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FOREWORD

DALE PINTO
EDITOR-IN-CHIEF

The articles included in this edition of the *Journal of the Australasian Tax Teachers Association* ('JATTA') were presented at the 31st Annual Conference of the Australasian Tax Teachers Association ('ATTA'), held 16–18 January 2019 and hosted by the Curtin Law School in Perth, Western Australia.

The theme of the 2019 ATTA conference was 'Tax, Innovation and Education: Tax in a Changing World', 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 challenging both national and international tax developments. Also, it was pleasing to see papers on issues that affect the profession more broadly, including one on key employability skills.

A range of inspiring and eminent speakers addressed the delegates, and two public keynote sessions were delivered by specialists from the field on Thursday and Friday of the conference. These sessions were delivered by Andrew Mills, Second Commissioner (Australian Taxation Office), Professor Therese Jefferson (Australian Research Council) and Karen Payne (Board of Taxation). We thank them all for their contributions, and their insightful reflections and commentary on tax issues that affect us all.

PhD students had the opportunity to showcase their research and gain valuable feedback from the audience during the PhD workshops, which were held on Wednesday morning. Our sincere congratulations to Dylan Damon (Best PhD student paper), Mpumi Monageng and Lindelwa Ngwenya (Best and Highly Commended PhD presentations, respectively, and joint winners of the Gordon Cooper Memorial Prize), for their achievements at this year's conference.

A lively panel discussion was held on Wednesday after lunch regarding the 'tax graduate of the future', and what it is that employers will be looking for in the next generation of taxation professionals. We also heard from past and recent graduates about their experiences while at university, and how those experiences shaped the trajectory of their careers.

A special thanks to our Patron, Tony Pagone QC, both for his Patron's Address and his ongoing support for ATTA. Also, thanks to Paul Fairall, our Foundation Dean of Law, for opening what was his last conference at the Law School due to his retirement later in the year. I would also like to thank all the authors who submitted their articles to JATTA 2019. Thank you also to the reviewers of articles for their contribution and support of JATTA.

Finally, a very special thanks to Annette Morgan and Donovan Castelyn for their tireless efforts in not only organising the conference but in managing the editorial process for this edition of JATTA.

Professor Dale Pinto
Curtin Law School, Curtin University
10 October 2019

PATRON'S ADDRESS
AUSTRALASIAN TAX TEACHERS ASSOCIATION CONFERENCE, 17 JANUARY 2019

GT PAGONE¹

It is a great privilege for me to have the opportunity of addressing the Australasian Association of Tax Teachers at its 2019 annual conference. The theme of your conference this year has something of a familiar, and constant, ring about it: 'Tax, Innovation and Education: Tax in a Changing World'. It seems to me that tax has been in a changing world for as long as I can remember, and that the need for tax, and for tax education, to come to terms with innovation has been a lament of many tax practitioners for a long time. Saying that does not lessen the novelty and complexity of the issues that are particular to these times, nor does it lessen the importance for tax education to come to terms with the changes in the world today and to educate those who develop and apply tax law as it is evolving now.

The changing world has given rise to new questions for our tax revenue base, and for its application and enforcement. Tax teachers have an important role in understanding the issues raised in our times and in framing the questions that are to be asked and the answers that are to be given. The issues, questions and answers will be with us for many years to come and the audience you need to address will cover every aspect of tax practice and administration for many years. The makers of policy may look to you for impartial guidance. Your students will be those who will come to apply, advise and guide taxpayers in understanding their duties and obligations. Those who apply the law (including tax officials, taxpayers, tax practitioners and judges) may all look to you for an impartial understanding of the issues, questions and answers they must deal with in the ever-changing world of today.

I will not trespass in my remarks upon the details of the many interesting topics you will be considering at this conference, but will confine myself to some general reflections (if I may) based upon my recent role as a judge having to impartially apply principles to facts where the answers were neither obvious nor easy. Those appearing before a court have duties to assist the judge in the administration of the law, but they do so as interested parties seeking to secure an outcome. Tax litigation is, perhaps sadly, conducted within the adversarial model of litigation, with the Commissioner adopting the position of an interested party seeking to win a case, rather than, as it could otherwise be, of an impartial regulator making submissions on the law and its application. There are instances of regulators participating in litigation for the more limited purpose of ensuring the impartial application of public policy reflected in the law, for which the regulator is particularly responsible. The traditional role of a prosecutor is, for example, as a 'minister of justice', whose primary duty is to assist the court fairly and honestly, and not just to secure the highest possible penalty.² The Commissioner must, of course, act as a model litigant in tax appeals, but the role of the Commissioner in that framework is not limited

¹ BA Dip Ed, LLB, (Monash), LLM (Cambridge), LLD (Melbourne). Retired Judge of the Federal Court of Australia; Professorial Fellow, Law School, University of Melbourne.

² *R v Lucas* [1973] VR 693, 705; *King v The Queen* (1986) 161 CLR 423.

to acting as a 'minister of justice', and acts frequently as an active partisan seeking to secure outcomes with vigour.

There is no criticism intended by a description of the Commissioner adopting a robust adversarial position in litigation, but it has an effect upon the dynamics of tax administration, including tax litigation, and suggests that there may be an important role for tax teachers in providing an impartial and independent understanding of the rules that a court is first called upon to understand and is next called upon to apply. It is a fact that many judges who are called upon to decide tax cases have not had much prior training and exposure to the provisions they are to interpret and apply. Indeed, it is thought by many to be a positive aspect of our legal system that the law, including tax law, is not left to be applied by specialists, but is rather to be applied by generalist judges who bring a wide and general knowledge of the law to the particular tax issues raised in a given case.³ In *Federal Commissioner of Taxation v Ryan*, Kirby J said:⁴

It is hubris on the part of specialised lawyers to consider that 'their Act' is special and distinct from general movements in statutory construction which have been such a marked feature of our legal system in recent decades. The [*Income Tax Assessment Act 1936* (Cth)] is not different in this respect. It should be construed, like any other federal statute, to give effect to the ascertained purpose of the Parliament.⁵

Even judges with a broad, deep knowledge and experience of tax, however, will be called upon from time to time to come to terms with provisions they have not seen before, and may come to task with no familiarity or intuitive understanding of them. Even when there is familiarity or intuitive understanding, it will often not be enough to resolve questions between contending parties who are each making plausible and forceful cases for their own, but incompatible, outcomes.

It is not uncommon in tax, and in other fields of specialist law, for decision-makers to seek guidance in the works by academics. The tax teacher is thus able to supply what the parties cannot be expected to supply: an unbiased, learned and dispassionate view about how novel challenges are addressed by novel tax provisions. The judge in a tax case hearing counsel for the Commissioner as an advocate understands the submissions as those of an interested party and not as those of the minister for justice, whose task is limited to assisting the judge in applying the law without an interest in the outcome. The judge lacks the resources of the litigants to find facts, to research all of the law, or to obtain reliable expert knowledge. The judge relies overwhelmingly on what the litigants present and is vulnerable to the defects, biases and nuances of what the parties have selected to put in terms of the law and how it is to be applied to the facts. However confidently a reasoned judgment may be expressed, its production is often achieved with anxious vulnerability. The teacher comes to the task frequently faced by judges without the partisan interest in an outcome, and may thereby give much useful and reliable insight into what the law means and how it is to be applied.

³ See Kirby J, 'Hubris Contained: Why a Separate Australian Tax Court Should Be Rejected' (Challis Taxation Discussion Group, 3 August 2007).

⁴ (2000) 201 CLR 109, 479.

⁵ See also *Federal Commissioner of Taxation v Scully* (2000) 201 CLR 148, 172 [43]; *Brodie v Singleton Shire Council* (2001) 206 CLR 512, 596 [218]; *Aktiebolaget Hässle v Alphapharm Pty Ltd* (2002) 212 CLR 411, 476 [137]; *R v Lavender* (2005) 222 CLR 67, 97 [94].

There are a few practical aspects of the impartial role of the tax teacher that I would like specifically to mention. The first is to emphasise the important role you can play in leading the conversation about ethics in tax practice and administration.⁶ There is much said about inappropriate tax behaviour by taxpayers that is highly partisan, uninformed and lacks reliable foundation and principled reasoning. It is not uncommon to hear generalised accusations of inappropriate behaviour by taxpayers or by the Commissioner that cannot be tested. Taxpayers are sometimes oddly accused of inappropriately taking into account the tax consequences of their transactions when that is precisely what tax legislation requires and must be expected to occur. The Commissioner is similarly criticised at times about so-called heavy-handed or unreasonable conduct towards taxpayers, or groups of taxpayers, in such generalised terms that the complaint cannot adequately be evaluated or assessed in public debate.

Such accusations are often seen in newspapers and public forums, in which meaningful responses are neither appropriate nor possible.⁷ Public debate about individual misconduct cannot result in reliable findings where all parties are given a fair hearing by an impartial and disinterested decision-maker, and measured intervention by academics through reasoned research and principled analysis could do much to find proper paths for future conduct.

Accusations of taxpayers and their advisors being tax cheats, and of the Commissioner being a bad tax administrator, undermine the confidence that the public needs to have in the public administration of a sound, reliable and fair system of taxation. The correct exaction of taxes according to law is an important and fundamental feature of our Constitution, with no person being required by the executive to pay more than Parliament has authorised. The proper payment of that amount is, by parity of reasoning, an obligation of citizenship in an ordered and civil society. Confidence in the administration and application of tax laws is essential: a sound system of taxation needs a strong and serene sense of trust and confidence. Taxpayers and the public need to feel confident that those who administer tax laws are doing so properly, reasonably and fairly. There should be no room for the tax profession and tax administrators to trade public insults and insinuations. Tax administrators should feel confident that tax professionals are robustly acting within the confines of their duties to the law. There needs similarly to be in place robust and reliable systems of accountability and oversight of tax administrators that are both independent and effective, and that enable the public, including taxpayers, to feel confident that administrators are applying the law fairly. There is an important role for tax teachers to lead discussion about the conduct, and its oversight, of those involved in tax practice and tax administration. Taxpayers and tax administrators will each be perceived to be partisan in such a debate, where what is so essential is that there be confidence that the laws are being applied fairly by the revenue and being applied properly by taxpayers and their advisors.

The next particular aspect I would like to mention is an aspect of the curriculum that may not yet have received sufficient attention. The teaching of tax to student or postgraduate

⁶ See Michael Bersten, 'Independence and Accountability of the Commissioner of Taxation' (2002) 12 *Revenue Law Journal* 5.

⁷ See Tom McIroy and Edmund Tadros, 'ATO Calls Out "Reckless" Legal Privilege Claims', *Australian Financial Review Weekend* (5 January 2019) 2.

tax practitioners focuses overwhelmingly upon rules and principles, without perhaps sufficient attention to the process by which decisions are actually made and how they may be effectively influenced. Heuristics and unconscious biases play some part in decision-making, which advocacy, and teaching, should more frequently develop. The process of advocacy is not confined to well-ordered thoughts, elegant presentation and emotive appeals. The process of advocacy requires an understanding of the grinding mechanics of decision-making, with divergent facts, contested issues and evidence scattered throughout the court materials like debris.

It is instructive to look at how issues are framed in cases where the outcome was difficult, as it so frequently is, to see how the framing of questions guide the way in which decision-makers reach outcomes. The logical power of framing an issue can be decisive to the outcome of difficult questions where the answer may not be obvious. One example I have frequently used in my teaching is that of *Cliffs International Inc v Federal Commissioner of Taxation*,⁸ in which a taxpayer had claimed a tax deduction of 15 cents (US) per tonne of ore mined arising from an obligation to pay that amount that had been assumed in a purchase agreement for the shares in a mining company. The Commissioner had treated the payment as part of the purchase price for the shares in the company and, therefore, as a non-deductible capital outgoing. The Commissioner's counsel framed the question for the court as being a need to decide whether the payments were 'for the sale and purchase of an asset',⁹ whilst counsel for the successful taxpayer framed the question within the context of the current regular business outgoings.¹⁰ The account of the argument for the taxpayer in the Commonwealth Law Report is:

The fact of mining, transporting and selling one ton of ore gives rise to obligations. First, the appellant must pay a royalty to the State. Secondly, the consortium mining the ore is obliged by its agreement with the appellant to pay it an amount equal to that royalty. Thirdly, the appellant must pay a royalty of 15 cents (US) to the persons from whom it bought the shares in the mining company. That outgoing is calculated by reference to the amount of income-earning activity which takes place. Applying standard tests, the expenditure has the indicia of a revenue outgoing. The consideration (other than the sum of \$200,000) for the purchase of the shares was executed, namely the promise to make further payments if mining took place. It is not enough only to look at what was acquired to determine the nature of the payment. The asset acquired was different in its nature from that involved in *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation*. The advantage sought by the appellant in agreeing to make the deferred payments was the mineral lease which enabled it to sub-let to the participants in the consortium which was an advantage of a revenue nature: *Federal Commissioner of Taxation v South Australian Battery Makers Pty Ltd*. The question is, what takes from the expenditure the character of revenue expenditure which one would otherwise have unhesitatingly attributed to it? There was no obligation to mine the land. If the appellant had not caused mining to take place, it would not have been obliged to give the shares back. It was well-known that the company was to be wound up. The payments were a cost of mining, analogous to any other payment quantified by use: *Jones v Inland Revenue Commissioners: Commissioner of Stamp Duties (NSW) v Henry*. The purchase was

⁸ (1979) 142 CLR 140.

⁹ Ibid 142.

¹⁰ Ibid 141-2.

consummated when the \$200,000 was paid. The subsequent payments were not for the shares.¹¹

The teaching of tax principles and tax rules are, of course, important, but that teaching can usefully be informed by the significance to outcomes of heuristics and other influences. Unconscious biases affected by such things as reference points created by statute and submissions play their part in critical ways. Achieving outcomes may also be affected by such mundane matters as the mechanical ordering of issues, facts and evidence. Instructing students about the mechanical process by which decisions are made is likely to better inform what practitioners need to do to secure favourable outcomes by leading decision-makers in a way that is helpful and effective. Judges typically end trials with a mass of materials in many places that need coordination and reliable synthesis. Those advocates who can do so reliably are likely to have a greater impact on the mind of the decision-maker.

These are neither idle nor obvious matters. Students who learn a succession of rules ultimately understand little of the law.¹² The student who understands how the rule gets applied in the complex debris of contested facts may have a better understanding of how the rules becomes part of the totality of a particular decision. The student who, in addition, understands the mechanical process of picking up the debris by the judge producing the judgment will have a head start in understanding how tax law gets decided as it does.

GT Pagone
17 January 2019
Verona, Italy

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¹¹ Ibid.

¹² KN Llewellyn, 'Bramble Bush — Some Lectures on Law and Its Study' (Lecture Series, Columbus University School of Law, 1930) 12.

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**PHILISTINES V ELITISTS? A COMPARISON OF AUSTRALIA'S AND NEW ZEALAND'S TAX-BENEFIT
TREATMENT OF COLLECTORS OF ARTWORKS**

JONATHAN BARRETT*

ABSTRACT

After a review of tax concessions granted to collectors of artworks in mature markets, this article considers the tax and benefit treatment of collectors in Australia and New Zealand. Relevant policy considerations are identified and applied to current tax and benefit provisions for Australasian collectors. The question of whether differential treatment of collectors (relative to other investors) can be justified on grounds such as promoting art markets and preserving cultural heritage is discussed. Recommendations are made, and conclusions are then drawn.

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I INTRODUCTION

The nature of art is highly contested,¹ but the general public is likely to consider the things that constitute artistic works under copyright law — paintings, sculptures, drawings, engravings, photographs, and artisanal works with artistic quality² — to be artworks. Provided Indigenous creations, which might be excluded from a traditional Western definition of fine art, such as batiks and weavings,³ are included, this copyright definition of artistic works adequately identifies artworks for the purposes of this article.

France, the UK and the US have mature art markets.⁴ ‘Maturity’, as used here, does not simply connote size. Although the US and the UK currently host the first and second largest art markets,⁵ China’s rapidly expanding art market is much larger than that of France,⁶ but the French market can be considered more mature. The buying and selling of artworks, particularly in Paris, takes place within the context of an art social system,⁷ or art ecosystem,⁸ that comprises well-established schools, ateliers, galleries and museums, auction houses, and clusters of specialisation.⁹ Principal nodes of the global art market, notably London, New York and Paris, have relevant infrastructure and concentrations of expertise; they also have the ‘status, branding, cachet, celebrity, and aesthetics’ that help to ensure optimal pricing of works in that market.¹⁰ In mature markets, collectors are also typically knowledgeable and active participants in the processes of creating, exhibiting

¹ See, for example, Arthur C Danto, *What Art Is* (Yale University Press, 2013).

² See *Copyright Act 1968* (Cth) s 10, definition of ‘artistic work’; *Copyright Act 1994* (NZ) s 2, definition of ‘artistic work’. Artisanal works are problematic under copyright law: see *George Hensher Ltd v Restawhile Upholstery (Lancs) Ltd* [1975] RPC 31. Nevertheless, people are likely to consider, say, an Eames lounge chair to be a work of artistic craftsmanship.

³ Compare *Resale Royalty Right for Visual Artists Act 2009* (Cth) s 7, definition of ‘artwork’.

⁴ Relative to financial markets, it is arguable that all art markets are immature. Olav Velthuis and Erica Coslor observe ‘the financialization of art has been incomplete — or is at least far from finished, especially when compared to other financial markets’. See Olav Velthuis and Erica Coslor, ‘The Financialization of Art’ in Karin Knorr Cetina and Alex Preda (eds), *The Oxford Handbook of the Sociology of Finance* (Oxford University Press, 2013) 471, 480.

⁵ In 2017, the US accounted for 40 per cent of the global art market, and the UK 21 per cent. See Arts Economics, *The British Art Market 2017* (survey prepared for the British Art Market Federation, 2017) <<http://tbamf.org.uk/wp-content/uploads/2014/08/The-British-Art-Market-2017.pdf>>.

⁶ *Ibid.* In 2017, China’s share of the global art market was 20 per cent, while France’s was 7 per cent. See also Darius A Spieth, ‘Art Markets’, *Oxford Art Online* (Web Page, 2019) <<http://www.oxfordartonline.com/page/Art-Markets#>>. Given its population and massive increase in wealth, China will most likely become the dominant player in the art market in the future. In the past 150 years, the centre of the art market has shifted from France to the UK, then to the US, and, perhaps in the future, to China.

⁷ See Niklas Luhmann, *Art as a Social System* (Stanford University Press, 2000).

⁸ See Nathalie Moureau, Dominique Sagot-Duvaurox and Marion Vidal, *Contemporary Art Collectors: The Unsung Influences on the Art Scenes* (Département des études, de la prospective et des statistiques, 2015) 18 <<https://books.openedition.org/deps/935?lang=en>>.

⁹ For example, New York has a strong market for contemporary art, London for ‘Old Masters’, Geneva for watches, and Amsterdam for furniture. See Joerg Wuenschel, ‘Article 95 EC Revisited: Is the Artist’s Resale Right Directive a Community Act beyond EC Competence?’ (2009) 4(2) *Journal of Intellectual Property Law & Practice* 130, 132, n 25.

¹⁰ United States Copyright Office, *Resale Royalties: An Updated Analysis* (December 2013) 57 <<https://www.copyright.gov/docs/resaleroyalty/usco-resaleroyalty.pdf>>.

and marketing artworks. Jurisdictions with such sophisticated art milieus may grant significant tax concessions to private collectors.¹¹

Net wealth taxes,¹² and capital transfer taxes, in particular, often include concessions for collectors.¹³ In order to ‘enlarge public collections and prevent exports of art works’,¹⁴ both France (*dation en paiement*) and the UK (acceptance in lieu) permit a taxpayer to settle their estate tax debt by transferring a culturally important artefact to the state. The Arts Council England operates the ‘acceptance in lieu’ scheme, with a panel of experts determining whether an object is sufficiently ‘pre-eminent’ to be accepted in lieu of monetary settlement of inheritance tax.¹⁵

Artworks may be exempted from capital gains tax (‘CGT’).¹⁶ This concession typically relates to private assets, rather than artworks as such. In France, however, gains from the sale of an artwork or other collectable item are exempted from CGT if the sale price does not exceed €5000 (about AUD8,000).¹⁷ In the US, although collectables are subject to a higher than normal rate of tax,¹⁸ sales of artworks used to qualify for CGT roll-over relief.¹⁹ While that concession has been recently abolished, CGT liability on the proceeds from sales of artworks can be deferred if the proceeds are invested in qualifying Opportunity

¹¹ According to Moureau, Sagot-Duvaurox and Vidal (n 8) 18, ‘[i]n academic literature, there are two different ways of defining a collector. The first takes a non-utilitarian, quantitative approach and determines that one becomes a collector “when one has run out of walls for one’s works” (ie, “one becomes a collector when one no longer views a work as a decorative object”). The second takes a more qualitative approach, emphasising the importance of the selection process. “The collector is guided by a certain taste”.’

¹² The number of OECD countries that levy net wealth taxes fell from 11 in 1990 to four in 2017: see OECD, *The Role and Design of Net Wealth Taxes in the OECD* (Tax Policy Studies No 26, OECD Publishing, 2018) <<https://doi.org/10.1787/9789264290303-en>>. In the face of the *gilets jaunes* (yellow vests) protests, the Macron administration in France, has reportedly considered reinstating its *impôt de solidarité sur la fortune* (wealth tax): see Harriet Agnew, ‘French Government Opens Door to Wealth Tax Concession’, *Financial Times* (online at 6 December 2018) <<https://www.ft.com/content/79d9c18c-f87b-11e8-af46-2022a0b02a6c>>.

¹³ See Ernst & Young, *Worldwide Estate and Inheritance Tax Guide 2017* (EY Private Client Services, 2017) <<https://www.ey.com/ch/en/Publications/20170929-Worldwide-Estate-and-Inheritance-Tax-Guide-2017/download>>.

¹⁴ Annabelle Gauberti, ‘Art Tax Law: A Double-Hedged Sword’, *Legal NewsRoom* (Blog Post, 17 January 2013) <<https://www.lexisnexis.com/legalnewsroom/tax-law/b/stateandlocaltaxation/posts/art-tax-law-a-double-hedged-sword>>.

¹⁵ ‘Acceptance in Lieu’, *Arts Council England* (Web Page) <<https://www.artscouncil.org.uk/tax-incentives/acceptance-lieu>>.

¹⁶ On Austria, Belgium, Germany, Italy, Switzerland, and the UK, see Deloitte, *Fine Art — Direct and Indirect Taxation Aspects, A Masterwork of Complexity* (2016) <<https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-en-artfinance-taxmatrix-16092013.pdf>>.

¹⁷ Annabelle Gauberti, ‘Taxation of Acquisition and Sale of Art Works: Auctions and Private Sales’, *Crefovi* (Web Page, 5 November 2015) <<http://crefovi.com/articles/taxation-of-acquisition-and-sale-of-art-works-auctions-and-private-sales-art-tax-law>>.

¹⁸ Gains on the disposal of collectables are taxed at a maximum rate of 28 per cent — significantly higher than the usual 15 per cent rate applicable to assets held long term. For a discussion, see Andrew Maples and Stewart Karlinsky, ‘The United States Capital Gains Tax Regime and the Proposed New Zealand CGT: Through Adam Smith’s Lens’ (2014) 16(2) *Journal of Australian Taxation* 156.

¹⁹ Georgina Adam reports: ‘The *Tax Cuts and Jobs Act* signed by President Trump in December 2017 saw the elimination of 1031s, or “like-kind exchanges”, a tax vehicle that has been a powerful driver of the US art market in recent years.’ See Georgina Adam, ‘Trump’s Tax Act Offers Potential Tax Havens for Art’, *The Art Newspaper* (online at 3 January 2019) <<https://www.theartnewspaper.com>>.

Zones.²⁰ Under UK law, artworks may attract the favourable CGT treatment accorded to plant with wasting value.²¹

Under the French General Tax Code (*Code général des impôts*), businesses that buy original works of living artists and allocate them to an immobilised asset account can deduct from their income in the year of purchase and the four following years an amount equal to 20 per cent of the purchase price. To obtain this deduction, the business must exhibit the work in a place readily accessible by the public throughout the deduction period.²² Furthermore, according to Nathalie Moureau and her co-authors:²³

The donation of works to a museum either as a gift from hand to hand or through an officially recorded procedure, may confer certain tax benefits. A sum equivalent to 66% of the value of the donation ... may be deducted from income tax, up to a value of 20% of taxable income. Where donations exceed 20% of the collector's taxable income, any remaining balance may be carried over the next five years.

Other tax incentives to promote artists include a TVA (GST) concession,²⁴ which allows registered artists to charge only 5.5 per cent TVA on direct sales of their artworks to collectors.²⁵

In the UK, goods and services that are exempted from value added tax ('VAT') include: admission charges by public authorities or eligible cultural bodies to certain cultural events, such as visits to museums and art exhibitions; and antiques, works of art or similar (as assets of historic houses) sold by private treaty to public collections or used to settle a tax or estate duty debt.²⁶ Furthermore, imported works of art are taxed at an effective rate of 5 per cent,²⁷ rather than the standard rate of 20 per cent. Imported works of art are therefore preferentially taxed, along with perhaps more obviously deserving items, such as children's car seats, but are not exempt, as, for example, children's clothes are. A European Union directive curtailed more favourable treatment of artworks.²⁸ Consequently, jurisdictions outside the European Union may provide more favourable VAT treatment of artworks.²⁹

²⁰ See Act of 22 December 2017, Pub L No 115-97 <<https://www.congress.gov/bill/115th-congress/house-bill/1>>.

²¹ In *HMRC v The Executors of Lord Howard of Henderskelfe* [2014] EWCA 278, the Court of Appeal held that Sir Joshua Reynolds' *Portrait of Omai* (1776) was plant and was therefore deemed by s 44 of the *Taxation of Chargeable Gains Act 1992* (UK) to be a 'wasting asset with a predictable life not exceeding 50 years'. While it may seem unusual that a 240-year-old painting should be considered a wasting asset, it was used to enhance Castle Howard, a commercial venture.

²² *Code général des impôts* (France) art 238 bis AB.

²³ Moureau, Sagot-Duvauroux and Vidal (n 8) 9.

²⁴ *Taxe sur la Valeur Ajoutée*.

²⁵ Gauberti, 'Art Tax Law' (n 14).

²⁶ *Value Added Tax Act 1994* (UK) s 31(1) sch 9, Groups 11 and 13.

²⁷ In terms of s 21(4) of the *Value Added Tax Act 1994* (UK), only 25 per cent of the value is taxable. The term 'work of art' is extensively defined in s 21(6). Compare with the definition of 'artwork' given in *Income Tax Assessment Act 1997* (Cth), s 995.1.

²⁸ See European Commission, 'European Commission Adopts Report on VAT and the Art Market' (Press Release IP/99/274, 28 April 1999) <europa.eu/rapid/press-release_IP-99-274_en.pdf>.

²⁹ Elizabeth R Lash, 'The European VAT: Good for Tax Revenue, Bad for the Commercial Art Market?', *Center for Art Law* (Blog Post, 4 March 2015) <https://itsartlaw.com/2015/03/04/el_vat>.

According to Annabelle Gauberti, in jurisdictions with mature art markets, 'tax law has ... become instrumental in promoting the creation, consolidation and expansion of private collections and patronage'.³⁰ Why? Gauberti boldly states: 'All Western countries have come to the conclusion that, no matter how much the state intervenes to keep art works, artefacts and antiques on its soil and in its museums, *the first and irreplaceable preserver of the national estate is the private owner.*'³¹

The tax-benefit systems of Australia and New Zealand include differential treatment of collectors. Since Australia provides no specific concessions to collectors, its approach might be caricatured as an exercise in philistinism.³² Conversely, New Zealand's preferences for collectors might be considered elitist. In fact, both manifestations of differentiation lack sophisticated policy consideration, and indicate jurisdictions with immature art markets.³³ Annette van den Bosch explains:³⁴

Australians only became serious art collectors in the 1960s. Initially, most collectors, even those who traveled widely, only collected Australian art ... Private collectors collect different works to art museums — they collect more decorative pictures. Private collectors are often surprised when a gift they propose to a state or national gallery is declined ... Inexperienced collectors lacking serious knowledge of art and museum collections can often be misled by an unscrupulous dealer or a belief in the supremacy of their own taste. Public policy and education in the arts varies from state to state and has frequently been the target of budget cuts or a 'back to basics' movement that emphasises literacy and numeracy skills over creative content. *Research on audiences for public galleries in Australia, and public attitudes to the arts, show that there is very restricted understanding of the work and role of an artist in contemporary society.*

The relatively unsophisticated nature of art investment in Australia was reflected in the recommendation of the government's *Super System Review Final Report* ('Cooper Review') that collectables should not be permitted as investments for self-managed

³⁰ Gauberti, 'Art Tax Law' (n 14).

³¹ Ibid (emphasis added). See also Gilbert Paul Verbit, 'France Tries a Wealth Tax' (1991) 12(2) *University of Pennsylvania Journal of International Business Law* 181, 184, n 13, on the expectation that exempting artworks from the wealth tax would keep artworks in France, and encourage French contemporary art.

³² The Cultural Gifts Program permits tax incentives for cultural gift to Australia's public collections. See Australian Government, *Cultural Gifts Program Guide: Tax Incentives for Cultural Gifts to Australia's Public Collections* (2013). Because the programme is not restricted to artworks and essentially covers any property that a public collection is prepared to accept, it will not be considered further in this article.

Australia also operates a resale royalty right scheme for artists (see *Resale Royalty Right for Visual Artists Act 2009* (Cth) and *Tax Laws Amendment (Resale Royalty for Visual Artists) Act 2009* (Cth)), and provides income tax concessions for artists (see 'Income Averaging for Special Professionals 2018', *Australian Taxation Office, Australian Government* (Web Page, 2018) <<https://www.ato.gov.au/Forms/Income-averaging-for-special-professionals-2018>>).

³³ To reiterate, the size of a country's art market does not in itself determine maturity, nevertheless, '[r]elative to the global market for visual art, the Australian market is small. In 2011, Australian auction sales represented 0.6% of the total global auction market.' See 'Global Art Market', *artfacts: (Web Page)* <<http://artfacts.australiacouncil.gov.au/visual-arts/global-10/fact-10-the-global-art-market-is-150-times-bigger-than-the-australian-art-market>>. The New Zealand market is too small to be measured in global comparisons.

³⁴ Annette van den Bosch, 'The Arts End of Superannuation', *The Conversation* (Web Page, 12 April 2011) <<https://theconversation.com/the-arts-end-of-superannuation-495>> (emphasis added).

superannuation funds ('SMSFs').³⁵ Nevertheless, the tax and benefit concessions that are granted merit analysis.

This article is structured as follows: after this Introduction, differential tax and benefit treatment of collectors in Australia and New Zealand is outlined in Section II. In Section III, relevant tax policy considerations are sketched and applied to the differential tax and benefit provisions. Section IV discusses whether differential treatment of collectors (relative to other investors) can be justified on other grounds, such as promoting art markets and preserving cultural heritage. Recommendations are made, and conclusions are then drawn.

II DIFFERENTIAL TAX AND BENEFIT TREATMENT OF COLLECTORS

Since neither Australia nor New Zealand levies net wealth taxes or capital transfer taxes, the significant preferences conferred by some countries through those taxes do not merit further consideration currently. Chapter 3 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth) establishes the tax-preferred goods and services under the Australian GST system. These do not include artworks.³⁶ The *Goods and Services Tax Act 1985* (NZ) seeks to tax all goods and services unless it is impracticable to do so.³⁷ Nevertheless, differential treatment of collectors is present in Australasian tax-benefit systems. This section of the article identifies this differential treatment.

A CGT

New Zealand does not levy a general CGT,³⁸ and is unlikely to introduce such a tax in the foreseeable future.³⁹ Nevertheless, the Tax Working Group ('TWG'), which reported in 2019, in making recommendations that were quite different from Australian law, provided useful points of comparison.

1 Australia

Under Australian law, personal use assets acquired for less than AUD10,000 are disregarded for CGT purposes. Personal use assets include boats, furniture, electrical goods and household items, but exclude collectables. Collectables include paintings,

³⁵ Treasury, Australian Government, *Super System Review Final Report: Part Two Recommendation Packages* (2010) 247 <https://static.treasury.gov.au/uploads/sites/1/2017/06/R2009-001_Final_Report_Part_2_Consolidated.pdf> ('Cooper Review'). On the impact of the regulatory changes following the Cooper Review, see Duncan Hughes, 'Art Lovers Selling Down Collections as SMSF Rule Changes Near', *Financial Review* (online at 18 September 2015) <<https://www.afr.com/personal-finance/superannuation-and-smsfs/art-lovers-selling-down-collections-as-smsf-rule-changes-near-20150915-gjn2r7>>.

³⁶ For a discussion of preferences under the Australian GST system, see Graeme S Cooper and Richard J Vann, 'Implementing the Goods and Services Tax' (1999) 21 *Sydney Law Review* 337.

³⁷ For a discussion of New Zealand's broad-based GST, see Matt Benge, Marie Pallot, and Hamish Slack, 'Possible Lessons for the United States from New Zealand's GST' (2013) 66(2) *National Tax Journal* 479.

³⁸ Certain receipts, which would be treated as capital gains under a CGT, are currently taxable as income under ss CB 3, CB 4 and CB 5 of the *Income Tax Act 2007* (NZ). For a discussion, see John Prebble and Grant Pearson, *Fundamentals of Income Tax* (Thomson Reuters, 2018) 128–9.

³⁹ See, for example, Stacey Kirk, 'Ardern Pushes CGT off the Table', *The Dominion Post* (Wellington, 18 April 2019) 1.

sculptures, drawings, engravings or photographs.⁴⁰ Gains on collectables acquired for less than AUD500 are excluded. Presumably, policymakers consider personal assets to be wasting assets, whereas collectables are not.

2 New Zealand

The TWG not only recommended a CGT but also proposed a blanket personal use asset exemption, including 'jewellery, fine art, taonga [treasures] and other collectables (rare coins, vintage cars etc)'.⁴¹

B Benefit means-testing

Welfare benefits can be broadly distinguished between universal and means-tested versions.⁴² For example, the New Zealand Superannuation is a universal benefit, whereas Australia's Age Pension is means-tested, albeit with a significant asset exemption.⁴³ This section outlines the position of collectors under Australasian means-tests.

1 Australia

The asset means-test for the Age Pension is comprehensive, and includes motor vehicles, boats, personal items, and trading, hobby or investment collections.⁴⁴ The same rules apply to aged care applications.⁴⁵ In short, policymakers draw no distinctions between different types of assets in applying means-testing.

2 New Zealand

For the purposes of ascertaining eligibility for the residential care subsidy ('RCS'), 'exempt assets' include 'personal collectables or family treasures or taonga such as artworks, books, stamps, and antiques'.⁴⁶ Although regulations may prescribe value limits for types of exempt property,⁴⁷ none currently apply to personal collectables, and so forth.

⁴⁰ See *Income Tax Assessment Act 1997* (Cth) sub-divs 108-B and 108-C; 'CGT Assets and Exemptions', *Australian Taxation Office, Australian Government* (Web Page, 16 March 2018) <https://www.ato.gov.au/general/capital-gains-tax/cgt-assets-and-exemptions/#Personal_use_assets>.

See also sub-div 30-A on deductions for gifts you can deduct.

⁴¹ Tax Working Group, New Zealand Government, *Future of Tax: Final Report Volume II — Design Details of the Proposed Extension of Capital Gains Taxation* (21 February 2019) 14 <<https://taxworkinggroup.govt.nz/resources/future-tax-final-report-vol-ii-html>> ('TWG II').

⁴² See, for example, Timothy Besley, 'Means Testing versus Universal Provision in Poverty Alleviation Programmes' (1990) 57(225) *Economica* 119.

⁴³ 'Assets', *Department of Human Services, Australian Government* (Web Page, 25 September 2019) <<https://www.humanservices.gov.au/individuals/enablers/assets/30621#a1>>.

⁴⁴ 'Aged Care Means Test for Residential Care', *Department of Human Services, Australian Government* (Web Page, 2018) <<https://www.humanservices.gov.au/individuals/services/aged-care-means-tests>>.

⁴⁵ *Ibid.*

⁴⁶ See the *Residential Care and Disability Support Services Act 2018* (NZ) s 4 definition of 'exempt assets', read with *Residential Care and Disability Support Services Regulations 2018*, cl 16 and sch 3, pt 1.

Neither legislation nor legislative instruments define 'personal collectables'. Presumably, 'personal' is used to exclude the stock of a professional dealer.

⁴⁷ *Residential Care and Disability Support Services Act 2018* (NZ) s 74(1)(g).

Furthermore, no relation-back provisions appear to prevent converting non-exempt assets into exempt assets, such as artworks.⁴⁸

III TAX-BENEFIT POLICY CONSIDERATIONS

This section of the article considers whether tax and benefit preferences may be justified when measured against usual criteria, in particular, equity and efficiency.

A Usual tax criteria

Tax commentators broadly agree that taxes should be fair and efficient.⁴⁹ Other desirable characteristics include simplicity,⁵⁰ convenience,⁵¹ and neutrality,⁵² sustainability,⁵³ and policy consistency.⁵⁴ The TWG sought to marry New Zealand's developing Living Standards Framework with *Te Ao Māori* (the Māori worldview),⁵⁵ and to situate tax criteria within that specific bicultural context. This was an ambitious goal that sought to extend analysis beyond usual tax criteria. Nevertheless, its analysis of tax policy relied on traditional criteria.⁵⁶

⁴⁸ Under the deprivation of income or property provision, in conducting a means assessment, the Ministry of Social Development can ignore any disposal of property: *Residential Care and Disability Support Services Act 2018* (NZ) s 39(1) and (2). Section 39(3) specifically excludes exempt assets from property. Guidelines issued by the relevant ministries do not clarify the issue. See 'Income and Asset Testing', *Ministry of Health, New Zealand Government* (Web Page, 15 June 2018) <<https://www.health.govt.nz/our-work/life-stages/health-older-people/long-term-residential-care/income-and-asset-testing>>; 'Residential Care Subsidy', *Work and Income, New Zealand Government* (Web Page) <<https://www.workandincome.govt.nz/products/a-z-benefits/residential-care-subsidy.html#null>>.

⁴⁹ Adam Smith's four maxims of taxation included equity and administrative efficiency: Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (Encyclopaedia Britannica, 1952) 361.

⁵⁰ Australian Government, *Reform of the Australian Tax System: Draft White Paper* (1985) included simplicity along with equity and efficiency as the essential criteria for assessing a tax system. John Ralph, Review of Business Taxation, *A Strong Foundation: Establishing Objectives, Principles and Processes* (Discussion Paper, Treasury, Australian Government, 1998) included 'facilitating simplification', with 'optimising economic growth' and 'ensuring equity', as 'national objectives'. Extracts provided in G Cooper, R Krever and R Vann, *Income Taxation: Commentary and Materials* (Australian Tax Practice, 4th ed, 2002).

⁵¹ Smith (n 49) 362.

⁵² Carl S Shoup, *Public Finance* (Aldine, 1969) 21.

⁵³ Sustainability of the revenue base was a particular concern of the 2010 Tax Working Group. See, Tax Working Group, 'A Tax System for New Zealand Future: Report of the Victoria University of Wellington Tax Working Group' (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, January 2010) <<https://www.victoria.ac.nz/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf>>.

⁵⁴ Treasury, Australian Government, *Australia's Future Tax System: Consultation Paper* (10 December 2008) ch 2 <http://taxreview.treasury.gov.au/content/ConsultationPaper.aspx?doc=html/publications/Papers/Consultation_Paper_Summary/Chapter_2.htm>.

⁵⁵ Tax Working Group, New Zealand Government, *Future of Tax: Final Report Volume I — Recommendations* (21 February 2019) 25 <<https://taxworkinggroup.govt.nz/resources/future-tax-final-report-vol-i-html>>.

⁵⁶ Ibid 28.

B Application of usual tax criteria

This section of the article applies the criteria of equity, efficiency, and other relevant considerations to CGT and means-tested benefits.

1 CGT

To reiterate, Australia allows a AUD10,000 exemption for personal use assets, excluding collectables, and a AUD500 exemption for collectables. Conversely, the TWG recommended including collectables in a complete exemption of personal use assets.

(a) Equity

According to the TWG, collectables 'are distinguishable from other types of personal use assets because they are often purchased as investments and are usually *expected* to increase in value'.⁵⁷ Perceptions about investments in art are distorted by the sensational prices artworks created by a select group of artists fetch in a duopoly of auction houses in London and New York. Artworks commonly do not appreciate in value. Indeed, even the works of global 'superstars', such as Damien Hirst, may lose value.⁵⁸ To reiterate, in the sophisticated Parisian contemporary art ecosystem that Moureau and her co-authors studied, collectors do not acquire works with an expectation of making a profit.⁵⁹

It seems likely that genuine collectors gain pleasure from their collections, beyond their potential investment value: for example, no one is likely to collect Star Wars figurines, unless they have a passion for Star Wars movies. The same consideration applies to collectors of artworks, the possibility of speculation in the high end of global markets, notwithstanding. It is then an example of simplistic policy reasoning to assume that collectors intend to and are able to purchase artworks that will necessarily increase in value. It should also be borne in mind that artworks are often fragile and easily destroyed,⁶⁰ and, if tainted as fakes,⁶¹ lose significant, if not all, value.

In the absence of a social judgement that certain types of investments are meritorious and therefore deserve special tax treatment,⁶² it is reasonable to expect government to treat different types of assets with an even hand.⁶³ It would, therefore, be equitable to treat private collectables for CGT purposes in the same way as personal use assets.

⁵⁷ TWG II (n 41) 14 (emphasis added).

⁵⁸ See Tim Schneider, 'A Decade after Damien Hirst's Historic 'Beautiful Inside My Head Forever' Auction, Resale Prices Are Looking Ugly', *Artnet News* (Web Page, 12 September 2018) <<https://news.artnet.com/market/damien-hirst-beautiful-resales-1346528>>.

⁵⁹ Moureau, Sagot-Duvaurox and Vidal (n 8) 15.

⁶⁰ See above n 21 on the apparent paradox of a 240-year-old painting being treated as a wasting asset. But paintings do typically waste. In one estimation, 95–99 per cent of 17th century Dutch paintings no longer exist: see Paul Taylor, *Condition: The Ageing of Art* (Paul Holberton, 2015) 68.

⁶¹ According to van den Bosch (n 34), '[i]n Australia, at any one time there are at least 400 people producing fakes of Aboriginal, historic and contemporary art'.

⁶² On merit wants and goods, see Richard A Musgrave, *The Theory of Public Finance: A Study in Public Economy* (McGraw Hill, 1959) 9–14. It is submitted that a persuasive argument can be raised that artworks constitute merit goods and should, therefore, be taxed preferentially relative to personal use assets. Space does not permit examination of that argument here.

⁶³ See, generally, Richard A Epstein, 'Taxation in a Lockean World' (1986) 4(9) *Social Philosophy and Law* 49.

(b) Efficiency

The TWG noted that '[e]xcluding these types of assets from an extension of the taxation of capital gains may incentivise investment in such assets over more productive assets'.⁶⁴ The proposed CGT would have been levied at marginal income tax rates (33 per cent maximum). Consequently, it is plausible that wealthy individuals might have been incentivised to invest in the global art market in search of tax-free gains. Such an incentive would have been perverse. The risks of investing in the global art market would be significant for individual investors,⁶⁵ and such investments may do nothing to develop the domestic art ecosystem. The Cooper Review recognised that tax concessions should not benefit investors in risky, unregulated forms of investment. The final report stated: 'The principal concern is that the cumulative regulatory and compliance complexities outweigh the potential benefits of allowing such a liberal investment menu to a sector that is not directly prudentially regulated.'⁶⁶

The art market is, indeed, generally recognised as the last unregulated mainstream market,⁶⁷ and, perhaps, the Australian market is in particular need of coherent regulation. In *McBride v Christie's Australia Pty Ltd*,⁶⁸ it was alleged that perhaps as many as one-third of artworks for sale in the Australian market are fakes.⁶⁹ According to Sasha Grishin, in addition to 'nine conflicting federal, state and territorial jurisdictions, lack of a proper catalogue raisonné for the work of most artists as well as a lack of a comprehensive register of fakes creates a fertile playground for crooks, forgers and ignorant collectors'.⁷⁰ (See Section IV.C below on speculation.)

Not only would a full exemption for artworks be economically inefficient, if a sufficient number of investors took advantage of the concession, the sustainability of the revenue base could be affected.

(c) Simplicity

Once policymakers draw distinctions between types of assets for CGT purposes, anomalies and absurdities inevitably arise. The UK distinguishes between personal assets deemed to have a lifespan shorter or longer than 50 years.⁷¹ Stamps, for example, are deemed to have a lifespan of more than 50 years and therefore potentially attract CGT on disposal, whereas antique clocks or watches are deemed to last fewer than 50 years and relevant capital gains are not taxed. Australian policymakers may not have engaged in this

⁶⁴ TWG II (n 41) 14.

⁶⁵ As van den Bosch (n 34) observes: 'The global art market is not a safe place for the average SMSF trustee or fund holder.'

⁶⁶ Cooper Review (n 35) 246.

⁶⁷ See Velthuis and Coslor (n 4) 480.

⁶⁸ [2014] NSWSC 1729.

⁶⁹ See Anne Davies, 'Supreme Court Fraud Case Reveals Corruption in Art Market', *Sydney Morning Herald* (online at 22 July 2014) <<https://www.smh.com.au/entertainment/art-and-design/supreme-court-fraud-case-reveals-corruption-in-art-market-20140721-zvdkz.html>>.

⁷⁰ Sasha Grishin, 'Is That a Whiteley? Why Collectors Buy Lousy Fakes as Masterpieces', *The Conversation* (Web Page, 19 March 2015) <<https://theconversation.com/is-that-a-whiteley-why-collectors-buy-lousy-fakes-as-masterpieces-38832>>.

⁷¹ 'Capital Gains Tax on Personal Possessions', *Gov.UK* (Web Page) <<https://www.gov.uk/capital-gains-tax-personal-possession>>.

degree of pettifoggery but the line between personal use assets and collectables is not clear. Furniture, for example, can be both utilitarian and collectable.

The TWG's proposal 'to exclude these assets for reasons of simplicity and compliance cost reduction' was ill-advised, and the Group appears to have recognised this when it qualified its recommendation, saying '[t]his concession should be monitored and, if necessary, revisited in the future, either entirely or by tax applying over a certain threshold'.⁷² A proportionate simplicity recommendation would be to apply the same cap to personal use assets and collectables.

2 *Benefits*

Unlike Australia, New Zealand only means-tests the RCS.

(a) Equity

In New Zealand, at least, it is arguably unfair that older people must pay for residential care, when healthcare is otherwise funded from general revenue. But, having noted this possibility, equity concerns lie with the class of people who might claim the RCS. If applicant A holds their wealth in shares, and applicant B holds their wealth in collectables, A's wealth will be used to fund their care, whereas B's wealth will be left untouched. It is plausible that having to sell a tangible artwork, rather than, say, intangible shares to fund residential care,⁷³ might cause more disutility to the applicant.⁷⁴ However, it seems unlikely that means-testing policy can accommodate such subjective possibilities. The Australian approach that permits an allowance for all personal property appears more equitable.

(b) Efficiency

Ample evidence exists to demonstrate that New Zealanders use trusts to divest themselves of real property with an eye to avoiding RCS contributions.⁷⁵ No case law or other publicly available documentary evidence exists to indicate that potential RCS applicants are similarly 'abusing' the collectable exemption. Nevertheless, it would be surprising if the elder advisory industry does not take note of this extraordinary concession. Even so, it seems unlikely that the concession has a significant effect on people's economic decision-making — more likely, it may provide an unplanned benefit for a small number of long-term collectors. In practice, however, because they often have a sense of curatorial duty, serious collectors may dispose of their collections as they reach old age from concerns about not being able to properly preserve and protect their

⁷² TWG II (n 41) 14.

⁷³ The shares might, however, be in a company the applicant has spent their working life building, whereas the artwork was purchased a month previously.

⁷⁴ On the concept of personhood property, see Margaret Jane Radin, 'Property and Personhood' (1982) 34 *Stanford Law Review* 957.

⁷⁵ See Jonathan Barrett and Lisa Marriott, 'Income Deprivation and Benefits: The Role of Trusts in New Zealand' (2020) *New Zealand Journal of Taxation Law and Policy* (forthcoming).

artworks.⁷⁶ In short, unlike the TWG's proposed collectables exemption, the RCS concession is likely to be practically trivial, but that does not justify it.

C Concluding comments

CGT is an inherently complex tax, and, once politically necessary exemptions are introduced, its complexity is exacerbated. Every deviation from a fundamental principle that all receipts should be taxed diminishes equity.⁷⁷ Equity is not, however, the only generally accepted tax principle. Efficiency, sustainability and simplicity, among other criteria, should also be considered.

In its recommendations on CGT and personal assets, the TWG elevated simplicity above other more pertinent considerations. Consequently, wealthy people might continue to receive tax-free capital gains by investing in their principal residence and collectables. This possibility would be unfair, inefficient, and potentially unsustainable.

IV DISCUSSION: BROADER POLICY CONSIDERATIONS

This section of the article presents broader policy considerations, in particular, whether grounds beyond traditional tax criteria might justify concessions for collectors. Why do governments in mature art markets privilege collectors?⁷⁸ They recognise, first, that art is socially valuable and, therefore, it is appropriate for the state to take measures to encourage the creation of art; second, they believe that aiding collectors is critical to achieving national cultural goals, such as retaining significant works within domestic collections.

A The social value of art

Art fundamentally contributes to the constitution of a national culture.⁷⁹ Specifically contemplating New Zealand, but expressing an idea that applies to all countries, Hamish Keith says:

The art made here or influenced by this place is the only art that speaks to us directly about our experience. That does not make it better, or worse, than the art of some other place — it just makes it different.⁸⁰

In their research on behalf of the Arts Council England, Andrew Mowlah and his co-authors sorted the social value of the arts and culture they observed into the categories of

⁷⁶ For example, Les and Milly Paris amassed the finest private collection of contemporary New Zealand art but, when Les died, Milly could no longer care for the collection and put it up for auction: see Sophie Speer, 'Artistic Vision Builds Something Special', *The Dominion Post* (online at 30 August 2012) <<http://www.stuff.co.nz/dominion-post/culture/7576393/Artistic-vision-builds-something-special>>.

⁷⁷ See Charles R Hulten and Robert M Schwab, 'A Haig-Simons-Tiebout Comprehensive Income Tax' (1991) 44(1) *National Tax Journal* 67.

⁷⁸ The possibility of policy capture by an elite is noted, but will not be considered further.

⁷⁹ See, generally, Francis Pound, *The Invention of New Zealand: Art & National Identity, 1930–1970* (Auckland University Press, 2009).

⁸⁰ Hamish Keith, *The Big Picture: A History of New Zealand Art from 1642* (Godwit, 2007) 269.

economy, health and well-being, society, and education.⁸¹ These categories are briefly outlined below.

1 *Economy*

The arts contribute directly to the national economy through gross value added, and the multiplier effects of artists and other arts industry workers' spent earnings.⁸² While it is difficult to accurately attribute earnings from tourism to the arts, particularly in mature art ecosystems, art collections do attract tourists.⁸³ At a sub-national level, local governments commonly expect the arts to attract visitors, create jobs and develop skills, attract and retain businesses, revitalise places, and develop talent.⁸⁴ Many cities seek to emulate 'the Bilbao effect' of Frank Gehry's Guggenheim Museum and to have the 'pulling power' of a destination gallery.⁸⁵ In Australasia, destination galleries away from the main metropolitan areas, include the Museum of Old and New Art ('MONA') in Hobart, and the Len Lye Centre at the Govett-Brewster Art Gallery in New Plymouth.

2 *Health and well-being*

A considerable body of literature exists on the health benefits of exposure to the arts.⁸⁶ For example, a comprehensive survey by the Scottish government demonstrated a positive link between engaging in cultural activities, and health and life satisfaction.⁸⁷

3 *Society*

According to Mowlah et al, 'children and young people's engagement with the arts and culture has a knock-on impact on their wider social and civic participation.'⁸⁸

⁸¹ Andrew Mowlah et al, *The Value of Arts and Culture to People and Society: An Evidence Review* (Arts Council England, 2nd ed, 2014).

⁸² Centre for Economics and Business Research, *The Contribution of the Arts and Culture to the National Economy: An Analysis of the Macroeconomic Contribution of the Arts and Culture and of Some of Their Indirect Contributions through Spillover Effects Felt in the Wider Economy* (Report for Arts Council England and the National Museums Directors' Council, May 2013) <https://www.cebr.com/wp-content/uploads/2013/05/CEBR_economic_report_web_version_0513.pdf>.

⁸³ The Museum of Contemporary Art, the Sydney Opera House, and street art in Melbourne may be attractions for overseas tourists in their own right.

⁸⁴ Local Government Association, *Driving Growth through Local Government Investment in the Arts* (March 2013) <<https://www.local.gov.uk/sites/default/files/documents/driving-growth-through-lo-334.pdf>>.

⁸⁵ See Rowan Moore, 'The Bilbao Effect: How Frank Gehry's Guggenheim Started a Global Craze', *The Guardian* (online at 1 October 2017) <<https://www.theguardian.com/artanddesign/2017/oct/01/bilbao-effect-frank-gehry-guggenheim-global-craze>>.

⁸⁶ On the Arts in Health movement, see Jane Macnaughton, Mike White and Rosie Stacy, 'Researching the Benefits of Arts in Health' (2005) 105(5) *Health Education* 332.

⁸⁷ Clare Leadbetter and Niamh O'Connor, *Healthy Attendance? The Impact of Cultural Engagement and Sports Participation on Health and Satisfaction with Life in Scotland* (Scottish Government Social Research, 2013) <<https://www.webarchive.org.uk/wayback/archive/20170118130801/http://www.gov.scot/Publications/2013/08/9956/downloads>>.

⁸⁸ Mowlah et al (n 81) 32. Some evidence exists to indicate that art-related interventions may reduce crime: at 33.

4 Education

Various reports indicate ‘that learning through the arts and culture improves attainment across many other aspects of the school curriculum and has a wealth of other beneficial impacts on young people’.⁸⁹

B Why do people collect artworks?

Various reasons can be adduced to explain why people collect art. Erin Thompson identifies: ‘an ostentatious desire to seem persons of superior taste’;⁹⁰ creating and developing social bonds; establishing perceived associations with notable people; but, she claims, ‘most collectors have little regard for profit’.⁹¹ Whether or not her observations are empirically supported, these reasons for collecting could not plausibly provide grounds for extending tax concessions to collectors — indeed, a sumptuary tax might be indicated. Tax preferences could only be justified if private collecting had identifiable social benefits. Even then, policymakers might feel unease about promoting private ownership of artworks for public benefit. Gauberti argues that, while policymakers in the UK and the US use art tax incentives liberally because they grasp the ‘big picture’, even in France, conflict exists ‘about the social impact of explicitly promoting ownership of art works, to implement a coherent set of incentivising art tax rules’.⁹²

Having researched the behaviour motivations of collectors of contemporary art in Paris, Moureau and her co-authors observe:

Collectors of contemporary art are not merely buyers. They operate on both sides of the market, not only creating demand, but also supply through their involvement in artistic life. Thus, over three quarters of collectors act in a variety of different ways to support those involved in the art ecosystem: the investor may invest in production (orders, financing of catalogues, etc), dissemination (loans for exhibitions, presenting to other collectors, etc), or assistance (financial, material or other support). Collectors’ actions may involve various other parties, eg artists, galleries or indeed institutions.⁹³

C Speculation

In the increasingly globalised art market, a distinction may be drawn between traditional collectors, who often demonstrate public-spiritedness,⁹⁴ and speculators for whom artworks are essentially a tradable commodity or a quasi-currency.⁹⁵ A speculator who, say, keeps an ‘Old Master’ in a bank vault provides no obvious benefit for living artists or the public,⁹⁶ and should not experience any tax encouragement to behave in that way.

⁸⁹ Ibid 35.

⁹⁰ Compare Thorstein Veblen, *Conspicuous Consumption* (Penguin Books, 2006).

⁹¹ Erin Thompson, ‘Why People Collect Art’, *Aeon* (Web Page, 23 August 2016) <<https://aeon.co/essays/what-drives-art-collectors-to-buy-and-display-their-finds>>.

⁹² Gauberti, ‘Art Tax Law’ (n 14).

⁹³ Moureau, Sagot-Duvauroux and Vidal (n 8) 5.

⁹⁴ According to Thompson (n 91), J Paul Getty, being London-based and phobic of air travel, never saw the full collection of works he had accumulated for the Getty Museum in Los Angeles.

⁹⁵ See, for example, *The Price of Everything* (HBO Documentary Films, 2018).

⁹⁶ In order to maintain an artwork’s market value, the collector may ensure its preservation. Future generations might eventually enjoy access to the preserved artwork. Conversely, concentrated storage of

The emergence of free ports for artworks has facilitated speculation. According to Ron Corver:

Free ports are warehouses in free zones, which were — originally — intended as spaces to store merchandise in transit. They have since become popular for the storage of substitute assets, including art, precious stones, antique, gold and wine collections — often on a permanent basis. Apart from secure storage, sales arguments in the free port business include the deferral of import duties and indirect taxes such as VAT or user tax as well as a high degree of secrecy.⁹⁷

In 2012, *The Economist* reported that '[t]he world's largest free ports, in Geneva and Zurich, are each filled with wooden crates believed to hold well over \$10 billion-worth of paintings, sculpture, jewels, gold, carpets and other items'.⁹⁸ Since then, free ports have proliferated.⁹⁹ As John Zarobell observes:

It is difficult to imagine a reason to keep art works in a freeport unless there is speculation going on. If you are a collector of fine art, you want to see and appreciate what you own. But if you are a speculator, all you need is private and secure storage, since you are betting that the work is going to increase in value.¹⁰⁰

D Collective action through charities

Australasian policymakers — in relation to both tax and culture — should be wary of models from countries with mature art markets that emphasise and privilege the role of individual collectors. This does not mean that tax policies should forego opportunities to promote the arts, but should rather develop existing policy. As British-heritage jurisdictions, Australia and New Zealand have long-established and broadly trusted traditions of collective action through charities, and both countries extend significant concessions to charities and their donors.¹⁰¹

Section 12(1)(e) of the *Charities Act 2013* (Cth) includes 'the purpose of advancing culture' as a 'charitable purpose'. New Zealand legislation does not define 'charitable purpose'.

artworks in free ports may lead to an increased risk of catastrophic destruction. See 'Paint Threshold', *The Economist* (online at 1 September 2012) <<https://www.economist.com/finance-and-economics/2012/09/01/paint-threshold>>.

⁹⁷ Ron Korver, Ex-post Evaluation Unit, European Parliament, *Money Laundering and Tax Evasion Risks in Free Ports* (Study at the request of the Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance, European Parliament, October 2018) 5 <[http://www.europarl.europa.eu/RegData/etudes/STUD/2018/627114/EPRS_STU\(2018\)627114_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/627114/EPRS_STU(2018)627114_EN.pdf)>.

⁹⁸ 'Paint Threshold' (n 96).

⁹⁹ See, for example, Graham Bowley and Doreen Carvajal, 'One of the World's Greatest Art Collections Hides behind This Fence', *The New York Times* (online at 28 May 2016) <<https://www.nytimes.com/2016/05/29/arts/design/one-of-the-worlds-greatest-art-collections-hides-behind-this-fence.html>>.

¹⁰⁰ John Zarobell, *Art and the Global Economy* (University of California Press, 2017) 235–6.

¹⁰¹ See, for example, *Income Tax Act 2007* (NZ) ss CW 41, CW 42, CW 43. Section CW 41 exempts the non-business income of charities. Section CW 42 exempts the business income of charities, but only to the extent that income is applied for charitable purposes within New Zealand. Subject to a minimum donation of NZD5, individuals may claim a tax credit of 33½ per cent of their aggregate annual donations. See *Income Tax Act 2007* (NZ) ss LD 1–LD 3. The total gifts that qualify for the tax credit may not exceed the individual's taxable income: *Tax Administration Act 1994* (NZ) s 41A(3).

Under the common law,¹⁰² a charity must be for the public benefit and have the purpose of relieving poverty, advancing education, advancing religion, or benefitting the community. Promotion of the arts has been found to satisfy that essential criterion. In *Royal Choral Society v Inland Revenue Commissioners*,¹⁰³ Lord Greene MR observed 'the education of artistic taste is one of the most important things in the development of a civilised human being'.¹⁰⁴ Furthering the arts in this way is included in the well-established category of education, but the general promotion of art has also been deemed to be a charitable purpose,¹⁰⁵ and gifts to art galleries have been found to be charitable in nature.¹⁰⁶

E Recommendations

It seems likely that promoting the arts in the public sphere and improving the economic well-being of artists are goals most effectively pursued through direct grants and subsidies.¹⁰⁷ A CGT exemption might also assist in achieving these objectives, but could be disproportionate. For example, while roll-over relief in the US generally benefitted the art market, it may have been a disproportionate way of promoting public access to the arts or helping those artists most in need, and is likely to have encouraged speculation.

In immature art markets, such as those of Australia and New Zealand, removing barriers to collecting works of local artists may be a more appropriate policy goal than seeking to provide incentives to collectors. To this end, no distinction should be drawn, as Australia does, between personal use and collectable assets, because a nudge towards personal use assets may discourage investment in artworks. Conversely, a cap on exempted personal use assets, if applied equally to collectables, might encourage purchases of less expensive artworks created by emerging local artists. While the New Zealand government has not taken up the TWG's recommendation for a CGT, the Group's proposed exemptions for collectables illuminate the unnecessary discrimination between personal use assets and collectables under Australian law. Finally, for more valuable artworks, a rebate might apply for public display. For example, if an owner lends an artwork to a public gallery for half the period they own it, a 50 per cent rebate could apply to any gain on disposal.

If Australasian art ecosystems were to develop to the sophisticated level exemplified by the Parisian collectors studied by Moureau and her co-authors, should we expect similar tax privileges? The answer must be resoundingly negative. The UK's VAT privileging of entrance fees to museums and galleries might present an example to be followed. But 'corrupting' its pure GST would be unthinkable in New Zealand, and introducing further complexity to the Australian GST system would be counter-productive. Besides, in Australasia, entrance to general exhibitions hosted by public museums and galleries is

¹⁰² See *Commissioner of Income Tax v Pemsell* [1891] AC 531.

¹⁰³ [1943] 2 All ER 101.

¹⁰⁴ *Ibid* 105.

¹⁰⁵ *Crystal Palace Trustees v Minister of Town and Country Planning* [1951] Ch 132.

¹⁰⁶ Donald Poirier, *Charity Law in New Zealand* (Department of Internal Affairs, New Zealand Government, 2013) 221.

¹⁰⁷ See, for example, Daniel Reid, 'An American Vision of Federal Arts Subsidies: Why and How the US Government Should Support Artistic Expression' (2009) 21 *Yale Journal of Law & the Humanities* 361.

usually free.¹⁰⁸ Focused grants and subsidies, revisited in annual budgets, are more effective than tax privileges that may become entrenched and therefore politically difficult to remove. Individual collectors do contribute to the constitution of national culture, but collective action through regulated and tax-privileged charities seems a more preferable option for Australia and New Zealand. Furthermore, as the European Union has discovered, extending tax concessions to collectors can facilitate abuse by speculators and criminals.¹⁰⁹

V CONCLUSION

This article has surveyed the types of tax concessions collectors enjoy in the mature art markets of France, the UK and the US, and compared these privileges with the tax-benefit treatment of collectors in Australia and New Zealand, countries with relatively immature art ecosystems.

Australia's inclusion of all types of assets in its superannuation and residential care means-test, coupled with a significant allowance, is preferable to New Zealand's blanket exemption of personal collectables. On the one hand, policies should encourage investment in domestic art because that promotes national culture, but, on the other hand, investment in the general economy should not be discouraged. The TWG's proposal of excluding all collectables from a putative CGT net on simplicity grounds was disproportionate and, unlike the RCS exemption, could have led to significant and undesirable economic distortions. Conversely, Australia's CGT approach to collectables sends odd signals to taxpayers. Surely, buying, say, a boat should not be privileged over buying an artwork? An appropriate approach would lie with allowing a AUD10,000 for all personal assets, including collectables. Australian tax-benefit policy in relation to the arts is not a manifestation of philistinism, and New Zealand has not opted for elitism, but relevant policy in both countries merits further consideration.

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¹⁰⁸ Despite being a private museum, MONA provides free access to Tasmanians and people under the age of 18.

¹⁰⁹ European Parliament, *P8_TA-PROV(2019)0240: Report on Financial Crimes, Tax Evasion and Tax Avoidance — European Parliament Resolution of 26 March 2019 on Financial Crimes, Tax Evasion and Tax Avoidance (2018/2121(INI))* (2019) <[http://www.europarl.europa.eu/cmsdata/162244/P8_TA-PROV\(2019\)0240.pdf](http://www.europarl.europa.eu/cmsdata/162244/P8_TA-PROV(2019)0240.pdf)>.

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**FACTORS THAT INFLUENCE TAX EVASION PERCEPTIONS IN AUSTRALIA AND TURKEY: A
STRUCTURAL EQUATION MODEL STUDY**

KEN DEVOS* AND METIN ARGAN†

ABSTRACT

The tax literature indicates that many factors impact upon and influence tax evasion and non-compliant behaviour. This study makes a contribution to the literature by investigating specific economic and tax variables that influence tax evasion perceptions. By employing a structural equation model using self-reported taxpayer data from both Australia and Turkey, the study examines the structural relationships between national well-being, life satisfaction, tax involvement and tax evasion. The findings reveal that significant positive and negative relationships exist between the selected variables. The results will be of interest to the Australian and Turkish governments, and have implications for tax policy development in both countries.

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I INTRODUCTION

The tax literature indicates that many factors impact upon and influence tax evasion and non-compliant behaviour. In particular, it is well documented in the tax literature that fairness of the tax system,¹ compliance and enforcement,² and taxpayer morals and ethics,³ all play key roles in determining levels of tax evasion. In the economic literature, there has been evidence of other factors that have impacted upon economic growth and the well-being of a country's citizens. These include the issues of rivalry amongst individuals regarding income levels, overestimation of the benefits of increased consumption, and generally a level of inequality in society.⁴ These later economic factors have also influenced tax evasion behaviour.

However, it is evident that, while tax and economic studies have investigated these factors independently, there are few that have combined the factors into a truly interdisciplinary study. This paper proposes to overcome this research gap, and makes a contribution to the existing literature by investigating three specific economic and tax factors that impact upon tax evasion perceptions. The study uniquely employs a structural equation model ('SEM'), and in particular explores the relationships between national well-being and life satisfaction, tax involvement and life satisfaction, as well as life satisfaction and tax evasion. Following a recent study investigating tax evasion attitudes in Australia and Turkey,⁵ this study builds on that prior research by examining three distinct relationships in an SEM, employing self-reported taxpayer data from both Australia and Turkey.

The rationale for comparing Australia and Turkey was the diverse, economic, religious and cultural differences that exist between the two countries, and how those differences may potentially impact upon the results. The Australian legal system is based on common law, while Turkey is a civil law jurisdiction. Australian society is of predominately Christian belief, while Turkey is predominately of Muslim belief. Australian culture is largely a mix of Anglo-Saxon and Aboriginal, although arguments could be mounted for a more multicultural society nowadays, while Turkey has strong European and Middle Eastern ties.⁶ Collaboration between Australian and Turkish universities was established to conduct the research, which reports on the opinions of both Turkish and Australian taxpayers with regards to tax evasion.

¹ Frank Cowell, 'Tax Evasion and Inequity' (December 1992) 13(4) *Journal of Economic Psychology* 521.

² Joel Slemrod, *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan Press, 1992).

³ Michael Wenzel, 'The Social Side of Sanctions: Personal and Social Norms as Moderators of Deterrence' (Conference Paper, Centre for Tax System Integrity Canberra Conference, Australian National University, 2003); Kristina Murphy, 'The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders' (2004) 28 *Law and Human Behaviour* 187.

⁴ Thomas Griffith, 'Progressive Taxation and Happiness' (2004) 45 *Boston College Law Review* 1363.

⁵ Robert McGee, Ken Devos and Serkan Benk, 'Attitudes toward Tax Evasion in Turkey and Australia: A Comparative Study' (2016) 5(10) *Social Sciences* 1. This study employed student data as opposed to real taxpayers.

⁶ *Ibid* 11.

This paper is structured as follows. After the introduction, a brief background of both the Australian and Turkish tax systems is provided in Section II. This is followed by a review of the relevant literature and the development of the hypotheses to be tested in this study in Section III. Section IV proceeds to describe the research method, including the various measures and sampling employed. Section V provides a discussion and analysis of the research results, including participant demographics, statistical analysis of the variables employed and the SEM. Finally, Section VI concludes by summarising the main findings and tax policy implications, and notes the study's qualifications and possible avenues for future research.

II BRIEF OVERVIEW OF THE AUSTRALIAN AND TURKISH TAX SYSTEMS

A The Australian tax system

Australia operates under a self-assessment tax system, whereby citizens lodge their tax return (either tax agent-assisted or not) based on an honest disclosure. The tax return information is taken as correct and will only be verified upon an audit, whereby any discrepancies may be subject to penalty. The Australian Taxation Office ('ATO') has enormous capacity to deal with the administration of some 15 million tax returns, along with the educational and enforcement activities it conducts. The Australian government's power to impose taxes comes from the Australian Constitution. Section 51(ii) of the Constitution grants the government power to impose laws with regards to the collection and administration of taxes.⁷

Compliance levels are relatively high despite having one of the more complex tax systems in the world, based on a number of legislative acts. However, as a result of the complex nature of the tax law and relatively high tax rates (income tax is payable at progressive rates, and the goods and services tax ('GST') rate is 10 per cent), there has been evidence of tax evasion and avoidance, which the government has placed greater emphasis on targeting in recent years.⁸ In particular, the ATO has identified evidence of tax evasion activity — for example, through certain labour hire arrangements that use discretionary trusts to split income, diversion of personal services income to self-managed super funds, and other arrangements that exploit mismatches between trust and taxable income.⁹

⁷ Kerrie Sadiq et al, *Principles of Taxation Law 2019* (Thomson Reuters, 12th ed, 2019).

⁸ The government introduced multinational anti-avoidance legislation in 2016, and a diverted profits tax of 40 per cent in 2017, to assist in curbing tax avoidance by multinational corporations. Additional resources in the 2019 Federal Budget have also been allocated to assist in this regard, signalling the government's intension to reduce avoidance.

⁹ 'Schemes We Have Identified', *Australian Taxation Office, Australian Government* (Web Page, 19 June 2018) <<https://www.ato.gov.au/general/tax-planning/tax-avoidance-schemes/schemes-we-have-identified/cited>>.

B The Turkish tax system

The power to tax in Turkey is found in the Foundation Decree, where the duties of the Department of Taxpayer Services are also outlined.¹⁰ There are three main types of taxes in Turkey, which are derived from various sources. These include income tax, expenditure and wealth taxes. Income tax is imposed upon both individuals and corporations, with progressive tax rates applying to various income brackets for individuals. Withholding tax on wages varies with income level, while the corporate tax rate was fixed at 22 per cent in the 2018 tax year. Taxes on expenditures include value added tax at a standard rate of 18 per cent, with a reduced rate of 8 per cent for applicable basic foodstuffs, for example. Taxes on wealth mainly cover real estate and motor vehicles.

There has been evidence of tax evasion and avoidance in Turkey, which has taken the form of 'undocumented commercial transactions', while the results of auditing activities revealed that there was some TL38,715,354,158 discrepancy in assessments for the year ended 2005.¹¹ Despite government efforts to target this tax discrepancy in recent years, arguably tax evasion is already widespread due to the large presence of the informal economy.

III LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The following section reviews the literature on the key variables employed in this study, namely tax involvement, national well-being, life satisfaction and tax evasion. The relevant research hypotheses to be tested in this study include:

H1: The level of a person's tax involvement has a positive effect on their level of life satisfaction.

H2: The level of a person's national and subject well-being has a positive effect on their level of life satisfaction.

H3: The level of a person's life satisfaction has a negative effect on their level of tax evasion.

A Tax involvement

There appears to be no specific definition of 'tax involvement' outlined in the literature, but it has previously been described as consisting of three factors. First, what role or ideal does tax play in a person's life, and how central is it to the person's functionality. Second, how does a person think about tax, and are they conscious of what role tax plays in society. Third, does taxation have any particular purpose or meaning in a person's life.¹²

¹⁰ Presidency of Revenue Administration, Department of Taxpayer Services, Turkish Government, *Taxation in Turkey* (Publication No 21, September 2006) 33 <https://www.gib.gov.tr/sites/default/files/fileadmin/user_upload/yayinlar/Taxation.pdf>.

¹¹ Ibid 41.

¹² Takanori Sumino, 'Level or Concentration? A Cross-National Analysis of Public Attitudes towards Taxation Policies' (2016) *Social Indicators Research* 129, 1115-34; Valerie Braithwaite, 'How Do Australians Think about Tax' (Seminar Paper, 'Public Perceptions: Making the Connection between Tax Investment and Return', Per Capita Working Seminar, :7 July 2009).

