴ V Singh, 'Goods and Service Tax, It Is Time', *The Malaysia Insider* (online), 21 September 2013.

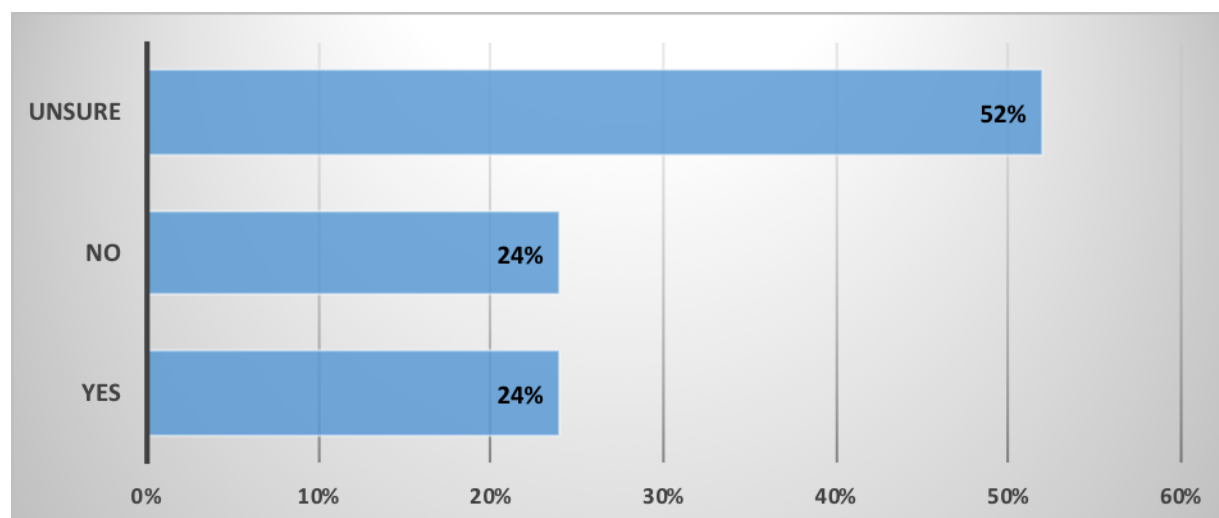
Figure 5: Business taxpayers' perceptions of the RMCD

Figure 5 demonstrates that, unfortunately, only 24 per cent of business taxpayers felt that the RMCD officers would provide friendly, courteous and helpful assistance to them during the interim period for implementation of GST, while 52 per cent were unsure if they would get any help, and 24 per cent indicated that the RMCD may not provide the required help and assistance.

This low level of 'approval' may indicate that business taxpayers were not confident that they could get help and assistance to sort their queries in a timely manner. ACCCIM¹⁰⁵ found that 50 per cent of the respondents to their study did not comment on the attitude of the officers handling tax audit, since the businesses had not been subjected to an audit within the past five years. This was an area of concern, since a lack of trust and the absence of a good relationship between business taxpayers and the RMCD staff could hamper the administration and collection of GST revenue.

It is important to note that if the RMCD fails to extend the required assistance, taxpayers may have to seek assistance from external tax advisers, but this can be costly. It is crucial that taxpayers have access to inexpensive and accurate information from the RMCD to encourage them to be compliant with GST rules and regulations. Prohibitive costs paid to external tax advisers should be avoided, since this can induce non-compliance when the same tax advice could be obtained free-of-charge from RMCD.

D Objective 4: Business perceptions in relation to business characteristics

The fourth objective of this study was to determine whether businesses' perceptions about GST were related to various characteristics of those businesses. The chi square statistic was used for testing relationships between perceptions and characteristics.

