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Role of reputational risk in tax decision making by large companies

Dr Catriona Lavermicocca¹ and Dr Jenny Buchan²

Abstract

Companies are increasingly expected to contribute to the tax revenue in countries they operate in. This article explores the relationship between reputational risk and aggressive income tax decision making in large companies, focusing on the role of the tax risk management system. It shows that few Australian companies use a comprehensive definition of tax risk that includes reputational risk and that shareholders do not play a significant role in the determination of a company's tax risk profile. This article contributes to an understanding of the relationship between reputational risk and tax aggressive decision-making and the limitations in current tax risk management systems in their ability to consider this relationship in development of tax strategy.

Key words: tax aggressiveness, corporate social responsibility, companies, reputation, shareholders, tax risk.

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1. INTRODUCTION

Large companies are concerned with the impact of negative publicity on their reputation. Their tax minimisation strategies have been identified by lobby groups and governments as a cause of reduced government capacity, as well as a possible solution to filling an increasing shortfall in income tax revenue collected by governments around the world. This attention potentially places pressure on high profile companies to take a less aggressive tax position than they would otherwise adopt. As highlighted by Forbes in 2013 quoting tax practitioner Hadley Leach, “[t]here has definitely been a trend toward more conservatism among corporations on international tax strategy. We’re seeing a huge shift in perception around issues of reputational and audit risk and that’s really starting to affect how companies approach tax planning.”³

Disclosure requirements and community expectations increasingly place pressure on large companies to pay their ‘fair share of taxes’. For instance, the recent authority⁴ granted to the Australian Taxation Office (ATO) to publish data concerning a company’s income tax payments is likely to increase pressure on reputational risk as interested parties will now be able to discover and compare companies’ tax contributions. Likewise, Ernst and Young (EY) states in its international ‘2011–12 Tax Risk and Controversy Survey Report’ that in its view “[c]ompanies now face unprecedented scrutiny and reporting of their tax affairs by advocacy groups and the media, often hurting brand reputation and—in the worst cases—shareholder value, even when such coverage is unwarranted or inaccurate.”⁵ In the EY survey 57 per cent of tax directors reported that the threat of a negative media article about their company was a concern, with only 40 per cent reporting it was not a concern. A subset within the EY cohort, 58 per cent of tax directors from the largest companies (those with annual revenues in excess of \$US5b), reported that the threat of negative media was a concern.

Good tax governance today therefore requires the identification and management of tax risks,⁶ including reputational risk, yet limited research has considered the impact of the management of tax risks on large company tax aggressiveness.⁷ Governments, public policy advocates and the community generally consider that aggressive tax decision-making that results in the taxpayer contributing less to the revenue than the ‘spirit of tax law’ requires, is inconsistent with the government tax policy and on that basis is behaviour that needs to be understood and addressed.⁸ This article focuses on the tax risk management approaches taken by large Australian companies and the

3 Joe Harpaz, ‘Corporate Reputation Influences Tax Strategy’, Forbes (online), 20 November 2013
<<http://www.forbes.com/sites/joeharpaz/2013/11/20/corporate-reputation-influences-tax-strategy/>>

4 Treasury, Commonwealth, Improving the Transparency of Australia’s Business Tax System: Discussion Paper (2013); Part 1A s3C Taxation Administration Act 1953 (Cth).

5 Ernst and Young, ‘2011–12 Tax Risk and Controversy Survey Report’

6 Tax risk is defined for the purposes of this article as ‘any event, action, or inaction in tax strategy, operations, financial reporting, or compliance that adversely affects either the company’s tax or business operations or results in an unanticipated or unacceptable level of monetary, financial statement or reputational exposure.’ In accordance with Ernst and Young, ‘Tax Risk Management: The Evolving Role of Tax Directors’ (2004).

7 Grant Richardson, Grantley Taylor and Roman Lanis, ‘The Impact of Risk Management and Audit Characteristics on Corporate Tax Aggressiveness: An Empirical Analysis’ (Conference paper presented at the Journal of Accounting and Public Policy Conference at the London School of Economics, 25 May 2012, Session 1). This paper identified that the higher the firm’s level of tax risk management and internal control effectiveness, the lower the level of tax aggressiveness.

8 For the purposes of this article a ‘tax aggressive’ position may not necessarily constitute non-compliance with the tax laws.

extent to which they ensure that tax decision makers are fully informed concerning the impact of their tax decisions on the company, focusing on the increasing importance of reputational risk as a result of a particular tax strategy. A large Australian company is identified as one whose annual turnover exceeded \$AU250 million in 2011.

First the theoretical framework and its literature are introduced. In sections 3, 4 and 5 the research proposition is stated then research methods and results are presented. The implications of the results for the leadership, accountability and reputation of large companies as well as for the community and governments are discussed in section 6. Finally, brief conclusions are presented.

2. THEORETICAL FRAMEWORK AND LITERATURE

The legal and governance concepts underlying this tax risk governance research are the separation of ownership and control in a company including agency theory, the increased importance of corporate social responsibility and reputational risk as well as the tax disclosure rules. They provide a framework for the research proposition, analysis and conclusions.

2.1 Separation of ownership and control: the corporate veil, and the agency principle

A company is a separate legal entity and as a consequence a 'corporate veil' separates the company and its shareholders.⁹ Each shareholder's direct, personal financial exposure is limited to the contributed share capital. Directors and managers have a fiduciary duty to make decisions in the best interest of the company as a whole. The nature of a company, a shareholder's financial exposure, and the fiduciary duty that guides decision making by directors and managers impact on the position a company takes in terms of its income tax aggressiveness.¹⁰

Although income tax and any penalties payable by a company do affect the return to individual shareholders indirectly, through reduced dividends and lowered share price, the direct responsibility for taxes and penalties is with the company. A consequence of shareholders not being directly accountable for a company's tax strategy means that they may not be sufficiently concerned about a company's tax strategy to influence policy.¹¹ An analysis of company income tax strategy must therefore recognise the absence of a direct nexus between a company's tax decisions and its individual shareholders.

While a company is treated as a taxpayer, it exists only by virtue of legal rules. Its corporate governance policies determine which roles within the company are made responsible for ensuring the company meets its obligations and compliance

9 *Salomon v Salomon and Co Ltd* (1897) AC 22 recognises the legal concept of a 'corporate veil' in which the personality of a company is distinguished from the personalities of its shareholders and protects shareholders from being held personally liable for the company's debts and obligations.

10 In the case of a company group, any tax liability incurred by one entity may be distributed through a number of entities before it will be reflected in dividends paid to individual shareholders.

11 Yoram Keinan, 'Corporate Governance and Professional Responsibility' (2003) 17(1) *Tax Law Journal of Taxation and Regulation of Financial Institutions* 10; Catriona Lavermicocca and Margaret McKerchar, 'The Impact of Managing Tax Risk and the Tax Compliance Behaviour of Large Australian Companies' (2013) 28 *Australian Tax Forum* 707.

requirements under tax laws.¹² The individuals making the decisions with respect to tax strategy do so as agents of the company.¹³ As agents, as long as directors and managers are acting within the limits of their authority, the common law agency principle makes the company accountable for its income tax and penalties. Corporate governance practices may be used to align the interests of the agent with those of the principal to ensure that a company's tax strategy is consistent with corporate goals and risk preferences.¹⁴

While the goals and objectives of a company should be the primary consideration in directors' and managers' decision-making, directors and managers do not operate in a vacuum. Their scope for defining company goals and objectives is limited by laws and other regulations including accounting standards and professional codes of ethics.¹⁵

The decision control systems within a large company typically separate management strategy making (initiation and implementation) and control (ratification and compliance monitoring). This separation also acts as a mechanism that regulates the directors' and managers' decision-making scope and ability.¹⁶ The company's board of directors (the Board) has a key role in the ultimate financial performance of the company through its effective control of management decision-making to ensure the interests of shareholders are protected. In fulfilling its role, the Board appoints managers and company officers who together are the decision-makers with respect to the company's acceptable tax risk profile.

Until the 21st century focus on tax risk management, many directors of large companies were not informed about the tax implications or the risk profile of a tax position taken by their company.¹⁷ It was believed that only the tax department within the organisation had the technical skills to understand the issues involved.¹⁸ In many large companies, tax managers control the detailed tax information and still only provide superficial information and aggregated data to the Board. Others rely on the

¹² Wolfgang Schön, 'Tax and Corporate Governance: A Legal Approach', (Paper presented at the Symposium on Tax and Corporate Governance, Munich, 8–9 December, 2006) 3.

¹³ Arne Friese, Simon Link and Stefan Mayer, 'Taxation and Corporate Governance' in Wolfgang Schön (ed), *Tax and Corporate Governance*, MPI Studies on Intellectual Property, Competition and Tax Law 3 (Springer-Verlag, 2008).

¹⁴ According to Pamela Hanrahan, Ian Ramsay and Geof Stapledon, *Commercial Applications of Company Law* (CCH, 13th ed, 2012) 531 "corporate governance is concerned with the way in which companies are directed and controlled. The term corporate governance is often used to describe the way in which a company's internal arrangements, taking into account external factors such as legislation, commercial or market pressure, provide; for responsibility for decision making to be divided between the company's members, its board and its executive management, for decisions to be taken and implemented, for the monitoring and review of decision-makers, and incentives for decision-makers to act in the interests of the company and disincentives to act in a manner that harms the company."; see also OECD, 'Principles of Corporate Governance' (2004) <<http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/31557724.pdf>>; ASX, 'Corporate Governance Principles and Recommendations – 3rd Edition' (2014) <<http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>>.

¹⁵ Directors and managers are subject to regulation in making business decisions. To understand tax decision-making in a company, an understanding of the relevant regulatory provisions is required. In an effort to align the goals of the directors and managers with the legitimate expectations of the shareholders, a number of duties are imposed on directors and managers by the common law and the *Corporations Act 2001* (Cth).

¹⁶ See Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305; Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88(2) *The Journal of Political Economy* 288; Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26(2) *Journal of Law and Economics* 301; Michael C Jensen, 'The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems' (1993) 48 *Journal of Finance* 831 for a discussion of the role of the separation of management and control in company decision making.

¹⁷ Joel Slemrod, 'The Economics of Corporate Selfishness' (2004) Dec *National Tax Journal* 877.

¹⁸ Linda M Beale, 'Putting SEC Heat on Audit Firms and Corporate Tax Shelters: Responding to Tax Risk and Sunshine, Shame and Strict Liability' (2003–2004) 29 *Journal of Corporate Law* 210.

advice of external tax advisers for determining the tax position taken by the company.¹⁹ Times have changed. Now, in identifying tax risk management as a part of good corporate governance practices, directors are required to consider tax risk profiles and the tax implications of business decisions.²⁰ What is an acceptable tax risk profile for a particular company will ultimately be determined by shareholder objectives reflected in company goals including profit maximisation and perhaps, increasingly, a sense of corporate social responsibility ('CSR').²¹ Before discussing our research we note relevant aspects of corporate social responsibility.

2.2 Corporate governance and social responsibility

In Australia, the UK and the US, corporate governance has traditionally focused on the interests of the financial stakeholders, typically shareholders.²² In line with this, directors and managers seek to minimise taxes payable by a company (within the law) and to the extent that they do not, their actions could be considered inconsistent with shareholder objectives.²³ Increasingly, however, a sense of social responsibility is seen as important to large business and creates an expectation that company decision-makers should also act in a broader social context in making business decisions.²⁴ The appropriateness of aggressive tax planning and tax minimisation may be reappraised through the lens of CSR as companies that do not pay their 'fair share of taxes' risk hostility from the public and ultimately reputational damage.²⁵

Consistent with this thinking, Justice Neville Owen of the HIH Commission of Inquiry²⁶ portrayed "business decision-making [as] a moral exercise",²⁷ a perspective considered by the Supreme Court of New South Wales in *Australian Securities and*

¹⁹ Jim Killaly, 'Large Business and International (Case Leadership)' (Speech delivered at the Australian Taxation Summit, Sydney, 15–17 February 2006) 16.

²⁰ Michael Carmody, 'Large Business and Tax Compliance—A Corporate Governance Issue' (Speech delivered at the Leaders' Luncheon, Sydney, 10 June 2003); OECD Forum on Taxation Information Note 'General Administrative Principles: Corporate Governance and Tax Risk Management' (2009) <<http://www.oecd.org/tax/taxadministration/43239887.pdf>>.

²¹ Judith Freedman, 'Tax and Corporate Responsibility' (2003) 695 (2) *Tax Journal* 1; John Christensen and Richard Murphy, 'The Social Irresponsibility of Corporate Tax Avoidance: Taking CSR to the Bottom Line' (2004) 47(3) *Development* 37.

²² Reuven S Avi-Yonah, 'Taxation, Corporate Social Responsibility and the Business Enterprise' (CLPE Research Paper 19/2009, Vol 05, No 03); Reuven S Avi-Yonah, 'The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility' (2005) 30 *Delaware Journal of Corporate Law* 767; Mark J Roe, 'A Political Theory of American Corporate Finance' (1991) 91 *Columbia Law Review* 10; Lucian Bebchuk and Mark J Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 *Stanford Law Review* 127; Mark D West, 'The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States' (2001) 150 *University of Pennsylvania Law Review* 527.

²³ Milton Friedman, 'The Social Responsibility of Business to Increase its Profits' *New York Times Magazine* (13 September 1970).

²⁴ Robert Baxt, 'The Dilemmas of the Modern Company Director', *Australian Corporations Commentary* (CCH, February 2011) [604–034]. This is consistent with the stakeholder model of the corporation articulated by R. Edward Freeman, 'Stakeholder Theory of the Modern Corporation' in *General Issues in Business Ethics*, 38–48 who identified that the stakeholders in the corporation are not only its owners, management and employees, but also include suppliers, local community and customers. Stakeholder theory and CSR is examined at Chapter 8 of R. Edward Freeman, Jeffrey S. Harrison, Andrew C. Wicks, Bidha L. Parmar, Simone De Colle *Stakeholder Theory: the State of the Art* Cambridge, 2010. Deeper discussion of this topic is beyond the scope of our article.

²⁵ Bernd Erle, 'Tax Risk Management and Board Responsibility' in Wolfgang Schön (ed), *Tax and Corporate Governance*, Springer, 2008 111.

²⁶ Commonwealth of Australia, The HIH Royal Commission, *Report on the Failure of the HIH Insurance Group in Australia* (2003).

²⁷ Neville Owen, 'Inaugural Lecture of the UTS Centre for Corporate Governance' (Speech delivered at UTS, Sydney, November 2003).

*Investments Commission v Macdonald [No 11]*²⁸ ('James Hardie'). The court in *James Hardie*²⁹ recognised that directors have moral responsibilities to a variety of stakeholders. The decision demonstrates that directors are required to make decisions after a consideration of the financial implications to the company as well as the moral implications. If this principle is also applied to the question of a director's stance on tax aggressiveness then directors should consider the company's moral requirement to make a 'fair contribution to the tax revenue' in making tax strategy decisions.

Following the line of thinking articulated by Justice Owen, and the decision in *James Hardie*, it could be argued that a company is expected to contribute to the revenue of a country in which they carry on business so that an aggressive tax position would be considered 'morally' unacceptable. To date no such moral responsibility exists under Australian law.³⁰

CSR itself imposes obligations on a company to a variety of stakeholders in addition to managers and shareholders including tax authorities, communities, political groups, customers and the public.³¹ For example, Muller and Kolk's research on multinationals operating in India found that taxation in developing countries is seen by multinationals as a CSR issue. Their research concluded that multinationals pay tax at considerably higher effective rates in India than do local companies.³²

Although no specific legislative provision requires an Australian company to be 'socially responsible' the ASX Corporate Governance Principles require ASX listed companies to "act ethically and responsibly" (Principle 3).³³ Accountability for the consequences of tax decisions is a likely consequence of Principle 3 which requires more than "mere compliance with legal obligations and involves acting with honesty, integrity and in a manner that is consistent with the reasonable expectations of investors and the broader community".³⁴ That there have been three separate inquiries into CSR in Australia over the past nine years reflects the topical nature of CSR.³⁵ In addition, the global financial crisis in 2008 added to the pressure on large companies to be socially responsible including the requirement to make a fair contribution to public revenue.³⁶

²⁸ [2009] NSWSC 28.

²⁹ Ibid.

³⁰ Andrew Lilico, 'Companies have a Moral Duty to Pay no More Tax than Legally Required' Telegraph Blogs 14 June 2013.

³¹ Robin W Roberts, 'Determinants of Corporate Social Responsibility Disclosure: an Application of Stakeholder Theory' (1992) 17 (6) *Accounting Organisations and Society* 595; Craig Deegan, 'Introduction: the Legitimising effect of social and environmental disclosures—a Theoretical Foundation' (2002) 15 (3) *Accounting, Auditing and Accountability* 282.

³² Alan Muller and Ans Kolk, 'Responsible Tax as Corporate Social Responsibility: The Case of Multinational Enterprises and Effective Tax in India' (2012) *Business and Society* 1.

³³ ASX, 'Corporate Governance Principles and Recommendations – 3rd Edition' (2014) <<http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>>.

³⁴ Ibid, 18.

³⁵ Parliamentary Joint Committee on Corporations and Financial Services (PJC), *Inquiry into Corporate Responsibility* (2006); Corporations and Markets Advisory Committee (CAMAC), 'Discussion Paper on the Inquiry into the Social Responsibility of Corporations' (November 2005); ASX, 'Corporate Governance Principles and Recommendations—3rd Edition' (2014).

³⁶ John Hasseldine, Kevin Holland and Pernill van der Rijt, 'The Market for Tax Knowledge' (2001) 22 *Critical Perspectives in Accounting* 39; OECD 'Moving Forward on the Global Standards of Transparency and Exchange of Information for Tax Purposes' (2009); Jeffrey Owens, 'Tax and Development: Why Tax is Important to Development' (2009) 4(4) *Tax Justice Focus* 1.

Traditionally the relationships between a company and other stakeholders have been ignored as the Board's focus has been on the company goal of profit maximisation. Consistent with this observation, Lanis and Richardson identify a surprising lack of research linking CSR with corporate taxation and argue that this may be due to the focus in accounting and business research relating to corporations, on agency theory and the relationship between managers and shareholders.³⁷

Henderson Global Investors surveyed 335 of the FTSE 350 companies in 2004 and noted that companies are increasingly required to "demonstrate to tax authorities (and also society) that they are complying with tax rules".³⁸

If a company is viewed as a 'real world entity', not just accountable to shareholders but to a variety of stakeholders, then addressing CSR would be considered legitimate.³⁹ In December 2012, for example, activists descended on Starbucks retail outlets in the United Kingdom (UK) to protest the company's failure to pay its required taxes, a failure that had been brought to light by a UK Parliamentary Investigative Committee.⁴⁰ Activists complained that as a consequence of Starbucks not paying the appropriate amount of taxes the less privileged and disadvantaged were not being looked after. Starbucks and other multinationals such as Google, Apple and Amazon have all been accused in recent time of failing to pay sufficient taxes and have accordingly been asked to explain their low rate of effective tax.⁴¹ Starbucks accepted that its reputation had been damaged by the accusation of tax dodging and that the perception had cost the company in terms of its viability to continue to carry on business in the UK.⁴² In response it announced that it would voluntarily pay £20 million in corporate tax in 2013 and 2014, regardless of whether the company was profitable.⁴³ The media continues to report on the low effective tax rates of high profile companies and the tax revenue implications of aggressive tax planning arrangements.⁴⁴

Starbucks' response indicates that community standards in relation to taxation can have an impact on a company's tax strategy. UK Uncut⁴⁵ has targeted other large businesses for failure to pay taxes in the UK and the public reaction indicates that "a social licence to operate has expanded beyond labour and environmental issues and beyond poor countries".⁴⁶ The impression that big business is not paying a 'fair

³⁷ Roman Lanis and Grant Richardson, 'Corporate Social Responsibility and Tax Aggressiveness: An Empirical Analysis' (2012) 31 *Journal of Accounting and Public Policy* 86.

³⁸ Henderson Global Investors, 'Tax, Risk and Corporate Governance' (2005) <<http://www.henderson.com/content/sri/publications/reports/taxriskcorporategovernance.pdf>>; Henderson Global Investors, 'Responsible Tax Report' (2005) <http://www.taxjustice.net/cms/upload/pdf/Global_Henderson_-_ResponsibleTax_-_OCT_2005.pdf>.

³⁹ Avi-Yonah, above n 22.

⁴⁰ Allison Christians, 'How Starbucks Lost its Social License—and Paid £20 million to Get it Back' *Tax Notes International* (2013) 71(7) 637.

⁴¹ Edward Kleinbard, 'The Lessons of Stateless Income' (2011) 65 *Tax Law Review* 99; James Hutchinson, 'Apple's tax falls to \$36m in Australia as sales hit \$6bn' *Australian Financial Review* (31 January 2014) <http://www.afr.com/p/technology/apple_tax_falls_to_in_australia_dWUlatWLWUYWD8XKa1Ln7K>; Jane Wardell, 'G20 Agrees on Push to Close Tax Loopholes, Make Multinationals Pay' Reuters (23 February 2014) <<http://in.reuters.com/article/2014/02/23/g20-australia-tax-idINDEEA1M05120140223>>.

⁴² Christians, above n 42; An IBE Survey (2012) found that tax avoidance was the second most important issue that the British public thought business needed to address.

⁴³ Christians, above n 42.

⁴⁴ Neil Chenoweth, 'International PwC Tax Schemes Exposed' *Australian Financial Review* (6 November 2014)

⁴⁵ UK Uncut is a grassroots movement taking action to highlight alternatives to the government's spending cuts.

⁴⁶ Christians, above n 42, 638.

amount of tax' encourages governments and bodies such as the OECD to look at taxation systems and provides support for a more heavy handed approach to corporate taxation.⁴⁷ The recent focus by the OECD on transfer pricing and tax base erosion, for instance, can be traced to a concern that multinational companies do not contribute sufficient taxes worldwide and that the current international tax agreements fail to address the shifting of profits to low tax jurisdictions.⁴⁸

Companies traditionally have not considered the payment of taxes to be an important part of their socially responsible behaviour⁴⁹ although the ownership structure of a company may moderate this.⁵⁰ Where a company's strategic goals include not just economic or financial goals but do also convey a sense of social responsibility it is expected that the company will place a higher level of importance on tax compliance and tax contributions to government.

Lobby groups including the The Tax Justice Network, Occupy Movement and Uncut UK and Uncut US all push for a larger contribution to tax revenue by big business.⁵¹ Publicised protests against alleged tax avoiders also have the potential to negatively impact on a company's reputation. Increasingly a social responsibility is recognised by companies in Australia and overseas and this may have an effect on a company's tax strategy.⁵²

A HMRC report highlights that large UK companies weigh up the potential impact on their reputation when considering whether to take a tax aggressive position.⁵³ As Christensen and Murphy argue the "[d]irectors now need to recognize that aggressive tax-planning strategies are not compatible with long term sustainability and therefore may not be in the shareholder's broader interests".⁵⁴

Difficulty exists in establishing whether a company is genuinely socially responsible. This in turn limits the ability to use published claims of socially responsible behaviour as indicators of tax aggressiveness. The role of CSR in reducing tax aggressive behaviour by large companies must be evaluated in the context of what Brunsson refers to as 'organised hypocrisy'⁵⁵ in which gaps arise between company talk, decisions and action. Sikka also argues that the CSR statements made by many companies are merely symbolic to "satisfy the demands from a critical external environment"⁵⁶ and the economic incentives for directors and management to increase

⁴⁷ OECD 'Action Plan on Base Erosion and Profit Shifting' (2013); OECD 'Addressing Base Erosion and Profit Shifting' (2013).

⁴⁸ Ibid.

⁴⁹ Angela K Davis, David A Guenther, Linda K Krull and Brian M Williams, 'Taxes and Corporate Sustainability Reporting: Is Paying Taxes Viewed as Socially Responsible' (Working Paper, Lundquist College of Business, University of Oregon, Eugene 2013).

⁵⁰ Susanne Landry, Manon Deslandes and Anne Fortin, 'Tax Aggressiveness, Corporate Social Responsibility, and Ownership Structure' (2013) *Journal of Accounting, Ethics and Public Policy* 14(3) 611.

⁵¹ Christians, above n42.

⁵² UTS Centre for Corporate Governance, 'The Changing Roles of Company Boards and Directors' (Final Report, September 2007).

⁵³ FDS International, 'Large Groups' Tax Departments: Factors that Influence Tax Management—A Qualitative Study' (Prepared for HMRC (UK), September 2006).

⁵⁴ John Christensen and Richard Murphy, 'The Social Irresponsibility of Corporate Tax Avoidance: Taking CSR to the Bottom Line' (2004) 47(3) *Development* 37, 43.

⁵⁵ Nils Brunsson, *Organised Hypocrisy: Talk, Decisions and Actions in Organisations* (John Wiley, 2003).

⁵⁶ Prem Sikka, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance' (2010) 34 *Accounting Forum* 153, 156. Sikka examined a number of large companies that state they behave in an ethical and responsible way yet at the same time were involved in tax avoidance and in some cases tax evasion.

profits through the reduction of taxes remain paramount.⁵⁷ Accordingly statements made by a company as to social responsibility need to be evaluated with scepticism and may not indicate anything about a company's tax aggressiveness.⁵⁸

Preuss' study of offshore finance centres based in tax havens found that 38 per cent of the offshore finance centres claimed to engage in 'socially responsible business practices' despite the fact that they were resident in low tax jurisdictions.⁵⁹ The relevant offshore finance centres were found to present themselves as being socially responsible yet still avoid paying taxes by locating in low tax countries. Here again is evidence that CSR claims are in some cases mere 'window dressing'.⁶⁰

Hasseldine and Morris⁶¹ criticise the conclusions made by Sikka because, they argue, Sikka did not appropriately define tax avoidance, and that the inclusion of companies that simply take an aggressive tax position as tax avoiders is not appropriate. Companies that plan their tax affairs to minimise taxes are not tax avoiders but a case of directors meeting their obligation to maximise profits according to Hasseldine and Morris.⁶² Theirs may prove to be 'old thinking'. Whilst there is no requirement that companies make decisions in a socially responsible way Sikka argues that if companies claim they are socially responsible they should not be pushing tax aggressive positions that minimise their contribution to the public revenue.⁶³

Hoi, Wu and Zhang, using unrecognised tax benefits⁶⁴ (UTB) over the period 2003 to 2009 as an indicator of tax aggressive behaviour, found that companies that demonstrate irresponsible corporate social activities are more likely to enter into tax sheltering arrangements.⁶⁵ Watson compared the level of UTBs to a company's CSR position and concluded that socially irresponsible firms have larger UTBs.⁶⁶ That is, a socially responsible company is less likely to adopt a tax aggressive position (reflected in a lower level of UTB) compared to socially irresponsible companies.

Of particular relevance to this article, Lanis and Richardson identified that a company's CSR principles can influence the stance the company takes in terms of tax aggressiveness and that influence is via the Board of directors.⁶⁷ Lanis and Richardson use data from a sample of 408 publicly listed Australian companies and conclude that a company's CSR position says something about the lengths a company is prepared to

⁵⁷ Ibid.

⁵⁸ Ibid.

⁵⁹ Lutz Preuss, 'Responsibility in Paradise? The Adoption of CSR Tools by Companies Domiciled in Tax Havens' (2010) 110 *Journal of Business Ethics* 1.

⁶⁰ Ibid.

⁶¹ John Hasseldine and Gregory Morris, 'Corporate Social Responsibility and Tax Avoidance' (2013) 37(1) *Accounting Forum* 1.

⁶² Ibid.

⁶³ Prem Sikka, above n 56, 153; Prem Sikka, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance—A reply to John Hasseldine and Gregory Morris' (2013) 37 *Accounting Forum* 15.

⁶⁴ A UTB is a tax position that a company's management is concerned will be challenged if examined by the revenue authority.

⁶⁵ Chun Keung Hoi, Qiang Wu and Hao Zhang, 'Is Corporate Social Responsibility (CSR) Associated with Tax Avoidance? Evidence from Irresponsible CSR' (2013) 88(6) *The Accounting Review* 2025.

⁶⁶ Luke Watson, 'Corporate Social Responsibility and Tax Aggressiveness: An Examination of Unrecognised Tax Benefits' (Paper presented at the American Accounting Association Annual Meeting—Tax Concurrent sessions Denver, Colorado US, August 2011).

⁶⁷ Lanis and Richardson, above n 37, 86.

go to reduce its tax liability.⁶⁸ Additional regression analysis demonstrates that social investment commitment, company strategy generally and the specific CSR strategy are all part of a firm's CSR activities and have a negative impact on tax aggressiveness.⁶⁹ The identification of a negative connection between social responsibility and tax aggressiveness suggests that companies that do address social responsibility are more concerned with ensuring compliance with the spirit of the tax laws than those companies that do not.

2.3 Reputational risk from tax decisions

As we have already noted in relation to Starbucks and other highly visible companies, the link between tax aggressive behaviour and a company's reputation could encourage companies to take a socially responsible approach to tax decision making where it is anticipated that the negative reputational impact outweighs any tax savings from an aggressive tax position. Negative media reporting of high profile multinationals that fail to contribute to the tax revenue in the jurisdiction in which they carry on business are increasingly common, having the potential to negatively impact that multinational's profitability.⁷⁰

Public opinion and perception, both directly and through the voice of the media, is a concern to large companies with 40 per cent of CEOs saying that the media had some influence on their company strategy and a further 12 per cent acknowledging that this influence was significant.⁷¹ In 2013, a US Government Accountability Office (GAO) Report on corporate tax rates highlighted that U.S. corporations paid on average a 13 per cent tax rate in 2010,⁷² a fact then widely reported in the media. The PricewaterhouseCoopers (PwC) Annual Global CEO survey, conducted in 2012 questioned 1038 CEOs in 68 countries about tax strategy and corporate reputation and the responses indicated that CEO's felt that corporate taxation has become a matter of public interest.⁷³

According to the PwC survey the single biggest danger that CEOs of large companies face in developing tax strategy is reputational.⁷⁴ As stated in the PwC report

[w]e're living in a world of 24-hour news and Twitter, a world where information is amplified and distributed in seconds and, most critically in the case of complicated tax arrangements, where complex issues are brutally summarised. Great damage can be done before a company has a chance to explain [its] position. Public opinion, even if it's based on inaccurate information, is powerful.⁷⁵

Further data that indicates the significance of reputational risk associated with tax decision-making by large companies was reported by ACE Group (one of the world's

⁶⁸ Ibid.

⁶⁹ Lanis and Richardson, above n 37, 105.

⁷⁰ Kleinbard, above n 41.

⁷¹ PricewaterhouseCoopers, 'Tax Strategy and Corporate Reputation—a Business Issue' (2013) 7.

⁷² United States Government Accountability Office, 'Corporate Income Tax—Effective Tax Rates Can Differ Significantly from the Statutory Rate' (May 2013) <<http://www.gao.gov/assets/660/654957.pdf>>.

⁷³ Ibid.

⁷⁴ Ibid, 8.

⁷⁵ Ibid.

largest property and casualty insurers).⁷⁶ The biggest source of reputational risk for 21 per cent of the 650 risk managers in the ACE survey report was aggressive tax avoidance/tax evasion in the business environment.⁷⁷ Similarly, the Thomson Reuters 2012 Australia and New Zealand Tax Survey sought the views of tax directors, corporate tax managers, heads of tax and Chief Financial Officers (CFO) at major companies in Australia and New Zealand and responses indicate that over half of the respondents (56%) were concerned about reputational risk with regard to non-compliance with tax laws and its effect on shareholder value.⁷⁸ The 2014 annual global survey of multinational CFOs conducted by Taxand, the world's largest global organisation of tax advisors to multinational businesses, indicates that 76 per cent of multinational CFOs felt that the focus in the media on corporate tax planning activity has had a detrimental impact on a company's reputation.⁷⁹ In fact 31 per cent of the Taxand survey respondents felt that the intense media focus on tax planning has had an impact on their approach to tax planning.⁸⁰

Whilst there is no clear and commonly agreed definition of 'company reputation' we use that proposed by Barnett, Jermier and Lafferty being "observers' collective judgements of a corporation based on assessments of the financial, social and environmental impacts attributed to the corporation over time".⁸¹ Because a company's reputation can affect its value and income earning potential, reputational tax risk concerns the impact on the company that may arise from its tax decisions and actions if persons outside the company were to become aware of it.⁸²

A potential negative impact on reputation as a result of a company adopting a tax aggressive position was not demonstrated in a pilot study of large companies in the UK in 2007.⁸³ Few of the respondents were concerned with the public's perceptions of their tax policy and planning behaviour. The authors suggest the lack of concern for negative publicity concerning tax aggressive behaviour could be due to the fact that in the UK at the time there was very little reporting of company tax strategy issues. In the light of the experience identified above of Starbucks, and others, it appears times have changed. Reputational risk is a "very real phenomenon facing multinationals if the public judges them to be too successful in reducing their tax bills".⁸⁴ The current view of the public can, to some extent, be ascertained from the results of a Gallup poll of US individuals in April 2013 that reported 66 per cent of respondents felt that companies pay 'too little' tax.⁸⁵

⁷⁶ ACE European Group, 'Reputation at Risk—ACE European Risk Briefing' (2013).

⁷⁷ Ibid, 11.

⁷⁸ Thomson Reuters, 'Thomson Reuters 2012 Australia and New Zealand Tax Survey' (2012).

⁷⁹ Taxand, 'Tax and Global Survey 2014—Navigating tax priorities: substance, reputational risk and reform' <http://www.taxand.com/sites/default/files/taxand/documents/Taxand%20Global%20Survey%202014.pdf>.

⁸⁰ Ibid.

⁸¹ Michael L Barnett, John M Jermier and Barbara A Lafferty, 'Corporate Reputation: The Definitional Landscape' (2006) 9(1) *Corporate Reputation Review* 26, 34.

⁸² Robert Booth, 'Starbucks Row Over Tax and Staff Contracts Could Squeeze Sales by 24 per cent' *The Guardian* (UK), 8 December 2012, 43.

⁸³ Judith Freedman, Geoffrey Loomer and John Vella, 'Moving Beyond Avoidance? Tax Risk and the Relationship between Large Business and HMRC' (Report of a Preliminary Study, Oxford University Centre for Business Taxation, June 2007).

⁸⁴ Christians, above n 42, 638

⁸⁵ Results are based on telephone interviews conducted April 4-7, 2013 with a random sample of 1000 adults, aged 18+ living in all 50 U.S. states and the District of Columbia; 'Gallup Poll (US)' 2013 <http://www.gallup.com/poll/161927/majority-wealth-evenly-distributed.aspx?ref=image>.

Community expectations also place pressure on governments and revenue authorities to do something about the failure (perceived or actual) of large companies to contribute to the revenue. In 2013, for example, the CEO of Apple was required to testify at the Senate Permanent Committee on Investigations in Washington, explaining why Apple manages to pay so little tax worldwide annually.⁸⁶ Other high profile multinationals, for example Amazon (6%), Boeing (7%), General Electric (16%) and Google (17%)⁸⁷ also demonstrate low effective tax rates. It is important to acknowledge that these multinationals are not necessarily involved in illegal activities rather they may be using legitimate tax-planning strategies to reduce their worldwide tax bill.⁸⁸

A number of researchers have considered the extent to which variables with an indirect impact on reputation drive tax decision-making. In analysing the tax planning activities of both public and private companies, Badertschera, Katzb and Rego note that because public companies are subject to greater financial reporting pressure, they tend to engage in more non-conforming tax planning.⁸⁹ In comparison, private companies are willing to adopt more book-tax conforming tax strategies which reduce their effective tax rates below those for public companies.⁹⁰

Badertschera, Katzb and Rego also considered private equity backed companies in the US that were involved in the management of investment funds and used, typically, to acquire mature businesses.⁹¹ Their research found that private companies, whose shareholders include private equity-based firms that were converted to public companies, engage in more tax avoidance than other public companies. This indicates that private equity ownership continues to influence the tax practices of a company after it becomes public.⁹² Badertschera, Katzb and Rego conclude that private equity backed companies view tax planning as an additional source of economic value to their firms, where the tax savings outweigh any potential reputational costs associated with company tax avoidance.⁹³ In a further dimension to the risk of reputation damage, Chen, et al (2010) found, not surprisingly, that family firms are more concerned about a potential tax penalty and/or potential damage to the family's reputation as a result of being found to be involved in tax avoidance than non-family firms.⁹⁴

Recent academic research has focused on the significance of company reputation in tax decision making. Specifically, Austin and Wilson⁹⁵ identify a set of firms with valuable consumer reputation and found no evidence that more highly rated consumer brands are associated with less tax avoidance but do find that managers of firms with

⁸⁶ Douglas S Stransky, 'US Tax Reform: Modern Tax Rules needed for the Modern Age of Business' *International Tax Review*, 18 June 2013.

⁸⁷ Ibid.

⁸⁸ Michelle Hanlon and Shane Heitzman, 'A Review of Tax Research' (2010) 50 *Journal of Accounting and Economics* 127.

⁸⁹ Brad Badertschera, Sharon P Katzb and Sonja Olhoft Rego, 'The Impact of Private Equity Ownership on Portfolio Firms' Corporate Tax Planning' (Unpublished working paper, University of Notre Dame, Columbia University and Indiana University 2011).

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Shuping Chen, Xia Chen, Qiang Cheng and Terry Shevlin, 'Are Family Firms More Tax Aggressive than Non-Family Firms?' (2010) 95 *Journal of Financial Economics* 41.

⁹⁵ Chelsea Rea Austin and Ryan Wilson, 'Are Reputational Costs a Determinant of Tax Avoidance?' (Working Paper, University of Iowa, February 2013).

valuable consumer brands use discretion inherent in financial reporting rules to report the benefits of tax planning more conservatively. In contrast Graham, Hanlon, Shevlin and Shroff⁹⁶ analysed survey responses from nearly 600 corporate tax executives to investigate firms' incentives and disincentives for tax planning and found that reputational concerns are important. Specifically 69 per cent of respondents rate reputation as important and rank reputation as second in order of importance among all factors explaining why they do not adopt a tax aggressive strategy.

Interdisciplinary research by Hardeck and Hertl links taxation, marketing and CSR and investigates the effects of media reports of aggressive or responsible corporate tax strategies on a company's success with consumers.⁹⁷ Hardeck and Hertl, using responses from a sample of German university students, found that a company's tax strategy can influence corporate success with consumers, in that a negative media report about a company's aggressive tax behaviour damages that company's reputation and lowers the likelihood that a customer will purchase that product.⁹⁸ In the alternative a media report on responsible tax behaviour has the opposite effect. Interestingly though, Hardeck and Hertl find that consumers are reluctant to pay higher prices for a product in order to induce responsible tax behaviour.⁹⁹ Arguably, increasing the level of disclosure of information about a company's tax compliance behaviour will increase the reputational risk, including the risk of consumer backlash, associated with aggressive tax decision-making by large companies. Yet on a more positive note increasing the level of disclosure of a company's responsible tax behaviour may enhance its reputation and provide benefits in the form of increased brand loyalty.

2.4 Disclosure of tax related information

The requirement to disclose information places pressure on company decision-makers to consider the implications of the disclosure on their relationship with stakeholders. The value that companies place on their reputation and the pressure to be more socially responsible suggests that disclosure of tax aggressive behaviour would be a concern to the Board and an important consideration in establishing a tax risk profile. Where a company is required to disclose detailed financial data, stakeholders have increased access to financial information about the company and are able to factor that information into decisions.

FIN48 including the disclosure of UTBs, s 404 of the *Sarbanes-Oxley Act of 2002* (US) ('SOX'), the ASX Principles of Good Corporate Governance, the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) ('CLERP 9') and the Continuous Disclosure Provisions¹⁰⁰ are measures that require primarily listed companies to justify and in some instances disclose details of the tax positions adopted.¹⁰¹ Revenue authorities have also been proactive in seeking greater

⁹⁶ John Graham, Michelle Hanlon, Terry Shevlin and Nemit Shroff, 'Incentives for Tax Planning and Avoidance: Evidence from the Field' (2014) 89(3) *The Accounting Review* 991.

⁹⁷ Inga Hardeck and Rebecca Hertl, 'Consumer Reactions to Corporate Tax Strategies: Effects on Corporate Reputation and Purchasing Behavior' (2013) 7 August *Journal of Business Ethics* 1.

⁹⁸ Ibid.

⁹⁹ Ibid.

¹⁰⁰ Companies listed on the ASX are subject to continuous disclosure obligations (with some exceptions) under ASX Listing Rule 3.1.

¹⁰¹ See also the *Dodd-Frank Wall Street reform and Consumer Protection Act* (US); PricewaterhouseCoopers 'Tax Accounting Services—Income Tax Disclosure' (Dec 2013).

transparency of material tax transactions. Australia requires taxpayers to notify the ATO of any reportable tax position¹⁰² and similar provisions exist internationally. Requirements to disclose information to the public are identified by Rice in an econometric study of small companies (assets between \$US1 million and \$US10 million) as encouraging tax compliant behaviour by a company.¹⁰³ Similarly, it is expected that increased regulation in terms of tax reporting will have an impact on company tax compliance as large companies are required to be transparent and accurate; they are becoming more accountable.

The research that links increased disclosure requirements to reduced tax aggressiveness is reflected in the 'OECD Report on Disclosure Initiatives' as it outlines the "importance of timely, targeted and comprehensive information to counter aggressive tax planning" and recommends that revenue authorities from OECD member countries introduce additional disclosure requirements to assist in the identification of tax aggressive behaviour.¹⁰⁴ Whilst the emphasis in the report is on the benefits to the tax administration of access to timely and detailed information for their review it is arguable that increasing the disclosure requirements will have an impact on the level of reputational risk faced by large companies that make the relevant disclosures.

The Head of the OECD's Global Transparency Forum, Monica Bhatia, stated in 2012 that "we are seeing a rise in transparency in policy, in incentives and in reporting, and it's only going in one direction: more transparency".¹⁰⁵ The introduction of country-by-country reporting requires companies to disclose a full consolidated profit and loss account for each and every jurisdiction in which it trades including full tax notes.¹⁰⁶ Some concern for information overload and public confusion as a result of the detailed information that will be available is noted.¹⁰⁷

The Australian Federal Government introduced legislation allowing the ATO to publish the corporate tax information of mining companies and businesses with \$AU100 million or more in total income.¹⁰⁸ An earlier Federal government discussion paper highlights that the publication of taxes payable by large business "... will enable the public to better understand the corporate tax system and engage in policy debates, as well as discourage aggressive tax minimisation practices by large corporate entities".¹⁰⁹ The ATO released, for the first time in May 2014, information showing where Australian companies shift revenues and analysts suggest that this is part of a

¹⁰² The reportable tax position schedule is the company income tax return to be lodged with the ATO. The schedule requires large businesses to disclose their most contestable and material tax positions.

¹⁰³ Eric Rice, 'The Corporate Tax Gap: Evidence on Tax Compliance by Small Corporations' in Joel Slemrod (ed), *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan Press, 1992) 125.

¹⁰⁴ Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure Report on Disclosure Initiatives OECD, February 2011.

¹⁰⁵ Matthew Gilleard, 'The Dark Side of Transparency' (2014) February *International Tax Review* 12.

¹⁰⁶ Gilleard, Ibid; PriceWaterhouseCoopers (2013) Tax Transparency and country-by-country reporting- An Ever Changing Landscape <http://www.pwc.com/en_GX/gx/tax/publications/assets/pwc_tax_transparency_and_country-by-country_reporting.pdf>.

¹⁰⁷ Gilleard, above n105. See also the *Foreign Account Tax Compliance Act* US 2010 ('FATCA')

¹⁰⁸ Part 1A s3C *Taxation Administration Act 1953* (Cth) requires the ATO Commissioner to make public specific information relating to the tax affairs of all corporate tax entities that have a reported total income of \$100 million or more.

¹⁰⁹ David Bradbury, Assistant Treasurer Press Release No 40 'Improving the Transparency of Australia's Business Tax System', 3 April 2013: Improving the Transparency of Australia's Business Tax System—Discussion Paper, April 2013 Commonwealth of Australia; Australian Treasurer Arthur Sinodinos hinted that the Australian disclosure laws may be repealed on the basis of concern detracts from well informed debate.

‘scare campaign’ by the ATO to stop multinationals from shifting profits to countries with lower tax rates’.¹¹⁰ The increasing importance of social responsibility and the greater community awareness in relation to the tax contribution of large companies through tax reporting and disclosure requirements mean that the reputational risk associated with tax decision making will be a significant tax risk for many companies.¹¹¹

An additional concern identified, as a result of the disclosure of tax paid by large companies, is the risk that the information disclosed “may be misleading and it could do big damage unfairly”.¹¹² Large business, governments and the OECD highlight that the publication of simplified tax figures may give a distorted impression of a company’s tax contribution and result in misinformed impressions and decisions.¹¹³ Despite this concern, research commissioned by the Tax Justice Network in Australia, indicates that there is widespread support in Australia to make corporate tax more transparent and almost two-thirds of respondents to the survey in 2014 felt negative about companies such as Apple for using loopholes to avoid tax, increasing substantially from 2013.¹¹⁴

As demonstrated by Starbucks, it is anticipated that reputational risks are, for many industries, a substantial concern. Our research proposition is that the complex issue of reputational risk will have an impact on a large company’s tax risk management decisions and ultimate tax risk profile.

3. RESEARCH PROPOSITION

This article considers the research proposition that the impact of a large company’s tax aggressiveness on its reputation is a significant tax risk, and a comprehensive tax risk management system should include an evaluation of reputational risk. Further it is proposed that the consideration of reputational risk by a company’s tax risk management system will result in a company adopting a lower level of acceptable tax risk. Other recent research looking at the relationship between reputational risk and tax decision making was discussed in section IIC and supports this research proposition.¹¹⁵ We now detail the research methods underlying our results.

¹¹⁰ Jonathan Pearlman, ‘Aussie Firms target Singapore in Quest for Lower Taxes’ *The Straits Times* 9 May 2019

¹¹¹ Neil Chenoweth, ‘How Ireland got Apple’s \$9bn profit’ *Australian Financial Review* 6 March 2014.

¹¹² Nassim Khadem, ‘OECD Cool on Mandatory Disclosure of Tax Bills’ *Australian Financial Review* 30 January 2014; United Voice and Tax Justice Network, Australia, ‘Who Pays for our Commonwealth? Tax Practices of the ASX 200’ (2014) <file:///D:/Users-Data/mq92502857/Downloads/Who%20Pays%20-%20ASX%20200%20Short%20Report%20(1).pdf>.

¹¹³ Ibid.

¹¹⁴ Tax Justice Network, ‘Australian Public Outraged with Multinational Corporations Avoiding Tax’ (15 September 2014).

¹¹⁵ Lavermicocca and McKerchar, above n 11, 66; Ernst and Young, ‘2011–12 Tax Risk and Controversy Survey Report’.

4. RESEARCH METHODS—POPULATION AND DATA COLLECTION

The empirical research consisted of two phases: the initial qualitative phase followed by a quantitative phase.¹¹⁶ In the first, the relationship between tax risk management and tax compliance was explored through in-depth interviews. The responses to interview questions were then analysed, and key themes and relationships were isolated. These were then used to formulate specific research questions that were tested quantitatively using data collected in a survey of large companies in Australia during the second phase.

4.1 Phase One—In-depth interviews

In-depth interviews were conducted with tax managers from 14 large Australian companies.¹¹⁷ Each in-depth interview included 19 open-ended questions relating to tax risk and tax decision-making (See Appendix 1). A tax partner with a ‘Big 4’ international accounting firm was also interviewed during this first phase to obtain his view on the tax risk management practices of large company clients and the impact of those practices on tax compliance behaviour. The views of the tax partner provided an additional insight into the approach to tax risk management by large Australian companies.

Participation in the in-depth interviews was voluntary. Interviews were conducted face-to-face or via telephone between October 2009 and June 2010. The responses to open-ended questions were analysed by coding responses then isolating key concepts to develop themes and relationships.¹¹⁸ Ultimately, the themes and relationships identified were used to build a range of specific research questions to be tested empirically during Phase Two.

4.2 Phase Two—Survey instrument

In Phase Two a survey (See Appendix 2) was conducted to collect information about tax risk management practices in Australia and the variables that have an effect on a

¹¹⁶ David L Morgan, ‘Practical Strategies for Combining Qualitative and Quantitative Methods: Applications to Health Research’ (1998) 8(3) *Qualitative Health Research* 362; Abbas Tashakkori and Charles Teddlie, *Mixed Methodology: Combining Qualitative and Quantitative Approaches* (Sage Publications, 1998); Abbas Tashakkori and Charles Teddlie (eds), *Handbook of Mixed Methods in Social and Behavioural Research* (Sage Publications, 2003).

¹¹⁷ Large company for the purposes of this research includes both listed and unlisted companies with a turnover exceeding \$250million. The Australian Tax Office (ATO) ‘Large Business Group’ includes business groups with a turnover exceeding AUD250 million and it is this group that the ATO focuses on in correspondence and publications concerning the need to adopt a tax risk management system. For the purposes of this research a ‘large company’ is defined as a company with a turnover exceeding AUD250 million, as it is this subset of companies that contribute significantly to company tax revenue in Australia (58%) and are the target of the ATO tax risk management initiative. According to ‘Australian Taxation Statistics 2009–2010’ Chapter 3 Box 3.2, Table 3.3 and Table 3.9, companies with a turnover exceeding AUD250 million constitute 0.1 per cent of the total number of company taxpayers in Australia yet contribute 58 per cent of company tax revenue. Inconsistent with the definition used for the purposes of this research, the ATO defines a ‘large company’ as a company with a turnover between AUD100 million and AUD250 million and a ‘very large company’ as a company with a turnover in excess of AUD250. The decision to use the threshold of AUD250 million in this research, as opposed to the AUD100 million used by the ATO, is justified based on the ATO focus on tax risk management practices of companies with a turnover exceeding AUD250 million and the fact that according to ‘Australian Taxation Statistics 2009–2010’ Chapter 3 Table 3.9 companies with a turnover between AUD100 million and AUD250 million contribute only .05 per cent of company tax revenue and the indication in preliminary research is that company group is unlikely to have put in place a comprehensive tax risk management system.

¹¹⁸ Juliet Corbin and Anselm Strauss, *Basics of Qualitative Research* (Sage Publications, 3rd ed, 2008) 160.

large company's ability to manage tax risk. Company 360, a database of Australian companies, was used to obtain the contact details of Australian companies with a turnover exceeding AUD250 million.¹¹⁹ The CFOs of all companies identified, (approximately 1,200 companies) were sent the survey instrument by mail in December 2011 and January 2012. A postal survey, as opposed to an email survey was used as only the postal address of CFOs of large Australian companies was available on the Company 360 database. This survey constitutes a cross-sectional population survey rather than a sample survey as the survey instrument was sent to all Australian companies in the sample.

To maximise the response rate and minimise the potential for bias in responses, the survey responses did not identify the respondent company and accordingly respondents remained anonymous. A follow-up survey was sent to all potential participants three weeks after the first survey mail out to ensure participation in the survey was maximised.¹²⁰ The survey instrument included both closed and open-ended questions. A range of techniques were employed to minimise bias.¹²¹ Coded data was entered as a dataset into SSPS, producing statistics for analysis.

Based on the Company 360 database, 36.7 per cent of Australian companies in the population are public companies and 63.3 per cent are proprietary (referred to as 'private' in this article). One hundred and twenty three responses were received to the Phase 2 survey. Of these, 35.8 per cent were from people working in private companies and 64.2 per cent were from those working in public companies, as shown in Table 1.

Table 1: Population and respondents by company type

	Population %	Respondents %
Private company	63.3	35.8
Public company	36.7	64.2
Total	100.0	100.0

The fact that the majority of respondents were public companies is consistent with the ATO statement in the 'Compliance Program 2011–2012' that "the majority of entities in the large business sector are public companies".¹²²

There is a noticeable difference between the response rates for public and private companies. The response rate calculated for private companies is $44/737 = 6.0$ per cent while the response rate for public companies is $79/427 = 18.5$ per cent. While the response rate is lower than other Australian tax compliance mail surveys,¹²³ this

¹¹⁹ For the purposes of this research a 'large company' is defined as a company with a turnover exceeding AUD250 million, as it is this subset of companies that contribute significantly to company tax revenue in Australia (58%) and are the target of the ATO tax risk management initiative.

¹²⁰ Floyd J Fowler, *Survey Research Methods: 1 (Applied Social Research Methods)* (Sage Publications, 2009) 59; Don A Dillman, *Mail and Internet Surveys: The Tailored Design Method* (John Wiley, 2nd ed, 2007).

¹²¹ Ibid, 59.

¹²² ATO, 'Compliance Program 2011–2012' <<http://www.ato.gov.au/content/downloads/cr00284023compliance.pdf>>, 24.

¹²³ Ken Devos, 'An Investigation Into Australian Personal Tax Evaders—Their Attitudes Towards Compliance And The Penalties For Non-Compliance' (2009) 19(1) *Revenue Law Journal* Article 2

survey can be distinguished on the basis that the potential respondent is the individual in a large company responsible or familiar with the company's tax risk management practices. Previous Australian tax compliance mail surveys relate to individual tax compliance and the potential respondent was the individual taxpayer.¹²⁴ The response rate may also be low because surveys may not have reached the appropriate individual in the company.

Although the response rate is low there is no predetermined minimum response rate required for a mail survey.¹²⁵ The response rate should be judged in light of the specific nature of the survey recipients as complex and multifaceted entities, where tax compliance and tax risk management is handled by a number of staff in the entity with competing demands on their time. Certainly, the potential for bias associated with non-response needs to be considered as it is possible that those survey recipients who had an interest in tax risk management or who had actually addressed tax risk management in their governance practices are more likely to respond to the mail survey.¹²⁶ An analysis of non-response bias compared the characteristics of the early and late completers of the survey to determine whether there are significant differences between them and none were detected.

The percentage of all company taxpayers from the different industry categories shows that companies in a range of industries participated in the survey. As a result, the responses reflect tax risk management processes, approaches and outcomes for a variety of industries. In addition, comparisons with total company taxpayer and total company income do not highlight any substantial discrepancy in the industries reflected in the respondent group.

While the letter accompanying the survey was addressed to the CFO, the CFO did not necessarily complete the survey. Table 2 shows the position of the individuals who completed the survey.

<<http://epublications.bond.edu.au/rhj/vol19/iss1/2>> 14; Pauline Niemiowski, Alexander J Wearing and Steve Baldwin, 'Identifying the Determinants of Australian Taxpayer Compliance' in Adrian J Scott (ed), *XXVI IAREP Annual Colloquium on Economic Psychology: Environment and Wellbeing* (2001) 199; Pauline Niemiowski, Steve Baldwin and Alex Wearing, 'Chapter 18' in Michael Walpole and Chris Evans (eds), *Tax Administration in the 21st Century* (Prospect, 2001) 211.

¹²⁴ Fowler, above n 120.

¹²⁵ Ibid.

¹²⁶ Fowler, above n 120, 221.

Table 2: Position in the company of the individual who completed the survey

	Frequency	Per cent
CFO	47	38.2
Tax director	23	18.7
CEO	4	3.3
Tax manager	28	22.8
Assistant tax manager	1	0.8
Financial controller	9	7.3
Finance manager	4	3.3
Other	7	5.7
Total	123	100.0

The CFO, tax manager and tax director as a group make up 79.7 per cent of all respondents. The individuals in those positions are ordinarily responsible for ensuring that tax risk is managed in accordance with company policy. Importantly, not all companies in the large company sector have a dedicated tax director or manager. The nature and complexity of the tax issues that a large company faces is expected to also determine the structure of the tax function including the number of tax staff and level of responsibility.

Each survey question asked the respondent to provide information on behalf of their company that will contribute to answering a number of specific research questions. The frequency distribution for each of the responses to the closed questions and answers to open-ended questions were analysed and applied to the specific research questions to develop an understanding of tax risk management practices in large Australian companies and the impact on income tax compliance behaviour. A chi-square goodness of fit analysis was also used to determine any relationships between a company's characteristics and the survey responses regarding compliance and tax risk management.

The statistical analysis, together with the analysis of open-ended questions, provides a rich understanding of the tax risk management practices of large Australian companies and the views of individuals responsible for tax risk management. The responses offer a meaningful insight into the income tax compliance behaviour of large Australian companies.

5. RESULTS

Whilst the in-depth interviews and survey asked questions concerning tax risk management practices and their impact more broadly, this article focuses on the results that relate specifically to an understanding of the role of reputational risk in tax decision making in a large Australian company. Because reputational risk has been identified as being so important to large companies, the implications of the results for the leadership within and the accountability and integrity of large companies, cannot be discounted.

5.1 Results relating to reputational tax risk management

All interviewees commented on the importance of the company's reputation and believed that any negative publicity concerning tax compliance¹²⁷ would affect the company's profitability. All noted that the company and its senior management would be most concerned if it was perceived as non-compliant with the tax laws or considered to have taken an aggressive tax position. No interview participant indicated that they take an aggressive tax position, but rather, that they made every effort to comply. They identified one of the key motivators for taking a conservative approach to tax compliance as being their concern for the company's reputation. This concern was clearly articulated by the Board and filtered down to the operational tax decision makers.

Four interview participants stressed the importance of maintaining their reputation as good company taxpayers and further stressed that the potential impact on a company's reputation of any negative publicity concerning possible aggressive arrangements actually resulted in the company accepting a lower level of acceptable tax risk. Three interview participants felt that the importance of the company's good reputation is a key motivator in establishing a tax risk management system to identify tax risks.

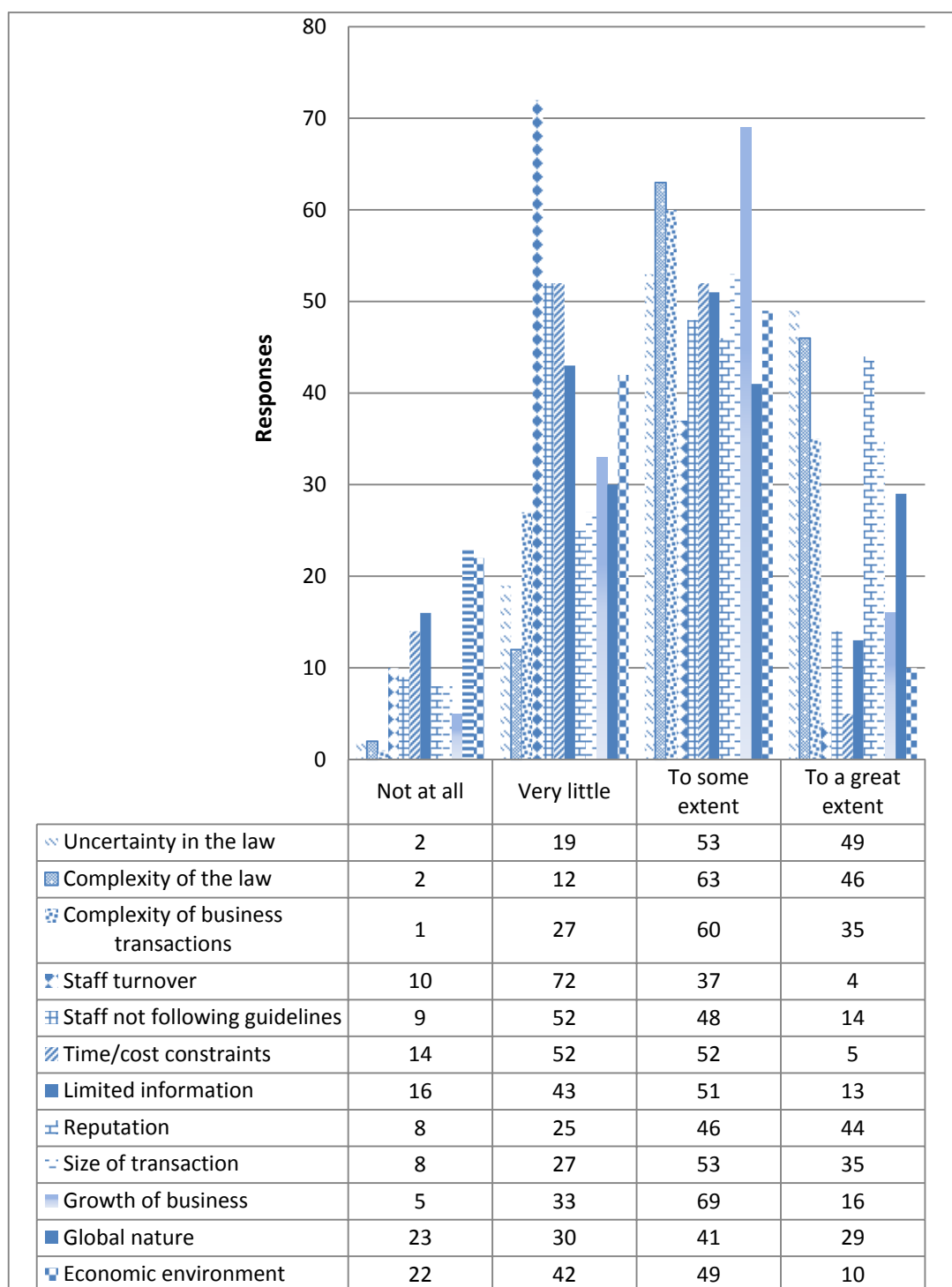
Survey Question 7 asked respondents whether certain factors increase or create tax risk for the company in carrying on its business activities including uncertainty and complexity in the tax laws, complexity of business transactions, staff turnover, staff not following guidelines, time and cost constraints, limited information flow to relevant staff, level of concern for reputation, size of the transaction, growth of the business, global nature of the business and economic environment. Figure 1 summarises the results for the relevant factors.

A significant number of respondent companies (73.2% as detailed in Table 3) indicated that concern for company reputation increases the level of tax risk that needs to be managed to some or a great extent. These respondents were concerned about the impact of tax non-compliance on their reputation.

Table 3: The extent to which the level of concern for reputation increases the level of tax risk (SQ7h)

	Frequency	Per cent
Not at all	8	6.5
Very little	25	20.3
To some extent	46	37.4
To a great extent	44	35.8
Total	123	100.0

¹²⁷ The interviews and survey asked about tax risk and tax decision making. Where the term 'compliance' was used it was meant and understood to mean *ex ante* tax strategy. No confusion was indicated by respondents about whether the questions related to *ex ante* strategic decision making or *ex post compliance* behaviour.

Figure 1: Factors that increase or create tax risk for large companies

5.2 Tax risk management system does affect the level of acceptable tax risk

Survey Question 16 asked the individual completing the survey on behalf of the respondent company whether in their view the current tax risk management system had an effect on the level of tax risk considered acceptable to the company. In addition, Survey Question 16 includes an open-ended component in which the individual on behalf of the respondent company can detail the actual effect on the level of acceptable tax risk and if it has no affect the reasons why. Only 68 of the 124 respondents did have a comprehensive tax risk management system.

While 82.4 per cent of respondent companies indicated that the tax risk management system did have an effect on the level of tax risk considered acceptable (detailed in Table 4 below) the comments by respondents in the open-ended component demonstrate that this is largely a result of the increased awareness and transparency of income tax risk. Potentially the increased awareness and transparency allows greater awareness of reputational risk. Tax decision makers are more informed of the relevant tax risks and possible consequences of their decisions as a result of the comprehensive identification and management of tax risks that the company faces, including reputational risk.

An increasingly global approach to the management of tax risk was identified by a number of respondent companies as ensuring a low level of acceptable tax risk, reflecting a conservative approach to tax risk globally. Some respondent companies indicated that acceptable tax risk is lower because the tax risk management system puts tax at the 'front of mind' of company executives when considering a business issue and staff have a better understanding of potential tax risk. Senior executives are increasingly committed to identifying and managing tax risk in recognition of the low tax risk profile.

Table 4: A Tax risk management system has an effect on the level of tax risk considered acceptable (SQ16)

	Frequency	Per cent
Strongly disagree	1	1.5
Disagree	5	7.4
Undecided	6	8.8
Agree	35	51.5
Strongly agree	21	30.9
Total	68	100.0

The results set out in Table 5 demonstrate that 73.5 per cent of respondent companies felt that the tax risk management system resulted in the lowest level of tax risk (Survey Question 23e). While 10.3 per cent disagreed with the view that the tax risk management system results in the lowest level of tax risk the remaining 16.2 per cent were undecided.

The large undecided component suggests that, in the absence of concrete evidence the tax risk management system results in the lowest level of tax risk, respondent companies were unable to respond to the question posed. As a substantial majority did feel that the tax risk management system results in the lowest level of tax risk it can be argued that a tax risk management system results in an improvement in tax compliance as company taxpayers take a more conservative and less aggressive approach in making tax compliance decisions.

Table 5: A tax risk management system results in the lowest level of tax risk (SQ23e)

	Frequency	Per cent
Strongly disagree	1	1.5
Disagree	6	8.8
Undecided	11	16.2
Agree	34	50.0
Strongly agree	16	23.5
Total	68	100.0

5.3 Statements and/or guidelines on what constitutes a tax risk

Table 6 details the percentage of respondent companies that have, and do not have statements and/or guidelines on what constitutes a tax risk that are used in the tax risk management process. A majority of respondent companies (54.5%) did not have statements and/or guidelines on what constitutes a tax risk. These results indicate that in many large companies there is a need for a clear definition of what constitutes a tax risk to ensure that all individuals involved in the tax risk management process have an understanding as to where and when a tax risk may arise.

Table 6: Companies that have statements and/or guidelines on what constitutes a tax risk (SQ6)

	Frequency	Per cent
No	67	54.5
Yes	56	45.5
Total	123	100.0

The open-ended component to Survey Question 6 enabled respondent companies that have statements and/or guidelines on what constitutes a tax risk to elaborate on the nature of those statements and/or guidelines. A respondent's definition of tax risk tended to focus on transaction risk, that is, the tax risk associated with specific transactions that the company enters into including "UTBs subject to a value threshold".¹²⁸ Some used the FIN48 criteria for UTB to determine the existence of a tax risk.¹²⁹

A number of respondent companies refer to policy guidelines that they use to determine the existence of a tax risk including not only transactional risk (the risk associated with specific transactions that a company enters) but also operational risk (the risk associated with the application of tax laws to the day to day operations) and compliance risk (the risk of failing to comply with all the various compliance requirements in the tax law). Only five respondent companies indicate that tax risk also includes the potential impact of more generic tax risk such as the impact on a company's reputation of negative publicity relating to tax aggressive decision making.

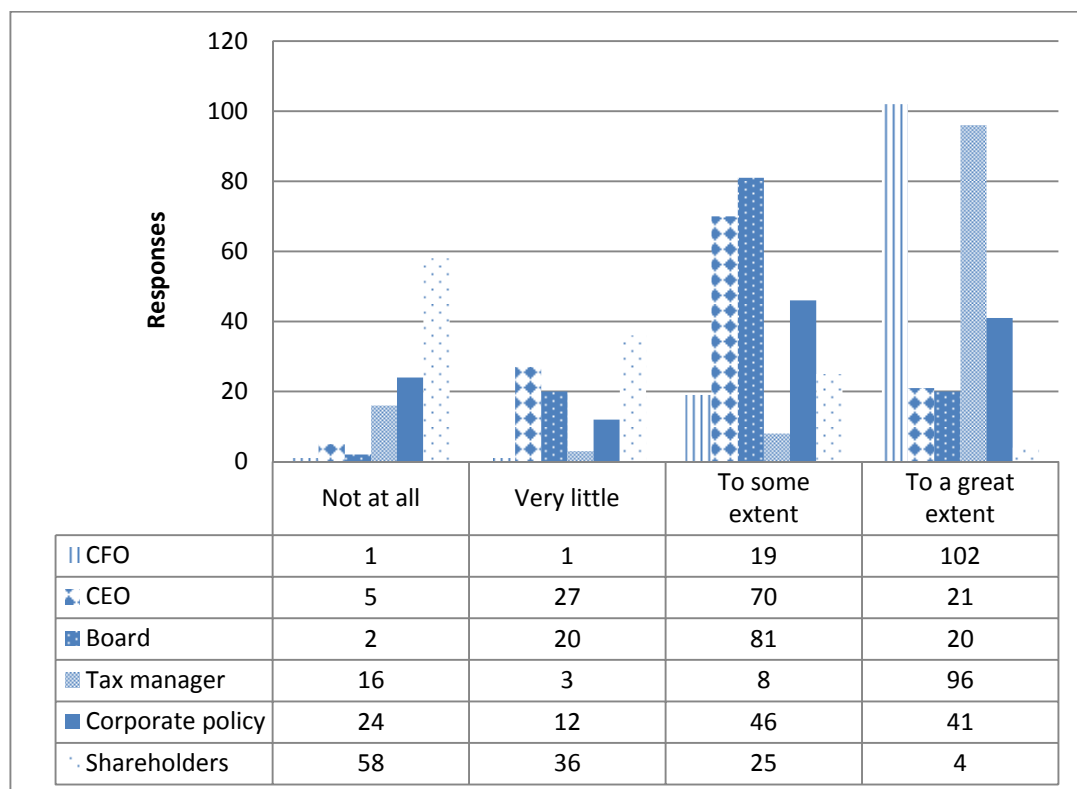
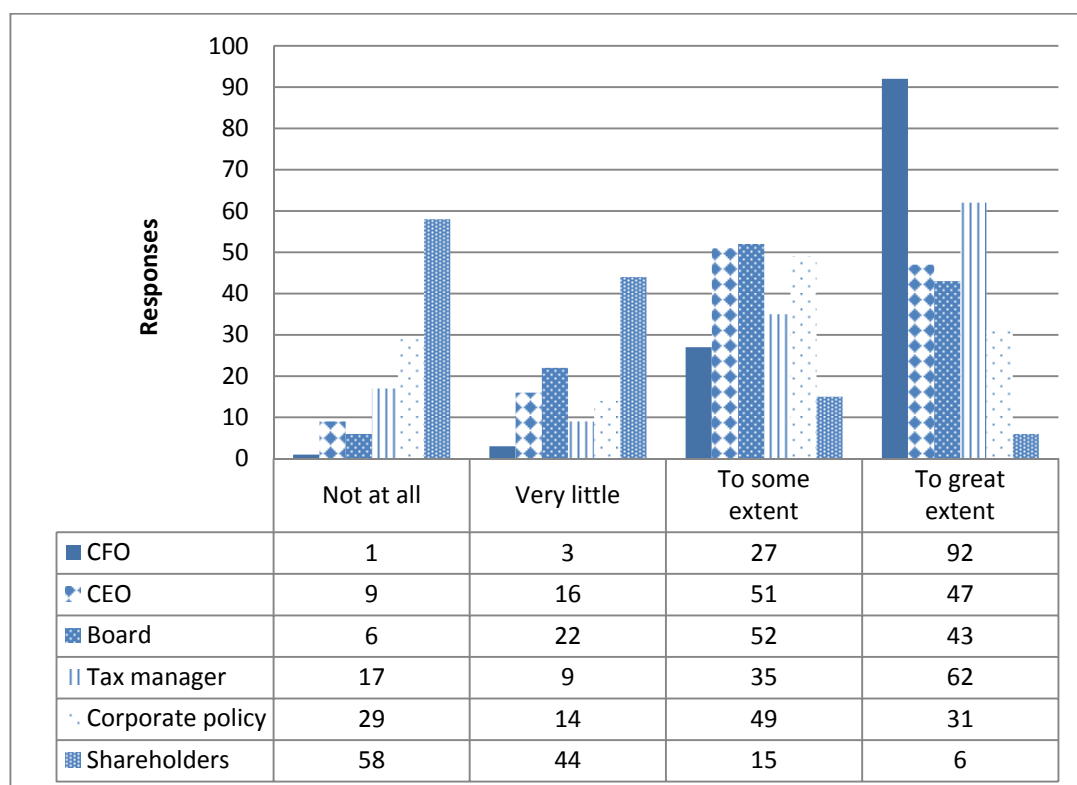
Only five respondent companies had a comprehensive definition of tax risk. A failure by the majority of respondents to use a comprehensive definition of tax risk may result in a number of tax risks, including reputational risk, being overlooked in the company's review process.

5.4 Individuals within companies who are involved and ultimately make the final decision on the acceptable level of tax risk

Figures 2 and 3 identify the individuals within respondent companies that are involved and ultimately make the final decision on their company's acceptable level of tax risk. The comparative figures demonstrate that the CFO and the tax manager are the most involved in the determination of acceptable tax risk and that the Board and the CEO also have a significant role. Company group policy was also shown to be a significant influencing factor. The shareholders were identified in only a few instances as having a significant role. The majority of respondents felt that the shareholders have very little or no involvement in the determination of an acceptable level of tax risk.

¹²⁸ Respondent Number 12.

¹²⁹ FIN48 states that firms should recognise in their financial statements the benefit of a tax position only after determining that it is more likely than not that the revenue authority would maintain the tax position after audit. In addition, the amount recognised in the financial statements should be the largest benefit that has a greater than 50 per cent likelihood of being realised upon settlement with the revenue authority.

Figure 2: Individuals involved in determination of acceptable tax risk**Figure 3: Individual who make the determination of acceptable tax risk**

Tables 7 and 8 show the extent to which the shareholders determine the acceptable level of risk. The shareholders in only 23.6 per cent of respondent companies were involved in the determination of the acceptable level of tax risk to at least some extent. The shareholders make only a small contribution in establishing the level of tax risk that will be tolerated and ultimately to at least some extent make the final decision on the acceptable level of tax risk in only 17.1 per cent of respondent companies.

Table 7: The extent to which the shareholders are involved in the determination of the acceptable level of tax risk (SQ4e)

	Frequency	Per cent
Not at all	58	47.2
Very little	36	29.3
To some extent	25	20.3
To a great extent	4	3.3
Total	123	100.0

Table 8: The extent to which the shareholders ultimately determine the acceptable level of tax risk (SQ5e)

	Frequency	Per cent
Not at all	58	47.2
Very little	44	35.8
To some extent	15	12.2
To a great extent	6	4.9
Total	123	100.0

5.5 Tax risk profile of respondents

Table 9 details the tax risk profile¹³⁰ of respondents with a majority (60.2%) indicating that they adopt a very low or low tax risk profile. Moderate tax risk is acceptable to 30.9 per cent of respondent companies and only 8.9 per cent of respondents are prepared to accept high or very high tax risk.

¹³⁰ Tax risk profile is defined in the survey and used in this article as 'the behavior of a taxpayer towards tax risk. The more aggressive the taxpayer's position with respect to tax risk, the higher the tax risk profile. The less aggressive the taxpayer's position with respect to tax risk, the lower the tax risk profile'.

Table 9: The tax risk profile of companies participating in the survey (SQ9)

	Frequency	Per cent
Very low	21	17.1
Low	53	43.1
Moderate	38	30.9
High	10	8.1
Very high	1	0.8
Total	123	100.0

The tax risk profile of respondent public companies (listed and unlisted) and private companies were analysed. The detailed cross tabulation set out at Table 10 below indicates that public companies are more likely to have a very low or low tax risk profile and private companies are more likely to have a moderate to very high tax risk profile.

Table 10: Cross tabulation company type and tax risk profile

Company type		Tax risk profile - Grouped responses (Survey Question 9)		
		very low/low	moderate/high/ very high	Total
Private company	Count	21	23	44
	Per cent private company	47.7%	52.3%	100.0%
	Per cent tax risk profile	28.4%	46.9%	35.8%
	Per cent of total	17.1%	18.7%	35.8%
Public company	Count	53	26	79
	Per cent public company	67.1%	32.9%	100.0%
	Per cent tax risk profile	71.6%	53.1%	64.2%
	Per cent of total	43.1%	21.1%	64.2%
Total	Count	74	49	123
	Per cent all companies	60.2%	39.8%	100.0%
	Per cent tax risk profile	100.0%	100.0%	100.0%
	Per cent of total	60.2%	39.8%	100.0%

The following section of this article discusses the research results detailed in this section looking specifically at the role of the tax risk management system, tax risk profile, reputational risk and tax aggressive decision making.

6. IMPLICATIONS

The results presented here demonstrate that, whilst a company's tax aggressiveness can have an impact on a company's reputation (as discussed in this article at section 2), most tax risk management systems used by large Australian companies do not systematically identify reputational risk as one of the tax risks that needs to be managed. That is the definition of tax risk used by large Australian companies does not include reputational risk yet a large majority of companies recognise their concern for reputation increases or creates tax risk.

Although a tax risk management system results in a lower level of acceptable tax risk it may not ensure that tax decision-makers are informed of the potential negative impact on reputation of a particular tax position taken. A company that has a comprehensive tax risk management system that identifies reputational risk will make more informed and potentially less aggressive tax decisions than a company that does not have a comprehensive tax risk management system that recognises reputational risk. The CFO and tax manager are most involved in the determination of the level of acceptable tax risk whilst shareholders have very little involvement. The results in relation to shareholders indicate that despite the increasing discussion and identification of CSR as a shareholder concern reflecting community values, few large companies consider the shareholders' views or preferences in relation to tax aggressiveness. This suggests that shareholders do not send clear messages concerning the level of tax aggressiveness they believe to be acceptable, and do not demonstrate an interest in 'their' company's income tax strategy *ex ante*. Currently it appears to be lobby groups that send messages to keep large companies accountable.

Private companies accept a higher tax risk profile than public companies and this result may be due to the fact that private companies are less exposed to share price fluctuation, requirements to disclose financial information and reputational risk generally. Research by Rice supports the relationship between company type and tax aggressiveness.¹³¹ Rice identified that tax compliance is positively correlated with being a publicly listed company and attributed this to the managers being more likely to be independent of the shareholders, and as a result under less pressure to reduce taxes.¹³²

Ultimately this research has identified that a comprehensive tax risk management system, one that considers all tax risks including reputational risk, results in more informed tax decision-making and constitutes good governance practice for a large company incorporated in Australia. This finding is of relevance not only to corporate taxpayers, but to tax policymakers and administrators who seek to understand the tax strategies adopted by this important taxpayer group. The extent to which the findings presented here apply to other jurisdictions is unclear, particularly in the light of differences in the legal and administrative frameworks that regulate company tax decision-making in other countries.

¹³¹ Rice, above n 103.

¹³² Ibid.

7. CONCLUSION

Given the importance of the large company taxpayers to revenue collections globally, it is believed that this research makes an important contribution. Notwithstanding, there is considerable scope for further research into the area of corporate tax strategy and the interconnected issues of tax risk management systems, reputational risk, CSR and increased tax disclosure requirements. The importance of reputational risk for large companies suggests that companies will most easily avoid adverse publicity about their tax if they systematically and routinely flag and address reputation as a tax risk and factor the need to be accountable to the public into their tax strategy.

8. APPENDICES

Appendix 1: In-depth interviews

Interviewer: Catriona Lavermicocca, PhD student, UNSW

This research project forms part of the data collection for the purposes of completion of a PhD in Taxation at the Australian School of Taxation (ATAX) at UNSW. The title of the PhD thesis is 'Tax Risk Management as a Corporate Governance Issue in Australia and the Impact on Income Tax Compliance by Large Company Taxpayers'.

Proposed questions for in-depth interviews concerning tax risk management:

1. To what extent does your organisation consider/evaluate tax risk?
2. Does your organisation have clear statements/guidelines on what constitutes a tax risk?
3. Who (not by name but by title) in the organisation determines the acceptable level of tax risk?
4. Do the organisation's corporate governance guidelines require tax risk to be managed?
5. Does your organisation have a tax risk management system?
6. What systems/procedures does your organisation have in place to ensure that tax risk is managed? To what extent are those systems/procedures documented and reviewed for compliance?
7. Have there been any recent changes in the approach the organisation takes to tax risk management?
8. What criteria are used to determine the acceptable level of tax risk in your organisation?
9. What factors do you consider have an impact on the level of tax risk that the organisation faces?
10. What limitations, if any, does the organisation face in managing tax risk?
11. What pressures do you believe have had an impact on the organisation's decision to adopt/not adopt a tax risk management system?
12. To what extent have the following had an impact on the organisation's decision to adopt/not adopt a tax risk management system?
 - ATO;
 - Shareholders;
 - Customers;
 - Stock market/listing rules;
 - Directors; and
 - SOX legislation.
13. What influence have the ATO announcements had on your organisation's tax risk management practices?
14. Have you received any correspondence from or entered into discussions with the ATO concerning tax risk management and tax decision-making practices?
15. Who (not by name but by title) are the key tax decision-makers in your organisation? Is there any board/director involvement in tax decision-making and, if any, what is the level of that involvement?
16. What are the performance measures in respect of the key tax decision-makers in your organisation?

17. What do you consider to be the impact of tax risk management systems on the determination of the acceptable level of tax risk?
18. Is the organisation more or less tax risk averse (or has there been no change) after the introduction of a tax risk management system?
19. To what extent does the organisation consider corporate social responsibility issues and if it does, does that include a consideration of the organisation's tax compliance profile?

Appendix 2: Survey of tax risk management practices of large Australian companies

Completing the Survey

You can answer most questions by ticking the appropriate box. In some instances further detail is requested. Please return your completed survey form in the reply paid envelope provided.

Definitions of some terms used in the survey

Compliance with the income tax laws - the taxpayer files all required income tax returns accurately and at the proper time, pays all outstanding taxes as they fall due and maintains all required records. The accuracy of the return and the records required are determined in accordance with the prevailing income tax laws, rulings, return instructions and court decisions.

Income tax liability - net income tax payable by a taxpayer in respect of a particular year of income

Large company - gross turnover exceeds \$250 million

Non-compliance with the income tax laws – the taxpayer does not file all required income tax returns accurately and at the proper time, and/or does not pay all outstanding taxes as they fall due and/or does not maintain all required records and/or the accuracy of the return and the records required are not in all instances determined in accordance with the prevailing income tax laws, rulings, return instructions and court decisions.

Operationalised - put in place and acted upon by decision makers as part of the ongoing and active business systems used by the organisation

Tax risk - any event, action, or inaction in tax strategy, operations, financial reporting, or compliance that adversely affects either the company's tax or business operations or results in an unanticipated or unacceptable level of monetary, financial statement or reputational exposure.

Tax risk management system - documented and operationalised systems and procedures to identify and manage tax risks

Tax risk profile - reflects the behavior of a taxpayer towards tax risk. The more aggressive the taxpayer's position with respect to tax risk, the higher the tax risk profile. The less aggressive the taxpayer's position with respect to tax risk, the lower the tax risk profile.

Please turn the page to commence the survey

Survey questions

1) Please indicate your company type

Public company <input type="checkbox"/> Private company <input type="checkbox"/> If your company is a public company is it listed on the Australian Securities Exchange? Yes <input type="checkbox"/> No <input type="checkbox"/>

2) In which of the following industries does the company carry on business? If your company operates in more than one industry please indicate the industry that best describes the industry in which the company carries on business.

Agriculture, forestry and fishing <input type="checkbox"/>
Mining <input type="checkbox"/>
Manufacturing <input type="checkbox"/>
Electricity, gas, water and waste services <input type="checkbox"/>
Construction <input type="checkbox"/>
Wholesale trade <input type="checkbox"/>
Retail trade <input type="checkbox"/>
Accommodation and food services <input type="checkbox"/>
Transport, postal and warehousing <input type="checkbox"/>
Information media and telecommunications <input type="checkbox"/>
Financial and insurance services <input type="checkbox"/>
Rental, hiring and real estate services <input type="checkbox"/>
Professional, scientific and technical services <input type="checkbox"/>
Administrative and support services <input type="checkbox"/>
Public administration and safety <input type="checkbox"/>
Education and training <input type="checkbox"/>
Health care and social assistance <input type="checkbox"/>
Arts and recreation services <input type="checkbox"/>
Other services <input type="checkbox"/>
Other <input type="checkbox"/> Please specify.....

3) What is your position in the company?

Chief Financial Officer <input type="checkbox"/>
Tax Director <input type="checkbox"/>
Chief Executive Officer <input type="checkbox"/>
Tax Manager <input type="checkbox"/>
Assistant Tax Manager <input type="checkbox"/>
Other <input type="checkbox"/>
Please specify

4) To what extent are the following persons involved in the determination of the acceptable level of tax risk with respect to a transaction or series of transactions?

***Tax risk** - any event, action, or inaction in tax strategy, operations, financial reporting, or compliance that adversely affects either the company's tax or business operations or results in an unanticipated or unacceptable level of monetary, financial statement or reputational exposure.*

a) CFO	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
b) CEO	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
c) Board of Directors	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
d) Tax manager	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
e) Shareholders	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
f) Corporate group policy	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
g) Other <input type="checkbox"/> Please provide detail			

5) To what extent do the following persons in your company ultimately make the final decision on the acceptable level of tax risk with respect to a transaction or series of transactions?

a) CFO	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
b) CEO	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
c) Board of Directors	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
d) Tax manager	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
e) Shareholders	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
f) Corporate group policy	To a great extent <input type="checkbox"/>	To some extent <input type="checkbox"/>	Very little <input type="checkbox"/>	Not at all <input type="checkbox"/>
g) Other <input type="checkbox"/> Please provide detail				

6) Does your company have statements and/or guidelines on what constitutes a tax risk?

Yes <input type="checkbox"/> No <input type="checkbox"/>
If yes, what constitutes a tax risk according to your company's statements and/or guidelines?.....

7) Please indicate the extent to which each of the following factors increase the level of tax risk your company is exposed to in carrying on its business activities.

a) Uncertainty in the application of the income tax law To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
b) Complexity of the income tax law To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
c) Complexity of business transactions To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
d) Staff turnover To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
e) Staff not following guidelines To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
f) Time and/or cost constraints To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
g) Limited information provided to tax staff by other divisions within the company To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
h) Level of concern for reputation To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
i) Size of the transaction To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
j) Growth of the business To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
k) Global nature of the business To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
l) Economic environment To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
m) Other <input type="checkbox"/> Please provide detail

8) How important is compliance with the income tax laws to your company?

Compliance with the income tax laws - the taxpayer does file all required income tax returns accurately and at the proper time, pays all outstanding taxes as they fall due and maintains all required records. The accuracy of the return and the records required are determined in accordance with the prevailing income tax laws, rulings, return instructions and court decisions.

Very important	<input type="checkbox"/>
Important	<input type="checkbox"/>
Moderately important	<input type="checkbox"/>
Of little importance	<input type="checkbox"/>
Unimportant	<input type="checkbox"/>

9) Which of the following best describes the tax risk profile of your company?

Tax risk profile – reflects the behavior of a taxpayer towards tax risk. The more aggressive the taxpayer's position with respect to tax risk, the higher the tax risk profile. The less aggressive the taxpayer's position with respect to tax risk, the lower the tax risk profile.

Very high	<input type="checkbox"/>	High	<input type="checkbox"/>	Moderate	<input type="checkbox"/>	Low	<input type="checkbox"/>	Very low	<input type="checkbox"/>
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10) Has there been a change in the tax risk profile of your company in the last three financial years?

Yes ☐ No ☐

If yes what is the nature of the change and what do you believe to be the reason for it?

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11) Does your company have systems and/or procedures in place to identify and manage tax risks?

Yes ☐ No ☐

If yes describe the systems and/or procedures in place to identify and manage tax risks and continue on to question 12)

.....

.....

.....

.....

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.....

If you answered NO to question 11) the survey is now complete. Thank you

**If you answered YES to question 11)
please turn the page and continue this survey.**

12) Considering the following factors please indicate the extent to which they limit the ability of your company to identify and manage the tax risks to which the company is exposed.

a) Uncertainty in the application of the income tax laws To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
b) Complexity of the income tax laws To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
c) Complexity of business transactions To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
d) Staff turnover To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
e) Staff not following guidelines To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
f) Time and/or cost constraints To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
g) Limited information provided to tax staff by other divisions within the company To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
h) Commercial pressure outside your tax department To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
i) Limitations of ATO staff To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
j) Country or countries where the company carries on business To a great extent <input type="checkbox"/> To some extent <input type="checkbox"/> Very little <input type="checkbox"/> Not at all <input type="checkbox"/>
k) Other <input type="checkbox"/> Please provide detail

13) Are the current systems and/or procedures used by your company to identify and manage tax risks documented?

To a great extent ☐ To some extent ☐ Very little ☐ Not at all ☐

14) Are the current systems and/or procedures used by your company to identify and manage tax risks operationalised in the company's business systems?

***Operationalised** - put in place and acted upon by decision makers as part of the ongoing and active business systems used by the organisation*

To a great extent ☐ To some extent ☐ Very little ☐ Not at all ☐

The following questions should only be answered if your company has systems and/or procedures in place to identify and manage tax risks that are to some extent documented and operationalised. If that is the case please continue.

If your company DOES NOT have systems and/or procedures in place to identify and manage tax risks that are to some extent documented and operationalised the survey is now complete.

Thank you

For the purposes of this survey systems and/or procedures that identify and manage tax risks that are to some extent documented and operationalised constitute a tax risk management system (TRMS).

15) When was the company's current tax risk management system introduced?

***Tax risk management system** – documented and operationalised systems and procedures to identify and manage tax risks*

In the 2011 financial year?	<input type="checkbox"/>
In the 2010 financial year?	<input type="checkbox"/>
In the 2009 financial year?	<input type="checkbox"/>
In the 2008 financial year?	<input type="checkbox"/>
Prior to the 2008 financial year?	<input type="checkbox"/>
Progressively over a number of years	<input type="checkbox"/>
If so please specify the relevant years	
.....	
.....	
.....	
.....	

16) The current tax risk management system does have an effect on the level of tax risk considered acceptable by your company.

Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
If you agree, describe ways in which the current tax risk management system has an effect on the level of tax risk considered acceptable by your company.
.....
.....
.....
.....
If you disagree, why do you believe the current tax risk management system does not have an effect on the level of tax risk considered acceptable to your company?
.....
.....
.....
.....

17) The current tax risk management system ensures compliance with the income tax laws by your company.

Strongly agree ☐ Agree ☐ Undecided ☐ Disagree ☐ Strongly disagree ☐

If you agree, describe ways in which the current tax risk management system ensures compliance with the income tax laws by your company.

.....

.....

.....

.....

.....

If you disagree, why do you believe the current tax risk management system does not ensure compliance with the income tax laws by your company?

.....

.....

.....

.....

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.....

.....

18) The current tax risk management system results in the identification of potential non-compliance with the income tax laws that would not otherwise be identified by your company.

Strongly agree ☐ Agree ☐ Undecided ☐ Disagree ☐ Strongly disagree ☐

If you agree, describe ways in which the current tax risk management system identifies potential non-compliance with the income tax laws that would not otherwise be identified by your company.

.....

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.....

If you disagree, why do you believe the current tax risk management system does not identify non-compliance with the income tax laws that would not otherwise be identified by your company?

.....

.....

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.....

19) If you disagree with the statement at 18) above you can continue to 20).

If you agree with the statement at 18) above, does your company act to ensure potential non-compliance with the income tax laws identified by your current tax risk management system do not occur?

To a great extent ☐ To some extent ☐ Very little ☐ Not at all ☐

20) The current tax risk management system results in the identification of opportunities to minimise your company's income tax liability that would not otherwise be identified.

Strongly agree ☐ Agree ☐ Undecided ☐ Disagree ☐ Strongly disagree ☐

If you agree, in what way does the current tax risk management system result in the identification of opportunities to minimise your company's income tax liability that would not otherwise be identified?

.....

If you disagree, why do you believe the current tax risk management system does not result in the identification opportunities to minimise your company's income tax liability that would not otherwise be identified?

.....

21) If you disagree with the statement at 20) above you can continue to 22)

If you agree with the statement at 20) above, does your company act to ensure opportunities to minimise the company's income tax liability identified by your current tax risk management system are put in place?

To a great extent ☐ To some extent ☐ Very little ☐ Not at all ☐

22) The current tax risk management system ensures that the following persons are informed concerning the tax risks that your company is exposed to

a) Directors
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
b) Tax decision makers
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
c) Chief Financial Officer
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
d) Chief Executive Officer
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
e) Chairman of the Board
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
f) Other person Please specify
.....
.....
.....
.....

23) The current tax risk management system results in:

a) Better documented tax risks
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
b) More informed tax decision making
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
c) Greater range of tax risks identified
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
d) Improvement in the management of tax risks
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
e) The lowest level of tax risk
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
f) Improvement in compliance with the income tax laws
Strongly agree <input type="checkbox"/> Agree <input type="checkbox"/> Undecided <input type="checkbox"/> Disagree <input type="checkbox"/> Strongly disagree <input type="checkbox"/>
g) Other benefits Please specify
.....
.....
.....
.....
.....
.....
.....

24) Has your company been the subject of an adjustment to taxable income as a consequence of audit by the ATO relating to any of the last three financial years?

Yes ☐ No ☐

If yes, was the company aware of a tax risk associated with the issue that gave rise to the adjustment by the ATO before the audit commenced?

.....
.....
.....
.....
.....

25) Are you aware of a transaction or series of transactions in respect of which the income tax treatment adopted by the company was subsequently found to be incorrect relating to any of the last three financial years?

Yes ☐ No ☐

If yes, were you aware of any tax risk associated with that transaction or series of transactions when the transaction or series of transactions was entered into?

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...

The survey is now complete.

Thank you for participating

Assessing the quality of services provided by UK tax practitioners

Jane Frecknall-Hughes¹ and Peter Moizer²

Abstract

This paper focuses on the work of UK tax practitioners. We divide the work of the practitioner into two forms—compliance and planning/avoidance work—and define how the quality of each can be evaluated. We consider the economic forces operating in the tax services market and their likely impact on the tax practitioner's choice of the quality level to which he or she works, aiming to show whether market forces alone may sufficiently protect the public from poor quality tax work and considering whether regulation may be of net benefit to society (UK tax practitioners currently are not regulated).

Keywords: quality assessment, reputation, regulation

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1. INTRODUCTION

This paper focuses on the work of the tax practitioner operating in the current UK market for tax services. Our aim is to show how the work of the tax practitioner can be categorised and how its quality can be evaluated. By examining the economic forces within which tax practitioners operate, we aim to show whether market forces alone can be expected to be sufficient to protect the public from poor quality tax work. Having established that there is likely to be some market failure at least in certain sections of the market, we seek to consider whether regulation is likely to be of net benefit to society and whether the increasing complexity of tax legislation and recent events make regulation more or less likely. In particular, the recent cases of Starbucks, Amazon, Google and Facebook have highlighted the issue of tax advice, with doubts being cast on the ethical considerations of those responsible for steering corporations towards certain courses of action designed to minimise tax. This issue is relevant in the context of more intense interest in the relationship of tax authorities and tax practitioners generally, often spoken of in terms of increasing the quality of tax work (see, for example, the study published by the Organisation for Economic Co-operation and Development (OECD, 2008) on tax intermediaries and HM Revenue & Customs' (HMRC, 2009) consultation paper on tax agents) and the wider issue of quality in terms of services provided by tax authorities (see Tuck, Lamb and Hoskin, 2011). The specific issue of how to assess, evaluate or measure the quality of the service a tax practitioner provides has not been considered in the light of this.

The work done to date on taxation services has been mostly carried out in the USA, and has concentrated on particular aspects. Erard (1993) summarises such work into focal studies on certain features of tax practice interlaced with econometric research. The focal studies have considered variously: the role played by tax practitioners in reducing taxpayer uncertainty (Scotchmer, 1989a, 1989b and Beck, Davis and Jung, 1991); the effect of tax practitioners in reducing the time and anxiety associated with tax return preparation and audit (Reinganum and Wilde, 1991); the usefulness of tax practitioners in uncovering ways to reduce tax liabilities (Slemrod, 1989); and the ability of tax practitioners to exploit legal uncertainties to reduce taxpayer penalties for non-compliance (Klepper, Mazur and Nagin, 1991). The econometric research has concentrated on identifying the kind of taxpayers who seek assistance and on whether employing tax practitioners improves or worsens compliance with tax laws (for example, Slemrod and Sorum, 1984; Long and Caudill, 1987; Collins, Milliron and Toy, 1988; Slemrod, 1989; Klepper et al., 1991; Dubin, Graetz, Udell and Wilde, 1992). The conclusions are that level of income, age, marginal tax rate and complexity of completion of the tax return encourage taxpayers to employ tax practitioners. Additionally, married taxpayers, self-employed taxpayers and taxpayers with many forms and schedules to complete are also likely to seek assistance. Taxpayers with high levels of education or significant tax knowledge tend to prepare their own returns.

Klepper et al. (1991) advance a formal model which jointly addresses the decision to engage a preparer and the compliance outcomes conditional on the preparation mode. The principal focus of their model is to formalise the argument that preparers are not only guardians against unequivocal breaches of the legal code, but also exploiters of legally ambiguous features of the tax code to the advantage of the taxpayer. Their model predicts that on some items, the preparer will play an enforcer role, contributing to greater compliance, while on other items, the preparer will play an advocacy role,

contributing to greater non-compliance by exploiting ambiguities. A second feature of the model is that the magnitude of the compliance effect of the preparer (whether it proves to be pro- or anti-compliance) will be greater, the greater the opportunity for non-compliance on an item. Therefore, the model predicts that the expert's participation will discourage non-compliance on legally unambiguous income sources, but encourage non-compliance on ambiguous sources. In the model, this dualism stems from the preparer's unique knowledge of reporting strategies for reducing penalties for non-compliance on ambiguous income, coupled with penalties that can be imposed on preparers for preparing returns which are non-compliant in some respect. The model has, therefore, implications for any regulatory regime as it predicts that increases in preparer penalties will have their desired effect—the enforcer effect will be magnified and the ambiguity-exploiter effect muted, although any increase in preparer penalties will increase the price to the taxpayer, and will discourage the use of preparers.

Dubin et al. (1992) and Erard (1993) further consider the issue of whether the type of tax practitioner chosen to assist the taxpayer has any significance, and both studies suggest that the type of preparer is important, Erard distinguishing between a Certified Public Accountant (CPA) or lawyer, a non-specialist and self-preparation and Dubin et al. using a wider range. Erard's results agree with those of Klepper et al. (1991) but, more specifically, in that the use of CPAs and lawyers is associated with a higher level of non-compliance. Inherent in these studies is the notion, naturally deriving from differentiating between types of preparer, that the services offered by one type of preparer are different from those offered by another, or are more suitable in certain circumstances, but this is not developed further in the literature to deal with the innate ideas of quality. A study by Newberry, Reckers and Wyndelts (1993) similarly contains these implicit but undeveloped suggestions that the quality of services offered is important. This seems an important area for development. The quality of the services offered by the tax professional would appear to be an unquantified (and, perhaps unquantifiable) variable which might further inform the studies already carried out. It is also of explicit concern for the tax profession, given that tax services historically are the cause of most malpractice suits against CPAs (see Hull, 1992, p. 51). Hull (1992) reporting on his own firm's implementation and development of a tax quality control programme³ suggests that there are evident rewards in seeing that more accurate tax products were developed, professional standards were met, that the tax practice was properly organised, and that preparer penalties and tax lawsuits were avoided. The firm's image and reputation were enhanced.

More recent research suggests that the relationship between taxpayers and tax practitioners is multifaceted, dependent on a number of factors, such as individuals' differing characteristics, especially attitudes to risk, with taxpayers demanding both cautious and aggressive advice and feeling that tax practitioners' performance fell short of expected standards. Technical proficiency and trust particularly affected taxpayer satisfaction levels (Tan, 2009⁴). Sakurai and Braithwaite (2003, p. 375) find

³ In accordance with the American Institute of Certified Public Accountants' voluntary tax practice review programme operating at that date. This was designed to ensure that a quality tax service is offered to CPA clients, and the implementation of such a programme has proved beneficial.

⁴ This is taken from the description of Tan's 2009 PhD thesis (the full version being unavailable), available online at <https://digitalcollections.anu.edu.au/handle/1885/10069?mode=full>. [Accessed 12 March 2014]

that, for Australian taxpayers, there are three ideal types—a “creative aggressive tax planning type”, a type who engaged in the “cautious minimisation of tax” and (the most popular), a “low risk, no fuss” practitioner. However, when taxpayers’ perceptions were combined with their ideals, “tax avoidance” and “doing the right thing” emerged as the “only two substantive dimensions”. Devos’s (2012) study notes the increased use of tax practitioners by Australian individual taxpayers (75%) and reveals (p. 23) “that there was a statistically significant relationship between the need for engaging tax professionals and compliance behaviour generally” and evidence of a “statistically significant relationship between tax professionals’ aggressive advice and compliance behaviour, but only amongst non-evaders”.

The remainder of the paper is organised in the following way. Section 2 describes the nature of the taxation services market in the UK. Section 3 examines the type of tax work carried out by tax practitioners and considers what is meant by quality in this context. Section 4 gives an economic analysis of the market for tax services and presents a model of tax service quality choice. Section 5 discusses ways of improving the quality of the service provided by tax practitioners, including the issues surrounding regulation. Section 6 outlines the conclusions to the paper.

2. THE NATURE OF THE TAXATION SERVICES’ MARKET IN THE UK

The market for the supply of tax services in the UK is fragmented. Per Frecknall-Hughes (2012, p. 178):

[T]ax advice is given by a broad range of business professionals including accountants, solicitors, barristers, payroll agents, former and current members of government revenue authorities, tax experts working within industry, as well as those officially designated as tax consultants as a result of their membership of tax dedicated professional bodies, such as the Chartered Institute of Taxation (CIOT) in the UK. Some tax professionals work as sole practitioners or in accounting, legal or tax specialist partnerships and will undertake various kinds of tax work on behalf of clients. While some persons with a legal background will be found working within accountancy practices, the tendency is still very strong for those with legal training in tax to stay within the legal profession. Tax experts working in industry are more typically employees of a company, or group of companies, in which instance employer and client are the same. Throughout both academic and professional literature, tax practitioners are also referred to as tax advisers, tax agents, tax intermediaries, tax preparers and tax professionals without any significant differentiation between these terms.

The term ‘tax intermediary’ is a more recent development adopted by the OECD, whereas ‘tax preparers’ is especially used in the USA to denote firms or individuals who provide chiefly assistance in tax return completion (such as, compliance work – see later). A currently emerging term is ‘tax structurer’, which may have significant implications.⁵

⁵ This term is used in a job advertisement for an in-house post (headed ‘Front Office Tax – Urgent’) in a global banking group at <http://www.accountancyjobsonline.co.uk/job/2136268/front-office-tax-urgent/>. There are six main bodies (other than the CIOT) professionally involved in taxation in the UK, namely

The main feature of the market for tax services in the UK is therefore the lack of any professional monopoly and the fragmented nature of professional regulation. In addition, there is no statutory definition of the words ‘accountant’ or ‘tax practitioner’ and so anyone can set up in business as an accountant or tax practitioner without having to satisfy any legal requirements.⁶ This is in contrast, for example, to the highly regulated position in Australia, where registration as a tax agent has been a nationwide requirement since 1943 (Fisher, 2010). Many other countries, including New Zealand, operate in the same way as the UK, but there is a general trend towards regulation. In the USA, since 1 January 2011, there has been mandatory federal registration of tax intermediaries, together with a range of compliance checks (related to good standing) and, for intermediaries not licensed by certain professional bodies, competency tests and requirements regarding continuing education are also currently being rolled out (Treasury Department, 2011).⁷

It is evident thus far that the fragmentation of the tax profession and its lack of monopoly, as observed in many countries in the 1990s by Thuronyi and Vanistendael (1996, pp. 160–163), still remain. As Frecknall-Hughes and McKerchar (2013, p. 424) comment:

The paucity of academic literature on this subject is somewhat surprising, given the almost universal acknowledgement that tax practitioners have increasingly become key players in modern tax administrations seeking to maximise taxpayer compliance.