Other studies have also developed and defined the concept of tax involvement from the perspective of self-interest, for example, focusing on how Australians think about tax, and discovering that tax outcomes and processes need to be respectful of people's self-interest.¹³ This, in particular, pertains to the democratic collective self that expects government to deliver in exchange for taxpayer cooperation, and expects to be respected as a citizen. This would include a taxpayer's trust in the tax authority.¹⁴

Tax involvement may also encompass a person's competitive self that aspires to wealth, power and status in some cases, and to job, family and home in others. In particular, a taxpayer's opportunity for investment and prosperity are considered along with their opportunity for tax minimisation and avoidance.¹⁵ For example, if a person wants to be a good person, and seen as honest and law abiding, their tax involvement will be acceptable to the tax authority.¹⁶ This would also encompass a taxpayer's attitude towards tax evasion and the employment of ethical tax advisers to ensure a plausible outcome is achieved. Clearly all these elements are critical in determining how connected and involved a person is with taxation.

A self-interest approach is equally applicable to an analysis of an individual's preferences and involvement in taxation, as was discovered by Sumino.¹⁷ The findings of Sumino's study strongly support an institutionalist understanding of tax behaviour. In particular the results reveal that attitudinal differences among different income groups become more salient in higher-taxed societies.¹⁸ Based on these results, Sumino concluded that 'tax targeting' does not have an interactional effect on the income-attitude linkage. Rather, relative to tax level, concentrated taxation might be invisible or hidden to ordinary citizens.¹⁹ Consequently, if taxpayers do not notice the degree of tax concentration in their country then it is not surprising that they fail to react to tax policies, or that the burden of tax policies are high in comparison to the expected benefits.²⁰ As such, taxpayers have little tax involvement, understanding or interest.

Evidence of how different people think about tax and the role it plays in society was uncovered in a study by Lim, Slemrod and Wilking.²¹ Their study aimed to investigate the views of both tax experts and the general public regarding various tax policy issues. Not surprisingly, given the different level of tax involvement and tax knowledge of the two samples, strikingly different views were discovered. In particular, the tax experts were largely in favour of the government's role in the redistribution of tax revenues, while the general public were not. This could be attributed to experts being trained to think of policy changes in a balanced-budget framework, whereas the general public are not.²² It is also acknowledged that differences in demographics, values and views about the

¹³ Braithwaite (n 12).

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ Sumino (n 12).

¹⁸ *Ibid* 1131.

¹⁹ *Ibid.*

²⁰ *Ibid* 1131–2.

²¹ Diane Lim, Joel Slemrod and Eleanor Wilking, 'Expert and Public Attitudes towards Tax Policy' (2013) 66(4) *National Tax Journal* 775.

²² *Ibid* 803.

economic consequences of tax policy alternatives may have also contributed to the differentiated results.²³

The self-interest argument explaining levels of tax involvement was also uncovered by Braithwaite.²⁴ Braithwaite employed an SEM to gauge taxpayer attitudes to tax policy, and in particular GST. Self-interest was a significant factor in shaping attitudes, with those feeling the tax burden expressing support for the goal of taxation efficiency.²⁵ Self-interest was found to be relevant and had a role to play in policy evaluation and tax involvement. Self-interest can also be gauged by how much a taxpayer thinks about taxation implications for themselves. For example, Prabhakar found that principles are important in shaping public attitudes to taxation, and that, in particular, people think about both the benefits and costs of taxation.²⁶ Although Prabhakar's findings revealed that the public makes systematic mistakes about taxation and that tax knowledge is lacking, they suggested that while the majority of taxpayers may not be directly involved in the tax system there is evidence of thought and consideration towards tax.²⁷

For the purposes of this study, the following definition of tax involvement is adopted: the role or ideal tax plays in a person's life; how central it is to the person's functionality; how a person thinks about tax; the role tax plays in society; and whether taxation has any particular purpose or meaning in a person's life.

B Life satisfaction

Life satisfaction refers to a cognitive judgemental process, and has been defined as 'a global assessment of a person's quality of life according to his/her chosen criteria'.²⁸ It is important to note that the key factor here is having personal criteria and values in which to gauge overall life satisfaction. It is not imposed externally, and different components of life will matter more or less for different individuals. Besides the affective emotional aspects of the life satisfaction construct, the cognitive-judgemental aspects are critical, and hence accurate measurement requires a multi-item scale, according to work carried out by Diener et al,²⁹ which is employed in this study.

It is also evident that life satisfaction may vary greatly depending on an individual's circumstances, and may or may not necessarily be related to happiness. For example, an important aspect of happiness and life satisfaction is the inclination to have more money. However, do individuals overestimate and misjudge the value of money? Additional happiness does not necessarily come with additional consumption.³⁰ Most people think that a 25 per cent increase in their pay would greatly increase their satisfaction with their

²³ Ibid 798.

²⁴ Braithwaite (n 12).

²⁵ Ibid.

²⁶ Rajiv Prabhakar, 'What Do the Public Think of Taxation? Evidence from a Focus Group Study in England' (2012) 22(1) *Journal of European Social Policy* 77.

²⁷ Ibid 81.

²⁸ Doh Shin and Dan Johnson, 'A Vowed Happiness as an Overall Assessment of the Quality of Life' (1978) 5 *Social Indicators Research* 474.

²⁹ Ed Diener et al, 'The Satisfaction with Life Scale' (1985) 49 *Journal of Personality Assessment* 71; see also Ken Devos, 'The Impact of Life Satisfaction on Tax Evasion Perceptions in Australia' (2017) 8(3) *International Journal of Advanced Biotechnology and Research* 197.

³⁰ Griffith (n 4); Devos (n 29).

lives, but individuals who are currently at that level do not report greater life satisfaction.³¹ Aspiration theory holds that an individual's aspirational level rises as income rises, and this aspirational level is somewhat higher than their current income.³² The actual increase in welfare is less than what actually occurs and, as such, the income increase can be disappointing.³³

In addition to studies on income and welfare, data on life satisfaction and happiness has also been taken to be a direct proxy for utility. Frijters, Johnston and Shields employed life satisfaction data to examine the issue of optimal taxation.³⁴ Employing Australian data, the study found that under an optimal scheme those with the lowest marginal satisfaction with income would be taxed more heavily in favour of those with the higher marginal satisfaction with income.³⁵ The results would be indicative of whether or not current transfer policies manage to tax those with little marginal satisfaction with income compared to those with higher marginal satisfaction with income.³⁶ The exception was younger, single Australians who are taxed far more heavily than their high marginal satisfaction with income would predict.³⁷ These findings may have implications for tax evasion motivations, in that those who believe they are unfairly overtaxed may potentially evade tax.³⁸

In examining life satisfaction levels, changes in aspirational levels may diminish the gains from additional consumption.³⁹ Consequently, if increased working hours results in additional taxes and less leisure time, it is possible this will be a disincentive for people to work harder/longer. In this case, the opposite effect of decreased working hours resulting in less money may encourage tax evasion, as people look for other ways to fill the income void. People may look for the additional income/benefits via tax evasion rather than earning it by conducting extra work.⁴⁰ This study adopts the above definition of life satisfaction as 'a global assessment of a person's quality of life according to his/her chosen criteria'.⁴¹

As indicated by Braithwaite, self-interest is a major factor or reason why people get involved with taxation.⁴² That is, there is a natural desire to become more prosperous or wealthy by understanding and appreciating the intricacies of taxation. Further, both Griffith and Lane found that having greater wealth and utility contributes to higher life satisfaction.⁴³ Consequently, this study examines the relationship between these two

³¹ Robert Lane, *The Loss of Happiness in Market Democracies* (Yale University Press, 2000); Devos (n 29).

³² Lane (n 31).

³³ Ed Diener and Eunkook Mark Suh, 'National Differences in Subject Well Being' in Daniel Kahneman, Ed Diener and Norbert Schwarz (eds), *Well-being: The Foundations of Hedonic Psychology* (Russell Sage Foundation, 1999) ch 22, 434, 435; Devos (n 29).

³⁴ Paul Frijters, David Johnston and Michael Shields, 'The Optimality of Tax Transfers: What Does Life Satisfaction Data Tell Us?' (2012) 13 *Journal of Happiness Studies* 821; see also Devos (n 29).

³⁵ Frijters, Johnston and Shields (n 34).

³⁶ *Ibid*; see also Devos (n 29).

³⁷ Frijters, Johnston and Shields (n 34); Devos (n 29).

³⁸ See also Devos (n 29).

³⁹ Griffith (n 4).

⁴⁰ *Ibid*.

⁴¹ Shin and Johnson (n 28).

⁴² Braithwaite (n 12).

⁴³ Griffith (n 4); Lane (n 31).

variables and hypothesises that the level of a person's tax involvement has a positive effect on their level of life satisfaction.

C National and subject well-being

The concept of national well-being is interpreted very widely and is often aligned with the concept of subject well-being in the literature. A common feature in the subject well-being literature is the assumption that the net resources of a person matter, whether they are aware of it or not, and that individuals with a higher living standard generally experience higher subject well-being levels.⁴⁴

Subject well-being as a subset of national well-being can also be considered in a cultural context. Davey and Rato found that subject well-being was normative in samples with varied socio-economic variables.⁴⁵ They examined China's personal well-being scores for citizens in Hong Kong, Macau and Zhuhai, and found that they were similar despite different cultural, societal and wealth issues.⁴⁶ The study indicated that improved living standards for China's growing middle class has had minimal influence on subject well-being.⁴⁷ So where the economic situation has improved in absolute terms, the taxpayers' relative income position has deteriorated due to rising income inequality.⁴⁸

There are similar findings in Western nations, where there is a gap between incomes and material aspirations and where money and materialism bring costs as well as benefits.⁴⁹ In this regard, the comparison of national well-being in both Australia and Turkey in the present study should also provide further insights as to whether differences in the culture, religion and legal systems of each country have implications for tax evasion.

Likewise, Oishi et al suggest that indicators of citizen's cognitive judgements of their society are also important, and include trust in national institutions, tolerance, social cohesion, social trust and fear of crime.⁵⁰ The general class of subjective indicators include measures of people's attitudes and values, evaluations, and perceptions as derived from their own experiences.⁵¹ Hence, the presence of money and financial gain alone as an indicator of national well-being becomes questionable, as is the case with life satisfaction.

Consequently, the literature appears to be mixed with regards to what constitutes both subject and national well-being. Griffith indicates that people tend to overestimate the benefits of additional consumption and wealth, and that this does not necessarily lead to

⁴⁴ Alpaslan Akay et al, 'Happy Taxpayers? Income Taxation and Well-Being' (Discussion Paper No 6999, Institute of Labor Economics, 2012).

⁴⁵ Gareth Davey and Ricardo Rato, 'Subjective Wellbeing in China: A Review' (2012) 13 *Journal of Happiness Studies* 333.

⁴⁶ Ibid 344.

⁴⁷ Ibid.

⁴⁸ Hilke Brockmann et al, 'The China Puzzle: Falling Happiness in a Rising Economy' (2009) 10(4) *Journal of Happiness Studies* 387.

⁴⁹ Davey and Rato (n 45).

⁵⁰ Shigehiro Oishi, Ulrich Schimmack and Ed Diener, 'Progressive Taxation and the Subjective Well-Being of Nations' (2012) 23(1) *Psychological Science* 86.

⁵¹ Ibid 90.

greater life satisfaction.⁵² Rather, Oishi et al indicate that it is people's values, attitudes and perceptions towards life that are critical in assessing national well-being.⁵³ However, if greater wealth and utility contribute to a higher standard of living it is possible that both subject and national well-being have also been enhanced.

This study adopts the above definition of subject and national well-being, which is aligned to people's values, attitudes and perceptions towards life. Therefore, the study proceeds to examine the relationship between these two variables, and hypothesises that the level of a taxpayer's national and subject well-being has a positive effect on the level of a taxpayer's life satisfaction.

D Tax evasion

Tax evasion can be described as the illegal non-payment of tax properly owing under the law. It is distinguished from tax avoidance, which is legal but against the spirit of the law, and tax planning, which can also be described as tax minimisation, which is within both the spirit and legal confines of the law. However, a blurring between tax avoidance and tax evasion has come about through an increase in aggressive tax planning. As taxpayers rigorously try to plan to pay less tax, they run the risk of going too far, and their actions can consequently result in tax evasion. Tax evasion has also been defined as intentional non-compliance, and this definition has been adopted in this paper. A review of the literature indicates that there are numerous factors that have influenced and impacted upon tax evasion over the years, but it is unclear whether life satisfaction per se has had an impact upon tax evasion perceptions.⁵⁴

Ajzen and Fishbein found that taxpayers' behaviour is directly determined by their intentions, which are a function of their attitude towards behaviour and perception of social norms.⁵⁵ This infers that tax evasion motivations could arise as a result of people's peers and community standards. Other researchers have concluded that tax evasion could also be influenced by educating taxpayers of their social responsibility to pay.⁵⁶

Other social and psychology studies have found that the fairness and equity of a tax system also impacts upon compliance and evasion.⁵⁷ In particular, the notion of 'exchange equity' (where taxpayers believe they are not receiving the benefits from the government in exchange for taxes paid) affects compliance. Wallschutzky found that the exchange relationship was the most important hypothesis explaining why taxpayers who evaded

⁵² Griffith (n 4).

⁵³ Oishi, Schimmack and Diener (n 50).

⁵⁴ Marianne Richardson and Adrian Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137; Betty Jackson and Valerie Milliron, 'Tax Compliance Research: Findings, Problems and Prospects' (1986) 5 *Journal of Accounting Literature* 125.

⁵⁵ Icek Ajzen and Martin Fishbein, *Understanding Attitudes and Predicting Social Behavior* (Prentice Hall, 1980).

⁵⁶ Robert Cialdini, 'Social Motivations to Comply: Norms, Values and Principles' in Jeffrey A Roth and John T Scholz (eds), *Taxpayer Compliance: Social Science Perspectives* (University of Pennsylvania Press, 1989) vol 2, 200.

⁵⁷ Ian Wallschutzky, 'Possible Causes of Tax Evasion' (1984) 5(4) *Journal of Economic Psychology* 371.

tax felt justified in doing so.⁵⁸ Wallschutzky also found that the burden of taxes was the main justification for increased levels of tax evasion and that tax advisers were perceived to have a significant impact upon taxpayers avoiding tax.⁵⁹

Social psychology studies have also examined the impact of ethics and moral values upon tax evasion. Indeed, much of the empirical work that has been carried out by social researchers in this area tends to refute the economic model of compliance (that is, that taxpayers are utility maximising creatures who only weigh up the expected costs of non-compliance against the potential gains) in its basic form.⁶⁰ For example, it has been demonstrated, by means of laboratory experiments,⁶¹ that even where the deterrence factor is so low that evasion makes obvious economic sense, some individuals nevertheless comply due to their high tax morals and values.⁶²

Historically, there have been three main views regarding the morality of tax evasion.⁶³ At one extreme is the first main view, that evading taxes is immoral and that one has an absolute duty to pay whatever taxes the government demands. Several justifications have been given for this position, based on religious and authoritarian grounds.⁶⁴ At the other extreme is the second main view, that evading taxes is never immoral. Those who espouse this view often believe that all governments are illegitimate and need not be obeyed or supported financially.⁶⁵ The third main view is that tax evasion may be justified on moral grounds sometimes. This view is the prevalent view in the theological, philosophical and empirical literature.⁶⁶

⁵⁸ Ian Wallschutzky, 'Taxpayer Attitudes to Tax Avoidance and Evasion' (Research Study No 1, Australian Tax Research Foundation, 1985), as cited in Ken Devos, 'An Investigation into Australian Personal "Tax Evaders" — Their Attitudes towards Compliance and the Penalties for Non-Compliance' (December 2009) 19 *Revenue Law Journal* 1; see also Devos (n 29).

⁵⁹ Wallschutzky, 'Taxpayer Attitudes' (n 58).

⁶⁰ Devos, 'An Investigation into Australian Personal "Tax Evaders"' (n 58).

⁶¹ James Alm, Isabel Sanchez and Ana De Juan, 'Economic and Noneconomic Factors in Tax Compliance' (1995) 48(1) *Kyklos* 3.

⁶² Devos, 'An Investigation into Australian Personal "Tax Evaders"' (n 58).

⁶³ Robert McGee, 'The Ethics of Tax Evasion: A Survey of Romanian Business Students and Faculty' (Working Paper Series, Andreas School of Business, September 2005), reprinted in RW McGee and GG Preobragenskaya, *Accounting and Financial System Reform in Eastern Europe and Asia* (Springer, 2006) 299; RW McGee, M Basic and M Tyler, 'The Ethics of Tax Evasion: A Survey of Bosnian Opinion' (2009) 11(2) *Journal of Balkan and Near Eastern Studies* 197; Martin Crowe, *The Moral Obligation of Paying Just Taxes* (Catholic University of America Press, 1944).

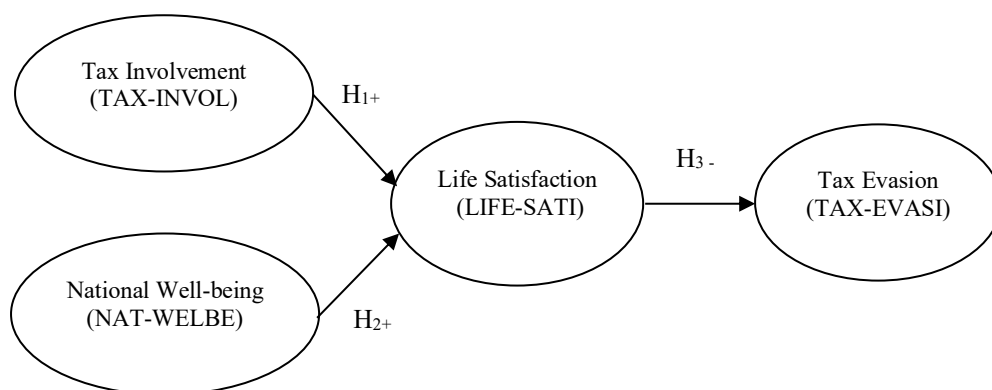
⁶⁴ McGee, Basic and Tyler (n 63); Devos, 'The Impact of Life Satisfaction' (n 29).

⁶⁵ Martin Crowe, Andrew Ross and Robert McGee, 'Education Level and Ethical Attitude toward Tax Evasion: A Six-Country Study' (2012) 15(2) *Journal of Legal, Ethical and Regulatory Issues* 93; Lysander Spooner, *No Treason: The Constitution of No Authority* (1870); Devos, 'The Impact of Life Satisfaction' (n 29).

⁶⁶ For theological literature, see Crowe, Ross and McGee (n 65). For philosophical literature, see Robert McGee, 'Is Tax Evasion Unethical?' (1994) 42 *University of Kansas Law Review* 411. For empirical literature, see James Alm and Benno Torgler, 'Cultural Differences and Tax Moral in the United States and in Europe' (2006) 27 *Journal of Economic Psychology* 224; Robert McGee and Guo Zhiwen, 'A Survey of Law Business and Philosophy Students in China on the Ethics of Tax Evasion' (2007) 2 *Society and Business Review* 299; Benno Torgler, *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis* (Edward Elgar, 2007); Benno Torgler et al, 'Causes and Consequences of Tax Morale: An Empirical Investigation' (2008) 38 *Economic Analysis and Policy* 313. See also Devos, 'The Impact of Life Satisfaction' (n 29).

The literature suggests that people's life satisfaction is arguably preoccupied with the accumulation of wealth and increased consumption. However, as indicated by Griffith, the opportunity cost of earning additional income is the loss of leisure time and the disincentive to work longer hours.⁶⁷ This situation has implications for the increased motivation for tax evasion and avoidance. As indicated in the literature above, there are myriad factors that contribute to tax evasion, including fairness,⁶⁸ exchange equity,⁶⁹ people's ethics/morals,⁷⁰ and perceptions and social norms.⁷¹ However, it is argued that where taxpayers are at ease with all these factors they are more likely to be satisfied with life, and less inclined to be involved in tax evasion. Consequently, this study proceeds to examine the relationship between these two variables and hypothesises that the level of a taxpayer's life satisfaction has a negative effect on the level of tax evasion. The research model described in Figure 1 shows the relationships among the variables.

Figure 1: Conceptual model



IV METHODOLOGY

A Measures

A questionnaire instrument for the empirical study of the relationships among tax involvement, national well-being, life satisfaction and tax evasion was developed on the basis of previous research and scale-developing procedures. The scale of tax involvement was developed by the authors according to the scale-development procedure recommended by Churchill.⁷² To develop initial items in Turkey, a combination of data

⁶⁷ Griffith (n 4).

⁶⁸ James Vogel, 'Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey Data' (1974) 27 *National Tax Journal* 499; Thomas Porcano, 'Correlates of Tax Evasion' (1988) 9 *Journal of Economic Psychology* 47; Gerrit Antonides and Henry Robben, 'True Positives and False Alarms in the Detection of Tax Evasion' (1995) 17 *Journal of Economic Psychology* 617.

⁶⁹ Wallschutzky, 'Taxpayer Attitudes' (n 58).

⁷⁰ Crowe, Ross and McGee (n 65).

⁷¹ Devos, 'The Impact of Life Satisfaction' (n 29).

⁷² Gilbert Churchill Jr, 'A Paradigm for Developing Better Measures of Marketing Constructs' (February 1979) 16 *Journal of Marketing Research* 64.

derived from in-depth interviews (23 taxpayers), in addition to a review of the tax involvement literature, was applied. Subsequently, a set of items designed to measure each tax involvement dimension was developed. The items were purified based on a pilot study (52 taxpayers) and expert opinion, as suggested by Churchill.⁷³ All the items of the tax involvement scale are measured by a seven-point Likert scale, ranging from 'strongly disagree' (1) to 'strongly agree' (7). Cronbach's α was 0.79 for the entire scale and 0.73, 0.75 and 0.79 for its subscales, respectively (see Table 2).

The scale of national well-being consisted of six items retrieved from a study by Davey and Rato.⁷⁴ The six items pertaining to national well-being were answered on a five-point end-defined Likert scale, anchored from 'very bad' (1) to 'very good' (5), with higher scores indicating a strong tendency for satisfaction. The six items measuring national well-being had a very satisfactory value of 0.93 for Cronbach's α (see Table 4). A satisfaction with life scale was adopted to assess a taxpayer's degree of satisfaction in life.⁷⁵ The three items measuring life satisfaction had a Cronbach's α of 0.87, which indicates acceptable internal consistency (see Table 4).⁷⁶ Finally, this study employed a tax evasion scale, which included 18 statements regarding the reasons given to justify tax evasion, developed by Crowe, Ross and McGee.⁷⁷ All the items of the scales for life satisfaction and tax evasion were measured by a seven-point Likert scale, ranging from 'strongly disagree' (1) to 'strongly agree' (7). Cronbach's α was 0.92 for the entire scale, and 0.93, 0.92 and 0.86 for its subscales, respectively (see Table 6), indicating satisfactory value.⁷⁸

B Sampling

Sampling in this study comprised taxpayers who resided in two countries, Australia and Turkey. These two countries display marked economic, social and cultural diversity, thereby providing a good basis for exploring and comparing their perceptions on tax involvement, national well-being, life satisfaction and tax evasion. The taxpayers selected were generally self-preparers, and the majority (99 per cent in Australia and 92.5 per cent in Turkey) were employed (see Table 1), meaning that they were actively concerned with tax issues. A convenience sampling method was used to apply the questionnaire. In Turkey, data was collected via questionnaires that specifically targeted citizens who pay tax. Out of 650 questionnaires distributed at popular places in Eskişehir, 480 questionnaires were returned, resulting in an overall response rate of 73 per cent. In Australia, an online questionnaire was conducted via a website for 45 days to collect sample data.⁷⁹ On average, the questionnaire took 15 minutes to complete. A total of 64 surveys (28 in Turkey, 36 in Australia) were deemed unusable due to invalid responses (for example, blank, double answers, etc) and were therefore eliminated from the sample. The total number of usable respondents was 733 (480 in Turkey, 253 in Australia).

⁷³ Ibid.

⁷⁴ Davey and Rato (n 45).

⁷⁵ Diener et al (n 29).

⁷⁶ Jane Nunnally and Ian Bernstein, *Psychometric Theory* (McGraw Hill, 3rd ed, 1994).

⁷⁷ Crowe, Ross and McGee (n 65).

⁷⁸ Devos, 'The Impact of Life Satisfaction' (n 29).

⁷⁹ 'Home', *Qualtrics* (Web Page, 2019) <<http://www.qualtrics.com>>.

V DISCUSSION AND ANALYSIS OF RESEARCH RESULTS

A Demographic characteristics of participants

Table 1 displays the demographic characteristics of the respondents who are from Turkey and Australia. The largest group of respondents in Turkey (63.1 per cent) were male, however, the gender ratio was approximately equal in Australia. In terms of marital status, 26.7 per cent of the Australian respondents were married, and 61.1 per cent of Turkish respondents. When average monthly income was examined, the largest group of Turkish respondents (42.7 per cent) had a monthly income of AUD930 or less. However, 23.7 per cent of Australian respondents (the largest group) had a monthly income of AUD3,001–6,000. In both countries, the proportion of respondents with an undergraduate educational level or equivalent was high — 49 per cent for Turkey, and 44.6 per cent for Australia. As shown in Table 1, there was a wide range of occupation groups, however, the ratio of office workers in Australia (30.8 per cent) was much higher than any other occupational group examined.

Table 1: Demographic characteristics of respondents

Turkey (N=480)			Australia (N=253)		
	<i>f</i>	<i>%</i>		<i>f</i>	<i>%</i>
<i>Gender</i>			<i>Gender</i>		
Male	303	63.1	Male	127	50.2
Female	177	36.9	Female	126	49.8
<i>Marital status</i>			<i>Marital status</i>		
Married	293	61.1	Married	67	26.7
Single	171	36.6	Single	150	59.8
Other	16	3.3	Other	34	13.5
<i>Education level</i>			<i>Education level</i>		
Primary or secondary	50	10.4	Primary or secondary	25	10.0
High school or equivalent	157	32.7	High school or equivalent	58	23.1
Undergraduate or equivalent	235	49.0	Undergraduate or equivalent	112	44.6
Postgraduate or qualification	38	7.9	Postgraduate or qualification	56	22.3
<i>Monthly income</i>			<i>Monthly income</i>		
AUD930 and <	205	42.7	Undeclared	52	20.6
AUD931–1,860	152	31.7	AUD3,000 and <	41	16.2
AUD1,861–2,790	54	11.3	AUD3,001–6,000	60	23.7
AUD2,791–3,720	29	6.0	AUD6,001–9,000	33	13.0
AUD3,721 and >	40	8.3	AUD9,001–12,000	29	11.5
			AUD12,001 and >	38	15.0
<i>Occupation</i>			<i>Occupation</i>		
Office worker	81	16.9	Office worker	78	30.8
Retail or shop worker	83	17.3	Retail or shop worker	22	8.7
Retired	36	7.5	Retired	1	0.4
Home duties	17	3.5	Home duties	3	1.2
Manager	38	7.9	Manager	59	23.3
Tradesperson	85	17.8	Tradesperson	21	8.3
Student	39	8.1	Student	5	2.0
Other	63	13.1	Other	64	25.3
Self-employed	38	7.9			

B Measures

1 Tax involvement

The tax involvement scale was first subjected to exploratory factor analysis ('EFA') to delineate the underlying factors. EFA with Varimax rotation, particularly useful for checking the unique (explained) and error (unexplained) variance of a specific variable,⁸⁰ was employed on the tax involvement data. The Kaiser–Meyer–Olkin ('KMO') amounted to 0.727, which indicated that the sample was adequate for factor analysis. Bartlett's Test of Sphericity was 1,336.123 ($p < 0.01$), indicating that the hypothesis variance and covariance matrix of variables as an identity matrix was rejected; therefore the factor analysis was appropriate. Table 2 indicates that all the factor loadings had satisfactory values greater than the cut-off value of 0.40.⁸¹

The results of the EFA reveal three valid factors entitled 'role and centrality', 'consciousness', and 'meaning in life'. These three factors regarding tax involvement explained 66.83 per cent of the total variance, which is a satisfactory level of variance explanation according to Hair et al,⁸² while the eigenvalues ranged from 1.97 to 3.02. All three factors comprised two statements, each concerning the direct or indirect attributes of tax involvement. The first factor of 'role and centrality' included two items with regards to tax's role in life. The 'consciousness' factor comprised two items regarding the subject's conscious citizenship. Similarly, two items in relation to 'meaning in life' made up the third factor.

Table 2: Factors and items related to the tax involvement scale

Factors	Std load	TUR		AUS		t
		Mean	SD	Mean	SD	
<i>Role and centrality</i>		5.03	1.50	4.13	1.27	8.07*
Tax has a central role in my life	0.76	4.83	1.78	3.98	1.43	
I know the tax rate because it encompasses many areas of our lives	0.81	5.22	1.64	4.29	1.40	
<i>Consciousness</i>		5.81	1.31	5.33	1.11	4.98*
I really like being a conscious citizen	0.78	5.57	1.57	5.12	1.30	
People need to be informed citizens	0.84	6.08	1.38	5.55	1.10	
<i>Meaning in life</i>		5.58	1.56	4.87	1.44	6.08*
Tax means nothing to me†	0.94	5.58	1.73	4.76	1.61	
Tax does not matter to me†	0.78	5.59	1.74	4.96	1.42	

CR = 0.76, 0.79, 0.85, respectively, according to factors.
 AVE = 0.62, 0.66, 0.75, respectively, according to factors.
 Reliability (Cronbach's α) = 0.73, 0.75, 0.79, respectively, according to factors.
 † Reverse statement; entire scale (six items) reliability = 0.79
 * $p < 0.01$

⁸⁰ Joseph Hair et al, *Multivariate Data Analysis* (Prentice Hall, 6th ed, 2006).

⁸¹ Nunnally and Bernstein (n 76).

⁸² Hair et al (n 80).

Significant differences appeared between the two countries in relation to all three factors ($t = 8.07$, $t = 4.98$, $t = 6.08$, respectively) with regards to tax involvement (see the last column in Table 2). The results indicated that the sampled Turks tended to have a slightly stronger tax conscience ($m = 5.81$) than the Australians ($m = 5.33$). Likewise, tax played a more central role in the lives of Turks ($m = 5.03$) compared to Australians ($m = 4.13$), and, overall, tax meant more to Turks ($m = 5.58$) than to Australians ($m = 4.87$). One explanation for the difference in tax involvement generally could be due to attitudinal differences between the different income groups of the Turks and the Australians in this sample, as found by Sumino.⁸³

As the EFA indices showed a satisfactory level, the confirmatory factor analysis ('CFA') was then employed to test the fit of the measurement model for tax involvement. As the χ^2 value is sensitive in a large sample, the researchers mostly referred to additional fit indices. For this reason, the goodness-of-fit of the model was assessed with the normed fit index ('NFI'), the non-normed fit index ('NNFI'), the comparative fit index ('CFI'), the root mean square error of approximation ('RMSEA'), the goodness-of-fit index ('GFI'), the adjusted goodness-of-fit index ('AGFI'), and the standardised root mean square residual ('SRMR'). Hu and Bentler suggested a 0.95 cut-off point for CFI and 0.09 for SRMR.⁸⁴ According to Chiu and Wang, AGFI and NNFI should exceed 0.8 and 0.9, respectively.⁸⁵ Additionally, according to Browne and Cudeck, RMSEA values higher than 0.10 indicate a poor fit, while values of 0.08 or less represent enough fit, and values of less than 0.06 indicate a good fit.⁸⁶

Table 3: CFA results on tax involvement

Fit indices	Whole sample (N=733) (TUR+AUS)	Turkey sample (N=480) (TUR)	Australia sample (N=253) (AUS)	Acceptable level
χ^2/df	2.33	2.21	1.12	< 5
RMSEA	0.043	0.050	0.022	< 0.08
SRMR	0.016	0.021	0.016	< 0.08
IFI	1.00	0.99	1.00	> 0.90
NFI	0.99	0.99	0.99	> 0.90
NNFI	0.99	0.98	1.00	> 0.90
CFI	1.00	0.99	1.00	> 0.90
GFI	0.99	0.99	0.99	> 0.90
AGFI	0.98	0.97	0.97	> 0.90

⁸³ Sumino (n 12).

⁸⁴ Lin Hu and Peter Bentler, 'Cutoff Criteria for Fit Indexes in Covariance Structure Analysis: Conventional Criteria Versus New Alternatives' (1999) 6(1) *Structural Equation Modeling* 1.

⁸⁵ CM Chiu and Ed Wang, 'Understanding Web-Based Learning Continuance Intention: The Role of Subjective Task Value' (2008) 45 *Information & Management* 194.

⁸⁶ Michael Browne and Rob Cudeck, 'Alternative Ways of Assessing Model Fit' in Kenneth A Bollen and John Scott Long (eds), *Testing Structural Equation Models* (Sage, 1993) 445.

As seen in Table 3, the ratios of the χ^2 value to degrees of freedom ($\chi^2/df = 2.33, 2.21, 1.12$, respectively) were less than the cut-off point of 3, as suggested by Bagozzi and Yi.⁸⁷ The fit indices of tax involvement in the whole sample (RMSEA = 0.043, CFI = 1.00, NFI = 0.99, IFI = 1.00) revealed an acceptable model fit. Furthermore, GFI (0.99) and AGFI (0.98) were greater than the recommended value of 0.9. RMSEA was 0.043, which is less than 0.08.⁸⁸ Therefore, the overall fit of the full structural model was satisfactory.

2 National well-being and life satisfaction

CFA was used to assess the scales relating to national well-being and life satisfaction. The results illustrate reliability coefficients and descriptive statistics (mean and standard deviation) about the factors and items. Both national well-being and life satisfaction represent a unidimensional construct (see Table 4).⁸⁹

No statistically significant difference was discovered between the Australian ($m = 2.56$) and Turkish ($m = 2.65$) samples with regards to national well-being. Consistent results appeared with respect to national security, economic, environmental and social conditions. The results also found no connection between income inequality and well-being perceptions, which is consistent with the findings of Diener and Oishi.⁹⁰ The findings are also consistent with Davey and Rato's study, which found that there was no difference in well-being perceptions for people of different cultural, societal and wealth backgrounds.⁹¹

It is noted that self-reports on subject well-being can be of a low quality and vulnerable to external disturbance and arbitrary measures. However, it is acknowledged that a combined happiness method, developed by Ng, may overcome these problems and improve the evaluation of overall national well-being.⁹² It is arguable whether an increase in an individual's subject well-being can be equated with 'a particular kind of sensation' — happiness, according to Kelman.⁹³ Consequently, other approaches to measuring subject well-being should be considered, and have been adopted in this study when considering the broader concept of national well-being.⁹⁴

There was evidence of a significant differentiation ($t = -4.57, p > 0.01$) with regards to the life satisfaction scores between the two countries. The Australian citizens' life satisfaction ($m = 4.80$) was higher than that of Turkish citizens ($m = 4.29$). While Australians were happier with their life conditions and prospects than Turks, it is important to note that

⁸⁷ Richard Bagozzi and Youjae Yi, 'On Evaluation of Structural Equation Models' (1988) 16 *Journal of the Academy of Marketing Science* 74.

⁸⁸ Hair et al (n 80) 7.

⁸⁹ Devos, 'The Impact of Life Satisfaction' (n 29).

⁹⁰ Ed Diener and Shigehiro Oishi, 'Money and Happiness: Income and Subject Well-Being across Nations' in Ed Diener and Eunkook M Suh (eds), *Culture and Subjective Well-Being* (MIT Press, 2000) ch 8, 198; see also Devos, 'The Impact of Life Satisfaction' (n 29).

⁹¹ Davey and Rato (n 45); see also Devos, 'The Impact of Life Satisfaction' (n 29).

⁹² Yew-Kwang Ng, 'Happiness Surveys: Some Comparability Issues and an Exploratory Survey Based on Just Perceivable Increments' (1996) 38 *Social Indicators Research* 1.

⁹³ Mark Kelman, 'Hedonic Psychology and the Ambiguities of "Welfare"' (2005) 33 *Philosophy & Public Affairs* 391.

⁹⁴ Haiou Zhou, 'A New Framework of Happiness Survey and Evaluation of National Wellbeing' (2012) 108 *Social Indicators Research* 491.

measurement is difficult and that both internal and external factors could play a vital role in influencing this level.⁹⁵ Australia offers, potentially, a more stable political and social system than Turkey, and this may have also contributed to the result. The difference between those with little marginal income satisfaction compared to others with higher income satisfaction may have also been another reason for the difference in the life satisfaction scores.⁹⁶

Table 4: Factors and items related to scales of national well-being and life satisfaction⁹⁷

Factors	Std load	TUR		AUS		t
		Mean	SD	Mean	SD	
<i>National well-being</i>		2.65	1.08	2.56	0.51	1.24
Economic situation in my country	0.87	2.71	1.19	2.50	0.60	
The state of the natural environment in my country	0.77	2.82	1.17	2.55	0.65	
Social condition in my country	0.89	2.65	1.16	2.62	0.70	
Government in my country	0.87	2.63	1.36	2.44	0.71	
Business in my country	0.83	2.41	1.18	2.60	0.59	
National security in my country	0.81	2.66	1.31	2.66	0.66	
<i>Life satisfaction</i>		4.29	1.53	4.80	1.22	-4.57*
In most ways my life is close to my ideal	0.84	4.43	1.70	4.59	1.29	
The conditions of my life are excellent	0.86	3.82	1.70	4.77	1.34	
I am satisfied with my life	0.81	4.61	1.78	5.04	1.35	
CR = 0.94, 0.88, respectively, according to factors.						
AVE = 0.72, 0.70, respectively, according to factors.						
Reliability (Cronbach's α) = 0.93, 0.87, respectively, according to factors.						
Entire scale (nine items) reliability = 0.90						
* p < 0.01						

The results of the CFA suggest that the fit measurement of the model was acceptable. In the whole sample, the values of the other fit indices were also found to be acceptable: CFI = 0.99; IFI = 0.99; RMSEA = 0.061; NFI = 0.99; NNFI = 0.99; and SRMR = 0.019. The fit indices of national well-being and life satisfaction for the Turkey sample ($\chi^2/df = 2.74$, RMSEA = 0.061, CFI = 0.99, NFI = 0.99, IFI = 0.97) also revealed an acceptable model fit. However, the Australian sample represented poor values in terms of RMSEA (0.095) and AGFI (0.89). All the other Australian statistics were within the acceptance ranges, indicating a good fit to the data overall (see Table 5).

⁹⁵ Shin and Johnson (n 28).

⁹⁶ Frijters, Johnston and Shields (n 34).

⁹⁷ Devos, 'The Impact of Life Satisfaction' (n 29).

Table 5: CFA results on life satisfaction and national well-being

Fit indices	Whole sample (N=733) (TUR+AUS)	Turkey sample (N=480) (TUR)	Australia sample (N=253) (AUS)	Acceptable level
χ^2/df	3.73	2.74	3.26	< 5
RMSEA	0.061	0.061	0.095	< 0.08
SRMR	0.019	0.023	0.044	< 0.08
IFI	0.99	0.97	0.97	> 0.90
NFI	0.99	0.99	0.96	> 0.90
NNFI	0.99	0.99	0.96	> 0.90
CFI	0.99	0.99	0.97	> 0.90
GFI	0.97	0.97	0.93	> 0.90
AGFI	0.95	0.94	0.89	> 0.90

3 Tax evasion

CFA was conducted to assess 18 items in the tax evasion scale. Seven items of the tax evasion scale were removed due to low factor loadings or multi-factorial loading. Table 6 displays factor loadings, reliability coefficients, and AVE values regarding tax evasion. In line with the literature, the factors fell under the general headings of 'fairness', 'tax system' and 'discrimination'. 'Fairness' included five items, which incorporated fairness perceptions. The 'tax system' factor comprised three items, which incorporated perceptions concerning tax rates and usage. Three items in relation to 'discrimination' issues made up the third factor. In addition, significant differences regarding tax evasion between the two countries were discovered in relation to the 'tax system' factor ($t = 4.07$, $p > 0.01$) and the 'discrimination' factor ($t = 3.91$, $p > 0.01$) (see Table 6).⁹⁸

The results indicate that Australians were more sensitive to the ethical issues surrounding the tax system ($m = 2.60$) than Turks ($m = 3.20$). Likewise, Australians were more sensitive to ethical issues around tax discrimination ($m = 2.88$) compared to Turks ($m = 3.46$). However, both the Turks and Australians had similar perceptions with regards to tax fairness issues (Turks = 2.08 and Australians = 2.18). The latter result is consistent with previous findings on the impact of tax fairness perceptions upon tax evasion,⁹⁹ and indicates that, regardless of culture, tax fairness is universal. One explanation for the difference in relation to the tax system could be that, as the Australian tax system is quite complex and tax rates are high relative to Turkey, there is the potential for greater avoidance/evasion. It also appears that tax evasion perceptions were not justified on discrimination grounds, but rather there was evidence of a duty to pay tax. This finding is also consistent with previous studies by McGee and Crowe.¹⁰⁰

⁹⁸ Devos, 'The Impact of Life Satisfaction' (n 29).

⁹⁹ Mark Spicer, 'A Behavioural Model of Income Tax Evasion' (PhD Thesis, Ohio State University, 1974); LM Tan, 'Taxpayers' Perceptions of the Fairness of the Tax System — A Preliminary Study' (1998) *New Zealand Journal of Taxation Law and Policy* 59; Young-dahl Song and Tinsley Yarbrough, 'Tax Ethics and Tax Attitudes: A Survey' (1978) 58 *Public Administration Review* 442; Chris Chan, Coleen Troutman and David O'Bryan, 'An Expanded Model of Taxpayer Compliance: Empirical Evidence from the United States and Hong Kong' (2000) 9 *Journal of International Accounting, Auditing and Taxation* 83.

¹⁰⁰ Crowe, Ross and McGee (n 65); see also Devos, 'The Impact of Life Satisfaction' (n 29).

Table 6: Factors and items related to tax evasion scale

Factors	Std load	TUR		AUS		t
		Mean	SD	Mean	SD	
<i>Fairness</i>		2.08	1.34	2.18	1.37	-0.92
Tax evasion is ethical even if most of the money collected is spent wisely	0.85	1.98	1.55	2.13	1.40	
Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	0.89	1.99	1.53	2.16	1.48	
Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me	0.91	2.25	1.70	2.20	1.39	
Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	0.90	1.96	1.46	2.15	1.41	
Tax evasion is ethical if the probability of getting caught is low	0.85	2.20	1.72	2.23	1.50	
<i>Tax system</i>		3.20	2.04	2.60	1.58	4.07*
Tax evasion is ethical if tax rates are too high	0.87	3.01	2.20	2.40	1.59	
Tax evasion is ethical if the tax system is unfair	0.91	3.29	2.27	2.69	1.65	
Tax evasion is ethical if a large portion of the money collected is wasted	0.92	3.28	2.22	2.70	1.72	
<i>Discrimination</i>		3.46	1.99	2.88	1.73	3.91*
Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940	0.71	3.40	2.20	3.10	2.02	
Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	0.92	3.51	2.30	2.76	1.77	
Tax evasion is ethical if the government imprisons people for their political opinions	0.89	3.45	2.35	2.79	1.88	
CR = 0.95, 0.93, 0.88, respectively, according to factors. AVE = 0.78, 0.81, 0.71, respectively, according to factors. Reliability (Cronbach's α) = 0.93, 0.92, 0.86, respectively, according to factors. Total scale (11 items) reliability = 0.92 * $p < 0.01$						

The overall fit of the model to the data, especially for the Australian sample, was not strong due to the inadequate fit indices of RMSEA (0.14), GFI (0.85) and AGFI (0.75). Hu and Bentler suggested that if GFI and AGFI perform poorly, they are not recommended for evaluating model fit, and rather other better fit indices should be considered.¹⁰¹ Moreover, Bagozzi and Yi indicated that all the indices that exceed 0.80 should meet the respective minimum criteria and show goodness-of-fit to the data and theoretical model overall.¹⁰² In particular, the CFA results achieved for the whole sample and the Turkey sample were acceptable. Based on these findings, it can be concluded that the model of the tax evasion scale was empirically supported (see Table 7).

¹⁰¹ Hu and Bentler (n 84); see also Devos, 'The Impact of Life Satisfaction' (n 29).

¹⁰² Bagozzi and Yi (n 87); see also Devos, 'The Impact of Life Satisfaction' (n 29).

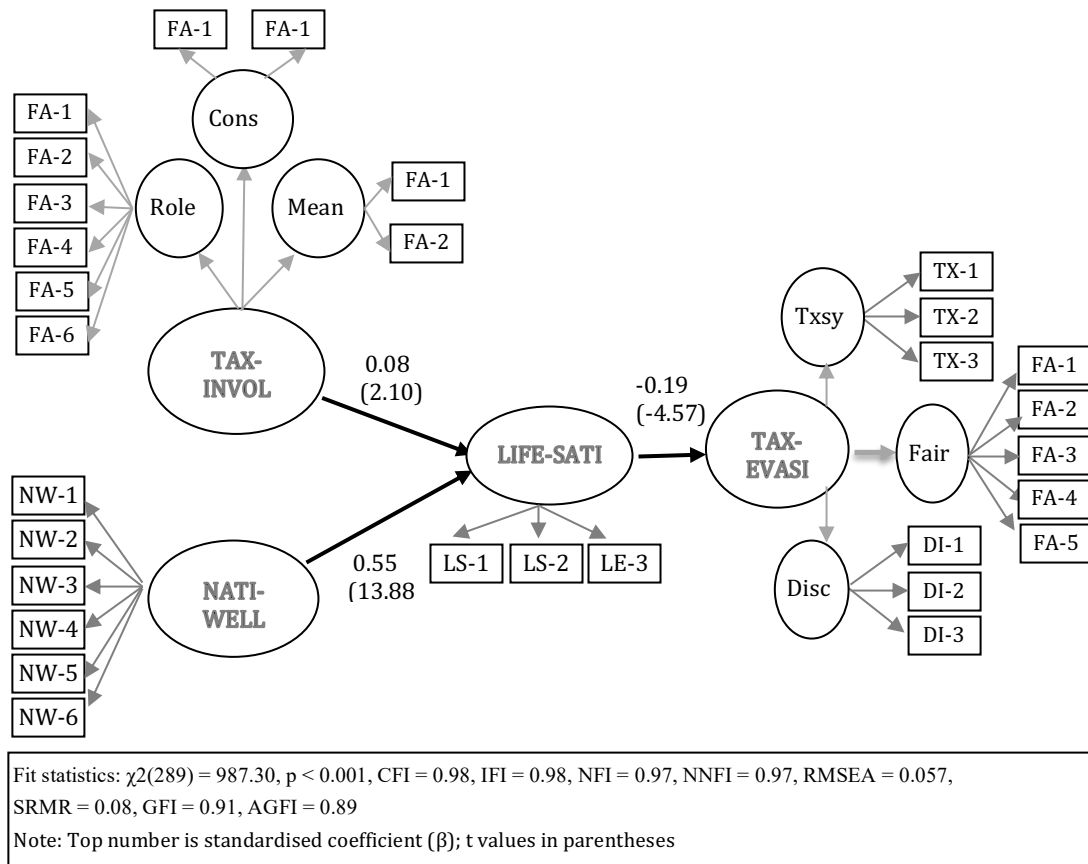
Table 7: CFA results on tax evasion

Fit indices	Whole sample (N=733) (TUR+AUS)	Turkey sample (N=480) (TUR)	Australia sample (N=253) (AUS)	Acceptable level
χ^2/df	5.68	3.90	6.08	< 5
RMSEA	0.080	0.078	0.14	< 0.08
SRMR	0.032	0.036	0.038	< 0.08
IFI	0.99	0.98	0.97	> 0.90
NFI	0.98	0.98	0.96	> 0.90
NNFI	0.98	0.98	0.96	> 0.90
CFI	0.99	0.98	0.97	> 0.90
GFI	0.95	0.94	0.85	> 0.90
AGFI	0.91	0.91	0.75	> 0.90

C Structural equation model¹⁰³

The hypothesised research model was empirically tested using an SEM, using LISREL 8.80. More precisely, the hypothesised model specifying the structural relationship among tax involvement, national well-being, life satisfaction and tax evasion fits the data well. The χ^2 is significant ($p < 0.01$), which is usually the case for large sample sizes. Except for GFI and AGFI, all the other statistics ($\chi^2 = 987.30$, $df = 289$, $\chi^2/df < 5$, CFI = 0.98, IFI = 0.98, NFI = 0.97, NNFI = 0.97, RMSEA = 0.057, SRMR = 0.08) were within the acceptance ranges, indicating a goodness-of-fit to the data.

¹⁰³ Claes Fornell and David Larcker, 'Evaluating Structural Equation Models with Unobservable Variables and Measurement Error' (1981) 28 *Journal of Marketing Research* 39.

Figure 2: Structural equation model among dimensions

The path coefficient estimates (standardised beta and t values) of the model are summarised concisely in Figure 2. The path analysis supports the finding that all three hypotheses are accepted. In other words, there were positive and significant relationships between the constructs of life satisfaction and national well-being ($\beta = 0.55$, $t = 13.88$, $p < 0.05$), and life satisfaction and tax involvement ($\beta = 0.08$, $t = 2.10$, $p < 0.05$). Rationally, there was also a negative relationship between life satisfaction and tax evasion ($\beta = -0.19$, $t = -4.57$, $p < 0.05$). The strongest relationship displayed was between national well-being and life satisfaction, a result that is strongly supported in the literature.¹⁰⁴

VI CONCLUSION

A Summary and findings

The primarily purpose of this research was to examine particular tax involvement dimensions that related to samples of both Turkish and Australian taxpayers. Specifically, CFA was applied to verify the relationships between key variables comprising tax involvement, national well-being, life satisfaction and tax evasion. The second aim of this study was to examine the structural relationship, if any, among these key variables.

¹⁰⁴ Oishi, Schimmack and Diener (n 50); Devos, 'The Impact of Life Satisfaction' (n 29).

The current study developed and validated the Australian and Turkish versions of the tax involvement scale. The scale demonstrated reliability, multidimensionality and validity, as well as consistency across the Turkish and Australian samples. The dimensions of tax involvement included 'role and centrality', 'consciousness' and 'meaning in life'. The findings revealed that there were significant differences between the two countries in relation to all three dimensions regarding tax involvement.

The CFA results in the current study indicate that the dimensions of tax evasion can be conceptualised and measured as a three-dimensional construct comprising 'fairness', 'tax system' and 'discrimination'. As indicated previously, the structural relationships among tax involvement, national well-being, life satisfaction and tax evasion in Turkey and Australia were also examined by employing the appropriate scales. The results revealed that particular relationships did exist between these dimensions. In particular, the overall results showed that life satisfaction plays a central role in the model. The relationship between life satisfaction and tax involvement was statistically significant and is consistent with previous findings.¹⁰⁵ Hence, the level of a person's tax involvement had a positive effect on their level of life satisfaction and H₁ was accepted. Likewise, a statistically significant positive relationship was found between national well-being and life satisfaction. Consequently, as the level of a person's national and subject well-being had a positive effect on their level of life satisfaction overall, H₂ was accepted.

As predicted, a negative relationship was found between life satisfaction and tax evasion, indicating that satisfaction with life may be a mediator between tax evasion, national well-being and tax involvement. The results indicated that tax evasion and tax involvement also relate to national well-being and life satisfaction. Specifically, tax involvement and national well-being correlated positively with life satisfaction, however, satisfaction with life had a significant negative effect on tax evasion perceptions. The results of the analysis were generally expected. That is, if taxpayers had greater tax involvement and were positive about national well-being, they were more likely to have greater life satisfaction (positive relationship). Conversely, taxpayers with greater life satisfaction would be less likely to harbour tax evasion perceptions (negative relationship). Therefore, as the level of a person's life satisfaction had a negative effect on their level of tax evasion, H₃ was also accepted.

Other possible reasons explaining the significant differences between the two countries in terms of national well-being, life satisfaction and all the dimensions of tax involvement could also be due to cultural differences. It was expected that the diversity in legal, social and economic values between Australia and Turkey would have contributed to the variance of the results to some degree.

B Tax policy implications

Investigating taxpayer perceptions regarding national well-being, life satisfaction, tax involvement or tax evasion is an important governmental activity of citizen-orientated countries. Where both national well-being and life satisfaction exist amongst a country's citizens it encourages loyalty and prosperity into the future. Consequently, it is vital to build a strong economy, and security systems, which represent key requirements for

¹⁰⁵ Griffith (n 4); Lane (n 31); Shin and Johnson (n 28).

generating long-term happiness and life satisfaction. In this respect, creation and delivery of humanistic values is an important antecedent of citizen loyalty. The results of this study provide some valuable insights into the relationship between tax systems and citizenship issues. It seems that the combination of national well-being and life satisfaction provided by governments not only relates to social issues, but also taxpayer perceptions.

It is acknowledged that Australia currently has extensive compliance programmes in place for its citizens. The ATO, for example, has become a world leader in tax administration and provides a sophisticated website and educational services for its taxpayers. However, this study revealed that more could be done to improve the tax fairness perceptions of Australian taxpayers,¹⁰⁶ by promoting and advertising the services taxpayers receive from the ATO. The government and social conditions in Australia were shown to have implications for both national well-being and life satisfaction measures in the SEM, which in turn influence tax evasion perceptions.

In Turkey, where the tax administration system is not as sophisticated as Australia's,¹⁰⁷ issues of tax fairness and discrimination are present, as revealed through this study.¹⁰⁸ In this regard, issues of exchange equity, and improvements in deterrents and enforcement by the revenue authority, were shown to have implications for both national well-being and life satisfaction measures in the SEM, which in turn influence tax evasion perceptions.

Consequently, it is important that both governments give due attention to issues of tax fairness, and tax education and enforcement in the case of Turkey, in order to build up the knowledge and understanding of its citizens. In particular, this may also involve addressing the issues of tax complexity, expenditures and transparency. This study's findings indicate that many issues, both social and psychological, may effectively shape perceptions in the tax context.

C Limitations and future studies

Although this study makes a valuable contribution in the area of tax evasion perceptions, some limitations are noted. First, the scope of this study was limited to only two countries (Australia and Turkey), which limits the generalisability of the findings beyond these countries. In addition, as convenient sampling was adopted in both Australia and Turkey, the samples are not representative of their populations and are not normally distributed but somewhat skewed.¹⁰⁹ This limitation was initially recognised and accepted in order for the study to be carried out.

Second, as the tax systems in the two countries are quite different from each other, it was highly likely that the perceptions of particular tax issues would vary. Therefore, future research could examine comparative countries with similar tax systems and cultures (for example, collectivist, individualist), which would enhance the researchers' ability to

¹⁰⁶ PA Hite and ML Roberts, 'An Analysis of Tax Reforms Based on Taxpayers' Perceptions of Fairness and Self-Interest' (1992) 4 *Advances in Taxation* 115; Chan, Troutman and O'Bryan (n 99); Tan (n 99) 60.

¹⁰⁷ Presidency of Revenue Administration (n 10) 34–5.

¹⁰⁸ See the Turkish statistical results regarding tax evasion in Tables 6 and 7 of this paper.

¹⁰⁹ A Q-Q plot was not provided in the analysis to determine normality.

generalise the findings beyond just two countries.¹¹⁰ Third, while this study investigated only four variables, in practice, taxpayers are potentially exposed to multiple variables that may provide more effective tax dimensions. Future research could therefore consider the impact of additional variables and their effects, in order to provide a more comprehensive understanding.

Finally, while the study employed a quantitative methodology, perhaps taking up a qualitative approach by way of semi-structured interviews of taxpayers could enhance and enrich the findings and cross-validate previous results. Traditionally, many countries have preferred to assist citizens with their tax obligations rather than just introduce new and more severe sanctions. Some commentators argue that the former course of action is the best way forward for tax administration in these countries.¹¹¹ In this regard, this study revealed some of the relationships between key economic and tax variables that should be considered in formulating any tax policy measures.

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¹¹⁰ Devos, 'The Impact of Life Satisfaction' (n 29).

¹¹¹ Simon James and Chris Alley, 'Tax Compliance, Self-Assessment and Tax Administration in New Zealand — Is the Carrot or Stick More Appropriate to Encourage Compliance?' (1999) 5 *New Zealand Journal of Taxation Law and Policy* 3.

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HOW EQUITABLE IS AUSTRALIA'S PROGRESSIVE TAX RATE? A REVIEW AT HIGHER INCOME LEVELS

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ABSTRACT

Vertical equity is concerned with differences in ability to pay, where those able to should pay more — that is, the progressivity of the tax system. Fundamental to any assessment of progressivity of an income tax system is the rate structure, consisting of tax brackets and tax rates. This exploratory paper assesses the progressivity of the Australian income tax system, for yearly income levels of AUD100,000 to AUD250,000. It finds that, while the system is progressive, it is highly regressively progressive at income levels associated with changes in tax brackets, becoming less regressively progressive at the higher end of each tax bracket.

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I INTRODUCTION

A progressive tax system is one where the tax burden, being the total amount of tax paid as a percentage of income, increases as the taxable income increases. It is a tax system based on the principle of 'ability to pay'.

There is an inherent feeling of equity, of fairness, in the term 'ability to pay'. When 'equity' is considered in matters of taxation, it is usually considered in terms of horizontal and vertical equity. A tax is said to be horizontally equitable when individuals with similar income and assets pay the same amount in taxes. If individuals with more wealth, income and access to more resources pay proportionally higher amounts in taxes then it is said to be vertically equitable.

There are four instruments available to influence the progressivity of a tax system. The most fundamental of these is the rate structure, which consists of tax brackets and tax rates. Second are allowances and deductions, both of which influence the size of the tax base. Third are tax credits, which reduce net tax liability. Last is the exemption of certain types of income from taxation, which also affects the size of the tax base.

Australia's income tax system is said to be progressive.¹ In addition to its relatively mature income tax system, Australia has a well-developed transfer system, which also contributes to the progressivity of the income tax system. These two systems, the income tax and transfer systems, are generally considered together as a single tax-transfer system in studies assessing the equity of the tax system.²

Defining what constitutes an equitable benchmark has been elusive. As noted in the most recent review of the Australian taxation system, *Australia's Future Tax System*, '[w]hether elements of the current tax-transfer system improve equity or not depends on a range of judgements. People put different degrees of emphasis on different priorities of a tax-transfer system and these priorities can sometimes conflict.'³ Indeed, this report also notes that there are 'a number of perspectives on equity that people use to inform their assessments of the tax-transfer system'.⁴

¹ 'Tax White Paper: At a Glance — The Progressivity of the Tax and Transfer Systems', *Treasury, Australian Government* (Web Page) <<https://treasury.gov.au/review/tax-white-paper/at-a-glance>>; Peter Whiteford, 'Who Gets What? Who Pays for It? How Incomes, Taxes and Benefits Work Out for Australians', *The Conversation* (Web Page, 22 June 2018) <<https://theconversation.com/who-gets-what-who-pays-for-it-how-incomes-taxes-and-benefits-work-out-for-australians-98627>>.

² '6537.0 — Government Benefits, Taxes and Household Income, Australia, 2015–16', *Australian Bureau of Statistics, Australian Government* (Web Page, 20 June 2018) <<https://www.abs.gov.au/ausstats/abs@.nsf/mf/6537.0>>; Treasury, Australian Government, *Architecture of Australia's Tax and Transfer System* (6 August 2008) <<http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/Publications/papers/report/index.htm>>; Treasury, Australian Government, *Australia's Future Tax System, Report to the Treasurer — Part Two: Detailed Analysis* (December 2009) <http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/Publications/Papers/Final_Report_Part_2/index.htm>; Peter Saunders, *Equity and the Impact on Families of the Australian Tax-Transfer System* (Monograph No 2, Institute of Family Studies, 1982); Ann Harding, 'The Suffering Middle: Trends in Income Inequality in Australia, 1982 to 1993–94' (1997) 30(4) *The Australian Economic Review* 341.

³ Treasury, *Australia's Future Tax System: Part Two* (n 2) s 3.2.

⁴ *Ibid.*

This is an exploratory paper that examines an old topic from a new perspective. It is part of a larger project assessing the sustainability of the Australian income system. This paper takes a step back and only considers progressivity of the income tax system based on rate structure and only for middle to high salary and wage earners.

Specifically, this paper considers taxpayers earning annual salary and wages between AUD100,000 and AUD250,000, and assesses the impact of any increase in salary and wages. It is not a choice between 'to work' or 'not to work', but rather explores whether the increase in salary and wages under consideration is worth the necessary additional work commitment required in accepting a promotion and/or in changing employer.

The objective and scope of the research associated with this paper are given in Section II. This is followed, in Section III, with a literature review. The key terms 'progressivity' and 'equity' are discussed in Section IV, particularly with regard to their interpretation with respect to this research. Section V contains the data, its analysis and deliberation. Concluding comments are made in Section VI.

II OBJECTIVE AND SCOPE

Two factors can be highlighted with respect to the traditional approach to considering the equity of the income tax system. The first is that the progressivity of the Australian tax system is not questioned. The second is that a socio-economic approach is taken, where the target is the most economically disadvantaged sector of society. This approach is not being questioned by this research. Indeed, it is appropriate given that benefits under both the income tax system and transfer system are targeted mainly at low income levels (such as the low income tax rebate) or at particular circumstances (such as family tax benefits).

This paper differs in respect of its focus. It looks to examine how equitable the income tax system is at the higher income levels. Under consideration are vertical equity and the progressivity of the income tax system at the upper tax bracket levels. It is acknowledged that this is a very simplistic approach. However, it will form the basis of a larger research project with later papers introducing other aspects of progressivity determination to assess the equitable effectiveness of their objectives and on their targets. By commencing with salary and wage earners with of AUD100,000 to AUD250,000, one can determine a baseline unaffected by other aspects of progressivity, namely allowances and deductions, tax credits, exemptions and the impact of the transfer system.

The scope of this paper is delineated as follows.

Only salary and wage income is considered. Excluded are untaxed income (such as exempt income and non-assessable non-exempt income), passive income (such as interest, dividend and rental income) and capital gains and losses. This is very taxpayer specific, not permitting generalisations to be drawn.

Only higher income levels are analysed. This is taxable income from AUD100,000 to AUD250,000. In addition, only annual incomes are considered. It is acknowledged that a lifetime or lifecycle perspective is a better measure of permanent income over the course of a lifetime, and therefore more accurate in comparing different make-ups at any given

level of income.⁵ However, as the focus of this research is on a decision to be made at a particular point in time, an annual perspective is appropriate.

The tax rates used are those for the 2018–19 income year, for an individual who is an Australian resident for tax purposes. The Medicare levy is included as it affects all taxpayers. The Medicare levy surcharge is disregarded.

Government transfers, particularly welfare-type programmes, accrue disproportionately to the lower levels of income distribution and reduce inequality in disposable income. Conceptually, such transfers should be included in any assessment of progressivity of a tax system. Given the focus of research is on the higher levels of income distribution, and considering that transfers represent a small fraction of upper-middle and high income earners' incomes, ignoring these transfers should have little impact.

Behavioural responses, such as tax avoidance and tax minimisation, are ignored. These vary in size and impact, requiring general equilibrium modelling to determine their effect on total tax burdens.⁶ Considering the basic case with no behavioural response is therefore a useful starting point. It is also to be noted that salary and wage earners do not have a choice between 'working' and 'not working'. Any reduction in hours will generally result in a corresponding pro rata decreasing adjustment of their salary and wages. Further, salary and wage earners at the higher income levels are usually contracted to complete tasks rather than complete a predetermined number of hours, as may be the case under enterprise agreements. Thus, working more than the standard 38 hours per week will almost never result in any additional, or overtime, pay.⁷

Finally, and to avoid all doubt, only income tax is considered. All other federal and all state taxes are ignored. The GST is considered to be regressive, as lower-income individuals spend a larger fraction of their income on taxed consumption goods and services. As the state taxes impacting on individuals are generally related to property (stamp duty) or personal choices (gambling tax), ignoring these will have no consequence on the research.

The research, therefore, considers what is normally referred to as middle and high income levels. These terms are, however, not defined. Studies that do relate to income levels tend to focus on household income,⁸ whereas the income tax system is concerned with individual income. In the Australian income tax system, income is divided into levels referred to as 'tax brackets', to which a particular tax rate applies. The Australian Bureau

⁵ Thomas Piketty and Emmanuel Saez, 'How Progressive Is the US Federal Tax System? A Historical and International Perspective' (Working Paper No 12404, National Bureau of Economic Research, July 2006) 8. See also Productivity Commission, Australian Government, 'Tax and Transfer Incidence in Australia' (Working Paper, 7 October 2015).

⁶ Don Fullerton and Diane Lim Rogers, *Who Bears the Lifetime Tax Burden?* (Brookings Institution, 1993).

⁷ Fair Work Ombudsman, Australian Government, *Maximum Weekly Hours and the National Employment Standards* (Fact Sheet, July 2017) <<https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/maximum-weekly-hours>>.

⁸ See, for example, Australian Council of Social Service and University of New South Wales, *Inequality in Australia 2018* (2018); Tim Edwards, 'Australia's Household Income and Wealth Distribution', *Mccrindle* (Blog Post, 2019) <<https://mccrindle.com.au/insights/blog/australias-household-income-wealth-distribution>>; '6523.0 — Household Income and Wealth, Australia, 2015–16', *Australian Bureau of Statistics, Australian Government* (Web Page, 13 September 2017) <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6523.02015-16?OpenDocument>>.

of Statistics, on the other hand, divides income and wealth into quintiles, and often at the household rather than individual level.⁹ One way of determining what are considered low, medium and high income levels is by considering the offsets available. The low income tax offset cuts out at income levels above AUD66,667. Eligibility for the low and medium income tax offset, on the other hand, is taxable income up to AUD125,333. Therefore, for tax purposes, a medium income level is one where the taxable income is more than AUD66,667 and does not exceed AUD125,333. By definition a taxable income exceeding AUD125,333 is considered to be a high income level.

III LITERATURE REVIEW

When taxes increase, there are both positive and negative outcomes. The positive is an increase in revenue that can be used to fund governmental spending or to redistribute under governmental policies. The negative is that tax increases may discourage taxpayers from working. Thus, there is an inevitable trade-off between raising revenue and distorting taxpayer behaviour.¹⁰

A Optimal tax models

As a result of this trade-off, optimal tax models have been developed to provide insights into what a tax system should look like.¹¹ Piketty and Saez consider the 'classical trade-off' between promoting social welfare through taxation and preventing negative influences on economic productivity.¹² Zelenak and Moreland's optimal tax model seeks to answer the question: 'What is the ideal tax and transfer system?'¹³

Other models explore how individuals' preferences shape the tax system. They therefore capture how taxpayers of different incomes have disparate preferences with respect to the tax system. For example, Meltzer and Richard conclude that, when the income of the 'decisive voter' is less than the median, they would choose to increase taxes and fund more redistribution.¹⁴ For Roberts, '[i]f the median income is less than the mean income ... then majority voting will lead to the tax schedule with the highest marginal tax rate being adopted'.¹⁵ Taking a different perspective, Romer concludes that, '[f]or a given government revenue requirement, the poorer individuals tend to favour higher marginal tax rates' and, as a result, '[t]he conflict between high national income and distributional

⁹ Groupings that result from ranking by the level of economic resources (income or wealth) and then dividing the population into five equal groups.

¹⁰ Edward J McCaffery and James R Hines Jr, 'The Last Best Hope for Progressivity in Tax' (2010) 83(5) *Southern California Law Review* 1031, 1054; Thomas Piketty and Emmanuel Saez, 'Optimal Labor Income Taxation' in Alan J Auerbach et al (eds), *Handbook of Public Economics* (North Holland, 2013) vol 5, 391.

¹¹ See, for example, Piketty and Saez, 'Optimal Labor Income Taxation' (n 10); JA Mirrlees, 'Optimal Tax Theory: A Synthesis' (1976) 6(4) *Journal of Public Economics* 327; JA Mirrlees, 'An Exploration in the Theory of Optimum Income Taxation' (1971) 38(2) *Review of Economic Studies* 175.

¹² Piketty and Saez, 'Optimal Labor Income Taxation' (n 10) 392–3.

¹³ See, for example, Lawrence Zelenak and Kemper Moreland, 'Can the Graduated Income Tax Survive Optimal Tax Analysis?' (1999) 53 *Tax Law Review* 51.

¹⁴ Allan H Meltzer and Scott F Richard, 'A Rational Theory of the Size of Government' (1981) 89(5) *Journal of Political Economy* 914, 916–17.

¹⁵ Kevin WS Roberts, 'Voting over Income Tax Schedules' (1977) 8(3) *Journal of Public Economics* 329, 331–2.

equality is paralleled by a conflict of interest between rich and poor'.¹⁶ What these tax models clearly illustrate is that taxpayers, on the entire spectrum from poor to rich, prefer different tax systems based on how much they are personally taxed, how the behaviour of other citizens are affected by the tax system and how much redistribution occurs.

Any optimal tax system model requires several inputs. First, elasticity, which is a measure of how sensitive taxpayers are to tax rates. The higher the elasticity, the more taxpayers are likely to change their behaviour in response to higher taxes.¹⁷ There are several factors that can affect elasticity, including individual circumstances at a particular point in time, age and gender. In a study conducted in 2002, Gruber and Saez found that the overall elasticity of taxable income was 0.4, rising to 0.57 for those taxpayers with a level of income over USD100,000.¹⁸ This seems to indicate that the higher the income, the more elastic is the response to increased tax rates. French, on the other hand, calculated elasticity based on age. This study found that elasticity increases from a range of 0.19–0.37 before age 60, to 1.04–1.33 after age 60.¹⁹ As a general rule, there is a correlation between older taxpayers and higher income levels. There have been elasticity studies focused on the top tax bracket.²⁰ However, the focus has been on determining how high the revenue-maximising tax rate should be. That is, the location of the taxpayer along the income scale is 'critically important for revenue responses to tax rate changes'.²¹

The second input to be considered is the distribution of taxpayer earning ability.²² This includes not only numbers of taxpayers along the income-earning spectrum but also the gap between the earning ability of the rich and the poor. However, earning ability is unobservable and can therefore only be modelled rather than measured.

Finally, there is the social welfare factor that requires combining and valuing the utilities of the individuals in the population. That is, it is a measure of the 'useful-ness' or satisfaction that an individual obtains from its consumption. Therefore, the choice of social welfare function affects different members of society differently.²³

In designing an optimal tax system, these inputs matter. McCaffery and Hines note how 'optimal tax models are extremely sensitive to changes in key assumptions and parameters'.²⁴ If sensitivity to taxes is high/low (elasticity), if there is more

¹⁶ Thomas Romer, 'Individual Welfare, Majority Voting, and the Properties of a Linear Income Tax' (1975) 4(2) *Journal of Public Economics* 163, 171.

¹⁷ Piketty and Saez, 'Optimal Labor Income Taxation' (n 10).

¹⁸ Jon Gruber and Emmanuel Saez, 'The Elasticity of Taxable Income: Evidence and Implications' (2002) 84 *Journal of Public Economics* 1, 3.

¹⁹ Eric French, 'The Effects of Health, Wealth, and Wages on Labour Supply and Retirement Behaviour' (2005) 72(2) *Review of Economic Studies* 395, 411–12.

²⁰ See, for example, E Saez, JB Slemrod and SH Giertz, 'The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review' (2012) 50 *Journal of Economic Literature* 3; SH Giertz, 'The Elasticity of Taxable Income: Influences on Economic Efficiency and Tax Revenues, and Implications for Tax Policy' in AD Viard (ed), *Tax Policy Lessons from the 2000s* (AEI Press, 2009) 101.

²¹ John Creedy and Norman Gemmill, 'Measuring Revenue-Maximising Elasticities of Taxable Income: Evidence for the US Income Tax' (Working Papers in Public Finance No 02/2014, Victoria University of Wellington, January 2014) 20.

²² Mirrlees, 'An Exploration in the Theory of Optimum Income Taxation' (n 11) 176–7.

²³ Zelenak and Moreland (n 13) 53.

²⁴ McCaffery and Hines (n 10) 1057.

equality/inequality (earning ability distribution), and if more care is given to the poor/rich (social welfare factor), then the optimal tax system changes. Thus, for example, if the elasticity of taxpayer behaviour is high, the optimal tax system will generally feature lower rates; the optimal top tax rate will change if the distribution of earning ability at the top end of the population is different.²⁵

B Application to research

While it is necessary to consider the literature on optimal tax systems, the parameters of this research are more limited. The focus is on taxpayers with salary and wages of AUD100,000 to AUD250,000. The inputs for this research, as determined from the literature review, are:

- elasticity is high, meaning taxpayers are sensitive to increases in tax rates
- earning ability is measured as annual salary and wages
- social welfare is not applicable, as only a portion of the total population is considered.

IV TERM DEFINITIONS

This research is concerned with 'progressivity' and 'equity'. This section examines the meaning of these terms and how they are interpreted for the purposes of this research.

A Measure of progressivity

An income tax system may be regressive, proportional or progressive. A regressive tax system is one where the increase in tax liability is less than the increase in income, while the increase in tax liability and increase in income is uniform in a proportional tax system. A progressive tax system means that the rate of increase in tax liability is higher than the rate of increase in income.

Another way of phrasing this is that, in a proportional tax system, the average tax rate equals the marginal tax rate. In a progressive tax system, the average tax rate is lower than the marginal tax rate, whereas the opposite holds true for a regressive tax system.

A progressive tax system itself may be regressive, proportional or progressive. If regressive, the rate of progression decreases when entering into higher tax brackets. A proportional progression means that the rate of tax increases uniformly with the rate of increase in income. And therefore, by definition, a progressive progressive tax system is one where the rate of increase in tax exceeds the rate of increase in income.