The results of all the chi square statistic tests have been summarised for characteristics such as legal form, turnover and industry sector and the corresponding three perception

¹⁰⁵ Cheng, ACCCIM, above n 96.

variables, namely overall GST readiness of business taxpayers, the compliance burden, and GST-induced stress levels. The results of the correlation analysis were carried out using the business turnover variable and nine business perception variables. Only three perceptions – ie, the overall readiness to implement the GST, computer system readiness and stress factor – seem to have a significant association with turnover. The legal form and industry sector variables were ignored, since they were not considered ordinal variables for the statistical analysis. Table 9 shows the correlation between annual turnover and business perceptions.

Table 9: Correlation between annual turnover and business perceptions

Variables	Pearson (r)	Spearman (rho)	Significance
Overall readiness	0.311	0.312	0.000***
Computer readiness	0.121	0.114	0.012**
Compulsory registration	0.086	0.076	0.191
Optional registration	0.025	0.021	0.724
Compliance burden	0.037	0.049	0.446
Managerial benefits	0.060	0.057	0.218
Cash flow benefits	0.016	0.012	0.744
GST-induced stress	-0.090	-0.081	0.062*
RMCD	0.070	0.076	0.147

* Significant at 10% ** Significant at 5% *** Significant at 1%

As shown in Table 9, the significant correlation coefficients for the variables overall readiness and computer system readiness suggest that the larger the business, the more ready they were for GST overall and the more likely they were to have an updated computer system. The negative sign of the correlation coefficient for stress factor indicates that, as expected, smaller businesses felt more stress about the implementation of GST than larger businesses.

The Cronbach's alpha is defined by researchers as 'reliability of measurement'. This method is used to estimate the level of reliability and internal consistency of the data, since there were several Likert-type questions in the survey. An alpha value of above 0.75 is generally taken to indicate a scale of high reliability; a value of 0.5 to 0.75 is generally accepted as indicating moderate reliability; and a value below 0.5 generally indicates low reliability.

The Cronbach's alpha estimate of this study was about 0.64, suggesting that the data was moderately reliable. Thus, it can be concluded that the collected sample data was reliable for further statistical analysis.

E What are the challenges for business taxpayers when GST is implemented?

Bernardi, Fumagalli and Gandullia¹⁰⁶ argued that the adoption of GST is often seen as an opportunity in developing countries to modernise tax administration. However, many developing countries found GST more difficult to administer than they initially thought, and problems with administration and enforcement often undermined its effectiveness. Ching et al¹⁰⁷ stated that in Bangladesh, even after more than two decades of implementation, businesses have difficulty in understanding GST legislation, due to excessive documentation, poor computerisation and delays in getting refunds.

Even developed countries had difficulty in selling the GST message, despite extensive consultation with business taxpayers and business organisations. For example, in Australia there was strong opposition by the public and business taxpayers. After several attempts, GST was eventually implemented at a rate of 10 per cent in 2000. In November 1999 (a year earlier), a survey was undertaken in Australia to seek business taxpayers' responses to GST compliance issues for the proposed July 2000 start date. Evans¹⁰⁸ listed some of the responses of business taxpayers, the key concern being that the GST compliance burden would be high. Many taxpayers expressed concern that there would be less time to run their business, less time for their family and reduced profitability. Others were worried about the complexity of complying with GST. The majority felt that they did not know enough to judge how GST would affect them, and many believed that it would be difficult to find adequate information on GST.

Based on the survey findings, it seems there are number of challenges Malaysian business taxpayers would face for the introduction of GST. The main issues are getting ready for GST, computerisation for GST, complexity of GST and the relationship with the RMCD. So, to overcome these challenges, Question 28 in the survey asked what business taxpayers wished from the government for the smooth introduction of GST. Normally, this could include monetary assistance to offset GST compliance costs, or free training to enhance tax knowledge. Kasipillai¹⁰⁹ stated that tax knowledge is an essential element in maximising voluntary compliance, and thereby affects the compliance behaviour of business taxpayers. Pope and Jabbar¹¹⁰ suggested providing free workshops. Kasipillai and Liew¹¹¹ recommended providing free software packages to business taxpayers. Singh,¹¹² taking the example of the Australian experience, proposed introducing a tax advisory board to assist business taxpayers in raising their issues with the RMCD during the implementation stage.