Increases in the volume and complexity of tax law, especially in the UK (see Aitken, 2010), mean that tax practitioners will necessarily be used by both individual and corporate taxpayers. As long ago as the mid-1990s, evidence from HMRC’s Independent Adjudicator (Green, 1995, pp. 1; 19–20 and 47) focused attention on the poor quality of the advice given by some tax practitioners, but there has been increased concern in recent years rather about the nature of tax advice provided, especially in terms of ethics (Shafer and Simmons, 2008), with a number of firms in the USA being investigated for the marketing of tax shelters which facilitate aggressive tax avoidance (Herman, 2004; Johnston, 2004; Scannell, 2005). Companies and their senior executives are frequently alleged to use ‘tax havens’ or tax shelters for the purpose of avoiding their tax obligations (Godar, O’Connor and Taylor, 2005; Dyreng, Hanlon and Maydew, 2007; Wilson, 2009; Dyreng, Hanlon and Maydew, 2010; Sikka, 2010). The KPMG tax shelter fraud case in the USA points to the involvement of tax professionals in such activities (Sikka and Hampton, 2005; Sikka, 2010), and the 2012 cases of Starbucks, Amazon, Google and Facebook,

the Association of Taxation Technicians, the Association of Chartered Certified Accountants, the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Institute of Indirect Taxation and the Society of Trust and Estate Practitioners. The Institute of Indirect Taxation has recently merged with the CIOT. There is also the Worshipful Company of Tax Advisers. In the public sector, there is, of course, HMRC. The 2009 HMRC report, *Modernising Powers, Deterrents and Safeguards. Working with Tax Agents: A Consultation Document*, in Ch. 5 looks more closely at different definitions for different types of tax professionals. See also Devos, 2012, p. 5.

⁶ The HMRC 2009 consultation document, *Modernising Powers, Deterrents and Safeguards. Working with Tax Agents: A Consultation Document*, does suggest, in Ch. 5, some form of registration for the 12,000 estimated tax practitioners who are currently unregulated by any professional body.

⁷ Registration of paid preparers has been a requirement in Oregon since 1973, in California since 1997, and in Maryland since 2008 (McKerchar, Bloomquist and Leviner, 2008, pp. 402–411).

highlighted in the British press (see, for example, Barford and Holt, 2012), indicate the continuing relevance of this topic, as company executives have been questioned by the UK government's Public Accounts Committee (PAC) about the level of corporation tax paid (or not) to the UK revenue authorities (see Armitstead, 2013; Fuller, 2013). The PAC also questioned the 'Big Four' accounting firms about the nature of the advice they provided to such firms. However, what is unclear is whether companies as recipients of this type of tax advice feel that their advisers have provided good quality advice or not. This perspective has not been examined. In general, HMRC will pursue an individual taxpayer in the case of errors, etc., but not the practitioner on whose advice the individual has relied, although the UK taxpayer might in certain circumstances have a claim against the practitioner for negligence (malpractice). This would be a separate issue and the aggrieved taxpayer would have to show that he or she had suffered a financial loss as a result of relying on the sub-standard service provided by the tax practitioner. UK practitioners who are members of professional bodies may also be subject to sanctions imposed by that body but, as already indicated, membership of a professional body is not mandatory.

Another aspect of market fragmentation that should not be ignored is the different type of client or customer who needs tax services. The tax service requirements of an employee with a small amount of investment income, or the self-employed plumber, are not comparable with the requirements of a multinational corporation, and these differing needs add further levels of complexity when trying to analyse the quality of services. A tax practitioner who deals competently with self-employed individuals might not be able to offer the same level of competence if faced with dealing with a multinational's tax affairs. Arguably there is not one, but many, markets for the provision of tax services. Our subsequent analysis veers, perhaps, towards the needs of the more sophisticated users of tax services, though much of what we discuss is relevant to all types of users/markets.

3. THE WORK OF THE TAX PROFESSIONAL

At this stage, it is helpful to consider in greater depth the nature of the service provided by tax practitioners. The service basically can be divided into two kinds: tax compliance and tax planning/avoidance advice. Tax compliance work involves the preparation of tax computations for submission on the taxpayer's behalf to HMRC, dealing with subsequent queries and the resolution of any uncertainties. Tax planning/avoidance (or mitigation) work occurs when the tax practitioner attempts to devise ways of reducing the taxpayer's liability to tax. These categorisations will be explored in the next two sub-sections.

3.1 Tax compliance work

This involves reporting the economic events that have occurred. The aim of the tax practitioner will be to ensure that the reporting of these economic events complies with tax law, but using whatever latitude is possible to present the information in the best possible way to serve a client's interests. Tax legislation may contain 'grey' areas, where the law is actually unclear, but often it is the situation to which the legislation is applied that is ambiguous. For example, the law is clear on the tax treatment of repairs as distinct from capital expenditure. However, in the case of

buildings, the distinction between the two may, in practice, be blurred. In addition, there will inevitably be areas of tax reporting where the amounts to be entered in the tax returns are subject to some uncertainty and hence to a process of negotiation with the tax authorities. Such negotiations can be considered to be a legitimate part of the tax process, because it is normal for some uncertainty to arise in particular circumstances. Typically, this will cover areas where values have to be agreed and may be the subject of differing professional opinions, such as determining the value of private company shares with no stock market price, or the value of real estate.

3.2 Tax planning/avoidance work

This second category involves a definite and deliberate manipulation of the taxpayer's affairs to reduce the amount of tax payable. For example, in the UK, inheritance tax may be charged on an individual's death where the value of assets in the estate, or given prior to death, exceeds certain exempt bands. In order to provide some relief, gifts taking place more than seven years before death are exempt and so it is possible to avoid paying some or all of the potential inheritance tax by making lifetime transfers of assets directly to the intended beneficiaries or indirectly into trusts. Hence, it is a normal part of inheritance tax planning to devolve estates so as to preclude a tax burden occurring on death, as this is legitimately avoidable. Such tax planning involves deliberately framing reality in a particular way to ensure that taxpayers are enabled to act pre-emptively in order to obtain future benefits, which they would otherwise miss because of a lack of knowledge of the technicalities of tax law. It is also possible for the tax practitioners to go further and deliberately test or stretch a tax statute, which is unclear or ambiguously written, such that one or more interpretations may be attempted, or where issues arise which are not the subject of specific statute or case law precedent. Such testing or stretching is at the outer extremes of tax planning, and may involve the establishment of complex or artificial schemes specifically framed with no other aim than to avoid tax. Such schemes have come not infrequently to the Courts for a decision as to their legitimacy, though internal UK schemes increasingly are filtered out by the disclosure of tax avoidance scheme rules (DOTAS) introduced in *Finance Act 2004*. However, the cases of Starbucks, Amazon, Google and Facebook indicate that schemes at an international level are still an issue. These should, perhaps, be better designated as 'tax arbitrage', as they are clearly designed to exploit to advantage the distinctions and differentials in treatments and rates between different tax jurisdictions, but we will, for the purpose of this paper, consider them as schemes.

In the UK, as elsewhere, a distinction is generally drawn between avoidance of tax, which has always been regarded as legitimate, and evasion, which has not. The term tax evasion is usually used to mean illegal avoidance of tax, and may be achieved by a variety of means, from falsely reporting transactions which have, or have not, occurred, to setting up artificial transactions. However, the extent to which transactions/actions may be regarded as legitimate avoidance or illegitimate evasion depends a great deal on the legal, social or political climate of the time. For example in 1929, Lord Clyde in *Ayrshire Pullman Motor Services and D.M. Ritchie v CIR* (14 TC 754, at 764–765) said:

No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable

HMRC⁸ to put the largest possible shovel into his stores. HMRC is not slow ... to take advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.

This was supported by the comments of Lord Tomlin in 1935 in *IRC v Duke of Westminster* [1936] AC 1, at 19–20:

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

These comments are well known and often cited in support of avoidance activities as legitimate. Case law seems to support this in other ways. For example, in the case of *Hurlingham Estates Ltd v Wilde & Partners* [1997] STC 627, it was inherently suggested (at 628) that a solicitor owed a duty to his client to structure a transaction so as to avoid a tax charge. A similar view initially prevailed in the long-running case of *Mehjoo v Harben Barker* [2014] EWCA Civ 358. Mr Mehjoo had sued his long-standing accountants, Harben Barker, for failing to recommend the use of an offshore tax avoidance scheme, the Bearer Warrant Scheme (BWS) (since banned by HMRC), which Mr Mehjoo's non-UK domiciled status would, *prima facie*, have allowed him to use to avoid capital gains tax on the disposal of a company. However, in the 2014 Court of Appeal judgment, which overturned earlier judgments, Lord Justice Patten placed great significance on the fact that Mr Mehjoo had “accepted in evidence that he would not have gone ahead with the BWS if he had been advised that there was a substantial risk of it being challenged by HMRC” (Rayney, 2014); and on the fact that under the terms of its engagement letter, Harben Barker was only obliged to provide limited tax planning advice. This case decision reflects the increasingly less benign climate for tax avoidance work, which has been demonstrated through a series of cases, perhaps notably beginning with *Ramsay (WT) Ltd v CIR* [1982] AC 300, with legal success sometimes going to the taxpayer, but at others to HMRC. Significant developments over recent years have been: a deliberate shift in terminology, such that tax avoidance has been categorised variously as ‘aggressive’, ‘unacceptable’, ‘abusive’, ‘illegitimate’ and ‘illegal’—the latter two seeming particularly at odds if avoidance is legal (see Wyman, 1997; Frecknall-Hughes, 2007); the development of DOTAS (see earlier) and attempts to introduce some kind of general anti-avoidance rule (now operationalised as a general anti-abuse rule from 2013 (see Aaronson, 2011); and the specific categorising of avoidance as unethical or immoral. For instance, the UK Chancellor of the Exchequer in his 2012 Budget speech referred to avoidance as being “morally repugnant” (Krouse and Baker, 2012). In its published guidance on the General Anti-Abuse Rule (GAAR) (HMRC, 2013), HMRC specifically highlights at Section B 2.1 a movement away from past case law, in that the GAAR:

... [t]herefore rejects the approach taken by the Courts in a number of old cases to the effect that taxpayers are free to use their ingenuity to reduce their tax bills by any lawful means, however contrived those means might be

⁸ At this date, ‘HMRC’ would refer to ‘Her Majesty’s Revenue Commissioners’.

and however far the tax consequences might diverge from the real economic position.

3.3 The quality of service provided by the tax practitioner

The distinction between the two forms of tax service is important, because determining the quality of the service provided by the tax practitioner will depend on which type of service is being offered. The following definitions of the quality of the two types of tax service will be used:

- i. **Quality of tax compliance work:** how closely the eventual tax liability corresponds to the minimum possible, given truthful reporting and perfect knowledge of tax law and the practices of HMRC. In practice, this idealised definition will become the extent to which the tax computations do not contain any significant errors or omissions as laid down by tax law.
- ii. **Quality of tax planning/avoidance:** how closely the eventual tax liability corresponds to the minimum possible, given the taxpayer's willingness to frame his or her affairs in the most tax efficient manner.

Whilst the definitions capture the elements of the tax practitioner's service, they may become inter-related, when, for example, the quality of the tax compliance work is affected by some particular tax avoidance scheme. A tax adviser with some particularly ambitious tax avoidance scheme is always likely to test the law to its limits and hence, although it may eventually be decided that the tax computations are wrong, the 'error' may have been due primarily to a lack of clarity in the legislation rather than incompetence. In addition, tax advisers working at the extremes of the law are effectively making probabilistic judgements about how worthwhile their schemes are, since each scheme is likely to impose costs on the taxpayer and so the chances of a scheme eventually being accepted have to be weighed against the cost of implementing it. This means that every so often a scheme will fail, but it does not necessarily mean that overall the tax practitioner is offering a poor quality service.

Having accepted the above caveats, evaluating quality in accordance with the two definitions is still not an easy task. In principle, a client of a tax practitioner should be able to make some sort of *ex-post* evaluation of the quality of the tax compliance work, based on the feedback that he or she receives from HMRC. However, HMRC does not necessarily scrutinise in detail all the tax computations submitted to it relying, instead on key ratios such as gross profit margins and the knowledge that, if some error were subsequently discovered, then it may be able to go back and look again at the earlier tax computations. The feedback that the clients would notice could be categorised into three forms: additional demands for extra tax and/or penalties because of errors in original computations, experience of the time taken by the tax practitioner to agree matters with HMRC or HMRC deciding to carry out an investigation. All of these would be directly observable by the taxpayer. However as indicated earlier, additional tax/penalties may become due, additional time may be required or an investigation may arise because of the use of some avoidance scheme and not necessarily because of errors or bad advice.

An *ex-post* evaluation of the quality of tax avoidance advice is even more difficult to undertake, because the theoretical minimum tax liability is unobservable. This will be forever unknown, and so all the client can rely on is some calculation based on either

the eventual size of the tax liability given the size of the transaction, or the amount of profit or gain that the client has made multiplied by the rate of tax appropriate to such transactions. There is also the problem for the client that the use of some tax avoidance measures may produce negative outcomes because of the bad publicity that could result. Such has been the case for Starbucks, with the protests by UK Uncut outside its coffee shops and the company's pledge to pay 'extra' corporation tax,⁹ which might be expected to be some £20m over 2013 and 2014.¹⁰ How a company can calculate the amount of 'extra' corporation tax due in such a situation is an interesting issue. A further example would be the furore that occurred when it was discovered that John Birt, the Director General of the BBC in the early 1990s, was being paid as a limited company rather than as an individual employee. The tax avoidance device of the limited company reduced the tax liability, but the bad publicity was such that he changed the method of payment to that of a normal employee. Hence the goal of the theoretical minimum tax liability has also to be weighed against any negative effects that the use of the tax avoidance scheme produces.

4. AN ECONOMIC ANALYSIS OF THE QUALITY OF THE SERVICE PROVIDED BY TAX PRACTITIONERS

Having outlined the nature of the tax service and how quality can be evaluated, we will now provide an economic analysis of the tax service to determine the incentives that exist to produce a quality service. The characteristics of the tax service that are evident from the foregoing discussion are that it is virtually impossible for the consumer to observe the quality of the service before consumption (explicitly stated by Stephenson, 2010, p. 102 and Bojanic, 1991, p. 29). Often too, in terms of professional services, the client or customer is reliant on the professional to diagnose in the first place the problem that needs solving and thus may not know what type or level of service to expect. It is only once the service has been provided that the consumer will be able to observe only particular aspects of its quality,¹¹ which might be specific to the nature of the problem dealt with, rather than generic (see Hill and Neeley, 1988).¹² This notion of observability plays a key role in economic analysis under uncertainty. Observability refers to the ability of parties to verify directly the events and conditions relevant to the formation and execution of economic transactions. The importance of verification lies in the opportunities which are created

⁹ See, for example, the BBC news report 'UK Uncut Protests over Starbucks "Tax Avoidance"' at <http://www.bbc.co.uk/news/uk-20650945>.

¹⁰ See the BBC news report 'Starbucks Agrees to Pay More Corporation Tax' at <http://www.bbc.co.uk/news/business-20624857>.

¹¹ Bojanic (1991) makes the point that it can be difficult to evaluate the quality of a service even after it has been consumed.

¹² Parasuraman, Zeithaml and Berry (1988) developed the SERVQUAL scale to measure the quality of service provided in different environments. While widely used, it was developed as a generic measure, and this has been the focus of criticism levelled at it: it needs to be customised to a specific service (see Brown, Churchill and Peter, 1993). It has, however, been adapted to assess the quality of services provided by a CPA firm (Bojanic, 1991), where key quality-related issues were firms' responsiveness to clients, partner knowledge and personal attention. There are many different models of service quality: Seth, Deshmukh and Vrat (2005) critique 19 of them, dominated by the focus on the consumer, rather than the service provider. Aspects associated with the service provider are the focus of fewer studies (but see Dotchin and Oakland, 1994; Nilsson, Johnson and Gustafsson, 2001).

when one self-interested party must rely upon the representations of another self-interested party, since the assumption of self-interest implies that each party will take advantage of any situation which could increase his or her welfare (Simunic and Stein, 1987a, 1987b).

A good example of what can happen in such a market is the used car market of Akerlof (1970). A vendor wishes to sell a used car of a particular level of quality. A customer wishes to buy the used car, but is unable to discern its quality before purchase. Hence the maximum amount that the customer should pay is the market price for a car of average quality. This will be so, because any statements by the vendor about the true quality of the car will not be believed by the customer, because the customer has no way of verifying the vendor's representations. The rationale behind the customer's attitude is that the vendor knows not only that price and quality are related, but also that the customer cannot observe the true quality of the car. Therefore, the customer will reason that it is in the vendor's interest to report that the quality of the car is high, whether it is or not.

In such a market consisting of imperfectly informed consumers in which producers have no chance to build a reputation, two factors will conspire to reduce the availability of high quality goods: moral hazard and adverse selection. If the quality of a purchase cannot be pre-determined, then both high and low quality products will eventually sell for the same price, as it is impossible for the buyer to distinguish between them before purchase. The producer's choice of quality cannot therefore have any influence on his or her sales volume. Accordingly, moral hazard will arise because sellers can maximise profits by supplying only poor quality, low cost products, since the returns from producing good quality accrue generally to all sellers regardless of the quality that an individual seller produces. Adverse selection will arise from the fact that sellers of the cheapest, low quality products will drive from the market any seller who for whatever reason wishes to supply higher quality products. Consequently, the average quality of goods on sale will be reduced and the size of the market will shrink (Akerlof, 1970).

In most markets where product quality cannot be determined in advance, it is at least possible for consumers to judge product quality after consumption, even if only imperfectly. In these markets a reputational effect occurs (Rogerson, 1983). The higher quality firm will attract more customers, because customers who have consumed the firm's product are less dissatisfied than the average customer and so fewer leave than on average. Word of mouth advertising also ensures that the higher quality firm attracts new customers. In such a market, product quality will reach an equilibrium level and not fall to the lowest level.

Klein and Leffler (1981) argue that firms producing high quality products will price them sufficiently in excess of salvageable production costs, so that the future stream of profits from producing and selling such high quality goods will exceed the one shot wealth increase available from selling a low quality product at a high quality price. The activity of producing low quality and selling at a high quality price is a once only occurrence in the model, because it is assumed that consumers become aware of the low quality soon after purchase and that this information is quickly disseminated to other potential consumers. Hence, firms with an established reputation for high quality will have incentives not to cheat by selling low quality goods and services. This model also implies a market price greater than the perfect competition price, so that it might be expected that there will be entry into that particular product area and a

resulting erosion of the price. Klein and Leffler argue against entry by other producers by suggesting that high quality firms will invest in non-salvageable firm specific assets and so deter other producers from entering the market. For example, they suggest that companies will invest in advertising and other market promotion activities to such an extent that the economic rents from selling high quality products are reduced to zero.¹³

Shapiro (1982) has shown why a producer would wish to increase the quality of his or her products. In his model of a monopoly producer acting in a market where product quality can be determined only after consumption, each consumer has some expectations regarding product quality at any particular point in time. These expectations constitute the monopolist's reputation, which in turn determines the position of the producer's demand curve. In order for the monopolist to produce higher quality goods, he or she must believe that the improvement in the quality of today's goods will cause the present consumer demand curves to move outwards in the future. Products the quality of which it is difficult to observe after use will display a slow or lagged adjustment in consumer expectations. The monopolist will then have to find the level of quality (and hence eventual reputation) which maximises the present value of his or her profits, since increased quality, whilst producing increased revenue as a result of the higher reputation, will also incur increased production costs as higher quality items will be more costly to produce. In the tax services market, the change in consumer expectations will be very slow and so there will be only a very small incentive for the tax practitioners to produce higher quality work in order to improve their reputation and hence their earning power.

A model of how a tax practitioner chooses a particular level of tax service quality for compliance work can be developed from the audit service model of Simunic and Stein (1987a, 1987b). The model assumes an uncertain world, in which economic agents are concerned primarily with their distributions of future wealth. In particular, taxpayers are concerned with their distribution of future wealth, conditional on a set of tax returns. Tax practitioners for their part are concerned with their distribution of future wealth, conditional on the tax service itself. A formal definition of tax service quality from this perspective can be expressed as:

$$q_{jk} = h \{ [f_{jk} | a_{jk}(c_j, z_j, s_{jk})], f_j \}$$

where:

q_{jk} = taxpayer j 's perception of the quality of the tax service by tax practitioner k

h = a function

f_{jk} = taxpayer j 's perceived distribution of wealth with respect to tax effects determined by tax practitioner k

¹³ Klein and Leffler's model has been developed further by Allen (1984) to conclude that the "main result is that, despite the competitive nature of the model, equilibria can exist in which price is not equal to marginal cost. If no warranties are feasible, price can be above marginal cost. Each firm does not cut its price, because this would change its incentives, and consumers would refuse to buy its products. If warranties are feasible, there is the additional possibility that equilibria can exist with price below marginal cost: each firm does not cut its output, because this would again change its incentives and result in no sales", (p. 327).

a_{jk}	=	the tax service for taxpayer j by tax practitioner k
c_j	=	a set of characteristics of taxpayer j
z_j	=	a set of environmental factors relevant to taxpayer j
s_{jk}	=	the inputs of tax practitioner k to the tax service for taxpayer j (tax service scope) including the quantities of such inputs
f_j	=	taxpayer j 's perceived distribution of wealth before any tax effects determined by tax practitioner k

Therefore, tax service quality is some function of the difference between j 's prior (pre-tax service) and posterior (post-tax service) distributions of wealth. In the model, taxpayers are expected to revise their priors based on a_{jk} alone—that is, the fact that the tax service is performed by tax practitioner k . Tax practitioners are expected to revise their priors based on their full knowledge of c_j , z_j and s_{jk} .

The final part of the model examines the relationship between tax service quality and tax service quantity (that is, time spent on the tax service). From the tax practitioner's perspective, tax service quality and tax service quantity measure the same dimension. For example, tax service quality could be measured by the conditional probability of producing a large tax saving, given a particular interpretation of existing tax law: thus this model could also be applied to the quality of tax avoidance work. However, the important aspect of the Simunic and Stein model is that when the taxpayers are introduced who can observe neither inputs nor output directly, the equivalence between tax service quality and tax service quantity breaks down. Tax service quality to consumers is a function of brand name and reputation and this user perceived tax service quality determines the level of quantity, which it is necessary to maintain an existing reputation. Formally, a profit maximising tax practitioner's problem is to minimise tax service costs subject to the constraint of the user perceived quality:

$$\begin{aligned}
 &\text{minimise} && p \cdot s_j \\
 &\text{subject to:} && h \{ [f_j \mid a_j(c_j, z_j, s_j)], f_j \} = q_j \\
 &&& s_j \geq \text{HMRC}_{\min}
 \end{aligned}$$

where q_j is the user perceived tax service quality for that tax practitioner implied by the tax practitioner's present reputation, p is a vector of market prices for the various tax service inputs and HMRC_{\min} is some minimum required level of tax service quality necessary to comply with generally accepted HMRC requirements. s_j is the inputs of the tax practitioner to the tax service for taxpayer j and a_j is the tax service for the taxpayer j . The constraint that the vector of inputs exceeds some lower bound prescribed by HMRC is consistent with the view that individual tax practitioner service failures impose external costs on him or her because of HMRC's 'black list'.

The value of the Simunic and Stein model is that it shows that a tax practitioner may choose to undertake more tax service work than that necessary to meet HMRC minimum requirements, in order to meet the reputational expectations of taxpayers. The question then becomes one of determining how taxpayers form reputational expectations of the work of a particular tax practitioner or firm of tax practitioners. HMRC receives the work of the tax practices and therefore it should be possible to use

the information it has in order to grade the quality of the tax services provided by individual practices. Unfortunately for prospective clients there is no publicly available feedback because of the position of confidentiality and impartiality maintained by HMRC. The only public data available is the 'well known' fact that most HMRC District Offices maintain a 'black list' of questionable tax advisers, although names have never been disclosed. Such evidence as there is of tax scandals is not necessarily an indicator of a less than satisfactory service, because it would rather be a case of negligence which would give rise to concern—and cases of negligence are invariably settled out of court on the advice of the insurance company providing the professional indemnity insurance. In most instances, tax cases reach the Courts purely because statute is not clear (for example, *Pepper v Hart* (1992) on benefits in kind and *Glaxo Group Ltd* (1996) on transfer pricing issues): there is nothing inherently scandalous in the work of the tax practice. Hence for many tax practices, the only evidence on reputation that new clients can use is the professional body to which members of the tax practice are affiliated. As indicated in Section 2, the problem is the plethora of professional bodies involved, augmented by the body of former HMRC employees who have transferred to private practice, who will have obtained internal HMRC qualifications. To our knowledge, no work has been done on how individual professional bodies are perceived by clients and whether in particular the use of the name 'chartered' produces any additional cachet, although most professional bodies have the word 'chartered' in their name.

As far as the reputation of an individual firm is concerned, given the unobservability of the quality of its service as a tax practice, it is likely that potential clients will make use of indirect measures, based on what they can observe, and hearsay evidence from others, something that has long been acknowledged (see, for example, Carey, 1955). From this perspective, how a tax practice is viewed is not determined primarily by the quality of its tax work, but rather how the firm is viewed more generally, that is, by its reputation in the financial community. Reputation has been defined as follows:

Reputation is the estimation of the consistency over time of an attribute of an entity. This estimation is based upon the entity's willingness and ability to repeatedly perform an activity in a similar fashion. Reputation is an aggregate composite of all previous transactions over the life of the entity, a historical notion, and requires consistency of an entity's actions over a prolonged time for its formation.

Herbig, Milewicz and Golden, 1994, p. 23

Reputation is a multidimensional construct and so a tax practice will have a composite reputation reflecting its reputation for quality work in the numerous services offered by the firm of which it is part, for example, auditing, accountancy, management consultancy, computer systems advice, personnel selection, etc., *as well as* taxation. Its reputation for quality work in one area is quite likely to affect its reputation in another, as shown by Jacoby and Mazursky (1984), who investigated the effects of selling products with either favourable or unfavourable images in stores, which themselves had either a favourable or an unfavourable image (see also Rao and Ruekert, 1994; Purovit and Srivastava, 2001). They found that a retailer with a relatively low image could improve this image by associating it with a more favourable product image. Similarly, a very favourable retailer image was likely to be damaged, if it became connected with brands having less positive images. Consequently, it is reasonable to suppose that the various reputations for each of the

services offered by an accounting firm will tend to influence each other. This will be especially true of the Big Four accountancy firms which typically offer a range of services all contributing to a generic reputation, rather than to a specific one for a particular type of service. Hence a potential client may well judge the likely quality of taxation services on the basis of the firm's overall brand image for quality service and/or value for money.

5. WAYS OF IMPROVING THE QUALITY OF THE SERVICE PROVIDED BY TAX PRACTITIONERS

The implication of the foregoing discussion is that market forces are unlikely to ensure that all tax practitioners will have a vested interest in offering a high quality service to their clients. If market forces are insufficient, that is, if market failure occurs and the public interest is no longer protected by such forces, then the suggestion almost inevitably follows that some form of regulation is necessary as a substitute for market forces. The complexity of tax law and major initiatives (such as the introduction of self-assessment for individuals and companies in the 1990s, compliance with DOTAS in the 2000s, etc.) increase the potential for mistaken advice, which is of concern, especially in a context where unregulated advisers exist. For instance, the cases of bad practice outlined in Chapter 2 of the 1995 report, *Regulation of Tax Advisers in the UK* (Green, 1995), were taken by all commentators in the professional press as evidence of the market failing. However, these were the first concrete examples of such failure. Until these details were published, evidence of poor tax advice was anecdotal, and while it is clear that these examples are selected as representative, it is unclear whether they represented a small or large problem (and there has been no subsequent research to clarify this).

From the point of view of the State, it is necessary to separate tax work into the two components identified in Section 3, namely, tax compliance work and tax avoidance, since it may not be in the State's interests to regulate tax avoidance work, despite its overall aim being to reduce the revenues that the State can collect (see later). A great deal of effort may be expended on, say, devising avoidance schemes to exploit existing or potential loopholes in legislation to benefit individuals not originally intended at law as the recipients of such benefits. Such individuals inevitably tend to be the wealthier members of society, able to afford tax advice aimed at preserving their personal wealth. From a Utilitarian point of view, they may be regarded as obstacles to the collection of taxation monies which could be used to benefit all members of society, and wasters of HMRC's time. HMRC must then itself spend time devising ways of plugging the gaps in the legislation—either by proposing additional anti-avoidance legislation (thus creating further complexities), amending DOTAS, taking cases to Court, drafting Extra Statutory Concessions, or responding by technical or press releases, such as in the case of *Pepper v Hart*. Admittedly this dynamic process does contribute to the development of tax law, but it is rather wasteful of resources, benefiting only the professionals themselves and the wealthier elements within society. (We are still waiting to see what the impact of the specific UK General Anti-Abuse Rule might be.)

The usual purpose of regulation is to protect the public interest, but this aim is somewhat problematic in the taxation services area since it is unclear who the public would be. As suggested earlier, it is not in the interest of the general body of

taxpayers that some taxpayers reduce their tax burdens by the use of clever tax avoidance schemes, as this will mean that the 'lost' tax has to be collected from them or that HMRC has to introduce complicated rules to nullify the avoidance scheme, thus increasing administrative costs. Hence, high quality tax advice can be seen as being detrimental to the well-being of the majority of the population. However, if the term 'public interest' is used more narrowly to relate to the consumers of the services of taxation practitioners, that is, existing and potential clients, then it means providing a service on which taxpayers can rely to minimise their tax liability and which they can use to deal fairly with HMRC on their behalf. O'Leary and Boland (1987) suggest that in the USA the phrase 'public interest' has developed in relation to the accounting profession from meaning policing the public interest against the threat of bureaucratic power to a duty to address the public's interest in the activities of the accounting profession (see also Wyatt, 2004). In a slightly different context in taxation terms, allegations of not protecting the public interest might mean not offering sufficient protection against the bureaucratic power of HMRC.

The term 'market failure' also needs to be defined in relation to the type of work being performed. The effects of market failure in terms of tax compliance work will mean that tax computations are being produced which do not comply with HMRC's requirements. Consequently, there is a possibility of either failure to collect all the tax that is legally due or of increased government administrative costs in checking and correcting the errors in the submitted computations. It is in this area that demands for some form of licensing have come, where there is a standard against which to judge the quality of the tax preparation work. From the consumers' point of view, regulation provides a means of protection and ensures that the tax adviser chosen will be of good quality as regards tax compliance work. However, regulation will only be appropriate if the benefits exceed the cost. Such benefits would include: reduced time spent by clients on tax related issues (because of less need to respond to HMRC queries); a reduction in the burden imposed on HMRC (higher quality tax computation submissions would require a lower level of monitoring); and the tax bill would better approximate to what it should be, given the fiscal law at that point in time (because of the submission of more accurate tax computations). The difficulty is that these benefits are not easily quantifiable, whereas the related costs are. These would essentially cover registration costs and would be borne ultimately by the taxpayer (though initially by the tax practitioner). McKerchar et al. (2008) suggest that regulation of tax practitioners does increase compliance and the overall quality of returns—and it was proposed in the USA by the National Taxpayer Advocate in her 2002 and 2003 reports to Congress, though the likely cost was acknowledged (Bauman and Manzke, 2004). This remains an ongoing debate.

The economic theory of regulation, developed by Stigler (1971) and elaborated by Peltzman (1976), which has often been referred to as 'capture' or 'interest group' theory, asserts that regulation exists to benefit the regulated parties. Stigler argued that an industry with sufficient political power and internal cohesion would strive to use state powers to augment that industry's profitability. Ayres, Jackson and Hite. (1989) refer to the US system of regulation whereby Circular 230 granted CPAs, lawyers and enrolled agents (the latter a specific process) the right to practise before the IRS—meaning that an individual so licensed may represent his/her client in all matters related to the IRS. Thus, such individuals are able to offer a broader range of services than can preparers without this professional certification. Regulation of the tax services allows the practitioners to interpret the law more to the benefit of the

taxpayer, further increasing the value of the regulated practitioner's services to the client and thus the total industry profitability (Ayres et al., 1989).

The means by which UK taxation services can be regulated to ensure quality are various and have been considered by Green (1995, p. 45), although she makes no distinction between compliance and avoidance work, as we make here. The suggestions cover providing improved information about tax advisers, voluntary schemes or codes of practice without legal force, codes of practice with legal force, licensing, self-regulation, and legislation and registration. Green's preferred model is one involving registration of tax practitioners (dependent on a suitable level of technical knowledge and/or experience certified by existing professional bodies), professional indemnity insurance, a minimum level of ongoing continual professional education, and a regulatory body in the form of a National Taxation Council. The role of the National Taxation Council would be like that of the independent National Tax Practitioners' Board, in Australia, which aimed primarily to deal with complaints against practitioners and make an annual report to Parliament. As HMRC already reviews a substantial number of tax computations, the Council could ask for HMRC involvement to identify any practitioners who fell short of current standards, since it is from this source that the impulsion to look at regulation has in part stemmed, and continues to do so. As has been mentioned previously, the HMRC 2009 consultation document, *Modernising Powers, Deterrents and Safeguards. Working with Tax Agents: A Consultation Document*, does suggest, in Chapter 5, some form of registration for the 12,000 estimated tax practitioners who are currently unregulated by any professional body. Hence this idea continues to resonate. In addition, HMRC (2010) has recently published draft legislation as part of its consultation on tax agents, designed to address deliberate wrongdoing by tax agents. Its independent adjudicator in the past has condemned the quality of advice given by tax agents (see, for example, the Third Annual Report from HMRC's independent adjudicator (Bunn, 1996)).

However, perhaps a simpler approach to improving the performance of UK tax practitioners would be to make the tax adviser responsible at law for his or her submission to HMRC (perhaps jointly with the tax client), with a legal penalty imposed if submissions were proved to be incorrect. Penalties could be a percentage of any additional tax due, and might be graded, according to the severity of the errors. This would provide a considerable incentive for the tax practitioner to 'get it right' personally and for the client, although it might mean that there would be less give and take and informality in dealings with HMRC. This would reverse the current position whereby the practitioner's client is pursued by HMRC in the first instance if errors are found. In Canada, it is the case that the adviser is responsible at law for his or her submissions and the USA imposes penalties on the preparer if there are errors. Klepper et al. (1991) provide support for this recommendation with their conclusion that increases in preparer penalties will have the effect of magnifying the enforcer effect (where the taxpayer is persuaded to comply with tax law) and mute the ambiguity-exploiter effect (where the tax practitioner encourages the taxpayer to exploit ambiguities in the law). However, the introduction of preparer penalties will inevitably increase the price to the taxpayer of the practitioner's services, which will discourage the use of preparers and encourage more taxpayers to do their own tax submissions with, inevitably, a drop in reliability because of their lack of knowledge.

6. SUMMARY AND IMPLICATIONS

In this paper we have considered the role of the tax practitioner in the UK tax services market and the existing forces that determine the standard of care to which the practitioner works. We noted the fragmented nature of professional regulation with the many professional bodies and also drew attention to the lack of statutory definition of the words ‘accountant’ and ‘tax adviser’. Hence anyone can call themselves either an accountant or a tax adviser with no requirement that they have shown that they are capable of fulfilling that role, either by virtue of experience or examination performance. In the UK, unlike in other countries such as the USA, there are no penalties imposed by the tax authorities for poor performance on the part of the tax practitioner. Any penalties are imposed on the taxpayer, who has to resort to suing the tax practitioner in the Courts for negligence in order to recoup some of his or her losses.

We have also categorised the work of the tax practitioner into two kinds: compliance work where the tax practitioner is essentially reporting what has already taken place with the aim of minimising the taxpayer’s liability to tax, given what has already occurred, and planning/avoidance work where the tax practitioner aims to (re)structure the client’s affairs with the aim of so organising them that the tax payable in the future is reduced. We showed that, where the tax practitioner provided avoidance advice as well as the compliance service, it would be difficult sometimes to evaluate whether apparent poor performance on the part of the tax practitioner was due to sub-standard compliance work or speculative tax avoidance schemes which ultimately proved not to work in law. Even for purely tax compliance work, it is not easy for individual clients to evaluate the service provided by the tax practitioner, since they have no benchmark against which to assess him or her as they would not know what a ‘good’ practitioner would have done in similar circumstances. The only feedback is the amount of queries and general aggravation that they receive from HMRC. It is known that HMRC has its own list of poor tax advisers, but details are not released to the outside world.

We adapted the model of Simunic and Stein from the audit context to show how reputation could work as a way of ensuring that the tax practitioner would work to a particular level of quality. However, the problem that we identified was how the prospective client might learn of the reputation of an individual practitioner or firm of practitioners. The reputation literature was examined and revealed that the reputation of a firm of accountants, for instance, would more than likely be a general one for the firm. Hence prospective clients would have a general image of the firm which would then be applied to the tax services offered.

Finally we looked at whether there was a case that could be made for regulating tax practitioners. Given the fragmentation of the profession, multiplicity of professional bodies and the fact that anyone could set up in business as a tax consultant, it is not obvious that professional self-regulation can be successful, because it would work only via the reputational effect of belonging to a professional body and there are too many professional bodies for that to be considered to have much impact. It is clear that if there were to be some form of regulatory regime that it would have to be organised by the State. However, there does not seem to be any role for the State in imposing some sort of regulatory regime on the provision of tax avoidance advice as it

is not in the interests of the State to encourage the setting up of schemes the primary purpose of which is to reduce the amount of tax revenues that the State would receive.

Hence any State regulation is likely to apply only to compliance work. Whether there is a net benefit in the State introducing regulation will depend primarily on who finances it. The main benefit to the State will be that the tax forms submitted to HMRC will be more accurate and hence that there will be less investigation required by HMRC (which should produce a cost saving). However, better advice will not necessarily increase the amount of tax payable to the State as taxpayers will be made aware of reliefs available to them and hence technically competent compliance work could on average reduce the amount of tax payable. The overall effect will depend on the extent to which the regulated tax practitioners are able to convince their clients to be more honest in their reporting of their affairs and hence the balance is between the additional honesty and the effects of full knowledge of the reliefs available.

If the regulatory process is financed by the tax practitioners via some levy (as happens in the current system of audit regulation), then the costs of tax practitioners will rise and so inevitably will their charges. Such an increase will discourage some taxpayers from using them, as they will prefer to prepare their own computations. Given the complexity of UK tax law, it is likely that taxpayers on their own are likely on average to do a worse job than even an unregulated tax practitioner would do and hence introducing costly regulation will have the effect of improving some of the tax returns to HMRC and reducing the quality of others. The overall effect will therefore depend on the costs of the regulatory scheme. The cheapest scheme is probably to make the tax advisers liable for any errors in the computations and failure to meet deadlines, etc. Such a scheme would not require some large regulatory watchdog, but would allow HMRC to target tax practitioners producing a poor quality service. If the public were made aware of who had been fined for poor performance, this would introduce a reputational effect to amplify the financial effects of the fine.

The advent of self-assessment in tax returns together with increasingly voluminous and complex legislation in recent years means that taxpayers will be likely to continue to seek assistance. The taxation services market has an economic interest in attracting new customers. Stressing the difficulty associated with meeting more stringent requirements imposed (for example, fines for late submission of tax returns) is one way of attracting them. However, there will be political costs if the government is seen as having forced some individual taxpayers (as they see it) to use professional tax advisers and then these tax advisers produce work of low quality which results in extra costs to the taxpayers. Hence in the end it may be the politics of the process rather than the economics that determines whether some form of regulation of tax advisers is introduced.

It is clear from the above that State regulation would be contentious on a number of levels, and would be likely to be resisted by practitioners, as it would be seen, perhaps, as eroding professional autonomy. There is the additional question of how it would be financed—and to whom exactly it would apply, given the fragmentation of the market for taxation services and type of individuals at work there. As we have outlined, it is also likely only to be applicable to compliance work and would not easily (if at all) address the difficulty of how to ensure that advice given complies not only with the letter of the law, but also its spirit, that is, to ensure that it is ethical. While DOTAS has been effective in filtering out domestic avoidance schemes, it cannot ‘reach’ international ‘tax arbitrage’. Our earlier suggestion of making the tax adviser

responsible at law for his/her submission to HMRC (perhaps jointly with the tax client), with a penalty applying if anything were incorrect, might be a relatively easy way to ensure better quality compliance, but there is no easy way to deal with avoidance. The answer may be a continuation of the ‘moral outrage’ stance taken by government (regardless of its political persuasion) that links tax avoidance explicitly to the reduction in public benefits resulting from decreased tax take: over time this may succeed in eroding the social acceptability of avoidance if it is seen as responsible, for example, for lack of funding for hospitals or care for the elderly.

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Relational impact of tax practitioners' behavioural interaction and service satisfaction: Evidence from New Zealand

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Abstract

This article reports the results of an investigation into taxpayers' perceptions of their present tax practitioners' explaining skills, listening skills, technical experience, competency and co-operative intentions (behavioural interaction factors), service satisfaction and their relationship commitment. To determine New Zealand taxpayers' perception of their present tax practitioner a survey was administered to clients of various accounting and law firms in New Zealand in late 2012. A total of 211 responses were analysed to test the proposed hypotheses.

By employing the Hayes PROCESS macro for SPSS, client satisfaction with their current tax practitioner is shown to mediate the effects of behavioural interaction factors on their relationship commitment. The findings reveal that clients prefer limited explanation of implications of tax regulations regarding their tax affairs and their obligations under the law.

The study suggests that the development of tax practitioner's skills to gaining their clients' satisfaction could improve the overall quality of tax practitioners' services and enhance taxpayer compliance.

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1. INTRODUCTION

A tax practitioner's role in tax compliance lies in between the taxpayer and the revenue authority. The services of a tax practitioner have a significant influence on taxpayers' voluntary compliance behaviour and minimisation of compliance and administrative costs.² The tax practitioner's knowledge of tax laws and procedures is much greater than that of an ordinary taxpayer and the purpose of using a tax advisor's services is to avail the benefit of this knowledge and expertise.³ Tax practitioners can be considered important gatekeepers to the tax system for taxpayers.⁴ Tax practitioners have a duty to uphold the integrity of the tax system and the vast majority of tax practitioners' work involves complying with the rules. The role of a tax practitioner has been defined by Pickhardt and Prinz as, "on the one hand they are allies of taxpayers, on the other hand they have a legal obligation to obey tax laws when professionally advising taxpayers".⁵ Survey research suggests that the primary reason that most taxpayers use the services of a tax practitioner is to deal with complexity of tax laws, lack of time, fear of penalties⁶ and to file an accurate return.⁷

The tax practitioner (sometimes referred to as tax professional, tax preparer, tax accountant, tax lawyer or tax agent depending on the jurisdiction) is an integral part of the tax system. The term 'tax practitioner' covers a diverse group of individuals, business structures and professional groups who provide a range of tax services for their clients.⁸ The current study adopts a broad definition of the term 'tax practitioner' and includes tax professionals, tax preparers, tax agents, tax accountants and tax lawyers and the terms are used interchangeably.

Since there is no statutory definition of the words 'tax accountant' or 'tax practitioner' it means that in some countries anyone can set up a business as a tax accountant or tax practitioner without having to satisfy any legal requirements.⁹ In New Zealand any

² B Erard, "Taxation with Representation: An Analysis of the Role of Tax Practitioners in Tax Compliance" (1993) 52:2 *Journal of Public Economics* 163.

³ SE Kaplan, PMJ Reckers, SG West and JC Boyd, "An Examination of Tax Reporting Recommendations of Professional Tax Preparers" (1988) 9:4 *Journal of Economic Psychology* 427.

⁴ PA Hite and G McGill, "An Examination of Taxpayers Preference for Aggressive Tax Advice" (1992) 45:4 *National Tax Journal* 389; KJ Newberry, PMJ Reckers and RW Wyndelts "An Examination of Tax Practitioner Decisions: The Role of Preparer Sanctions and Framing Effects Associated with Client Condition" (1993) 14:2 *Journal of Economic Psychology* 439 and LM Tan "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20:4 *Journal of Economic Psychology* 431.

⁵ M Pickhardt and A Prinz, "Behavioral Dynamics of Tax Evasion – A survey" (2014) 40:1 *Journal of Economic Psychology* 1.

⁶ K McKinstry and JC Baldry, "Explaining the Growth in Usage of Tax Agents by Australian Personal Income Taxpayers" (1997) 13:1 *Australian Tax Forum* 135-153.

⁷ JH Collins, VC Milliron and DR Toy, "Determinants of Tax Compliance: A Contingency Approach" (1990) 12:1 *Journal of the American Tax Association* 9; PA Hite and G McGill "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45:4 *National Tax Journal* 389; PA Hite, T Stock and CB Cloyd, "Reasons for Preparer Usage by Small Business Owners: How Compliant Are They?" (1992) 37:2 *National Public Accountant* 20.

⁸ R Marshall, M Smith and R Armstrong, "The Impact of Audit Risk, Materiality and Severity on Ethical Decision Making: An Analysis of the Perceptions of Tax Agents in Australia" (2006) 21(5) *Managerial Auditing Journal* 499.

⁹ It is in contrast to the highly regulated position in Australia and United States of America. M McKerchar, K Bloomquist and S Leviner, "Improving the Quality of Services Offered by Tax Agents: Can Regulation Assist?" (2008) 23:4 *Australian Tax Forum* 399.

person who owns a business where annual income tax returns are prepared or has a professional practice and prepares annual income tax returns for ten or more taxpayers can register with Inland Revenue as a tax agent.¹⁰ Reinganum and Wilde's¹¹ study on the positive and negative effects of engaging a tax practitioner in the United States of America (USA) reported that the tax agency generally preferred taxpayers to prepare their own returns but where tax practitioner efficiencies were sufficiently large, taxpayers would engage a tax practitioner. During 2010–11 income year more than 2.3 million individuals and businesses in New Zealand, relied on the assistance of a tax practitioner to assist them to plan and structure their tax affairs.¹² This large reliance on a tax practitioners' expertise shows the importance of a tax practitioner's services to the tax system and his/her responsibilities to society, to the law and to one's profession.¹³

Over the last four decades New Zealand's socio-economic and demographic character has changed and tax practitioners are now operating in a competitive market. New Zealanders with diverse ethnic, socio-cultural, economic and demographical backgrounds¹⁴ have diverse expectations as customers, and in order to retain their clients tax practitioners must exhibit appropriate behaviours. Most clients are keen to form a long term professional relationship with their tax practitioner.¹⁵ The relationship between clients and their tax practitioner is very important because clients gain a certain sense of security regarding the type of service provided to them. The quality of service improves through long term relationships with tax practitioners having greater understanding of their clients' business and sources of income history. Based on the results of empirical research of Profit Impact of Market Strategies ("PIMS"), product quality (as judged by customers) has a strong positive relationship with profitability. Effectively this could result in more profitability for the tax practitioners in terms of more clients as well as more money per client.¹⁶

The focus on satisfaction is central to the service delivery approach to tax practitioners. Service satisfaction reduces uncertainty and vulnerability in a relationship, especially for services that are difficult to evaluate due to their intangible, complex and technical nature.¹⁷ Taxpayer disengagement can be addressed through satisfaction with services

¹⁰ A practising tax agent or adviser must be a registered New Zealand Inland Revenue customer. About 5,300 tax agents are registered with Inland Revenue Department at 31 March 2013 and on an average there were 460 clients per agent. The tax agents filed just over 75% of all income tax returns. Available at <http://www.ird.govt.nz/aboutir/external-stats/tax-agents/>

¹¹ JF Reinganum and LL Wilde, "Equilibrium Enforcement and Compliance in the Presence of Tax Practitioners" (1991) 7:1 *The Journal of Law, Economics and Organisation* 163.

¹² Available at <http://www.ird.govt.nz/aboutir/external-stats/tax-agents/>.

¹³ LS Shapiro, "Doing What is Right" (1996) 41:12 *The National Public Accountant* 7.

¹⁴ M Khawaja, B Boddington and R Didham, *Growing Ethnic Diversity in New Zealand and its Implications for Measuring Differentials in Fertility and Mortality*, Wellington; Statistics New Zealand, 2007.

¹⁵ PJ Danaher, DM Conroy and JR McColl-Kennedy, "Who Wants a Relationship Anyway? Conditions When Consumers Expect a Relationship with their Service Provider" (2008) 11:1 *Journal of Service Research* 43.

¹⁶ S Schoeffler, RD Buzzell, and DF Heany, PIMS: "A Breakthrough in Strategic Planning". (1973) Marketing Science Institute, Cambridge, MA. Marketing Science Institute in 1972 and 1973 examined the relationship between superior perceived quality and profitability among some 950 individual business units from 93 different companies.

¹⁷ LL Berry, "Relationship Marketing of Services: Growing Interest, Emerging Perspectives", (1995) 23:1 *Journal of the Academy Marketing Science* 236.

of a tax practitioner.¹⁸ Satisfaction is a key variable of relationship continuity (loyalty)¹⁹ and will deliver value to clients, practitioners and revenue authorities by enhancing taxpayer compliance from a platform of transparency and dialogue.²⁰

Despite the above, little formal empirical research has been conducted in the international accounting and tax literature to evaluate clients' relationship commitment with their tax practitioners. Given that a good relationship is critical to both clients and tax practitioners, and in order to develop and maintain a healthy relationship and to understand such relationships, further research is warranted.

The objective of the present study is to address this potential research gap by extending previous literature on the factors associated with clients' judgments of tax practitioners' behavioural interaction and to evaluate how these factors may influence a clients' satisfaction with the tax practitioner services and the relationship commitment to their tax practitioner.

The findings of the present study may shed some light on clients' expectations and perceptions with respect to tax practitioners' behavioural interaction and could assist tax practitioners in developing methods to better serve their clients' within a laid framework.

The remainder of this paper is organised as follows. Section 2 provides a succinct review of the tax practitioners' interaction behaviour literature, with particular reference to a client's satisfaction with tax practitioner services and their relationship commitment and hypothesis development. Section 3 of the paper details the research design and methodology employed. The results of the survey are outlined in Section 4. Section 5 summarises the findings and considers the limitations and sets out the conclusions emerging from this study.

2. BRIEF LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A considerable body of research exists in the marketing literature²¹ that examines the issues of clients' satisfaction in terms of self-reported satisfaction with the service, overall evaluation of the service and intent to use the service in the future. However, in the accounting and tax literature in New Zealand and overseas, few studies have considered the relationship between the tax practitioners' communication skills, technical experience, competency and clients' satisfaction with services.

¹⁸ V Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy*, Cheltenham, UK and Northampton, USA: Edward Elgar Publishing Ltd., 2009.

¹⁹ M Huang, "The Influence of Selling Behaviours on Customer Relationships in Financial Services" (2008) 19:4 *International Journal of Service Industry Management* 458.

²⁰ B McEvily, V Perrone and A Zaheer, "Trust as an Organizing Principle" (2003) 14:1 *Organizational Science* 91.

²¹ D Tse and P Wilton, "Models of Consumer Satisfaction Formation: An Extension" (1988) 25:2 *Journal of Marketing Research* 204; E Gummesson and C Gronroos "Quality Services - Lessons from the Product Sector" (1987) *Add Value to Your Service: The Key to Success*, C. Suprenant (ed.) American Marketing Association, Chicago, II 35-39; A Wong and L Zhou "Determinants and Outcomes of Relationship Quality: A Conceptual Model and Empirical Investigation" (2006) 18:3 *Journal of International Consumer Marketing* 81.

Smith and Kinsey,²² Klepper et al²³ and Hite et al²⁴ studies suggest that clients use a tax practitioner for filing a tax return which is prepared correctly, thereby reducing the risk of being audited. The findings from Collins et al²⁵ and Kinsey²⁶ examined the factors associated with demand for a tax practitioner's services. Their study reports that the most common reasons that had been linked to seeking tax practitioner assistance are to ensure accurate tax returns and lower tax liabilities.

Sakurai and Braithwaite²⁷ surveyed 2,040 Australian taxpayers to investigate how taxpayers differentiate the styles of tax practitioners, what they would prefer in their ideal tax practitioner and what they have opted for in real life. The study reports that taxpayers' ideal tax practitioners were people who were competent, honest and whom they can trust to keep them on the right side of the law and were risk averse. The results revealed that taxpayers did not feel any need to trade off honesty for cleverness. However, their study did not focus on the impact of descriptors of tax practitioners' soft skills (listening and explaining) on a client's satisfaction with the services provided.

Devos²⁸ surveyed Australian taxpayers to investigate whether or not a relationship exists between taxpayers retaining/terminating their client/advisor relationship based on the tax advice they receive from their tax practitioners and their own compliance behaviour. The results revealed statistically significant relationships between conservative tax advice and termination or retention of the tax agent based on that advice and compliance behaviour. However, in retaining/terminating their client/advisor relationship, the role of tax practitioner's interaction behaviour factors and trust was not identified.

Christensen²⁹ surveyed 235 taxpayers and 31 tax practitioners to investigate their perception on tax service quality on technical and functional quality dimensions. Their findings suggest that clients' satisfaction with a tax service was more based on what a client actually received in the form of advice or a completed tax return rather than the way in which the service is delivered. The results revealed that many clients do not believe tax preparers adequately understand their individual needs with regard to tax services. The study aptly pointed out that tax advisers' perceptions of what clients expect from a quality service differ significantly from actual client expectations.

²² KW Smith and KA Kinsey, *Tax Preparer and Compliance: Some Empirical Evidence* (Paper presented at the 12th Annual Convention of the Eastern Economic Association, Philadelphia, 10 April 1986).

²³ S Klepper, M Mazur and D Nagin, "Expert Intermediaries and legal Compliance: The Case of Tax Preparers" (1991) 34 :1 *Journal of Law and Economics* 205.

²⁴ P Hite, T Stock and CB Cloyd, "Reasons for preparer Usage by Small Business Owners: How Compliant Are They?" (1992) 37:2 *National Public Accountant* 20.

²⁵ JH Collins, VC Milliron and DR Toy, "Factors Associated with Household Demand for Tax Preparers" (1990) 12:1 *Journal of the American Taxation Association* 9.

²⁶ KA Kinsey, *Advocacy and Perception: The Structure of Tax Practice* (Working paper, American Bar Association, Chicago II, August 1987).

²⁷ Y Sakurai and V Braithwaite, "Taxpayers' Perceptions of Practitioners: Finding One Who is Effective and Does the Right Thing?" (2003) 46:3 *Journal of Business Ethics* 375.

²⁸ K Devos, "The Impact of Tax Professionals upon the Compliance Behaviour of Australian Individual Taxpayers" (2012) 22:1 *Revenue Law Journal* 1.

²⁹ AL Christensen, "Evaluation of Tax Services: A Client and Preparer Perspective" (1992) 14:2 *Journal of the American Taxation Association* 60.

However, the investigation into communication skills only evaluated the tax service quality, and did not identify the influence of explaining and listening skills.

Chang and Bird³⁰ surveyed United States taxpayers to investigate the determinants of client satisfaction with their tax practitioner's services. The study was based on 187 clients of three local accounting firms. Their findings suggest that actual tax and time savings, accuracy in tax return preparation, easy and quick accessibility of services play a key role in taxpayers' selection of a tax practitioner. Their study reports that professional image did not significantly affect satisfaction of clients.

Coyne and Smith³¹ explored the structure of tax practice and the factors influencing practitioners' role and attitudes toward regulations governing their practices. Their study examined an issue of the nature of clients' expectations and preferences. The research found that clients' expectations and preferences were influenced by the tax practitioner's firm size and provided incentives and constraints on the use of a tax practitioner. Fleischman and Stephenson³² in their US study examined the association between the key perceptions of clients in hiring a tax practitioner and specific motivations to hire. Their findings suggest that clients are desirous of having their tax practitioner be their advocate in a manner that shields them from the revenue authorities.

Tan³³ in New Zealand and Hite and McGill³⁴ in the United States examined taxpayers' preferred attributes in a tax practitioner, preference for types of advice, risk engagement and retention/termination of taxpayers' services. They found that taxpayers prefer a tax adviser who gives them the confidence that their tax matters are under control, and their tax paying behaviour is lawful. However, when clients disagree with the advice they tended not to retain the tax adviser. Their findings also suggest that taxpayers interested in tax minimisation were open to having a tax practitioner who was aware of both low and high risk strategies. However, these studies found no significant effects of audit probability on a taxpayer's decisions.

Tan³⁵ investigated the tax practitioners' and the business taxpayers' roles and relationship using a Tax Practitioner—Client Role Model. Her findings suggest that qualities of good tax practitioners as perceived by taxpayers are competency, honesty, trustworthiness, good communication skills and acting in the interest of the client. The results also revealed ambiguity of the tax practitioner's role. The research showed that the tax practitioners are unaware that they fall short of taxpayers' technical proficiency and trust expectations of them. The research covered the role of tax practitioners in

³⁰ OH Chang and CJ Bird, "What Clients Really Want From Their Tax Preparers" (1993) 52:4 *The Ohio CPA Journal* 21.

³¹ ML Coyne and KW Smith, *A Conceptual Framework of the Incentives and Constraints of Tax Practices* Mimeo, American Bar Foundation 1987.

³² GM Fleischman and T Stephenson, "Client Variables Associated With Four Key Determinants of Demand for Tax Preparer Services: An Exploratory Study" (2012) 26:3 *Accounting Horizons* 417.

³³ LM Tan, "Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination" (1999) 20:4 *Journal of Economic Psychology* 431.

³⁴ P Hite and G McGill, "An Examination of Taxpayer Preference for Aggressive Tax Advice" (1992) 45:4 *National Tax Journal* 389.

³⁵ LM Tan, *Towards an understanding of the tax practitioner-client role relationship: A role analysis*, (Thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy, The Australian National University 2009), available online at <https://digitalcollections.anu.edu.au/handle/1885/10069?mode=full>.

taxpaying behaviour and tax practitioners' explaining and listening skills are included under communication skills. However, the marketing literature suggests that listening skills and explaining skills are two attributes, whereas the literature on the role of tax practitioners seems to be somewhat scant on these separate dimensions. Thus, in the present study the descriptors of listening and explaining behaviour in the questionnaire were framed around these two dimensions.

Overall, past research³⁶ has indicated that the key reasons for seeking a tax practitioner's assistance are: perception of audit risk; reduction in tax liability; or overall accuracy and absence of errors. These studies had claimed that these reasons also useful in the evaluation of technical capability of a tax practitioner. However, the dimensions of functional quality (service delivery): service providers listening and explaining skills responsiveness to the client's needs; providing the service in an efficient manner; and the co-operative intentions and physical surroundings of the service delivered had been identified by marketing scholars.³⁷

The association of service satisfaction with relationship commitment has been well established in the literature³⁸ and it is conceivable that service satisfaction does not fully mediate the effects of interaction behaviour factors on relationship commitment. It is likely that interaction behaviour factors may have direct and significant effect on relationship commitment.

However, to the author's knowledge, no systematic empirical study in the accounting and tax literature has yet been conducted on the indirect effects through clients' service satisfaction with tax practitioners' interaction behaviour factors and their relationship commitment.

Given, the tax practitioners' role involves dealing with financial affairs of clients, in the accounting and tax field it is particularly worthy of investigation whether tax practitioners' interaction behaviour factors (soft skills, technical experience and competence) are postulated to exert an effect on creating and sustaining long term relationships between the tax practitioners and the clients through intervening variable,

³⁶ KW Smith and KA Kinsey, *Tax Preparer and Compliance: Some Empirical Evidence* (Paper presented at the 12th Annual Convention of the Eastern Economic Association, Philadelphia, 10 April 1986); JH Collins, VC Milliron and DR Toy, "Factors Associated with Household Demand for Tax Preparers" (1990) 12 :1 *Journal of the American Taxation Association* 9; KA Kinsey, *Advocacy and Perception: The Structure of Tax Practice* (Working paper, American Bar Association, Chicago II, August 1987); S Klepper, M Mazur and D Nagin, "Expert Intermediaries and legal Compliance: The Case of Tax Preparers" (1991) 34:1 *Journal of Law and Economics* 205.

³⁷ A Wong and L Zhou, "Determinants and Outcomes of Relationship Quality: A Conceptual Model and Empirical Investigation" (2006) 18:3 *Journal of International Consumer Marketing* 81; AL Stewart, A Nápoles-Springer, EJ Pérez-Stable, SF Posner, AB Bindman, HL Pinderhughes and AE Washington, "Interpersonal Processes of Care in Diverse Populations" (1999) 77:3 *The Milbank Quarterly* 305; SS Gaur, X Yingzi, Q Ali and N Swathi, "Relational Impact of Service Providers' Interaction Behaviour In Healthcare" (2011) 21:1 *Managing Service Quality* 67; N Sharma and PG Patterson, "Switching Costs, Alternative Attractiveness and Experience as Moderators of Relationship Commitment in Professional, Consumer Services" (2000)11:5 *International Journal of Service Industry Management* 470.

³⁸ D Tse and P Wilton, "Models of Consumer Satisfaction Formation: An Extension" (1988) 25:2 *Journal of Marketing Research* 204; E Gummesson and C Gronroos "Quality Services-Lessons from the Product Sector" *Add Value to Your Service: The Key to Success*, C. Suprenant (ed.) American Marketing Association, Chicago, IL, 1987 35-39.

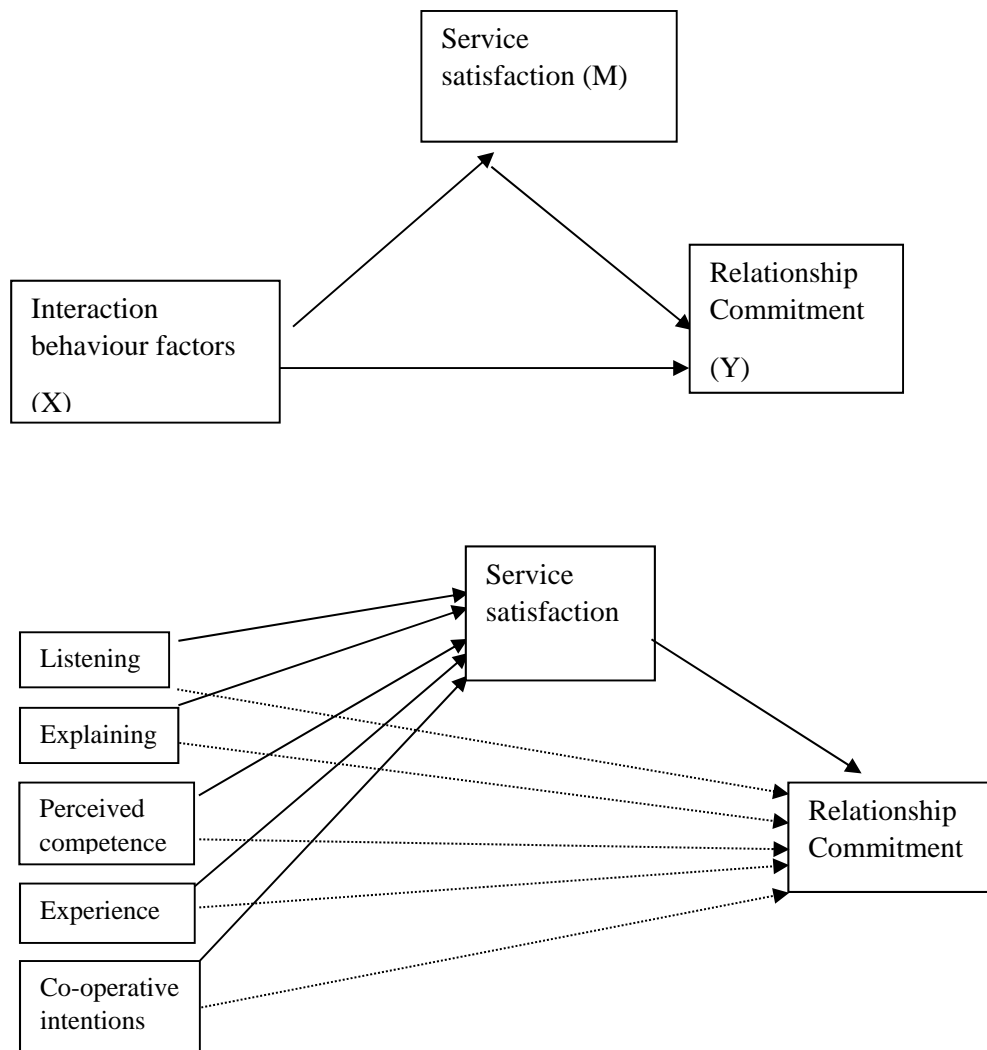
satisfaction with tax practitioners' services (mediator).³⁹ The results for these factors in the accounting and tax field may be much different than in other service fields. A mediator explains how or why a relationship exists between the predictor and dependent variable.⁴⁰ Comprehensive explaining, listening skills, positive efficiency and technical experience, high competency and co-operative intentions, increases clients' satisfaction with tax practitioners' services which enhances their relationship commitment.

Consequently, the present study is an attempt to explore this potential research gap by examining whether an association of service satisfaction, a mediator between behavioural interaction factors and relationship commitment exists and to what extent. Prior research does not explain exactly the dimensions of communication skills. This research creates a scale to report two soft skill constructs (listening and explaining) each consisting of multiple items. Overall, the present study contributes to the published literature by creating a scale to report the five interaction behaviour factors, service satisfaction and relationship commitment, each consisting of multiple items and eliminating potential bias wherever possible.

To achieve the objectives of the present study, the hypotheses are drawn from the conceptual model (Figure 1) and tested.

³⁹ A variable is a mediator if independent variable significantly accounts for variability in the mediator and the independent variable significantly accounts for variability in dependent variable. Mediator significantly accounts for variability in dependent variable when controlling the independent variable as shown in conceptual model and significant relation between the independent variable and dependent variable is no longer significant.

⁴⁰ RM Baron and DA Kenny, "The Moderator-Mediator Variable Distinction in Social Psychological Research: Conceptual, Strategic, and Statistical Considerations" (1986) 51:6 *Journal of Personality and Social Psychology* 1173; GN Holmbeck, "Toward Terminological, Conceptual, and Statistical Clarity in the Study of Mediators and Moderators: Examples from the Child-clinical and Pediatric Psychology Literatures" (1997) 65:4 *Journal of Consulting and Clinical Psychology* 599.

Figure 1. Conceptual model

Note: —→ Shows that service satisfaction fully mediates the effects of interaction behaviour factors on relationship commitment. No significant direct effect of interaction behaviour factors on relationship commitment is anticipated.

.....→ Shows direct relationship between interaction behaviour factors and relationship commitment. It includes five additional paths, from interaction behaviour factors to relationship commitment.

- H1. Tax practitioner's listening behaviour is positively associated with clients' satisfaction with tax practitioner services.
- H2. Tax practitioner's explaining behaviour is positively associated with clients' satisfaction with tax practitioner.
- H3. Tax practitioner's perceived competence is positively associated with clients' satisfaction with tax practitioner.
- H4. Tax practitioner's efficiency and technical experience is positively associated with clients' satisfaction with tax practitioner.
- H5. Tax practitioner's co-operative intentions are positively associated with clients' satisfaction with tax practitioner.
- H6. Clients experiencing higher levels of service satisfaction with his/her tax practitioner report higher relationship commitment regardless of the practitioner's listening and explaining skills, competence and co-operative intentions of the practitioner.
- H7. Tax practitioner's listening behaviour is positively associated with clients' relationship commitment.
- H8. Tax practitioner's explaining behaviour is positively associated with clients' relationship commitment.
- H9. Tax practitioner's perceived competence is positively associated with clients' relationship commitment.
- H10. Tax practitioner's efficiency and technical experience is positively associated with clients' relationship commitment.
- H11. Tax practitioner's co-operative intentions are positively associated with clients' relationship commitment.

3. RESEARCH DESIGN AND METHOD

This section describes the sample, survey questionnaire, measures used in the analysis and the summary of demographic data.

As the purpose of the current study is to investigate the relationships between the variables "that have been previously identified and measured" rather than exploring "what variables are involved", quantitative methodology is more appropriate than qualitative methodology.⁴¹ The survey was designed to provide information about the clients' expectations and perceptions with respect to tax practitioners' behaviour and services in New Zealand. This information could assist tax practitioners in developing an effective relationship with their clients and help serve them better.

⁴¹ C Perry, "A Structured Approach for Presenting Thesis" (1998) 6:1 *Australasian Marketing Journal* 78.

To determine the effect of tax practitioners' behavioural interaction factors on client's service satisfaction and their relationship commitment in New Zealand, the questionnaire (along with a self-addressed prepaid postage envelope) was mailed to the potential respondents during the later part of 2012. Ball⁴² considered it an advantage to mail the questionnaires as this could lead to a better response rate. Accordingly, accounting and law firms were randomly selected from the telephone book and were invited to participate in the survey. One thousand five hundred and ten copies of the survey instrument (along with a self-addressed prepaid postage envelope) were distributed to the accounting and law firms who agreed to participate in the survey and were requested to mail the survey instrument to their clients.

The respondents' ethical and privacy requirements were taken into consideration. The survey was completed by 211 respondents.

3.1 Questionnaire development

The survey questionnaire for the study was developed on the basis of the literature review and focus group.

A focus group is a data collection method that combines the features of brainstorming and brain writing.⁴³ A focus group was appropriate for this research as it could generate and help prioritise ideas about tax practitioner behaviour and a client's relationship with their tax practitioner in New Zealand. A nomination list for invitation to focus group was obtained from accounting and law firms, who agreed to participate in the survey. Four clients from two accounting firms and two clients from one law firm were randomly recruited to discuss and explain their viewpoints of their relationship with their tax practitioner. Results determined by the group findings as a whole were added to the literature list in the questionnaire. The considerable industrial marketing and distribution channels literature⁴⁴ provides strong evidence that relationship commitment, the key variable is inextricably linked to customer satisfaction and the issues of clients' satisfaction in terms of self-reported satisfaction with the service, overall evaluation of the service and intent to use the service in the future. Hence, the factors identified in marketing literature are particularly worthy of investigation because they may be contributing to different results in the accounting and tax field. Accordingly, the following items were drawn in the questionnaire:

- Tax practitioners' listening and explaining skills were measured using the items drawn from the scale developed by Stewart et al.⁴⁵

⁴² C Ball, "Rural Perceptions of Crime" (2001) 17:1 *Journal of Contemporary Criminal Justice* 37.

⁴³ C Brahm and BH Kleiner, "Advantages and Disadvantages of Group Decision Making Approaches" (1996) 2:1 *Team Performance Management* 30.

⁴⁴ D Tse and P Wilton, "Models of Consumer Satisfaction Formation: An Extension" (1988) 25:2 *Journal of Marketing Research* 204; E Gummesson and C Gronroos "Quality Services-Lessons from the Product Sector" (1987) *Add Value to Your Service: The Key to Success*, C. Suprenant (ed.) American Marketing Association, Chicago, II 35-39; A Wong and L Zhou "Determinants and Outcomes of Relationship Quality: A Conceptual Model and Empirical Investigation" (2006) 18:3 *Journal of International Consumer Marketing* 81.

⁴⁵ AL Stewart, A Nápoles-Springer, EJ Pérez-Stable, SF Posner, AB Bindman, HL Pinderhughes and AE Washington, "Interpersonal Processes of Care in Diverse Populations" (1999) 77:3 *The Milbank Quarterly* 305.

- Tax practitioners' efficiency and technical experience were measured using the items drawn from the scale developed by Chang and Bird.⁴⁶ The experience statement items represent the effectiveness and efficiency of tax practitioner services.
- Tax practitioners' perceived competence was measured using the items drawn from the scale developed by Brown and Swartz.⁴⁷
- Tax practitioners' co-operative intention was measured using the items drawn from the scale developed by Crosby et al.⁴⁸
- For the measurement of the client's satisfaction with tax practitioner, the items were drawn from the scale developed by Oliver and Swan⁴⁹ and Westbrook and Oliver.⁵⁰
- Items for the measurement of relationship commitment were adopted from the scale developed by Anderson and Weitz⁵¹ and Morgan and Hunt.⁵²

Following pre-testing and modifications, a questionnaire was professionally customised for the purpose of this research. The questionnaire was pilot tested with New Zealand taxpayers' who fairly represented the clients that the researcher sought to survey and fine-tuned in the light of participants' feedback before the final version was posted to the accounting and law firms.

Ethics approval for the survey was sought and granted by the University Ethics Committee, (application 12/164). The survey questionnaire included the following two sections:

- Section 1: taxpayers' perception about the services of their present tax practitioner section (contained questions concerning the tax practitioners' behavioural interaction factors, service satisfaction and their relationship commitment); and
- Section 2: background information (including items on types of returns filed, services used and previously or currently under audit by New Zealand Inland Revenue).

The survey questionnaire items are provided in Appendix 1 of this article.

⁴⁶ OH Chang and CJ Bird, "What Clients Really Want From Their Tax Preparers" (1993) 52:4 *The Ohio CPA Journal* 21.

⁴⁷ SW Brown and TA Swartz, "A Gap Analysis of Professional Service Quality" (1989) 53:2 *Journal of Marketing* 92.

⁴⁸ LA Crosby, KR Evans and D Cowles, "Relationship Quality in Services Selling: An Interpersonal Influence Perspective" (1990) 54:3 *Journal of Marketing* 68.

⁴⁹ RL Oliver and JE Swan, "Consumer Perceptions of Interpersonal Equity and Satisfaction in Transactions: A Field Survey Approach" (1989) 53:2 *Journal of Marketing* 21.

⁵⁰ RA Westbrook and RL Oliver, "The Dimensionality of Consumer Patterns and Consumer Satisfaction" (1991) 18:1 *Journal of Consumer Research* 84.

⁵¹ E Anderson and B Weitz, "The Use of Pledges to Build and Sustain Commitment in Distribution Channels" (1992) 24:1 *Journal of Marketing Research* 18.

⁵² RM Morgan and SD Hunt, "The Commitment-trust Theory of Relationship Marketing" (1994) 58:3 *Journal of Marketing* 20.

3.2 Measures

To facilitate data analysis, the respondents' ratings for each construct in the research model was codified into a seven-point quantitative scale where one represented 'strongly disagree' and seven represented 'strongly agree' and moderate scores were found in between the two extremes. The Czaja and Blair⁵³ study reported test-retest reliability greater than 0.95 for the 'likely-unlikely' scale which supports the standard attitude that scales are highly reliable in measuring the strength of beliefs and intentions.

In part one, respondents were requested to answer some questions designed to provide information about their current tax practitioners' behavioural interaction, service satisfaction and the relationship commitment. In part two, respondents were asked to provide information on their demographic and economic position. The respondents were asked to give reasoning about their views about tax practitioner in the last question.

3.3 Respondent recruitment procedures and data collection

The survey recruitment strategy was designed to include all taxpayers in New Zealand who were either clients of chartered accounting firms, solicitors practising in tax area and other accounting firms in New Zealand. The first contact with the survey respondents was in October 2012, which introduced about 60 tax practitioners to the study and invited them to participate. The tax practitioners who were identified as a tax services providers were randomly selected from the telephone book from the different areas of New Zealand and a request was made to them to support the research. A participant information sheet explaining the purpose of the study and the survey questionnaire was attached to this requisition letter. The requisition letter indicated that if tax practitioners decided to support the study the researcher would provide a sealed research pack consisting of a questionnaire, an information sheet and a self-addressed prepaid postage envelope. To protect clients' privacy, tax practitioners conducted the distribution of surveys and the survey responses were received by the researcher directly at the University.

To encourage candid responses to the survey, the cover letter explained that the responses would remain anonymous. No inducement was offered. On the survey questionnaire, no name or address details were provided by respondents. Since respondents were asked for their personal perceptions, the survey also emphasised there was no right or wrong answer. To assist respondents, the author's email address was stated in the participant information sheet preceding the questionnaire.

After two weeks a reminder was posted to potential tax practitioners to participate in the research. Seven days before the due date for returning the survey a telephone follow-up of non-respondents was conducted by the researcher. In all, up to three series of contacts were made with potential tax practitioners. The successive reminder and telephone follow-ups delivered a total of nine tax practitioners' responses.

⁵³ R Czaja and J Blair, *Designing Surveys: A Guide to Decisions and Procedures* Thousand Oaks, CA: Sage, Pine Forge Press, 1996.

One thousand five hundred and ten copies⁵⁴ of the research pack were distributed to these tax practitioners, who were asked to mail the research pack to their clients. Ten days before the due date for the return of the survey forms, the accounting firms reminded the potential respondents by an email to participate in the research. Out of a total of 1,510 surveys administered, 226 were completed. Via the data screening process, 15 questionnaires were abandoned, because of numerous missing values. Consequently, there were 211 valid questionnaires for use in the data analysis, giving a response rate of 14 per cent.

3.4 Response rate

This is a relatively low response rate compared to prior studies⁵⁵ but given the sensitive nature of the topic it was considered acceptable in providing insight into the area of clients' perceptions about their present tax practitioner behavioural interaction, service satisfaction and relationship commitment. There are several possible explanations for the low response rate in identified taxpayers. Without extensive tracking, the author could not conclude a definite explanation for the low response rate in the identification of potential survey respondents.⁵⁶ This was because the researcher had no control over the respondents⁵⁷ particularly when third parties, for example a number of accounting and law firms, were involved in the process of distributing questionnaires in this study. The survey was four pages in length and well designed for participants. A number of respondents commented that they enjoyed participating in the survey questionnaire because it was simple and quick.

4. ANALYSIS

Data stored within Microsoft Excel was exported into SPSS for analysis. This paper contains univariate and multivariate statistics to investigate the relationship between variables studied.⁵⁸ The data was tested for non-response bias and it was concluded that this issue was not a concern.⁵⁹ Overall, the frequency of demographic data suggests that the survey consisted of a fairly representative sample as on an average

⁵⁴ Floyd Fowler Jr, *Survey Research Method*, Thousand Oaks, CA: Sage Publications, 2nd ed., 1993. A sample of 150 people would describe a population of 15000 or 15 million or even less given NZ population size with virtually the same degree of accuracy. Following this representativeness of samples to population basis, it was determined that somewhere between 150-250 usable responses would be desirable for this study given the taxpaying population in New Zealand.

⁵⁵ Tax researchers have claimed that tax surveys consistently produce lower response rates and it is more realistic to expect a rate around 30% (see IG Wallschutzky, *Issues in Research Methods: With Reference to Income Tax Research*. (Unpublished manuscript, University of Newcastle: Australia 1996); Oxley achieved a 29% response rate (see P Oxley, "Women and Paying Tax", in C Scott (ed), *Women and Taxation*, (Wellington, Institute of Policy Studies, 1993)); and Hasseldine et al achieved a 22% response rate (see DJ Hasseldine, SE Kaplan, and LR Fuller, "Characteristics of New Zealand Tax Evaders: A Note", (1994) 34:2 *Accounting and Finance* 79).

⁵⁶ The variables with high intercorrelations well measure one underlying variable, which is called a 'factor'.

⁵⁷ David de Vaus, *Surveys in Social Research*, Sydney: Allen & Unwin, 2002, 128.

⁵⁸ BG Tabachnick and LS Fidell, *Using Multivariate Statistic*, Pearson, 2012, 6th edition.

⁵⁹ The appropriate *t* tests of differences in means between the respondents and non-respondents to test for non-response bias was calculated.

more than 87 per cent of the respondents were using the accounting services with tax advice increasing the richness of the data.

Before performing any analysis, the validity of the measurements for relationship commitment constructs were investigated. Interrelated items were summed to obtain an overall score for each participant for the constructs. The Cornbach alpha coefficient was calculated to determine the internal consistency or average correlation of items in a survey instrument in order to gauge the reliability of the scales. The higher the alpha value, the more reliable the measurement. All of the measurement scales exhibited high reliability (alpha 0.70 or higher as suggested by Hair et al.⁶⁰).

Table 1: Scale reliabilities

Scale	Number of items	Cronbach alpha
Listening (LISTN)	4	0.93
Explaining (EXPL)	4	0.89
Technical experience (EXP)	8	0.78
Perceived competence (COMP)	5	0.80
Co-operative intentions (INT)	4	0.74
Service satisfaction (SAT)	3	0.93
Relationship commitment (COMMIT)	5	0.90

An exploratory factor analysis was performed to confirm the validity of scales and to ensure that the items that make up one construct are highly correlated with each other and not with those items that make up the other constructs.⁶¹ Items from listening, explaining, experience statement, perceived competence, cooperative intention, trust, service satisfaction and relationship commitment were entered into the factor analysis and the eigenvalues of each of the factor was greater than 1.0 and emerged cleanly. No item had loading on two factors with a difference less than 0.25. The absolute loadings ranged from 0.549 to 0.846, being above the 0.50 as recommended to be statistically significant.⁶²

4.1 Demographic effects

Section 2 of the survey dealt with demographics (which included items related to the professional status of their present tax practitioner, types of services used, income levels, types of return filed, gender, education, age, accounting knowledge and audit by Inland Revenue. Summary of the demographic data of the sample is provided in tables X and Y in the Appendix to this article.

⁶⁰ JF Hair, RE Anderson, RL Tatham and WC Black, *Multivariate Data Analysis* 5th ed. New Jersey: Prentice Hall, 1998.

⁶¹ RG Netemeyer, WO Bearden and S Sharma, *Scaling procedures; Issues and applications*, Thousand Oaks: Sage Publications, Inc. 2003; JM Lattin, JD Carroll and PE Green, *Analyzing Multivariate Data*, Pacific Grove, California: Thomson Learning Inc. 2003.

⁶² JF Hair, RE Anderson, RL Tatham and WC Black, *Multivariate Data Analysis* 5th ed. New Jersey: Prentice Hall, 1998.

The results show that the majority of the respondents (62.6%) were male, (75%) in the 31–60 age group and had graduate degree/graduate diploma or higher (57%). The sample consists of 70 per cent of respondents who possessed accounting knowledge. The professional membership status of the tax practitioners is varied. The majority of respondents (83%) were using the services of NZICA and CPA Australia members and 90 per cent of them had not changed their tax practitioner in the last three years. Approximately 44 per cent of respondents were using the services of the same practitioner for the last 10 years. Most of the respondents (74%) were either very unlikely or unlikely to switch to a new tax practitioner during the next year and the majority of respondents (69%) were never audited by the New Zealand Inland Revenue. The annual taxable income of the respondents varies as well. Most of them (65%) had more than \$200,000 to \$1 million annual taxable income which is reflected by the fact that majority of the respondents (92%) were filing individual tax return and 79 per cent were also filing the Goods and Services Tax return. This is followed by 52 per cent also filing both company tax and trust tax returns. New Zealand, like many other jurisdictions, uses a tax system based on voluntary compliance. Under section 33A(1) *Tax Administration Act* 1994, those individuals who had their annual gross income taxed at source at the correct marginal tax rate, are not obliged to file a return.⁶³ Approximately 97 per cent of the tax practitioners were also providing accounting services and 80 per cent of the practitioners were also providing business advisory services. Most of the respondents (87%) were using accounting services along with tax advice. This is followed by 43 per cent using the business advisory services. Approximately 70 per cent of the tax practitioners were also providing audit services but only a minority of the respondents (8.5%) were using audit services. It is suggested that the majority of businesses in New Zealand are small and are not required to get their accounts audited by a qualified auditor. Overall, the frequency of demographic data indicates that the survey consisted of a fairly representative sample and on an average more than 87 per cent of the respondents were using accounting services with tax advice, increasing the richness of the data.

The mean rating suggests that the most preferable reasons for using the tax practitioner services were considerable time saving in filing tax returns (6.27 out of 7) and appointments with the practitioner being easily and quickly made (6.22). However practitioner's concern with meeting clients' needs than earning fees (3.44) and tax practitioner charging reasonable fees for the services rendered (3.54) were rated as the least preferable. The discussion of these reasons is beyond the scope of this article. The respondents' rating for all items in descending order of their respondents' satisfaction with the current tax practitioner is provided in Appendix (Table Z) to this article. Means, medians and standard deviations for the independent and dependent variables are provided in Table 2.

⁶³ In New Zealand taxpayers who have their gross income from employment where PAYE is deducted or interests or dividends that have RWT deducted are not required to file a tax return. Given this, taxpayers who have income from business and/ or from other sources hire a tax practitioner to help them plan and structure their tax affairs. This may influence the type of clients using tax practitioner services.

4.2 Results

Table 2: Summary of relationship variables in descending order of preference for a tax practitioner

Variable	Mean	Median	S. D.	Ranking
Listening (LISTN)	5.65	5	1.08	1
Explaining (EXPL)	5.51	6	1.21	2
Perceived competence (COMP)	5.18	5	0.86	3
Technical experience (EXP)	4.73	6	0.80	5
Co-operative intention (INT)	4.66	5	0.97	6
Service satisfaction (SAT)	4.60	5	1.47	7
Relationship commitment (COMMIT)	4.38	6	1.35	8

Note: The variables are arranged by rank.

The present study took the composite measure for all variables (dependent and independent) by taking an average of all items on a scale which is based on the assumption that all the items contribute equally to the construct. Application of this assumption in the present study is reasonable as all the scales used are well established in the literature.⁶⁴

The respondents' rating for all items was measured on an ordinal scale. Correlations for dependent and independent variables are provided in Table 3 below.

Table 3: Correlation of the variables.

Variables	LISTN	EXPL	EXP	COMP	INT	SAT	COMMIT
LISTN	-						
EXPL	.79**	-					
EXP	.64**	.51**	-				
COMP	.75**	.67**	.70**	-			
INT	.64**	.62**	.61**	.61**	-		
SAT	.64**	.50**	.78**	.65**	.59**	-	
COMMIT	.58**	.39**	.62**	.60**	.68**	.75**	-

Note: N = 211; ** $p < 0.001$.

⁶⁴ JF Hair, RE Anderson, RL Tatham and WC Black, *Multivariate Data Analysis* 5th ed. New Jersey: Prentice Hall, 1998; J Cohen, *Statistical Power Analysis for the Behavioral Sciences*, New Jersey: Lawrence Erlbaum Associates 1988, 2nd edition.

The information relating to correlations (Table 3) shows that all the variables related to service satisfaction have a significant relationship with service satisfaction ($p < 0.001$). Tax practitioners' efficiency and technical experience have a strong significant-positive relationship with service satisfaction, which makes up (.78**), meanwhile other variables (listening, explaining, perceived competence, cooperative intention and trust) are moderately-positively associated to service satisfaction (.64**, .50**, .65**, .59**, .74**).

To evaluate the conceptual model in Figure 1, Hayes⁶⁵ PROCESS macro for SPSS was employed. The model has the ability to examine indirect as well as direct effects in mediation. A description and visual depiction of each model that can be tested with the PROCESS is available from Hayes.⁶⁶ The indirect effects of five interaction behaviour factors on relationship commitment has been bootstrapped using PROCESS macro for SPSS. The method also depicts the direct impact of the five interaction behaviour factors on relationship commitment. The macro is based on Ordinary Least Squares (OLS) regression and it incorporates aforementioned bootstrapping procedures for investigating mediation. The current analysis was conducted using 5,000 bootstrapped samples. An advantage of PROCESS macro for the present analyses is that the macro automatically computes post hoc probing for mediating effects. This bootstrapping approach overcomes the limitations of the widely used Barron and Kenny⁶⁷ and Sobel⁶⁸ approaches thus yielding results that are argued to improve accuracy and less influenced by sample size.⁶⁹

Tables 4 to 6 present the results of total and specific indirect effects by bootstrapping confidence intervals.

⁶⁵ AF Hayes, *Introduction to mediation, moderation, and conditional process analysis: A regression based approach*, Chapters 5-7, The Guilford Press, New York, 2013.

⁶⁶ AF Hayes, "Model templates for Process for SPSS and SAS". Retrieved from <http://www.ahayes.com/public/templates.pdf>.

⁶⁷ RM Baron and DA Kenny, "The Moderator-Mediator Variable Distinction in Social Psychological Research: Conceptual, Strategic, and Statistical Considerations" (1986) 51:6 *Journal of Personality and Social Psychology* 1173.

⁶⁸ ME Sobel, "Asymptotic Confidence Intervals for Indirect Effects in Structural Equation Models" (1982) 13 *Sociological Methodology* 290.

⁶⁹ KJ Preacher and AF Hayes, "SPSS and SAS Procedures for Estimating Indirect Effects in Simple Mediation Models" (2004) 36 *Behaviour Research Methods, Instruments and Computers* 717; KJ Preacher and AF Hayes, "Asymptotic and Resampling Strategies for Assessing and Comparing Indirect Effects in Multiple Mediator Models" (2008) 40:3 *Behaviour Research Methods* 879; AF Hayes "Beyond Baron and Kenny: Statistical Mediation Analysis in the New Millennium" (2009) 76:4 *Communication Monographs* 408.

Table 4: Model summary

Model	R Square	df	F	<i>p</i>
1	.65	6	60.79	.000

Model (DV service satisfaction)

Model	Unstandardized β coefficients	Std. Error	<i>p</i>
(Constant)	-1.294	.355	.000
Listening	.332**	.107	.002
Explaining	-.210*	.098	.034
Experience	.503***	.071	.000
Perceived Competence	.165**	.112	.007
Cooperative intention	.197*	.090	.030

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

Lower limit of confidence interval (LLCI); upper limit of confidence interval (ULCI).

The Model summary in Table 4 indicates a high degree of correlation ($R=0.8$). R^2 of 0.65 (65%) is moderately large and shows that 65 per cent of service satisfaction can be explained by these five variables viz: listening, explaining, experience statement, perceived competence and cooperative intention. Changes in the levels of these variables significantly account for the variations in the presumed mediator ($p < 0.01$).

The standardised coefficients (β) provide information on each predictor variable which is required to predict service satisfaction from behavioural interaction variables viz: listening ($\beta = .332^{**}$), explaining ($\beta = -.210^*$), experience ($\beta = .503^{***}$), perceived competence ($\beta = .165^{**}$) and cooperative intention ($\beta = .197^*$). As hypothesised, the standard coefficients for all variables significantly contribute to service satisfaction ($p < 0.05$). The results indicate that tax practitioners' explaining behaviour is found to have a significant negative effect on clients' service satisfaction ($\beta = -.210$, $p < 0.05$). It shows that if clients want to reduce their tax liability and the tax practitioner support that approach, satisfaction with services is high and provides support for all interaction behaviour factors except explaining in $H2$. However, for the $H2$ counter intuitive results were found. The results show that clients' satisfaction with a tax practitioner significantly reduces when a tax practitioner gives comprehensive information to the clients about their tax issues and explains their obligations under the law. Thus, the second hypothesis is not supported.

The results presented in Table 5 below shows the indirect effect through service satisfaction, that is, paths from interaction behaviour factors (X) to service satisfaction (M) and service satisfaction (M) to relationship commitment (Y) controlling for interaction behaviour factors (see Figure 1).

Table 5: Model summary

Model	R Square	df	F	<i>p</i>
1	.62	7	45.74	.000

Model (DV relationship commitment)

Model	Unstandardized β Coefficients	Std. Error	<i>p</i>
Constant	.027	.358	.940
Service satisfaction	.446***	.069	.000
Listening	.228*	.107	.034
Explaining	-.363***	.088	.000
Experience	.191*	.096	.048
Perceived Competence	.223**	.111	.047
Cooperative intention	.499***	.091	.000

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

The Model summary in Table 5 indicates a significant degree of correlation ($R=0.78$). R^2 is 0.62 (62%) and moderately large, which confirms that service satisfaction with tax practitioner mediates 62 per cent effect of interaction behavioural factors on relationship commitment. Results indicate that the clients' higher levels of satisfaction with the tax practitioner enhances their relationship commitment regardless of their experience with the practitioner's listening and explaining skills, efficiency and technical experience, competence and co-operative intentions ($\beta = .446$ ***) which provides support for hypothesis *H6*.

Table 6: Total effect model – model summary

Model	R Square	df	F	<i>p</i>
1	.53	5	45.025	.000

DV relationship commitment

Model	Unstandardized β Coefficients	Std. Error	<i>p</i>
(Constant)	-.550	.380	.149
Listening	.376**	.114	.001
Explaining	-.372***	.096	.000
Experience	.172*	.076	.025
Perceived Competence	.359**	.120	.003
Cooperative intention	.559***	.099	.000

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

The Model summary indicates a high degree of correlation ($R=0.73$). R^2 is 0.53, which shows that 53 per cent of relationship commitment can be explained by behavioural interaction variables viz: including listening, efficiency and technical experience, perceived competence and cooperative intention and these variables can statistically significantly predict relationship commitment variable ($p < 0.05$) and provides support for hypothesis *H7 and H9 to H11*. Tax practitioner's explaining behaviour is found to have a significant negative effect on their relationship commitment ($\beta = -.372$, $p < 0.001$). The results show that a client's relationship commitment with a tax practitioner significantly reduces when a tax practitioner is cautious and spends time on explanation of implications of tax laws and regulations and risks associated with client's approach. Thus, *H8* is not supported. This means that people prefer a tax practitioner as one who listens to them, is competent, has cooperative intentions and has effective experience without particular explanation of law in low risk and high risk tax minimisation schemes and aggressive tax planning. This is noticeably different from the results of the study conducted by Hite and McGill,⁷⁰ which suggested that taxpayers interested in tax minimisation were open to having a tax practitioner who was aware of both high and low risk strategies.

The relative effect of behavioural interaction variables on relationship commitment (when service satisfaction is controlled, as shown in Table 5) to the effect of behavioural interaction variables on relationship commitment (when service satisfaction is not controlled as shown in Table 6) is shown in Table 7.

⁷⁰ PA Hite and G McGill, "An Examination of Taxpayers Preference for Aggressive Tax Advice" (1992) 45:4 *National Tax Journal* 389.

Table 7: Total effect of behavioural interaction variables on relationship commitment

Effect	Std. Error	t	p	LLCI	ULCI
0.470	0.120	3.175	.002**	.150	.602

Direct effect of behavioural interaction variables on relationship commitment

Effect	Std. Error	t	p	LLCI	ULCI
0.103	0.055	1.89	.059	.017	.439

Indirect effect of behavioural interaction variables on relationship commitment

Effect	Std. Error	z	p	Boot LLCI	Boot ULCI
0.367	0.123	2.991	.003**	.045	.267

*** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

The output in Table 7 shows that total⁷¹ and indirect effect⁷² of the behavioural interaction variables on the relationship commitment is significant (0.470, $p < .01$), and direct⁷³ effect of behavioural interaction variables on relationship commitment is not significant (0.103, $p > .05$). The difference between the total and direct effects is the total indirect effect through mediator which depicts whether service satisfaction is transmitting the effects of behavioural interaction variables to relationship commitment. The results show that indirect effect viz: path from behavioural interaction variables to service satisfaction and service satisfaction to relationship commitment controlling for behavioural interaction variables is significant (0.367, $p < .001$) and $H6$ is supported. The specific indirect effects in bootstrap mediation analysis indicates that service satisfaction mediate the relationship between all behavioural interaction variables and relationship commitment. A 95 per cent bias corrected bootstrap confidence intervals (based on 5,000 bootstrap samples) for specific indirect effects through service satisfaction do not include zero. To sum up, the output in Table 7 establishes that good listening, limited explanation of client's tax obligations, efficiency and technical experience, competence and cooperative intention of tax practitioner contribute to clients' satisfaction with a tax practitioner's services which results in their relationship commitment.

It is certainly relevant and interesting to test whether being audited affects other interaction behavioural factors being tested, thus affecting the outcome variables. Therefore, to investigate the relative impact of interaction behavioural factors on

⁷¹ Path from from behavioural interaction variables to relationship commitment (c) plus paths from behavioural interaction variables to service satisfaction, paths from service satisfaction to relationship commitment controlling for behavioural interaction variables.

⁷² A specific indirect effect represents service satisfaction's (mediator's) unique ability to mediate the behavioural interaction variables and relationship commitment relationship.

⁷³ The direct effect of behavioural interaction variables on relationship commitment = Total effect of behavioural interaction variables on relationship commitment (c) minus indirect effect of behavioural interaction variables on relationship commitment through mediator service satisfaction.

service satisfaction and relationship commitment, an audit was held as a constant. Hayes⁷⁴ SPSS and SAS routines for bootstrap-based inference were used to find out indirect as well as direct effects in mediation. The indirect effects of five interaction behaviour factors on relationship commitment was bootstrapped using Hayes⁷⁵ PROCESS macro for SPSS. The model shows the indirect impact of listening, explaining, experience statement, perceived competence, cooperative intention (independent variables (IV)) to relationship commitment (dependent variable (DV)) via clients' satisfaction with tax practitioner services as mediating variable (MV), with a number of Inland Revenue audits entered as a control variable. It also shows the direct impact of the interaction behaviour factors on relationship commitment with a number of Inland Revenue audits entered as a control variable. Interestingly, the number of Inland Revenue audits was not found to have a statistically significant effect on clients' service satisfaction and relationship commitment with a tax practitioner.

5. SUMMARY, LIMITATIONS AND CONCLUSIONS

It is suggested that this study makes a valuable contribution to the literature regarding the relationship commitment between service providers and their clients in terms of trust and self-reported satisfaction. This New Zealand study attempted to explore the impact of the factors associated with clients' judgments of tax practitioners' behavioural interaction and how these factors determine clients' service satisfaction and their relationship commitment with a tax practitioner.

The present study incorporated the views of 211 New Zealand taxpayers regarding the present tax practitioners' interaction behaviour factors, service satisfaction and their relationship commitment. To evaluate the impact of taxpayers' perception about the services of their present tax practitioners, the study considered two key points. First, the study measured the direct relationship between interaction behaviour factors (tax practitioners' listening, explaining, perceived competence, cooperative intention behaviour and technical experience) and their relationship commitment. Secondly, it sought to explain the indirect effect of interaction behaviour factors through an intervening variable (mediator), clients' satisfaction with services on their relationship commitment.

The results establish that interaction behavioural factors (listening, technical experience, competence and cooperative intention) appears to exert an effect on their relationship commitment through service satisfaction. Clients' service satisfaction with a tax practitioner is found to have a significant effect on the relationship between interaction behaviour factors and their relationship commitment. The study demonstrates that tax practitioners' good listening, limited explanation of clients' obligations, perceived competence, clients' positive experience with a tax practitioners' technical experience, and cooperative intentions enhance relationship commitment under conditions of high service satisfaction with a tax practitioner. The most noteworthy finding of the study is that the service satisfaction results show that survey

⁷⁴ AF Hayes, *Introduction to mediation, moderation, and conditional process analysis: A regression based approach*, Chapter 5, The Guilford Press, New York, 2013.

⁷⁵ AF Hayes, *Introduction to mediation, moderation, and conditional process analysis: A regression based approach*, Chapters 5-7, The Guilford Press, New York, 2013.

participants expressed a negative attitude when tax practitioners give enough information to them about their tax issues; explain implications of tax laws and regulations for their tax affairs using terminologies which they understand; explain the risks associated with a particular issue; and also explain their obligations under the law. Tax practitioners often take clients through a detailed questionnaire to ensure that all the relevant information is included in the return. It is suggested that the key reason for this attitude is that after giving the tax practitioner an authority to act on their behalf, clients believe that the tax practitioner understand their tax service needs and should accordingly make a judgment on their behalf rather than wasting their time. Most of the tax practitioners bill their clients according to time involved in tax advice, including explaining the implications of different approaches. The smaller tax practitioners' firms tend to deal directly with the taxpayers who have a financial stake in the resulting tax advice given and they are likely to be placed under greater pressure. It is suggested most tax practitioners in New Zealand are afraid of being held liable by their clients for giving incorrect advice and as a consequence, they tend to give conservative advice to their clients and provide detailed explanations on the tax consequences of their operations and should continue doing that under ethical pronouncement of the profession. Therefore, it demonstrates that tax practitioners have to be careful in dealing with their clients and marketing their skills in a way that is suitable to their clients and maximise taxpayer compliance, without any need to trade off their responsibilities to uphold the integrity of the tax system, to the revenue authorities and the Government.

This study is subject to several limitations. The principal limitation is attributable to the sampling process used. The respondents to the survey may not necessarily be representative of New Zealand taxpayers' population. The random selection of accounting firms (participants) and clients from those organisations alleviates this concern to some degree but does not completely rule it out.

Secondly, while there is a ranking for interaction behaviour factors, satisfaction and relationship commitment items, the reasons why some respondents regarded some items as 'strongly disagree' or 'strongly agree', compared to others, are not known. Each respondent is subjected to a set of factors that are unique to him/her. There is no reason to assume that participants did not answer honestly or that self-selection bias would render the results invalid. The non-response bias was tested by comparing responses received shortly after mailing to those received last but no statistically-significant differences were found.⁷⁶ It is suggested that further qualitative research be conducted to cross validate the statistical results perhaps. Furthermore, given the group sizes, it is not feasible to separate the subjects of the study into larger and smaller firms to test the effect of firm size or industry. A survey methodology measuring a single point in time also limits the conclusions about causality in relationship. The study relies on theory and existing literature to suggest the causal direction of various relationships, but it would be useful for future studies to statistically test the causality. Furthermore, the questionnaire was answered by New Zealand taxpayers, so the results of the present study might not be directly applicable to any other country or culture.

⁷⁶ The appropriate *t* tests of differences in means between the respondents and nonrespondents to test for nonresponse bias was calculated.

Notwithstanding these limitations, the overall findings of this study largely confirm that trust and satisfaction with tax practitioner services are important determinants of behavioural interaction factors and their relationship commitment. Tax practitioners may use the information provided in this study to develop their skills and a services marketing plan that is more explicit about the qualities that taxpayers ultimately want. Potentially this will assist with building a relationship commitment between taxpayers and the tax practitioners, maximising taxpayer compliance and would lead to more client referrals, and ultimately, higher revenues.

The study suggests that tax practitioners should survey their clients regularly to determine their clients' needs and the strengths and weaknesses of their existing tax services. The study also suggests that practitioners should try to gain and maintain their clients' satisfaction by adopting fair practices and service-oriented behaviour. Knowledge gained from this study is beneficial to clients, tax practitioners, revenue authorities and tax practitioners' professional bodies. Consequently, this study contributes to the call for investigating the impact of trust upon the relationship between interaction behaviour factors and relationship commitment. Future research in this area is clearly warranted.

6. APPENDIX

Table X and Table Y present the demographic data of the sample.