While these definitions of regressivity, proportionality and progressivity are universally accepted, measuring the degree of income tax progressivity is not as settled. There are two conventional ways of measuring progressivity. The first measure is according to the difference between the tax rates paid by high-income and low-income groups. For this, the focus is on tax brackets (including the tax-free threshold) and marginal tax rates. The second is where progressivity is measured as the greater the share of income received by

²⁵ Piketty and Saez, 'Optimal Labor Income Taxation' (n 10) 412.

the rich, the greater their share of taxes paid. Here the focus is on the proportion of the population who are high income earners and on the share of tax paid.

Various methods are proposed that express the ratio of change in the variables used in the calculation. Pigou developed two measures, the first being average rate progression, which measures the change in the average tax rate, and the second is marginal rate progression, which is the ratio of change in the marginal tax rate to the change in income.²⁶ Alternative measures are liability progression, which measures the percentage change in tax liability to the percentage change in income, and residual income progression, which measures the ratio of the percentage change in income after tax to the percentage change in income before tax.²⁷ A variety of other measures have been proposed,²⁸ including using the share of taxes paid,²⁹ and comparing the impact of a tax with more general measures or indexes of income inequality.³⁰

For this research, progressivity is defined as the gap between pre-tax and post-tax income. It is not the amount of tax paid.

B Equity

Equity is often associated with redistribution. Indeed, 'the equity or redistributive goal' has been stated to be one of the 'overall objectives, or principles, of taxation'.³¹

The concept of equity, or fairness, refers to the fact that the tax system should be equitable in the way taxpayers are treated. It is usually defined in terms of 'economic position'. That is,

[h]orizontal equity requires individuals in the same economic position to be treated the same by the tax-transfer system. Vertical equity is generally considered to mean that individuals in different economic positions should be treated differently, usually with those having greater economic capacity paying more.³²

Here 'economic position' is defined by reference to criteria such as family circumstances and geographical area, not merely to individual income. Thus, two taxpayers with equal incomes, the first being single and the second married with two children, are not regarded as being in the 'same economic position'. This impacts only on horizontal equity.

Vertical equity, on the other hand, is concerned with differences in ability to pay, where those able to pay should pay more — that is, the progressivity of the tax system. Vertical

²⁶ AS Pigou, *A Study in Public Finance* (Macmillan, 3rd revised ed, 1960).

²⁷ RA Musgrave and Tun Thin, 'Income Tax Progression' (1948) 56(6) *Journal of Political Economy* 498.

²⁸ See, for example, KS Peter, S Buttrick and D Duncan, 'Global Reform of Personal Income Taxation, 1981–2005: Evidence from 189 Countries' (2010) 63(3) *National Tax Journal* 447; I Joumard, M Pisu and D Bloch, 'Tackling Income Inequality: The Role of Taxes and Transfers' (2012) 1 *OECD Journal: Economic Studies* 37; NC Kakwani, 'Measurement of Tax Progressivity: An International Comparison' (1977) 87(345) *Economic Journal* 71; D Suits, 'Measurement of Tax Progressivity' (1977) 67 *American Economic Review* 747.

²⁹ Kakwani (n 28); Suits (n 28).

³⁰ An example is the Gini coefficient, which measures how unequal the distribution of income is among individuals and households. By estimating the Gini coefficient before taxes and transfers, and comparing it with the Gini coefficient after taxes and transfers, the progressivity of the tax and transfer system can be ascertained.

³¹ Saunders (n 2) 25.

³² Treasury, *Architecture of Australia's Tax and Transfer System* (n 2).

equity also involves the perceived equity of the taxpayer's burden relative to that of other taxpayers.³³ Indeed, it has been suggested that the perceived fairness of the tax rate is more important than its absolute level.³⁴

Of relevance to this research is vertical equity and the perceived fairness of the progressivity of the income tax system as determined by the objective analysis of pre- and post-tax income.

V DATA AND ANALYSIS

A The data

A progressive tax system is usually segmented into tax brackets that progress to successively higher rates of tax. Each tax bracket represents a marginal tax rate that increases in each tax bracket. That is, income is taxed on the extra income earned in each tax bracket at successively higher rates. At the highest bracket it becomes a flat tax rate. Australia currently has five tax brackets.

The data used in this study is taxable income from AUD100,000 to AUD250,000, at AUD10,000 intervals. These income levels correlate to the fourth and fifth tax brackets, with marginal tax rates of 37 per cent and 45 per cent, respectively. The tax payable and Medicare levy is calculated using 2018–19 tax rates. With AUD100,000 being the baseline, factors of income, tax and net income are calculated and an average tax plus Medicare levy rate determined. This data is shown in Table 1.

Table 1: Calculated data based on selected taxable annual incomes

Taxable income (AUD)	Tax payable (AUD)	Medicare levy (AUD)	Net income (AUD)	Factor from baseline			Average tax + Medicare (%)
				Income	Tax	Net income	
250,000	85,597	5,000	164,403	2.500	3.494	2.177	36.24
240,000	81,097	4,800	158,903	2.400	3.310	2.105	35.79
230,000	76,597	4,600	153,403	2.300	3.127	2.032	35.30
220,000	72,097	4,400	147,903	2.200	2.943	1.959	34.77
210,000	67,597	4,200	142,403	2.100	2.759	1.886	34.19
200,000	63,097	4,000	136,903	2.000	2.576	1.813	33.55
190,000	58,597	3,800	131,403	1.900	2.392	1.740	32.84
180,000	54,097	3,600	125,903	1.800	2.208	1.668	32.05
170,000	50,397	3,400	119,603	1.700	2.057	1.584	31.65
160,000	46,697	3,200	113,303	1.600	1.906	1.501	31.19
150,000	42,997	3,000	107,003	1.500	1.755	1.417	30.66
140,000	39,297	2,800	100,703	1.400	1.604	1.334	30.07

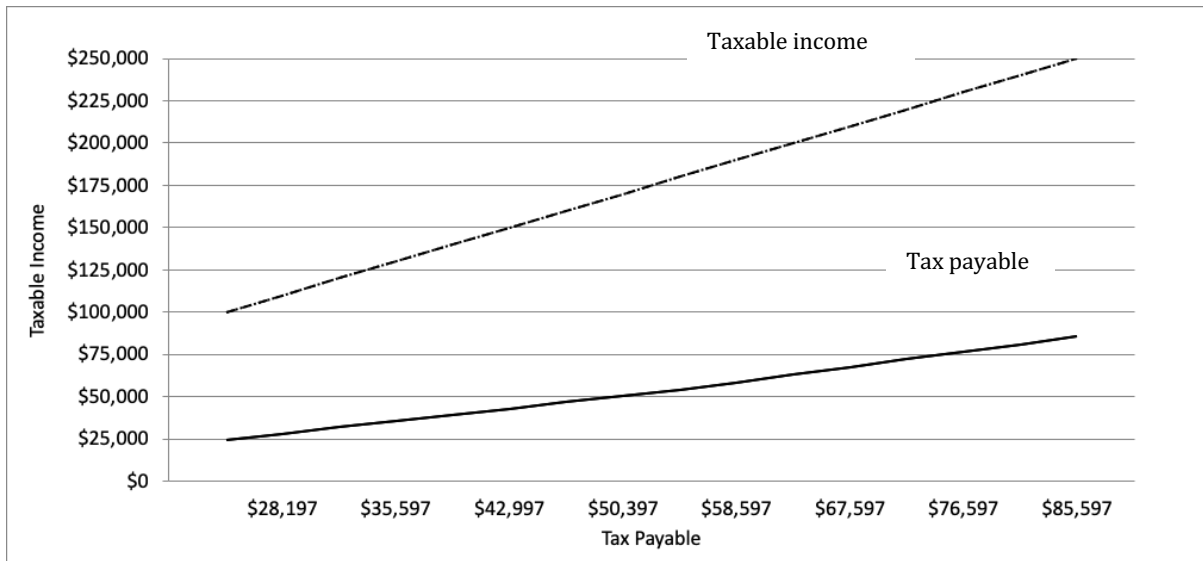
³³ BR Jackson and VC Milliron, 'Tax Compliance Research: Findings, Problems and Prospects' (1986) 5 *Journal of Accounting Literature* 125.

³⁴ DV Moser, JH Evans III and CK Kim, 'The Effects of Horizontal and Exchange Inequity on Tax Reporting Decisions' (1995) 70(4) *Accounting Review* 619, cited in Nicoleta Bărbuță-Mișu, 'A Review of Factors for Tax Compliance' (2011) 1 *Economics and Implied Informatics* 69, 70.

130,000	35,597	2,600	94,403	1,300	1.453	1.250	29.38
120,000	31,897	2,400	88,103	1,200	1.302	1.167	28.58
110,000	28,197	2,200	81,803	1,100	1.151	1.083	27.63
100,000	24,497	2,000	75,503	1,000	1.000	1.00	26.50

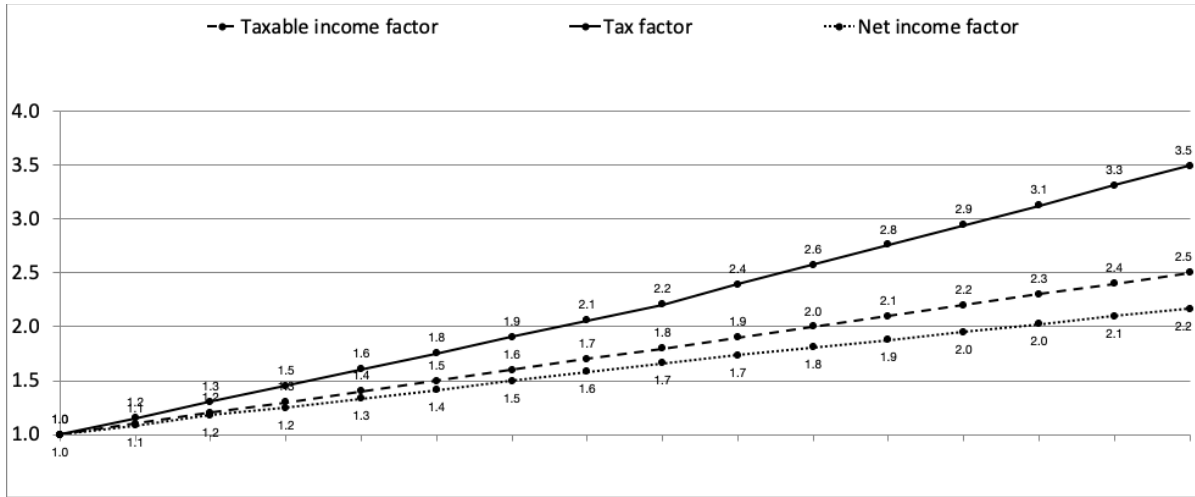
Figure 1 illustrates the relationship between taxable income and tax payable. Progressivity is depicted by the widening gap between pre-tax income and tax payable. It is the equitability of this gap, this progressivity, with which this research is concerned.

Figure 1: Relationship between taxable income and tax payable (AUD)



A baseline is a point of reference. Using a baseline allows comparisons to be made and also enables the identification of any correlations within the dataset. The factors, and therefore the comparisons and correlations made in this study, are income, tax and net income. The relationship between these factors is shown in Figure 2, which serves as another depiction of the progressivity of the Australian income tax system. As taxable income (dash line) increases, so net income (dotted line) increases at a declining rate, shown by the increasing gap between the taxable income and net income factors. While the increase in tax (straight line) progressively increases, it is at a substantially faster rate than taxable income.

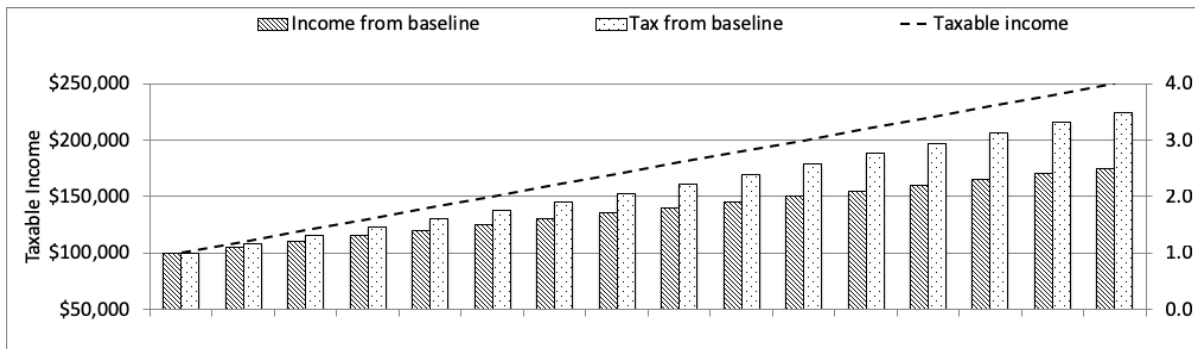
Figure 2: Relationship between the taxable income, tax and net income factors



B Graphical analysis

Figure 3 compares the increase in income over the data range with the corresponding tax payable. There is clearly a disproportionate increase in tax paid compared with income before tax.

Figure 3: Comparison of income and tax from the baseline (AUD)



The income factor means that a salary of AUD250,000 is 2.5 times that of AUD100,000. The tax factor, on the other hand, shows that an individual on AUD250,000 pays 3.5 times the amount of tax than an individual who earns AUD100,000. The disposable income relative to AUD250,000, shown by the net income factor, is 2.2 times that of disposable income from AUD100,000. The relationship between tax payable and net income is shown in Figure 4.

Figure 4: Comparison of net income and tax from the baseline (AUD)

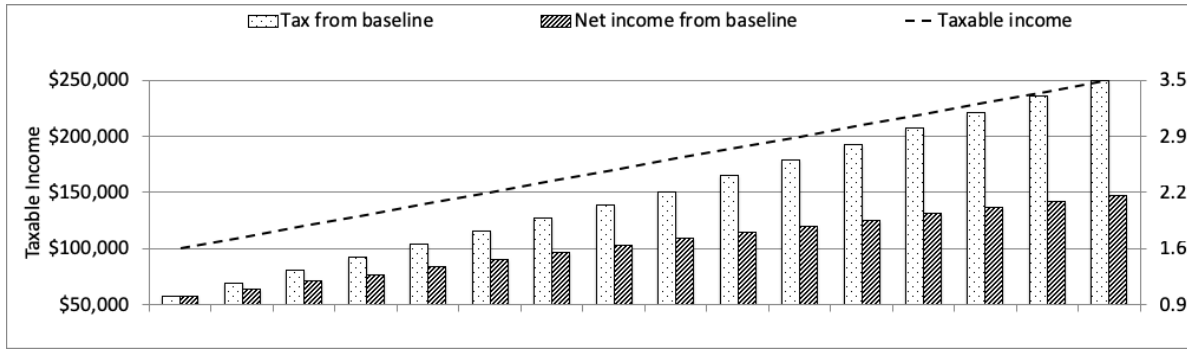
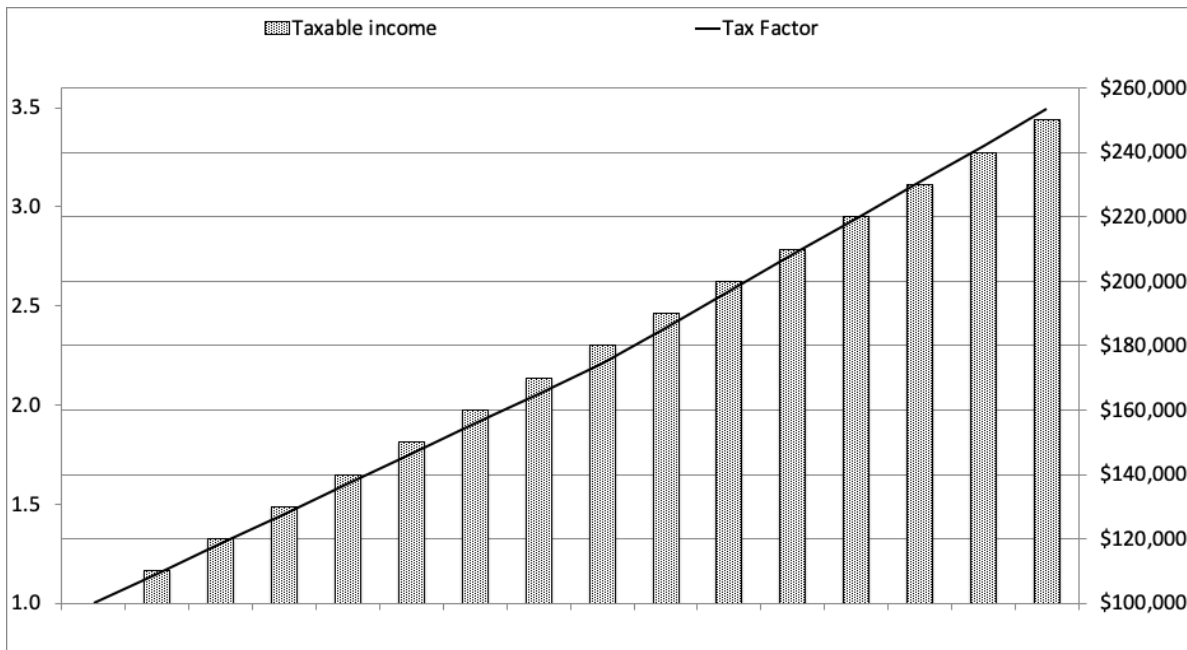


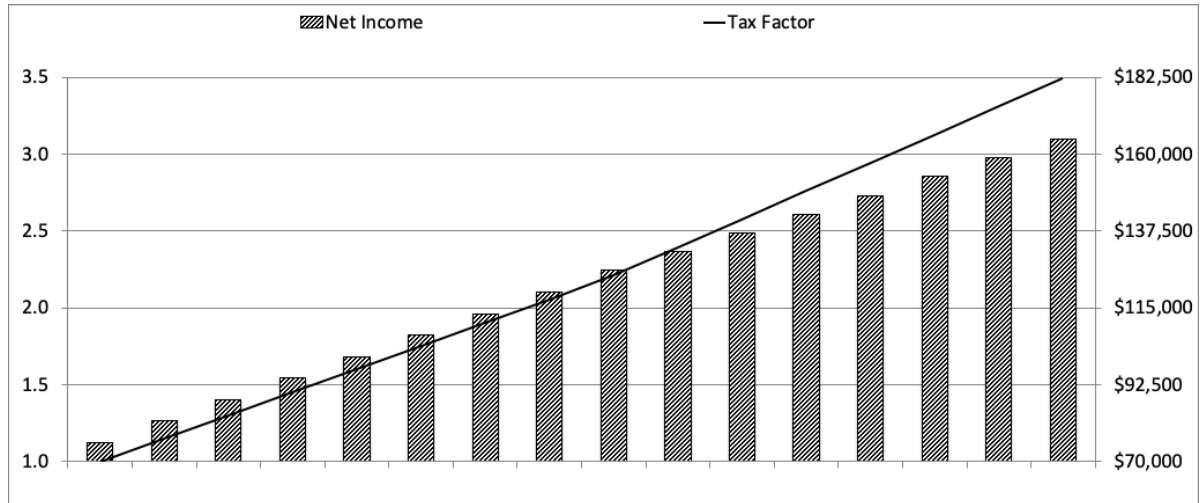
Figure 5 illustrates the relationship between taxable income and the tax factor. It shows that, up to AUD180,000, the taxpayer is keeping incrementally more of their increases. Above that (being the top tax bracket), the more income one gets, the less of that income one keeps.

Figure 5: Relationship between taxable income (AUD) and the tax factor



This is supported when comparing net income and the tax factor as shown in Figure 6. Note that the net income associated with a taxable income of AUD180,000 is AUD122,303.

Figure 6: Relationship between net income (AUD) and the tax factor



C Data analysis

For each increase of AUD10,000 in taxable income, the income increases by a factor of 0.1 from the baseline. This is irrespective of the tax brackets. The change in tax bracket at an income level of AUD180,000 shifts the tax and net income factors from the baseline, given the increase in marginal tax rate associated with the change in tax bracket. Thus, the incremental tax factor for each AUD10,000 increase in taxable income is 0.151 in the lower tax bracket and 0.184 in the top marginal tax bracket. This is a gain of 0.033. For net income the incremental factor decreases from 0.083 to 0.073, a decrease of 0.01.

A hallmark of a progressive tax system is that average tax rates are less than marginal tax rates. That is clearly evident in the data. The current marginal tax rate for the income bracket of AUD180,000 and above is 45 per cent, and 37 per cent for the lower income bracket containing salary and wages of AUD100,000 to AUD179,999. By examining the incremental change in the average tax and Medicare rate, one can ascertain the degree of progressivity. This information is contained in Table 2.

Table 2: Incremental change in average tax (including Medicare) rates

Taxable income (AUD)	Average tax + Medicare (%)	Incremental change in average (%)
250,000	36.24	0.45
240,000	35.79	0.49
230,000	35.30	0.53
220,000	34.77	0.58
210,000	34.19	0.64
200,000	33.55	0.72
190,000	32.84	0.79
180,000	32.05	0.41
170,000	31.65	0.46
160,000	31.19	0.52
150,000	30.66	0.60
140,000	30.07	0.69
130,000	29.38	0.80
120,000	28.58	0.95
110,000	27.63	1.14
100,000	26.50	

As taxable income increases, the average rate of tax and Medicare levy increases. However, it increases at a declining rate in each tax bracket. This shows that a taxpayer is better off towards the top end of each tax bracket.

It is also worth noting that a taxable income of AUD140,000 gives an average tax rate close to the company tax rate of 30 per cent, and that a taxable income of a little under AUD110,000 equates to the 27.5 per cent tax rate of a base rate entity.

D Discussion

Obviously a salary and wage earner will have more net income, or disposable income, the more their taxable income increases. But it is the tax liability that will determine what the increase in net income is relative to the increase in taxable income.

A progressive tax system appears equitable and fair. Marginal tax rates increase as incomes go up. This means that individuals on higher incomes pay more in taxes than those on lower incomes. However, the structure of income tax brackets means that any change to the bottom of the rate schedule directly affects the tax liability of all taxpayers who make more than that amount.

Given that only the middle to top end of the total salary and wage earning taxpayer population is considered in this aspect of the research, it is necessary to consider the term 'inframarginal', meaning below the margin. For example, assume Taxpayer Bob earns AUD170,000 annually. An opportunity arises that will give Taxpayer Bob an annual salary of AUD190,000. However, he will need to work harder at this new job than where he is currently employed. In making the decision about whether to work harder in order to gain an additional AUD20,000, Taxpayer Bob is concerned with the marginal tax rate that applies to the extra AUD20,000. If the government were to raise the tax rate that applies to the first AUD90,000, this will have negligible effect on Taxpayer Bob's decision as to whether to earn additional income. Because he earns more than AUD90,000, this rate change is 'inframarginal' to Taxpayer Bob. Since there are many taxpayers earning over AUD90,000, raising this tax rate would result in considerable revenue but relatively little distortion in behaviour.

However, raising rates at higher levels of income has potentially the opposite effect. At least in theory. There is support for the contention that if the government raises tax rates at high levels of income, it distorts the behaviour of the rich.³⁵ However, this is not settled. It is also stated that 'there is no empirical evidence that marginal tax rates on moderately high incomes, of between 35% and 50% cause significant inefficiencies or discourage work or investment'. At a practical level, one can say 'of course not'. Only those individuals with an alternative source of income to salary and wages have the luxury of declining to work just because the tax rate has increased. Working for a wage is the price people must pay to live in society, put food on the table, educate their children, have access to medical treatment when required, and be able to take the occasional holiday.

What gives the tax system its progressivity are the tax brackets. The higher the number of tax brackets, the greater is the progressivity. Conversely, a reduction in the number of

³⁵ McCaffery and Hines (n 10) 1055; Gruber and Saez (n 18) 3; Mirrlees, 'An Exploration in the Theory of Optimum Income Taxation' (n 11).

tax brackets causes the tax system to become more of a proportional progressive tax system. The tax rates have a smaller, if any, impact on progressivity. Their impact is more on vertical equity. Reduction in tax rates flatten the rate structure, edging the progressive tax system towards being more of a progressive proportional tax system.

This study considers vertical equity and the progressivity of the income tax system at the upper tax brackets. It is concerned with salary and wage income, or taxable income, of AUD100,000 to AUD250,000. This covers two tax brackets with marginal tax rates (including Medicare levy) of 39 and 47 per cent, the change-over point being at AUD180,000, which is approximately 2.1 times the average wage in Australia.³⁶

As depicted in Figure 6 by the tax factor line intersecting with net income, an individual keeps incrementally more of their increase up to a taxable income of AUD180,000. Indeed, the difference in the income and net income factors is around 0.1, which increases to 0.2 and more from AUD200,000. The perception of fairness, or equity, from the taxpayer's perspective, therefore, diminishes as the taxpayer moves into the top tax bracket.

There is a definite advantage to being towards the top of a tax bracket. The more one progresses through a tax bracket, the lower the incremental increase in the average tax rate is, as shown in Table 2. Due to the change in marginal tax rates when changing income tax brackets, there is an increase in the incremental change in the average tax rate. A taxpayer who moves from a salary of AUD180,000 to AUD185,000 or AUD190,000 is at much more of a disadvantage than a taxpayer on, say, AUD150,000 or AUD230,000 who receives a similar dollar increase.

This creates specific motivations for the taxpayer to change employers. It is usually only by changing jobs that one is able to secure a substantial increase in taxable income. This can be illustrated using an increase of AUD170,000 to AUD200,000, where there is just under an average of 2 per cent increase in tax. When nearing the top end of a tax bracket there is an incentive to move jobs and secure a substantial increase in taxable income, otherwise the after-tax benefit of a normal or CPI-related increase (consumers price index) is marginal. That is, the increase in disposable income relating to an increase in taxable income of AUD180,000 to AUD190,000 is less than that derived from a lower taxable income. This also impacts on the perception of fairness.

As noted above, a progressive tax system can itself be regressive, proportional or progressive.³⁷ Essentially, it is regressive if the rate of progression falls when entering into higher income brackets.³⁸ This is shown diagrammatically when the line of tax progression lies above the income line, as in Figure 7. The closer the lines when moving up the income scale, the lower is the regressive progression. Conversely, if the distance

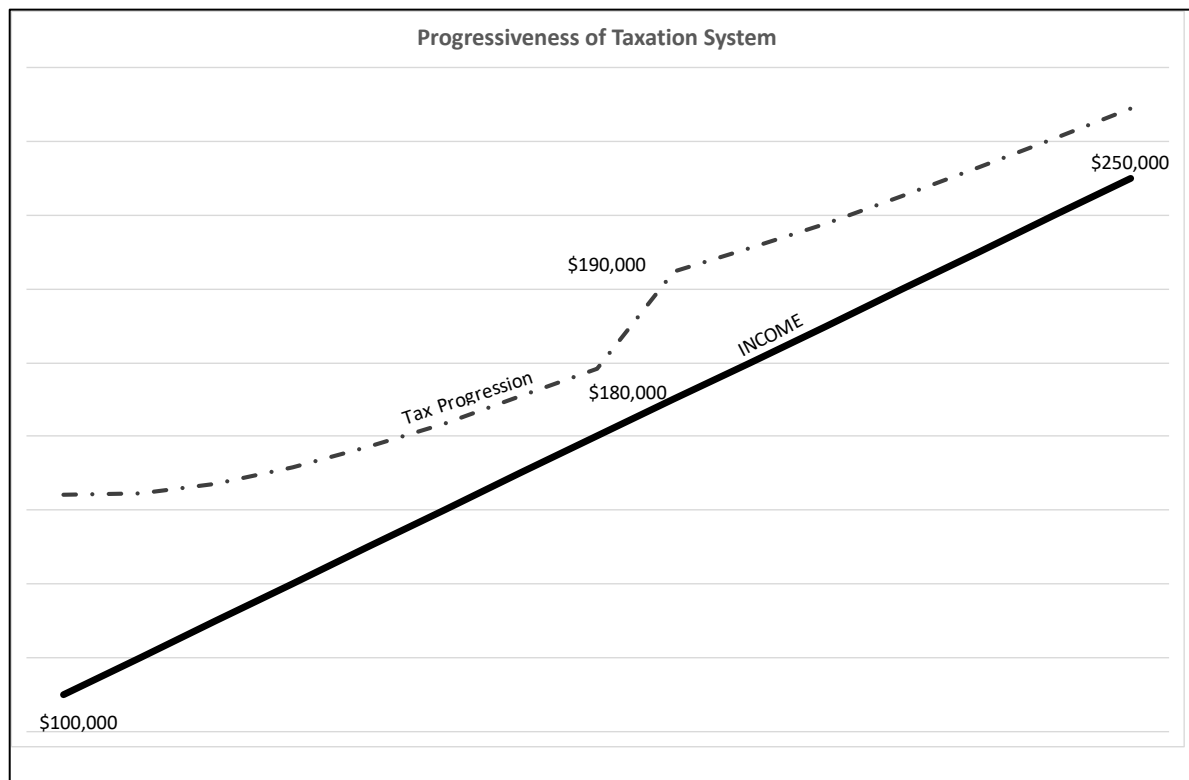
³⁶ '6302.0 — Average Weekly Earnings, Australia, May 2019', *Australian Bureau of Statistics, Australian Government* (Web Page, 21 February 2019) Table 1 <<https://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0>>.

³⁷ See Section IV.A.

³⁸ Florije Govori, 'A Different Approach of Tax Progressivity Measurement' (Working Paper No 62846, Munich Personal RePEc Archive, January 2015).

between the tax progression and income lines increases, the higher is the degree of regressive progression.³⁹

Figure 7: Progressivity of the tax system



This indicates that, at least at income levels between AUD100,000 and AUD250,000, the Australian income tax system is highly regressive progressive at the entry point of each tax bracket. As individuals move towards the top end of a tax bracket, the regressivity of the progressive tax system decreases.

It is also interesting to note that a taxable income of around AUD140,000 gives an average tax rate (including Medicare levy) equivalent to that of the statutory company rate. A taxable income of a little under AUD110,000 equates to the same tax rate applicable to base rate entities. The latter is well within the ‘middle income’ level.⁴⁰

VI CONCLUDING REMARKS

Reducing the number of tax brackets decreases the progressivity of the tax system. This is what has been proposed in the 2019 Federal Budget by the Morrison Coalition Government. The proposal is that, by 2024–25, there will be only four income tax brackets. The third tax bracket will cover taxable income of over AUD45,000 to AUD200,000, at a marginal tax rate of 30 per cent. The fourth tax bracket remains at 45

³⁹ Ibid.

⁴⁰ See the discussion on the low and medium income tax offset in Section II.

per cent for those individuals earning over AUD200,000. This will be a much flatter tax system than is currently the case. Nevertheless, it is stated that the progressive tax system will be maintained. Progressivity is measured as the 'share of personal income tax paid'. The example given is that an individual on AUD200,000 earns more than 4.4 times a person on AUD45,000 but will pay 10 times more tax.⁴¹

Therefore how progressivity is defined and measured does have an impact on how the message is perceived. Individuals are not concerned with where they sit with respect to the share of personal income tax they pay. Indeed, most taxpayers consider themselves to be 'middle income earners'.⁴² Individuals are concerned with the amount of personal income tax they pay. With respect to other taxpayers, the concern is largely limited to ensuring compliance with tax obligations and that those who need financial assistance receive an adequate redistribution.⁴³

While the tax system is inherently equitable, it must be perceived to be fair, too. And it is fair, at the higher end of each tax bracket. However, for an increase in income across the change in tax bracket, this increase must be significant if it is to provide material benefit to an individual.

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⁴¹ 'Budget 2019-20: Lower Taxes for Hard-Working Australians and Small Business', *Treasury, Australian Government* (Web Page) <<https://www.budget.gov.au/2019-20/content/tax.htm>>.

⁴² Matt Wade, 'Think You Are a Middle-Income Earner? You're Probably Wrong', *Sydney Morning Herald* (Sydney, 7 April 2019).

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**TOWARDS SIMPLIFICATION OF VALUE ADDED TAX COMPLIANCE FOR SMALL BUSINESSES IN
BOTSWANA — LESSONS FROM NEW ZEALAND**

TSHEPISO MAKARA* AND ADRIAN SAWYER†

ABSTRACT

The value added tax ('VAT') system in Botswana, introduced in July 2002, has since gone through several reforms. These include: an increase in the VAT rate from its introductory rate of 10 per cent to the current 12 per cent in 2010; two increases in the registration threshold from the initial BWP250,000 (AUD32,000) to BWP500,000 (AUD64,000) in 2010, and from BWP500,000 (AUD64,000) to the current BWP1 million (AUD128,000) in 2015; and an increase in the number of zero-rated and exempted goods and services. Such reforms complicate the VAT system and increase VAT compliance costs, especially for small businesses. This paper explores possible VAT simplification measures for small businesses in Botswana, using the New Zealand GST system as a benchmark for a simplified VAT system. The New Zealand GST system is globally known as a model system, which has influenced GST design in many countries. This study concludes with VAT policy implications for Botswana and, potentially, for similarly placed countries. The study recommends a broadening of the VAT base, a reduction of VAT returns filing frequency, and the introduction of cash accounting for small businesses as measures to simplify the VAT system in Botswana.

Keywords: Value added tax; Goods and services tax; Simplification; Compliance; Small businesses.

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I INTRODUCTION

A Overview

This study aims to investigate possible measures that can be employed to simplify the Botswana VAT.¹ The study draws on the policies employed by the New Zealand government to simplify their GST system. Small businesses are the main focus of this study because they are important to the economy of Botswana. Small businesses in Botswana are defined as enterprises employing between five and 25 people, with an annual turnover of around BWP60,000–BWP1,500,000 (AUD7,680–AUD192,000).²

The VAT system in Botswana is perceived to be burdensome and unreasonably complicated.³ To begin with, small businesses have to file VAT returns every two months and use an accrual method of accounting for VAT. In addition, some goods and services are VAT-exempt. A complex VAT system makes compliance burdensome and elevates VAT compliance costs, particularly for small businesses. Prior studies indicate that VAT is costly, regressive, and falls with disproportionate severity on small businesses.⁴ To this end, this study investigates possible VAT simplification measures for small businesses in Botswana, using the New Zealand GST system as a benchmark. The New Zealand GST system is globally known as a model system. It is hoped that the recommendations that will emanate from this study will enlighten the government of Botswana (and potentially those of similarly placed countries) on possible simplification measures through which the burden of VAT compliance on small businesses can be reduced.

B Methodology and limitations

This study employs the case study research approach, involving an in-depth, detailed study of an individual or a small group of individuals or an event. Such studies are typically qualitative in nature, resulting in a narrative description of behaviour or experience.⁵ This paper reviews the literature in order to investigate key elements of an optimal VAT design. In addition, the study examines the Botswana VAT and the New Zealand GST design features as comparative case studies, with the aim of identifying possible VAT simplification measures that Botswana can adopt.

It must be noted that Botswana and New Zealand differ in many respects, such as socio-economic environment, governance, political climate, size, tax structure and the development and administrative capabilities of the revenue departments. As such,

¹ Also known as GST in other countries. These terms will be used interchangeably in this paper.

² The exchange rate of Botswana Pula (BWP) to Australian Dollar (AUD) as at August 2018 was 0.128: *XE Currency Converter* (Web Page) <www.xe.com>.

³ Tshepiso Makara and Nthathi Rametse, 'Taxpayer Attitudes, Compliance Benefits Perceptions and Compliance Costs of the Value Added Tax System in Botswana' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 246.

⁴ These studies are summarised in the study by 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. See also Tshepiso Makara and Nthathi Rametse, 'Estimates of the Cash Flow and Managerial Benefits of Value Added Tax in Botswana' (2017) 23(4) *New Zealand Journal of Taxation Law and Policy* 422; Makara and Rametse, 'Taxpayer Attitudes' (n 3).

⁵ Robert K Yin, *Case Study Research Design and Methods* (Sage, 5th ed, 2014).

comparing these two countries may be problematic and 'more likely to mislead than enlighten'.⁶ Moreover, differences in definitions and other areas of focus can lead to a comparison of 'apples and oranges'.⁷ Notwithstanding these risks, an investigation of the VAT/GST design features of the two countries is cautiously made, since such differences do not mean that Botswana cannot learn anything from the New Zealand GST system. Throughout this paper, we use VAT and GST interchangeably, as well as the relevant label for a particular jurisdiction.

This paper adopts an institutional theory perspective. By institutional theory, we are focusing on the effects of institutions in society on political outcomes, including policy formation and legislative changes.⁸ It is not the intention of this paper to provide a detailed overview of institutional theory and its application to tax research.

The remainder of the paper is organised as follows. Section II discusses the overall design of a VAT and identifies features of a VAT that make it either complex or simple. Section III reviews the Botswana VAT and the New Zealand GST designs. Possible VAT simplification measures for Botswana are identified in Section IV, while Section V concludes with policy recommendations.

II DESIGN OF A VAT SYSTEM

A Synopsis

The design of a VAT system is important, as it affects the manner of tax compliance as well as taxpayer compliance costs. Certain features complicate a VAT system, such as the number of VAT rates, exemptions and zero-rating of certain goods and services. A complex VAT design has higher compliance costs that burden smaller businesses the most. Such a burden may be perceived as unfair and, consequentially, can arouse negative attitudes in taxpayers. This section does not aim to cover all aspects of a VAT system design. Readers interested in an in-depth discussion of the design of a VAT are referred to other studies.⁹

⁶ Cedric Sandford, *Tax Compliance Costs: Measurement and Policy* (Fiscal Publications, 1995) 405.

⁷ International Finance Corporation, *The Costs of Tax Compliance in Ukraine* (2009) 95 <www.ifc.org/Ukraine/IC>.

⁸ See further the discussion of institutional theory in Lisa Marriott, *The Politics of Retirement Savings Taxation: A Trans-Tasman Comparison* (CCH Australia, 2010).

⁹ See, for example, Alan Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund ('IMF'), 1988); 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); Liam P Ebrill, Michael Keen and Victoria J Perry (eds), *The Modern VAT* (IMF, 2001); International Tax Dialogue ('ITD'), *The Value Added Tax: Experiences and Issues* (2005); Richard Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries* (Cambridge University Press, 2007).

B Definition of a VAT

The VAT is the predominant form of consumption tax across the globe,¹⁰ being now implemented by over 150 countries worldwide.¹¹ It is alleged to be the most important single tax in developing and transitional countries,¹² while in the European Union, it is said to be the cornerstone of tax policy and the economic system.¹³ In Africa, the proliferation of VAT has been phenomenal, with the majority of African countries adopting a VAT of some sort.

Martinez-Vasquez and Bird assert that the success of VAT reflects a number of factors. To begin with, VAT has a high revenue-raising potential and is relatively simple, conceptually at least. In addition, VAT enhances economic efficiency, trade and growth. Its relatively mild consequences on income distribution and equity may be alleviated with ease. Furthermore, fewer and relatively less complex political economy issues seem to interfere with its introduction and development, compared with other potential revenue-raising taxes.¹⁴

In addition, the spread of VAT across most continents signifies its value as a source of revenue in many countries.¹⁵ In the OECD alone, VAT generated around 20 per cent of total tax revenue in 2015,¹⁶ and for many countries the VAT yield can be anywhere between less than 1 per cent and over 10 per cent of gross domestic product.¹⁷ Keen and Lockwood assert that VAT raises about 20 per cent of the world's tax revenue, and also that approximately four billion people are affected by it directly.¹⁸ Principally, countries that have a VAT generally have higher government tax revenues than those that do not.¹⁹

C VAT design

1 Overview

The design of a VAT is important, not only to its success in achieving high compliance and meeting revenue targets, but also to the magnitude of VAT compliance costs incurred by businesses in the process of complying with the VAT system. Good tax design seeks to minimise the real costs to society that are inherent even in the best-designed taxes.²⁰

¹⁰ Susan Symons, Neville Howlett and Katia Alcantara, *The Impact of VAT Compliance on Business* (PricewaterhouseCoopers, 2010) 5.

¹¹ Stephane Buydens, *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD, 2011) 11; Ine Lejeune, *The EU VAT Experience: What Are the Lessons?* (Tax Analysts, 2011) 257.

¹² Bird and Gendron (n 9) 1.

¹³ Lejeune (n 11) 257.

¹⁴ Jorge Martinez-Vasquez and Richard Bird, 'Value Added Tax: Onward and Upward?' (Working Paper No 10-26, International Studies Program, Andrew Young School of Policy Studies, 2010) 1.

¹⁵ Ebrill, Keen and Perry (eds) (n 9) noted that, at the time of their study, many countries had a VAT that raised, on average, 25 per cent of their tax revenue.

¹⁶ OECD, *Revenue Statistics 2017: Tax Revenue Trends in the OECD* (OECD Publishing, 2017) 3.

¹⁷ Ebrill, Keen and Perry (eds) (n 9) 8.

¹⁸ Michael Keen and B Lockwood, 'The Value Added Tax: Its Causes and Consequences' (Working Paper No 183, Fiscal Affairs and Secretary's Departments, IMF, 2007) 3.

¹⁹ Ebrill, Keen and Perry (eds) (n 9) 8.

²⁰ Richard Bird and Eric Zolt, 'Tax Policy in Emerging Countries' (2008) 26 *Environment and Planning C-Government and Policy* 73, 76.

Krever affirms that ‘to a very large extent, the potential effectiveness of a VAT depends on the fundamental design of the legislation as well as the way the design is translated into law’.²¹ Complex VAT design leads to significant compliance costs. It also increases the possibility of non-compliance, giving taxpayers the incentive to avoid tax by misclassifying goods or services as exempt or zero-rated.²²

According to Lejeune, the design of a best-practice VAT requires a balance to be established between the objectives of three stakeholders: the government, businesses and citizens. The government’s principal aim is to increase the revenue necessary to fund public services (essentially infrastructure, health, welfare security and education), to attract and retain businesses as well as create new jobs and secure existing ones. The objectives of businesses, however, are to participate in ‘global’ competition and maximise profit. Citizens usually seek a non-regressive and non-inflationary tax.²³

Key factors, namely VAT rates, zero-rating, exemptions and the registration threshold, are the cornerstones of VAT design. These factors determine: how much government revenue will be raised from VAT (after considering the administrative costs); the magnitude of compliance costs borne by taxpayers (businesses); and the regressivity of the VAT upon final consumers (citizens). The authors suggest that the manner and frequency of VAT returns filing are also important cornerstones, as they have a direct bearing on the compliance costs borne by taxpayers. The elements of a conceptually simple VAT, as suggested by the United States Government Accountability Office (‘USGAO’), are displayed in Table 1. Ideally, a conceptually simple VAT would have a single rate and a zero threshold, be inclusive of all goods and services (with the exception of exports, at zero per cent), and use invoices/receipts for sales/purchases verification.

Table 1: Elements of a conceptually simple VAT system²⁴

Element	Definition
Single tax rate	One rate applies to the base.
Broad, non-exclusionary tax base	All goods and services are subject to the VAT, including financial transactions and real estate.
All business, government, and non-profit entities are taxed	All entities are subject to paying VAT on purchases and required to charge VAT on qualifying sales of goods and services.
Destination principle	Goods and services are subject to taxation in the jurisdiction in which they are consumed. Therefore, imports are subject to VAT in the importing country, and exports (taxed at zero per cent) are excluded from the domestic tax base.

²¹ Rick Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 9.

²² United States Government Accountability Office (‘USGAO’), *Value Added Tax. Lessons Learned from Other Countries on Compliance Risks, Administrative Costs, Compliance Burden and Transition: Report to Congressional Requesters* (2008) 4–5.

²³ Lejeune (n 11) 264.

²⁴ USGAO (n 22) 12–13.

Credit invoice mechanism	Tax calculations are based on valid invoices and sales receipts for each transaction by subtracting the taxes paid on all input purchases from taxes collected on all output sales.
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2 VAT rate(s)

The rate, or number of rates, at which VAT is imposed is a significant element in the design of VAT. Tax administrations generally levy more than one VAT rate (being the standard rate and reduced rate(s)) on goods and services. The most common type of reduced rate is a zero rate, commonly applied on exports, and certain basic goods and services that are usually consumed by the less well-off.²⁵ The application of a zero rate on exports ensures that VAT is borne entirely by the final consumer in the country where consumption takes place, and is not recoverable in a foreign jurisdiction (often referred to as the ‘destination principle’).

In terms of the goods and services consumed by the ‘poor’, the use of the lower or zero rate(s) is intended to reduce the regressivity of VAT on such consumers (equity considerations). It has, however, been argued that the use of lower or zero rates for redistribution purposes is practically limited, because the rich generally spend more, in absolute terms, on the rate-reduced commodities. Thus, the rate decrease benefits the rich more than the poor.²⁶ Additionally, where there are other income redistribution instruments, it is less likely that social benefits will be derived from setting more than one rate of VAT.²⁷ Ebrill et al maintain that personal income tax provides a more effective way of redistributing income.²⁸ Remaining issues of regressivity can be solved without the VAT, such as through income supplements and welfare payments from the government.

Furthermore, having several VAT rates increases the VAT system’s complexity,²⁹ and resultant compliance costs, especially for small traders.³⁰ As the number of rates increases, tax forms become more complicated and compliance costs tend to increase considerably. Moreover, a VAT system with many rates distorts consumer and producer choices, and invites rent reeking.³¹ The basic rule in VAT design is to have as few tax rates as will satisfy the preference of politicians.³² Similarly, Cnossen suggests that the differentiation of VAT rates should be kept to a minimum.³³ However, others propose that

²⁵ The government of Botswana imposes a zero rate on certain goods and services. See *Value Added Tax Act 2001* (Botswana) 72–83 (‘VAT Act’); *Value Added Tax (Amendment) Act 2015* (Botswana) A.1–2 (‘VATA Act’). New Zealand only has a zero rate for exports, and for transfers of what is known as a ‘going concern’.

²⁶ ITD (n 9) 14–15.

²⁷ Ebrill, Keen and Perry (eds) (n 9) 74.

²⁸ Ibid.

²⁹ Cnossen (n 9) 82.

³⁰ For example, Milka Casanegra de Jantscher, ‘Problems of Administering a Value Added Tax in Developing Countries’ (Working Paper No WP/86/15, IMF, 1986) 3; Krever (n 21) 19.

³¹ Matt Benge, Marie Pallot and Hamish Slack, ‘Possible Lessons for the United States from New Zealand’s GST’ (2013) 66(2) *National Tax Journal* 479, 480. Rent reeking, viewed from the perspective of economic and public-choice theory, refers to a person or entity attempting to increase their share of current wealth without producing or creating any additional wealth.

³² Tait (n 9) 42.

³³ Cnossen (n 9) 83.

a conceptually simple VAT should have a single rate that applies to all goods and services.³⁴

Applying a single rate of VAT to all goods and services (with the exception of exports, at a zero rate) generally simplifies compliance.³⁵ The reason a single rate reduces the burden of compliance is because it makes record keeping easier, by eliminating the need to separate goods and services into different categories. Also, a single rate removes the incentive to intentionally misclassify items.³⁶

With regard to the magnitude of the VAT rate, a high rate is seen to be more effective than a low one. Tait maintains that levying a VAT at a low rate below 10 per cent might be considered a poor allocation of resources.³⁷ In terms of increasing the VAT rate, as is common with many countries,³⁸ Buydens advises that countries should consider the efficiency of rate increases compared with broadening the VAT base and decreasing the number of reduced rates.³⁹ He suggests that reducing the number of exemptions to broaden the VAT base would enhance the efficiency and neutrality of the tax. Essentially, this offers an effective alternative to increasing VAT rates.⁴⁰

3 Exemptions

VAT exemptions refer to the complete exclusion of certain goods and services from the tax base.⁴¹ Exemptions contradict the principle of neutrality, which requires VAT to be a broad-based tax,⁴² and lead to breaks in the VAT chain,⁴³ by denying the businesses that trade in exempt supplies to claim the input VAT. Other problems with exemptions include tax revenue effects, distortion of input choices, an incentive to self-supply, disruption of the destination principle, an incentive to import VAT-exempt inputs, strenuous record keeping for partially exempt traders, and exemption creep.⁴⁴

VAT exemptions also result in the imposition of tax-on-tax (cascading) and introduce inequities in the VAT system that distort production decisions.⁴⁵ In addition, the exclusion

³⁴ For example, USGAO (n 22) 12; Bird and Gendron (n 9) 108.

³⁵ Ebrill, Keen and Perry (eds) (n 9) 78.

³⁶ Ibid 78–9.

³⁷ Tait (n 9) 39.

³⁸ Botswana increased the VAT rate from 10 per cent to 12 per cent on 1 April 2010. Many other countries (for example, South Africa, Ghana and Singapore) have increased their VAT rates. In the OECD, 12 countries (Chile, Germany, Greece, Iceland, Mexico, Netherlands, New Zealand, Norway, Portugal, Slovenia, Switzerland and Turkey) have increased their VAT rate since 2000. See Buydens (n 11) 72–4.

³⁹ Ibid 15.

⁴⁰ Ibid.

⁴¹ VAT exemptions often include basic education services, basic health services, financial services, real estate and construction. See Ebrill, Keen and Perry (eds) (n 9) 91–9. The different VAT exemptions by OECD countries are outlined in an OECD study of consumption tax trends. See Stephane Buydens, OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (OECD Publishing, 2012) 86–8. In Botswana, the VAT-exempt goods and services include accommodation, education services, health services provided by a public medical facility, financial services and supply of domestic passenger transportation. See *VAT Act* and *VATA Act* (n 25).

⁴² Buydens, *Consumption Tax Trends 2010* (n 11) 15.

⁴³ Ebrill, Keen and Perry (eds) (n 9) 85.

⁴⁴ Ibid 83–90. Exemption creep is a situation whereby exemption creates direct pressure for further exemptions.

⁴⁵ For example, Tait (n 9) 50; ITD (n 9) 8.

of some goods and services from the tax base distorts consumer choices and reduces tax revenue.⁴⁶ Tait asserts that the more exempt goods and traders there are, the greater the possibility that VAT is unintentionally taxed at different rates.⁴⁷ Moreover, increased exemptions could possibly entice other traders to claim exemption for themselves and thereby erode the tax base. Accordingly, theoretically and practically, exemptions should be kept to a minimum,⁴⁸ and limited to basic health, education and financial services.⁴⁹

4 VAT registration threshold

The choice of a registration threshold is very important in the design and implementation of VAT.⁵⁰ VAT registration thresholds differ from one country to another across the globe. For example, the general VAT registration threshold in Australia, New Zealand and South Africa is set at AUD75,000, NZD60,000 (approximately AUD54,000) and ZAR1 million (AUD92,868),⁵¹ respectively. In Botswana, the VAT registration threshold is BWP1 million (AUD128,000).⁵² A low registration threshold requires smaller businesses to adhere to the stringent requirements of VAT (for example, proper record keeping, VAT collection and remittance, and timely filing of VAT returns). This imposes a disproportionate compliance burden upon smaller traders that, in turn, may evoke negative attitudes (and tax evasion) from small businesses. Indeed, a low registration threshold may motivate businesses to engage in non-compliant behaviour, such as 'dishonesty and failure to report some sales, artificial separation of a business into multiple unregistered parts, and reduction of activity to reduce sales'.⁵³

However, a high registration threshold results in differential treatment of businesses, which, in turn, leads to distortions in competition in favour of small businesses below the registration threshold. Such distortions, implied by additional costs in the form of the tax liability and compliance costs, affect VAT-registered businesses.⁵⁴ To this end, some argue that a low threshold is necessary to reduce incentives for malpractices such as sales suppression.⁵⁵ Others have suggested that transitioning rules can be used to mitigate threshold problems. Providing subsidies to offset compliance costs and tax for businesses crossing the registration threshold will reduce the double shock of compliance costs and higher tax.⁵⁶ Indeed the choice of an optimal VAT registration threshold is a very contentious issue.⁵⁷

⁴⁶ Cnossen (n 9) 78.

⁴⁷ Tait (n 9) 50.

⁴⁸ Ibid.

⁴⁹ For example, Cnossen (n 9) 83; ITD (n 9) 15.

⁵⁰ For example, Ebrill, Keen and Perry (eds) (n 9) 113; Michael Keen and Jack Mintz, 'The Optimal Threshold for a Value Added Tax' (2004) 88(3-4) *Journal of Public Economics* 559, 559; ITD (n 9) 16.

⁵¹ The exchange rate of South African Rand (ZAR) to Australian Dollar (AUD) as at August 2018 was 0.09: *XE Currency Converter* (Web Page) <www.xe.com>.

⁵² See the BWP-AUD exchange rate (n 2).

⁵³ Yige Zu, 'VAT/GST Thresholds and Small Businesses: Where to Draw the Line?' (2018) 66(2) *Canadian Tax Journal* 309, 312. See also Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) ch 4C.

⁵⁴ Ebrill, Keen and Perry (eds) (n 9) 120.

⁵⁵ Bengé, Pallot and Slack (n 31) 495.

⁵⁶ Zu (n 53) 312.

⁵⁷ Keen and Mintz (n 50) 559-60.

Essentially, some sort of balance is required when deciding on the level of the registration threshold. Shome maintains that small businesses should be taxed for two reasons. First, the contribution to tax by small businesses, when combined with medium-sized taxpayers, can be large, at over a quarter of total revenue. Second, there is likely to be a strong effect upon economic growth emanating from ignoring a large portion of potential tax revenue from particular sectors.⁵⁸

In contrast, Keen and Mintz assert that the revenue that is lost by raising the registration threshold and dropping many small businesses from the tax base can be traded-off against the compliance costs saved by the taxpayers.⁵⁹ Similarly, the International Tax Dialogue affirms that, on balancing the government's need for revenue against tax compliance costs, it will generally be optimal to levy the tax only on taxpayers above some critical size, and entirely exclude all those below it.⁶⁰ With regard to most developing and transitional countries, it is likely wiser to set the registration threshold too high than too low.⁶¹

5 VAT design and compliance costs

As mentioned earlier, a VAT system can be either simple or complex depending on the number of VAT rates, the presence and number of zero-rated and exempt goods and services, as well as the level of the registration threshold (whether it is relatively high or low). Other factors that affect the nature of a VAT system are the frequency of VAT returns filings, and the system used in VAT returns filing (whether submitted online or in person).

Many governments often incorporate small business 'special treatment clauses' or concessions in their tax policies, in an attempt to mitigate the disproportionate burden of tax compliance. In reality, in many countries, small businesses expect, and generally receive, special tax treatment or tax concessions.⁶² However, concessions in the form of lower VAT rates or exemptions lead to considerably higher compliance costs, because businesses have to separate their stock at the checkout counter according to the tax treatment. Large businesses can automate this process and amortise the initial setup costs over high volumes of sales. Small businesses, on the other hand, rarely have automated checkout systems. They are, therefore, forced to amortise the costs of compliance over a much smaller sales volume. Thus, the burden of differentiating fully and lower taxed products falls inequitably on small firms.⁶³

Pope asserts that recurrent tax compliance costs would be minimised under a simple tax that incorporates a single rate, a high threshold and a minimum of special exemptions, reliefs and provisions.⁶⁴ Tax payment arrangements such as less frequent returns and

⁵⁸ Parthasarathi Shome, 'Tax Administration and the Small Taxpayer' (Policy Discussion Paper No 04/2, IMF, 2004) 3-4.

⁵⁹ Keen and Mintz (n 50) 562.

⁶⁰ ITD (n 9) 23.

⁶¹ Bird and Gendron (n 9) 3.

⁶² Jeff Pope, 'Small Business Taxation: An Evaluation of the Role of Special Treatment Policies' (2008) 10(2) *The Business Review, Cambridge* 14, 14.

⁶³ Krever (n 21) 19.

⁶⁴ Jeff Pope, 'The Compliance Costs of Major Commonwealth Taxes in Australia' (PhD Thesis, Curtin University of Technology, 1993) 81.

simplified methods of calculating the GST liability may be made in favour of small businesses to alleviate their burden of GST compliance.⁶⁵

III VAT/GST DESIGNS IN BOTSWANA AND NEW ZEALAND

A The design of the Botswana VAT system

The VAT system in Botswana was introduced at a rate of 10 per cent in July 2002. In April 2010, the Botswana Unified Revenue Service ('BURS') increased the VAT rate to 12 per cent.⁶⁶ This increase was a result of the 2009 recommendations made by the International Monetary Fund to strengthen tax administration and increase the VAT rate and fuel levy to match the rates of nearby countries. The increase was aimed at enhancing the VAT revenue and possibly reducing Botswana's dependence on mining revenue in the longer term.

The Botswana VAT system, modelled on the traditional European VAT, allows for certain goods and services to be exempt while others are zero-rated.⁶⁷ The VAT-exempt goods and services consist primarily of financial services, healthcare services, accommodation in a dwelling, and educational activities. Zero-rated goods and services comprise basic foodstuffs in their natural state, and not mixed with other products,⁶⁸ exports, international transport services, and paraffin.⁶⁹

Registration for VAT is compulsory for any business that makes taxable supplies of BWP1 million (AUD128,000) or more per annum,⁷⁰ or expects that this limit will be exceeded during the following 12 months. Compulsory VAT registration is not required if the business can clearly demonstrate that the value of the taxable supplies exceeded BWP1 million due to the termination, or significant and permanent reduction in the size or scale, of a taxable activity; or the replacement of capital goods.⁷¹ Voluntary registration is open to businesses with a taxable income below BWP1 million, and this is done at the discretion of the Commissioner General of the BURS. Chapter 50:03 of the *Value Added Tax Act 2001* (Botswana) states that, while a business can register voluntarily, the option to de-register can only be exercised two years after the date of registration. Failure to apply for

⁶⁵ Jeff Pope, 'Estimating and Alleviating the Goods and Services Tax Compliance Cost Burden upon Small Business' (2001) 11(1) *Revenue Law Journal* 6, 16.

⁶⁶ IMF, *Botswana: 2009 Article IV Consultation — Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Botswana* (Country Report No 10/172, 2010) 18.

⁶⁷ Botswana Customs and Excise, Government of Botswana, *A Guide to Botswana's Value Added Tax* (2001) 41. Exempt supplies, such as education services and public medical facilities, are not subject to VAT. They are not counted as part of a business's taxable turnover. Zero-rated supplies are those that attract VAT at the rate of zero per cent, such as exports and basic food products. Sections 10 and 11 of the first schedule of the *Botswana VAT Act* (n 25) provide a comprehensive list of exempt and zero-rated supplies.

⁶⁸ These include foods that are consumed mainly by the poor, such as millet grain, wheat grain, maize cobs, flour, sugar, maize meal and millet meal.

⁶⁹ This list is by no means exhaustive. Readers interested in a complete list of zero-rated goods and services are referred to Botswana's *VAT Act* (n 25) ch 50:03.

⁷⁰ See the BWP-AUD exchange rate (n 2).

⁷¹ PricewaterhouseCoopers, *Overview of VAT in Africa* (2011) 2 <<http://www.pwc.co.za/en/publications/overview-of-vat-in-africa.jhtml>>.

registration when required is an offence that attracts high penalties. The penalties include fines, interest on late payments, and imprisonment.⁷²

The BURS classifies VAT-registered businesses into three groups: A, B and C. Groups A and B comprise businesses with a turnover below BWP12 million (AUD1.5 million), whereas Group C encompasses businesses that have an annual turnover exceeding BWP12 million. These groups are also distinguished by the manner in which they file VAT returns. Large businesses (Group C) file VAT returns monthly,⁷³ while Groups A and B file VAT returns bimonthly on alternate months.⁷⁴

During the financial year 2014–15, the BURS introduced an online VAT returns filing system (e-filing). However, the BURS notes that ‘there has been a slow uptake of the use of e-services as most taxpayers continue to file manually’.⁷⁵ Thus, the frequency and manner of VAT returns filing in Botswana pose a question of the complexity of the country’s VAT system and the burden of VAT upon businesses, especially small ones. The BURS has to encourage e-filing of VAT returns by offering free and ongoing training related to e-services and, where possible, subsidies related to computers and the internet for small businesses.

B Botswana VAT system reforms

The VAT system in Botswana has since gone through multiple reforms. The first two reforms came in the form of an increase in the VAT rate and VAT registration threshold. The VAT rate was increased from its introductory rate of 10 per cent to the current 12 per cent, while the registration threshold, which started off at BWP250,000, increased to BWP500,000 in April 2010.

On 23 January 2015, the Botswana government amended the VAT registration threshold by increasing it to BWP1 million (AUD128,000).⁷⁶ In addition to the threshold amendment, the government introduced some new zero-rated goods into the VAT system.⁷⁷ While, an increase in the number of zero-rated goods may reduce consumption costs of the poor, such a move actually complicates the VAT system and increases VAT compliance costs, especially for small businesses.

VAT amendments require businesses to update their VAT accounting systems in order to meet new requirements. These reforms complicate the VAT system and make compliance arduous. Moreover, they increase VAT compliance costs and arouse negative attitudes in taxpayers, which in turn may lead to tax evasion.

VAT taxpayers in Botswana have indicated that they find VAT requirements to be burdensome. The businesses that find VAT to be onerous and unreasonably complicated have reported higher average VAT compliance costs and also expressed resentment in

⁷² Botswana Customs and Excise (n 67) 36.

⁷³ The BURS set up a Large Taxpayer Unit to administer the tax affairs of large enterprises that contribute the largest portion of tax revenue.

⁷⁴ This was done mainly to reduce congestion at the VAT office during the VAT returns filing period. Botswana Customs and Excise (n 67) 26.

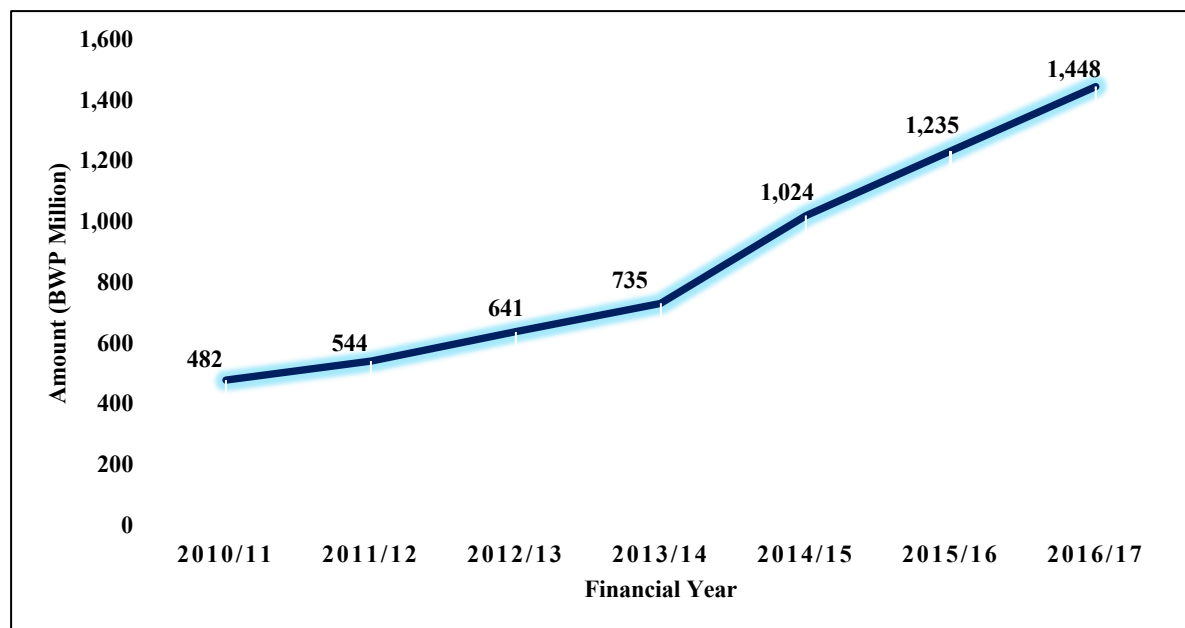
⁷⁵ Government of Botswana, *BURS Annual Report 2015* (2015) 29.

⁷⁶ See the exchange rate of BWP–AUD (n 2).

⁷⁷ *VATA Act* (n 25) A.1–2.

doing their VAT work.⁷⁸ This could possibly explain why Botswana faces an ongoing challenge of VAT non-compliance, as evidenced by growing VAT arrears (see Figure 1). The BURS mentioned that there is a culture of low tax compliance in the Botswana market, among small to medium businesses, and that there is a need to engender compliance with revenue laws.⁷⁹

Figure 1: VAT arrears⁸⁰



C The design of the New Zealand GST system

In New Zealand, the goods and services tax ('GST') was introduced on 1 October 1986. The New Zealand GST is broad-based and is currently levied at a rate of 15 per cent on almost all goods and services.⁸¹ The VAT registration threshold in New Zealand is currently NZD60,000 (AUD54,300).⁸² The New Zealand GST system is considered to be a model system that represents a contrasting approach to that of the traditional European model. As part of a radical reform package in the mid-1980s, New Zealand introduced a broad-based low-rate VAT, known as a goods and services tax, while concurrently lowering marginal tax rates significantly (from a top rate of 66 per cent to 33 per cent), eliminating most exemptions and credits in the tax system, and embarking on major reform to tax filing obligations of individuals. When New Zealand introduced its GST system in 1986, it was at a rate of 10 per cent and a registration threshold of NZD24,000. The GST rate in

⁷⁸ Makara and Rametse, 'Taxpayer Attitudes' (n 3) 246.

⁷⁹ Government of Botswana, *BURS Annual Report 2012* (2012) 14.

⁸⁰ Data derived from the *BURS Annual Reports* (2012–17).

⁸¹ The original rate was 10 per cent in 1986, increasing to 12.5 per cent in July 1989, and 15 per cent in October 2010.

⁸² The original threshold was NZD24,000 in 1986, increasing to NZD30,000 in October 1990, NZD40,000 in October 2000, and NZD60,000 in April 2009.

New Zealand has been increased twice, with the latest increase coming in 2010 when the rate went from 12.5 per cent to 15 per cent.

New Zealand's GST is known for having an extremely broad base, very few exemptions, and a focus on efficiency. For example, Vial observes that the New Zealand GST is not only 'an international benchmark for indirect tax design but that it has the highest C-efficiency ratio in the OECD (at 93.5 per cent)'.⁸³ The C-efficiency is the ratio of VAT revenue to consumption expenditure, divided by the standard tax rate, expressed as a percentage. Politicians have resisted major changes to the GST in New Zealand since its introduction, with the exception of increasing the rate twice and the registration threshold three times, increasing the breadth to include certain excluded areas (for example, certain financial services and certain electronic transactions), and remedial legislative amendments.

Maples and Sawyer explored the international impact of the New Zealand GST model in contrast to that of the traditional VAT model.⁸⁴ They identified 18 'GSTs' that have been developed with New Zealand's GST as the initial starting point. Australia is among those countries that have followed the New Zealand GST as a model for their GST designs. With the exception of a few jurisdictions (including Singapore), the other jurisdictions have moved away from the 'purity' of the New Zealand GST to introduce multiple rates, more exemptions and so on.

A particular aspect of New Zealand's GST system that works in support of small businesses is that they may file GST returns every six months, provided certain criteria are met. Specifically, their turnover cannot exceed NZD500,000 (AUD452,500) in the past 12 months or be expected to exceed it in the next 12 months, otherwise they will need to adopt standard two-monthly returns (a one-month return period applies for large taxpayers). There are several methods for accounting for GST that apply to small businesses. The standard methods are the invoice (or accruals) basis, and the payments basis (a type of cash accounting system). The payments basis applies to non-profit bodies, persons with less than NZD2 million (AUD1.81 million) worth of taxable supplies for a month, or where the Commissioner of Inland Revenue is satisfied this method is appropriate. A third method is known as the hybrid basis (introduced in 1991), which can be used by any person or business registered for GST.⁸⁵ It has some cash flow disadvantages in that input tax credits cannot be claimed until payment is made, but output tax must be paid on the issue of an invoice or the receipt of payment, whichever is earlier.

There are no special rates or lower rates for any items, other than the limited situations where the zero rate applies (exports and transfers of a 'going concern'). Certain supplies of land have also been exempted from GST. Thus the standard rate of GST applies to

⁸³ Peter Vial, 'The Sustainability of the New Zealand Tax Base: Are We at the End of the Road for the New Zealand Tax System?' (2009) 15(1) *New Zealand Journal of Taxation Law and Policy* 17, 22, citing Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Reuters, 2007) viii.

⁸⁴ 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.

⁸⁵ The hybrid basis is a system where a GST-registered entity accounts for GST on its sales (and other income) using the invoice (or accruals) basis and accounts for its GST on purchases and expenses using the payments (or cash) basis. In order to use this basis of accounting for GST, a business must apply in writing to the Commissioner of Inland Revenue for approval.

almost all supplies. That said, it remains a relatively complex tax to apply, as reflected in the ever-growing legislative provisions and challenges faced by the courts. During the 1990s and 2000s, New Zealand undertook a rewrite of its *Income Tax Act*. The Tax Rewrite Project did not extend to rewriting other major tax statutes, such as the *Tax Administration Act 1994* and the *Goods and Services Tax Act 1985*. A call has been made, to no avail, to rewrite the *Goods and Services Tax Act 1985* from New Zealand's highest court, the Supreme Court:⁸⁶

[I]t is to be hoped that once the redrafting exercise on the *Income Tax Act* is completed the team will move on to the [*Goods and Services Tax Act 1985*], which is not, and never has been, a user-friendly statute.

In summary, New Zealand's GST reflects the pureist and most efficient GST model anywhere in the world. It has remained robust since its inception against conceptual reform.

IV POSSIBLE VAT SIMPLIFICATION MEASURES

A Overview

It has been suggested that complex VAT requirements lead to high VAT compliance costs.⁸⁷ The compliance costs of VAT and other taxes do not affect businesses equally. As a result of the fixed-cost nature of tax compliance costs, small businesses carry a burden of these costs that is not proportional to their size. The regressivity of tax compliance costs puts small firms at a competitive disadvantage,⁸⁸ and leads to a competition policy concern by conflicting with the aim of establishing a 'level playing field' between all types and sizes of business.⁸⁹ This section discusses the possible policy measures that can help to simplify the VAT system in Botswana.

Key policy recommendations for the possible simplification of the Botswana VAT system are suggested in this section. These recommendations are inspired by the design of the New Zealand GST system, which is popularly known as a model GST.

B Introduction of the cash accounting method for VAT

The system of cash accounting is seen as a measure that can simplify the VAT system. Cash accounting allows businesses to account for VAT only when they receive cash for taxable supplies or when they make payment for goods and services bought. This system has been used in such countries as the UK, where it was reported to lead to cost savings and benefits for businesses.⁹⁰ In Australia, the cash accounting system was introduced as part of the simplified tax system. Small businesses with an aggregated turnover of less than AUD10 million can account for GST on a cash basis. Such businesses account for GST on the

⁸⁶ Peter Blanchard, 'Some Basic Concepts of New Zealand GST' in Krever and White (eds) (n 83) 91, 92.

⁸⁷ Makara and Rametse, 'Taxpayer Attitudes' (n 3).

⁸⁸ Michael Godwin and Cedric Sandford, 'Simplifying VAT for Small Traders' (1983) 13(52) *Accounting and Business Research* 281.

⁸⁹ Pope, 'Estimating and Alleviating the Goods and Services Tax Compliance Cost Burden' (n 65).

⁹⁰ National Audit Office, UK Government, *HM Customs and Excise: Cost to Business of Complying with VAT Requirements* (Her Majesty's Stationery Office, 1994) 7.

Business Activity Statement, covering the period during which they received/made payment for sales/purchases.⁹¹ The payments (or cash) basis method has been available in New Zealand from the commencement of its GST, with the hybrid basis available since 1991.⁹²

A recent study on the cash flow and managerial benefits of VAT in Botswana found that small to medium enterprises (Group A and B businesses), which had settlement periods of three months, incurred cash flow costs of BWP9 million in 2010–11.⁹³ An introduction of the cash accounting system will eliminate this cost for businesses.

C Reduction of VAT returns filing frequency

The frequency of VAT returns filing in Botswana is a major concern, especially for small businesses. Small- and medium-sized businesses file their VAT returns every two months, while larger businesses file VAT returns monthly. A reduction of VAT filing frequency, from bimonthly to six monthly, will reduce the burden and magnitude of VAT compliance costs for small businesses. Eligible small businesses in New Zealand are able to file VAT returns every six months. In addition to a reduction of VAT compliance costs, administrative costs incurred by the BURS will also be reduced, allowing the revenue authority to focus resources on large taxpayers that contribute the larger share of the VAT revenue. The Botswana government should consider reducing the VAT returns filing frequency to semi-annually, if the revenue losses resulting from such a policy change do not outweigh the overall compliance cost savings.

D Broadening (and altering) of the VAT base

The presence of zero-rated and exempt goods and services complicates a VAT system. A recent study by Makara and Rametse reported that 77 per cent of businesses that trade in VAT-exempt and zero-rated goods and services find the Botswana VAT system to be unreasonably complicated and, as such, have concerns when undertaking their VAT work.⁹⁴ As mentioned earlier, the BURS has reported that there is a culture of non-compliance among small businesses in Botswana, and the revenue authority grapples with mounting VAT arrears. The authors suggest that the BURS should adopt a broad-based VAT system, similar to the New Zealand GST system, which has minimal exempt and zero-rated goods and services. This advice is consistent with the trend in recent international VAT literature recommending broader bases.⁹⁵ Given the economic circumstances of Botswana, the VAT should also increase its threshold for registration. With regard to the foods consumed by the poor, the Botswana government can consider introducing income supplements and welfare payments in order to simplify the VAT.