Based on the questions pertaining to requests for monetary and non-monetary assistance from the RMCD: 37 per cent of respondents hoped that the government would compensate them for GST start-up costs, which ranged from RM5000 (USD1250) for

¹⁰⁶ L Bernardi, L Fumagalli and L Gandullia, 'Tax Systems and Tax Reforms in South and East Asia: Overview of the Tax Systems and Main Tax Policy Issues' (2005) *Società italiana di economia pubblica*.

¹⁰⁷ Ching, Kasipillai and Sarker, above n 26.

¹⁰⁸ D Evans, 'Concern over Compliance, Few See Benefits' (1999) 34(1) *Taxation in Australia* 10–12.

¹⁰⁹ Kasipillai, 'Taxpayer's Knowledge Index', above n 39.

¹¹⁰ J Pope and H A Jabbar, 'Small and Medium Size Enterprises and Regulatory Burden in Malaysia. Alleviating the Compliance Costs of Goods and Services' (Paper presented at the Global Economy Conference 2007, Malaysia).

¹¹¹ Kasipillai and Liew, above n 97.

¹¹² V Singh, *Tax Thoughts on Today Are Taxing Times* (Digibook Sdn Bhd, 2005).

SMEs to RM20 000 (USD5000) for larger businesses; 22 per cent hoped that the government would provide free GST training; 20 per cent wanted GST postponed until a tax impact statement was published by the RMCD; 17 per cent wanted a grace period before the imposition of GST penalties; and 4% wanted lesser penalties until GST was accepted. It seems there was an urgent need for funding for training and for purchase of computer hardware and software.

One of the concerns of the newly enacted *Goods and Services Tax Act 2014* is the tax complexity. It has 165 pages with 197 sections and must be read in conjunction with GST orders and GST-related regulations, with the added burden of 35 tax codes.¹¹³ Saad¹¹⁴ argued complexity of tax laws can lead to high compliance costs, which can provide strong incentives for business taxpayers to illegally stay out of the system, damaging the integrity of GST. There seems to be reluctance on the part of business taxpayers to get necessary help and assistance from the RMCD. This may be due to a lack of clarity in relation to the application of the draft GST legislation. RMCD has released several customs regulations on GST matters that have not yet been explained clearly to business taxpayers. The potential contradiction between RMCD positions and the law may add to confusion, leading to taxpayer reluctance in seeking assistance from RMCD officials and the adoption of a 'wait and see' approach until GST is implemented.

IV LIMITATIONS OF THE STUDY

This study had some strengths and weaknesses. Some of its strengths included a good response rate of 28 per cent and the support of the survey from major business organisations. In addition, several major variables were identified to capture the perceptions of the underlying GST issues using different legal forms, sizes and industry sectors.

Some of the weaknesses of the study were: the survey was carried out during the heat of a general election, so the responses may be politically biased and not objective; since the GST had not been implemented it is difficult to know to what extent respondents really understood the questions to respond effectively, without having a practical working knowledge of GST; there is no input from the RMCD operational team to validate the findings; importantly, the survey was carried out from April to June 2013, 21 months before GST was implemented. According to the findings at this time, business taxpayers were poorly prepared for the implementation of GST. This may not be the case in June 2015, as the RMCD had by then carried out numerous GST education programmes. Hosni¹¹⁵ stated that by the end of February 2015, 6443 training programmes were conducted by the RMCD and 61 600 people had attended. Currently GST training and examinations are still being conducted to increase GST knowledge of business taxpayers. It seems all these educational training programmes may have helped to increase the tax knowledge of business taxpayers and that circumstances may have improved somewhat since 2014.

¹¹³ Kasipillai, *A Guide to Malaysian Taxation*, above n 64.

¹¹⁴ Saad, above n 65.

¹¹⁵ H Husni, '350,054 Companies GST-Ready as of March 11', *New Straits Times*, 11 March 2015.