Table X: Summary of demographic data

Variable	Responses	Percentage (%)
Age		
20-30	11	5.2
31-40	49	23.2
41-60	110	52.1
Over 60	41	19.5
Total	211	100
Gender		
Male	132	62.6
Female	79	37.4
Total	211	100
Highest level of completed education		
Some high school	21	10
High school	70	33.1
Graduate degree	98	46.5
Postgraduate qualification	22	10.4
Total	211	100
Accounting knowledge		
No knowledge at all	17	8.1
I can understand financial reports	47	22.4
Basic bookkeeping knowledge	78	37.1
Good bookkeeping knowledge	44	21
Qualified bookkeeper	18	8.6
Qualified accountant	6	2.8
Total	210	100
Annual taxable income in current year		
Under \$40,000	1	0.5
Over \$40,000-\$100,000	21	10
Over \$100,000-\$200,000	32	15.2
Over \$200,000-\$500,000	78	37.1
Over \$500,000 -\$1 Million	59	28.1

Over \$1 Million -\$5Million	17	8.1
Over \$5 Million-\$20 Million	2	1
Total	210	100
Current tax practitioner		
A Big Four Chartered accounting (CA) firm	4	1.9
A local or regional CA firm	171	81
A non CA firm	32	15.2
A law firm	4	1.9
Total	211	100
Changed tax practitioner in the last 3 years		
Yes	22	10.4
No	189	89.6
Total	211	100
Audited by the Inland Revenue before		
Once	60	28.4
More than once	5	2.4
Never	146	69.2
Total	211	100
Switch to a new tax practitioner during the next year		
Very unlikely	85	40.3
Unlikely	71	33.6
Undecided	41	19.4
Likely	9	4.3
Very likely	5	2.4
Total	211	100
Using the services of current tax practitioner		
Last 5 years	69	32.7
Last 10 years	93	44.1
Last 15 years	37	17.5
Last 20 years	12	5.7
Total	211	100

Table Y: Summary of demographic data

Type of return filed using tax practitioner's service		
Individual (IR 3)	194	92
Company (IR 4)	109	51.7
Partnership income (IR 7)	62	29.4
Trust (IR 6)	110	52.1
Clubs or Societies (IR 9)	11	5.2
GST returns	166	78.7
Other, please specify	4	1.9
Type of services provided (excluding tax advise)		
Business Advisory services	169	80.1
Accounting services	200	94.8
Audit services	147	69.7
Other	6	2.8
None	3	1.4
Type of services used (excluding tax advise)		
Business Advisory services	91	43.1
Accounting services	184	87.2
Audit services	18	8.5
Other	4	1.9
None	6	2.8

Table Z: Summary of survey results in descending order of items showing preferences for the tax practitioner

Description of item	Min*	Mean	Median	S. D.	Ranking
The use of my tax adviser's service saves me considerable time in filing my tax return. (Q 13)	2	6.27	6	0.94	33
My appointments with the adviser are made easily and quickly. (Q 16)	2	6.22	6	0.98	32
My tax adviser gives me enough time to provide relevant information. (Q 22)	1	6.03	6	1.1	31
The qualification of my tax adviser is important to me. (Q 18)	2	5.69	6	1.03	30
My tax adviser listens carefully to what I have to say. (Q 23)	1	5.69	6	1.2	29
My tax adviser explains to me my obligations under the law. (Q 29)	2	5.68	6	1.34	28
My tax adviser informs me my tax position when deciding my tax liability. (Q 21)	2	5.66	6	1.24	27
My tax adviser gives me enough information about my tax issues. (Q 26)	1	5.6	6	1.36	26
My tax adviser does not ignore what I have to say. (Q 24)	1	5.56	6	1.22	25
My tax adviser tells me the risks associated with the tax advice. (Q 28)	1	5.46	6	1.43	24
My tax adviser saves me from paying a considerable amount of taxes. (Q 9)	1	5.41	6	1.41	23
My tax adviser treats me the same whether the issue involves a small amount or a large amount. (Q 32)	1	5.36	6	1.18	22
My tax adviser takes my concerns seriously. (Q 25)	1	5.34	6	1.27	21
My tax adviser explains implications of tax laws and regulations for my tax affairs using words I understand. (Q 27)	1	5.3	6	1.43	20
My tax adviser keeps up on the latest changes in tax laws. (Q 20)	1	5.27	6	1.33	19
My tax adviser has expressed a desire to develop a long term business relationship with me. (Q 33)	1	5.12	5	1.3	18

I do not look out for an alternative tax adviser. (Q 38)	1	5.09	5	1.58	17
My tax adviser has better training than the average tax adviser. (Q 17)	1	5	5	1.05	16
I am very satisfied with my present choice of tax adviser. (Q 1)	2	4.66	5	1.44	15
I feel good about the decision to choose my present tax adviser. (Q 2)	2	4.6	5	1.43	14
If I had to do it all over again, I would choose the same tax adviser. (Q 3)	1	4.54	5	1.55	13
My tax adviser takes the time to prepare working papers and notes for my tax issues for me to evaluate. (Q 31)	1	4.52	5	1.22	12
My adviser helps me to reduce the chance of an IRD audit. (Q 15)	2	4.48	4	1.14	11
I have a strong sense of loyalty toward my tax adviser. (Q 37)	2	4.4	4	1.53	10
I make a good effort to maintain the relationship with my tax adviser. (Q 36)	1	4.35	4	1.66	9
My tax adviser does not make errors in preparing my tax returns. (Q 12)	1	4.29	4	1.35	8
Compared with other tax advisers, my tax adviser makes fewer mistakes. (Q 19)	2	4.26	4	1.08	7
I am very committed to my relationship with my tax adviser. (Q 34)	1	4.21	4	1.6	6
My tax adviser knows many ways to save taxes. (Q 10)	1	4.16	4	1.29	5
I intend to maintain my relationship indefinitely. (Q 35)	1	3.84	4	1.59	4
My tax adviser helps me to interpret ambiguous or grey areas of tax laws in my favour. (Q 30)	1	3.64	3	1.44	3
My tax adviser charges reasonable fees for the service rendered. (Q 14)	1	3.54	3	1.51	2
My tax adviser is more concerned with meeting my needs than earning fees. (Q 11)	1	3.44	3	1.43	1

*Maximum for all questions is 7 (strongly agree).

6.1 Questionnaire items

6.1.1 *Tax practitioner's explaining behaviour (1-7 Likert type scale)*

1. My tax practitioner gives me enough information about my tax issues.
2. My tax practitioner explains implications of tax laws and regulations for my tax affairs using words I understand.
3. My tax practitioner tells me the risks associated with the tax advice.
4. My tax practitioner explains to me my obligations under the law.

6.1.2 *Tax practitioner's listening behaviour (1-7 Likert type scale)*

1. My tax practitioner gives me enough information.
2. My tax practitioner listens carefully to what I have to say.
3. My tax practitioner does not ignore what I have to say.
4. My tax practitioner takes my concerns seriously.

6.1.3 *Tax practitioner's perceived competence (1-7 Likert type scale)*

1. My tax practitioner has better training than the average tax practitioner.
2. The qualification of my tax practitioner is important to me.
3. Compared with other tax practitioners, my tax practitioner makes fewer mistakes.
4. My tax practitioner keeps up on the latest changes in tax laws.
5. My tax practitioner informs me my tax position when deciding my tax liability.

6.1.4 *Tax practitioner's efficiency and technical experience (1-7 Likert type scale)*

1. My tax practitioner saves me from paying a considerable amount of taxes.
2. My tax practitioner knows many ways to save taxes.
3. My tax practitioner is more concerned with meeting my needs than earning fees.
4. My tax practitioner does not make errors in preparing my tax returns.
5. The use of my tax practitioner's service saves me considerable time in filing my tax return.
6. My tax practitioner charges reasonable fees for the service rendered.
7. My practitioner helps me to reduce the chance of an IRD audit.
8. My appointments with the practitioner are made easily and quickly.

6.1.5 Tax Practitioner's co-operative intentions (1-7 Likert type scale)

1. My tax practitioner helps me to interpret ambiguous or grey areas of tax laws in my favour.
2. My tax adviser takes the time to prepare working papers and notes for my tax issues for me to evaluate.
3. My tax practitioner treats me the same whether the issue involves a small amount or a large amount.
4. My tax practitioner has expressed a desire to develop a long term business relationship with me.

6.1.6 Client's service satisfaction with tax practitioner (1-7 Likert type scale)

1. I am very satisfied with my present choice of tax practitioner.
2. I feel good about the decision to choose my present tax practitioner.
3. If I had to do it all over again, I would choose the same tax practitioner.

6.1.7 Relationship commitment (1-7 Likert type scale)

1. I am very committed to my relationship with my tax practitioner.
2. I make a good effort to maintain the relationship with my tax practitioner.
3. I have a strong sense of loyalty toward my tax practitioner.
4. I do not look out for an alternative tax practitioner.

Tax compliance and the public disclosure of tax information: An Australia/Norway comparison

Ken Devos¹ and Marcus Zackrisson²

Abstract

A combination of both persuasive and enforcement measures have been applied by governments in attempting to tackle tax non-compliance. With increasing pressure to raise revenue in the current economic climate, governments need to assess the effectiveness of various compliance measures. This paper presents and analyses the strategies adopted by tax authorities globally and specifically in Australia and Norway, regarding the public disclosure of tax information and the likely compliance impact. The paper provides an insight into how public disclosure could indirectly improve compliance in the setting of one country, while some limited disclosure may supplement other compliance strategies in another.

Key Words: Tax compliance, public disclosure, deterrence

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1. INTRODUCTION

It is evident that a large volume of research into the factors that act as a deterrent and impact upon tax compliance has been conducted over many years (Kirchler, Hoelzl, and Wahl, 2008; Slemrod, 2007; Raskolnikov, 2006; Feld and Frey, 2003 & Dubin, Graetz, and Wilde, 1987). However, of the different factors employed within various research studies, an investigation into the impact of public disclosure of tax information has also been critical (Mazza, 2003; Laury & Wallace, 2005; Kornhauser, 2005). Arguably, while there is evidence of public disclosure at the corporate level limited findings have appeared with regards to individual income tax reporting (Slemrod, Thoresen, Thor, and Erlend, 2013). A key reason for this is that very few countries practice public disclosure of tax information at the individual level (Slemrod, et al., 2013, p 5). The debate over whether public disclosure of tax information or tax privacy promotes greater deterrence and thereby improves taxpayer compliance is as old as the income tax itself (Bittker, 1981).³

This paper argues that public disclosure of taxpaying is potentially useful for improving compliance in Australia. Public disclosure is identified as an addition to ‘traditional compliance strategies’—audits, simplifications and guidance. The theoretical reasons for why or why not compliance may be improved as a result of increased public disclosure are discussed in section 2 of the paper. Section 3 discusses the impact of public disclosure of tax information globally, citing specific countries which have employed various measures. The paper then proceeds to compare the strategies of two countries which are relatively at the extremes with respect to individual income tax reporting and disclosure in sections 4 and 5. The comparison encompasses the Norwegian system, where public disclosure of individual tax information is now accessible via the internet and the Australian situation, where privacy principles still protect this information from disclosure. A comparison of the strategies pertaining to the disclosure of corporate tax information in both countries is also undertaken, given the recent changes prompted by the *Tax Laws Amendment Bill (2013)* in Australia. Based on current global practices and the Norwegian and Australian comparison, section 6 then discusses how public disclosure improves deterrence and supplements other compliance strategies. In particular, tax policy recommendations are proposed, regarding what combination or mix of disclosure may be the most effective in improving compliance. Finally, Section 7 concludes the paper.

2. BRIEF REVIEW OF THE THEORY ON PUBLIC DISCLOSURE OF TAX INFORMATION

The reasons for why or why not compliance may improve as a result of increased public disclosure generally relate to good governance and tax administration. Specifically, in favour of disclosure are the principles of transparency, accountability and fairness. The overarching principle or reason against disclosure is privacy. As indicated by Bittker (1981), the debate over privacy verses public disclosure of tax information is not new. Although the literature extends over a number of years, more

³ Boris Bittker commented in 1981 that this question “was not invented yesterday”.

recent studies have been examined in this section. A critical analysis of the above principles and the respective theory follow.

Transparency is defined as that which can be clearly seen through, easily understood and free from affectation or disguise.⁴ In the tax context it would refer to situations where tax figures could be easily reconciled and working papers and accounts easily followed when viewing the final tax return. Showing or revealing the true taxation position without hindrance or bias would be critical in building public confidence and assisting the revenue authorities in carrying out their compliance activities. Consequently in the absence of transparency, individuals and corporations may run foul of the revenue authorities in establishing credibility.

Lenter, Shackelford, and Slemrod (2003) provided a brief history of the US federal tax disclosure laws and then debated the advantages and disadvantages of public disclosure. The arguments in favour of disclosure included: aiding regulators to police corporate governance; improving the functioning of financial markets; promoting tax compliance; and applying political pressure for good tax policy. The disadvantages put forward were that disclosure violates confidentiality, may create confusion with regards to transparency, provides too much power to the Federal government and may have unintended behavioural responses, such as, increasing the cost of business. Overall, the authors did not support full disclosure but were sympathetic to partial disclosure—in particular, disclosure of total tax liability alone, or along with a small number of bottom line items or public reconciliation between tax and book concepts of income.

The point to note with regards to the study by Lenter et al. (2003) is the possible negative affect of increased disclosure upon transparency. That is, the actual level of disclosure could create a problem in itself, in that different taxpayers become more transparent than others. Some taxpayers may become unsure as to the level of their own reporting, creating uncertainty.

Tax fairness is another principle which impacts upon the level of public disclosure. Indeed the Australian Taxation Office (ATO) and the Australian government need to improve the fairness of the tax system, a finding generally supported by the literature (for example, Hite and Roberts, 1992; Chan, Troutman, and O'Bryan, 2000; Tan, 1998). Specifically, the ATO continues to pursue and address issues of horizontal, vertical and exchange inequity, as well as the problems associated with taxpayers legally avoiding payment of their fair share of tax.

In the public disclosure context, increased information provides the tax authority with the opportunity to reveal those who are not paying their fair share, whether this is done through normal enforcement measures or through public detection. In this regard the perception of fairness is as important to taxpayers as fairness itself. If the taxpaying community believes that being privy to other taxpayer information will ultimately improve compliance behaviour, the value of disclosure is enhanced.

Accountability is defined as a counting or reckoning of money entrusted.⁵ In the public disclosure context it requires those taxpayers who have been entrusted through the system of self- assessment, to honestly contribute the amount of correct tax

⁴ As defined in the Oxford Dictionary

⁵ As defined in the Oxford Dictionary

payable based upon their taxable income. According to Kornhauser (2005) the increasing accountability of governments is also a vital factor to show how money was received and used in these current times of revenue shortages.

However, the capability of the government to carry out the task of revenue collection can also be difficult to assess. There are changes in revenue collections as reported in the ATO Annual Reports and Australian National Audit Office (ANAO) Reports which indicate performance levels, but the accuracy of these figures could validly be questioned. Aggregate statistics in Annual Reports say nothing about the ATO's unfairness in focusing on some taxpayers more than others. Further to this, Australians have long been sceptical of high wealth individuals (HWI) paying their fair share of tax and the lack of accountability generally. Consequently, increasing disclosure measures to make the work of the ATO more visible is also important.

On the other hand, privacy is defined as being withdrawn from society or public interest⁶ which would be completely opposite to that of public disclosure. In the tax context, privacy rules prohibit governments from publicly releasing details of any specific taxpayer's tax return or audit history unless the taxpayer consents. However debate over this question surfaces often, especially when the government seeks innovative ways to address the "tax gap"⁷ (Blank, 2013). The notion of whether privacy has been used as the rationale for not asking questions and looking too hard for tax discrepancies is a valid one.

Opposed to public disclosure have been the defenders of tax privacy. For example Blank (2011; 2013) argued that tax privacy enabled the US government to inflate taxpayers' perceptions of the probability of detection and the expected costs of non-compliance. On the other hand, public disclosure could lead to tax-enforcement weaknesses and lower individuals' perceptions of the magnitude of penalties (Blank, 2013).

Blank 2013 proposed that a strategic-publicity function would support two models of taxpayer behaviour. Firstly, a traditional deterrence model of taxpayer behaviour where individuals weighted up the expected costs and benefits. Secondly, a reciprocity model of behaviour where individuals were happy to contribute to the public good if they believed others was doing the same. Overall, Blank concluded that individual tax return information should remain private other than when enforcement action is instituted against an individual taxpayer. It was suggested that the government could employ the strategic-publicity function of tax privacy to increase voluntary compliance.

However, many scholars have questioned the hypothesis that, in the absence of tax privacy, individuals would withhold important personal information from the revenue authority (Kornhauser, 2005; Linder, 1990; Mazza, 2003; Schwartz, 2008; Thorndike, 2009; Bernasek, 2010). Several of these scholars have suggested that tax privacy no longer plays as critical a role in fostering tax compliance as it did in the past (Kornhauser, 2005, pp. 101-103; Thorndike, 2009, p. 691; Schwartz, 2008, pp. 895-896). By lifting the curtain of tax privacy these scholars argue that public access to tax

⁶ As defined in the Oxford Dictionary

⁷ The "tax gap" is the difference between the tax payable according to the tax law and the amount of tax actually collected.

return information would cast “millions of eyes” (Thorndike, 2009, p. 691) on tax returns serving as an “automatic enforcement device” (Bernasek, 2010, p.11).

Kornhauser (2005) revaluated publicity as a tax compliance tool in light of legal and social changes regarding privacy that had occurred over time. It was suggested that a redefined concept of publicity would be a better tool to attack both intentional and unintentional non-compliance. In particular, Kornhauser suggested that a form of partial disclosure be adopted. This incorporates a moderate approach that minimizes the invasion of privacy while still publicizing enough information to promote increased compliance. In other words, a balance between having total and no disclosure that would provide the tax authorities with further limited information only. This would enhance good governance and tax administration as tax authorities are able to target and use their limited resources more productively.

A modern day “pink slip”⁸ was suggested by Kornhauser that incorporated the taxpayer’s name, a non-specific address, gross and taxable income within narrow income ranges, any capital gains, particular deductions and credits and finally the taxpayer’s marginal and effective tax rates. As much of the publicity was considered educational only, it encroached far less on privacy than traditional publicity. A sense of wider and more effective dissemination of information was the aim while advocating for limited disclosure.

Mazza (2003) was also an advocate for limited disclosure. Mazza’s thorough review of the literature revealed that restricted disclosure of return information for narrow purposes can be part of an effective compliance strategy while at the same time preserving taxpayers’ reasonable expectations of privacy. Empirical evidence suggested that publicity could play a positive role in discouraging non-compliant behaviour and increasing the public’s commitment to the system. In particular, Mazza proposed disclosure exceptions authorising the Inland Revenue Service (IRS) to publicize its enforcement efforts aimed at three specific types of non-compliance including: criminal tax evasion; failure to pay assessed taxes; and investments in abusive tax shelters. Mazza believed that the benefits to government in each case of disclosure would outweigh any threats to taxpayer privacy interests.

Taking a slightly different perspective to public disclosure by the tax authority was the situation of increased disclosure by taxpayers themselves, as advocated by Pearlman (2002). Pearlman indicated that mandatory tax disclosure of information relating to tax-relevant transactions may serve three enforcement and compliance functions. First, audit function where information would assist the IRS to evaluate the effect of a transaction on a disclosing party’s tax liability. Second a tax policy function where disclosure could provide important information regarding administrative and legislative responses to current law. Third deterrence function which discouraged taxpayer investment in particularly questionable transactions. Supporting the latter was the apparent strong association between public information disclosure (that is, non-tax information reporting by public companies) and high compliance (Pearlman, 2002, p. 308).

⁸ In 1934 a pink slip required six pieces of information to be disclosed including; name, address, gross income, total deductions, taxable income and tax liability see Act of May 10 1934, s 55(b), 48 Stat, 680, 698 (1934).

However, the literature is vague on how public disclosure actually increases compliance. In summary, the pro-arguments fall into two tracks—public disclosure of tax information can cast millions of eyes on the tax returns and will generate tips or in other ways alert tax administrations. Secondly, the shaming-factor makes taxpayers provide accurate information to the tax administrations. The idea being, those taxpayers do not want to show neighbours and colleagues that they are evading taxes. Associated with this, is the lack of evidence as to what degree public disclosure actually generate tips. Although the extent to which the shaming-factor has been investigated in relation to large scale public disclosure of tax information is uncertain, there has nevertheless been evidence⁹ in some cases of a shaming-factor.

Overall, the argument against public disclosure is mainly based on the invasion of privacy, but Blank (2011) provides further arguments as to how public disclosure actually decreases compliance. While both Blank (2011) and Kornhauser (2005) raise the question of what public disclosures could (or should) include, there is evidence that suggests that the type of disclosed information has an effect on taxpayer behaviour and compliance. There is also evidence to suggest that the cultural contexts matter, (that is, disclosure of tax information in a society with high compliance may have a different effect than disclosure in a society with low compliance). It is this concept of tax culture which also requires further investigation.

Tax culture could be described as the beliefs and attitudes a particular nationality hold about paying tax to the authorities. A more extensive definition of a country-specific tax culture includes “the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country’s culture, including the dependencies and ties caused by their ongoing interaction” (Nerre, 2001). From this working definition it becomes evident that to understand a specific country’s tax culture requires a lot of research effort, because a lot of actors and institutions have to be studied as well as the procedures and processes when they interact. Consequently good policy advice should not disregard the national tax-cultural constraints (Nerre, 2001).

The success of any major tax changes and reforms, such as increased disclosure levels, does depend on a country’s tax culture and how the taxpaying public responds to them. That is, a highly compliant tax culture may be more accepting of increased disclosure levels whereas a less compliant tax culture could be more resistant or react through game playing. The resistance to change or greater tax disclosure could result in taxpayers of some countries to find further ways to avoid tax. Whether this involves manipulating disclosure thresholds or entering into avoidance schemes, the potential outcomes could defeat the purpose of the tax change all together.

The relationship between tax compliance and nationality or culture has also been subject to prior empirical research. A literature review by Roth, Scholz, and Witte (1989) found studies which used whites and non-whites as a proxy variable and found whites to be more compliant. However, Beron, Tauchen, and Witte (1992) suggest the results are dependent upon other variables used in the studies. In particular, the income variable was found to have a distorting effect. Other studies of commitment to compliance using indices by Song and Yarbrough (1978) found the largest differences

⁹ As indicated in section 3 of the paper, see the list of evaders exposed in Ireland and New Zealand.

between races. In their study, race explained 19 per cent of the scale variance by itself, while controlling for other relevant variables such as income and education (p. 445).

On the other hand, other econometric results have failed to find strong relationships between nationality and tax compliance. For example, Witte and Woodbury (1983) found statistically negative coefficients on 'per cent non-white' in two audit classes, but insignificant coefficients in the other five classes. Likewise, Beron et al. (1992) found a significant negative coefficient on percentage non-whites in only one audit class in their regression analysis. Nevertheless, despite the mixed empirical findings, it is considered that overall one's nationality and culture does influence taxpayer compliance attitudes and behaviour. It is with this background that the paper proceeds to examine how public disclosure of tax information has been perceived globally and then specifically from an Australian and Norwegian cultural context.

3. PUBLIC DISCLOSURE OF TAX INFORMATION-GLOBALLY

As there are various forms and levels of individual disclosure of tax information, it is apparent that this may result in varying degrees of deterrence that ultimately impact upon compliance. However, the experience of individual public disclosure on a global scale has been limited (Slemrod et al., 2013). At one extreme we have the Nordic countries where personal level public disclosure is displayed with Norway (analysed in detail in Section 5) leading the way. At the other extreme we have the majority of western countries which honour privacy principles with some exceptions in Europe and the US which has trialled limited spells of public disclosure. In between the extremes, other countries have adopted and then discarded various forms of disclosure or as in the case of Australia (analysed in detail in section 4), have adopted limited disclosure measures for corporations only. The following section provides a brief overview of disclosure measures adopted in selected countries and the impact, if any these measures have had upon taxpayer compliance.

Investigating both Sweden and Finland as fellow Nordic countries it is apparent that both corporate and personal level disclosure exists. In Finland not only can one apply to the tax authority for information about individuals but the media also publishes the top 1000 income earners and provides personal details including how much tax has been paid as a portion of salary (Catanzariti, 2004). There are also boutique publications that publish guides on everyone who earns about 40,000 Euros, but otherwise it is just a long list of people the Finns would know of. Given there are only five million people in the country and very few foreigners, it is highly likely that many tax evaders would be known or identified (Catanzariti, 2004, p. 2). Consequently, the transparency in the Finnish system is accepted and has generally a positive effect on compliance rates.

Slemrod, Hasegawa, Hoopes, and Ishida (2012) investigated the empirical evidence regarding the effect of public disclosure of tax reports of individuals and businesses in Japan up until its abolition in 2005. It was discovered that where there was a threshold of disclosure (that is, taxable incomes above about 40,000 yen for individuals, \$400,000AUD equivalent and 75,022,000 yen for corporations) many taxpayers whose liability would otherwise be close to the threshold chose to under-report income so as to avoid disclosure. However, the strong result only applied to disclosure systems with a threshold and the financial statements of companies provided no

evidence that taxable incomes declined after the end of the disclosure system. Overall, it was concluded that public disclosure had the power to change behaviour.

Other European countries such as Italy and France have experienced short spells of public disclosure. For example, in Italy in 2008 the tax authorities put all 38.5 million tax returns for 2005 up on the internet before being blacked out following widespread protest (Slemrod et al, 2013).¹⁰ No doubt the taxpaying culture in Italy had an impact upon this compliance measure which potentially could have produced exaggerated revenue results. Providing details of tax evaders has been another popular form of disclosure. Under Greek law the presentation of a new budget is accompanied by the names of tax evaders in the previous year compiled by the finance ministry (Slemrod et al., 2013, p. 6). However, given the culture of taxpaying in Greece as evidenced by the recent European financial crisis and austerity measures put in place by the European Union (EU), there is limited evidence that the disclosure of these tax evaders has had a deterrent impact upon non-compliant behaviour.

The issue of disclosing tax evaders as a tax compliance tool has also been adopted with varying success in other Commonwealth countries. Up until the early 2000s the Commissioner of Inland Revenue in New Zealand, regularly released a document entitled “Tax Evaders Gazette” which listed those taxpayers who had either been prosecuted or had penalty tax imposed for evading their tax obligations. Since 1997 the Commissioner was able to publish the names of those taxpayers involved with “abusive tax avoidance” (Slemrod et al., 2013, p. 6). This measure has now been withdrawn despite fulfilling a deterrent role and assisting the generally high taxpaying culture evident in New Zealand. The motivations of the Inland Revenue Department (IRD) in this regard were not clearly specified. Despite obvious privacy issues around releasing taxpayer details, the naming and shaming of offenders has been successful both as a deterrent and a revenue raiser in Portugal for example,¹¹ and has received support in the literature.¹²

However, the theoretical support for naming and shaming should be qualified in this regard. Naming and shaming of individuals, if stigmatizing does enormous harm and can create enemies for life. This is neither desirable nor an objective of punishment itself. Instead for individuals, naming and shaming can be employed in a non-stigmatising fashion. For example mediation could be conducted between those found cheating on their taxes, and their accountant, employer or industry association. The

¹⁰ The Economist May 8, 2008. Before being blacked out, vast amount of data were downloaded and transferred to other sites or burned on to discs and sold.

¹¹ Portuguese Tax Authorities publish a list of debtors, and their categorization, in accordance with the amount of the debt, on their website <<http://www.e-financas.gov.pt/de/pubdiv/de-devedores.html>>. In April 2010, the Portuguese Government officially announced that it had recovered more than a thousand million Euros due to publication of the list of taxpayers (individuals and corporations) with tax debts.

¹² The reintegration shaming literature, see for example, J. Braithwaite, “Crime, Shame and Reintegration; Braithwaite, J and Drahos, P, “Zero Tolerance, Naming and Shaming: Is There a Case for it in Crimes of the Powerful?” (2002), 35, 3 *Australian and New Zealand Journal of Criminology*, 269-288, 275, where it was concluded that naming and shaming was a bad policy for the powerless but could be a strategic policy with regards to corporate or organizational crime. See also Van Erp, J, “Naming without Shaming: The Publication of Sanctions in the Dutch Financial Market,” <<http://onlinelibrary.wiley.com/doi/10.1111/j.1748-5991.2011.01115.x/full>, 1-9, 7>, where it was found that exposing the offender raises the expectation of a moral message about the inappropriateness of certain behaviour. The Study showed that regulatory enforcement provides an opportunity to express what is morally right and to change perceptions as to what is meant by appropriate behaviour.

matter could be discussed and an action plan could be put in place to ensure it doesn't occur again.¹³ In regards to corporations (mainly larger ones) the naming or shaming is not personal and is a risk factor in their business models. Ultimately it has the desired effect of curbing undesirable behaviour by the corporate as reputational damage can impact on future business.

The Canadian Customs and Revenue Agency compliance strategy also involved publicizing court convictions for tax fraud and releasing the names of offenders. In Ireland a list of tax defaulters was formally published on an annual basis in the Revenue Commissioners Annual Report, but recently the list is published on a quarterly basis in *Iris Oifigiuil*¹⁴ in which several legal notices including insolvency notices are required by law to be published and reported in the national and local newspapers. According to the tax agency this measure "aims to raise the profile of compliance and provide a continuous deterrent to other potential tax evaders. Frequently, taxpayers make a full disclosure of irregularities to auditors at the commencement of an audit to avoid the possibility of being punished for tax offences". Moreover, the well-publicised quarterly list is "more likely to be spotted by suppliers, customers, business associates and friends" and would need to be avoided at all costs (Tax Agency as cited in Slemrod et al., 2013, pp. 6-7).

In Korea, only a few non-compliance statistics audited for certain limited taxpayers are irregularly released to the public. Likewise individual tax return information for randomly selected anonymous taxpayers is released for public use in limited circumstances (for example, academic research). This level of tax compliance information (TCI) disclosure has led to conflicts and heated debates between the tax authority and various parties. Hyun and Kim (2007) propose that it is the bad equilibrium that has trapped some countries such as Korea, into a "very low degree of TCI disclosure" and a "pervasive level of tax evasion" (p. 4). Likewise in Mongolia national statistical information is published under the Prime Minister, not the tax authority and contains only a small amount of tax information which has nothing to do with TCI. Arguably, this has done nothing to promote greater deterrence and improve compliance.

In the United States of America (USA) the history of public disclosure of tax information has been gradual. Initially disclosure laws of one form or another were enacted in 1862, 1864, 1909, 1924 and 1934 demonstrating that confidentiality as a general rule is a relatively recent phenomenon. The shift came in 1976 following allegations that the Nixon Administration had improperly used tax return information against political opponents. Since 1976 as per s 6103 of the Internal Revenue Code, disclosure of return information is forbidden, except under limited circumstances. Public disclosure rules of tax information for corporations at the state and local levels have nevertheless been permitted in Massachusetts, West Virginia and Kansas since the 1990s. The IRS has also occasionally in the past made public the names of tax offenders (Lenter et al, 2003). Whether the deterrent impact of this limited form of disclosure has been effective in influencing compliance over the years is uncertain and continues to be challenged.

¹³ Also described as reintegrative shaming. See Braithwaite, J and Braithwaite, V "*Revising the theory of Reintegrative shaming*" in Ahmed E, Harris, N Braithwaite, J and Braithwaite, Shame Management through reintegration, Cambridge: Cambridge University Press, pp 315-330, 2001.

¹⁴ The *Iris Oifigiuil* is the official newspaper of record in Ireland.

4. PUBLIC DISCLOSURE OF TAX INFORMATION ADOPTED IN AUSTRALIA

As it is evident that the level of disclosure of tax information varies from country to country, the following section focuses on the current state of play in Australia. In particular, both individual and corporate disclosure rules will be discussed in line with the current privacy principles which operate. Particular strategies that have been adopted by the Australian government will be outlined and analysed for their potential effectiveness and future as a deterrent measure and compliance tool.

4.1 Disclosure of individual taxpayer information

The disclosure of individual taxpayer information has generally been non-existent in Australia. Other than the public having access to tax information via court records and other documents in the public domain it is difficult to acquire knowledge of a taxpayer's dealings. Access could be sought under the *Freedom of Information Act 1982* but this is limited somewhat by the National Privacy Principles. In particular, *National Privacy Principle Number 2—Use and disclosure* indicates in 2.1 (a) that an organisation must not disclose personal information about an individual for a purpose (the secondary purpose) other than the primary purpose of collection unless (a) both of the following apply:

- i. the secondary purpose is related to the primary purpose of collection and if the personal information is sensitive information, directly related to the primary purpose of collection,
- ii. the individual would reasonably expect the organisation to use and disclose the information for the secondary purpose or

(b) the individual has consented to the use or disclosure ...

This severely limits the tax authority in divulging any type of personal tax information unless as per 2.1(f) the organisation has reason to suspect that unlawful activity has been, is being or may be engaged in and uses or discloses the personal information as a necessary part of its investigation of the matter ... Also in 2.1(h) where the organisation believes that the use or disclosure is reasonably necessary for ... (i) prevention, detection, investigation, prosecution or (ii) punishment of criminal offences, breaches of law imposing a penalty or sanction ... (iii) the protection of the public revenue ... Consequently, we see the ATO and other government agencies publish via media releases¹⁵ and press outlets, the details of tax evaders who have been caught, in an effort to get the message out and create a general deterrent. How effective this has been over the years is unknown, given its indirect and somewhat infrequent occurrence.

Further invasion of individual taxpayer information is protected by the *Tax Laws Amendment Bill (2013)*, which was introduced to increase the disclosure of company information. Specifically, *Chapter 3: Improving the transparency of Australia's corporate tax system* Paragraph 3.10 indicates that the government is committed to maintaining the confidentiality of taxpayer information of natural persons. The amendments contain express protections for natural persons. This is in line with the

¹⁵ For example, see Australian Federal Police Media Release: Three charged in joint tax evasion and money laundering investigation, October 16, 2013.

Statement of Compatibility with Human Rights (Parliamentary Scrutiny) Act 2011, paragraph 3.74 which indicates that information is not capable of being used to identify an individual ... recognises the importance of affording privacy to individuals personal affairs ... and promote the prohibition on interference with privacy under article 17 of *International Covenant on Civil and Political Rights*. As indicated in the Explanatory Memorandum to the *Privacy Amendment (Privacy Alerts) Bill 2013* Second Reading Speech, the right of an individual to control what happens with his or her personal information is an important aspect of the right of privacy.¹⁶

4.2 Disclosure of corporate taxpayer information

Similar to the situation with individuals, the disclosure of corporate tax information in Australia up to 2013 had been limited¹⁷ but this has changed recently with the introduction of the *Tax Laws Amendment Bill (2013)* since 1 July 2013, discussed above. The main objectives of the new legislation were to discourage aggressive tax avoidance practices; promote greater tax policy debate; enable better public disclosure of aggregate tax revenue collections despite taxpayers being potentially identified; and to allow improved sharing of tax information between government agencies.¹⁸

Specifically, the new legislation aims to improve the transparency of Australia's business tax system by publishing certain information from tax returns where the corporate has a total income of \$100 million AUD or more for an income year. Separately, the Commissioner of Taxation will also have a duty to publish the final amount of the entity's annual Minerals Resources Rents Tax (MRRT)¹⁹ or Petroleum Resources Rent Tax (PRRT) payable, regardless of total income. Importantly, the second measure amends the taxpayer confidentiality provisions to ensure publication of aggregate tax information to fulfil its financial reporting obligations, unless the entity is an individual. The third measure enhances information sharing between government agencies by allowing a tax officer to disclose confidential taxpayer information to the Treasury with regards to decisions concerning the *Foreign Acquisitions and Takeovers Act (1975)* or Australia's Foreign Investment Policy.²⁰

The implications of the new disclosure legislation will vary for Australian listed entities, privately held large businesses and Australian subsidiaries of foreign owned multi-national groups. It will also depend on the cash tax profiles of the large businesses. From a deterrent perspective, public perception issues may arise from the disclosures. For example, if businesses have low cash tax payable due to factors such as carry-forward losses or R&D deductions, increased queries may arise in the absence of full information, from analysts, the public or social welfare groups (Ernst & Young, 2013). Another danger for business is that mandatory disclosure of tax information may adversely affect consumers' buying behaviour (similar to the recent

¹⁶ *Privacy Amendment (Privacy Alerts) Bill, 2013*, Second Reading Speech, House of Representatives, 29 May 2013, 4230.

¹⁷ Only a few large businesses and multi-nationals publicly disclosed the taxes they paid, see for example, Rio Tinto.

¹⁸ *Tax Laws Amendment Bill (2013 Measures No 2) Bill 2013*, 76.

¹⁹ It should be noted that the *Minerals Resources Rents Tax Repeal and Other Measures Bill 2013* was introduced and passed in 2014 directly impacting on the disclosure rule.

²⁰ *Tax Laws Amendment Bill (2013 Measures No 2) Bill 2013*, 77-78.

protests directed at Starbucks in Britain).²¹ In addition, governments themselves are large consumers of goods and services and may take information on tax contribution into account when making purchasing decisions. There have also been reports about “ethical investors” who ignore purchasing shares in companies that are not viewed as tax compliant (Grieve, Bertram, and Smith, 2013).

4.3 Effectiveness and future of disclosure strategies adopted

To gauge the benefit and effectiveness of the improved disclosure requirements on corporations involves considering factors other than just increased revenue. Importantly the new legislation will update Australia’s tax rules to be able to cope with the modern global economy. In the digital age the ability to conduct business over the internet anywhere in the world has highlighted the inadequacy of the residency and source rules. Consequently, the new disclosure measures may be a first step to diagnosing deficiencies in the tax system and pave the way to aligning it to a digital and global economy (Grieve et al., 2013, p. 2).

To some extent the new legislation also replaces the deterrent that was removed from individual taxpayers in the late 1990s. That is, the “naming and shaming” of large businesses and multi-national taxpayers that do not pay their fair share of tax in Australia given the qualifications discussed previously that apply to individuals.. The bad publicity could have financial implications and may influence the investment decisions of companies currently operating in Australia and those considering establishing a business in Australia. In this regard, it is vital corporations review the appropriateness of their business and entity structures and transfer pricing policies so that they are not exposed to legitimate criticism. Potentially the legal costs of large business and multi-nationals will rise if they need to take advice on whether disclosure under the new legislation breaches any legal or commercial confidentiality obligations. Consequently, one danger the more onerous disclosure obligations could bring is a ‘race to the bottom’²² as enterprises discover they are paying more tax than their competitors (Grieve et al., 2013, p. 2). This could negate the overall benefits derived from increased disclosure.

Apart from improving corporate compliance the revenue projections of the new legislation are nevertheless important to government. In this regard it was impossible to obtain any information (statistical data) directly from the ATO concerning the revenue projections of future disclosure requirements.²³ However, an inspection of the 2011–12 Annual Report of the Commissioner of Taxation did reveal a trend in company profits and income tax payable since 2002²⁴ giving some idea of past performance. A comparison of the profits and net income tax reported in corporate tax returns with a corporate profit estimate from the Australia Bureau of Statistics (ABS) indicated that overall company tax performance was generally in line with improving

²¹ Coffee chain Starbucks agreed to voluntarily pay an additional 20 million pounds in tax over the next two years after it was revealed that, despite having generated over 3 billion pounds in sales since 1998, it had only paid 8.6 million pounds in income tax.

²² This is where companies deliberately under-perform and report less income so as to avoid disclosure requirements.

²³ Enquiry made with the ATO statistics team on 8 October, 2013 revealed no such statistics were kept.

²⁴ <http://www.annualreport.ato.gov.au/ourperformance/protecting-people-and-the-community/income-tax/Reporting>

profits. Further to this, the ATO's 2012–13 Compliance Program revealed that the companies' income tax reporting was generally accurate.²⁵ Based on these past figures it is suggested that the increased disclosure requirements may have an even greater impact upon the visibility of ATO activity and future revenue projections as the majority of corporate taxpayers choose to comply.

However, because of the strict privacy principles²⁶ in place with respect to the disclosure of individual tax information it is suggested that there will be little, if any deterrent effect and impact upon compliance at this level. For individual taxpayers, the ability of the revenue authority will be limited in disclosing tax information publically, other than when investigating unlawful activity and criminal offences. Consequently, this may affect future revenue collections and even have a negative impact upon taxpayer behaviour. For instance, even compliant taxpayers may choose to hide other tax information behind the strict privacy rules.

5. PUBLIC DISCLOSURE OF TAX INFORMATION ADOPTED IN NORWAY

The following section focuses on the current state of play in Norway. Again both individual and corporate disclosure rules will be discussed along with their potential effectiveness and future as a deterrent measure and compliance tool. Initially, it should be noted that there is no measure of tax gap or other measurements of tax compliance in Norway and neither are there reliable international comparisons, but the extensive use of third party reporting and pre-filled tax returns, in combination with payroll withholding tax generally ensures a high degree of compliance.

The main strategies available for the Norwegian Tax Administration are the volume and types of audits conducted and information and guidance efforts. However, disclosure of tax data is determined by law and is therefore outside the direct control of the Norwegian Tax Administration and consequently has not been part of the Administration's efforts to increase compliance. A long standing tradition in Norway, as well as in other Nordic countries, is openness in public affairs/administration (*offentlighetsprinsippet*).²⁷ It basically means that all public documents should be available for the public, if the document is not deemed confidential.

Taxation in Norway is levied by the central government, the county municipality and the local municipality. The tax level in Norway is high. In 2014, the total tax revenue was 42 per cent of the gross domestic product (GDP). The most important taxes, in terms of revenue, are income tax and Value Added Tax (VAT). Most direct taxes are collected by the Norwegian Tax Administration and most indirect taxes are collected by the Norwegian Customs and Excise Authorities.

5.1 Disclosure of individual taxpayer information

Since the middle of the nineteenth century there has been public disclosure of individual taxpayer information in Norway. It has historical roots and cannot be solely

²⁵ Large business in 2011–12 accounted for 36% of total ATO collections.

²⁶ See n 16, *Privacy Amendment (Privacy Alerts) Bill 2013*.

²⁷ An equivalent in English speaking countries is the "Freedom of Information Act".

contributed to tax compliance.²⁸ Public disclosure of tax data should therefore be seen in the light of freedom of information. In the latest revision of the *Tax Assessment Act (1980)* it was argued that public disclosure of tax lists is contributing to transparency in the tax assessment, and to the fairness of the system; increased compliance was not explicitly mentioned.

Information on individual Norwegian taxpayers' taxable income, paid taxes and taxable wealth have been available in the tax lodges located at the local tax office since the early 20th century, so anyone interested could access this information. Arguably, most people did not visit the local tax office for a manual search of the tax lists. However, in a number of municipalities tax information about local residents was widely distributed through sales of paper copies of the tax lists. The sale was usually a fundraising activity for local soccer teams or other local associations. Unfortunately, there is no measure as to how widespread these were, but since most of the municipalities with sales of paper copies were small, it can be assumed the penetration in most cases was fairly high (Slemrod et al., 2013, pp. 2-3).

In 2001, the tax lists were distributed electronically and newspapers started to present searchable lists on their websites.²⁹ Basically anyone with internet access could obtain information on taxable income, paid taxes and taxable wealth for any individual Norwegian taxpayer. The organization of the tax data is search friendly since it was organized by individuals' names, zip codes and city. The transition from paper to electronic distribution was not primarily driven by any concerns about compliance, but rather as a consequence of the Norwegian government's digitalization strategy.³⁰ Although this practice raised the debate on privacy, no detailed studies on the effect of this level of disclosure had been carried out until Slemrod et al. (2013). Slemrod's study showed that compliance increased more in municipalities where tax information was not distributed widely through paper catalogues. On average Slemrod et al. (2013, pp. 26-27) found that publication of tax lists increased reported income among business owners by approximately three per cent. The increase among wage earners was lower.

Assuming a change in policy to disclose tax information has had the impact suggested by Slemrod et al. upon compliance this would have resulted in an increase in tax revenue of 10 billion NOK (approx. \$1.4 billion USD) since the opening of the tax lists. In the last ten years Norway has also had an increase in the number of self-employed persons. Significantly, the Slemrod et al. study shows a higher compliance effect on self-employed persons than for regular employees. The effect on tax revenue and compliance might therefore be higher still. There are also reasons to believe there would be some dynamic effect over time. However, Slemrod et al. do not discuss the issue of psychological changes in taxpayer behaviour. While on one hand the probability of public detection increases the more years' tax lists are published, on the

²⁸ A discussion of historical explanation for openness in public affairs is outside the scope of this paper, but a good introduction (in Norwegian!) to the matter can be found in NOU (2009).

²⁹ In 2007, the list became indexed for internet search, which meant that in a search of a person (on Google for instance) his/her tax information would appear high on the search result.

³⁰ The Norwegian Government has for the ten last years had a digitalization strategies (with different names) which in summary means that as many public services as possible should be available on digital format in order to improve service to the citizen and reduce costs (Digitizing Public Sector Services: Norwegian e-government program).

other hand, disclosure of income, wealth and taxes paid may provide incentives to 'hide' income and wealth to avoid public scrutiny and thereby decrease compliance.

5.2 Disclosure of corporate taxpayer information

In line with the openness for individual taxpayers, annual reports for all (public and private) registered companies are publicly available. For a fee (approx. \$10USD) any annual report is available for download from the national business register. This register and most of the national registers are administrated by The Brønnøysund Register Centre.³¹ This has been in the Norwegian legislation since their independence from Sweden in 1905 and this practice has not been questioned or been subject to political debate.

However, it has been argued that the access to annual reports makes it easier for foreign companies to analyze and eventually enter the Norwegian market. It is also argued that a possible compliance effect is primarily on small companies and this decreases with an increase in the size of the company, but there are no studies which confirm that perception.

In Norway, as in other countries there is a lot of focus on tax payments from multinationals.³² There have been very limited attempts to compile tax data for multinationals, although it is publicly available in Norway. However, the recent international debate on tax avoidance and multinational corporations has resulted in attempts to estimate tax payments from large Norwegian corporations.³³ Norway does not have a long tradition of 'tax activism' but the issue is being addressed in the on-going Norwegian Public Inquiry on Corporate Taxation.³⁴ Yet up to now, it has been considered to be outside the role of the Norwegian tax authority to compile and disclose lists of taxes paid by corporations.

5.3 Effectiveness and future of disclosure strategies adopted

Overall, the current disclosure requirements for Norwegian taxpayers may be subject to change in the near future. A recent change in government (in October 2013) raised the issue of limiting the internet access to individual tax data. In addition to privacy arguments, the possibility the tax lists assist criminals identify rich individuals has been an important argument in the debate although there is no evidence. Several models for limiting internet access have been discussed but the new law effective from 2015 is that the taxpayer will be informed through their personal governmental web accountants to who is looking into his or her tax information. Currently there are no plans to make changes in the disclosure of corporate tax data.

Likewise, public disclosure of tax data is outside the scope of the traditional components of compliance strategies—audits, simplifications and guidance. Although

³¹ The Brønnøysund Register Centre develops and operates many of the Norway's most important registers and electronic solutions. The Brønnøysund Register Centre is a government body under the Norwegian Ministry of Trade and Industry, and consists of several national digital registers.

³² See for example the Starbucks and Google cases in the UK.

³³ A master thesis has looked into the issue, see Selseth (2013).

³⁴ www.regjeringen.no/nb/dokumentarkiv/stoltenberg-ii/fin/Nyheter-og-pressemeldinger/pressemeldinger/2013/nytt-offentlig-skatteutvalg.html?id=717804

public disclosure is assumed to generate a substantial number of tips, largely due to resource constraints, the Norwegian Tax Administration does not investigate the origin of the tips so it is impossible to know what role public disclosure has played. The system of public disclosure of tax data on the internet has been in place for twelve years in Norway and while there is some evidence it actually increases compliance, further studies need to be undertaken on the subject to increase validity and reliability..

It is important to note that only taxable income, taxes paid and taxable wealth³⁵ is disclosed. Consequently, the tax lists include just a small fraction of data available for the Tax Administration. However, it is also worth noting that there have been no suggestions made to increase the information disclosed. For instance, if disclosure included specific deductions or the particular source of income, arguably there may be an even greater impact upon compliance.

To take the Slemrod et al. study further would be to investigate what caused the income to increase. One explanation might be that the taxpayers reduced the size and/or numbers of deductions or alternatively the income increases were due to a larger part of the revenue being reported. Due to technical limitations, it is not possible (or at least very difficult) to study changes in deductions over time for specific Norwegian taxpayers. However, a preliminary and limited investigation was conducted of the deductions amongst self-employed/small business owners in four municipalities before and after the internet access of tax list were introduced, which did not have the circulation of catalogues. The findings did not reveal any pattern of changes in deductions, but as there were so few cases it was impossible to come to any firm conclusions. Unfortunately, the restrictions in the accessibility of data also made such a follow-up study difficult. Consequently, the reasons for why taxpayers' income increases when tax lists get published are still largely a mystery.

6. RECOMMENDATIONS BASED ON GLOBAL PRACTICES AND THE AUSTRALIA/NORWAY COMPARISON.

Consequently, based on a comparison of the current Norwegian and Australian disclosure practices and the level of disclosure of tax information globally, some suggestions regarding what measures might be best in terms of increasing deterrence and improving tax compliance are put forward. In advocating a case for limited disclosure, the following section initially briefly outlines how disclosure can improve deterrence and compliance bearing in mind the social values discussed earlier. This is followed by a discussion of how disclosure supplements other strategies thereby providing a suite of compliance mechanisms from which certain tax policy recommendations are put forward.

6.1 How public disclosure of tax information can improve deterrence and compliance

Advocates of publicity see disclosure as increasing taxpayer confidence in the tax system which in turn has the salutary effects of increasing compliance and revenues. The visibility of information improves transparency and the ability to be accountable.

³⁵ Taxpayers have to report 'wealth' since Norway has a wealth tax. The imposition of this tax has been heavily debated and suggestions have been put forward for its removal. The base for reporting wealth will in this case disappear, as it has in Sweden.

Likewise publicity can improve taxpayers' knowledge of the tax law which in turn can diminish both intentional and unintentional non-compliance (Kornhauser, 2005). As ignorance and laziness when it comes to carrying out legal obligations should not be tolerated, disclosure may be able to assist when it comes to facilitating a system of voluntary compliance as exists in most modern economies. The prefilling of tax returns certainly alleviates the taxpayer from potential incorrect returns. Also corporate taxpayers may think twice before engaging in more tenuous legal tax avoidance because of the shaming and reputational damage which follows. That is, as everyday taxpayers have access to this information the detection if not enforcement function is increased as the public may discover schemes not caught by tax officials. Despite the limited resource capacity of the revenue agency non-compliant activity could nevertheless be revealed.

6.2 How public disclosure of tax information supplements other compliance strategies

There are indeed a number of deterrent strategies available to a tax authority which are utilised to improve compliance, a discussion of which is outside the scope of this paper. However, the more common strategies adopted include: legal sanctions (Raskolnikov, 2006); audits (Dubin, 2007); media advertising (Hite, 1997); education and tax knowledge (Ern Chen Loo, 2006; James and Alley, 1999); rewards and incentives (Callihan and Spindle, 1997); and certainly a consideration of the morals and social norms of taxpayers (Wenzel, 2003; Kirchler et al., 2008).

As most compliance strategies embrace a combination of both persuasive and punitive measures it is suggested that public disclosure of tax information could also be incorporated therein. Particularly where resources are limited, disclosure offers the opportunity of public involvement to enhance detection, and increase public stigma of non-compliers and tax evaders. Targeted disclosure also has the capacity to improve education and tax knowledge as advocated by Kornhauser (2005) and Mazza (2003). The media exposure employed to enhance a general deterrent can be amplified through disclosure of tax evaders such as the issuing of a 'dirty dozen: list of scams' and highlighting the tax fraud of high wealth individuals (HWI) in the community Blank (2013). However, a strategy of publicly shaming corporates would need to be balanced against the re-integrative shaming of individuals discussed earlier. So while Blank (2013) may advocate stigmatizing HWI's this course of action may prove counter-productive and mediation may be a more appropriate alternative in this case.

6.3 Tax policy recommendations

Despite legitimate concerns over taxpayer privacy and the standards that must be adhered to under the National Privacy Principles, there appears to be a valid case for increasing disclosure requirements in Australia for individual taxpayers. Apart from supplementing other compliance strategies as indicated above the bold move to a greater disclosure of corporate taxpayer information could be accompanied by some future limited exposure of individual taxpayer information. In the interests of increasing transparency and accountability as was found in other countries Australia could adopt stronger individual disclosure rules than it currently has. In this regard a limited/partial form of exposure as suggested by Kornhauser (2005) that minimized the evasion of privacy while still publishing enough information to promote increased compliance is recommended.

The recommendation for a modern day ‘pink slip’ which includes the taxpayer’s name, a non-specific address, gross and taxable income within narrow income ranges, capital gains, particular deductions and credits and finally the taxpayer’s marginal and effective tax rates, is suggested. This could then be assessed at a later date to gauge its effectiveness not just in terms of increased tax dollars but also improved taxpayer education (Kornhauser, 2005; Mazza, 2003).

If the level of disclosure suggested by the modern day ‘pink slip’ appears to be a drastic measure, possibly the naming and shaming of corporate tax offenders should be considered. This approach has acted as a strong deterrent for non-compliant behaviour as evidenced in both the Irish and Portuguese experiences. As indicated by Blank (2013) in the USA at the state level, the taxing authorities publish the identities of business and individuals that have failed to pay outstanding taxes on time. Employing websites to conduct the shaming campaign, taxpayers receive a pending internet posting warning them of the proposed disclosure. State revenue agencies indicate that taxpayers have responded positively to the shaming warnings resulting in millions of dollars of outstanding taxes in recent years (Blank, 2013, p. 25).

At a corporate level it may be worthwhile reconsidering the listing in the Commissioner’s Annual Report of, by name and offence, large corporate tax evaders who risk reputational damage. However, for individual tax evaders in Australia the re-integration strategy discussed earlier, involving mediation and consultation, would be a more measured approach capable of producing the desired results.

In order to enhance the reliability and validity of disclosure in increasing compliance it is further recommended that disclosure be combined with the more traditional and direct compliance strategies such as cash economy benchmarks, raising of default assessments and conducting more BAS³⁶ refund checks. Likewise, the ATO should continue with, and step-up, their current practices which include: targeted education campaigns for specific industries and occupations; voluntary disclosure initiatives and amnesties;³⁷ strengthening of the proof of identification requirements; and disruption activities (for example, interception of tax refunds).³⁸

As mentioned previously, these deterrent and prevention strategies should also be balanced with more media advertising and visibility within the community, which has been found to be very effective in previous studies (Hite, 1997). According to an Australian National Audit Office (ANAO) report,³⁹ while the ATO has been able to raise the awareness of tax fraud through the use of community perception surveys and media releases, in order to substantiate the deterrent effect, it was suggested that certain criteria and international benchmarking ought to be employed to measure the effectiveness of these strategies. These criteria or indicators include: the number of investigations and prosecutions completed; the revenue protected, and feedback

³⁶ BAS (Business Activity Statements)

³⁷ The ATO recently offered a voluntary disclosure initiative ‘Project Do it’ providing a chance for those with overseas assets and income to come back into the tax system before the end of 2014. The Chairman of the Parliamentary Tax Committee, John Alexander, welcomed the ATO’s decision to look overseas to countries like Norway and Denmark for examples of best practice and ways to improve the Australian system. (Media Release 2013/08 27 March 2014.)

³⁸ See the Australian National Audit Office Report No. 34, 2008-09, Australian Taxation Office, Management of Serious Non-Compliance, pp. 58-59.

³⁹ ANAO Report No. 34, 2008-09, pp. 62-66.

received from stakeholders. It is suggested that such measures would also better inform future planning and targeting of risks by the ATO.

However, other evidence suggests that the ATO is addressing its detection capabilities by building risk profiles and identifying risk characteristics among taxpayer groups, as well as employing rather sophisticated data-matching techniques.⁴⁰ In this regard, it is suggested that strengthening these strategies would also improve taxpayers' awareness of audit and detection rates.

7. CONCLUSIONS AND FURTHER STUDIES

Public disclosure should be considered as part of an integrated compliance strategy as ultimately it will be the fine balancing of a mix of compliance tools which will have the greatest deterrent effect and potential for increasing taxpayer compliance. Australia should therefore consider a form of limited disclosure for individual taxpayers post the introduction of the new disclosure rules for corporations in 2013. Considering the possible future dilution in the disclosure of individual taxpayer information in Norway, primarily based on privacy concerns and where tax culture differs from that in Australia, there is also a strong argument that full disclosure is not appropriate or feasible. Perhaps a version of the modern day 'pink slip' as suggested by Kornhauser (2005) as a form of limited disclosure incorporating the taxpayer's name, and more general tax information could be used as an educational tool whilst having the potential to increase compliance.

It is surprising how little is known about the compliance effect of public disclosure and consequently more empirical studies are desperately needed. Possible avenues for future research may include considering what type of taxpayers react to public disclosure measures, and actually what type of information tax administrations should make public in order to increase compliance. Overall, in carrying out future studies it is also suggested where possible, that tax administrations should be involved in their design and implementation.

⁴⁰ ANAO Report No. 34, above n 34, pp. 58-59.

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Let's talk about tax compliance: Building understanding and relationships through discourse

Robert B Whait¹

Abstract

The Australian Taxation Office's (ATO) cooperative compliance model (CCM) has been regarded by some as an innovative method through which to improve voluntary compliance. Since its introduction in the late 1990s and early 2000s, it has been adopted in many other regulatory areas and by many other jurisdictions. Consequently the model represents a historically significant event, yet little research surrounding its development and adoption has been conducted. Prior research has focused on themes of administrative equity and efficiency and their implications for risk management. This article builds on that work by discussing more factors and themes relevant to the CCM's development and adoption, specifically discourse, relationships and understanding.

The methodology employed was traditional historiographic methodology where data from a variety of written and oral sources was located, gathered, organised, and analysed using thematic analysis. An interpretative approach was used so that causes and explanations for the model's development and adoption could be found. The research took an instrumentalist constructionist approach which focused on the model as adopted by the ATO and explained its existence by building an account of the past. This account was developed by using the themes discovered through the thematic analysis in combination with selected quotations.

The analysis revealed that the CCM was adopted partly as a result of the ATO's realisation that it needed a new approach to improve compliance in the small business segment that was based on improved understanding of that segment. To improve understanding, relationships also had to improve. Both of these could not be achieved without the ATO engaging in discourse with taxpayers and community leaders. Thus discourse was a key enabler of the adoption of the CCM and it culminated in various industry, ATO and academic representatives coming together in the Cash Economy Task Force (CETF) that recommended that CCM be adopted. A similar approach was taken as the CCM was adapted for the large business and international (LBI) segment. Discourse was also critical in the CCM gaining acceptance within the ATO in the face of some opposition. The importance of the role of discourse in improving relationships and creating mutual understanding has some implications for tax administration in the current context. These implications are discussed.

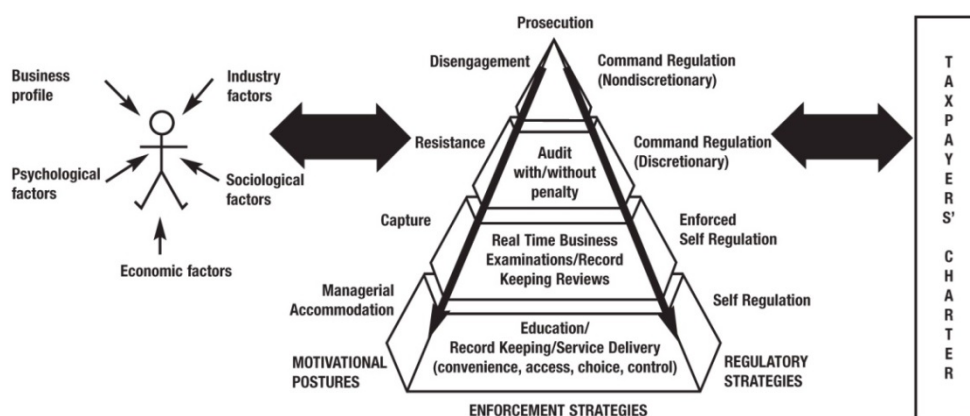
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1. INTRODUCTION

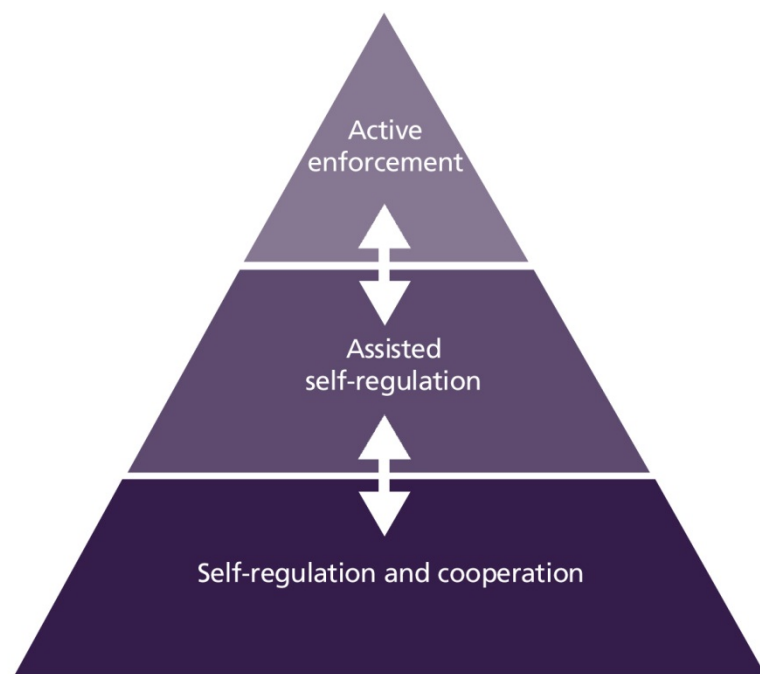
The importance of taxation in public good provision and in economic management means that improved compliance with tax laws is continually sought after (Allan 1971; OECD 1998; Tanzi 2000; D'Ascenzo 2010; Commonwealth of Australia 2010). Near the turn of the century, the ATO adopted the cooperative compliance model (CCM) as its compliance improvement strategy. This approach combines deterrence measures with so-called compliance measures in a hierarchy of regulatory actions chosen in accordance with the taxpayer's attitude to compliance and the context in which noncompliance or otherwise occurred (Commonwealth of Australia 1998; Braithwaite 2011).

Figures 1 and 2 illustrate the CCM. Figure 1 was developed for the cash economy as part of the Cash Economy Task Force (CETF; Commonwealth of Australia 1998). The compliance pyramid in the centre illustrates the aforementioned hierarchy of sanctions. Informing the pyramid is the Business, Industry, Sociological, Economic and Psychological (BISEP) model on the left while the *Taxpayers' Charter* is shown on the right. The *Taxpayers' Charter* is not strictly part of the CCM, however, the CCM was designed with it in mind. Figure 1 was used as a basis to develop Figure 2 for the Large Business and International (LBI) segment of the ATO (Commonwealth of Australia 2000). While Figure 1 may be regarded as the *compliance model* and Figure 2 may be regarded as the *cooperative compliance model*, this article will refer to both as the cooperative compliance model (CCM) for simplicity since they are both founded on the same concepts and theory and this article is interested in the history of the concept of cooperative compliance.

Figure 1: The CCM for the cash economy



(Commonwealth of Australia 1998, p. 58)

Figure 2: The CCM for LBI

(Commonwealth of Australia 2000, p. 5)

The CCM applies theoretical research in regulation developed by John and Valerie Braithwaite and a number of their colleagues (Braithwaite & Braithwaite 2001; Braithwaite, V 2002a). Valerie Braithwaite and her team developed motivational posturing theory which is modelled on the left side of the pyramid (Braithwaite & Braithwaite 2001; Braithwaite, V 2002a). In the taxation context, motivational posturing is concerned with a taxpayer's attitude to compliance as manifested in his or her compliance behaviour and determined by applying the BISEP model (Braithwaite & Braithwaite 2001). The most compliant posture is *commitment* (labelled as *managerial accommodation* in Figure 1), followed by *capitulation* (labelled as *capture* in Figure 1). The CCM assumes that most taxpayers are committed to voluntary compliance and have a commitment posture (Braithwaite, V 2002a). The next two postures, *resistant* and *disengaged*, are the least compliant (Commonwealth of Australia 1998; Braithwaite, V 2002a). While a resistant taxpayer may be persuaded to comply, it is considered unlikely that a disengaged taxpayer will ever comply (Braithwaite & Braithwaite 2001).

The right side of the pyramid applies John Braithwaite's responsive regulation theory which is generally concerned with the regulator acting in an appropriate manner based on the context and in accordance with the motivational posture of the taxpayer (Ayres & Braithwaite 1992; Braithwaite 2011). It is based on the view that different forms of compliance or noncompliance ought to be met with different actions from the regulator (Kagan & Scholz 1984; Braithwaite 1985; Graetz, Reiganum & Wilde 1986;

Ayres & Braithwaite 1992). Using punishment and persuasion, where appropriate, is considered to be superior to using either alone (Ayres & Braithwaite 1992). Possible responses for each posture are listed in the pyramid and range from self-regulation, to forms of enforced self-regulation to traditional deterrence measures for the least compliant. While a disengaged taxpayer is unlikely to ever comply, compliance strategies from the base of the pyramid are always tried first. Deterrence strategies are used once the compliance strategies have failed (Braithwaite & Braithwaite 2001).

Previous research (Whait 2012, 2014) has concentrated on the influence of administrative equity and administrative efficiency in the development and adoption of the CCM. This article broadens the discussion to include other themes after having considered more written and oral evidence. After this introduction, Section 2 will provide a brief overview of the extant literature concerning the history of the CCM. The methodology employed will then be discussed in Section 3 followed by findings in Sections 4 and 5. Some policy implications will be discussed in Section 6 after which the article draws to a brief conclusion in Section 7.

2. LITERATURE REVIEW

To date, no formal histories of the CCM have been conducted apart from the aforementioned research by Whait (2012, 2014) that discusses the influence of administrative equity and efficiency in its development and adoption. Prior to these articles, discussion was confined to introductory comments in articles about its theoretical underpinnings and operation predominantly by those who developed it (Braithwaite & Braithwaite 2001; Braithwaite 2002; Braithwaite, V 2002b; Braithwaite 2011).

These articles discuss the origins of responsive regulation with the publication of John Braithwaite's (1985) book, *To Punish or Persuade: Enforcement of Coal Mine Safety* and Ian Ayres and John Braithwaite's (1992) book, *Responsive Regulation: Transcending the Deregulation Debate* after much influence from master practitioners and others (Braithwaite 2011). Thus the early development of responsive regulation was a collective effort. These volumes capture the *punish versus persuade* debate that was taking place in the regulation literature at that time and argued that rather than it being a contest between the two methods, applying both may be more successful. At that time, the compliance pyramid had been developed but had not yet been combined with motivational posturing, nor were the hierarchy of sanctions tailored to the taxation context, although taxation was one of the areas where such an approach may be appropriate (Ayres & Braithwaite 1992).

By April 1998, responsive regulation, motivational posturing and BISEP had become combined to form the CCM under the auspices of the CETF but little is known regarding the process by which this occurred except that the CETF persuaded that the ATO use the CCM to improve compliance in the cash economy and to use BISEP to better understand taxpayers (Commonwealth of Australia 1998; Braithwaite, V 2002a; Braithwaite & Job 2003). Similarly, the process of its adaptation for LBI is unknown, except that there was some doubt as to whether it could be applied there because it was not a taxation specific method of regulation (Braithwaite & Braithwaite 2001; Braithwaite 2002; Braithwaite, V 2002a; Commonwealth of Australia 2000). Interestingly, no empirical testing of the CCM was ever performed (Braithwaite 2011).

Contextual developments are regarded as being influential in the CCM's development and adoption, such as a re-emergence of aggressive tax planning by high wealth individuals in the late 1990s, the introduction of the Goods and Services Tax and concerns about the cash economy (Braithwaite 2007). The *Taxpayers' Charter*, developed in the mid-1990s and adopted on 1 July 1997 (Commonwealth of Australia 2004) also appears to have been influential as the CCM was adopted, in part, to complement it (Commonwealth of Australia 1998; Braithwaite, V 2002a).

These insights refer mainly to activity during the mid to late 1990s. They also originated predominantly from those who provided the key theoretical foundation for the CCM and helped the ATO to implement it, namely, John and Valerie Braithwaite. The following questions, however, remain unanswered and are the focus of this article:

- What were the key change factors that prompted and shaped the emerging discourse?
- What was the nature of the transition from the previous deterrence approach to the CCM?
- What was the pattern of development of the CCM in Australia?
- What influences shaped the emergence of the officially promulgated model?

The article by Whait (2012) has partly addressed these questions. Briefly, the CCM was adopted to enable the ATO to take into account the circumstances of the taxpayer when determining its response to noncompliance. These allowed the ATO to administer penalties in a more flexible manner. It also allowed the ATO to move away from a one size fits all approach in its treatment of taxpayers. The CCM was also adopted as part of a long process, beginning with self-assessment, to allocate its scarce resources more efficiently by targeting only those taxpayers who were assessed as being a risk to the revenue. There are a number of gaps in that article, however. It does not describe and explain how and why motivational posturing was combined with responsive regulation, how and why the hierarchy of treatments were developed, how and why the cooperative appliance concept was applied and adapted for LBI, and how and why BISEP was developed. Furthermore, when these events took place and by whom remain unanswered. This article seeks to fill these gaps to provide a more complete history of the CCM's development and adoption for the cash economy, LBI and the whole of the ATO.

3. METHODOLOGY

This article has applied a similar methodology to Whait (2012). Written and oral sources were searched and selected on the basis of the above research questions and subsequently classified, authenticated and analysed (Stanford 1986; Previts, Parker & Coffman 1990a; Miles & Huberman 1994; Glesne 2006). Sources were discovered in various locations including libraries and the Internet (Goodman & Palmon 2001; Sangster & Tyrrell 2008; Walker 2008). Interviewees who participated in this research also provided some sources. These were classified with respect to its date and place and origin, primary or secondary characteristics, content and aim (Previts, Parker & Coffman 1990a). The types of places from which sources were gathered are indicated in the following list. The time period of interest was the 1970s to 2000.

- Scholarly books;
- Journal articles;
- Working papers, conference papers and other unpublished research papers that were not written for the purpose of providing a history of the CCM;
- ATO publications;
- ATO PowerPoint presentations;
- Speeches given by Commissioners of Taxation, Deputy Commissioners and Assistant Commissioners;
- Speeches given by politicians;
- Hansard;
- Government taxation and finance reviews;
- Senate inquiry and other committee reports;
- Submissions to senate committees by interested parties;
- Miscellaneous government reports concerned with taxation or other relevant topics;
- Commentary from the professional accounting and taxation bodies;
- Newspaper articles.

As foreshadowed above, semi-structured interviews based on a combination of open, closed and probing questions were also used with selected interviewees that were chosen on the basis of their direct involvement in the development and adoption of the CCM and/or their experience with respect to the ATO's compliance improvement approaches during the period under study. Interviews represent a purposive rather than probabilistic data gathering technique and were conducted until the researcher was satisfied that the point of saturation had been reached (Strauss & Corbin 1990 as cited in Bowen 2008; Morse 1995; Guest, Bunce & Johnson 2006; Glesne 2006; Marginson 2008). Interviewees may be separated among the following three categories:

- Current and former ATO employees.
- Taxation academics.
- Other – comprising tax professionals or members of the CETF who are not in any of the other categories above.

A total of 25 interviews were conducted. Specific numbers are detailed in Table 1.

Table 1: Interviewee categories and number

Category of Interviewee	Number of interviews
ATO employees (former and current)	11
Academics	7
Other (former CETF members and tax professionals)	7

Many of the interviewees can be placed in more than one category, however, as many have a broad range of experience. The richness of this experience is detailed in Table 2.

Table 2: Range of interviewee experience

Type of Experience	Number interviewed with such experience
ATO employee (former and current)	13
Academics	9
CETF	9
Interviewees with professional industry experience (ie non-academic and non ATO experience)	6

There were three iterations of the CETF and members from the first two, and particularly the second, were regarded as relevant to the research questions having been among the group who recommended the ATO adopt the CCM in Figure 1. The ATO employees interviewed, except for two, were also involved in or oversaw the CCM's adoption and development. The authority of staff interviewed ranged from those who acted in support of the CETF to middle management and senior positions. The two ATO employees interviewed who were not directly involved in the development and adoption of the CCM had extensive knowledge of the ATO's compliance strategies during the period under study. Since the CCM was influenced by academic research, various senior academics that conducted research in tax compliance and administration were also interviewed.

The mastery of the sources is the hallmark of historical scholarship (Fleishman, Mills & Tyson 1996; Evans 1997; Tosh 2010). Consequently, in a manner similar to the historicists, the sources (written and oral) were treated with the utmost respect and were regarded as the keys to recounting the past with respect to the development and adoption of the CCM (Evans 1997, Parker 1997; Budd 2009). These were analysed through an ordering or reconstruction of the evidence using creative mental effort (Elton 1967; Stanford 1986). While the use of social science methods may be regarded as ahistorical (Stanford 1986) they may also be useful in reconstructing the evidence gained from the sources, particularly with respect to organising and describing the data, identifying patterns amongst it, creating explanations and linking stories to others (Fleishman, Mills & Tyson 1996; Glesne 2006). Consequently, thematic analysis was employed to help order, make sense of and summarise the data (Appleby,

Hunt & Jacob 1994; Parker 1999; Budd 2009). In broad terms this involved coding the data among categories that are determined through the researcher being immersed in the sources, reading and re-reading them and through inductive reasoning (Neuman 2011).

While the aim of historicists was to produce an objective history that recounted the past as it actually was, history's ability to be objective began to be questioned in the 20th century, especially after World War II (Appleby, Hunt & Jacob 1994; Evans 1997; Parker 1997; Budd 2009). In its quest for objectivity, history had aligned its methodology with the physical sciences, but once the physical sciences and the scientists themselves, became regarded as political and subjective to a degree, so too did history. Also, many history graduates in post-war United States sought to have their story heard over the traditional history of human progression told from the perspective of political leaders and decision makers. These trends led to the postmodernist recognition of the role of the historian in producing history and allowed for many varied viewpoints to be expressed and many different methodologies to be employed. Historical research then became in danger of being reduced to nihilism (Appleby, Hunt & Jacob 1994; Evans 1997; Parker 1997; Tosh 2010). Despite these developments and the now recognised limitations in historical study, history is generally regarded as the best means to understand the past and provide a way for the future (Tosh 2010). This article recognises the impact of the historian in producing history, especially with respect to analysis of the sources and reconstruction of the history (Appleby, Hunt & Jacob 1994; Evans 1997; Tosh 2010). Nevertheless, the sources provided the foundation of the history presented herein (Vincent 1995). Indeed, the sources are paramount to this end.

Many of the steps involved in historical scholarship described above are iterative and necessarily overlap. Writing the history is no different due to a process that Parker (1997, p. 139-140) calls "revelation through writing". This is especially the case for this article since it aims to produce an interpretive history to explain how the CCM came into existence through building an account of the past (Stanford 1986; Previts, Parker & Coffman 1990a, b; Parker 1997).

4. FINDINGS

This section will discuss how understanding taxpayers, building relationships and discourse were influential in the development and adoption of the CCM. These themes are highly interrelated; therefore each theme will not be discussed separately. Instead, discourse will be used as the primary theme with discussion of the other two themes embedded within it. Consequently, the discussion is mostly in chronological order. The story begins with how the ATO realised that it needed to engage with and understand small business better to improve compliance, particularly with respect to the cash economy.

4.1 Definition of discourse and its relevance to this research

This research has utilised a definition of discourse espoused by Michel Foucault and elucidated by other scholars after his death (Foucault 1970, 1972; Sheridan 1980; Mills 2003, 2004; Gutting 2005; O'Farrell 2005). Foucault defined discourse in various ways which may be regarded as somewhat contradictory (Mills 2003, 2004;

O'Farrell 2005). He defined it in a general sense as "a way of speaking" (Foucault 1972, p. 193, cited in O'Farrell 2005) and as a way to categorise "the group of statements that belong to a single system of formation [of knowledge]" (Foucault 1972, pp. 107-108, cited in O'Farrell, p. 78). Foucault himself tried to explain any apparent contradiction by saying that:

I instead of gradually reducing the rather fluctuating meaning of the word 'discourse', I believe I have in fact added to its meanings: treating it sometimes as the general domain of all statements, sometimes as an individualizable [*sic*] group of statements, and sometimes as a regulated practice that accounts for a number of statements (Foucault 1972, p. 80, cited in Mills 2004, p. 6).

This explanation illustrates the tripartite nature of his definition of discourse. It may consist of written or verbal statements where statements are defined as, "an authoritative phrase or sentence which is affirmed by institutions and which has an effect on individuals" (Mills 2004, p. 147). Discourse may also be defined as groupings of statements into more complex formations on a topic, theme or issue such as medical or tax discourse, including tax compliance discourse (Foucault 1972; Mills 2003, 2004; O'Farrell 2005). Lastly, the regulation of discourse is itself part of discourse, an aspect that Foucault was particularly interested to understand why some discourses dominate over others, why some are accepted and become 'truth' while others are rejected (Foucault 1972; Mills 2003, 2004). In summary, discourses are accepted or rejected through a process of exclusion where sentences are compared to those already accepted discourses within society and accepted or rejected (Foucault 1972; Mills 2003).

According to Foucault, society's perspective, understanding, interpretation and experience of the material world are constructed through discourse (Mills 2003, 2004, O'Farrell 2005). This means that society generates what it regards as knowledge and truth through discourse by producing mutual understanding (Mills 2003, 2004; Gutting 2005). Discourse creates knowledge as well as disseminates it (Gutting 2005). Whether any particular discourse can be verified as 'truth' by analysis of empirical data or otherwise is irrelevant (Mills 2003, 2004).

This research utilises Foucault's definition of discourse since it is concerned with how the discourse of cooperative compliance came to dominate over command and control discourse in Australian taxation administration. Foucault's definition of discourse is used also due to its association with power (Delanty 2003; Mills 2003, 2004). For Foucault, power is closely associated with knowledge since knowledge produces power (Foucault 1977, 1978; Mills 2003; O'Farrell 2005; Schwan & Shapiro 2011). Tax compliance can be framed within a power relationship between the taxpayer and the regulator and power is a key element of discourse since, according to Foucault, power operates through discursive systems (Braithwaite, V 2002a; Delanty 2003; Mills 2003, 2004). In addition, Foucault argued that power and resistance are also closely aligned such that where there is power there is also resistance (Foucault 1977, 1978; Mills 2003; O'Farrell 2005; Schwan & Shapiro 2011). In essence, Foucault's definition of discourse allows an examination as to how power, knowledge and resistance interacted leading to the development and adoption of the CCM within the ATO.

... discourse can be both an instrument of power, but also a hindrance, a stumbling block, a point of resistance and a starting point for an opposing strategy. Discourse transmits and produces power; it reinforces it, but also undermines and exposes it, renders it fragile and makes it possible to thwart it (Foucault 1978, pp. 100-101, cited in Mills 2003, p. 55).

4.2 Small business issues put the focus on engagement

As discussed in Whait (2012), the ATO began to use service and education provision as key compliance improvement strategies in the early 1990s and it was not too long before these techniques had gained some tentative empirical support (Wirth 1993; Sutton 1995). Despite this, by 1993 weaknesses began to appear in that approach especially for small business which was regarded as the least compliant market segment (Sutton 1992, 1995). This may have been due to a number of factors. Small business had a poor understanding of tax rules and did not keep up to date with legislative change. This was perhaps due to small business being more concerned with day-to-day business matters such as maintaining cash flows, improving sales and developing new products (Gibson & Wallschutsky 1993; McKerchar 1995). Complicating matters was the wide diversity present in small business in terms of culture, language and business practices partly caused by increases in Asian immigration over the preceding decades (Foster & Stockley 1988; Vivani 1990; Coleman & Freeman 1994, 1996; Jupp 1994; Mitchell 1995). This diversity made it difficult to take individual circumstances into account when treating noncompliance and in tailoring education and service solutions (Mitchell 1995). Despite this, it was hoped that new methods of improving compliance could be developed that took diversity into account through market segmentation.

Being realistic, we do not expect to be able to identify the 1990s equivalent of “self-assessment” as a means of changing the general environment within which SBI [small business income] operates. The sheer diversity of the Small Business sector will prevent this. However, what we do hope to achieve is some new ideas on how to better segment this sector, and (in turn) to identify some particular directions we need to follow to make it easier for small business to meet their tax obligations (Mitchell 1995, p. 21).

Thus the small business segment presented a number of challenges to the ATO. It caused the ATO to reassess the risks which that segment posed to the revenue, how to allocate resources to meet the needs of that segment and, perhaps most significantly, whether its extant compliance strategy would best meet the needs of that segment (Mitchell 1995). The public's negative perception of the ATO, as expressed via the Joint Committee of Public Accounts (JCPA) as far back as 1993, was also a consideration (Commonwealth of Australia 1993; Mitchell 1995; Hite 1997).

One particular pressing compliance issue relevant to small business that emerged in the late 1990s was noncompliance in the cash economy. The ATO was concerned about the perception in the community that it was acceptable to not pay tax on cash income (Australian Taxation Office 1997) and it established the CETF in November 1996 to find a means of improving compliance (Commonwealth of Australia 2003). Up until that time, the community perceived the ATO's responses to noncompliance in the cash economy as not having ‘sufficient impact’ and this perception was ‘a major threat to maintaining public confidence in the tax system and the ATO's

administration' (Commonwealth of Australia 2003, p. 15). The ATO thought that the best way to address this issue was to improve its understanding of the cash economy in the hope that it would lead to a more tailored solution, but by the time the first CETF report was finalised in May 1997, the ATO still regarded education as the basis of such a solution (Australian Taxation Office 1997). The seeds for the CETF were sown in discussions, a form of discourse, among ATO staff and tax practitioners.

I used to chair the main tax practitioner forum ... My very first meeting I went to ... I had two practitioners who gave me a really hard time about the cash economy ... and said that the ATO was a joke and you're doing nothing about it and I knew it's a very complex area, and no matter what I said at that meeting they just wouldn't let up ... So I then thought about that, and had conversations with [Commissioner] Michael Carmody ... So we ... decided to set up a Task Force, a Cash Economy Task Force and invited those two practitioners to be members of it and they both accepted (ATO employee).

4.3 Help from the CSA

The Child Support Agency (CSA) faced similar compliance issues in the late 1980s and early 1990s. This agency was established within the ATO in 1988 at a time when the payment of child support was not commonly accepted in the community (Commonwealth of Australia 1993; Buchtmann 1993). Furthermore, an increasing rate of divorce was putting pressure on the CSA requiring it to increase its levels of service and efficiency (Mackay 1993; Buchtmann 1993). The CSA used education and service provision to increase peoples' awareness of their rights as well as market research to listen to their needs and develop appropriate treatments. The CSA also sought to improve the level of cooperation between divorced couples in the hope of changing attitudes in the community toward payment of child support (Buchtmann 1993). This approach was influenced by drink driving and AIDS awareness campaigns undertaken in the 1980s in Australia that were regarded as successful in positively changing social attitudes toward those issues (Buchtmann 1993). This influence came via the CSA's manager, Trevor Sutton, who had been the National Campaign Director of the Australian AIDS Education Campaign during the mid to late 1980s (Australian Bureau of Statistics 2013). The CSA had an emphasis on treating people with respect and understanding their individual motivations for compliance. This approach, labelled as 'social marketing' by those involved, was subsequently utilised to improve compliance under the CCM.

Social marketing, it's just not about information, it's about persuasion, it's about explaining why, ... what's more personal to people about why they might want to comply, or what are the barriers to them complying ... And during that period we probably developed a sort of a prototype approach to a more behavioural-based approach to compliance management, but it was in the Child Support Scheme (former CETF member).

The CSA appears to have been particularly influential in highlighting the value of knowing and working with individuals since it became interested in understanding behavioural issues in custody disputes in the hope of finding solutions that benefited all parties. The desire to understand peoples' behavioural issues and their circumstances later influenced the CCM.

The two parents, that had [a] relationship breakdown, financial stress, both obviously love their kids but not being able to agree on the best way to do that and the law coming in and deciding for them how it will be done. So we did quite a bit of work there around what makes motivations, motivations to pay, not pay, and that's probably sowing the seeds [for the CCM] (ATO employee).

These behavioural factors included treating people fairly, listening to and taking into account their circumstances and trying to achieve the best possible outcome for the child. The influence of the social media campaigns was evident in this approach through attempts to change behaviour by illustrating the benefits of the change to everyone, rather than simply telling people what they ought to be doing and issuing threats for noncompliance. The desire to understand the motivations of those involved in custody disputes directly influenced the CETF's desire to understand the drivers of noncompliance in the cash economy thus becoming a key part of compliance improvement in the CCM (Commonwealth of Australia 2003).

The other thing that I think was really interesting was if you understood how people behave in terms of compliance with the tax system, why people behave that way or they didn't behave that way, what might be an incentive or a disincentive for one group may not work at all for another group. And so I think just opening our eyes to that kind of approach was a big break through for us in terms of the way we might want to influence behaviour in the community (ATO employee).

4.4 From the CSA to the CETF

Neil Mann and David Butler joined the Small Business Income market segment (SBI) within the ATO in 1996 after having worked with Trevor Sutton in the CSA. David Butler also had extensive experience within the ATO as an assessor. Both soon became part of the CETF with Neil Mann becoming the Project Manager and David Butler becoming the Chairperson. They brought the CSA's approach of using respect, fair treatment and consideration of a person's circumstances and motivations for compliance or noncompliance into the CETF. It was believed that this approach might be useful in changing community attitudes toward noncompliance in the cash economy in a similar manner to changing community perceptions regarding the payment of child support. Neil Mann became aware of Valerie Braithwaite's research through Trevor Sutton who, as was mentioned above, was the Director of the CSA. Trevor Sutton became aware of Valerie Braithwaite through his doctoral studies at the Australian National University (ANU) where she was an academic (Australian Bureau of Statistics 2013). Valerie Braithwaite brought some valuable skills and connections to the CETF.

... she brought with her two things. One, her own background in regulation in nursing homes in particular but with a promise around trust in the system, and trust in the regulator, but of course she also brought the connections with her partner at the time, John Braithwaite, and his long history with regulatory theory ... we were able to move away from that almost instrumental approach to the hierarchy of compliance to a more behaviourally based one around what is motivating people (ATO employee).

Neil Mann approached Valerie Braithwaite at the time of the first iteration of the CETF in 1997 since he recognised that her research could help the ATO to improve its relationships with taxpayers. He regarded improving relationships as being important in finding a response to systemic noncompliance since it could help the CETF, and the ATO more broadly, to engage with people in a deeper way to gain the understanding needed to find the required solution. While the social marketing approach of the CSA was regarded as a success, Neil Mann and David Butler wanted to take it further and they saw the research of John and Valerie Braithwaite as a means to do so. The importance of improving relationships in this process was well understood.

Neil Mann understood that relationships were important for getting a good exchange of information so that the systemic noncompliance can be dealt with (former CETF Member).

This statement illustrates the importance of having constructive relationships to allow discourse to take place between the ATO and taxpayers so that knowledge (and therefore power) may be gained to improve taxpayer compliance behaviour.

4.5 Engagement with academia

As the CSA sought to understand motivations for compliance and noncompliance, so too did the CETF with respect to the cash economy. Part of this process entailed conducting a review of academic research into the “nature of the cash economy and the motivating factors affecting taxpayer compliance behaviour” (Commonwealth of Australia 2003, p. 5). A relatively new ATO officer named Jenny Job was given the responsibility for this. She had a sociology and anthropology background and therefore brought a fresh perspective to tax compliance. She had also worked with Neil Mann and David Butler in the CSA.

Such a review is likely to have provided little practical guidance since tax compliance behaviour was poorly understood at that time particularly with respect to behavioural factors (Andreoni, Erard & Feinstein 1998; McKerchar 2001; Richardson & Sawyer 2001). Indeed, the failure of the taxation academic community to provide practical solutions to compliance issues had been recognised for some time (Baldry 1993, 1994; Wallschutzky 1993). Studies of the behavioural aspects of tax compliance were still in their infancy at the time of the first CETF and the effect of deterrence measures such as audits and associated penalties on compliance had been somewhat discredited (Bardsley 1994a, b; Andreoni, Erard & Feinstein 1998). Even though the CETF was considering the work of John and Valerie Braithwaite, it did not break completely from the past, however, as the balanced compliance improvement methods that the ATO had already developed to improve efficiency such as education and service provision continued to be utilised and were incorporated into the base levels of the CCM. Thus, the engagement with John and Valerie Braithwaite's work marks a shift in emphasis in the ATO's compliance improvement approaches rather than a completely new development. The following quotation shows how John and Valerie Braithwaite's work was combined to form the compliance pyramid of the CCM.

And then I – by Val Braithwaite, I was pointed in the direction of John Braithwaite's work, Ayres and Braithwaite's transcending the response of regulation book. And then also some work that she and John and a couple of others had done on nursing homes, nursing home regulation and compliance.

And when I read all those papers, it just suddenly struck me “this is the answer”. It was light bulb moment ... And so I then had to construct something, so I got a regulatory pyramid and ... what I did is [sic] I mapped John Braithwaite’s regulatory responses down the side and then I mapped Val Braithwaite’s motivational postures up the other side, and then mapped through the middle of it, all the things that we did in the Tax Office that sort of responded to John’s regulatory strategies that we could use (ATO employee).

In this way, the discourse of John and Valerie Braithwaite prevailed. The aforementioned literature review did not go entirely to waste. Since the ATO was interested in understanding the motivations for compliance, it sought to derive a model that included a broad range of possible factors. These factors appear in the resultant BISEP model (Shover, Job & Carroll 2001). Similar analyses of these types of factors had been conducted since risk management was introduced as part of environmental scanning (Saavé-Fairley & Sharma 1993; Nelson 1995; Wickerson 1995). Those in the ATO responsible for compliance improvement since self-assessment made it their business to study the academic literature to understand taxpaying behaviour in the hope of making use of it within the ATO. The BISEP model therefore represented another shift in emphasis where that type of analysis was to become more common and more formalised throughout the ATO once the CCM was adopted (Commonwealth of Australia 1998). As such, the BISEP approach does not represent a new development, but a formalisation of, and a progression from, previous ATO practice that became combined with the compliance pyramid to form the CCM. BISEP became a method of summarising the various factors that might impact on the taxpayer’s compliance behaviour.

So it’s about understanding what you’re working with. It’s about environmental scanning. And so I did what became known as the BISEP, so what are the drivers, what are the factors that we’re looking at? Well B for Business fact, I for Industry fact, S for Sociological, E for Economic, P for Psychological. You know all these things are happening in people’s lives and have an impact upon their lives and that makes them behave the way they do towards you the Tax Officer and you have to understand that. And you also have to understand that the way you behave has an impact on their response to you as well (ATO employee).

Engagement with academic discourse also occurred in LBI to adapt the CCM to that segment. Jim Killaly, the Director of LBI, was ready to adapt the CCM for that segment. Andrew Wirth, an ATO officer within LBI, was well read in the compliance and regulation literature and he approached John Braithwaite for help. Andrew assisted John Braithwaite in the writing of an article entitled *Co-designing a New Approach to Compliance Assurance under the New Tax System* (Australian Taxation Office 2000) to generate some discussion regarding compliance approaches in LBI and in developing a prototype model was produced and presented to large business taxpayers (Braithwaite & Braithwaite 2001; Australian Taxation Office 2002; Wirth 2004a). After some discussion with large business, to be detailed below, the CCM in Figure 2 was released to the public (Commonwealth of Australia 2000).

5. THE ROLE OF DISCOURSE IN THE CCM'S ADOPTION

After the development of the CCM through engagement with academic discourse, the ATO began to engage in discourse about it with taxpayers and with its own officers. It engaged with small business and other community leaders first via the CETF then large business via the Corporate Consultative Committee (Australian Taxation Office n.d.). As will be discussed below, taxpayers were generally supportive of the CCM and provided some suggestions for its development, but ATO staff were polarised in their support with many being vehemently opposed to it. Even though taxpayers saw promise in the CCM, small business and large business taxpayers had generally different reasons for doing so. Continued and persistent discourse was instrumental to it being accepted by ATO staff. This section will discuss the discourse that took place and how it influenced the development and adoption of the CCM.

5.1 Discourse with taxpayers and community leaders

When the CETF was established in November 1996 (Commonwealth of Australia 2003) it was regarded as an opportunity for the ATO to implement a new approach to consultation. Thus the CETF comprised leaders from the building and construction industry, the tax profession and the retail industry among others. It also comprised community leaders from, for example, the Australian Council of Social Services as well as representatives from other public service organisations such as the Australian Transaction Reports and Analysis Centre. There were also a number of ATO employees who were not officially part of the CETF but who supported it in the background by facilitating sessions, taking notes, providing literature reviews and testing various aspects of the newly developed CCM. The above discussion regarding the influence of academic discourse illustrates how the support staff contributed. The CETF sought to apply the approaches pioneered by the CSA: to understand taxpayers' compliance behaviour and use social marketing to educate taxpayers in the benefits of complying.

... the formulation of the Cash Economy Task Force was based on the fact that we were ... starting to be aware that ... things like market research were really important, you know to understand people. Understand them but get an appreciation of them ... and so the creation of that I thought was a breakthrough ... (ATO employee).

The CETF undertook the task of understanding the nature of the cash economy through discourse to produce mutual understanding of it (Commonwealth of Australia 1998, 2003). During the first CETF (from late 1996 to early 1997), experts in mapping dynamic systems facilitated this discourse by taking a systems view. Early discourse also centered on trying to define the cash economy and there was recognition that the cash economy would never completely disappear. The systems diagram was published as part of the first report that was presented to Commissioner Carmody in May 1997 (Commonwealth of Australia 2003, p. 24).

During the first and second iterations of the CETF, members told each other stories regarding the cash economy, what they had either been involved in or witnessed within their own industry. Initially, some were reticent to speak about their experiences, but they later opened up to discuss many aspects of the cash economy. Discussion was encouraged without fear of ramification and there was a willingness to

let people have their say to improve knowledge and mutual understanding. Thus, understanding and relationship building was taking place through the telling of stories, that is, through discourse.

... there was lots of storytelling and that's what actually made it such an effective Task Force and the storytelling [was] on both sides the tax officers too loosened up and started sharing some of their problems and they were understood and so a rapport developed in that group and a commitment to try to deal with the cash economy task force better (former CETF member).

Stories were also told regarding how cooperation with clients or taxpayers led to an outcome that was amenable to both parties and helped diffuse conflict. There was also discussion regarding the nature of cash, its movement in society and the types of activity that occurs in the cash economy. Most of the members of the CETF had input into this process. There was also discussion about motivations to comply or to not comply. Some of the discussion was quite animated due to disagreements concerning compliance motivations in the cash economy. Through these discussions, it became clear that not all small business taxpayers and their advisors had positive regard for the cash economy.

I remember having a fairly heated discussion with [name withheld] because [gender withheld] said to me "well you're representing business and you've got contractors and people you put on and you pay cash wages to them" and I was able to explain to them that cash wages really did not suit my small clients (former CETF member).

As discussed in section 4.4 some ATO officers had been working on a model that was hoped to improve compliance in the cash economy from as early as November 1996. After this, Valerie Braithwaite was asked to formally join the CETF as part of its second iteration by Neil Mann (Commonwealth of Australia 1998). She was reticent to discuss matters in the early meetings, but soon began to raise relationship issues among the rest of the CETF. She presented the already developed CCM as an essentially complete model with motivational posturing and BISEP included. The CETF members discussed some aspects of the CCM's operation, such as the level which a certain activity ought to be placed on the pyramid and what response ought to be appropriate. Nevertheless, they quickly seized upon it as the answer to noncompliance in the cash economy for the reasons previously discussed by Whait (2012), that is, it allowed the circumstances of the taxpayer to be taken into account and provided flexibility in determining any applicable penalty. It even gave scope for no penalty to be applied if that was deemed appropriate. The CETF members thought that it made intuitive sense. A key feature was the improving of relationships as it was recognised that building relationships would be instrumental in improving compliance.

I think that Task Force understood the relationship building stuff very quickly and in part that was because they had all of us there from such different walks of life, really saying to them look this is all about relationships and being prepared to say how we felt about tax office and telling funny stories ... but there was no reluctance to actually express them and there was no punishment for actually speaking truth as it were and then with Neil I think having an understanding of the relational side of things seeing that very quickly, getting on board with the responsive regulation stuff which was all about relationships management so it really flew well

within that environment which was quite nurturing of different ways of working with new ideas (former CETF member).

The second CETF finished with a celebratory dinner where Commissioner Carmody expressed his delight regarding the CCM and that it could be applied across the whole of the ATO. One former CETF member recalls comments by Commissioner Carmody stating how the approach of the CCM was to be applied across the ATO.

... I recall [Commissioner] Carmody's comment when we met him at dinner, he said "You have not written anything about the cash economy, you've written a paper about the operations of the Tax Office in general". They saw straight away that this wasn't just about the cash economy this was actually about tax compliance more generally, and you could apply it and should apply it across the board (former CETF member).

Large business taxpayers also appreciated the focus on building cooperative relationships as well as generating community confidence (Australian Taxation Office n.d; Wirth 2004a). They thought it was a positive concept, a better way of working and they liked its simplicity (Australian Taxation Office 2002; Wirth 2004a). Additionally, large business appreciated the focus on optimising economic growth which would have been particularly appealing at the time since memories of the "recession we had to have" are likely to have been fresh in the minds of large business taxpayers (Killaly 2000-2001; Quiggin 2004, p. 178). Recovery from that recession was long and slow (Quiggin 2004) and therefore large business would arguably have appreciated a compliance approach that allowed them to concentrate on business operations without the distractions of an intrusive audit.

Despite the positive reaction to the CCM, large business was concerned that the aforementioned prototype model used too many buzzwords and that these ought to be replaced with simpler choices. They were also concerned about whether they could trust the ATO and that only senior management was committed to it and that it would not cascade down among all ATO staff (Wirth 2004b). Indeed, both the ATO and large business had concerns about the trust aspect upon which the CCM appeared to rely (Australian Taxation Office 2002; Wirth 2004a). For large business taxpayers, that meant that there was little point in the ATO adopting the CCM if the ATO officers with whom they dealt on a daily basis were not committed to it.

While the CCM gained qualified support from taxpayers and community leaders, many ATO officers reacted quite differently as vehement opposition appeared after a short period of apparent acceptance of the general concept of cooperative compliance. Ultimately, persistent discourse led to its eventual acceptance. The next section will discuss that process.

5.2 Discourse within the ATO

Prior to revealing the CCM to the CETF, David Butler and Neil Mann wanted to ensure that the rest of the ATO would accept John and Valerie Braithwaite's theoretical work and they set about gauging the reaction of ATO officers toward it. This was achieved by gathering 15 to 20 ATO officers from various market segments to act as champions for it. The reaction of ATO staff was considered positive enough to press ahead and to develop a diagrammatic model shown in Figure 1. The operation

of Foucauldian discourse is evident here since the group of 15 or 20 was chosen on the basis of their ability to influence others through the power of their discourse.

Soon after its development, this was presented to senior ATO staff consisting of the three top levels: Commissioner, Second Commissioners and the National Program Managers. Special presentations were made to these senior executives as a group and then to the National Program Managers individually. Importantly, Commissioner Carmody and some other senior officers saw the benefits of the CCM immediately, especially regarding the hierarchy of responses to noncompliance. This would help the ATO to find the appropriate balance between education, service and enforcement that had been its goal from the late 1980s onwards (Boucher 1993). These senior officers also appeared to have also been persuaded by the academic discourse associated with the CCM. The above process of consultation is likely to have taken place in the first half of 1997 while the first CETF meetings were taking place. The latest possible timing was September 1997 since the second CETF had been established by that stage. Upon being presented with the CCM, Commissioner Carmody sought to have it adopted widely throughout the ATO and he put his full weight of authority behind it.

Thus began the wider discourse among the ATO regarding the CCM which began after its endorsement by the CETF. Despite the support from Commissioner Carmody, not every senior officer was enthusiastic about it resulting in colourful views being expressed. In addition, some executive officers questioned its underlying concepts in a patronising manner using discourse as a means of resistance.

I had an executive level officer come and hit me in the face like this with the paper that, which actually I could have had him up on a charge, laughing "This is s**t", laughing his head off. "This piece of c**p you know? ... You are putting something like this up. It'll never get anywhere," and I had a lot of people coming to me and saying "This will never take off, this is rubbish" (ATO employee).

This was to be a common occurrence within SBI and LBI. Generally it was the auditors and lawyers who were the most opposed to the CCM, but not all since some regarded the CCM as an opportunity to bring some compassion to their work as auditors which had been hitherto lacking (Woellner 1993). Many ATO officers in LBI were positive in their view of the CCM and they saw that it had potential since many regarded improving relationships as important (Australian Taxation Office 2002; Wirth 2004a). They also regarded it as evolutionary rather than revolutionary since they thought most of what it advocated was already being done (Australian Taxation Office 2002; Wirth 2004a). The CCM therefore allowed them to bring out the best in what they did and push them further forward in that direction (Australian Taxation Office 2002; Wirth 2004a). For these ATO staff members, it helped articulate a strategy or a rationale toward improving the compliance of large business (Australian Taxation Office 2002; Wirth 2004a).

Many, however, regarded the CCM as a threat and believed that their role was no longer valued. Ironically, some opposition was based on similar observations to those who were more positive about it, that is, that the ATO was already doing it (Australian Taxation Office 2002; Wirth 2004a). Other concerns were more pessimistic, that none of it would work or that some staff would not be able to implement it (Australian Taxation Office 2002; Wirth 2004a). Many auditors were concerned that the ATO was going soft on taxpayers. Some who had been working in the ATO for a considerable

time had grown comfortable in their role as an enforcer and they felt betrayed that the ATO sought to try other approaches. A general level of fatigue in the ATO surrounding new approaches and models fuelled further resistance to the CCM in LBI (Braithwaite & Wirth 2001). The CCM was initially viewed as just another one of many new approaches that had been tried that would disappear in twelve months. When the prototype CCM was sent to staff in LBI for comment, most ATO staff ignored the document. Some ATO officers thought that the ATO was going soft on taxpayers and resisted it as a result.

But a lot of people thought it was about falling in love with multinationals, or “I’m going to have to fall in love with a group tax manager now”. Being weak, soft, touchy-feely stuff, “oh so what - we are not going to do any more audits now? We are going gutless” (ATO employee).

Furthermore, some ATO staff held similar concerns to large business taxpayers that were raised above that it was too theoretical and that it was difficult to see how it could be implemented in their daily work (Australian Taxation Office 2002; Wirth 2004a). The ATO set about changing the perception of auditors by promoting the CCM as a means to enhancing their role rather than diminishing it. Consequently new techniques were developed to support the CCM. SBI developed real time reviews and LBI adopted client risk reviews. These were required to bridge the gap between the education and services at the base of the pyramid and the deterrence measures at the peak. These measures also gave ATO staff a means of implementing the CCM in a practical manner in their day-to-day work. Many ATO officers found the concepts and approach of the CCM foreign, therefore one challenge was to open their minds to the benefits associated with the CCM and that a change in approach could improve compliance.