⁹¹ 'Accounting for GST on a Cash Basis', *Australian Taxation Office, Australian Government* (Web Page, 30 June 2017) <https://www.ato.gov.au/business/gst/accounting-for-gst-in-your-business/choosing-an-accounting-method/?anchor=Accounting_for_GST_on_a_cash_basis#Accounting_for_GST_on_a_cash_basis>.

⁹² See above n 85 and accompanying text.

⁹³ Makara and Rametse, 'Estimates of Cash Flow' (n 4) 440.

⁹⁴ Makara and Rametse, 'Taxpayer Attitudes' (n 3) 261.

⁹⁵ 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* (Kluwer Law International, 2013).

New Zealand more recently included online services within the scope of its GST,⁹⁶ and proposes to include online services in the GST tax base with effect from late 2019.⁹⁷ In contrast, certain land transactions have been made zero-rated for GST purposes in order to simplify the operation of GST with respect to land transactions. The compulsory zero-rating rules were introduced in 2011,⁹⁸ and require a transaction that would normally attract GST at 15 per cent to be zero-rated if:

- the transaction involves land (any interest in land will be sufficient)
- the vendor is GST-registered
- the purchaser (or recipient, such as a nominee) acquires the property to carry on a taxable activity and not as a principal place of residence. The residence exception covers associates of the purchaser.

V CONCLUSION AND LIMITATIONS

This article has investigated optimal design features of a VAT. Specifically, the paper has discussed the design features of the Botswana VAT and the New Zealand GST systems in order to identify possible policy measures that can help simplify the VAT system in Botswana. These policy recommendations are cautiously made, owing to the size, economic, political and governance differences between the two countries.

Prior studies have reported that small business taxpayers in Botswana perceive the VAT to be burdensome and costly. This could be due to the frequency with which small businesses are required to file VAT returns in Botswana. Other problem areas include the use of the accrual method of accounting for VAT and the presence of exempt and zero-rated goods and services. This paper recommends that the BURS should consider introducing the cash accounting method for VAT, reducing the frequency of VAT returns filing for small businesses from bimonthly to semi-annually, broadening the VAT base and increasing the VAT registration threshold. More work is necessary to further investigate the complexity of the VAT system in Botswana, in order to uncover the reasons for the non-compliance culture that is reported to be prevalent among small businesses. Future studies should also look into the VAT e-filing system and investigate why small businesses are slow in accepting and using it.

This study has a number of limitations. First, the comparison undertaken with Botswana is with one jurisdiction only, namely New Zealand. The recommendations may have differed should one or more countries have been included or if the sole comparative country was different, such as Australia. Second, the paper focuses on major components of the respective VAT/GST of the two countries, and does not explore the complexities of the legislative provisions in detail, or the associated case law.

⁹⁶ See *Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016* (NZ).

⁹⁷ See further: Inland Revenue, New Zealand Government, *GST on Low-Value Imported Goods: An Offshore Supplier Registration System* (Discussion Document, May 2018) <<http://taxpolicy.ird.govt.nz/sites/default/files/2018-dd-gst-low-value-goods.pdf>>.

⁹⁸ See further: Inland Revenue, New Zealand Government, *Goods and Services Tax — Compulsory Zero-Rating of Land Rules (General Application)* (Interpretation Statement No 17/08, September 2017) <<https://www.ird.govt.nz/technical-tax/interpretations/2017/interpretations-2017-is1708.html>>.

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A CRITICAL REVIEW OF THE PROPOSED LAW TO REMOVE THE MAIN RESIDENCE EXEMPTION FOR NON-RESIDENTS

JOHN MCLAREN*

ABSTRACT

The Australian government is in the process of introducing new laws to remove the main residence exemption from income tax on the capital gain for non-resident home owners. This has been initiated on the basis that it will make housing more affordable for resident Australians. The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 has serious implications for Australians wanting to work and live in an overseas country and change their residency status from that of Australia. In some cases, Australian residents for taxation purposes need to live and work overseas for employment opportunities or career enhancement, or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's main residence will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Moreover, if a main residence is sold at a loss, the capital loss may not be disregarded by the former owner. Main residence owners faced with paying income tax on their real property may be deterred from working and living overseas. This paper critically reviews the consequences that flow from this proposed law and what it means for Australian residents for taxation purposes wanting to work or live in another country. The paper will also make recommendations on how the proposed law may be amended so that certain Australian residents who own their own main residence may avoid paying income tax on a capital gain that is exempt for every other person who maintains their Australian residency for taxation purposes.

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I INTRODUCTION

The Australian government has introduced new laws to remove the main residence exemption from income tax on the capital gain for non-resident real property owners. This has been initiated on the basis that it will make housing more affordable for Australian residents. The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 ('Treasury Bill 2018') has serious implications for Australian residents for tax purposes wanting to work and live in an overseas country and change their residency status from that of Australia.¹ In some cases, Australian residents for tax purposes need to live and work overseas for employment opportunities or career enhancement, or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's main residence will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Moreover, if a main residence is sold at a loss, the capital loss may not be disregarded by the former owner. Main residence owners faced with paying income tax on their real property may be deterred from working and living overseas. In the Second Reading speech, then Treasurer Scott Morrison stated the objective of the new law:

The government wants all Australians to be able to buy a home, where they can, and access housing that is affordable. Housing is fundamental to the wellbeing of all Australians and is a driver of social and economic participation, promoting better employment, education and health outcomes. This bill implements measures announced in the government's 2017-18 budget housing package to improve housing affordability, encourage investment in affordable rental housing and improve the integrity of the tax system. The measures in this bill support those already introduced by the Turnbull government as part of the Treasury Laws Amendment (Housing Tax Integrity) Bill 2017 and the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 1) Bill 2017. This bill is an important step to ensuring homeownership is more achievable for Australians.²

These new measures have implications for those Australian residents who are faced with the prospect of living or working overseas and changing their residency status from that of Australia. The date of effect of the Treasury Bill 2018 was 7:30pm legal time in the ACT on 9 May 2017. At the time of writing this paper, the Bill had not passed both Houses of Parliament, so the law will be applied retrospectively when it finally receives Royal assent. There was a transition period for non-residents who sold their main residence before 30 June 2019. The main residence exemption will apply during this period to an

¹ In this paper reference is made to Australian residents for tax purposes who may dispose of their main residence while living overseas as a non-resident of Australia. The use of the term 'Australian' in this context does not distinguish between Australian nationals, Australians with permanent residency or Australians for tax purposes that are living in Australia. They are all potentially affected by the proposed law to remove the main residence exemption.

² Australian Government, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 Second Reading*, House of Representatives, 8 February 2018, 710 (Scott Morrison, Treasurer)

<<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansardr%2F31776340-cbfd-4793-af0f-753ff0be0a7d%2F0013%22>>.

individual non-resident taxpayer whose main residence dwelling was subject to a capital gains tax ('CGT') event. They will not be subject to income tax on their capital gain but equally they will not be able to claim a capital loss if the main residence is disposed of at a loss. The submission made by CPA Australia to the Standing Committees on Economics, Economics Legislation Committee suggested that this may have an impact on the supply of housing as non-residents dispose of their dwelling before the end of the transition period.³ This proposed law does not affect a foreign investor who does not live in their taxable Australian real property, because any capital gain on the sale of their dwelling has never been exempt from income tax, and nor would they have received the 50 per cent discount on any capital gain, as that concession was abolished for foreign owners after 8 May 2012.⁴

The objective of this paper is to critically analyse the implications for Australians faced with the need to move to another country for work purposes or retirement. There are two subsidiary implications that flow from this proposed law: first, will these measures actually make housing in Australia more affordable, as the Australian government contends; and second, will this impact on how an Australian resident will be assessed as a 'resident' or 'non-resident' when this law takes effect. The Board of Taxation has published their own review of the residency rules, and has called on the public to provide submissions. If *Income Tax Assessment Act 1936 (Cth)* ('ITAA 36') s 23AG had not been repealed, then in certain circumstances the salary or wage being earned by an Australian resident would have been exempt from further income tax in Australia, and they may not have wanted to change their residency status from that of Australia.⁵ These implications will be examined in detail later in this paper.

The next section of this paper will examine what constitutes a 'main residence' for taxation purposes. Section III of this paper will provide an overview of the proposed changes to the CGT main residence exemption. Section IV will critically review the intended and unintended consequences that flow from this proposed law, and what they means for Australians wanting to live or work in another country. This will include a detailed examination of what it means to be considered a 'resident' or 'non-resident' of Australia for taxation purposes. Section V will briefly examine the issues facing Australia in terms of housing affordability and whether this new measure will make any difference to house prices and affordability. Section VI will make recommendations on how the proposed law may be amended so that certain Australian residents who own their own family home may either avoid or reduce the income tax on a capital gain that is exempt for every other Australian who maintains their Australian residency. Section VII will draw a conclusion as to the merits of amending the main residence CGT exemption.

³ CPA Australia, Submission No 10 to Senate Standing Committees on Economics, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018* (5 March 2018).

⁴ *Income Tax Assessment Act 1997* (Cth) ss 115-105 and 115-115.

⁵ ITAA 36 s 23AG allows certain foreign service income to be exempt from income tax in Australia if the Australian resident earned the income for a continuous period in excess of 91 days. From 1 July 2009 the exemption was restricted to foreign employment only with a recognised non-government organisation or as an aid worker or specified government employee such as a police officer or defence worker engaged overseas.

II WHAT IS A 'MAIN RESIDENCE'?

The starting point for this paper is to determine what exactly is a 'main residence' for the purposes of the CGT provisions. If a property is not a main residence for taxation purposes, then any capital gain is subject to income tax with or without a discount applying. This depends upon the circumstances of the taxpayer.

Currently, the main residence is exempt from income tax on the capital gain for all Australian residents for tax purposes, irrespective of their immigration status. As a result, the main residence is the most tax-effective investment in Australia.⁶ In many instances, though not all, the main residence is the family home. In order to satisfy the main residence exemption, the dwelling must consist of residential accommodation contained in a building or a caravan, houseboat or mobile home.⁷ The main residence exemption applies not just to a family home or family apartment, but to other forms of residential accommodation. *Income Tax Assessment Act 1997* (Cth) ('ITAA 97') s 118-100 refers to a 'dwelling' that is your main residence. The definition of what constitutes a dwelling is contained in s 118-115:

- a) a unit of accommodation that:
 - (i) is a building or is contained in a building; and
 - (ii) consists wholly or mainly of residential accommodation; and
- b) a unit of accommodation that is a caravan, houseboat or other mobile home; and
- c) any land immediately under the unit of accommodation.

This means that the new law relating to the main residence exemption applies not only to real property but also to a wider group of dwellings.

The definition of a dwelling as a unit of accommodation has been extended to a shed containing a bed, mains water and a toilet.⁸ A legal or equitable interest in the dwelling is sufficient for it to be a main residence, and joint ownership of the dwelling is exempt if used as the main residence.⁹ The main residence exemption is only available to individuals and not companies or trustees.¹⁰

ITAA 97 s 118-110 states that a capital gain or capital loss you make from a CGT event that happens in relation to a CGT asset is disregarded if you are an individual and the dwelling was your main residence throughout your ownership period. This section makes it clear that it is a requirement to disregard any capital gain or capital loss. The taxpayer is not given a choice under this subsection. If a main residence is disposed of by

⁶ The capital gain on the sale of the main residence is not subject to income tax, whereas any other form of investment in equities or bank interest is subject to income tax.

⁷ ITAA 97 s 118-115.

⁸ *Summers and Federal Commissioner of Taxation* (2008) 71 ATR 279.

⁹ See ATO, *Income Tax : Capital Gains : Jointly Owned Property : Not the Principal Residence of All Joint Owners* (IT 2485, 14 July 1988).

¹⁰ ITAA 97 s 118-110(1)(a).

the individual owner at a loss, then that loss cannot be utilised to offset a capital gain. If the proposed law to change the main residence exemption was enacted by Parliament then the non-resident taxpayer would be able to utilise a capital loss from the sale of their main residence. In that situation, they would not have to disregard the gain or loss.

However, s 118-110 further states that this exemption may not apply in full if:

- it was your main residence during part only of your ownership period, or
- it was used for the purpose of producing assessable income.

If the main residence is rented for the purpose of producing assessable income during the period of ownership, then that portion of time during which it was rented will be subject to income tax on any capital gain. However, ITAA 97 s 118-145 states that a main residence will maintain its exemption from income tax if it is only used for income-producing purposes for a maximum of six years. These six years do not have to be consecutive. Section 118-145(2) states that you are entitled to another maximum period of six years each time the dwelling again becomes and ceases to be your main residence. If the main residence is not used to produce assessable income and the owner is not residing in the main residence, then it maintains its exemption during the period of absence. The six-year time limit only applies if the main residence is producing assessable income.

III THE PROPOSED AMENDMENT TO THE CGT PROVISIONS

The proposed amendments to the CGT provisions have implications for three groups of individuals that become non-residents of Australia while owning a 'main residence'. The first group are the existing non-residents or potential non-residents who own a main residence in Australia. If the main residence dwelling is not subject to a CGT event while the non-resident is living overseas, then no income tax implications arise. The disposition of the main residence is only subject to income tax if the owner is a non-resident at the time of sale. If the main residence is not sold and the non-resident returns to Australia and takes up Australian residency, then no liability to tax arises on the subsequent sale of the main residence.

The second group affected by the proposed law are those non-residents who own a main residence in Australia but pass away while a resident of an overseas country. They may have retired to their country of birth but maintained the family home in Australia. The home loses its main residence exemption and income tax is paid on the total capital gain at the non-residence rate of tax.

The third group are beneficiaries who are currently non-residents of Australia and have inherited a main residence in Australia. The main residence dwelling loses its main residence exemption when bequeathed to the non-resident beneficiary.

All of these circumstances are discussed in detail below. The Explanatory Memorandum to the Treasury Bill 2018 provides a number of examples as to how the proposed law will operate. These examples are discussed below.

A CGT event A1 — sale of the main residence

In the first example, the owner of the main residence is entitled to the exemption. James, a New Zealander, moves to Australia in July 2017 and obtains a special category visa. He

purchases a dwelling in Australia and establishes it as his main residence. He is a resident of Australia for taxation purposes while he resides here. James continues to reside in the dwelling for several years. He signs a contract to sell the dwelling, departing Australia several months later (to return to live in New Zealand).

James was an Australian resident for taxation purposes at the time CGT event A1 occurred to the dwelling — that is, when he signed the contract to sell it. As James was not a foreign resident at the time CGT event A1 occurred, he is entitled to the main residence exemption in respect of his ownership of the dwelling.¹¹

In the next example, the main residence exemption is denied. Vicki acquires a dwelling in Australia on 10 September 2010, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 1 July 2018 Vicki vacates the dwelling and moves to New York. Vicki rents the dwelling out while she tries to sell it. On 15 October 2019 Vicki finally signs a contract to sell the dwelling, with settlement occurring on 13 November 2019. Vicki is a foreign resident for taxation purposes on 15 October 2019.

The time of CGT event A1 — the sale of the dwelling — is the time the contract for sale was signed, that is 15 October 2019. As Vicki was a foreign resident at that time she is not entitled to the main residence exemption in respect of her ownership interest in the dwelling.

This outcome is not affected by:

- Vicki previously using the dwelling as her main residence
- the absence rule in ITAA 97 s 118-145 that could otherwise have applied to treat the dwelling as Vicki's main residence from 1 July 2018 to 15 October 2019 (assuming all of the requirements were satisfied).

If Vicki had signed the contract for sale prior to the end of the transition period (30 June 2019), then the exemption would have applied.¹²

In the next example, the owner of the main residence returns to Australia and then disposes of the family home. Amita acquires a dwelling in Australia on 20 February 2003, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 15 August 2020 Amita signs a contract to sell the dwelling and settlement occurs on 12 September 2020.

Amita uses the dwelling as follows during the period of time in which she owns it:

- resides in the dwelling from when she acquires it until 1 October 2007
- rents it out from 2 October 2007 until 5 March 2011 while she lives in a rented home in Paris as a foreign resident (assume the absence provision applies to treat the dwelling as her main residence)
- resides in the dwelling and uses it as a main residence from 6 March 2011 until 15 April 2012

¹¹ Explanatory Memorandum, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 (Cth) 17.

¹² Ibid 18.

- rents it out from 16 April 2012 until 10 June 2017 while she lives in a rented home in Hong Kong as a foreign resident (assume the absence provision applies to treat the dwelling as her main residence)
- resides in the dwelling from 11 June 2017 until it is sold.

The time of CGT event A1 is the time the contract for sale was signed, that is 15 August 2020. As Amita was an Australian resident for taxation purposes at that time (as she had re-established her Australian residency) she is entitled to the full main residence exemption for her ownership interest in the dwelling, as it is, or is taken to be, her main residence for the whole of the time that she owned it.¹³

B Main residence sold due to the death of the non-resident owner

If a deceased person was a foreign resident at the time of their death, then the portion of the main residence exemption accrued by the deceased in respect of the dwelling is not available to the beneficiary. The beneficiary continues to be entitled to the main residence exemption for any part of the exemption that they accrue in their own right (provided that they are not a foreign resident at the time the CGT event for the ownership interest in the dwelling occurs).

The main residence exemption does not apply if:

- the deceased person was a foreign resident at the time of their death
- the beneficiary that inherits the ownership interest in the dwelling was a foreign resident at the time the CGT event occurred. If the main residence exemption does not apply, the beneficiary must account for the whole of the capital gain or loss that accrues on the ownership interest in the dwelling.

The following example taken from the Explanatory Memorandum to the Treasury Bill 2018 illustrates how the above provisions will operate.

Edwina acquires a dwelling on 7 February 2011, moving into it and establishing it as her main residence as soon as it is first practicable to do so. Edwina uses the property as follows:

- resides in the dwelling until 25 September 2016
- rents the property out from 26 September 2016 at which time Edwina moves to Johannesburg.

Edwina passes away on 20 January 2018. At this time, she is a foreign resident for taxation purposes. Rebecca inherits the dwelling from Edwina. Rebecca moves into the dwelling and establishes it as her main residence on 21 January 2018. She continues to reside in it and use it as her main residence until she sells it. She signs the contract to sell the dwelling on 2 February 2020 (at which time she is a resident of Australia for taxation purposes) with settlement occurring on 2 March 2020.

The deceased estate main residence exemption provisions apply to Rebecca's sale of the dwelling as follows:

¹³ Ibid.

- the period that Edwina owned the dwelling (2,539 days) is treated as non-main residence days (as Edwina was a foreign resident at the time of her death)
- the period from when Rebecca moved into the property until she signed the contract for sale (the date of CGT event A1) of 742 days is treated as main residence days, as she used the property as her main residence for the whole of this time.

The capital gain or loss amount is the amount that the capital gain or loss would be if no main residence exemption applies. It is assumed, for the purposes of this example, that the capital gain amount for the dwelling is equal to AUD100,000.

Therefore, Rebecca's capital gain or capital loss from the dwelling is equal to:

$$\begin{aligned} &= \text{CG or CL amount} \times \frac{\text{Non-main residence days}}{\text{Days in ownership period}} \\ &= \text{AUD100,000} \times \frac{2,539}{3,281} \\ &= \text{AUD77,385} \end{aligned}$$

Rebecca then reduces the capital gain by any current income year and prior income year capital losses and any capital gains discount. She then adds to the resulting capital gain the amount of any other capital gains she has realised during the income year (if any). The result is her net capital gain, which she must include in her assessable income for the 2019–20 income year.¹⁴

C Main residence bequeathed to a non-resident

The following example taken from the Explanatory Memorandum to the Treasury Bill 2018 illustrates the implications for a non-resident beneficiary inheriting a main residence. In this example, a foreign resident beneficiary inherits a main residence from a deceased person who was an Australian resident at the time of their death.

Con acquires a dwelling on 7 February 2001, moving into it and establishing it as his main residence as soon as it is first practicable to do so. He continues to reside in the property and it is his main residence until his death on 9 August 2017.

Jacqui, Con's daughter, inherits the dwelling following Con's death. Upon inheriting the dwelling, Jacqui rents it out. It is not her main residence at any time. On 25 January 2021 Jacqui signs a contract to sell the dwelling and settlement occurs on 23 February 2021. Jacqui resides in Buenos Aires and is a foreign resident for the whole of the time she has an ownership interest in the dwelling.

Jacqui is entitled to a partial main residence exemption for the ownership interest that she has in the dwelling at the time she sells it, being the exemption that accrued while Con used the residence as his main residence (7 February 2001 until 9 August 2017). She is not entitled to any main residence exemption that she accrued in respect of the dwelling (9 August 2017 until 25 January 2021). This is because she was a foreign

¹⁴ Ibid 25.

resident on 25 January 2021, the day she signed the contract to sell her ownership interest (CGT event A1). Note that Jacqui will need to apply ITAA 97 s 118-200 to work out the amount of the capital gain or loss that she realises from the sale of the ownership interest in the dwelling.

If Jacqui had sold the dwelling on or before 9 August 2019, she would have been entitled to a full main residence exemption. This is because the whole of the main residence exemption would have, or would be taken to have, accrued from Con's use of the residence. This includes the two-year period following Con's death.¹⁵

D Effect of the transitional rules

The following example illustrates how the transitional rules apply to a disposition of a main residence. A main residence that was owned before 9 May 2017 is disposed of on or before 30 June 2019. Samantha acquires a dwelling on 13 April 2013, moving into it and establishing it as her main residence as soon as it is first practicable to do so. On 10 January 2019, Samantha signs a contract to sell the dwelling, and settlement occurs on 7 February 2019.

Samantha uses the dwelling as follows when she owns it:

- resides there until 15 September 2016
- rents the property out from 16 September 2016 until it is sold (assume the absence provision applies to treat the dwelling as her main residence during this later period).

From 16 September 2016, Samantha resides in rented accommodation in Bahrain, and is a foreign resident. CGT event A1 for the sale of the dwelling occurs when the contract for sale is signed, that is 10 January 2019. As Samantha held her ownership interest in the dwelling on or before 9 May 2017, she continued to own it until it was sold and as it was sold before 1 July 2019 she is entitled to the main residence exemption under the transitional rule.¹⁶

IV RESIDENCY AND THE IMPACT OF THE PROPOSED LAW

How the proposed amendments to the CGT provisions will affect Australians moving overseas for employment or retirement and becoming non-residents will only become clear after 30 June 2019, the end of the transition period. The full impact of the proposed law will apply when the main residence is sold outside of the transition period.

One of the major considerations of this proposed law is whether Australians living and working overseas should maintain their status as a resident for tax purposes, so that any future sale of their main residence will still be exempt from CGT. For example, an Australian living overseas for a number of years decides to sell their main residence but does not include any of the capital gain in their Australian assessable income. The Australian Taxation Office ('ATO') then issues an assessment, but the Australian claims

¹⁵ Ibid 22.

¹⁶ Ibid 30.

that they are still a resident for taxation purposes and that they had no intention of changing their residency status.

In practice the reverse usually happens. In most situations Australians working and living overseas in a low-tax country go to extraordinary lengths to prove that they are not a resident of Australia for tax purposes. For example, individual income tax rates in countries such as Singapore, Hong Kong and many Middle Eastern countries are considerably lower than those applied in Australia, and therefore the attraction of becoming a non-resident taxpayer is obvious.¹⁷ In that case, there is a distinct advantage in not being taxed in Australia as a resident, particularly if the period of employment is for several years. However, if that same taxpayer was deriving considerable income from investments in Australia, then by maintaining their Australian tax residency they would not be subject to the higher rates of personal income tax that apply to non-residents on their Australian sourced income. Similarly, they would not face the effect of CGT event I1 applying to their assets.¹⁸ For example, a resident is entitled to the tax-free threshold of AUD18,200, whereas a non-resident pays income tax at the rate of 32.5 per cent on each dollar of taxable income up to AUD87,000, where the tax rate increases to the next marginal rate of 37 per cent.

However, with the introduction of these proposed CGT amendments, taxpayers may be arguing the opposite case. Namely, that they have maintained their Australian residency for taxation purposes. In order to examine this issue, it is necessary to review the current law relating to what constitutes 'residence' in Australia.

The common law in relation to the issue of residency of an individual was relatively settled in Australia with very few decisions by the Full Bench of the Federal Court of Australia, the Federal Court of Australia and the Administrative Appeals Tribunal ('AAT') on the meaning of 'resides in Australia', 'domicile', 'permanent place of abode' and 'usual place of abode'. According to Michael Dirkis, this was due to the fact that employment income was generally exempt from further income tax pursuant to ITAA 36 s 23AG.¹⁹ This section now requires the Australian resident to be employed in foreign service for a continuous period of at least 91 days, provided the employment was as an aid worker, charitable worker or government employee (such as a peacekeeper with the Australian Defence Force). Prior to 1 July 2009, the employment was not restricted to the above categories, so all Australians were exempt on their employment income provided they paid income tax in the country where the income was earned.²⁰

¹⁷ In Singapore, the maximum personal rate of income tax is 17 per cent, whereas in the UAE the income tax rate is zero.

¹⁸ CGT event I1 applies to all assets that the individual owns, except any 'taxable Australian real property', at the date they become a non-resident. At that time, they can either pay any income tax on the unrealised capital gain or elect to pay Australian income tax on realised capital gains in the future.

¹⁹ Michael Dirkis, 'The Ghosts of Levene and Lysaght Still Haunting 90 Years On: Australia's "Great Age" of Residence Litigation?' (2018) 47 *Australian Tax Review* 41, 45.

²⁰ *Tax Laws Amendment (2009 Budget Measures No 1) Act 2009* (Cth).

Dirkis has examined over 30 new cases since 2010 relating to the application of the 'resides' and 'domicile' tests;²¹ the determination of 'permanent place of abode';²² the application of the 183 day test;²³ the application of the superannuation test;²⁴ the application of the treaty tie-breaker test;²⁵ and related matters with the onus of proof in the context of the former s 23AG,²⁶ and the impact that this litigation has had on the understanding of the concept of residency in Australia. These observations are incorporated into the following examination of residency in Australia.

An individual will be considered to be a resident of Australia for tax purposes if they satisfy any one of four statutory tests, described below.

A Statutory tests for residency

The Explanatory Memorandum to the Treasury Bill 2018 para 1.21 states that an individual is a foreign resident if they are not an Australian resident for taxation purposes,²⁷ as defined in ITAA 36 s 6(1). Individuals who are Australian residents for taxation purposes at the time a CGT event occurs to a dwelling are not affected by this measure. ITAA 36 s 6(1) states that 'resident' or 'resident of Australia' means:

- a) a person, other than a company, who resides in Australia and includes a person:
 - (i) whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia;
 - (ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his

²¹ *Re Mynott and Commissioner of Taxation* [2011] AATA 539; *Iyengar and Commissioner of Taxation* [2011] AATA 856; *Gunawan and Commissioner of Taxation* [2012] AATA 119; *Sneddon and Commissioner of Taxation* [2012] AATA 516; *Sully and Commissioner of Taxation* [2012] AATA 582; *Re Bezuidenhout and Commissioner of Taxation* [2012] AATA 799; *Ellwood and Commissioner of Taxation* [2012] AATA 869; *Re Pillay and Commissioner of Taxation* [2013] AATA 447; *ZKBN and Commissioner of Taxation* [2013] AATA 604; *Murray and Commissioner of Taxation* [2013] AATA 780; *Re Dempsey and Commissioner of Taxation* [2014] AATA 335; *Agius and Commissioner of Taxation* [2014] AATA 854 (appeal on source issue dismissed in *Agius v Commissioner of Taxation* [2015] FCA 707); *The Engineering Manager and Commissioner of Taxation* [2014] AATA 969; *Hughes and Commissioner of Taxation* [2015] AATA 1007; *Landy and Commissioner of Taxation* [2016] AATA 754.

²² *Re Boer and Commissioner of Taxation* [2012] AATA 574; *Mayhew and Commissioner of Taxation* [2013] AATA 130.

²³ *Re Clemens and Commissioner of Taxation* [2015] AATA 124; *Re Jaczenko and Commissioner of Taxation* [2015] AATA 125; *Re Koustrup and Commissioner of Taxation* [2015] AATA 126; *Groves and Commissioner of Taxation* [2011] AATA 609; *Guissouma and Commissioner of Taxation* [2013] AATA 875.

²⁴ *Baker and Commissioner of Taxation* [2012] AATA 168.

²⁵ *Re Tan and Commissioner of Taxation* [2016] AATA 1062.

²⁶ *Shord v Commissioner of Taxation* [2016] FCA 761 (s 23AG(7) & onus — Appeal lodged 29.7.16) (being an appeal from *Re Shord and Commissioner of Taxation* [2015] AATA 355 (resident test)); *Boyd and FCT* [2013] AATA 494 (s 23AG); *Horrocks v Commissioner of Taxation* [2010] AATA 307; *Mulherin v FCT* [2013] FCAFC 115 (dismissed appeal from *Murray and Commissioner of Taxation (No 3)* [2012] AATA 557) (on onus of proof); *Commissioner of Taxation v Seymour* [2015] FCA 320 (reversing order allowing video evidence in *The Overseas Applicants and Commissioner of Taxation* [2014] AATA 788); *Seymour and Commissioner of Taxation* [2016] AATA 397.

²⁷ Explanatory Memorandum to the Treasury Bill 2018.

usual place of abode is outside Australia and that he does not intend to take up residency in Australia; or

(iii) who is: ... (A) a member of the superannuation scheme established by deed under the Superannuation Act 1990; or (B) an eligible employee for the purposes of the Superannuation Act 1976; or the spouse, or a child under 16, of a person covered by sub-subparagraph (A) or (B).

1 *Meaning of 'resides'*

The residence test concerns the individual who resides or lives in Australia, whereby the 'ordinary' meaning of the term 'resides' is applied to the taxpayer. This test is also referred to as the 'ordinary concepts' test, whereby the common law is used to describe what is meant by the term 'reside'. The judgment of Viscount Cave LC in the UK case of *Levene v IRC* ('*Levene*') is the most quoted statement on the interpretation of 'residence':²⁸

[T]he word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live at a particular place'. ... In most cases there is no difficulty in determining where a man has his settled or usual place of abode, and if that is ascertained he is not the less resident there because from time to time he leaves it for the purpose of business or pleasure.

The facts in *Levene* help to illustrate what is meant by the term 'reside'. *Levene* had been a resident of the UK, but when he retired and sold his business he lived for five years in hotels in the UK and abroad. He returned to the UK each year for a period of four months to receive medical treatment and attend religious ceremonies. The House of Lords held that it was only when he obtained a lease of a flat in Monte Carlo some five years later that he ceased to be a resident of the UK for taxation purposes. He exhibited ongoing ties with the UK, and his stays abroad were seen as being of a temporary nature.

The ATO issued a ruling, TR 98/17, which is designed to cover the situation with individuals entering Australia.²⁹ The ruling only applies to:

- migrants
- academics teaching or studying in Australia
- students studying in Australia
- visitors on holiday
- workers with pre-arranged employment contracts.

The ruling examines the common law factors that are taken into consideration when determining whether or not an individual living in Australia is considered a resident for taxation purposes. A period of residence of six months or more may be a determinant, but also factors such as: the purpose of the visit; the location and maintenance of assets; family ties; and social and living arrangements. Foreign students are considered to be residents because virtually all courses last for more than six months. Many of the common

²⁸ [1928] AC 217.

²⁹ ATO, *Income Tax: Residency Status of Individuals Entering Australia* (TR 98/17, 25 November 1998).

law factors discussed below in relation to Australian residents ceasing to live in Australia and becoming non-residents apply to those individuals covered by TR 98/17.

A number of factors need to be taken into account when determining if an Australian taxpayer has changed their residency. The broad factors, outlined below, should be considered in that determination:

- (i) The physical presence in Australia and the frequency of visits to Australia by a taxpayer are of vital importance because if they continually return to Australia for family, business or personal reasons then they may not be exhibiting the type of conduct necessary to show that they reside in a foreign country. This was the situation in the case of *Re Shand and Federal Commissioner of Taxation* ('*Re Shand*'),³⁰ where the AAT affirmed an Objection decision to treat the taxpayer as a resident of Australia, even though during the disputed years he spent considerable time in Kuwait and Canada for business purposes. The taxpayer had a family home in Queensland, where his wife, children and grandchildren lived. The taxpayer: maintained his medical insurance; took out Australian citizenship; set up a self-managed superannuation fund; stated on his immigration form when departing and returning to Australia that he was a resident departing and arriving; paid his money from his overseas business into his Australian bank account; and gave his address in Australia as his address for all banking details. The maintenance of a home in Australia may be a strong indication that the taxpayer intends to remain an Australian resident.³¹ In terms of the proposed amendments to the CGT provisions relating to the main residence, the fact that the taxpayer has not sold the family home may work in their favour that they are still an Australian resident for taxation purposes.

A further example of the importance of 'physical presence' is found in the case of *Joachim v Federal Commissioner of Taxation* ('*Joachim*'),³² where the AAT held that once a person has established a home in a particular place their physical presence in that country during the income year is a relevant factor. However, it is not necessary that they are physically present for a particular part of the year. It is sufficient that they have an intention to return and to continue to treat that place as home. In the recent case of *Iyengar v Commissioner of Taxation* ('*Iyengar*'),³³ Senior Member Walsh considered 'physical presence' as the first item of a checklist to be considered in determining the residence of the taxpayer. In this case, Iyengar maintained a limited physical presence in Australia and in the Middle East, but he retained a continuity of association with Australia through his family home in Perth during the relevant income years, and intended to return to Australia on completion of his contract of employment. In his judgment, Senior Member Walsh noted that weight should be given to each factor in the checklist, and that it varies with the individual and no one factor is decisive. Other than physical presence,

³⁰ (2003) 52 ATR 1088.

³¹ This situation may be revisited in light of the decision of the Full Bench of the Federal Court in *Harding v Federal Commissioner of Taxation* [2019] FCAFC 29.

³² (2002) 50 ATR 1072.

³³ [2011] AATA 856.

those factors included: nationality; history of residence and movements; habits and 'mode of life'; frequency, regularity and duration of visits; purpose of visits to or absences from a country; family and business ties with a country; and maintenance of a 'place of abode'.

There is a danger in relying on a list of factors when determining the residency of a taxpayer. This was pointed out by Justice Logan, Presidential Member Hack and Senior Member Kenny in the case of *Re Dempsey and Commissioner of Taxation*:³⁴

However useful such checklists may be, they are no substitute for the text of the statute and the recollection that ultimate appellate authority dictates that the word 'resides' be construed and applied to the facts according to its ordinary meaning.

- (ii) Family or business ties in Australia may be such that the taxpayer is still regarded as being a resident even though they live and work in a foreign country. This is particularly so when a taxpayer leaves their spouse and children in Australia while they work overseas. In the case of *Joachim*,³⁵ the AAT held that, even though the taxpayer spent more than 80 per cent of his time on ships outside Australia, the fact that his family resided in Australia and he spent his leave with them meant that he was still a resident of Australia according to the ordinary concepts of residency. A similar finding can be found in the case of *Re Shand*,³⁶ where Deputy President Muller held that:

[T]he evidence shows that although Mr Shand spent a significant amount of time in Kuwait during the relevant tax years, he spent almost as much time in Australia. His personal effects and emotional ties were within Australia, whereas the only factor which tied him to Kuwait was his business.

- (iii) The quality of the accommodation in the foreign country will also be taken into account when determining the status of the taxpayer. For example, in the case of *Re Shand*,³⁷ the taxpayer lived in a furnished apartment and only took with him sufficient clothing for his brief stays. It was therefore very difficult for him to show that he resided outside Australia in a permanent home environment when his accommodation was not consistent with his situation in Australia. This situation is also reinforced by the AAT decision in the case of *Re Crockett and Federal Commissioner of Taxation ('Re Crockett')*,³⁸ where the taxpayer was unable to show that he had a sufficiently 'permanent place of abode' outside Australia in order to overcome the evidence that: his family home was in Australia; his family lived in Australia; and he took out Australian citizenship. In the case of *Iyengar*,³⁹ Senior Member Walsh held that Iyengar had not demonstrated that his 'permanent place of abode' was in fact Dubai, and later Doha, but that his 'family home' was in

³⁴ [2014] AATA 335.

³⁵ *Joachim* (n 32).

³⁶ *Re Shand* (n 30).

³⁷ *Ibid.*

³⁸ (1998) 41 ATR 1156.

³⁹ *Iyengar* (n 33).

Australia with his wife, and that he sent almost all of the income he earned back to Australia in order to pay the mortgage. He had only taken a few personal items with him overseas, such as clothing and other household items.

It can be seen from the above analysis of the concept of 'resides' that maintaining the main residence and close ties with Australia, and not having substantial accommodation in another country, may be sufficient evidence that the taxpayer maintains their Australian residency. Therefore, any subsequent sale of the main residence while the taxpayer is living overseas may not attract a CGT liability.

2 *Australian domicile*

The 'domicile' test refers to a person whose domicile is Australian, and as a result demonstrates strong ties with Australia, unless the Commissioner of Taxation is satisfied that their 'permanent place of abode' is outside Australia. The term 'domicile' is a legal concept defined under the *Domicile Act 1982* (Cth) and the common law. The term 'domicile' must be read with reference to a particular country, in that the laws of that country will apply to the particular person, together with legal rights and duties. There are three types of domicile: domicile of origin, domicile of choice and domicile of dependency. For example, a person born in a particular country acquires a domicile of origin and may at a later time acquire a new domicile, a domicile of choice, when they move to another country with the intention of permanently living there, as stated in the *Domicile Act 1982* (Cth) s 10.

For taxation purposes, a taxpayer who was born in Australia, or has moved to Australia with the intention of living there permanently, will have an Australian domicile and is regarded as being a resident for tax purposes. However, pursuant to the above definition, if the Commissioner is satisfied that their 'permanent place of abode' is outside Australia, they may not be regarded as being an Australian resident for taxation purposes. Franki J of the Full Bench of the Federal Court of Australia, in the case of *Federal Commissioner of Taxation v Applegate*,⁴⁰ provides the best statement of what is meant by 'permanent place of abode': '[T]he phrase "permanent place of abode outside Australia" is to be read as something less than a permanent place of abode in which the taxpayer intends to live for the rest of his life.'

In this case, the taxpayer was held to be a non-resident for tax purposes during their period of absence from Australia. The taxpayer had: a permanent job in another country; no home in Australia; no Australian source income; and established a permanent home in the other country. He returned after only being away for two years due to an illness. In the similar case of *Federal Commissioner of Taxation v Jenkins*,⁴¹ the taxpayer returned to Australia due to illness after only 18 months of living and working in the New Hebrides. He had not been able to sell the family home in Australia, but had leased it out. He originally had no fixed time to return to Australia when he commenced work for a bank in the New Hebrides.

The ATO issued a ruling, IT 2650, to provide guidelines for determining whether individuals who leave Australia temporarily to work or study in a foreign country cease

⁴⁰ (1979) 9 ATR 899.

⁴¹ (1982) 12 ATR 745.

to be Australian residents for taxation purposes.⁴² The Commissioner outlined the factors that are taken into account when determining residency each financial year:

It is clear from *Applegate* and *Jenkins* that a person's permanent place of abode cannot be ascertained by the application of any hard and fast rules. It is a question of fact to be determined in the light of all the circumstances of each case. Some of the factors which have been considered relevant by the Courts and Boards of Review/Administrative Appeals Tribunal and which are used by this Office in reaching a state of satisfaction as to a taxpayer's permanent place of abode include:

- (a) the intended and actual length of the taxpayer's stay in the overseas country;
- (b) whether the taxpayer intended to stay in the overseas country only temporarily and then to move on to another country or to return to Australia at some definite point in time;
- (c) whether the taxpayer has established a home (in the sense of dwelling place; a house or other shelter that is the fixed residence of a person, a family, or a household), outside Australia;
- (d) whether any residence or place of abode exists in Australia or has been abandoned because of the overseas absence;
- (e) the duration and continuity of the taxpayer's presence in the overseas country; and
- (f) the durability of association that the person has with a particular place in Australia, ie, maintaining bank accounts in Australia, informing government departments such as the Department of Social Security that he or she is leaving permanently and that family allowance payments should be stopped, place of education of the taxpayer's children, family ties and so on.

The Commissioner contends that his office would regard a stay of two years or more to be a substantial period, however, if the taxpayer had no fixed place of abode while absent from Australia for two or more years then they would still be regarded as having an Australian domicile. The Commissioner considers that the home that is established overseas should be relatively substantial and not such a thing as a mining town, barracks or oil rig. Similarly, maintaining bank accounts and having children attend schools in Australia may be factors that weigh against a finding that the taxpayer was a non-resident during the period of absence. It should be noted that tax rulings are binding on the Commissioner, but not on taxpayers.

In the recent AAT decision in *Re Mynott v Commissioner of Taxation ('Re Mynott')*,⁴³ the tribunal held that the taxpayer was not a resident of Australia for taxation purposes, even though he moved extensively around the world in order to obtain work as an electronics engineer. The decision by Senior Member Dunne was based on the fact that the taxpayer had sold his assets in Australia prior to leaving, except for a few personal items that were left with his parents in Adelaide. He maintained a bank account with a credit union in

⁴² ATO, *Income Tax: Residency — Permanent Place of Abode outside Australia* (IT 2650, 8 August 1991).

⁴³ [2011] AATA 539.

Adelaide. Even though he had no substantial home associated with his work, he maintained rented premises for his de facto partner and her children from a previous marriage in the Philippines. He did not stay for lengthy periods in the Philippines, but this was sufficient for him to establish a 'permanent place of abode'.

The recent case of *Harding v Commissioner of Taxation* ('*Harding* [2019]')⁴⁴ supports the above AAT decision in *Re Mynott*. The Full Bench of the Federal Court, per Logan, Davies and Steward JJ, held that during the 2010–11 financial year, Harding was a non-resident for taxation purposes. This was because 'place of abode' refers to a town or country and, in this case, it was Bahrain.⁴⁵ Davies and Steward JJ rejected the contention made by the Commissioner of Taxation as to the temporary nature of Harding's accommodation in Bahrain. They held that living in a serviced apartment and temporary rented accommodation for many years was relatively commonplace for Australians who seek to make their life in another country before they obtain a permanent home.⁴⁶ The judges confirmed the decision of the primary judge at first instance, Derrington J,⁴⁷ that even though Harding had maintained the family home and had significant financial ties with Australia, that was not sufficient to find that the taxpayer was a resident, because his intention all along was to leave Australia indefinitely.⁴⁸

These two cases do not appear to assist an Australian resident now living in another country to claim that they have maintained their residency status by living in temporary accommodation and maintaining significant financial ties with Australia, including maintaining the family home. In fact, the *Harding* [2019] decision would appear to contradict the ATO ruling IT 2650, as discussed above. It appears that the decision in *Harding* [2019] was strongly influenced by the intention of the Australian taxpayer to permanently leave Australia for career purposes, even though he maintained close personal and financial links to Australia. Perhaps an Australian wishing to maintain their Australian residency while living and working overseas should at all times intend to return to Australia within a set timeframe. This may counter the *Harding* [2019] decision and safeguard the main residence CGT exemption.

3 *The 183 day test*

The 183 day test refers to an individual who has actually been in Australia, continuously or intermittently, for more than half the year of income, unless the Commissioner is satisfied that their usual place of abode is outside Australia, and that they do not intend to take up residency in Australia.⁴⁹ This test has been applied to taxpayers living in Australia, rather than Australian residents living in a foreign country for more than half a year. The important thing to note with this test is that it is based on the year of income.

Migrants moving to Australia are regarded as satisfying this test if they live in Australia for more than 183 consecutive days and have no 'usual place of abode' in another country.

⁴⁴ *Harding* [2019] (n 31).

⁴⁵ *Ibid* para 26.

⁴⁶ *Ibid* para 55.

⁴⁷ *Harding v Commissioner of Taxation* [2018] FCA 837.

⁴⁸ *Harding* [2019] (n 31) para 64.

⁴⁹ ITAA 36 s 6(1)(a)(ii).

The first part of the test is regarded as being purely mathematical.⁵⁰ The second part of the test provides an exception for the taxpayer: if they have their 'usual place of abode' outside Australia and do not intend to take up residency, then they are not regarded as a resident for tax purposes.⁵¹ The reference to 'usual place of abode' rather than 'permanent place of abode' indicates that the government intended a less stringent test to apply to the taxpayer so that they could be considered a resident even if they were just working in Australia. The Commissioner issued a tax ruling, IT 2681, to cover business migrants.⁵²

This test is only relevant for the purposes of this paper if the Australian owner of a main residence living and working overseas is able to spend more than 183 days of each financial year in Australia. However, if they have an Australian domicile, then they would have to consider satisfying that test of residency.

4 *Commonwealth superannuation fund membership*

The Commonwealth superannuation test refers to Australian public servants who are attached to foreign embassies and foreign government offices (and on secondment to foreign government agencies) being residents of Australia by virtue of being members of a Commonwealth superannuation fund, which is compulsory for public servants employed by the Australian government. In many cases the public servant may be absent from Australia for many years, but retain their obligation to pay income tax as a resident of Australia for taxation purposes.

B Board of Taxation review of the residency rules for individuals

The Board of Taxation is currently reviewing the income tax residency rules for individuals.⁵³ The Board's core finding was that the current individual tax residency rules were no longer appropriate and required modernisation and simplification. The Board completed its *Review of the Income Tax Residency Rules for Individuals* in August 2017, and provided a copy to government. The government supported the view of the Board that further consultation was required, and in September 2018 the Board produced a consultation guide seeking responses to specific questions based on their earlier recommendations.⁵⁴ The Board of Taxation stated in its report that the government would receive a final report in November 2018.⁵⁵

It is important to briefly examine the recommendations of the Board of Taxation in order to assess their likely impact on the proposed changes to the main residence exemption. These proposed rules for determining the residency of an individual may be critical in

⁵⁰ K Sadiq et al, *Principles of Taxation Law* (Thomson Reuters, 2019) 100.

⁵¹ *Ibid*.

⁵² ATO, *Income Tax: Residency Status of Business Migrants* (IT 2681, 14 May 1992).

⁵³ Board of Taxation, Australian Government, *Review of the Income Tax Residency Rules for Individuals* (August 2017) <<http://taxboard.gov.au/consultation/self-initiated-review-of-the-income-tax-residency-rules-for-individuals>>.

⁵⁴ Board of Taxation, Australian Government, *Review of the Income Tax Residency Rules for Individuals: Consultation Guide* (September 2018) <<https://cdn.tspace.gov.au/uploads/sites/70/2018/09/BoT-Residency-Consulation-Guide-FINAL.pdf>>.

⁵⁵ *Ibid* 27.

imposing income tax on the capital gain derived from the sale of the main residence, if there is doubt as to the status of that individual when the family home was sold.

The following statement by the Board illustrates the approach being taken in determining residency:

Whether you are an Australian resident for tax purposes is based on both your time spent in Australia and the nature and quality of your ties to Australian society. The more substantial your ties to Australia, the more likely you will be a resident. This Division determines your residency status by considering the relevance of your ties and calculating your time spent.⁵⁶

The Board is focusing on the time spent both in and out of Australia as a primary test that provides a 'bright-line' for most individuals. They believe that if the test is based on days it will take the complexity out of the current tests and provide certainty.⁵⁷ Having a 'bright-line' test is similar to the UK, but it has been adopted for an Australian context. The number of days has not been specified at this stage, but it will differ for those individuals coming into Australia and those individuals previously residents of Australia.⁵⁸

If an individual does not satisfy any of the 'bright-line' tests, the Board contends that the preferred approach would be to apply a secondary test, called the 'factor test'. The factors are set out and described in Table 1.

Table 1: The 'factor test'

Factor	Description
Time spent in Australia	<p>An individual must spend sufficient time in Australia, that is:</p> <ul style="list-style-type: none"> – a set number of X days or more if previously a resident – a larger set number of Y days or more if never an Australian resident. <p>Both must be fewer than 183 days for this factor to be useful (otherwise the individual would automatically be a resident). The number of days for an individual previously a resident should also be lower than a non-resident, in line with the adhesive principle.</p>
Immigration status	An individual must be an Australian citizen or permanent resident.
Family	An individual's family (or relevant social grouping) must be largely located in Australia.
Australian accommodation	An individual must have readily accessible Australian accommodation (owned or rented) that they actually use throughout the income year.

⁵⁶ Ibid 8.

⁵⁷ Ibid 9.

⁵⁸ Ibid 11.

Economic ties	An individual must have substantial Australian economic ties (such as employment or business interests).
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The Board suggests that these factors reflect the key issues covered in the case law and ATO determinations.

For an Australian resident moving to another country to work and live, this may make it easier to maintain their Australian residency status and not affect their main residence if it was subsequently sold while they were living and working overseas. The Board seems determined to stop Australians reducing their income tax by moving to low-tax jurisdictions and tax havens by tightening the residency rules. However, their approach may be greatly advantageous for an Australian working and living overseas for a number of years but not wanting to put at risk their main residence exemption. The approach being considered by the Board is set out below:

A rule could be adopted to impose tax on income and gains that arise during short term absences from Australia. In essence, this rule targets schemes that rely on brief periods of non-residency where the individual never intends to actually cut ties with Australia. ... [E]mployment income would be excluded from such a tax.⁵⁹

If the government eventually adopted this approach to Australians changing their residency in order to take advantage of low-tax jurisdictions, then it may present an opportunity for taxpayers with a main residence to continue maintaining their Australian residency without a great deal of difficulty. They would need to plan extended holidays in Australia and maintain a connection with Australia. The main residence is a good example of their connection with Australia.

V HOW DOES THIS PROPOSED LAW MAKE HOUSING MORE AFFORDABLE?

A number of public submissions on the proposed law to remove the main residence exemption from CGT were received by the Economics Legislation Committee in 2018.⁶⁰ The report from the Committee notes that the submissions that they received in relation to housing affordability did not express any assurance in these CGT measures having any effect on housing affordability. In fact, the submissions expressed the opposite.⁶¹ A non-resident Australian owning a main residence would now be less inclined to sell their family home until they returned to Australia as a resident, otherwise they would be paying a substantial amount of income tax on the capital gain.⁶² The submission made by CPA Australia to the Committee suggested that this proposed law may have an impact on

⁵⁹ Ibid 19.

⁶⁰ Submissions to Senate Standing Committees on Economics, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018* (5 March 2018) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/HousingandforeignCGT/Submissions>.

⁶¹ Economics Legislation Committee, Australian Government, *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018 [Provisions]/Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018 [Provisions]* (Senate Report, March 2018) 12.

⁶² Ibid 13.

the supply of housing, as non-residents disposed of their dwellings before the end of the transition period (30 June 2019).⁶³ If an Australian non-resident does not sell their main residence when they are living and working in another country, then this will have a neutral impact on the supply of housing and housing affordability. But, if the property has not been sold and therefore is not available for purchase, it may be rented while the owners are living overseas, and this may help the supply of property for rental purposes, but again this does not necessarily make housing more affordable. In this respect, any assessment would have to have waited until after 30 June 2019 and indeed longer.

Housing affordability is a complex issue and it is not intended in this paper to undertake a substantial discussion of the current situation in Australia. However, given that the basis for introducing this new law is to make housing more affordable, it is necessary to briefly examine the factors involved and to assess the government's assertions. Otherwise, why not simply present these amendments to the CGT main residence exemption as a tax reform measure, which may herald other reforms to the CGT provisions. It would appear that housing affordability is related to the cost of housing, and currently, in some parts of Australia, the price of housing is falling.

The latest CoreLogic *Housing Affordability Report for Australia* makes the following observation on the current situation:⁶⁴

Although housing affordability has recently started to improve, due to falling prices while incomes inch higher and mortgage rates remain low, the longer run view has seen housing affordability across the nation deteriorate. While this trend is clearly evident cumulatively across most regions of Australia over the past two decades, the past ten years has seen worsening housing affordability being fuelled primarily by strong growth in property prices across Sydney, Melbourne, Regional NSW and more recently Hobart. While Sydney and Melbourne are the two largest cities and have a strong influence over the national trends, outside of these markets property price growth has been limited and in many instances housing affordability has been improving as incomes rise and mortgage rates have reduced.⁶⁵

Housing affordability relates to the cost of housing in terms of purchase price, mortgage payments or rent as a proportion of the income being derived by Australian individuals. The Reserve Bank of Australia ('RBA') made a submission to the Standing Committees on Economics, *Inquiry into Home Ownership*, in June 2015, and that report provides an insight into the complex issues that relate to housing affordability:⁶⁶

While it is undeniable that more younger households would be able to purchase a home if housing prices were significantly lower relative to their incomes, there are no examples internationally of large falls in nominal housing prices that have occurred other than through significant reduction in capacity to pay (eg recession and high

⁶³ CPA Australia (n 3).

⁶⁴ CoreLogic, *Housing Affordability Report for Australia* (June Quarter, September 2018) <<http://reports.corelogic.com.au/CL-HOUSING-AFFORDABILITY/CL-HOUSING-AFFORDABILITY-5261534F.pdf>>.

⁶⁵ Ibid 4.

⁶⁶ RBA, Submission No 21 to House of Representatives Standing Committee on Economics, *Inquiry into Home Ownership* (June 2015) 25 <<https://www.rba.gov.au/publications/submissions/housing-and-housing-finance/inquiry-into-home-ownership/pdf/inquiry-into-home-ownership.pdf>>.

unemployment). There is no mechanism to get a large and sustained level shift down in prices while a substantial fraction of the population can — safely and sustainably — service the obligations involved in paying the higher price. Additional housing supply ought to dampen housing prices, and more probably will reduce the growth rate of housing prices that occurs in response to increases in demand for housing. There is, therefore, an argument for government policy to avoid creating unnecessary barriers to supply. However, there is no example in Australia or internationally where supply expansion on its own generated housing price declines of a similar order of magnitude to the increases in prices seen in some Australian cities in recent years; some academic work on this issue suggests that removing supply constraints in a single population centre might not reduce prices significantly.

It is very difficult to see how this new law will make any substantial difference to housing affordability in Australia. It is apparent from the above authorities on housing that purchase price is a major issue for affordability. Some main residences in Australia may have been sold prior to the expiry of the transition period and some main residences may be sold earlier than expected if the owners decide to live and work overseas for a substantial period. But, it may be that governments may want to consider imposing income tax on capital gains made from the sale of all real property in Australia, including the main residence. This could be the first step in such a programme.

VI OPTIONS AND RECOMMENDATIONS

CPA Australia's submission to the Economics Legislation Committee on the views of their members to the proposed amendments to the main residence exemption formulated the following improvement options to be considered by the Committee:⁶⁷

- persons who retain their Australian citizenship or permanent residency should be excluded from the provisions of the Bill — regardless of their tax residency
- the proposed regime should only apply to property acquired from 9 May 2017
- the cost base of the property should be reset to its market value on the day the taxpayer becomes a non-resident, so that the capital gain is calculated on the increase in value since the taxpayer ceased to be a resident
- there should be a partial exemption for the number of days the taxpayer was a resident and lived in the dwelling as their main residence.⁶⁸

The proposed law effectively takes into account any capital gain that has accrued to a non-resident from 20 September 1985, the date that the CGT requirements commenced in Australia. The CPA Australia submission stated that many Australian taxpayers may not have sufficient records or other details to be used in the cost base calculation when the home is sold, given that it is the main residence and not, as far as they are concerned, subject to income tax on the capital gain.

If this proposed law comes into effect, then the following recommendations should be considered for an Australian resident for tax purposes faced with the prospect of living and working overseas for an extended period of time:

⁶⁷ CPA Australia (n 3).

⁶⁸ *Ibid.*

- They could continue to maintain their Australian residency by lodging a tax return each year and paying income tax in both the foreign country and Australia. They may be entitled to claim a tax credit for income tax paid in the foreign country. They would continue to pay the Medicare levy, but at the same time avail themselves of the tax-free threshold as a resident. By doing this, the main residence exemption may be maintained. The fact that they still maintain a main residence in Australia is strong evidence of their continued ties to Australia in support of this contention. However, residency is a question of fact and not a choice that a taxpayer can exercise to suit their own purposes.
- They could sell the family home to a family member, or at arm's length to the public, before the end of the transition period, and pay no income tax on the capital gain.
- They could become a resident of another country for taxation purposes but not sell the family home until they return to live in Australia, and pay a lesser amount of income tax on the capital gain accrued while living overseas.
- They could not accept the employment opportunity being offered overseas or not consider retirement in an overseas country. In other words, stay in Australia and claim the main residence exemption.
- They could sell the main residence before contemplating living in another country in retirement or leaving the family home to a non-resident beneficiary.

One major concern about the proposed CGT amendment is that there will be Australian citizens living in other countries that still have a main residence in Australia that is rented, and these citizens will have no knowledge of the changes to the main residence exemption. They may be living in their country of birth, having retired from employment in Australia, and they may decide to sell the former family home, or they may pass away, leaving the main residence to a relative still living in Australia. How are these citizens of Australia, but non-residents for taxation purposes, going to be informed about these CGT amendments? They may no longer have a professional relationship with their accountant or lawyer in Australia. This situation must be given careful consideration, and the Australian government or the ATO should try to inform as many former residents of Australia about the proposed CGT amendments as they feasibly can.

VII CONCLUSION

In some cases, Australians need to live and work overseas for employment opportunities or for their career enhancement or even to maintain their employment if transferred by their employer. The consequence of changing residency is that the owner's family home, the main residence, will be subject to income tax on the capital gain if sold while they live overseas as a non-resident of Australia for taxation purposes. Home owners faced with paying income tax on the family home may be deterred from working and living overseas, especially if they are unsure about their future living arrangements.

This paper has reviewed the consequences that flow from this proposed law and what this means for Australians wanting to work and live in another country. Moreover, there are serious consequences for Australian non-residents currently living in retirement overseas who may have retained their main residence in Australia and are totally unaware of the proposed changes to the CGT provisions. Furthermore, all lawyers and accountants must become aware of these proposed amendments if involved in estate

planning, due to the consequences of leaving a main residence to a non-resident beneficiary.

This paper has also made recommendations on how the proposed law may be amended so that certain Australian residents who own their own family home may reduce or even legally avoid paying income tax on a capital gain that is exempt for every other Australian who maintains their Australian residency.

A further concern of this proposed amendment to the CGT provisions relating to the main residence is that it could be the precursor to other CGT amendments affecting the family home. While some Australian taxpayers may be of the view that the main residence exemption should be repealed, the fact that home ownership in Australia is on the decline is one good reason for maintaining the taxation benefit. If the home ownership rate continues to decline, then older Australians facing retirement may need greater financial support from the government in the form of an increased age pension. Perhaps the answer is to leave the main residence exemption alone.

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TAXATION, INNOVATION AND EDUCATION: REFLECTIONS ON A FLIPPED LECTURE ROOM

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ABSTRACT

In recent times the use of flipped classrooms in tertiary education has become more prevalent. This article considers the implementation of a flipped classroom structure to deliver Taxation Law at the University of Western Australia. The Taxation Law unit is a core subject in the Business Law major with over 150 students. The unit examines the basic concepts and fundamentals of Australian taxation law. Delivery of the unit was changed from a traditional lecture and tutorial model to a blended learning or flipped classroom. The current delivery mode includes a combination of short videos, online reading materials, online learning activities, and in-person workshops and tutorials. This article identifies why and how change was implemented and the pedagogical theory underlying the change in delivery mode, and discusses the effectiveness of the change using an action research design. In particular, the article will examine key risks in developing and implementing this type of delivery mode, along with quantitative and qualitative data to highlight changes in student perceptions, student motivation and engagement, student achievement, and teacher perceptions.

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I INTRODUCTION

Taxation Law was established as a new unit at the University of Western Australia ('UWA') in 2013 as a large core unit in a Business Law major for undergraduate students. The unit was originally designed to comprise weekly lectures and tutorials, with assessment consisting of tutorial participation, an assignment and a final exam. However, student satisfaction and engagement was low, and lecture attendance was approximately 15 per cent for most classes. The unit was not much fun to teach, and teaching staff were spending a disproportionate amount of time on administrative matters. Pedagogical theory suggests that flipping a classroom should help address some of these issues;¹ and so, with the help of UWA's Educational Enhancement Unit, we flipped the classroom. Lecture content and activities were placed online and lectures converted to workshops. Tutorials were retained. Student perceptions of pastoral care and of flexibility, as well as student motivation and engagement and teacher enjoyment all generally increased. There is also some weak evidence supporting an increase in student achievement. However, student feedback indicated an ongoing desire for a more prescriptive narrative and more coordinated reinforcement of that narrative in teaching materials. There were also some initial perceptions by the teaching staff in the unit of mild institutional resistance.

This article reflects on our experience of flipping Taxation Law, in order to assist any teachers thinking of flipping their own tax classes. To this end, Section II of this article explains the problems associated with the original design of the unit, and how we flipped the classroom to address these difficulties. Section III outlines the pedagogical theory that supports the introduction of flipped classrooms and the improvements that might be expected following the introduction of a flipped classroom. It also surveys the literature on flipped classrooms, and key risks and challenges associated with implementation. Section IV outlines the methodology adopted. Section V then outlines the results from our implementation of a flipped classroom in the Taxation Law unit, and discusses those results under the themes of student perceptions, student motivation and engagement, student achievement, and teacher perceptions. Section VI concludes.

II THE PROBLEM AND THE RESPONSE

This section provides an overview of the Taxation Law unit and how it was taught prior to the introduction of a flipped classroom model. It also examines why the decision was made to trial a flipped classroom, and outlines the specific changes that were made to the unit. Before moving to that discussion, it is important to note the key common characteristics of a flipped classroom:²

- a change in the use of out-of-class time
- completing traditional in-class activities out of class

¹ See, for example, Lakmal Abeysekera and Phillip Dawson, 'Motivation and Cognitive Load in the Flipped Classroom: Definition, Rationale, and a Call for Research' (2015) 34(1) *Higher Education Research & Development* 3.

² Ibid 3.

- pre-class activities
- post-class activities
- use of technology
- a change in the use of classroom time
- completing traditional homework activities in class
- in-class activities that emphasise active, peer and problem-based learning.

A The original design of the Taxation Law unit

Before examining the changes that were made to the Taxation Law unit, it is helpful to examine its original format. The Taxation Law unit was first offered at UWA in 2013 and is a core unit for students enrolled in a Bachelor of Commerce majoring in Business Law. It is also offered to students enrolled in the Bachelor of Philosophy and to all other undergraduate students as an elective unit. The Taxation Law unit is designed to provide students with a basic understanding of Australian taxation law, how it is administered, and the ethical and professional responsibilities of a tax practitioner. The unit is intended to act as a foundational unit for further tax study. Students do not generally have a detailed knowledge of the law, but are required to have first studied two other introductory law units.

The Taxation Law unit was originally designed in much the same way that most law units are traditionally structured in Australian universities. In this regard, the unit employed a 'traditional model of legal education',³ consisting of two hours of lectures and a one-hour tutorial each week. This amounted to a total of 26 hours of lectures and 11 hours of tutorials over the semester. Students were also assigned approximately four hours per week of out-of-class reading from a textbook. The unit was designed such that the total study commitment, including attending lectures, tutorial preparation and attendance, and completing the assigned readings and assessments, was approximately 115 hours.

At the end of the unit, it was expected that students would have a foundation-level understanding of the following topics:

- the key components of the Australian income taxation system, including income, deductions, capital allowances, tax accounting and trading stock
- how Australian taxation law applies to individuals, companies, partnerships and trusts
- the purposes and operation of goods and services tax ('GST') and fringe benefits tax ('FBT')
- the ethical and professional responsibilities of a tax practitioner
- the functions of the Commissioner of Taxation and the Australian Taxation Office.

The assessment comprised tutorial participation (10 per cent of the total grade), an assignment (30 per cent) and a final exam (60 per cent). The tutorials were taught in a small-group environment consisting of approximately 15 to 20 students. Problem- and

³ Mary Keyes and Richard Johnstone, 'Changing Legal Education: Rhetoric, Reality and Prospects for the Future' (2004) 26 *Sydney Law Review* 537, 537; Elizabeth Shi, Paul Myers and Freeman Zhong, 'Interteaching: An Alternative Format of Instruction for Law Classes' (2018) 11 *Journal of the Australasian Law Teachers Association* 58, 58.

policy-based tutorial questions were released to students online through the university's online learning management system (Blackboard), and the students were expected to prepare before attending classes. The assignment generally required students to write a 2,000-word essay on a set question, while the two-hour final exam required students to apply what they had learned during the semester to two long-format problem-based questions.

B The problem with the original design of the Taxation Law unit — student and lecturer satisfaction a catalyst for change

Before the flipped classroom was implemented, student satisfaction in the Taxation Law unit was low. Between 2013 and 2015, students were asked whether they 'strongly disagree', 'disagree', 'agree' or 'strongly agree' with the statement: 'Overall, this unit was a good educational experience.' The results are summarised in Table 1.

Table 1: Survey results to the question: 'Was the unit a good educational experience?'

Period	Response rate (%)	No of responses (with %)			
		Strongly disagree	Disagree	Agree	Strongly agree
2013	36.59%	6 (13.33%)	14 (31.11%)	23 (51.11%)	2 (4.44%)
2014	25.79%	4 (8.16%)	16 (32.65%)	26 (53.06%)	3 (6.12%)
2015	38.46%	5 (7.14%)	19 (27.14%)	39 (55.71%)	7 (10.00%)

Clearly, a large number of students did not think that the Taxation Law unit was a 'good educational experience', with 44.44 per cent (2013), 40.81 per cent (2014) and 34.28 per cent (2015) indicating that they strongly disagreed or disagreed with the survey question.⁴ Between 2013 and 2015, the unit coordinators made various changes to the unit, taking into account both quantitative and qualitative feedback from students, whilst still retaining the traditional model of legal education. This experience is consistent with that of Cameron and Dickfos, who observe that a 'traditional lecture format in law courses is unlikely to quell ... student disenchantment because it does not promote active student learning or address the variety of student learning styles'.⁵ Nevertheless, while the changes made by the unit coordinators resulted in some improvement in student satisfaction, the student experience in the unit lagged behind other units taught in the law school, and the coordinators felt that there was further scope for improvement.

There were also a number of other challenges encountered in 2013–15 that led the unit coordinators to consider changing the teaching methodology. While lectures in the unit

⁴ Note that the same unit coordinator was responsible for the unit in 2013 and 2014. A new unit coordinator was appointed in 2015 (with the previous unit coordinator still being involved in the delivery of half of the lectures). However, as the results indicate, this change in staffing arrangements, together with the other changes made to the unit, did not, in the authors' view, produce an acceptable improvement to student satisfaction.

⁵ Craig Cameron and Jennifer Dickfos, 'Peer Review of Teaching Law to Business Students in Traditional and Flipped Lecture Environments' in Christopher Klopper and Steve Drew (eds), *Teaching for Learning and Learning for Teaching* (Sense Publishers, 2015) 99, 100.

were recorded, the lecture-recording facilities proved to be unreliable, with lectures regularly failing to record or lecture recordings being of a poor quality. This particular issue resulted in several students complaining to the unit coordinator about lecture recordings, and may also have influenced the low student satisfaction with the unit. For example, in 2015, 40 per cent of the qualitative feedback focused on issues with the contemporaneous lecture recordings.

Furthermore, lectures were characterised by low student attendance, often with fewer than 20 students in the room, and low student engagement, with questions posed by the lecturer to the students often going unanswered. The unit also generated a significant administrative load for the unit coordinator when compared to other units with a similar number of student enrolments. In this regard, the unit coordinator would receive many queries from students that ordinarily would have been raised by the student and addressed in class, had the student attended lectures. These factors contributed to the unit coordinators and other teaching staff having a low sense of satisfaction with the unit.

C Redesigning the unit and implementing a flipped classroom model

Before any changes were made, a comprehensive review of the unit was carried out by the lecturers in conjunction with teaching and learning-enhancement staff. The assessment structure, teaching modes and unit content were closely examined before a decision was made to restructure the unit, utilising a flipped classroom model.

Additionally, the Taxation Law unit, in its traditional form, had been approved by the Tax Practitioners Board under the *Tax Agent Services Regulations 2009* (Cth) and satisfied the educational requirements of a number of accounting professional associations. It was important to ensure that this accreditation was not put at risk when flipping the classroom and that the unit still consisted of face-to-face classes (workshops and tutorials), private study and research totalling 100–130 hours.⁶ For this reason, it was not possible to make any substantive changes to the course content or the number of hours to complete the unit, because doing so would likely require reaccreditation.

Flipping the unit involved breaking the 26 lectures into 13 online learning modules⁷ and making approximately 1.5 hours of video recordings for each module. Most modules comprised between four and six videos, which were generally around 15 minutes, but were occasionally up to 30 minutes. This amounted to around 21 hours of recordings, which was slightly less time than the time previously spent in lectures. The recordings were made using the university's recording software (Camtasia), edited and uploaded to YouTube.⁸ The recordings were made publicly available on YouTube, but were 'unlisted' such that they would not appear in searches carried out on the YouTube platform. A link

⁶ Tax Practitioner's Board, Australian Government, *Proposed TPB Guideline: Course in Australian Taxation Law that Is Approved by the Board* (TPB(PG) No 03/2010, 16 December 2010) 13 and 16.

⁷ The initial modules were: introduction to the Australian tax system; the income tax formula; ordinary income; statutory income, exempt income and non-assessable non-exempt income; general deductions; specific deductions and capital allowances; capital gains tax; tax timing and trading stock; taxation of companies, partnerships and trusts; GST; FBT; residence and source; tax administration and professional responsibilities.

⁸ We do not discuss intellectual property issues in this article, but they are clearly relevant, especially where content is publicly available.

to the YouTube video was then placed on the online learning management system. Reading material was assigned for each module, typically textbook pages, some summary lecture notes, cases and legislation (the readings were similar to the readings previously provided for out-of-class study following each traditional lecture). Again, this material was specified and, where possible, linked on the learning management system. Additional study questions and solutions were developed for each online module and placed online. Some of these were based on questions that had previously been posed in lectures to students or assigned previously as out-of-class reading.

Concise and clear instructions were provided to students about how they should undertake their self-directed learning and how to prepare for and what to expect from the in-class workshops. These instructions were provided on the unit's learning management system web page, in the unit outline and in the first workshop. In addition, in the unit outline and at the first workshop we explained to students why the unit had been flipped, with reference to the low student satisfaction and engagement.

The explanation below was provided to students on starting the unit, and summarises how the unit was restructured as a flipped and blended learning experience:

This unit will be taught differently to some of the other units you may have taken.

It is comprised of 13 online modules with each covering a different area of Taxation Law. The modules can be accessed through the unit website on Blackboard at www.lms.uwa.edu.au. It is suggested that you complete one module each week in accordance with the Unit Schedule in the unit outline.

This unit does not involve any traditional face-to-face lectures. Instead, traditional lectures have been replaced by short video clips on Blackboard. This means that each module is designed to allow you to learn at your own pace (and from the comfort of your own home!).

Each module is broken into four sections:

What is this module about?

This section gives a general overview of the content that will be covered in the module.

Watch it!

You should start each module by watching the video clips which are intended to guide you through the relevant legislation, case law and readings. The video clips are not intended to cover every aspect of the course in detail but, instead, are designed to explain key concepts and highlight important issues.

Read it!

Once you have watched the video clips, you should complete the required readings which are listed in this section of the Module. The readings are intended to cover the finer points of the concepts which may have been discussed in the video clips. These readings will form part of the assessable content for the unit.

Apply it!

Once you have watched the video clips and completed the readings, you should consolidate your learning by attempting to answer the questions listed in this section of the Module. Once you have answered the questions, you can then check how you went by comparing your answers to the Answer Guide. You will also have the opportunity to apply what you have learnt in each Module by attending the Interactive Workshops and Tutorials.

In place of lectures, you will attend tutorials and interactive workshops. The interactive workshops are designed to support you in completing the assessments in this unit. There are two workshops to help you complete the assignment and four workshops to help you prepare for the final exam. It is an expectation that students will attend all of the interactive workshops.

Thus, the transmission of information and initial short testing of student understanding of concepts was all shifted online, where students had the ability to control the pace and order of study. In terms of face-to-face activities, lectures were replaced by six 1.5-hour interactive workshops spread across the semester. The workshops were expressly geared toward supporting student preparation for assessment tasks (the same assessment structure was retained), with two workshops focused on preparing students for their assignment and the remaining workshops being in the style of mock exams. At the beginning of each workshop, students were placed in groups of around four to five, which generally worked out to around 25 groups. For each workshop the lecturer was assisted by several tax practitioners from accounting firms (and sometimes additional lecturers), which provided excellent modelling and also industry contacts. It also meant that each facilitator had responsibility for around eight groups, which proved manageable. Answers were debated within groups and then shared and peer- and teacher-reviewed using the discussion board on Blackboard.

The rooms utilised for the workshops were standard lecture rooms. However, as there were several facilitators (including the lecturer and tax practitioners) and the students were divided into small groups, there was ample opportunity for the lecturer/facilitator to walk around the room and interact with each group individually. Recording of the workshops was not practicable given the number of participants/students talking and the group-work format of the activities. Whilst the inability to record workshops may have resulted in a reduction in flexibility for some students, attendance at the workshops was not compulsory, there were only six workshops across the course of the semester (meaning face-to-face contact hours were kept to a minimum), and all students taking the unit were enrolled to study the unit on-campus.

To give a sense of what each workshop involved and the ways that peer- and teacher-led learning occurred, Example 1 shows sample instructions provided to students.

Example 1: Workshop structure

Purpose?

The purpose of this workshop is to help you prepare for the final exam by tackling mock exam questions on Modules 1 to 3.

What should I do to prepare?

- Complete Modules 1 to 3 on Blackboard.