V CONCLUSION

The findings of this study will contribute to the tax compliance literature in terms of explaining the GST issues faced by SMEs in a developing country. Specifically, this study highlights the issues, namely, readiness for GST, computerisation for GST, complexity of GST and the help and assistance from the tax authority to meet compliance obligations. Overall conclusions from this study's findings are broadly in line with other studies in Malaysia and around the world.

In the end, taxpayers are legally obliged to be ready for GST. But, no matter what the reasons for the low preparedness, this research reveals that there were areas where the government, perhaps through the RMCD, could be doing more to help prepare Malaysian businesses. There is no doubt that GST could be simplified for taxpayers facing unwarranted complexity, and this could be done without unduly compromising the integrity of the GST system. For example, Australia has been very successful in designing simplified GST accounting methods for many businesses that make both taxable and non-taxable supplies, thereby avoiding the costly problem of individually classifying a supply at the point of sale. Indeed, it is arguable that the government should be drawing more on external expertise to address the numerous GST implementation challenges.

In short, the survey in this study appears to be a good representation of the views of businesses across Malaysia. While the research data still needs to be statistically analysed for deeper and more targeted results, overall the survey results indicate that SMEs were poorly prepared for the implementation of GST, while larger businesses were better prepared overall.

Finally, an important point to note is that this data was collected around 21 months before GST was implemented. It seems that the circumstances have improved somewhat since the survey date in 2013. Yong,¹¹⁶ the Deputy Finance Minister, announced that as of 16 August 2014 only 12 500 businesses had registered. RMCD expected 122 000 to register for GST and later this figure was revised to 240 000. Registrations then increased sharply, as noted by Maslan,¹¹⁷ and by June 2015, 380 313 business entities had registered. On the face of it, one would presume that GST education training programmes had helped to increase registration of business taxpayers through better tax knowledge, but, on the contrary, it seems the deterrence or 'carrot and stick' approach by the RMCD to impose hefty fines had forced substantially increased registration numbers by 2015.

Businesses that chose not to register for GST are a concern for RMCD. As Hashim¹¹⁸ stated, some SMEs in Malaysia opted not to register their businesses for fear of being taxed for income tax and GST. These SMEs are considered part of the non-formal sector, which accounts for about 31 per cent of GDP and thus could lead to a significant loss of revenue for the government.

GST should be incorporated with the larger objective of achieving long-term fiscal sustainability, despite any initial implementation problems. The following short- and long-term policy recommendations are put forward to alleviate some of the major issues

¹¹⁶ C T Yong, 'Registration for Implementation of GST Picks Up Speed Time', *The Star* (online), 16 August 2014.

¹¹⁷ A Maslan, 'Govt Collects More Than RM 6 Billion, in GST', *The Star* (online), 12 June 2015.

¹¹⁸ H Hashim, 'Why Some SMEs Refuse to Register', *New Straits Times*, 20 July 2015.

uncovered from this study. The RMCD should study these recommendations and take appropriate action.

The short-term recommendations are:

1. Expedite ways and means to spread GST tax knowledge and education to the business taxpayers, for example, providing industry-based targeted seminars.
2. Extend financial assistance to business taxpayers for purchase of computers and software.
3. Take measures that will reduce the compliance burden by reducing the GST tax codes from 35 to a lower figure, reducing the frequency of reporting, and increasing the threshold from RM500 000 (USD125 000) to RM1 million (USD250 000).
4. Put in place procedures for the improvement of the RMCD's relationship with business taxpayers, for example, by employing more multicultural staff who can communicate in Chinese and Tamil languages.
5. Conduct an independent survey on GST compliance issues faced by business taxpayers to find out 'first hand' the issues confronting business taxpayers.

Long-term recommendations are:

1. The Government of Malaysia should publish a GST tax impact statement.
2. The government should establish a GST Research Centre with the universities.
3. The government should establish one tax authority for the administration of direct and indirect taxes, which should reduce compliance costs for business taxpayers and administration costs for the government.