But it was actually about challenges to people’s thinking to some degree, that if you worked for 20 years doing investigations ... to think you actually could get better compliance by doing something different ... some people found that a bit of a struggle but the vast majority of people just saw the benefit of it (ATO employee).

To achieve wider acceptance, the CCM was promoted via workshops and seminars through SBI and LBI. Since Commissioner Carmody’s support was unwavering, he allowed a handful of ATO officers who were involved in the CCM’s development to travel among many ATO offices giving seminars and training sessions to teach staff about it and to encourage its use. In SBI, these staff became known as translators acting as a bridge between the top and operational levels of the ATO and explained its operation. They were also chosen because of their potential to influence others. Similar workshops were held within LBI. Thus there was an active attempt to use discourse to promote the CCM. Some ATO officers made a firm commitment to promote the CCM and speak about it positively at every opportunity.

We’d actually make people sign up to a process to say that they were on board and they would do all within their power to talk to people about it, listen to stuff that was going on, jump in and correct misapprehensions, spread the word ... (ATO employee).

These workshops were not pleasant for the facilitators since some ATO staff used discourse to voice their strong resistance using colourful discourse to resist.

They [the workshops] were torrid, torrid ... there was one branch office where they were always **super** aggressive. That's where they actually called out "You're a w****r!", like abuse was hurled out at me (ATO employee).

The torrents of abuse that the CCM generated began to dissipate as resistant ATO officers were slowly convinced by others and through the persistence of those conducting the seminars and workshops. Success stories, another form of discourse, fuelled acceptance of the CCM in SBI. These stories were written up in staff newsletters and their circulation meant that many would have read about the CCM being portrayed positively. Suddenly, the promotion and positive discussion of the CCM began to achieve critical mass and opposition to its adoption waned.

... and then suddenly "Holy s**t, it's taking off" and everyone wanted to jump on the bandwagon and have a piece of it, which they did (ATO employee).

One unique occurrence in LBI was the engagement of large business taxpayers to help promote the CCM in an indirect way by asking ATO officers about it (Australian Taxation Office 2002; Wirth 2004a). In this way, large business was co-opted into keeping the discourse about the CCM alive and they did so since they were keen to adopt it. The persistence allowed a few who saw merit in the CCM to express their views and the CCM slowly began to be accepted. In one meeting, an ATO officer expressed positive sentiment regarding the CCM:

... the tone of the whole session changed after that, and a few of the others actually said "Well actually, come to think of it, there's a bit over here on this page where I thought he might have a good point" (ATO employee).

After all the workshops and discussion with large business, the final CCM for large business was updated and released in November 2000 in a paper entitled *Cooperative Compliance: Working with Large Business in the New Tax System* (Commonwealth of Australia 2000).

6. IMPLICATIONS

As discussed above, one benefit of historical research regarding the CCM is that it can provide guidance and direction with respect to tax compliance policy and administration (Parker 1997, 1999; Carson & Carson 1998). Since discourse features so heavily in the CCM's development and adoption, this section will discuss certain policy implications of it.

Enhancing relationships with taxpayers continues to be a key goal for the ATO as it aims to reinvent itself and improve taxpayers' experience with the tax system (Olesen 2013; Hayes 2014). However the CCM appears to advocate a 'hands off' approach for most taxpayers due to the assumption that most are compliant and only need education and service provision to help them to comply. Ironically, the CCM appears to favour discourse predominantly with those taxpayers with whom the ATO is in dispute. The emphasis on administrative efficiency (Whait 2012) has also meant that the ATO targets its resources toward only noncompliant taxpayers only. It could be alternatively argued that the ATO ought to target its resources in building relationships with those taxpayers with whom relationships are likely to improve. It is possible that

an investment in improving relationships with compliant taxpayers will make it easier to resolve any future dispute with them thereby reducing costs. Scope therefore exists for the ATO to increase its discourse with compliant taxpayers with the aim of enhancing relationships and improving understanding. This will require real discourse to take place in addition to education and services and resources ought to be set aside for this purpose. However, since building relationships may not be regarded as an efficient use of resources (in the short term at least), there may be a similar trade-off between the two as there is between administrative efficiency and administrative equity as discussed by Whait (2012).

Despite this, there are a number of associated benefits that may arise from improving relationships with compliant taxpayers and allocating resources to that end. The ATO may learn more regarding taxpayer compliance issues and improve its service and education offerings accordingly. Such issues may arise due to the complexity of the tax system, a lack of clarity in the law, issues with information technology systems, issues with tax agents, issues with tax return forms or indeed a multitude of concerns. Effectively dealing with these issues will help to develop mutual trust between the ATO and taxpayers. While the ATO may not be directly responsible for all of these concerns, particularly regarding tax law complexity, it can feed these concerns to Treasury. Engaging in this discourse with taxpayers may enable the ATO to obtain a richer understanding regarding the processes involved in taxpayer compliance as it is essentially equivalent to a qualitative approach.

Discourse, relationships and understanding are two-sided and this may also be beneficial to the ATO. Through discourse taxpayers will begin to understand and provide feedback on the ATO's operations such as this, for example, associated with risk management. Taxpayers have recently been frustrated by a lack of understanding between regarding risk management and it necessitates an inquiry by the Inspector General of Taxation to shed light in that area (Commonwealth of Australia 2013). Taxpayers who desire to be voluntarily compliant will learn more regarding what it means to comply. As mutual trust and understanding develop with improved relationships, the administration of the tax system may progressively improve as it functions to serve those the majority of taxpayers. The JCPA inquiry *An Assessment of Tax* was critical of the ATO in the early 1990s since it had come to ignore the people that it was meant to serve (Commonwealth of Australia 1993). On the other hand, taxpayers' expectations of the ATO may become more reasonable as they begin to understand the nature and complexity of tax administration. A tax system based on discourse leading to understanding and improved relationships may help the ATO to avoid such criticism in the future.

In a similar manner to personal relationships, those between taxpayers and the ATO require continual effort and time to maintain and are likely to be inconsistent. Some relationships are always likely to be poor as will be the case with disengaged taxpayers. One cause of relationship breakdown may be a lack of clarity in the law. Australia's new Tax Commissioner, Chris Jordan, refers to the extensive level of discourse taking place between the ATO and large business when there is a disagreement in the operation of law which results in both parties in a seemingly never-ending exchange of views with no likelihood of agreement (Dugdale 2013). With both parties apparently using discourse in an attempt to persuade the other, another means to break the deadlock appears to be required. Commissioner Jordan's proposal to utilise dispute resolution practices more effectively (Dugdale 2013; Hayes

2014) appears to be a worthwhile course of action. It is possible, however, that large business will continue to engage in dialogue without resolution unless there is further clarity in the law. Such an example illustrates how discourse may be used as a stumbling block rather than for understanding. Therefore, at some stage, appropriate court proceedings or legislative change may be required to provide taxpayers and the ATO with that certainty. Healthy relationships are not without disagreement at times, therefore court proceeding ought to not necessarily be regarded as indications of a poor relationship.

That discourse was so instrumental to the CCM's acceptance within the ATO suggests that discourse ought to continue within it regarding compliance issues and taxpayer behaviour. Not only is understanding between the ATO and taxpayers important but it is also important that understanding develops and improves among ATO staff. This can help to galvanise staff in the goal of improving compliance, sharing techniques and experiences and improving morale generally. Discourse among the ATO staff in different market segments can help to break down any silos that exist.

7. CONCLUSION

This chapter has discussed how the CCM came to be developed and adopted and how discourse played a major role in this process for understanding and relationship improvement. Prior to the CCM's development, discourse was used to gauge whether ATO staff would accept and relate to the concepts of John and Valerie Braithwaite in the hope of changing the ATO and bringing the *Taxpayers' Charter* to life. Their work was also regarded as a means to change the community's perception regarding the cash economy. The CCM was then presented to senior management including Commissioner Carmody who advocated for its adoption. Thus it was likely decided during the time of the first CETF to adopt the CCM for the ATO even before the CETF had been exposed to it. After Valerie Braithwaite presented it to the CETF, it was recommended for use in the cash economy, SBI and was adapted for LBI.

While taxpayers were largely supportive of the CCM, many within the ATO were threatened and they did not want to be regarded as going soft on taxpayers. However, over time, many auditors began to see that their role was enhanced by the CCM, not diminished. The ability of discourse to create mutual understanding was critical in this regard since persistence of ATO staff who conducted workshops and seminars and produced pamphlets and booklets slowly broke down the resistance. Through this discourse, some who had previously been resistant began to see merit in the approach. When these individuals expressed their support for the CCM, the resistance then began to dissipate.

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The internal costs of VAT compliance: Evidence from Australia and the United Kingdom and suggestions for mitigation

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Abstract

Existing literature has established the regressive nature of tax compliance costs, and in particular, the compliance costs associated with indirect taxes such as value added taxes (VAT) (known in Australia as Goods and Services Tax (GST)). Costs of compliance impact on the willingness of taxpayers to comply; they influence the relationship between taxpayers and the tax authority; and they also impact on the trust relationship in tax administration. The small business sector is a key player in the tax system and is critically important to maintaining the integrity of the system and cooperation between business and the revenue authority.

This article focuses on one specific aspect of tax compliance costs: the internal (time) costs of compliance borne in the small business sector in relation to VAT/GST. It notes how such compliance costs vary significantly between Australia and the United Kingdom (UK), both of which have been the subject of recent detailed analysis. The article examines possible causes for the variations in internal tax compliance time spent on dealing with the VAT/GST that are evident in these comparable regimes. If certain design features of a VAT/GST system trigger compliance costs, changes to the design that might alleviate those costs should be considered.

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1. INTRODUCTION

Compliance costs studies in relation to taxation date back over 30 years. Such studies have established the regressive nature of tax compliance costs, and in particular the compliance costs associated with indirect taxes such as value added taxes (VAT).⁵ Costs of compliance affect the willingness of taxpayers to comply; influence the relationship between taxpayers and the tax authority; and also impact on the trust relationship in tax administration. The small business sector is a key player in the tax system and is critically important to maintaining the integrity of the system and cooperation between business and the revenue authority.

This article focuses on the internal (time) costs of compliance imposed on owners and managers in the small business sector, and considers possible reasons as to why such compliance costs vary between the UK and Australia in relation to VAT/GST. Given that the internal time costs of the entrepreneur are such an important factor for small businesses (typically such costs comprise about two thirds of all tax compliance costs for small business operators), the opportunity costs of tax compliance may be disproportionately large and constitute a real impediment to small business growth and sustainability in those countries where system design is flawed.

The remainder of the article proceeds as follows. Section 2 provides background and context through a brief review of the literature. Findings and concerns raised by compliance costs studies will then be addressed, with particular attention paid to a recent study that found that compared to the UK, Australian small businesses incur significantly higher internal tax compliance costs in relation to VAT/GST.⁶ The authors identify design factors associated with VAT/GST compliance that are potential significant causes of compliance costs. These are: registration; calculation of liability; lodgement of returns; and obtaining advice. Sections 3 to 6 of the article will then examine these identified factors in the context of both the UK VAT and Australian GST systems, in order to determine whether there are significant differences in the design of the two tax regimes. If differences can be identified, they may help explain the higher compliance costs borne by Australian small business taxpayers. As compliance costs can affect the willingness of taxpayers to comply with their relevant tax obligations, reforms that might alleviate those costs should be considered by the relevant revenue authority, and will be addressed in this article.

2. BACKGROUND

2.1 Overview of VAT/GST

With the exception of the United States, all OECD member countries use VAT/GST as a broad-based consumption tax.⁷ Whilst Australia did not introduce a GST until

⁵ Evans, C (2008) 'Taxation compliance and administrative costs: An overview' in M Lang et al (eds), *Tax compliance costs for companies in an enlarged European Community*, 457-459.

⁶ Evans C, Hansford A, Hasseldine J, Lignier P, Smulders S and Vaillancourt F (2014) 'Small business and tax compliance costs: A cross-country study of managerial benefits and tax concessions', 12(2) *eJournal of Tax Research* pp. 453-482.

⁷ OECD (2012) *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, 8.

2000, VAT has existed in the UK since 1973.⁸ Despite some differences in terminology, both taxes operate in largely the same way. VAT/GST is payable on taxable supplies (which includes the supply of goods and services),⁹ and an entitlement to input tax credits arises on acquisitions acquired as part of carrying on a business.¹⁰ For a supply to be a taxable supply, the supplier must be registered or be required to be registered for VAT/GST.¹¹ Similarly, input tax credits will not be available to an entity unless the entity is registered or required to be registered for VAT/GST.¹²

In both countries, VAT/GST contributes significantly to total tax receipts, making up the most significant portion of tax revenue after income tax. In 2010-11, VAT made up 19 per cent of total tax receipts in the UK (compared to 64% of tax receipts from income tax).¹³ In the same year in Australia, GST revenue (excluding customs duty) comprised 15.43 per cent of Australia's tax revenue. (Income tax on both individuals and corporations comprised 72.11%.)¹⁴ Considering the importance of VAT/GST as a form of tax revenue in both countries, ensuring taxpayers comply with their obligations is an area of concern for taxation authorities.

One measure of the extent to which taxpayers are complying with their obligations is the amount of the 'tax gap'.¹⁵ Broadly, the tax gap can be defined as the difference between the tax revenue that was collected by a revenue authority and the tax revenue that would have been collected if taxpayers had fully complied with their taxation obligations.¹⁶ As defined by the Australian Taxation Office (ATO): "the tax gap is an estimate of the level of theoretical tax losses through non-reporting of tax by businesses through a failure to register or failure to lodge returns, net under-reporting of tax obligations or over-claiming of refunds".¹⁷ While it is noted that there are conceptual difficulties in measuring tax gaps,¹⁸ both the ATO and HM Revenue and Customs (HMRC) publish estimates of the tax gap in relation to VAT/GST, shown in Tables 1 and 2 below.

⁸ OECD (2012) *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, 69.

⁹ *Value Added Tax 1994* (UK), s 4; *A New Tax System (Goods and Services Tax Act) 2000* (Cth), s 7-1.

¹⁰ *Value Added Tax 1994* (UK), s 26; *A New Tax System (Goods and Services Tax Act) 2000* (Cth), s 7-1.

¹¹ *Value Added Tax 1994* (UK), ss 3, 4; *A New Tax System (Goods and Services Tax Act) 2000* (Cth), s 9-5.

¹² *Value Added Tax 1994* (UK), s 26; *A New Tax System (Goods and Services Tax Act) 2000* (Cth), s 11-5.

¹³ HM Revenue and Customs (2014) *HMRC Tax and NIC Receipts* HMRC Knowledge Analysis and Intelligence Data Policy and Coordination, 3. Income tax includes income tax, capital gains tax and national insurance contributions for individuals, and corporations tax.

¹⁴ Australian Taxation Office (2013) *Taxation Statistics 2010-11* Commonwealth of Australia, 7-8.

¹⁵ Australian Taxation Office (2012) *Measuring tax gaps in Australia for the GST and LCT* Commonwealth of Australia, 1.

¹⁶ See for example: Villios, S (2011) 'Measuring the tax gap of business taxpayers in Australia' 21(1) *Revenue Law Journal* 1; McManus, J and Warren, N (2006) 'The Case for Measuring Tax Gap' 4(1) *eJournal of Tax Research* 61.

¹⁷ Australian Taxation Office (2012) *Measuring tax gaps in Australia for the GST and LCT* Commonwealth of Australia, 2.

¹⁸ Gemmell, N and Hasseldine, J (2014) 'Taxpayers' behavioral responses and measures of tax compliance 'gaps': A critique and a new measure' 35(3) *Fiscal Studies* p. 275-296.

Table 1: United Kingdom – estimated VAT gap as a percentage of VAT revenue¹⁹

Year	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
VAT Gap	11.2%	14.4%	12.9%	11.7%	14.2%	11.6%	10.4%	10.4%	10.9%
The higher than average tax gap in 2005-06 was due to an increase in missing trader intra-community (carousel) fraud. In 2008-09, the increase can be attributed to unpaid VAT debts as a result of the global financial crisis. ²⁰									

Table 2: Australia – estimated GST gap as a percentage of GST revenue²¹

Year	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-10*
GST Gap	9.6%	9.2%	7.5%	8.3%	6.4%	6.7%	8.1%	6.9%
* The GST gap increased in 2008-09 before a significant fall in 2009-10. The figure shown in the table is an average of these two years. According to the ATO, the rise and fall in the GST gap for this two year period was due to timing differences rather than significant shifts in compliance. “Therefore in reporting the GST gap we have averaged the two-year period to ensure we give a more accurate reflection of the underlying trend in the GST gap”. ²²								

As non-compliance increases, so too does the tax gap.²³ There are numerous factors that can impact on the extent that taxpayers comply with their obligations. In terms of deliberate non-compliance, factors such as the rate of tax, the probability of audit or other enforcement activity and the severity of penalties may all play a role.²⁴ However, whilst non-compliance can be a result of intentional tax avoidance or evasion, it can also be unintentional – caused by taxpayers making honest errors or misinterpreting the law.²⁵ In this vein, Nina Olson (the IRS National Taxpayer Advocate) has stated: “Understanding the causes of a particular form of noncompliance may enable the IRS to identify solutions that do not require it to expend enforcement resources. For example, if the cause of noncompliance is tax law complexity (‘unknowing’ noncompliance), the most effective approach might be legislative reform”.²⁶ In the Australian context, McKerchar undertook significant research to determine causes of unintentional non-compliance, and in particular the impact of tax complexity on such non-compliance. She stated: “The effect of

¹⁹ HM Revenue & Customs (2014) *Second Estimate of the VAT Gap for 2012-13*, available online: <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/292860/Second_estimate_of_the_VAT_gap_for_2012-13.pdf>.

²⁰ Ibid.

²¹ Australian Taxation Office (2012) *Measuring tax gaps in Australia for the GST and LCT* Commonwealth of Australia, 3.

²² Australian Taxation Office (2012) *Measuring tax gaps in Australia for the GST and LCT* Commonwealth of Australia, 2.

²³ McKerchar, M (2003) ‘The impact of complexity upon tax compliance: A study of Australian personal taxpayers’, *Australian Tax Research Foundation*, 17.

²⁴ Witte, A and Woodbury, D (1983) ‘What We Know About the Factors Affecting Compliance with the Tax Laws’ in Sawicki, P (Ed.) *Income Tax Compliance: A Report of the ABA of Taxation Invitational Conference on Tax Compliance*, ABA, Washington DC: ABA, 133-148.

²⁵ Australian Taxation Office (2012) *Measuring tax gaps in Australia for the GST and LCT* Commonwealth of Australia, 2. (LCT stands for Luxury Car Tax).

²⁶ Olson, N (2009) ‘Minding the gap: a ten-step program for better tax compliance’, 20 *Stanford Law & Policy Review* 7, 7-36, 15.

complexity was directly related to compliance costs and that this in turn had an effect on personal taxpayers' commitment to compliance (which was found to be high).²⁷ Similarly, in the UK, Hansford and Hasseldine noted that small businesses may lack access to professional advice and may therefore not understand their compliance obligations.²⁸ Thus the tax gap and/or higher than necessary tax compliance costs may be a result of complexity of the VAT/GST law in a jurisdiction.

This article will now turn to a brief discussion of compliance costs studies, including recent evidence in relation to compliance costs associated with indirect taxes in the UK and Australia.

2.2 Compliance costs

Taxation compliance costs can be defined as: "those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax".²⁹ Various studies in relation to taxation compliance costs undertaken by Sandford found that such costs were regressive – that is, they have a larger impact on smaller businesses relative to the size of the business.³⁰

When the GST debate was taking place in Australia in the mid-to-late 1990s, Evans and Walpole noted that little attention had been paid to compliance costs associated with the tax.³¹ This was despite the fact that around the same time, the Australian government was recognising the importance of taxation compliance costs to businesses. Evans and Walpole reviewed compliance cost studies in relation to VAT/GST undertaken in five different countries, concluding: "the incidence of compliance costs in relation to trader turnover is broadly consistent between the United Kingdom, Germany, the Netherlands, Canada and New Zealand. The research shows that the compliance costs of the VAT/GST are severely regressive, and they may be more so than other business taxes".³²

A recent report by Barbone, Bird and Vázquez-Caro provides an extensive review of the literature in relation to VAT/GST compliance costs.³³ Barbone et al confirms the findings of Evans³⁴ that compliance costs are high and significant, that they are

²⁷ McKerchar, M (2007) 'Tax complexity and its impact on tax compliance and tax administration in Australia' *The IRS Research Bulletin* 185-204, 193. The study referred to was: Margaret McKerchar (2003) *The impact of complexity upon tax compliance: A study of Australian personal taxpayers* Australian Tax Research Foundation.

²⁸ Hansford, A and Hasseldine, J (2012) 'Tax compliance costs for small and medium sized enterprises (SMEs): the case of the UK' *eJournal of Tax Research* 10(2), 288-303, 290.

²⁹ Sandford, C, Godwin, M and Hardwick, P (1989) *Administrative and Compliance Costs of Taxation*, Bath: Fiscal Publications, 10.

³⁰ Ibid.

³¹ Evans, C. and Walpole, M. (1996-97) 'The Hidden Costs of a GST – An International Perspective', *Policy*, 3.

³² Ibid, 9-10.

³³ Barbone, L, Bird, R and Vazquez-Caro, J (2012) *The costs of VAT: A review of the literature*, CASE Network Reports No 106/2012, Warsaw, 8.

³⁴ Evans, C (2008) 'Taxation compliance and administrative costs: An overview' in M Lang et al (eds), *Tax compliance costs for companies in an enlarged European Community*, 457-459.

regressive and that they are not reducing over time.³⁵ Based on the past studies, they conclude: “The regressivity of the compliance burden of taxation, and VAT in particular, which can be taken as definitively established in the literature, in particular stems from the large diseconomies of scale involved in complying with tax requirements, together with the learning curve effect that militates strongly against small firms”.³⁶

Despite the agreed consensus in the literature that compliance costs (particularly those related to VAT/GST) are regressive, the amount of VAT/GST compliance costs as a percentage of total taxation compliance costs differs significantly between countries. Empirical studies carried out in 2010-11 across four countries (including the United Kingdom and Australia) collected and collated data about the levels of compliance costs experienced by small businesses. The studies, which utilised broadly similar survey instruments, compared internal and external tax compliance costs incurred by small businesses across different taxes.³⁷ For the purposes of the surveys, internal compliance costs were defined as “costs of labour/time consumed in completion of tax activities”.³⁸ (These are in contrast to external costs, which are the costs of “purchasing expertise”, such as external advisers.³⁹).

The results of the surveys indicated that internal compliance costs were higher than external compliance costs, which is consistent with previous research. Further, VAT/GST compliance costs comprised a significant percentage of total internal compliance costs,⁴⁰ with Hansford and Hasseldine stating in relation to the UK that “VAT compliance consumes a disproportionate amount of in house time”.⁴¹ Small businesses in the UK and Australia had broadly similar internal compliance costs (as a percentage of total compliance costs) – being 64 per cent for the UK and 68 per cent for Australia. However, a significant difference arose in relation to VAT/GST compliance costs. In the UK, 41 per cent of internal compliance costs were comprised of VAT compliance costs.⁴² In Australia, 58 per cent of internal compliance costs were due to GST compliance costs.⁴³

Sections 3 to 6 of this article will examine various characteristics of the VAT/GST systems in the UK and Australia, in order to identify differences in design that may explain the high GST internal compliance costs borne by Australian small businesses. The design factors that will be considered in more depth in this article include registration (Section 3); calculation processes (Section 4); lodgement processes (Section 5); and availability of advice and guidance (Section 6).

³⁵ Barbone et al., above n 33, 32.

³⁶ Ibid, 33.

³⁷ Evans C, Hansford A, Hasseldine J, Lignier P, Smulders S and Vaillancourt F, (2014) ‘Small business and tax compliance costs: A cross-country study of managerial benefits and tax concessions’, *eJournal of Tax Research* 12(2), 453-482

³⁸ Ibid, 9.

³⁹ Ibid.

⁴⁰ Ibid

⁴¹ Hansford and Hasseldine, above n 28, 300.

⁴² Ibid, 295; Evans et al., above n 37, 9.

⁴³ Ibid

3. REGISTRATION

3.1 Registration threshold

Both the UK and Australia have registration thresholds for VAT/GST purposes. Entities that are running businesses with annual turnover above the threshold are required to register. Businesses with turnover below the threshold can voluntarily register.⁴⁴

In the UK, businesses that are entitled to register for VAT include those run by individuals, in partnership, as a company, a club, an association, a charity and any other organisation or group of people acting together under a particular name, such as an educational or health institution, exhibition, conference, a trust and a Local Authority.⁴⁵

Turnover determines whether businesses are required to register and this figure regularly changes, with the revised figure announced in the Budget statement each year. Businesses supplying goods or services within the UK with a turnover in excess of the current threshold of £81,000⁴⁶ (previously £79,000) must register for VAT. If turnover exceeds the registration threshold temporarily then it may be possible to apply for exception from registration if it can be demonstrated to HMRC's satisfaction that in the longer term turnover will be below the de-registration threshold that currently stands at £79,000 (previously £77,000).⁴⁷

Businesses with turnover in excess of the registration threshold that supply mainly zero-rated items may be able to apply for exemption from registration. It is up to HMRC to agree that the business is exempt from VAT registration on the understanding that any changes in the nature of the business must be informed to HMRC.⁴⁸ VAT turnover is allocated to each taxable person, be that an individual, partnership, limited company, and if the legal entity runs more than one business then the sales of all those businesses must normally be added together to determine whether the VAT registration threshold has been exceeded. HMRC decides whether there has been any artificial separation or fragmentation of one business into smaller parts in order to avoid registering for VAT. However, in circumstances where businesses are run through genuinely different legal entities, then there will be no requirement to combine the sales of those businesses to determine whether VAT registration is required.⁴⁹

In Australia, an entity (which is defined broadly as including individuals, bodies corporate, corporations, partnerships, unincorporated bodies, trusts, and

⁴⁴ *Value Added Tax Act 1994* (UK), Sch 1; *A New Tax System (Goods and Services Tax Act) 1999* (Cth), ss 23-5, 23-10.

⁴⁵ *Value Added Tax Act 1994* (UK), s 94.

⁴⁶ Applicable from 1 April 2014.

⁴⁷ *Value Added Tax Act 1994* (UK), s 3; HM Revenue and Customs *When to register for UK VAT*, available online <<http://www.hmrc.gov.uk/vat/start/register/when-to-register.htm>>. For historical VAT thresholds, see HM Revenue and Customs *Should I be registered for VAT: Notice 700/1 and 700/11 Supplement* (March 2014).

⁴⁸ *Value Added Tax Act 1994* (UK), Sch 1 s 14.

⁴⁹ HMRC (2012) *Statement of Practice - F4: Artificial separation of business activities*, available at: <http://www.hmrc.gov.uk/agents/sop.pdf#statement>.

superannuation funds)⁵⁰ is able to register for GST if they are carrying on an enterprise or intend to carry on an enterprise from a particular date.⁵¹ An enterprise is defined broadly as including (by way of example) an activity or series of activities done in the form of a business, trade, profession, vocation or calling.⁵² It does not include activities carried out as an employee, private recreational pursuits or hobbies, or activities carried out by individuals where there is no reasonable expectation of profit.⁵³

An entity that is carrying on an enterprise is required to be registered for GST if its current or projected GST turnover for a 12-month period is at or above the registration turnover threshold.⁵⁴ GST turnover is essentially gross business income, but excludes supplies that are input taxed,⁵⁵ supplies where no consideration is paid, supplies that are not made in connection with the enterprise, and supplies that are not connected with Australia.⁵⁶ When GST was first introduced in Australia, the registration turnover threshold was set at \$50,000 AUD (and \$100,000 AUD for non-profit entities).⁵⁷ The threshold was subsequently increased to \$75,000 AUD (with an associated increase to \$150,000 AUD for non-profit bodies), with effect from 1 July 2007.⁵⁸ Unlike in the UK, the GST registration threshold is not revised each year.

Whilst the UK and Australian thresholds sound similar when expressed in local currency, a significant difference is seen when the thresholds are converted to US Dollars based on the World Bank Purchasing Power Parity rates for 2013, with the UK threshold being more than double that of Australia, as shown in Table 3 below.

Table 3: Registration thresholds for VAT/GST – UK and Australia

Country	Currency	General Threshold		
		National currency	USD	Exchange rate ⁵⁹
United Kingdom	GBP	81,000	103,846	0.78
Australia	AUD	75,000	48,701	1.54

Using a similar conversion, the OECD noted that the UK threshold is the highest out of all OECD countries that have introduced a VAT-style consumption tax.⁶⁰

⁵⁰ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 29-45. “Entity” is defined in s 184-1. “You” is defined in s195-1 as applying to entities generally.

⁵¹ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 23-10.

⁵² *A New Tax System (Goods and Services Tax) 1999* (Cth), s 9-20(1) provides further examples.

⁵³ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 9-20(2).

⁵⁴ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 23-5. (Entities who are carrying on an enterprise but do not meet this threshold have the choice of whether or not to register for GST, see s 23-10).

⁵⁵ An input taxed supply is a supply where no GST is charged, but the supplier is not entitled to any input tax credits on acquisitions associated with the supply. Input taxed supplies are provided in Division 40.

⁵⁶ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 188-15.

⁵⁷ *A New Tax System (Goods and Services Tax) 1999* (Cth), s 23-15.

⁵⁸ *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth), regs 23-15-01; 23-15-02.

⁵⁹ World Bank Purchasing Power Parity rates, available at:
<<http://data.worldbank.org/indicator/PA.NUS.PRVT.PP>>.

Given the significant difference in thresholds, one reason for the higher compliance costs faced by Australian small businesses may be due to those at lower turnover levels being required to register. However, in both the UK and Australia, businesses below the threshold can voluntarily register. If businesses in both countries are registering for VAT/GST when they are not required to, it is unlikely that increasing the compulsory registration threshold would have any substantial impact in the number of businesses registered. For this reason, the extent of voluntary registrations is discussed in Section 3.2 below.

3.2 Number of registrations

In both countries, a substantial number of businesses choose to voluntarily register for VAT/GST. This can be seen in Table 4 below, which shows the total number of registered businesses and the percentage of registered businesses that are below the threshold.

⁶⁰ OECD (2012) *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, 84.

Table 4: Businesses voluntarily registered for VAT/GST (as a percentage of total VAT/GST registrations) – UK and Australia

Year	United Kingdom ⁶¹		Australia ⁶²	
	Total no. of registered businesses ⁶³	Percentage of businesses below threshold ⁶⁴	Total no. of registered businesses	Percentage of businesses below threshold
2007-08	2,051,080	43.29%	2,599,253 ⁶⁵	30.17% ⁶⁶
2008-09	2,070,690	42.59%	2,660,854 ⁶⁷	30.88% ⁶⁸
2009-10	2,020,180	44.31%	2,721,013 ⁶⁹	31.7% ⁷⁰
2010-11	1,997,160	43.10%	2,676,888 ⁷¹	37.2% ⁷²
2011-12	1,995,400	42.00%	2,723,733 ⁷³	N/A ⁷⁴
2012-13	2,000,650	43.20%	2,690,747 ⁷⁵	N/A ⁷⁶

Whilst a higher percentage of registrations in the UK are voluntary, this is not surprising considering the much higher threshold. (That is, if Australia had the same threshold as the UK, a greater number of businesses would fall below the compulsory registration threshold.)

Despite the number of voluntary registrations in the UK, the majority of businesses are unregistered, as shown in Table 5 below. Most recent figures indicate that approximately 40 per cent of UK businesses are registered for VAT. In contrast, over

⁶¹ As at 31 March each year.

⁶² As at 30 June each year.

⁶³ HMRC (2013) *Value Added Tax (VAT) Factsheet 2012-13*, Spreadsheet 2.7. Available at: <
<https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutyBulletins.aspx>>.

⁶⁴ Ibid.

⁶⁵ Australian Taxation Office (2008) *GST administration end-year performance 2007-08* Canberra: Commonwealth of Australia, 18.

⁶⁶ Ibid.

⁶⁷ Australian Taxation Office (2009) *GST administration end-year performance 2008-09* Canberra: Commonwealth of Australia, 13.

⁶⁸ Ibid.

⁶⁹ Australian Taxation Office (2010) *GST administration end-year performance 2009-10* Canberra: Commonwealth of Australia, 21.

⁷⁰ Ibid.

⁷¹ Australian Taxation Office (2011) *GST administration end-year performance 2010-11* Canberra: Commonwealth of Australia, 47.

⁷² Ibid.

⁷³ Australian Taxation Office (2013) *GST administration end-year performance 2011-12* Canberra: Commonwealth of Australia, 20.

⁷⁴ N/A = Data not available. This data is no longer contained in the GST administration performance reports.

⁷⁵ Australian Taxation Office (2013) *GST administration end-year performance 2012-13* Canberra: Commonwealth of Australia, 23.

⁷⁶ N/A = Data not available. This data is no longer contained in the GST administration performance reports.

90 per cent of Australian businesses are registered for GST. As shown in the table, there are a higher number of VAT/GST registrations in Australia than in the UK, despite the UK having a significantly higher total business population.

Table 5: Number of registered businesses as a percentage of total businesses – UK and Australia

Year	United Kingdom			Australia		
	Total no. of businesses (private sector) ⁷⁷	Businesses registered for VAT ⁷⁸	% of businesses registered for VAT/GST	Total no. of businesses ⁷⁹	Businesses registered for GST	% of businesses registered for VAT/GST
2010	4,448,765 ⁸⁰	2,093,000 ⁸¹	47.05%	2,859,435	2,721,013 ⁸²	95.16%
2011	4,542,765 ⁸³	2,060,000 ⁸⁴	45.35%	2,901,680	2,676,888 ⁸⁵	92.25%
2012	4,794,105 ⁸⁶	2,143,000 ⁸⁷	44.70%	2,957,540	2,723,733 ⁸⁸	92.09%
2013	4,895,655 ⁸⁹	2,156,000 ⁹⁰	44.04%	N/A	2,690,747 ⁹¹	N/A

The much higher proportion of businesses registering for GST in Australia compared to those registering for VAT in the UK seems to the authors to be significant, the

⁷⁷ As at 1 January each year.

⁷⁸ These figures are estimates and due to slight differences in methodology and dates, the figure will vary from those shown in Table 4.

⁷⁹ The total number of businesses has been calculated as the number of entities (individuals, partnerships, trusts and companies) that recorded business income in their income tax return for the relevant year, as shown in the ATO Taxation Statistics, available at: < <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2011-12/?anchor=income#income>>. Although the Australian Bureau of Statistics publishes “Count of Australian Businesses” (NAT 8165.0), businesses that are not registered for GST are excluded from that data.

⁸⁰ Department for Business Innovation & Skills (2011) *Statistical Release – Business population estimates for the UK and regions 2011* Sheffield: BIS, 1-2.

⁸¹ Ibid, 6.

⁸² Australian Taxation Office, above n 69.

⁸³ Department for Business Innovation & Skills (2011) *Statistical Release – Business population estimates for the UK and regions 2011* Sheffield: BIS, 2.

⁸⁴ Ibid, 6.

⁸⁵ Australian Taxation Office, above n 71.

⁸⁶ Department for Business Innovation & Skills (2012) *Statistical Release – Business population estimates for the UK and regions 2012* Sheffield: BIS, 3.

⁸⁷ Ibid, 7.

⁸⁸ Australian Taxation Office, above n 73.

⁸⁹ Department for Business Innovation & Skills (2013) *Statistical Release – Business population estimates for the UK and regions 2013* Sheffield: BIS, 3.

⁹⁰ Ibid, 7.

⁹¹ Australian Taxation Office, above n 75.

difference is so large. These figures raise the question as to why businesses voluntarily register for VAT/GST, and in particular, why do such a high number of Australian businesses register? In both countries, the reasons for registering (or not registering) appear to be similar.

One of the main reasons a business may not want to register for VAT/GST is the increased compliance costs. Businesses that voluntarily register have the same responsibilities as any other VAT/GST registered business and must keep all the required records, and complete and lodge required forms. (There are some concessions given in relation to how often such forms must be lodged, discussed in Section 4.)

Another disadvantage of registering is the increased costs to customers, as VAT/GST will need to be charged. However, if the 'customer' is also registered for VAT/GST and has acquired the goods/services in the course of their business, they will be able to claim back the tax that they have paid, and will not have to personally bear the cost. A number of online resources for small businesses suggest that if you are mainly going to be providing goods or services to VAT/GST registered businesses, you should register, even if it is not a requirement.⁹² There are a number of reasons for this.

First, by registering for VAT/GST, a business can claim back any tax they have paid on their business inputs. Second, a business that is below the threshold may want to register for VAT/GST for image purposes – that is, they may not want to advertise that their threshold is below the turnover level. A business that is registered may have more credibility, by appearing larger and more reliable than an unregistered business.⁹³ Third, a business that is close to the registration threshold may prefer to register so they do not continually have to check their expected turnover. Or, if they know that in the future their turnover will be above the threshold, they may not want to have to explain to customers why their prices have increased (as a result of being required to register and start charging VAT/GST). Finally, there may also be cash-flow advantages. VAT/GST is generally collected from the customer at the point of sale; however, it does not have to be remitted to the tax authority until a later date.⁹⁴

Whilst these reasons may explain why a business voluntarily registers for VAT/GST, it does not explain why such a high proportion of Australian businesses register compared to the UK. This may be explained by the process of registration, discussed in Section 3.3. That the number of registrants is high in Australia has, of course been noticed. Former Second Commissioner of Taxation Mr Bruce Quigley, who had

⁹² Kashflow Accounting Solutions (2014) *Should I register for VAT?*, available at: <<http://www.kashflow.com/should-i-register-for-vat/>>; Sage (2013) *Sage Blog* "Should I register for VAT?", available at: <<http://www.sage.co.uk/blog/index.php/2013/06/should-i-register-for-vat/>>.

⁹³ Ibid. Simply Business (2010) *VAT registration – is it right for my business?*, available at: <<http://www.simplybusiness.co.uk/knowledge/articles/2010/07/2010-07-06-VAT-registration---is-it-right-for-my-business/>>; Flying Solo (2010) *Should you register for GST?*, available at: <http://www.flyingsolo.com.au/finance/business-tax-tips/should-you-register-for-gst>.

⁹⁴ Tran-Nam, B and Glover, J (2002), 'Estimating the Transitional Compliance Costs of the GST in Australia: a Case Study Approach', *Australian Tax Forum*, 17(4): 499-536; Law, K (2014) *GST and cash flow management*, available at: <http://www.kpmg.com/au/en/issuesandinsights/articlespublications/tax-insights/pages/gst-cash-flow-management-10-march-2014.aspx>.

carriage of the introduction of GST, has publicly commented on this, and on the strain it imposed at the time of GST implementation.⁹⁵

3.3 Registration process

In both the UK and Australia, an entity must be carrying on a business / enterprise before it can register for VAT/GST. In both countries, there are registration requirements before an entity can carry on a business. In the UK, if the business is to be operated as a sole trader or a partnership, this involves registering for self-assessment with HMRC.⁹⁶ If the business is to be run as a company, once the company is incorporated with Companies House, it must obtain a Unique Taxpayer Reference from HMRC in order to be set up for Corporation Tax.⁹⁷ Regardless of how the business is to be operated, VAT registration is a separate process to the business registration process. For example, if you register for VAT via post, you need to complete form VAT 1 “Value Added Tax Application for Registration”.⁹⁸ If the business is being carried on as a partnership, form VAT 2 will also need to be completed “Value Added Tax Partnership Details”.⁹⁹ These are in addition to any forms that need to be completed to register for self-assessment or Corporation Tax. (Whilst most VAT registrations can be completed online, it is still a separate registration process.)

In Australia, whilst some requirements are similar to the UK, the process for registering for GST is more streamlined. All businesses are required to obtain an Australian Business Number (ABN) before commencing operations.¹⁰⁰ As noted by the ATO: “When you apply for an ABN you can also apply for the tax registrations you need”.¹⁰¹ This includes applying for a tax file number (TFN) (if required¹⁰²) and for GST. It is only if the business is to be carried on as a company that a separate registration may be necessary. If the company has not already been established, it will need to be incorporated with the Australian Securities and Investment Commission (ASIC) and obtain an Australian Company Number (ACN).

⁹⁵ Bruce Quigley, Keynote address ‘The Australian GST, its origins and its future’, *ATAX Annual GST Conference*, Brisbane, April 2014.

⁹⁶ UK Crown (2014) ‘Register your business in the UK’ *Set up a business in the UK*, available at: <<https://www.gov.uk/set-up-business-uk/register-your-business-in-the-uk>>; UK Crown (2014) *Set up a business partnership*, available at: <https://www.gov.uk/set-up-business-partnership>.

⁹⁷ UK Crown (2014) ‘Register your business in the UK’ *Set up a business in the UK*, available at: <<https://www.gov.uk/set-up-business-uk/register-your-business-in-the-uk>>; UK Crown (2014) ‘Set up your company for Corporation Tax’ *Set up a private limited company*, available at: <https://www.gov.uk/limited-company-formation/set-up-your-company-for-corporation-tax>.

⁹⁸ HMRC, *VAT 1 – Value Added Tax – Application for Registration*, available at: www.hmrc.gov.uk/forms/vat1.pdf.

⁹⁹ HMRC, *VAT 2 – Value Added Tax – Partnership Details*, available at: <<http://www.hmrc.gov.uk/forms/vat2.pdf>>.

¹⁰⁰ If GST registration is not required, it is not compulsory to have an ABN. However, if a business does not have an ABN, other businesses are required to withhold 46.5% tax from any payments and remit this to the ATO.

¹⁰¹ ATO (2013) *Register your new business*, available at: <<https://www.ato.gov.au/Business/Registration/Register-your-new-business/>>.

¹⁰² For example, most individuals would already have a TFN. If they are operating their business as a sole trader, a separate TFN is not required.

Essentially, if a person wants to start a business in the UK, they need to register their business and then register for VAT. In Australia, a business can register for GST as part of the business registration process. The combined ABN/GST registration process may explain why such a high percentage of Australian businesses are registered for GST. A person registering for an ABN may register for GST without giving it much thought, and without fully appreciating the compliance requirements that come with the registration, such as the process for calculating the correct amount of VAT/GST as well as lodgement requirements. These requirements are discussed in Sections 4 and 5 of the article.

4. CALCULATION PROCESSES

4.1 Tax base and rate

A VAT style tax is often defined as a broad-based consumption tax.¹⁰³ In an ideal form, there would be one rate of tax and few exemptions.¹⁰⁴ It is well established that exempting certain goods and services from consumption tax and/or applying different rates of tax increases the complexity of the system, which in turn leads to greater compliance costs.¹⁰⁵ Both the UK VAT and the Australian GST contain a number of exemptions. Certain goods and services are not subject to VAT/GST when supplied, but the supplier can still claim back any VAT/GST that was paid in relation to the supply. Such goods and services are referred to as zero-rated in the UK and GST-free in Australia.¹⁰⁶ Certain other goods and services (referred to as exempt in the UK and input-taxed in Australia) are not subject to VAT/GST when supplied, however the supplier cannot reclaim any tax that was paid in relation to the supply.¹⁰⁷ Further, in addition to zero-rated and exempt items, certain goods and services in the UK are subject to a reduced rate of VAT (5 per cent instead of the standard 20 per cent). (Whilst Australia's GST does contain exemptions, all goods and services that are subject to GST are subject to a standard 10 per cent rate).

The OECD has attempted to estimate the 'robustness' of consumption tax regimes through the calculation of a VAT revenue ratio (VRR), which they describe as follows:

The VRR measures countries' ability to optimise revenues from the potential tax base for VAT. In a 'pure' VAT regime, all final consumption expenditure would be subject to VAT at the standard rate. In theory, the closer the VAT system of a country is to the 'pure' VAT regime, the closer its VRR is to 1. Any other value – higher or lower – indicates deviation from a single tax rate applied on all final consumption or a failure to collect all tax due. A VRR close to 1 is taken as an indicator of a VAT bearing uniformly

¹⁰³ OECD (2014) *International VAT/GST Guidelines*, 5-6.

¹⁰⁴ Tait, A (1988) *Value Added Tax: International Practice and Problems* Washington DC: International Monetary Fund, 50.

¹⁰⁵ See for example: Commonwealth Treasury (2010) *Australia's Future Tax System* Canberra: Commonwealth of Australia, D2-1.

¹⁰⁶ *Value Added Tax Act 1994* (UK), s 30, Schedule 8; *A New Tax System (Goods and Services Tax) 1999* (Cth), s 9-30; Div 38.

¹⁰⁷ *Value Added Tax Act 1994* (UK), s 31, Schedule 9; *A New Tax System (Goods and Services Tax) 1999* (Cth), s 9-30; Div 40.

on a broad base with effective tax collection. On the other hand, a low VRR may indicate an erosion of the tax base at the standard rate and/or significant failures to collect tax due.¹⁰⁸

In 2010, the unweighted average VRR of OECD member countries was 0.55. Both the UK and Australia fell below this average – with VRRs of 0.47 and 0.52 respectively.¹⁰⁹ It is beyond the scope of this article to discuss in depth the various VAT/GST exemptions that exist in the UK and Australia. However, the similarity in VRRs would seem to indicate the consumption taxes in both countries suffer from complexity due to the existence of numerous exemptions. The higher internal GST compliance costs borne by Australian small businesses are therefore not explained by this design factor. If anything, if this design feature was being looked at in isolation, it would be expected that UK small businesses would have higher compliance costs due to the existence of more than one VAT rate.

4.2 Method of accounting

Both the UK and Australia allow certain taxpayers to use cash accounting (as opposed to accruals accounting). As the name suggests, taxpayers using cash accounting attribute VAT/GST to the period in which the payment was received, whereas under accrual accounting, VAT/GST is accounted for on the basis of the date of supply.¹¹⁰ In the UK, a business can use the Cash Accounting Scheme (CAS) if their annual VAT taxable turnover is less than £1.35 million.¹¹¹ A business that is using cash accounting can continue to do so until their VAT taxable turnover reaches £1.6 million.¹¹² The CAS is not available to taxpayers who are behind in the lodgement of VAT returns or the payment of VAT; or have been convicted of a VAT offence or charged a penalty for VAT evasion in the last year.¹¹³ For the year ended 31 March 2013, approximately 90 per cent of registered businesses would have been entitled to use cash accounting based on turnover.¹¹⁴ It is not known how many businesses used cash accounting, as this information does not need to be provided to HMRC.

In Australia, an entity may choose to adopt the cash basis if it is considered a small business entity;¹¹⁵ if it has GST turnover of less than \$2 million AUD;¹¹⁶ the entity accounts for income tax on a receipts (cash) basis; and the Commissioner has

¹⁰⁸ OECD (2010) *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, 108-109.

¹⁰⁹ OECD (2012) *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing, 107.

¹¹⁰ ATO (2013) 'Cash and non-cash accounting', *Fact Sheet for businesses with a GST obligation*, available online: <https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/bus13266n3136_052013.pdf>.

¹¹¹ USD \$1.73 million, converted using World Bank PPP as shown in Table 3.

¹¹² USD \$2.05 million, converted using World Bank PPP as shown in Table 3.

¹¹³ HM Revenue and Customs *Cash accounting scheme for VAT*, available online: <<http://www.hmrc.gov.uk/vat/start/schemes/cash.htm>>.

¹¹⁴ HM Revenue and Customs (2013) *Value Added Tax (VAT) Factsheet 2012-13*, Table 2.11, available online: <<https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutyBulletins.aspx>>.

¹¹⁵ Essentially, an entity with income of less than \$2 million AUD (USD \$1.3 million converted using World Bank PPP as shown in Table 3).

¹¹⁶ USD \$1.3 million converted using World Bank PPP as shown in Table 3.

approved the cash basis for the type of business that is carried on.¹¹⁷ An entity that does not meet these requirements may still apply to the Commissioner to get permission to account on a cash basis. The Commissioner will take into account the nature and size of the enterprise; the nature of the accounting system; value and volume of supplies and whether they are made on a cash or credit basis; whether there is circulating capital and consumables; the reliance (if any) on capital items; and whether the business has formal procedures for extending credit and recovering debts. Special rules exist to cover circumstances in which an entity changes from cash to accruals or vice versa.¹¹⁸ In the year ended 30 June 2011, 98.9 per cent of GST registrants would have been entitled to use cash base accounting (on the basis of GST turnover). Therefore, although the threshold for using cash accounting is higher in the UK, a higher proportion of Australian businesses are able to make use of it.

Whilst figures are not available as to the percentage of VAT/GST registered businesses that use cash accounting, it is not expected that choosing to use cash accounting over accruals (or vice versa) would result in any significant changes in compliance costs.

4.3 Concessional methods

As noted earlier, both the UK VAT and the Australian GST contain a number of exemptions (with the UK having the added complexity of both a standard and a reduced rate). Because of this, in both countries, there are a range of simplified accounting methods (SAMs) that can be used by small businesses if certain conditions are met. In the UK, the simplified methods can be used across different retail industries, however in Australia, the methods can only be used by food retailers who sell both GST-free and taxable food items.

4.3.1 Flat rate / business norms

One of the more widely used simplified schemes is known as the flat rate scheme in the UK and the business norms method in Australia. In the UK, businesses that have VAT taxable turnover of less than £150,000¹¹⁹ can apply a flat rate percentage¹²⁰ to total-VAT inclusive turnover. VAT cannot be reclaimed on purchases, as that has been taken into account in calculating the flat rate percentage.¹²¹ Once a business joins the scheme it can continue to use it until total business income is more than £230,000.¹²² The most recent HMRC VAT statistics indicate that approximately twenty percent of all VAT traders who are eligible to use the scheme do so.¹²³

¹¹⁷ *A New Tax System (Goods and Services Tax Act) 1999* (Cth), s 29-40.

¹¹⁸ *A New Tax System (Goods and Services Tax Act) 1999* (Cth), s 159-10; 159-15; 159-20; 159-25.

¹¹⁹ USD \$192,308 converted using World Bank PPP as shown in Table 3.

¹²⁰ The rate varies from 6 percent to 14.5 percent based on business sector.

¹²¹ HM Revenue and Customs *Flat rate scheme for VAT*, available online <<http://www.hmrc.gov.uk/vat/start/schemes/flat-rate.htm>>; HM Revenue and Customs *Flat rate scheme for small business: Notice 733* May 2013.

¹²² USD \$294,872 converted using World Bank PPP as shown in Table 3.

¹²³ HM Revenue and Customs (2013) *Value Added Tax (VAT) Factsheet 2012-13*, available online: <<https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutyBulletins.aspx>>.

Similarly, under the business norms method, Australian businesses of a certain type¹²⁴ with turnover of \$2 million or less¹²⁵ can estimate GST-free sales and purchases by applying a set percentage that has already been determined based on the type of business (the business norm) to total sales and purchases.¹²⁶ Independent research commissioned by the ATO in 2011 and conducted by Chant Link and Associates found that the business norms method was the most widely used out of all the Simplified Accounting Methods (SAMs) available to small business taxpayers. It was suggested that the Business Norms method be expanded to encompass a greater range of businesses.¹²⁷

4.3.2 Retail schemes

The UK has three simplified ‘retail schemes’ that are design to be used by small businesses that sell a high-volume of inexpensive items.¹²⁸ Whilst there is an annual turnover limit to use these schemes, it is extremely high, currently set at £130 million.¹²⁹ These schemes generally allow a business to determine the amount of sales or purchases (depending on the scheme) made at each tax rate (either zero, the reduced rate, or the standard rate) over a limited period of time during the year. The information gathered from the sample period can be applied for the remainder of the year.

In Australia, in addition to the business norms method, there are four other SAMs that can be used.¹³⁰ These are broadly similar to the UK retail schemes, but are more limited in scope – as they can only be used by food retailers with an annual turnover of less than \$2 million.¹³¹

The 2011 research by Chant Link & Associates found that although SAMs simplified the process for small business owners, (and as a result, reduced compliance costs) it “still represented a complex means of calculating GST, particularly in cases where Business Norms could not be used”.¹³² Therefore, whilst the wider availability of simplified methods in the UK (due to the higher turnover threshold and the application

¹²⁴ The business must be one of the following: Cake shops, continental delicatessen, convenience stores that prepare takeaway food but do not sell fuel or alcohol; convenience stores that do not prepare takeaway food and do not sell fuel or alcohol; Fresh fish retailers; health food shops; hot bread shops; pharmacies that also sell food; rural convenience stores.

¹²⁵ Turnover in this sense refers to SAM turnover – and only includes trading sales (sales of trading stock and other trading income). This converts to USD \$1.3 million using World Bank PPP as shown in Table 3.

¹²⁶ In addition to the turnover requirement, the business must be of a prescribed type: Cake shops, continental delicatessen, convenience stores that prepare takeaway food but do not sell fuel or alcohol; convenience stores that do not prepare takeaway food and do not sell fuel or alcohol; Fresh fish retailers; health food shops; hot bread shops; pharmacies that also sell food; rural convenience stores.

¹²⁷ Chant Link & Associates (2011) *A research report: GST and simplified accounting methods*, 22.

¹²⁸ Apportionment scheme, direct calculation scheme, and point of sale scheme. See HM Revenue and Customs *Retail schemes: Notice 727* (May 2012); HM Revenue and Customs *VAT retail schemes*, available online <<http://www.hmrc.gov.uk/vat/start/schemes/retail.htm>>.

¹²⁹ Ibid.

¹³⁰ Stock purchases method, Snapshot method, Sales percentage, Purchases snapshot.

¹³¹ USD \$1.3 million, converted using World Bank PPP as shown in Table 3.

¹³² Chant Link & Associates (2011) *A research report: GST and simplified accounting methods*, 16.

beyond the food industry) may have some impact on internal compliance costs, the difference is not expected to be significant.

5. LODGEMENT PROCESSES

5.1 Frequency of lodgement and payment

In the UK, a business that has a VAT turnover of less than £1.35¹³³ million pounds is eligible to make use of the Annual Accounting Scheme, which requires only one VAT return each year. However, VAT has to be paid on account throughout the year in nine monthly or three quarterly instalments. Once the VAT return has been completed any shortfall has to be paid to HMRC or alternatively a refund can be claimed if too much VAT has been paid. It is up to the business to elect for annual accounting and should not be considered for businesses that regularly reclaim VAT as the repayment due would only be made at the end of the year. According to recent HMRC statistics, whilst 90 per cent of VAT registered businesses were eligible to use the Annual Accounting Scheme, less than one percent chose to do so.¹³⁴

Businesses that are not eligible for the Annual Accounting Scheme (or choose not to use the scheme) must lodge VAT returns (and pay any VAT due) on a monthly basis. The returns and payments must be made electronically.¹³⁵

In Australia, a Business Activity Statement must be provided to the ATO for each tax period. Australia has a similar system available to businesses as the Annual Accounting Scheme, in that an entity that is not required to be registered for GST may elect to have an annual tax period, meaning they report and pay GST on an annual basis.¹³⁶ Additionally, small business taxpayers (entities with a turnover of less than \$2 million)¹³⁷ may choose to pay GST by instalments. Under this method, the ATO provides an estimated GST amount to be paid each quarter. A GST return is then lodged annually, with a reconciliation occurring between the instalments paid and actual amount due.¹³⁸ In 2010-11, 98.9 per cent of GST registrations were below the \$2 million threshold (approximately 2,649,420 businesses). In 2010-11, 223,828 businesses chose to report on an annual basis.¹³⁹

Even if an entity does not fall below the \$2 million threshold, most taxpayers are only required to lodge their BAS and pay GST quarterly. Unlike the UK, the only entities that are required to use monthly tax periods are those whose GST turnover is \$20 million¹⁴⁰ or more, or an entity that will carry on the enterprise in Australia for fewer

¹³³ USD \$1.73 million, converted using World Bank PPP as shown in Table 3.

¹³⁴ HM Revenue and Customs (2013) *Value Added Tax (VAT) Factsheet 2012-13*, available online: <<https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutyBulletins.aspx>>.

¹³⁵ HM Revenue and Customs (2013) *Deadlines for your VAT return and payment*, available online: <<http://www.hmrc.gov.uk/vat/managing/returns-accounts/deadlines.htm>>.

¹³⁶ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 151-5.

¹³⁷ USD \$1.3 million, converted using World Bank PPP as shown in Table 3.

¹³⁸ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) Division 162.

¹³⁹ Australian Taxation Office (2011) *GST administration end-year performance 2010-11* Canberra: Commonwealth of Australia, 47-48.

¹⁴⁰ USD \$13 million, converted using World Bank PPP as shown in Table 3.

than three months, or the entity has a history of failing to comply with their taxation obligations.¹⁴¹

Taxpayers with GST turnover of \$20 million or more must lodge their GST returns electronically.¹⁴² Taxpayers below this threshold have the option of lodging physical GST returns (that is, completing a return on paper and mailing it to the ATO), or electronically. Further, lodgement by telephone may be available if there are no amounts to report for the tax period.¹⁴³

Based on the above, frequency of lodgement cannot explain the higher internal compliance costs faced by Australian small businesses. Although less than 10 per cent of eligible businesses in Australia report on an annual basis, this is still a higher percentage than the percentage of businesses that use the annual accounting scheme in the UK. Further, in the UK, any business that does not use the annual accounting scheme must lodge monthly returns. Monthly reporting is only required in Australia for those entities with a turnover of over \$20 million. Therefore, the vast majority of UK taxpayers are lodging monthly returns, whilst the vast majority of Australian businesses are only required to lodge quarterly. If a higher frequency of lodgement increased compliance costs, it would be UK small businesses (rather than Australian small businesses) that would be adversely affected.

5.2 Correcting errors

In both the UK and Australia, the method of correcting an error on a VAT or GST return will vary based on the amount of the error. In the UK, errors below the error threshold can be corrected on the next VAT return that is lodged (within a four year period). However, errors must be reported to HMRC if they are above the threshold, or were deliberate.¹⁴⁴

Table 6: Methods of correcting VAT return errors (UK)

Error amount	Method of correcting	Description of methods
< £10,000 ¹⁴⁵	Method 1 or 2	Method 1: Error can be adjusted on the next VAT return
Between £10,000 and £50,000, ¹⁴⁶ but less than 1% of total outputs shown in current VAT return	Method 1 or 2	
Between £10,000 and £50,000, but exceed 1% of total outputs shown in current VAT return	Method 2	Method 2: Report the error to the HMRC using the form (or writing a letter that contains the information that would be included in the form).
Errors that were deliberate (regardless of amount)	Method 2	

¹⁴¹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 27-15. An entity may also elect to use monthly tax periods: s 27-10.

¹⁴² *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 31-25.

¹⁴³ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 31-15.

¹⁴⁴ HM Revenue and Customs (2013) *Notice 700/45 How to correct VAT errors and make adjustments or claims*.

¹⁴⁵ USD \$12,820, converted using World Bank PPP as shown in Table 3.

¹⁴⁶ Between USD \$12,820 and \$64,103, converted using World Bank PPP as shown in Table 3.

In Australia, if an error has been made on a BAS, a taxpayer can either lodge a revision to the activity statement, or correct the error on a later BAS if certain conditions are met. The error may have resulted in either an overstatement of GST liability (credit error) or an understatement of GST liability (debit error).

There is generally a four year statutory period of review once an activity statement is lodged. A credit error can be corrected in a BAS for a later tax period that starts within this period of review. If a debit error has been made, a value limit applies to the amount of the error that can be corrected in a later BAS. If the error (or sum of multiple errors) is above the debit error value limit, the original BAS must be revised. The debit limits are shown in Table 7 below. Different time limits also apply based on the amount of the error. Additionally, regardless of the amount of the error, it must be corrected in the first BAS after it is identified and must not be the result of recklessness or intentionally disregarding the GST law.¹⁴⁷

Table 7: Value limits and time limits for correcting an error in a subsequent BAS (Australia)

GST Turnover	Debit error value limit	Debit error time limit
Less than \$20 million ¹⁴⁸	Less than \$10,000 ¹⁴⁹	The debit error must be corrected on a BAS that is lodged within 18 months of the due date of the activity statement in which the error was made.
\$20 million to less than \$100 million ¹⁵⁰	Less than \$20,000 ¹⁵¹	The debit error must be corrected on a BAS that is lodged within 12 months of the due date of the activity statement in which the error was made.
\$100 million to less than \$500 million ¹⁵²	Less than \$40,000 ¹⁵³	
\$500 million to less than \$1 billion ¹⁵⁴	Less than \$80,000 ¹⁵⁵	
\$1 billion and over ¹⁵⁶	Less than \$450,000 ¹⁵⁷	

¹⁴⁷ *Goods and Services Tax: Correcting GST Errors Determination 2013* (Cth).

¹⁴⁸ USD \$13 million, converted using World Bank PPP as shown in Table 3.

¹⁴⁹ USD \$6,497, converted using World Bank PPP as shown in Table 3.

¹⁵⁰ Between USD \$13 million and USD \$64.9 million, converted using World Bank PPP as shown in Table 3.

¹⁵¹ USD \$12,897, converted using World Bank PPP as shown in Table 3.

¹⁵² Between USD \$64.9 million and USD \$324.7 million, converted using World Bank PPP as shown in Table 3.

¹⁵³ USD \$25,974, converted using World Bank PPP as shown in Table 3.

¹⁵⁴ Between USD \$324.7 million and USD \$649.4 million, converted using World Bank PPP as shown in Table 3.

¹⁵⁵ USD \$51,948, converted using World Bank PPP as shown in Table 3.

¹⁵⁶ Over USD \$649.4 million, converted using World Bank PPP as shown in Table 3.

¹⁵⁷ USD \$292,208, converted using World Bank PPP as shown in Table 3.

The vast majority of Australian businesses have a turnover of less than \$20 million, and would therefore be subject to the \$10,000 debit error value limit. Higher limits apply for all UK businesses. Whilst it is therefore easier for UK businesses to correct errors, it is unlikely that this explains the higher compliance costs borne by Australian small businesses, as it would only impact upon those businesses that had in fact made an error.

5.3 Costs associated with invoicing and record keeping

In the UK the method used to keep business records is at the discretion of the business. However, there is a clear requirement that the records must be easy to access in the event of a VAT inspection. Broadly the records required include sales and purchase invoices, credit and debit notes, self-billing agreements, goods given away or for private use, non-allowable purchases, goods exported and any adjustments or corrections made. In addition a VAT account is required and the objective of this is to provide the link between business records and the VAT Returns. The VAT account provides details of VAT owed on sales, on acquisitions from other European Union (EU) countries, any amount due under a reverse charge procedure and any owed following a correction or error adjustment. In addition it includes details of VAT that can be reclaimed on acquisitions from other EU countries and any entitlement following a correction or error adjustment. Business records that are relevant for VAT need to be retained for at least six years and they can be kept in either paper or electronic format. For businesses that trade internationally, documentation relating to foreign sales or purchases of goods or services, imports or exports outside the European Union (EU) or selling or buying within the EU must be retained. Generally a business must keep all its business records that are relevant for VAT for at least six years. If this causes it serious problems in terms of storage or costs, then HMRC may allow it to keep some records for a shorter period.¹⁵⁸

A VAT invoice must include certain information, such as an invoice number and date, the seller's name, VAT registration number and address, the customer's name and address, a description of the goods and services, any cash discount given, and the amount of VAT charged. Simplified VAT invoices, which do not require as much information, can be issued for retail sales of £250 or less (including VAT).¹⁵⁹

In Australia, record keeping requirements for indirect tax transactions are prescribed in the *Taxation Administration Act 1953* (Cth).¹⁶⁰ Records must be kept that explain all transactions that relate to (among others things) taxable supplies, taxable importations, creditable acquisitions, creditable importations, GST-free supplies and input taxed supplies.¹⁶¹ For most transactions, these records need to take the form of a tax invoice. If requested by the purchaser, a tax invoice must be issued within 28 days

¹⁵⁸ HM Revenue and Customs *Accounts and records for your VAT*, available online: <<http://www.hmrc.gov.uk/vat/managing/returns-accounts/accounts.htm>>.

¹⁵⁹ HM Revenue and Customs *VAT invoices: what they must show*, available online <<http://www.hmrc.gov.uk/vat/managing/charging/vat-invoices.htm>>.

¹⁶⁰ Schedule 1, Sub-division 382-A.

¹⁶¹ *Taxation Administration Act 1953* (Cth), Schedule 1, s 382-5.

for any taxable supplies of \$75 (excluding GST) or higher.¹⁶² For sales that are less than \$1,000, the tax invoice must contain enough information to clearly ascertain: the supplier's identity and ABN; what is supplied, the quantity and the price; whether each supply is a taxable supply; the date the document is issued; and the amount of GST (if any). It must also be clear that the document is intended to be a tax invoice. For sales of \$1,000 or more, the invoice must also contain the buyer's identity or ABN.¹⁶³ If a tax invoice includes both taxable and non-taxable (either GST-free or input taxed) supplies, the invoice must show each taxable sale, the amount of GST to be paid, and the total amount to be paid. Although a tax invoice is not required unless requested by the purchaser, the purchaser will not be able to claim an input tax credit for a creditable acquisition unless a valid tax invoice is held.¹⁶⁴ (For purchases of \$75.00 or less (excluding GST), records such as cash register receipts must be kept.)

The ATO's current guidance on what meets the requirements of a valid tax invoice is contained in GSTR 2013/1. In that ruling, the ATO summarises the importance of a tax invoice by stating: "The requirement to issue a tax invoice is a key component of the integrity of the GST system. It forms an essential part of the audit trail and is an important indicator that a taxable supply has been made."¹⁶⁵

Tax invoices and other GST records must be kept for five years after the relevant transaction has been completed.¹⁶⁶ Failure to comply with record-keeping requirements may result in the ATO imposing an administrative penalty of up to 20 penalty units.¹⁶⁷ The Commissioner of Taxation also has wide-ranging powers to gather information and access premises.¹⁶⁸ The Commissioner of Taxation may require taxpayers to provide information; give evidence; produce documents; and give full and free access to all buildings, books, documents etc.¹⁶⁹

As the invoicing and record keeping requirements in both countries are similar, this design factor would not explain the difference in compliance costs across UK and Australian small businesses. Further, similar records would be required for income / corporation tax purposes.

6. AVAILABILITY OF GUIDANCE

6.1 General guidance

The ATO and HMRC provide general information and guidance to taxpayers through a number of avenues. For example, general information is available through the ATO

¹⁶² *A New Tax System (Goods and Services Tax Act) 1999* (Cth) s 29-80 provides that a tax invoice is not required for a taxable supply for which the value does not exceed \$50, or a higher amount if specified by regulation. Reg 29-80-01 prescribes an amount of \$75.

¹⁶³ *A New Tax System (Goods and Services Tax Act) 1999* (Cth), s29-70.

¹⁶⁴ GSTR 2013/1 Goods and Services Tax: Tax Invoices, [5].

¹⁶⁵ *Ibid.*

¹⁶⁶ *Taxation Administration Act 1953* (Cth), Sch 1, s 382-5.

¹⁶⁷ *Taxation Administration Act 1953* (Cth), Sch 1, ss 288-25, 298-20.

¹⁶⁸ These powers are contained in the *Taxation Administration Act 1953* (Cth) and apply to both income tax and indirect taxes such as GST. See s353-10 Schedule 1 *Taxation Administration Act 1953* (Cth).

¹⁶⁹ *Taxation Administration Act 1953* (Cth), Sch 1, s 353-10.

and HMRC website.¹⁷⁰ Taxpayers can also contact the ATO and HMRC via phone, with HMRC stating that the “quickest and easiest” way to obtain guidance about a VAT issue is to ring the VAT helpline.¹⁷¹ A business can write to the HMRC for guidance if: they have reviewed the VAT information that is published online; have already contacted the VAT helpline; or can demonstrate that the HMRC’s guidance or the law are unclear.¹⁷²

The ATO answered almost 1.4 million calls in relation to GST in the 2011–12 year.¹⁷³ They also provide tailored assistance to small businesses to increase GST understanding and compliance, which includes assistance visits,¹⁷⁴ seminars,¹⁷⁵ outbound education calls, online support, and more recently, the introduction of webinars. In October 2011, the ATO introduced the Online Small Business Forum “which provides an opportunity for small business to interact directly with the ATO and learn from other small businesses.”¹⁷⁶

6.2 Formal guidance

If the law is unclear, a business can ask the HMRC to provide a ‘clearance’, which is written confirmation of HMRC’s view of how tax law is applied to a specific transaction or event. A business can then rely on the advice contained in the clearance.¹⁷⁷

Australia has a similar, but more formalised, system of taxation rulings which provide the Commissioner’s interpretation of a particular aspect of law. Taxpayers can also apply to the ATO for a private ruling, which is “a written expression of the Commissioner’s opinion on how a relevant provision applies, or would apply, to a particular entity in relation to a specified scheme, arrangement or transaction. It provides the taxpayer with advice on how the Commissioner will apply the tax law (which includes its administration or collection) to their particular circumstances”.¹⁷⁸ Private rulings are only binding in favour of the applicant. The tax rulings system is administered through the *Taxation Administration Act*.¹⁷⁹ However, until recently, there was no legislated rulings regime for GST, with these being issued under the

¹⁷⁰ Australian Taxation Office: <www.ato.gov.au>; HM Revenue and Customs: <www.hmrc.gov.uk>.

¹⁷¹ HM Revenue and Customs, “VAT Helpline” *VAT enquiries*, available at <http://search2.hmrc.gov.uk/kb5/hmrc/contactus/view.page?record=dMVkEC6liWE>.

¹⁷² HM Revenue and Customs *Questions about VAT: writing to HMRC to get them answered*, available online <<http://www.hmrc.gov.uk/vat/managing/problems/getting-answers.htm>>.

¹⁷³ Australian Taxation Office, *GST Administration Annual Performance Report 2011-12*, 45.

¹⁷⁴ 6,596 assistance visits were conducted in 2012-13: Australian Taxation Office (2013) *GST administration end-year performance 2012-13* Canberra: Commonwealth of Australia, 3. See also: Australian Taxation Office, *Free and helpful tax assistance – no strings attached*, available online <<http://www.ato.gov.au/Business/Business-Portal/In-detail/Help/Free-and-helpful-tax-assistance---no-stringsattached/>>.

¹⁷⁵ In 2012-13, 20,306 participants attended either seminars, webinars or workshops. Australian Taxation Office (2013) *GST administration end-year performance 2012-13* Canberra: Commonwealth of Australia, 3.

¹⁷⁶ Australian Taxation Office, *GST Administration Annual Performance Report 2011-12*, 23.

¹⁷⁷ HM Revenue and Customs *Other Non-Statutory Clearance Guidance*, available online <<http://www.hmrc.gov.uk/cap/nscg.htm>>.

¹⁷⁸ PS LA 2008/3 *Provision and guidance by the ATO*, [80].

¹⁷⁹ *Taxation Administration Act 1953* (Cth), Sch 1, Divs 357-359.

Commissioner's power of general administration. Without an express legislative framework, a taxpayer could not object to a ruling issued by the Commissioner. Rather, a taxpayer would have to request an assessment for the relevant tax period, and then object to that assessment.¹⁸⁰ In December 2008, the Board of Taxation recommended: "The income tax ruling system should be adopted for GST, luxury car tax and wine equalisation tax".¹⁸¹ As a result of this recommendation, indirect taxation rulings were brought into the *Taxation Administration Act* with effect from 1 July 2010.¹⁸²

It may have been anticipated that once GST rulings became covered by the legislative framework, requests for such rulings would increase, but this was not the case. The ATO noted in their 2011–12 *GST Administration Annual Performance Report* that the number of GST private binding rulings decreased from 1,397 in 2010–11 to 1,156 in 2011–12. However, they noted that the complexity of the requests was increasing, with many large businesses applying for private rulings in relation to topics such as financial supplies, property and construction. Additionally, the number of interpretative guidance requests (which the ATO defines as "general information that is not taxpayer specific"), increased from 3,314 requests in 2010–11 to 4,665 in 2011–12.¹⁸³

Lack of appropriate guidance from the relevant revenue authority may result in increased compliance costs for businesses. However, this would not explain the higher internal compliance costs borne by Australian small businesses. Both HMRC and the ATO provide informal and formal guidance, and it would appear that the ATO provides a greater amount of assistance and education to small businesses than is available in the UK.

7. CONCLUSION

There has already been significant research in relation to taxation compliance costs, with it being well-established that VAT/GST compliance costs are regressive.¹⁸⁴ However, recent research by Evans et al has established that the VAT compliance cost burden varies from country to country, with small businesses in Australia facing significantly higher internal compliance costs than those in the UK.¹⁸⁵ This article has sought to explain potential reasons for this difference, by focusing on particular aspects of the design of the UK VAT and Australian GST systems. Factors examined include registration threshold; calculation and lodgement processes; invoicing and record keeping requirements; special rules and accounting methods and the availability of helpful guidance from the revenue authority.

¹⁸⁰ Board of Taxation (2009) *Review of the legal framework for the administration of the goods and services tax* Canberra, Commonwealth of Australia, 72-73.

¹⁸¹ *Ibid*, 77.

¹⁸² *Taxation Administration Act 1953* (Cth), Sch 1, s 359-60.

¹⁸³ Australian Taxation Office, *GST Administration Annual Performance Report 2011-12*, 43.

¹⁸⁴ Barbone, L., Bird, R. and Vazquez-Caro, J. (2012) *The costs of VAT: A review of the literature*, CASE Network Reports No 106/2012, Warsaw, 8.

¹⁸⁵ Above n 6.

The comparative study of these design features has shown that many aspects of the UK VAT and Australian GST system are quite similar. This is particularly the case in relation to calculation and lodgement processes; invoicing and record keeping requirements; and the availability of guidance from the revenue authority. Those design factors would therefore not explain the difference in compliance costs.

The simplified accounting methods that have been discussed in this article apply to a broader range of businesses in the UK. In Australia, the simplified methods are limited to food retailers. Although this may have some impact on compliance costs, research conducted in Australia has shown that even the simplified accounting methods are complex and are not fully understood by businesses. It therefore seems unlikely that broadening the scope of these simplified accounting methods would cause a significant reduction in compliance costs.

It would appear that the main difference between the Australian GST and UK VAT system is the registration threshold, with the UK threshold currently set at more than double that of Australia when translated to constant currency terms. This difference will continue to increase as the UK threshold is indexed each year. As compliance costs are (highly) regressive, a lower threshold requirement will clearly have a significant impact, with a much greater number of small businesses being required to register. In both countries, a significant number of businesses below the threshold choose to voluntarily register. However, the majority of UK businesses remain unregistered for VAT, whereas over 90 percent of Australian businesses are registered for GST.

This article has identified reasons why businesses below the threshold in both countries may choose to register, and in the case of Australia, registering for GST is a more streamlined process. However, further research is needed to examine what is the driving cause of voluntary registration, as it is these voluntary registrants that are significantly affected by compliance costs. Opportunities for mitigation of the internal tax compliance costs burden in Australia through system and process re-design may then be highlighted. This could be an outcome that could be of considerable assistance to a time-poor small business sector always struggling under the burden of red tape imposed by the tax and other workplace obligations.

Information sharing by government agencies: The effect on the integrity of the tax system

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Abstract

Inland Revenue (IR) in New Zealand is currently increasing its information sharing activity with other government departments and agencies. This is in line with the New Zealand government's Better Public Services programme, and will improve the quality and speed of IR's services to business and individual customers, and support other government departments in meeting their objectives.

IR was aware that customers would be sensitive about how information sharing by government departments would affect their right to privacy. Therefore, to contribute to its policy development, IR researched views of the general public, businesses, cultural groups, tax agents and law groups in five studies conducted between 2010 and 2013. These studies included two multi-method studies involving quantitative surveys and qualitative interviews and three qualitative studies. This paper combines the findings from all five studies, with a particular emphasis on the three most recent studies:

1. Public perspectives on sharing of individuals' information to combat serious crime
2. Cultural perspectives from Māori, Pasifika and Asian communities on the sharing of individuals' information
3. Businesses and key informants' perspectives on the sharing of businesses' information.

The key findings were that:

- There was cautious support for cross-government information sharing, balanced with a strong desire for privacy, particularly regarding income and debt information.
- Participants' perceptions regarding the integrity of the tax system were most positively influenced by scenarios of IR being involved in information sharing targeting.
- Protecting public monies (especially from tax and benefit fraud).
- Ensuring customers receive their correct entitlements.
- Making it easier for customers to deal with their tax matters.
- The main concerns were regarding the potential misuse of information by government agencies, the accuracy of the information, and the security of government agencies' information handling processes.
- There was a desire for transparency of information sharing processes, and customers to be asked for consent for information sharing where feasible.

IR will use these findings in developing its policies and processes for increased information sharing with other government agencies, paying particular attention to the areas of risk to public perceptions of the integrity of the tax system.

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1. INTRODUCTION

Tax administrations worldwide have arrangements for sharing taxpayers' information with other government departments and agencies. Most of these arrangements are aimed at preventing fraudulent activities and ensuring taxpayers receive their correct social assistance entitlements, but there are also some arrangements for law enforcement, countering terrorism, and policy development purposes.⁵ By sharing information, tax administrations not only improve their own outcomes, they also contribute to other agencies' goals, thus improving the public service overall.

Government agencies are expected to continuously improve their services,⁶ and opportunities for information sharing are increasing as information technology advances. It follows that New Zealand's government departments and agencies, including Inland Revenue (IR), are developing new information sharing initiatives.

However, information sharing carries considerable concerns about privacy of information:

[Information sharing] runs counter to two of the most fundamental principles of data protection — that personal information should be collected directly from the individual to whom it pertains, and should only be used for the purpose for which it was collected [with limited exceptions]. Data sharing respects neither of these principles. Data sharing involves information that has been collected indirectly, and used for a purpose which may not have been intended at the time of the original collection.⁷

Countries have developed legislation to respond to the contradiction between information sharing and privacy protection. In New Zealand, the rules controlling IR's sharing of taxpayer information are detailed in the Tax Administration Act (1994) which allows IR to share taxpayer information only for very specific purposes. IR also observes the information privacy principles of New Zealand's Privacy Act (1993).⁸ In addition, IR considers whether the taxpayer would consider the information to be highly sensitive, and whether the information sharing will benefit the taxpayer, the recipient government agency, or the wider public. IR is aware that taxpayers are reluctant to relinquish any information privacy unless there are clear public benefits.⁹ IR needs to maintain taxpayers' confidence in its management and use of their information so taxpayers will continue to provide full and frank information to IR.¹⁰

Research to date on cross-government information sharing has shown that the public generally knows little about government agencies' practices for managing and sharing

⁵ Litmus (2011) (Litmus is a market research company).

⁶ The New Zealand Government launched a 'Better Public Services' initiative in 2012 (see State Services Commission, 2012) which included targets for improved digital services for government agency customers.

⁷ Wright, T. (1995).

⁸ While IR observes the principles in New Zealand's Privacy Act (1993), the information privacy rules in New Zealand's Tax Administration Act (1994) take priority. Some information sharing by IR runs counter to the Privacy Act principles but is allowed under the Tax Administration Act.

⁹ In UMR (2010), 61% of the general public was concerned about government agencies sharing information with other government agencies.

¹⁰ Braithwaite, V. (2003), Hazell, R. & Worthy, B. (2009), and Lips, M., O'Neill, R., & Eppel, E. (2009)

information,¹¹ and tends to overestimate how much information sharing currently happens.¹²

The studies showed consistently that people want government agencies to:

- share only the information that is strictly necessary¹³
- be transparent about their storage, management and sharing of customer information¹⁴
- use their information for the purposes intended¹⁵
- where possible, ask customers for their consent prior to their information being shared with other government agencies.¹⁶

In the context of increased e-services from government agencies, and changing information technology, IR wanted to understand how the public viewed IR's involvement in cross-government information sharing. This included key questions regarding the impact of information sharing on people's views of the integrity of the tax system.

2. METHOD

The core research questions underpinning all five studies included in this paper are:

1. What benefits and risks do people see in information sharing between government agencies?
2. What impact would an increase in information-sharing have on perceptions of the integrity of New Zealand's tax system?

Specific aims for each study are included in the methodology descriptions below.

2.1.1 *Study 1: Public attitudes to the sharing of personal information in the course of online public service provision*

Aim: To gather views of information sharing in the context of accessing public services online.

Methodology:

- Qualitative (focus groups), n=63 participants from the general public.
- Included a literature review conducted to provide points of comparison for the findings.

¹¹ Thomas, R. & Walport, M. (2008), and Whiddett, R., Hunter, I., Engelbrecht, J., & Handy, J. (2005).

¹² Ministry of Health (2010).

¹³ Lips et al. (2009) and Whiddett et al. (2005)

¹⁴ Ministry of Health (2010), Whiddett et al. (2005), and Thomas, R. & Walport, M. (2008).

¹⁵ Whiddett et al. (2005), and UMR (2010) (UMR is a market research company).

¹⁶ Thomas, R. & Walport, M. (2008), Department of Internal Affairs (2009), and Whiddett et al. (2005).

- Conducted in May and June 2010 (Lips, Eppel, Cunningham, & Hopkins-Burns).

2.1.2 Study 2: *The impact of change on the integrity of the tax system*

Aim: To explore the potential impact of increasingly joined-up government services, new information technology and changes in information sharing legislation on people's views of the integrity of the tax system.

Methodology:

- Qualitative (face-to-face interviews and focus groups), n=59 participants, included senior IR staff, tax and law experts, and a cross section of the general public.
- Included a literature review conducted to inform the research design.
- Conducted from April to June 2011 (Litmus).¹⁷

2.1.3 Study 3: *Cross-government information-sharing to identify, stop or disrupt serious crime*

Aim: To gather views on cross-government information sharing to stop serious crime.

Methodology:

- Qualitative (face-to-face and telephone interviews)
 - N=48 participants, included business owners, and representatives from government agencies, tax and law firms, media and communication technology fields.
 - Conducted in May and June 2012 (Litmus and the authors).
- Survey
 - Online survey, n=323 respondents, included business owners, government agencies, tax and law firms, media and communications.
 - Margin of error of $\pm 5.5\%$ (at 95% confidence level).¹⁸
 - Conducted in June and July 2012 (Litmus).

2.1.4 Study 4: *Information sharing between government agencies—cultural perspectives*

Aim: To explore cultural considerations for Māori,¹⁹ Pasifika and Asian peoples regarding cross-government information sharing.²⁰

¹⁷ Litmus is a market research company.

¹⁸ The response rate for this online survey was calculated as an 'adjusted rate' of 71%, using a calculation that removed all non-responses from the total sample (i.e. non-responses due to invalid email addresses or people self-selecting as not being the right person to complete the survey).

¹⁹ In accordance with New Zealand's Treaty of Waitangi, this study had more emphasis on the views of Māori than Pasifika and Asian participants. These are the three largest population groups in New Zealand apart from European New Zealanders.

²⁰ Note –This study was small-scale and exploratory, meaning that it is not intended to provide a full understanding of the views of Māori, Pasifika and Asian peoples on information sharing.

Methodology:

- Qualitative (face-to-face interviews and focus groups).
- N=38 participants, included community cultural representatives, IR staff, and members of relevant government organisations.
- Included a literature review to inform the research design.
- Conducted in February and April 2013 (the authors).

2.1.5 *Study 5: The impact on the integrity of the tax system of IR sharing information with other public sector organisations; NZ businesses' perspective*

Aim: To gather business owners' views on how sharing businesses' information across government affects perceptions of the integrity of the tax system.

Methodology:

- Qualitative
 - Face-to-face and telephone interviews, n=21 participants, included business owners, business 'leaders', professional business groups, and business 'service providers'
 - Conducted in February and March 2013 (Research New Zealand).²¹
- Telephone and online survey
 - N=573 respondents (business owners)
 - Response rate 21% (telephone survey only)²²
 - Margin of error of $\pm 4.7\%$ (at 95% confidence level)
 - Conducted in April and May 2013 (Research New Zealand).

2.2 Limitations of this research

The overall rationale for the five studies was to investigate attitudes regarding cross-government information sharing and the integrity of the tax system. These studies included discussion of the likely effects on behaviour, such as customers providing full and frank information to IR, but did not extend to investigating actual behavioural change.

All five studies involved qualitative research which is not generalizable, although the results are indicative for similar population groups and situations. Further, three studies incorporated focus groups, which tend to create 'group think' where participants' comments and possibly their opinions are shaped by the interaction with the other group participants.

²¹ Research New Zealand is a market research company.

²² The response rate for the online survey stage was not calculated. The survey involved sending a written invitation to the research sample to do the survey online, and then following-up after one week with a telephone call to offer to conduct the survey by telephone.

Both of the multi-method studies included online surveys which generally have low response rates due to a range of factors such as incorrect email addresses in the research sample, people opting out if they believe they are the wrong person to answer the survey, and people being averse to using the online survey technology.

We also note that participants' attitudes at the time of the studies may have been influenced by media articles highlighting information security breaches involving government agencies. Privacy and information sharing are highly emotive topics for the general public.

3. RESULTS

This report describes the findings of our research in two main sections. The first section details the findings from the first two studies which, together, build a picture of how various stakeholders and the general public perceive cross-government information sharing and their views of its impact on the integrity of the tax system.

The second section details the findings from the three most recent studies, each of which investigated divergent aspects of cross-government information sharing, namely: information sharing to combat serious crime; cultural perspectives on sharing personal information; and the sharing of businesses' information.

3.1 Studies 1 and 2: The public's views of government information sharing

IR conducted two initial studies on public views of cross-government information sharing: Study 1 — on the public's views of information sharing in the context of online public services;²³ and Study 2 — on the public's views of information sharing in the context of changing information technology and increasingly joined-up government services.²⁴ Together, these studies provide a good overview of the public's attitudes regarding information sharing.

Both studies found that the general public cautiously supported increasing certain types of cross-government information sharing. The perceived benefits include:

- Protection of public monies
- Ensuring customers receive entitlements
- Improving government agency efficiency
- Making service interactions or meeting obligations easier for customers
- Better public health and safety.

The concerns centre on privacy and trust in government agencies. The following sections describe these perceived benefits and concerns in more depth.

²³ Lips, Eppel, Cunningham, & Hopkins-Burns (2010).

²⁴ Litmus (2011).

3.1.1 *Protection of public monies*

Both studies found that participants strongly disliked “people ripping off the system”, particularly through tax or benefit fraud, and through avoiding paying fines. Participants stated that they were inclined to overlook “low-value” fraudulent activity, but they did not accept it when it reached the level of “hundreds of dollars” per week. Interestingly, participants who were beneficiaries generally supported cross-government information sharing to combat benefit fraud.

Participants expected government departments to share information to curb this, and they expected IR to be a key agency in such information sharing as part of maintaining the integrity of the tax system.

3.1.2 *Ensuring customers receive entitlements*

Studies 1 and 2 also found that there was a strong expectation that government information sharing would help to ensure customers received their correct financial and service entitlements. This was particularly true for customers who need assistance from multiple agencies. This expectation was particularly mentioned by younger participants in reference to customers not always knowing their entitlements or how to access them.

3.1.3 *Improving government agency efficiency*

Other expected benefits of cross-government information sharing were that sharing anonymous statistical information would aid government departments and agencies in evaluating their services, developing new policies and initiatives, and providing the right services to the right customers in the right locations.

Further, participants expected cross-government information sharing to offer cost efficiencies through minimising the duplication of effort by different agencies and improving the accuracy of the information they hold.

3.1.4 *Making it easier for customers*

Both studies found that people made clear associations between information sharing and easier customer interactions with government agencies. This is particularly relevant for customers with multiple social policy interactions with different government agencies. Potentially, they can become frustrated at ‘making too many calls to too many people’.

In discussing this issue, some participants described ‘clusters’ of government agencies which they viewed as appropriate for sharing specific types of customer information. For instance, participants described an ‘income/social policy’ cluster which included IR, the Accident Compensation Corporation and Ministry of Social Development. Another example was an ‘enforcement’ cluster which included New Zealand Police, Courts and the Immigration Service.

3.1.5 *Better public health and safety*

One further benefit highlighted in these studies was that cross-government information sharing can mitigate some risks to public health and safety. In particular, participants saw advantages for: better coordination of health care services; faster responses in

domestic violence and child protection cases; and improved crime reduction and countering terrorism threats.

3.1.6 *Concerns—privacy and trust in government agencies*

Both studies pointed to the importance of customers' trust in government agencies to act in their best interests. The majority of participants, and especially the salary and wage earners and retirees, were satisfied that New Zealand's government agencies were acting in their best interests. Interestingly, they tended to assume there was considerable cross-government information sharing currently taking place, but acknowledged that they knew very little about what information is held by government agencies and what information sharing actually happens.

Some participant groups had markedly lower trust in New Zealand's government agencies than others, particularly, Māori, Pasifika, self-employed people and beneficiaries. These participant groups were noted as having higher overall levels of interaction with government agencies and/or higher dependency on financial and service entitlements, and some felt powerless when dealing with government agencies and did not feel that the government was working for them.

In addition, most participants simply regarded certain types of information as private regardless of their trust levels. Importantly for IR, income information is described as particularly sensitive and private. For instance, one participant who was a beneficiary felt "shame" over being poor, and one Pasifika participant described income privacy as "part of their culture". Regarding tax specifically, tax professionals from both the accounting and legal professions were especially keen to maintain tax secrecy. They stated that, because taxpayers are legally obliged to supply IR with their income information rather than voluntarily providing it, it follows that IR is obliged to keep that information secret.

Participants believed that appropriate cross-government information sharing relies on agencies having very strong information security safeguards. They expected government agencies to only ask for information that is strictly necessary, and to only use information for the purpose intended at the time it was gathered with very few exceptions. This can be understood as an evaluation of the information sharing action as being 'fit for purpose'. While participants tended to believe IR had a good record of information privacy, they were concerned that other government agencies 'did not have the same respect for information as IR'.

3.2 **Studies 3–5; Investigating specific aspects of information sharing**

This section details the findings from the three most recent studies conducted to investigate specific aspects of information sharing. Due to the divergent aims of the studies, each one is detailed separately.

3.2.1 *Study 3: Combating serious crime*²⁵

This study focused on cross-government information sharing to combat serious crime. It included a survey and qualitative interviews. Four hypothetical scenarios were tested to identify the boundaries of acceptable information sharing. Three scenarios

²⁵ Litmus (2012).

were focused on financial crime (property obtained from crime, money laundering and fraud), and one was focused on safety (sex offending). The four hypothetical scenarios tested were as follows:

Scenario 1. IR discovers information during an audit about property obtained from crime and shares this with New Zealand Police.

Scenario 2. IR is involved in a taskforce combating money laundering with agencies such as New Zealand Police and the Serious Fraud Office and shares information about individuals and businesses under investigation. There are also links to Australia so the taskforce also passes this information to the Australian Police.

Scenario 3. IR has a system of scoring the likelihood of an individual being involved in tax evasion, and shares that with the New Zealand Police for profiling regarding serious crime.

Scenario 4. IR is able to find links between individuals and uses this to assist the Department of Internal Affairs to find which people are connected to a ring of sex offenders.

As a general principle, all participants stated that they wanted ‘some form’ of cross-government information sharing activity to occur when serious crimes are suspected, particularly with regard to sex offending. They felt that addressing serious crime was important enough to override the privacy concerns of the (hypothetical) individuals involved.

Some participants described the ideas presented (such as the taskforce on money-laundering and the use of ‘known linkages’ between citizens) as innovative and giving a positive impression of ‘joined-up’ government services.

3.2.2 *Concerns with the scenarios addressing serious crime*

Some participants were concerned that the scenarios involved sharing more than the strict minimum of information (such as address and contact details). Participants stressed that agencies should share only strictly relevant and carefully verified information.

Regarding the individual scenarios, the key concern with Scenario 1 was about IR staff ‘identifying property obtained from crime’. Some participants felt this was going beyond IR’s core role and capabilities, and made IR seem “sly” and working for the police.

With Scenario 2, a key concern was whether there was a strong enough connection between New Zealand and overseas authorities (such as the Australian Federal Police) for them to be included in any information sharing. This was debated in terms of the ‘sovereignty’ of information.

The main concern with Scenario 3 was about passing on agency-generated information (in this case, tax evasion risk scores). Some participants were concerned that this type of agency-generated information might be misinterpreted and misused by a different agency, leading to false positives. Further, participants were worried that such agency-generated information could carry on being used by the recipient

agency in ways which could be quite different to the intention of the original information request.

With the sharing of information based on the strong linkages between people in Scenario 4, some participants felt this type of information may be useful, but did not believe IR was the authoritative source to provide it. This Scenario was described as a “fishing expedition”, having “Orwellian” or “police state” overtones, with participants concerned about the risk of implicating innocent people.

One final note on Study 3 is that, overall, the participants who were tax and legal experts were consistently more concerned about the above issues than the other participants who were from the government, academic and commercial sectors.

3.2.3 *Study 4: Cultural perspectives*²⁶

This exploratory study sought the views of Māori, Pasifika and Asian peoples²⁷ regarding the cultural aspects of cross-government information sharing.²⁸ This was a qualitative study that gathered participants’ personal reactions to information sharing as well as their opinions about what reactions and sensitivities might be expected from other people in their wider cultural group. Study 4 built on the findings from Lips et al. (2010) that Māori and Pasifika participants had more concerns about information sharing than European participants. It was aimed at providing more understanding of the specific areas of sensitivity for customers in these cultures, along with the views of participants from a range of Asian communities. The study acknowledges the generally Euro-centric perspective of New Zealand government agencies and services.

Consistent with the other studies reported here, Study 4 found that participants supported cross-government information sharing, provided strong privacy safeguards are maintained. The benefits these participants expected from cross-government information sharing matched the benefits described in the previous studies (i.e., protecting public monies, ensuring customers receive entitlements, government agency efficiency, making it easier for customers, and public health and safety).

While the Māori or Pasifika participants were supportive of cross-government information sharing, there were some strong concerns, and these are detailed in the next section. The Asian participants in this study were markedly more supportive of information sharing, expressing high levels of trust in New Zealand government agencies to work in their best interests. Further, some overseas-born Asian participants had considerable past experience of government agencies sharing citizen information. The key benefit emphasised by the Asian participants was improved government efficiency.

3.2.4 *Concerns related to cross-cultural differences*

While Asian participants expressed high trust in New Zealand government departments and agencies, Māori and Pasifika participants described quite different

²⁶ Bickers, P. & Bennett, A. (2013)

²⁷ These are the three largest population groups in New Zealand apart from European New Zealanders.

²⁸ This research was not designed to provide a complete description of the views of Māori, Pasifika and Asian peoples, and it was also understood that these three cultural groupings encompassed a variety of individual cultures. Rather, this study was intended to provide initial insights and point to areas for further research or consideration.

and complex trust relationships with them. These differences directly affected their views on cross-government information sharing.

For instance, some Māori participants talked about “a hundred years of mistrust” and Māori being marginalised in New Zealand. In addition, some Māori participants described their concern that, even if government agencies intend to use information sharing in a positive way, there may be detrimental and disempowering effects for Māori. Specifically, there is a fear of “negative statistics about Māori” being shared without context, which could create an unfavourable impression of Māori and deflect attention from the issues driving such statistics.

The concerns expressed by the Pasifika participants arose from a different set of circumstances and experiences. In essence, Pasifika participants felt their communities were unfamiliar with government agency processes and were fearful of ‘the system’. Pasifika participants felt that this general lack of familiarity would make information sharing especially unnerving for Pasifika customers.

Also, some Pasifika participants in Study 4 believed that Pasifika communities were more likely than the general population to have low incomes and to be supplementing this with undeclared income, including some people working in New Zealand without the necessary immigration status. As a result, they felt the Pasifika communities would see government information sharing as a risk to this additional income.

Cross-cultural differences were apparent in the way participants viewed their information, and viewed service interactions. Some participants from all three cultural groups stated that people of their culture can be nervous and embarrassed about giving information to government agencies. Further, some Māori participants described their personal information as being “sacred”, and “part of themselves”. Both Māori and Pasifika participants stated that people of their culture may give incorrect information rather than revealing that they do not understand or cannot answer a question. Another comment from a Korean participant was that Asian people can find it disconcerting if government agency staff ask direct or blunt questions, leading the customer to “hold information back”.

According to the majority of the Māori, Pasifika and Asian participants interviewed, even the simplest level of information gathering, collecting a name from a customer, involves cross-cultural differences. For example, the names of an individual can be difficult to confirm due to the range of naming conventions in each culture, such as using surnames as first names or using simplified versions of their name in certain circumstances.

Several participants noted that the above situations may be alleviated by government agency staff being from the same cultural group, and ideally being able to speak the customer’s first language. They also felt that matching the culture and language of the customer can also lead to more accurate and complete information being gathered due to the staff person having a better understanding of the context of the customer’s information. Some Māori participants expanded on this and stated that minimising cross-cultural differences would provide comfort to Māori customers that their information would be “looked after”. It is clear that cultural awareness training for staff, and staff recruitment policies are integral to effective service delivery as much as cross-government information sharing.

3.2.5 Study 5: Businesses' perspectives²⁹

This study included a survey and interviews to gather the views of business owners, focussing on sharing businesses' information rather than individuals' information. In the interviews, four hypothetical information sharing scenarios were tested. Scenarios A and B were about financial crime, Scenario C was about helping businesses get government grants, and Scenario D was about sharing of IR-generated 'risk scores' with debt collection agencies. The four hypothetical scenarios tested were as follows:

Scenario A. IR is involved in a taskforce combating money laundering with agencies such as New Zealand Police and the Serious Fraud Office and shares information about individuals and businesses under investigation. There are also links to Australia so the taskforce also passes this information to the Australian Federal Police.³⁰

Scenario B. IR is aware of company directors engaged in aggressive tax avoidance cases and shares this information with the Companies Office so that the Companies Office can ban them from becoming directors of other companies.

Scenario C. IR identifies new businesses with research and development expenditure and shares this with the Ministry of Business, Innovation and Employment so it can contact the businesses to discuss whether they may qualify for Government grants.

Scenario D. IR scores the likelihood of an individual being involved in tax evasion, and shares that with the credit reporting agencies and debt collectors profiling of the riskiest businesses and to aid their debt collection activities.

In the survey, nine further hypothetical scenarios were tested; again to see where the boundaries of acceptable information sharing were. Five involved information sharing between government departments and four involved sharing with private sector agencies. These nine scenarios were as follows:

Scenario 1. A company takes on a debt it cannot pay; IR shares this with the Registrar of Companies so that the company directors can be disqualified.

Scenario 2. A taxpayer earns income from Department of Conservation owned land, but does not declare this income; IR shares this with the Department of Conservation.

Scenario 3. A new immigrant tells the Immigration Service that they have made a large investment in New Zealand but does not report this investment; IR shares this with the Immigration Service.

Scenario 4. A company pays staff below the minimum wage; IR shares this with the Department of Labour.

Scenario 5. The directors of a company make false statements in a registered prospectus; IR shares this with the Financial Markets Authority.

Scenario 6. A bankrupted taxpayer fails to declare some income; IR shares this with the Official Assignee.

²⁹ Research New Zealand (2013)

³⁰ This is the same as 'Scenario 2' in the previous section on information sharing to combat serious crimes.

Scenario 7. A company moves money to a related company before being liquidated; IR shares this with the liquidator.

Scenario 8. A chartered accountant makes false statements; IR shares this with the New Zealand Institute of Chartered Accountants.

Scenario 9. A taxpayer has outstanding tax debt; IR shares this with companies that determine credit ratings.

As in the previous research detailed in this paper, Study 5 found strong support for cross-government information sharing, in particular to protect public monies. For instance, 89 per cent of respondents were in favour of IR sharing businesses' information with government departments responsible for benefits; 83 per cent believed this would reduce benefit fraud, and 65 per cent believed this type of sharing already happens.

Similarly, regarding illicit business activity, 80 per cent of respondents supported IR sharing information with government departments responsible for goods, services and people coming in and out of the country, and 71 per cent felt this would ensure businesses work within the law. Interestingly, 13 per cent believed this sharing already happens. Likewise, 72 per cent supported IR sharing information with government departments responsible for regulating businesses, and 16 per cent believed this already happens.

This study also found strong support for cross-government information sharing to protect public safety, especially to address serious crime. This included information relating to the directors of businesses and their associated business interests, and sharing information with government agencies outside of New Zealand—particularly in Australia. Eighty-three per cent of respondents favoured IR sharing businesses' information with government departments responsible for criminal investigations, and 83 per cent felt this would assist with criminal investigations. Twelve per cent believed this sharing already happens.

Regarding making things easier for customers, 63 per cent of respondents felt that cross-government information sharing would reduce compliance costs to businesses. And for government agency efficiency, 59 per cent felt information sharing would create a more efficient public sector.

For trust in IR, almost 59 per cent of respondents had 'moderate to high trust' in IR, and 33 per cent had 'mid-range trust'. This reflects the overall finding from the earlier research that the majority of people have relatively strong trust in New Zealand government agencies in general.

3.2.6 *Concerns of business owners*

Even though trust in IR was high, there were exceptions, with eight per cent of respondents reporting 'low' trust in IR. Related to this, 17 per cent felt that 'too much information/knowledge would lead to an abuse of power' and 10 per cent felt there could be 'unintended consequences resulting from the sharing of inaccurate information or the poor interpretation of information'. There was also a mention of the risk of people being less inclined to provide information once they knew it was likely to be shared.

Interestingly, Study 5 found that respondents with low trust were more likely than other respondents to say they were ‘not at all informed’ about IR’s information sharing with government departments, which suggests that there is value in government agencies being transparent about their information sharing processes.

The highest risk associated with cross-government information sharing was ‘privacy being compromised’ (69 per cent saw this as a risk). Underpinning this finding was a perception that government departments have a poor record of managing privacy.

Respondents were more comfortable about sharing information about the business than their personal information. For instance, more respondents were comfortable with IR sharing contact details for businesses (86 per cent support) than contact details of business owners (73 per cent). Similarly, there was more support for sharing businesses’ tax paid and owed (57 per cent) and businesses’ turnover (56 per cent support) than for sharing tax and financial information about business owners (47 per cent support). These figures also show that support for sharing financial information of any type is markedly lower than support for sharing contact details.

In general terms, respondents were considerably more comfortable about information sharing with government agencies only (62 per cent support) than with the private sector (24 per cent).

4. DISCUSSION

IR wished to understand views of cross-government information sharing, and what implications there would be for the integrity of the tax system. These five studies covered the views of the general public, business owners, cultural groups, tax agents and law professionals.

4.1 Cautious support for information sharing

The findings from the five studies outlined here show cautious public support for cross-government information sharing. The public believes information sharing is beneficial for; protecting public monies, ensuring customers receive correct entitlements, improving government agency efficiency, making it easier for customers when dealing with government agencies, and for better public health and safety.