- Attempt to answer the Mock Exam on Modules 1 to 3.
- Bring your answers to the Mock Exam with you to the workshop.

What will we do in the workshop?

- The lecturer will break students into groups.
- Students will have time to complete the mock exam questions in their groups.
- The lecturer will move between the groups and answer any questions.
- Groups will post their answers to the mock exam questions on the discussion board.
- Groups will then ‘mark’ the answers posted on the discussion board by assigning a rating out of 5.
- We will then discuss the best answer and how it could be improved.

One workshop differed materially in that it involved students bringing a draft of their assignment question and obtaining peer and teacher feedback in class.⁹ Here there was a broader range of issues, making it vitally important to focus on certain core matters, such as modelling the use of the IRAC (issue, rule, analysis and conclusion) method to answer an issue, modelling the function of an introduction and identifying examples of proper referencing.

III LITERATURE REVIEW

A Pedagogical basis for flipping the classroom

The flipped classroom model shifts the focus away from didactic teaching to a student-centric approach to learning. It can promote flexibility in the learning environment. However, in general, the flipped classroom is considered to be under-theorised, under-researched, and scant in rigorous methods. Nevertheless, the general understanding of the pedagogy underpinning a flipped classroom is:¹⁰

- the movement of information-transmission teaching out of the classroom
- use of class time for learning activities that are active and social
- a requirement for students to complete pre- and/or post-class activities to fully benefit from in-class work.

⁹ The other assignment workshop involved more discrete issues and more general assignment-writing training.

¹⁰ Abeysekera and Dawson (n 1) 3.

Thus, while several studies have found that the traditional lecture format in law courses does not promote 'active learning',¹¹ in contrast, the literature suggests that a flipped classroom can promote it.¹² Active learning occurs where students do not passively receive information about a concept, but themselves work on a question or task to help gain understanding of the concept.¹³ Indeed, Comber and Brady-Van den Bos suggest that it may be the in-class active- and peer-learning activities that foster student learning to a greater extent than the flipped classroom model itself.¹⁴

While there are concerns around the removal of the lecture and therefore face-to-face contact, studies have demonstrated the flipped classroom model improves the teacher/student dynamic. In fact, there is some evidence to suggest that a flipped classroom is the preferred learning environment for business students studying law units.¹⁵ This may be because under a flipped classroom model teachers act as 'the guide on the side', facilitating discussions and providing greater support and clarification for students, in contrast to a traditional lecture format where students remain passive during lectures.¹⁶ As Cameron and Dickfos observe:¹⁷

The 'flipped lecture' can reconceptualise the traditional lecture format by reducing the amount of material delivered in the lecture. As a consequence, time can be devoted during the lecture for activities that encourage students to engage in deep learning.

In terms of support, Comber and Brady-Van den Bos also found that students perceived their lecturer to have a genuine interest in their learning, which contributed to the success of the flipped classroom model.¹⁸ Their findings also speak to the lecturer creating a safe, inclusive and accepting learning environment, with students feeling comfortable to engage in group discussions. In another study, just-in-time feedback from tutors indicated the significance of teacher presence in workshop settings, where students perceived the better the support, the more engaged they felt to work on the in-class activities.¹⁹ Furthermore, the interactive nature of the in-class peer-learning activities were cited by students to be at the core of a successful flipped classroom.²⁰

¹¹ See, generally, Richard Johnstone, 'Rethinking the Teaching of Law' (1992) 3(1) *Legal Education Review* 1; Marlene Le Brun and Richard Johnstone, *The Quiet (R)evolution: Improving Student Learning in Law* (Law Book Company, 1994); Cameron and Dickfos (n 5) 100.

¹² Cf Abeysekera and Dawson (n 1) 2; Cameron and Dickfos (n 5) 100–1.

¹³ As to active learning, see, for example, T Andrews et al, 'Active Learning Not Associated with Student Learning in a Random Sample of College Biology Courses' (2011) 10(4) *CBE Life Sciences Education* 394, 394.

¹⁴ Darren PM Comber and Mirjam Brady-Van den Bos, 'Too Much, Too Soon? A Critical Investigation into Factors that Make Flipped Classrooms Effective' (2018) 37(4) *Higher Education Research & Development* 685, 689–90. See also Debra D Burke, 'Scale-Up! Classroom Design and Use Can Facilitate Learning' (2015) 49 *The Law Teacher* 189, 191, 192.

¹⁵ Cameron and Dickfos (n 5) 99.

¹⁶ *Ibid* 100.

¹⁷ *Ibid* 101.

¹⁸ Comber and Brady-Van den Bos (n 14) 690.

¹⁹ Min Kyu Kim et al, 'The Experience of Three Flipped Classrooms in an Urban University: An Exploration of Design Principles' (2014) 22 *Internet and Higher Education* 42.

²⁰ Comber and Brady-Van den Bos (n 14) 689. See also Kylie Burns et al, 'Active Learning in Law by Flipping the Classroom: An Enquiry into Effectiveness and Engagement' (2017) 27(1) *Legal Education Review* 4;

However, a flipped classroom must be implemented with care, and O'Flaherty and Phillips highlight the need to ensure that in-class activities do indeed involve active learning and integrate into the overall structure of the course.²¹ Moreover, one of the main criticisms with flipped classroom environments is that they rely on student commitment to complete pre-class activities and actively participate in in-class activities.²² Therefore, understanding the key themes that underpin student motivation can enhance the support of this engagement, and empower students to support their basic cognitive needs within the learning context.

While research into the pedagogy of flipped classrooms is still growing,²³ Abeysekera and Dawson offer a theoretical model. It consists of a series of propositions identifying the pedagogical basis for the flipped classroom to support student learning through motivation (self-determination theory) and delivery of instructional and learning design (cognitive load theory).²⁴ They argue that flipped classrooms can support student motivation by meeting these psychological needs within the learning environment.

B Self-determination theory

Self-determination theory states there are three psychological needs to intrinsic and extrinsic motivation.²⁵ These are: competence (a sense of control and mastery of knowledge); relatedness (a sense of interaction and connection with others); and autonomy (a sense of independence over the learning journey).

The flipped classroom model can meet these aspects of self-determination theory, whereby students can feel competence through participating in active-learning activities, such as peer collaboration. These contexts of engagement and interaction with peers enhance intrinsic motivation. The sense of competence must be accompanied by feelings of autonomy, and occur in social contexts that create a perceived sense of relatedness to peers and with instructors (such as small numbers in group-work settings), in order to foster intrinsic motivation in students to commit to completing the work.²⁶ Intrinsic motivation can be fostered when learning activities are an inherently satisfying experience for the student.

Extrinsic motivation is driven by external factors, such as grades.²⁷ While a common theme in higher education is that students will not complete a task unless grades are attached, self-determination theory offers the chance to integrate personal and course

Gerald F Hess, 'Blended Courses in Law School: The Best of Online and Face-to-Face Learning?' (2013) 45 *McGeorge Law Review* 51, 56.

²¹ Jacqueline O'Flaherty and Craig Phillips, 'The Use of Flipped Classrooms in Higher Education: A Scoping Review' (2015) 25 *Internet and Higher Education* 85, citing Bill Tucker, 'The Flipped Classroom: Online Instruction at Home Frees Class Time for Learning' (2012) 12(1) *Education Next* 82, 82-3.

²² Cameron and Dickfos (n 5) 102.

²³ Sarah J DeLozier and Matthew G Rhodes, 'Flipped Classrooms: A Review of Key Ideas and Recommendations for Practice' (2017) 29 *Educational Psychology Review* 141, 142.

²⁴ Abeysekera and Dawson (n 1) 4.

²⁵ Ibid; Edward Deci and Richard Ryan, *Intrinsic Motivation and Self-Determination in Human Behaviour* (Plenum Press, 1985).

²⁶ Abeysekera and Dawson (n 1) 4-6.

²⁷ Richard Ryan and Edward Deci, 'Intrinsic and Extrinsic Motivations: Classic Definitions and New Directions' (2000) 25(1) *Contemporary Educational Psychology* 54.

values that are fostered through the learning environments.²⁸ There are varying types of extrinsic motivation that can achieve this degree of integration, which is also relative to the degree of autonomy. These types of extrinsic motivation vary from motivation driven by external rewards or demands (such as completing an activity as requested by a teacher), to more integrated regulation — for instance, where goals are extrinsic, but there is also enjoyment in the experience that is inherent to the activity (such as a student taking the lead on a group project because it satisfies their need to be in charge, while enjoying the group activity as a secondary motivator).²⁹

C Cognitive load theory

Cognitive load theory is an instructional theory regarding the effort required for the working memory.³⁰ This effort reflects the limitations on the mental capacity to develop schemata.³¹ In this regard, research by Cameron and Dickfos suggests that some students may have a perception of ‘information overload’ under a flipped classroom model.³² Understanding cognitive load can assist instructors in designing learning activities that mitigate an overload in mental processing of information.

There are three types of cognitive load to be considered. First, intrinsic load relates to the qualities that are inherent to the concept at hand. The ability to call on existing schemata assists students with the processing of this intrinsic load.³³ Second, extraneous load relates to the method in which the information is delivered, which can present additional complexities requiring further effort to process. This could be a poorly delivered lecture with too much information on slides or insufficiently connected teaching materials, resulting in cognitive overload. The third and final type of cognitive load is germane load — the effort required to process the information into a new schema. An example of this type of load is when a student explains a newly acquired concept in a peer-collaborative group setting.

Abeysekera and Dawson suggest that the flipped classroom model supports cognitive load theory through shifting the information-transmission of teaching to outside the lecture in the form of pre-class activities, as evidenced by other studies.³⁴ These pre-class activities can be: micro-lectures, pre-recorded in 10- to 15-minute videos; other multimedia resources, such as YouTube videos; online resources; or pre-reading

²⁸ Abeysekera and Dawson (n 1) 6, citing Deci and Ryan (n 25). See also Marylene Gagne and Edward Deci, ‘Self-Determination Theory and Work Motivation’ (2005) 26 *Journal of Organizational Behaviour* 331, 333–4.

²⁹ Abeysekera and Dawson (n 1) 6.

³⁰ John Sweller, ‘Cognitive Load Theory’ in Jose P Mestre and Brian H Ross (eds), *The Psychology of Learning and Motivation* (Elsevier, 2011) vol 55, 38.

³¹ Tina Seufert, ‘The Interplay between Self-Regulation in Learning and Cognitive Load’ (2018) 24 *Educational Research Review* 117. Schema (plural schemata or schemas) is the mental process of organising information.

³² Cameron and Dickfos (n 5) 112.

³³ *Ibid* 117.

³⁴ Abeysekera and Dawson (n 1), citing Ruth C Clark, Frank Nguyen and John Sweller, *Efficiency in Learning: Evidence-Based Guidelines to Manage Cognitive Load* (Pfeiffer, 1st ed, 2005); Paul Ginns, ‘Meta-Analysis of the Modality Effect’ (2005) 15(4) *Learning and Instruction* 313; Ron Owston, Denys Lupshenyuk and Herb Wideman, ‘Lecture Capture in Large Undergraduate Classes: Student Perceptions and Academic Performance’ (2011) 14(4) *Internet and Higher Education* 262.

materials, such as journal articles and textbooks. Research by Butt suggests that the student learning experience in a flipped classroom environment can be improved by making short pre-recorded video lectures available to students.³⁵ These pre-class activities allow students the flexibility to view the resources multiple times, and in a method that is tailored to their ideal process, such as pausing videos to write down notes. Therefore, Abeysekera and Dawson propose the flipped classroom model is ideal for students, as it supports their tailored needs and reduces cognitive overload through self-paced learning.³⁶

Abeysekera and Dawson also propose the flipped classroom model provides scope for learning design activities to be tailored to the degree of student expertise in the subject matter.³⁷ Unit coordinators are faced with the challenge of providing a learning experience to accommodate an increasingly diverse student cohort, from domestic and international students and high school leavers, to students returning to study after 20 years in the workforce. Therefore, the deliberate intent of tailoring pre-class activities to be scaffolded to suit the needs of varying degrees of student expertise could potentially support the management of cognitive load.³⁸

D Key risks and challenges

The adoption of a flipped classroom model is not entirely without risks and challenges. In particular, it is important to consider student perceptions of change and that changes do not adversely impact student motivation or workload, as well as considering staff perceptions and workload. Further, our flipped unit, akin to many flipped classrooms, involved group workshops, which raises a series of challenges.

1 Student perceptions

As flipped classroom approaches are still relatively novel, students can be hesitant to embrace a different approach from the traditional lecture, and some students dislike taking greater responsibility for their own learning and having to spend time covering course content outside of classes.³⁹ Recent research by Butt suggests that the majority of students will view the introduction of a flipped classroom positively.⁴⁰ However, when implementing a flipped classroom, Butt argues that it is still necessary to provide a variety of different learning opportunities (such as video recordings, course materials and tutorials), due to the perceived value different students place on different learning activities.⁴¹ It is thus critical to explain to students why the class has been flipped, what

³⁵ Adam Butt, 'Students Views on the Use of a Flipped Classroom Approach: Evidence from Australia' (2014) 6(1) *Business Education & Accreditation* 33, 40.

³⁶ Abeysekera and Dawson (n 1) 9.

³⁷ *Ibid* 9–10.

³⁸ Alison S Burke and Brian Fedorek, 'Does "Flipping" Promote Engagement?: A Comparison of a Traditional, Online, and Flipped Class' (2017) 18 *Active Learning in Higher Education* 11, 14.

³⁹ Burns et al (n 20) 6; O'Flaherty and Phillips (n 21) 85, 89, 94; Anne E Mullins, 'The Flipped Classroom: Fad or Innovation?' (2015) 92 *Oregon Law Review Online* 27, 29.

⁴⁰ Butt (n 35) 38.

⁴¹ *Ibid*.

the new expectations of students are under this format and how students ought to undertake self-directed learning.⁴²

2 *Student engagement and motivation*

While motivating students to engage in content is an inherent challenge to all teaching and learning strategies,⁴³ it is perhaps more acute in the context of a flipped classroom. This is because a flipped classroom model involves a student-centred approach where a greater responsibility for learning is placed on the student (when compared to a traditional classroom model). In this regard, students in our flipped classroom environment were required to complete the online learning modules and set tasks prior to participating in the workshops.⁴⁴ This relies on students both understanding the approach of the model and having sufficient motivation to complete pre-class activities. If students did not complete the pre-class activities, they would not have sufficient grounding to then participate in the workshops. However, a key strategy employed to enhance student engagement and motivation was to align workshops with assessment tasks in the unit. It was hoped that aligning the workshops with assessment items would motivate students to complete their pre-class activities, keep up with the online learning modules and attend the workshops.

3 *Student workload*

It is important to ensure when flipping the classroom that expectations of work to be completed pre- and in-class are made explicit to students early in the semester, and that consideration is taken of whether the changed format will increase that work.⁴⁵ While the video recordings and online reading materials were a few hours under the length of the replaced lectures and materials, the additional study questions did not entirely overlap with previous material and required about an extra three hours across the semester. The workshops themselves required 12 more hours across the semester. However, as the workshops supported assignment and exam preparation, we anticipated that the majority of the 12 hours (and any preparation time) would have been spent preparing for those assessment items in any event. Accordingly, the net effect on total study hours for students was broadly neutral.

4 *Lecturer perceptions*

Staff and institutional perceptions of adopting a flipped classroom may also be a key challenge,⁴⁶ especially where there is insufficient acknowledgment of the resources required.⁴⁷ In particular, the video-recording process can be difficult to master and time-

⁴² Burns et al (n 20) 3–4.

⁴³ See, for example, Roy Ballantyne, John Bain and Jan Packer, 'Researching University Teaching in Australia: Themes and Issues in Academics' Reflections' (1999) 24(2) *Studies in Higher Education* 237, 243; Brett Freudenberg and Lisa Samarkovski, 'Enthusiasm and the Effective Modern Academic' (2014) 56(1) *Australian Universities Review* 22, 24–5.

⁴⁴ Burns et al (n 20) 3.

⁴⁵ Cf O'Flaherty and Phillips (n 21) 89.

⁴⁶ Carol Shepherd, Madelon Alpert and Marilyn Koeller, 'Increasing the Efficacy of Educators Teaching Online' (2007) 2 *International Journal of Social Science* 173, 173–4.

⁴⁷ O'Flaherty and Phillips (n 21) 89.

consuming.⁴⁸ The first time that lectures were recorded the lecturers in the unit each had multiple hours of dedicated assistance from our Educational Enhancement Unit to ensure that videos were of a sufficient quality and that recordings were made as efficiently as possible. Even so, it took around 2–2.5 hours of recording time per hour of lecture time. This time needs to be allocated well in advance so that the videos are recorded and available for students from the start of semester, or at least well in advance of the relevant module. Updates in subsequent years took slightly longer to record and then splice back into earlier recordings, so that a 5- to 10-minute update would require around 30 minutes. In most instances it would have been quicker to record an entirely new 10-minute recording than to splice 10 minutes into an existing 30-minute recording. Thus, in addition to aiming for 10- to 15-minute recordings to suit student attention spans, these shorter-length recordings can also aid updates.

5 *Group workshops*

As outlined in Section II.C, the workshops were run with the whole class, but split into around 25 groups. This potentially raises common risks associated with large-class teaching and group work, such as providing pastoral care for students, ensuring accountability, providing immediate feedback, designing group tasks that promote learning and team development, and ensuring optimal group formation and operation.⁴⁹ We aimed to reduce group tension and accountability issues (which may impact on relatedness with peers and teachers), as the group work was not assessed.⁵⁰ However, to ensure students remained motivated to prepare, the work was directly relevant to individual performance on future assessment tasks. This was assisted by the online transmission of information and initial short testing of student understanding. This measure ensured that students did not become unduly anxious about the performance of their fellow group members. Accountability for individual contributions to each group was also helped by the facilitators speaking multiple times with each group during workshops, something enabled only by the presence of volunteer tax practitioners.

The group workshop format of a flipped classroom can also require the development of new teaching skills.⁵¹ For instance, teachers may have to select good and poor answers for discussion (assisted in our class by students first peer reviewing and rating the responses online), look for elements that may be missing in some answers, and sum up an overall answer to each question (all without the teacher having an opportunity to prepare beforehand). Furthermore, while exposure to poor answers carries with it the

⁴⁸ See, for example, *ibid* 85, 88–9; Burns et al (n 20) 5.

⁴⁹ See, for example, Larry Michaelsen and Michael Sweet, 'The Essential Elements of Team-Based Learning' (2008) 116 *New Directions for Teaching and Learning* 7; Felix Maringe and Nevensha Sing, 'Teaching Large Classes in an Increasingly Internationalising Higher Education Environment: Pedagogical, Quality and Equity Issues' (2014) 67 *Higher Education* 761.

⁵⁰ As to tensions that assessed group work can raise, along with strategies to deal with those tensions, see Linda Nilson, *Teaching at Its Best: A Research-Based Resource for College Instructors* (Jossey-Bass, 4th ed, 2016) 236–44; Charles Brooks and Janice Ammons, 'Free Riding in Group Projects and the Effects of Timing, Frequency and Specificity of Criteria in Peer Assessments' (2003) 78(5) *Journal of Education for Business* 268.

⁵¹ Burns et al (n 20) 5; Shepherd, Alpert and Koeller (n 46) 3–4.

risk that students may become confused, this risk can be reduced by explaining how poor answers can be improved and taking students through a model answer to the question.⁵²

It is also important to focus time on group formation, so as to increase diversity within groups and reduce pre-existing coalitions that are common when students select their own groups.⁵³

IV METHODOLOGY

We employed an action research design to better understand how we could improve student satisfaction and engagement through shifting to a flipped classroom model. Action research attempts to capture the perspectives and behaviours of the participants (in this case, the students enrolled in the unit and the teachers), and analyse that data.⁵⁴ Occurring in a continuous feedback loop over the semesters, this enabled us to identify aspects of the learning and instructional design that required further work. Thus, we looked first to the existing teaching and learning literature and theory to identify dimensions in which to anticipate change in perspectives and behaviours (student perceptions; student engagement and motivation; student achievement; and teacher perceptions), before collecting data and considering how that data related to the identified dimensions. The approach adopted is particularly useful due to the deep understanding it can provide for the individual circumstances examined.⁵⁵ Its potential flexibility is a key benefit for exploratory research.⁵⁶ Given the emergent status of theoretical understandings of flipped classrooms, a methodological approach aligned with exploratory research is essential.

To gather the data, a mixed method approach was utilised. Mixed method research involves undertaking both qualitative and quantitative analysis.⁵⁷ To reduce research costs and safeguard student time, we analysed the rich data collected under our university's teaching quality assurance mechanism, the Students' Unit Reflective Feedback ('SURF'),⁵⁸ which contains quantitative and qualitative feedback. We also

⁵² As to the importance of providing feedback that explicitly addresses weaknesses and strengths, see, for example, Boris Handal, Leigh Wood and Michelle Muchatuta, 'Students' Expectations of Teaching: The Business, Accounting and Economics Experience' (2011) 5(1) *E-Journal of Business Education & Scholarship of Teaching* 1, 11-12.

⁵³ Michaelsen and Sweet (n 49) 7, 10.

⁵⁴ Keith F Punch, *Introduction to Social Research: Quantitative & Qualitative Approaches* (SAGE Publications, 2004) 143.

⁵⁵ Earl Babbie, *The Practice of Social Research* (Wadsworth Cengage, 12th ed, 2010) 296; Ariadne Vromen, 'Debating Methods: Rediscovering Qualitative Approaches' in David Marsh and Gerry Stoker (eds), *Theory and Methods in Political Science* (Palgrave Macmillan, 3rd ed, 2010) 249, 257.

⁵⁶ Babbie (n 55) 326; Vromen (n 55) 257.

⁵⁷ Cf Margaret McKerchar, 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation' (2008) 6(1) *eJournal of Taxation Research* 5; R Burke Johnson, Anthony J Onwuegbuzie and Lisa Turner, 'Towards a Definition of Mixed Method Research' (2007) 1(2) *Journal of Mixed Method Research* 112, 113.

⁵⁸ The SURF is an electronic survey implemented through the online learning management system for every unit at UWA. It comprises six survey questions designed to ascertain the students' overall satisfaction with the educational experience. These are assessed on a four-point scale. Students also have space to provide qualitative feedback.

analysed assessment results and YouTube viewing data. Ethics approval was obtained from the university's Human Ethics Office for the use of this data.

In terms of the qualitative feedback, thematic coding was undertaken for the years 2013–18. The data was then triangulated to ensure consistency in the identification of themes.

V RESULTS AND DISCUSSION

In keeping with the description of this article's methodology, the results are discussed under the themes of student perceptions (Section V.A), student engagement and motivation (Section V.B), student achievement (Section V.C) and teacher perceptions (Section V.D).

A Student perceptions

As discussed in the literature review, there is a risk that students will view the change to a flipped classroom negatively. The SURF qualitative commentary reflected this risk:

I strongly disliked the structure of this unit being mostly done through online modules. However, the lecturer is clear, concise and easy to understand so I must say that the lectures are good — but I wish that there were weekly in person lectures as I would then attend every week rather than leaving all the modules to the last 2 weeks to watch ... (2016 student)

I would much rather prefer face-to-face lectures instead of learning through YouTube videos. Face to face lectures would allow the lecturer to engage with the students. This interaction would have provided a clearer indication of what the majority of students understood well and what they did not and then put more of a focus on concepts the majority of students did not understand as thoroughly. (2017 student)

However, student satisfaction with the unit improved dramatically following the flip, as captured in the SURF survey results for the statement: 'Overall, this unit was a good educational experience' (see Table 2).

Table 2: Student perception of educational experience

Year	2013	2014	2015	2016	2017	2018
Score out of 4 ⁵⁹	2.5 (36.6% response rate)	2.6 (25.8% response rate)	2.7 (38.5% response rate)	3.4 (62% response rate)	3.2 (29.3% response rate)	3.5 (26.5% response rate)

The qualitative analysis also indicated that student satisfaction was enhanced under the flipped classroom. Many students provided SURF comments that reflected a positive view of the change, with positive statements exceeding or equalling negative statements in

⁵⁹ The mid-point of the scale is 2.5 (Strongly disagree = 1, Disagree = 2, Agree = 3, Strongly agree = 4) and the university expectation is that a large core unit should score around 3.2.

each year following the flip and, overall for 2016–18, exceeding negative statements 55 per cent to 45 per cent. For instance:

The current structure of the online modules with a face to face workshops have worked out really well. The assignment given was very indicative of my performance at the time and it helped me fix specific areas I was lacking and was more confident in my learning by the exam ... (2016 student)

The online videos were really helpful. The lecturers and tutors were really kind and extremely helpful. The workshops worked really well and gave us a good guide to prep for exams and for the assignment. (2018 student)

Several themes emerged from the qualitative SURF data, which shed light on these perceptions. The first theme was an increased sense of pastoral care, which is consistent with Comber and Brady-Van den Bos' findings of an improved teacher/student dynamic in flipped classrooms.⁶⁰ For example, post the flip, in addition to the final quote set out immediately above, some of the feedback indicated:

It is obvious that [the lecturer] cares about how his students perform, as evident by his willingness to help with mock answers before the exam and adjusting to students feedback frequently. One of my favourite units so far. (2017 student)

Greatly structured unit. Initially I thought the unit would be monotonous but the interest and clarity shown by [lecturer A] and [lecturer B], as well as my tutor led to a solid educational experience. (2018 student)

The lecturers and tutors were really kind and extremely helpful. The workshops worked really well and gave us a good guide to prep for exams and for the assignment. (2018 student)

Likewise, the qualitative analysis highlights that, before flipping, student comments reflected a concern that there was limited recognition of student desire/need for a flexible learning structure. For example:

I hated the fact that there were so many problems with lectures and the fact that the lecturer made me feel bad for preferring to watch the lecture online rather than attend the lecture. (2015 student)

Unit coordinator expressed that he wanted us to attend lectures however not everyone can do this due to part time jobs and some prefer to watch lectures online as they can be paused and more easily understood. Not everyone has the luxury of attending uni without having to work. We, the students are they [sic] ones paying to attend uni. (2015 student)

After the flip there was limited focus on a desire for flexibility, suggesting that students felt that the flipped classroom was delivering the flexibility they needed:

Really enjoyed the online modules, as it meant you could learn at your own pace, and also made it easier to go back and revise certain aspects of a week's content that needed revising, without having to sift through the entire lecture. Information was given

⁶⁰ See Comber and Brady-Van den Bos (n 14) and accompanying text.

concisely which made it easier to learn the required content. Workshops and provision of regular practice exams was useful for consolidating our knowledge of the topics. Overall I enjoyed this unit, and the way it was structured made it all the more enjoyable. (2016 student)

The structure of the unit was really well designed with the modules being helpful in learning at my own pace. Workshops were great as well with the added help of going through content and doing an assignment review. (2016 student)

Learning modules were very helpful, particularly the ability to easily pause to take notes and rewatch certain ones. They were very to the point, which I appreciated. Posting all the tutorials as early as possible was also very helpful, gave plenty of time to prepare ... (2016 student)

The online lectures were great, as I worked extremely long hours during the week at my employment, and watching online was an easy way to cut out travel time to and from university. (2017 student)

Notably, there was a close connection between the perception of pastoral care and flexible learning design. This indicated that students considered the provision of flexibility in the learning design to be a response by the lecturers to their needs and pressures.

B Student engagement and motivation

While attendance (or absenteeism) may occur for a range of reasons, attendance is a potentially important indicator of student motivation and 'behavioural engagement'.⁶¹ Based on lecturer estimates of attendance and reflecting the literature on flipped classrooms,⁶² there was a dramatic increase from before to after flipping the classroom. This is consistent with the observations of Butt, who also found a dramatic improvement in class attendance following the implementation of a flipped classroom.⁶³

Table 3: Student attendance

Attendance	2013		2014		2015		2016 Workshops	2017 Workshops	2018 Workshops ⁶⁴
	First and final lectures	Other lectures	First and final lectures	Other lectures	First and final lectures	Other lectures			
Approximate head count as percentage of enrolled students	65%	20-30%	45%	15-20%	15-25%	10-15%	55-70%	50-65%	50-70%

⁶¹ Cf Jennifer Fredricks, Phyllis Blumenfeld and Alison Paris, 'School Engagement: Potential of the Concept, State of the Evidence' (2004) 74(1) *Review of Educational Research* 59, 60; Sarah Moore, Claire Armstrong and Jill Pearson, 'Lecture Absenteeism among Students in Higher Education: A Valuable Route to Understanding Student Motivation' (2008) 30(1) *Journal of Higher Education Policy and Management* 15. 'Behavioural engagement' reflecting 'participation', that is, taking part in academic and class activities.

⁶² For a meta-analysis, see O'Flaherty and Phillips (n 21) 89.

⁶³ Butt (n 35) 40.

⁶⁴ Excluding workshop 5, which was held just before the due date for an assignment in the unit, and for which the attendance was a little over 10 per cent.

One potential factor underlying this increased attendance is that lectures had previously been recorded, but the replacement workshops, due to their interactive nature, were not recorded. This is unlikely, however, to be a complete explanation. In 2015, in particular, there were numerous problems, of which students were aware, in obtaining lecture recordings, but no obvious increase in lecture attendance. For instance, a representative student SURF comment for 2015 noted:

The coordinator seems to expect all student to attend lectures, lecture recordings are too poor (failure to use microphone). Coordinator should be considerate of student's personal circumstances that may limit their ability to attend lectures.

Further, students who attended workshops generally appeared to the teachers and facilitators to have completed the out-of-class preparatory activities and materials. While statistics for unique views of the recorded lectures were not captured, the existing statistics are that recordings were viewed between a minimum of 85⁶⁵ and a maximum of 361 times per year across 2017 and 2018 — with only three videos watched fewer than 140 times per year in that time.⁶⁶ As the class size was around 140–150 students over each of these years, it suggests that most students watched most of the videos, although some students may have watched videos multiple times.

Student SURF comments also reflected changes in some factors that would be expected to improve engagement and motivation. As discussed in Section V.A, the SURF comments suggest increased student perceptions of pastoral care and access to flexibility. The former should typically lead to improved 'emotional engagement', as well as relatedness and hence motivation, given that it involves more positive perceptions of teaching staff.⁶⁷ The latter indicates a perceived improvement in autonomy and hence motivation and 'cognitive engagement'.⁶⁸

However, SURF comments also indicated some negative impacts on student engagement and motivation. In particular, we underestimated the continued student desire for a more prescriptive narrative and greater reinforcement in lecture materials. This was to the detriment of emotional and cognitive engagement and motivation, which was a key theme from SURF comments before and after the classroom was flipped. For example:

I found much of this unit vague and it felt like I was trying to learn street names without a road map to understand how that was relevant ... I understand the desire to engage students by posing questions rather than having slides filled with sections and cases, but I have found it difficult to be sure I have gone back and covered each topic comprehensively without missing some aspect of a topic. Perhaps some summary notes released after lectures would be helpful for revision. (2014 student)

Whilst I found the module layout of the unit (weekly online videos) to be excellent compared to lectures, the accompanying slides and the videos themselves were severely

⁶⁵ In the case of at least one of these videos, the students were told that the material was not examinable.

⁶⁶ Obtained from YouTube analytics, which exist for 2017 and 2018, but not 2016.

⁶⁷ 'Emotional engagement' concerns 'positive and negative reactions to teachers, classmates, academics, and school and is presumed to create ties to an institution and influence willingness to do the work': Fredricks, Blumenfeld and Paris (n 61) 60.

⁶⁸ 'Cognitive engagement' concerns 'willingness to exert the effort necessary to comprehend complex ideas and master difficult skills': *ibid.*

inadequate in assisting my understanding of the unit content. ... Though I understand slides should only form a skeleton to accompany the body of a lecture, the notes provided in this unit covered the absolute minimum and it was very easy to miss key points. (2018 student)

A greater quantity of material was available to students once the classroom had been flipped, as students were also provided with test questions and answers for each module, as well as the workshop materials. However, SURF comments indicate that students continued to want lecture notes for each lecture rather than just video recordings or textbook readings. Further, after the flip, there were also more SURF comments requesting a greater emphasis on ensuring a seamless connection between the course materials. For instance:

Strong disconnect between lecture slides, required readings and tutorial exercises. (2016 student)

Some of the modules did not flow well when there was a change in presenter from video to video, I would have preferred to have the same presenter for the whole module. Otherwise the unit was great, modules and readings were very helpful. (2018 student)

This suggests that a flipped classroom may increase student desire for greater narrative prescription, as a flipped classroom potentially involves a greater range of materials (with more guidance thus required on the interaction of those materials) and potentially less emphasis on the teacher's description of the tax rules, since the in-class emphasis is on applying those rules, not setting them out. This is potentially consistent with Butt's insight that students still need a range of different learning opportunities, which may include short re-caps delivered in workshops or recorded for viewing before workshops.⁶⁹ It is also consistent with the discussion of cognitive load theory, in that extraneous cognitive load may be increased by too much divergence in materials.

In 2017 and 2018 we trialled a response to student requests for lecture notes by providing tidied-up copies of the lecturers' personal notes for several of the trickier topics and the SURF comments have generally been positive about access to those notes:

Addition of lecture notes on top of lecture slides were great learning resources. (2017 student)

However, the provision of a further set of materials makes the task of ensuring a seamless connection between the various materials harder.

SURF comments also suggest that student engagement and motivation was negatively affected in the first year of the flipped classroom by reason of significant differences in the length of video recordings for different modules. In particular, we had one module for ordinary income, which comprised multiple videos totalling 3.5 hours, and two separate modules covering GST and FBT, each of which consisted of multiple videos of around one hour in combined length.

The modules were too long for some whilst others were short. Some of the content was too long as well. (2016 student)

⁶⁹ See above n 42 and accompanying text.

Learning modules should be around the same length every week, not have some modules being extremely long and tedious whilst others only span for 10 minutes. Students should be able to devote the same amount of time each week to learning modules but if some modules take longer than others, it makes it difficult to keep up and stay on top of the unit. (2016 student)

We subsequently split the ordinary income module in two and combined FBT and GST, achieving greater consistency in total length of videos for each module, and there were no SURF comments in 2017 and 2018 focusing on divergent module lengths.

C Student achievement

There is some flipped classroom literature suggesting that learning, and hence student achievement, should be improved.⁷⁰ However, this is equivocal, and a study by Findlay-Thompson and Mombourquette questions whether flipped classrooms result in improved student grades.⁷¹ Cognitive load theory suggests that where students can control the pace at which information is delivered, the cognitive load should be reduced and so learning should improve.⁷² While we identified above several ways in which we need to better segment the recorded material, the flipped classroom still involved a broader range of online material that students could access at their own pace. In addition, there is a significant body of literature suggesting that active learning (anticipated to increase in a flipped classroom) improves student achievement and this was a second reason for expecting improved student performance on assessment tasks.⁷³

Table 4 sets out the percentage of students achieving high distinction ('HD'), distinction ('D'), credit ('C'), pass ('P') and fail ('F') overall grades for the unit from 2013 to 2018. The years are broadly comparable, although 2014 evidences a much higher percentage of Cs and a lower number of HDs than other years, while 2013 and 2018 both reflect far fewer F grades. The means for the overall percentage grades each year are set out in Table 5, but before considering the means, it is pertinent to note that there has been far more consistency in the style and format of assessment from 2015 to 2018, during which members of the current teaching team have had primary responsibility for setting and grading assessment. By way of example of one difference in style, the 2014 final exam contained two questions with a combined total of nine sub-questions, while the 2015 exam contained two questions with four sub-questions, permitting more in-depth analysis for each issue.

⁷⁰ Cf O'Flaherty and Phillips (n 21) 89.

⁷¹ Sandi Findlay-Thompson and Peter Mombourquette, 'Evaluation of a Flipped Classroom in an Undergraduate Business Course' (2014) 6(1) *Business Education & Accreditation* 63.

⁷² See, for example, Abeysekera and Dawson (n 1) 8-9.

⁷³ Michelle J Richardson, Charles Abraham and Rod Bond, 'Psychological Correlates of University Students' Academic Performance: A Systematic Review and Meta-analysis' (2012) 138(2) *Psychological Bulletin* 353, 368, 372-3. Albeit, a range of other factors have a larger influence.

Table 4: Student grades — percentage and number of students

Final grade ⁷⁴	2013 (122)	2014 (190)	2015 (177)	2016 (133)	2017 (156)	2018 (146)
HD ≥80%	10.7% (13)	1.6% (3)	7.3% (13)	9.8% (13)	14.1% (22)	9.6% (14)
D ≥70%	29.5% (36)	26.8% (51)	29.9% (53)	38.3% (51)	29.5% (46)	32.2% (47)
C ≥60%	37.7% (46)	54.7% (104)	31.6% (56)	31.6% (42)	32.1% (50)	35.6% (52)
P ≥50%	19.7% (24)	9.5% (18)	21.5% (38)	12.8% (17)	14.7% (23)	17.8% (26)
F <50%	2.4% (3)	7.4% (14)	9.6% (17)	7.5% (10)	9.6% (15) ⁷⁵	4.8% (7)

Table 5: Student results — mean grade and standard deviation

	2013	2014	2015	2016	2017	2018
Mean grade (%)	66.4	63.6	62.6	65.6	64.9	65.4
Std dev	9.54	10.78	13.33	13.55	15.04	12.57
Number of students	122	190	177	133	156	147

We have applied Student's t-test to compare the means for 2013–15 (combined) and for 2016–18 (combined), to test the hypotheses that the means for the two groups were the same or, alternatively, that the mean for the 2016–18 group was significantly larger than that for the 2013–15 group.⁷⁶ As there were teaching improvements made for 2015, we have likewise compared the 2015 mean with that for 2016–18.

The comparison of the 2015 mean against 2016–18 indicated that there is a significant difference between the means and that the 2016–18 mean is significantly larger than the 2015 mean, as shown in Table 6.

Table 6: T-test for 2015 versus 2016–18

	2015	2016–18
Mean grade (%)	62.6	65.3
Std dev	13.33	13.77
Number of students	177	435
p (one-tail)		0.013
t		-2.25
t critical one-tail		1.65

However, we should be cautious about inferring too much from this result, as Table 7 demonstrates that, when we look at the larger range of data, there is no significant difference between the 2013–15 and 2016–18 means.⁷⁷ As noted above, while there are

⁷⁴ Excluding students who withdrew, did not undertake any assessment or sat deferred exams.

⁷⁵ Most of these fails were students who only completed one item of assessment.

⁷⁶ See, for example, Alan Elliot and Wayne Woodward, *Statistical Analysis Quick Reference Guidebook* (Sage, 2007). As an F-test indicated that the variances for the 2013–15 set and the 2016–18 set were unequal, the t-test was applied assuming unequal variance.

⁷⁷ The p-value is greater than 0.05 and the t-value lies between -t critical one-tail and +t critical one-tail, both of which indicate no significant difference, at the 95% confidence level. In any event, we note that grades are not the sole indicator of student learning and thus academic success, but rather an aspect of a

reasons to expect the 2015 data to differ from that for 2013–14, and hence to compare 2015 with the post-flip years, the reasons for treating 2015 differently also suggest that the mean should have been higher in 2015, when in fact that was not the case.

Table 7: T-test for 2013–15 versus 2016–18

	2013–15	2016–18
Mean grade (%)	63.9	65.3
Std dev	11.57	13.77
Number of students	489	435
p (one-tail)		0.054
t		-1.61
t critical one-tail		1.65

D Teacher perceptions

A further important factor in assessing the results of implementing a flipped classroom is considering how the change of delivery impacts the lecturers' perceptions. To ascertain this, the three unit lecturers debriefed on their experience with the flipped classroom. Two of the lecturers had been involved in the unit both pre- and post-flip, and were instrumental to the change in delivery mode. The third lecturer became involved only after the flip. However, this lecturer was able to reflect upon their experience in other similar tertiary units that used the traditional didactic lecture format as a point of comparison.

There were four main themes arising from the reflections, three of them being an increase in lecturer satisfaction due to:⁷⁸

- enhanced interactions with students through greater attendance and engagement at workshops
- the reduced need for out-of-class one-on-one feedback on assessment tasks due to the workshop design⁷⁹
- the development of teaching skills in relation to providing real-time feedback, flexibility in content discussion so as to tailor in-class time to areas of student need, and the recording of YouTube clips.

An increase in lecturer satisfaction and enthusiasm is not just a personal matter, but has also been linked to effectiveness in teaching.⁸⁰ The lecturers indicated that the flipped classroom model of delivery was more motivating due to the significant increase in student attendance at workshops. Increased student attendance had a number of advantages. First, it allowed a greater number of groups (and participants within each

number of variables, which include persistence, acquisition of skills and competencies, attainment of learning outcomes, career success, satisfaction and academic achievement. Cf 'Revised Conceptual Model of Academic Success' in Travis T York, Charles Gibson and Susan Rankin, 'Defining and Measuring Academic Success' (2015) 20(5) *Practical Assessment, Research & Evaluation* 1.

⁷⁸ Burns et al (n 20) 4.

⁷⁹ Debora L Threedy and Aaron Dewald, 'Re-conceptualizing Doctrinal Teaching: Blending Online Videos with In-Class Problem-Solving' (2015) 64 *Journal of Legal Education* 613.

⁸⁰ See, for example, Freudenberg and Samarkovski (n 43) 23.

group) in workshops, which ensured more diverse opinions and perspectives being canvassed and a more dynamic environment in the lecture room.⁸¹ One area for improvement in future is for greater attention to group formation, as recommended by Michaelsen and Sweet in the literature review discussion.

Second, similar to the experiences of Cameron and Dickfos,⁸² it provided the lecturers with enhanced opportunities to get to know and meaningfully interact with a larger number of the student cohort. The structure of the workshops also provided a platform that enabled more focused interactions between lecturers and students. It seems likely that the enhanced student perception of pastoral care discussed above resulted in greater emotional engagement, further supporting interactions with lecturers. The lecturers also found it satisfying to see the students interact in groups, building their 'peer to peer relatedness', as well as observing them interacting with members of the profession. Indeed, the SURF comments indicate that these professional volunteers were key to maintaining a sense of pastoral care in the large workshops:

The unit is exceptionally well structured. The use of online learning modules to allow the facilitation of the interactive workshops has added to the knowledge base I have developed with regard to the unit. The assistance and knowledge provided by the PWC staff [in workshops] has been fantastic as well as adding a real word [sic] approach to the workshop questions. (2016 student)

The workshops provided a valuable mechanism for giving formative feedback before the assignment or exam. This allowed students to seek early feedback and gave them an incentive to prepare earlier. A flow-on effect was that students were more prepared for their assignment and better understood why certain grades were awarded, resulting in fewer individual queries to the lecturer about the format, substance or design of the assignment. As a result of a workshop being set specifically on the assignment, the students also had the opportunity to discuss with their peers any concerns they may have had. As discussed above, there is weak evidence of a modest improvement in student grades. That said, consistent with the observations of Butt, it was necessary to exercise care during the workshops to ensure an appropriate balance between active classroom activities and clarification or explanation by teachers.⁸³

Third, as outlined in the literature review, the workshops required the lecturers to develop new skills in giving instant feedback on written answers posted to the discussion board during the workshop and in addressing good and poor answers. Additionally, certain workshops assisted in the identification of unforeseen widespread misunderstandings of particular content that could then be addressed. However, this necessitated the lecturer being flexible. For example, one workshop session revealed that a number of students had misunderstood the ratio of *FCT v Stone*.⁸⁴ Whilst this was not the purpose of the workshop, unearthing this issue enabled the lecturers to discuss and

⁸¹ As to the benefits of diversity within groups, see above n 54 and accompanying text.

⁸² Cameron and Dickfos (n 5) 112.

⁸³ Butt (n 35).

⁸⁴ (2005) 222 CLR 289.

clarify the impact of this decision. It is unlikely that, without the workshop environment and the type of application question that was set, this issue would have been uncovered.⁸⁵

The literature review also emphasised the importance of responding with sufficient guidance in the case of poor answers. For some workshops, we posted full workshop answers online, but were concerned that if this became expected students might not attend workshops but just read the answers. Workshop questions were also typically framed as relatively short discrete issues that involved some tax uncertainty on the specific issue, so there was room for debate within groups, but the output was short and could be typed and posted onto the discussion board during the workshops. Thus, guidance on how to improve poor answers could be provided in relatively swift and discrete portions.

The fourth theme was the lecturers' experience of mild staff and institutional resistance to the adoption of a flipped classroom and its workload implications. At the time, the university's workload policies were not well suited to non-traditional modes of teaching. The unit coordinators had to explain the underlying pedagogy justifying the unit changes in order to make a case for the flipped classroom model and workload recognition. This reflects the risk identified in the literature of insufficient acknowledgment of resourcing.⁸⁶ In particular, an initial concern was that, once the content for the unit was captured and placed on Blackboard, there would be limited workload recognition in subsequent years, as 13 weeks of lectures (26 face-to-face teaching hours) had been replaced by 6 weeks of workshops (12 face-to-face teaching hours). It took several discussions before the university settled on an approach of providing the same workload credit for the flipped unit as had been provided for the traditional delivery mode. We consider this is the minimum level of recognition that ought to be accorded. The transition process of planning and recording lectures for the first time took substantially longer than 13 weeks — two to three times longer. On top, there is the need to develop and deliver in-class workshops.

Our experience has been that, for the first year, workload increased, while in subsequent years workload ended up about the same as for traditional lectures. This is consistent with the experiences of Butt, who also observed that the implementation of a flipped classroom involves an increase in preparation time the first time it is taught.⁸⁷ However, contrary to Butt, we did not necessarily observe an overall decrease in time spent updating the unit in subsequent years.⁸⁸ This might be explained, in part, by the constantly changing area of taxation law, which necessitates yearly updates to course materials, video recordings and workshop content.

VI CONCLUSION

Self-determination theory and cognitive load theory suggest that flipping the classroom can reflect better pedagogy than the traditional in-class lecture. This is particularly due to increasing student engagement and motivation through greater autonomy,

⁸⁵ Cf Burns et al (n 20) 4.

⁸⁶ See above n 48 and accompanying text.

⁸⁷ Butt (n 35) 41.

⁸⁸ *Ibid.*

competence and relatedness, and by increasing student control over learning, as well as by promoting more active learning. We found evidence of improved student engagement and motivation through higher attendance rates. SURF comments also provided qualitative support for enhanced relatedness, evidenced by the increased perception of pastoral care in the flipped classroom; and for student autonomy due to the flexible access to unit materials. However, competence remained a challenge, as illustrated by SURF comments about student desire for a more cohesive narrative and more prescriptive course materials.

We also found that the act of flipping itself enhanced student perceptions of pastoral care, as students felt that past student concerns had been heard. In addition, we found the teaching experience far more enjoyable, as it involved greater interaction with students and the development of new skills. Thus, in-class attendance tripled and student satisfaction soared from equally satisfied/dissatisfied to overwhelmingly satisfied. There was some evidence of an improvement in results, but caution should be exercised until further years of data are collected.

However, while our experience was positive overall, there were a number of risks and challenges. Material care needs to be taken to ensure that the method of flipping the classroom provides sufficient support for developing relatedness and competence (autonomy generally being improved under most methods). Scaffolding for these dimensions also ties in to student feedback about the need for a more prescriptive and cohesive narrative embedded in teaching materials. Additionally, flipping itself poses a risk for student perceptions, since flipped classrooms are often a relatively novel experience. Likewise, the novelty raises institutional dangers around workload, as well as teacher capacity risks relating to the skills, time and additional workshop facilitators required to record material and run workshops. Careful planning is needed to address these potential risks. In this vein, we will continue to develop our flipped unit, especially in relation to group formation and diversity, and in ensuring that there is greater prescription and reinforcement in teaching materials.

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HOW COULD SALES OF RESIDENTIAL PREMISES BETWEEN OTHERWISE UNREGISTERED HOMEOWNERS BE BROUGHT INTO THE VAT BASE?

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ABSTRACT

In jurisdictions with a value added tax ('VAT'), the normal practice is that sales of existing residential premises are regarded as exempt from VAT, or outside of its scope. Under what is known as the prepaid method, it is assumed that the value of new residential premises at the time of purchase is equal to the use and enjoyment (consumption) of the residential premises. However, a problem with this approach, which has been recognised in the VAT literature, is that the consumption value of residential premises generally appreciates over time (as the property increases in value). Therefore, the value of total consumption of the premises as represented by the general increase in its market value may be greater than its value at the time of first purchase. This is problematic from the perspective that VAT is a consumption tax, and the key economic objective of the VAT is to tax the flow of consumption.

A feature common to much of the literature on the optimal VAT treatment of immovable property is the call for sales of residential premises by unregistered homeowners to be brought into the VAT base, with deferred input tax credits for the initial acquisition. This article will provide further thought regarding this approach. It will suggest multiple ways that VAT could be collected on each sale of residential premises, and provide further discussion regarding the question of the appropriate quantum of input tax credits that should be available as deferred input tax credits. It then questions whether homeowners should be able to claim deferred input tax credits before coming to a conclusion.

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I INTRODUCTION

Under the theoretical model of VAT,¹ a purchaser of goods would be entitled to claim input tax credits in relation to VAT paid when acquiring those goods.² VAT would then be imposed on the annual value of goods as they depreciate and are used. However, to simplify matters, under what is known as the prepaid method, VAT is imposed just once, when goods are originally purchased. VAT on the original purchase is regarded as a measurement of the present value of VAT payable on all future consumption.³ Second-hand sales of goods by unregistered vendors 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. Pomp and Oldman have provided the following example:

Assume that ... A bought a stereo for \$1,000 cash, paying a 10 percent sales tax of \$100. This year A sells the used stereo to B for \$550. ... The stereo's tax inclusive cost to A was \$1,100 ... A sold it for half of the tax inclusive cost ($\$550 = \frac{1}{2} \times \$1,100$). The \$550 that A received on the resale can be viewed as consisting of two parts: \$500, half the \$1,000 tax exclusive cost of the stereo ($\$500 = \frac{1}{2} \times \$1,000$) and \$50, half of the sales tax paid on its purchase ($\$50 = \frac{1}{2} \times 100$).⁴

Use of the prepaid method generally produces the correct result for most goods.⁵ However, the problem with this approach when it comes to the VAT treatment of residential premises is that upfront taxation generally does not correspond with the present value of all future consumption. While the value of residential buildings depreciates over time as the buildings waste, the value of residential land underlying the buildings generally rises over the longer term.⁶ Any appreciation in the value of residential land, an element in the value of an owner-occupier's consumption, is not captured within the VAT base.⁷

¹ As VAT is the term most commonly used internationally for this type of consumption tax, it will be the term that will be used in this article.

² See Richard Krever, 'Designing and Drafting VAT Laws for Africa' in Richard Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008) 24.

³ Christine Peacock, 'Is There a Viable Way to Tax the Consumption of Immovable Property That Is More Consistent with the Economic Objective of the VAT?' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 336, 338.

⁴ Richard D Pomp and Oliver Oldman, 'A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins' (1990) 43(4) *National Tax Journal* 427, 427-8. This example relates to the application of retail sales tax in the US. Van Brederode has also explained that the resale price of a used good includes a fraction of the tax-inclusive price made by the first consumer. See Robert F van Brederode, *Systems of General Sales Taxation: Theory, Policy and Practice* (Kluwer Law International, 2009) 169.

⁵ See Peacock (n 3) 338-9.

⁶ This is recognised in 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) 369. See also Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax: A Comparative Approach* (Cambridge University Press, 2nd ed, 2015) 409.

⁷ In the Mirrlees Review report, it was recognised that the consumption value of housing 'may change a great deal over time. Hence, their up-front price may prove to be a bad approximation to the value of consumption services they eventually provide': Institute for Fiscal Studies, *Tax by Design: The Mirrlees Review* (Oxford University Press, 2011) 380.

Peacock has noted that '[i]t 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'.⁸ Imputed rent is the residential services that an owner-occupier receives for living in their home.⁹ Including imputed rent in the VAT base would involve treating an owner-occupier as if they were supplying those services to themselves.¹⁰ VAT would not be charged on the first sale of the residential premises, but instead a value would be placed on those services for a specific period, such as a year, and this value could be updated as the immovable property appreciates. However, it has been recognised in the VAT literature that including imputed rent in the VAT base would involve administrative and political challenges.¹¹

A feature common to much of the literature on the optimal VAT treatment of residential premises envisages an alternative approach of bringing sales of residential premises between otherwise unregistered homeowners into the VAT base, with deferred input tax credits for the initial acquisition.¹² The key research question that this article seeks to answer is: 'How could sales of residential premises between otherwise unregistered homeowners be brought into the VAT base?' This article will first review the earlier literature recommending this approach (Section II), before suggesting multiple ways in which VAT could be collected on each sale of residential premises (Section III), and considering issues relating to the appropriate quantum of input tax credits that should be available as deferred input tax credits (Section IV). It then questions whether homeowners should be able to claim deferred input tax credits (Section VI), before coming to a conclusion (Section VII).

⁸ Peacock (n 3) 337.

⁹ Donald B Marsh, 'The Taxation of Imputed Income' (1943) 58(4) *Political Science Quarterly* 514, 514.

¹⁰ Sijbren Cnossen, 'Improving the VAT Treatment of Exempt Immovable Property in the European Union' (Working Paper No 10/19, Oxford University Centre for Business Taxation, 2010) 1.

¹¹ See 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, 227; Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) 5(3) *International Tax and Public Finance* 399, 405; Sijbren Cnossen, 'Three VAT Studies' (CPB Special Publication No 90, CPB Netherlands Bureau for Economic Policy Analysis, December 2010); Sijbren Cnossen, 'VAT Treatment of Immovable Property' in Victor T Thuronyi (ed), *Tax Law Design and Drafting* (International Monetary Fund, 1996) vol 1, 235-6; Robert F Conrad, 'The VAT and Real Estate' in Malcolm Gillis, Carl S Shoup and Gerardo P Sicat (eds), *Value Added Taxation in Developing Countries* (World Bank, 1990) 102; Robert F Conrad, 'Value Added Taxation and Real Estate' (Discussion Paper No DRD224, Development Research Department, World Bank, February 1987) 25; Rita de la Feria and Richard Krever, 'Ending VAT Exemptions: Towards a Post-Modern VAT' in de la Feria (ed) (n 11) 28; Krever (n 2) 24; Peacock (n 3) 337-8.

¹² Cnossen has proposed a tax on sales of residential premises between unregistered homeowners, to be applied on the difference between the selling price and purchase price of residential premises, and levied on the vendor at the time of sale: See Cnossen, 'Three VAT Studies' (n 11) 71-3. The application of this proposal would involve different considerations to the other proposals considered in this article, which involve VAT being imposed on the purchaser of residential premises at the time of purchase, and the homeowner later being entitled to a deferred input tax credit when they sell the residential premises. Therefore, Cnossen's proposal is not considered in this article.

II SUMMARY OF ALTERNATIVE PROPOSALS

First suggested by Conrad in his 1987 stock value added tax (or 'S-VAT') proposal, the idea of bringing sales of residential premises between otherwise unregistered homeowners into the VAT base was restated in a modified form by Conrad and Grozav in 2008. Later variations include Poddar (2009), *Value Added Tax: A Model Statute and Commentary* (1989) ('Model Statute'), van Brederode (2011), and Cnossen (2013).¹³

Conrad's proposed alternative of the S-VAT was one of the earliest proposals recommending that all sales of residential premises be included in the VAT base.¹⁴ He acknowledged that, in theory, a VAT should tax flows of consumption, and that this would imply that VAT should operate as a tax on 'consumption' rather than on 'transactions'.¹⁵ However, he suggested that there is 'no feasible way for the government to determine the value of these periodic rentals other than via some arbitrary rule'.¹⁶ Instead, Conrad proposed that VAT should be payable on all sales of immovable property (including sales of residential premises), and that homeowners would receive the VAT that they earlier paid on the purchase of their residential premises as a refund if they later sell the residential premises.¹⁷ The S-VAT was later modified by Conrad and Grozav's real estate VAT.¹⁸ These authors also proposed that all sales of residential premises should be taxable,¹⁹ and that homeowners should be entitled to claim input tax credits in relation to the purchase of residential premises if they later sell.²⁰

Later, Poddar investigated three possible alternative VAT treatments of immovable property that could be considered if the US were to adopt a federal VAT. One of these options (Option A) was similar to the approach advocated previously, under which the resale of residential premises would be taxable, and a homeowner would have a right to claim input tax credits relating to the purchase of residential premises at the time of resale.²¹ Poddar wrote:

Conceptually, this option is the most comprehensive. It addresses the two gaps in taxation of housing consumption ... It extends the scope of VAT to the consumption of

¹³ See Satya Poddar, 'Taxation of Housing under a VAT' (2009) 63 *Tax Law Review* 443; Committee on Value Added Tax of the American Bar Association Section of Taxation, *Value Added Tax: A Model Statute and Commentary* (Tax Management Education Institute, 1989) ('Model Statute'); Robert F van Brederode (ed), *Immovable Property under VAT: A Comparative Global Analysis* (Kluwer Law International, 2011) vol 37, 1; Cnossen, 'A Proposal to Improve the VAT Treatment of Housing in the European Union' (n 11).

¹⁴ See Conrad, 'Value Added Taxation and Real Estate' (n 11); Conrad, 'The VAT and Real Estate' (n 11).

¹⁵ Conrad, 'Value Added Taxation and Real Estate' (n 11) 1.

¹⁶ *Ibid* 25.

¹⁷ *Ibid* 11-12.

¹⁸ Conrad and Grozav acknowledged that the real estate VAT is a modification of the S-VAT proposal: Robert Conrad and Anca Grozav, 'Real Property and VAT' in Krever (ed) (n 2) 90.

¹⁹ Conrad and Grozav noted that '[t]he fact that sales of real property would be taxed implies that all leases would also be taxed under the proposal; an action that would ensure neutrality between the uses of real property': *ibid*.

²⁰ *Ibid* 93.

²¹ Poddar (n 13) 453-8. This option (Option A) will be considered in this article, whereas Poddar's Option B and Option C will not be considered in detail. Poddar's Option B was very similar to Option A, except residential rent would not be taxable under Option B, whereas it would be under Option A. Option B therefore would not achieve neutrality between homeowners and lessees. Option C involves regarding sales and leases of residential premises as exempt from VAT, and so it is not relevant to this article.

existing stock of housing, as well as to any unanticipated future increases in the rental value of new housing units.²²

The Model Statute, published by the Committee on Value Added Tax of the American Bar Association, included a similar proposal that casual sales by sellers who are not registered for VAT should be taxable, if the consideration that the seller receives exceeds a prescribed statutory threshold.²³ This proposal provided for a deferred credit of the VAT paid when the residential premises were acquired, which would become available at the time that the residential premises are sold.²⁴ The following example was provided of how this would work (it assumes a VAT rate of 10 per cent):

Assume Consumer A purchased her home for \$100,000 plus \$10,000 VAT. She later sold her home for \$120,000. Assuming the sale is taxable ... Consumer A charges \$12,000 VAT on the sale to Consumer B and claims a \$10,000 credit ... she remits the net \$2,000 to the government.²⁵

Similarly, van Brederode has proposed that homeowners should pay VAT on all purchases of residential premises. Under this proposal, homeowners would be assumed to use their residential premises for consumption purposes until they sell. At this point, a 'fiscal metamorphosis' would occur, and homeowners would then be regarded as registered for VAT, and able to claim input tax credits relating to the initial purchase of the residential premises.²⁶

III HOW WOULD THE COLLECTION OF VAT OCCUR?

Currently, an entity must be registered for VAT in order to make taxable supplies and receive input tax credits relating to the VAT paid on acquisitions in the course of its business. Generally, in order for an entity to be eligible to register for VAT, a business activity must be carried on, and aggregate taxable supplies made by that entity must exceed the registration threshold.²⁷ Registered entities must comply with various administrative obligations.²⁸ For instance, they are generally required to charge VAT on

²² Ibid 456.

²³ See Model Statute (n 13) ss 4003(a)(3A) and 4005(a).

²⁴ See Model Statute (n 13) s 4019.

²⁵ Ibid 76–7.

²⁶ Robert F van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' in van Brederode (ed), *Immovable Property under VAT* (n 13) 16.

²⁷ Williams has explained that 'the law imposing the VAT usually makes it clear that only economic activities are within the scope of the tax. How this is defined varies among laws. Some laws require that the supply be made as part of economic activity, or the business activities of the supplier, or in the course or furtherance of a business carried on by the supplier. Others refer to supplies made by the taxable person acting as such, that is, acting in the capacity as a taxable person making taxable supplies': David Williams, 'Value-Added Tax' in Thuronyi (ed) (n 11) 164, 198. In the European Union, an entity must carry on an 'economic activity': Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003) 313. In New Zealand, an activity must be carried on 'continuously or regularly': *Goods and Services Tax Act 1985* (NZ) s 6(1)(a). Regarding the registration threshold that generally applies, see Williams (n 27) 171–81 and 60–4.

²⁸ Terminology used to describe entities that are registered for GST is different in different countries. In Australia, entities registered for GST are generally referred to as registered entities. In New Zealand, the *Goods and Services Tax Act 1985* imposes obligations on 'a registered person': *Goods and Services Tax Act 1985* (NZ) s 8(1). In the European Union, home of VAT, a registered entity is known as a 'taxable person':

the market value of their supplies, and are entitled to claim input tax credits on the VAT that they pay in relation to any acquisitions that they make in the course of their business. They also must submit regular VAT returns, and collect the VAT owing relating to sales of their taxable supplies, and remit this VAT to the tax administration, less any VAT claimable back as an input tax credit.²⁹

VAT is not imposed on supplies made in the course of an activity that is regarded as personal.³⁰ For this reason, homeowners who purchase residential premises to live in those premises are generally regarded as not eligible to register for VAT.³¹ Living in residential premises is not generally regarded as satisfying the requirement that there is a business activity being carried on. At first glance, a clear administrative argument against charging VAT on all sales of residential premises is that this would place an increased administrative burden on homeowners. One would think that, in order for sales of residential premises to come within the VAT base, the VAT registration rules would need to be changed in order to elevate homeowners to the status of a registered entity. In this regard, van Brederode has suggested that it would not be 'practically nor politically feasible to register all individuals who sell residential property and charge them with collecting tax from other private individuals'.³² However, three possible ways in which VAT collection could occur without homeowners having to register for VAT will be outlined below.

The first possible option is that an intermediary could collect VAT on behalf of homeowners. For example, Conrad and Grozav have proposed that all sales of residential premises should be taxable, and homeowners should be entitled to input tax credits in relation to the purchase of residential premises if they later sell. To facilitate this, they have proposed that a 'closing agent, solicitor or tax official would collect and credit the VAT. Thus, VAT collection would not be dependent on whether the person is really a taxpayer in any traditional VAT sense of the term.'³³ Similarly, van Brederode has noted that sales of residential premises:

Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax [2006] OJ L 347/1, art 9 ('EU Directive'). Interestingly, a registered entity is also known as a 'taxable person' in Singapore (*Goods and Services Tax Act 2005* (Singapore) s 2(1)). This is likely to be because of the influence of the UK VAT system on drafters of the Singaporean GST legislation, the UK also being a country where the 'taxable person' terminology is used: *Value Added Tax Act 1994* (UK) s 3(1). The terminology used in the UK presumably comes from the EU Directive (n 28).

²⁹ Sijbren Cnossen, 'A Primer on VAT as Perceived by Lawyers, Economists and Accountants' in Michael Lang et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (International Bureau of Fiscal Documentation, 2009) 138.

³⁰ Williams (n 27) 197.

³¹ This has been recognised by Cui (n 6) 369; Schenk, Thuronyi and Cui (n 6) 409.

³² van Brederode, *Systems of General Sales Taxation* (n 4) 190.

³³ Conrad and Grozav (n 18) 92. It is worth noting that some of the early proposals to include all sales of residential premises in the VAT base did not detail how VAT would be collected when sales of residential premises occur between homeowners who would not otherwise be registered for VAT. Poddar, for example, recommended that the resale of owner-occupied housing be included in the VAT base, but did not address how the VAT on resale would be collected: Poddar (n 13). Likewise, the Model Statute proposed that casual sales above a threshold be regarded as taxable, but did not address how the VAT on such sales would be collected: Model Statute (n 13). As part of his S-VAT proposal, Conrad proposed that VAT should be payable on all sales of immovable property, but '[c]onsumers would not be VAT taxpayers and they

are generally mediated by legal professionals ... involved in title verification and the disbursement of moneys. In most jurisdictions they are already responsible for the collection of transactional taxes, such as transfer or conveyance taxes. It makes practical sense to also charge these mediators with withholding of VAT due as regards a sale of real estate on behalf of the seller.³⁴

Van Brederode's view is probably influenced by his experience working in the US. In Australia, homeowners can use either lawyers or conveyancers to assist in property transfers. For example, in the Australian State of Victoria, whilst some homeowners use lawyers to assist in transfers of residential premises, licensed conveyancers can perform tasks that include the transfer of title to the immovable property and the payment of stamp duty that is generally owed on the purchase of immovable property.³⁵ Whoever handles the transfer of residential property, whether it be a lawyer or conveyancer, may therefore be highly suited to collect VAT owing on the purchase of residential premises from the purchaser, and remit this VAT to the tax administration.

Alternatively, there may be some jurisdictions where it might be more suitable for the collection of VAT from the purchaser to occur not through an individual intermediary such as a conveyancer, but through an agency responsible for the transfer of title. This is the second possible way in which VAT could be collected from the purchaser. In jurisdictions with subnational governments, it might be appropriate for this to be done at a state or provincial level, perhaps in a similar way to how stamp duty may be collected.³⁶ There are several countries where stamp duty is levied, including Australia, Hong Kong, Singapore and South Africa.³⁷ However, it should be noted that in recent times there have been tax reviews that have recommended the abolition of stamp duty.³⁸

The experience of some agencies in collecting tax revenue relating to when motor vehicles are sold also indicates that it is possible for agencies to perform a revenue collection role. For example, in the US and Canada, payment of sales tax owing on the purchase of used motor vehicles is a precondition to registration, and is regarded as a simple process. In this regard, van Brederode has written that consumer-to-consumer resales of durable goods:

would never need to file any type of return': Conrad, 'Value Added Taxation and Real Estate' (n 11) 15. Conrad and Grozav's proposal builds upon this idea.

³⁴ van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

³⁵ 'Conveyancing work' is defined in the *Conveyances Act 2006* (Vic) s 4. Regarding the payment of stamp duty, see William DM Cannon, 'Fundamental Principles of Stamp Duty' (1996) 19(1) *UNSW Law Journal* 1, 2. Originating from England, stamp duty is described by Cannon as 'one of the most important sources of revenue collection for the States and Territories of Australia': at 1.

³⁶ For a detailed history of how the Australian states previously collected income taxes, see Peter Mellor, 'Origins of the Judicial Concept of Income in Australia' (2010) 25 *Australian Tax Forum* 339, 344-54.

³⁷ Jonathan Barrett, 'Property Taxes as a Policy Response to Foreign Investment as a Perceived Cause of Housing Unaffordability' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 1, 10. Regarding the transfer duty payable in South Africa, see Enid Slack, 'Property Taxation in Australia' in Richard M Bird and Enid Slack (eds), *International Handbook of Land and Property Taxation* (Edward Elgar, 2004) 203.

³⁸ See, for example, Treasury, Australian Government, *Australia's Future Tax System: Final Report* (2 May 2010) Recommendation 51; Institute for Fiscal Studies (n 7) 403; Productivity Commission, Australian Government, *Shifting the Dial: 5 Year Productivity Review* (Inquiry Report No 84, 2017) Recommendation 4.8. The frequency of recommendations to abolish stamp duty might be increased if all sales of residential premises were subject to VAT.

that require registration, such as automobiles, motorcycles, boats and campers, are taxed in the majority of states for the single reason that this is a simple matter from an administrative perspective. Payment of sales tax is a precondition for registration, and payment can be made in many states upon registration with the Department of Motor Vehicles.³⁹

As van Brederode has noted, similar rules exist in the European Union regarding cross-border sales of new means of transport, such as motor vehicles,⁴⁰ to a purchaser in another Member State when they are transported to the other Member State.⁴¹ The example he has provided is of a Belgian consumer ('C1') who purchases a motor vehicle in a private capacity, and pays VAT on the purchase price but does not have a right to claim input tax credits. He purchases the motor vehicle for EUR25,000, plus EUR5,000 in VAT. He later sells the car to his nephew ('C2') in Germany for EUR20,000. The sale of the motor vehicle to C2 means that C1 is regarded as a registered entity.⁴² However, because the sale involves a cross-border, intracommunity transaction, van Brederode explains that it is zero-rated in Belgium. C2 then pays VAT in Germany on the purchase price, and C1 is entitled to input tax credits for part of the VAT paid on the original purchase price.⁴³

A third possible way to collect VAT on all sales of residential premises might be to leverage off the system, introduced in Australia in 2018, of generally requiring the recipient of a sale or long-term lease by a registered entity of new residential premises or potential residential land to pay the GST payable on that supply directly to the Australian Taxation Office ('ATO').⁴⁴ Under this system, the vendor is then entitled to an input tax credit of the amount of GST paid by the purchaser.⁴⁵ These rules could be

³⁹ See Robert F van Brederode, 'A Normative Evaluation of Consumption Tax Design: The Treatment of the Sales of Goods under VAT in the European Union and Sales Tax in the United States' (2009) 62(4) *The Tax Lawyer* 1055, 1071–2. See also Pomp and Oldman (n 4) 427. In Canada, provincial sales tax may apply when a motor vehicle that was bought through a private sale is registered: 'GST/HST and Motor Vehicles', *Government of Canada* (Web Page, 15 April 2019) <<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/gst-hst-businesses/charge-collect-specific-situations/motor-vehicles.html>>.

⁴⁰ See EU Directive (n 28) arts 2.2(a) and (b).

⁴¹ van Brederode, 'A Normative Evaluation of Consumption Tax Design' (n 39) 1070–1.

⁴² *Ibid* 1071. See also EU Directive (n 28) art 9.2.

⁴³ van Brederode, 'A Normative Evaluation of Consumption Tax Design' (n 39). See also EU Directive (n 28) art 172.

⁴⁴ ATO, *Purchaser's Obligation to Pay an Amount for GST on Taxable Supplies of Certain Real Property* (LCR 2018/4, 1 July 2018) paras 2, 3, 4 and 15. Australia's former Treasurer Scott Morrison explained that these rules were designed to prevent tax evasion by property developers who may dissolve their business before the GST owing would otherwise become payable: Australian Government, *Treasury Laws Amendment (2019 Measures No 1) Bill 2019 Second Reading*, House of Representatives, 27 February 2018 (Scott Morrison, Treasurer).

⁴⁵ ATO, *Purchaser's Obligation to Pay an Amount for GST* (n 44) para 4. Similarly, in Australia, precedent for one-off liabilities on people not otherwise registered for tax purposes exists in the capital gains tax ('CGT') rules. A CGT withholding requirement is generally imposed on purchasers of Australian immovable property, with a market value of AUD750,000, or more where the sale is made by a vendor who is deemed a foreign resident. In this situation, the purchaser must pay 12.5 per cent of the purchase price to the ATO as a foreign resident capital gains withholding payment. The foreign resident can then claim a credit for this amount once they have lodged an Australian tax return for the relevant year: 'Capital Gains Withholding — A Guide for Conveyancers', ATO, *Australian Government* (Web Page, 11 December 2017) <<https://www.ato.gov.au/general/capital-gains-tax/in-detail/calculating-a-capital-gain-or-loss/capital-gains-withholding---a-guide-for-conveyancers>>.

expanded to require all purchasers of residential premises to pay the GST payable on such supplies directly to the ATO.

IV ASSUMING SALES OF RESIDENTIAL PREMISES ARE INCLUDED WITHIN THE VAT BASE, WHAT IS THE APPROPRIATE QUANTUM OF INPUT TAX CREDITS THAT SHOULD BE AVAILABLE TO HOMEOWNERS?

Generally, entities that are registered for VAT purposes are eligible to claim input tax credits for the VAT that they pay in relation to purchasing taxable inputs, in order to supply taxable outputs. For example, a commercial business that purchases, renovates, then sells buildings would be entitled to claim input tax credits in relation to the VAT that is paid on the purchase of the buildings, and any inputs into their renovation. This results in no net VAT effect to the commercial business, but some administrative burden in terms of the business having to comply with VAT requirements (see Section III).

As the VAT is a consumption tax, and the burden of the VAT rests on the consumer, a consumer purchasing residential premises for a non-commercial purpose is currently not entitled to claim input tax credits in connection with any VAT that they pay relating to the purchase or maintenance of the premises. The authors of the alternative proposals reviewed in Section II all propose, however, that if all residential premises are included within the VAT base, deferred input tax credits relating to the VAT paid in connection with purchasing the residential premises should be available when they are sold.⁴⁶

The proposed deferred input tax credits give rise to questions about whether input tax credits relating to construction costs, alterations and renovations should be claimable. In this regard, Poddar proposed that the quantum of input tax credits claimable should include 'any improvements to the home ... other than repairs and maintenance'.⁴⁷ This appears logical, as improvements increase the value of residential premises, and under the alternative proposals, the VAT payable relates to this value.

The authors of the alternative proposals appear to use the purchase price as a proxy for the consumption value of residential premises. Applying this logic, it would be consistent with the alternative proposals for deferred input tax credits relating to the VAT chargeable on construction costs of building residential premises to be claimable, as these costs are not unlike the costs of purchasing residential premises that have already been built.