Dealing with taxation matters in Malaysia remains a challenge, since very little research is published on taxation issues. At the time of this study, there seemed to be a lack of commitment by the government to allocating resources for taxation research, since revenue collection had been their focus due to the fiscal deficit. The introduction of a broad-based GST was one of the most significant reforms Malaysia had made to its public finance regime. The experiences of other countries have taught us that the implementation of GST must be carefully managed. This is not only regarding the structural design of the GST, but also regarding the initial implementation of the GST. It is worth investing considerable resources to get the implementation right from the start as failures to correct the weaknesses will leave a legacy that will be felt for some time and prove costly to correct in the future.

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APPENDIX 1: SURVEY QUESTIONNAIRE



THE UNIVERSITY OF
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Goods and Services Tax (GST) Survey Questionnaire on issues due
to the implementation of proposed GST in Malaysia

SURVEY QUESTIONNAIRE

A THIS SECTION ASKS ABOUT YOUR BUSINESS' BACKGROUND

1. Legal form of your business

Sole proprietor Partnership Private Ltd Public Listed

2. Location of the head office of your business

Johor Penang
 Kedah Perak
 Kelantan Perlis
 Kuala Lumpur Sabah
 Melaka Sarawak
 Negri Sembilan Selangor
 Pahang Terangganu
 Others (please specify)

3. Primary activity of your business

Agriculture, Timber, Fishery,
Gardening Manufacturing
 Constructions & Contractor Mining
 Finance, insurance, business
services Professionals
 Hotel, Restaurants Property Developer
 Imports & Exports Plantations
 Information Technology Travel & Entertainment
 Logistics Wholesale & Trading
 Others (please specify).....

4. Annual turnover of your business in Ringgit Malaysia (RM)

Below 200,000
 200,000 up to 249,999
 250,000 up to 499,999
 500,000 up to 4,999,999
 5 million up to 9,999,999
 10 million up to 24,999,999
 25 million up to 49,999,999
 50 million or more

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Goods and Services Tax (GST) Survey Questionnaire on issues due to the implementation of proposed GST in Malaysia

11. How does your business intend to submit GST returns?

GST Electronic filing Use of external tax professionals

Manual GST returns Unsure

12. How does your business plan to get ready for the GST?
(Please tick more than one circle if appropriate).

To read GST articles in the media To study cash-flow impacts of GST

To stock up inventory before GST To wait for Government public training

To conduct In-house staff training To hire external GST experts

To review contracts for goods/ services purchases To change computer software

To send staff for external training Others (please specify)

13. If you have ticked more than one circle in Q12, which is likely to be the most important step you could take to get ready for GST?
Please specify one option from the above ten options.

14. Is your business computer system (hardware and software) ready for the implementation of GST?

Yes No Unsure

15. Have you paid any costs pertaining to the proposed implementation of GST?(Costs include one-off advice on GST matters paid to external consultants, training staff in-house or attendance at GST courses, seminars, capital cost such as new computers, software includes bought or hired computers or special equipment e.g. cash registers).

Below RM 5000

RM 5001 up to RM 9,999

RM 10,000 up to RM 19,999

RM 20,000 or more

3

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Goods and Services Tax (GST) Survey Questionnaire on issues due to the implementation of proposed GST in Malaysia

16. Have you studied the transitional GST tax issues, to avoid double taxation and business disruption to your entity? Examples are reviewing existing non reviewable and reviewable contracts and review of stock ordering process to account for GST.


Yes No Unsure

17. How ready is your business to implement the GST. State the degree of readiness of your business for the implementation of GST.

0% 1%- 25% 26%- 50% 51% -75% Above 75% Not sure

18. Assuming your business is not ready to implement the GST. What is a suitable grace period you need to get your business ready for GST?

12 months 18 months 24 months Not sure



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C THIS SECTION IS ABOUT THE UNDERSTANDING OF THE FUNDAMENTALS OF GST DESIGN AND STRUCTURE BY THE BUSINESS TAXPAYER

19. The proposed GST rate is 4%, do you think this is a suitable rate for your business?

- Yes No Unsure

20. The GST threshold is set at RM 500,000. Should this limit be increased to a higher figure to reduce the compliance burden to your business?