Some sections of the public are more cautious than others about increased cross-government information sharing. For instance, Māori and Pasifika, the self-employed and beneficiaries had less trust in government agencies and more concerns about whether they would personally benefit from their information being shared. Tax and legal professionals had more concerns about ‘tax secrecy’ than other participant groups.

Two other potential benefits of cross-government information sharing briefly mentioned by participants, but not elaborated on, were: debt minimisation through consolidation of financial information, and government agencies working together to offer assistance earlier for customers experiencing problems.

4.2 Information sharing's effect on views of the integrity of the tax system

As stated earlier in this paper, it is vital for IR to maintain the public's positive perceptions about the integrity of the tax system and encourage full and frank disclosure of tax information by taxpayers.³¹ The research results can be linked to the integrity of the tax system in two ways. Firstly, the information sharing needs to match IR's core business. People viewed IR's core business as tax, but they also recognised IR has a role in ensuring 'customers receive their correct entitlements'. They felt there were logical links between IR and other income and social policy agencies such as the Ministry of Social Development and the Accident Compensation Corporation.³²

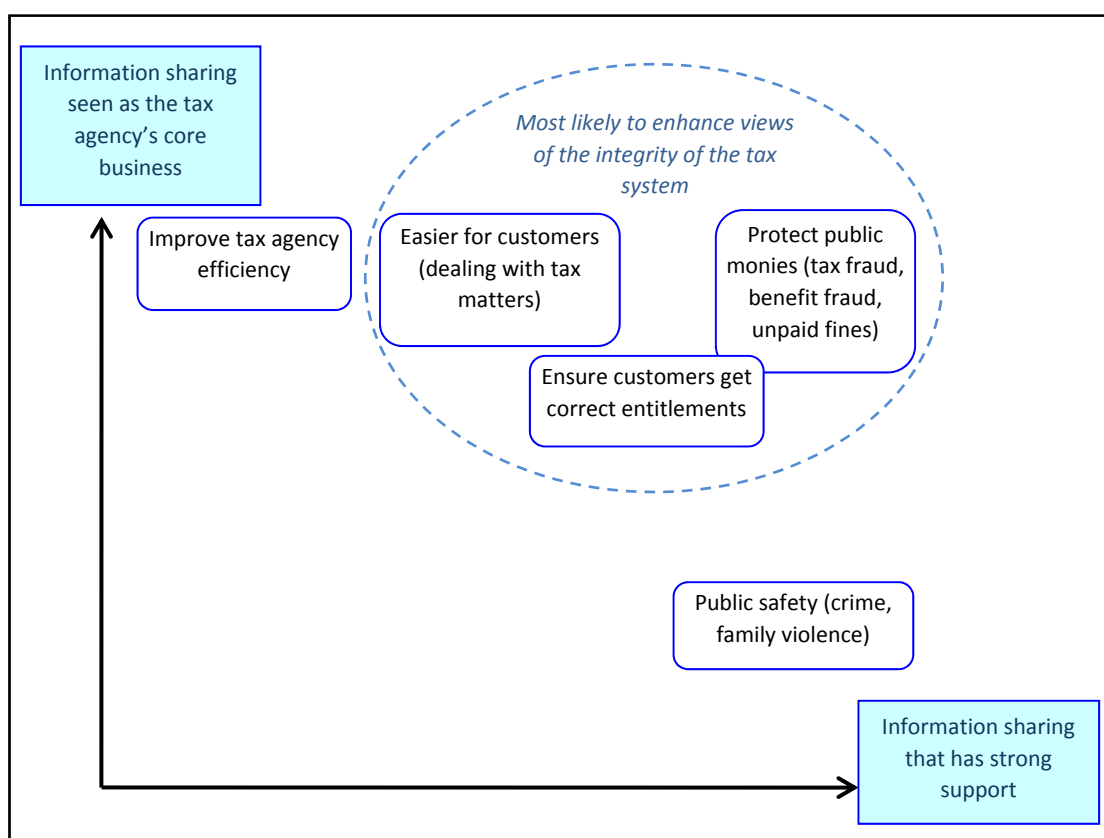
A second aspect of the public's positive perceptions about the integrity of the tax system is the importance people place on the aim of cross-government information sharing. There was widespread support for all the perceived benefits, but some seemed markedly more important to participants than others. Public safety (for example, addressing serious crime and family violence) and protecting public monies (for example, from tax and benefit fraud) received particularly strong support. Ensuring customers receive their correct entitlements also had relatively strong support. In comparison, support for benefits such as making it easier to deal with the agency and improving agency efficiency was not as strong, but still wide-spread amongst the participants.

Figure 1 below combines the two themes of; (i) how well the information sharing matches the tax agency's core business, and (ii) the importance that participants placed on the aims of the information sharing. This highlights three benefits that are most likely to enhance the integrity of the tax system. Protecting public monies stands out as being highly important to the public, and part of IR's core business. The next most positive items are ensuring customers receive correct entitlements and making it easy to deal with tax matters. Although improving tax agency efficiency is also part of IR's core business, it does not have as much support as the other benefits, so it may have less effect on public views of tax system integrity. On a different note, public safety is highly valued as a government goal, but is missing an obvious connection to the tax system.

³¹ Braithwaite, V. (2003), and Hazell, R. & Worthy, B. (2009).

³² Lips et al. (2010)

Figure 1: Information sharing initiatives likely to improve views of the integrity of the tax system



5. CONCLUSION

These five studies show cautious support for increased cross-government information sharing even though such an activity runs contrary to the principle of ‘using information as intended when supplied’. People can tolerate some loss of privacy when there are clear personal benefits or societal benefits, if safeguards are in place to ensure only strictly necessary information is shared, and if the information has been carefully checked for accuracy.

Notably for IR, these studies also show that cross-government information sharing can enhance public perceptions of the integrity of the tax system if it matches IR’s core business and aims for goals that the public sees as important. The goals that best match these criteria are:

1. Protecting public monies
2. Ensuring people receive correct financial and service entitlements, and
3. Making it easier for customers to deal with their tax matters.

To maintain people’s trust when sharing information, the most helpful action for government agencies would be to ask for consent. However, this is not always

practical or in the best interests of the public as a whole, for instance where criminality is suspected, or in a fraud investigation.

As an alternative to asking consent at the time of sharing, government agencies could be transparent and notify customers when the information is supplied or collected, and about how, when, why, and with whom the information may be shared. Early notification may still leave customers feeling aggrieved, for instance if an enforcement action is taken, or if an entitlement is reduced. However, these studies did show that early notification would be appreciated.

This transparency would also address the overall lack of knowledge that people expressed regarding how their information was stored, what cross-government information sharing was occurring and which agencies were involved. It would also help reassure the public about information only being shared when strictly necessary, and that the accuracy of the information is verified.

It is likely that, as part of the global trend, IR will increase its cross-government information sharing activity. It is vital that IR protects the current high regard that the public holds for its standards of privacy by limiting its information sharing to the most pressing needs, and continuously tightening its information security processes. There is no guarantee that information security lapses will not occur, but, through the principle of transparency, and working towards goals that the public sees as important and appropriate, public support for IR's involvement in cross-government information sharing can be maintained.

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Does the Australian Higher Education Loan Program (HELP) undermine personal income tax integrity?

Richard Highfield and Neil Warren¹

Abstract

While considerable attention has been given to the interaction between government personal income taxes and transfers, little has been given to how government non-tax revenue collection interacts with other tax and expenditure programs. This paper examines the overlooked issue of the impact on personal income tax collections of the repayment of government loans to fund student contributions to their tertiary education.

In 1989, the Australian government introduced a student contribution for undergraduate study funded through an income contingent loan, expanding the scheme in 2002 to postgraduate students and in 2010 to vocational education programs. For individuals, this Higher Education Loan Program (HELP) allows them to either contribute through the upfront payment of fees to tertiary institutions (sometimes at a discount and therefore avoiding a HELP debt), make voluntary repayments of their loan debt (also at a possible discount) and to make repayments which are contingent on their income as defined for HELP purposes.

Reasonable estimates now put the gross HELP debt in Australia at \$70.4 billion in 2017–18, impacting 26 per cent of citizens aged 18–54 years. With low rates of HELP repayment and indications of weakness in the regime for HELP repayment collection, there is real concern that HELP design may be encouraging (and rewarding) undesirable taxpayer behaviour. This paper examines tax-related aspects of HELP to establish whether there are any indications that its design and administration encourage greater personal income tax planning (legal) and evasion (illegal) designed to minimize HELP repayments with consequent effects on the collection of HELP debts and personal income tax system integrity.

Evidence is found for bunching of HELP debtors around HELP repayment thresholds and that recent HELP policy design reforms have provided greater incentive to avoid HELP debt repayment. Attention is given to how current, proposed, and alternative reforms to the personal income tax treatment of deductions could improve both HELP repayments and related personal income tax system integrity. However, the findings in the paper will also have implications for the HELP policy framework as reforms to personal income tax are likely to be a necessary complement to actions designed to address observed personal tax and HELP integrity issues.

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1. INTRODUCTION

Often the action of government to address one area of market failure compromises the achievement of government policy objectives in another resulting in unintended trade-offs. One area where such conflicts are acknowledged concerns the interaction between the tax and transfer system where the resulting high effective marginal tax rates impact on an individual's movement from transfer dependency to paid employment. However, an area where this conflict is little acknowledged is the interaction between the personal income tax system and the income-based arrangements designed to repay income contingent loans used to fund student access to tertiary education.

While the economics underlying the use by government of income contingent loans schemes to fund access to previously general-revenue funded public services is well accepted and largely uncontroversial (Chapman 2007)², far less well understood is how the repayment of any resulting loan based on the debtor's income, might adversely impact on other government policies such as personal income tax integrity. If any adverse interaction affected only a few individuals or occurred for a relatively short period of time, this might not be important enough for a considered policy response.

However, with budget-constrained governments considering income-contingent loans as an approach to funding a broad range of public services and therefore potentially impacting more individuals, there is a real need to better understand debtors' responses to loan repayment obligations. This paper examines the case of Australia's Higher Education Loans Program (HELP)³ which, while introduced in 1989 with modest objectives, has since been rapidly expanded. If evidence can be found of an adverse interaction between HELP debt repayment and personal income tax liabilities, then this will have major implications for the integrity of both HELP and the tax system and require a policy response.

Section 2 begins by developing a conceptual framework capable of providing insight into the funding options for tertiary education including what design parameters are determined by government and what decisions individuals must make when deciding how to fund their part of the total spent on tertiary education. Section 3 applies this framework to understanding the evolution of HELP design in Australia since 1989 and how the changes made have contributed to the rapid escalation in both HELP debtors and their debt levels. The evidence will show that this escalation is the result of

² At its most basic, since capital markets fail to work efficiently and provide those undertaking tertiary education with loans to fund their education, the government addresses this market failure by acting as a lender to those undertaking education which enhances their human capital and therefore their labour related income stream.

³ Annex 1 outlines in detail the history of the Australian Higher Education Loans Program since its inception in 1989.

government policies designed to increase tertiary education participation rates and fees⁴ without the political cost of requiring greater up-front contributions.

Section 4 examines how HELP design and associated debt could result in tax planning and evasion by those taxpayers with HELP liabilities and whether there is evidence of such effects in Australia. After finding evidence that at even relatively modest levels of HELP debt there is a behavioural response, Section 5 focuses on what HELP design and administrative reforms could be adopted to reduce the impact that any rapid rise in HELP debt might have on the integrity of both HELP and personal income taxation.

Section 6 questions whether personal income tax design and administration might itself contribute to HELP debtors avoiding or evading their compulsory HELP repayments and thereby challenging not only the integrity of the personal income tax but also the viability of rapidly expanding access to HELP. Section 7 concludes that only with a sound understanding of how HELP and the personal income tax interact can we ensure integrity and sustainability in both systems in the long term.

2. FUNDING HIGHER EDUCATION IN PRINCIPLE

While education enhances the human capital stock of an individual, the beneficiaries of that enhancement are more than just the individual and include employers and society more generally. As a result, funding education has three possible sources: the student (/employee), employers and the government (and hence all taxpaying individuals) as shown in Figure 1. In the case of the employer and government, their contribution is inevitably upfront and funded from recurrent sources. In the case of the individual, if capital markets worked perfectly they could fund their fees through loans which were serviced and repaid through the stream of earnings from their education-induced human capital enhancement. Since capital markets fail to provide such loans⁵ and making student fund fees upfront would lead to an under demand for higher education, it has become a common practice for governments⁶ that are intent on encouraging increased participation in higher education to provide income-contingent loans to students to fund their contribution to the cost of education.

In theory, any repayment of these loans should be based on the potential return to the enhanced human capital stock. In practice, actual income and that from more than just human capital forms the base of any repayments and those on lower incomes are exempt from being required to repay their debt. Figure 1 details the parameters which are set by government and determine the operation of government-provided income contingent higher education loan arrangements. For government, this begins with determining available funding and what this means for available education places (F in

⁴ This was evident from the uncapping of government funded undergraduate Commonwealth supported places (except medicine) in 2012 and the ability to fund postgraduate course fees on HELP (formerly Postgraduate Education Loans Scheme (PELS) in 2002).

⁵ While information asymmetry is an important reason why private capital markets for student debt funding of education have not developed, also important is the high level of uncertainty attached to education investments which results in education being a high risk for lenders.

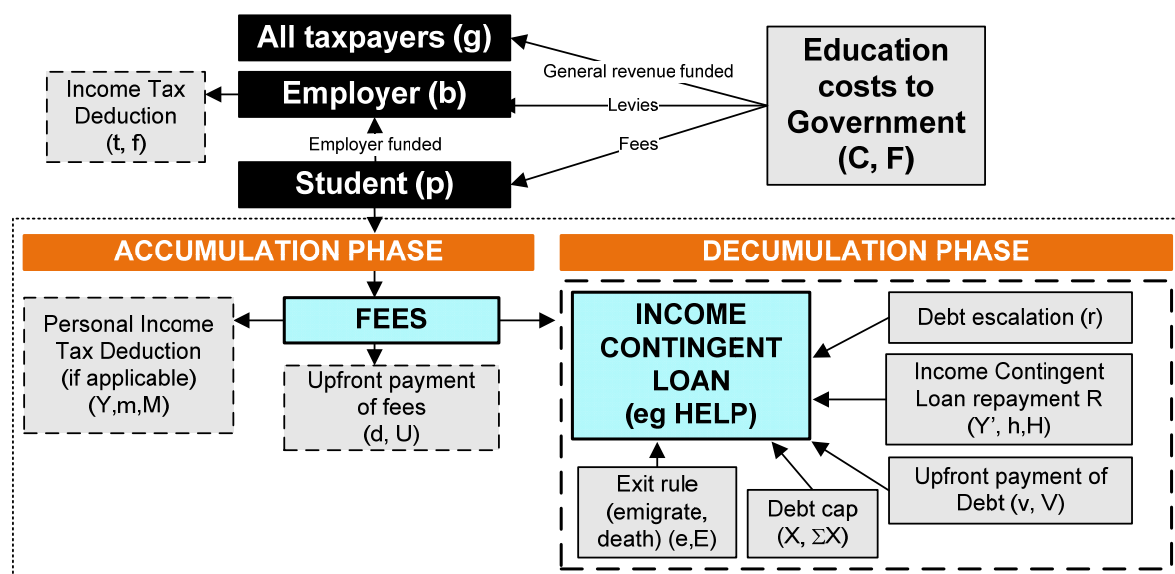
⁶ While Australia and the UK were leaders in the adoption of income-contingent students loan schemes, they have now found applications in an increasing number of countries including South Africa, Thailand, and New Zealand. See discussion in Chapman (2007), Demange, Fenge and Uebelmesser (2008) and Chapman and Hunter (2009).

Figure 1) and the proportion of the cost (C) to be funded through government general revenue (g), employer levies (b) and by students (p). For government, this is however not the end of their liability for the provision of education. If student fees are deductible against personal income tax liability then depending on the individual's income in the year in which the fees were incurred and their marginal tax rate (which determines m and M), some of this cost can be transferred to government through reduced income tax collections. Similarly, a proportion of any cost borne by the employer through levies (b) or by students shifting some of their share directly to their employers can be transferred back to government if such costs are tax deductible (t). If these shifted student costs are not tax deductible to individuals when paid by employers, they could be subject to fringe benefits tax (f) prior to being deductible by employers.

If the students have available to them the option of discounts on upfront payment of fees (d), then some part of their fees could be shifted back to government, regardless of whether the remaining expense is deductible or not. For that part of the higher education fees payable by students which is added to their income contingent loan, several factors may also ultimately shift the burden of providing higher education back onto government. Discounts on upfront repayments of debt (v) will shift some of this debt back to government as will the lack of any debtor exit rules (E) related to death or emigration that lead to ultimate write off of unpaid debts. The adoption of a debt escalation rule (r) which is less than an economically efficient escalation rate can also act to erode the real value of debt and therefore transfer some of this burden onto government.

A less obvious but equally important approach to shifting some of the cost of education expected to be borne by individuals back to government is that which results from changes in their behaviour that are designed to minimise the income measure (Y') used to calculate the income contingent loan repayments (R) based on the repayment schedule (h, H). Since income is a net concept, this can arise from changes to how income is received (or not reported) or what income deductions are incurred (or claimed, even if not incurred). Since personal income tax liability is based on an income concept (Y) not too dissimilar from that (Y') used to estimate income contingent loan repayments, any avoidance or evasion activity impacting on loan repayments has the potential to also directly impact personal income tax liability. While in the case of the income contingent loan repayment this may only act to delay the inevitable, in the case of personal income tax any loss due to evasion and avoidance resulting from minimising loan repayments is lost permanently.

What the analysis below (and Figure 1) highlights is just how complex and broad ranging are the interdependencies between government income-contingent tertiary education loan schemes and the tax system. However, while considerable attention has been given to how to expand access to tertiary education, little attention has been given to how repayment of any loan might impact on any debt repayment arrangements or the design and administration of other taxes. This paper attempts to redress this situation by examining the behavioural response of HELP debtors to their repayment obligations and whether Australia could learn from recent reforms to the loan decumulation arrangements in comparable schemes in the United Kingdom (UK) and New Zealand (NZ).

Figure 1 Funding higher education based around income contingent loans

PARAMETERS

GOVERNMENT SET PARAMETERS

Fees (Accumulation Phase)

- C Unit cost to government of education
- d Discount for upfront payment of fees
- f Business FBT rate on employee fringe benefits
- t Business tax rate
- g Government share (funded from general revenue) (Residual after aggregate of (b+p) specified)
- m Personal income tax marginal rate(s)
- M Personal income tax threshold(s)
- Y Taxable income definition for personal income tax (ie after all deductions)

Debt (Decumulation phase)

- e Exit rule (on death or emigration)
- F Number of education places (funded and unfunded)
- h Repayment rate(s)
- H Repayment threshold(s)
- r Debt escalation rate
- v Discount for upfront debt repayment of debt
- X Annual limit to debt
- ΣX Cumulative limit to debt
- Y' Income definition for repayment of debt

BEHAVIOURAL VARIABLES

Persons

Fees (Accumulation Phase)

- b Employer's share of unit cost
- p Person's share of unit cost
- U Upfront fee repayment
- Y Income taxable under personal income tax

Debt (Decumulation phase)

- E Exit decision (non-resident and on-death liability)
- V Upfront debt repayment
- Y' Income for repayment of income contingent loan

Employers

- b Employee share of education unit costs (possibly negotiated by employees with business)

Tax administration

Agency Problem: Debt owned by education department with tax authority as debt collector. As a result, the:

1. Tax authority does not own debt and therefore does not have a priority to ensure compliance by those with an income contingent loan (or debt).
2. Tax authority might not see debt as a risk to taxes for which it is responsible.
3. Enforcement of Y' could be inadequate due to poor information and poor employer compliance.
4. Evasion and avoidance of Y' impacts R which directly impacts Y and therefore personal income tax)

3. AUSTRALIA'S HELP DEBT AND ITS REPAYMENT

3.1 HELP parameters

The historical evolution of the parameters underpinning Australia's HELP scheme are detailed in Annex 1 and show how the requirement to repay HELP debt only occurs once a borrower's income in a year exceeds a prescribed threshold termed the 'HELP repayment income' (HRI) level. This determination is made as part of the annual income tax return assessment process provided HELP debtors have submitted returns as required under the income tax law. Over the years, the definition of the HRI level has been adjusted to take better account of a borrower's perceived capacity to make repayments. Initially, the level was set at an amount equivalent to the borrower's 'taxable income' but over subsequent years redefined to now be 'taxable income plus any total net investment loss (which includes net rental losses), total reportable fringe benefits amounts, reportable super contributions and exempt foreign employment income'. When a borrower's HRI exceeds the minimum HRI threshold level, a graduated rate scale is applied to determine the amount of debt to be repaid as part of the income tax assessment process, as shown in Table 1 and Chart 1.

Where borrowers are employees, they are also required to inform their employers of their HELP debt status in order to determine whether additional tax withholdings should be made by them in anticipation of a HELP debt annual assessment liability. In practice, the effectiveness of this requirement is contingent on borrowers properly reporting to their employers that they have a HELP debt. A disincentive for them to do so is that HELP repayments are calculated on the total amount of a taxpayer's HRI once it exceeds a prescribed threshold, not the excess over the threshold. As a result, as shown in Chart 1 for 2013–14, taxpayers who are HELP debtors with just one additional \$1 of HRI over a repayment threshold can be exposed to significant HELP repayments.

The interaction of HELP with the personal income tax is not just an issue for HELP repayment. Since student contributions (with the exception of HECS) are a deductible income tax expense when work-related, some of this student contribution can be shifted by taxpayers to government through the personal income tax system. Non-recovery of HELP debt therefore limits recovery of this tax cost to government.

Clearly, the effectiveness of the HELP loan repayment arrangements is contingent on timely and accurate compliance by borrowers with their pay-as-you-go (PAYG)⁷ withholding and/or income tax return assessment obligations. Taxpayers who do not properly comply with employee withholding obligations and/or who do not file tax returns can escape repayment of their full HELP debts while those who participate in tax planning and evasion practices in response to their HELP debt, can not only reduce their HELP debt repayment (at least in the short term), but immediately reduce their tax liabilities and if this behaviour is learnt and perpetuated, the income tax loss could reoccur each year indefinitely.

In the case of outstanding HELP debts (such as, loan balances), these are indexed annually in line with movements in the CPI, meaning that they are made effectively

⁷ For a description of the PAYG system, see <https://www.ato.gov.au/Business/Employers/Preparing-to-engage-workers/Pay-as-you-go-%28PAYG%29-withholding/>

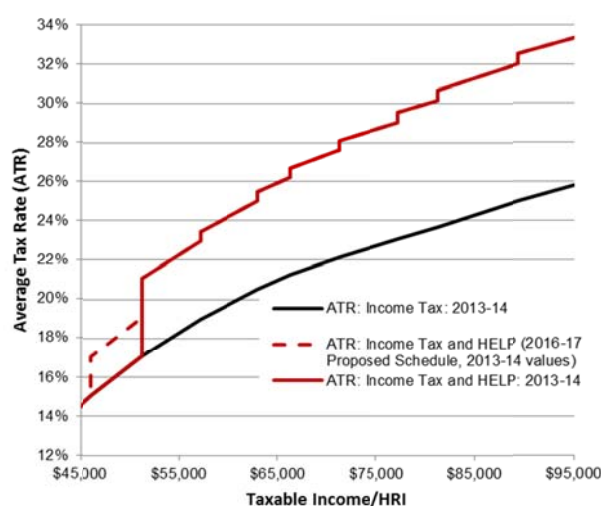
‘interest-free’. The indexation adjustment is made by the Australian Tax Office (ATO) on 1 June each year and applied to the portion of debt that has been unpaid for 11 months or more. The fact that HELP debts are indexed to the CPI also diminishes their cost relative to the return on the human capital investment through time (Table A3) by how HELP changes as a proportion of average weekly ordinary time earnings (AWOTE) over time. In the 2014–15 Budget, the Commonwealth announced its intention (from 1 June 2016)⁸ to apply annual indexation to HELP debts based not on the Consumer Price Index but at a rate equivalent to the yield on 10 year bonds issued by the Australian Government (capped at 6.0 per cent per annum).

Table 1 HELP repayment liability: 2013–14 and 2016–17

2013-14						2016-17 Schedule; 2013-14 Values		
HELP repayment income (HRI) ranges (\$)	Repayment rate as % of HRI	Additional repayment on first \$1 over lower HRI bound	Income tax payable at lower HRI bound (incl. Medicare Levy) for Single Person	Total HELP repayment at lower HRI bound	Total HELP repayment as % of Income tax (incl. Medicare Levy) for Single Person	HELP repayment income (HRI) ranges (\$)	Repayment rate as % of HRI	Total HELP repayment at lower HRI bound
Below \$51,309	Nil	0	0	0		Below \$46,178	Nil	0
\$51,309 - \$57,153	4.0%	2,052	8,992	2,052	22.8%	\$41,788 - \$51,308	2.0%	924
\$57,154 - \$62,997	4.5%	286	10,979	2,572	23.4%	\$51,309 - \$57,153	4.0%	2,052
\$62,998 - \$66,308	5.0%	315	12,966	3,150	24.3%	\$57,154 - \$62,997	4.5%	2,572
\$66,309 - \$71,277	5.5%	332	14,092	3,647	25.9%	\$62,998 - \$66,308	5.0%	3,150
\$71,278 - \$77,194	6.0%	356	15,782	4,277	27.1%	\$66,309 - \$71,277	5.5%	3,647
\$77,195 - \$81,256	6.5%	386	17,793	5,018	28.2%	\$71,278 - \$77,194	6.0%	4,277
\$81,257 - \$89,421	7.0%	406	19,231	5,688	29.6%	\$77,195 - \$81,256	6.5%	5,018
\$89,422 - \$95,287	7.5%	447	22,374	6,707	30.0%	\$81,257 - \$89,421	7.0%	5,688
\$95,288 and above	8.0%	477	24,633	7,623	30.9%	\$89,422 - \$95,287	7.5%	6,707
						\$95,288 and above	8.0%	7,623

Source: ATO Website <https://www.ato.gov.au/Rates/HELP-repayment-thresholds-and-rates/>
 Australian Government, 2014-15 Budget Paper No 2, pp77-78 <http://www.budget.gov.au/2014-15/content/bp2/html/index.htm>

Chart 1 Impact of HELP on Taxable Income



Source: Own calculations using data in Annex 1 and 2014 Budget Paper No 2, p77

⁸ See Annex 1 and Australia, Budget 2014-15, Budget Measures, Budget Paper No 2, p78

HELP debtors who move overseas do not have to report their income to the ATO and so are not required to make repayments of their debt, regardless of the level of the income they earn as non-residents. This is because Australia applies no exit rule (E in Figure 1) to HELP debtors who leave the country temporarily or permanently or who die. However, HELP debtors cannot escape debt repayment through bankruptcy as under the *Bankruptcy Act 1966* accumulated HELP debts are not provable. This means they must be paid, regardless of whether a person is declared bankrupt. In the case of death, all HELP debts are written off for the borrower.

3.2 HELP debt trends

Any such adverse reaction to HELP liabilities which directly impacts income tax integrity might not be an issue if it applies only to a small number of taxpayers. However, as indicated in Charts 2 and 3 (and Tables A5 and A6), there are now over two million HELP debtors and by 2017–18, HELP debt will have grown to in excess of \$70 billion. This is particularly striking when viewed in the light of the decline in the number of HELP assessments as a proportion of HELP debtors from 31.6 per cent in 2001–02 to 24.4 per cent in 2010–11, a fall of 23 per cent over a period when the value of HELP debt relative to personal income tax collections increased by 69 per cent. These trends are occurring at a time when the number of HELP debtors grew by 43 per cent and their average HELP debt increased by 82 per cent, resulting in a total debt increase over the period of 160 per cent (as detailed in Annex 1). Combining this trend with the expected threefold growth in HELP debt between 2010–11 and 2017–18 (Tables A5 and A6) and assuming the repayment trends in Chart 2 persist, not only will there be considerably more HELP debtors but they will be debtors for much longer with greater potential to adversely impact on personal income tax system integrity.

Chart 2 HECS-HELP: Number of HELP debtors and compulsory assessments

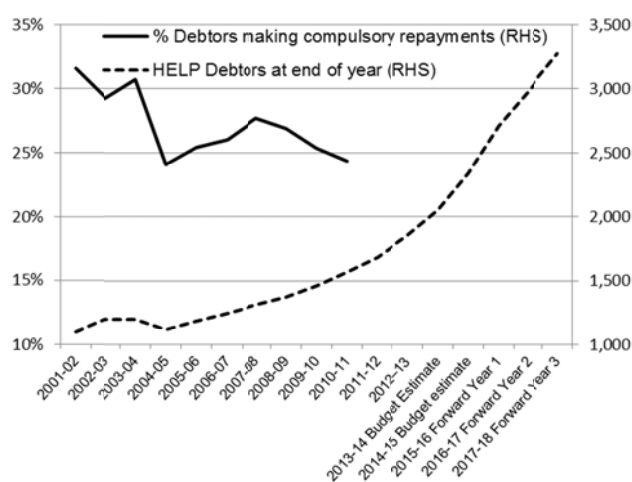
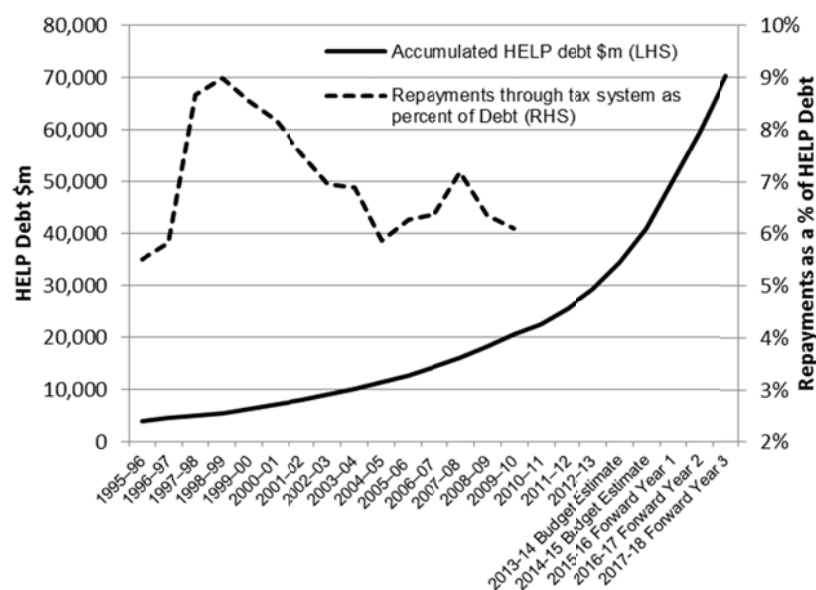


Chart 3 HECS-HELP: Value of year-end debt and year by year assessments

A review of the parameter changes over this period (in Tables A1, A2 and A3) provides some insight into the basis of this trend. A significant contributing factor was increasing the lowest HELP repayment threshold by nearly 30 per cent (as a proportion of AWOTE) in 2004–05 despite the rates of repayment being increased once above the threshold. However, more important has been the expansion in the scope of HELP (Tables A1 and A2) and the reduction in incentives to make fee and debt repayments upfront. With the scope of HELP further expanded in the forward years to 2017–18 (Table A2), accumulated HELP debt is expected to grow at rates not previously seen under the scheme and an increasing proportion of new HELP debt is not expected to be repaid (Tables A5 and A6). Table A6 shows that by 2017–18 almost a quarter of all HELP debt is not expected to be repaid, up from 17 per cent in 2013–14. If HELP debt is assumed largely restricted to 18–54 year olds⁹, then over the period 2003–04 to 2017–18, the ratio of those with a HELP liability will rise from 13.5 per cent to 25.7 per cent, up from 11.4 per cent in 2003–04¹⁰.

Of concern also is the trend evident in Table A4 over the period 2007 to 2011 which showed that there was a gradual increase in the average time to make the first compulsory repayment (from 4.9 to 5.1 years), the average time to make first voluntary repayment (6.8 to 7.1 years) and the average time to repay debt (for those who have repaid, from 7.5 to 8.1 years). With the proportion of taxpayers confronted with a HELP debt more than doubling between 2003–04 and 2017–18 and them taking longer to repay their debt, how HELP debt is incurred and repaid inevitably must have

⁹ This calculation is based on the assumption that all HELP debtors are between 18 and 54 years old. This is not unreasonable since the scheme had its beginning in 1989 and was only available to fund undergraduate degrees (HECS) until 2002 when PELS was introduced.

¹⁰ The ATO reported that as at 30 June 2011, some 1.567m individuals had a HELP liability. Drawing on the ATO 1% sample taxpayer file, it can be shown that only 1.18m individuals had lodged a 2011 tax return by 31 October 2013, implying that some 25% of HELP debtors had not lodged income tax returns for 2011.

important implications for personal income tax compliance and for how the tax and HELP repayment regimes are administered.

Important here is how HELP debt is administered. While in the Australian case it is the Department of Education that reports the debt as an asset, the collection of the actual HELP debt is a responsibility assumed by the ATO through an inter-agency agreement between it and the Department of Education. An important part of understanding the revenue risk from HELP debt is to understand the different reporting of this debt by these two government agencies. Table A6 details the HELP debt and its repayment reported by the Department of Education (including forward estimates). These estimates include recognition of the debt not expected to be repaid (DNER) and the fair (actuarial) value of the accumulated debt. However, in administering HELP debt, the ATO manages actual accumulated debt without adjustment until (as upon death) this is necessary. As a consequence, the HELP debt reported by the ATO in its *Taxation Statistics* (shown in Table A6) is actual aggregate nominal HELP debt of all individuals as reported to the ATO by the Department of Education, less the aggregate value of repayments made.

What is clear is the significant gap between the Department of Education and ATO reporting of HELP debt. Table A6 uses this disparity to project forward from the Department of Education Budget estimates for the forward years to 2015–16 and 2017–18 of what could be expected of the accumulated HELP debt as managed by the ATO. In 2017–18, this yields an accumulated HELP debt estimate of \$70.4 billion, rising from \$34.5 billion in 2013–14. The rate of increase is, as noted previously, largely the result of a significant expansion of the HELP scheme but it does have the effect of drawing much greater attention to the management of this substantial asset and the administration of its realisation by government. In a tight fiscal environment, any delay to HELP repayments or lost personal income tax due to the impact of HELP debt on taxpayer compliance should be of major concern to government.

In the following section, attention is given to examining data on personal income tax payers with and without a HELP liability to learn more about how HELP might impact personal income tax integrity. In subsequent sections, the findings are used to assess what implications they might have for income tax or HELP design and administration.

4. DOES HELP DESIGN IMPACT PERSONAL INCOME TAX INTEGRITY?

For HELP debtors, there are two distinct stages to their interaction with HELP which have the potential to elicit very different behavioural responses. As shown in Figure 1, the first is the HELP debt accumulation (build up) phase and the second, the decumulation (or pay down) phase. Both phases see HELP interact differently with the personal income tax and with this, related risks to both HELP and income tax.

During the accumulation phase, the student contribution (whether funded through HELP or not), is deductible against taxable income if work-related (with the exception of HECS). The effect is to have government share some of the contribution. However, where the contribution is not related to current work but possibly to future employment, it is not deductible and therefore cannot be deducted from current income. The tax effectiveness of any deduction is also impacted by how education is undertaken. Studying full-time where employment income is reduced is potentially

less tax effective when a deductible expense (and therefore work-related) is incurred because of diminished income (and lower marginal tax rates). If the self-education expense could be offset against income as it is earned, this effect would be diminished.

What is not adequately recognised in the Australian case is how the deductibility of work-related self-education expenses sits with HELP, especially in the case of non-HECS fees. In a 2013 Treasury discussion paper on reform to deductions for self-education expenses¹¹, no mention was made of this important issue in the debate about the deductibility of such expenses. While this paper will not contribute to this debate or to the design of HELP during the accumulation phase, these are nonetheless issues which require further consideration in the debate about the design of HELP.

In the remainder of this paper, the focus will be on the HELP during the decumulation phase (Figure 1) and its interaction with personal income tax. With HELP loan repayments collected through the personal income tax assessment process, an obvious risk that arises in practice concerns the extent to which borrowers are encouraged not to comply with their income tax obligations in order to reduce, defer, or avoid their loan repayments. Such non-compliance can take various forms, including the non-disclosure of assessable income, the over-claiming of tax deductions, and the failure to lodge tax returns (on time and at all).

With taxable income being a net concept which reflects the difference between income and related (income or tax) reliefs (Warren 2014a, 2014b), the question for this study is whether there is a distinct behavioural difference between comparable taxpayers with and without HELP liability. If a discernible difference can be observed which cannot be readily explained, then it has implications for both HELP and personal income tax design.

4.1 Bunching below the HELP repayment thresholds – and minimising HELP repayments

The Australian government has long been concerned about the distortionary effects of high effective marginal tax rates (EMTR) on decisions to work arising from the interaction between income taxes and the social welfare system (AFTS 2009). Of particular concern has been the bunching of individuals below the threshold where higher effective marginal tax rates impact, such as when means tests for transfer payments come into effect. However, far less attention has been given to those EMTRs which arise from the interaction between the income tax and the repayment of HELP debt. As shown in Table 1, the nominal impact on HELP debtors as they pass through various thresholds is high and with it, extreme EMTRs occur on the point of transition (Chart 4).

With around 26 per cent of 18–54 year olds in 2017–18 estimated (in Table A6) to have an average HELP debt of \$21,500, up from 11.4 per cent in 2003–04, the risk from such high HELP EMTRs is that taxpayers with HELP debt may be encouraged (and rewarded) for undertaking behaviour which minimizes (legally or not) their HRI and therefore HELP repayments. Not only is this outcome economically inefficient and compromises HELP integrity, by minimizing HRI taxable income is also reduced and with it the personal income tax liability which might have otherwise have been paid without such a behavioural response. Worse, while HELP debtor actions might

¹¹ See *Reform to deductions for education expenses* at <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2013/self-education-expense>

simply act to delay HELP repayments, any resulting loss in personal income tax is lost permanently.

Chapman and Leigh (2009) explored this issue using anonymised tax return data records supplied by the ATO for 2003–04. For the purpose of their research, they used a sample of tax return data in respect of HELP debtors and compared the distribution of debtors around the minimum HELP repayment threshold with those taxpayers not affected by the ‘kink’ point (such as those without a HELP debt). From their analysis, they “observe a small but significant degree of bunching at the repayment threshold, but the budgetary cost and the lost pre-tax earnings from this substantial discontinuity in the taxation schedule appear to be relatively small” (p 277).

While the findings by Chapman and Leigh are important, so too is whether the substantial increase in the threshold and repayment rate that has occurred since 2003–04 has also been accompanied by evidence of bunching around the now-increased threshold. If this is the case then taxpayers who were previously well above the lower HELP repayment threshold are now responding to the higher threshold which impacts on them by taking actions to bring them below the now-increased threshold.

As shown in Table A1, the HELP repayment threshold in 2003–04 was increased from 52 per cent of AWOTE to 68 per cent in 2004–05 and the initial repayment rate from three per cent to four per cent. The effect was to substantially increase the minimum ‘kink-point’ on the HELP repayment schedule from \$760 in 2003–04 to \$1,400 in 2004–05. In 2013–14, the amount of HELP repayment at the minimum threshold is \$2,052 on debtors whose HRI increases by one dollar above \$51,309 (Table 1). Using data from the 2010–11 ATO one per cent sample file of taxpayers¹², Chart 4 reports in detail on the grouping of HELP and non-HELP taxpayers around the minimum HRI kink-point. This chart yields a similar pattern of results to those by Chapman and Leigh (2009, p281) when the 2003–04 minimum threshold was 52 per cent of AWOTE rather than 67 per cent as in 2010–11 (Table A1). Importantly, moving the minimum threshold does not appear to remove bunching—it simply moves to the new kink-point. What is of particular concern is that any behaviour designed to minimize HRI also directly impacts taxable income and therefore personal income tax collections. Moreover, it is reasonable to assume that any behaviour once learnt will be maintained even if the HELP threshold is increased or the HELP debt is repaid. In this case, such learnt behaviour results in those taxpayers acting to minimise their personal income tax each year thereby undermining the integrity of the personal income tax.

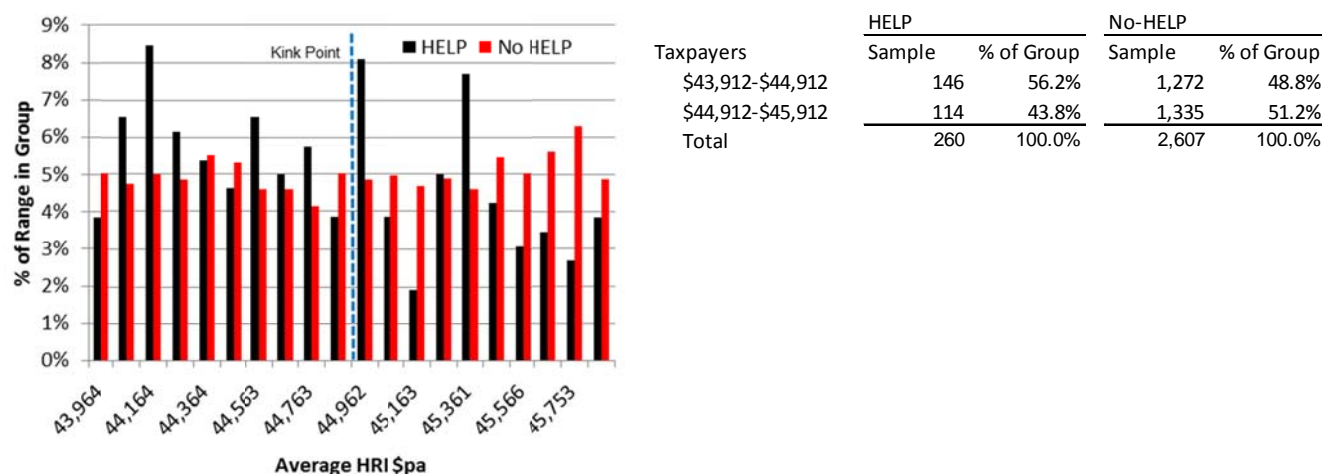
Chapman and Leigh’s observation that the “lost pre-tax earnings from this substantial discontinuity in the taxation schedule appear to be relatively small” (p 277) also needs further review. If, as noted above, the ratio of HELP debtors rises to 25.7 per cent (Table A6) in 2017–8 from 13.5 per cent in 2010–11, what might have been

¹² The ATO makes available each year a statistical file of anonymised personal tax return records—the Individual Sample File—for external research purposes. The file approximates to 1% of personal tax returns filed for each income year in the 16 month period after the end of the relevant income year. Individual record data made available include selected items of information from the processing of tax returns, for example, demographic data on age, sex, occupation code, resident/ non-resident status, existence of HELP debt, method for filing return, self-preparers/ tax agents.; the types and value of income reported such as wages, pensions, interest, dividends, business income, and income from foreign sources, and; data on types and value of deductions claimed including work-related deductions (by type), gifts, rental, and others.

unimportant in 2003–04 when the ratio was 11.4 per cent could be much more important when it applies to twice as many. Furthermore, since the HELP repayment rate adds directly to both the marginal and average tax rate of taxpayers (Table 1 and Chart 1), the incentive for taxpayers to reduce their HRI is significant when the HELP repayment rate is between four per cent and eight per cent across *all* HRI income ranges, not just on increases to HRI. If the trend decline in the proportion of HELP debtors making a repayment through the tax system shown in Chart 3 continues and arises from non-compliance, this has major ramifications for both HELP and income tax integrity.

The important question then is what is the source of this bunching? Since taxable income and HRI are net income concepts, in practice it can be impacted by two discretions available to taxpayers: firstly, their non-disclosure of assessable income; and secondly, their over-claiming of tax deductions. The remainder of this section will focus on those options which result in bunching.

Chart 4 Distribution of Taxpayers with \$1,000 of Minimum Threshold (Kink Point): 2010-11



Source: 1% ATO taxpayer sample file 2010 – 11

4.2 Evidence on claiming excess deductions

Similar to the tax systems of countries such as Canada and the United States, Australia requires the vast majority of adult citizens to prepare and lodge an annual tax return in which they must report all assessable income and claim deductions and credits to which they are entitled. The most commonly-claimed deductions are in respect of work-related expenses, gifts to approve benevolent institutions, deductions against rental income, and a miscellaneous ‘other deductions’ category. Like some overseas personal tax systems, Australia’s tax system requires a fair degree of itemisation of deduction claims, presenting opportunities for non-compliance through deliberate, careless and ignorant behaviour resulting in over-claimed deductions, and associated understatements of taxable income and revenue leakage. As HELP debt repayment is based on reported taxable income and other tax return items (in HRI) it is not immune from the impacts of such non-compliance.

In analysing the taxpayer record data on deductions, some initial explanatory variables for taxpayer behaviour were able to be quickly dismissed because of the lack of any clear differences in patterns, this being the case with HELP and non-HELP taxpayers grouped by gender, employment status and occupation. What did prove significant was the age profile of taxpayers and whether they had deductions for work-related expenses or gifts. Since losses on rental investments cannot be offset against HRI income and HELP debtors are more often than not earlier in their career, it was decided that rental income and related expenses were unlikely to be a significant factor in reducing HRI.

4.2.1 *Work-related expenses*

Deductions for work-related expenses are the most commonly-claimed deduction item in personal tax returns. For the 2010–11 income year, total claims numbered just over 8.3 million (from a return population of around 12.6 million) and amounted to around \$18.3 billion.¹³ Across employee taxpayers earning in excess of \$30,000 and who are entitled to claim deductions for work-related expenses the incidence of claims exceeds well over 90 per cent. As such deductions are not subject to any form of systematic verification (such as a system of third party reporting as occurs for categories of income such as wages, pensions and interest income) the ATO can only validate the claims made in returns by individual audit inquiries. Given the vast number of taxpayers making deductions, the level of audit attention is extremely low (under 1%).

Over-claimed deductions are generally considered a compliance risk area and the ATO has regularly reported concerns for the incidence of over-claimed work-related deductions in tax returns in its annual compliance program statement.¹⁴ In 2008, Highfield¹⁵ in a submission to the review of Australia's Future Tax System (the so-called 'Henry Review') argued that the overall incidence of claims was likely to be in the region of 15 per cent. This claim was made on the basis of long experience with the administration of Australia's tax system and on observations of the experiences of revenue bodies such as Canada that had demonstrated such non-compliance levels from random audit programs. The AFTS (2009) review accepted these claims and its final report made two explicit recommendations advocating a tightening of the rules for work-related expense deductibility and the introduction of a standard deduction (comprising a nominal base amount for those with labour and/or capital income and a proportion of labour-related income up to a capped amount).¹⁶ As of 2014, neither the recommendations nor any other related reform measures had been implemented.

In the context of this study concerning the collection of HELP debts, the issue of over-claimed work-related deductions is relevant in two respects:

¹³ These data, obtained from *Taxation Statistics 2010-11*, relate to returns processed in the 16 month period after 30 June 2011. They will increase marginally (by around 7-8%) as further returns (i.e. late lodgements) are processed by the ATO after 31 October 2012.

¹⁴ For example, see *ATO Compliance Program 2007-08*, (page 12), *ATO Compliance Program 2008-09*, (page 17); and *ATO Compliance Program 2009-10* (page 8)

¹⁵ See http://taxreview.treasury.gov.au/content/submissions/post_14_november_2008/Highfield_Richard_20090425.rtf

¹⁶ *Australia's Future Tax System*, Chapter A1, page 35, Recommendations 11 and 12.

1. Does the design of the HELP debt collection element in the income tax system induce an even higher level of over-claimed deductions than might otherwise be the case?
2. Putting aside (1), what might be the impact of over-claimed deductions in general on the rate of HELP debt collection via the income tax system?

Deductions for work-related expenses were examined for both HELP and non-HELP debtors by both age groups and income levels. From a population of 125,349 taxpayer records—11,762 with HELP debts and 113,567 without—some 82,717 records with deductions for work-related expenses (WRE) were analysed. While this analysis for some categories was handicapped by relatively small sample sizes there are some discernible patterns suggesting the possibility of an increased tendency by taxpayers in some age groupings of HELP debtors to over-claim deductions to minimise HELP repayments. Based on the patterns evident in Chart 5 (and Annex 2) in relation to the incidence of claims and average claim value combined with a detailed review of the related data, the following findings can be made:

Age group: 20-29

- HELP debtors in this age grouping exhibit a marginally lower incidence of claims to non-HELP debtors (75.2%/76.7%) and a lower average deduction claim (\$1,705/\$2,093).
- Deductions claimed by HELP debtors rise marginally above those of non-HELP debtors immediately before the minimum threshold but their growth rate is not sustained vis-à-vis non-HELP debtors; an abnormal growth rate of HELP deduction claims was observed around the highest repayment rate threshold where the eight per cent repayment threshold rate commences.

Age group: 30-39

- HELP debtors in this age grouping exhibit a similar incidence of claims to non-HELP debtors (75%) and a marginally lower average deduction claim (\$2,401/\$2,549).
- Deduction claims of non-HELP debtors rise consistently while those of HELP debtors rise sharply immediately before the minimum repayment threshold and quickly fall away only to rise sharply again; a similar pattern was observed around the highest threshold where the eight per cent repayment rate commences.

Age group: 40-49

- HELP debtors in this age grouping exhibit a significantly lower incidence of claims to non-HELP debtors (68.3%/75.0%) but a marginally higher average deduction claim (\$2,395/\$2,346).
- Deduction claims of non-HELP debtors rise consistently while those of HELP debtors rise sharply immediately before the minimum threshold and quickly fall away only to rise sharply again; consistently above non-HELP debtors at all levels.

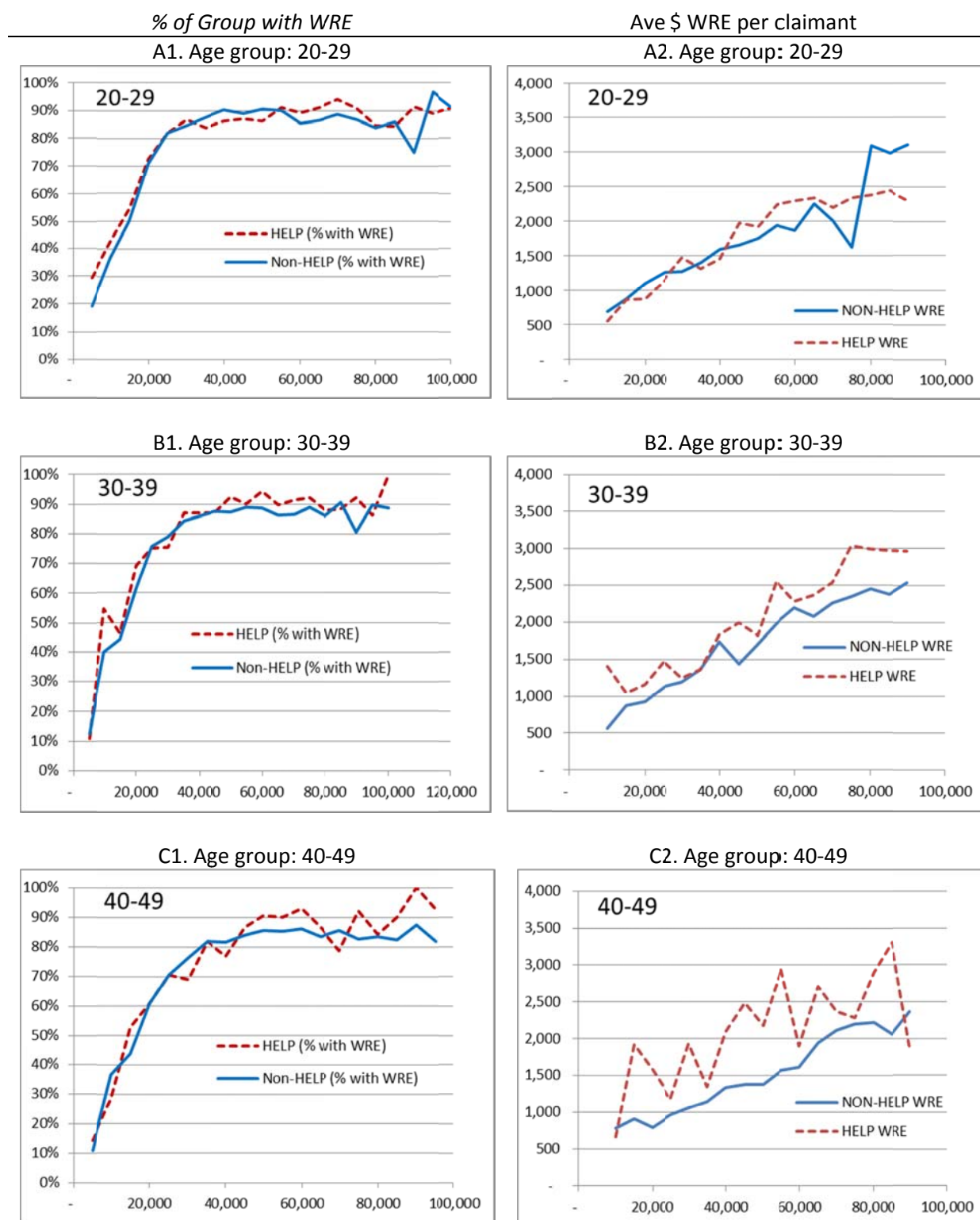
Age group: <20, 50+

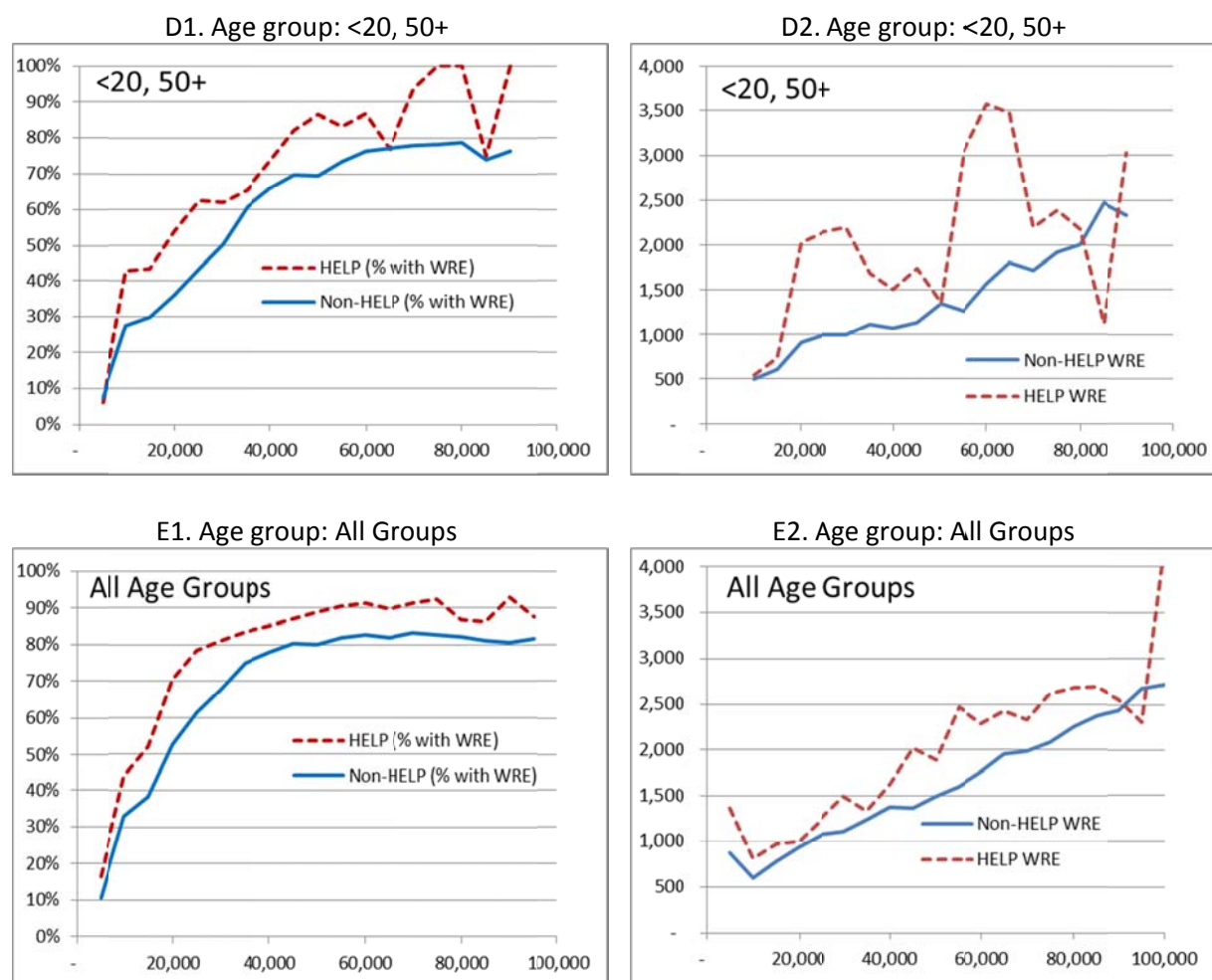
- HELP debtors in this age grouping exhibit a significantly higher incidence of claims to non-HELP debtors (62.2%/52.0%) but a lower average deduction claim (\$1,599/\$1,865).
- The HELP population is quite small and may not be reliable. However, the same sharp rise and fall of deduction claims by HELP debtors is evident around the minimum repayment threshold.

Overall

- Across all age groups and income levels, HELP debtors exhibit a significantly higher incidence of claims than non-HELP debtors (73.7%/65.2%) but a marginally lower average claim value (\$1,988 /\$2,183).
- Deduction claims of non-HELP debtors rise consistently while those of HELP debtors rise fairly sharply just before the minimum threshold and subsequent rate thresholds only to fall away and then rise marginally again.
- Across each and all age groups in aggregate HELP debtors exhibit a significantly higher incidence of deductions for self-education expenses (which are comprised in WRE aggregates). A higher incidence of deductions for self-education expenses among HELP debtors vis-à-vis non-HELP debtors is not surprising given that the former is likely to include a larger proportion of taxpayers in professions and who require ongoing training for career progression purposes. However, a Government discussion paper in 2013 proposing a \$2,000 cap on deductions for self-education expenses drew attention to the tendency for higher income earners to claim large deductions for such expenses that, while having some connection with their employment, provided a significant private benefit paid for by taxpayers at large).

Chart 5 Work related expenses by age group for HELP and non-HELP debtors: 2010-11





Source: ATO 1% Taxpayer Sample File and Annex 2

The second aspect examined ((2) above) concerns the extent to which the collection of HELP debts via the income tax system might be avoided or deferred by the incidence of over-claimed deductions, assuming a normal pattern of non-compliance of 15 per cent on average and a higher level of 20 per cent. Table 2 provides an estimate using data from the ATO one per cent sample file of the increased revenue from HELP debt repayments if 15 per cent or 20 per cent of work-related expenses were over-claimed and through improved compliance, addressed.

While the revenue raised through additional HELP repayments is relatively modest in both cases, the savings in personal income tax across HELP debtors would be three times higher. If WRE compliance was improved across all taxpayers then, as shown in Table 2, the additional revenue raised from personal income tax would be over 30 times greater than the change in HELP payments since in 2010–11 HELP debtors comprised 9.4 per cent of the one per cent ATO taxpayer sample file. This is a pattern of results common with the case where 20 per cent of deductions are over-claimed.

If the HELP schedule is in fact encouraging increased over-claiming of WRE, as evident through bunching around the minimum HELP repayment threshold, the

concern should clearly not just be with its impact on HELP debt repayments but on personal income tax collections where any learnt behaviour by HELP debtors will impact their compliance into the future, with consequential implications for revenue collection each year.

Table 2 Revenue impact from over-claimed WRE deductions (\$m): 2010–11

	% of WRE overclaimed			
	15%		20%	
	\$m	% income Tax	\$m	% income Tax
Personal Income Tax:				
All Taxpayers	815	0.6%	1,088	0.8%
HELP Taxpayers	70	0.1%	94	0.1%
	% HELP		% HELP	
	\$m	Repayments	\$m	Repayments
HELP Debt repayments	25	1.9%	33	2.5%

Source: Own calculations using 1% ATO Sample file

4.2.2 Gift deductions

Australia's tax laws provide deductions for gifts in excess of \$2 to approved benevolent institutions. For the 2010–11 income year, total deduction claims were around 4.8 million (from a return population of around 12.6 million) and amounted to \$2.2 billion.¹⁷ In aggregate, the value of deductions is concentrated among a relatively small share of the taxpayer population, with less than eight per cent of deduction claims representing around two thirds of the overall value of deductions. In other words, the vast majority of claims (over 92%) are for relatively small amounts (that is, less than \$1,000). Deductions are not subject to any form of systematic verification (such as via a system of third party reporting as occurs for categories of income such as wages, pensions and interest income) and, accordingly, the ATO can only validate the claims made in returns by individual audit inquiries. In practice, the level of gift deductions subject to audit inquiry is likely to be extremely low.

Domestic or foreign insights as to the likely incidence of over-claimed gift deductions could not be located other than a general observation that in the absence of third party reporting regimes the incidence of compliance by individuals the incidence of compliance by individuals is unlikely to exceed 85–90 per cent.¹⁸

As for work-related deductions, gift deduction claims were examined for both HELP and non-HELP debtors by both age groups and income levels. From a population of 125,349 taxpayer records—11,762 HELP debtors and 113,567 non-HELP debtors—some 47,583 records with gift deductions were analysed. While this analysis for some categories was handicapped by relatively small sample sizes there are some discernible patterns as shown in Chart 6 (and Annex 2), suggesting an increased

¹⁷ These data relate to returns processed in the 16 month period after 30 June 2011. They will increase marginally (by around 7–8%) as further returns (i.e. late lodgements) are processed by the ATO after 31 October 2012.

¹⁸ This observation is based on the published compliance research findings of both the Canada Revenue Agency and the United States Internal Revenue Service.

tendency for some age groupings of HELP debtors to over-claim deductions to minimise HELP repayments. The detailed findings are as follows:

Age group: 20-29

- HELP debtors in this age grouping exhibit a fairly higher incidence of claims than non-HELP debtors (33.9%/ 28.6%) and marginally higher average deduction claim (\$196/\$174).
- The incidence of claims, and their average value, by HELP debtors is significantly greater than non-HELP debtors at just about all income levels approaching and extending beyond the HELP debt repayment threshold (from \$40,000-85,000), as indicated in Chart 6.

Age group: 30-39

- HELP debtors in this age grouping exhibit a marginally higher incidence of claims than non-HELP debtors (40.0%/ 37.7%) and higher average deduction claim (\$301/\$266).
- The incidence of claims and their average value by HELP debtors increases fairly significantly for many income levels approaching and extending beyond the HELP debt repayment threshold (from \$40,000-85,000), as indicated in Chart 6, but not to the same degree observed for the 20-29 age group.

Age group: 40-49

- Sample populations for HELP debtors in this age group (1,254) are generally too small for drawing conclusions by income level; that said, across all income levels HELP debtors exhibit a significantly lower incidence of claims than non-HELP debtors (36.3%/ 42.4%) and a substantially lower average claim value (\$264/\$335).

Age group: <20, 50+

- Sample populations for HELP debtors in this age group (617) were too small for drawing any reliable conclusions.

Overall

- Across all age groups and income levels, HELP debtors exhibit a marginally lower incidence of claims than non-HELP debtors (36.0%/ 38.2%) and, not surprisingly, a substantially lower average claim value (\$247/\$350).

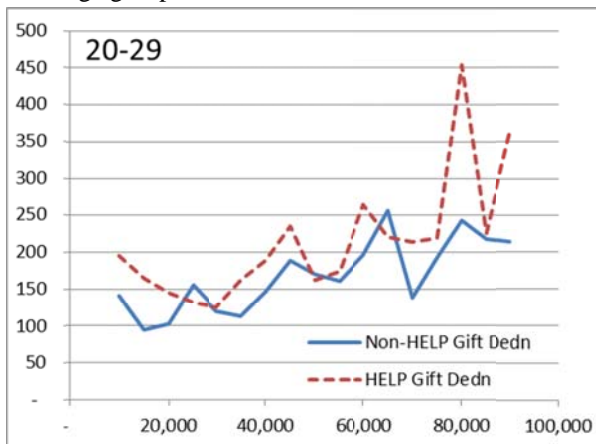
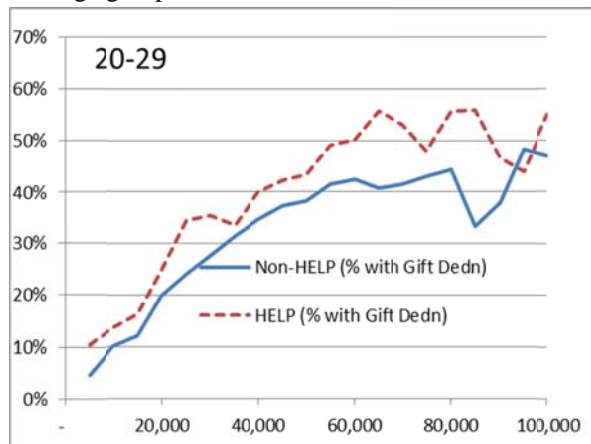
Chart 6 Gifts by age group for HELP and non-HELP debtors: 2010-11

% of Group with Gifts

Ave \$ Gift per claimant

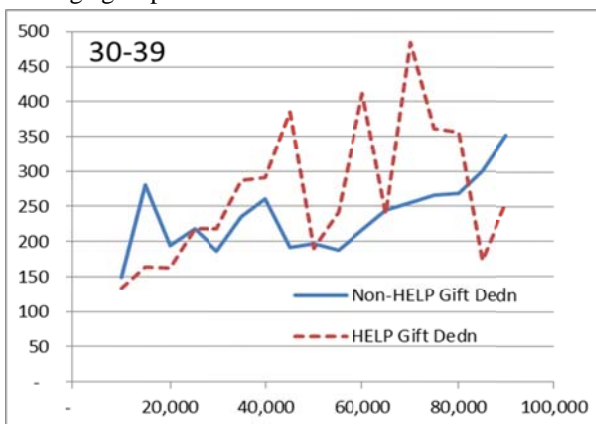
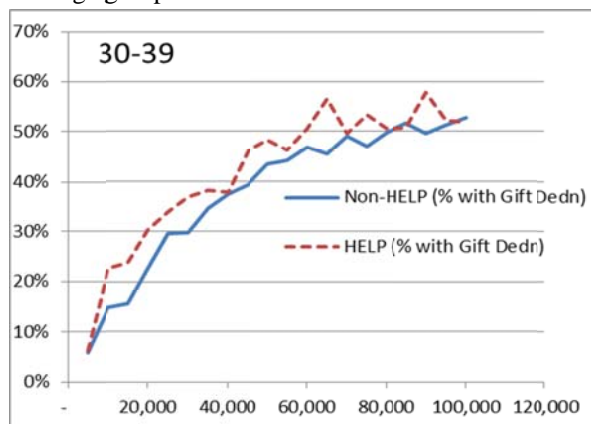
A1. Age group: 20-29

A2. Age group: 20-29

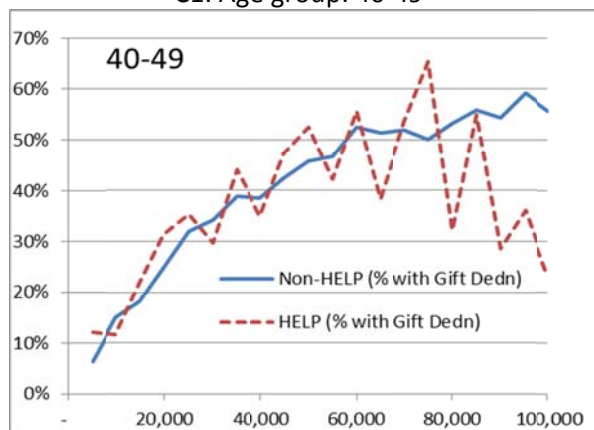


B1. Age group: 30-39

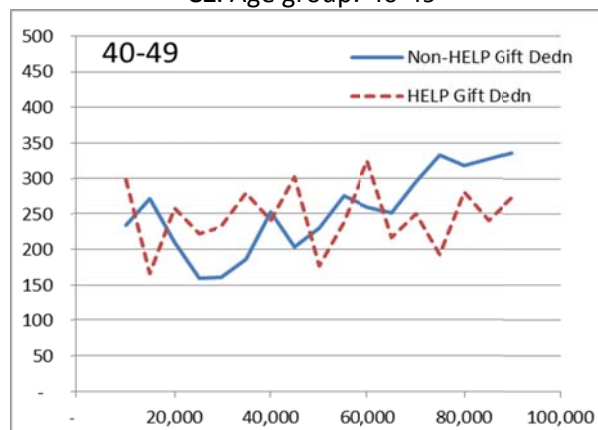
B2. Age group: 30-39



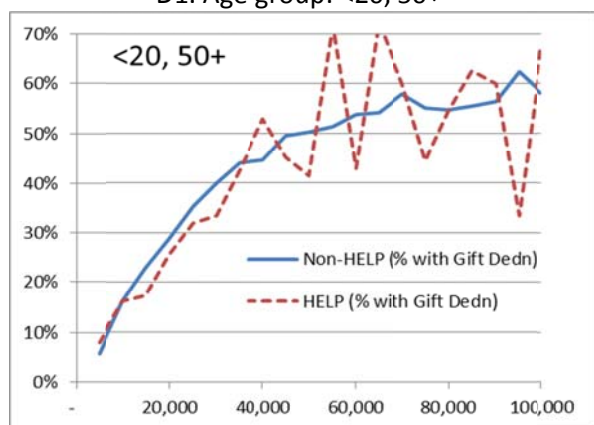
C1. Age group: 40-49



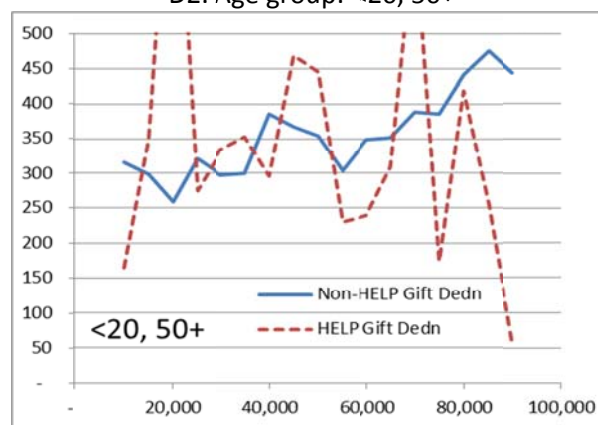
C2. Age group: 40-49



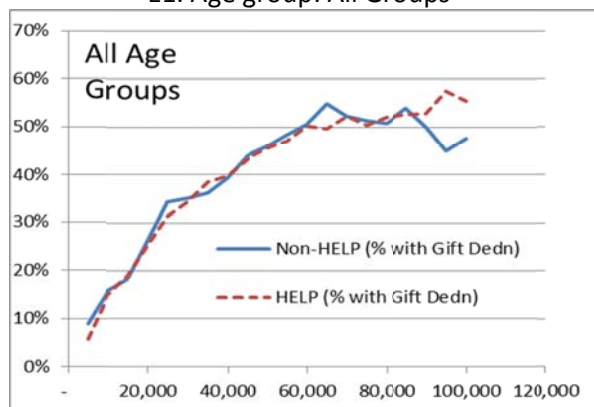
D1. Age group: <20, 50+



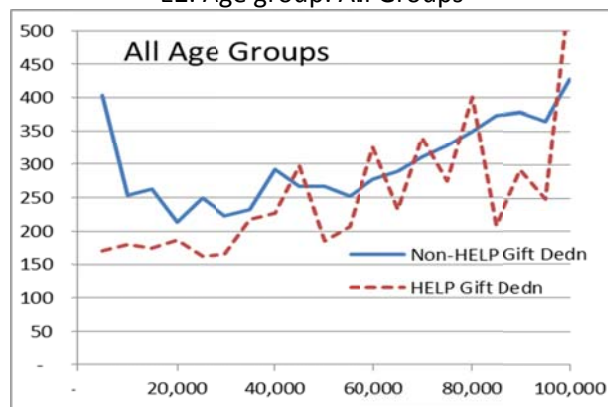
D2. Age group: <20, 50+



E1. Age group: All Groups



E2. Age group: All Groups



4.3 General non-compliance with the tax system

In addition to the over-claiming of deductions, taxpayers have a variety of other means to delay or avoid the repayment of HELP debt, including a failure to declare all assessable income in their returns or to lodge tax returns late or not at all. While there has been only limited qualitative research on this aspect the findings point to the

likelihood that some HELP debtors will be inclined to take steps to limit their exposure to HELP debt repayment.

Ahmed (2005) records the findings of a study undertaken to explore the question of whether schemes such as HELP pose extra challenges for the efficient functioning of the tax system because of the additional incentives they bring for non-compliance behaviour by those impacted and, if so, what strategies are needed to mitigate this situation. Ahmed's study relies on a number of qualitative surveys undertaken of a sample of students (at two universities in the Australian Capital Territory) and households to examine the relationship between carrying a HECS-HELP debt and cheating on tax. In the case of both sample surveys, they find that carrying a HECS-HELP debt was positively and significantly related to tax evasion, implying debt poses a compliance problem for tax authorities.

For this study, it was decided to focus on return non-lodgement as a means of avoiding or deferring the repayment of HELP debt.

4.3.1 Avoiding or delaying HELP debt repayment through the non-lodgement/ late lodgement of tax returns

As noted earlier, some HELP debtors may avoid or delay the repayment of their HELP debts by failing to lodge a tax return on time (or at all) where they have an obligation to do so and their income is above the minimum HRI threshold. However, such action risks detection by ATO enforcement programs that are undertaken to pursue outstanding personal tax returns.

The ATO does not publish regular and detailed information on aspects of its programs to detect and enforce the lodgement of tax returns (such as selection criteria, numbers pursued, and numbers filing after initial contact.). However, some details of the methods adopted and the overall incidence of non-lodgement/ late lodgement can be found in a report by the Inspector-General of Taxation (IGT, 2009) of a study into the incidence of return non-lodgement by personal taxpayers in Australia. According to the IGT's report, the study was prompted by information received indicating that many millions of non-lodged returns had accumulated which potentially involved large amounts of revenue.¹⁹ The ATO assisted with completion of this work by conducting a detailed study of its taxpayer database and third party reporting information sources, filtered using a variety of means to identify those records where a tax return was unlikely to be required, to arrive at an estimate of the proportion of the taxpayer population that should have lodged a return but had failed to do so. The IGT's study was also assisted by an independent community survey into the level of non-lodgement of tax returns as well as community attitudes to the situation.

The study concluded²⁰ that the number of non-lodged individual tax returns in any year can conservatively be estimated at between 1.2-1.5 million (around 9-10% of the total estimated population liable to lodge a tax return). However, the study made no reference to the incidence of non-lodgement by HELP debtors and, in fact, made no

¹⁹ *Review into the non-lodgement of individual income tax returns*, Inspector General of Taxation, June 2009
http://www.igt.gov.au/content/reports/non_lodgement_tax/non_lodgement_of_income_tax_returns_review.pdf

²⁰ *ibid* especially pp 7-8.

reference whatsoever to the existence of HELP debt as a risk criterion for lodgement enforcement purposes.

Taken at first glance, the relatively high incidence of return non-lodgement indicated in the IGT report would seem to imply significant non-compliance with tax laws (that would include some HELP debtors), albeit of perceived relatively low overall risk to revenue. However, there are some additional factors to be borne in mind, particularly in the context of HELP debt collection.

The IGT study, and the associated ATO study, were largely carried out in 2008 and took into account returns for the 2005–06 fiscal year that were lodged roughly in the following 18-24 month period. However, it is a characteristic of Australia's tax system that a fair number of personal tax returns are lodged relatively late, for some taxpayers many years after the relevant year of income. To illustrate this particular point, Table 3 sets out data on the numbers of personal tax returns lodged, both as reported in the IGT's report and more recently by the ATO in its annual statistical reports.

Table 3 Personal income tax returns lodged for the 2005–06 fiscal year

Point in time	Actual number of returns lodged (millions)	Estimated number of returns outstanding (millions)	Proportion of returns due but unlikely to be lodged (%)
At the time of the IGT/ ATO study (circa mid-2008)	11.51	1.5	11.5
As of October 2012	12.21 (1)	0.80 (1)	6.1

Source: ATO Taxation Statistics 2010-11;

(1) Numbers assume ATO's 2008 estimate of potential lodgement population have remained constant.

Drawing on the data in Table 3, it can be seen that the proportion of citizens required to lodge a return for the 2005–06 fiscal year but who never did, is likely to have settled at around six per cent of the estimated potential population, well below the 9-10 per cent level implied by the conclusions in the original IGT report. Of course, none of this should ignore the fact that the numbers of taxpayers lodging returns late and well after the relevant due date is large in absolute terms, which inevitably must have implications for both tax and HELP debt collection.

While the IGT study did not throw any light on the incidence of return non-lodgement by persons with HELP debts, it seems reasonable to conclude that it would have encompassed a representative proportion of HELP debtors. For the 2005–06 fiscal year that would represent a population of HELP debtors who should have lodged but have never done so of the order of 70,000, taking account of the ratio of HELP debtors to the total population of taxpayers for that fiscal year²¹. However, the numbers of such non-lodgers with income over the HELP repayment threshold cannot be estimated with any precision without further detailed analysis that can only be done within the ATO.

²¹ HELP debtors as at end 2005–06 numbered 1.185 million, or around 9% of the estimated taxpayer population for that year of 13 million (as per the IGT's report). With an estimated 0.8 million returns not lodged as at October 2012, the representative share of HELP debtors in this population could conceivably be around 70,000 (9%).

An additional consideration in the context of return non-lodgement (and also, tax debt collection) concerns the operation of the PAYG withholding arrangements that form part of the personal income tax system.

Many taxpayers who do not lodge returns are known to be employees whose income generally has been subject to withholdings of tax at source. Such withholdings, where properly made, reduce the risk to revenue resulting from return non-lodgement and this explains the generally low priority afforded by the ATO to lodgement enforcement in respect of taxpayers who are recorded as employees but who do not lodge returns as generally required under the law. Under the withholding provisions and related administrative procedures employees with HELP debts are required to inform their employers so that the appropriate level of withholdings can be made from their remuneration. However, from inquiries made with the ATO it appears that while employees' withholding declarations are computer processed there is no cross-checking made with the HELP debtors database to ensure that the taxpayers' status as a HELP debtor has been reported. For the future, as the population of HELP debtors grows to significant levels, there is merit in at least testing the potential value of systematic cross-checking with the HELP debtor database to minimize the incidence of insufficient withholdings.

4.3.2 Trends in late lodgement of returns by HELP and non-HELP debtors

For the purposes of this study research has been confined to examining recent ATO publications and other documents concerning lodgement enforcement activities, in particular any information concerning HELP debtors, and identifying the trend in the rate of return non-lodgement by both HELP debtors and non-HELP debtors over time.

A review of ATO publications (including annual compliance program statements, annual reports, and statistical publications) provided no explicit information concerning compliance activities involving HELP debtors. In line with this observation, discussions with ATO officials revealed that for fiscal years up to 2011–12 the existence of HELP debt had not been used as a specific risk criterion in lodgement enforcement processes, with HELP debtors being targeted indirectly through general lodgement campaigns and actions. More recently, it had been decided to vary this approach and in 2013–14 actions are being taken to give greater recognition to both the existence of HELP debtors and identified income sources indicating that the taxpayers concerned have income in excess of the HELP repayment threshold. As a result, there will be more targeted efforts undertaken to enforce the lodgement of outstanding tax returns from HELP debtors with income over the HELP repayment threshold.

Table 4 sets out data on the numbers of recorded HELP debtors at 30 June for the years indicated and a projection (based on the ATO sample file) of the number of them lodging and not lodging tax returns within 16 months after the end of the relevant fiscal year. Also included is identical information for the estimated population of non-HELP debtors at the same points in time. Of course, not all HELP and non-HELP debtors have an obligation to lodge a tax return each year but on the assumption that the proportion of either population remains roughly constant over time their respective trends and/or differences in the rates of non-lodgement could serve as indicators of likely movements in lodgement non-compliance.

Table 4 Indicators of tax return late lodgement by HELP debtors

Income year	HELP debtors				All taxpayers (excluding HELP debtors)			
	No. at end of income year (millions) (1)	No. lodging returns within 16 months (millions) (2)	No. not lodging returns within 16 months (millions)	Estimated non-lodgement rate (%)	No. estimated at end-fiscal year (millions) (5)	No. lodging returns within 16 months (millions) (6)	No. not lodging returns within 16 months (millions)	Estimated non-lodgement rate (%)
2011-12	1.681	1.259	0.422	25.1	13.562	11.055	2.507	18.48
2010-11	1.567	1.178	0.389	24.8	13.381	11.070	2.311	17.27
2009-10	1.462	1.108	0.354	24.2	13.172	10.918	2.254	17.11
2008-09	1.371	(3)	(3)	(3)	12.940	(3)	(3)	(3)
2007-08 (7)	1.313	1.036	0.277	21.1 (4)	12.695	11.327	1.368	10.78
2006-07	1.247	0.938	0.309	24.8	12.363	10.553	1.810	14.64
2005-06	1.185	0.854	0.331	27.9	12.099	10.325	1.774	14.66
2004-05	1.120	0.804	0.316	28.1	11.748	10.110	1.638	13.94
2003-04	1.200	0.838	0.362	30.3		9.778		

Notes:

- (1) Based on reporting in *Taxation Statistics* for the income years identified.
- (2) This number has been determined as follows: Number of HELP debtors lodging returns as per ATO sample file for the income year x 100).
- (3) Extract of the sample file for this year indicated that it may not have reflected a true representation of HELP debtors. This issue has been brought to the attention of the ATO. Accordingly, neither the number of HELP debtors lodging returns nor rate of non-lodgement could be estimated.
- (4) This abnormally lower rate can be attributed to the significant 'bring forward' of return lodgement in 2008-09 (of 2007-08 returns) with the then Government's tax bonus measure to offset the impacts of the global financial crisis.
- (5) Derived using the estimated potential taxpayer population identified for 2005-06 (i.e. 13.22 million) in the IGT's study on non-lodgement, adjusted to exclude HELP debtors and to take account of annual growth in the official labour force.
- (6) Based on reporting in *Taxation Statistics* for years identified, adjusted for number of HELP debtors lodging returns.
- (7) The abnormal 'once off' shift in lodgement patterns that occurred in respect of returns for the 2007-08 financial year were the result of the Government's once off cash bonus whose receipt was conditional on lodging a tax return. The trend estimated rate of non-lodgement has therefore continued its rising trend.

Drawing on the data provided, it will be seen that there is a statistically significantly higher rate of non-lodgement among HELP debtors vis-à-vis non-HELP debtors pointing to a possible increased tendency by HELP debtors to not lodge returns when required. A more intensive examination of individual tax records, which only the ATO could carry out, would be required to quantify the significance of this difference with any precision and an acceptable degree of confidence.

With aggregate HELP debt and the numbers of HELP debtors projected to grow significantly in the years beyond 2010-11 (Table A6), the larger proportion of taxpayers exposed to HELP debt repayment in the future can be expected to result in a larger number of taxpayers being tempted not to lodge returns on time and possibly not at all. This suggests the need for increased vigilance by the ATO not only in relation to return non-lodgement but also to ensuring that the PAYG withholding provisions are applied as intended for employees who are HELP debtors and are deriving income likely to exceed the annual threshold for repayment.

4.4 Exit strategies to escape HELP repayment

A person has two ways of exiting (and escaping) their HELP debt repayment. Firstly, at the point of death, any HELP liability is extinguished by the ATO. Secondly, if a debtor leaves Australia to live overseas, their overseas or non-Australian-sourced income is not taken into account for assessing HELP debt repayments. Only when their Australia-sourced income exceeds the minimum HRI threshold are they obligated to make a loan repayment and then only base on their Australia-sourced income. If they do not return to Australia, both their loan balance and its on-going interest cost are borne by the Government or more precisely, by all taxpayers. This ‘gap’ in the loan repayment mechanism has been criticised on the grounds of its fiscal cost and the inequity vis-à-vis debtors in similar circumstances in Australia who are obliged to make loan repayments.

Using a variety of data sources and assumptions under differing scenarios Chapman and Higgins (2013) derive an estimate, conservative in their view, that the foregone revenue from this perceived shortcoming in the repayment regime was around \$400 million for the period 1989 to 2011. However, they note that under other plausible assumptions, the foregone revenue could be close to double this amount. Foregone revenue of \$400 million over this period would approximate to the loans outstanding of around 25,000 borrowers.

After noting that a number of other countries (including New Zealand, United Kingdom and United States) attach some importance to enforcing the payment of such loans by non-resident borrowers, Chapman and Higgins (2013) conclude by stating “the fact that the Australian Government has not enacted any policy step to address the costs of unpaid HELP debts from those going overseas is both a curiosity and a policy indictment. Possible solutions to the issue are worth considering, given that the costs reported in this article illustrate that the problem is both non-trivial and becoming increasingly significant” (p295).

For the purposes of this study, the findings and conclusions of Chapman and Higgins are accepted. Furthermore, it is noted that a number of other countries have not been deterred by the challenge of seeking loan repayments from debtors living outside of their respective countries and have implemented a variety of policy and administrative measures to this end.

New Zealand is a particularly useful example to acknowledge, especially as its ‘Overseas-based Borrower Compliance Initiative’ extends to New Zealanders living and working in Australia and the United Kingdom. This is achieved through a suite of administrative requirements designed to encourage overseas-based debtors to meet their obligations when they satisfy the income criteria for repayment. These requirements include obligations on debtors to 1) notify tax authorities when leaving the country; 2) provide a contact address while overseas; 3) report details of income received; and 4) make repayments where income exceeds the repayment threshold. Furthermore, while student debt is not indexed for domestic residents, it is indexed for those living overseas. The New Zealand approach has helped reduce the incidence of the amounts owed by overseas-based borrowers and improved their compliance behaviour. However, this population continues to represent an increasingly disproportionate share of overdue debt—in 2013, they represented 15 per cent of all

borrowers, 62 per cent of borrowers with overdue debt, and 84 per cent of the total amount overdue²².

Contributing to this outcome is the fact that overdue debts of overseas-based debtors attract interest while those of residents do not. Furthermore, a voluntary repayment bonus that operated from April 2009 and whose terms favoured resident loan debtors, achieved considerable success in encouraging payments from resident loan debtors but much less so from those based overseas. With the benefits of the voluntary repayment bonus no longer applicable and toughened administrative procedures in place, overseas-based debtors have a strong incentive to remain overseas and, in the views of some commentators, are being prevented unfairly from returning to New Zealand.²³ Unlike Australia however, New Zealand has an active and open discussion about strategies capable of encouraging student loan repayment as evident from a recent annual report on the Student Loan Scheme.²⁴

Given the current level of Australia's HELP debt inventory and future projections of its growth, not to mention broader Government budgetary considerations, it is hard to conceive a defensible rationale for Australia ignoring any longer such an obvious weakness in the HELP debt collection framework. Recommendation 4 of the recently completed Senate Education and Employment Committee *Report into the Higher Education and Research Reform Amendment Bill 2014* recommended that the government explore avenues to recover HELP debts of Australians residing overseas.²⁵ Norton (2014, p38) in a report for the Grattan Institute recently argued that not only should those with a HELP debt and overseas be required to make HELP repayments, but so too should the estates of those deceased who still have a HELP debt, an issue pursued further in Section 5.5.

4.5 Performance of the tax administration

With the vast majority of HELP loan repayments made directly through the income tax system—both through the PAYG withholding system and the tax return self-assessment process—the ATO has important responsibilities for ensuring that the HELP repayment mechanism operates effectively. To understand how the ATO carries out its responsibilities and to gain some insights as to its overall performance, available published materials were reviewed, including ATO annual performance reports and statistical tabulations, annual compliance program statements, and other available reports dealing directly or indirectly with aspects of HELP administration.

Generally speaking, a reasonable level of statistical reporting was found on the overall level of HELP debt and assessments raised through the income tax system and

²² See discussion on New Zealand Inland Revenue's overseas-based borrowers' initiative in *NZ Inland Revenue Annual Report 2012* p25 <http://www.ird.govt.nz/aboutir/reports/annual-report/>

²³ Source: Blog http://www.students.org.nz/continuing_changes_to_student_loan_now_include_prison_time

²⁴ See discussion on the Overseas-based Borrower Compliance Initiative in *Student Loan Scheme Annual Report 2013*, Education Counts, New Zealand Government, p36 <http://www.educationcounts.govt.nz/publications/80898/2555>

²⁵ See Australian Parliament, Senate Education and Employment Committee, *Report into the Higher Education and Research Reform Amendment Bill*, October 2014, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Education_and_Employment/Higher_Education/Report

features of the HELP debtor population (including the size of debts and average time to repay debts). Such information has been used in various parts of this study to determine, for example, the magnitude of recorded HELP liabilities, rates of collection, and their trend over time. However, no publicly-available information on compliance-related aspects of the personal tax system concerning HELP debt collection could be identified, resulting in the need for some informal inquiries to tax officials for any further information that might be made available on these matters. From these inquiries it would appear that until very recently the operation of the HELP debt collection mechanism of the income tax system (including the PAYG withholding provisions) has largely been considered as an incidental element of a much larger income tax system and given limited explicit recognition in a tax compliance context. In our view, while such a position may have been justified in the past when the HELP debtor population and debt were much smaller this is no longer the case. Furthermore, the findings described in Section 4 of this report provide indications that HELP debt is influencing the income tax compliance behaviour of many taxpayers in a variety of ways, with negative revenue consequences, both in relation to the collection of HELP debts and personal income tax.

There are some concerns for the future, particularly when expected growth patterns in overall HELP debt and debtor populations are taken into consideration. With the ATO's recent decision to no longer publish its long-standing *Taxation Statistics* series, information on the ATO-administered aspects of the HELP scheme could, in the absence of alternate reporting measures, become less transparent and more complex to readily assemble. A more significant concern, and this also pertains to the reporting responsibilities of the Department of Education, is that compared with the level of reporting observed in respect of New Zealand's student loan scheme,²⁶ the overall level of reporting that is publicly available on Australia's student loan scheme is severely lacking and warrants urgent consideration.

4.6 Summary of observations

Against the background of low overall collections and rapidly growing debt our research points to a range of contributing factors:

- A relatively generous minimum repayment threshold in the income tax assessment process (especially having regard to regimes in similarly advanced economies);
- A relatively high value initial payment on entry into the repayment regime (now over \$2,000 on the first \$1 of income above the minimum HRI threshold) which is likely to act as an incentive for a fair number of debtors to not comply by not properly reporting all income and deductions.
- Evidence of bunching of HELP debtors' WRE claims around the repayment thresholds, especially the minimum one, suggesting indications of over-claimed deductions.
- A higher incidence of self-education WRE among HELP debtors; collection priority should be given to collecting HELP debt before further benefits are given to HELP debtors on account of their education.

²⁶ Above 24

- A higher (unexplained) incidence of gift deductions among HELP debtors in some age groups.
- A collection gap: HELP debtors living and working overseas have no obligations to make repayments even where their income is above the minimum threshold—this is inequitable and costly to Government.
- Progressive erosion of incentives for upfront or voluntary debt repayments.
- The need for a more robust and comprehensive policy in the ATO to identify and address the risks to income tax non-compliance by HELP debtors.
- While HELP debtor activities may postpone HELP debt repayment, the impact each year on personal income tax collections is final and unrecoverable.

5. WHAT HELP DESIGN AND ADMINISTRATIVE REFORMS WOULD ADDRESS INCOME TAX INTEGRITY CONCERNS?

5.1 Do prospective HELP changes address or exacerbate HELP debt?

A range of actions have recently been taken by the Commonwealth which have directly impacted on HELP debts or will do so into the future:

1. expanded access;
2. reduced upfront discounts (and their ultimate elimination); and
3. 2014–15 Budget announcement to deregulate university fees and to modify the design of the HELP regime (that is, indexation, repayment thresholds and rates of repayment).

5.1.1 *Expansion of access*

The dramatic expansion of access to HELP followed the release of the Bradley Review²⁷ in 2008 in which the Commonwealth Government moved to lift the Commonwealth supported places over-enrolment cap from five per cent to 10 per cent in 2010 and 2011 and then uncapped these places from 1 January 2012. In the 2013–14 Budget it was announced that Student Start-up Scholarships would no longer be a grant but become an income contingent loan and part of HELP. At the same time, following a review of VET-FEE HELP,²⁸ as shown in Table A3 there is a planned rapid escalation in VET-FEE HELP in forthcoming years. In the 2014–15 Budget, the

²⁷ See Review of Australian Higher Education at <http://www.innovation.gov.au/highereducation/ResourcesAndPublications/ReviewOfAustralianHigherEducation/Pages/ReviewOfAustralianHigherEducationReport.aspx>

²⁸ VET FEE-HELP provides income contingent loans to students of higher-level VET courses such as diplomas and advanced diplomas. The scheme has been expanded following a review reported in: <http://ris.finance.gov.au/files/2012/10/03-VET-FEE-HELP-REDESIGN-RIS.pdf>
http://www.tda.edu.au/cb_pages/files/VET%20FEE-HELP%20Redesign%20Discussion%20Paper%20Final.pdf
http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201314/VocationalEducat

Trade Support Loans for apprentices (capped at \$20,000) would also become part of HELP and those apprentices who successfully complete their training would receive a 20 per cent discount on the amount to be repaid.²⁹

5.1.2 *Reduction and elimination of discounts*

The progressive reduction and eventual abolition of the HECS upfront fee discount and upfront HELP debt repayment discount are shown in Table A1.³⁰ The combined effect of expanded access and reduced discounts is, as shown in Table A6, to rapidly escalate HELP debt and debtors such that by 2017–18, around 26 per cent of those aged 18–54 years are likely to have some HELP debt and confront the average and marginal tax rates shown in Table 1 and Chart 1. While the expansion of HELP access might be important, so too is attention to a program for mitigating the incentive for taxpayers to not comply with their HELP repayment obligations and in turn impact adversely on income tax integrity.

*2014–15 Budget decisions*³¹

In May 2014, the Commonwealth announced as part of the 2014–15 Budget a number of proposals which, if implemented as intended, will have a significant overall impact on the future growth of HELP debt and its repayment:

- Changes to higher education will allow universities to set their own tuition fees from 2016. (For students already studying, existing arrangements will remain until the end of 2020.)
- The Government will reduce the income threshold for repayment of *Higher Education Loan Program* (HELP) debts commencing in 2016–17 and will adjust the indexation of HELP debts from 1 June 2016. (This is estimated to achieve savings of \$3.2 billion over four years from 2014–15.)
- A new minimum threshold will be established for the repayment of HELP debts, set at 90 per cent of the minimum threshold that would otherwise have applied in 2016–17. The new minimum threshold is currently estimated to be \$50,638 in 2016–17. A new repayment rate of two per cent of repayment income will be applied to debtors with incomes above the new minimum threshold (as indicated by the dashed line in Chart 1). There will be no other change to current repayment rates.
- The annual indexation applied to HELP debts will be adjusted from the Consumer Price Index to a rate equivalent to the yields on 10 year bonds issued by the Australian Government, capped at six per cent per annum, from 1 June 2016.
- From July 2014, the Government will also support those learning a trade by providing concessional Trade Support Loans of up to \$20,000 over a four-year apprenticeship, repayable under HELP and with a 20 per cent discount upon completion of the apprenticeship.

²⁹ 2014–15 Budget Paper 2, *Budget Measures 2014–15*, p172 See http://www.budget.gov.au/2014-15/content/bp2/download/BP2_consolidated.pdf

³⁰ This was scheduled for 1 January 2014 but to date, the legislation enacting the abolition of the upfront fee and debt repayment discounts has not been enacted.

³¹ These announcements are conditional on their approval by Parliament.

- The HECS-HELP benefit, which was intended to provide an incentive for graduates of particular courses to take up related occupations or work in specified locations will end from 2015-16. (This follows a recommendation of the *Review of the Demand Driven Funding System*³² that the benefit be discontinued, there being little evidence it had been effective in addressing skill shortages.)

As noted in 3.2, the combined impact of these changes over the medium term will be to significantly increase both the overall level of HELP debt and numbers of debtors. Realistically, this can only have a negative impact on tax compliance and collections of personal tax if not rigidly enforced.

5.2 Should HELP income definition be broadened? (Y')

Possible responses capable of removing these disincentive effects must begin with designing HELP parameters (Figure 1) in such a way as to remove scope for behavioural responses by HELP debtors that are designed to avoid or evade repayment of their debt. Since HELP repayments are determined by HRI (Y') and the repayment schedule (h, H), an obvious first line of any strategy would be to define HRI in such a way as to minimize the scope for the debtor to have discretion over its value without directly impacting their well-being. One obvious option is to exit the country (Section 5.4 below) but another is to receive income in a way which impacts HRI but not the welfare of the individual. This could be achieved through manipulating HRI by receiving income in non-taxable forms or incurring expenses deductible against income included in HRI (Section 6). Since HRI is directly related to taxable income under the personal income tax, there is limited action that can be undertaken with HRI independent of taxable income. However, as shown in Annex 1, while HRI was once equivalent to taxable income it is now much broader and removes scope for HELP debtors to use losses, fringe benefits or superannuation contributions to reduce their HELP debt repayments. What scope does remain for broadening HRI is evident from a review of the tax expenditure statement prepared by Treasury.³³ Omitted from HRI is the capital gains discount on investments other than the main residence, all capital gains on the main residence, the concessional treatment of non-superannuation termination benefits and of superannuation entity earnings.

As shown in Table 5, past moves to expand HRI to include reportable fringe benefits (RFB) and investment losses have prevented avenues for some HELP debtors to avoid HELP repayments. Another approach to broadening HRI would be to reduce those deductions which can be offset against income and therefore impact HRI. This was effectively the outcome of not enabling losses on investments (especially residential property) from being deductible against HRI (Annex 1). Table 5 outlines the HELP repayments and debtor impact in 2010–11 of moving to disallow either just work-related expenses or all deductions. By disallowing WRE, the number of HELP debtors making repayments would increase 6.4 per cent and repayments 9.5 per cent, while if 'all deductions' were not allowed, the respective figures would be 7.2 per cent and 11.1 per cent. Broadening the base obviously not only increases the number of

³² See <http://www.education.gov.au/report-review-demand-driven-funding-system>

³³ See <http://www.treasury.gov.au/Treasury%20Home/PublicationsAndMedia/Publications/2014/TES%202013>

HELP debtors liable for repayments, it also increases repayments by those already making payments.

Table 5 Impact of broadening HRI in HELP: 2010–11

	Base Case (BC) with:					
	No change	RFB and losses ignored	RFB ignored	Losses ignored	Deductions disallowed	WRE deductions disallowed
Revenue (\$m)	1,732	1,562	1,618	1,677	1,925	1,896
Taxpayers with HELP Repayment liability	402,700	375,700	383,000	396,100	431,800	428,600
HELP Debts with Repayments as a % of:						
All Taxpayers	3%	3%	3%	3%	3%	3%
All HELP debtors	34%	32%	33%	34%	37%	36%
Change from Base Australian case of:						
Popln making HELP Repayments	0	-27,000	-19,700	-6,600	29,100	25,900
Revenue (\$m)	0	-171	-114	-55	192	164

Source: Own estimates using ATO 1% Taxpayer file

5.3 Should the HELP repayment schedule be changed? (h, H)

While broadening HRI can increase HELP repayments, a more direct approach is to change either the rate of repayment (h) or the threshold (H) at which those different rates apply. Annex 1 sets out the rate schedules which have applied since 2000–01 and Table A1 calibrates the highest and lowest thresholds against AWOTE.

Most striking about the trends in Table A1 is the degree of movement in both the thresholds and rate over time. While the income contingent loan system was introduced in a way designed to only impact on those on around 90 per cent of AWOTE, the need for increased revenue saw the lowest thresholds reduced to around 55 per cent of AWOTE in 1997–98 and when the lowest rate was increased from three per cent to four per cent in 2004–05, the lowest threshold was increased to 68 per cent of AWOTE.

With the rapid expansion of the HELP scheme since 2005 into VET programs (Tables A1 and A2), it can be expected that many lower income HELP debtors will enter the scheme. If the capacity of the Commonwealth to fund HELP debts from general revenue is diminishing, then attention must inevitably be given to how the threshold (H) and rate (h) are set.

Both NZ and the UK have recently sought to address just this issue by adjusting both the threshold and rate of repayment under their income contingent student loan schemes³⁴. Table 6 presents the results from applying to Australia the current UK and NZ repayment schedules for their income contingent student loan schemes. The thresholds in each case are set on the basis of the average weekly earnings in the respective countries and applying that ratio to devise an Australian scheme. There is, however, one key difference between the Australian and UK and NZ schedules: while the Australian schedule applies a flat rate to all income once that rate is determined (Table 1 and Chart 1), the UK and NZ schemes only apply the rate on the excess of income above the threshold.

³⁴ The UK also moved to increase the student contribution as an increased the repayment rate and threshold.

With NZ applying a rate of 12 per cent at 35 per cent of average weekly earnings and the UK a rate of nine per cent applied at 84 per cent, Table 6 estimates what impact such schedules would have on HELP repayments and the number of HELP debtors making such repayments in Australia. What is apparent is the relatively generous approach in the UK and the strident approach taken in NZ to recouping the cost of providing tertiary education. Applying the NZ model in Australia would have seen the number of HELP debtors making repayments increase some 85 per cent from current levels and the level of repayments increase by just over 50 per cent.

Even if Australia was to introduce the initial threshold (in real terms) that it had in place in 2003–04, the effect would be to increase the number of HELP debtors required to make a repayment by nearly 40 per cent and the amount of repayment by 34 per cent. If a decision was made not to raise increased revenue from this change but to reduce the repayment rates each by two per cent so that the rates varied between two per cent and six per cent, the reduction in the threshold would be revenue neutral (Table 6) and act to reduce (but not eliminate) the pattern evident in Chart 1. If instead it was decided to both reduce the initial threshold to comparable levels to that in NZ and reduce the rates each by two per cent, Table 6 shows that an additional \$869 million would be raised, resulting in revenue not too dissimilar from that raised from NZ's 12 per cent rate imposed above the threshold.

In contrast, the approach announced in the 2014–15 Budget (shown in Table 1) is to set from 2016–17, a new lower threshold at 90 per cent of the existing four per cent threshold and to impose a two per cent rate before the 4 per cent threshold comes into force. The effect of this proposal as shown in Chart 1 will be to reduce the impact of stepping up initially to a four per cent rate, an approach justified given the significant disincentive that exists with the current repayment regime. There is however, still a case for a lower overall threshold, especially with the planned expansion of the HELP scheme to include institutions who can compete with current tertiary institutions in offering diploma, advanced diploma, associate degree and bachelor degree level course but who might receive lower remuneration upon graduation arising from the public standing of the institution.