According to Poddar's proposal, input tax credits relating to maintenance costs, including repairs, should not be deductible.⁴⁸ Following the logic of the alternative proposals, this appears to be the correct VAT treatment, as presumably, maintenance costs incurred would not result in any increase in the market value of residential premises when another

⁴⁶ Conrad, 'Value Added Taxation and Real Estate' (n 11) 11-12; Conrad and Grozav (n 18) 91; Poddar (n 13) 254 (regarding Option A); Model Statute (n 13) s 4019; van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

⁴⁷ Poddar (n 13) 454. Millar has also noted that '[p]rovided ... the improvements form part of the value of the property when resold ... they ought to be creditable because they are taxed as part of the price of the on-going sale': Rebecca Millar, 'VAT and Immovable Property: Full Taxation Models and the Treatment of Capital Gains on Owner-Occupied Residences' in de la Feria (ed) (n 11) 253, 277.

⁴⁸ Poddar (n 13) 454.

homeowner next purchases them. If residential premises suffered wear and tear, but maintenance costs were not incurred to address this issue, the value of the residential premises might depreciate in recognition of the use and consumption of the residential premises.⁴⁹ If maintenance costs were incurred that merely maintained the value of the residential premises, there would be no additional value of consumption to apply VAT to, and no corresponding input tax credits to provide to the homeowner.⁵⁰

It would be important to clearly distinguish between repairs and improvements, as input tax credits should only be available when homeowners incur VAT on the cost of improvements (as it is only improvements, and not repairs, that increase the value of residential premises). Differentiating between deductible repairs and capital improvements for income tax purposes in Australia requires examining the ordinary meaning of these terms, as no legislative definition of what is a 'repair' appears in the income tax legislation.⁵¹ Whilst the ATO has produced a ruling providing guidance on this issue in the context of revenue versus capital expenses,⁵² there has been no consideration of this distinction for GST purposes, as GST law does not normally distinguish between capital and revenue expenditures. Whether there is a repair or an improvement in terms of law is a question of fact and degree.⁵³

One factor in the context of revenue or capital expenses, which has been considered important in making this distinction by courts in the UK, Australia and New Zealand, is whether the entirety of an asset or just a part of the asset is changed. If the entirety is changed, there is more likely to be a capital improvement. If only a part of the asset is changed, this is more likely to be a deductible repair.⁵⁴ However, what will constitute a change to an entirety is not clear.⁵⁵ To promote clarity and consistency, perhaps tax legislation, regulations or even tax administration rulings could be adopted to differentiate repairs and improvements by reference to the relative cost of the expense of making a change to residential premises compared to the value of the relevant residential premises. For ease of simplicity, a proxy that could be used for the value of residential premises is its net annual value, which is determined on an annual basis for local tax purposes (see Section VI). The higher the cost of the expense in proportion to its value, the more likely the cost would be regarded as an improvement rather than a repair.

⁴⁹ When discussing the VAT treatment of residential premises, Poddar has recognised that 'any decrease in value is presumed to be attributable to its use or consumption': Poddar (n 13) 455.

⁵⁰ In Australia, the costs of repairs to a home owned by an investor are deductible against assessable income: ATO, *Income Tax: Deductions for Repairs* (TR 97/23, 3 December 1997). However, different considerations apply in determining whether a homeowner (who would be regarded as a registered entity under the alternative proposals) should be entitled to claim input tax credits for repair costs.

⁵¹ *Income Tax Assessment Act 1997* (Cth) s 23-10.

⁵² ATO, *Income Tax: Deductions for Repairs* (n 50).

⁵³ This appears to be the case also in New Zealand and the UK.

⁵⁴ The distinction between an entirety and subsidiary was discussed in *Lurcott v Wakeley and Wheeler* [1911] 1 KB 905.

⁵⁵ For example, in *Elite Investments Ltd v Davstone (Holdings) Ltd* [1980] 1 QB EGLR, the cost of replacing an entire room was found to be a repair, whereas replacement of an entire aluminium cladding of commercial premises in *Credit Suisse v Beegas Nominees* [1994] EGLR 76 was found to be an improvement. Whilst these are cases from the UK, they have often been referred to in Australia and New Zealand in determining whether changes made to an asset are repairs or improvements.

VAT is generally payable in relation to fees charged to acquire property, such as lawyer's fees and conveyancing costs paid in relation to the transfer of title of residential premises, provided that the services are supplied by registered entities, as these are taxable professional services. Input tax credits should be available to homeowners when they incur lawyer's fees or conveyancing costs in connection to the transfer of title of residential premises, as following the logic of the alternative proposals would involve treating the homeowner as a registered entity. Further, incurring lawyer's fees or conveyancing costs would relate to the homeowner's consumption of the residential premises.

It has been highlighted by van Brederode that, where input tax credits are claimable, such as in relation to renovations, 'private individuals would need to keep and maintain records in order to be able to exercise their right of deduction at the time of closing'.⁵⁶ On face value, it might seem that this would be likely to result in a large extra administrative burden for homeowners. Tax administrations tend to only require taxpayers to keep general records relating to their tax affairs for a certain number of years. In Australia, for example, taxpayers must keep general tax records for five years.⁵⁷

However, the requirement to keep records for the purpose of claiming input tax credits would not be dissimilar to requirements imposed for capital gains tax ("CGT") purposes. For example, in Australia, a taxpayer's main residence is usually exempt from CGT, but records should still be kept (either in hard copy or electronic format)⁵⁸ by homeowners, in case this exemption no longer applies at some point in the future (this might be the case if a homeowner later uses their home to produce income). For CGT purposes, records should be kept of the purchase and sale contract and all expenses relating to the purchase and sale, as well as of all costs of owning the residential premises, and capital expenditures on improvements.⁵⁹

If homeowners do not want the burden of keeping records, they could simply not claim input tax credits.⁶⁰ Alternatively, a type of presumptive input tax credit entitlement system could be introduced (or any existing one in operation could be adapted) for the purpose of claiming input tax credits. Zu has explained that:

⁵⁶ van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

⁵⁷ 'Keeping Your Tax Records', *ATO, Australian Government* (Web Page, 3 January 2019) <<https://www.ato.gov.au/individuals/income-and-deductions/in-detail/keeping-your-tax-records>>.

⁵⁸ *ATO, Income Tax: Record Keeping and Access — Electronic Records* (TR 2018/2, 14 February 2018). Generally, for Australian taxation purposes, records can be retained in hard copy or electronically.

⁵⁹ 'Keeping Records for Real Estate', *ATO, Australian Government* (Web Page, 30 March 2019) <<https://www.ato.gov.au/General/Capital-gains-tax/Your-home-and-other-real-estate/Keeping-records-for-real-estate/#Recordsforyourhome>>.

⁶⁰ Homeowners may opt to not claim input tax credits in relation to minor alterations, for example, but they would probably want to claim input tax credits relating to the purchase price and any major alterations. In Australia, homeowners owning homes for investment purposes would usually already keep records of these costs for CGT purposes. Owners of premises owned for residential purposes are generally eligible to claim the main residence exemption: *Income Tax Assessment Act 1997* (Cth) sub-div 118-B.

[p]resumptive input tax entitlement regimes seek to simplify the calculation of VAT liability by removing the need to record ... input tax on all acquisitions and instead allowing qualifying persons to substitute a single presumptive input tax entitlement.⁶¹

A schedule of amounts claimable under such a regime could be introduced, including items such as a fixed amount for an addition of a balcony, addition of a bedroom, and so on. If homeowners desire to claim more than the fixed amount, they would need to keep records. Obviously, a disadvantage with such a regime would be its inaccuracy. Homeowners would often claim more or less than the VAT that they paid in connection with the improvements. This problem would need to be weighed against the cost of complexity if input tax credits were allowed in connection with the cost of improvements but such a presumptive regime were not introduced.

In some of the proposals considered in Section II, it is envisaged that the claiming of input tax credits be facilitated through the VAT paid in relation to the purchase of the residential premises being recorded on its title. For example, Conrad and Grozav proposed that 'VAT would be recorded as part of the closing documents'.⁶² Similarly, van Brederode has suggested that a deferred input tax credit claim could be verified if the VAT paid on purchase was registered 'in the real estate registers that most jurisdictions require either at the local or regional level'.⁶³

The Torrens title system of land transfer and registration used in a number of jurisdictions, particularly in Commonwealth jurisdictions including Australia, New Zealand, and some Canadian provinces, could be adapted so that VAT paid on the purchase of residential premises is recorded on the title documents evidencing their ownership.⁶⁴ This might be possible, particularly in Australia where GST revenue is collected by the government and distributed to the states and territories as part of Australia's formal system of horizontal fiscal equalisation. In this situation, the states and territories might be interested in keeping records of such information. However, it should be noted that the equity of which states and territories receive which amounts of GST revenue has been an ongoing, contentious issue.⁶⁵

Regarding the quantum of input tax credit claimable, Conrad and Grozav have recommended that:

inflation adjustments are necessary to adjust the VAT paid at the time of purchase to a current credit at the time of sale. This difficulty can be reduced to some degree by using one cumulative inflation index (presumably the GDP deflator) and publishing the value of that index annually.⁶⁶

⁶¹ Yige Zu, 'VAT/GST Thresholds and Small Businesses: Where To Draw the Line?' (2018) 66(2) *Canadian Tax Journal* 309, 339. Zu explains how these regimes sometimes apply in the case of small businesses.

⁶² Conrad and Grozav (n 18) 90. Earlier, Conrad had similarly proposed that 'when the real estate is sold, the title search (or deed) should contain prior first payment of the tax': Conrad, 'Value Added Taxation and Real Estate' (n 11) 16.

⁶³ van Brederode, 'Theory and Practice of VAT Treatment of Real Estate' (n 26) 16.

⁶⁴ For example, in the Australian State of Victoria, according to the *Transfer of Land Act 1958* (Vic) s 27(1), '[t]he Registrar must keep a Register of land which is under the operation of the Act'.

⁶⁵ See, for example, Productivity Commission, Australian Government, *Horizontal Fiscal Equalisation* (Inquiry Report No 88, 2018).

⁶⁶ Conrad and Grozav (n 18) 94.

Making adjustments for inflation appears logical, as \$1 paid today is not the same as \$1 paid in five years' time. However, this would add an extra layer of complexity, especially given that the rate of inflation generally tends to change from time to time. Perhaps there are lessons to learn from the Australian experience with indexing the cost base to take into account the inflationary effect for CGT purposes. As a result of the Ralph Report recommendations, the income tax law in Australia was amended so that it is not possible to index the cost base of CGT assets acquired from 21 September 1999.⁶⁷ Instead, a system of discounting the capital gain was introduced.⁶⁸ Calculating the discount capital gain is regarded as a simpler step than indexing the cost base for CGT purposes. However, a cost of this system is its inequity. As high-income persons are more able to afford residential premises, they are more likely to take advantage of the ability to discount the capital gain than low-income earners.⁶⁹ This inequity could be replicated if the alternative proposals were implemented and homeowners were allowed to claim deferred input tax credits, as it is more likely that such a system would benefit higher-income than lower-income persons.

V SHOULD HOMEOWNERS BE ENTITLED TO CLAIM DEFERRED INPUT TAX CREDITS?

In Section III, a discussion was provided of issues relating to the quantum of input tax credits claimable and how these could be claimed, assuming that homeowners are entitled to claim deferred input tax credits in relation to their purchase of residential premises. However, it will be suggested in this section that if sales of residential premises are included within the VAT base, then homeowners should not be entitled to claim input tax credits. The following example will be used to demonstrate why this is the case. Assuming a 10 per cent VAT rate, a homeowner might purchase residential premises for AUD1 million, pay AUD100,000 VAT and sell the residential premises 10 years later for AUD2 million. If this homeowner were entitled to the full AUD100,000 VAT paid as input tax credits, the neutral net VAT result would not reflect that the homeowner has effectively consumed some of the residential premises over the 10-year period. If the residential premises were a pure investment, then the correct result would be achieved.⁷⁰ However, residential premises have both an investment and a consumption component.⁷¹

⁶⁷ See *Income Tax Assessment Act 1997* (Cth) divs 114 and 115; John Ralph, *Review of Business Taxation, A Tax System Redesigned: More Certain, Equitable and Durable* (Treasury, Australian Government, 1999) Recommendation 18.1(b) ('Ralph Report').

⁶⁸ Ralph Report (n 67) Recommendation 8.2(a).

⁶⁹ By virtue of *Income Tax Assessment Act 1997* (Cth) sub-div 118-B, the effect of the main residence exemption is that homeowners generally do not pay CGT when they sell residential premises that they have regarded as their main residence. Therefore, in the context of residential premises, discounting the capital gain generally only applies to individual investors, trusts and complying superannuation funds who have held residential premises for at least 12 months.

⁷⁰ Conrad and Grozav have recognised that, consistent with VAT being a consumption tax, '[i]nvestment (savings) are not taxed ... Stocks, bonds and other financial instruments are explicitly exempt from VAT taxation': Conrad and Grozav (n 18) 85–6.

⁷¹ Several studies have also recognised that residential premises may have both a consumption and investment component: see Robert F Conrad, 'Commentary' (2009) 63 *Tax Law Review* 471, 473; Conrad and Grozav (n 18) 91; Millar (n 47) 260; Schenk, Thuronyi and Cui (n 6) 409.

It is possible to estimate the value of the consumption benefits that flow from the ownership of residential premises. For this purpose, we assume that homeowners live in the residential premises that they own. The accommodation services that the residential premises theoretically provide to the homeowner have a value that can be measured on a regular basis. For example, the accommodation services provided by residential premises in the Australian State of Victoria could be determined to be the net annual value (or imputed rent). This is calculated to be 5 per cent of the capital-improved value, which is determined on 1 January each year for rating purposes.

As the capital-improved value is determined on an annual basis, it is possible for it to appreciate or depreciate in the following year.⁷² VAT could be applied to the net annual value. Using such an approach, homeowners should not be charged VAT upfront on their purchase, as they would pay VAT on an annual basis. They should also not be entitled to input tax credits, as homeowners would have paid the amount of VAT relating to the consumption component of the residential premises. VAT could be collected on an annual basis through an agency, as mentioned in Section III. In Australia, it might be appropriate for the VAT to be collected on a state basis. The State Revenue Offices may be appropriate agencies to collect this revenue, as they hold information on all owners of residential premises, including the purchase price of residential premises, and information for land tax purposes (this tax applies when people own more than one property).

VI CONCLUSION

Whilst it is possible from an administrative perspective for all sales of residential premises to be brought within the VAT base, and there are multiple ways in which VAT on these sales can be collected, this would give rise to housing affordability concerns. Homeowners would be faced with having to pay VAT on purchases of used residential premises, an area of the property market currently not subject to VAT. The price of used residential premises would be likely to rise if they were included within the VAT base, as the price of residential premises appreciates.

A potential increase in the price of used residential premises as a result of sales of all residential premises being included within the VAT base might be somewhat offset, however, by potential purchasers becoming less interested in purchasing used residential premises. Further, allowing homeowners the ability to claim input tax credits, as per the recommendations in the VAT literature (see Section II), would help to 'sweeten the deal' for homeowners, as the availability of input tax credits might ultimately give rise to a neutral net VAT result for the homeowner. For example, if Homeowner One purchased residential premises for AUD1 million, and sold those residential premises 10 years later to Homeowner Two for AUD2 million, assuming a 10 per cent VAT rate,

⁷² Whilst the capital-improved value can fluctuate from year to year, on average over time the value of residential premises in metropolitan cities generally increases. For example, the per annum compound annual increase in the price of residential premises in Melbourne over a 14-year period, calculated using data published by the Australian Bureau of Statistics, is 1.067 per cent: 60.7 (Residential Property Price Index for September 2003 Quarter) $\times (1 + x)^{14} = 150.4$ (Residential Property Price Index for September 2017 Quarter), where x is 6.7 per cent.

Homeowner One would pay AUD100,000 VAT when they purchase the residential premises, but then receive AUD100,000 back as input tax credits 10 years later.

However, the relevant recommendations summarised do not take into account the fact that residential premises have both a consumption and an investment component. Allowing the homeowner full input tax credits would be to treat the residential premises as a pure investment, as there would be no net VAT effect of a homeowner paying VAT on the purchase of residential premises and then later receiving this VAT as a deferred input tax credit. The only significant change that would result from implementation of the relevant recommendations is added administrative complexity regarding the collection of VAT on residential premises, and also particularly regarding the administration of input tax credit claims available to homeowners. The fact that homeowners enjoy accommodation in residential premises and that this accommodation has a value that can be measured on a regular basis would not be taken into account. A better approach would be for homeowners to not be eligible to claim input tax credits, and a more appropriate result would be achieved, from a consumption tax perspective, if the value of residential premises were included in the VAT base on a yearly basis.

Including sales of used residential premises within the VAT base would result in a new revenue stream for the government. Using the details included in the above example, the government would collect AUD100,000 from Homeowner One's purchase, and AUD200,000 from Homeowner Two's purchase. If the proposals discussed in Section II were implemented, these amounts collected would later be returned to homeowners as input tax credits when they later sell the residential premises. However, the amount of VAT revenue that the government would gain each time residential premises are sold would generally increase as the value of residential premises appreciate. The amount of VAT revenue raised by the government from including used residential premises in the VAT base would be greater if homeowners were not eligible to claim input tax credits. As an approximation, using results reported by the Australian Bureau of Statistics for Melbourne in the December 2018 quarter, this would result in the government raising an extra AUD627 million from sales of used residential premises in that region for that quarter (assuming homeowners are not eligible to claim input tax credits).⁷³

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ATO, *Purchaser's Obligation to Pay an Amount for GST on Taxable Supplies of Certain Real Property* (LCR 2018/4, 1 July 2018)

Conveyances Act 2006 (Vic)

Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax [2006] OJ L 347/1

Goods and Services Tax Act 1985 (NZ)

Goods and Services Tax Act 2005 (Singapore)

Income Tax Assessment Act 1997 (Cth)

Transfer of Land Act 1958 (Vic)

Value Added Tax Act 1994 (UK)

D Other

'6416.0 — Residential Property Price Indexes: Eight Capital Cities, Dec 2018', *Australian Bureau of Statistics* (Web Page, 19 March 2019) <<https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6416.0Dec%202018?OpenDocument>>

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- 'Keeping Records for Real Estate', *ATO, Australian Government* (Web Page, 30 March 2019) <<https://www.ato.gov.au/General/Capital-gains-tax/Your-home-and-other-real-estate/Keeping-records-for-real-estate/#Recordsforyourhome>>
- 'Keeping Your Tax Records', *ATO, Australian Government* (Web Page, 3 January 2019) <<https://www.ato.gov.au/individuals/income-and-deductions/in-detail/keeping-your-tax-records>>
- 'Lawyers and Conveyancing', *Victorian Legal Services Board & Commissioner* (Web Page, 7 December 2017) <http://lsbc.vic.gov.au/?page_id=264>
- 'Properties That are Included and Excluded', *ATO, Australian Government* (Web Page, 13 February 2019) <<https://www.ato.gov.au/business/gst/in-detail/your-industry/property/gst-at-settlement/?page=4>>
- 'Property and Registering for GST', *ATO, Australian Government* (Web Page, 4 October 2019) <<https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Property/GST-and-property/?page=2>>

THE OECD'S MULTILATERAL INSTRUMENT — WILL IT BE AN EFFECTIVE SOLUTION FOR NEW ZEALAND TO COUNTER MULTINATIONAL TAX AVOIDANCE?

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ABSTRACT

A key part of the OECD's base erosion and profit shifting ('BEPS') is the multilateral instrument ('MLI') that is designed to simultaneously amend many of world's double tax agreements ('DTAs'), to deal with the problem of multinational tax avoidance. The MLI can be regarded as modular, in that signatory states can enter reservations to parts of it. This paper analyses the reservations that all New Zealand's DTA partners (as at 1 June 2019) have entered in respect to the MLI. It is concluded that the MLI is unlikely to be effective for New Zealand to deal with BEPS, and that this has led New Zealand to enact changes to its domestic law unilaterally.

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I INTRODUCTION

Tax avoidance by major multinational enterprises ('MNEs') has been very topical since the global financial crisis of 2008. Regular disclosures throughout this decade of major US multinationals paying very low or nil tax on their substantial foreign earnings has led to considerable debate, particularly in Europe and other parts of the world, and calls for something to be 'done' about it. These pressures have resulted in the OECD undertaking a major project to develop a multilateral consensus on acceptable solutions to this problem. This project, which commenced in 2013, is known as the base erosion and profit shifting ('BEPS') project.¹

The BEPS project resulted in a list of 15 agreed 'actions' for states to deal with the BEPS problem. The last of these is a multilateral convention — known as the multilateral instrument ('MLI') — which is intended to simultaneously modify the application of a great number of the world's bilateral double tax agreements ('DTAs').² Many of the modifications under the MLI are necessary if states are to deal with MNE tax avoidance, as many of the arrangements adopted by MNEs rely upon provisions in existing DTAs, or stand in the way of states making domestic law changes to counter them.

The MLI can be viewed as modular, in that signatory states do not have to adopt all parts of it. With respect to many of its provisions, signatory states have scope to enter reservations. This paper analyses the responses of all New Zealand's 40 DTA partners (as at 1 June 2019) in respect to the MLI. The analysis in this paper suggests that the MLI is unlikely on its own to be effective for New Zealand to deal with BEPS, nor particularly effective internationally. Tax disputes between countries may become more common in the future if the MLI proves as ineffective as the analysis in this paper suggests.

II THE BEPS PROJECT AND THE MLI

The BEPS project was organised by the OECD in response to pressure raised by, mainly European, members concerning perceived substantial levels of tax avoidance by US MNEs around the time of the global financial crisis in 2008. On the streets of Europe there was considerable outrage about austerity measures brought about by collapses of major financial institutions requiring taxpayer bailouts and pressure from the EU over member states who were running large deficits. Thus public disclosures of major tax avoidance by foreign MNEs made it politically imperative that something be done in response. There were also major concerns that some countries might adopt unilateral measures in response to these disclosures, which would create an unstable international tax environment, undermine greater global economic integration and undo an international tax consensus, which the OECD had forged mainly through its Model Tax Convention.³ As the OECD largely comprises developed Western countries, its recommendations and

¹ For an overview of the whole BEPS project, see OECD, *Background Brief — Inclusive Framework on BEPS* (OECD Publishing, January 2017); 'International Collaboration to End Tax Avoidance', OECD, *Inclusive Framework on Base Erosion and Profit Shifting* (Web Page, 2019) <<http://www.oecd.org/tax/beps>>.

² OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing, 24 November 2016) ('MLI').

³ OECD, *Model Tax Convention on Income and on Capital* (OECD Publishing, December 2017).

measures (as exemplified in the OECD Model Tax Convention) have sometimes been criticised as favouring wealthy countries over the developing world, so with the BEPS project a dialogue was established with many countries outside the OECD membership. This has led to many non-OECD states directly adopting some (or all) of the BEPS measures, possibly leading to a revised international tax consensus that would be widely supported beyond just OECD member states.

The key part of the BEPS project was the identification and analysis of the range of methods by which MNEs were avoiding tax. This analysis led the OECD to formulate 15 'actions' (in better English they would be 'action points' or 'action plans') to deal with the BEPS issue:⁴

Action 1	Addressing the Tax Challenges of the Digital Economy
Action 2	Neutralising the Effects of Hybrid Mismatch Arrangements
Action 3	Designing Effective Controlled Foreign Company Rules
Action 4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
Action 5	Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
Action 6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
Action 7	Preventing the Artificial Avoidance of Permanent Establishment Status
Actions 8–10	Aligning Transfer Pricing Outcomes with Value Creation
Action 11	Measuring and Monitoring BEPS
Action 12	Mandatory Disclosure Rules
Action 13	Transfer Pricing Documentation and Country-by-Country Reporting
Action 14	Making Dispute Resolution Mechanisms More Effective
Action 15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

None of the 15 'actions' require any state to adopt a particular course of action, as the BEPS measures are not mandatory on any state. Some represent the OECD consensus on how certain matters should be dealt with (for example, Action 2 on dealing with hybrid security mismatches and Action 4 dealing with thin capitalisation) while others merely outline best practice (for example, Action 3 on designing effective CFC rules).

One of the major issues the OECD had to address with the BEPS project in formulating appropriate strategies to deal with the MNE tax avoidance problem was the worldwide

⁴ OECD, *OECD/G20 Base Erosion and Profit Shifting Project — Executive Summaries 2015 Final Reports* (OECD Publishing, 2015).

network of DTAs, comprising currently over 3,000 agreements.⁵ Existing provisions in nearly all of these DTAs are likely to constrain states in how they deal with the BEPS issue. Furthermore, some of the provisions found in many existing DTAs underpinned some of the methods adopted by MNEs to shift profits. A good example of this (but not the sole instance) was the way that a permanent establishment ('PE') in a DTA (based on the OECD Model Tax Convention) was defined, which had been drafted well before the emergence of electronic commerce (for example, as carried on by Google) allowing MNEs to avoid paying any tax in the jurisdictions where their customers were resident.

In some states, international treaties such as a DTA are not always paramount to their domestic law, while in other countries such superiority is entrenched under constitutional law. If a state does have scope to override international treaties by domestic enactments, such overrides are likely to create friction with other treaty partners and also undermine a state's reputation in its international dealings. On the other hand, there are major difficulties for a state to renegotiate each of their DTAs on one-by-one basis. These constraints and limitations led the OECD to arrive at a multilateral convention — the MLI — in Action 15, which will sit alongside (or on top) a state's existing DTAs to modify their application to implement the BEPS measures, rather than a state needing to negotiate amending protocols to each of their existing DTAs.

First, while on paper such a comprehensive multilateral convention could deal with the issue of simultaneous revision of many hundreds (if not thousands) of DTAs, the reality is that no state could be forced to sign such a convention. Second, there would surely be almost insurmountable difficulties in arriving at a consensus on what articles such a multilateral convention should contain, especially considering that nearly 100 countries had participated in the BEPS project, from wealthy developed countries to poor underdeveloped countries. Third, some states (mainly small ones, such as Singapore, Luxembourg and the Netherlands) had become very wealthy developing their economies as 'international financial centres', which relied upon an extensive network of DTAs to attract (mainly mobile) foreign investment. While publicly such states may have expressed concern about BEPS and MNE tax avoidance, their economies were often the beneficiary of BEPS and the current international tax order, and it was unrealistic to expect these states to agree voluntarily to undermine highly successful sectors of their economies. Consequently, the MLI is largely modular, and signatory states can enter reservations to significant parts of it.⁶ There are very few provisions of the MLI that are mandatory.⁷ It should be noted at this point that the MLI only applies to modify

⁵ Govind and Pistone refer to the International Bureau of Fiscal Documentation DTA database having 3,115 tax treaties in force in the English language in September 2017. Sriram Govind and Pasquale Pistone, 'The Relationship between Tax Treaties and the Multilateral Instrument: Compatibility Clauses in the Multilateral Instrument' in Michael Lang et al (eds), *The OECD Multilateral Instrument for Tax Treaties: Analysis and Effects* (Kluwer Law International, 2018) ch 6, 111, fn 1.

⁶ For a discussion on these reservations, see Benjamin Walker, 'Reservations to the Multilateral Instrument' in Lang et al (eds) (n 5) ch 8.

⁷ MLI (n 2). The mandatory provisions are found in arts 6(1)–(2), 7 and 16. While these provisions are mandatory to signatories, there is some limited scope for states to choose how they will meet these minimum standards, which are found in arts 6(4) and (6), and 7(15)–(17). States can actually enter reservations to both articles if a covered tax agreement already contains provisions that meet the minimum standards (see arts 6(4) and 7(15)(b)). Additionally, art 7(15)(a) allows a state to meet the prevention of treaty abuse standard using their own measures not specified in the MLI.

comprehensive DTAs and not more limited bilateral tax treaties, such as the more recent tax information exchange agreements.

III INSIDE THE MLI

Given the breadth of matters covered by the MLI and the almost impossibility of obtaining a full consensus on all BEPS measures from nearly 100 states, the MLI is a complex convention upon which signatory states have considerable leeway as to how far they adopt the various parts of it. There are, however, some provisions that signatory states must adopt even though there is some choice within these provisions. These are termed 'minimum standards', which are:

- the requirement for the preamble to a DTA to state, as well as the aim to eliminate double taxation, that the parties intend to prevent opportunities for non-taxation or reduced taxation⁸
- the introduction of anti-abuse rules⁹
- amendments to the DTA dispute resolution provisions to make them more efficient and effective.¹⁰

Additionally, there is ongoing monitoring and peer review between signatory states as to their compliance with the MLI and other BEPS provisions, but these are outside the MLI itself. At this stage, it should be noted that these 'minimum standards' do not on their own 'go very far towards preventing BEPS'.¹¹

The remainder of the MLI contains a number of articles designed to deal with certain BEPS techniques (for example, avoidance of creation of a PE), but to which signatory states can enter reservations. Thus, these articles can be regarded as elective (or optional), the only condition being that if a state enters a reservation to them, then that reservation applies to all the DTAs to which that state is a party that they have specified are covered by the MLI (known as 'covered tax agreements'). However, states do not have an unfettered right to enter reservations to any part of the MLI. The ability to do so is limited by the provisions of art 28 of the MLI, which are very complex.

Thus, in summary, for a provision of the MLI to apply to modify an existing DTA, there are a series of steps that need to be met:¹²

- (1) The contracting states to that DTA must both be signatories to the MLI. As at 1 June 2019, 88 states have signed, the US being a major gap.¹³ Some key Asian countries

⁸ Ibid arts 6(1) and (2).

⁹ Ibid art 7.

¹⁰ Ibid pt V arts 16 and 17.

¹¹ See James Keate, 'Venturing beyond the OECD: An Analysis of New Zealand's Response to Multinational Corporate Tax Avoidance' (Student/Alumni Paper No 28/2018, Legal Research Papers, Victoria University of Wellington, 4 April 2018) 8.

¹² See OECD, *Applying the Multilateral Instrument: Step-by-Step* (OECD Publishing, June 2017) <<https://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf>>.

¹³ The reason for the US not signing has been given as the MLI largely following existing US DTA policy, which does have strict provisions against treaty shopping arrangements, for example. Henry Louie (Deputy International Tax Counsel at the US Department of the Treasury) is noted as saying that the US treaty

(for example, the Philippines, Thailand and Vietnam) have also not yet signed, although Thailand has expressed interest in doing so.¹⁴

- (2) If (1) is met, both states must then agree that the particular DTA is a covered tax agreement for the purposes of the MLI. New Zealand has specified that 36 of its 40 DTAs are covered tax agreements, but interestingly some of those covered tax agreements are with countries that have yet to sign the MLI, so not all of the 36 will in fact be modified or subject to the provisions of the MLI.¹⁵
- (3) If (2) is met, both countries must then agree to be bound by a particular article of the MLI. If one of the states has entered a reservation to a particular article, then that article will not apply to modify that covered tax agreement.

Thus, even though a large number of states have signed the MLI, that on its own has little significance in terms of the MLI achieving its goal of modifying a large number of the world's DTAs and hence reducing MNE tax avoidance. The MLI can only achieve its intended outcome if there is a careful alignment of the relevant DTAs being covered tax agreements and agreement by the two states on reservations (or lack of them) to the key parts of the MLI.¹⁶

The optional parts of the MLI are:¹⁷

- Part II (arts 3, 4 and 5), which deals with hybrid mismatches arising from fiscally transparent and dual-resident entities as well as hybrid securities.
- Part III (arts 6, 7, 8, 9, 10 and 11), which deals with treaty abuse. While arts 6 and 7 form part of the 'minimum standards', the remaining articles are elective. Of these elective provisions, art 8 applies to dividend transfer transactions, art 9 is designed to deal with 'land-rich' companies, art 10 contains an anti-abuse rule to deal with PEs in third jurisdictions, and art 11 explains in what situations the MLI can limit a resident state in taxing its own residents.
- Part IV (arts 12, 13, 14 and 15), which deals with PE avoidance techniques.
- Part VI (arts 18, 19, 20, 21, 22, 23, 24, 25 and 26), which contains articles pertaining to arbitration if a state elects to adopt the arbitration provisions under art 18.

network is already robust to prevent treaty shopping, and already has a low degree of exposure to base erosion and profit shifting. He is quoted as saying 'the bulk of the multilateral instrument is consistent with US tax treaty policy that the Treasury Department has followed for decades'. He is also mentioned as citing the complexity of getting necessary approvals from the US Department of State and from the Senate. Alston & Bird LLP, *International Tax Advisory* (14 July 2017).

¹⁴ See OECD, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (29 May 2019) <<https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>>.

¹⁵ New Zealand Government, *New Zealand — Status of List of Reservations and Notifications at the Time of Signature* (8 June 2017) art 2, 2–6 <<http://www.oecd.org/tax/treaties/beps-mli-position-new-zealand.pdf>>.

¹⁶ As at 1 June 2019, the OECD has reported that there are 2,712 'notified agreements', leading to 1,527 'matched agreements': see OECD, *Signatories and Parties to the Multilateral Convention* (n 14). These figures suggest that around half of the world's DTAs will fall within the ambit of the MLI, although the effect of falling within the 'matched' category will be limited by the reservations entered into by states.

¹⁷ MLI (n 2).

IV NEW ZEALAND AND THE MLI¹⁸

On 7 June 2017, New Zealand signed the MLI and released a provisional list of its reservations and notifications. Of the 40 DTAs New Zealand has negotiated and that are currently in force, 36 have been designated by New Zealand as covered tax agreements for the purposes of the MLI. These are outlined in Table 1.

Table 1: New Zealand's covered tax agreements, as at 1 June 2019

Australia*	India	Poland*
Austria*	Indonesia	Russia
Belgium*	Ireland*	Singapore
Canada*	Italy*	South Africa
Chile*	Japan*	Spain*
China (People's Rep)#	Korea*	Sweden*
Czech Republic*	Malaysia	Switzerland*
Denmark*	Mexico*	Thailand
Finland*	Netherlands*	Turkey*
France*	Norway*	United Arab Emirates
Germany*	Papua New Guinea	UK*
Hong Kong	Philippines	Vietnam

*Note: Jurisdictions marked * above are OECD member states. The remaining jurisdictions are either developing countries, those that have not sought OECD membership (Singapore, United Arab Emirates), or those not recognised as sovereign entities (Hong Kong, Taiwan).*

The 1986 China–New Zealand DTA is a covered tax agreement under the MLI, however, the newly negotiated 2019 DTA with China will not be a covered tax agreement.

There are four DTAs that New Zealand has not included as covered tax agreements, with Fiji, Samoa, Taiwan and the US. Samoa, Taiwan and the US have not signed the MLI, although Fiji has. Fiji has specified its DTA with New Zealand as a covered tax agreement but New Zealand has chosen not to do so. This appears to reflect New Zealand's intention to renegotiate the Fijian DTA in the near future, although it has not yet occurred to date.¹⁹

Of the 36 DTAs that New Zealand has specified as covered tax agreements, the MLI cannot apply to three of them as the other contracting states (the Philippines, Thailand and Vietnam) have not yet signed the MLI. Of these three, it is understood that only Thailand has expressed an intention to sign the MLI, but has not yet done so. As a result of these various exclusions, the MLI applies to only 33 of New Zealand's 40 current DTAs.

¹⁸ This analysis is current to 1 June 2019.

¹⁹ At 1 April 2019 it was disclosed that negotiations are in progress for a DTA with Luxembourg and a replacement DTA with the UK. In both cases, negotiations have been in progress over a long period of time. See 'Double Tax Agreements', *Ministry of Foreign Affairs and Trade, New Zealand Government (Web Page)* <<https://www.treaties.mfat.govt.nz//search/details/p/63>>. It is notable that other countries (for example, Portugal) have appeared on this list in earlier times, but have been removed, suggesting that negotiations have broken down. A new DTA was negotiated with China in April 2019, being the first DTA to be concluded by New Zealand since the MLI was signed, which incorporates anti-BEPS measures. The author has been informed that it will not be a covered tax agreement for the purposes of the MLI.

The remaining 33 covered tax agreements are with an interesting range of countries. While most are with other OECD states, among them are several jurisdictions, such as Singapore, Hong Kong and United Arab Emirates, that are either tax havens or low-tax jurisdictions, commonly utilised by many MNEs as part of their tax avoidance arrangements.

V OPTIONAL PARTS OF THE MLI AND NEW ZEALAND'S COVERED TAX AGREEMENTS

New Zealand has adopted a large proportion of the MLI. It has entered no reservations to the optional parts of the MLI. This is explicit evidence that New Zealand wishes to protect its revenue base from erosion by MNEs who have adopted BEPS techniques, and also sees the solution to the BEPS problem through adopting solutions formulated in a multilateral forum such as the OECD. New Zealand's lack of reservations to any major part of the MLI suggests that New Zealand sees the MLI as a way of amending a substantial number of its DTAs quickly. The alternative path would be to undertake piecemeal revision of each DTA by bilateral renegotiation, which would be incredibly resource intensive and take a long time, especially given New Zealand's small size and lack of economic importance to most of its DTA partners.²⁰

But for the MLI to provide effective protection to its revenue base, it is not sufficient that 33 of New Zealand's 40 DTAs are designated as covered tax agreements, but it is also necessary that the other parties to those 33 agreements have not entered reservations to the key parts of the MLI when they adopted it. The following sections of this article will examine the reservations the other states have entered to the MLI to see if there is alignment between what New Zealand has agreed to under the MLI and the other parties to New Zealand's covered tax agreements.

A Part II: Hybrid mismatches — arts 3-5

Part II containing arts 3, 4 and 5 of the MLI deals with hybrid mismatches. Article 3 deals with fiscally transparent entities that are not explicitly dealt with in the existing *OECD Model Tax Convention on Income and on Capital* ('OECD Model').²¹

Article 4 of the MLI deals with dual-resident corporate entities (being entities other than individuals). While art 4 of the OECD Model contains a comprehensive residence tie-breaker clause, not all DTAs negotiated from the OECD Model necessarily contain provisions to deal with dual-resident corporate entities. Article 4(1) of the MLI extends an anti-avoidance provision that a dual-resident corporate entity that has not had its residence resolved by mutual agreement under the MLI will not be able to obtain any relief or exemption from tax arising under a covered tax agreement, until agreed by the competent authorities of two contracting states.

Article 5 aims to address situations where there is double non-taxation, which may arise with cross-border holdings of hybrid securities. This article aims to modify existing provisions in covered tax agreements that deal with the methods to relieve double

²⁰ See C Peters, *National Interest Analysis: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (4 August 2017) paras 27-8.

²¹ See OECD, *Model Tax Convention on Income and on Capital* (n 3).

taxation — being either a foreign tax credit or an exemption. New Zealand has previously dealt with tax avoidance involving hybrid security mismatches by using the general anti-avoidance rule (*Income Tax Act 2007* ('ITA 2007') s BG 1), as illustrated in *Alesco New Zealand Limited v. CIR*.²² The provisions in art 5 of the MLI authorise a departure from a tax credit or exemption being required where it will facilitate tax avoidance using hybrids.

Table 2 shows the position on arts 3–5 of the contracting states to New Zealand's 33 covered tax agreements.²³

Table 2: Position of New Zealand's contracting states: MLI arts 3–5

	Article 3	Article 4	Article 5
<i>New Zealand</i>	√	√	√
Australia	√	√	√
Austria	Reservation	Reservation	√
Belgium	√	Reservation	√
Canada	Reservation	Reservation	Reservation
Chile	√	Reservation	√
China (People's Rep)	Reservation	Reservation	Reservation
Czech Republic	Reservation	Reservation	Reservation
Denmark	Reservation	Reservation	Reservation
Finland	√	Reservation	√
France	Reservation	Reservation	Reservation
Germany	Reservation	Reservation	√
Hong Kong	Reservation	Reservation	Reservation
India	Reservation	√	Reservation
Indonesia	Reservation	√	Reservation
Ireland	Reservation*	√	√
Italy	Reservation	Reservation	√
Japan	√	√	√
Korea	Reservation	Reservation	Reservation
Malaysia	Reservation	Reservation	Reservation
Mexico	√	√	√
Netherlands	√	√	√
Norway	√	√	√
Papua New Guinea	√	Reservation [^]	√
Poland	√	√	√
Russia	√	√	Reservation
Singapore	Reservation	Reservation	Reservation
South Africa	√	√	Reservation
Spain	√	√	√

²² [2013] NZCA 40.

²³ Information in this and subsequent tables has been taken from 'MLI Database — Matrix of Options and Reservations', *OECD* (Web Page, 1 June 2019) <<http://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm>>. The limitations and restrictions upon the use of this database is explained in *OECD, Multilateral Instrument: Matching Database* <<https://www.oecd.org/tax/treaties/MLI-database-disclaimer-and-manual.pdf>>.

Sweden	Reservation	Reservation	Reservation
Switzerland	Reservation	Reservation	√
Turkey	√	√	Reservation
United Arab Emirates	Reservation	Reservation	Reservation
UK	Reservation*	√	√
Total no adopting out of 33 states	14 + 2 partial	14 + 1 partial	17

* Partial reservation entered to MLI art 3(2).

^ Partial reservation entered to MLI art 4.

While New Zealand has adopted all three articles from the MLI in respect of its covered tax agreements, the above table shows that many other contracting states have entered reservations to them. Thus New Zealand's adoption of arts 3, 4 and 5 will be of little consequence in modifying many of New Zealand's DTAs. The reservations entered to the three articles in pt II of the MLI does not necessarily signify that New Zealand's DTA partners do not wish to address issues of hybrid entity and security mismatches. For many of them, such methods of tax avoidance are likely to be of concern, it is just that they prefer to adopt other strategies to deal with this particular type of avoidance. This may include existing provisions in DTAs that they may believe are adequate, and they may want to avoid the possible complications or confusion arising from applying the MLI provisions.

B Part III: Treaty abuse — arts 6-11

Part III of the MLI deals with treaty abuse. Articles 6 and 7 impose certain minimum standards upon signatory states and offer some limited options as to how states can meet these minimum standards.²⁴ The remaining articles in pt III (arts 8-11) are optional ones that states can adopt or enter a reservation to.

Article 8 of the MLI applies to situations where inter-company dividends are exempt due to a specified shareholding threshold being met, along with certain other shareholding requirements. Article 8 imposes a minimum time period of 365 days for which such shareholdings must be in place, to deal with avoidance facilitated by temporary changes in shareholding in order to secure an exempt inter-company dividend.

Article 9 applies to stem artificial arrangements to defeat the rules applying to 'land-rich' companies. Sale of shares in such companies can, in economic substance, effect the sale of land. If companies' assets comprise land above a specified threshold, sale of shares in these companies can be taxed as a sale of the land itself. These provisions have been defeated by land-rich companies temporarily acquiring non-land assets so that the threshold for the land-rich company provisions is not breached. Article 9 of the MLI clarifies the time period the threshold test applies so that temporary arrangements to defeat the test will not be effective.

Article 10 introduces an anti-abuse rule for PEs in third jurisdictions. It is designed to address tax avoidance where an enterprise sets up a PE in a jurisdiction to derive mainly passive income (that is, no active business income), where that income will receive

²⁴ See above n 7 and accompanying text.

concessional tax treatment and will be exempt from tax in the residence jurisdiction. Under art 10 of the MLI, the source state will not be obliged to grant treaty benefits to such income derived by PEs in third countries where the tax imposed is less than 60 per cent of the tax that would be imposed in the state where the enterprise is resident.

Article 11 is a 'savings' clause, which seeks to prevent a covered tax agreement from restricting how a contracting state may tax its own residents. However, this right for a contracting state to tax their residents as they see fit is limited by a carve-out of 10 situations where treaty provisions would still apply.

New Zealand has not entered any reservations in respect to arts 8–11 of the MLI to its covered tax agreements. Table 3 shows whether the other contracting states to New Zealand's covered tax agreements have entered reservations to arts 8–11 of the MLI.

Table 3: Position of New Zealand's contracting states: MLI arts 8–11

	Article 8	Article 9	Article 10	Article 11
<i>New Zealand</i>	√	√	√	√
Australia	√	Reservation^^	Reservation	√
Austria	Reservation	Reservation	√	Reservation
Belgium	√	Reservation~	Reservation	√
Canada	Reservation	Reservation	Reservation	Reservation
Chile	Reservation	√	Reservation**	Reservation*^
China (People's Rep)	√	Reservation~	Reservation	√
Czech Republic	Reservation	Reservation	Reservation	Reservation
Denmark	Reservation	Reservation	Reservation	Reservation
Finland	Reservation	Reservation	Reservation	Reservation
France	√	√	Reservation	Reservation
Germany	Reservation*	√	√	Reservation
Hong Kong	Reservation	Reservation	Reservation	Reservation
India	Reservation^	√	√	√
Indonesia	√	√	Reservation	√
Ireland	√	√	Reservation	Reservation
Italy	Reservation	Reservation	Reservation	Reservation
Japan	Reservation	√	√	Reservation
Korea	Reservation	Reservation	Reservation	Reservation
Malaysia	Reservation	Reservation	Reservation	Reservation
Mexico	√	√	√	Reservation*^
Netherlands	√	√	√	Reservation
Norway	Reservation*	Reservation	Reservation	√
Papua New Guinea	Reservation	Reservation^^ ^	Reservation	Reservation
Poland	√	√	Reservation	√
Russia	Reservation*	Reservation^^	√	√
Singapore	Reservation	Reservation	Reservation	Reservation
South Africa	√	Reservation	Reservation	Reservation
Spain	√	√	√	Reservation
Sweden	Reservation	Reservation	Reservation	Reservation
Switzerland	Reservation	Reservation	Reservation	Reservation
Turkey	Reservation	Reservation^*	Reservation	Reservation
United Arab Emirates	Reservation	Reservation	Reservation	Reservation
UK	Reservation	Reservation	Reservation	Reservation

Total no adopting out of 33 states	11 + 4 partial	11 + 6 partial	8 + 1 partial	8 + 2 partial
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* Partial reservation entered to MLI art 8(3)(b)(i).

^ Partial reservation entered to MLI art 8(3)(b)(iii).

^^ Partial reservation entered to MLI art 9(6)(e).

^^^ Partial reservations entered to MLI arts 9(6) and (8).

~ Partial reservation entered to MLI art 9(6)(b).

^* Partial reservation entered to MLI art 9(6)(f).

** Partial reservation entered to MLI art 10(5)(b).

*^ Partial reservation entered to MLI art 11(3)(b).

Again, many of New Zealand's DTA partners have entered reservations to the four articles designed to deal with four specific types of treaty abuse. Many of the partial reservations are not particularly significant in scope and can be almost regarded as acceptance of the particular article rather than a reservation to an article in its entirety. However, the large number of reservations does mean that New Zealand's wide-ranging acceptance of nearly all of the optional provisions of the MLI will be of limited effect to its DTA network. The partial reservations will result in particularly complex analyses to determine exactly how much of one of those articles will apply to a covered tax agreement, and may well result in disagreements as to what actually does apply.

C Part IV: PE avoidance — arts 11–14

Avoiding the creation of a PE in a state — to avoid any liability for income tax on profits derived from a business wholly or partly carried on in that state — is a tax avoidance strategy used by a number of MNEs in the electronic commerce area.²⁵ The MLI contains three articles that aim to deal with this mode of tax avoidance. Article 12 of the MLI modifies the existing definition of a PE found in the OECD Model (and most DTAs) to encompass certain preliminary or preparatory activities that habitually lead to the conclusion of contracts. Article 13 of the MLI will modify the existing exclusions of certain activities from constituting a PE found in the OECD Model (and most DTAs), which have enabled certain tax avoidance strategies. Article 14 of the MLI aims to modify existing DTAs where there has been artificial division of activities so that they fall below certain time thresholds, above which a PE would be deemed to be created. Common examples of this are building construction or installation projects that exceed 12 months (sometimes six months under some of New Zealand's DTAs). Many of New Zealand's existing DTAs contain such time thresholds for the creation of a PE beyond just construction projects.²⁶ As part of the enactment of BEPS measures, New Zealand has also incorporated the term 'permanent establishment' into its domestic law from 1 July 2018.²⁷

²⁵ See Andrew Smith, 'Will BEPS Allow New Zealand to Finally Tax Google?' (Conference Paper, Conference of the Australasian Tax Teachers Association, 17–19 January 2018).

²⁶ MLI (n 2). For example, in the Australia–New Zealand DTA, a PE arises if a person performs independent services in a contracting state for more than 183 days in any 12-month period (art 5(4)(a)) or activities for the exploration or exploitation of natural resources for more than 90 days (art 5(4)(b)).

²⁷ Under ITA 2007 s YD 4B(2), where an enterprise resident in a jurisdiction with which New Zealand has concluded a DTA that includes a definition of a PE, the term has the meaning attributed to it in the DTA, or by ITA 2007 s GB 54, if the enterprise meets the requirements of that anti-avoidance provision. Otherwise the term is defined in ITA 2007 sch 23, where a DTA is not applicable.

New Zealand has adopted all three of these articles in respect to the MLI. Table 4 shows whether the other contracting states to New Zealand's covered tax agreements have also agreed to be bound by arts 12–14, or whether they have reserved their positions.

Table 4: Position of New Zealand's contracting states: MLI arts 12–14

	Article 12	Article 13	Article 14
<i>New Zealand</i>	√	√	√
Australia	Reservation	Reservation*	Reservation [^]
Austria	Reservation	√	Reservation
Belgium	Reservation	√	Reservation
Canada	Reservation	Reservation	Reservation
Chile	√	√	√
China (People's Rep)	Reservation	Reservation	Reservation
Czech Republic	Reservation	Reservation	Reservation
Denmark	Reservation	Reservation	Reservation
Finland	Reservation	Reservation	Reservation
France	√	√	Reservation
Germany	Reservation	√	Reservation
Hong Kong	Reservation	Reservation	Reservation
India	√	√	√
Indonesia	√	√	√
Ireland	Reservation	√	Reservation [^]
Italy	Reservation	√	Reservation
Japan	√	√	Reservation
Korea	Reservation	Reservation	Reservation
Malaysia	√	√	Reservation
Mexico	√	√	Reservation
Netherlands	Reservation	√	Reservation [^]
Norway	√	√	Reservation [^]
Papua New Guinea	√	√	√
Poland	Reservation	Reservation	Reservation
Russia	√	√	Reservation [^]
Singapore	Reservation	Reservation*	Reservation
South Africa	Reservation	√	Reservation
Spain	√	√	√
Sweden	Reservation	Reservation	Reservation
Switzerland	Reservation	Reservation	Reservation
Turkey	√	√	Reservation
United Arab Emirates	Reservation	Reservation	Reservation
UK	Reservation	√	√
Total no adopting out of 33 states	12	20 + 1 partial	6 + 5 partial

* Partial reservation entered to MLI art 13(2) (Australia) and MLI art 13(4) (Singapore).

[^] Partial reservation entered to MLI art 14, in respect of contracts for natural resource exploration or exploitation.

Table 4 indicates that very few of New Zealand's 33 DTAs are going to be modified by the MLI provisions applying to avoidance of the creation of PEs. This means that many of New Zealand's DTAs will potentially continue with unmodified definitions of 'permanent establishment'. New Zealand has recognised that many of its DTA partners entered reservations, particularly to arts 12 and 13, and has introduced domestic law changes to address this gap.²⁸

ITA 2007 s GB 54 is an anti-avoidance provision enacted in 2018, which applies to New Zealand's DTAs (including both covered tax agreements and those not covered) where the treaty does not incorporate art 12(1) of the MLI (or equivalent) and is part of a tax avoidance arrangement. If New Zealand does apply s GB 54 to enterprises resident from those states, it remains to be seen whether a New Zealand court will uphold s GB 54 as overriding the existing provisions in those states' DTAs with New Zealand. Furthermore, it is possible that these states will dispute the New Zealand application of s GB 54 on grounds that the taxpayer's arrangements do not constitute tax avoidance involving unintended abuse of DTAs.

The large number of reservations to art 14 possibly reflects that most of New Zealand's covered tax agreements already contain provisions dealing with artificial splitting of contracts to avoid PE creation. The other contracting states may well believe that these existing provisions are adequate and may not want the additional complexity of the MLI overlying them.

D Part VI: Arbitration — arts 18–26

New Zealand has adopted the arbitration option in pt VI of the MLI. Until this adoption, New Zealand did not appear to favour arbitration to resolve problems arising from the application of a DTA, as arbitration provisions are only found in the DTAs with Australia and Japan.²⁹ New Zealand has taken this step because it wants the arbitration option as 'an incentive for the competent authorities of two jurisdictions to come to an agreement within the required time period for MAP [the mutual agreement procedure]'.³⁰

Table 5 shows the position on art 18 of the contracting states to New Zealand's covered tax agreements.

Table 5: Position of New Zealand's contracting states: MLI art 18

	Article 18		Article 18
<i>New Zealand</i>	√	Japan	Reservation
Australia	Reservation	Korea	√
Austria	Reservation	Malaysia	√
Belgium	Reservation	Mexico	√
Canada	Reservation	Netherlands	Reservation
Chile	√	Norway	√
China (People's Rep)	√	Papua New Guinea	√

²⁸ See above n 27 and accompanying text.

²⁹ *Double Tax Agreement*, Australia–New Zealand (2009) art 25(6) and (7); *Double Tax Agreement*, Japan–New Zealand (2012) art 26(5).

³⁰ See Peters (n 20) para 39.

Czech Republic	√	Poland	√
Denmark	√	Russia	√
Finland	Reservation	Singapore	Reservation
France	Reservation	South Africa	√
Germany	Reservation	Spain	Reservation
Hong Kong	√	Sweden	Reservation
India	√	Switzerland	Reservation
Indonesia	√	Turkey	√
Ireland	Reservation	United Arab Emirates	√
Italy	Reservation	UK	Reservation
Total no adopting out of 33 states			16

This provision will appear to have some significance for New Zealand's covered tax agreements, as it will enable the arbitration option to apply for another 16 of New Zealand's DTAs in addition to the existing provisions in the Australian and Japanese DTAs.

VI ANALYSIS OF RESULTS

One very clear trend, apparent from Tables 2–5, is that many of New Zealand's DTA partners have entered a significant number of reservations to the optional provisions of the MLI. Therefore, the results flowing from New Zealand's enthusiastic adoption of the MLI by not entering any significant reservations will be limited.

A number of New Zealand's DTA partners have entered into reservations to all the optional provisions to the MLI. The backgrounds of these states are quite varied. Three such states are Hong Kong, Singapore and the United Arab Emirates. These three states are low-tax jurisdictions, which are likely to have economically benefitted from the existing BEPS strategies adopted by many MNEs, and might understandably be reluctant to agree to measures that could reduce their ability to gain from their existing DTA networks. Belgium and Switzerland have also entered a large number of reservations, and they can be regarded as 'partial' tax havens, as they have traditionally offered concessional taxing regimes to attract foreign mobile capital.

China is another state that has entered reservations to most (but not all) of the optional parts of the MLI, although it is not a tax haven. Li, in her analysis of the impact of the MLI in China,³¹ does not specifically discuss the relatively large number of reservations China has entered to the MLI, but does note that China is not an OECD state and that the OECD Model (including commentaries)³² has never been an official interpretive reference in China.³³ She further notes that the OECD commentaries have largely been drafted by a small group of OECD countries where China has no voting power and thus no obligation to follow.³⁴

Along with these low-tax jurisdictions and 'partial' tax havens, a number of OECD states have also entered a large number (or complete number) of reservations to the optional

³¹ Na Li, 'The Impact of the Multilateral Instrument in China' (2018) 24(6) *Asia-Pacific Tax Bulletin*.

³² See OECD, *Model Tax Convention on Income and on Capital* (n 3).

³³ Li (n 32) s 3.

³⁴ *Ibid*.

parts of the MLI. These include Austria, Canada, Czech Republic, Finland, Korea, Sweden and Switzerland, among others. These states are not low-tax jurisdictions and are likely to have been concerned about BEPS along with other OECD members. There are a variety of possible reasons why they may have taken this stance. Some may have been concerned about the potential confusion and complexity arising from adoption of the whole MLI, plus the lack of flexibility that would arise from its complete adoption, as they would have to apply it to all their covered tax agreements. Possibly these states would prefer to deal with the BEPS issues on a state-by-state basis, through bilateral DTA negotiations. Some of these states are also major capital exporters and may have perceived the MLI as tipping the balance between source/resident states more towards source states, therefore undermining revenues gained by residence states. On the opposite side, Oguttu notes that the selective adoption of MLI parts could disadvantage developing countries,³⁵ as the MLI allows developed countries to 'cherry-pick' the parts that favour them, but create more gaps and mismatches between the tax rules of different countries.³⁶

Cynics might also see the large number of reservations entered into by major OECD states as evidence that the BEPS project was political in nature, designed to assure an angry (mainly European) populace that governments were reacting to the BEPS problem. Given the complexity of the BEPS responses, and the MLI in particular, lay persons might well be convinced that their governments were reacting appropriately to the BEPS problem, when the real political will was much less.

The complexity arising from the application of the MLI to existing DTAs has been noted by a number of international commentators. Kleist discusses at length the resulting complexity and legal uncertainty from the application of the MLI.³⁷ Kleist also refers to issue of reservations being entered and the resulting effect that many covered tax agreements will not be modified by the MLI.³⁸ Oguttu, in analysing the interests of developing countries in the MLI, refers to the complexity and uncertainty that the MLI creates.³⁹ Antón discusses the problems arising from the reservations entered to the MLI, especially the partial reservations.⁴⁰ Avi-Yonah and Xu, while being more positive about the MLI than each of Kleist and Antón, conclude in their analysis of the MLI that

[w]hether the MLI will succeed remains to be seen. While its adoption by seventy countries (with more to come) is an achievement, the absence of the United States is important, and other OECD members have agreed to only a limited set of provisions. On the other hand, the MLI may prove more appealing to developing countries because it enhances source-based taxation and limits treaty shopping.⁴¹

³⁵ Annet W Oguttu, *Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty-Related Base Erosion and Profit Shifting Measures?* (Policy Paper, Center for Global Development, November 2018).

³⁶ *Ibid* 13.

³⁷ D Kleist, 'The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS — Some Thought on Complexity and Uncertainty' (2018) 1 *Nordic Tax Journal* 31, 41–2 and 44–7.

³⁸ *Ibid* 42–4.

³⁹ See Oguttu (n 36) 13–15.

⁴⁰ R García Antón, 'Untangling the Role of Reservations in the OECD Multilateral Instrument: The OECD Legal Hybrids' (August 2017) 71(10) *Bulletin for International Taxation*.

⁴¹ Reuven S Avi-Yonah and Haiyan Xu, 'A Global Treaty Override? The New OECD Multilateral Tax Instrument and Its Limits' (2018) 39(2) *Michigan Journal of International Law* 155, 216.

If states have entered reservations to all of the optional parts of the MLI, it may well be because of these concerns over complexity, uncertainty and ambiguity, rather than ambivalence about the BEPS problem. New Zealand may be naïve in its adoption of the MLI without entering reservations, and is yet to encounter the problems that other states fear and are concerned about. This is perhaps compounded by the New Zealand Inland Revenue Department's reluctance to produce synthesised versions of its covered tax agreements modified by the MLI, despite other states already doing so, such as Australia. It may well be that, down the road, New Zealand will face more disputes about the application of its covered tax agreements, which might eventually be resolved when it renegotiates its existing DTAs and replaces them with updated ones that incorporate the new BEPS provisions. In this respect, the problems that might arise for New Zealand adopting the MLI so thoroughly may be temporary until its covered tax agreements are renegotiated with ones incorporating the BEPS provisions.

VII CONCLUSION

New Zealand has been one of the more enthusiastic adopters of the MLI, if judged by the very limited number of reservations it has entered to the MLI, which are mainly in respect of the options arising under the arbitration provisions in pt VI. The apparent reason behind this approach is clearly valid, in that it is very difficult and slow to renegotiate all of a state's existing DTAs, and that, given New Zealand's small size, it can be difficult to get DTA partners to schedule negotiations when they have more important DTAs to negotiate.

Unfortunately for New Zealand, many of its key DTA partners have either not signed the MLI (for example, the US) or have entered into a large number of reservations in respect of the optional parts of the MLI. Thus, fewer than half of New Zealand's 40 existing DTAs will be subject to any substantial modification or supplementation as a result of the MLI. At the same time, New Zealand has taken the additional step of enacting domestic law changes (dressed up as anti-avoidance measures), which must reflect a conclusion that the MLI on its own may not be adequate to protect the New Zealand tax base.

The end outcome of these developments is considerable complexity and uncertainty for taxpayers applying New Zealand's existing DTAs. For those covered tax agreements to which the MLI will substantially apply, considerable complexity will arise. For those DTAs that are either not covered tax agreements or ones where the other contracting state has entered significant numbers of reservations to the optional parts of the MLI, there is the uncertainty as to how the domestic law changes will apply and whether they will be upheld by a future New Zealand court. Disputes about treaty overrides with other states may also arise. The adoption of the MLI by New Zealand has introduced a huge step up in complexity for taxpayers in applying any one of its 33 existing DTAs.

In the longer term, it would be desirable if all of New Zealand's DTAs were renegotiated to incorporate the latest version of the OECD Model to deal with BEPS, and thus would no longer need to be classified as covered tax agreements. In this way the MLI, over several decades, would be of diminished relevance, and greater certainty and clarity would be regained with updated and revised DTAs using the latest versions of the OECD Model.

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**MINIMISING POTENTIAL TAX AVOIDANCE BY STRENGTHENING TAX POLICY ON TRANSFER PRICING
IN INDONESIA**

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ABSTRACT

This article examines transfer-pricing implementation and challenges in Indonesia since its first tax reforms in 1983. The OECD has been formulating guidelines, and the concept of the arm's-length principle, since 1979, lately through the Action Plan on Base Erosion and Profit Shifting ('BEPS') in July 2013. The government of Indonesia put serious effort into transfer-pricing issues in the late 2000s, when it identified high numbers of potential transfer-pricing abuses. This research takes a qualitative approach — the data was collected through a literature review and interviews. It shows that the arm's-length principle was adopted in Indonesia when tax reforms began in 1983, but its implementation didn't start until 2008 due to a lack of expertise in transfer pricing. Since its implementation, the tax authority has faced technical challenges due to a lack of competent experts. When Indonesia declared their commitment to implement transfer-pricing rules following the OECD BEPS Action Plan 2013, the tax authority should have followed global examples of transfer-pricing policy. In Indonesia, this policy implementation is still in progress, with many improvements required.

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I INTRODUCTION

Transfer pricing is a global and growing issue whereby a transaction is conducted between divisions of a company (often a multinational enterprise comprised of multiple entities in different jurisdictions) with unfair pricing compared to a transaction between independent parties on the open market. In the context of tax, this transfer-pricing pattern has an impact on the return received by the company, and on the amount of tax that should be paid in a particular jurisdiction.¹ To optimise the income received after tax, multinational enterprises will seek a jurisdiction with the lowest possible tax rate for their income. This transaction pattern has led to the diminishing of the tax base. There has been a continuous effort by tax authorities to minimise such practices worldwide, including in Indonesia.

In the current context of globalisation, business activities are moving directly or indirectly across jurisdictions. A study conducted by Danny Darussalam Tax Center Indonesia found that, in 1970, there were only 10,000 multinational enterprises worldwide. However, by 2010, the number had increased exponentially to 103,786, controlling about 892,114 affiliated entities. In general, this growth is due to multinationals aiming to optimise their market power, by striving for excellence in ownership and location, and by gaining internalisation advantages.

According to a survey conducted by Ernst & Young in 2010 with 850 multinational enterprises in 24 countries, 40 per cent of respondents stated that the issue of transfer pricing is the most important issue in taxation.² This is why many consulting institutions have published information related to transfer pricing in recent years.³ Moreover, research conducted by Christian Aid also revealed that up to 60 per cent of world trade transactions were conducted between entities within multinational enterprises.⁴ This phenomenon is giving an important signal that the reasonable (arm's-length) transfer price needs to be properly evaluated.

In response to the growing issue of transfer pricing worldwide, the OECD has formulated guidelines related to the concept of the arm's-length principle.⁵

Indonesia is one of the countries in Asia that has adopted regulations of transfer pricing in its taxation system, since the beginning of its tax reformation marked by the enactment

¹ R Feinschreiber (ed), *Transfer Pricing Methods: An Application Guide* (John Wiley & Sons, 2004) 3–4.

² Ernst & Young, *2010 Global Transfer Pricing Survey: Addressing the Challenges of Globalization* (2010). Then, a survey conducted by Ernst & Young in 2016 further confirmed the importance of the global transfer pricing issue: see Ernst & Young, *2016 Transfer Pricing Survey Series: In the Spotlight — A New Era of Transparency and Risk* (2016) <[https://www.ey.com/Publication/vwLUAssets/EY-2016-transfer-pricing-survey-series/\\$FILE/EY-2016-transfer-pricing-survey-series.pdf](https://www.ey.com/Publication/vwLUAssets/EY-2016-transfer-pricing-survey-series/$FILE/EY-2016-transfer-pricing-survey-series.pdf)>.

³ RW McGee, 'Ethical Issues in Transfer Pricing' (2010) 7(2) *Manchester Journal of International Economic Law* 24.

⁴ David McNair, Rebecca Dottey and Alex Cobham, *Transfer Pricing, and the Taxing Rights of Developing Countries* (Christian Aid, 2010) <https://www.christianaid.org.uk/sites/default/files/2017-08/transfer-pricing-november-2010_0.pdf>.

⁵ OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017* (OECD Publishing, 2017). See also OECD, *Transfer Pricing and Multinational Enterprises* (OECD Publishing, 1979); OECD, *Transfer Pricing and Multinational Enterprises — Three Taxation Issues* (OECD Publishing, 1984); OECD, *Thin Capitalisation* (OECD Publishing, 1987).

of the *Income Tax Law 1983*. The government of Indonesia has realised the importance in preventing transfer-pricing practices as described in *Income Tax Law 1983* art 18(3).⁶

In this paper, the discussion on the implementation of tax policy in Indonesia will include a history, an overview of the previous policies, and the challenges now faced by the tax authority and taxpayers. Several previous studies have discussed the technical regulations related to transfer pricing in Indonesia,⁷ the determinants of transfer-pricing decisions by manufacturing companies in Indonesia,⁸ and other factors affecting the transfer-pricing behaviour of manufacturers.⁹ Thus, this research contributes to the whole picture of Indonesian transfer-pricing policy.

Furthermore, this article will briefly discuss the implementation of transfer-pricing regulations in China, as a benchmark study for Indonesia's work in overcoming the issue of transfer pricing. This study shows that Indonesian transfer-pricing rules pay more attention to the technical aspects of assessment — such as comparability analyses, functional analyses and others — and that these aspects commonly become the main drivers of tax disputes. China, on the other hand, has paid considerable attention to other factors besides technical aspects, such as location savings, market premiums and the possibility of using other methods besides the common method.

II RESEARCH METHOD

This research used a qualitative paradigm and methodology. According to Creswell, qualitative research begins with assumptions, a point of view, the possible use of theory, and an examination of an existing social problem for individuals and social groups.¹⁰ Data and information was collected through a literature study and field research. A series of in-depth interviews were conducted with relevant informants: workers for the tax authority, such as tax auditors for multinational enterprises under the Foreign Investment Tax Office; tax consultants from PricewaterhouseCoopers Indonesia and the MUC Consulting Group; and taxpayers whose main businesses operate both within the Indonesian territory and multinationally.

III LITERATURE REVIEW

A Overview of the transfer-pricing concept

Transfer pricing is basically the restructuring of a transaction between entities within a company, as a result of various combined market forces and internal policies, that causes

⁶ Danny S Darussalam and B Bawono Kristiaji (eds), *Transfer Pricing: Ide, Strategi dan Panduan Praktis dalam Perspektif Pajak Internasional* (Danny Darussalam Tax Center, 2013).

⁷ MK Huda et al, 'The Problem of Transfer Pricing in Indonesia Taxation System' (2017) 7(4) *International Journal of Economics and Financial Issues* 139.

⁸ A Susanti and A Firmansyah, 'Determinants of Transfer Pricing Decision in Indonesia Manufacturing Companies' (2018) 22(2) *Jurnal Akuntansi dan Auditing Indonesia*.

⁹ YN Indriaswari and RA Nita, 'The Influence of Tax, Tunneling Incentive, and Bonus Mechanisms on Transfer Pricing Decision in Manufacturing Companies' (2017) 7(1) *The Indonesian Accounting Review* 69.

¹⁰ JW Creswell, *Research Design: Qualitative, Quantitative and Mixed Methods Approaches* (Sage Publications, 2nd ed, 2002).

a difference in pricing if it is compared to a transaction on the open market carried out between independent parties.¹¹ It can also refer to the pricing of a transferred contribution to a company, including assets, services and funds;¹² or a rearrangement of the income between entities that make cross-jurisdiction transactions in an attempt to rearrange the tax base.¹³ The United Nations state that there are two reasons why a company might have an interest in transfer pricing: first, the company is looking to pay minimal tax on its income; and second, the company would like to optimise its business structure by taking consideration of the most effective tax burden.¹⁴

The problems that face multinational enterprises regarding the practice of transfer pricing are: they must optimise their business strategies and internal policies with regards to pricing restructuring; they must use their resources efficiently; and they must provide reasons for their price setting if they are audited by the tax authority. Almost all multinational enterprises strive to achieve a balance between these three factors.¹⁵ However, from a taxation perspective, the objective of transfer-pricing schemes is to minimise the overall tax burden of a multinational enterprise by taking advantage of the different tax rates in the country where the particular division resides, by setting higher or lower prices on transactions.

Moreover, the government of a country will always strive to protect their taxation base. This situation emphasises the need to set up fair and reasonable prices for both transactions conducted between independent parties and transactions between divisions of a company, for tangible and intangible goods, as well as cross-jurisdiction transactions.

The Tax Justice Network stated that:

[T]ransfer pricing is not, in itself, illegal or abusive. What is illegal or abusive is transfer mispricing, also known as transfer pricing manipulation or abusive transfer pricing. (Transfer mispricing is a form of a more general phenomenon known as trade mispricing ...)¹⁶

OECD *Model Tax Convention on Income and on Capital* art 9 regulates the special relations:

Where,

- a) an enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

¹¹ TP Ostwal, 'Chapter 1: An Introduction to Transfer Pricing' (United Nations, Geneva Meeting, 16 October 2012).

¹² L Eden, R Mackenzie and A dan Xilimas, *Transfer Pricing and Customs Valuation* (KPMG, 2011).

¹³ Veronica Vragaleva, 'Tax Aspects of Transfer Price Regulation: Perspective of Implementation in the Republic of Moldova' (2015) 1(1) *Analele Universităţii Constantin Brâncuşi din Târgu Jiu: Seria Economie* 200.

¹⁴ United Nations, *Transfer Pricing for Developing Countries* (Newsletter of Financing for Development No 2013/3, May 2013).

¹⁵ Vragaleva (n 13) 203.

¹⁶ 'Transfer Pricing', *Tax Justice Network* (Web Page) <<https://www.taxjustice.net/topics/corporate-tax/transfer-pricing>>.

- b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between the independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profit of that enterprises and taxed accordingly.¹⁷

A survey conducted by Ernst & Young in 2010 revealed that the most common transfer-pricing transactions are related to intra-group services (see Table 1).

Table 1: Types of transfer-pricing practices¹⁸

Types of transactions	Score (%)
Services	62.5
Transfer of intangible goods	50
Inter-company financing	32.4
Licenses of intangible property	30
Cost sharing/cost contribution arrangements	20
Imputed/increased compensation/indemnification payments for business charges	10
Other	5

B The concept of tax regulation implementation on transfer pricing

Based on the implementation practices in developing countries, Nakayama from the Fiscal Affairs Department of the International Monetary Fund stated that the many obstacles to implementing transfer-pricing regulations in developing countries include:¹⁹

- difficulty and incapability in performing transfer-pricing adjustments, which is caused by:
 - limited skills or numbers of experts in transfer pricing
 - limited data that can be accessed by the public
 - limited knowledge transfer related to the implementation of transfer-pricing guidelines in developing countries
- a lack of support for aggressive examination, sufficient mechanisms needed to perform the examination, and available workable dispute resolution mechanisms
- no significant increase in income from aggressive examination through the enforcement of transfer-pricing disclosure.

¹⁷ OECD, *Model Tax Convention on Income and on Capital* art 9 (18 December 2017).

¹⁸ Ernst & Young, *2010 Global Transfer Pricing Survey* (n 2) 14.

¹⁹ K Nakayama, 'Transfer Pricing for Developing Countries' (Expert Group Meeting on Practical Transfer Pricing Issues for Developing Countries, Fiscal Affairs Department, International Monetary Fund, 14 March 2012). See also Caroline Silberstein, *Transfer Pricing and Developing Economies* (OECD Publishing, 2013) <<https://www.oecd.org/site/oecdgfd/44562250.pdf>>.

Nakayama further formulated several principal aspects of how transfer-pricing disclosure policy can be performed in developing countries:²⁰

- The implementation of the arm's-length principle — Silberztein at the OECD gives the arm's-length principle this definition: '[T]he condition of transactions between enterprises that belong to the same MNE group should not be different from what they would be if the parties were independent'.²¹ Therefore, there is a need for general guidelines from the tax authority concerning the information (which must be comparable, and publicly accessible) that companies must make available, such as: geographical adjustments; location savings; non-competitive business arrangements; risk stripping (contract manufacturer, commissioner) that supports business activities; policies on safe harbour; and how information should be documented.
- Tax administration — there is a need for a special unit within the internal tax authority that deals with transfer pricing (for instance, a large taxpayer office), where the implementation is done by tax officers with sufficient experience in international transaction auditing. Moreover, the auditor team should comprise team members with other expertise besides taxation, including law, economics, accounting and even engineering. Furthermore, there needs to be quality control for transfer-pricing assessments and post-assessment reviews. This implementation will require a high level of capability in the tax administration.
- Dispute resolution — dispute resolution mechanisms facilitate and eliminate the massive and aggressive disputes related to conflicts in tax avoidance. This is expected to open the way for mutual agreement procedures.
- Advance Pricing Agreements ('APAs') — APAs are a reliable way to decrease the potential for tax avoidance and minimise other disputes from a transfer-pricing audit. However, this mechanism is time-consuming and requires a large amount of resources.