- Yes No Unsure

21. The proposed GST will benefit the Malaysian economy since it will help the government to raise a more stable and more tax revenue.
(Please use the scale below to indicate your attitude to this statement).

- Strongly disagree Disagree Neutral/Don't know Agree Strongly agree

22. The proposed GST will certainly burden the poor since it will lead to an increase in prices due the general belief that there will be an inflationary impact attributable to the introduction of the GST.
(Please use the scale below to indicate your attitude to this statement).

- Strongly disagree Disagree Neutral/Don't know Agree Strongly agree

23. The proposed GST will certainly burden the business in terms of extra paper work to comply with the new tax laws. This will also entail employing new staff, training and purchasing new equipment to carry out the regulatory GST compliance work which will add further load to your current self-assessment role of the business taxpayer.
(Please tick below to indicate your attitude to this statement).

- Strongly disagree Disagree Neutral/Don't know Agree Strongly agree

D THIS SECTION ASKS ABOUT THE PSYCHOLOGICAL COSTS OF PROPOSED GST

Stress is often a normal response to change. Stress can sometimes bring positive changes to the business. However other times, the rate of change can be too great and the stress that accompanies can be lead to non compliance of the tax legislation and increase in tax evasion.

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Goods and Services Tax (GST) Survey Questionnaire on issues due
to the implementation of proposed GST in Malaysia

28. What type of assistance do you desire from the government in regards to the smooth implementation of GST?

- The postponement of its implementation until a GST impact statement is issued.
- Incentives given to taxpayers to compensate for the additional costs incurred due to the implementation of GST.
- Provision of free of charge training by Government.
- A grace period before the imposition of penalties and recovery action.
- Lesser penalties during the grace period until GST is well accepted.

29. How do you perceive the attitude of the RMCD officers who will be handling the administration of GST? In your opinion, will the officers be more friendly, courteous and focused on assisting you during the interim period of GST implementation.

Yes No Unsure

F THIS SECTION ASKS FOR YOUR GENERAL COMMENTS

30. GST reform may provide your business with managerial benefits such as better information for decision-making and better book keeping. Since to comply with GST, all books of accounts have to be reconciled and kept up to date to pay the GST liability. As a result, do you think your business will experience such managerial benefits?

Yes No Unsure

31. GST reform may provide your business with some cash flow benefits. There will be a timing difference between the date when the GST is collected and paid over to Inland Revenue, so your business would enjoy a use of cash for a short time. Do think your business will experience such a cash flow benefit?

Yes No Unsure

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Goods and Services Tax (GST) Survey Questionnaire on issues due
to the implementation of proposed GST in Malaysia

32. GST reform may cause some negative cash flow benefits. For example if your business uses an accruals system for booking the sales invoices, a credit period would be normally stated in the invoice. In this case, cash is not collected when the sales invoices are generated but delayed for a later time. This may result in a negative cash flow due to timing differences between the time cash is collected from the customer and paid over the revenue authorities. In other words, you may have to pay the GST before you collect the GST from your customers. Do you think your business will be worse off under the GST regime because you may experience a negative cash flow?

Yes No Unsure

33. Please comment on how you think tax compliance costs could be reduced. (but abolishing GST is not an option).

Yes No Unsure

THIS SECTION ASKS FOR YOUR GENERAL COMMENTS

30. GST reform may provide your business with managerial benefits such as better information for decision-making and better cash flow. Do you think your business will experience such managerial benefits? As a result, do you think your business will experience such managerial benefits?

Please add any other comments you wish to add on this survey.

Yes No Unsure

31. GST reform may provide your business with some cash flow benefits. There will be a timing difference between the date when the GST is collected and paid over to the revenue authorities. Do you think your business will experience such a cash flow benefit?

Yes No Unsure

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