Table 6 Impact of alternative HELP repayment schedules: 2010–11

	Australian Model				NZ Model (c)	UK Model (c)
	Actual Rates and	2003-04 Thresholds (b)		NZ Thresholds		
	Thresholds(a)	Actual Rates (a)	Rates less 2%	Rates less 2%		
Lower Threshold: % of Average Weekly Earnings	68%	52%	52%	35%	35%	84%
\$A equivalent (Dec 2013)	45,913	34,625	34,625	23,287	23,287	56,492
Repayment Rate	4%-8%(a)	4%-8%(a)	2%-6%	2%-6%	12%	9%
HELP Repayments (\$m)	1,732	2,323	1,764	2,601	2,628	518
Change from Aust Case (\$m)	0	591	32	869	896	-1,214
Taxpayers with HELP Repayment liability	402,700	559,100	559,100	745,500	745,500	263,000
Change in taxpayers from Australia Case	0	156,400	156,400	342,800	342,800	-139,700
HELP Debtors with repayments as a % of:						
All Taxpayers	3%	4%	4%	6%	6%	2%
All HELP debtors	34%	47%	47%	63%	63%	22%

Note:

a. A flat rate of between 4% to 8% applies to all income when income exceed an income threshold (as detailed in Annex 1 and Table 5)

b. Thresholds for 2010-11 are set on the basis that the ratio of threshold to AWOTE in 2003-04 applied in 2010-11.

c. NZ schedule is 12% on income above NZ\$19,084pa and the UK schedule, 9% on income above £21,000

Source:

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6302.0Nov%202013?OpenDocument>

<http://www.ird.govt.nz/studentloans/guide/changes/>

<http://www.stats.govt.nz/~media/Statistics/Browse%20for%20stats/QuarterlyEmploymentSurvey/HOTPD13qtr/QuarterlyEmploymentSurveyDec13qtrH>

<https://www.gov.uk/student-finance/repayments>

Source: Own estimates using ATO one per cent taxpayer file

What is apparent from the discussion in this section and the results in Table 6 is that attention to the rate and threshold associated with HELP repayments is a critical first step in any move to increase repayments. However, given the significant disincentive effects associated with the current repayment schedule design (evident in Table 1), any action to lower the threshold and expose more HELP debtors to such disincentives must be associated with greater attention to limiting the scope for such debtors to respond adversely.³⁵

5.4 Would new exit rules HELP? (e)

At its simplest, an income contingent loan is designed to enable a person to enhance their human capital skills and, when the return from that human capital is realised, to use their increased earnings to fund repayment of the loan. While how to measure HRI and where the lowest HELP repayment threshold should be set are key considerations, it is meaningless if debtors can escape their loan obligation by simply changing their country of residence. While both NZ³⁶ and the UK³⁷ have programs in place to recoup outstanding loans from non-resident debtors, Australia has no such program. In the case of NZ, their program is now complemented with provisions that

³⁵ Under NZ and UK repayment schedules, the marginal and average rates differ at different income levels whereas under the Australian schedule, they are the same. As shown in Table 1, this results in real incentives for debtors to keep below HELP repayment thresholds. A lower rate associated with any lowering of thresholds (especially the initial threshold) would begin to address this issue.

³⁶ See NZ Inland Revenue Department Annual Report 2013, p24, <http://www.ird.govt.nz/resources/6/4/643702804171ef74bb01fb6fe0111a70/annual-report-2013.pdf> and, see <https://www.ird.govt.nz/studentloans/overseas/making-payments/#01>

³⁷ For the UK see http://www.studentloanrepayment.co.uk/portal/page?_pageid=93,6678653&_dad=portal&_schema=PORTAL

include ‘arrest at border’ legislation for those with overdue debts who do not notify authorities of their intention to travel overseas.³⁸

If these debts were a factor in the individual deciding to reside in another jurisdiction, this obviously has implications for integrity of domestic personal income tax. However, in the majority of cases, such debts will not be the primary consideration. Nonetheless, not having in place any program designed to address outstanding debts from income contingent loans for tertiary study does undermine the integrity and sustainability of the scheme in the long term in an environment where tertiary-educated individuals are more mobile across international frontiers.

However, there is some debate about the effectiveness of the schemes and the need for bilateral arrangements between countries where debtors are working in order for the schemes to be effective. Voluntary repayments are fine in principle but problematic in practice, as noted by the UK NAO in their review of student loan payments.³⁹

Suggestions have been made by Chapman and Higgins (2013) that a legal obligation be imposed on those who go overseas for more than six months to repay a minimum HELP obligation of \$2,000 a year (on a self-assessment basis). In principle, their concern for this gap in HELP debt collection is shared and one can expect that the changes announced in the 2014–15 Budget will, if implemented, only increase the incentive for new graduates to seek employment overseas. However, a repayment of \$2,000 per annum would be a relatively modest amount for some debtors working overseas noting, for example, that a counterpart (with a HELP debt) remaining in Australia and earning say \$80,000 in 2013–14 would be expected to repay some \$5,200 of their HELP debt on assessment (Table 1). An alternative approach would be to require HELP debtors working overseas to report their annual income, thereby enabling a more realistic and equitable assessment to be made of their capacity to repay HELP debts.

5.5 Should outstanding debts be paid from debtors’ estates? (e)

Norton (2014)⁴⁰ argues that outstanding HELP debts should be collected from the estates of debtors, as would normally apply in the case of other debts of deceased debtors. When the Commonwealth Minister for Education, Christopher Pyne⁴¹ raised the possibility of this during the post 2014–15 Budget discussion, it was immediately described in some quarters as a ‘death’ tax.

While the equity arguments underpinning this suggestion are acknowledged, consideration of such any proposal along these lines also raises the legitimate issue of why repayments of HELP debt from capital assets might only be sought on the death of HELP debtors. For example, under current taxing arrangements, taxpayers (and HELP debtors) can enjoy certain capital gains free of any tax liability (as with sales of residence and lottery winnings) while only 50 per cent of assessable capital gains form

³⁸ See <http://taxpolicy.ird.govt.nz/publications/2013-commentary-sls-3/policy-changes>

³⁹ See http://www.nao.org.uk/wp-content/uploads/2013/11/10307-001-Student-loan-repayments_BOOK-ES.pdf

⁴⁰ See <http://grattan.edu.au/static/files/assets/dc751829/809-doubtful-debt.pdf>

⁴¹ See <http://www.smh.com.au/federal-politics/political-news/christopher-pyne-suggests-collecting-hecs-debts-from-dead-students-as-way-to-help-budget-20140528-394rx.html>

part of an individual's taxable income and are therefore taken into account for HELP repayment purposes.

In short, the suggestion of HELP debts being paid from debtors' estates warrants consideration but ideally in the context of a broader review of assessing all of the issues relevant to determining the debtors' capacity to repay their HELP debts.

5.6 Fee share (g), access (F) and loan limits (ΣX , X)

If the concern of government is less with the aggregate level of HELP debt in the long term and more with receiving a greater return in the short term, a laterally-based strategy might be to expand access to the scheme (F), as has been done in Australia, and to raise the contribution by individuals to the cost of tertiary education to government (g), as the UK did when it allowed institutions the option to increase tertiary fees up to a maximum of £9,000pa from the previous £6,000pa in 2012. A consequence of such a scheme is a high level of HELP debt and the likelihood that a substantial proportion of this debt might inevitably be written off. However, such an outcome might not be a problem if the original intention was to have those with a greater ability to pay, to pay more and those less able, to pay less.

To prevent individual debt from becoming unsustainable in such situations, an option available is to cap the size of the loan (ΣX). Australia has taken such an approach in the case of loans obtained through FEE-HELP as shown in Table A1 and, in the case of HECS-HELP, moved to capped access between 2005 and 2011 at seven effective full-time student load (EFTSL). This cap was removed in 2012 for HECS-HELP, an approach in common with NZ and UK.

However, in the 2014–15 Budget, it was announced that from 2016, Universities would have payments for their Commonwealth Supported Places reduced, the 'student contribution' uncapped and HECS-HELP uncapped. This policy proposal has been highly controversial and whether it is ultimately implemented is unclear. However, what is clear is that while increasing the student fee share and expanding access might help government recoup more of the cost of tertiary education, the risk to integrity of the personal income tax system is still present and significant, arising through the interaction between the income-contingent loan repayments on now much higher HELP debt and the personal income tax system. This challenge can only be addressed by actions designed to limit what debtors can do to minimise their loan repayments and in turn impact on personal income tax collections.

5.7 What escalation rate on HELP debt (r)

If debt was cost free, the real cost of that debt would be eroded with time due to the effects of price inflation. Furthermore, if that debt funded an investment in human capital whose inflation is greater than price inflation—as is typically the case—then there is no incentive to repay that debt. In Australia, HELP debt is indexed to the consumer price index (CPI) meaning that while ever wages rise faster than the CPI, there is little incentive to pay education costs fees upfront or to make HELP debt repayments upfront.

In NZ the indexation rate is zero per cent for domestic residence⁴² with a debt and for non-residents, equal to the five-year average of the 10-year bond rate to December in the year preceding the tax year to which the rate will apply (to two decimal places) plus a margin of 0.74 per cent⁴³. In contrast, the UK applies an indexation rate which is equivalent to the consumer price index below the threshold and increases above the threshold of £21,000, rising by the consumer price index plus three per cent above £41,000.⁴⁴ While the NZ approach reflects the opportunity cost of borrowed funds for the NZ government (but only for non-residents), the UK approach effectively incorporates some element of wage inflation into its measure as well as some progressivity. In contrast, the Australian approach is generous although not as generous as the NZ model although NZ has a much reduced threshold at which debt repayments begin. As a consequence, those with a debt begin making payments on their loan at 35 per cent of average weekly earnings compared to 68 per cent in Australia and 84 per cent in the UK (Table 6). The zero per cent interest-rate in NZ may therefore be not that important when repayment is expected over a short period of time.

However, the rate of debt escalation is important to income tax integrity if repayment is expected over a long period in which case it might impact on the incentive individuals have to repay their debt. If the debt is only increasing at the CPI and wages increase faster, then there is an incentive for individuals to delay repayment through non-compliance to delay the loan repayment. If the indexation rate is similar or greater than that for wages, there is an increased incentive to make early payments and less benefit from non-compliance. Combined with a lower threshold at which payments begin, a high debt escalation rate would help to reduce any incentive for non-compliance to delay debt repayment.

5.8 Would changes in HELP repayment administration make a difference?

Under existing governmental arrangements, the Department of Education is responsible for national policies and programs that help Australians access post-school higher education, international education and academic research.⁴⁵ This encompasses the HELP program and as part of its responsibilities the Department of Education promotes access to Government loans to students who meet eligibility requirements, as well as ensuring that the ATO is supplied with requisite individual student loan data for HELP debt collection purposes. The Department of Education is also responsible for the HELP receivable and each year it provides an actuarial assessment of its estimated present value for government financial reporting purposes (Table A6), along with a limited array of key performance indicators (including average amount of debt per student, average time to fully pay debt, and amount expected never to be repaid).⁴⁶

⁴² <https://www.ird.govt.nz/studentloans/overseas/interest-free/>

⁴³ See http://www.educationcounts.govt.nz/publications/tertiary_education/2555/student-loan-scheme-annual-report-2013 http://www.educationcounts.govt.nz/_data/assets/word_doc/0004/144571/2013-Student-Loan-Scheme-Support-Changes.docx

⁴⁴

http://www.studentloanrepayment.co.uk/portal/page?_pageid=93,6678823&_dad=portal&_schema=PORTAL

⁴⁵ Until September 2013, the HELP was the responsibility of the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education.

⁴⁶ The most recent actuarial assessment suggests that by 2017-18 the proportion of new debt unlikely to be repaid will be equivalent to around 22% of the total receivable (Table A6 refers).

Given the nature of its responsibilities, the Department of Education can be regarded as the ‘owner’ of the HELP receivable.

For its part, the ATO has responsibilities for recording the value of HELP loans made to students in their individual loan accounts, processing voluntary repayments, undertaking the annual indexation of HELP debts, providing online access for HELP debtors to their loan accounts, administering the PAYGO withholding provisions in relation to HELP debtors, and raising HELP assessments via the income tax return assessment process where the conditions for loan repayment via the tax system are met. Until 2014, the ATO also published fairly detailed statistical information about HELP debtors and aggregate debt in its annual statistical series. However, reference to the operation of the HELP repayment process in the ATO’s annual performance report is extremely limited vis-à-vis other administered programs. Given the nature of its responsibilities, the ATO can be seen to have a central role in the collection of HELP debts, but nevertheless remains an ‘agent’ of the Department of Education.

While this paper will not explore in any detail the nature of the arrangements between the Department of Education (and its predecessor agencies) and the ATO for managing HELP debt and, in particular, the HELP debt collection process, this is an important issue. In 2006–07 the HELP program was the subject of review by the Australian National Audit Office (ANAO) which focused on assessing the effectiveness of procedures and processes used by Department of Education Science and Training (DEST, the government agency at the time responsible for HELP) and the ATO to record HECS–HELP student loans.⁴⁷ The ANAO’s findings were generally positive although its report noted that its examination specifically excluded the HELP repayment process. Concerning the HELP receivable, it is important to note that while both agencies publish their own aggregates (that is, covering both the value of debt and numbers of debtors) there is no attempt to reconcile their respective data or to report holistically on the HELP program ‘end-to-end’ (an issue raised in Table A6).

Reviewing the published materials of both agencies does not convey any real sense of collective ownership nor management of HELP debt and while this may misread the reality of what occurs in practice, the management of HELP repayment activities and outcomes would nevertheless benefit in our view from a more robust and comprehensive collection strategy and more extensive reporting of processes and outcomes in a ‘whole of government’ sense. This point is made, in particular, having regard to recent growth in HELP debt and its projected trend and is in line with increased ‘whole of government’ efforts to collect student loans observed in recent years in some other countries (including NZ and the UK). An example of the more concerted effort envisaged can be found in the report of the UK’s National Audit Office (NAO) titled *Student Loan Repayments* published in November 2013.⁴⁸ In their report on the UK student loan scheme, which has many design similarities to HELP and is expected to grow significantly in the coming years, the NAO references the need for a “jointly-owned strategy for improving collection performance” (p7), including:

⁴⁷ *The Higher Education Loan Programme*, ANAO, Audit Report No.50 2006–07.

⁴⁸ *Student loan repayments*, Report by the Comptroller and Auditor General, HC 818, Session 2013–14, 28 November 2013, United Kingdom.. http://www.nao.org.uk/wp-content/uploads/2013/11/10307-001-Student-loan-repayments_BOOK.pdf

1. Actions to better understand how the stock of receivables is performing;
2. Transparent and understandable forecasting of the amounts expected to be collected;
3. Consideration of collections targets;
4. Development of a collections strategy;
5. Analyses to better understand the circumstances of borrowers with no current employment record;
6. Better targeting of borrowers where there is a greater risk that they could be avoiding repayment;
7. Consideration of the use of external debt collection bodies, particularly in respect of borrowers living overseas; and
8. Work with other government departments to develop a strategy for sharing data that provides opportunities to gain information on the circumstances of specific borrowers.

There are strong arguments for similar attention in the Australian context.

5.9 HELP design findings

While the basic principles underlying the design of HELP are widely accepted,⁴⁹ how the scheme operates in practice is more controversial. If the intention of the HELP scheme was to offer a loan to all eligible tertiary education students and universally recoup that loan once HELP debtors earn income, then the analysis in this paper would conclude that the HELP collection regime underperforms in terms of both economic and administrative efficiency. However, the HELP scheme was not designed with this objective in mind; rather, it seeks repayment of loans only from those who have the capacity to repay them. It does this by a combination of discounts for upfront payment of student fees and upfront repayment of the debt; and mandatory repayments of debt based on annual income (as defined for HELP purposes). The findings of this paper are that the scheme only partially achieves its objective, given the following unsatisfactory aspects and developments:

1. By over-claiming deductions and not lodging returns, many taxpayers appear to be deferring, avoiding or reducing their repayments.
2. HELP debtors can leave Australia and be not obliged to repay debt, regardless of their income.
3. The repayment rate scale acts as an incentive for over-claiming deductions or understating income.

⁴⁹ See Section 3. Annex 2 also outlines the student income contingent loan schemes operating in Canada, NZ, Sweden, UK, and the US. While each of the schemes is different in terms of its operation, the ultimate objective is common.

4. The design of the repayment regime appears relatively generous vis-à-vis schemes elsewhere.
5. The direction of reform is for no incentives for upfront payment.

In response, this section has proposed the following reform options should be considered:

1. Lowering the repayment threshold by at least \$10,000 and introducing a lower initial repayment based on a rate of two per cent, rising progressively till it reaches six per cent rate (currently 8%); this would increase HELP aggregate repayments and reduce the incentive to avoid and evade by current HELP debtors, although it would expose more HELP debtors to higher marginal tax rates. The 2014–15 Budget proposal for a two per cent rate beginning at 90 per cent of the current four per cent rate threshold is an acknowledgement of the high threshold and its high effective marginal rate but is only a partial solution to inadequate levels of repayment.
2. At a minimum, the definition of HRI should be expanded and consideration given to writing back all WRE deductions or at a minimum, deductions for self-education expenses.
3. Establish a requirement for HELP debtors living overseas to make repayments where their income is over the threshold, with sanctions for non-compliance but where the approach taken is relatively simple and administrable.
4. Review the need to reconsider the non-payment of outstanding debt from deceased estates to assess whether this option for repayment should complement debtors' action to ensure repayments from those who exit their HELP debt by living and working overseas.
5. Restore incentives for early and voluntary fee and debt payments but only where the incentive to make such payments is restored through higher debt escalation rates, lower repayment thresholds and strict arrangement for repayments by overseas debtors.
6. Index HELP debt to AWOTE, not the CPI, or introduce an arrangement similar to that in the UK where the escalation rate on income-contingent loans depends on the borrowers' earnings. The adoption of the 10 year bond rate as the index in the 2014–15 Budget reflects the cost to government of the HELP debt and not the income generated through education or the ability to pay for that education funding.
7. Establish loan limits for each program (as for FEE-HELP and as did previously apply to HECS-HELP) combined with consideration of a global (all up) limit.
8. HELP repayment administration must give greater attention to the risk to income tax integrity from non-compliance by HELP debtors.

With these reforms comes the additional benefit of less need to write off HELP debt as more taxpayers become liable for HELP repayments and because those exiting overseas will not escape HELP debt obligations. As a result, the difference between

the debt as reported by the Department of Education and by the Australian Tax Office in Table A6 would be reduced.

6. DOES PERSONAL INCOME TAX DESIGN AND ADMINISTRATION IMPACT HELP LOAN COLLECTION INTEGRITY?

While the focus of this paper is on the impact of HELP on personal income tax integrity, the approach to personal income taxation is not independent of HELP design. While HRI is broader but inclusive of taxable income, any changes in the tax treatment of taxable income sources and deductible expenses will directly affect HRI. Although Section 5.2 highlighted how HRI had been broadened since the introduction of HELP, it is equally possible to change HRI through a broadening of the taxable income base. This could be achieved by denying various deductions or income discounts to HELP debtors. However, while changes to HRI will only affect HELP debtors, changes to taxable income will affect all taxpayers. In this case, the issues involved relate more to tax deduction design (Warren 2014a, 2014b) and less to HRI.

A further complication is the policy inconsistency arising from having work-related self-education expenses a deductible expense for income tax purposes when those expenses are funded through a government provided loan which might not be repaid or not indexed appropriately. There is also a question about consistency where self-education expenses are not deductible when those expenses are related to potential future employment income but not current employment, a major reason for tertiary education. To be consistent, expenses related to current and future employment should both be deductible. However, if those expenses are met through income contingent loans, a case for their non-deductibility could be developed.

Another approach to reducing the distortion arising from the HELP repayment schedule is to change the personal income tax rates and thresholds (M , m in Figure 1) but this would be costly and a poorly targeted strategy to addressing the root cause of the problem. Similarly, action to improve income tax compliance by HELP debtors involves more issues than just HELP compliance and would have implications for all income tax payers.

7. WAY FORWARD

The main purpose of this study was to examine whether there are indications that the operation of HELP undermines personal income tax integrity. In other words, does HELP as currently designed lead to increased personal income tax non-compliance by some HELP debtors in order to defer or avoid the repayment of their HELP debts?

In our view, and acknowledging the limitations of the methodology used, there are such indications but these need to be tested more fully against the full population of HELP debtors to assess with any reasonable level of precision their significance and revenue consequences for collections of both personal income tax and HELP debt.

In completing this study it also became apparent that there are inherent design weaknesses in the HELP program that not only unduly impede the collection of HELP debt but also encourage abuse of the personal income tax.

The HELP debt book is now a significant public asset and one which will grow significantly over the coming decade. In line with this there will also be significant growth in the HELP debtor population with implications, based on the findings of this study, for personal income tax integrity.

The 2014–15 Budget response has been both to acknowledge the problem, offer some modest solutions, such as a lower repayment threshold. However, it also proposes policies that will significantly add to overall HELP debt (such as, deregulating student fees, broadening access to HELP, and indexing HELP debt based on the funding cost to government). In the event these policies are adopted what results, as shown in Table A6, is a rapid escalation in total and average student debt over the Budget forward estimate period.

Missing from the 2014–15 Budget was concerted attention to formulating a broad range of reforms designed to both reduce opportunities for undermining the personal income tax and to ensure a speedier collection of HELP debt. As this paper has argued, there is no single solution; rather, attention should be given to HELP design (both in the accumulation and decumulation phases), to the design of the personal income tax, and to the administration of HELP debt repayment.

Matters needing consideration in this context include:

HELP design

- Lowering the HELP repayment threshold well below that proposed in the 2014–15 Budget, while retaining the proposed two per cent initial rate (see 5.3 and 5.9).
- Modifying the definition of HRI (see 5.2 and 5.9).
- Imposing an obligation on eligible HELP debtors living overseas to make repayments, supported by appropriate sanctions for non-compliance (see 4.3, 5.4 and 5.9) (accompanied by incentives and sanction along the lines of those adopted by NZ).
- Review alternatives to automatically writing-off of all HELP debts for deceased estates.
- Restoring incentives for early and voluntary repayments (see 5.1 and 5.9) (rather than their abolition as currently proposed).
- Modifying the HELP debt indexation approach (see 5.6 and 5.7) by aligning it to AWOTE (rather than the 10 year bond rate proposed in the 2014–15 Budget).

Personal income tax design

- Adoption of recommendations made in the AFTS (2009) concerning work-related expenses and gifts (see 4.2 and 5.2).

HELP repayment administration

- Development of a jointly-owned and comprehensive HELP debt collection strategy (see 4.4, 4.5 and 5.8).

- More comprehensive and transparent reporting on HELP repayment administration (see 4.5 and 5.8).

Income tax administration

- Increased recognition to HELP debt as a compliance risk criterion for all aspects of income tax administration, including PAYG withholding requirements (see 4.4 to 4.6).

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9. ANNEX 1: AUSTRALIAN HIGHER EDUCATION LOAN PROGRAM (HELP)

The Australian Higher Education Loan Program provides students with universal access to a higher education loan to fund their tertiary education student contribution. Discounts are available where students make a voluntarily upfront payment of their student contribution⁵⁰ or a voluntarily upfront repayment of their accumulated HELP debt. In relation to repaying any HELP debt, this is done through the tax system once the debtor's income exceeds a prescribed HELP Repayment Income (HRI) threshold. The HELP scheme is therefore an income contingent loan with incentives to repay early and income-based rules for when mandatory repayments are required.

9.1 Historical Changes: 1989-2013

While the original loan arrangements were introduced to enable undergraduate students in Commonwealth supported places to obtain a loan to fund the charge set by and paid to the government under the Higher Education Contribution Scheme (HECS), as Tables A1 and A2 show the scope of the loan scheme has since been progressively expanded. Today, HELP comprises five separate schemes including: 1) HECS-HELP which funds Commonwealth-supported (mostly undergraduate) students to pay their student contribution amounts; 2) FEE-HELP which supports fee paying students (primarily postgraduates); 3) SA-HELP which is available to pay for all or part of student services and amenities fee; 4) OS-HELP which assists eligible undergraduate Commonwealth supported students to pay their overseas study expenses; and 5) VET FEE-HELP which is available to students undertaking higher-level vocational education and training courses at approved VET providers⁵¹.

This evolution has been gradual. In 2002, the undergraduate focussed HECS was complemented with a Postgraduate Education Loans Scheme (PELS) designed to provide loans to fund the cost of postgraduate study and a scheme to support overseas study (OS) study by undergraduate students. In 2005, HECS was changed from being a charge set by and paid to the government to being a 'student contribution' set by and going to universities, up to a maximum set by the Commonwealth, with HECS-HELP being the scheme designed to finance the associated student loan. In the same year, the debt under the PELS and OS, renamed FEE-HELP and OS-HELP respectively, were combined with the HECS-HELP into a single loan scheme – the Higher Education Loan Program⁵².

Any resulting HELP debt incurred by students is treated as an advance paid to students by the Department of Education with the recovery of this advance managed on behalf of the Department by the ATO. In 2012, HELP was further expanded with access to the scheme made available to fund vocational education and training (VET-HELP) and student services and amenities fee (SA-HELP), and from July 2014, those learning

⁵⁰ Under decisions of the previous Government, it was planned for the discount on both upfront payment of fees and the repayment of debt to be abolished from 1 January 2014. However, as a 1 April 2014, this legislation had not passed both Houses of the Australian Parliament and these discounts were still available.

⁵¹ See : <http://studyassist.gov.au/sites/StudyAssist/HELPpayingMyFees>

⁵² A further change in 2005 that was administrative in nature was that access to HELP was available to all higher education providers that met the requirements set by government, rather than being available to students in designated institutions. In doing so it depoliticised system and significantly broadened student access to HELP.

a trade and accessing a Trade Support Loan, would have their loan added to their HELP debt.

In contrast to HECS which is a ‘student contribution’ to the shared cost of Commonwealth supported places, the other tertiary education fees are determined by educational institutions (and the market) for the educational service and can be funded through a HELP loan. In some cases as with FEE-HELP (Table A1), there are caps on the fees able to be funded through HELP. As a result, only HECS fee limits are determined by the Commonwealth and their level (equivalent to (p+b).C in Figure 1) is detailed in Table A3 for the period since the inception of the scheme. Not only does the Commonwealth set the number of Commonwealth Supported Places (CSP) (until 2012) (or F in Figure 1) for which the HECS student contribution is payable by students, it also makes a direct additional contribution to the tertiary institutions. With HECS indexed to the consumer price index, if AWOTE is a better measure of the growth in value of what students earn from their education investment then HECS will decline relative to AWOTE. However, as shown in Table A3, this decline has been responded to twice, once in 1997 and again in 2005, with each increase acting to restore some of the decline in HECS relative to AWOTE.

Another trend also evident in Table A1 is the progressive reduction in the discount for upfront voluntary payment of HECS and for the upfront voluntary repayment of any HELP debt. Currently, students wishing to pay the full student contribution upfront need only pay 90% of the total fee as the balance of 10% is paid directly to the course provider by the Government, an amount known as the HELP discount.⁵³ HELP debtors may also make voluntary repayments at any time to reduce their accumulated HELP debt with voluntary repayments over \$500 attracting a bonus of 5%.⁵⁴ With this discount now considerably less than originally available, it must be expected that this decline must act to substantially reduce the incentive for students to pay their HECS in advance, or for those with HELP debt to make an early repayment.

9.2 Prospective HELP changes: 2014 and beyond

A range of actions were proposed in the Commonwealth 2014-15 Budget which will directly impact HELP debt into the future including: expanded education program access; reduced upfront discounts (and their ultimate elimination); and a proposal to deregulate university fees and to modify the design of the HELP regime (i.e. indexation, repayment thresholds and rates of repayment).

9.2.1 Expansion of access

The dramatic expansion of access to HELP followed the release of the Bradley Review⁵⁵ in 2008 in which the Commonwealth Government moved to lift the Commonwealth supported places over-enrolment cap from 5 per cent to 10 per cent in 2010 and 2011 and then uncapped these places from 1 January 2012. In the 2013-14 Budget it was announced that Student Start-up Scholarships would no longer be a grant but become an income contingent loan and part of HELP. At the same time,

⁵³ See note 1 in Table A1

⁵⁴ *ibid*

⁵⁵ See Review of Australian Higher Education at <http://www.innovation.gov.au/highereducation/ResourcesAndPublications/ReviewOfAustralianHigherEducation/Pages/ReviewOfAustralianHigherEducationReport.aspx>

following a review of VET-FEE HELP⁵⁶, as shown in Table A3 there is an expected rapid escalation in VET-FEE HELP in forthcoming years.

9.2.2 *Reduction and elimination of discounts*

The progressive reduction and eventual abolition of the HECS upfront fee discount and upfront HELP debt repayment discount is shown in Table A1⁵⁷.

The combined effect of these two policies is in the first instance to rapidly increase access to HELP while at the same time removing any incentive for upfront payment of fees or early repayment of HELP debt. What results is shown in Table A6, a rapid escalation in HELP debt and debtors such that by 2017-18, around 26% of those aged 18-54 years are likely to have some HELP debt and confront the average and marginal tax rates shown in Table A7.

An additional factor which could have indirectly impacted HELP debt repayment was the 2013-14 Budget announcement of the previous Government to introduce a \$2,000 cap on the tax deduction for work-related self-education expenses. This proposal was initially delayed by the then-Labor Government and eventually abolished by the incoming Liberal-National Party government.

9.2.3 *2014-15 Budget decisions*

In May 2014, the Commonwealth announced as part of the 2014-15 Budget a number of proposals which, if implemented as intended, will have a significant overall impact on the future growth of HELP debt and its repayment

- Changes to higher education will allow universities to set their own tuition fees from 2016. (For students already studying, existing arrangements will remain until the end of 2020.)
- The Government will reduce the income threshold for repayment of *Higher Education Loan Program* (HELP) debts commencing in 2016-17 and will adjust the indexation of HELP debts from 1 June 2016. (This is estimated to achieve savings of \$3.2 billion over four years from 2014-15.)

A new minimum threshold will be established for the repayment of HELP debts, set at 90 per cent of the minimum threshold that would otherwise have applied in 2016-17. The new minimum threshold is currently estimated to be \$50,638 in 2016-17. A new repayment rate of 2 per cent of repayment income will be applied to debtors with incomes above the new minimum threshold (as indicated by the dashed line in Chart 1). There will be no other change to current repayment rates.

⁵⁶ VET FEE-HELP provides income contingent loans to students of higher-level VET courses such as diplomas and advanced diplomas. The scheme has been expanded following a review reported in: <http://ris.finance.gov.au/files/2012/10/03-VET-FEE-HELP-REDESIGN-RIS.pdf>
http://www.tda.edu.au/cb_pages/files/VET%20FEE-HELP%20Redesign%20Discussion%20Paper%20Final.pdf
http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201314/VocationalEducat

⁵⁷ This was scheduled for 1 January 2014 but to date, the legislation enacting the abolition of the upfront fee and debt repayment discounts has not been enacted.

- The annual indexation applied to HELP debts will be adjusted from the Consumer Price Index to a rate equivalent to the yields on 10 year bonds issued by the Australian Government, capped at 6.0 per cent per annum, from 1 June 2016.
- From July 2014, the Government will also support those learning a trade by providing concessional Trade Support Loans of up to \$20,000 over a four-year apprenticeship, repayable under HELP and with a 20 per cent discount upon completion of the apprenticeship.
- The HECS-HELP benefit, which was intended to provide an incentive for graduates of particular courses to take up related occupations or work in specified locations, will end from 2015-16. (This follows a recommendation of the *Review of the Demand Driven Funding System*⁵⁸ that the benefit be discontinued, there being little evidence it had been effective in addressing skill shortages.)
- Announcement that Trade Support Loans for apprentices (capped at \$20,000) would also become part of HELP and those apprentices who successfully complete their training would receive a 20 per cent discount on the amount to be repaid.

As noted in 3.2, the combined impact of these changes over the medium term will be to significantly increase both the overall level of HELP debt and numbers of debtors⁵⁹.

9.3 HELP trends

Aggregate debt has been growing significantly over recent years (as shown in Tables A5 and A6). Total HELP debt outstanding as at end-2011 was of the order of \$22.6 billion, having increased by 160% over the prior 10 years and is expected to increase more than threefold over the period 2010-11 to 2017-18 (Table A6).

The population of HELP debtors at the end of 2012 was 1,681,000, having grown by 52% over the prior eleven year period and around 2.1 million by the end of 2014, in part fuelled by decisions of the Government to expand the number of higher education places.

Despite the HELP scheme having been in place well over twenty years, the number of debtors subject to HELP assessments has risen only marginally over the last decade. Except for financial year 2004-05 when the repayment threshold was raised substantially, the number of debtors making payments through the annual tax return assessment process has been in the range 300,000-380,000 (or just over 25% of all debtors in 2011). Viewed over the decade to June 2011, annual assessments rose by just under 9% while the value of assessments increasing 121%. During the 10 years to 2011-12, the aggregate value of HELP assessments each financial year as a proportion of overall HELP debt declined from 7.0% to 5.7% (Table A8), although the results for more recent years will increase marginally as late-lodged returns are processed although their impacts are unlikely to alter the downwards trend observed. The trend

⁵⁸ See <http://www.education.gov.au/report-review-demand-driven-funding-system>

⁵⁹ See the Report on several of these issues by the Australian Senate Education and Employment Committee cited in note 26 above.

towards expanding access HELP, especially Commonwealth supported places (HECS-HELP in Table A2) has contributed significantly to this outcome.

Table A1 Australian HELP parameters: 1988-98 to 2013-14

Year*	HELP Threshold relative to Debt		HELP Repayment Rates				HELP Discount (1)		Scope of HELP (F) (2)					Limit to Debt		HELP Income (Y)	Personal Income Tax MTR on H _L (m) (4)	Company Tax Rate (t) (4)	Fringe Benefits Tax (f) (4)
	AWOTE:															HRI			
	indexation rate (r)	Lower Threshold (H _L)	Upper Threshold (H _U)	Lowest Threshold (h _L)	Highest Threshold (h _U)	Range Increment	Upfront HECS Fee (d)	Upfront Debt Repayment (v)	HECS (UG)	FEE (PG)	OS	VET-FEE	SA	HECS-HELP (ΣX)	FEE-HELP (ΣX) (Non-Medical)				
2013	2.0%	66%	111%	4.0%	8.0%	5.0%	10%	5%	✓	✓	✓	✓	✓	Uncapped	96,000	HRI 4	32.5%	30%	46.5%
2012	2.9%	67%	124%	4.0%	8.0%	0.5%	10%	5%	✓	✓	✓	✓	✓	Uncapped	93,204	HRI 5	32.5%	30%	46.5%
2011	3.0%	68%	125%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	89,706	HRI 5	30.0%	30%	46.5%
2010	1.9%	67%	124%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	86,422	HRI 5	30.0%	30%	46.5%
2009	3.9%	67%	125%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	85,062	HRI 4	30.0%	30%	46.5%
2008	2.8%	68%	126%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	83,313	HRI 4	30.0%	30%	46.5%
2007	3.4%	68%	127%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	81,600	HRI 4	30.0%	30%	46.5%
2006	2.8%	68%	127%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL	80,000	HRI 4	30.0%	30%	46.5%
2005	2.4%	67%	125%	4.0%	8.0%	0.5%	20%	10%	✓	✓	✓	✓	✓	7.0 EFTSL		HRI 4	30.0%	30%	48.5%
2004	2.4%	68%	127%	4.0%	8.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	30.0%	30%	48.5%
2003	3.1%	52%	93%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	30.0%	30%	48.5%
2002	3.6%	52%	94%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	30.0%	30%	48.5%
2001	5.3%	52%	94%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	30.0%	30%	48.5%
2000	1.9%	53%	95%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	30.0%	34%	48.5%
1999	1.2%	55%	99%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 3	34.0%	36%	48.5%
1998	-0.1%	55%	99%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 2	34.0%	36%	48.5%
1997	2.0%	55%	100%	3.0%	6.0%	0.5%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 2	34.0%	36%	48.5%
1996	4.6%	79%	143%	3.0%	6.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 2	34.0%	36%	48.5%
1995	2.5%	80%	127%	3.0%	5.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	34.0%	36%	48.5%
1994	1.9%	81%	129%	3.0%	5.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	34.0%	33%	48.25%
1993	0.9%	83%	132%	3.0%	5.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	38.5%	33%	48.25%
1992	2.4%	90%	143%	2.0%	4.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	35.5%	39%	48.25%
1991	6.4%	89%	142%	2.0%	4.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	38.0%	39%	47.0%
1990	8.0%	88%	140%	2.0%	4.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	38.5%	39%	47.0%
1989		87%	138%	1.0%	3.0%	1.0%	25%	15%	✓	✓	✓	✓	✓	Uncapped		HRI 1	39.0%	39%	49.0%

Notes:

* Year shown is start year if data applies to fiscal year eg 2004 applies to 2004-05 fiscal year as with HELP repayment schedule

HRI 5 = Taxable income plus any total net investment loss (which includes net rental losses), total reportable fringe benefits amounts, reportable super contributions and exempt foreign employment income.

HRI 4 = Taxable income plus any net rental losses, total reportable fringe benefits amounts and exempt foreign employment income.

HRI 3 = taxable income plus any net rental losses and total reportable fringe benefits amounts

HRI 2 = Taxable income plus any net rental losses

HRI 1 = Y = Taxable income

(1) The intention was for the HELP payment/repayment incentives to be set at 0% from 1 July 2014 but the relevant legislation for changing them has not passed by the Senate.

(2) UG CSP is undergraduate Commonwealth support places; PG is postgraduate.

(3) EFTSL is Equivalent Full Time Study Load

(4) Tax data is for fiscal year beginning from June for personal income tax and April for fringe benefits tax, for the year shown.

Sources:

ABS 6302.0 Average Weekly Earnings, Australia

Chapman(2007)

ATO Website (www.ato.gov.au)

http://parinfo.aph.gov.au/parInfo/download/legislation/billsdgs/2326534/upload_binary/2326534.pdf;fileType=application/pdf

http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1314/QG/HELP

<http://parinfo.aph.gov.au/parInfo/search/display/display.w3p;query=ld%3A%22library%2Fpubs%2F2935268%22>

<http://studyassist.gov.au/sites/StudyAssist/>

<http://heimshelp.deewr.gov.au/sites/heimshelp/news/pages/201308-os-help>

Table A2 Current additions to HELP loans by source: 2010–11 to 2017–18 (Parameter F)

	Actual			Budget Estimates		Budget Projections			2010-11 to 2017-18
	2010–11	2011–12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	
Commonwealth supported places for which HECS-HELP loans paid (F)	395,177	414,709	450,314	472,700	497,000	544,000	599,000	621,000	57%
Places for which FEE-HELP loans paid (F)	64,766	70,849	75,388	90,700	87,000	93,000	129,000	137,000	112%
OS-HELP loans to assist students to undertake some of their course overseas (F)	4,086	5,035	5,675	7,200	12,600	13,800	15,200	16,300	299%
SA-HELP loans to assist students to pay their services and amenities fees (F)	0	0	307,339	402,900	463,400	478,900	492,100	503,900	0%
Places for which VET FEE-HELP loans paid (F)	20,108	28,570	37,700	87,700	172,300	186,900	248,000	263,500	1210%

Sources:

http://budget.gov.au/2013-14/content/bp1/download/bp1_consolidated.pdf

<http://docs.education.gov.au/node/35771>

<http://www.innovation.gov.au/AboutUs/Budget/Pages/Library%20Card/PortfolioBudgetStatementsDIICSRTE2013-14.aspx:pp92-93>

<http://www.innovation.gov.au/AboutUs/CorporatePublications/AnnualReports/AnnualReport201213/wp-content/uploads/annual-report-2013.pdf>

Tables 25 and 26 p70; Section 1.3 p181; Note 24H p245

Table A3 HELP fees for students commencing study by year per EFTSL: 1989 to 2014 (Parameters (p+b)*C in Figure 1)

Year	Uniform Contribution		National Priority		Band 1		Band 2		Band 3	
	%	AWOTE	Mathematics, Statistics, Science,	%	Education, Nursing, Humanities, Behavioural Science, Social studies, Foreign languages, Visual and Performing arts, Nursing, Education, Clinical Psychology	%	Computing, Built Environment, Health Sciences, Engineering, Surveying, Agriculture	%	Law, Dentistry, Medicine, Veterinary science, Accounting, Administration, Economics, Commerce	%
2014					\$6,044		\$8,613		\$10,085	
2013					\$5,868	7.9%	\$8,363	11.2%	\$9,792	13.1%
2012			\$4,520	6.3%	\$5,648	7.9%	\$8,050	11.2%	\$9,425	13.2%
2011			\$4,355	6.3%	\$5,442	7.9%	\$7,756	11.3%	\$9,080	13.2%
2010			\$4,249	6.5%	\$5,310	8.1%	\$7,567	11.5%	\$8,859	13.5%
2009			\$4,162	6.6%	\$5,201	8.3%	\$7,412	11.8%	\$8,677	13.8%
2008			\$4,077	6.8%	\$5,095	8.5%	\$7,260	12.2%	\$8,499	14.3%
2007			\$3,998	7.0%	\$4,996	8.8%	\$7,118	12.5%	\$8,333	14.6%
2006			\$3,920	7.2%	\$4,899	9.0%	\$6,979	12.8%	\$8,170	15.0%
2005			\$3,847	7.3%	\$4,808	9.1%	\$6,849	13.0%	\$8,018	15.2%
2004					\$3,768	7.5%	\$5,367	10.7%	\$6,283	12.6%
2003					\$3,680	7.7%	\$5,242	10.9%	\$6,136	12.8%
2002					\$3,598	7.9%	\$5,125	11.2%	\$5,999	13.2%
2001	\$2,644 (continuing)				\$3,521	8.1%	\$5,015	11.6%	\$5,870	13.6%
2000	\$2,600 (continuing)				\$3,463	8.4%	\$4,932	12.0%	\$5,772	14.0%
1999	\$2,560 (continuing)				\$3,409	8.7%	\$4,855	12.4%	\$5,682	14.5%
1998	\$2,520 (continuing)				\$3,356	8.8%	\$4,779	12.5%	\$5,593	14.7%
1997	\$2,478 (continuing)				\$3,300	9.0%	\$4,700	12.8%	\$5,500	15.0%
1996	\$2,442	6.9%								
1995	\$2,409	7.1%								
1994	\$2,355	7.3%								
1993	\$2,328	7.4%								
1992	\$2,250	7.3%								
1991	\$1,993	6.7%								
1990	\$1,882	6.7%								
1989	\$1,800	6.8%								

Note: EFTSL is effective full time student load;

Source:

http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/Publications_Archive/archive/hecs<http://studyassist.gov.au/sites/studyassist/help-paying-my-fees/csps/pages/student-contribution-amounts><http://www.universitiesaustralia.edu.au/resources/400/386>**Table A4 Status of HELP debt and average time to make a repayment (by payment type)**

Status of HELP debt	As of June 2007		As of June 2009		As of June 2011	
	No	%	No.	%	No.	%
Paid off	881,770	41.2	1,018,785	42.4	1,160,362	42.6
Paying off	502,989	23.5	440,507	18.3	592,844	21.8
Written off	8,856	0.4	10,304	0.4	9,581	0.4
No repayments ever made	744,476	34.8	931,407	38.8	958,585	35.2
<i>Totals</i>	<i>2,138,091</i>	<i>100.0</i>	<i>2,401,003</i>	<i>100.0</i>	<i>2,721,372</i>	<i>100.0</i>
Average time to make first compulsory repayment	1,789 days / 4.9 years		1,874 days/ 5.1 years		1,860 days / 5.1 years	
Average time to make first voluntary repayment	2,485 days/ 6.8 years		2,572 days/ 7.0 years		2,577 days / 7.1 years	
Average time to repay debt (for those who have repaid)	2,729 days/ 7.5 years		2,869 days/ 7.9 years		2,953 days /8.1 years	

Source : ATO Tax Statistics 2010-11

Table A5 Accumulated HELP debts and debt not expected to be repaid: 1989-90 to 2009-10

Year	Accumulated HELP debt (b)		Fair value of accumulated HELP debt			Debt expected not to be repaid (DNER) (c)		Voluntary repayment s by students	Compulsory repayments through tax system (a)
		% repaid through tax system	\$m	% of Accumulated HELP Debt	% repaid through tax system	\$m	% of accumulated HELP debt (d)		
2009-2010	20,497	6.1%	14,018	68%	8.9%	4,495	21.9%	202	1,251
2008-2009	18,278	6.4%	12,048	66%	9.7%	3,934	21.5%	196	1,163
2007-2008	16,113	7.2%	10,517	65%	11.0%	3,698	22.9%	184	1,158
2006-2007	14,425	6.4%	9,603	67%	9.6%	2,964	20.5%	158	921
2005-2006	12,779	6.3%	8,830	69%	9.1%	2,496	19.5%	137	800
2004-2005(e)	11,371	5.9%	7,580	67%	8.8%	2,166	19.0%	193	666
2003-2004	10,185	6.9%	6,891	68%	10.2%	2,055	20.2%	156	701
2002-2003	9,164	7.0%	5,918	65%	10.8%	2,019	22.0%	137	638
2001-2002	8,104	7.6%	5,661	70%	10.8%	1,723	21.3%	134	612
2000-2001	7,162	8.2%	5,323	74%	11.0%	1,397	19.5%	97	586
1999-2000	6,229	8.5%	4,812	77%	11.1%	1,124	18.0%	80	532
1998-99	5,526	9.0%	N/A			953	17.2%	72	497
1997-98	4,922	8.7%	N/A			700	14.2%	67	427
1996-97	4,504	5.8%	N/A			607	13.5%	58	262
1995-96	3,958	5.5%	N/A			687	17.4%	32	218
1994-95	3,354	5.0%	N/A			541	16.1%	16	169
1993-94	2,932	4.5%	N/A			438	14.9%	19	133
1992-93	2,321	3.1%	N/A			386	16.6%	11	73
1991-92	1,749	3.3%	N/A			N/A	N/A	12	58
1990-91	1,190	4.2%	N/A			N/A	N/A	6	50
1989-90	673	4.2%	N/A			N/A	N/A	2	28
1988-89	216	4.2%	N/A			N/A	N/A	0	9

Source: Australian Taxation Office / DEEWR/ Budget Papers 2013-14

(a) Compulsory repayments (PAYG withholdings) made through the tax system are in relation to the income year.

(b) The actual outstanding HELP debt for a particular year may be different to that published in the Annual Report for that year because the Annual Report is based on estimated compulsory repayments and estimated first half year debt.

(c) 'Debt not expected to be repaid' arises from the income contingent nature of HELP repayments and debt being written off upon death of a debtor. The estimated provision for the amount of HELP debt not expected to be repaid is determined by a preliminary actuarial assessment accounting for compulsory (PAYG) repayments when they are credited against individuals' outstanding debts. The actual amount is determined once a full dataset is available for the financial year. The income repayment threshold was

(d) Debt not expected to be repaid as a percentage of estimated net outstanding debt taking account of PAYG receipts over the course of the financial year that have not yet been allocated against individual debtors' obligations.

(e) Before 2005, debts were incurred under HEFA. From 1 January 2005, debts are incurred under HESA and are known as HELP debts. Debts incurred under HEFA include HECS, PELS, BOTPLS and OLDPS debts. All previous debts under these schemes became HELP debts on 1 June 2006. HELP debts incurred since 1 January 2005 include HECS-HELP, FEE-HELP and OS-HELP

Table A6 HELP debt: 2010–11 to 2017–18

Department of Education	Actual			Budget Estimates		Budget Projections			2010-11 to 2017-18
	2010–11	2011–12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	
Higher Education Loan Program (Advances paid)* (\$m)	16,489	18,617	21,473	25,183	29,908	36,796	43,599	51,436	212%
Average amount of debt (\$)	14,402	15,200	15,900	16,800	17,500	18,600	20,000	21,500	49%
Average number of years to repay debt	8.1	8.3	8.4	8.6	8.7	8.9	9.3	9.8	21%
Proportion of new debt not expected to be repaid	16%	17%	17%	17%	20%	21%	22%	23%	44%
Number with HELP debt (m) (Estimated from Advances paid/Average debt) (Actuarial Basis)	1.145	1.225	1.351	1.499	1.709	1.978	2.180	2.392	109%
Indexation of HELP receivable and other student loans (\$m)	216	388	503	536	671	1,366	1,640	2,012	831%
Australian Taxation Office									
Number of Debtors (Actual)^ (millions)	1.567	1.681	1.849	2.052	2.339	2.708	2.984	3.275	109%
Total HELP Debt (\$m)* ^	22,573	25,486	29,396	34,475	40,943	50,373	59,686	70,415	212%
Average amount of debt (\$) (Estimated)^	14,404	15,202	15,903	16,803	17,503	18,603	20,003	21,503	49%
Total HELP Debt deemed unrecoverable (\$m)* ^	6,084	6,869	7,923	9,292	11,035	13,577	16,087	18,979	212%
HELP Debtors as a % of 18-54 year olds	13.5%	14.3%	15.5%	17.0%	19.1%	21.8%	23.7%	25.7%	75%

Notes

* THE ATO HELP debt and those of the Department of Education can be reconciled as follows. The ATO taxation statistics records all HELP debt since 1989. The Department of Education has an accruals accounting value of all HELP debt. As noted in the 2012-13 Annual Report (cited in Sources) on p181 it is stated that: "In the process of applying the accounting policies listed in this note the Department has made the following judgements that have the most significant impact on the amounts recorded in the financial statements:

- The value of the Higher Education Loan Program (HELP) receivable is calculated each year by actuarial assessment. The two main measures impacting on the calculation of the HELP asset are the face value of the debt not expected to be repaid and the fair value of the remaining receivable calculated as the present value of projected future cash flows."

The implications of this assumption are detailed in Note 24H on p245 of the Department of Education 2012-13 Annual Report.

^ For years 2011-12 forward, projections are based on the ratio of the value of ATO HELP debt to Department of Education data on HELP Advanced Paid.

The values for 2010-11 and 2011-12 were based on previous Budget estimates but revised in such a way as to make those years forward estimates comparable with the aggregates for the period 2012-13 to 2016-17 reported in the 2013 Budget Papers.

Sources:

<http://www.innovation.gov.au/AboutUs/Budget/Pages/Library%20Card/PortfolioBudgetStatementsDIIICCS RTE2013-14.aspx:pp92-93>

<http://www.innovation.gov.au/AboutUs/CorporatePublications/AnnualReports/AnnualReport201213/wp-content/uploads/annual-report-2013.pdf>

Tables 25 and 26 p70; Section 1.3 p181; Note 24H p245

<http://www.ato.gov.au/uploadedFiles/Content/CR/downloads/AR2012-13-complete.pdf>: Table 2.8

http://www.ato.gov.au/uploadedFiles/Content/CR/Research_and_statistics/In_detail/Downloads/cor00345977_2011TAXSTATS.pdf: Table 2.15 - 2.19

http://www.budget.gov.au/2010-11/content/fbo/html/part_2.htm: Notes 5 and 14

http://www.budget.gov.au/2011-12/content/fbo/html/part_2.htm: Notes 5 and 14

http://www.budget.gov.au/2013-14/content/bp1/html/bp1_bst9-01.htm: Notes 5 and 13

Table A7 HELP repayment income levels and repayment Rates: 2000-01 to 2013-14

HELP repayment income (HRI*)	Repayment rate	HELP repayment income (HRI*)	Repayment rate
2013-14		2012-13	
Below \$51,309	Nil	Below \$49,096	Nil
\$51,309 - \$57,153	4% of HRI	\$49,096-\$54,688	4% of HRI
\$57,154 - \$62,997	4.5% of HRI	\$54,689-\$60,279	4.5% of HRI
\$62,998 - \$66,308	5% of HRI	\$60,280-\$63,448	5% of HRI
\$66,309 - \$71,277	5.5% of HRI	\$63,449-\$68,202	5.5% of HRI
\$71,278 - \$77,194	6% of HRI	\$68,203-\$73,864	6% of HRI
\$77,195 - \$81,256	6.5% of HRI	\$73,865-\$77,751	6.5% of HRI
\$81,257 - \$89,421	7% of HRI	\$77,752-\$85,564	7% of HRI
\$89,422 - \$95,287	7.5% of HRI	\$85,565-\$91,177	7.5% of HRI
\$95,288 and above	8% of HRI	\$91,178 and above	8% of HRI
2011-12		2010-11	
Below \$47,196	Nil	Below \$44,912	Nil
\$47,196-\$52,572	4% of HRI	\$44,912-\$50,028	4% of HRI
\$52,573-\$57,947	4.5% of HRI	\$50,029-\$55,143	4.5% of HRI
\$57,948-\$60,993	5% of HRI	\$55,144-\$58,041	5% of HRI
\$60,994-\$65,563	5.5% of HRI	\$58,042-\$62,390	5.5% of HRI
\$65,564-\$71,006	6% of HRI	\$62,391-\$67,570	6% of HRI
\$71,007-\$74,743	6.5% of HRI	\$67,571-\$71,126	6.5% of HRI
\$74,744-\$82,253	7% of HRI	\$71,127-\$78,273	7% of HRI
\$82,254-\$87,649	7.5% of HRI	\$78,274-\$83,407	7.5% of HRI
\$87,650 and above	8% of HRI	\$83,408 and above	8% of HRI
2009-10		2008-09	
Below \$43,151	Nil	Below \$41,595	Nil
\$43,151-\$48,066	4% of HRI	\$41,595-\$46,333	4% of HRI
\$48,067-\$52,980	4.5% of HRI	\$46,334-\$51,070	4.5% of HRI
\$52,981-\$55,764	5% of HRI	\$51,071-\$53,754	5% of HRI
\$55,765-\$59,943	5.5% of HRI	\$53,755-\$57,782	5.5% of HRI
\$59,944-\$64,919	6% of HRI	\$57,783-\$62,579	6% of HRI
\$64,920-\$68,336	6.5% of HRI	\$62,580-\$65,873	6.5% of HRI
\$68,337-\$75,203	7% of HRI	\$65,874-\$72,492	7% of HRI
\$75,204-\$80,136	7.5% of HRI	\$72,493-\$77,247	7.5% of HRI
\$80,137 and above	8% of HRI	\$77,248 and above	8% of HRI
2007-08		2006-07	
Below \$39,825	Nil	Below \$38,149	Nil
\$39,825-\$44,360	4% of HRI	\$38,149-\$42,494	4% of HRI
\$44,361-\$48,896	4.5% of HRI	\$42,495-\$46,838	4.5% of HRI
\$48,897-\$51,466	5% of HRI	\$46,839-\$49,300	5% of HRI
\$51,467-\$55,322	5.5% of HRI	\$49,301-\$52,994	5.5% of HRI
\$55,323-\$59,915	6% of HRI	\$52,995-\$57,394	6% of HRI
\$59,916-\$63,068	6.5% of HRI	\$57,395-\$60,414	6.5% of HRI
\$63,069-\$69,405	7% of HRI	\$60,415-\$66,485	7% of HRI
\$69,406-\$73,959	7.5% of HRI	\$66,486-\$70,846	7.5% of HRI
\$73,960 and above	8% of HRI	\$70,847 and above	8% of HRI
2005-06		2004-05	
Below \$36,185	Nil	Below \$35,001	Nil
\$36,185-\$40,306	4% of HRI	\$35,001-\$38,987	4% of HRI
\$40,307-\$44,427	4.5% of HRI	\$38,988-\$42,972	4.5% of HRI
\$44,428-\$46,762	5% of HRI	\$42,973-\$45,232	5% of HRI
\$46,763-\$50,266	5.5% of HRI	\$45,233-\$48,621	5.5% of HRI
\$50,267-\$54,439	6% of HRI	\$48,622-\$52,657	6% of HRI
\$54,440-\$57,304	6.5% of HRI	\$52,658-\$55,429	6.5% of HRI
\$57,305-\$63,062	7% of HRI	\$55,430-\$60,971	7% of HRI
\$63,063-\$67,199	7.5% of HRI	\$60,972-\$64,999	7.5% of HRI
\$67,200 and above	8% of HRI	\$65,000 and above	8% of HRI
2003-04		2002-03	
Below \$25,348	Nil	Below \$24,365	Nil
\$25,348-\$26,731	3% of HRI	\$24,365-\$25,694	3% of HRI
\$26,732-\$28,805	3.5% of HRI	\$25,695-\$27,688	3.5% of HRI
\$28,806-\$33,414	4% of HRI	\$27,689-\$32,118	4% of HRI
\$33,415-\$40,328	4.5% of HRI	\$32,119-\$38,763	4.5% of HRI
\$40,329-\$42,447	5% of HRI	\$38,764-\$40,801	5% of HRI
\$42,448-\$45,628	5.5% of HRI	\$40,802-\$43,858	5.5% of HRI
\$45,629 and above	6% of HRI	\$43,859 and above	6% of HRI
2001-02		2000-01	
Below \$23,242	Nil	Below \$22,346	Nil
\$23,242-\$24,510	3% of HRI	\$22,346-\$23,565	3% of HRI
\$24,511-\$26,412	3.5% of HRI	\$23,566-\$25,393	3.5% of HRI
\$26,413-\$30,638	4% of HRI	\$25,394-\$29,456	4% of HRI
\$30,639-\$36,977	4.5% of HRI	\$29,457-\$35,551	4.5% of HRI
\$36,978-\$38,921	5% of HRI	\$35,552-\$37,420	5% of HRI
\$38,922-\$41,837	5.5% of HRI	\$37,421-\$40,223	5.5% of HRI

	\$41,838 and above	6% of HRI	\$40,224 and above	6% of HRI
* Details of progressive broadening of HRI definition				
2010-11	HRI = Taxable income plus any total net investment loss (which includes net rental losses), total reportable fringe benefits amounts, reportable super contributions and exempt foreign employment income.			
2005-06	HRI = Taxable income plus any net rental losses, total reportable fringe benefits amounts and exempt foreign employment income.			
1999-2000	HRI= taxable income plus any net rental losses and total reportable fringe benefits amounts			
1996-97	HRI = Taxable income plus any net rental losses			
1989	HRI= Taxable income			

Source: www.ato.gov.au**Table A8 ATO selected HELP performance indicators 2001-02 to 2011-12**

Financial year	HELP Debtors		Average HELP Debt (\$)	HELP assessments for financial year (2)		Average HELP assessments	Value of HELP assessments / HELP debt	No. HELP Assessments / No. HELP debtors	% of Income Tax Payers with HELP:		Value of HELP Debt / Personal Income Tax
	(000's) (1)	Debt (\$b) (1)		No.	Value	\$	(%)	(%)	Debt	Assessment	(%)
2001-02	1,100	8.7	7,909	349	0.612	1,753	7.0	31.7	10.1	3.2	10.1
2002-03	1,200	9.8	8,166	352	0.639	1,815	6.5	29.3	10.8	3.2	10.5
2003-04	1,200	10.9	9,083	369	0.704	1,907	6.5	30.8	10.6	3.3	10.8
2004-05	1,120	11.0	9,821	270	0.683	2,529	6.2	24.1	9.6	2.3	10.0
2005-06	1,185	12.4	10,464	302	0.809	2,678	6.5	25.5	9.9	2.5	10.8
2006-07	1,247	14.0	11,226	325	0.939	2,889	6.7	26.1	10.2	2.7	11.5
2007-08	1,313	15.8	12,033	364	1.124	3,087	7.1	27.7	10.5	2.9	12.5
2008-09	1,371	17.8	12,983	369	1.195	3,238	6.7	26.9	10.6	2.8	14.6
2009-10	1,462	19.9	13,611	377	1.270	3,368	6.4	25.8	11.3	2.9	15.9
2010-11	1,567	22.6	14,422	401	1.407	3,508	6.2	25.6	12.2	3.1	17.0
2011-12	1,681	25.5	15,169	402	1.451	3,609	5.7	23.9			
% per annum change 2001-	4.3%	11.4%	6.7%	1.4%	9.0%	7.5%	-2.0%	-2.8%			
% Total	52.8%	193.1%	91.8%	15.2%	137.1%	105.9%	-18.6%	-24.6%			

Source: Taxation Statistics and Commissioner's Annual Reports

(1) As reported each year in ATO Commissioner's Annual Report and/or Taxation Statistics.

(2) These are cumulative data, as reported in Table 1 of ATO Taxation Statistics 2010-11

10. ANNEX 2: DEDUCTIONS BY HELP AND NON-HELP DEBTORS (2010-11 INCOME YEAR)

(Source: ATO Individuals 1% Sample File 2010-11)

Shaded area: Deviation in incidence of claims by HELP and non-HELP debtors exceeds 4%+ (absolute)

10.1 A. Deductions for work-related expenses of HELP and Non- HELP debtors

Age group: 20-29

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	546	468	85.7	1,612	1,532	1,301	84.9	1,711
30,000	488	408	83.6	1,512	1,641	1,436	87.5	1,751
35,000	437	365	83.5	1,530	1,577	1,402	88.9	1,969
40, 000	438	376	85.8	2,047	1,487	1,315	88.4	1,942
45,000	315	273	86.7	1,923	1,148	1,037	90.3	2,254
50,000	307	277	90.2	1,988	895	809	90.4	2,669
55,000	262	238	90.8	2,027	685	611	89.2	3,016
60,000	223	203	91.0	1,768	545	489	89.7	3,108
65,000	194	182	93.8	1,985	407	374	91.9	3,078
70,000	150	134	89.3	1,767	323	289	89.5	3,146
75,000	95	74	77.9	1,752	259	234	90.3	3,549
80,000	68	57	83.8	2,486	230	207	90.0	3,931
85,000	60	56	93.3	3,029	157	137	87.3	3,663
Above	(Data for income ranges over \$85,000 not elaborated but included in totals)							
Totals	6,689	5,028	75.2	1,705	18,596	14,260	76.7	2,093

Age group: 30-39

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	171	129	75.4	1,843	1,142	852	74.6	1,458
30,000	173	148	85.5	1,904	1,301	1,041	80.0	1,902
35,000	210	175	83.3	2,279	1,309	1,096	83.7	1,946
40, 000	212	187	88.2	2,441	1,354	1,149	84.9	1,976
45,000	184	162	88.0	1,876	1,295	1,111	85.8	2,227
50,000	205	184	89.8	2,783	1,168	1,029	88.1	2,281
55,000	203	187	92.1	2,567	1,153	1,015	88.0	2,687
60,000	194	171	88.1	2,655	1,032	916	88.8	2,761
65,000	163	145	88.9	2,980	920	820	89.1	2,981
70,000	135	122	90.4	2,797	852	770	90.4	3,166
75,000	83	73	88.0	3,111	717	640	89.3	3,195
80,000	65	59	90.8	3,433	636	566	89.0	3,070
85,000	60	56	93.3	2,890	573	499	87.1	3,249
Above	(Data for income ranges over \$85,000 not elaborated but included in totals)							
Totals	3,222	2,415	75.0	2,401	22,545	16,908	75.0	2,549

Age group: 40-49

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	84	59	70.2	1,999	1,250	871	69.7	1,263
30,000	85	67	78.8	1,951	1,342	1,016	75.7	1,349
35,000	85	61	71.8	2,116	1,467	1,136	77.4	1,681
40, 000	74	63	85.1	2,763	1,492	1,202	80.6	1,730
45,000	80	69	86.2	2,264	1,344	1,141	84.9	1,918
50,000	70	60	85.7	2,898	1,189	1,014	85.3	1,949
55,000	59	54	91.5	2,590	1,194	1,038	86.9	2,291
60,000	49	42	85.7	2,510	1,111	955	86.0	2,453
65,000	56	47	83.9	2,861	1,029	893	86.8	2,633
70,000	25	24	96.0	3,573	931	806	86.6	2,805

75,000	27	24	88.9	3,089	866	753	86.9	2,801
80,000	20	17	85.0	3,348	733	635	86.6	2,785
85,000	14	12	85.7	3,654	683	600	87.8	2,704
Above	(Data for income ranges over \$85,000 not elaborated but included in totals)							
Totals	1,254	856	68.3	2395	24,907	18,165	75.0	2,346

Age group: <20, 50+

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	47	30	63.8	2,302	2,769	1,269	45.8	1,256
30,000	39	31	79.5	1,652	2,811	1,538	54.7	1,305
35,000	37	28	75.6	2,057	2,771	1,698	61.3	1,388
40,000	30	25	83.3	2,297	2,478	1,639	66.1	1,392
45,000	30	23	76.7	1,008	2,348	1,628	69.3	1,604
50,000	27	21	77.8	1,933	1,995	1,442	72.3	1,716
55,000	21	19	90.5	2,800	1,787	1,347	75.4	1,828
60,000	18	15	83.3	866	1,516	1,180	77.8	2,063
65,000	20	19	95.0	2,542	1,363	1,051	77.1	2,146
70,000	18	17	94.5	1,481	1,257	986	78.4	2,349
75,000	11	11	100	2,337	1,090	867	79.7	2,454
80,000	9	6	66.6	1,599	974	754	77.4	2,699
85,000	4	4	100	522	862	671	77.8	2,453
Above	(Data for income ranges over \$85,000 not elaborated but included in tables.)							
Totals	617	384	62.2	1599	47,519	24,701	52.0	1,865

All ages

Totals	11,782	8,683	73.7	1,988	113,567	74,034	65.2	2,183
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10.2 B. Gift Deduction Claims of HELP and Non- HELP debtors**Age group: 20-29**

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of gift claims	% claiming	Average claim value	No. of records	No. of gift claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	547	194	35.5	125	1,531	423	27.6	120
30,000	489	164	33.5	161	1,640	516	31.5	113
35,000	436	174	39.9	189	1,576	548	34.8	146
40,000	437	185	42.3	235	1,488	555	37.3	189
45,000	314	136	43.3	162	1,145	438	42.6	170
50,000	306	150	49.0	174	897	373	41.6	161
55,000	263	132	50.0	264	685	291	42.5	196
60,000	223	124	55.6	220	541	220	40.7	256
65,000	194	103	53.1	214	408	169	41.4	138
70,000	150	72	48.0	219	323	139	43.0	192
75,000	95	53	55.8	454	262	116	44.3	243
80,000	68	38	55.9	226	231	77	33.3	218
85,000	60	28	46.6	362	156	59	37.8	214
Above	(Data for income ranges over \$85,000 not elaborated but included in tables.)							
Totals	6,689	2,271	33.9	196	18,596	5,315	28.6	174

Age group: 30-39

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of gift claims	% claiming	Average claim value	No. of records	No. of gift claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	168	62	36.9	218	1,139	340	29.9	187
30,000	175	67	38.2	287	1,294	448	34.6	236
35,000	206	78	37.9	290	1,310	491	37.5	260
40,000	213	98	46.0	386	1,347	531	39.4	192
45,000	182	88	48.3	190	1,293	562	43.5	197
50,000	205	95	46.3	242	1,170	518	44.3	187

55,000	202	102	50.5	412	1,145	535	46.7	216
60,000	193	109	56.5	239	1,021	465	45.5	244
65,000	165	82	49.7	484	927	454	49.0	256
70,000	135	72	53.3	361	850	399	46.9	266
75,000	81	41	50.6	356	720	359	49.9	268
80,000	69	35	50.7	172	631	326	51.7	300
85,000	57	33	57.9	257	569	282	49.5	352
Above	(Data for income ranges over \$85,000 not elaborated but included in totals)							
Totals	3,222	1,288	40.0	301	22,545	8,504	38.0	266

Age group: 40-49

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of gift claims	% claiming	Average claim value	No. of records	No. of gift claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	84	25	29.8	233	1,253	428	34.2	161
30,000	84	37	44.0	278	1,335	519	38.9	187
35,000	83	29	34.9	241	1,456	560	38.5	252
40,000	74	35	47.3	302	1,480	628	42.4	203
45,000	80	42	52.5	177	1,328	607	45.7	230
50,000	71	30	42.3	238	1,188	556	46.8	275
55,000	61	34	55.7	324	1,192	625	52.4	259
60,000	47	18	38.3	216	1,116	574	51.4	252
65,000	56	30	53.6	250	1,021	531	52.0	295
70,000	26	17	65.4	192	921	462	50.2	333
75,000	28	9	32.0	281	879	468	53.2	317
80,000	20	11	55.0	241	730	408	55.9	327
85,000	14	4	28.6	274	680	370	54.4	336
Above	(Data for income ranges over \$85,000 not elaborated but included in tables.)							
Totals	1,254	455	36.3	264	24,907	10,568	42.4	335

Age group: <20, 50+

Max income	HELP debtors				Non-HELP debtors			
	No. of records	No. of gift claims	% claiming	Average claim value	No. of records	No. of gift claims	% claiming	Average claim value
Below	(Data for income ranges up to \$20,000 not elaborated but included in totals)							
25,000	48	16	33.3	334	2,796	1,117	39.9	297
30,000	40	17	42.5	354	2,801	1,233	44.0	300
35,000	36	19	52.8	296	2,760	1,230	44.6	386
40,000	31	14	45.2	469	2,458	1,215	49.4	367
45,000	29	12	41.4	446	2,355	1,183	50.2	354
50,000	28	20	71.4	229	2,006	1,030	51.3	304
55,000	21	9	42.9	239	1,779	958	53.9	348
60,000	18	13	72.2	309	1,512	819	54.2	351
65,000	20	12	60.0	648	1,354	784	57.9	388
70,000	18	8	44.4	175	1,256	691	55.0	386
75,000	11	6	54.5	419	1,093	597	54.6	441
80,000	8	5	62.5	255	971	538	55.4	475
85,000	5	3	60.0	59	865	488	56.4	444
Above	(Data for income ranges over \$85,000 not elaborated but included in totals)							
Totals	617	228	37.0	410	47,519	18,954	39.1	447

All ages

Totals	11,782	4,242	36.0	247	113,567	43,341	38.0	350
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10.3 C. Rental income deductions

Age groups	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
20-29	6,689	262	3.9	18,711	18,596	744	4.0	18,352
30-39	3,222	396	12.3	18,776	22,545	3,085	13.7	21,062
40-49	1,254	180	14.4	18,984	24,907	4,389	17.6	22,544
<20, 50+	617	92	14.9	21,247	47,519	8,624	18.1	19,862
Totals	11,782	930	7.9	19,042	113,567	16,842	14.8	20,714

Other deductions

Age groups	HELP debtors				Non-HELP debtors			
	No. of records	No. of claims	% claiming	Average claim value	No. of records	No. of claims	% claiming	Average claim value
20-29	6,689	169	2.5	516	18,596	657	3.5	847
30-39	3,222	194	6.0	1,238	22,545	1,898	8.4	1,233
40-49	1,254	84	6.7	1,443	24,907	2,669	10.7	1,990
<20, 50+	617	54	8.6	1,423	47,519	3,647	7.7	2,009
Totals	11,782	501	4.2	1,049	113,567	8,871	7.8	1,751

A chilling account: North American and Australasian approaches to fears of over-defensive responses to taxpayer claims against tax officials

Dr John Bevacqua¹

Abstract

Judges frequently deny relief to taxpayers in claims against tax officials because of concerns about the possible adverse motivational effects on tax officials of imposing liability. In particular, there is a concern that the fear of being sued will result in tax officials becoming over-defensive in carrying out their tax administration duties. These over-defensive behaviours are often described as ‘chilling’ effects or ‘chill-factor’ concerns.

The inherent logical appeal of these chill-factor concerns is rarely subjected to the rigours of the rules of evidence or even to close academic scrutiny. Further, no attempt has been made to devise robust legal principles for appropriate judicial treatment of chill-factor concerns. This article addresses these deficiencies.

Specifically, Part 2 explains the main controversies surrounding the existence, nature and most appropriate weight to be afforded to chill-factor concerns in taxpayer claims against tax officials. Part 3 examines the judicial treatment of chill-factor concerns in taxpayer claims against tax officials in the United States, Canada, Australia, and New Zealand. Part 4 draws on the various approaches in each of these jurisdictions and, mindful of the controversies and complexities discussed in Part 2, sets out a series of guidelines to assist policy-makers and judges in determining the appropriate treatment of chill-factor policy concerns in taxpayer claims against tax officials.

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1. INTRODUCTION

Taxpayer claims against tax officials for harm caused by tax administration activities give rise to a number of complex public policy concerns which judges need to consider. One of the policy concerns most commonly raised to deny taxpayer recovery is the ‘chill-factor’ effect.² The nub of the chill-factor effect argument is that imposing legal liabilities on tax officials may result in a range of over-defensive responses. For example, in the face of increased risk of liability for incorrect advice provided to taxpayers, a revenue authority may cease providing taxpayers with even the most basic information or only provide that information after multiple expensive and time-consuming cross-checking procedures have been followed.³ Similarly, higher risk tax collection activities may be avoided for fear of being sued if a mistake is made.⁴ Over-defensiveness might also manifest itself in the form of tax authorities seeking to avoid difficult cases being brought before the courts. Otherwise willing people may also be deterred from becoming tax officials.⁵

Consequently, judges are often faced with submissions that taxpayer recovery in claims against tax officials should be denied due to chilling-effect concerns. This article examines cases in which such concerns have been raised in the United States, Canada, Australia and New Zealand and the judicial approaches to dealing with these concerns in those cases. These jurisdictions have been chosen as they represent significantly different approaches to the chill-factor issue. The aim is to distil from these differing approaches a number of guidelines for consistent and robust judicial treatment of chill-factor concerns in tax cases.

Specifically, Part 2 elaborates on some of the controversies and complexities concerning the existence, nature and most appropriate weight to be afforded to chill-factor concerns in taxpayer claims against tax officials.⁶ An appreciation of these is essential to understanding the challenges facing judges in dealing with chill-factor policy concerns. Part 3 discusses the contrasting judicial approaches to dealing with

² Often also referred to as the ‘chilling’ effect or ‘over-defensiveness’ effect. These terms are used interchangeably in this article.

³ Such arguments have been used to defend Revenue powers to revoke or modify Revenue Rulings on a retroactive basis. See, for example, Edward Morse, ‘Reflections on the Rule of Law and “Clear Reflection of Income”: What Constrains Discretion?’ (1999) 8 *Cornell Journal of Law and Public Policy* 445, 490.

⁴ For example, falls in tax collection actions by the United State Internal Revenue Service in the 1990’s have been attributed to the threat of personal actions for damages against tax officials. See Christopher Pietruszkiewicz, ‘A Constitutional Cause of Action and the Internal Revenue Code: Can You Shoot (Sue) the Messenger?’ (2004) 54 *Syracuse Law Review* 1, 5. See also Seth Kaufman, ‘IRS Restructuring and Reform Act of 1998: Monopoly of Force, Administrative Accountability, and Due Process’ (1998) 50 *Administrative Law Review* 819, 827.

⁵ This concern was noted in *Harlow v Fitzgerald* 457 U.S. 800 (1982). In that case, the United States Supreme Court expressed concern about ‘the general costs of subjecting officials to the risks of trial—distraction of officials from their governmental duties, inhibition of discretionary action, and deterrence of able people from public service.’ These comments were cited with approval in *Mitchell v Forsyth* 472 U.S. 511 (1985), 526.

⁶ For the purposes of this article, the examination extends to claims against tax officials in their personal capacities as well as claims against the Revenue.

chill-factor policy concerns in taxpayer claims against tax officials in the United States, Canada, Australia and New Zealand. Part 4 draws on these contrasting approaches and, mindful of the controversies and complexities discussed in Part 2, proposes a number of specific guidelines to assist policy-makers and judges to deal with chill-factor effect concerns in tax cases in a predictable and principled manner.

2. CHILL-FACTOR CONTROVERSIES AND COMPLEXITIES

The chill-factor effect, as with most public policy concerns, raises a number of complexities and controversies. These include fundamental questions about whether chilling effects are a real and observable phenomenon, and if they are, whether those effects should be feared. Debate also surrounds the appropriate weighing up of chill-factor concerns against any countervailing positive policy effects of imposing liability to taxpayers on tax officials. There are also questions about whether tax officials, in particular, respond in over-defensive ways to adverse judicial determinations and the form any such over-defensiveness might take. Judges need to be mindful of such issues in dealing with chill-factor concerns in tax cases. Hence, each of these complexities and controversies is elaborated below:

2.1 Is the chill-factor a real and observable phenomenon?

Some commentators question whether, despite its inherent logical appeal, the chill-factor effect is a real and observable phenomenon. This scepticism is fuelled by the limited number of empirical studies into the issue and the lack of uniformity in the results of those studies.⁷ For example, a United States study by Cordes and Weisbrod into the allocational impact of the imposition of liability on highway authorities found evidence of a ‘chill-factor’ phenomenon.⁸ In contrast, a study by O’Leary into the effect of judicial determinations on activities of the United States Environmental Protection Agency was less conclusive, finding both negative and positive motivational effects.⁹ A number of additional United States studies have reached similarly qualified conclusions.¹⁰ The Australasian empirical work is also equivocal. A 2004 Australian study by McMillan and Creyke into the effects of adverse judicial

⁷ These facts are lamented by the UK Law Commission in their recent consultation paper on administrative redress for citizens from public bodies. (The Law Commission, United Kingdom, *Administrative Redress: Public Bodies and the Citizen*, Consultation Paper No 187 (2008)). Similar comments were made by the Committee in their earlier report—See The Law Commission, Public Law Team, United Kingdom, *Monetary Remedies in Public Law: A Discussion Paper* (2004), [7.10]–[7.11].

⁸ See Joseph Cordes and Burton Weisbrod, ‘Government Behaviour in Response to Compensation Requirements’ (1979) 11 *Journal of Public Economics* 47.

⁹ See Rosemary O’Leary, ‘The Impact of Federal Court Decisions on the Policies and Administration of the US Environmental Protection Agency’ (1989) 41 *Administrative Law Review* 549.

¹⁰ Other United States studies with similarly qualified conclusions as to whether impact of judicial decisions on public bodies will be positive or negative include: Charles Johnson, ‘Judicial Decisions and Organisational Changes: Some Theoretical and Empirical Notes on State Court Decisions and State Administrative Agencies’ (1979) 14 *Law and Society Review* 27; and Bradley Canon, ‘Studying Bureaucratic Implementation of Judicial Policies in the United States: Conceptual and Methodological Approaches’ in Mark Hertogh and Simon Halliday (eds), *Judicial Review and Bureaucratic Impact: International and Interdisciplinary Perspectives* (2004).

review determinations on Australian government bodies¹¹ found that, aside from a few noted instances, there was no evidence of significant chilling effects flowing from adverse judicial review determinations.¹²

In addition to the variability and authority-specific nature of the results of the various studies, it is questionable whether the findings in any one jurisdiction would readily transfer to other jurisdictions. The seemingly contradictory results may also simply indicate that different public bodies will respond in different ways to potential chilling effect triggers. A further complication is that responses to adverse judicial determinations are likely to change over time as public service attitudes, policies and practices evolve and change, reducing the utility of any older studies.

The academic debate on the issue does little to resolve these empirical gaps and complexities. There is, however, qualified academic acceptance of the legitimacy of over-defensiveness concerns.¹³ Levinson, for example, acknowledges the validity of chill-factor concerns, but questions their potential impact, arguing that in many cases public authorities respond to political rather than economic ramifications.¹⁴

Others challenge chill-factor concerns on the basis that the extent and nature of any motivational impact of a particular judicial determination or legislative imposition of liability will depend upon the nature of the wrong to which that judgment or legislation relates. For example, over-defensive responses to torts imposing personal liability on officials may be more extreme than in cases where liability is imposed at an organisational level.¹⁵

Some also discount chill-factor concerns by distinguishing between short-term and long-term effects of over-defensive behavioural responses. For example, Roots suggests that such policy concerns are weak because they are short-term in effect. In

¹¹ Robin Creyke and John McMillan, 'The Operation of Judicial Review in Australia' in Mark Hertogh and Simon Halliday (eds), *Judicial Review and Bureaucratic Impact - International and Interdisciplinary Perspectives* (2004), 161.

¹² Ibid at 178, the authors note a particularly pertinent comment from one agency clearly indicating a view that chill-factor effects had resulted from an adverse judicial review outcome: 'The court's decision made the department super cautious about adhering to process. They adopted a no risk policy which increased the complexity of the statement of reasons process and made the system more expensive. The expectation of intense scrutiny by the courts meant that "a hell of a lot" more time was spent by the department on the process.'

¹³ The tortious academic literature on this issue is particularly voluminous. See, for example, Osborne Reynolds, 'The Discretionary Function Exceptions of the Federal Torts Claims Act' (1968) 57 *Georgetown Law Journal* 81, 121-123; Paul Craig and Duncan Fairgrieve, 'Barrett, Negligence and Discretionary Powers' [1999] *Public Law* 626, 635; Susan Kneebone, *Tort Liability of Public Authorities* (1998), 393; Keith Stanton et al, *Statutory Torts* (2003), 57; Harry Woolf, *Protection of the Public - A New Challenge* (1990), 60; Cornelius Peck, 'The Federal Tort Claims Act: A Proposed Construction of the Discretionary Function Exception' (1956) 31 *Washington Law Review* 207, 223; and Donal Nolan, 'Suing the State: Governmental Liability in Comparative Perspective' (2004) 67 *Modern Law Review* 844, 859-860.

¹⁴ Daryl Levinson, 'Making Government Pay: Markets, Politics and the Allocation of Constitutional Costs' (2000) 67 *University of Chicago Law Review* 345.

¹⁵ See Peter Schuck, *Suing Government* (1983). This is a significant issue which is taken up in Part 4 in deriving guidelines for dealing with chill-factor concerns in taxpayer claims against tax officials.

the long-run, improvements in administrative decision-making resulting from imposing liability on public authorities outweigh any chilling effects.¹⁶

2.2 Weighing chill-factor concerns against countervailing policy effects

None of the preceding empirical work or academic commentary examines chill-factor concerns in a tax context. However, tax cases raise their own complexities. For example, where the chill-factor issue is raised in tax cases, judges need to weigh the possible adverse motivational effects of imposing liability on tax officials against possible countervailing positive motivational effects on taxpayers. These effects might offset any observable short-run chill-factor effects and lead to long-run overall improvements in tax administration through fostering voluntary compliance behaviour.

Unfortunately, though, just as there are no tax-specific studies into potential chilling effects on tax officials, there have also been no empirical studies of any possible positive motivational effects of taxpayer success in claims against tax officials. The most closely applicable studies are those examining possible links between taxpayer compliance and taxpayer perceptions of justice. Wenzel in his study of the impact of justice concerns on tax compliance notes the results of numerous studies, concluding that “taxpayers are less likely to be compliant with a tax system they consider unjust, unfair, and, thus, illegitimate”.¹⁷ To the extent that taxpayers might perceive unfairness or injustice in restricting the liability of tax officials due to chill-factor concerns, the effect may be a reduction in voluntary compliance behaviour. Conversely, positive compliance benefits might well flow from allowing taxpayers to succeed in claims against tax officials more often, despite any potential chill-factor concerns.

It may also be possible to extrapolate from studies linking sanctions imposed on taxpayers and the effect on compliance¹⁸ and to hypothesise on a possible positive link between greater ‘sanctions’ imposed on tax officials and the level of taxpayer compliance. It would, however, be a significant leap of faith to assert that the motivations and responses of taxpayers will be the same as the motivations and responses of tax officials.

Commentators such as Book also note the risks of drawing any concrete conclusions from the literature, pointing out the subtleties of tax administration and “the possibility that increasing post-assessment procedural protections may embolden non-compliance

¹⁶ As Roots has observed: ‘Do we deny compensation to the person aggrieved because, in the short term, administrative bodies are likely to be inhibited in their decision-making functions, or do we, accepting the risk of short term disruption and inhibition, focus on the long-term benefits of higher quality administrative action, the reduction of loss caused to individuals, and relief for those aggrieved, in both the short and long term, and allow compensation? Obviously, the latter option is the more equitable and definitely preferable.’ Lachlan Roots, ‘A Tort of Maladministration: Government Stuff-Ups’ (1993) 18 *Alternative Law Journal* 67, 71.

¹⁷ Michael Wenzel, ‘The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers’ Identity’ (2002) 87(4) *Journal of Applied Psychology* 629, 629.

¹⁸ These studies conclude, somewhat unsurprisingly, that harsher sanctions might foster greater taxpayer compliance. The logic of such findings has been noted by Roth, Scholz and Witte: “The hypothesis that more certain or severe legal sanctions will encourage compliance with the law is consistent not only with ... economic theories ... but also with exchange theory in sociology.” See Jeffrey Roth, John Scholz and Ann Witte (eds), *Taxpayer Compliance: An Agenda for Research* (1989) vol 1, 91.

or, alternatively, increase compliance through a greater sense of public confidence in the fairness of procedures".¹⁹

2.3 Do tax officials respond over-defensively to adverse judicial determinations?

Few commentators have ventured to consider how or to what extent over-defensiveness might manifest itself in tax official conduct. Writers such as Schuck have, however, more generally speculated on the likely effects on 'street level' officials of imposing liability on them. Schuck points to four common forms of risk averse behaviour by public officials. These are: inaction,²⁰ delayed action,²¹ formalism through following formal procedures aimed at insulating the decision-maker against potential suit²² and changes in the character of decisions to those with lower attendant risks of suit than decisions that might otherwise have been made.²³

While Schuck's summary of possible chilling effects is not tax-specific, Schuck goes on to paint a vivid picture of the environment which might conceivably face a tax official and prompt such over-defensive behaviours:

His environment is characterized by pervasive uncertainty concerning what behavior is correct, a relatively high probability of error and potential for public harm, and unusually great opportunities for behavior that minimizes the risks to his personal interests ... He also faces significant uncertainties concerning the availability to him either of immunity or of devices to shift risks to others. As a result, the official's caution is likely to assume proportions that can reduce his willingness to pursue the objectives that his agency is required to advance.²⁴

This cost-benefit type of analysis of the motivations of public officials—this time with specific application to tax officials—is also advanced by Pietruszkiewicz who observes:

For the revenue agent or a revenue officer, there can be no benefit for incurring the risks taken in attempting to assess or collect taxes ... As a result, the cost-benefit analysis strongly favours risk aversion by a public servant.²⁵

Despite the logical appeal of such hypotheses, the potential motivators of tax officials which might bring about such risk aversion responses are difficult to predict. The response to the threat of liability to taxpayers may well manifest itself differently and to varying degrees depending on a wide range of factors. These include the level of authority and experience within the organisation of the relevant official, whether the

¹⁹ Leslie Book, 'The Collection Due Process Rights: A Misstep or a Step in the Right Direction' (2004) 40 *Houston Law Review* 1145, 1160.

²⁰ Peter Schuck, 'Suing our Servants: The Court, Congress, and the Liability of Public Officials for Damages' (1981) *Supreme Court Review* 281, 309-310.

²¹ *Ibid* 310.

²² *Ibid* 310-311.

²³ *Ibid* 311-312.

²⁴ *Ibid* 284-285.

²⁵ Christopher Pietruszkiewicz, above n 4, 64-65.

threat is of personal liability or liability at an organisational level,²⁶ the official's level of knowledge and understanding of the ramifications of adverse judicial outcomes, and the degree of legal certainty about the limits of potential liability of tax officials. It is easy to conceive of many more similar considerations which might be material to ascertaining the extent and likelihood of any over-defensive tax official response in any particular case.

There is also the broader philosophical question of whether protecting the Revenue requires taking *extra* care to avoid setting precedents which might generate over-defensive tax official responses. The question arises because any challenge to the activities of a revenue authority indirectly creates vulnerabilities in the funding of the other functions of State and important social initiatives of government. Accordingly, it could be argued that, in the taxation context, judges need to consider not only the direct ramifications of imposing liability on tax officials, but also potential flow-on effects on any of a range of other government activities and initiatives. As Cohen has noted, "[t]he cost may be borne by another department, a bureaucracy independent from the one whose actions are most directly associated with the injury".²⁷

Of course, taken to its logical conclusion, such an argument could be used to resist imposing liability on tax officials in any circumstances. And no one seriously advocates endowing tax officials with absolute immunity from liability for all of their wrongs due to chill-factor concerns.²⁸ A line must, therefore, be drawn. The following Part discloses where that line has been drawn by United States, Canadian, Australian and New Zealand judges.

3. NORTH AMERICAN AND AUSTRALASIAN JUDICIAL APPROACHES TO CHILL-FACTOR CONCERNS

Despite the controversies and complexities surrounding the chill-factor effect outlined in the preceding Part, judges are frequently called upon to adjudicate arguments about potential chill-factor effects of imposing liability on tax officials. This Part examines the contrasting judicial approaches adopted in United States, Canada, Australia and New Zealand.

3.1 United States judicial approaches to chill-factor concerns

The chill-factor effect and the possible adverse effects of it were first judicially noted in the United States in 1788 in *Respublica v Sparhawk*,²⁹ a case which is widely

²⁶ The relevance of this issue is explored further in Part 4.

²⁷ David Cohen, 'Suing the State' (1990) 40 *University of Toronto Law Journal* 630, 647.

²⁸ United States judges, in particular, have acknowledged that some principles, such as some Constitutionally protected rights, should take priority over tax collection and administration activities. For example, the United States Court of Appeal observed in *National Commodity and Barter Association National Commodity Exchange v Gibbs* 886 F.2d 1240 (10th Cir. 1989), at 1248, that "...while the comprehensive scheme of the Internal Revenue Code should not be indiscriminately disrupted by the creation of new remedies, certain values, such as those protected by the first and fourth amendments, may be superior to the need to protect the integrity of the internal revenue system."

²⁹ 1 U.S. 357 (1788). The case involved an unsuccessful application for relief by the plaintiff, Sparhawk, for goods seized by the State for protection in anticipation of a British invasion of Philadelphia but which, notwithstanding these efforts, ultimately fell into the hands of the invading British in any event.

attributed with reinforcing the doctrine of sovereign immunity in the United States.³⁰ However, the first detailed consideration came over 150 years later, in *Gregoire v Biddle*³¹, a case concerning the malicious detention of a Frenchman during the Second World War. In that case, Justice Learned Hand struggled with weighing up potential ‘monstrous’ outcomes of letting loss caused by malicious public servants go unpunished, against the public good of not submitting innocent public officials to the fear of being sued. Ultimately, however, chill-factor concerns were determinative with His Honour concluding that “it has been thought in the end better to leave unredressed the wrongs done by dishonest officers than to subject those who try to do their duty to the constant dread of retaliation”.³²

Clearly influential in the reasoning was the fact that the case involved a challenge to governmental officers exercising judicial functions.³³ United States courts have subsequently refined the distinction between judicial or prosecutorial functions of public officials and other functions—with chill-factor concerns being afforded greater weight in cases involving the former. Consequently, in *Mitchell v Forsyth*³⁴ the Supreme Court rejected a chill-factor argument that the Attorney-General should be afforded immunity from suit when exercising national security functions. The Court distinguished national security functions from judicial functions, with the Court observing that “..the mere threat of litigation may significantly affect the fearless and independent performance of duty by actors in the judicial process..”³⁵ but would not have the same effect on non-judicial functions. This line of reasoning has been used to support affording immunity from suits in cases alleging wrongful prosecution by United States Internal Revenue Service (IRS) officers exercising prosecutorial powers.³⁶

In the tax context, the interest in chill-factor arguments has been renewed in recent years in cases considering constitutional damages claims against tax officials. In *Bivens v Six Unknown Named Federal Agents of Federal Bureau of Narcotics*³⁷ (*Bivens*) the United States Supreme Court created a constitutional damages action allowing citizens whose constitutional rights have been infringed by a public officer to

In order to illustrate the dangers of over-defensive conduct in public officials the Court, at 363, referred to the following extract from Clarendon’s History: “...the Lord Mayor of London, in 1666, when that city was on fire, would not give directions for, or consent to, the pulling down 40 wooden houses, or to the re- moving the furniture, &c. belonging to the Lawyers of Temple, then on the Circuit, for fear he should be answerable for a trespass; and in consequence of this conduct half that great city was burnt.”

³⁰ Ibid 363.

³¹ 177 F.2d 579 (1949).

³² Ibid 581.

³³ The Court observed, *ibid* at 580, (citing *Yaselli v Goff* 12 F.2d 396 (1926), 406) that “[t]he public interest requires that persons occupying such important positions and so closely identified with the judicial departments of the Government should speak and act freely and fearlessly in the discharge of their important official functions.”

³⁴ 472 U.S. 511 (1985). This case is authority for the principle that United States Attorneys-General do not enjoy absolute immunity from suit.

³⁵ Ibid 522.

³⁶ See, for example, *Stankevitz v IRS* 640 F.2d 205 (1981) applying the precedent set in *Butz v Economou* 438 U.S. 478, 508-17 (1979).

³⁷ 403 U.S. 388 (1971).

sue that officer personally for damages, even where there is no statutory avenue of relief.³⁸

However, courts have struggled with potential chill-factor effects of allowing such claims to proceed against IRS officers.³⁹ For example, in *Vennes v An Unknown Number of Unidentified Agents of the United States*⁴⁰ the majority, referring to the risks of extending the availability of *Bivens* relief to taxpayers, observed:

Expanding *Bivens* in this fashion would have a chilling effect on law enforcement officers and would flood the federal courts with constitutional damage claims by the many criminal defendants who leave the criminal process convinced that they have been prosecuted and convicted unfairly.⁴¹

There was a similar result in *National Commodity and Barter Association, National Commodity Exchange v Gibbs*⁴² (*Gibbs*). However, in *Gibbs*, the door was left open for a potential *Bivens* action in the tax context with the Court pointing out the need for competing public policy interests to be weighed up in determining whether to allow taxpayer relief:

... while the comprehensive scheme of the Internal Revenue Code should not be indiscriminately disrupted by the creation of new remedies, certain values, such as those protected by the first and fourth amendments, may be superior to the need to protect the integrity of the internal revenue system.⁴³

Clearly, this approach envisages that there may be situations where the risk of generating an adverse chill-factor effect through imposing liability on tax officials may be justified. Unfortunately, however, clear guidelines to delineate when chill-factor concerns should be considered prohibitive in taxpayer *Bivens* actions are yet to emerge and United States judges tend not to elaborate on their chill-factor concerns when they raise them.⁴⁴

It is evident, though, that chill-factor concerns weigh more heavily on the minds of United States judges where personal liability of tax officials is in question. For

³⁸ In *Carlson v Green* 446 U.S. 14 (1980), at 18, the Supreme Court summarised the availability of *Bivens* relief in these terms: “the victims of a constitutional violation by a federal agent have a right to recover damages against the official in federal court despite the absence of any statute conferring such a right.”

³⁹ Leave to bring action is typically denied. See, for example, *Capozzoli v Tracey* 663 F.2d 654 (5th Cir. 1981); and *Morris v United States* 521 F.2d 872 (9th Cir. 1975).

⁴⁰ 26 F.3d 1448 (8th Cir. 1994).

⁴¹ *Vennes*, *ibid* [13]. This was notwithstanding the extreme behaviour of the tax officials in question in that case. Scott summarises the extreme facts in this case as follows: ‘Undercover IRS employees furnished \$100,000 in cash to the plaintiff, who lost it. The employees apparently did not like the idea of trying to explain the loss, and instead attempted to recover the money by threatening to dismember the plaintiff’s children. The threats forced the plaintiff into drug and weapons offenses in an attempt to satisfy the employees. The plaintiff claimed that the threats were a denial of due process.’ See Ridgeley A. Scott, ‘Suing the IRS and its Employees for Damages: David and Goliath’ (1996) 20 *Southern Illinois University Law Journal* 507, 561.

⁴² 886 F.2d 1240 (10th Cir. 1989).

⁴³ *Ibid* 1248.

⁴⁴ The case law is far from settled with writers such as Pietruszkiewicz asserting that “a *Bivens* remedy may or may not be available depending on the Circuit in which the case is litigated...” Christopher Pietruszkiewicz, above n 4, 55.

example, Biggers J in *Baddour Inc. v United States*⁴⁵ in dismissing the taxpayer's claim for damages for a wrongful levy of his property by a tax official observed that "creation of a damages remedy ... resulting in the personal liability of Internal Revenue Service employees would serve to hamper the ability of such employees to perform a function that is a difficult one and one that is vital to our nation".⁴⁶

3.2 Canadian judicial approaches to chill-factor concerns

Generally speaking, Canadian judges have been far more nuanced and sceptical in their approach to chill-factor concerns than their United States counterparts. For example, in *Nelles v Ontario*⁴⁷ (*Nelles*), a case involving allegations of malicious prosecution against the Canadian Attorney-General, Lamer J in delivering the leading judgment of the Canadian Supreme Court, described the 'chilling effect' argument as "largely speculative".⁴⁸

In the most detailed and considered analysis of chill-factor concerns of any of the cases cited in this article, Lamer J also acknowledged the limited force of chill-factor arguments in situations where proving a claim involves demonstrating improper motive or malice of a public official rather than simply an error in the exercise of discretion or judgment.⁴⁹ According to Lamer J, to do otherwise would effectively give officials a "license to subvert individual rights".⁵⁰

In the tax context, chill-factor effects in Canada have received judicial attention in a spate of recent actions involving taxpayer tortious claims against the Revenue. For example, in *783783 Alberta Ltd v Attorney-General (Canada et al)*⁵¹ the Alberta Court of Appeal relied in part on chill-factor concerns to deny taxpayer relief. The taxpayer plaintiff had claimed damages for Revenue Canada's failure to apply certain tax deductibility rules correctly in assessing the tax liabilities of one of the plaintiff's overseas competitors. This error resulted in the taxpayer losing its competitive advantage from being a Canadian resident. In rejecting the taxpayer's claim, the Court of Appeal noted that to do otherwise would mean "[s]ignificant resources would have to be diverted to dealing with inquiries and complaints about the application of particular rules of taxation ...".⁵²

In *Canadian Taxpayers Federation v Ontario (Minister of Finance)*⁵³ the plaintiff sought to bring a claim alleging a negligent misrepresentation by the Minister of Finance in breaching a pre-election commitment not to introduce the Ontario Health

⁴⁵ 802 F.2d 801 (5th Cir. 1986).

⁴⁶ Ibid 807-808.

⁴⁷ [1989] 2 SCR 170.

⁴⁸ Ibid 197.

⁴⁹ His Honour surmised, *ibid* at 197, that "...in cases of malicious prosecution we are dealing with allegations of misuse and abuse of the criminal process and of the office of the Crown Attorney. We are not dealing with merely second-guessing a Crown Attorney's judgment in the prosecution of a case but rather with the deliberate and malicious use of the office for ends that are improper and inconsistent with the traditional prosecutorial function".

⁵⁰ Ibid 195.

⁵¹ 2010 ABCA 226.

⁵² Ibid [48].

⁵³ (2004) 73 O.R. (3d) 621.

Premium. Roleau J referred to a number of policy reasons in rejecting the plaintiff's claim including chill-factor concerns:

Imposing a duty of care in circumstances such as exist in the present case would have a chilling effect ... Once elected, members would be concerned about the representations they made during their election campaigns and would not consider themselves at liberty to act and vote in the public interest on each bill as it came before the legislature. In my view, therefore, it would be unwise to impose a duty of care in such circumstances.⁵⁴

In *Leighton v Attorney-General of Canada*⁵⁵ the taxpayer alleged (among a range of other claims), that the Canada Revenue Agency (CRA) had been negligent in its approach to an audit of the taxpayer's company. Fisher J disposed of the plaintiff's claim on proximity grounds and hence, did not need to deal at length with policy concerns. However, His Honour alluded to the relevance of such concerns by referring to "residual policy considerations that would militate against recognizing a duty of care in this case ...".⁵⁶

The chill-factor argument has received a less sympathetic hearing in other tax cases—more consistent with the skeptical and nuanced approach taken by Lamer J in *Nelles*. For example, in *Sherman v Canada (Minister of Internal Revenue)*⁵⁷ Layden-Stevenson J agreed with the taxpayer's contention that "the chilling effect on future investigations is not a valid reason to refuse disclosure".⁵⁸ That case involved a claim for access to statistics about tax collection assistance activity between CRA and the United States IRS which CRA had refused to release to the taxpayer plaintiff. This approach is consistent with the approach to the chill-factor taken in *Rubin v Canada Minister of Transport*⁵⁹ in which the chill-factor argument opposing release of information was described as "nebulous". Canadian judges have generally taken the view that in such cases, the public interest in disclosure and the positive effect on service standards of the greater accountability to the public fostered by disclosure outweighs any potential chilling effect of disclosure.

3.3 Australasian judicial approaches to chill-factor concerns

In Australia, the possible chilling effect on the provision of information was acknowledged as a concern by Brennan J in *San Sebastian Pty Ltd v Minister Administering the Environmental Planning and Assessment Act 1979*.⁶⁰ His Honour observed in that case that:

To impose a legal duty of care on the unsolicited and voluntary giving of any information and advice on serious or business matters would chill

⁵⁴ Ibid [71].

⁵⁵ 2012 BCSC 961.

⁵⁶ Ibid [58]. Fisher J concluded that a relationship of proximity sufficient to support a prima facie duty of care did not exist in this case, hence there was no need to comprehensively consider whether any policy reasons otherwise precluded the establishment of such a duty.

⁵⁷ [2004] F.C. 1423.

⁵⁸ Ibid [16].

⁵⁹ [1998] 2 F.C. 430.

⁶⁰ (1986) 162 CLR 340.

communications which are a valuable source of wisdom and experience for a person contemplating a course of conduct.⁶¹

Unfortunately, His Honour did not elaborate on this chill-factor argument. However, Brennan J did elaborate in *Northern Territory v Mengel*⁶², confirming that chilling-effect concerns should be afforded less weight in cases where malicious or deliberate intent of a public official is alleged. In situations where liability for public official behaviour falling short of malice (and more akin to negligent behaviour) is sought to be impugned, chill-factor concerns should be given greater consideration.⁶³ This approach parallels the Canadian approach of Lamer J in *Nelles v Ontario*⁶⁴ and in the recent spate of negligence cases against CRA discussed above. However, Australian judges have generally been far less considered in their treatment of chill-factor concerns than their Canadian or United States counterparts.

For example, in the tax context, the Australian High Court directly, but briefly, discussed the issue in *Pape v Federal Commissioner of Taxation*⁶⁵ (*Pape*). In that case, the Australian Commissioner of Taxation argued that the taxpayer's argument in seeking to place constitutional limits on the power of appropriation contained in the Australian Constitution 'would cause Parliament constantly to be "looking over its shoulder and being fearful of the long term consequences" if it made an appropriation outside power.'⁶⁶ Heydon J rejected the argument, observing that "[t]he occasional declaration that federal legislation is invalid does not cause the progress of government to be unduly chilled or stultified".⁶⁷ Neither the Australian Commissioner in making the argument, nor Heydon J in rejecting it, raised any evidence to justify their respective views.