IV DISCUSSION

A Brief overview of transfer-pricing rules in Indonesia

Transfer pricing has been a particularly important issue in the Indonesian tax system since 2005. The issue emerged when the Ministry of Finance, specifically the Directorate General of Taxes ('DGT'), received information that there were 750 foreign capital investment enterprises that did not pay their taxes due to long-term losses. Following that, an examination was conducted to reveal if their transaction prices were reasonable.²² Since the enactment of the *Income Tax Law 1983*, transfer-pricing policy has been adopted as set out in art 18(3):

²⁰ Nakayama (n 19) 5–9.

²¹ Silberztein (n 19).

²² Study Group on Asian Tax Administration and Research, 'Recent Development: Transfer Pricing in Indonesia' (Working Paper, 2012).

Special relation as meant ... in the case where Taxpayer is a corporation (a.1) relations between two or more Taxpayers under the same ownership or control, directly or indirectly (a.2) relations between Taxpayers that possess 25% or more investment on the other party, or relations between Taxpayers that possess 25% or more on the two or more other parties, as well as relations between two or more that was last mentioned.

The Study Group on Asian Tax Administration and Research recently recorded that, although transfer-pricing policy was formulated in the *Income Tax Law* in 1983, there is still no institution with sufficient capability to cover the examination of taxation of business transactions between entities with special relations. Therefore, the regulations stated in art 18(3) were not implemented until the DGT stipulation KEP-01/1993 (on guidelines for auditing business entities with special relations) and the DGT Circular Letter SE-04/1993 (on guidelines for transfer-pricing dispute settlements) were enacted. Kurniati states that the policies have significant shortcomings, and that they are not supported by explicit guidelines for taxpayers. Moreover, the regulations have not taken into account internationally recommended aspects in relation to comparability analysis, and other factors that are vital in implementing the arm's-length principle.²³

Meanwhile, policies on obligatory documentation relating to transfer pricing were enacted in 2001, where particular corporate taxpayers must report their transactions between entities with special relations on their corporate income tax return. *Income Tax Law 2000* art 18(3) states: 'Directorate General of Taxes has the authority to redefine income and deduction as well as debt as capital to calculate the amount of taxable income for taxpayers with special relations with other taxpayers according to the arm's length principle that is not influenced by special relations'. APAs were first introduced at this time, but the revisions in *Income Tax Law 2000* have not significantly improved the transfer-pricing issue, due to the lack of guidelines available for taxpayers to implement the arm's-length principle.

Moreover, regulations under the Indonesian formal tax law, *Undang-undang Ketentuan Umum dan Tata Cara Perpajakan (General Provision and Procedure Law) 2007*, state that there is an obligation to report transactions between entities with special relations, and to report the transactions on the corporate income tax return. Furthermore, minor revisions to the *Income Tax Law 2008* stated that the DGT would perform intensive assessments in response to the enormous numbers of businesses participating in transfer-pricing practices. This change marked the restructuring of the DGT to form special units to tackle the issue of transfer pricing.

A Study Group on Asian Tax Administration and Research working paper described that, in 2009, the government regulated the transaction disclosure for parties with special relations through filing and reporting the documents attached to the corporate income tax notification letter, covering:

- detailed information on all entities with whom the corporate taxpayer has a special relationship, along with details of their transactions (Form 3A)

²³ Based on research by Stania Kurniati regarding the motivation behind transfer-pricing practices in Indonesia. Stania Kurniati, 'Pengaturan Praktik Transfer Pricing di Indonesia' (Master Thesis, Fakultas Hukum Universitas Indonesia, 2014).

- responses to various questions that are complementary to the income tax notification letter and various transactions conducted between parties/entities with special relations — this document identifies whether the transactions are fair (Form 3A-1)
- detailed information pertaining to transactions between entities that are residents of tax havens (Form 3A-2).

Furthermore, in 2009 the DGT also published a circular letter concerning guidelines for comparing the transfer prices of several targeted industries that had potential to be audited for transfer-pricing practices.

As implementation guidelines for transfer-pricing documentation and examination, the DGT in 2010 published regulations for examining transaction pricing fairness: PER-43/2010 on the implementation of the arm's-length principle on transactions between taxpayers with special relations; and PER-69/2010 on APAs. In 2011, PER-43/2010 was revised to PER-32/2011, which states that a fair price examination can use the most appropriate assessment method, and doesn't need to follow the hierarchy of techniques. These regulations were mainly adoptions of the OECD's guidelines — however, a lack of detail around their execution has often led to different interpretations.

In 2013, the government released the Ministry of Finance No.17/PMK.03/2013 regulation on investigation guidelines. Later, the DGT published regulation PER-22/PJ/2013 on inspection guidelines for taxpayers with special relations, as an advanced technical rule. This policy provides descriptions of special relations, and steps for conducting an examination of transfer-pricing practices. This regulation has had insignificant implementation. Table 2 shows the history of the regulation of transfer pricing in Indonesia.

Table 2: The history of transfer-pricing regulations in Indonesia²⁴

Year	Description
1983	Regulations concerning transfer pricing were contained in <i>Income Tax Law 1983</i> art 18(3).
1993	A DGT decree (KEP-01) was published as a guideline to audit transactions between entities with special relations. This was followed by a DGT Circular Letter (SE-04) to instruct on tackling transfer-pricing issues. Traditional methods were examined, such as comparable uncontrolled transactions ('CUPS'), the resale price method ('RPM') and the cost-plus method ('CPM').
2001	The revised <i>Tax Income Law 2000</i> art 18(3) described fair price examination methods, such as CUP, RPM, CPM, profit split, transaction net margin method, and others.
2007	A regulation was published to reveal transactions made under special relations on income tax annual notifications.

²⁴ Information sourced from a compilation of tax regulations on transfer pricing in Indonesia, as cited in the table.

2008	There was a minor change in the transfer-pricing regulation contained in the <i>Corporate Income Tax Law</i> .
2010	Various regulations were published concerning the examination of transactions conducted between entities with special relations:
	PER-43 The Implementation of the Arm's Length Principle on the Transactions between Taxpayers and Parties with Special Relations
	PER-48 on the Mutual Agreement Procedure
	PER-69 on the Advance Price Agreement
2011	PER-32/2011 revised PER-43, to regulate the selection of the examination method for fair price or profit.
2013	PER-22/PJ/2013 was enacted on the Guidelines for Examination of the Taxpayers with Special Relation.
2015	No.7/PMK.03/2015 concerning the Procedure for Advance Pricing Agreement
2016	Ministry of Finance Regulation No. 213/PMK.03/2016 was the basis for adopting the OECD Base Erosion and Profit Shifting ('BEPS') Action Plan 13 recommendations.

In reality, PER-43, which was published and revised to PER-32, was the first policy on transfer-pricing practices in Indonesia that provided steps for documenting prices on transactions with taxpayers' affiliated agencies. This policy also regulates the comparability analysis, the selection of the transfer-pricing method, fair price determination, other transfer documentation formats, as well as other aspects required by taxpayers and tax officers as guidelines.

According to the research by Kurniati on the implementation of transfer-pricing policies in Indonesia, particularly PER-43/2010 with the latest revision in PER-32/2011, various notes are revealed:²⁵

1. Special relations: transfer-pricing regulations and the *Income Tax Law* in Indonesia adopted the OECD description of special relations, stating that two entities are considered to have special relations if one entity invests in the other directly or indirectly with 25 per cent minimum shares.²⁶
2. The scope of transfer-pricing regulations: PER-43 contains details of transactions conducted by taxpayers with other parties under special relations; PER-32 focuses on transactions where there is a potential or motivation to generate profit from the different tax rates. This is not explicitly mentioned in the OECD *Model Tax Convention*.²⁷

²⁵ Kurniati (n 23) 63–79.

²⁶ OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration* (OECD Publishing, 2010) <<http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>>.

²⁷ OECD, *Model Tax Convention on Income and on Capital* (n 17).

3. The arm's-length principle: regulations in Indonesia adopted the arm's-length principle as a comparability analysis principle.
4. Comparability analysis: according to the OECD, 'comparable' refers to there being no material differences in the conditions of a transaction between affiliated parties and those of a transaction between independent parties.²⁸ If such differences exist, they can be eliminated with an accurate adjustment. The Indonesian regulations do not provide a clear distinction between 'equal' and 'comparable', as the two words are often used interchangeably. In contrast to the OECD, the transfer-pricing regulations in Indonesia do not yet provide step-by-step instructions for conducting comparability analyses that could facilitate taxpayers in implementing the arm's-length principle expected by the policy.
5. The selection of comparability analysis method: the OECD recommends selecting the most appropriate method. Initially, PER-43/2010 regulated that the method should be selected by hierarchy, but later on was revised (in PER-32) to recommend using the most appropriate method.²⁹
6. Service delivery: the OECD suggests that the fairness of a service delivery transaction is examined through its economic value, which could increase the position or commercial capacity of the service consumer.³⁰ The Indonesian regulations fully adopt this OECD regulation. PER-32 also mentions, however, that the transaction does not satisfy the arm's-length principle if it occurs only because of the existence of shareholders on a particular corporate ownership in one or several entities of the same company, similar to activities conducted solely upon the arrangement of a shareholders' meeting.
7. The cost contribution agreement: Indonesian regulations fully adopt the OECD guidelines, which emphasise the fair contribution values according to the transfer-pricing analysis. The Indonesian regulation PER-32 only emphasises the OECD principle, without describing the steps to be conducted to examine the fairness of the transactions.
8. The transfer-pricing documentation adopts the descriptions contained in the OECD guidelines.

In summary, according to various studies concerning the implementation of transfer-pricing regulations in Indonesia, the Indonesian regulations have adopted most of the OECD guidelines without any proportional adjustment in consideration of the economic

²⁸ OECD, *Transfer Pricing Guidelines 2010* (n 26) ch 3.

²⁹ According to OECD, *Transfer Pricing Guidelines 2010* (n 26), there are two general categories of assessment methods: the 'traditional transaction methods', consisting of CUP, RPM and CPM; and the 'transactional profit methods', consisting of the transactional net margin method and the profit split method. Following the OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 1995), selection of a transfer pricing assessment method was based on hierarchical principles, from the traditional methods down to the transactional profit methods. Since 2010, following the OECD *Transfer Pricing Guidelines 2010*, the selection of assessment method has been based on that most appropriate to a particular case.

³⁰ OECD *Transfer Pricing Guidelines 2010* (n 26) ch 7.

conditions and tax systems applicable in Indonesia. Moreover, the Indonesian regulations are not equipped with technical guidelines, which would be the first step to successful implementation of these regulations.

B The challenges of implementing transfer-pricing rules in Indonesia

1 Comparability analysis and the transfer-pricing audit process

In a self-assessment system, as adopted by Indonesia, the tax administrator has the authority to audit the transfer-pricing documentation reports, to determine whether they are reasonable or not in the context of the arm's-length principle, by using comparable data as an analysis tool. According to research by Irawan et al, transfer-pricing disputes in Indonesia began with the difference between the comparable data used by taxpayers and that used by the tax administration to assess the reasonability of transactions.³¹ The number of transfer-pricing cases seen in the tax court during 2012–13 due to the difference between comparable data used was high (see Table 3).

Table 3: Transfer-pricing disputes, by subject, in Indonesian tax court 2012–13³²

Subject of dispute	2013 (%)	2012 (%)
Documentation availability	1	0
Method of transfer pricing examination	9	16
Debt-to-equity ratio	9	8
Related party	17	5
Comparable data and arm's-length range	26	37
Substantial material dispute	44	34

An acceptable comparable dataset should meet the OECD's standard, wherein it should cover a wide range of transaction characteristics, economic conditions, business strategies and FAR (function, asset and risk) analyses, as well as other appropriate factors to justify that the data is reliable and valid.

However, several problems are commonly found when taxpayers are required to supply comparable data during the tax audit process:³³

- From a taxpayer perspective, tax auditors often do not really understand the nature of the taxpayer's business (the production process, the products and services produced), and insufficient comparable data used by tax auditors, and a lack of substantial discussion between auditors and taxpayers during the tax audit period, can lead to massive disputes. If the taxpayer produces products with highly specific

³¹ Romi Irawan, F Kihonia and B Bawono Kristiaji, 'Analisis Kesebandingan in Darussalam' in Darussalam and Kristiaji (eds) (n 6) 133.

³² Sourced from 'Tren Perdagangan Global dan Isu Transfer Pricing dalam: Proyek BEPS' (May 2016) 38 *Inside Tax* 69 <<https://ddtc.co.id/uploads/pdf/InsideTax-38th-Edition.pdf>>. The table is recreated by the author.

³³ This information is the summary of interviews with tax auditors from the DGT who are engaged in Foreign Investment Tax Offices, and tax consultants from PricewaterhouseCoopers Indonesia and the Center for Indonesia Taxation Analysis.

characteristics, they often cannot find the appropriate comparable data to make the tax audit fair. From the tax auditor's perspective, the taxpayer has not understood the transfer-pricing regulations and has under-disclosed transfer-pricing documentation.

- There is often a lack of reliable, comparable data available to be accessed by the tax auditor.
- The DGT has not released sufficient official guidelines on the selection of data to be used as comparable data for the purpose of transfer-pricing audits. In many cases, the tax auditor selects the data manually, based on their own justification.
- The tax auditor often has insufficient transfer-pricing knowledge for their analysis of controlled transactions compared with uncontrolled transactions in comparable circumstances, affected by direct and indirect factors.
- The tax auditor and the tax auditing team often lack supporting knowledge, for example, quantitative analysis and language fluency, to accomplish their technical work.
- Tax auditors have to meet transfer-pricing audit targets, as assigned by the DGT, which has led to messy and insufficient audits being performed.

There have been similar findings about transfer-pricing audits in Indonesia in other studies.³⁴ Table 4 shows a summary of findings with regards to transfer-pricing audit challenges.

Table 4: The challenges of transfer-pricing audits³⁵

Challenges due to the DGT internal targets	Limited time to perform tax audits, and therefore findings are made that are unreliable and invalid.
Challenges due to the DGT work-management issues	<ul style="list-style-type: none"> • Lack of time allocated for substantial discussions during the audit. • Lack of tax auditor transfer-pricing knowledge and other essential supporting knowledge to understand the taxpayer's business process and to deal with the tax audit work. • Work overload faced by the tax auditor to accomplish targets set by the DGT. • Lack of reliable and comparable data, references and access to information.
Challenges due to taxpayer behaviour	Reluctance to fully disclose information.

2 Availability of APAs

For countries that implement a self-assessment system, the availability of APAs is essential to minimise potential transfer-pricing disputes. APAs are intended to align the understanding of the taxpayer and the tax authority in determining the reasonable price

³⁴ Abdul Haris Mudammadi, Zahir Ahmed and Ahsan Habib, 'Multinational Transfer Pricing of Intangible Assets: Indonesian Tax Auditors' Perspectives' (2016) 24(2) *Asian Review of Accounting* 313.

³⁵ See above n 33 and accompanying text.

of transactions between related parties. In Indonesia, APAs were introduced in *Income Tax Law 2000*, however, the technical guidelines (DGT regulation PER-69/PJ/2010) were not released for another 10 years. An APA is valid for three years, and each year the taxpayer has to submit an annual compliance report. The APA is subject to review at the end of the third year. Table 5 shows the progress of APAs concluded up until 2018.

Table 5: Indonesia APA progress³⁶

Year	Request received	Request closed	Ending balance
Pre-2016	14	0	14
2016	25	3	36
2017	2	3	35
2018	13	15	33

'Request received' refers to how many APA applications were received in that year. 'Request closed' shows how many applicants reached an agreement in that year — the DGT states that there are two types of agreement indicated by 'request closed': agree to agree, and agree to disagree. 'Ending balance' indicates how many applicants were still in discussion with the DGT at the end of that year and would be carried forward into the next.³⁷

Based on empirical research, there are several factors, both internal and external of the tax authority, that lead to obstacles to concluding APAs in Indonesia:

- Internal factors:
 - No regulation on the timeframe for APA application approval, and no strong regulation ensuring that information submitted to the tax authority will be kept restricted. The people appointed to deal with the APA process are not engaged based on standardised operating procedures, and therefore the negotiation process commonly raises tensions, for example, about the determination of the roll-back period.
 - A lack of expertise and competence in dealing with transfer-pricing issues, and insufficient knowledge about taxpayers' business processes. No specific body within the tax authority has been designed, and therefore it is not well prepared for engaging with this problem.
 - A lack of coordination with other related institutions.
- External factors: the amount of time and resources it takes to apply for an APA, added to by a lack of certainty regarding the approval time of an APA application.

As a G20 member, the government of Indonesia signed the OECD BEPS Action Plan, particularly Action Plan 13 as a minimum standard, on 12 May 2016.³⁸ It then adopted the plan into its domestic regulations, in Ministry of Finance regulation No.7/PMK.03/2015 regarding the formation and implementation of an APA, and

³⁶ 'APA MAP', *Direktorat Jenderal Pajak* (Web Page, 2018) <<https://pajak.go.id/id/apa-map>>.

³⁷ Author interview with the DGT (March 2019).

³⁸ Trade Union Advisory Committee, OECD, *The Case for Making Country-by-Country Reporting Public* (OECD Publishing, 27 June 2016).

No.213/PMK.03/2016 ('PMK-213') on the types of document and/or additional information that should be kept by taxpayers who conduct transactions with parties under special relations.

3 *The adoption of BEPS Action Plan 13 country-by-country report in Indonesia*

With regards to the country-by-country reporting of transfer-pricing documentation, the OECD recommends that countries who participate and agree to the adoption of BEPS Action Plan 13 regulate the reporting of cross-jurisdictional transactions between divisions of a multinational enterprise using particular criteria.

The Ministry of Finance regulation PMK-213 was published in 2016 to regulate the types of documents and/or additional information required to be kept by taxpayers who conduct transactions with other parties under special relation (and the regulation includes implementation guidelines). This regulation later became a mandate for the DGT to implement regulation of transfer-pricing documentation.

The regulations in PMK-213 emphasise the obligation for three types of documentation:

- Master file: A document providing general information on the multinational company's business activities and its transfer-pricing determination policies.
- Local file: A document containing information on business activities, finances, and any affiliated transactions, including analyses of the inter-affiliate transactions.
- Country-by-country report: Documents compiled according to the format attached to the PMK-213. Each country report is a transfer-pricing document that contains income allocations, tax paid and business activities of all divisions of the enterprise, presented in special tables according to the appropriate international standard, and shared with other countries following the international tax agreement. Through this reciprocal information sharing, Indonesia will receive information from Indonesian taxpayers and their parent entities who reside in foreign countries pertaining to the countries/jurisdictions where the parent entities are located.

Each country report provides:

- information on income allocation, the tax paid and the business activities by each country/jurisdiction of all the divisions of the enterprise, within or outside the country
- lists of the entities and their main business activities by each country/jurisdiction
- relevant descriptions of each point.

The entities covered in each country report, which is called the constituent entity, consist of:

- the ultimate parent entity ('UPE')
- each entity within the parent entity included in the consolidated financial report of the parent entity (UPE or non-UPE) for financial reporting purposes
- each entity within the parent entity that is not included in the consolidated financial report of the parent entity considering their scale of business or materiality
- the permanent establishment.

Table 6 shows the rules for the entity in documenting transfer pricing.

Table 6: BEPS Action Plan 13 adoption in Indonesia transfer-pricing rules³⁹

Parent and local documents	
Transactions with parties under special relations with threshold limit	
Types of transactions	Threshold limit
Gross turnover in the previous year	More than IDR50,000,000,000
Transactions of tangible goods delivered in the previous year	More than IDR20,000,000
Transactions of services, royalties and other deliveries	More than IDR50,000,000
Transactions between parties with special relations located in the country with the lower tax rate	None
Taxpayers that are the parent entity, with IDR11 trillion gross consolidated turnover are also obliged to document transfer prices.	
The minimum information that should be available in the parent entity's document: <ol style="list-style-type: none"> 1. ownership structure and charts, country/jurisdiction of each entity 2. business activities conducted by the enterprise 3. intangible assets owned by the enterprise 4. the financial and cost activities of the enterprise 5. consolidated financial report of the parent entity and tax information pertaining to transactions between entities. 	
The minimum information required in the local entity's document: <ol style="list-style-type: none"> 1. identity and the business activities 2. affiliated and independent transactions 3. the implementation of the arm's-length principle 4. financial information of the taxpayers 5. events/incidents/non-financial facts that influence the price and profit determination level 6. consolidated financial report of the parent entity and tax information of the affiliated transactions. 	
Each country report	
Conducted by parent entities with a minimum IDR11 trillion gross consolidated turnover.	
If the parent entity is located in a foreign country, the entity in Indonesia is obliged to provide each country report, if the parent entity's jurisdiction: <ul style="list-style-type: none"> • does not require delivery of country reports 	

³⁹ Sourced from PGN Grup, *PMK No.213/PMK.03/2016: Penerapan dan Implikasinya bagi PGN Grup* (Presentation by Indonesia State Owned Enterprises on gas distribution, Jakarta, 2 February 2017) <http://www.iaiglobal.or.id/v03/files/file_publicasi/Implikasi%20PMK%20213%20bagi%20PGN%20Grup%20Revisi%20Final.pdf>.

- does not have an agreement with the Indonesian government on tax information sharing

has an agreement with the Indonesian government, but the country reports are not received from the foreign country.

The contents of each country report must include:

1. information on income allocations, tax paid and business activities of all entities of each country, including:
 - name of the country/jurisdiction
 - gross income earned, delineated from the group entity earnings and separated from the third party earnings
 - profit/loss before tax (including income and non-operational costs)
 - income tax deducted/collected/paid
 - income tax payable, not included in deferred tax
 - capital
 - accumulated retained profit
 - the number of permanent employees
 - the number of assets, cash and cash equivalent
2. list of the entities and their business activities by country

working papers on the information used to compile the report.

An interview between MUC Consulting Group and the Indonesian tax authorities revealed that there is a significant number of multinational companies based in Indonesia that should deliver the country-by-country report.⁴⁰ According to a rough estimation, there are hundreds of corporate taxpayers that are required to compile and deliver the report. This should encourage corporate taxpayers to be more transparent and show that the transactions conducted within their enterprise have followed the arm's-length principle. By doing this, the tax authority will be able to determine whether the affiliated transaction prices or profits are fair, and whether the level of tax payment is appropriate.

Furthermore, the tax authority states that the country-by-country report is applicable to entities with a parent entity located in a country/jurisdiction without a tax information sharing agreement with the Indonesian government. The Indonesian government could also request that the entity delivers the report if it is not received from a partner country that has signed the tax information sharing agreement. This is recognised as a secondary filing mechanism. If the entities that are obliged to deliver the reports fail to do so, they will be charged according to the applicable tax regulation.

Entrepreneurs appreciate the government's policy in adopting the BEPS Action Plan 13, particularly concerning the country-by-country reporting. The positive impact of this policy is that it initiates a transparency culture, and encourages monitoring of transactions more carefully according to the arm's-length principle. However, at the beginning of this policy enactment, taxpayers encountered challenges in delivering the reports, due to the lack of time between the policy announcement and the time for delivery. Moreover, the taxpayers' compliance costs increased as a result of the obligation to deliver the reports annually. Adding to the challenge, the PMK-213 regulation does not

⁴⁰ Interview with MUC Consulting Group (DGT, September 2018).

state whether the transfer-pricing documentation obligation is applicable to cross-border economic activities. This means that the policy covers domestic transactions, while the transfer-pricing determination in the context of tax obligation would be more relevant if conducted by domestic taxpayers or permanent establishments with foreign country taxpayer affiliates.⁴¹

This becomes more significant for national enterprises, such as state-owned enterprises ('SOEs'), in which most entities are located within one country. These companies have a very low possibility of conducting transfer pricing merely to avoid tax. On the other hand, for an entity, particularly within a SOE, to fulfill their reporting obligations, an adjustment is required to the price determination in transfer-pricing documentation, and a special team is needed to perform various functions.⁴² This has led to technical challenges. Cost of compliance will increase due to the unavailability of comparable data that is generally applicable and standardised, as recommended by the OECD, to fulfill the fair documentation obligation. Moreover, there is no explanation of safe harbour provisions that differentiate corporate taxpayers from the low-risk sector, which will eventually lead to an increase in material and non-material costs paid by the taxpayers, particularly the non-compliant taxpayers. Furthermore, keeping the information confidential and encouraging taxpayers to fulfill their obligations according to the policy has become another challenge for the tax authority.⁴³ A brief description below provides a case study on how China implemented transfer-pricing policy and adopted the BEPS Action Plan into their domestic policies. This could become a benchmark for the government of Indonesia to aspire to and improve their domestic policies.

4 Lesson learned: Transfer-pricing regulations in China

China is a G20 member and a member of BRICS (Brazil, Russia, India, China and South Africa), which has implemented transfer-pricing policy and adopted the BEPS Action Plan 13. From a law perspective, like Indonesia, China also committed to the civil law, where the law system is affected by various customs. From an economic perspective, China is a capital-importing country with an enormous population and a vast area.

Research conducted by Wardhana reveals that, historically, there were three transfer-pricing policy implementation stages in China. The first stage was the pilot programme, started in the 1980s, followed by transfer-pricing legislation development in the 1990s, and a very strict transfer-pricing regime in 2007. The policy development during the pilot programme era was a response to the openness of investment opportunities that occurred in 1988, where the policy was aimed to minimise the aggressive tax planning and profit shifting from China to other countries.⁴⁴

At the second stage, the China State Tax Administration released a national policy, targeted to each local government's authority, to implement the transfer-pricing policy. During this stage, transfer-pricing legislation was introduced, as part of the income tax

⁴¹ Center for Indonesia Taxation Analysis, 'Transfer Pricing Public Discussion' (January 2017).

⁴² PGN Grup (n 39).

⁴³ M Darmawan Saputra, 'Implikasi BEPS 13 Terhadap Aturan TP Doc di Indonesia' (Danny Darussalam Tax Center, 20 February 2017).

⁴⁴ A Wardhana, 'Legislative Reform Proposals to Address Aggressive Transfer Pricing: A Comparative Study of Indonesia and China' (Dissertation Research, Queensland University of Technology, 2017).

policy, known as the *Income Tax Law of the People's Republic of China for Enterprise with Foreign Investment and Foreign Enterprises*, which was implemented in 1991. Also during this stage, the arm's-length principle was introduced, along with how to conduct the adjustment on the transfer pricing if it did not follow the applicable policies. The transfer-pricing policy included complete guidelines and how to implement the policies by each party. Wardhana emphasised that, in this period, the transfer-pricing policy in China was sufficiently comprehensive.⁴⁵

During the perfection era in 2007, the transfer-pricing policy in China adopted the adjustment of cost-sharing arrangements, thin capitalisation, controlled foreign corporations and general anti-avoidance rules. The China tax authority also provided statistical data to monitor multinational corporate business activities, profit reporting according to the regional location, types of industries, and multinational company entities that generated low income from China. Although the government of China adopted the OECD policy on transfer-pricing documentation, the government also modified the domestic policy due to their vast geographical area, the variation of the economic conditions, and the variation of the types of markets. The available comparable data was arranged to fit these conditions. China was one of the countries that had a decent transfer-pricing policy at that moment, despite the various challenges pertaining to the technical issues on transaction auditing, such as price quantification and allocation in relation to location-specific advantages.

Like Indonesia, China has also adopted the BEPS Action Plan 13 into their domestic policy, including the master file, local file and country-by-country reporting documentation policies. Ernst & Young of China published that the issues concerning the implementation of country-by-country reporting in China are around value chain analysis, location-specific advantages, and effective tax rate disclosures. However, the government of China has adjusted the criteria around the types of entities that are obliged to document their reports completely or in part, according to an examination of the purpose of each entity, as well as the contents of each report. For example, for the local file submission, the tax authority requires entities that are part of a multinational enterprise to disclose their contribution to their enterprise's global value chain. Thus, this obligation leads entities to provide information about the amount of profit attributed to the multinational enterprise, and show the China division's value creation and contribution to location-saving advantages.

In addition, the China tax authority strongly encourages China-based entities of a multinational enterprise to provide analysis and adjustment based on the creation of local intangibles and contribution to location-saving advantages to the value of the enterprise's intangibles and restructuring activities during the year. Certain entities are obliged to disclose the flow of goods and funds, and the flow in relation to value creation, and whether it contributes to initial goods design, development processes, production, marketing, delivery or after-sales services. This requirement is part of the tax authority's

⁴⁵ Ibid.

efforts to guide the taxpayer to perform more transparent disclosure on cross-border transactions between related parties.⁴⁶

V CONCLUSION

Transfer pricing is a global issue that has become a concern for many countries, particularly with regards to minimising tax base erosion and avoiding profit shifting, which is commonly conducted by multinational companies. Various theories and methods to examine the practice of the arm's-length principle have been published and introduced by various institutions from academic and non-academic sectors. This represents how it affects the tax system, particularly related to the fairness of the amount of tax that should be paid by a business entity in a particular jurisdiction.

The transfer-pricing policy in Indonesia is not a new thing. Since the tax reforms in 1983, Indonesia has included this policy in its *Income Tax Law*. However, how to implement this policy in the practices of taxpayers and the tax authority remains a material discussion between stakeholders. The technical guidelines of transfer-pricing implementation in Indonesia were only published in 2010, with revisions in 2011, in response to the increased popularity of transfer-pricing practices, which were reducing the tax base in Indonesia. However, the policy was not yet developed with a strong legal basis, but only in the form of a regulation of the DGT, despite the vital function of the tax for government finances.⁴⁷ The Indonesian government's efforts to tackle transfer-pricing issues have been admirable, but the government still needs to improve tax regulations so that the issue attains more consideration and significance within the Indonesian tax system.

Indonesia's commitment, as a member of G20, to adopting the BEPS Action Plan 13, followed by the enactment of PMK-213 on transfer-pricing documentation reporting, should also be appreciated. However, there are still many things to consider for further improvement. What modifications are needed concerning the adoption of the BEPS Action Plan into Indonesian domestic regulations can be taken from what has been done by the government of China, such as considering other factors besides technical aspects, for instance, location savings, market premiums and the possibility of using other methods besides the common method. Should the tax authority adapt its structure and focus on the skills development of its workers, to aid in implementation of PMK-213? Should transfer-pricing documentation between affiliated taxpayers located within the same country be necessary? Should there be a space for safe harbour and low-risk transaction policies, as well as the availability of standardised comparable data prepared by the government? Should the government provide more detailed instructions on how

⁴⁶ KPMG International Tax Review, *China: Looking Ahead* (Tax Reference Library 111, 6th ed, 2018) 18–23 <<https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2016/12/China-Looking-Ahead-ITR-201601.pdf>>.

⁴⁷ The Indonesia legislation system has a hierarchy, and the higher the placement of a rule in the hierarchy, the more importance it has. The hierarchy is as follows: (i) laws and government regulations in lieu of a law; (ii) government regulations; (iii) presidential regulations; (iv) minister regulations; (v) provincial regulations; and (vi) regional/local government regulations (refers to Law No 12 2012, concerning drafting the rule or 'Pembentukan Peraturan Perundang-undangan'). The DGT regulations are only the technical implementation guidelines of the Ministry of Finance regulations. Before the release of PMK-213 in 2016, transfer pricing rules were governed only by the DGT, even though transfer pricing is one of most important issues to Indonesian government revenue sustainability.

to implement the policies in a systematic way? The availability of more comprehensive policies, under the appropriate law, will ensure enforcement for taxpayers and the tax authority. This could reduce taxpayers' compliance costs and improve compliance to transfer-pricing documentation delivery, while minimising potential disputes.

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KEY EMPLOYABILITY SKILLS REQUIRED OF TAX ACCOUNTANTS

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ABSTRACT

Over the past three decades, numerous studies have addressed the importance of generic skills and have focused on the broad category of employability skills for accountants, without differentiating between the various types of occupations within the accounting profession. As an extension and contribution to this literature, this study examines the key employability competencies or skills required by employers of tax accountants. We conducted a content analysis of skills specified in job advertisements over a 12-month period in Australia and New Zealand. The results show that personal and interpersonal skills were the most frequently mentioned in advertisements for tax accountants. These findings are generally consistent with prior studies, and tax educators should continuously consider ways to help graduates develop these skills.

Keywords: Job advertisements; Tax; Skills; Competencies.

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I INTRODUCTION

With rapid changes in digital technologies and the globalisation of economies, employers are looking for recruits who not only have technical knowledge but also possess relevant employability or non-technical skills, such as interpersonal and organisational skills.¹ Employability has therefore become an ongoing issue for several stakeholders, including governments, professional bodies, employers, educators and graduating students worldwide.²

Employability can be defined as

a set of achievements — skills, understandings and personal attributes — that makes graduates more likely to gain employment and be successful in their chosen occupations, which benefits themselves, the workforce, the community and the economy.³

At the tertiary education level, the literature on the generic employability skills expected of accounting graduates, irrespective of their speciality within the discipline (for example, taxation, audits, accounting, and so on), suggests accounting programmes are failing to meet the expectations and needs of employers.⁴

Although there is general consensus among academics that employability skills need to be developed in the curriculum,⁵ it is a challenge to identify not only what but also how to incorporate the development and assessment of a wide range of employability skills. Educators are also constrained by insufficient time available to assist students in developing these skills, as the accounting (and tax) curriculum is already crowded with the required technical content.⁶ Another constraint is the lack of expertise and resources in assisting students with skills development. Universities that prioritise recognising and rewarding research over teaching could also have an adverse effect on academics' enthusiasm in teaching and students' learning.⁷ There have been further suggestions that

¹ International Accounting Education Standards Board ('IAESB'), *International Education Standard (IES): Initial Professional Development — Professional Skills (Revised)* (2014).

² Binh Bui and Brenda Porter, 'The Expectation-Performance Gap in Accounting Education: An Exploratory Study' (2010) 19(1) *Accounting Education* 23.

³ Mantz Yorke, *Employability in Higher Education: What It Is — What It Is Not* (Higher Education Academy, 2006).

⁴ Bui and Porter (n 2); 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.

⁵ Kim Watty, 'Generic Skills within the Accounting Curriculum' in Richard Wilson (ed), *The Routledge Companion to Accounting Education* (Routledge, 2014) 276.

⁶ Greg Stoner and Margaret Milner, 'Embedding Generic Employability Skills in an Accounting Degree: Development and Impediments' in Kim Watty, Beverley Jackling and Richard Wilson (eds), *Personal Transferable Skills in Accounting Education* (Routledge, 2012) 121; Lesley Willcoxson, Monte Wynder and Gregory Laing, 'A Whole-of-Program Approach to the Development of Generic and Professional Skills in a University Accounting Program' (2010) 19(1-2) *Accounting Education* 65.

⁷ Brett Freudenberg and Lisa Samarkovski, 'Enthusiasm and the Effective Modern Academic' (2014) 56(1) *Australian Universities Review* 22.

some generic skills are best developed and applied in the workplace, rather than taught in a university environment.⁸

As it is not practical to develop and assess all generic skills, educators perhaps need to prioritise the particular skills deemed to be most important in the workplace. The workplace could be a small, medium or large firm, and different sized firms may regard certain skills as more important than others. For instance, Hayes et al found that the majority of Australian small to medium accounting ('SMA') firms placed more emphasis than larger firms on technical skills like tax knowledge and the ability to use tax software.⁹ However, no differences were found between SMA and large firms' skills expectations in a New Zealand study carried out by Lowe et al.¹⁰

Jackling and de Lange noted that, as the global economy evolves, it is essential to continuously ascertain and articulate employers' opinions on what makes graduates employable, so that educators are kept abreast of the most valued workplace skills and attributes.¹¹ However, over the past three decades, numerous studies on important generic skills have focused on a broad range of employability skills in accounting, without differentiating its disciplines or providing more information about various job occupations within one discipline, such as tax.¹² As an extension and contribution to the literature, our study focuses on the skills required of tax accountants.¹³

Tax accountants are very much in demand, as many businesses and individuals rely on them for advice on their tax matters, particularly as tax law increases in complexity.¹⁴ In the OECD report on tax administration,¹⁵ about 74 per cent of personal income tax returns and 90 per cent of corporate tax returns in Australia in 2013 were prepared with the assistance of tax professionals. Similarly, the OECD report noted that tax professionals filed about 67 per cent of personal tax returns and 75 per cent of corporate tax returns in New Zealand in 2013.

In identifying the skills required of a tax accountant in the workplace, this study provides additional insights, particularly for tax educators, into employers' demands for

⁸ Reva Brown and Sean McCartney, 'Competence Is Not Enough: Meta-Competence and Accounting Education' (1995) 4(1) *Accounting Education: An International Journal* 43; Jeanette Purcell, 'National Vocational Qualifications and Competence-Based Assessment for Technicians: From Sound Principles to Dogma' (2001) 43(1) *Education and Training* 30.

⁹ Sharon Hayes, Brett Freudenberg and Deborah Delaney, 'Role of Tax Knowledge and Skills: What Are the Graduate Skills Required by Small to Medium Accounting Firms' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 152.

¹⁰ Mary Low et al, 'Accounting Employers' Expectations — The Ideal Accounting Graduates' (2016) 10(1) *e-Journal of Business Education & Scholarship of Teaching* 36.

¹¹ Jackling and De Lange (n 4).

¹² Willcoxson, Wynder and Laing (n 6).

¹³ Accountants are involved in many different types of work, including financial accounting and reporting, management accounting, auditing and tax work. The term 'tax accountants' used in this article refers to those who are involved in tax work.

¹⁴ Lin Mei Tan, 'Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination' (1999) 20(4) *Journal of Economic Psychology* 431; Teresa Stephenson, 'Do Clients Share Preparers' Self-Assessment of the Extent to Which They Advocate for Their Clients?' (2007) 21(4) *Accounting Horizons* 411; OECD, *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies* (OECD Publishing, 2015).

¹⁵ OECD (n 14).

employability skills, and assists in identifying the essential skills that need to be developed in the tax curriculum. Students with an interest in tax should also be aware of the skills that are in demand, and be proactive in developing them to become employable and add value to their future employers.¹⁶ Furthermore, the findings will be of interest to accounting professional bodies, as their professional programmes are aimed at developing the skills required by employers and ensuring their new members can develop successful professional careers.

Unlike most prior studies, which use the conventional methods of focus groups, interviews and surveys,¹⁷ we conducted a comprehensive content analysis of job advertisements, as they provide useful information about employers' demands for skills and competencies when recruiting staff for tax work. As indicated by Kennan et al, they provide a window to the skills that employers are looking for, and those skills they believe are needed for the organisation to continue and thrive.¹⁸ The content analysis examined the words and phrases used in the job advertisements, thereby providing more comprehensive information about the skills employers are seeking in recruiting accountants for tax work.

This paper is organised in the following manner. The next section provides an overview of the literature on employability skills and prior research focusing on the tax discipline. This is followed by a discussion of the framework used in this study. The research method and findings are then presented, discussed and summarised. The final sections provide the implications for tax educators, the limitations of the study and the conclusion.

II LITERATURE REVIEW

A Employability skills

There is a wide range of terms and meanings used to denote employability skills, including generic skills, non-technical skills, enterprise skills, key competencies, personal transferable skills, and soft skills and attributes. They are considered relevant to both entry-level and established employees.¹⁹ For instance, employability skills have been defined as 'the non-technical skills required to effectively participate in the workplace'.²⁰ Further, Brewer points out that 'employability entails much more than the ability to get

¹⁶ See also Yorke (n 3), who also pointed out the need to 'facilitate the development in students of the understandings, skills and attributes that will help them to make a success of their careers'.

¹⁷ Jackling and De Lange (n 4); Marie Kavanagh and Lyndal Drennan, 'What Skills and Attributes Does an Accounting Graduate Need? Evidence from Student Perceptions and Employer Expectations' (2008) 48(2) *Accounting and Finance* 279; Watty, Jackling and Wilson (n 6).

¹⁸ Mary Kennan et al, 'IS Knowledge and Skills Sought by Employers: A Content Analysis of Australian IS Early Career Online Job Advertisements' (2009) 15(2) *Australasian Journal of Information Systems* 169.

¹⁹ Chartered Accountants Australia and New Zealand ('CAANZ'), *The Future of Talent: Opportunities Unlimited* (2017); 'Core Skills for Work Developmental Framework', *Department of Employment, Skills, Small and Family Business, Australian Government* (Web Page, 25 July 2019) <<https://www.employment.gov.au/core-skills-for-work-developmental-framework>>; Brendan O'Connell et al, *Shaping the Future of Accounting in Business Education in Australia* (CPA Australia, 2015); Watty, Jackling and Wilson (n 6).

²⁰ Department of Education, Employment and Workplace Relations, Australian Government, *Employability Skills Framework Stage 1 — Final Report* (2012) 2.

that first job. It is having the capacity to network and market oneself, navigate through a career and remain employable throughout life.²¹ Furthermore, skills required could be context or discipline specific, and they may change over time as the nature of work changes.

Since the mid-1980s, the literature on employability skills has expanded in many countries (for example, the UK, US, Australia and New Zealand), indicating that the issue is not particular to a single country but is a growing concern worldwide across all disciplines as employers express their desire for recruits with relevant employability skills. Tertiary education institutions in countries like Australia and New Zealand are also facing increasing pressure from the government, the funder of these institutions, to produce employable graduates.²² In New Zealand, for instance, universities are now required to provide information about where their graduates are employed and how much they are earning. This is to ensure that the skills graduates develop in tertiary education are well matched to labour market needs and therefore contribute to economic growth and improvement.²³

There are several employability skill frameworks that identify non-technical skills, which are developed by the government, business communities, professional bodies and academics. For instance, the Australian Qualifications Framework and the New Zealand Qualifications Framework provide the standards for Australian and New Zealand qualifications, and the skills required are phrased in terms of learning outcomes. Graduates with an Australian bachelor degree will have: the cognitive skills to review critically, analyse, consolidate and synthesise knowledge; the cognitive and technical skills to demonstrate a broad understanding of knowledge, with depth in some areas; the cognitive and creative skills to exercise critical thinking and judgement in identifying and solving problems with intellectual independence; and the communication skills to present a clear, coherent and independent exposition of knowledge and ideas.²⁴ Another framework, the Core Skills for Work Developmental Framework funded by the Australian government, provides some guidance in teaching employability skills in a structured manner.²⁵ It was developed with input from employers, with the intention of making more clear and explicit the non-technical skills required for successful participation in work. Ten skill areas were identified that fall under the umbrella of three skill clusters:

1. navigate the world of work (manage career and work life, work with roles, rights and protocols)
2. interact with others (communicate for work, connect and work with others, recognise and utilise diverse perspectives)

²¹ Laura Brewer, *Enhancing Youth Employability: What? Why? and How? Guide to Core Work Skills* (Skills and Employability Department, International Labour Organization, 2013).

²² Willcoxson, Wynder and Laing (n 6).

²³ See Yorke (n 3); 'Tertiary Education Strategy 2014–2019', *Ministry of Education, New Zealand Government* (Web Page, 30 January 2018) <<http://www.education.govt.nz/further-education/policies-and-strategies/tertiary-education-strategy>>.

²⁴ Australian Qualifications Framework Council, *Australian Qualifications Framework* (2nd ed, 2013) <<http://www.aqf.edu.au/wp-content/uploads/2013/05/AQF-2nd-Edition-January-2013.pdf>>.

²⁵ 'Core Skills for Work Developmental Framework' (n 19).

3. get the work done (plan and organise, make decisions, identify and solve problems, create and innovate, work in a digital world).

The New Zealand Qualifications Framework states that a graduate with a bachelor degree is able to: demonstrate intellectual independence, critical thinking and analytic rigour; engage in self-directed learning; demonstrate knowledge and skills related to the ideas, principles, concepts, chief research methods and problem-solving techniques of a recognised major subject; demonstrate the skills needed to acquire, understand and assess information from a range of sources; and demonstrate communication and collaborative skills.²⁶

The accounting professions in different countries also have their own skills frameworks. In the US, the American Institute of Certified Public Accountants ('AICPA') Core Competency Framework for entry into the accounting profession (issued in 1999) reflects a paradigm shift from a content-driven to a skills-based curriculum.²⁷ Important skills were considered under three broad categories: functional (technical); personal (values and attributes); and broad business perspectives (in both internal and external business contexts). To meet the challenges of the changing environment in which professional accountants work, the revised International Education Standard 3 ('IES 3') (*Initial Professional Development — Professional Skills*) came into effect on 1 July 2015 and expects that International Federation of Accountants member bodies design their professional accounting education programmes so that graduates achieve an intermediate level of proficiency in various professional skills.²⁸ The skills to demonstrate professional competence are considered under four broad categories: intellectual; interpersonal and communication; personal and organisational (which a professional accountant needs to integrate with technical competence); and professional values, ethics and attitudes. In this light, O'Connell et al pointed out that academics play a key role in delivering initial professional development, whereas an employer's role is to help in nurturing the professional development of accounting graduates.²⁹

In Australia and New Zealand, Birkett developed a set of competency-based standards for professional accountants, which were ultimately adopted by the major Australian and New Zealand accounting bodies (CPA Australia, Institute of Chartered Accountants in Australia and New Zealand Institute of Chartered Accountants).³⁰ Birkett's taxonomy of skills comprises two main groups: cognitive and behavioural.³¹ He identified three dimensions of cognitive skill (technical, analytic/constructive and appreciative), and a further three dimensions of behavioural skill (personal, interpersonal and organisational).³² Birkett noted that 'professional work requires action, supported by

²⁶ 'Bachelor's Degree', *New Zealand Qualifications Authority* (Web Page) <<http://www.nzqa.govt.nz/studying-in-new-zealand/understand-nz-quals/bachelors-degree>>.

²⁷ Peggy Hite and John Hasseldine, 'A Primer on Tax Education in the United States of America' (2001) 10(1) *Accounting Education* 3.

²⁸ IAESB (n 1).

²⁹ O'Connell et al (n 19).

³⁰ William Birkett, *Competency Based Standards for Professional Accountants in Australia and New Zealand* (Australian Society of Certified Practising Accountants, Institute of Chartered Accountants in Australia and the New Zealand Society of Accountants, 1993).

³¹ *Ibid.*

³² See Section III for further discussions of these skills.

decision processes; it involves the exercise of instrumental skills, supported by intellectual skills'.³³ He suggested that both cognitive and behavioural skills are likely to parallel typical patterns of career progression — with technical and personal skills drawn on initially, then analytic/constructive and interpersonal skills, with appreciative and organisational skills coming to the fore at more advanced career stages.

However, prior studies on the important employability skills required of accounting graduates do not always adopt a skills framework. Many studies on skills examine diverse groups, such as academics/educators, employers, professional accounting bodies and students/graduates.³⁴ Data about skills is normally collected from focus groups, interviews, or postal/online surveys.³⁵ The findings suggest several skills are important, but personal, interpersonal and intellectual abilities usually rank highly.³⁶ For example, communication and interpersonal skills are generally rated by employers as the most important skills.³⁷ The ability to use software such as Microsoft Excel[®], Windows[®], and word-processing and spreadsheet packages is also in high demand.³⁸ Nevertheless, the ranking of individual skills varies for different groups of graduates/students and educators/employers.³⁹ For example, employers rate working independently highly, in contrast to academics who rate teamwork and communication skills as more important. The study on graduates by De Lange et al found significant expectation gaps, particularly in interpersonal skills, oral expression and computing/information technology skills.⁴⁰ With regard to technological skills, Rackliffe and Ragland pointed out that there is a possible disconnect between the Excel skills needed in practice and those developed in accounting education.⁴¹ Bui and Porter's study showed that there are differences in educators' and employers' perceptions of the knowledge, skills and competencies required of graduates.⁴² Employers, in particular, have expressed their disappointment

³³ Birkett (n 30).

³⁴ See, for example, Bui and Porter (n 2); Paul De Lange, Beverley Jackling and Anne-Marie Gut, 'Accounting Graduates' Perceptions of Skills Emphasis in Undergraduate Courses: An Investigation from Two Victorian Universities' (2006) 46 *Accounting and Finance* 365; Kavanagh and Drennan (n 17); Monica Keneley and Beverley Jackling, 'The Acquisition of Generic Skills of Culturally-Diverse Student Cohort' (2011) 20(6) *Accounting Education: An International Journal* 605; Gary Spraakman et al, 'Employers' Perceptions of Information Technology Competency Requirements for Management Accounting Graduates' (2015) 24(5) *Accounting Education* 403; Graham Morgan, 'Communication Skills Required by Accounting Graduates: Practitioner and Academic Perceptions' (1997) 6(2) *Accounting Education* 93; O'Connell et al (n 19); Watty (n 5); Watty, Jackling and Wilson (n 6); Paul Wells et al, 'Professional Skills and Capabilities of Accounting Graduates: The New Zealand Expectation Gap?' (2009) 18(4) *Accounting Education* 403.

³⁵ See Jackling and De Lange (n 4); Kavanagh and Drennan (n 17); Watty, Jackling and Wilson (n 6).

³⁶ For example, De Lange, Jackling and Gut (n 34); Wells et al (n 34). For a summary of generic skills used in accounting education research, see Watty (n 5).

³⁷ See, for example, Linda Johnson and Van Johnson, 'Help Wanted — Accountant: What the Classifieds Say about Employers' Expectations' (1995) 70 *Journal of Education for Business* 130; Morgan (n 34).

³⁸ Sharon Burnett, 'The Future of Accounting Education: A Regional Perspective' (2003) 78 *Journal of Education for Business* 129; Johnson and Johnson (n 37).

³⁹ See Kavanagh and Drennan (n 17); Lin Mei Tan, Michael Fowler and Lindsay Hawkes, 'Management Accounting Curricula: Striking a Balance between the Views of Educators and Practitioners' (2004) 13(1) *Accounting Education* 51.

⁴⁰ De Lange, Jackling and Gut (n 34).

⁴¹ Usha Rackliffe and Linda Ragland, 'Excel in the Accounting Curriculum: Perceptions from Accounting Professors' (2016) 25(2) *Accounting Education* 139.

⁴² Bui and Porter (n 2).

that the new graduates they have employed lack numerous essential skills, or do not match their expectations.⁴³ A study by Wells et al indicated a gap exists between expectations of graduates and what university course programmes are providing in New Zealand universities.⁴⁴ The greatest gap identified by graduates, employers and academics is the development of team skills.⁴⁵

Overall, it appears that accounting educators recognise the importance of assisting graduates to develop certain employability skills, but their expectations are different from those of employers and graduates. As there are very few studies that focus on skills required by employers to perform tax work, this study raises the question: 'What are the essential skills that employers look for in recruiting tax workers?' Employers that look for recruits to do tax work can be accounting firms or non-accounting firms. In Tan's study on the tax practitioner-client relationship, 71 per cent of her sampled firms indicated that they spent 50 per cent or more of their time in tax work.⁴⁶ In a study by Hayes et al on graduate skills required by SMA firms, most of the firms in their study were involved in tax compliance work apart from other non-tax work.⁴⁷

B Tax discipline

Taxation is a subject that is usually embedded within accounting and law degrees at tertiary institutions.⁴⁸ Students with an interest in taxation or those aiming to be tax professionals in the future usually enrol in more than one taxation course. Although strong technical knowledge of tax law is vital, tertiary institutions that merely equip students with technical knowledge are no longer the norm due to the many calls in the last 30 years for university programmes to help students develop the required generic workplace skills.⁴⁹

However, there is little literature that examines the employability skills required for those who have an interest in tax work. Earlier studies in the tax discipline tend to focus on instructional styles and the common body of tax knowledge required in

⁴³ Phil Hancock et al, *Accounting for the Future: More than Numbers* (Final Report, Australian Learning and Teaching Council, 2009) vol 1; Kavanagh and Drennan (n 17); CAANZ (n 19).

⁴⁴ Wells et al (n 34).

⁴⁵ See, for example, De Lange, Jackling and Gut (n 34); Department of Employment, Education and Training ('DEET'), Australian Government, *Accounting in Higher Education: Report of the Review of the Accounting Discipline in Higher Education* (1990) vol 1; Beverley Oliver et al, 'Accounting Graduates and the Capabilities that Count: Perceptions of Graduates, Employers and Accounting Academics in Four Australian Universities' (2011) 2(1) *Journal of Teaching and Learning for Graduate Employability* 2.

⁴⁶ Lin Mei Tan, 'Towards an Understanding of the Tax Practitioner-Client Role Relationship: A Role Analysis' (PhD Thesis, Australian National University, July 2009).

⁴⁷ See Hayes, Freudenberg and Delaney (n 9).

⁴⁸ 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. For a brief discussion of the CPA Australia and CAANZ accreditation requirements, which now include an undergraduate tax course, see Hayes, Freudenberg and Delaney (n 9).

⁴⁹ Anne Christensen and Angela Woodland, 'Is Participation in the Volunteer Income Tax Assistance (VITA) Program Associated with Students' Problem-Solving Skills and Professional Commitment?' (2016) 31(1) *Issues in Accounting Education* 71; Paul Kenny et al, 'Improving the Students' Tax Experience: A Team-Based Learning Approach for Undergraduate Accounting Students' (2015) 10(1) *Journal of the Australasian Tax Teachers Association* 43.

undergraduate accounting programmes, with very little focus on employability skills.⁵⁰ For instance, an early study by Boley and Wilkie asked public accounting practitioners in the US to indicate the minimum tax knowledge that should be possessed by all entry-level graduates in public accounting.⁵¹ Their results showed high rankings were given to hybrid tax/financial accounting and compliance/practice skills topics, and an unexpectedly low ranking was assigned to computer usage.

Interestingly, another study by Arlinghaus and Salzarulo indicated that tax professionals in the US generally rate technical tax skills (tax research, technical tax knowledge, computer applications, familiarity with code and regulations) as more appropriately developed through on-the-job training.⁵² Schwartz and Stout's study on the educational preparation needed for entry-level tax positions showed that, compared to tax educators, practitioners have a greater preference for practical-based teaching methods, suggesting the need for educators to be aware of what employers desire in order to narrow the expectation gap.⁵³ Stara et al reported that practitioners rank the following as the top three (out of nine) important skills in graduate tax courses: the ability to conduct tax research; tax issue identification; and understanding tax code, regulations and cases.⁵⁴ The next three skills ranked as important are written communication skills, fact gathering for tax engagement, and tax ethics. Practitioners perceive that these skills will help entry-level graduates to perform simple or complex tax engagements early in their careers. The three lowest-ranked skills are oral presentation skills, computer applications and tax return preparations.

In view of the debate on the curriculum and skills that should be covered in tax courses, the AICPA established a Model Tax Curriculum Task Force in 1999, to provide tax educators with some guidance into skills development in taxation courses.⁵⁵ The AICPA further indicated that the critical skills that should be a part of tax education include oral and written communication, critical problem-solving, use of technology, interpersonal skills, business and professional ethical considerations and team building.⁵⁶ The Model Tax Curriculum and the AICPA Core Competency Framework,⁵⁷ therefore, support a

⁵⁰ Philip Siegel, Mark Persellin and John Rigsby, 'The Relation between Graduate Tax Education and Professional Performance' (1992) 14(2) *Journal of the American Taxation Association* 134; Lin Mei Tan and Frances Chua, 'Tax Ethics Education in New Zealand Tertiary Institutions: A Preliminary Study' (2000) 9(3) *Accounting Education: An International Journal* 259; Craner and Lymer (n 48).

⁵¹ Richard Boley and Patrick Wilkie, 'Practitioners' View of the Common Body of Tax Knowledge for Persons Entering Public Accounting' (1986) 8(1) *Journal of the American Taxation Association* 80.

⁵² Barry Arlinghaus and W Peter Salzarulo, 'The Importance of Post-Baccalaureate Education for Tax Professionals' (1986) 17 *Akron Business and Economic Review* 8.

⁵³ Bill Schwartz and David Stout, 'A Comparison of Practitioner and Educator Opinions on Tax Education Requirements for Undergraduate Accounting Majors' (1987) 2(1) *Issues in Accounting Education* 112.

⁵⁴ Nancy Stara, Paul Shoemaker and James Brown, 'The Curriculum Required to Develop a Tax Specialist: A Comparison of Practitioner Opinions with Current Programs' (1991) 9 *Journal of Accounting Education* 79.

⁵⁵ The latest revision was made in 2014 in collaboration with the American Taxation Association. See 'Tax Education Resources for Students and Teachers', AICPA (Web Page, 2 August 2018) <<http://www.aicpa.org/InterestAreas/Tax/Careers/Pages/tax-education-resources-for-students-and-teachers.aspx>>.

⁵⁶ Hite and Hasseldine (n 27).

⁵⁷ AICPA, *AICPA Pre-Certification Core Competency Framework: Reference Guide* (2018) <<https://www.aicpa.org/content/dam/aicpa/interestareas/accountingeducation/resources/downloadabledocuments/aicpa-pre-certification-core-competency-framework.pdf>>.

skills-based curriculum and enhance lifelong learning, although Hite and Hasseldine noted that it will be challenging for tax educators to groom students to meet the profession's demand for dynamic competencies in the various skills.⁵⁸

In the UK, Miller and Woods questioned the future direction of taxation teaching within UK undergraduate programmes.⁵⁹ Their study showed that there is a gap between employers' expectations and the tax knowledge covered in tax courses at university.⁶⁰ The expectations of employers and educators also differ on interpersonal and writing skills. Interestingly, the ability to use software is not ranked highly in practitioners and educators' expectations, whereas the ability to perform computation is considered to be a very important skill.

There are few studies that focus on tax education and development of skills in the tax curriculum in Australia and New Zealand. An early study by Hasseldine and Neale on Australian and New Zealand tertiary institutions showed that tax education tends to cover aspects that are more procedural than conceptual.⁶¹ Another New Zealand study by Tan and Veal found that educators and practitioners agree that a higher level of conceptual understanding, as compared to technical proficiency, is required.⁶²

Other studies have focused on the pedagogical and work-integrated learning approaches — the practice of combining traditional academic study with student exposure to the real world — that educators use in or outside the classroom to develop skills such as communication, problem-solving, critical thinking, teamwork, lifelong learning skills, and moral reasoning, with the use of teamwork and case studies/scenarios/short stories.⁶³ These studies did not set out to explore the skills that employers look for in their recruitment for people to perform tax work.

⁵⁸ Hite and Hasseldine (n 27).

⁵⁹ Angharad Miller and Christine Woods, 'Undergraduate Tax Education: A Comparison of Educators' and Employers' Perceptions in the UK' (2000) 9(3) *Accounting Education* 223.

⁶⁰ That is, the expectations of employers who recruit graduates who have studied taxation at university.

⁶¹ John Hasseldine and Ann Neale, *Issues in Professional Advanced Accounting Education* (Department of Accountancy, University of Canterbury, 1991).

⁶² Lin Mei Tan and John Veal, 'Tax Knowledge for Undergraduate Accounting Majors: Conceptual v. Technical' (2005) 3(1) *e-Journal of Tax Research* 28. In Tan and Veal's study, conceptual knowledge refers to 'the mental processes ranging from simple recall or awareness to creative thinking or evaluations', and technical ability refers to the 'skills in applying knowledge of tax law to specific taxation problems'.

⁶³ Examples can be found in Mitchell Franklin, 'Flipping the Tax Classroom for a Better Student Learning Experience' (2015) *The Tax Adviser* 852; Kenny et al (n 49); Fiona Martin and Margaret Connor, 'Using Blended Learning to Aid Law and Business Students' Understanding of Taxation Law and Problems' (2017) 12(1) *Journal of the Australasian Tax Teachers Association* 53; Nava Subramaniam and Brett Freudenberg, 'Preparing Accounting Students for Success in the Professional Environment: Enhancing Self-Efficacy through a Work Integrated Learning Program' (2007) 8(1) *Asia-Pacific Journal of Cooperative Education* 87; Tan and Chua (n 50); Tan and Veal (n 62); Bruce Renig, Ira Horowitz and Gene Whittenburg, 'Determinants of Student Attitudes toward Team Exams' (2014) 23(3) *Accounting Education: An International Journal* 244; Adrian Sawyer, Stephen Tomlinson and Andrew Maples, 'Developing Essential Skills through Case Study Scenarios' (2000) 18(3) *Journal of Accounting Education* 257; Patricia McCourt Larres and George Radcliffe, 'Computer-Based Instruction in a Professionally Accredited Undergraduate Tax Course' (2000) 9(3) *Accounting Education* 243; Larry Crumbley and Murphy Smith, 'Using Short Stories to Teach Critical Thinking and Communication Skills to Tax Students' (2000) 9(3) *Accounting Education* 291.

C Summary

The issue of employability skills has been debated in the literature for over three decades. Most universities acknowledge the importance of skills development, but there is little evidence that accounting education has changed much to meet the demands of key stakeholders such as employers and professional accounting bodies.⁶⁴ There is also little evidence from the employers of accounting graduates that the level of generic skill development has improved over the past two decades. Although there is general consensus that the development of generic skills is needed in the accounting curriculum, the extent to which each skill should be developed at tertiary institutions remains debatable. Therefore, it is not surprising that the skills expectation gap continues to be an area of concern in the 21st century.⁶⁵

In the tax discipline, very few studies have been carried out to examine the employability skills required by employers in recruiting people to do tax work. Prior studies have mainly focused on the required tax knowledge in an undergraduate programme, and the term 'skills' has had a wider connotation, as it has appeared at times to cover both technical and non-technical skills. To provide further insights into this area, this study used a content analysis of job advertisements to tease out the key employability skills, that is, the non-technical skills required of those who aspire to be tax accountants.

III STUDY FRAMEWORK

Most employability skills frameworks have some common elements that concern basic/fundamental skills, people-related skills, conceptual/thinking skills, personal skills and attributes, and skills related to the business world and community.

For this study, we draw on the frameworks developed by Birkett,⁶⁶ and IES 3,⁶⁷ as both have identified similar relevant skills categories required of accounting graduates. Figure 1 shows the employability skills framework used in this study. Based on Birkett's framework, skills are considered under two broad categories: cognitive and behavioural. Cognitive skills are subcategorised into two dimensions:

1. Routine/technical skills — Based on Birkett's framework, these skills consist of performing defined routine tasks with some mastery (for example, tasks to be performed are defined, and performance involves the exercise of pre-focused and pre-developed skills). It is not about technical knowledge as such, but more about the application of technical knowledge to everyday tasks, such as the ability to write and understand reports, computer literacy, accounting literacy, etc.
2. Intellectual skills — IES 3 describes intellectual skills as the ability to identify and evaluate information from various sources and reach well-reasoned conclusions, apply reasoning, and perform critical analysis and innovative thinking to solve problems (including unstructured and multifaceted problems). Birkett considered

⁶⁴ De Lange, Jackling and Gut (n 34); Watty (n 5).

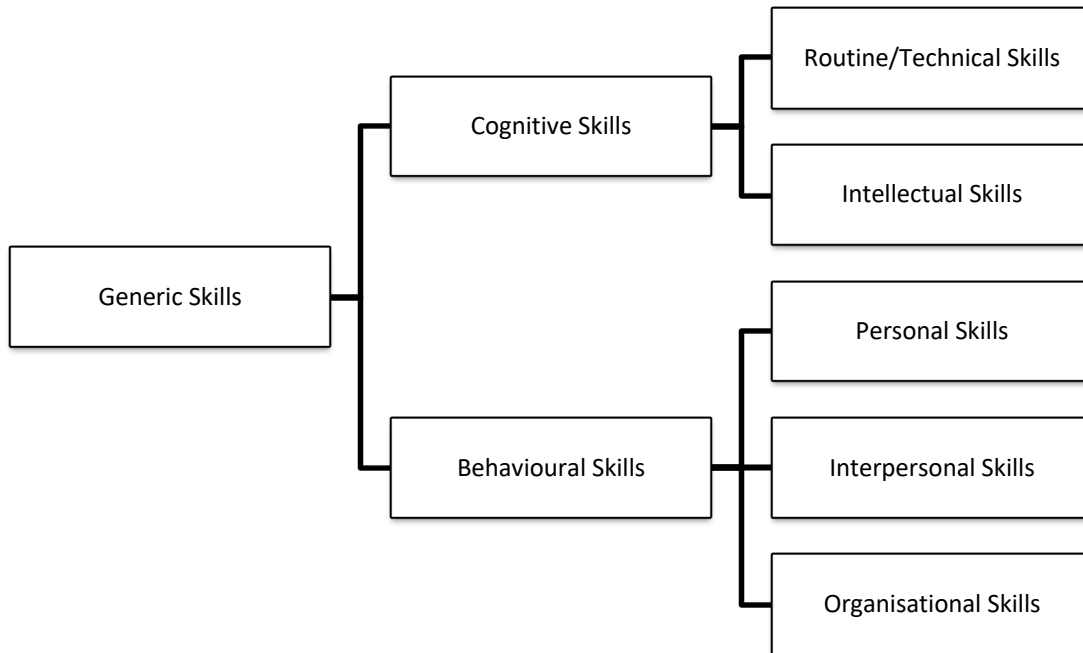
⁶⁵ O'Connell et al (n 19).

⁶⁶ Birkett (n 30).

⁶⁷ IAESB (n 1).

skills like problem identification and development of solutions to be ‘analytical’ skills, and evaluation of complex situations and making creative and complex judgements to be ‘appreciative’ skills. Drawing from IES 3 and Birkett’s analytic and appreciative dimensions, skills that relate to the ability to solve problems, make decisions and to exercise professional judgement are categorised as ‘intellectual’ skills.

Figure 1: Employability skills framework



Behavioural skills are subcategorised into three dimensions:

1. Personal skills — Drawing from IES 3 and Birkett’s work, this dimension includes the ability to: apply professional scepticism through questioning and critically assessing all information; anticipate challenges and plan potential solutions; apply an open mind to new opportunities; and demonstrate a commitment to lifelong learning. It includes: the ability to manage one’s own learning using available resources; an enthusiasm for ongoing learning; being flexible in new or different situations; having a positive, proactive and reflective attitude about one’s own performance; and the ability to handle oneself in situations of challenge, stress, conflict, time pressure and change.
2. Interpersonal skills — These skills are about the ability to secure outcomes through interpersonal interactions. Drawing from IES 3 and Birkett’s framework, elements of interpersonal skills include: working effectively with others; communicating clearly and concisely; and engaging and negotiating with people effectively. Basically, it is about having people skills and understanding group dynamics.
3. Organisational skills — These skills refer to securing outcomes through use of organisational networks. It is about accessing and using power and culture, and building and activating intra- and inter-organisational networks. Based on IES 3 and Birkett’s framework, it includes: the ability to organise work to meet deadlines;

reviewing own work and other people's work to determine whether it complies with standards; and the ability to organise and delegate tasks.

IV RESEARCH METHOD

A Data collection

This study examines the content of job advertisements to identify the employability skills required by employers in prospective employees. Content analysis of job advertisements has been widely used in other non-accounting domains in the last three decades, but less so to assist in understanding the issue of employability skills in tax work.⁶⁸ They are the most easily available and (possibly) reliable indicator of the short- to mid-term direction of workplace demands for skills and competencies. Further, they provide a good indication of what employers believe they need for the organisation to continue and thrive.⁶⁹

We examined tax job advertisements in both Australia and New Zealand, as there is a high degree of labour mobility between the two countries. We used a major online job site, www.seek.co.nz, which is one of the most popular in Australasia.⁷⁰ From this website, we initially selected 'accounting' as the main job classification, and then selected 'tax' under the job subcategory. We captured and examined the job advertisements for a one-year period, from July 2015 to June 2016, and focused the content analysis on employability skills required for the job.

B Analysis

We used a content analysis software package, QDA Miner[®] version 5 and WordStat[®] version 7, to generate the frequencies of specific categories of skills included in the advertisements.⁷¹

Drawing from the literature, we initially built a categorisation dictionary of employability skills that fall under each of the five categories shown in Figure 1. We started with a list of well-known words or phrases commonly used in the literature to denote skills for each of the five main categories and their respective subcategories.⁷² The initial categorisation dictionary was then applied to the database of job advertisements to identify the frequency with which specific categories were listed in the advertisements. We then examined the most frequently stated words and phrases in the advertisements that were not in our initial dictionary. Words or phrases that we considered relevant were subsequently included in our subcategories after having considered their context in the

⁶⁸ Verity Orme, 'You Will Be... : A Study of Job Advertisements to Determine Employers' Requirements for LIS Professionals in the UK in 2007' (2008) 57(8) *Library Review* 619.

⁶⁹ Kennan et al (n 18).

⁷⁰ Kamrul Ahsan, Marcus Ho and Sabik Khan, 'Recruiting Project Managers: A Comparative Analysis of Competencies and Recruitment Signals from Job Advertisements' (2013) 44(5) *Project Management Journal* 36. Data on accounting advertisements in general was also collected for another study: see Lin Mei Tan and Fawzi Laswad, 'Professional Skills Required of Accountants: What Do Job Advertisements Tell Us?' (2018) 27(4) *Accounting Education* 403.

⁷¹ Provalis Research, *SimStat and WordStat* (Software, 2005) <<http://www.simstat.com>>.

⁷² For example, Birkett (n 30); Watty (n 5); IAESB (n 1).

entire advertisement's text. Words or phrases that were irrelevant were ignored. Words that occurred in fewer than 2 per cent of the advertisements were also ignored. Appendix 1 shows the terms included in the final dictionary, which comprises five categories and 31 subcategories.

V FINDINGS

After removing any repeated advertisements, there were 4,109 and 206 tax job advertisements in Australia and New Zealand, respectively. Australia had a much higher proportion of taxation jobs (95.2 per cent) than New Zealand (4.8 per cent). The larger job market in Australia perhaps reflects its larger economy and population,⁷³ and more complex tax system,⁷⁴ as compared to New Zealand.⁷⁵

Table 1 shows the frequency of skills as mentioned in the advertisements for tax jobs. Out of the five broad skills categories, interpersonal and personal skills ranked as the top two most frequently mentioned skills (more than 50 per cent of advertisements). In the Australian advertisements, routine/functional skills were the third most in demand for tax jobs (42 per cent of advertisements). New Zealand advertisements showed intellectual skills as ranking third in demand (49 per cent of advertisements). In comparison, organisational skills were less frequently mentioned in both countries' advertisements.

Table 1: Skills by country — mean number of citations and percentage of advertisements

Skills	Australia			New Zealand		
	Mean ⁷⁶	% ⁷⁷	Rank	Mean	%	Rank
Interpersonal	3.05	89.5	1	3.75	92.7	1
Personal	1.35	60.8	2	1.91	71.8	2
Intellectual	0.54	34.8	4	1.02	48.5	3
Routine/functional	0.80	41.9	3	0.62	35.9	4
Organisational	0.43	30.1	5	0.49	35.9	4

⁷³ The current populations of Australia and New Zealand are about 25 million and 5 million, respectively. See 'Population: Australia and New Zealand', *Worldometers* (Web Page) <<http://www.worldometers.info/world-population/australia-and-new-zealand-population>>.

⁷⁴ Of note is that, unlike New Zealand, Australia has a comprehensive capital gains tax in place. Australia's GST system is also more complex than New Zealand's as it has an extensive list of goods and services that are GST-free or completely zero-rated (see Rick Krever and Peter Mellor, 'Where's the Complexity in Tax Law?' (Conference Paper, Centre for Business Taxation, Said Business School, University of Oxford, 25 June 2015)

<http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/symposia/2015/krever-paper.pdf>.

⁷⁵ Chris Jordan, 'Winning Friends and Influencing People' (2018) 5(1) *Acuity* 26. In this article, Chris Jordan, the Australian Commissioner of Taxation, indicated that Australia ranks second-highest in the world for the use of tax agents.

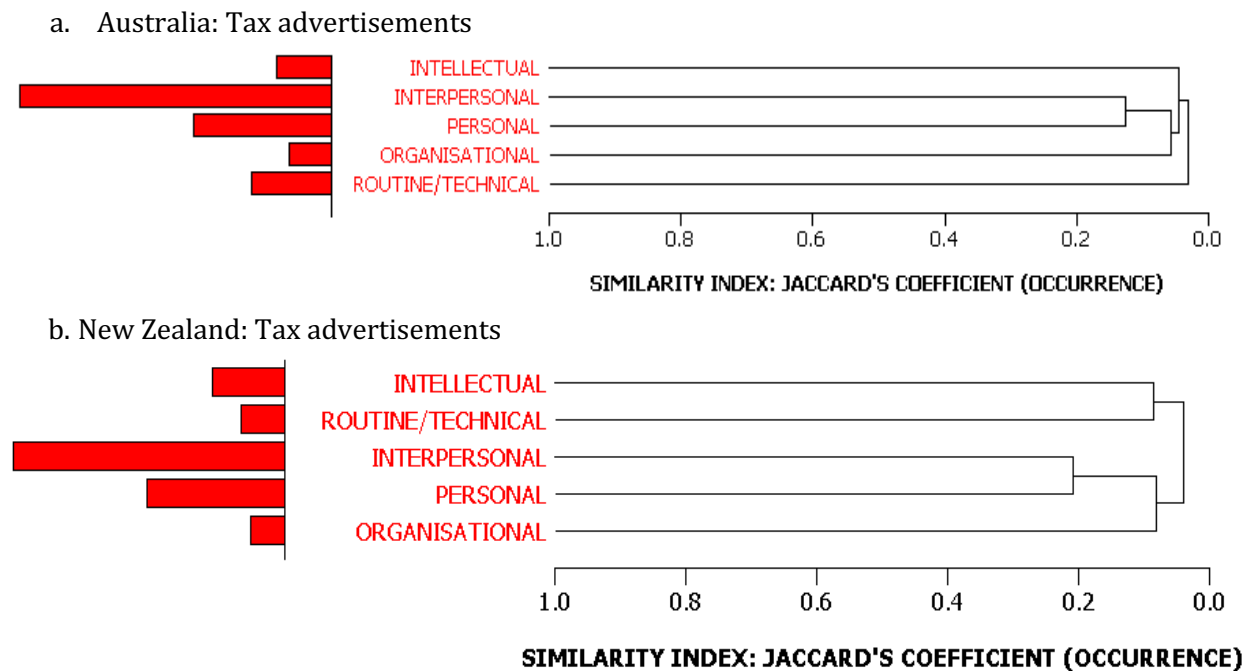
⁷⁶ The mean is the average number of skills cited in each broad category, divided by the number of advertisements.