This lack of detailed consideration of the chill-factor argument is also evident in New Zealand case law, even where its validity has been accepted. A good recent example is *Ch'elle Properties (NZ) Ltd v Commissioner of Inland Revenue*.⁶⁸ In that case, which concerned a claim of negligence against the New Zealand Commissioner of Inland Revenue, one of the grounds for rejection of the plaintiff's claim was on the basis of chill-factor concerns. Keane J affirmed the views expressed in *Rolls Royce New Zealand Ltd v Carter Holt Harvey*⁶⁹ that "[t]here is a legitimate public interest in regulatory bodies being free to perform their role without the chilling effect of undue vulnerability to actions for negligence".⁷⁰

⁶¹ Ibid 372.

⁶² (1995) 185 CLR 307.

⁶³ To date all cases alleging malicious conduct by Australian tax officials have failed, typically due to the difficulties of proving malicious intent. Equally, all tortious claims against the Australian Commissioner of Taxation have been summarily dismissed. Hence, the distinction advanced by Brennan J is yet to be applied or discussed in a tax case.

⁶⁴ [1989] 2 SCR 170.

⁶⁵ (2009) 238 CLR 1.

⁶⁶ Ibid 205-206, relying on *Victoria v Commonwealth and Hayden* (1975) 134 CLR 338 at 418 per Murphy J who asserted that a narrow construction of the provision would have a "chilling effect...on governmental and parliamentary initiatives."

⁶⁷ Ibid 208.

⁶⁸ [2005] NZHC 190.

⁶⁹ [2005] 1 NZLR 324.

⁷⁰ Ibid [35].

Again, as in *Pape*, there was no judicial discussion of the merits of any chill-factor concerns. This lack of judicial analysis characterises the Australasian approach to dealing with chill-factor concerns. Troublingly, it has been judicially conceded in Australia that policy concerns such as chill-factor concerns have ‘intruded’ in some tax cases, heightening the need for guidelines for dealing with such issues in a consistent and principled manner.⁷¹ This is the challenge taken up in Part 4 below.

4. GUIDELINES FOR DEALING WITH CHILL-FACTOR CONCERNS

The examination of the relevant case law in the preceding Part reveals a number of differing judicial approaches to chill-factor concerns. These diverse approaches deal to varying degrees with the complexities and challenges discussed in Part 2. It is, however, possible to formulate a number of guidelines from this multi-jurisdictional analysis to aid judges and policy-makers in dealing with chilling-effect concerns in a principled and legally consistent manner, irrespective of the jurisdiction in which they operate. Four such guidelines are set out and elaborated below:

4.1 Chill-factor effects and individual tax official liability

The chill-factor effect should be afforded greater weight where the cause of action imposes personal liability on individual tax officials. We have seen, for example, that chilling-effect fears are often raised in United States *Bivens* Constitutional damages actions. These actions involve claims against individual officers. If officials are prone to react in an over-defensive manner they are more likely to do so where personal liability is at stake. Hence, extra caution is required in such cases to prevent triggering over-defensive responses to adverse outcomes.

However, the approach must be more nuanced than simply accepting chill-factor concerns as determinative whenever the taxpayer suit is against an individual tax official. This is because some personal actions against public officials involve high and difficult evidentiary hurdles for taxpayers to overcome in order to proceed with their suit. For example, torts such as the tort of misfeasance in public office and the tort of malicious prosecution require the plaintiff to discharge the onus of demonstrating that the relevant official has acted maliciously and deliberately. As Lamer J observed in Canada in *Nelles v Ontario*, proving such claims is notoriously difficult and there are numerous other ‘built-in’ deterrents to bringing such actions such as adverse costs orders for filing frivolous or vexatious claims.⁷²

Accordingly, an honest official acting rationally has little to fear from suit and should not be expected to react in an over-defensive manner to the potential for these types of suits. Equally, dishonest officials should not be permitted to escape liability on the basis of general policy concerns that their honest colleagues might react over-defensively. The weighing up of policy interests clearly militates against such a result. Doing otherwise risks granting tax officials a ‘licence’ to behave maliciously or dishonestly.⁷³

⁷¹ Gaudron and Gummow JJ in *Commissioner of Taxation v Payne* (2001) 177 ALR 270, 281.

⁷² [1989] 2 SCR 170, 197.

⁷³ As alluded to by Lamer J in *Nelles v Ontario*, *ibid*.

Conversely, in cases where negligent or innocent mistakes have been made causing taxpayer harm the potential chilling effects of imposing liability should be afforded greater consideration. There is a common thread among the judicial comments in each of the jurisdictions examined to this effect. In particular, we have seen that chilling-effect concerns feature prominently in negligence cases against tax officials in Australasia and Canada.⁷⁴

In summary, therefore, significant evidentiary weight should be afforded to chill-factor fears in those cases where: (1) liability on individual officers is proposed; *and* (2) where that liability is for lower standards of misbehaviour, such as negligent or other unintentional mistakes. This approach would bring together current threads of judicial reasoning evident across the jurisdictions examined. It also would compel judges to expressly recognise that, given the controversies and complexities surrounding chilling-effect concerns, these concerns should not be dealt with as an ‘all or nothing’ proposition.

4.2 Chill-factor effects and judicially-generated uncertainty

The chill-factor effect should be afforded greater evidentiary weight in cases in which allowing a claim to proceed would result in generating legal uncertainty as to the potential for tax officials to be sued. The logic behind this principle stems from the fact that the chill-factor effect represents a concern about *over*-defensive responses - not defensive behaviour *per se*. Consequently, it is easy to appreciate the potential for officials to respond in an over-defensive manner where their potential exposure to liability is uncertain or indeterminate, even when those officials are acting rationally. As observed in Part 2, uncertainty characterises the environment where over-defensive responses are most likely to result.⁷⁵

Hence, where a comprehensive legislative code for dealing with taxpayer complaints exists, judges should be cautious about setting precedents which introduce uncertainty by extending tax official liability outside of these legislative parameters. It is understandable, therefore, that in cases in the United States involving *Bivens* damages claims judges have referred to the potential chill-factor effects of second-guessing Congress and introducing a cause of action which Congress, via the Internal Revenue Code, may have intended to displace.⁷⁶

The same caution should be applied where taxpayer success would create exceptions to well established limits of liability.⁷⁷ Doing otherwise simply creates an environment

⁷⁴ It will be recalled that many of the cases which have overtly discussed chill-factor concerns referred to in Part 3 concerned allegations of negligence by public officials.

⁷⁵ See, for example the comments of Schuck referred to above at n 24.

⁷⁶ There is also Canadian authority for such an approach being taken in relation to unjust enrichment claims involving tax legislation, albeit in the context of discussion of the ability to raise an unjust enrichment claim in cases of non-compliance with statutory time frames set out in tax legislation. See *British Columbia Ferry Corp v MNR* [2001] 4 FC 3. See also the discussion of this case by Beninger in Michael Beninger, ‘Taxpayer Rights: Emerging Legal Techniques’ (Paper presented at the 52nd Annual Canadian Tax Foundation Conference, Toronto, 24-27 September 2000), [10.8].

⁷⁷ This recommendation is consistent with the tortious approach in countries such as Canada and Australia of requiring express consideration and weighing up of public policy concerns where the imposition of a duty of care in novel circumstances is proposed. Both countries derive their approaches from the United Kingdom *Anns* two-stage approach (so-named after *Anns v Merton Borough Council*

where tax officials can legitimately fear the potential for frequent and indeterminate liability.⁷⁸ As Pietruszkiewicz, referring to current uncertainty surrounding the ability of taxpayers to recover damages from tax officials in the United States, has observed: “The sword of Damocles does exist; however, it does little more than deter Internal Revenue employees from carrying out their duties”.⁷⁹

4.3 Chill-factor and the policy/operational distinction

Greater weight should be afforded to chilling-effect concerns in cases involving challenges to discretionary/policy functions as distinct from purely operational/administrative activities of tax officials. There is an inherent logical appeal in ensuring that tax officials are not over-defensive in exercising legislatively sanctioned discretions such as decisions whether to prosecute tax offenders, how to interpret various tax provisions and how to apply limited tax administration funds.⁸⁰ In contrast, it is much more difficult to sustain an argument for avoiding over-defensive responses to challenges to purely operational functions such as administrative activities undertaken to implement policy or discretionary decisions.

The reasoning behind this distinction is that many of the operational functions of revenue authorities are similar to those of any other large business—basic clerical and/or mechanical and repetitive tasks carried out by low level employees and aimed at implementing higher level policies and decisions. Such activities are characteristically procedural. In the long run, defensive responses to liability for malfunctions in these operational tasks are likely to result in improvements in the carrying out of these procedural tasks.⁸¹ Disproportionately-defensive responses pose little direct threat to the revenue base.

It is conceded that distinguishing between discretionary and operational functions will be difficult in some cases;⁸² however, this does not detract from the potential utility of the distinction for a number of reasons. First, the discretionary/operational distinction is familiar to jurists in each of the jurisdictions examined.⁸³ For example, in the United

[1977] 2 All ER 492) which expressly requires public policy to be considered at the second stage of the analysis.

⁷⁸ Indeterminate liability or ‘floodgates’ arguments go hand-in-glove with chill-factor concerns and are frequently discussed together by judges. See, for example, two Canadian examples cited in Part 3: 783783 *Alberta Ltd v Attorney-General (Canada) et al* 2010 ABCA 226 and *Nelles v Ontario* [1989] 2 SCR 170 and the United States Supreme Court comments in *Vennes v An Unknown Number of Unidentified Agents of the United States* 26 F.3d 1448 (8th Cir. 1994) cited above at n 41.

⁷⁹ Christopher Pietruszkiewicz, above n 4, 67-68.

⁸⁰ United States judges have specifically expressed concern that fear of suit may inhibit discretionary action. See, for example, the comments of the United States Supreme Court in *Harlow v Fitzgerald* 457 U.S. 900 (1982) reproduced above at n 5.

⁸¹ This is consistent with the analysis of chill-factor concerns by Roots as summarised in Part 2 above.

⁸² As has been famously judicially observed: “It would be difficult to conceive of any official act, no matter how directly ministerial that did not admit of some discretion in the manner of its performance, even if it involved only the driving of a nail.” *Ham v Los Angeles County* 46 Cal App 148 (1920), 162. These comments have been picked up and applied in a number of other jurisdictions—most famously by Lord Slynn in the United Kingdom in *Barrett v Enfield London Borough Council* [2001] 2 AC 550 who observed, at 571, that “even knocking a nail into a piece of wood involves the exercise of some choice or discretion...”.

⁸³ As one United States commentator has pointed out: “[T]he terms “planning” and “operational” are indefinite; the problem of drawing a line remains. But all interpretations involve drawing distinctions.

States the distinction is contained in s421 of the *Federal Tort claims Act of 1948*,⁸⁴ legislation which aims to delineate the limits of immunity from suit in tort of Federal officials in that country.⁸⁵ A similar distinction has been used in Australia, Canada and New Zealand as an appropriate guide for determining when a public authority owes a tortious duty of care.⁸⁶

Second, the distinction is broad enough to encapsulate distinctions which, as noted in Part 3, have already been recognised in jurisdictions such as the United States and Canada between prosecutorial and judicial functions – which are characteristically discretionary – and other administrative functions.⁸⁷ Finally, and perhaps most pertinently, the distinction has been described as specifically aimed at limiting potential chill-factor effects of imposing liability on the State by permitting ‘suits for ordinary torts while not chilling government activities...’⁸⁸

4.4 Chill-factor and countervailing policy effects

Potential chill-factor effects should be weighed up against possible countervailing positive effects on tax administration activities of imposing liability on tax officials. As noted in Part 2 of this article the existence and extent of any chilling effect from imposing liability on public officials is far from clear and universally accepted. Hence sound legal analysis demands that judges considering what weight to afford to chill-factor concerns should engage in this weighing-up process.

The preceding three guidelines are essentially examples of this type of weighing-up process. A prime example is the need to weigh possible over-defensive effects against the prospect of providing immunity from suit to tax officials who have acted with dishonesty or malice toward a particular taxpayer. In those circumstances, the likely adverse consequences for taxpayer morale and trust and confidence in tax administrators of leaving the harm caused by such behaviour un-remedied is likely to outweigh any possible wider over-defensive effects of imposing liability on the offending official.

However, a specific guideline is required to emphasise that judges should always engage in some consideration of countervailing possible positive consequences of

The present situation is aided by terms which have a considerable history of application. They have been used, with varying degrees of consciousness...’ Reynolds, above n 13, 129.

⁸⁴ *Federal Tort Claims Act of 1948*, 28 USC Pt IV Ch 171 (1948). Hink & Schutter have extensively detailed the relevance of the policy/operational distinction in respect of the *Federal Tort Claims Act* noting that: “Section 421 of the *Federal Tort Claims Act* sets out a number of classes of claims as to which the United States does not waive its immunity. The most important of these is a non-waiver of claims based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government...” Heinz Hink and David Schutter, ‘Some Thoughts on American Law of Government Tort Liability’ (1965-1966) 29 *Rutgers Law Journal* 710, 721-722.

⁸⁵ Consequently, the distinction has generated a great deal of judicial discussion in the United States. See, for example, *Dalehite v United States* 346 US 15 (1953); *Indian Towing Co v United States* 350 US 61 (1955); and, more recently, *United States v Gaubert* 499 US 315 (1991).

⁸⁶ Following the precedent set in the landmark United Kingdom case of *Anns v Merton London Borough Council* [1977] 2 All ER 492. For a detailed discussion see Stephen Bailey and Michael Bowman, ‘The Policy-Operational Dichotomy—Cuckoo in the Nest’ (1986) 45 *Cambridge Law Journal* 430, 431-436.

⁸⁷ See, for example the comments of the United States Supreme Court in *Mitchell v Forsyth* 472 U.S. 511 (1985) reproduced (in part) above at n 35.

⁸⁸ Ridgeley A. Scott, above n 41, 520.

imposing liability on tax officials whenever the question of a possible chilling effect of so doing is raised. The case law examined in Part 3 shows that most judges do not presently expressly engage in any such weighing-up process.

In the tax context, at a minimum, whenever chill-factor concerns are raised to resist imposing liability on tax officials, judges should always attempt to weigh up these concerns against other possible positive motivational effects such as: (1) possible positive effects on taxpayer morale and compliance of allowing recovery against tax officials; and (2) possible short term and long term improvements in tax administration service standards and efficiency which might result from imposing liability on tax officials. While, as noted in Part 2, there is presently significant uncertainty surrounding these issues, similar uncertainties surround the chill-factor effect itself. Further, this sort of judicial consideration may provide a trigger for legislative attention and further empirical work to be undertaken to resolve these uncertainties.

5. CONCLUSION

From the outset this article has acknowledged the significant complexities and controversies surrounding the existence of any chill-factor effect, the extent to which potential over-defensive behaviour should be a concern in the tax context and how potential chilling effects might manifest themselves in the tax context. The analysis shows that presently the only certainty is the absence of empirical evidence which could be used to confidently predict positive *or* negative motivational effects of imposing liability on tax officials. Consequently, courts considering taxpayer claims against tax officials should resist dealing with chilling effect concerns in any cursory manner.

In addition, the case law examined in this article reveals that there is little uniformity in the judicial treatment of chill-factor concerns in tax cases. Judicial approaches vary from unqualified acceptance to outright rejection and most positions in between. Few judges in any of the jurisdictions examined have ventured to subject chill-factor concerns to the rigours of the rules of evidence. Nevertheless, taken together, a number of common threads can be drawn from these differing judicial approaches which can lead to a more legally robust and predictable approach to dealing with chill-factor concerns.

This article has extrapolated these threads and set them out as a series of four basic guidelines for judges and policy-makers. None of these guidelines is a perfect solution in every case. Further, in most cases more than one of the guidelines would need to be applied to satisfactorily address the issue. This is an unsurprising result as public policy concerns are typically incapable of being addressed in a single formulaic manner. Chill-factor concerns are no exception.

However, the guidelines set out in this article address the present fundamental problems associated with dealing with chill-factor considerations purely on a discretionary case-by-case basis. As one Australian judge has observed:

To apply generalised policy considerations directly, in each case, instead of formulating principles from policy and applying those principles, derived

from policy, to the case in hand, is, in my view, to invite uncertainty and judicial diversity.⁸⁹

The proposed guidelines also encourage a more detailed and nuanced approach to dealing with chill-factor concerns. Over time, a body of judicial commentary will develop to aid all tax administration stakeholders in understanding their rights and responsibilities. They may also serve as a primer for future empirical testing of the validity of various chill-factor fears and to assist tax administrators and policy makers in foreseeing possible over-defensive behaviour and minimising the harm of such behaviour.

⁸⁹ Stephen J in *Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"* (1976) 136 CLR 529, 567.

Tax simplification: A review of initiatives in Australia, New Zealand and the United Kingdom

Simon James, Adrian Sawyer and Ian Wallschutzky¹

Abstract

This paper examines the role of tax simplification in the operation of a tax system as a whole and then uses that framework to analyse initiatives in Australia, NZ and the UK. We begin with the subject of simplification itself and what it can mean, and follow this with a discussion concerning how to simplify tax systems. The paper then focusses on three key steps with simplifying tax systems, namely: simplifying tax law, simplifying taxpayer communications and simplifying tax administration.

The paper then examines several long term approaches to simplification, such as the Office for Tax Simplification in the UK and the TWG in NZ. The paper observes the contrasting approach of Australia, such as pre-filling tax returns, which has not simplified its tax system. Prior to the concluding observations, the paper suggests that the establishment of some form of independent authority may enable effective simplification of the tax systems in the three jurisdictions reviewed.

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The complexity of our code in the main is not there because of some mischief. Most of it is there in the effort to do more perfect justice.

Senator Russell Long, Former Chairman, US Senate Finance Committee²

[We] will first settle the broad outline of the kind of tax system it would like to see established eventually and work back from that to the changes in the present system that would have to be made before that long-term aim could be realised
(Asprey Review)³

[T]he Review has taken a systemic approach in redesigning the tax and transfer system ... that is, the Review has evaluated specific taxes and transfers from the perspective that each is a part of a single national tax and transfer system. Recommendations on the implementation of reforms as they affect the system's administration, the client interface and the assignment of revenue within the federation also reflect this perspective.
(The Henry Review)⁴

1. INTRODUCTION

Simplicity is an important attribute for a tax system and there have been many attempts made to simplify tax systems in different countries. However these attempts have not been very successful. The main reason is that there are, of course, important factors that cause tax systems to be complex. Taxes are primarily used to raise revenue but are also a valuable instrument for achieving government policies through influencing taxpayer behaviour.

The aims of particular taxes have to be achieved in a complex and changing socio-economic environment where issues such as fairness also have to be given appropriate consideration and many attempts at simplification have not given sufficient consideration to the relative importance of all the key aspects involved. Indeed there is evidence that taxpayers in general may prefer fairness to simplicity and this necessarily then involves a balancing between competing tax policy principles as both are ideally desirable in a good tax system. An important example is the United Kingdom (UK) community charge or 'poll tax', which was about as simple as a major tax could be, but taxpayers considered it to be unacceptably unfair and it generated such powerful negative responses it had to be repealed.

A further difficulty has been that attempts at simplification have often been made on an ad hoc basis and, once the enthusiasm has exhausted itself, trends towards greater complexity continue. We comment on how the Internet (and e-commerce more specifically) will continue to make tax systems more complicated and observe how simple systems are open to avoidance and evasion which will in turn inevitably lead to change (which adds to complexity).

Comparative research enriches our understanding through exploring similarities and differences between jurisdictions which can provide policymakers and other researchers with the opportunity to reflect upon the implications of different choices,

2 Quoted by Sheldon D. Pollack, 'Tax Complexity, Reform, and the Illusions of Tax Simplification' 2 Geo. Mason Indep. L. Rev. [iii] (1993-1994) at 319.

3 Taxation Review Committee, Full Report, 1975, para 1.12.

4 Australia's Future Tax System, Final Report, 2010, Part 1, Overview, Chapter 2.

as well as provide a benchmark for other jurisdictions that may contemplate similar tax reform.

In 2005 the Australian Taxation Office (ATO) was awarded a Plain English Campaign Golden Bull award⁵ for **Section 165-55** *A New Tax System (Goods and Services Tax) Act 1999*:

For the purpose of making a declaration under this Subdivision, the Commissioner may:

- a) treat a particular event that actually happened as not having happened; and
- b) treat a particular event that did not actually happen as having happened and, if appropriate, treat the event as:
- c) having happened at a particular time; and
- d) having involved particular action by a particular entity; and
- e) treat a particular event that actually happened as:
- f) having happened at a time different from the time it actually happened; or
- g) having involved particular action by a particular entity (whether or not the event actually involved any action by that entity).

In fairness, the role of the ATO is to administer the law, not to draft it, so the ‘credit’ for this award may lie elsewhere. However, this example illustrates the pressures on tax systems and the purpose of this particular piece of legislation is examined further in section 3.4 of this paper which deals with tax avoidance. Of course, scholars in glass houses should not throw too many stones – the Institute for Fiscal Studies in the United Kingdom (UK) won a 2006 Golden Bull⁶ for a website document description:

While the literature on nonclassical measurement error traditionally relies on the availability of an auxiliary dataset containing correctly measured observations, this paper establishes that the availability of instruments enables the identification of a large class of nonclassical nonlinear errors-in-variables models with continuously distributed variables.

While public pressure may have encouraged institutions to improve their communications, there is still scope for improvement. For instance HM Revenue and Customs received a Golden Bull in 2013 for this response⁷ to a taxpayer who had sent an email:

⁵ Plain English Campaign (2005) <http://www.plainenglish.co.uk/campaigning/awards/2001-2010-awards/2005-awards/800-golden-bull-awards-2005.html>. Accessed 20 February 2014.

⁶ <http://www.plainenglish.co.uk/campaigning/awards/2001-2010-awards/2006-awards/794-golden-bull-awards-2006.html>. Accessed 6 February 2014.

⁷ <http://www.plainenglish.co.uk/campaigning/awards/2013-awards/golden-bull-awards.html>. Accessed 6 February 2014.

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However, the simplification issue is not just one of language. As tax systems generally have become more complex, calls for tax simplification have become a frequent phenomenon. Most such calls seem to assume that simplification is easily achievable but the difficulty is that the issue is not a simple one. As this paper will demonstrate, there are many considerations that include not only the drafting of legislation and taxpayer communications but also that modern tax systems are often used to advance a range of policy objectives and have to operate in a complex and changing socio-economic environment in a way that is broadly acceptable to taxpayers. There have been initiatives in Australia, New Zealand (NZ) and the UK concerned with simplification but they have not always taken an approach that takes sufficient account of the competing forces on tax systems to be both successful and sustainable. The terms of reference of the Review of Australia's Future Tax System⁸ (AFTS, or the Henry Report) included simplifying the tax system and it certainly made a valuable contribution but, as Evans⁹ has argued, it did not go far enough. This may have been because the successful achievement of simplification is indeed a complex issue and this paper sets out to indicate why. In contrast, the Tax Working Group (TWG) in NZ was more successful than AFTS, where Sawyer comments that "[t]iming, the early embracing of the work of the TWG, and NZ's relatively small tax community, facilitated the work of the TWG, including the ultimate outcome of major tax policy legislative reform."¹⁰

In terms of methodology this paper utilizes a comparative case study framework,¹¹ through which the experiences of Australia, NZ and the UK are contrasted against the framework of various initiatives designed to redress the growing level of complexity through adoption of measures intended to initially simplify their tax legislation and more recently seek to tackle the more important ramifications of complex tax policy.

2. SIMPLICITY AND COMPLEXITY

It may seem self-evident that simplicity has considerable advantages over complexity in tax systems. There are some fairly obvious costs associated with complexity – particularly in administration and the costs to the community of complying with the tax system. The connection between complexity and the costs of compliance and

⁸ *Australia's future tax system, Report to the Treasurer*, December 2009. The Henry Report was submitted on 23 December 2009 but not publicly released until 2 May 2010. It has two Parts: Part 1 is an Overview (216 pages); Part Two, which contains the Detailed Analysis, has two volumes – Volume 1 (377 pages) and Volume 2 (479 pages). Altogether, there are over 1,000 pages and 138 recommendations.

⁹ Chris Evans, 'Priority reform directions for the tax and transfer system', <http://www.treasury.gov.au/~media/Treasury/Policy%20Topics/Taxation/Tax%20Forum/Statements%20and%20Submissions/Academics/PDF/UNSW%20Evans.ashx>, 2011. Accessed 21 February 2014.

¹⁰ Adrian Sawyer, 'Moving on from the Tax Legislation Rewrite Projects: A Comparison of Approaches in New Zealand and the United Kingdom' *British Tax Review*, 2013 (3), 321-344, at 344. See also Adrian Sawyer, 'Rewriting Tax Legislation: Can Polishing Silver Really Turn It Into Gold?', *Journal of Australian Taxation*, 2013, 15(1), 1-39.

¹¹ See generally Robert K. Yin, *Case Study Research: Design and Methods*, (3rd ed, Sage, 2003).

administrative is itself complex, but generally there is a positive correlation.¹² Furthermore, estimates of compliance costs have limitations which are sometimes considerable. One in particular is that surveys of compliance costs often include only those who are economically active in a particular way. Those who do not participate, for example who do not run a small business because of the complexity of tax and other regulations, are not normally included in compliance cost studies.¹³

In addition, overly complex and obscure legislation might reduce the willingness of taxpayers to comply voluntarily with the requirements of the tax system. This is particularly important with a system of self-assessment. To the extent that complexity impedes clarity it may also make the estimation of future revenue and costs more difficult and will therefore make economic decision-making harder.

It may also generate unfairness because, for example, not everyone is equally able to take advantage of the various complexities of a tax system. There is also a more general point: that the main purpose of most taxes is to pay for public expenditure. A tax system that is very complicated and difficult to understand might reduce public support for the improvement of important public services. Furthermore a high level of complexity in a tax system can make discussion of tax policy and the introduction of improvements more difficult.

However, there are many pressures for greater complexity and it is often a necessary feature of a tax system that is to function successfully in the face of all the demands placed on it in an increasingly complex and changing socioeconomic environment. Indeed an indication of the challenge simplification faces becomes apparent even as soon as the meaning of simplification is explored. Cooper¹⁴ suggests there are at least seven issues:

1. *Predictability.* In this context, a rule would be simple if that rule and its scope were easily and accurately understood by taxpayers and their advisers.
2. *Proportionality.* A rule would be simple if the complexity of the solution were no more than reasonably necessary to achieve the intended aim.
3. *Consistency.* This would apply where a rule deals with similar issues in the same way and without the need to make arbitrary distinctions.
4. *Compliance.* A rule would be simple if it were easy for taxpayers to comply without incurring excessive costs.
5. *Administration.* A rule would be simple if it were easy for a revenue authority to administer.

¹² See for example, Louis Kaplow, 'How Tax Complexity and Enforcement Affect the Equity and Efficiency of The Income Tax' *National Tax Journal* 1996, 49, 135-50; and Chris Evans, 'Studying the studies: An overview of recent research into taxation operating costs', *eJournal of Tax Research*, 2003, 1, 64-92, stating at p 72: "Complexity of legislative provisions together with the frequency of legislative changes are identified as prime causes of high compliance costs".

¹³ Simon James and Ali Edwards, *An Annotated Bibliography of Tax Compliance and Tax Compliance Costs*, 2010, ESRC: <http://www.esrc.ac.uk/my-esrc/grants/RES-000-23-1595/outputs/read/e026df04-3812-4aa1-96fe-10cd4b442e49>. Accessed 20 February 2014.

¹⁴ Graeme S. Cooper, 'Themes and Issues in Tax Simplification', *Australian Tax Forum*, 1993, 10, 417-60.

6. *Co-ordination*. A rule would be simple if it fitted appropriately with other tax rules; it would be complicated if its relationships with other rules were obscure.
7. *Expression*. A rule would be simple if it were clearly expressed.

Cooper also suggested that simplification could be seen as being at different levels. The first level is the choice of the tax base, whatever that may be. The second is the design of the rules to be applied to the tax base. The third is in the expression of those rules and the final level of complexity is the administrative requirements imposed on taxpayers.

This, of course, demonstrates the importance of ensuring that simplification at one level does not cause difficulties at other levels or elsewhere at the same level. One of the present authors can recall a vivid example which illustrated the difficulties of attempting to improve one aspect of the tax system in terms of simplicity and comprehensibility without considering other aspects. This example came to light at a presentation to relevant tax officials at a UK university by an academic graphic design specialist who had offered to help the Revenue and redesigned an Inland Revenue form. The result was initially very impressive. Text had been moved around the form and excellent improvements in terms of graphics, layout and presentation had been incorporated. Sadly, however, the designer had not troubled herself to understand the role of the form. That part of the tax system had not yet been computerised and the form was one of four parts of a document designed so that completion of the top form by a tax official would simultaneously produce carbon copies of the same information on the forms beneath. The information was the same but they were different forms because they were designed for different purposes. There was no point in redesigning one part without ensuring it continued to be compatible with the other three. The designer was very pleased with her work but unfortunately she had not taken a systematic approach to her proposals for improvement and her efforts were worthless – except as an object lesson of the importance of taking account of all aspects of the issue under consideration.

Against the above background, the question of what simplification in a tax context means warrants consideration. It is useful to consider tax simplification within two broad areas, namely legal simplicity (focussing on readability and understandability of tax legislation), and effective simplicity (how easy it is to determine the correct tax liability).¹⁵ Much of the effort in the three jurisdictions which are considered in this article has focussed on the former, and much less on the latter.

This paper takes a more systematic approach to the question of simplification. Cooper's first level of simplification, the choice of the tax base, is a good place to start and the paper now turns to issues concerning simplification of the tax system itself.

3. SIMPLIFICATION OF TAX SYSTEMS

A simple tax system obviously avoids many of the disadvantages of a more complex one and, other things being equal, a simple tax will normally be preferred to a more

¹⁵ See further Binh Tran-Nam, 'Tax Reform and Tax Simplification: Some Conceptual Issues and a Preliminary Assessment', *Sydney Law Review*, 1999, 21, 500.

complicated one. However, the comment shown at the beginning of the paper by Senator Russell Long captures one of the basic features of the whole subject: “The complexity of our code in the main is not there because of some mischief. Most of it is there in the effort to do more perfect justice”. Complexity often exists in tax systems for good reasons.

There is much agreement about the main criteria that could be used to assess a particular tax or proposed tax reform: the effects on efficiency, incentives, fairness, compliance costs, administrative costs and so on.¹⁶ Simplicity is one factor, of course, but by no means always the most important one. Other important considerations include the socioeconomic environment in which a tax system has to function, the multiple policy objectives that might be supported by the tax system, the requirement for tax systems to be seen to be fair by taxpayers, responses to anti-avoidance behaviour and certainty in taxation. These are discussed in turn.

3.1 The Socio-economic environment

Tax systems have to operate in an increasingly complex and changing socioeconomic environment. An analysis of the tax environment indicates some powerful trends towards increasing complexity.¹⁷ Social factors include demographic variables, social mobility and increasing levels of education. Demographic factors include less stable family structures and an increasing number of older people who tend to have more complex financial affairs involving a range of investments and pensions. A further aspect is that higher levels of education and consumer awareness may enable and encourage taxpayers to take a greater and more effective interest in tax matters, again often adding to the pressure for greater complexity. Economic factors include rising incomes often drawn from a variety of sources, and an increasing variety and complexity of financial instruments. Technological developments such as electronic commerce have added further challenges to tax systems.¹⁸ Furthermore as the pressure of increased public expenditure has driven up the requirement for tax revenues, taxes have to be more closely attuned to individual circumstances: a simple rough and ready tax system might be acceptable at low rates of taxation but it is far less likely to be so at much higher rates of taxation. Globalisation, with increased economic interdependence and increasing mobility of capital and labour, has also tended to mean that tax systems have to be more finely tuned to the environment in which they have to operate. There are also further implications. For example, the communiqué issued following the meeting of the G20 Finance Ministers and Central Bank Governors in Sydney in February 2014 affirmed their commitment to a global response to Base Erosion and Profit Shifting (BEPS) on the grounds that “profits should be taxed where economic activities are performed and where value is created”,¹⁹ to the exchange of tax information among G20 members and for more jurisdictions

¹⁶ Simon James and Chris Nobes, *The Economics of Taxation: Principles, Policy and Practice*, 13th ed, 2013, Fiscal Publications, Birmingham.

¹⁷ Simon James, ‘The Future International Tax Environment and European Tax Harmonisation: A Personal View,’ *European Accounting Review*, 1999, 8(4), 731-747.

¹⁸ See, for example, Aaron Lukas, *Tax Bytes: A primer on the taxation of electronic commerce*, Trade Policy Analysis, CATO Institute, 1999, <http://object.cato.org/sites/cato.org/files/pubs/pdf/tpa-009.pdf>. Accessed 20 February 2014.

¹⁹ G20, ‘G-20 Communique Following Feb. 22-23 Meetings in Sydney’ (Sydney, February 2014), para 9, https://www.g20.org/sites/default/files/g20_resources/library/Communique%20Meeting%20of%20G20

to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Such initiatives have much to be said for them but they may well add significantly more complexity to tax systems.

3.2 Multiple and changing policy objectives

While one of the main functions of a tax system is, of course, to raise revenue for government expenditure and redistribution, the tax system is also one of the most powerful tools for achieving a range of government economic and social policies. Thus certain activities such as smoking and drinking which are considered to have undesirable effects might be subject to additional taxation. Conversely the government may use the tax system in order to encourage activities considered to be desirable, such as saving and contributing to a pension by setting up a variety of tax concessions. More generally there is the whole issue of ‘tax expenditures’ where some fiscal advantage is conferred on a group of taxpayers or a particular activity by reducing tax liability rather than a cash subsidy – a phenomenon first extensively analysed by Surrey.²⁰ Necessarily such provisions involve discrimination in the taxation of different activities and therefore add to complexity themselves. They also have implications for anti-avoidance measures discussed below. Furthermore the objectives of policy makers are often multi-dimensional and priorities can change, sometimes quite quickly.

3.3 Fairness

As a prime example of Senator Long’s point about tax complexity being mainly a result “the effort to do more perfect justice”, tax systems have to respond to perceptions of fairness if they are to be acceptable to taxpayers. As tax systems have tended to extend their reach further and further into the everyday life of more and more people and to be levied at higher rates, they have had to be increasingly compatible with taxpayers’ views of fairness.

The issue of fairness means that a simple tax may not be acceptable. An extreme but highly relevant example was the UK Community Charge, or ‘poll tax’. It was simple in that it was basically a fixed charge for each person in a particular local authority jurisdiction. In terms of the economic criteria for a good tax, the poll tax also scored highly because it did not vary with economic behaviour and should not, therefore, cause people to behave inefficiently for tax reasons. However, the tax failed on the criteria of fairness. The historical precedents were not encouraging. The Rising of 1381 originated from a hatred of the poll tax.²¹ The Archbishop of Canterbury who, as Chancellor of the realm, represented the government was beheaded by Wat Tyler’s men on Tower Hill and, quite remarkably, the rebels captured London itself. The modern version of the tax was introduced in Scotland in 1989 and in England and Wales in 1990. Nevertheless, as in the fourteenth century, its perceived unfairness²²

[%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%202022-23%20February%202014_0.pdf](#). Accessed 25 February 2014.

²⁰ Stanley S Surrey, *Pathways to Tax Reform*, 1973, Harvard University Press.

²¹ George M. Trevelyan, *English Social History*, 2nd ed. 1946, Longmans, Green and Co.

²² Peter Smith, ‘Lessons from the British Poll Tax Disaster’, *National Tax Journal*, 1991, 44; J. Cullis, P. Jones and O. Morrissey, ‘Evaluating the Poll Tax as a Tax Reform’, *Local Government Studies*, 1993, 19, 77-91.

led to serious civil disobedience²³ and it was a factor in the events leading to the resignation of Margaret Thatcher as Prime Minister.²⁴ Its replacement, the Council Tax, was designed to take far more account of personal circumstances and has survived successfully.

A celebrated example of the results of the complexity that can arise from trying to design a fair tax system involves VAT in the UK. To increase the political acceptability of VAT, the zero rate band is applied to a range of items such as many types of food.²⁵ This involves complex arrangements to establish whether some foods are taxable or not and one famous case involved small cakes with chocolate coverings. Customs and Excise had treated such items as chocolate covered biscuits and therefore considered them to be taxable at the standard rate of tax whereas cakes should be subject to the zero rate. As one implication of the case later came before the House of Lords in 2005 on its way to the European Court of Justice, Lord Hoffman said:

The supply of food is in general zero-rated for VAT ... But there are exceptions. One exception is confectionery ... But there is an exception to that exception: cakes or biscuits are in general also zero-rated. There is however an exception to that exception to the exception, namely biscuits wholly or partly covered with chocolate. They are standard-rated.²⁶

More generally, when it comes to matters of fairness in taxation complexity often wins over simplicity. For instance, in Australia for the tax year 2013/14 there is a tax free threshold of \$18,200 for income tax then tax rates of 19% (over \$18,200), 32.5% (over \$37,000), 37% (over \$80,000) and 45% (over \$180,000). The tax system would be much simpler if there were a zero tax free threshold and a flat rate of tax on all income. There could then be a flat rate deduction at source for wages, interest, dividends etc. and many individuals would not have to lodge a tax return. Although such a system may be a very simple one, it is unlikely to be acceptable to Australian taxpayers. What is acceptable can vary over time and between countries. For example Australia could adopt the simpler UK arrangement of generally not allowing employees' tax deductions for work related expenses but, despite some discussion, has not chosen to do so.²⁷ In contrast, NZ has focused on having a tax system with the hallmarks of efficiency and relative simplicity, and less so on fairness (as measured by way of highly progressive rates of taxation).

3.4 Tax avoidance

It is not always easy to use the tax system to achieve policy aims including fairness effectively. Where there are concessions in the tax system in the interests of fairness, or for other purposes, taxpayers, or frequently their advisers, may find opportunities to exploit the tax system and the official response is often more complex legislation to restrict their ability to do so. The purpose of the section in the Australian GST

²³ D. Mair and R. Damania, 'Fiscal Crisis and Local Government Reform', *Local Government Studies*, 1992, Vol. 18, 179-190.

²⁴ John Gibson, *The Politics and Economics of the Poll Tax, Mrs Thatcher's Downfall*, EMAS, 1990.

²⁵ Simon James 'The contribution of behavioral economics to tax reform in the United Kingdom', *Journal of Socio-Economics*, 2012, 41(4), 468-475.

²⁶ *Marks and Spencer plc v. Customs and Excise*, [2005] UKHL 53.

²⁷ Simon James, Ian Wallschutzky and Clinton Alley, 'The Henry Report and the Taxation of Work Expenses', *Journal of Finance and Management in Public Services*, 2013, 11(2), 46-58.

legislation quoted at the beginning of the paper was to counter tax avoidance, specifically:

The object of this Division is to deter schemes to give entities benefits by reducing GST, increasing refunds or altering the timing of payment of GST or refunds. If the dominant purpose or principal effect of a scheme is to give an entity such a benefit, the Commissioner may negate the benefit an entity gets from the scheme by declaring how much GST or refund would have been payable, and when it would have been payable, apart from the scheme. This Division is aimed at artificial or contrived schemes.²⁸

This Division then continues by describing circumstances in which these provisions do not apply.

A specific example of complexity to restrict tax avoidance involved the UK Parliament's desire to avoid imposing VAT on children's clothes. This involved establishing the definition of children's clothing. If it is simply related to the age of a child then clothes sold for large children could be used by small adults. If it is based on the size of the child then the concession would be available to small children but not to large ones. The result is considerable complexity. To be zero-rated for VAT under this heading an item has to be an article of clothing or footwear, it must not be made of fur, it must be designed for young children, and it must only be suitable for young children. To give a flavour of the resulting complexity it is sufficient to look at one example 'hats and other headgear'. It seems young children have proportionately larger heads than older people and so many children's hats will fit adults. However they can still be zero-rated if they are suitable only for young children such as babies' bonnets and school hats or if they are clearly held out for sale for young children. Whether or not riding hats may be zero-rated is a more complicated matter and they may need written approval from the tax authorities in order to get the concession. Then there is a distinction between 'clothing' in the form of hats and 'accessories' which do not cover the whole head such as 'alice bands', hair ribbons, 'scrunchies', sun visors and ear muffs or 'toys' such as novelty hats, party hats and play hats. These are subject to VAT at the standard rate. Similar problems arose in zero-rating food. Originally take-away meals were free of VAT but not meals eaten on the premises. Since this was open to abuse and apparently led to a remarkable increase in the level of food claimed to be consumed off rather than on the supplier's premises, the rule was changed so that hot take-away food from restaurants was brought into tax. Hence in the UK caviar as a cold food is zero rated but fish and chips are not. More generally moves to limit tax avoidance are one of the biggest causes of tax complexity.

3.5 Certainty

Certainty is a further important factor in a tax system and may be seen as another aspect of Long's "effort to do more perfect justice". Both taxpayers and tax officials require guidance where the law is, or may be, unclear. This leads to new provisions in the law or new authorities which may clarify but also complicate the tax system. On a practical level Paul suggested that a new legal authority will appear when the amount

²⁸ *A New Tax System (Goods and Services Tax) Act 1999*–Sec 165.1.

of tax revenue at stake in clarifying an uncertainty exceeds the cost of producing the authority.²⁹

3.6 Scope for simplifying the tax system

There is no doubt that many aspects of a tax system could be less complicated than they have turned out to be and still achieve government objectives, counter tax avoidance and so on. However, what is quite clear is that general calls for the simplification of the tax system without carefully addressing the issues raised in this section are unlikely to be helpful. What is needed is a more comprehensive approach and this is developed further in section 8. The next major aspect is simplifying tax law.

4. SIMPLIFYING TAX LAW

4.1 Tax law complexity

The nature of tax law itself is another important factor. As already indicated, one important trend in the environment in which taxation has to operate is the increasing complexity of socio-economic systems.³⁰ Hence Prebble's view³¹ that complexity arises from trying to fit the law around the "natural facts of economic life". This is not necessarily a straightforward process. To take a fairly central issue, Vickrey³² suggested that complications in the legislation and administration of income tax arise largely from the need to answer four types of question:

1. Is it income?
2. Whose income is it?
3. What kind of income is it?
4. When is it income?

This leads into all sorts of wonderful discussions about the definition of income, capital gains, business profits and so on.

Surrey's view³³ was that tax law complexity arises from:

[C]omplex substantive tax rules with complex inter-relationships characterised by complex variations in the tax treatment of transactions often not differing greatly in substance or form, all of which are expressed in a complex statutory terminology and arrangement.

²⁹ Deborah L. Paul, 'Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?' *North Carolina Law Review*, 1997-1998, 76, 151.

³⁰ Simon James, 'The Future International Tax Environment and European Tax Harmonisation: A Personal View,' *European Accounting Review*, 1999, 8(4), 731-747.

³¹ John Prebble, 'Why is the Tax Law Incomprehensible?' *British Tax Review*, 1994, 380-393.

³² William Vickrey, 'Tax Simplification Through Cumulative Averaging', *Law and Contemporary Problems*, 1969, 34(4), 736-750 at p. 736.

³³ Stanley S. Surrey, 'Complexity and the Internal Revenue Code: The Problem of Management of Tax Detail, *Law and Contemporary Problems*, 1969, 34, 673.

At least some of this, however, is clearly necessary. As Sir Ernest Gowers, a former Chairman of the UK Board of Inland Revenue, wrote in his *Complete Plain Words*,³⁴ though with respect to a different example of legal language:

[The] sentence is constructed with that mathematical arrangement of words which lawyers adopt to make their meaning unambiguous. Worked out as one would work out an equation, the sentence serves its purpose; as literature it is balderdash.

There is often an attempt to cater for every eventuality which can only lead to greater complexity. One possibility might be greater use of purposive law rather than ‘black letter’ law. Avery Jones, for example, has argued³⁵ for less detailed legislation in line with principles and “not a continuation of the plague of tax rule madness”. The advantages of such an approach though may be outweighed by a loss of certainty and a resulting increase in compliance and administrative costs.

Although there are, of course, reasons why tax law may be complex, there is often scope for simplifying it. Like many other people Lord Howe has pointed out that plain language law – which is clear and user-friendly—is obtainable and the key components are:

[A] clearer structure of what it is intended to achieve; much shorter sentences, clearer and better signposted definitions; modern design and layout and headings that help the user.³⁶

In the 1990s improving the language seemed to be the way forward and various Tax Law Improvement Projects (TLIPs) to address this were established.

4.2 Tax law reviews

In Australia, NZ and the UK there have been various tax law review projects. In the UK the Tax Law Review Committee was set up in 1994 to rewrite tax legislation in plain English and examine explanatory documentation. In Australia the process began with a report produced by the Joint Committee of Public Accounts in 1993³⁷ and the Tax Law Improvement Project (TLIP) was set up with the task of improving the “understanding of the law, its expression and its readability.” In NZ, the Tax Rewrite Project (TRP) was accompanied by a Rewrite Advisory Panel (RAP), comprising tax experts from the professions and IRD/Treasury, and operated within the framework of the Generic Tax Policy Process (GTPP).³⁸ The intention was to make the legislation more understandable through reorganising and rewriting the text.³⁹ There is no doubt

³⁴ Sir Ernest Gowers, *The Complete Plain Words*, 1954, London, HMSO.

³⁵ John Avery Jones, ‘Tax law: rules or principles?’ *Fiscal Studies*, 1969, 17(3), 63-89.

³⁶ Geoffrey Howe, ‘Tax Law Simplification in the United Kingdom’ in C. Sandford ed., *Further Key Issues in Tax Reform*, 1998, p. 108.

³⁷ Summarised by the Tax Law Review Team, *The Broad Framework*, 1994, Canberra, Australian Tax Office.

³⁸ See further on the GTPP: Adrian Sawyer, ‘Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’’, *Australian Tax Forum*, 2013, 28(2), 401-425.

³⁹ See further Adrian Sawyer, ‘New Zealand’s Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity’, *British Tax Review*, 2007 (4), 405-427. With regard to the reliability of assessing readability as a measure of understandability, see Adrian Sawyer, ‘Enhancing Compliance Through Improved Readability: Evidence from New Zealand’s Rewrite “Experiment”’, in M E Gangi and A

that improvements have been made though such attempts have not always been well received. For example, in Australia Lehmann referred to some of the rewritten law as “kindergarten babble”. He cited “Your assessable income includes income according to ordinary concepts, which is called ordinary income”. Warming to his theme, Lehmann suggested that “the rewrite of the core provisions has not resulted in simple legislation, but a loquacious, patronising and confused babble of educationalese. Reading it is like trying to wade through styrofoam mixed with treacle”.⁴⁰

There are two main reservations about simplifying tax law in this way. The first is that rewriting the law may inadvertently change its meaning in places when over many years Courts have gone to considerable trouble to establishing precise meanings. The second is that taxpayers themselves do not normally read primary tax legislation and therefore there is no need to direct it at them. It seems at the time the tax law rewrite initiatives were seen as the solution to the problem of excessive complexity but, certainly on their own, they are not.

An initial part of the Australian rewrite duly appeared as the *Income Tax Assessment Act 1997*. In reviewing the position, Krever⁴¹ pointed out that a superficial look at that Act seemed to support the view that the complexity of the system was the fault of the drafters of earlier legislation. However he went on to say that taxpayers and their advisers soon discovered that, although the new legislation was easier to read and comprehend than what had gone before, the complexity was still there. In fact the process had exposed the true cause of the previous law’s complexity – that is its “wholly irrational and inconsistent policy base”.⁴² Furthermore, TLIP seemed to have distracted attention from the normal process of revising tax legislation outside the project where problems continued and might even have increased. In the UK the Tax Law Review Committee’s final report⁴³ listed three types of complexity – linguistic, policy and compliance – and acknowledged that a comprehensive tax reform would have to address all three areas (paragraph 6.10). The Committee also stated that “without policy changes the benefits from rewriting legislation are limited” (paragraph 12).

There is no doubt that improvements can be made in simplifying tax law. A valuable Australian contribution has been the Taylor Report⁴⁴ on reducing tax law complexity and it makes a number of recommendations for improvement. However, as with the tax system, the complexity of simplifying tax law suggests there should be a more comprehensive approach of the sort described in section 8.

Plumley (eds), *Recent Research on Tax Administration and Compliance: Selected Papers Given at the 2010 IRS Research Conference*, IRS, 2011, Washington DC, 221-253.

⁴⁰ Geoffrey Lehmann, ‘The reform that does not reform and the simplification that does not simplify–The Tax Law Improvement Project Fiasco’, *Butterworth’s Weekly Tax Bulletin*, 1995, 33, 530-533.

⁴¹ Richard Krever, ‘Taming Complexity in Australian Income Tax’, *Sydney Law Review*, 2003, 25, 467-505.

⁴² *Ibid.*, at p. 493.

⁴³ Tax Law Review Committee, *Final Report on Tax Legislation*, 1996, London, Institute for Fiscal Studies.

⁴⁴ C. John Taylor, *Beyond 4100: A report on measures to combat rising compliance costs through reducing tax law complexity*, (2006), Sydney, Taxation Institute of Australia.

5. SIMPLIFYING TAXPAYER COMMUNICATIONS

Simplifying communications with taxpayers in the form of tax explanatory leaflets and so on is another area where there is often scope for improvement. There have been campaigns, such as the Plain English Campaign referred to in the introduction, and particular initiatives such as simplifying the language in tax guides and other tax literature by using shorter sentences and simpler words. However even in such an apparently straightforward area there can be pitfalls. Nor are they new and one illustration is reported by Sir Alexander Johnson. The Board of Inland Revenue had sent Lloyd George, who was then Chancellor of the Exchequer, a paper about Estate Duty Liability on settled property:

Mr Lloyd George rejected this paper and demanded an explanation in words of one syllable. The Board sent a new paper – in words of one syllable; but it was reported that the subject matter remained as complicated as before and the monosyllables made it rather harder to understand.⁴⁵

However, there is no doubt that this is an area where much can be done and communications with taxpayers can often be made more comprehensible.⁴⁶ There has also been particular success with simplified returns such as the United States' 1040EZ.⁴⁷ This consists of remarkably few questions for a tax return and may be used by US taxpayers with relatively simple circumstances. However, it is worth noting that the 1040EZ can only be as simple as it is because of arrangements elsewhere in the system, which leads on to the next aspect: tax administration.

6. SIMPLIFYING TAX ADMINISTRATION

It is possible to have a very complex tax system overall but to keep the administration simple for many taxpayers, for example by avoiding the requirement for large numbers of taxpayers having to complete a tax return at all. In the UK most taxpayers are not required to complete a tax return each year because the cumulative tax Pay-As-You-Earn system, at least in principle, can withhold tax to a very high degree of accuracy.⁴⁸ NZ's decision to remove the requirement for the majority of individual taxpayers to file tax returns (where their income is taxed at source and information is collected from third parties), has greatly reduced compliance costs and enabled the IRD and tax agents to focus on taxpayers with more complex tax affairs. The income statement confirmation process is simple, although some taxpayers who are in a refund situation may not be receiving the refunds they are entitled to.

Furthermore, with advances in technology it is also becoming feasible to issue returns which already include information about the taxpayers' circumstances supplied by third parties to the tax authority electronically.⁴⁹ These 'pre-populated' tax returns can

⁴⁵ Sir Alexander Johnson, *The Inland Revenue*, 1965, Allen & Unwin, London.

⁴⁶ Simon James, Alan Lewis, and Frances Allison *The Comprehensibility of Taxation: A Study of Taxation and Communications*, 1987, Avebury, Aldershot.

⁴⁷ <http://www.irs.gov/pub/irs-pdf/f1040ez.pdf>. Accessed 20 February 2014.

⁴⁸ Simon James and Ian Wallschutzky, 'Should Australia Adopt a Cumulative Withholding Tax System?' *Australian Tax Forum*, 1994, 11(3), 311-335.

⁴⁹ Richard Highfield, 'Pre-populated Income Tax Returns', 7th International Tax Administration Conference, 2006, ATAX, Faculty of Law, University of New South Wales.

contain details of most major sources of income together with the tax withheld, asset sales and purchases, specific deductions that are obtained from third party sources or calculated according to a formula, personal tax reliefs, tax credits and the calculations of tax payable or refundable. The role of the taxpayer in this process is to confirm the information is correct and to supply any further information required. Such arrangements have been used for some time – Denmark led the way by introducing such arrangements in 1988 though these originally were quite primitive since the amount of information that could be collected and processed was quite limited. However, the system was progressively enhanced during the 1990s and similar arrangements were introduced in Sweden in 1994 and Norway in 1998. As the application of technology to tax administration progressed moves in this direction have also been made elsewhere.⁵⁰ The case for such a development in the US has been examined by Cordes and Holen⁵¹ but they concluded that “adopting a return-free tax preparation system is not an advisable course of action for the federal government” (p. 27). Their analysis indicated that costs savings would be modest and additional costs to employers and others would be substantial as well there being a range of other challenges. This seems to indicate yet again that successful simplification of one part of the system has to take account of a range of other factors. The paper now turns to some longer term initiatives in Australia, NZ and the UK.

7. LONGER TERM APPROACHES

More recently there have been initiatives to establish more long term approaches to simplification such as the Office for Tax Simplification in the UK and the Tax Working Group (TWG) in New Zealand. Looking first at NZ, the TWG cannot be considered in isolation, in that without the Generic Tax Policy Process (GTPP), it is unlikely that the TWG would have been formed or successful in convincing the government of the need for structural tax reform. Much has been written about the GTPP,⁵² which is essentially a structure for developing tax policy (that eventually becomes legislation) which is heavily dependent upon consultation with the tax profession, taxpayers, and input from tax officials. Its hallmarks are transparency and rigorous analysis, with important review and feedback loops. The TWG operated as an independent external input recommending a package of tax policy changes that eventually with the support of the government worked through the legislative process.

The TWG’s focus was on reviewing the tax system with the goal of addressing structural deficiencies, rebalancing the tax mix, but done within the fiscal constraint

⁵⁰ François Vaillancourt (ed.), *Prefilled Personal Income Tax Returns: A Comparative Analysis of Australia, Belgium, California, Quebec and Spain*, 2011, Fraser Institute, available at: <https://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/prefilled-personal-income-tax-returns.pdf> . Accessed 20 February 2014.

⁵¹ Joseph Cordes and Arlene Holen, *Should Government Prepare Individual Tax Returns?* 2010, Technology Policy Institute, Washington DC.

⁵² For some recent examples, Adrian Sawyer, “Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’”, *Australian Tax Forum*, 2013, 28(2), 401-425; Adrian Sawyer, “Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?”, *Hong Kong Law Journal*, 2013, 43(2), 579-609; and Struan Little, Geof D. Nightingale, and Ainslie Fenwick, “Development of Tax Policy in New Zealand: The Generic Tax Policy Process”, *Canadian Tax Journal/Revue Fiscale Canadienne*, 2013, 61(4) 1043-1056.

that all series of recommendations must be revenue neutral. Importantly all national-level taxes were within the scope of the review, unlike the Henry Review in Australia where GST was “off limits”. As Little et al observe:⁵³

The TWG proved to be a considerable success. It was a good forum for debate of the pros and cons of various tax changes. The TWG provided an open discussion process, with papers from the meetings and a record of debates being published on the Internet. This helped to inform the wider public on key tax policy issues.

It would be fair to say that the TWG would not have been as successful if the GTPP were not in place.⁵⁴ It also involved academics in the consultation and policymaking process, something that the GTPP has struggled with previously.⁵⁵ A word of caution, however, is that the TWG was largely a ‘right of centre’ leaning group, with a right of centre government in place at the time. Should there have been a ‘mismatch’ of political tax philosophy, then the TWG’s success (and possibly recommendations⁵⁶) would have differed. Like the GTPP, the TWG was an example of a successful delicate balancing between law and politics when seeking to develop tax policy.⁵⁷ To a sizable extent, the TWG removed some of the politics from tax policy development, enabling key tax principles, such as simplicity, to have a reasonable opportunity to feature in any policy recommendations. The TWG was much more successful in seeing its recommendations adopted and implemented, than for example, the Tax Review 2001.⁵⁸ Unfortunately in our view, the TWG was disbanded after it provided its recommendations, suggesting that when the need arises for major tax reform in the future, a new body, perhaps similar to the TWG, will need to be established.

Turning to the OTS in the UK, it should not come as a surprise that given the relatively ineffectual outcome of the TLRP in the UK, the need for a mechanism to address major policy challenges and concerns underlying the UK’s tax system was necessary. The OTS was established in July 2010 to provide advice to the UK Chancellor of the Exchequer (Chancellor) on simplifying the UK tax system, with the objective of reducing compliance burdens on both businesses and individual taxpayers.

It was set up with a limited life (the current UK parliamentary term which expires in 2015), given a sizeable agenda, although as Sawyer comments, it has focussed largely on minor issues, and left untouched major structural issues that add to complexity.⁵⁹

⁵³ Little et al, *Ibid*, 1052.

⁵⁴ Adrian Sawyer, ‘Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?’, *Hong Kong Law Journal*, 2013, 43(2), 579-609, at p.587.

⁵⁵ Struan Little, Geof D. Nightingale, and Ainslie Fenwick, ‘Development of Tax Policy in New Zealand: The Generic Tax Policy Process’, *Canadian Tax Journal/Revue Fiscale Canadienne*, 2013, 61(4) 1043-1056, 1056.

⁵⁶ Adrian Sawyer, ‘Establishing a Rigorous Framework for Tax Policy Development: Can New Zealand Offer Instructional Guidance for Hong Kong?’, *Hong Kong Law Journal*, 2013, 43(2), 579-609, at p.589.

⁵⁷ Adrian Sawyer, ‘Reviewing Tax Policy Development in New Zealand: Lessons from a delicate balancing of ‘Law and Politics’’, *Australian Tax Forum*, 2013, 28(2), 401-425, p.423-424.

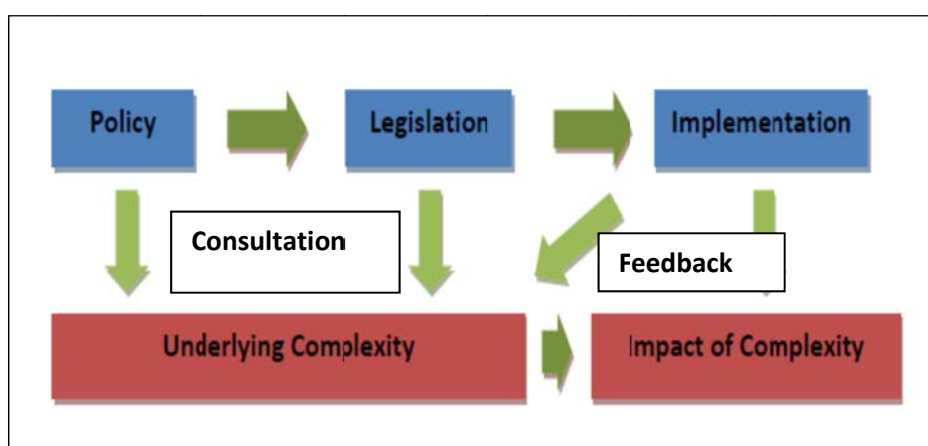
⁵⁸ Adrian Sawyer, ‘New Zealand’s Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity’, *British Tax Review*, 2007, 4, 405-427, 329-330.

⁵⁹ Adrian Sawyer, ‘The Office of Tax Simplification: An Evaluation from Downunder’, paper submitted to *British Tax Review*, 2013, 30-31.

One small area of relative success has been the Complexity Index launched for consultation by the OTS in 2012, leading to debate and refinement.⁶⁰ The Complexity Index was published in December 2012 with the aim being to provide an indication of which areas of tax legislation are considered to be particularly complex compared to others and to develop a tool that can help prioritise the future work of the OTS. The methodology is intended to assist UK tax policymakers prioritise areas for future tax simplification and avoid unnecessary complexity. The Complexity Index is intended to be applied to the complete UK tax system (including EU legislation that operates in the UK).

Within the OTS's Complexity Index methodology paper is an interesting diagram of how the OTS sees complexity arising within the tax system. This is reproduced below as Figure 1:

Figure 1: How complexity arises within the policy framework⁶¹



As Sawyer observes, Figure 1 suggests the OTS recognises that the policy process itself is critical to addressing issues of complexity.⁶² The OTS also recognises that complexity may be minimised if some broad guidelines are followed when designing policy, legislation, and implementation, although Sawyer comments that the OTS has yet to undertake research to develop some general principles to minimise tax complexity.⁶³

Whether the Complexity Index will prove effective remains unclear, as while it focuses on legislative complexity, it does not appear to be able to differentiate between business size and sector, both critical factors in the debate over complexity. As Evans and Tran-Nam observe, in order to “... develop a rigorous and acceptable

⁶⁰ Adrian Sawyer, ‘New Zealand’s Tax Rewrite Programme: In Pursuit of the (Elusive) Goal of Simplicity’, *British Tax Review*, 2007, 4, 405-427, 336-337.

⁶¹ Office of Tax Simplification, *The Office of Tax Simplification Complexity Index* (2012), 2 (boxes for Consultation and Feedback have been included at their anticipated places in the process). The OTS has not provided an updated version of Figure 1 in the second version of its Complexity Index; see Office of Tax Simplification, *The Office of Tax Simplification Complexity Index – Version 2* (2013),

⁶² Adrian Sawyer, ‘The Office of Tax Simplification: An Evaluation from Downunder’, Department of Accounting and Information Systems Working Paper, (University of Canterbury, 2013), 17.

⁶³ *Ibid.* 17.

tax system complexity index it is necessary to review both the tax complexity literature and the basic theory of index numbers”.⁶⁴

The OTS came within the public spotlight with the Public Accounts Committee’s (PAC’s) investigation into tax avoidance and the role of large accountancy firms in 2013.⁶⁵ This report suggested that the OTS has made little in the way of substantial contribution to the simplification of the UK tax system. The Rt. Hon Michael Jack, Chair of the OTS, was quick to respond to ‘correct’ some of the statements made.⁶⁶ The Chair of PAC, Rt. Hon Margaret Hodge, responded that the PAC supports the OTS’s work, and accepts that the OTS ‘punches above its weight’ given the resources at its disposal.⁶⁷ Hodge went on to urge the UK Government to increase the support and resources of OTS. Of particular interest also was the comment that HM Treasury and HMRC should “... work together to make more radical progress in addressing the inadequacies of existing tax law.” A formal response from the UK Government to the PAC’s concerns over the OTS’s resourcing has not been made to the writers’ knowledge.

Going forward, an unresolved matter is the outcome of discussion over the type of evaluation that should be undertaken on the OTS to assist the UK Government in deciding what to do about the OTS post-2015, as well as potentially assisting the OTS in the shorter term with how it carries out its reviews.⁶⁸

Comparing the TWG and OTS, it should not come as a surprise that the TWG has been more effective in bringing about change to the tax structure, including aspects of simplification although this was not a major focus of its review of the tax system. The OTS, on the other hand, has an almost total focus on aspects of simplification, although it has approached its work by seeking to address minor issues and ‘avoid’ the major policy issues that contribute to complexity. Thus, even with its uncertain future, it would come as a surprise if the OTS were to deliver effective simplification of the UK tax system. Indeed it would be fair to suggest that enhanced equity is considered to be more important as a goal than greater simplicity, whereas in New Zealand, simplification is considered as important as equity, although efficiency appears to have been the most important criterion for recent tax reform in NZ.

Australia, while not taking up the opportunity to simplify its tax system in a manner similar to NZ and the UK, has sought to make tax compliance simpler through various initiatives. One such initiative is the pre-filling of tax returns. Evans and Tran-Nam⁶⁹ are of the view that tax policy simplification is virtually not possible and that tax law simplification has limited benefits. The authors examine the pre-filling of income tax returns in Australia as an example of administrative simplification. Writing in 2010, they conclude that the approach in Australia is a step in the right direction but had not

⁶⁴ Chris Evans and Binh Tran-Nam, ‘Towards the development of a tax system complexity index’, *Fiscal Studies*, 2014, 35, 341-370, at p.367.

⁶⁵ House of Commons Committee on Public Accounts, *Tax Avoidance: The role of large accountancy firms* (April 2013) 44 Report of Session 2012-13 at 3, 12 and Ev 18.

⁶⁶ Rt. Hon. Michael Jack, Letter to Rt. Hon Margaret Hodge re ‘Tax Avoidance: The role of large accountancy firms’ (1 May 2013).

⁶⁷ Rt. Hon. Margaret Hodge, Letter to Rt. Hon Michael Jack re ‘Tax Avoidance: The role of large accountancy firms’ (5 June 2013).

⁶⁸ *Ibid*, 337.

⁶⁹ Chris Evans and Binh Tran-Nam, ‘Managing Tax System Complexity: Building Bridges Through Pre-Filled Tax Returns’, *Australian Tax Forum*, 2010, 25, 245-274.

yet led to significant operating cost savings. If the recommendations of the Henry Review⁷⁰ were to be fully accepted and implemented, the authors see the opportunity for positive change. However, to date most of the Henry Review's recommendations have not been implemented, including those that would enhance the future value of pre-filling of returns.

8. A MORE SYSTEMATIC OR STRATEGIC APPROACH

Although initiatives for simplification can often result in improvements, it may be better to follow a more comprehensive approach by addressing the range of factors from which complexity arises.⁷¹ Before doing so, the special case of small businesses will be briefly mentioned first.

8.1 The case of small businesses

A very important sector in particular need for the tax system to avoid unnecessary complexity is small business. There is widespread support for help for small businesses⁷² and for good reason. Among other things, small enterprises, and particularly very small ones, do not normally have the expertise and other resources to cope with complexity. They are also collectively a very large and often dynamic part of economic life. Special provisions for small businesses are possible. For example, in the UK small businesses with a very modest turnover are assisted by arrangements for the submission of simplified accounts – requiring only the figures for turnover, expenses and net profit – to HM Revenue and Customs. Another example in New Zealand is to allow small business to use their GST return as the basis for making their provisional tax payments. In Australia, for example, the small business tax concessions have provided some gains but not to the extent anticipated by the Australian Government. Burton argues that the evidence relied upon for their introduction and continuation is both partial and flimsy.⁷³ More recently, Lignier and Evans examine the small business tax concessions as part of their survey of Australian SME compliance costs, concluding that many respondents were unaware of their eligibility and that these concessions frequently introduced further complexity into the tax system.⁷⁴

8.2 A strategy for simplification

The academic discipline that has paid most attention to the subject of developing strategy is Management. An essential input in the development of successful strategies is the systematic analysis and understanding of the factors involved. This includes the wider environment in which the activity is being conducted as well as the areas of

⁷⁰ Australia's Future Tax System, *Final Report*, 2010.

⁷¹ See, for example, Simon James and Alison Edwards, 'A strategic approach to personal income tax reform', *Australian Tax Forum*, 2007, 22(2), 105-126.

⁷² See, for example, D. Holz-Eakin, 'Should small businesses be tax-favoured?' 1995, *National Tax Journal* 48, 3, 387-395.

⁷³ Mark Burton, 'The Australian small business tax concessions—public choice, public interest or public folly?', *Australian Tax Forum*, 2006, 21, 71-130.

⁷⁴ Philip Lignier and Chris Evans, 'The rise and rise of tax compliance costs for the small business sector in Australia', *Australian Tax Forum*, 2012, 27, 615-672.

immediate concern. A key part in the development of strategy is implementation. Mintzberg⁷⁵ is one of the most prominent management scholars in this area and he believes that strategy is an interactive process requiring constant feedback between thought and action and that successful strategies evolve from experience. He also stresses the importance of strategists having expertise in the area and that they should not simply pontificate at a high level of abstraction and leave it to others to implement the strategies (and certainly not blame them for any shortcomings in the strategy). Other commentators such as Grant⁷⁶ are also clear that the formulation and implementation of strategy go together. A well-designed strategy should take account of the process of implementation and it is through the implementation that a strategy can be refined and reformulated.⁷⁷

In terms of tax simplification the process may be summarised in four main areas:

- Evaluate the importance of different aims of tax policy.
- Incorporate simplification into the tax policy process itself.
- Develop a ‘simplification culture’.
- Monitor and review progress.

As already stated, simplification is not the sole aim of tax policy – indeed it is incidental to the main purposes of taxation. For long term improvement to be achieved, the relative importance of simplification to other goals should be established – and this may change over time so the process must be a continuing one. In the UK the Revenue has discussed the creation of a ‘simplification “culture” within the Revenue which it is important to maintain and encourage.’⁷⁸ It is also desirable that such a culture should extend to the tax policymaking process as well. It is important to be able to measure the outcome to establish how far the aims have been achieved and whether they are being maintained and different approaches to such measurement have been examined by Wallschutzky.⁷⁹

9. A PROPOSAL

It is quite likely that any project to simplify taxation on its own will not achieve lasting success – the forces generating complexity are simply too strong. There is also the key point that the simplest possible tax system is not the aim. There is a trade-off between simplification and other policy goals which requires a careful balancing of competing priorities that might ultimately be determined by the ruling political party at the relevant time.

⁷⁵ Henry Mintzberg, *Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*, 2004, San Francisco: Berrett-Koehler, Publishers, 55.

⁷⁶ Robert M. Grant, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, 4th ed., 2002, Oxford: Blackwell.

⁷⁷ Simon James, ‘Tax Compliance Strategies to Tackle the Underground Economy’ in Chris Bajada and Friedrich Schneider (eds.) *The Size Cause and Consequences of the Underground Economy: An International Perspective*, 2005, Ashgate, 275-289.

⁷⁸ Inland Revenue, *The Path to Tax Simplification: A Background Paper*, 1995, London, HMSO.

⁷⁹ Ian G. Wallschutzky, ‘TLIP: Stage 1 – Benchmarking’, *Australian Tax Forum*, 1995, 12, 115-55.

To achieve structural and long-term benefits, what may be required is the establishment of a permanent body to oversee on a long term basis the development of tax policy, including simplification.

The direction of possible lasting improvement might be indicated by the conduct of monetary policy. The main economic policies available to governments are monetary policy – associated with interest rates and the money supply and fiscal policy – taxation and public expenditure. In the UK, while the Government retains final control of the aims and objectives of monetary policy, in 1997 it granted operational independence to the Bank of England in setting interest rates. Section 11 of The Bank of England Act 1998 states that the objectives of the Bank of England in respect to monetary policy shall be: (a) to maintain price stability, and (b) subject to that to support the economic policy of the government including its objectives for growth and employment. However the Bank's Monetary Policy Committee is free to pursue these objectives by setting interest rates without reference to the government of the day. Similarly in Australia and NZ, their respective Reserve Bank Board and Governor set interest rates independently of the political process. Such arrangements are also used in other countries in order to avoid the political manipulation of interest rates and to ensure that monetary policy is used to pursue long-term goals.

Fiscal policy in many ways is so bound up in almost every conceivable way with the operation of the economy and government influence over it that it is hard to imagine any government passing operational control to an independent body in the way that it has been done with monetary policy. However, perhaps it might be worth exploring the possibility that an independent contribution to the development of tax strategies could be advantageous. Currently most of the input in this area comes from *ad hoc* enquiries and miscellaneous contributions from both the public and private sectors. If an appropriate body were charged with the responsibility of collecting the information necessary to develop strategies on a permanent basis, it could offer systematic guidance to the process of reforming taxation over time. An obvious example is in observing how inflation and economic growth is affecting the tax structure. Such a body could also take account of other factors such as economic growth and economic and social change more generally, both nationally and internationally. There may even be scope for some limited aspects of the tax system to be changed, in much the way interest rates are for monetary policy, without the need for direct government involvement. An example is the way some countries have linked tax thresholds to inflation.

The suggestion here is for a body with a much wider remit than the OTS, covering all relevant aspects of the tax system and its operation, and including simplification as a standard dimension on which taxes must be continually assessed. The NZ GTPP and TWG also give an indication of what might be done.

There would be no shortage of work for such a body. Particular aspects include attempts at weighing up the importance of different aspects of the income tax. For example, how far should the income tax be tailored to individual circumstances and how far should simplicity be sought and complexity limited. Clearly answers to questions such as this may change over time and be different in different contexts. Another substantial task is analysing the economic, social, political and technological

environment in an international context⁸⁰ and the implications for the successful operation of the tax system.

There is clearly scope for a more detailed analysis of the possible role and powers of such a body. Some existing bodies might have the potential to play at least part of this role. The Australian Tax Research Foundation (ATRF), for example, exists to undertake independent and impartial research into the reform of taxation and the Taxation Institute (TI) could also play a useful role.

An independent Tax Studies Institute was proposed at the National Tax Forum held in Australia in 2011. The National Tax Forum recommended:⁸¹

The Commonwealth Government should respond positively to Recommendation 134 of the AFTS Review (2009) by committing funds to the development of an independent multidisciplinary and multi-institutional tax research centre, The Australian Centre for Tax Research. Commonwealth funding should comprise \$2.5 million each year for 10 years; such funding to be accompanied by State and Territory Governments and the private sector both contributing \$0.25 million per annum over 10 years.

To date this recommendation has yet to be accepted by the Australian Government and implemented.

What seems very clear is that the present situation, in which complexity continues to grow until there is an *ad hoc* response, is not the optimal arrangement. In addition to anticipating necessary change, such an independent authority could also assess other proposals systematically for suitability for implementation. It has been suggested that the political process might provide temptations to generate tax changes, and more complexity, in order to improve short-term popularity rather than long stability – for example, there have been many contributions to the literature on the political-business cycle since Kalecki's contribution over half a century ago.⁸² With elections taking place at least once every five years in the UK and once every three years in Australia and NZ, an independent authority might be a powerful force for rational decision-making with respect to tax reform.

We accept that there is enormous political difficulty in accepting this recommendation. For example, in an Australian context, when a suggestion was made at the National Tax Forum in 2011, the response we received was that the “government was not going to contract out what it was elected to do.” This may be interpreted as a polite dismissal of such suggestions. Also, it is foreseeable that governments may be reticent to agree with such suggestions as they may perceive this as the government losing control/power over tax policy. Should a precedent for such an approach emerge somewhere in the world, it should be examined closely by policymakers and researchers.

⁸⁰ See, for example, Simon James, ‘The Future International Tax Environment’, *International Tax Journal*, 1999, 25(1), 1-9.

⁸¹ National Tax Forum, *Statement of Reform Priorities*, 2011, Joint Statement to Tax Forum on Government Response to AFTS (2009) Recommendation 134 (emphasis added).

⁸² M. Kalecki, ‘Political Aspects of Full Employment’, *Political Quarterly*, 1943, 14(4), 322-310.

10. CONCLUSIONS

Tax simplification is a very desirable aim but previous attempts at achieving it have not been very successful. One of the main reasons is that there are important reasons why tax systems are complex and those wishing to simplify the tax system have to take them into account if overall improvements are to be gained. The best tax system is unlikely to be the simplest. Therefore there must be a process to weigh up the trade-offs between simplicity and the other aims, objectives and realities of a tax system and the environment in which it has to operate. The failure to do this seems to have been the main underlying reason why previous initiatives have not had the success their supporters had hoped to achieve. For permanent improvements in tax simplification, and other aspects of the tax system, there should be a long term and comprehensive approach to taxes and tax reform. Possibly an independent authority, as outlined section 9, could be established to address complexity in the tax system.

Research opportunities in the area of tax simplification abound. Jurisdictions other than the three reviewed in this paper will have stories and experiences that contribute to our broader understanding of the intricacies of tax simplification. The desirable level of simplification within a given jurisdiction's tax system is unlikely to be optimal for another jurisdiction.

Furthermore, the views of the various actors, including taxpayers, tax agents, revenue authorities and policymakers are unlikely to be in agreement as to the optimal level of simplification. Nevertheless, there are expected to be features common across jurisdictions that enhance or hinder simplification, and further research that shares insights may lead towards a more collective understanding of the importance of simplification. We encourage further research into this and other aspects of tax simplification.

Building trust through leadership: A longitudinal study on Inland Revenue's response to, and learnings from, the Canterbury earthquakes—Years 1 and 2

Elisabeth Poppelwell, Hailong Sun and Peter Bickers¹

Abstract

The 2010 and 2011 Canterbury earthquakes in New Zealand caused major social and economic disruptions. Because a responsive tax regime is considered to be a key building block in re-development after an adverse event, the New Zealand Inland Revenue Department (Inland Revenue) is undertaking a longitudinal study of three to five years to better understand the impact these types of events can have on tax compliance and what impact its actions have had on mitigating these risks.

The research focuses on small and medium enterprises (SMEs). This sector makes a significant contribution to the New Zealand economy, but it is also more susceptible to incurring debt. A large proportion of the total tax debt is owed by this sector—about one third of tax debtors within New Zealand.

There is also a concern that tax debt could increase during the reconstruction phase, as some SMEs grow faster than their ability to meet their new tax filing and payment obligations. Disasters can also make people question and change their attitudes towards tax compliance. This could impact on SMEs in certain industries as they become exposed to hidden economy opportunities in the recovery and rebuild phases.

This research forms part of a suite of research that the government, universities and other organisations are undertaking on the impact of the Canterbury earthquakes on New Zealand's social and economic wellbeing. Findings from the longitudinal study will feed into this bigger pool of information which will help other agencies in their policy decision making. It will also help the government develop a collective view of the key issues facing Canterbury. The Year 1 (2012) findings showed that there has not been a major shift in attitudes towards tax compliance but tax compliance behaviour has worsened for some businesses. SMEs with business savings and better management practices were better able to meet tax obligations. However, concerns were raised by research participants in Year 2 (2013) about whether businesses have the time and expertise to maintain their tax compliance while they are growing. The Year 2 research provided a picture of business recovery and what the 'new normal' for Christchurch looks like in 2013. Key learnings for tax administrations highlight the importance of communication between the tax administration and businesses, and that proactivity on the part of a tax authority is vital. The New Zealand tax administration actions helped some businesses manage their tax obligations, with SMEs in Year 1 rating waiving of penalties, payment arrangements and extension of time as being helpful. The overall expectation for the tax administration was to be lenient and provide tailored assistance for businesses that are still struggling, but to return to 'business as usual' (BAU) monitoring and enforcement of tax compliance for businesses that have recovered.

The research to date has been used by Inland Revenue as a general barometer of where businesses are placed in terms of recovery and compliance. Specifically, it has used the research to inform government Ministers of the different stages of recovery of businesses when considering removing the Orders in Council that provided relief after the earthquakes. The research has also identified the risk areas in Christchurch. As it continues, the other benefit is in understanding what is actually happening to businesses and how SMEs are managing, and determining how a tax administration might address identified compliance issues and/or promote further voluntary compliance. The information has also influenced the Canterbury Earthquake Recovery Authority's (CERA's) work programme, which now has a stronger focus on existing businesses and investors than it otherwise might have.

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1. INTRODUCTION

In 2010 and 2011, a series of major earthquakes hit Canterbury, New Zealand, with one particular earthquake on 22 February 2011 resulting in 185 deaths. The earthquakes caused major economic and social disruptions to everyday activities and social life, and this prompted the New Zealand Inland Revenue Department (Inland Revenue) to look at how it responds to sudden large-scale adverse events (adverse events). This is because the department plays a central role in securing most of the financial resources required by the Government. These resources provide essential services and facilities that improve New Zealanders' quality of life.

Following an adverse event, a well-working tax system and its administration are key to helping the economic and social recovery of the affected region and country. This is why Inland Revenue wants to better understand how an adverse event can affect long-term tax debt, and whether social norms and attitudes change leading to increased hidden economy activity during recovery. As the tax administrator, Inland Revenue also wants to know what impact its actions may have in mitigating these risks so that learnings can be applied to respond appropriately to future adverse events.

In 2012 Inland Revenue commenced a longitudinal research project. The first two years of this study consisted of a desktop review of literature, analysis of Inland Revenue's administrative data, quantitative and qualitative research with small businesses and tax agents, Christchurch-based Inland Revenue staff, and other key stakeholders. This paper presents findings from the first two years of research and how the research is being used to influence Inland Revenue's decision making.

2. BACKGROUND

Natural disasters create a socially disorganised and disordered environment and this social disorganisation increases the opportunity for non-compliant behaviour (Davila, Marquart and Mullings, 2005; Kerstein, 2006).

Tax compliance behaviour is likely to be affected by a customer's relationship with their tax administration (Ayres and Braithwaite 1992; Braithwaite, 2002; Braithwaite, Murphy and Reinhart, 2007; Braithwaite and Wenzel, 2008; Murphy and Tyler, 2008; Murphy, Tyler and Curtis, 2009; Tyler, 1990, 2006, OECD, 2010). The 2010 and 2011 Canterbury earthquakes prompted New Zealand's tax administration to look at its response to major adverse events because of the flow-on effects on tax compliance behaviour and revenue collection.

Small to medium enterprises (SMEs) are more susceptible to incurring debt than other Inland Revenue customers, and a disaster makes SMEs from certain industry sectors more exposed to incurring tax debt. There is also a concern that tax debt could increase during the reconstruction phase as some SMEs grow faster than their ability to meet their new tax filing and payment demands.²

² Research has found that while most SMEs are aware there are financial penalties for late payment of business tax, there is a lack of detailed knowledge and understanding of how they are applied (Poppelwell, Kelly and Wang, 'Intervening to reduce risk: Identifying sanction thresholds among SME

Disasters can also make people change their attitudes towards tax compliance. This could impact on SMEs in certain industries as they become exposed to hidden economy opportunities during the various recovery and rebuild phases.

Businesses do not always fail immediately after a disaster; sometimes it can take two to four years. Business owners can continue to struggle to recover until they have exhausted all their resources. The literature states that the smaller the business, the less likely the recovery. Those that rely on discretionary spend, or sustain more structural damage, and those that fail to comply with regulations (Stevenson, Kachali, Whitman, Seville, Vargo, & Wilson, 2011) are particularly affected. In addition, smaller businesses generally have fewer resources to prepare for disasters. Large businesses tend to fare better than small businesses after a disaster as they tend to have more resources for disaster recovery (Webb, Tierney and Dalhammer, 1999; Kroll, Landis, Shen and Stryker, 1991; Powell, 2010). For example, a New Zealand study found more than 80 per cent of small to medium businesses did not have adequate insurance (Powell and Harding, 2010).

2.1 Phases of a disaster

When events have large-scale adverse consequences for individuals, organisations and communities they become disasters. The more the event results in unravelling the community fabric, the greater the disaster and the harder it is for survival and recovery to occur (Alesch and James, 2007).

Disasters or adverse events generally have two or three phases: prevention, response and recovery (Webb, et al, 1999; Kerstein, 2006; Runyan, 2006; Powell, 2010). Research undertaken in the first year of this longitudinal study showed that SMEs in Canterbury who were still operating were in several stages of recovery—surviving, recovering and recovered. In the second year of the research, ‘stagnating’ and ‘booming’ were added to these stages.

Business disaster preparedness or lack thereof emerged as a main theme within the papers that were located in the literature search. The consensus of most studies on the disaster preparedness of small businesses is that the majority either do not engage or engage only to a low level, in formal planning to prepare for a disaster (Runyan, 2006; Powell, 2010; Popp, 2006).

2.1.1 Support from the New Zealand tax administration

In the aftermath of the Canterbury earthquakes, Inland Revenue offered a package of general support to SMEs to help businesses to recover by:

- providing a range of tools and services that help organisations self-manage
- educating businesses about how they can comply with tax requirements during the recovery
- offering free business seminars and tailored presentations, meetings, events and expos for businesses affected by the earthquake

tax debtors.’ *eJournal of Tax Research*. Vol 10, No. 2. October 2012). This lack of detailed knowledge did not impact on the compliance behaviour of SMEs who have never been in debt, but did for those who were in debt or had been in debt.

- waiving penalties for late filing.

2.1.2 *What is good compliance?*

A critical component of an efficient and effective tax system is voluntary compliance, that is, taxpayers proactively comply with their tax obligations. For this research, good compliance³ is when an Inland Revenue customer files their tax return on time and pays tax owing on time and in full. Examples⁴ of good compliant attributes include a SME business owner who:

- is organised and uses a tax agent
- builds savings and uses personal cash reserves if necessary
- has a positive personal ethos or attitude about tax (for example, that tax provides services to society)
- has good business acumen
- creates a financial forecast for the business
- belongs to professional bodies
- builds networks
- uses technology (for example, MYOB) to help with their tax and other regulatory obligations
- uses good business practices (for example, calendar)
- has insurance
- is proactive in working with their tax agent and/or tax administration if facing a tax-related problem.

2.1.3 *What are the risk factors?*

Risk factors that can lead to non-compliance are when the SME business owner:

- lacks knowledge and interest in tax obligations, and has a poor knowledge of the business' financial situation
- considers tax agents an unnecessary expense, and sees tax as a burden and 'easy money' for the Government
- relies heavily on cash flow

³ There are five components of tax compliance. These are registration, reporting, filing, payment and claiming. The research will focus on the filing and payment components of compliance. These categories are defined as the percentage of returns filed on time and the percentage of payments made on time. That is, the ratio of number of late filings to a total number of filings per tax year. A return is considered to be on time if it is filed within seven days after the due date, and the ratio of number of late payments to a total number of payments per tax year. A payment is considered to be paid on time if it is paid in full within seven days after the due date.

⁴ The examples of good and poor compliant behaviours were identified from the project's interviews and survey, and also from previous SME research (Poppelwell, Kelly and Wang 2012).

- has a small business (for example, no or few employees to help out)
- uses future earnings to pay staff, creditors, and debts
- has poor management practices for dealing with debt
- gives a low priority to administration work
- when having tax-related problems, does not work with a tax agent or the tax administration.

3. RESEARCH OBJECTIVES AND METHODOLOGY⁵

A responsive tax regime is seen in the research literature (on disasters⁶) as a key building block in re-development after an adverse event. By late 2011, there was anecdotal evidence⁷ that the Canterbury earthquakes were having an impact on small business compliance behaviour. The longitudinal study will identify what the long-term tax implications are for Canterbury and the rest of New Zealand, and develop a framework⁸ from the learnings for responding to future large-scale adverse events. Because there is very little international literature on the impact of adverse events or disasters on SME tax compliance behaviour, a large component of the study is exploratory.

The purpose of the research is to:

1. Understand the impact of an adverse event on SME tax compliance.
2. Understand the effect an adverse event has on long-term debt, and on norms and values.
3. Explore whether Inland Revenue's actions have mitigated the risk of increased long-term tax debt and hidden economy activity.
4. Identify learnings for tax administrations for future adverse events.

3.1 Outcomes

The research will identify how the prolonged nature of recovery from the Canterbury earthquakes has impacted on SME compliance behaviour, how Inland Revenue tried to mitigate it, and how we can learn from this. In addition to identifying the long-term implications for Canterbury and the rest of New Zealand, findings from the study will form a body of information that will help Inland Revenue and other government agencies inform future strategies, and develop a framework for managing compliance behaviour following an adverse event.

⁵ A more detailed explanation of the methodology is in Appendix 2.

⁶ The available research literature generally refers to sudden large-scale adverse events as 'disasters'.

⁷ There were reports that some businesses were under-reporting the number of staff they have in their tax returns.

⁸ For example, managing compliance behaviour: 1) in a cash economy immediately following an adverse event; 2) due to business failure; 3) during the reconstruction period.

Much of previous research looked at personal impact and general recovery. When we contacted other tax jurisdictions we found there has been very little, if any, research undertaken that focused specifically on the impact of an adverse event on SME tax revenue.

Our literature review helped us to better understand the different phases of a disaster (prevention, response, recovery) and that each phase may require different actions from a tax administration.

The first year of the project focused on gathering baseline data. This included analysis of Inland Revenue's administrative data to measure the impact of major disasters on tax compliance behaviours, and developing a framework to monitor the administrative data throughout the life of the project.⁹

Inland Revenue's National Research and Evaluation Unit commissioned Colmar Brunton, an external research provider, to undertake the field work and analyse the findings from the survey and interviews.

3.2 Year 1

The qualitative and quantitative research was carried out with SMEs and tax agents in Canterbury. The qualitative research stage consisted of individual in-depth interviews with 21 SMEs and nine tax agents in April 2012, and a focus group with Christchurch-based Inland Revenue staff.

The quantitative stage of the research consisted of a telephone survey of 1,161 SMEs and 100 tax agents in the Canterbury region. Fieldwork was conducted from 21 June to 31 July 2012. The overall response rates to the surveys were 35 per cent for SMEs and 42 per cent for tax agents. Data was weighted to ensure the sample reflected population characteristics in terms of business size and debt history status.

3.3 Year 2

In-depth individual interviews were conducted with 39 stakeholders from a range of business sectors, government agencies and professional bodies, as well as 11 with Inland Revenue staff¹⁰ identified by the project advisory group and research team. The participants were all Christchurch-based, and were knowledgeable and experienced in their respective sector of activity. They also had a good understanding of SMEs within the sector.

The interviews were conducted face-to-face in Christchurch and over the telephone. Their duration was up to one hour in length, and a semi-structured discussion guide was used to elicit viewpoints.

⁹ The population base used is SMEs who were active on 4 September 2010. Using this data has the benefits of being able to take both historic and current measures (i.e. pre and post quakes). Inland Revenue will continue monitoring the data until SMEs return to pre-quake 'normality', or it is obvious that a 'new normal' has been established.

¹⁰ Please note that the views, opinions, findings, and conclusions expressed by Inland Revenue staff do not necessarily reflect the views of the department.

An additional seven interviews were conducted in April 2013 by Inland Revenue's National Research & Evaluation Unit with contractors from New Zealand Contractors' Federation.

4. KEY FINDINGS FROM YEAR 1 (2012) AND YEAR 2 (2013) RESEARCH

This section looks at some of the main themes drawn from the last two years of research, including:

- the type and level of impact the earthquakes had on business activity and recovery
- what the 'new normal' might look like
- the extent to which the earthquakes changed business attitudes and behaviours with regard to tax compliance
- what impact the tax administration has had on mitigating long-term non-compliant behaviour.

4.1 Impact of the 2010 and 2011 earthquakes on businesses

Many businesses were adversely affected by the earthquakes. In 2012, business participants in the qualitative research commented that the quakes struck businesses 'blindly', and many suffered at different times and to different degrees over the long period of recurring earthquakes. Some businesses who were not affected by the magnitude 7.1 earthquake which occurred on 4 September 2010 suffered damage in the magnitude 6.3 earthquake on 22 February 2011.

Two thirds (67%) of business owners surveyed in 2012 reported having at least one business adversely affected by the earthquakes. Smaller SMEs, SMEs that were located in the central business district (CBD), SMEs that have experienced a decline in business income, and SMEs in the wholesale, retail and accommodation and food sectors, reported that they were more likely to have been negatively impacted by the earthquakes.

The qualitative research illustrates the difficulties that some business participants were experiencing one year on from the earthquakes. They spoke about the emotional effects of seeing their business failing.

Last year was emotionally hard. I lost half of my business. It was hard. I'm just coming to terms with it now. There's nothing positive ... (SME, hospitality)

They also spoke about the financial impacts arising from such things as keeping up with their tax payments and keeping their staff in employment.

What we bought [business] isn't here anymore, so we can't sell it. But we still have to pay tax. We'll foot the bill with personal money. (SME, hospitality)

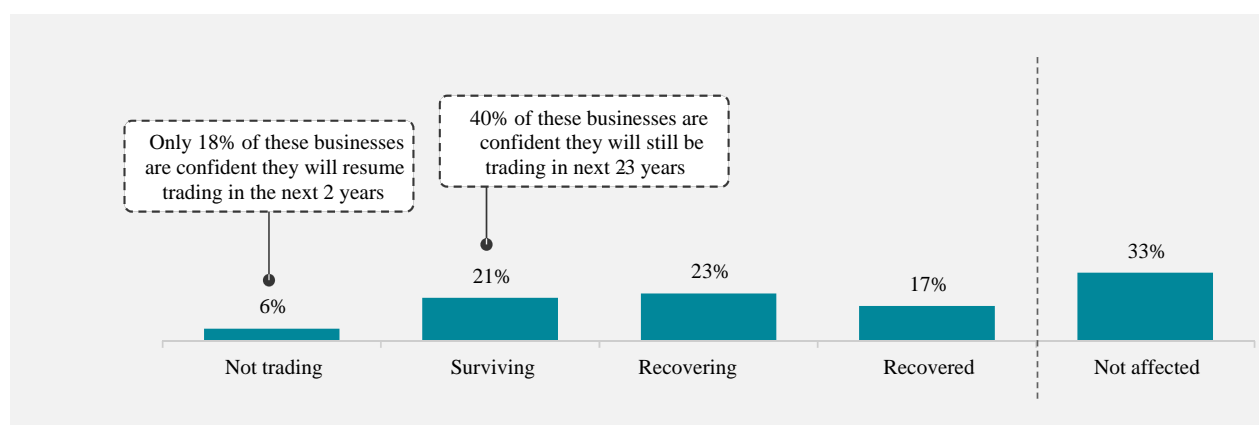
My priority is to survive today. My obligations are: pay my staff. I can't let them go. (SME retail)

4.2 Stages of recovery for businesses

Business impact and recovery following a disaster varies. As previously mentioned, a literature scan revealed that, generally, adverse events have two or three phases: prevention, response and recovery, but there is little specific research on the impact of adverse events on SME tax compliance behaviour. The research classified Canterbury in 2012 as being in the recovering phase and predicted that, with assistance, some small businesses would likely return to a growth phase. However, it was also expected that some SMEs would not recover, and Inland Revenue would need to take action (for example, closing down, bankruptcy, liquidation) to avoid the business getting into unrecoverable debt or increasing its debt level.

Figure 1 shows that business participants surveyed in 2012 are still in different stages of recovery one year after the February 2011 quake.

Figure 1: Business impact and stage of recovery.¹¹



Base: All SMEs (1,161)

SMEs are spread across different stages of recovery from the earthquakes:

- six per cent are currently not trading—only 18 per cent of these SMEs are confident that they will resume trading in the next two years
- 21 per cent are ‘surviving’ (that is, the business is focused on doing what it takes just to survive)—only 40 per cent of ‘surviving’ SMEs are confident that they will still be trading in the next two to three years
- 23 per cent are ‘recovering’ (that is, the business has passed the survival stage, but is still focussed on minimising the impacts of the earthquakes)
- 17 per cent have ‘recovered’ (that is, the business is as strong, or stronger, than before the earthquakes)

¹¹ The diagram and analysis is from Colmar Brunton and published in the Inland Revenue and Colmar Brunton Year 1 report <http://www.ird.govt.nz/resources/4/0/4025ff804f2dec32a019b460ef02f5a5/r-and-e-report-adverse-events-year-1.pdf>.

- 33 per cent were not adversely affected by the earthquakes.

Other key impacts of the earthquakes on SMEs are:

- 40 per cent of SMEs still trading experienced a decrease in their business income since before the earthquakes, 40 per cent have experienced no change in their business income and 18 per cent have experienced income growth. SMEs in earlier stages of recovery are more likely to have experienced a decrease in business income (81% in 'surviving' and 58% in 'recovering')
- 18 per cent of SMEs adversely affected by the earthquakes, but still trading, reduced their staff levels. Only eight per cent have increased their staff levels. 38 per cent of SMEs no longer trading employed staff prior to the earthquakes
- Around one quarter (26%) of SMEs affected by the earthquakes have moved location since the earthquakes (12% have moved multiple times)
- Only one quarter (24%) of SMEs that are currently located outside of the CBD, but were previously located in the CBD, plan to move back to the CBD once the rebuild provides an opportunity to do so. An additional 28 per cent are unsure of their future movements. Nearly half (48%) say they are relocated permanently outside of the CBD.

From interviews undertaken in Year 2 (2013) with stakeholders and Inland Revenue staff, participants expected SMEs to have resumed trading or to have closed down their business. However, they also acknowledge that some SMEs would be still struggling (for example, with re-location and insurance issues).

Based on these interviews, the SME recovery model¹² (from the Year 1 research) was reviewed to reflect the variety of situations SMEs were still experiencing in 2013. Figure 2 illustrates the revised recovery model.

¹² In Year 1, the 'failure vs growth' spectrum model showed that SMEs experienced different phases before reaching a growth phase. The linear model was: failure, loss, survival, recovery and growth.

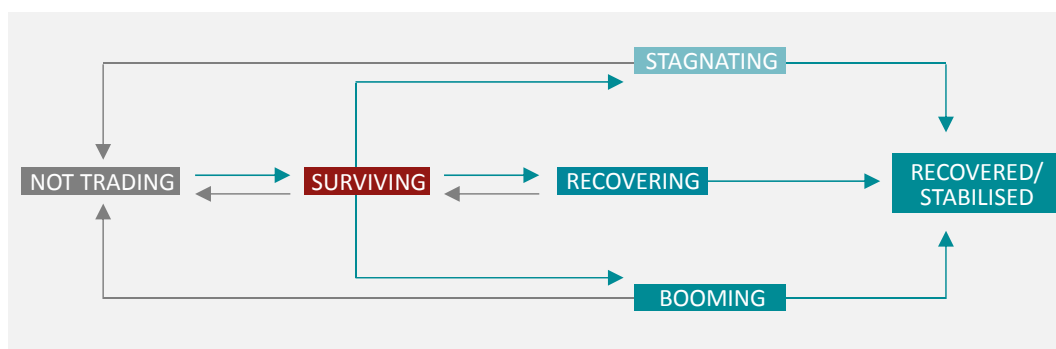
Figure 2: Year 2 recovery model¹³

Figure 2 shows the different stages of SME recovery after an adverse event:

- **Not trading:** This stage results *immediately* from the earthquakes. A variety of SMEs in different sectors found themselves unable to trade as a consequence of the earthquakes. Today, stakeholders and Inland Revenue staff believe that SMEs should not be in this stage anymore: they should have resumed trading or closed down. If SMEs are not trading today, stakeholders and Inland Revenue staff believe it is more likely due to other issues than the earthquakes themselves (for example, cashflow and insurance problems).
- **Surviving:** Some SMEs are still in this stage and struggle to resume regular business patterns (for example, business disruption through unexpected roadworks). They face financial difficulty (for example, irregular income, tax debt). This stage includes SMEs in a range of sectors.
- **Stagnating:** SMEs have resumed trading, but are unable to grow their business (e.g. due to limited foot traffic and online presence). Although their financial situation is better than in the Surviving stage, Stagnating SMEs still need to monitor their situation carefully. Their struggles result from dealing with the earthquakes' consequences (for example, insurance problems, roadworks and building assessment).
- **Recovering:** These SMEs have re-established regular business patterns and are in a better financial position to grow their business sustainably.
- **Booming:** A number of SMEs are experiencing exponential growth and feel financially secure. These SMEs need to ensure they have appropriate systems and processes in place to manage their rapid growth. In addition, this level of growth is unsustainable and these SMEs may face financial difficulty when the 'bubble bursts'. These SMEs are likely to be found in the building/construction sector, because of the rebuild, as well as in the hospitality sector (for example, café, bars and restaurants), because of the lack of competition.

¹³ The diagram and analysis is from Colmar Brunton and published in the Inland Revenue and Colmar Brunton Year 2 report <http://www.ird.govt.nz/resources/8/88b4bc8040b39c1b8111cbe0a6c6ba36/r-and-e-report-adverse-events-year-2.pdf>

- **Recovered/Stabilised:** Very few SMEs are in this stage, which is characterised by a solid business foundation and practices leading to sustainable business growth.

Stakeholders and Inland Revenue staff believe that some SMEs have reached business-as-usual (BAU), while others have not. Those who have reached BAU have re-established their business and seem to be doing well (for example, earning an income). These SMEs are in the Recovering and Booming stages, and in the future will be in the Recovered/Stabilised stage. However, the SMEs that have not reached BAU are still struggling to reach a business activity level that would give them financial security. These SMEs are in the Surviving and Stagnating stages. Stakeholders and Inland Revenue staff think that it will take three to four years for these SMEs to reach BAU.

Stakeholders and Inland Revenue staff discussed BAU at the industry level or Christchurch city level. In these cases, it would take even longer for industries and the city to reach BAU (five years and at least ten years respectively). Stakeholders and Inland Revenue staff expect that BAU for Christchurch city will be reached when the CBD is functional.

4.3 Factors that have influenced SME recovery

The first year research findings showed that for SMEs in Canterbury there are several stages of a recovery, and that assistance during the survival stage is critical for businesses. Stakeholders and Inland Revenue staff who were interviewed in Year 2 of the research (2013) were divided about SME recovery times and when SMEs reach BAU. Since the earthquakes, SMEs have experienced some enabling and hindering factors that have influenced their recovery. They are summarised in Table 1.

Table 1: Factors that have influenced SME recovery¹⁴

Factors	Characteristics
Enabling	External assistance (e.g. wage subsidy) SMEs' proactivity Having a business branch outside of Canterbury Business resilience Personal resilience of business owners
Hindering	Lack of clarity around the roles and responsibilities of the parties involved in the rebuild SMEs' insurance and financial difficulties

¹⁴ The table and analysis is from the Colmar Brunton (2013) Year 2 technical report and published in the Inland Revenue and Colmar Brunton Year 2 report
<http://www.ird.govt.nz/resources/8/8/88b4bc8040b39c1b8111cbe0a6c6ba36/r-and-e-report-adverse-events-year-2.pdf>

4.4 The extent the earthquakes changed business attitudes and behaviours with regard to tax compliance

A number of factors have impacted the tax compliance behaviour of SMEs across the stages of recovery from the earthquakes. These include:

- the priority the business places on tax compliance against other business priorities
- whether the business has appropriate and effective financial management and tax processes
- the use of cashflow to meet tax payments, as opposed to paying that from funds put aside.

These factors led to many businesses not meeting their tax requirements during the early recovery stage.

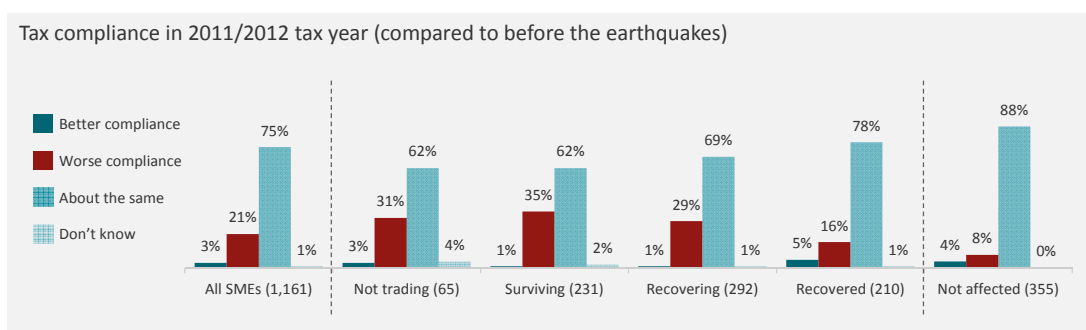
“Most people did nothing for some time after the earthquakes. It was a combination of trauma due to the quakes, and low anxiety about tax. People were not too worried about tax at the time.” (Interview 30 Tax agent)

4.4.1 SMEs' self-reported tax compliance in 2011/2012 (compared to before the earthquakes)

In the telephone survey, we also explored with SMEs how well they have been able to meet their tax obligations during the 2011/2012 tax year. ‘Meeting tax obligations’ was defined for respondents as whether the business filed its tax returns and paid its tax on time (or within any extensions of time given) and paid the correct amount (including any amounts agreed to as part of a payment arrangement). Respondents were then asked whether during the period of April 2011 to March 2012 their business was better, worse or about the same in meeting its tax obligations compared to before the earthquakes.¹⁵

¹⁵ The reader should note that this question is not measuring whether the business found it more difficult to meet their tax obligations. Rather the focus was on their end success or otherwise of filing and paying on time for the correct amount. Results for this question are presented by stage of recovery in the next chart.