⁷⁷ The percentage of advertisements is the proportion of advertisements with one or more skills cited in the broad categories of skills. The ranking is based on this percentage.

We further explored the structural characteristics of job advertisements by using cluster analysis to see which skills categories were often mentioned together in the advertisements. WordStat produced a dendrogram, which is a graphical display of the clustering process. The hierarchical agglomerative approach (Jaccard's coefficient) joins two words or phrases with the most similar patterns. At each successive step, subsequent words or phrases are joined to the existing clusters until one large cluster is formed. Pairs of skills that are close together suggest that they are frequently mentioned together in the advertisements.

Figure 2 shows the dendrogram. Of the five broad categories, the interpersonal and personal skill cluster had the most similarity or concurrence in both Australian and New Zealand job advertisements. This means that these two skill categories occurred more frequently together in the advertisements, indicating that employers want recruits who have good interpersonal skills as well as personal skills. In the New Zealand tax advertisements, the intellectual and routine skills were also in close proximity, indicating that these two skills were frequently mentioned. It appears that there are employers in New Zealand who are particular about recruits possessing routine/functional skills as well as demonstrating intellectual skills in their work.

Figure 2: Cluster analysis of five broad categories — dendrograms for Australian and New Zealand advertisements



To gain further insights into the occurrence of specific skills cited in the advertisements, we examined the frequencies of advertisements that had words/phrases shown in the categorisation dictionary. The results show that 15 out of the 31 specific skills in the dictionary were cited in more than 10 per cent of the total advertisements. Of the top 15 skills identified in the Australian and New Zealand advertisements, four were personal, four were intellectual, three were interpersonal, two were routine and two were organisational. These results suggest that although employers considered all the five

broad categories important in their recruitment, some types of skills were much more frequently mentioned than others and thus considered very important to have.

Table 2: Top 15 skills ranked by percentage of job advertisements

Skills	Australia	New Zealand
<i>Interpersonal</i> : Collaborating with colleagues	1 (75.5%)	1 (84.0%)
<i>Interpersonal</i> : Presenting/discussing/defending views	2 (59.1%)	3 (49.0%)
<i>Personal</i> : Showing a positive attitude	3 (37.0%)	2 (51.0%)
<i>Routine</i> : Competently using information technology	4 (26.4%)	7 (18.0%)
<i>Interpersonal</i> : Understanding group dynamics	5 (22.4%)	4 (42.2%)
<i>Personal</i> : Being flexible	6 (17.9%)	14 (14.6%)
<i>Personal</i> : Thinking and acting independently	7 (17.6%)	5 (25.7%)
<i>Organisational</i> : Meeting deadlines	8 (15.2%)	9 (16.5%)
<i>Organisational</i> : Applying leadership skills	9 (14.6%)	11 (16.5%)
<i>Personal</i> : Acting strategically	10 (12.3%)	6 (23.3%)
<i>Intellectual</i> : Initiating and conducting research	11 (12.0%)	9 (16.5%)
<i>Intellectual</i> : Solving problems and constructing arguments	12 (10.4%)	8 (17.5%)
<i>Routine</i> : Complying with legal requirements	13 (10.2%)	15 (14.1%)
<i>Intellectual</i> : Being observant and aware	14 (9.6%)	13 (15.1%)
<i>Intellectual</i> : Analysing, reasoning and conceptualising issues	15 (4.6%)	11 (16.0%)

Table 2 shows the extent of citations of skills in advertisements for tax jobs in Australia and New Zealand. Those skills that were mentioned in at least 20 per cent of the tax job advertisements in Australia were ranked as follows: collaborating with colleagues, presenting/discussing/defending views, showing a positive attitude, competently using information technology, and understanding group dynamics. Collaborating with colleagues was the most frequently mentioned interpersonal skill, and was mentioned in more than 70 per cent of the job advertisements. This finding suggests that employers value teamwork and prefer a candidate who is a team player. This aspect of interpersonal skills appears to have become more and more important, as it is critical to an organisation's productivity and profitability.⁷⁸ It was also the most frequently mentioned skill in the New Zealand advertisements (84 per cent). Similarly, New Zealand employers also value teamwork and place high priority on employees being able to collaborate with colleagues in tax work.

⁷⁸ See Deloitte Access Economics, *Soft Skills for Business Success* (Deloitte Touche Tohmatsu, 2017).

The second-ranked skill, mentioned in more than 50 per cent of the job advertisements in Australia, is also an interpersonal skill: presenting, discussing and defending views. This encompasses communication, presentation and speaking skills.

One aspect of personal skills — showing a positive attitude — was ranked third in the Australian advertisements. Employers are therefore expressing their desire for employees who are committed, passionate, dynamic, energetic, vibrant and self-driven. In New Zealand, the ranking of these two skills did not differ much, with positive attitude ranked second and presenting/discussing/defending views ranked third.

The fourth-ranked skill in Australia was competently using information technology. Not surprisingly, although use of information technology is a routine skill, it is considered an important skill in today's global, technologically demanding economy. The ability to use Excel, MYOB[®], spreadsheets, or Xero[®], was cited more frequently in the Australian advertisements (26 per cent, ranked fourth) than in the New Zealand advertisements (18 per cent, ranked seventh).

Understanding group dynamics — that is, having good people skills — was mentioned in more than 20 per cent of the advertisements for Australian jobs, denoting that people skills are also important in tax jobs. It was ranked fifth in Australia compared to fourth in the New Zealand advertisements.

Three other personal skills — being flexible, thinking and acting independently, and acting strategically — ranked sixth, seventh and tenth, respectively, in the Australian advertisements. This finding alludes to employers' high preference for a recruit who is practical and proactive, able to adapt to circumstances, has acumen and good work ethics, and is commercially and intellectually astute, as well as holding professional scepticism. The ranking of these skills in the New Zealand advertisements differed significantly: being flexible ranked 14th, and acting strategically ranked sixth. Being flexible or able to fit in with others is a personal attribute that refers to someone who can adapt to different circumstances. With the constantly changing tax law requirements, the ability to adapt quickly to changes, coupled with enthusiasm and inquisitiveness, are skills to which employers in Australia gave higher priority than those in New Zealand. In contrast to the Australian advertisements, New Zealand advertisements more often emphasised acting strategically.

Two aspects of organisational skills — meeting deadlines and applying leadership skills — ranked eighth and ninth, respectively, in the Australian advertisements. These results suggest that employers are also particular about good organisational skills, such as the ability to meet deadlines and provide leadership, both vital for managing their work. These skills were ranked ninth and eleventh in the New Zealand advertisements, respectively.

Four aspects of intellectual skills — initiating and conducting research, solving problems and constructing arguments, being observant and aware, and analysing, reasoning and conceptualising issues — ranked 11th, 12th, 14th and 15th, respectively, in the Australian advertisements. Certainly, in a complex and changing tax environment, recruits are expected by employers to be competent researchers, logical thinkers and good problem-solvers, as well as show accuracy and attention to detail. New Zealand employers, however, had a higher preference for good problem-solvers in tax work, that is, those who think laterally and are able to argue logically.

A routine skill — complying with legal requirements — ranked 13th in the Australian advertisements, compared with 15th in the New Zealand advertisements, signifying the importance of knowing the requirements of legislations and relevant regulations. Being observant and aware was ranked 13th in the New Zealand advertisements, indicating that employers in New Zealand expected tax accountants to be detail-oriented, in order to detect errors, discrepancies or inconsistencies. Analysing, reasoning and conceptualising issues was also ranked higher in the New Zealand advertisements (11th) compared to the Australian advertisements (15th). These analytical and logical reasoning skills are intellectual skills, which appeared to be expected more of New Zealand recruits than Australian recruits, who perhaps are more involved in routine compliance rather than tax planning/advisory work.

VI SUMMARY

Our analysis of job advertisements shows that a combination of interpersonal, personal, intellectual, routine and organisational skills is sought by employers of tax accountants in Australia and New Zealand. More specifically, this study shows that those skills that were mentioned in at least 20 per cent of the total Australian advertisements for tax-related work were (in order): collaborating with colleagues; presenting/discussing/defending views; showing a positive attitude; competently using information technology; and understanding group dynamics. In New Zealand, they were: collaborating with colleagues; showing a positive attitude; understanding group dynamics; thinking and acting independently; and acting strategically.

The top three skills — collaborating with colleagues, presenting/discussing/defending views, and showing a positive attitude — are aspects of interpersonal and personal skills. These findings reflect that tax accountants need to be engaging professionals. Those who can clearly demonstrate that they are team players who are enthusiastic and passionate about their work and can communicate well with others will certainly have a competitive edge in securing employment in tax work.

Understanding group dynamics, that is, having good people skills, is also a critical interpersonal skill, as tax accountants need to engage and work with colleagues, clients, peers and the tax authorities. The Australian advertisements for tax jobs further indicated that information technology competence is a critical routine skill. Employers in Australia clearly desire those who are proficient in using various digital tools, such as Excel, MYOB, Xero and other database systems. In the New Zealand advertisements for tax jobs, it was surprising to see that information technology was less emphasised than in the Australian advertisements. In comparison, other personal skills, like thinking and acting independently and strategically, were more frequently cited, and therefore considered more important. Tax work may involve tax compliance (for example, filing tax returns) or tax advisory/planning services. Perhaps more of the Australian tax jobs were involved with tax return compliance than those in New Zealand.

VII IMPLICATIONS

What implications do these results have for tax academics? Students who aspire to be tax accountants certainly need a blend of technical knowledge and various critical employability skills such as interpersonal and personal skills. Prior literature has also

indicated that interpersonal skills have the greatest gap as identified by graduates, employers and academics.⁷⁹ Being such important skills, which would enhance the employability of their graduates who aspire to be tax accountants, academics certainly need to consider ways to help students develop these skills within the tax curriculum. For instance, team projects might provide students with the opportunity to develop interpersonal skills, including listening, communicating and negotiating with others, and these employability skills are interconnected in many ways.⁸⁰ Various forms of work-integrated learning would also help students to enhance their problem-solving, teamwork and communication skills.⁸¹ For instance, some universities allow students to gain industry experience as well as people skills, teamwork skills and confidence through internships, community work, or networking opportunities with the profession and industry. In the US, many accounting students can participate in the Volunteer Income Tax Assistance programme,⁸² as a community service activity and an experiential learning opportunity.⁸³ By helping taxpayers to prepare their income tax returns, students benefit by not only enhancing their technical skills (for example, tax knowledge), but also their communication skills, problem-solving skills,⁸⁴ interpersonal skills and personal capacities.⁸⁵ In Australia, the Curtin University's Faculty of Business and Law has also recently opened a clinic that allows students, under the supervision of experienced tax practitioners, to work closely with unrepresented taxpayers in meeting or complying with their taxation obligations. This type of community service mutually benefits the tax authorities as well as the participating students. However, it requires academic staff to take the initiative to organise work-integrated learning activities, which also requires the support of the university and/or tax authorities.

The results of this study further show that employers want people with good personal attributes, such as an energetic, dynamic, passionate and adaptable personality. These are considered to be important skills, as they are very often cited in job advertisements. Some of these attributes may be harder to develop in formal education, as some personality traits are strongly influenced by genetics or culture, but they may be indirectly influenced during the development of other employability skills. In contrast, attributes like good work ethics and professional scepticism are easier to integrate into the tax curriculum. Nevertheless, students need to be made aware of the importance of personal skills.

⁷⁹ See, for example, De Lange, Jackling and Gut (n 34); DEET (n 45); Oliver et al (n 45).

⁸⁰ Kenny et al (n 49). A number of ideas to help students develop various skills have been suggested by several tax educators. See above n 63.

⁸¹ Denise Jackson, 'An International Profile of Industry-Relevant Competencies and Skill Gaps in Modern Graduates' (2009) 8(3) *International Journal of Management Education* 29; Subramaniam and Freudenberg (n 63).

⁸² The VITA programme trains volunteers to provide free tax help for low- to moderate-income families who need help with their tax returns. See 'IRS Tax Volunteers', *Internal Revenue Service, United States Government* (Web Page, 1 May 2019) <<https://www.irs.gov/individuals/irs-tax-volunteers>>.

⁸³ Cynthia Blanthorne and Stu Westin, 'VITA: A Comprehensive Review of the Literature and an Analysis of the Program in Accounting Education in the US' (2016) 31(1) *Issues in Accounting Education* 51.

⁸⁴ Christensen and Woodland (n 49).

⁸⁵ Janice Carr, 'Service-Learning in Accounting: A Role for VITA Programs' in Dasaratha V Rama (ed), *Learning by Doing: Concepts and Models for Service Learning in Accounting* (American Association for Higher Education, 1998).

Some universities' tax curricula may have already incorporated various employability skills in their courses, although they will likely vary in the emphasis of certain skills over others and the way that these skills are integrated into academic programmes.⁸⁶ How much of a gap there is between the competencies and skills developed at university and the skills required of graduates by prospective employers depends on how effective their integration into the course is.⁸⁷ It remains a challenge for tax educators, as it is not possible to teach all the skills demanded by employers.⁸⁸ Other factors like class size, time, motivation, expertise, funding and teaching resources also impede the development of non-technical skills in the curriculum.⁸⁹ Furthermore, it can be challenging to gauge and assess students' proficiencies in interpersonal and personal skills.⁹⁰

VIII LIMITATIONS AND FUTURE RESEARCH

A limitation of the study is that only advertisements for tax work under the accounting classification on the website we used were examined. Tax jobs may also be advertised in the law category of the website, and it is possible that those who aspire to be tax specialists may go through a non-accounting path, such as law. However, we consider that most advertisements were included in our data, as we examined all advertisements related to tax work. Future research may contribute to the literature on skills in tax work by examining advertisements on other websites that advertise for tax jobs.

Our study did not show the skills required of recent graduates, or differentiate the skills required by different sized firms. Most advertisements on the particular website we used did not indicate the level of experience required or the size of the firm. Our findings therefore did not differentiate the important skills required in tax work based on years of experience or firm size. Future research could explore this issue further by another means of data collection.

Another limitation of the study is that job advertisements may not have included all the job requirements of employers. Job advertisements tend to be brief to minimise costs of advertising and maximise impact, and are targeted to appeal only to potential applicants who have the required skills. There may be other skills employers require, and these skills are often stated in job description documents that prospective applicants may request from employers. These additional skills may also be explored during job interviews for short-listed applicants. However, job advertisements certainly tell us those essential skills that are most desired or valued by employers.

Perhaps what is also interesting is the level of tax proficiency required by employers, which is hardly mentioned in the job advertisements. Studies have indicated that employers generally tend to view that educators are not doing a good job in preparing

⁸⁶ Hite and Hasseldine (n 27).

⁸⁷ See Hancock et al (n 43), where they indicated several strategies that can be used to help develop non-technical skills in professional accounting programmes across all Australian universities.

⁸⁸ Bryan Howieson, 'Accounting Practice in the New Millennium: Is Accounting Education Ready to Meet the Challenge?' (2003) 35 *The British Accounting Review* 69.

⁸⁹ See Kenny et al (n 49); Freudenberg and Samarkovski (n 7).

⁹⁰ See Yorke (n 3). For suggestions on assessment, see Peter Knight and Mantz Yorke, *Employability: Judging and Communicating Achievements* (Higher Education Academy, 2004).

graduates for the workplace. Such perceptions raise the question of, 'how much is enough?' The interviews conducted by Hancock et al with Australian employers show that they had modest expectations for new graduates' technical skills, but viewed non-technical skills as very important.⁹¹ Future research could look into the level of skill proficiency required by employers.

IX CONCLUSION

In a globalised business and employment environment and with advances in technology, the issue of employability skills has become increasingly important over the years. Universities in countries such as Australia and New Zealand are also facing increasing pressures from governments to produce employable graduates.⁹² With the demand for tax accountants and the changing tax service landscape,⁹³ this study focused on the tax accountant job market as it is pertinent to gain insights into the critical skills in demand in the workplace.

Consistent with prior studies on important skills required of accounting graduates, personal and interpersonal skills were highly sought after by employers in their recruitment for tax workers. These findings suggest that tax educators need to continuously be considering new ways to support graduates' development of these essential skills. The responsibility for skills development, however, should not fall entirely with educators, as employers also have a key role to play in helping their recruits to develop these important skills. Workplace learning is indispensable, and employers can help to foster the important skills by on-the-job training, mentoring, and providing support for attendance at professional development courses.⁹⁴

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⁹¹ Hancock et al (n 43).

⁹² Willcoxson, Wynder and Laing (n 6).

⁹³ For a discussion on the changing service provider landscape, see OECD, *Rethinking Tax Services: The Changing Role of Tax Service Providers in SME Tax Compliance* (OECD Publishing, 2016) <<https://dx.doi.org/10.1787/9789264256200-en>>.

⁹⁴ See O'Connell et al (n 19); Yorke (n 3).

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Appendix 1: Categorisation dictionary

Category label	Examples of dictionary words/phrases
COGNITIVE	
<i>Routine/Functional</i>	
Compliance with legislative and regulatory requirements	legislation, legislations, work regulations, regulatory, compliances, complying
Communication	communicating, communication, literacy, structuring report, writing reports
Using information technology	accounting software, computer literacy, computer technology competence, database systems, Excel, MYOB, spreadsheets, Xero
Numeracy/calculations	calculation, calculations, carry out calculations, numeracy, statistics, statistical
Technical	technically
<i>Intellectual</i>	
Identify, evaluate and manage information and evidence	evaluate, identifying
Initiate and conduct research	research, research skills
Analyse, reason and conceptualise issues	analytical, logical reasoning, reasoning
Solve problems and construct arguments	forward thinking, lateral thinking, logical, logical argument, outside the square, problem analysis, problem-solve, problem-solver, problem-solving, solve, thinker, the box
Engage in ethical reasoning	ethical, ethics, integrity
Receive, react to ideas	accepting of new or others' ideas, open minded
Adapt and respond positively to challenges	able to deal with complexity, complexity
Think and act critically	creative, creatively, critical thinking, innovative thinking, strategic thinking, thinking on your feet, intellectual
Observant/aware	accuracy, accurate, accurately, attention to details
	eye for detail, numerical detail

BEHAVIOURAL	
<i>Personal</i>	
Be flexible/fit in with others	adapt, adaptability, adaptable, adapting to circumstances, flexibility, flexible
Positive attitude values	attitude, committed, driven, dynamic personality, dynamic tertiary, energetic, enthusiasm, enthusiastic, objective, passion, passionate, positive, personality vibrant
Act strategically	acumen, commercially astute, good work ethics, work ethic, intellectually astute, proactive, pro-active, technically astute
Think and act independently	apply professional skepticism, self-motivated initiative, inquisitive, practical, self-management, confident
Be focused on outcomes	outcome, outcomes
Commitment to lifelong learning	continuous learning, learn, takes initiative
<i>Interpersonal</i>	
Listen effectively	active listening, listening, communicate, communicate clearly, communication, communicator
Present/discuss/defend views	oral, oral communication, presentation skills, verbal, verbal communication, written, written communication
Negotiate with people	negotiate, negotiation, negotiation skills, rapport
Understand group dynamics	people skills, relationships
Collaborate with colleagues	collaborative, consultative skills, in-team, team, teamwork, team player, interpersonal
Fluency in English	English
Interpersonal skills	interpersonal skills
<i>Organisational</i>	

Undertake assignments in accordance with established practices to meet datelines	quickly, deadline, decision-making, efficient, organised, time management, pressure
Apply leadership skills	leadership, leader, strategic management
Apply delegation skills	delegate, delegating
Review own work and others to determine whether it complies with standards	management skills, self-management, task management

PRIOR EXPERIENCE, TRUST, AND IS SUCCESS MODEL: A STUDY ON THE USE OF TAX E-FILING IN INDONESIA*

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ABSTRACT

The purpose of this paper is to explore taxpayer perceptions of online tax filing in Indonesia, using prior experience, trust, and the IS (information system) success model. We examine how IS quality can be influenced by attributes such as prior experience in offline tax filing, trust in the government, trust in the technology, and trust in the e-filing website. Following this, we explore the influence of IS quality on perceived usefulness and user satisfaction. This paper is intended to ascertain whether these last two dimensions (perceived usefulness and user satisfaction) can influence the perceived net benefit of the e-filing website. This research used primary data generated by distributing online questionnaires; 933 of the 1,095 respondents were actively using online tax filing (e-filing). The results found that trust in the government and trust in the technology have a positive influence on the trust in the e-filing website, which subsequently influences all three IS quality dimensions. Information quality, system quality and service quality were found to have consistent and significant influence on the perceived usefulness of and user satisfaction in the e-filing website.

Keywords: E-filing; Online tax return; IS quality; Trust.

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I INTRODUCTION

Tax revenue plays an important role in Indonesia since most government expenditure is financed by tax revenue. Therefore, in order to increase tax revenue, it is important for the Indonesian government, especially the Directorate General of Taxes ('DGT'), to increase taxpayer compliance. One type of tax compliance is the submission of tax returns, and the DGT has tried to simplify the tax return submission process by introducing an online filing (e-filing) system in 2005. Currently, the e-filing system is available only for individual income tax returns. According to the DGT, the advantages of the e-filing system are the reduced environmental footprint, increased precision, and increased safety of taxpayer information. According to data from the DGT, up to the submission deadline for the 2017 individual income tax returns (31 March 2018), there had been around 8.47 million individual income tax returns submitted through the e-filing system (80 per cent of total submissions).

Online tax filing will soon be mandatory in Indonesia. Thus, the DGT must design an impeccable system that accommodates taxpayer needs. This study has found many attributes that are relevant for users of e-filing, and this input will be advantageous for e-filing system enhancement. In Chen et al, prior offline experience was used to moderate the relationship between trust in a government website and trust in the government.¹ The moderation itself demonstrated insignificant influence. They found, however, that prior offline experience significantly enhances the perception of government e-services. Belanger and Carter found that trust in government e-services consists of two aspects: trust in the entity that provides the online service (ie, the government), and trust in the reliability of the enabling technology to deliver the service itself (ie, the internet).² On top of that, the perceived quality of the information can be increased if the government website is more highly trusted by citizens.³ In addition, the perception of the website's system quality can be improved with increased trust.⁴ Furthermore, those variables can in turn influence the user satisfaction in and perceived net benefits of using the website.⁵

The tax system is unique to every country. This study provided context-specific evidence. In Indonesia, where tax compliance is considered low, the use of e-filing is expected to increase taxpayers' willingness to pay and report their taxes. This study examined user

¹ Jengchung Victor Chen et al, 'Factors Affecting Online Tax Filing — An Application of the IS Success Model and Trust Theory' (2015) 43 *Computers in Human Behavior* 251.

² France Belanger and Lemuria Carter, 'Trust and Risk in E-Government Adoption' (2008) 17(2) *Journal of Strategic Information Systems* 165.

³ Chen et al (n 1).

⁴ See Thompson SH Teo, Shirish C Srivastava and Li Jiang, 'Trust and Electronic Government Success: An Empirical Study' (2008) 25(3) *Journal of Management Information Systems* 99; Vachiraporn Khayun, Peter Ractham and Daniel Firpo, 'Assessing E-Excise Success with DeLone and McLean's Model' (2012) 52(3) *Journal of Computer Information Systems* 31.

⁵ See Yi-Shun Wang and Yi-Wen Liao, 'Assessing E-Government Systems Success: A Validation of the DeLone and McLean Model of Information System Success' (2008) 25(4) *Government Information Quarterly* 717; Ardion Beldad, Menno de Jong and Michael Steehouder, 'How Shall I Trust the Faceless and the Intangible? A Literature Review on the Antecedents of Online Trust' (2010) 26(5) *Computers in Human Behavior* 857; Ching-Wen Chen, 'Impact of Quality Antecedents on Taxpayer Satisfaction with Online Tax-Filing Systems: An Empirical Study' (2010) 47(5-6) *Information and Management* 389; Chen et al (n 1).

perception of the benefits of e-filing. In addition, this research also categorised trust into three separate dimensions: trust in government, trust in technology, and trust in the e-filing website. On top of that, this study surveyed a larger and more diverse sample than Chen et al⁶ — a total of 1,097 respondents, 993 of whom were actively using e-filing, and including individuals from several different provinces in Indonesia. Furthermore, this study conducted clustering analyses between respondents from Java and outside Java, and also between millennials and non-millennials, in order to find out any variation on the responses.

This paper examines how IS quality will be influenced by attributes such as prior experience in offline tax filing, trust in government, trust in technology, and trust in the e-filing website. Following this, the influence of IS quality on perceived usefulness and user satisfaction is explored. To end the paper, we answer the question of whether these last two dimensions (perceived usefulness and user satisfaction) affect the perceived net benefit of the e-filing website.

II LITERATURE REVIEW

A Prior experience

The users of e-filing are similar to those who previously used traditional offline government services. According to Mostafa and El-Masry, the interaction of citizens with the government by electronic devices is merely a substitution of their civic involvement through traditional channels.⁷ Citizens may also develop an understanding that the online channel is another part of the organisation, thus it is considered similar to the offline channel.⁸ Lee et al analysed data obtained from a local district government in Seoul, Korea, and revealed that the willingness to adopt government e-services increased when users perceived high-quality service provision in offline service channels. They and others argue that prior interactions with the tax authority through traditional channels shape users' belief, confidence and trust in the organisation, which, in turn, influences their perception of the quality of service provided online.⁹ Chen et al used prior offline experience to moderate the influence of trust in government to trust in a government website.¹⁰ The moderation itself demonstrated insignificant influence. However, prior offline experience significantly enhanced the perception of government e-services. Thus:

⁶ Chen et al (n 1).

⁷ Mohamed M Mostafa and Ahmed A El-Masry, 'Citizens as Consumers: Profiling E-Government Services Users in Egypt via Data Mining Techniques' (2013) 33(4) *International Journal of Information Management* 627.

⁸ Carol Kaufman-Scarborough and Jay D Lindquist, 'E-Shopping in a Multiple Channel Environment' (2002) 19(4) *Journal of Consumer Marketing* 333.

⁹ Jooho Lee, Hyun Joon Kim and Michael J Ahn, 'The Willingness of E-Government Service Adoption by Business Users: The Role of Offline Service Quality and Trust in Technology' (2011) 28(2) *Government Information Quarterly* 222; Eric W Welch, Charles C Hinnant and M Jae Moon, 'Linking Citizen Satisfaction with E-Government and Trust in Government' (2005) 15(3) *Journal of Public Administration Research and Theory* 371.

¹⁰ Chen et al (n 1).

H₁: Prior experience in offline tax filing services has a positive influence on trust in the e-filing website.

B Trust

Online self-service technologies involve new risks and uncertainty that may hinder their adoption.¹¹ Therefore, previous literature in this field considers trust as one of the most important determinants of successful e-filing implementation. Belanger and Carter found that trust in government e-services consists of two aspects: trust in the entity providing the online service (ie, the government), and trust in the reliability of the enabling technology to deliver the service itself (ie, the internet).¹²

1 Trust in the government

Trust in the government is defined as society's perception of the integrity and capacity of the agency who provide a public service.¹³ People trust the government if they believe that it will act for the best benefit of the citizen. This suggests that trust in the government heavily depends on how the government performs.¹⁴ In the initial stages of government e-service implementation, citizens will likely have some doubts, as they are not accustomed to the possible risks of the new mode of service.¹⁵ Internet users' confidence in the government's ability to protect citizens' personal data will reduce the perceived risks of disclosing such data for government e-services, leading to a switch from offline to online channels.¹⁶ Willingness to share and utilise e-filing would be higher if citizens had higher trust in the government.¹⁷ Customers need to trust the vendor in order to trust the vendor's website. Therefore, the success of a government website is also influenced by citizens' trust in the government.¹⁸ Thus:

H₂: Trust in the government has a positive influence on trust in the e-filing website.

¹¹ Walid Chaouali et al, 'Understanding Citizens' Adoption of E-Filing in Developing Countries: An Empirical Investigation' (2016) 27(2) *The Journal of High Technology Management Research* 161.

¹² Belanger and Carter (n 2).

¹³ Lemuria Carter and France Belanger, 'The Utilization of E-Government Services: Citizen Trust, Innovation and Acceptance Factors' (2005) 15(1) *Information Systems Journal* 2.

¹⁴ Naci Karkin and Marijn Janssen, 'Evaluating Websites from a Public Value Perspective: A Review of Turkish Local Government Websites' (2014) 34(3) *International Journal of Information Management* 351.

¹⁵ Emad Abu-Shanab, 'Antecedents of Trust in E-Government Services: An Empirical Test in Jordan' (2014) 8(4) *Transforming Government: People, Process and Policy* 480.

¹⁶ See Ardion Beldad, Menno de Jong and Michael Steehouder, 'I Trust Not Therefore It Must be Risky: Determinants of the Perceived Risks of Disclosing Personal Data for E-Government Transactions' (2011) 27(6) *Computers in Human Behavior* 2233; Chaouali et al (n 11); Muhammad ZI Lallmahomed, Naguib Lallmahomed and Gias M Lallmahomed, 'Factors Influencing the Adoption of E-Government Services in Mauritius' (2017) 34(4) *Telematics and Informatics* 57.

¹⁷ See Carter and Belanger (n 13); Shin-Yuan Hung, Chia-Ming Chang and Ting-Jing Yu, 'Determinants of User Acceptance of the E-Government Services: The Case of Online Tax Filing and Payment System' (2006) 23(1) *Government Information Quarterly* 97; Chen et al (n 1); Murathan Kurfali et al, 'Adoption of E-Government Services in Turkey' (2017) 66 *Computers in Human Behavior* 168.

¹⁸ Teo, Srivastava and Jiang (n 4).

2 *Trust in the technology*

Trust in the internet as the enabling mechanism of government e-services has been addressed in many studies, because it is one of the primary antecedents of trust in e-filing adoption.¹⁹ Technology acceptance depends on potential user perception of the internet's trustworthiness to provide accurate information and safe transactions. Online sharing of personal data is considered risky by many.²⁰ Sharing personal, confidential information to the government on the internet raises some concerns, due to citizens' fears that the data will be leaked and misused,²¹ retrieved by unauthorised third parties to be rented or sold to other organisations, or used for other purposes without the permission of the person associated with the data.²² The decision to adopt government e-services requires citizens' trust in the technology through which electronic transactions are executed (ie, the internet).²³ According to Teo et al, the citizen will likely be afraid that their ID and password will be leaked, or their credit card number will be hacked, if they are not confident that the technology enabling the e-filing system is secure enough.²⁴ On the other hand, online transactions with government agencies can be conducted successfully if the citizen exerts a high level of trust in e-filing technology. Chen et al showed that trust in the internet encourages citizen to use government e-services.²⁵ Thus:

H₃: Trust in technology has a positive influence on trust in the e-filing website.

3 *Trust in the e-filing website*

According to Mostafa and El-Masry, in order to boost government e-service adoption, the government needs to develop a trustworthy relationship with the citizen.²⁶ Apart from that, the government must also give assurances to the citizen that their data will not be accessed by unauthorised users, and that any information presented on the website is both up-to-date and accurate. Web developers can utilise many tools, such as firewalls and encryption technology, to increase the security of websites. The role of trust itself is particularly relevant in the context of e-filing, since there are no other websites offering the same service²⁷ — if users do not trust the government's e-filing website, submitting a tax return using the traditional offline method will remain their only option. Trust is essential to government e-service acceptance so, similar to that of Chen et al,²⁸ this study tried to assess e-filing effectiveness in the context of trust. After initial use of the e-filing website, citizens were asked to assess the information services provided. Respondents' quality perception will be based on their trust of the government website: a citizen with high trust will think that the website's flaws can be attributed to external reasons, and

¹⁹ See Carter and Belanger (n 13); Chen et al (n 1); Chaouali et al (n 11); Kurfali et al (n 17).

²⁰ Beldad, de Jong and Steehouder, 'I Trust Not Therefore It Must Be Risky' (n 16).

²¹ United States General Accounting Office, 'Electronic Government: Challenges Must Be Addressed with Effective Leadership and Management' (Statement for the Record by David L McClure, Director, Information Technology Management Issues, 11 July 2001) <<https://www.gao.gov/new.items/d01959t.pdf>>.

²² Beldad, de Jong and Steehouder, 'I Trust Not Therefore It Must Be Risky' (n 16).

²³ Carter and Belanger (n 13).

²⁴ Teo, Srivastava and Jiang (n 4).

²⁵ Chen et al (n 1).

²⁶ Mostafa and El-Masry (n 7).

²⁷ Chaouali et al (n 11).

²⁸ Chen et al (n 1).

they will tend to be less demanding of the website's functionality; on the other hand, if a citizen doubts the intention or commitment underlying the e-filing website, any flaws will be perceived as evidence of low quality.²⁹

It is very important to examine how trust may influence the perception of information quality in online exchange, since users cannot physically experience the object of the exchange.³⁰ The perception of information quality is a result of the evaluation of whether the information is accurate, reliable and up-to-date. Since citizens may not always have objective standards, and may have variation in understanding the information presented on the website, the degree of their belief in the e-filing website will influence this evaluation.³¹ Trust shapes expectations, as higher trust leads to more favourable perceptions of information quality.³² The more citizens trust the e-filing website, the better their appreciation of the quality of the information being provided.³³ Thus:

H₄: Trust in the e-filing website has a positive influence on perceptions of information quality.

E-filing is analogous to e-commerce. Higher perception of the system quality of the website will depend on the trust in the company that provides the e-service. Customers need to believe that the company will be accountable to ensuring the technical reliability and ease of use of the website.³⁴ Following this argument, trust enables citizens to believe that the government agency that runs the website will be able to effectively address various technical issues for enhancing the website usability and providing an efficient process. A better impression of system quality of the e-filing website can be gained with higher trust in the website itself.³⁵ Thus:

H₅: Trust in the e-filing website has a positive influence on perceptions of system quality.

In the context of e-filing, service quality perceptions are determined by interactions between citizens and government. Citizens with high trust in e-filing are expected to be more lenient and understanding of system failures. They may attribute any negative experience of e-filing (for example, a lengthy processing time) to reasons other than unreliability of the website.³⁶ Thus:

H₆: Trust in the e-filing website has a positive influence on perception of service quality.

C Information system quality

This study adopts the updated model of information system quality by DeLone and McLean, which is deemed to be an appropriate framework for examining the success of

²⁹ Teo, Srivastava and Jiang (n 4).

³⁰ Chen et al (n 1).

³¹ Teo, Srivastava and Jiang (n 4).

³² Beldad, de Jong and Steehouder, 'How Shall I Trust the Faceless and the Intangible' (n 5).

³³ Chen et al (n 1).

³⁴ Teo, Srivastava and Jiang (n 4).

³⁵ See Teo, Srivastava and Jiang (n 4); Khayun, Ractham and Firpo (n 4).

³⁶ Teo, Srivastava and Jiang (n 4).

information technology.³⁷ It has been argued that higher-quality information, systems and services increase the success of the information technology.³⁸ By using this framework, this study examines the information quality, systems quality and services quality of the e-filing website in Indonesia.

1 *Information quality*

Chang et al describe 'information quality' as the degree to which the information provided meets the needs of customers.³⁹ In this study, information quality represents how the information provided in the e-filing system could help taxpayers in submitting their tax returns to the DGT. Information quality can be measured by its accuracy, relevance, timeliness and completeness, and by its usefulness to users.⁴⁰ Since taxpayers have varying knowledge of how to use the system, their perceptions of the system would become more favourable if the system could provide better information.⁴¹ This is supported by Chen et al, who found that the quality of the information provided by the information technology positively affects its perceived usefulness.⁴² Therefore, in this study, if the e-filing website could provide a higher quality of information, users would have a better perception of its usefulness. Thus:

H₇: The quality of the information provided on the e-filing website has a positive influence on users' perception of its usefulness.

Furthermore, Borek et al stated that information quality would enhance user performance.⁴³ Users would be satisfied in using the system if information was high quality and supported them in operating the system more effectively.⁴⁴ Chen et al also found that better quality information increases user satisfaction in government e-services.⁴⁵ In this study, the information provided on the e-filing website should be up-to-date, accurate, relevant, sufficient and easy to understand. Such information will help taxpayers to use the system more effectively, and thus increase their levels of satisfaction in the system. Therefore, the quality of the information provided by the e-filing website is expected to affect the degree of satisfaction of its users. Thus:

³⁷ William H DeLone and Ephraim R McLean, 'Information System Success: The Quest for the Dependent Variable' (1992) 3(1) *Information Systems Research* 60.

³⁸ See William H DeLone and Ephraim R McLean, 'The DeLone and McLean Model of Information Systems Success: A Ten-Year Update' (2003) 19(4) *Journal of Management Information Systems* 9; Stacie Petter, William DeLone and Ephraim McLean, 'Measuring Information Systems Success: Models, Dimensions, Measures and Interrelationship' (2008) 17(3) *European Journal of Information Systems* 236. See also Syed Kashif Raza Zaidi, 'The Moderating Effect of Culture on E-Filing Taxes: Evidence from India' (2017) 7(1) *Journal of Accounting in Emerging Economies* 134.

³⁹ I-Chiu Chang et al, 'An Empirical Study on the Impact of Quality Antecedents on Tax Payers' Acceptance of Internet Tax-Filing Systems' (2005) 22(3) *Government Information Quarterly* 389.

⁴⁰ DeLone and McLean, 'The DeLone and McLean Model of Information Systems Success' (n 38).

⁴¹ Adel M Aladwani, 'A Cross-Cultural Comparison of Kuwaiti and British Citizens' Views of E-Government Interface Quality' (2013) 30(1) *Government Information Quarterly* 74.

⁴² Chen et al (n 1).

⁴³ Alexander Borek et al, 'A Risk Based Model for Quantifying the Impact of Information Quality' (2014) 65(2) *Computers in Industry* 354.

⁴⁴ See Beldad, de Jong and Steehouder, 'How Shall I Trust the Faceless and the Intangible' (n 5); Chen (n 5).

⁴⁵ Chen et al (n 1).

H₈: The quality of the information provided on the e-filing website has a positive influence on user satisfaction.

2 System quality

In this study, 'system quality' characterises the degree to which the functionalities of the e-filing system can help taxpayers in meeting their needs, easily and with minimal problems.⁴⁶ A high-quality system, in this study, is one that: is easy to access; provides clear guidelines; provides downloadable forms; is easy to use; encounters minimal technical problems (ie, crashing); and simplifies inputting and revising information. If taxpayers experience such a high-quality system that facilitates the e-filing of their tax returns, their perception of the usefulness of the e-filing website will thus increase. Thus:

H₉: The quality of the e-filing website's system has a positive influence on users' perception of its usefulness.

Further, previous studies have suggested that user satisfaction in the system will be significantly impacted if they can easily navigate the website.⁴⁷ If users find minimal problems in using the system, this will positively affect the user experience and thus increase user satisfaction. Therefore, in the context of the e-filing website in Indonesia, the quality of the system is expected to positively affect user satisfaction. Thus:

H₁₀: The quality of the e-filing website's system has a positive influence on user satisfaction.

3 Service quality

In this study, 'service quality' represents how services are delivered by the DGT to support users in operating the e-filing system so that their needs are met.⁴⁸ The use of the e-filing website should be supported by high-quality services provided by the DGT. In Indonesia, the DGT provides several services, such as the electronic filing identification number (EFIN), and the call centre (Kring Pajak), among others. These services should effectively assist Indonesian taxpayers in carrying out their tax return obligations. Chen et al found that service quality has positive impacts on users' perception of the usefulness of the government e-service.⁴⁹ Thus:

H₁₁: The quality of service to support the use of the e-filing website has a positive influence on users' perception of its usefulness.

Service quality is also considered to be a determinant of user satisfaction, as websites should be able to provide enhanced and simplified services to help users to solve their

⁴⁶ See Chang et al (n 39); DeLone and McLean, 'The DeLone and McLean Model of Information Systems Success' (n 38).

⁴⁷ See Teo, Srivastava and Jiang (n 4); Stacie Petter and Ephraim R McLean, 'A Meta-Analytic Assessment of the DeLone and McLean IS Success Model: An Examination of IS Success at the Individual Level' (2009) 46(3) *Information and Management* 159; Hollis Landrum, Victor R Prybutok and Xiaoni Zhang, 'The Moderating Effects of Occupation on the Perception of Information Services Quality and Success' (2010) 58(1) *Computers and Industrial Engineering* 133.

⁴⁸ DeLone and McLean, 'The DeLone and McLean Model of Information Systems Success' (n 38).

⁴⁹ Chen et al (n 1).

problems.⁵⁰ Further, Floropoulos et al stated that better quality service improves customers' perception of the usefulness of the system, and their satisfaction in it.⁵¹ Therefore, in this study, if the Indonesian tax office could provide high-quality services to taxpayers, to support their use of the e-filing website, it is expected to positively affect its perceived usefulness and taxpayer satisfaction. Thus:

H₁₂: The quality of the services to support the use of the e-filing website has a positive influence on user satisfaction.

D Perceived usefulness

A system is recognised to be beneficial if it offers net benefits to its users. Chang et al stated that net benefits can include: error reduction; time savings, including a quicker refund processing time; and lower costs of communication.⁵² In this study, user perception of the usefulness of the e-filing website is measured in its ease of use, its reduction of error, and its benefits for users. Chen et al found that the perceived usefulness of government e-services positively affects user satisfaction.⁵³ Therefore, in the context of the e-filing website in Indonesia, user perception of the usefulness of the e-filing website is expected to have positive impacts on user satisfaction. Thus:

H₁₃: Perceived usefulness of the e-filing website has a positive influence on user satisfaction.

Floropoulos et al suggested that if users find a system useful, it improves their satisfaction in the system.⁵⁴ Furthermore, Chen et al found that a better perception of the usefulness of government e-services increases the perceived net benefits of using the system (such as time and cost savings).⁵⁵ Therefore, the better the perception of usefulness, the better the user satisfaction and the higher the users' perceived net benefits in using the system. In line with the previous studies, the user perception of the usefulness of the e-filing website in Indonesia is expected to positively impact their perceived net benefits. Thus:

H₁₄: Perceived usefulness has a positive influence on users' perception of the net benefits.

E User satisfaction

Chang et al, and Wang and Liao, have argued that the success of government e-services relies on user satisfaction with the system.⁵⁶ In this study, user satisfaction is measured by how effectively the e-filing website helps taxpayers to carry out their tax obligation to the government, and whether the current system meets their expectations of an e-filing website. If users have a positive experience using the system, their satisfaction levels will

⁵⁰ Jordan Floropoulos et al, 'Measuring the Success of the Greek Taxation Information System' (2010) 30(1) *International Journal of Information Management* 47.

⁵¹ *Ibid.*

⁵² Chang et al (n 39).

⁵³ Chen et al (n 1).

⁵⁴ Floropoulos et al (n 50).

⁵⁵ Chen et al (n 1).

⁵⁶ Chang et al (n 39); Wang and Liao (n 5).

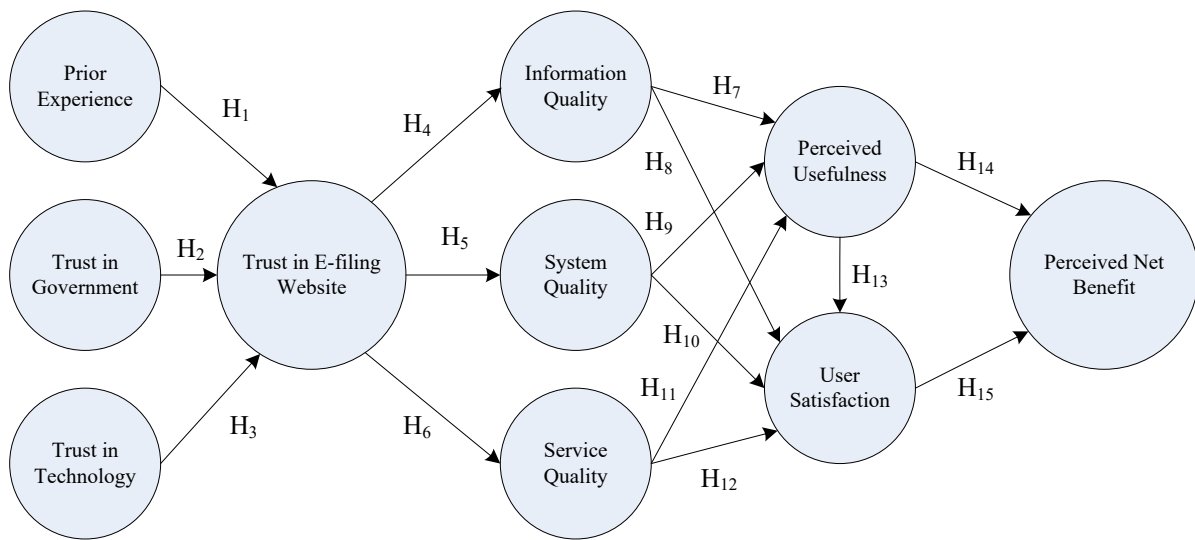
be higher.⁵⁷ This is supported by Chen et al, who found that user satisfaction with government e-services positively affects users' perception of the net benefits of the system,⁵⁸ while the perceived net benefits will, in turn, affect subsequent usage.⁵⁹ Thus:

H₁₅: User satisfaction has a positive influence on their perception of the net benefits of the system.

F Perceived net benefits

The perceived net benefits are the taxpayer's assessment of the net advantage they can get by using e-filing instead of a traditional, offline tax refund submission. The benefits can be in terms of ease of communication, cost and time savings, and better system performance.⁶⁰ Gilbert et al found that perceived benefit is an important dimension, triggering willingness to adopt government e-services.⁶¹ Since the emphasis of this study is on the measurement of government e-service success from the perspective of taxpayers, the net benefits in this study refer to the taxpayers' perception of the net benefits of the system. Hence, the perceived net benefits can be considered an important measure of government e-service success. Figure 1 illustrates the research model for this study.

Figure 1: Research model



⁵⁷ Wang and Liao (n 5).

⁵⁸ Chen et al (n 1).

⁵⁹ DeLone and McLean, 'The DeLone and McLean Model of Information Systems Success' (n 38).

⁶⁰ See Wang and Liao (n 5); Chen et al (n 1).

⁶¹ David Gilbert, Pierre Balestrini and Darren Littleboy, 'Barriers and Benefits in the Adoption of E-Government' (2004) 17(4) *International Journal of Public Sector Management* 286.

III RESEARCH METHODOLOGY

A Data collection and sample

In order to gain users' perceptions of the e-filing system in Indonesia, this study used a survey questionnaire, which was developed based on previous research.⁶² The survey questions were adjusted to fit the context of the e-filing system in Indonesia. It included questions on prior experience of offline tax returns, trust in the government, trust in the technology, trust in the e-filing website, perceived quality of the information provided by the e-filing website, perceived quality of system, perceived quality of the service, perceived usefulness, user satisfaction and perceived net benefits. The survey used a four-point Likert scale, from strongly disagree (1) to strongly agree (4). Table 1 shows the survey questions asked to measure the construct.

Table 1: Survey questions

Construct	Question items
Prior experience of offline tax returns ⁶³	<p>PE1: I feel that offline tax filing doesn't take a long time.</p> <p>PE2: I feel that offline tax filing is easy to do.</p> <p>PE3: Tax officials can handle the problem well when I have problems related to offline tax filing.</p> <p>PE4: Tax officials can provide an easy-to-understand explanation when I have questions related to offline tax filing.</p> <p>PE5: Tax officials are friendly in communicating with me when I report taxes offline.</p>
Trust in the government ⁶⁴	<p>TG1: I believe that the DGT acts in the best interests of citizens.</p> <p>TG2: I believe that the DGT is honest in carrying out its obligations.</p> <p>TG3: I believe that the DGT is competent in carrying out its obligations.</p> <p>TG4: I believe that the DGT can manage the e-filing system appropriately.</p> <p>TG5: I believe that the DGT can maintain taxpayer information in the e-filing system.</p>

⁶² See Wang and Liao (n 5); Amitabh Ojha, GP Sahu and MP Gupta, 'Antecedents of Paperless Income Tax Filing by Young Professionals in India: An Exploratory Study' (2009) 3(1) *Transforming Government: People, Process and Policy* 65; Ludwig Christian Schaupp, Lemuria Carter and Megan E McBride, 'E-File Adoption: A Study of U.S. Taxpayers' Intentions' (2010) 26(4) *Computers in Human Behavior* 636; Ramlah Hussein et al, 'E-Government Application: An Integrated Model on G2C Adoption of Online Tax' (2011) 5(3) *Transforming Government: People, Process and Policy* 225; Chen et al (n 1).

⁶³ Chen et al (n 1).

⁶⁴ See Schaupp, Carter and McBride (n 62); Chen et al (n 1).

Construct	Question items
Trust in the technology ⁶⁵	<p>TT1: I am sure that the internet has adequate protection that makes me feel comfortable when reporting taxes using the e-filing system.</p> <p>TT2: I am sure that laws pertaining to technology protect me from problems on the internet when reporting taxes using the e-filing system.</p> <p>TT3: I am sure that encryption and other technological advancements on the internet make me feel safe when reporting taxes using the e-filing system.</p> <p>TT4: In general, the internet is now a safe environment for reporting taxes using the e-filing system.</p>
Trust in the e-filing website ⁶⁶	<p>TW1: I believe that the e-filing system protects tax information from changes, destruction or theft by unauthorised parties.</p> <p>TW2: I believe that the e-filing system has adequate safety standards to protect taxpayers.</p> <p>TW3: In general, e-filing systems can be trusted to report taxes.</p>
Information quality ⁶⁷	<p>IQ1: Information presented in the e-filing system is up-to-date.</p> <p>IQ2: Information presented in the e-filing system is accurate.</p> <p>IQ3: Information presented in the e-filing system is relevant for tax-reporting purposes.</p> <p>IQ4: Information presented in the e-filing system is adequate for tax-reporting purposes.</p> <p>IQ5: Information presented in the e-filing system is easy to understand.</p>
System quality ⁶⁸	<p>SysQ1: The e-filing system can be accessed easily at any time.</p> <p>SysQ2: The e-filing system provides downloadable forms for tax-reporting purposes.</p> <p>SysQ3: The e-filing system provides guidance that helps taxpayers in tax reporting.</p> <p>SysQ4: The e-filing system is easy to use.</p> <p>SysQ5: The e-filing system does not crash when it is used.</p> <p>SysQ6: I can easily enter and revise my data when using the e-filing system.</p>
Service quality ⁶⁹	<p>SrvQ1: Services provided by tax officials related to the use of the e-filing system are reliable.</p>

⁶⁵ Chen et al (n 1).

⁶⁶ Ojha, Sahu and Gupta (n 62).

⁶⁷ Chen et al (n 1).

⁶⁸ See Schaupp, Carter and McBride (n 62); Hussein et al (n 62); Chen et al (n 1).

⁶⁹ See Ojha, Sahu and Gupta (n 62); Chen et al (n 1).

Construct	Question items
	SrvQ2: Services provided by tax officials related to the use of the e-filing system meet my needs. SrvQ3: The Kring Pajak service can handle problems well regarding tax reporting using the e-filing system.
Perceived usefulness ⁷⁰	PU1: The use of the e-filing system facilitates my tax reporting. PU2: The use of the e-filing system reduces errors in my tax reporting. PU3: Overall, the e-filing system is useful for me.
User satisfaction ⁷¹	US1: I feel that the e-filing system is effective in helping me to fulfil tax obligations to the government. US2: Overall, I am satisfied with the current e-filing system. US3: Overall, the current e-filing system has met my expectations.
Perceived net benefits ⁷²	PNB1: When compared to offline tax filing, the e-filing system reduces the time needed for the tax-reporting process (time savings). PNB2: When compared to offline tax filing, the e-filing system reduces the costs required for the tax-reporting process (cost savings). PNB3: Overall, when compared to the offline tax filing, the e-filing system is more useful.

The survey questionnaires were distributed online to prospective respondents or users of the e-filing website in Indonesia. In order to ensure that the respondents were users of the e-filing website, the first question pertained to whether they had used the e-filing website to submit their tax returns. The numbers of respondents in the sample are shown in Table 2.

Table 2: Research sample

Description	Number of respondents
Total respondents	1,097
Not e-filing users	(97)
Number of e-filing users	1,000
Invalid responses	(7)
Total valid responses	993

⁷⁰ Ojha, Sahu and Gupta (n 62); Chen et al (n 1).

⁷¹ See Wang and Liao (n 5); Chen et al (n 1).

⁷² Chen et al (n 1).

B Research methodology

Data analysis was conducted using covariance-based structural equation modelling ('CB-SEM') for factor analysis and hypothesis testing. The survey questionnaire was tested for its validity and reliability. For the validity test, the standardised factor loading for each indicator had to be larger than 0.5. If the standardised factor loading was less than 0.5, the indicators were deleted (see Table 4). Meanwhile, each construct had good reliability if the average variance constructed was more than 0.5 and the construct reliability was more than 0.7. In order to test the hypotheses, the t-values and path coefficients were used to determine whether the hypotheses were supported (see Table 5). The hypothesis testing was conducted across the whole sample, and also on subsets of the sample divided into Java and non-Java residents, and millennials vs non-millennials, in order to find any variation on the responses.

IV RESEARCH FINDINGS AND DISCUSSIONS

The largest group of our respondents were 26–35 years old, with 51.2 per cent male. This justified the assumption that the majority of e-filing users are young professionals, the millennials, who are more keen to use technology to fulfil their tasks, and more familiar with online services.⁷³ This age distribution is also consistent with the statistic released by the Indonesia Internet Service Provider Association in 2017, stating that almost 50 per cent of internet users in Indonesia were in the 19–34 age group.⁷⁴

We also managed to get responses from all across Indonesia, although the majority resided in the capital city of DKI Jakarta, and other areas in close proximity, such as West Java (Jawa Barat) and Banten. Overall, the percentage of respondents from Java surpassed respondents from any other island. It demonstrates that Java is the most developed area in Indonesia, and thus has the best internet connection and penetration. A complete characteristic of the respondents can be found in Table 3.

Table 3: Characteristics of respondents

Demographics	Category	Sample	
		N	%
Gender	Male	508	51.2
	Female	485	48.8
Age	<26 years	93	9.4
	26–35 years	500	50.3
	36–45 years	236	23.8
	46–55 years	128	12.9
	>55 years	36	3.6
Education	Elementary school	1	0.1
	Junior high school	0	0.0

⁷³ Sulaiman Ainin, Shamsul Bahri and Asri Ahmad, 'Evaluating Portal Performance: A Study of the National Higher Education Fund Corporation (PTPTN) Portal' (2012) 29(3) *Telematics and Informatics* 314.

⁷⁴ Asosiasi Penyelenggara Jasa Internet Indonesia, *Infografis Penetrasi & Perilaku Pengguna Internet Indonesia: Survey 2017* (2017) <<https://www.apjii.or.id/content/read/39/410/Hasil-Survei-Penetrasi-dan-Perilaku-Pengguna-Internet-Indonesia-2018>>.

	Senior high school	16	1.6
	Diploma I	7	0.7
	Diploma II	0	0.0
	Diploma III	44	4.4
	Bachelor degree (Diploma IV)	541	54.5
	Master degree	352	35.5
	Doctoral degree	32	3.2
Domicile	Aceh	6	0.6
	Sumatera Utara	6	0.6
	Sumatera Barat	11	1.1
	Riau	8	0.8
	Jambi	2	0.2
	Sumatera Selatan	18	1.8
	Bengkulu	0	0.0
	Lampung	11	1.1
	Kepulauan Bangka Belitung	6	0.6
	Kepulauan Riau	1	0.1
	DKI Jakarta	369	37.2
	Jawa Barat	236	23.8
	Jawa Tengah	42	4.2
	Daerah Istimewa Yogyakarta	22	2.2
	Jawa Timur	38	3.8
	Banten	109	11.0
	Bali	13	1.3
	Nusa Tenggara Barat	6	0.6
	Nusa Tenggara Timur	2	0.2
	Kalimantan Barat	1	0.1
	Kalimantan Tengah	3	0.3
	Kalimantan Selatan	6	0.6
	Kalimantan Timur	12	1.2
	Kalimantan Utara	2	0.2
	Sulawesi Utara	4	0.4
	Sulawesi Tengah	2	0.2
	Sulawesi Selatan	25	2.5
	Sulawesi Tenggara	3	0.3
	Gorontalo	3	0.3
	Sulawesi Barat	1	0.1
	Maluku	4	0.4
	Maluku Utara	1	0.1
	Papua	3	0.3
Papua Barat	1	0.1	
Offshore	16	1.6	
Type of tax return (SPT)	SPT 1770 SS	179	18.0
	SPT 1770 S	736	74.1
	SPT 1770	78	7.9

Table 4: Descriptive analysis, validity and reliability results

Construct*	Items	Mean	Standard deviation	Standardised factor loading	Average variance constructed	Construct reliability
PE	PE1	1.94	1.11	Deleted	0.74	0.89
	PE2	2.01	0.96	Deleted		
	PE3	2.77	0.95	0.88		
	PE4	2.85	0.91	0.94		
	PE5	2.95	0.86	0.75		
TG	TG1	3.44	0.71	0.77	0.65	0.90
	TG2	3.14	0.83	0.81		
	TG3	3.28	0.77	0.86		
	TG4	3.35	0.72	0.82		
	TG5	3.38	0.73	0.78		
TT	TT1	3.16	0.78	0.83	0.75	0.92
	TT2	3.22	0.76	0.88		
	TT3	3.30	0.73	0.91		
	TT4	3.23	0.76	0.84		
TW	TW1	3.25	0.73	0.89	0.80	0.92
	TW2	3.29	0.72	0.93		
	TW3	3.44	0.65	0.86		
IQ	IQ1	3.47	0.65	0.82	0.69	0.92
	IQ2	3.44	0.64	0.83		
	IQ3	3.51	0.61	0.90		
	IQ4	3.49	0.62	0.87		
	IQ5	3.34	0.75	0.72		
SysQ	SysQ1	3.20	0.87	0.73	0.54	0.87
	SysQ2	3.37	0.78	0.65		
	SysQ3	3.41	0.74	0.77		
	SysQ4	3.38	0.76	0.79		
	SysQ5	2.65	0.97	0.67		
	SysQ6	3.18	0.84	0.77		
SrvQ	SrvQ1	3.23	0.78	0.90	0.68	0.86
	SrvQ2	3.28	0.75	0.93		
	SrvQ3	2.89	0.86	0.60		
PU	PU1	3.67	0.57	0.86	0.69	0.87
	PU2	3.43	0.71	0.72		
	PU3	3.65	0.57	0.91		
US	US1	3.65	0.56	0.78	0.76	0.90
	US2	3.41	0.71	0.92		
	US3	3.30	0.75	0.90		
PNB	PNB1	3.77	0.52	0.88	0.76	0.90

Construct*	Items	Mean	Standard deviation	Standardised factor loading	Average variance constructed	Construct reliability
	PNB2	3.75	0.53	0.85		
	PNB3	3.74	0.52	0.88		

* Note: PE = prior experience; TG = trust in the government; TT = trust in the technology; TW = trust in the e-filing website; IQ = information quality; SysQ = system quality; SrvQ = service quality; PU = perceived usefulness; US = user satisfaction; PNB = perceived net benefits.

Figure 2: Structural model (ns = non-significant)

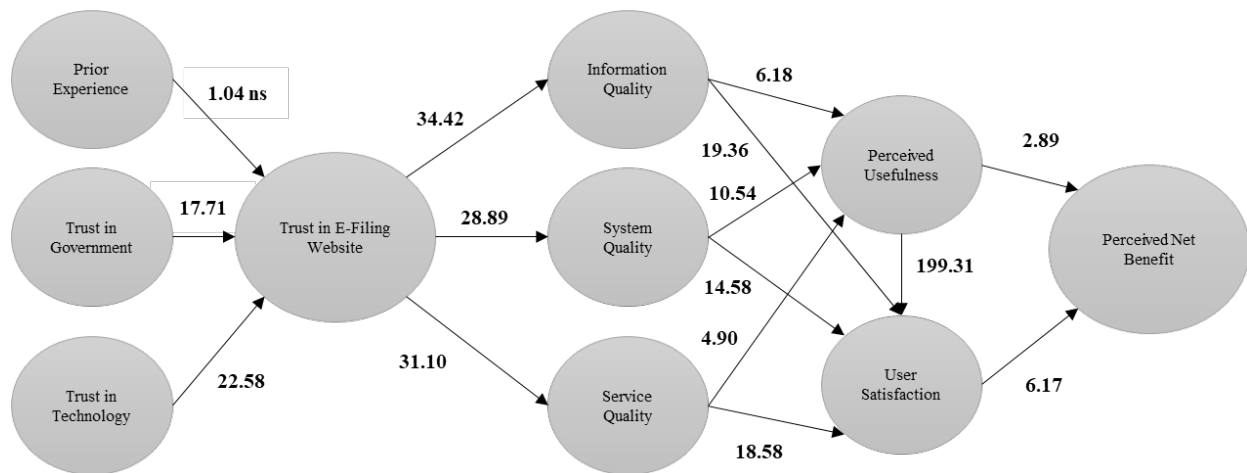


Figure 2 and Table 5 show our research findings. They suggest that trust in the government and the technology can shape trust in the e-filing website. Taxpayers will value the e-filing website if the government has a good image that engenders taxpayer trust and makes them believe that it will offer them the best service and provide a safe online environment. Trust in the technology also influences the willingness of taxpayers to switch from offline to online tax filing.⁷⁵ The internet must be reliable and secure,⁷⁶ since taxpayers will disclose their confidential information during the tax filing process.⁷⁷ A high level of trust in technology will facilitate taxpayers' belief that online transactions and interactions with government agencies can be conducted successfully.⁷⁸ This finding reflects that Indonesian citizens' trust in the government and the technology play an important role in their intention to use e-filing.

In addition, this study shows that trust in the e-filing website is significantly associated with user perceptions of all the system attributes: information quality, system quality and service quality. This result is consistent with Chen et al, whereby trust in the e-filing website significantly affects user perceptions of information quality.⁷⁹ It is explained by

⁷⁵ Kurfali et al (n 17).

⁷⁶ Anastasia Voutinioti, 'Determinants of User Adoption of E-Government Services in Greece and the Role of Citizen Service Centres' (2013) 8 *Procedia Technology* 238.

⁷⁷ Beldad, de Jong and Steehouder, 'I Trust Not Therefore It Must Be Risky' (n 16).

⁷⁸ Teo, Srivastava and Jiang (n 4).

⁷⁹ Chen et al (n 1).

Teo et al, who state that a citizen using an e-filing website for information searches or online services that involve transactions with government agencies, hence fulfilling the citizen's information and transaction needs, are the two basic functions of a government website.⁸⁰ Trust in the e-filing website poses the least influence on system quality, which indicates that a secure website alone is not enough to create the perception of an easily functioning application for the user. To be effective, the system must also be easy to use and come against minimal problems during the tax e-filing process.

All of the quality elements significantly affect perceived usefulness, with system quality having the highest influence. It indicates that every feature embedded in the system will give additional value for the user in facilitating their tax filing, with accessibility and easiness of the system having the biggest influence. User satisfaction is also likely to be determined by the information contained in the system to help the user in their tax refund submission. Many Indonesian citizens are not familiar with e-filing, especially new taxpayers. Hence, users will likely demand more comprehensive information in order to successfully fulfil their tax obligations. Apart from it, to be effective, the system must also be backed by human support to help in the tax filing process. The user may be satisfied if the transaction is completed successfully.⁸¹

Table 5: CB-SEM results

Hypothesis	Relationships of variables (IV → DV)	Path coefficients	t-statistic	Results
H1	PE → TW	0.019	1.04	Not supported
H2	TG → TW	0.47	17.71	Supported
H3	TT → TW	0.61	22.58	Supported
H4	TW → IQ	0.72	34.42	Supported
H5	TW → SysQ	0.74	28.89	Supported
H6	TW → SrvQ	0.78	31.10	Supported
H7	IQ → PU	0.17	6.18	Supported
H8	IQ → US	0.18	19.36	Supported
H9	SysQ → PU	0.45	10.54	Supported
H10	SysQ → US	0.091	14.58	Supported
H11	SrvQ → PU	0.22	4.90	Supported
H12	SrvQ → US	0.13	18.58	Supported
H13	PU → US	0.71	199.31	Supported
H14	PU → PNB	0.25	2.89	Supported
H15	US → PNB	0.53	6.17	Supported

* Note: PE = prior experience; TG = trust in government; TT = trust in technology; TW = trust in e-filing website; IQ = information quality; SysQ = system quality; SrvQ = service quality; PU = perceived usefulness; US = user satisfaction; PNB = perceived net benefits.

The most notable relationship in this research was the influence of perceived usefulness to user satisfaction. It demonstrated that the system is deemed able to meet user expectations if it can speed up and ease the tax filing process. Hence, user satisfaction can

⁸⁰ Teo, Srivastava and Jiang (n 4).

⁸¹ Ibid.

be improved if users acknowledge the advantages of the system in terms of cost and time savings.

Following the previous research in this field, we considered prior experience as one of many variables that explain trust in the e-filing website. The citizen will have a positive attitude toward e-filing if they perceive this service as an extension of the traditional one. It implies that a positive experience using traditional tax filing will build a belief that the online service will bring a similar experience. This is consistent with the research by Chen et al, whereby prior offline experience has a significant relationship with trust in the government website.⁸² However, our finding shows the contrary. It indicates that prior experience in offline government services has nothing to do with citizens' belief in the online service. Our respondents acknowledged offline tax filing as time-consuming, difficult, and lacking in support from tax officials. Nevertheless, taxpayers seem to ignore this bad experience when they decide to use the online system, believing that e-filing will give them a better experience.⁸³

In addition to the overall data analysis, we also divided the data into four clusters according to region (Java and non-Java residents) and age (millennials and non-millennials). The purpose of conducting subset analysis was to find out whether different clusters may have different behaviours toward e-filing.

We only used Java and non-Java clustering in the regional analysis, since the respondents from Java outnumbered those from any other area. There was a fear of having unreliable results if we further divided the data coming from outside Java, due to the insignificant quantity of the responses. Therefore, we combined the responses from areas outside Java into one group. Java is known as the centre of government and business in Indonesia. It is common knowledge that Java is Indonesia's most developed island, hence we expected that the internet connection would be more stable and have higher penetration than any other region.

Our findings on the hypothesis testing on Java were consistent with the overall data, while non-Java residents considered that information quality and system quality negatively affected user satisfaction. This implies that users from outside the Java area perceive that the information provided by the current e-filing system does not satisfy their needs. Therefore, a negative relationship between user satisfaction and information quality was found in this subset. The results from users outside the Java area also suggest that system quality has nothing to do with user satisfaction. Difficulty in accessing the internet for residents outside Java will lead to frequent problems in e-filing, and hence reduced functionality of the system. We also note that the current e-filing system does not have a 'save' feature. Therefore, if an error happens during the tax filing process, the user must begin the process again. A complete result on the Java and non-Java residents analysis can be found in Exhibit 1.

In addition, we also conducted a separate analysis based on age to identify any generational differences. Millennials are the respondents who were born after the year

⁸² Chen et al (n 1).

⁸³ Lee, Kim and Ahn (n 9).

1980.⁸⁴ A previous study on tax compliance has suggested that there are differences of perceptions towards tax fairness among different generations.⁸⁵ Therefore, we expected a difference in behaviour between the millennials and non-millennials, especially since millennials have long been considered technologically savvy. Thus, millennials were expected to value e-filing more than non-millennials.

Our analysis found that millennials did not define their perceived net benefit from their satisfaction in using e-filing, while there is a positive correlation between user satisfaction and perceived net benefit for non-millennials. This result means that the use of the e-filing website satisfies millennials in fulfilling their tax obligation to the government. However, it does not necessarily reflect that they obtain benefits from using it, such as cost and time savings. This is probably due to the fact that millennials use technology more often, so the benefit of utilising the technology does not mean much for them.

Furthermore, our results for non-millennials suggest that system quality does not significantly affect their satisfaction. Non-millennials are considered less technologically savvy than millennials, and therefore this result probably suggests that non-millennials tend to have fewer concerns about the quality of the system in determining their degree of satisfaction. The complete result of the millennial and non-millennial analysis is shown in Exhibit 2.

V CONCLUSION, LIMITATIONS AND IMPLICATIONS

A Conclusion

We found that trust in the government and the technology are able to shape trust in the e-filing website. This finding reflects that Indonesian citizens' trust in the government and trust in the technology play an important role in their intention to use e-filing. In addition, this study showed that trust in the e-filing website is significantly associated with user perceptions of the system attributes (ie, information quality, system quality and service quality). This result is consistent with Chen et al, whereby trust in the e-filing website significantly affects user perceptions of information quality.⁸⁶ All of the quality elements significantly affect perceived usefulness, with system quality having the highest influence. Finally, our findings demonstrated that users of e-filing in Indonesia perceive the online tax system as saving them both cost and time, and facilitating their tax obligations to the government.

B Limitations

The sample of this research was more concentrated on Java, compared to the other islands in Indonesia. Thus, the recommendation of future research is to add more samples from outside Java in order to analyse taxpayer behaviour based on cultural differences.

⁸⁴ Susan Journey, Tim Rupert and Marty Wartick, 'Generational Differences in Perceptions of Tax Fairness and Attitudes towards Compliance' (2017) 24 *Advances in Taxation* 163.

⁸⁵ *Ibid.*

⁸⁶ Lee, Kim and Ahn (n 9).

C Implications

From the results of this research, the DGT in Indonesia should emphasise improving the system and service quality of the e-filing website, as well as evaluating the quality of the information contained in the website, so as to increase taxpayer satisfaction in using the system. In addition, the government should improve the system quality (infrastructure) for the non-Java area, to increase tax compliance from taxpayers outside Java.

Exhibit 1: CB-SEM results — Java vs non-Java residents

Hypothesis	Relationships of variables (IV → DV)	Path coefficients (all data)	Path coefficients (Java)	Path coefficients (non-Java)
H1	PE → TW	0.019 (NS)	0.018 (NS)	0.0027 (NS)
H2	TG → TW	0.47	0.43	0.049
H3	TT → TW	0.61	0.65	0.025
H4	TW → IQ	0.72	0.71	11.20
H5	TW → SysQ	0.74	0.73	10.67
H6	TW → SrvQ	0.78	0.77	10.61
H7	IQ → PU	0.17	0.20	0.20
H8	IQ → US	0.18	0.25	-0.072
H9	SysQ → PU	0.45	0.42	0.46
H10	SysQ → US	0.091	0.17	-0.074 (NS)
H11	SrvQ → PU	0.22	0.22	0.26
H12	SrvQ → US	0.13	0.042	0.24
H13	PU → US	0.71	0.67	0.87
H14	PU → PNB	0.25	0.39	0.34
H15 (NS)	US → PNB	0.53	0.38	0.49

* Note: PE = prior experience; TG = trust in government; TT = trust in technology; TW = trust in e-filing website; IQ = information quality; SysQ = system quality; SrvQ = service quality; PU = perceived usefulness; US = user satisfaction; PNB = perceived net benefits.

Exhibit 2: CB-SEM results — millennials vs non-millennials

Hypothesis	Relationships of variables (IV → DV)	Path coefficients (all data)	Path coefficients (millennial)	Path coefficients (non-millennial)
H1	PE → TW	0.019 (NS)	0.032 (NS)	0.00058 (NS)
H2	TG → TW	0.47	0.39	0.71
H3	TT → TW	0.61	0.64	0.32
H4	TW → IQ	0.72	0.72	0.83
H5	TW → SysQ	0.74	0.63	0.81
H6	TW → SrvQ	0.78	0.76	0.81
H7	IQ → PU	0.17	0.25	0.10
H8	IQ → US	0.18	0.059	0.17
H9	SysQ → PU	0.45	0.39	0.31
H10	SysQ → US	0.091	0.044	0.0010 (NS)
H11	SrvQ → PU	0.22	0.21	0.46
H12	SrvQ → US	0.13	0.14	0.20
H13	PU → US	0.71	0.79	0.71
H14	PU → PNB	0.25	0.67	0.38
H15	US → PNB	0.53	0.11 (NS)	0.44

* Note: PE = prior experience; TG = trust in government; TT = trust in technology; TW = trust in e-filing website; IQ = information quality; SysQ = system quality; SrvQ = service quality; PU = perceived usefulness; US = user satisfaction; PNB = perceived net benefits.

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