Figure 10: Tax compliance in 2011/2012 tax year (compared to before the earthquakes)¹⁶



Source: Q5ci
Base: Varies – see graph

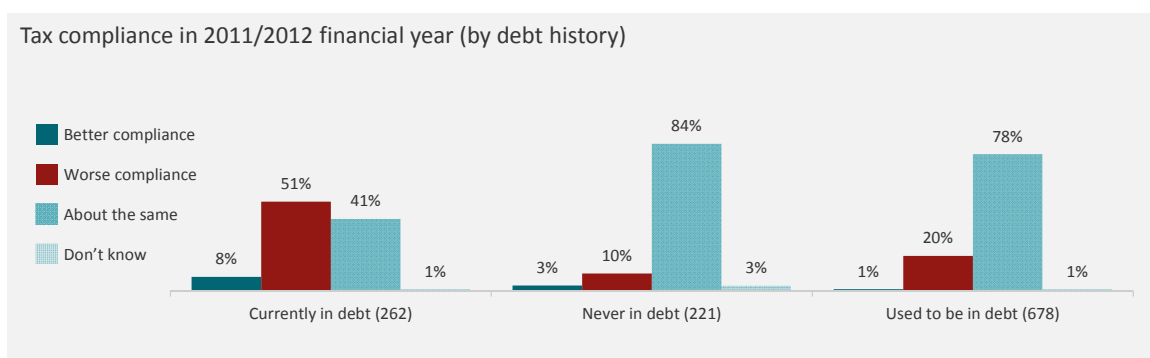
Around one in five SMEs (21%) indicated their business was worse at meeting its tax obligations during the 2011/2012 tax year than before the earthquakes. The majority (75%) said their compliance was about the same.

The degree of impact of the earthquakes on the business clearly has an impact on tax compliance. SMEs currently not trading or in the ‘surviving’ or ‘recovering’ stages are more likely to have worsened compliance (30% on average) compared to those who have recovered (16%) or were not affected (8%).

4.4.2 Impact of debt history on meeting tax obligations

Debt status is also a defining factor in tax compliance, with around half (51%) of those in debt in late 2012 indicating they were worse at meeting their tax obligations in 2011/2012 than before the earthquakes.

Figure 11: Tax compliance in 2011/2012 financial year (by debt history)



Source: Q5ci
Base: Varies – see graph

¹⁶ Figures 10 and 11 are from Colmar Brunton’s analysis, and published in the Inland Revenue and Colmar Brunton Year 1 report

<http://www.ird.govt.nz/resources/4/0/4025ff804f2dec32a019b460ef02f5a5/r-and-e-report-adverse-events-year-1.pdf>.

These factors are consistent with previous research on SME tax debt.¹⁷ However, in this research the earthquakes accentuate them, especially in the earlier stages of recovery (for example, 'surviving' stage). For instance, tax compliance becomes even less of a priority for SMEs. Likewise, the heavy reliance on cashflow is exposed as a poor strategy for tax compliance when income is unpredictably cut due to an adverse event.

The earthquakes compounded already poor tax compliance strategies, by introducing new factors such as damage to business premises and lost records.

There is limited evidence in the research that general attitudes towards tax have changed significantly one year after the earthquakes. Most business participants who were surveyed in 2012 agreed that they:

- accept responsibility for paying their fair share of tax (90%)
- believe paying tax is the right thing to do (86%)
- believe that by paying tax they are contributing to New Zealand society (80%).

These levels of agreement are similar to those evident among a national sample of SMEs in Inland Revenue's Customer Satisfaction and Perceptions (CS&P) survey (although the strength of agreement is somewhat weaker among Canterbury SMEs).

Few (8%) said that they resent paying tax. This level of resentment is lower than that among SMEs in the CS&P survey. It is possible that this lower level of resentment is tied to a belief that paying tax is important because it contributes to the Christchurch rebuild (65% of all SMEs in Canterbury agree with this notion).

Resentment that does exist among Canterbury SMEs largely stems from a belief that they pay too much tax, disapproval of how tax money is spent by government and a general sense of the tax system being unfair. However, none of these reasons appear to be unique to the Canterbury situation.

Stakeholders and Inland Revenue staff who were interviewed in 2013 (Year 2 of the longitudinal study) believe that attitudes have not fundamentally changed following the earthquakes. They explain that tax compliance is a mindset or a moral attitude, and as such is difficult to shift one way or the other.

Stakeholders and Inland Revenue staff consider that compliant taxpayers' fundamental attitude to tax compliance is unlikely to change, that is, these taxpayers believe that everyone needs to contribute their fair share of tax. With signs of the rebuild, people and SMEs are more optimistic about economic growth for the region and feel more positive about contributing to tax.

However, slight attitudinal shifts may occur in terms of relative priority for compliant taxpayers. For example, if they are forced to change from a long-term strategic business plan to a more short-term, functional approach to business. In addition, if people and businesses do not perceive much progress in the rebuild, they may lose confidence about the purpose of paying tax and contributing to the rebuild.

¹⁷ Poppelwell, Kelly, and Wang (2012). Intervening to reduce risk: identifying sanction thresholds among SME tax debtors. *E-Journal of Tax Research*, 10, 2, 403-435.

With regard to tax compliance behaviour, stakeholders and Inland Revenue staff note that it has changed following the earthquakes. Initially, SMEs were unable to file their returns and pay their tax because of the high levels of destruction (for example, buildings and records destroyed) and also personal injury and trauma.

In the months following the destructive earthquakes, some SMEs resumed filing their returns and paying their tax. For some, this involved setting up payment arrangements with the tax authority. However, some SMEs have continued deprioritising their tax obligations, either intentionally or accidentally.

SMEs at different stages of recovery may face more or less difficulty meeting their tax obligations. For example, Surviving SMEs are likely to have an irregular income, thus making it difficult to pay their tax. Recovering SMEs, however, earn a regular income and are more able and likely to meet their tax payments.

General attitudes towards tax tend to be more positive among SMEs in later stages of recovery from the earthquakes than SMEs in earlier stages of recovery (including those not trading).

However, the Year 1 survey findings indicate that many participants believe that businesses adversely affected by the earthquakes should be given tax leeway:

- around half (53%) of SMEs agree that businesses should not have to pay previous tax debts until they are fully operating again (with the remainder more likely to take a neutral stance)
- the notion of businesses adversely affected by the earthquakes paying a lower tax rate attracts a polarised response, with four in ten SMEs (41%) agreeing with this idea and around a quarter (28%) disagreeing.

The request for tax leeway can be explained by changes in ability to comply in that the tax compliance behaviour of SMEs has been impacted by the earthquakes both in the short term and the long term:

- seventy three per cent of tax agents say that more than three quarters (76% to 100%) of their business client base has stayed the same in terms of how well they meet their tax obligations. Likewise, the majority (75%) of SMEs said their compliance was about the same in 2011/12 compared to before the earthquakes. Cash reserves, savings (both personal and business), and adequate cashflow were important in enabling SMEs to meet their tax obligations
- just over half (54%) of tax agents say that up to a quarter (1% to 25%) of their business client base was worse in meeting their obligations in 2011/12 compared to before the earthquakes, with an additional 19 per cent of tax agents saying more than a quarter (26% to 100%) of their client base has got worse.

Around one in five of all SMEs (21%) indicate their business was worse at meeting its tax obligations during the 2011/12 tax year than before the earthquakes. Levels of worsened tax compliance are higher among:

- those in earlier ('surviving' or 'recovery') stages of recovery from the earthquakes (30% said their tax compliance was worse)

- those with declining business income (36% said their tax compliance was worse)
- those with debt in late December 2010 (50% said their tax compliance was worse).

Of the quarter (27%) of SMEs affected by the earthquakes that are currently trading and report experiencing a worsening in tax compliance since the earthquakes, 45 per cent expect to see an improvement in meeting their tax obligations by 2012/13 and 30 per cent by 2013/14, with the remaining 26 per cent not expecting to see an improvement by 2013/14 or being unsure. Irregular business patterns and the on-going earthquakes contribute to SMEs' uncertainty about their ability to meet future tax obligations.

5. MITIGATING THE EFFECT OF NON-COMPLIANT BEHAVIOUR FOLLOWING AN ADVERSE EVENT AND RESTORING PRE-DISASTER COMPLIANCE LEVELS

The qualitative research findings suggest that there are slightly different views on what constitutes 'hidden economy activity', with a range of perceptions from deliberate cash payments and non-declaration of income through to accidental paperwork errors (claiming for expenses that they shouldn't, or making mistakes). SMEs' definitions in turn drive their behaviour and attitudes on the acceptability of the behaviours and what is the appropriate response from Inland Revenue.

Large majorities of both SMEs and tax agents think that there either has been no change in hidden economy activity¹⁸ (69% and 64% respectively) or they are unsure (20% and 22% respectively). Business owners who perceive there has been a change are fairly evenly divided between those who think there has been an increase (6% of all SMEs) and those who think there has been a decrease (5% of all SMEs). Tax agents are more likely to think there has been a decrease (11%).

When prompted on what may have caused a change in the hidden economy, SMEs highlight the changes that are now unique to Christchurch—it is not 'business (and behaviour) as usual' which in turn drives attitudes and behaviour specific to the Christchurch environment. This can create more opportunities for hidden economy behaviour than previously.

Perceptions of an increase in hidden economy activity most commonly stem from recognition of financial pressures and competition, and a desire by smaller operators to cut corners and get the job done quicker. In the qualitative research findings, business owners distinguished between those who willingly deal with 'under the table' cash payments and those who, due to the general disruptions caused by the earthquakes, have or will inadvertently take part in the cash economy (for example, the need to use estimates if lost records cannot be recreated, or sloppy paperwork due to the business owner spending more time focusing on getting the business up and running again).

18 In the telephone survey, hidden economy activity was described to respondents as payments businesses receive for work completed that they do not declare for tax purposes. Respondents were further told that this included cash payments which are sometimes referred to as payments made 'under the table'.

Perceptions of a reduction in hidden economy activity most commonly stem from the involvement of professional organisations and the requirements of larger contracts, as well as a perceived increase in electronic transactions.

The tax administration taking a hard line in dealing with ‘under the table’ payments with fines and prosecution receives support from around half of SMEs (48%). While some disagree with this approach (16%), many hold a more neutral stance (30%). Tax agents are more strongly in favour of Inland Revenue taking a hard line approach (67%).

Relatively few believe that because of the earthquakes Inland Revenue should take a more lenient approach to ‘under the table’ payments (only 16% of SMEs and 5% of tax agents agree with this notion). However, only a small majority of SMEs (59%) disagree with this statement as some take a more neutral stance (21%).

In the qualitative research, SME owners suggested Inland Revenue use a softer/lenient approach during the survival phase as most SMEs are struggling. This includes educating and informing SMEs about appropriate business, financial and tax management versus cash, using an approachable and understanding manner that will enable business owners to ask for assistance if required, and communicating the option of payment arrangements to struggling SMEs. Inland Revenue is then expected to take a tougher/stricter approach during the recovery phase as SMEs should have resumed a regular, non-cash business pattern. Following education and advice about risks and consequences, SMEs expect audits and legal action, proceedings to be made public to discourage others, and Inland Revenue to proactively target SMEs/industries that are deemed at risk.

5.1 Assistance to SMEs

In the qualitative research, there was a perception that Inland Revenue responded to the earthquakes by offering the ‘usual’ assistance available to SMEs in compliance difficulty such as time extensions, waived penalties and payment arrangements. Inland Revenue further combined this with possibly increased proactivity, extending some of the provisions (for example, longer time periods than usual) and a sympathetic and helpful manner.

However, there is not a perception that there was an extraordinary ‘assistance package’ formulated in response to an adverse event.

Having said that, tax agents and SMEs are generally positive about Inland Revenue’s assistance and support during the earthquakes and feel that Inland Revenue was approachable, available, flexible and lenient, thus helping them to meet their tax obligations within the new context of their changing circumstances. Take-up rates of Inland Revenue’s assistance included:

- thirty seven per cent of all SMEs (or their accountants) received an extension of time for their business to file a tax return or make a payment (58% of those in debt late December 2010 received this)
- twenty one per cent of SMEs negotiated a payment arrangement for the late payment of tax

- fourteen per cent had penalties waived by Inland Revenue (43% of those in debt late December 2010 received this).

Large majorities (74% to 88%) of SMEs that received these types of assistance found them helpful. These forms of assistance enabled SMEs to address their immediate tax obligations and prevent them from incurring (sometimes additional) debt in the initial period following the earthquakes. However, there was a strong call in the qualitative research for support and assistance to be extended beyond the initial few weeks/months. Many SMEs are either still ‘surviving’ or feel they have only recently resumed a sense of ‘normal’ business.

SMEs appreciated the range of communication channels Inland Revenue used to let business owners know what to do if their business had been affected by the earthquakes. Only a minority of SMEs had direct contact with Inland Revenue: 19 per cent of SMEs phoned Inland Revenue, Inland Revenue phoned 12 per cent of SMEs, and just four per cent had face-to-face contact.

Recall levels of the more generic communication channels were higher: 45 per cent recalled the letter, 45 per cent recalled the advertisement and 33 per cent visited Inland Revenue’s website.

Face-to-face contact is viewed especially favourably (82% of those who had face-to-face contact found it helpful) as it enabled business owners to address their concerns, discuss the complexities of their situation, seek clarification and receive reassurance that they are doing the right thing.

Ratings of the other forms of contact and communications were not as high, with around half (or a little more) of recipients indicating they were helpful (many of the remainder gave a neutral rating). Key issues were a perceived drop off in Inland Revenue’s interest and understanding (evident in phone calls to Inland Revenue), as well as a decrease in the frequency of updates on the website, once a slowdown in earthquakes occurred.

The main suggestions for improving Inland Revenue’s overall approach to providing support and assistance during the survival stage of an adverse event are to provide a more ‘extraordinary response’ rather than an improved BAU response. This means, for example:

- greater profile and visibility in the community with the opportunity for face-to-face contact
- increased proactivity with Inland Revenue contacting SMEs (by phone), rather than the onus on SMEs to make the contact. Relying on SMEs to contact Inland Revenue means it may not happen as SMEs deprioritise tax or fear Inland Revenue’s response
- not sending automated, generic letters and statements. These often contradicted what business owners had agreed with their tax agents or Inland Revenue and caused some SMEs considerable anxiety
- additional assistance to sole traders. Smaller SMEs are more likely to have been adversely affected by the earthquakes than larger SMEs. The qualitative research suggests sole-traders wanted more personalised communication or

targeted information, especially if they did not have a tax agent. They felt that Inland Revenue's assistance was primarily aimed at employers.

5.2 Assistance to tax agents

As an authoritative intermediary between SMEs and Inland Revenue, tax agents play a critical role in supporting SME survival and recovery from the earthquakes and maintaining SME compliance behaviour. Over half (57%) of tax agents said they have been more involved in the financial management of their business clients since the earthquakes.

There has been a strengthening of relationships, negotiations and trust between Inland Revenue and tax agents, with face-to-face meetings being particularly helpful.

Tax agents report that the interventions provided by Inland Revenue directly to tax agents have been helpful to them professionally (managing their own workload) and to their SME clients. The most useful interventions have been:

- time extensions
- payment arrangements and penalties waived
- ability to negotiate what is provided and when
- use of estimates when lost records could not be recreated or duplicated.

Tax agents believe extensions of time, payment arrangements and the waiving of penalties continue to be important for SMEs in recovery. Tax agents also made suggestions about improving relationships through the provision of locally-based staff (see previous comments about visibility) and/or dedicated staff who were completely up-to-date with the situation in Christchurch.

Stakeholders and Inland Revenue staff are generally very positive about the diverse assistance Inland Revenue provided to SMEs. They believe it has been helpful to SMEs' recovery. Inland Revenue has been approachable, flexible and friendly, thus enabling SMEs to address their tax issues. This has also resulted in Inland Revenue's profile and reputation being lifted in the community.

However, stakeholders and Inland Revenue staff explain that struggling SMEs may have found it difficult to remain compliant because of the problems faced by their business (for example, irregular income and insurance issues). These SMEs need to reprioritise their tax obligations as soon as possible with Inland Revenue's personalised assistance. Stakeholders and Inland Revenue staff believe that non-compliance is unacceptable, but Inland Revenue needs to use its discretion to help SMEs address their tax obligations.

Surviving SMEs still require some specialised assistance from Inland Revenue to move to the Recovering stage. Stakeholders believe that Inland Revenue needs to assess each struggling SME's situation on an individual basis. Both stakeholders and Inland Revenue staff believe that a thorough evaluation of SMEs' viability is key to understanding if these SMEs can recover, and what type of assistance they require.

Some stakeholders and Inland Revenue staff recognised that Inland Revenue's leniency was helpful to SMEs during the earthquakes. However, they believe that,

today, Inland Revenue's leniency has become unhelpful to those SMEs that do not feel a sense of urgency to become compliant. These stakeholders and Inland Revenue staff believe a 'deadline on leniency', which can be revisited, is required.

6. LEARNINGS

6.1 A new sense of normality in Christchurch

The 'new normal' is vastly different from 'the normal' that people and businesses knew prior to the earthquakes. The following factors explain what has changed in Christchurch to create this new sense of normality:

- the rebuild is about recreating a place and a sense of place from scratch rather than renovating
- the rebuild is a journey rather than a point in time and the new sense of normality is achieved gradually through this journey. It is an incremental process of change and stakeholders and Inland Revenue staff are unable to pinpoint a specific point in time when it started
- underlying anxiety about more earthquakes.

Many stakeholders and Inland Revenue staff believe that Inland Revenue needs to return to BAU now and apply its practices of educating, investigating, following up, auditing and prosecuting. One person felt that Inland Revenue returning to BAU is a necessary part of helping SMEs return to better compliance levels, and decreasing hidden economy activity.

The place won't ever recover if we continue to treat it as broken. (Interview 33, Inland Revenue)

To mitigate the hidden economy, some stakeholders and Inland Revenue staff suggest that Inland Revenue develop social marketing campaigns to increase understanding of the tax obligations, and 'goodwill' about contributing to the rebuild.

They expect that these campaigns would increase compliance and reduce participation in the hidden economy. Stakeholders and Inland Revenue staff feel that, today, non-compliance has become even more unacceptable, as the destructive earthquakes were over two years ago, and SMEs should now be able to meet at least some of their obligations (for example filing returns).

Should SMEs remain non-compliant or take part in the hidden economy, stakeholders and Inland Revenue staff want Inland Revenue to make an example of these SMEs to show that Inland Revenue applies the rules and to deter SMEs from non-compliance and hidden economy activities.

However, stakeholders and Inland Revenue staff also emphasise that Inland Revenue needs to be flexible and use its discretion with SMEs that are still struggling and require assistance. This needs to be evaluated on a case-by-case basis. The key is that Inland Revenue needs to be consistent.

6.2 SMEs' creativity and innovation have flourished

Stakeholders and Inland Revenue staff believe that creativity and innovation have flourished since the earthquakes. In some cases, employees from large companies have left to start up their own businesses.

It has provided a springboard for smart, innovative people to create their own companies. So, we've got quite a lot of individuals who might have been working for, say, Fulton Hogan or some of the bigger companies, who've gone out and created, started up their own company and are doing well out of it: minimal overheads, [they] have some good skills, and so there's a great opportunity for companies like that. (Interview 45)

In other cases, businesses have had to rethink how to do things.

We've been able to do things that we weren't really good at ordinarily, like live music. We've had a lot of live music going on in the evenings, just because there was nowhere. So, we were really busy with that. (Interview 22)

Some businesses whose premises were destroyed have had to come up with new premises quickly, and some have set up an online presence instead of relying solely on foot traffic.

Some [business people] are smarter, more creative. They have reopened in a [shipping] container. And people [customers] are more accepting. (Interview 4, SME, hospitality)

6.3 Decreased competition for some SMEs

In different industries, SMEs have seen competition levels change due to the earthquakes. Some SMEs have benefited from the demise of their competitors and have thrived, regardless of how much the earthquakes have affected them.

I think the survivors did really well, most businesses, because there were fewer of them. There's less restaurants, there's less hotels, there's less accommodation, so everyone that is up and standing is doing really well and they still are. (Interview 3)

For some SMEs, business growth has been incremental while for others it has been exponential.

We can't get enough vans to meet up with demand. (SME, retail)

Over time, this new sense of normality has been strengthened because:

- the earthquakes have decreased in number and intensity
- many SMEs have resumed trading
- some level of disruption is tolerated (for example, roadworks)
- it feels like a long time since the earthquakes. People and SMEs have to 'get on with their life'

- today the rate of business creation and de-establishment is similar to what it was prior to the earthquakes.

Throughout [the earthquakes and after], they [births and deaths of SMEs] dropped away a little bit to begin with, but actually they came back quite quickly, and now births and deaths and failures are very similar to where they were [prior to the earthquakes]. Obviously, there's been some loss of retail, permanent loss of retail, tourism and accommodation in particular, and those will come back over time. But that's been offset by booms in construction, procurement, you know, supply chain kind of markets as the rebuild really kicks in. (Interview 44)

6.4 The earthquakes have built a stronger community spirit and sense of resilience

Throughout the ordeal, people and businesses have become a lot more supportive of each other. They have come together to restore the city and their business. Stakeholders and Inland Revenue staff believe that this sense of 'togetherness' will help rebuild a better and stronger Christchurch. They want the city to thrive again and grow economically.

Since the earthquakes, people and businesses that are outside of the 'old boys' network' have had to become less insular and more open to professional advice and business connections outside of Christchurch/ Canterbury. For example, SMEs recruit skilled and experienced staff from outside of Canterbury and overseas. This may help people and businesses get back into 'business mode' more rapidly with this new external support.

6.5 More co-operation between SMEs and between government agencies

Stakeholders and Inland Revenue staff observe that SMEs in Canterbury tend to co-operate more today. For example, hairdressers and architects whose salon and office were destroyed now share the same business premises. Business people, through professional organisations and business networks, help each other despite being competitors. SMEs have created a new 'business dynamic' unique to Christchurch and are more reliant on each other.

I know from my association with the local Institute of Architects that we formed a little committee to find out who needed help ... There's a real professional bond, I suppose. Different practices [worked] in other firms. I mean, we made an offer for other firms that they could come and use our space here, use our facilities, and a lot of firms went and worked from home on a temporary basis. Some firms did join ranks and work together. So no, there's no professional jealousy. It was basically a lot of collaboration and professional help and guidance. (Interview 9)

More co-operation also exists between government agencies and other organisations. For example, Inland Revenue and the Ministry of Social Development (MSD) shared work premises and have provided more coordinated assistance and information to SMEs. Inland Revenue's and MSD's collaboration has been more effective and productive for assisting SMEs.

I sense a really good collaboration. Across government and the business sector people are willing to share and open together. If you look at us, this is Corrections, so they're with us as well. There's willingness for people to give it a go and share things that traditionally they won't, and I think that's good for business. (Interview 29)

6.6 Learnings for a tax administration:

- Visibility and proactivity are important.
- A tax administration's actions need to match the different stages of a disaster and the stage of recovery a business is at.
- More awareness that the 'surviving' timeframe is variable from business to business.
- A more tailored approach is needed for businesses that are recovering.

7. CONCLUSION

7.1 In the short-term adverse events can impact on business tax compliance but not necessarily on attitudes towards meeting tax obligations

Due to the lack of a benchmark study, the research is limited in its ability to fully answer the question on whether attitudes towards tax have changed. However, research findings to date suggest there has not been a major shift in attitudes towards tax compliance. The vast majority of SMEs in Canterbury exhibited positive attitudes towards tax one year after the February 2011 quake. However, there is an expectation that businesses should be given tax leeway to help recover from the earthquakes.

Regarding their tax compliance behaviour, the research notes that SMEs were initially unable to file returns or pay tax due to their buildings and records being destroyed but also personal injury and trauma.

The administration data shows that tax compliance behaviour has worsened for some SMEs, and business and tax agent participants in Year 1 reported that their compliance behaviour had worsened following the earthquakes. Restoring good tax compliance behaviour may require the tax authority to encourage SMEs to get back into the habit of filing and paying tax so that these behaviours once again become routine.

Filing and payment compliance began to improve in the months following, and while some SMEs set up payment arrangements with Inland Revenue others continued to intentionally or unintentionally deprioritise their tax obligations. This may be due to the stage of recovery they were in—for example, SMEs earning a regular income are more capable and likely to pay tax than those with irregular income.

A corollary of this is the leniency Inland Revenue showed SMEs after the earthquakes. Some stakeholders interviewed believed this “has become unhelpful to those SMEs that do not feel a sense of urgency to become compliant” and that “Inland Revenue needs to return to BAU now and apply its practices of educating, investigating, following up, auditing and prosecuting. This will not only help SMEs return to better

compliance levels, but also help decrease hidden economy activities” (Inland Revenue & Colmar Brunton, 2013).

7.2 Learnings for tax administrations for future adverse events

The approach towards the hidden economy during the ‘survival’ stage is bound up with the type of response and interventions that a tax administration should take towards all tax non-compliance. A case-by-case approach is needed where the tax administration should be proactive, helpful, compassionate and lenient towards businesses whose lack of compliance is outside of their control or a ‘genuine’ error/oversight, while taking a hard-line approach to ‘deliberate’ tax avoidance.

Once SMEs have returned to a more regular business pattern (recovering and recovered), most SME participants believe that the tax authority should be tougher and more proactive in dealing with the hidden economy. SMEs’ suggestions are similar to previous debt research, in that deliberate tax avoidance requires enforcement.

The suggestions that stand out as slightly different in an adverse event situation are for the tax authority to be more visible in the community, meet with businesses face-to-face, build relationships, provide reassurance and apply more individual and tailored interventions and solutions.

Many of SMEs’ and tax agents’ suggestions for communication would also be appropriate in a BAU context. However, in extraordinary situations and while in the survival phase, SMEs and tax agents suggest more extraordinary communication. SMEs and tax agents need the tax authority to increase its visibility (for example, face-to-face) and to be proactive for an extended period of time and provide a more individualised/tailored approach, while reducing generic communications such as automated letters.

One of the key learnings of the research is that the ‘surviving’ timeframe is very variable from SME to SME and depends on a number of factors, for example, the nature and timeframe of the event itself, the extent of disruption to the business and industry demand. This means that a tax authority’s response and interventions will need to be tailored to the SME’s circumstances, rather than a more generic ‘survival’ response. The research suggests a survival timeframe anywhere on a spectrum of a few weeks, to 18 months or beyond.

Surviving is typified by using both personal and business resources to continue trading, generating revenue and/or cover costs. It seems that SMEs in the surviving phase oscillate between moving towards either ‘loss’ and failure of the business or eventual ‘recovery’. Many of the environmental factors and SMEs’ decision-making that sway the balance one way or the other will be outside of the tax administration’s control, but it would appear that proactive assistance of the tax administration (and tax agents) could be a tipping point factor to avert failure. The timing of this assistance will be critical and will need to include some objective measures of the likelihood of the intervention sustaining the business into recovery, or only staving off deepening debt and inevitable failure.

Surviving/recovering transition is likely to be based on personal and business resilience, environmental factors (for example, being in an industry that is in demand) and key interventions such as payment arrangements, waiving penalties, providing

time extensions etc. that enable the SME to financially re-establish itself. SMEs that are recovering may need close tax management to ensure that re-establishing tax compliance is as high a priority as re-establishing the business, for example, ensuring that reinvesting in the business, paying staff and suppliers etc. is not to the detriment of tax compliance.

SMEs may recover to a point where their financial position matches or even exceeds that prior to the adverse event. Some tax agents have suggested that SMEs that are recovered (and in growth) may also need close tax management to ensure that both their current and forward tax payments are accounted for. SMEs that are in growth industries may get themselves into a 'busy cycle', meeting new demands and accounting/financial management needs that may be more typical of a 'new' business, that is, they need to up-skill their financial and tax management to meet the new demands such as a growth in staff numbers, more invoicing etc.

A tax authority's response and interventions will need to be tailored to the SME's individual circumstances. This will ideally require close liaison between the authority and tax agents to determine which stage of recovery a business is at. Regardless of the stage of survival or recovery, it would appear to be critical for the tax authority to proactively contact these SMEs to ensure that they are maintained within the 'system' and ensure that there is an active plan in place to manage tax requirements. For SMEs that have become less visible (for example, the tax authority does not have up-to-date contact details), there may need to be some encouragement for SMEs to come forward (with no risk of penalty) so that a joint strategy/plan can be implemented.

8. NEXT STEPS

The research to date has been used by Inland Revenue as a general barometer of where businesses are at in terms of recovery and compliance. Specifically, it has used the research to inform government Ministers of the different stages of recovery of businesses when considering removing the Orders in Council that provided relief after the earthquakes.

The research has also identified the risk areas in Christchurch and, as it continues, the other benefit is in understanding what is actually happening to businesses and how SMEs were managing, and determining how a tax administration might address compliance issues identified or how to promote further voluntary compliance. The information has also influenced the Canterbury Earthquake Recovery Authority's (CERA's) work programme, which now has a stronger focus on existing businesses and investors than it otherwise might have.

In Year 3 of the study (2014) researchers will follow-up with the SMEs and tax agents who participated in the 2012 benchmark research. The research will revisit how the prolonged nature of recovery has impacted on SME compliance behaviour, how Inland Revenue tried to mitigate it, and how we can learn from this.

In addition to identifying the long-term implications for Canterbury and the rest of New Zealand, findings from the study will form a body of information that will help tax administrations and other government agencies inform future strategies, and develop a framework for managing compliance behaviour following an adverse event.

9. APPENDICES

9.1 Appendix 1: Key definitions

Adverse events

When events have large-scale adverse consequences for individuals, organisations and communities they become disasters. The more the event results in unravelling the community fabric, the greater the disaster and the harder it is for recovery to occur (Alesch & James, 2007; Alesch et al, 2001). The defining feature of such an event is a loss of productive capacity that is sufficiently large in relation to the income and wealth of the affected country that it reduces national consumption and welfare (Phaup & Kirschner, 2009). Disasters have a great impact on large concentrations of people, activity and wealth. Their effects spread beyond the region originally affected and they can generate widespread anxiety (OECD, 2004).

Small and Medium-sized Enterprises (SMEs)

For this project, SMEs are:

- All entities with an active relationship for GST or PAYE that do not belong to large enterprises or non-profit organisations, and
- All non-individual entities without active registration for GST or PAYE not belonging to non-profit organisations.¹⁹
- Enterprises with less than \$100 million GST turnover annually.

Locations

- The Canterbury Region is defined based on the Inland Revenue Christchurch District Office area which includes the Kaikoura, Hurunui, Waimakariri, Selwyn, and Christchurch City Councils.



¹⁹ <http://www.ird.govt.nz/aboutir/external-stats/tax-statistics-terms-definitions.html>

9.2 Appendix 2: Methodology

Research questions

Based on the project's four key objectives or overarching questions, the research questions are:

In what ways and to what extent have the earthquakes impacted on SME tax compliance?	What is the mechanism by which the earthquakes have an impact on SME tax compliance?	How have the actions of Inland Revenue affected that impact?	How should Inland Revenue act to get the best compliance result when adverse events occur?
<p>What are the recovery times before 'business as usual' is restored?</p> <p>How can Inland Revenue identify/ recognise signs of 'normality' (pre-quake activity)? (This will include a comparison between 'old normal' and 'new normal').</p> <p>How long does it take to return to SME compliance behaviour at pre-quake levels, if at all?</p> <p>To what extent have the Canterbury earthquakes changed SMEs' attitudes and behaviours with regard to tax compliance?</p>	How could Inland Revenue influence SME post-quake attitudes and behaviour to return to pre-quake tax compliance acceptable levels?	<p>What impacts did Inland Revenue's presence, its communication flow at various phases, and the assistance package have on maintaining SME compliance behaviour?</p> <p>Did Inland Revenue's presence or actions have a positive impact on business survival and recovery and did it prevent long-term tax debt?</p>	<p>What is the level of acceptable SME tax behaviour and can Inland Revenue mitigate the effect of non-compliant behaviour to reduce the 'acceptability' of committing hidden economy activity and restore pre-disaster compliance levels?</p> <p>What have we learnt from this event?</p> <p>Can these learnings be applied as part of the future response plan for sudden adverse events?</p>

Method

A combination of qualitative and quantitative research methodologies were employed for both Year 1 and Year 2 of the research. In Year 1, qualitative research was conducted first to explore the subject matter in-depth and provide a diagnostic understanding of the issues. Quantitative research was then conducted to measure the extent to which perceptions and self-reported behaviours exist in the SME and tax agent populations. Detailed discussion of each methodology employed is provided below.

Out of scope and linkages

This longitudinal study does not include the design of interventions and also excludes risk and assessment analysis (although it will provide robust information to underpin future strategies).²⁰ This research will complement social, economic wellbeing and natural hazard research that is currently being undertaken by other government and non-government agencies.

Qualitative research

The qualitative research consisted of 30 in-depth individual interviews with SME owners (21) and tax agents (nine), as well as one focus group with Inland Revenue staff based in Christchurch. Interviews were around 1 ½ hours in length and were

²⁰ Although out of scope, economic measures identified in Brondolo's 2009 IMF paper '*Collecting taxes during an economic crisis: Challenges and policy options*' do provide us with some ideas, factors of influence and measures of change.

mainly conducted at the business's premises. All of the qualitative fieldwork was conducted during April, 2012. A semi-structured discussion guide was used to elicit business owners' responses while providing them with the freedom to explore the topic from their own distinct perspectives.

Sample

A range of SMEs were recruited according to four key criteria:

- Size: from sole trader to medium-sized SMEs (20 employees).
- Industry: building, retail, hospitality and agriculture (note, the agricultural industry was included to act as a control group as the impact of the earthquakes on this industry was felt to be more limited).
- Activity level: growing, dormant and declining.
- Location: Christchurch Red Zone, Greater Christchurch and Canterbury (e.g. Kaiapoi).

In the final sample:

- The majority of SME owners used a tax agent.
- All SMEs had different levels of business turnover compared to before the earthquakes.
- The focus was primarily on SMEs that have been affected (to varying degrees) by earthquakes and had experienced a change in tax compliance as a result.
- The tax agents were located in the Red Zone, Greater Christchurch or Canterbury, and varied in size from sole practitioner to large firms.

For the focus group, Inland Revenue contacted and internally recruited key local staff that had played an active role throughout the crisis (e.g. assisting SMEs and tax agents with information and support).

Quantitative research

The quantitative research consisted of a telephone survey of 1,161 SME owners and 100 tax agents in the Canterbury region. Fieldwork was conducted from 21 June to 31 July 2012.

Questionnaire development

The questionnaire was developed by Colmar Brunton in close consultation with the researchers from Inland Revenue's National Research & Evaluation Unit. Two rounds of questionnaire testing were undertaken:

- Six cognitive face-to-face interviews were conducted with respondents to qualitatively pre-test the survey questions (five of the interviews were with SME owners and one interview was with a tax agent).
- The revised questionnaire was then piloted with 16 respondents to test the survey processes, interview length, and provide further feedback on the questionnaire.

A small number of changes were made to the questionnaire following each round of testing. A copy of the final questionnaire used for the main fieldwork is appended to this document. The average interview lengths were 14 minutes (for SMEs) and 13 minutes (for tax agents).

Sampling approach

Contact lists were provided by Inland Revenue for sampling respondents.

The sample was stratified by a customer's tax debt history status and business size. A disproportionate sampling approach was undertaken that increased the number of interviews with employers and those who had current debt (in December 2010) so that sufficient numbers of interviews were conducted in these key subgroups of interest to allow for statistically robust comparisons between groups.

At the analysis stage, the data have been weighted to ensure that the sample reflects population characteristics in terms of business size and debt history status.

The table below provides a profile of the total sample (using both unweighted and weighted data).

Table A.1. Total sample profile by weighted and unweighted data

	Unweighted data		Weighted data	
	n=1,161	%	n=1,161	%
Business size				
sole traders	450	39%	879	76%
1-5 employees	337	29%	180	15%
6-19 employees	278	24%	78	7%
20+ employees	96	8%	24	2%
Debt history status (December 2010)				
Currently in debt	262	23%	152	13%
Never in debt	221	19%	316	27%
Used to be in debt	678	58%	693	60%
Location (December 2010)				
CBD	151	13%	145	13%
Rest of Great Christchurch	691	60%	687	59%
Rest of Canterbury	319	27%	329	28%
non CBD	1,010	87%	1,016	87%
Use of a tax agent				
Tax agent	842	73%	779	67%
no tax agent	319	27%	382	33%
Industry				
Primary	156	13%	182	16%
Agriculture, Forestry and Fishing	155	13%	182	16%
Mining	1	0%	0	0%
Industrial	264	23%	229	20%
Manufacturing	104	9%	69	6%
Electricity, Gas, Water and Waste Services	7	1%	12	1%
Construction	153	13%	148	13%

<i>Distribution</i>	233	20%	190	16%
Wholesale Trade	81	7%	73	6%
Retail Trade	113	10%	77	7%
Transport, Postal and Warehousing	39	3%	41	4%
<i>Business and finance</i>	90	8%	132	11%
Financial and Insurance Services	16	1%	18	2%
Rental, Hiring and Real Estate Services	74	6%	114	10%
<i>Service</i>	418	36%	428	37%
Accommodation and Food Services	85	7%	70	6%
Information Media and Telecommunications	12	1%	20	2%
Professional, Scientific and Technical Services	128	11%	148	13%
Administrative and Support Services	67	6%	64	5%
Public Administration and Training	4	0%	4	0%
Education and Training	20	2%	26	2%
Healthcare and Social Assistance	28	2%	26	2%
Arts and Recreation Services	16	1%	20	2%
Other Services	58	5%	50	4%

Base: All SME respondents

Source: Inland Revenue sample

Response rates

The overall response rates to the surveys were 35% for SMEs and 42% for tax agents.

Margins of error

The table below provides estimated margins of error for key groups used in the analysis. All margins of error have been calculated at the 95% confidence level.

Table A.2 Maximum margins of error

	n=1,161	Maximum margin of error
All tax agents	100	+/-9.8%
All SMEs	1,161	+/-3.8%*
Business size		
sole traders	450	+/-4.6%
1-5 employees	337	+/-5.3%
6-19 employees	278	+/-5.9%
20+ employees	96	+/-10.0%

Debt history status		
Currently in debt (December 2010)	262	+/-6.1%
Never in debt	221	+/-6.6%
Used to be in debt	678	+/-3.8%

*The margin of error associated with the total sample of SMEs takes into account the 'effective sample size' (which takes into account weighting effects).

Extensive subgroup analysis has been carried out throughout this report. All differences noted in the written commentary are statistically significant at the 95% confidence level (unless otherwise stated) and assume simple random sampling.

Notes to the reader

Some of the analyses of the quantitative data use variables that Inland Revenue provided as part of the sample. These variables include the following:

- Debt history status (currently in debt, used to be in debt, never in debt) – as per Inland Revenue's records in December 2010.
- Business size (sole trader, 1-5 employees, 6-19 employees, 20+ employees) – as per Inland Revenue's records in December 2010.
- Location (CBD, rest of greater Christchurch, rest of Canterbury) – as per Inland Revenue's records in December 2010.
- Tax compliance (payments) – as per Inland Revenue's records during 2004 to 2009. Note, this variable has only been used in Section 2 of this report in the context of assessing whether attitudes towards tax differ by tax compliance history.

10. QUALITATIVE METHODOLOGY FOR YEAR 2 RESEARCH

This research project consisted of 50 in-depth individual interviews conducted face-to-face in Christchurch and over the telephone. One of these interviews was paired, i.e. it involved two respondents.

1 Sample

The project advisory group and research team identified 39 stakeholders and 11 Inland Revenue staff as instrumental to this project. These respondents are knowledgeable and experienced in their respective sector of activity. They have a good understanding of SMEs within the sector and give their views on SMEs' situations throughout the report. Please note that the views, opinions, findings, and conclusions expressed in this report do not necessarily reflect the views of Inland Revenue.

All respondents were based in Christchurch. Table A.3 provides a breakdown of the organisations participants are from.

Table A.3 Breakdown of the organisations who took part in Year 2

Sector of activity	Organisations
Building/construction and manufacturing	Interviews 1-8 (eight interviews involving six organisations)
Design and architecture (consultancy and project management)	Interviews 9-15 (seven interviews involving seven organisations)
Finance (investment and tax)	Interviews 16-19 (four interviews involving four organisations)
Hospitality and tourism	Interviews 20-23 (four interviews involving four organisations)
Retail and services	Interviews 24-28 (five interviews involving five organisations)
Government organisations and infrastructure	Interviews 29-43 (15 interviews involving five organisations, including Inland Revenue)
Business and professional organisations	Interviews 44-50 (seven interviews involving seven organisations)

Note: some stakeholders and Inland Revenue staff do not want to be identified; therefore we have provided minimal identifier details.

2 Fieldwork

Inland Revenue's National Research & Evaluation Unit commissioned Colmar Brunton to conduct the interviews during February and March 2013. The interviews were up to one hour in length. Most interviews (34) were conducted face-to-face at the respondent's business premises in Christchurch, the remaining 16 were conducted over the telephone.

A semi-structured discussion guide was used to elicit stakeholders' and Inland Revenue's staff's perceptions while providing them with the freedom to explore the topic from their own distinct perspectives.

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Tax professionals' perception of tax system complexity: Some preliminary empirical evidence from Portugal

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Abstract

This paper analyses tax professionals' (*TOCs*) perception of tax complexity within the Portuguese fiscal system.

This study is relevant to the international tax literature research for two reasons. Firstly, its intention is to determine the dimensions of the endogenous causes of tax complexity, creating indices of these causes using the Principal Component Analysis (PCA) method. Secondly, it aims to identify the factors that could influence the level of tax complexity perceived by *TOCs*.

In 2013, a survey was conducted in Portugal to evaluate *TOCs*' perception of tax complexity. This paper presents the results collected from 994 questionnaires responded to by *TOCs*. The survey findings concluded that *TOCs* perceived three dimensions of causes of tax complexity: «Legal Complexity»; «Complexity of Preparation of Information and Record Keeping»; and «Complexity of Tax Forms». The exogenous factors include tax knowledge, with a negative effect, and size of companies, with a positive effect on *TOCs*' perception of tax complexity. Understanding these relationships can be a key issue for tax policy makers, in order to reduce their negative effects on the perception of tax complexity. Therefore, this paper contributes to the international tax literature by presenting empirical evidence concerning the dimensions of tax complexity.

Keywords: Legal Complexity; Compliance Complexity; Tax Complexity Indices; Tax Professionals

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1. INTRODUCTION

In recent decades, tax systems have become more complex, particularly for many countries⁵ that have implemented the self-assessment tax system. Under this system, taxpayers are given greater responsibility for handling their own tax affairs and complying with their tax liabilities. Some taxpayers may not be able to cope with these responsibilities. As a result, many of them seek the help of tax professionals,⁶ who play key roles in many tax systems. In the case of the Portuguese tax system, the role of tax professionals is extremely important in the context of business tax, which are calculated and collected through authorised tax professionals, the *TOCs* [*Técnicos Oficiais de Contas*].

In Portugal, *TOCs* deal with tax complexity on a daily basis. It is they who are most acquainted with and knowledgeable about the problems arising from tax complexity. 89.1 per cent of *TOCs* perceived the Portuguese tax system as having a high level of complexity.⁷ Thus, it is important to know in greater detail the perceptions of tax professionals regarding tax complexity and the factors that could influence their perception of this. The findings of this study could be used by policy makers in order to minimize tax complexity and its negative effects on revenue collection.

To gain more insights regarding the views of *TOCs* concerning the Portuguese tax system, a survey was conducted to assess their perception for the 2012 tax year. This paper presents some of the findings from the statistical analysis of the data collected from the 994 questionnaires responded to.

It is also crucial to know how *TOCs* divide the direct (endogenous) causes of tax complexity into dimensions, and how they classify these causes by order of complexity. There are many limitations to the simplification of the endogenous factors of tax complexity. Arguably, some levels of tax complexity are necessary, due to the need to reconcile the various goals⁸ of a good system and to maintain equity, and as a consequence of the complex international economic environment (McKerchar, Meyer & Karlinsky, 2008). In this context, it is also important to be acquainted with and have an in depth understanding of the exogenous factors that could influence *TOCs*' perception of tax complexity.

The aim of this study is twofold. Firstly, it aims to determine the dimensions of the causes of tax complexity perceived by *TOCs* and to understand the endogenous causes which each of these dimensions comprises. Secondly, it aims to ascertain the exogenous factors that could influence *TOCs*' perception of tax complexity.

⁵ For example: Portugal, Australia, Bangladesh, Canada, Japan, Malaysia, New Zealand, Pakistan, Kenya, UK and US.

⁶ Also known as tax agents and tax preparers, in Anglo-Saxon literature.

⁷ Data from our survey.

⁸ The goals, or principles, currently accepted, of a good tax system, have their basis in the four pillars of the tax system listed by Adam Smith in his book of 1776 «An Inquiry Into the Nature and Causes of the Wealth of Nations». The four pillars advocated by Adam Smith were equity, certainty and simplicity, timeliness and neutrality, and efficiency. In most studies, the main goals of tax systems consist of three goals: equity, efficiency and neutrality, and simplicity. [Accessed on December 26th, 2011. Available at: <http://ebooks.adelaide.edu.au/s/smith/adam/s64w/complete.html#chapter31>].

This paper is presented in six parts. Following the introduction in Part 1, a brief review of the relevant literature is presented in Part 2. Part 3 outlines the research hypotheses. Part 4 explains the research methodology and variables used. This is followed by the presentation of statistical findings in Part 5. The conclusion, limitations of the study and further research suggestions are discussed in Part 6.

2. LITERATURE REVIEW

The endogenous causes of tax complexity referred to in several studies are usually similar. However, the way in which these causes are grouped into different dimensions varies greatly from one study to another. Tax complexity in general terms is commonly divided into three dimensions: «Technical Complexity», «Structural Complexity», and «Compliance Complexity» (McCaffery, 1990; McKerchar 2002, 2007; McKerchar *et al.*, 2008⁹). Other authors divide it into different dimensions (Slemrod, 1989; Cooper, 1993; Tran-Nam, 1999; Lopes, 2003; MF, 2007; Chau & Leung, 2009). In particular, causes of tax complexity perceived by tax professionals were separated into six dimensions: «Ambiguity», «Computations», «Change», «Detail», «Record Keeping» and «Forms» (Long & Swingen, 1987; McKerchar, 2005).

Table 1: Dimensions and causes of tax complexity perceived by tax professionals

Dimensions of tax complexity	Causes of tax complexity	Long and Swingen (1987) - US	Green (1994) UK	McKerchar (2005) Australia
Legal tax Complexity	Ambiguity of income tax rulings			X
	Ambiguity of income tax cases			X
	Ambiguity and uncertainties of tax law	X	X	X
	Frequent change of tax laws	X	X	X
	Numerous rules	X	X	X
	Too many exceptions to rules			X
Declarative tax complexity	Detailed record keeping	X		
	Record keeping very onerous			X
	Confusing tax forms	X	X	X
	Confusing tax form instructions			X
	Too Many computations	X		X
	Tax computation too difficult			X

Source: Adapted from Long and Swingen (1987), Green (1994) and McKerchar (2005).

In this study, tax complexity is grouped into two main dimensions—legal complexity and declarative complexity.¹⁰ Table 1 presents the division of these two dimensions of tax complexity and the endogenous causes reviewed (Long & Swingen, 1987; Green,

⁹ Ralph Review.

¹⁰ Declarative complexity is also known as administrative complexity or compliance complexity.

1994; McKerchar, 2005). It appears that the legal tax complexity dimension has more indicators than the declarative dimension. Nevertheless, the causes of tax complexity are quite consistent in these studies.

While it is important to understand the endogenous causes of the perception of tax complexity, it is also crucial to ascertain the exogenous causes that could impact on *TOCs*' perception of tax complexity. The exogenous factors that could influence their perception of tax complexity are age, gender, tax knowledge and size of customers' businesses.

Studies amongst the international tax literature that relate to tax professionals' age or gender and their perception of tax complexity are rare. However, several studies have revealed that older taxpayers felt a greater need to engage tax professionals due to their higher perception of tax complexity (Slemrod & Sorum, 1984; Klepper, Mazurd & Nagin, 1991; Long & Caudill, 1987, 1993). As for gender, the study found that female taxpayers were more likely to hire paid tax professionals than male taxpayers (McKerchar, 2002).

Tax knowledge¹¹ also appeared to be an important exogenous factor that could influence taxpayers' and professionals' perception of tax complexity (Eriksen & Fallan, 1996; O'Donnell, Koch & Boone, 2005; Loo, 2006; Woellner, Coleman, McKerchar, Walpole & Zetler, 2007). Customer size was also found to have a relationship with the increased complexity of tax issues. However, in the view of tax professionals, the relationship between company size and the level of tax complexity was unclear (Ayres, Jackson & Hite, 1989).

3. RESEARCH HYPOTHESES

Several studies concluded that tax complexity was the main reason why taxpayers hired tax professionals (Slemrod & Sorum, 1984; Klepper, et al, 1991; Long & Caudill, 1987, 1993; McKerchar, 2002). There was greater use of professionals by older taxpayers, who were more susceptible to the uncertainty caused by tax complexity. It would be interesting to ascertain whether this perception of tax complexity among older taxpayers is also observed among older *TOCs* in Portugal.

Hence, it is important to know whether there is any significant relationship between *TOCs*' age and gender and their perception of tax complexity. For this purpose, the following research hypotheses were formulated:

H1: *TOCs*' perception of the dimensions of causes of tax complexity is related to their age.

H2: *TOCs*' perception of the dimensions of causes of tax complexity is related to their gender.

H3: *TOCs*' perception of tax system complexity is related to their age.

H4: *TOCs*' perception of tax system complexity is related to their gender.

¹¹ Degree, tax experience and theoretical knowledge, in tax matters.

The literature supported the existence of a relationship between tax knowledge factors and the perception of tax complexity among taxpayers and tax professionals (see for example, Eriksen & Fallan, 1996;¹² O'Donnell et al., 2005¹³). Therefore, there is a possibility that tax knowledge factors could influence Portuguese *TOCs*' perception of tax complexity. Thus, the following research hypotheses are presented:

- H5:** *TOCs*' perception of the dimensions of causes of tax complexity is related to their level of tax experience.
- H6:** *TOCs*' perception of the dimensions of causes of tax complexity is related to their tax knowledge.
- H7:** *TOCs*' perception of tax system complexity is related to their tax experience.
- H8:** *TOCs*' perception of tax system complexity is related to their tax knowledge.

It is also important to discover whether there is a relationship between size of customers'/ employers' businesses and *TOCs*' perception of tax system complexity. In the Portuguese case, the size of *TOCs*' customers' businesses is measured in two ways: by customers' turnover and by the way *TOCs* develop their activities.¹⁴ Hence, the hypotheses to be tested are listed below.

- H9:** There is a relationship between the sizes of companies for which professionals are responsible and their perception of the dimensions of causes of tax complexity.
- H10:** There is a relationship between the way *TOCs* develop their activities and their perception of the dimensions of causes of tax complexity.
- H11:** There is a relationship between the sizes of companies for which professionals are responsible and their perception of tax system complexity.
- H12:** There is a relationship between the way *TOCs* develop their activities and their perception of tax system complexity.

¹² In the taxpayers' context.

¹³ In the tax professionals' context.

¹⁴ *TOCs* who work in accounting and taxation offices are responsible for smaller companies, while *TOCs* who have expertise in taxation are the ones responsible to the accounting and taxation department of a company.

4. RESEARCH METHOD

To address the objectives and to test the hypotheses of this study, a questionnaire was adopted. The hard copy of the questionnaires was distributed via convenient sampling to 2,391 *TOCs* who were present at the *OTOC* [*Ordem dos Técnicos Oficiais de Contas*]'s tax seminars in February 2013.¹⁵ The same questionnaire was also posted online to those *TOCs* who could not attend the *OTOC* seminars. *TOCs* who had responded during the *OTOC* seminars were requested not to respond to the online survey.

A total of 1,567 questionnaires were returned, of which 1,233 were collected from those distributed during the tax seminars and 334 were responded to via online survey. The response rate of the hard copy questionnaire was about 52% of *TOCs* who attended the tax seminars, which represents a favourable response rate.

The survey instrument consisted of three parts. Parts I and II solicited some socio-demographic, professional and technical variables from the *TOCs*. The socio-demographic variables were gender and age. The professional and technical variables were classified into two main variables, tax knowledge and size of customers'/employers' businesses. Tax knowledge variables consisted of qualifications, *TOCs*' experience and the frequency with which they update their tax knowledge. These variables were transformed into an additive index the *TOCs* Tax Knowledge Index. Part III sought *TOCs*' perception of the complexity of the Portuguese tax system in two aspects. In regard to the first aspect, *TOCs* were requested to classify whether the Portuguese tax system was very simple or very complex, in relation to the overall tax system. The second aspect concerned the importance of perceived complexity based on two major dimensions, the Legal Complexity Dimension and the Administrative or Declarative Complexity Dimension. This part required the *TOCs* responses regarding the two dimensions of tax complexity based on five-point Likert scales ranging from very important to not important.

The causes of legal complexity were volume, density of the tax law and the interpretation of legislation. The causes of declarative or administrative tax complexity were divided into three major ones: (i) preparation of information, (ii) tax forms filled in and (iii) record keeping (tax archive).

Table 2 presents the two dependent variables and a set of independent variables that could influence as well as explain the dependent variables. In addition, the expected positive or negative relationships are also presented in Table 2.

¹⁵ The information provided by *OTOC* in February 2013 showed that there were 72,063 registered members of *TOCs*. However, only 38,614 members are actively practising.

Table 2: Explicative variables

Dependent variables	Independent variables	Expected signal
Dimensions of tax complexity	Age	Older
	Gender	Female
	Tax knowledge	-
	Tax updating	-
	Tax experience	-
	The size of customers'/employers' businesses	+
	The way in which <i>TOC</i> activity is developed	+
Perception of tax system complexity	Dimensions of tax complexity	+
	Age	Older
	Gender	Female
	Tax knowledge	-
	Tax updating	-
	Tax experience	-
	The size of <i>TOCs'</i> customers'/ employers' businesses	+
	The way in which <i>TOC</i> activity is developed	+

4. RESULTS AND DISCUSSION

4.1 Endogenous causes of tax complexity: constructions of the dimensions of causes of tax complexity from *TOCs'* perspective

Drawing on the findings of the questionnaire survey, it was discovered that the five main causes of tax complexity perceived by *TOCs* were: (i) frequent change of tax laws (88.4%); (ii) tax law too widely dispersed (86.1%); (iii) preparation of

accounting information for fiscal purposes (83.2%);¹⁶ (iv) too many exceptions to the rule and transitional arrangements (82.2%); and (v) low perception and ambiguity of tax language (80.1%). It is observed that out of the five causes of tax complexity, four were related to the complexity of tax laws.

These endogenous causes of the perception of tax complexity were not classified according to order of importance. The objective of this study is to group them into different dimensions, to compare the importance of each dimension with the others, and to compare these results with those of international studies.

In order to ascertain how many dimensions of tax complexity *TOCs* effectively perceived in the Portuguese tax system, based on the data collected, using Principal Component Analysis (PCA), three indices of the dimensions of causes of tax complexity were constructed. The three dimensions are the Legal Tax Complexity Index (see Table 3), the Index of Complexity of Preparation of Information and Record Keeping (see Table 4), and the Index of Complexity of Tax Forms (see Table 5).

As presented in Table 3, the component matrix for the Legal Tax Complexity Index showed a KMO¹⁷=0.898 (between 0.8 and 0.9) and $p=0.000$ ($p<0.001$), and Bartlett's test of sphericity, with χ^2 (36)=6.036,756 and $p=0.000$ ($p<0.001$), demonstrated good suitability of the PCA for the population. In addition, Cronbach's Alpha, with a value of 0.925 (>0.9), demonstrated excellent reliability of the index.

Table 3: Construction of the Legal Tax Complexity Index (PCA)*

Variables	N	Min	Max	Mean	S. D.	Factorial weights
Tax code with very extensive articles with references to others articles (or tax codes)	994	1	5	4.21	1.03	0.865
Portuguese tax legislation too dispersed	994	1	5	4.36	0.97	0.858
Many exceptions to the rule and transitional arrangements	994	1	5	4.24	1	0.849
Frequent change of tax laws	994	1	5	4.44	0.92	0.817
Very extensive tax codes	994	1	5	4.01	1.05	0.801
Transposition of EU tax legislation	994	1	5	3.98	0.96	0.758
Tax language too technical	994	1	5	3.89	1	0.745
International legislation	994	1	5	3.88	1	0.731
Low perception and ambiguity of tax language	994	1	5	4.18	0.95	0.681

* KMO = 0.898; $p<0.001$; Cronbach's Alpha: 0.925; Explained variance: 62.71%

¹⁶ Data in line with those obtained by Lopes (2009). The results of this study show that within the SME [Small and Medium-sized Enterprise], time costs appear to be the highest compliance cost in the preparing of information to fill in tax forms.

¹⁷ Kaiser-Meyer-Olkin - measure of sample adequacy.

The Index of Complexity of Preparation of Information and Record Keeping (see Table 4) showed a component matrix of KMO=0.500 (between 0.5 and 0.6), and $p=0.000$ (<0.001) indicated that the quality is poor. However, given the particularity of the measure on five-point Likert scales, the PCA is acceptable. Bartlett's test of sphericity, with $\chi^2(1)=219,505$ and $p=0.000$ ($p < 0.001$), demonstrated the suitability of the PCA for the population. In addition, Cronbach's Alpha, with a value of 0.606 (between 0.6 and 0.7), demonstrated an acceptable reliability index.

Table 4: Construction of the Index of Complexity of Preparation of Information and Record Keeping (PCA)*

Variables	N	Min	Max	Mean	S.D.	Factorial weights
Record Keeping	994	1	5	3.60	1.07	0.852
Preparation of accounting information for fiscal purposes	994	1	5	4.14	0.81	0.852

* KMO = 0.500; $p < 0.001$; Cronbach's Alpha: 0.606; Explained variance: 72.59%

Table 5 presented the construction of the Index of Complexity of Tax Forms. The component matrix with KMO=0.606 (between 0.6 and 0.7) and $p=0.000$ (<0.001) indicated that the quality is reasonable and the PCA is acceptable. In addition, Bartlett's test of sphericity, with $\chi^2(3)=218,498$ and $p=0.000$ ($p < 0.001$), demonstrated the suitability of the PCA for the population. Cronbach's Alpha, with a value of 0.890 (between 0.8 and 0.9), also demonstrated a very good reliability index.

Table 5: Construction of the Index of Complexity of Tax Forms (PCA)*

Variables	N	Min	Max	Mean	S. D.	Factorial weights
The reduced help provided by tax administration staff	994	1	5	3.98	1.05	0.771
Computerization of tax obligation	994	1	5	4.02	0.961	0.731
Confused tax forms and unclear instructions	994	1	5	3.68	1.14	0.663

*KMO = 0.606; $p < 0.001$; Cronbach's Alpha: 0.890; Explained variance: 52.34%

All three indices were justified by the extraction of one component, the Kaiser criterion and the explained variable. The results showed that the explained variables (62.70% for the Legal Tax Complexity Index, 72.59% for the Index of Complexity of Preparation of Information and Record Keeping and 52.34% for the Index of Complexity of Tax Forms) are acceptable. Hence, it can be concluded that these three indices with one dimension are adequate.

The above three indices of tax complexity were regrouped into a new index, the General Tax Complexity Index (see Table 6). As presented in Table 6, the component matrix of the three indices showed a KMO=0.51 (between 0.5 and 0.6), and $p=0.000$ (<0.001) indicated that the quality is poor. However, given the particularity of the measure on five-point Likert scales, the PCA is acceptable. Bartlett's test of sphericity with $\chi^2(3)=203,288$ and $p=0.000$ ($p<0.001$) demonstrated the suitability of the PCA for the population. Cronbach's Alpha of the General Tax Complexity Index with a value of 0.528 (between 0.5 and 0.6), demonstrated a less reliable index. However, given the particularity of the measure using five-point Likert scales, and the fact that this is the conjugation of the three previous indices of tax complexity, the reliability of the index was acceptable.

In a similar manner to the three indices discussed earlier, the extraction of one component using the Kaiser criterion showed an explained variable of 51.6 per cent, allowing us to conclude that this index with one dimension is adequate.

Table 6: Construction of the General Tax Complexity Index (PCA)*

Variables	N	Min	Max	Mean ¹⁸	S. D.	Factorial weights
Index of Complexity of Tax Forms	994	-3.84	1.44	0	1	0.797
Index of Complexity of Preparation of Information and Record Keeping	994	-3.72	1.39	0	1	0.685
Legal Tax Complexity Index	994	-4.02	1.09	0	1	0.668

* KMO = 0.581; $p<0.001$; Cronbach's Alpha: 0.528; Explained variance: 51.65%

Consequently, from *TOCs'* perception of the causes of Portuguese tax system complexity, the results showed the statistically significant existence of the three different dimensions. This is because the indices were concurrently validated based on three key factors: Cronbach's Alpha, which evaluated the quality of the indices; the weights of the items' coefficients; and the quality of the composite scores that were expressed by the explained variables.

Compared to other studies (Long & Swingen, 1987; McKerchar, 2005), the Portuguese case is much simpler, as the *TOCs* only perceived three dimensions of causes of tax complexity. The General Tax Complexity Index, in its own unique index and the three dimensions, allows us to check the relative weight of the partial indices. The findings of this study differ from the previous study, which quantified the importance of each dimension of tax complexity (McKerchar, 2005). That study confirms the great significance of dimensions related to legal factors and accords minor importance to the others (for example, in McKerchar, 2005).

In the Portuguese case, the *TOCs* perceived that the relative weights of each partial dimension are very similar. This means tax complexity is not confined to one dimension but is shared equally by all partial dimensions. The findings of this study

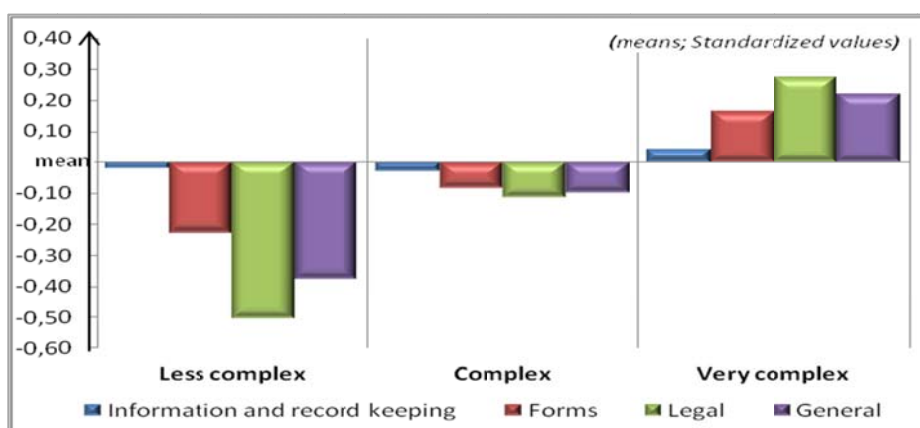
¹⁸ The mean values of zero indicate that it is an index of three indices, i.e. the relative weights of each index.

imply that policy makers need to pay attention to all dimensions of tax complexity with a view to simplifying the Portuguese tax system.

To better understand the *TOCs*' perception of tax complexity, they were categorised into three profiles,¹⁹ *TOCs* who perceived the Portuguese tax system to be «less complex», *TOCs* who perceived the Portuguese tax system to be «complex», and *TOCs* who perceived the Portuguese tax system to be «very complex». Subsequently, cross tabulation analyses were conducted in relation to the perception of tax system complexity with the three categories of *TOCs*.

Figure 1 represents the cross tabulation results between the profiles and the dimensions of causes of tax complexity. It shows that the *TOCs* who perceived the Portuguese tax system to be «less complex» perceived all the tax complexity dimensions to be significantly inferior to the mean values. Those *TOCs* who perceived the Portuguese tax system to be «complex» perceived all the dimensions as being inferior to, but close to, the mean values, while those who perceived the Portuguese tax system to be «very complex» also perceived all the dimensions of tax complexity to be above the mean values²⁰. This could imply that there is a relationship between both profiles and dimensions, and that the dimensions reflect the perception of the *TOCs* regarding each profile.

Figure 1: Dimensions of tax complexity *versus* *TOCs*' perception of tax system complexity



4.2 Exogenous causes of tax complexity: *TOCs*' profile with regard to perceptions of tax complexity

With regard to the dimensions of causes of tax complexity, in terms of age (see Figure 2), the results showed that older (>65 years old) *TOCs* perceived all the dimensions of causes of tax complexity to be below the mean values, while those who were between 35 and 50 years old perceived all the dimensions of causes of tax complexity as being above the mean values. In terms of gender (see Figure 3), it is interesting to note that

¹⁹ The survey results show that nearly 90% of the *TOCs* classify the Portuguese tax system as complex and very complex.

²⁰ Above the mean values' signifies «Very Important», while 'below the mean values' means «Less Important» or «Of No Importance», in the analysis from Figure 1 to Figure 7.

the results showed that female *TOCs* perceived all the dimensions of causes of tax complexity to be above the mean values.

The results of the analysis showed that only those *TOCs* who had five or fewer than five years of working experience perceived all the dimensions of causes of tax complexity as being above the mean values, while those who had more than 25 years of working experience perceived complexity of tax forms as being above the mean values (see Figure 4).

Figure 2: Dimensions of causes of tax complexity *versus* *TOCs*' age

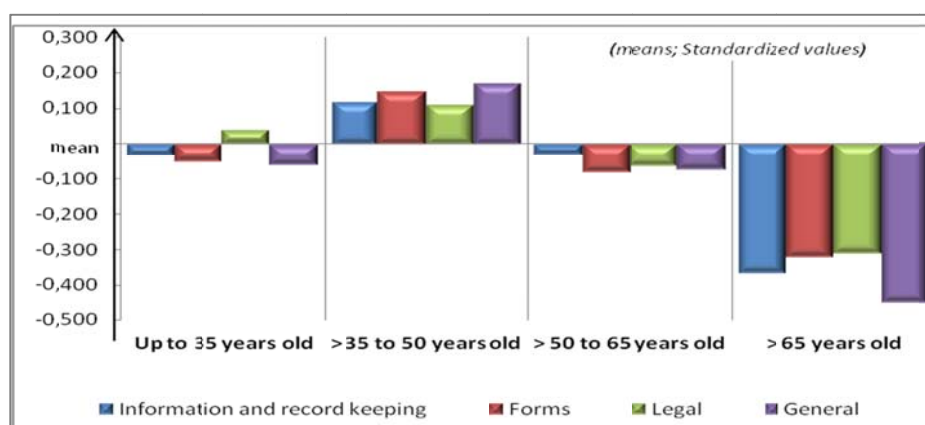


Figure 3: Dimensions of causes of tax complexity *versus* *TOCs*' gender

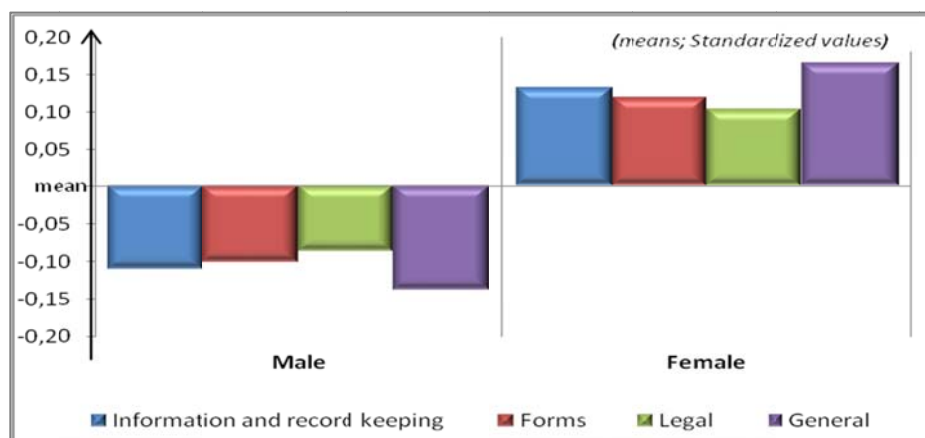


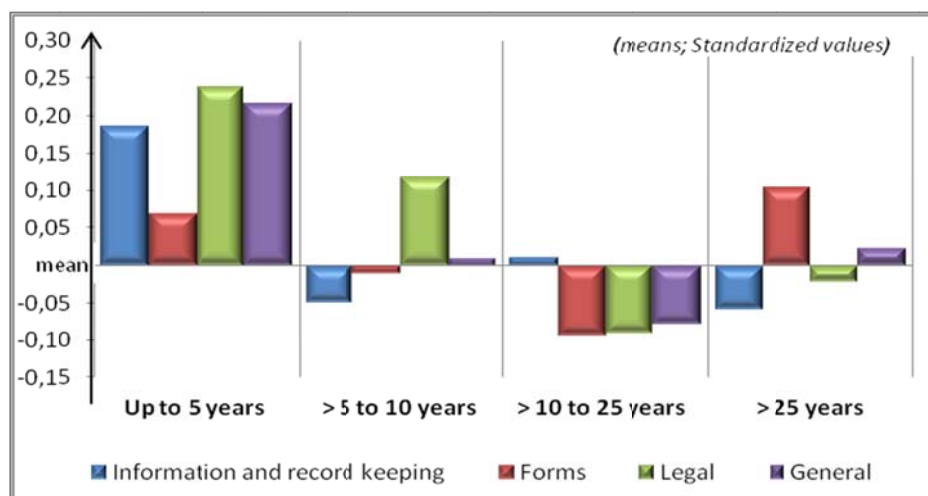
Figure 4: Dimensions of causes of tax complexity *versus* *TOCs*' experience

Figure 5 shows that the *TOCs* who have higher levels of *TOCs* Tax Knowledge Index²¹ (that is, those who have had a university education, have more experience and frequently update their tax knowledge), perceived all the dimensions of causes of tax complexity to be below the mean values. In contrast, those *TOCs* who possess lower levels of tax knowledge perceived all the dimensions of causes of tax complexity to be above the mean values.

With regard to the turnover of *TOCs*' customers or employers, those *TOCs* whose customers' turnover is between two million and 10 million € perceived all the dimensions of causes of tax complexity to be above the mean values (see Figure 6). In contrast, most of those *TOCs* who were responsible for small businesses perceived the dimensions of causes of tax complexity to be below the mean values (see Figure 6 and Figure 7).²²

²¹ Tax Knowledge is an additive index composed of three variables: (i) degree; (ii) *TOCs*' professional experience; (iii) *TOCs*' fiscal updating.

²² The *TOCs* who work in accounting and taxation offices are responsible for smaller companies and perceive tax complexity as less important than those *TOCs* who work in companies in other sectors, with their own accounting and taxation departments (the biggest companies).

Figure 5: Dimensions of causes of tax complexity *versus* levels of *TOCs* Tax Knowledge Index

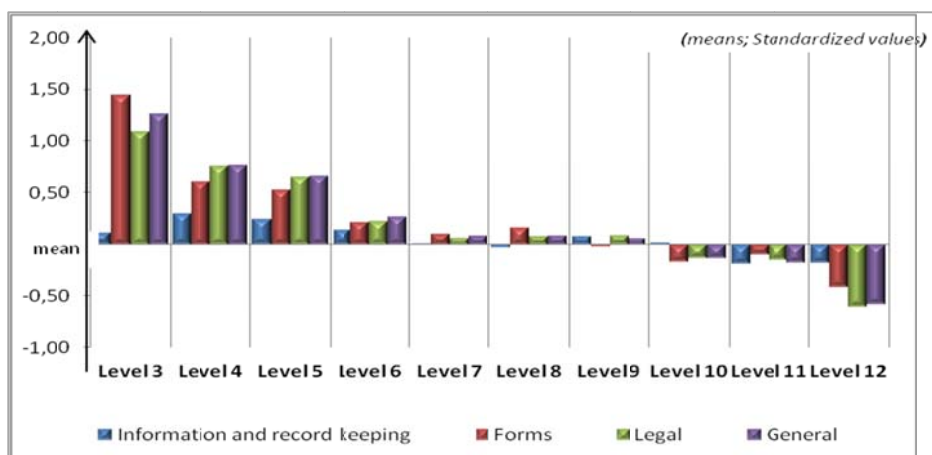


Figure 6: Dimensions of causes of tax complexity *versus* *TOCs*' customers'/employers' turnover

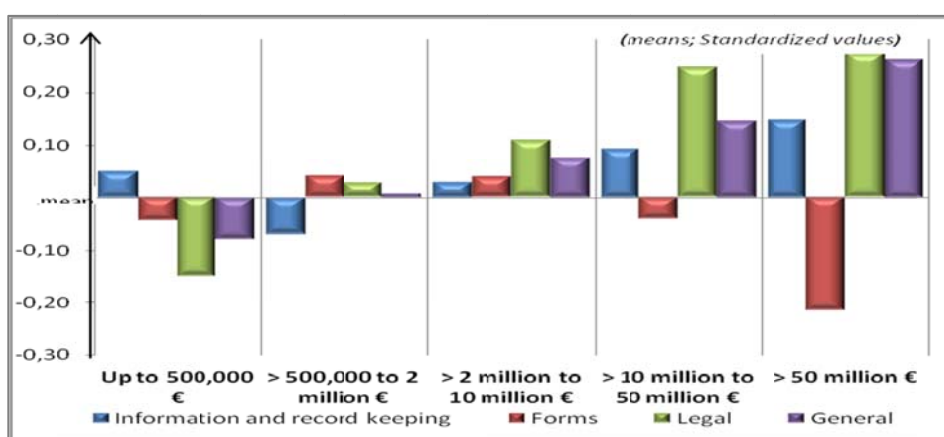
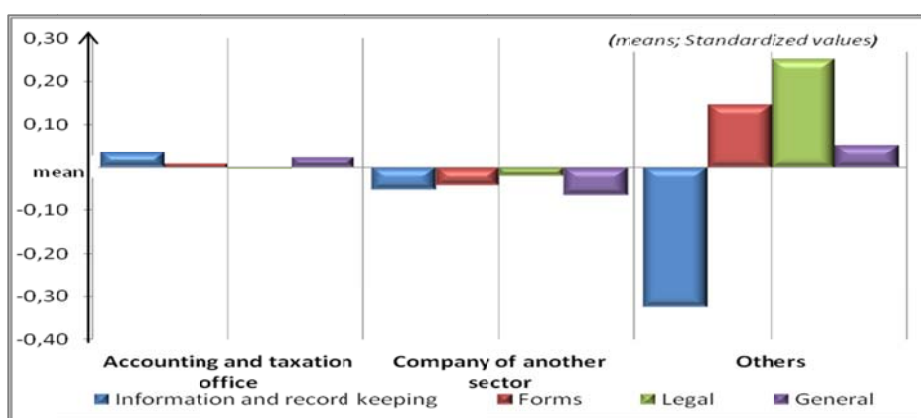


Figure 7: Dimensions of causes of tax complexity *versus* TOCs' ways of developing their activity



In relation to the exogenous factors affecting *TOCs'* perceptions of tax system complexity, it is noted that all the age groups perceived the Portuguese tax system to be complex in some way (see Figure 8). Male and female *TOCs* also perceived the Portuguese tax system to be complex or very complex (see Figure 9).

Figure 8: *TOCs'* perception of tax system complexity *versus* *TOCs'* age

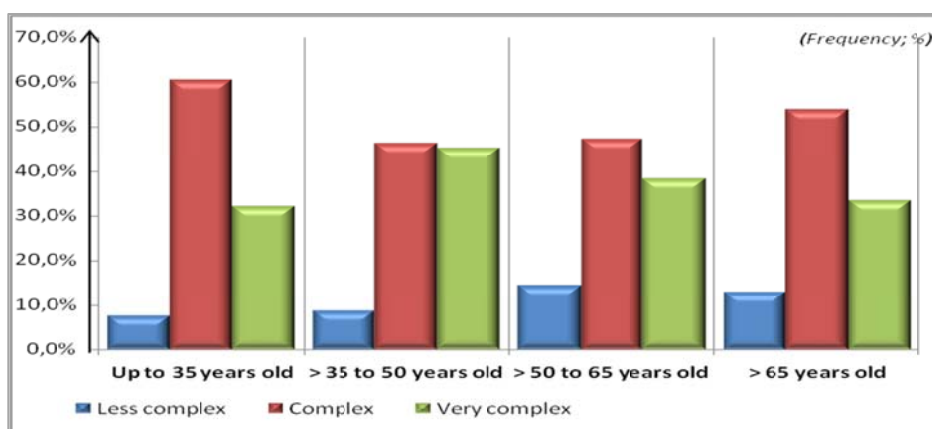
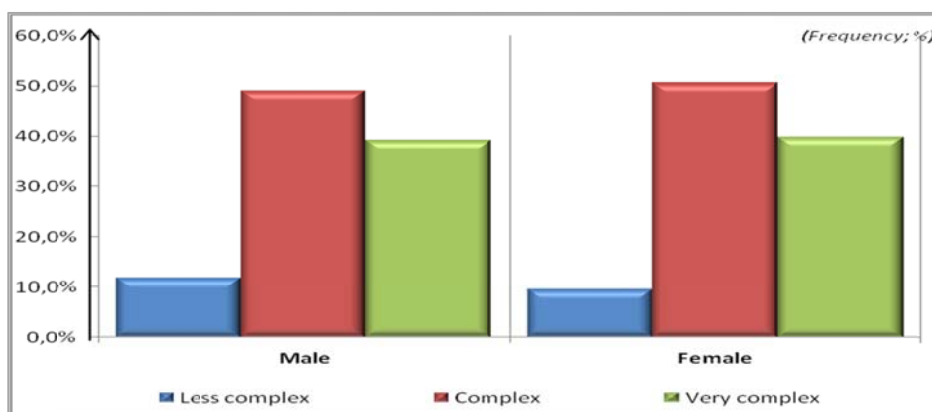


Figure 9: *TOCs'* perception of tax system complexity *versus* *TOCs'* gender



It is interesting to note that the *TOCs* with working experience of fewer than five years and more than 25 years perceived the Portuguese tax system to be complex (see Figure 10). *TOCs* who have higher levels of tax knowledge perceived the Portuguese tax system to be less complex (see Figure 11).

Figure 10: *TOCs*' perception of tax system complexity versus *TOCs*' experience

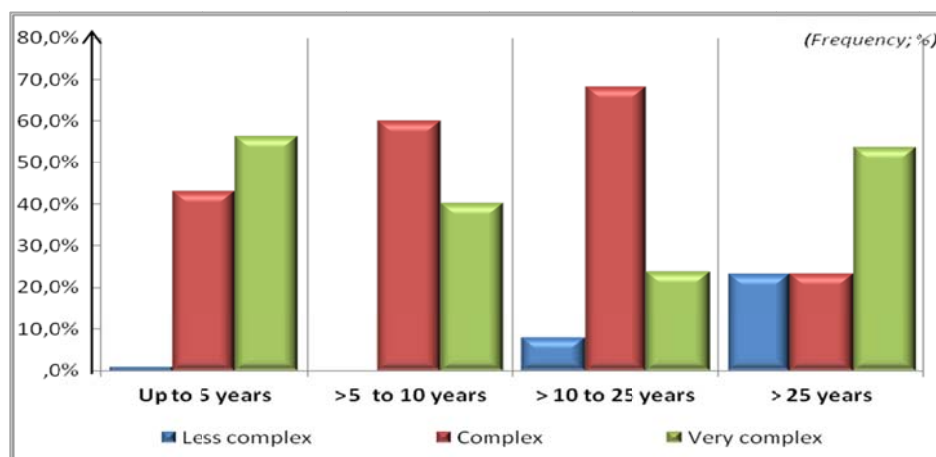
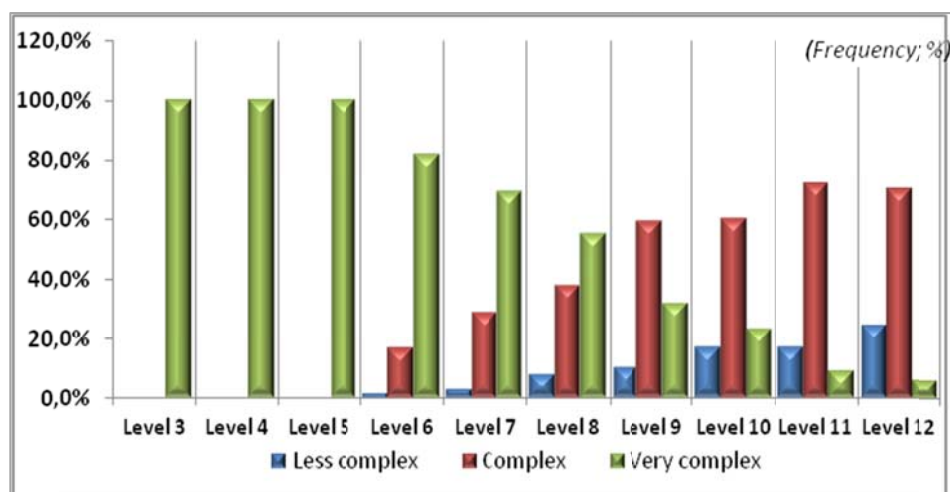


Figure 11: *TOCs*' perception of tax system complexity versus levels of *TOCs* Tax Knowledge Index



Regardless of the turnover of *TOCs*' customers or employers (see Figure 12) and the ways in which *TOCs* developed their activity (see Figure 13), the majority of *TOCs* perceived the Portuguese tax system to be complex or very complex.

Figure 12: *TOCs'* perception of tax system complexity versus customers'/employers' turnover

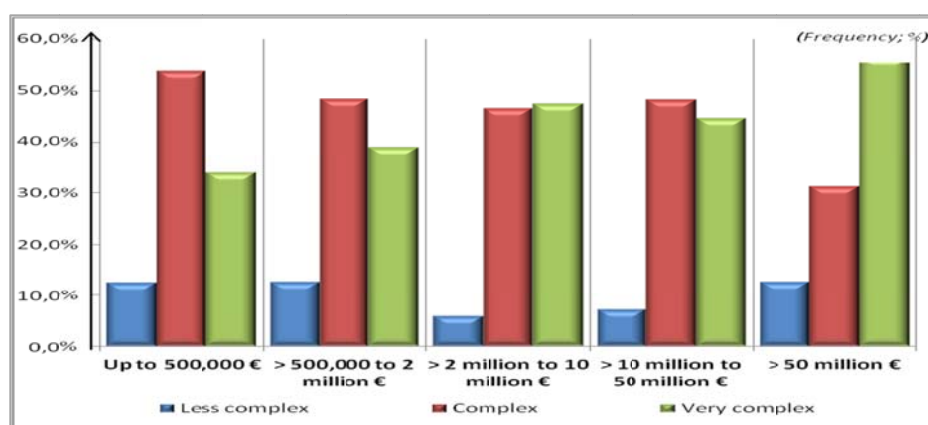
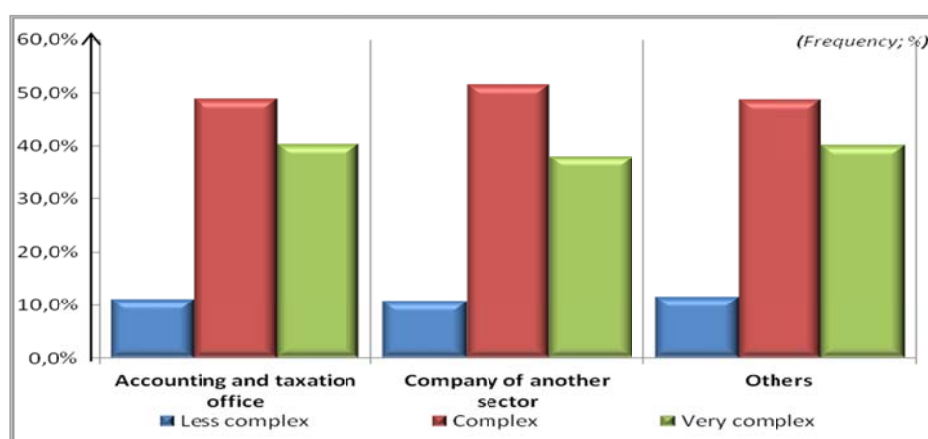


Figure 13: *TOCs'* perception of tax system complexity versus *TOCs'* ways of developing their activity



A summary of the above analysis (Figures 2 to 7) of the dimensions of tax complexity is presented in Table 7, while the summary of the analysis of the perception of tax complexity shown in Figures 8 to 13 is presented in Table 8.

Table 7: Profile of tax complexity (dimensions of tax complexity)

Exogenous factors	Dimensions of tax complexity	
	Higher perception	Lower perception
<i>TOCs'</i> gender	Female	Male
<i>TOCs'</i> age	> 35 to 50 years old	> 65 years old
<i>TOCs'</i> professional experience	Up to 5 years	> 10 years to 25 years
<i>TOCs</i> Tax Knowledge Index	Level: 3	Level: 12
The size of <i>TOCs'</i> customers or employers (turnover)	> 50 million €	≤ 500.000 €
The way <i>TOCs</i> develop their activity	Other entities	Company of another sector

Table 8: *TOCs*' profile regarding their perception of tax system complexity

Exogenous factors	Tax system complexity as a whole	
	Higher perception	Lower Perception
<i>TOCs</i> ' gender	No significant differences	No significant differences
<i>TOCs</i> ' age	> 35 to 50 years old	> 65 years old
<i>TOCs</i> ' professional experience	Up to 5 years	> 10 to 25 years
<i>TOCs</i> Tax Knowledge Index	Levels: 3, 4 and 5	Level: 12
The size of <i>TOCs</i> ' customers or employers (turnover)	> 50 million €	≤ 500,000 €
The way <i>TOCs</i> develop their activity	No significant differences	No significant differences

On the one hand, from the summary shown in Tables 7 and 8, the size of *TOCs*' customers' / employers' businesses appeared to be an exogenous factor that increases the perception of tax complexity (both in terms of the dimensions of causes of tax complexity and of tax system complexity as a whole). On the other hand, the increase in *TOCs*' experience and their level of tax knowledge (a broader concept than professional experience, embracing professional experience, degree, training and in-service courses), minimises the exogenous factors impacting on perceived tax complexity.

4.3 Testing the research hypotheses

In order to test the research hypotheses, bivariate analysis was employed. This analysis aims to determine whether differences between gender, age, size of customers' businesses and other exogenous factors exert a relative influence on *TOCs*' perceptions of tax complexity. Since the samples meet the necessary assumptions,²³ the *t test*, *one-way ANOVA* and *Kruskal Wallis test* were conducted. To measure the strength and direction of the relationship between variables, the Pearson correlation²⁴ was adopted.

Table 9 presents the effects of each independent variable, *that is*, the exogenous factors of tax complexity impacting on *TOCs*' perception of dimensions of causes of tax complexity (dependent variable). Table 10 presents the effects of each exogenous factor of tax complexity (independent variable) on the dependent variable, the *TOCs*' perception of tax system complexity as a whole.

²³ The application of parametric tests requires the simultaneous fulfillment of the two following conditions: normality and homoscedasticity [homogeneity of variances (Maroco, 2011)].

²⁴ However, when the samples were not normally distributed or the variables are nominal, the Spearman Correlation was used (Pestana & Gageiro, 2000).

Table 9: Effects of socio-demographic, professional and technical variables on *TOCs*' perception of the dimensions of causes of tax complexity

Variables	<i>t</i> / <i>F</i> / <i>H</i> ²⁵	df	p-value	Correlation
<i>TOCs</i> ' age	23.591	894	0.000**	$r = -0.113$; $p = 0.001 < 0.01$
<i>TOCs</i> ' gender	- 4.560	897	0.000**	$r = 0.151$; $p = 0.000 < 0.01$
<i>TOCs</i> Tax Knowledge Index	3.737	891	0.000**	$\rho = -0.172$; $p = 0.000 < 0.01$
<i>TOCs</i> ' tax experience	2.452	897	0.062***	----
The size of <i>TOCs</i> ' customers or employers (turnover)	5.534	896	0.237***	----
The way in which <i>TOCs</i> develop their activity	3.426	920	0.180***	-----

* $p < 0.05$; ** $p < 0.001$; *** $p > 0.05$

Table 10: Effects of socio-demographic, professional and technical variables on *TOCs*' perception of tax system complexity as a whole

Variables	<i>t</i> / <i>F</i> / <i>H</i> ²⁶	df	p-value	Correlation
<i>TOCs</i> ' age	9.542	986	0.023*	$r = -0.43$; $p = 0.179 > 0.05$
<i>TOCs</i> ' gender	0.662	989	0.508***	----
<i>TOCs</i> Tax Knowledge Index	197.366	994	0.000**	$\rho = -0.435$; $p = 0.000 < 0.01$
<i>TOCs</i> ' tax experience	47.036	994	0.000**	$r = -0.115$; $p = 0.000 < 0.001$
Size of <i>TOCs</i> ' customers or employers (turnover)	14.608	989	0.006*	$\rho = 0.113$; $p = 0.000 < 0.01$
The way <i>TOCs</i> develop their activity	0.114	989	0.892***	----

* $p < 0.05$; ** $p < 0.001$; *** $p > 0.05$

The results of the bivariate analysis, presented in Tables 9 and 10, shows that there is a statistically significant relationship between the *TOCs* Tax Knowledge Index and *TOCs*' perception regarding both the dimensions of causes of tax complexity and the perception of tax system complexity as a whole. Hence, H6 and H8 are accepted.

²⁵ *t* test, one-way ANOVA and Kruskal Wallis test, respectively.

²⁶ *t* test, one-way ANOVA and Kruskal Wallis test, respectively.

It appeared that gender has no statistically significant relationship with *TOCs'* perception of tax system complexity. On the contrary, gender showed a statistically significant relationship with the dimensions of causes of tax complexity. Thus, H2 is accepted, while H4 is rejected.

With regard to *TOCs* experience, the results showed a statistically significant relationship with the *TOCs'* perception of tax system complexity, but no statistically significant relationship was found between *TOCs'* experience and the dimensions of causes of tax complexity. Hence, H5 is rejected and H7 is accepted.

Size of companies only showed a statistically significant relationship with *TOCs'* perception of tax system complexity. Hence H11 is accepted while H9 is rejected. Similarly, both H10 and H12 are rejected, as no statistically significant relationships were found between the way *TOCs* develop their activities and both *TOCs'* perception of tax system complexity and their perception of the dimensions of causes of tax complexity.

In terms of the strength of the relationship, only the *TOCs* Tax Knowledge Index showed a moderately negative relationship with *TOCs'* perception of tax system complexity, the other independent variables presenting weaker relationships with the dependent variables. Nevertheless, the findings of this study confirm the statistically significant importance of some exogenous factors impacting on *TOCs'* perception of tax complexity.

5. CONCLUSIONS

Portuguese tax professionals perceived their tax system as having a high level of complexity (89.1%). This result is in line with the international tax literature. The endogenous causes perceived by the *TOCs* were mostly related to legal concerns, *that is*, (i) volatility of tax laws (88.4%); (ii) tax law too dispersed (86.1%); (iii) preparation of accounting information for fiscal purposes (83.2%); (iv) many exceptions to the rule and transitional arrangements (82.2%); and (v) low perception and ambiguity of tax language (80.1%).

Three partial indices and a general index using PCA were constructed. The three indices were (i) Index of Complexity of Preparation of Information and Record Keeping; (ii) Index of Complexity of Tax Forms; (iii) Legal Tax Complexity Index. The General Tax Complexity Index was meant to check the relative weights of the three partial indices. In contrast with other studies, in the Portuguese case the differences are insignificant. Therefore, it can be concluded that all dimensions of endogenous causes of tax complexity are on the same level.

Tax knowledge appeared to be the only exogenous factor that showed a negative relationship with the perception of tax system complexity. This shows that tax knowledge plays a very significant role in designing *TOC* profiles. As the level of the *TOCs* Tax Knowledge Index increases, the perception of tax system complexity decreases. This is consistent with some international literature (for example, see O'Donnell *et al.*, 2005; Woellner *et al.*, 2007).

TOCs' fiscal experience and the size of *TOCs'* customers'/employers' businesses also influences their level of tax knowledge, in relation to the reduction in the perception of

the complexity of the Portuguese tax system. A good management of these exogenous factors may lead to a decrease in *TOCs*' perception of tax complexity. Perhaps, to enhance this contrasting effect, the regulatory body of tax professionals in Portugal could conduct different tax seminars specially to cater for the *TOCs* who work with companies of different sizes and with different tax problems, so that these *TOCs* could update their knowledge even more.

It is acknowledged that this study has limitations. A survey method with its self-reported behaviour may be less reliable than observed behaviour, especially when the information sought is sensitive, particularly in the area of tax research. In addition, only six exogenous factors were taken into account in this study, although there could be others.

However, the findings of this study, drawing from the empirical evidence collected in Portugal, would contribute to the literature, as there was no known prior study in this area conducted in Portugal. The main conclusions of this paper are relevant to the international literature, as they present new evidence as regards the dimensions of causes of tax complexity.

For future research, two pertinent issues are proposed. Firstly, an update over time, *that is*, a longitudinal study, could be conducted in order to justify the indices created in this research as well as to gain further insight into the consequences of tax complexity. Secondly, there could be other exogenous factors at play that require further research in order to determine the factors that may influence *TOCs*' perception of tax complexity.

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Modernising the Australian Taxation Office: Vision, people, systems and values

Presentation by Michael D'Ascenzo AO¹, to TAX INDABA 2014, Johannesburg, 11 June 2014.

Abstract:

The Australian Taxation Office (ATO) transformed itself into a pre-eminent tax administration over a period of 20 years. It changed from an unremarkable administration into a thought leader on tax administration globally. It did this through inspired and inspiring leadership and the engagement, commitment, innovation and integrity of the ATO's people. This paper chronicles the ATO's transformational journey and highlights key areas of focus, particularly the importance of alignment in values and engagement to achieve breakthrough improvements.

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1. INTRODUCTION

Many countries are seeking to improve their tax administrations as a way to advance national prosperity. The purpose of this paper is provide the Australian Taxation Office's (ATO) transformational story as a guide. The ATO's journey may provide lessons of wide application which could help tax administrations grow to their potential, while reminding the ATO as to where its strengths might lie. The paper does this by outlining in their historical setting the key areas of focus that made a good organization great.

It needs to be recognised up front that that each country has a different legal, political and cultural environment. What works in one country or even what is feasible may not be so in another. Moreover, the task facing countries with endemic corruption, low levels of community respect for or trust in government authorities, or whose administration is under-resourced or limited by its mandate is a daunting one. Nevertheless, if one is serious about improving tax administration, the tax agency itself must believe that reform is not only possible but essential for the development of the nation: "To accomplish great things, we must not only act, but also dream; not only plan, but also believe."²

2. GLOBAL ACCOLADES

It was not that long ago that Jeffrey Owens, then head of the Organisation for Economic Co-operation and Development's (OECD) Centre for Tax Policy and Administration, remarked to me that it was amazing how the Australian Taxation Office (ATO) had transformed itself from a good but unremarkable tax administration to a leading tax agency in 30 years.³

For tax authorities who wish to accelerate their transformational journey, 30 years might sound a long time, but in fact a tax agency's passion for enhancement needs to be an enduring value.

Mr Owens is not the only person to acknowledge the reputation of the ATO as a leading tax administration. In 2007 Professor John Hasseldine wrote:

Anecdotally, the Australian Tax Office is perceived as one of the leading tax agencies in the world. It has met challenges of tax administration through a close working relationship with the community and a focus on compliance.⁴

In the ATO's centenary year, 2010, Mr Pravin Gordhan, a former Minister of Finance and a former Commissioner of the South African Revenue Service, was gracious in his praise:

² Anatole France, *Works of Anatole France*,
http://www.goodreads.com/author/quotes/48535.Anatole_France

³ Conversation between Jeffrey Owen and author, Jeffrey Owen's visit to Australia, Canberra, 2011.

⁴ John Hasseldine, 'Consultancy Report for the National Audit Office of the United Kingdom', 15 October 2007.

The ATO is highly regarded amongst its peers around the world and in many instances has been the world leader both in terms of thought processes, strategic leadership, and, indeed, implementing those in day to day practice.⁵

Similarly generous was the accolade provided by Mr Doug Schulman, former Commissioner of the United States Internal Revenue Service:

ATO is one of the best Tax Agencies in the world in both words and deeds and one on the forefront of modern tax administration pushing forward innovative ideas to meet the challenges and opportunities of the future.⁶

For a former tax administrator such comments are a source of pride. For Australia, the effectiveness and integrity of the ATO provided the country with a comparative advantage in the reliable collection of taxes with which to fund the policies and vision of respective governments; and in terms of helping to build trust and confidence in Australia's democracy.

It would be easy to rest on one's laurels, but it would be a mistake to do so. Even when the fundamentals are sound you need to ensure that the agency continues to be a learning organization, responsive to a changing environment and thirsty for opportunities for improvement. This requires a questioning mind about the way things are done, or could be done. A good tax administration has high integrity and continually looks at its policies, processes and procedures from the taxpayer's perspective (and from the perspective of the taxpayers' agents).

3. HISTORICAL CONTEXT: A FIRM FOUNDATION

This story begins with a former Commissioner, Trevor Boucher. In the 1980s Boucher faced a new economic, social and political environment from what had gone before. They were in a time of change as governments around the world began to remove regulatory controls and expose their economies to greater competition. In Australia it was also a time of greater public scrutiny and accountability, a time when political and community consciousness turned to tax matters, and a time of reforms to the Commonwealth Public Service.

This is a good place to begin because of the similarities with the environment now faced by many countries. Indeed the growth of globalisation and advances in information communication technology have made the world a smaller place with countries more exposed to the winds of competition.

In addition, community expectations have continued to grow exponentially and most governments are looking for improvements in fiscal performance. The universal expectation is that their tax administrations will 'do more with less'.

In many ways change was and is inevitable. It is those public sector institutions that see change as both a challenge and as an opportunity that provide good value to their countries.

⁵ Pravin Gordhan, '*ATO Centenary Message*', October 2010.

⁶ Doug Schulman, '*ATO Centenary Message*', October 2010.

For the ATO the challenges of the tax avoidance scheme era of the late 1970s and early 1980s had shown that more resources had to be put into compliance, with more and better-trained staff, and that had to be matched by creating a better relationship with the taxation industry. Boucher recognized the need for change, and the schemes era provided the burning platform.

The momentum for change quickened with the introduction of self-assessment in 1986. Self-assessment required the ATO to provide taxpayers with assistance in helping them (and their agents) to fulfil their tax responsibilities.

Self-assessment was supported by the introduction of the electronic lodgement system, and also released scarce resources to field activities. These initiatives required the development of new procedures and approaches.

Reactions from taxpayers and their agents to the shift to self-assessment reinforced the need for consistency and certainty in ATO operations. This led to legislative changes to the administrative provisions of the tax law to include new interest, penalty and ruling regimes. These changes were recognized as making the system fairer and more certain for taxpayers.⁷

Today, citizens and non-resident investors seek, above all, consistency and certainty in the application of the tax law by the tax administrators of any country. Binding public ruling and private ruling systems are today regarded as best practice features of modern tax administrations because of the certainty they provide taxpayers and, especially with public rulings, because of the consistency of interpretations that is afforded by the directions they provide to tax officers.

A reasonably unique feature of Australia's private ruling system is the ability of taxpayers to appeal against a private ruling.⁸ Bellinz⁹ makes it clear that the Commissioner of Taxation must seek to properly apply the law and that the Commissioner would be acting *ultra vires* if that was not the case.

An important administrative enhancement to Australia's public ruling system was the introduction of a Public Rulings Panel by Commissioner Carmody. The existence of this Panel, which includes external experts, to advise the Commissioner on this important aspect of tax administration provides extra legitimacy to the quality and integrity of public rulings and also signalled the ATO's intent of being open and accountable.¹⁰

Commissioner Carmody began his term in the 1990s at the beginning of a long period of prosperity for the Australian economy. Nevertheless, community expectations had changed, and he realized that the community would no longer tolerate inconsistent treatment which was possible under a decentralized branch office structure. The hybrid headquarters and branch office organisation that existed at the time detracted

⁷ *Taxation Laws Amendment (Self Assessment) Act 1992*.

⁸ Michael D'Ascenzo, Ownership: *the Bellinz saga* [online]. *Tax Specialist*, Vol. 2, No. 2, Oct 1998. For another analysis of the implications of *Bellinz* see Yuri Grbich, 'After Bellinz and Ralph: A New Focus for Decision Making in the Australian Tax System', www.abc.net.au/4corners/content/2003/20030630.../grbich.pdf.

⁹ *Bellinz Pty Ltd v FCT*, 98 ATC 4634.

¹⁰ The Auditor-General, Audit Report No.7, 'Administration of Taxation Rulings', 2004–05.

from national approaches and made the lines of authority unclear. Structure was inhibiting strategy and the further innovation possible under national programs.

In 1994 the ATO was reorganized around business and service Lines (Divisions), using modern communications and transport technologies to link all ATO sites around Australia into one unified office. This was a major transformation for the ATO. The move to a national approach provided the ATO with greater flexibility and a customer centric focus based on market segmentation. A national approach allowed for the better allocation of scarce resources to manage the higher priority tax risks, assessed on a national basis.

Moreover, by bringing service and enforcement together within the new Line structures, real coherence could be given to the development of strategies based on the new Compliance Model. The development of the ATO Compliance Model represented a breakthrough and one that today is followed by most leading tax agencies around the world.

The Australian tax compliance model is state of the art in literature and in practice for tax administrations.¹¹

Under the Compliance Model, strategies are developed to address the causes of non-compliance and not merely the symptoms. These strategies can utilise all the levers available to the ATO to address compliance concerns and to nurture high levels of voluntary compliance. Typically this involves a balanced program of service and enforcement. While this approach could be described as a 'carrot and stick' method it grew in sophistication to be a melding of assistance and harder edged strategies forming holistic and integrated compliance programs. The ATO approach has been described as 'responsive regulation'.

Australia was an early pioneer of the tax risk management model for tax authorities, utilizing the concept of responsive regulation and a compliance model based on the notion of an enforcement pyramid...¹²

National programs facilitated the development of a National Plan.¹³ This refinement to the ATO's planning processes provided greater flexibility for structure to follow strategy rather than circumscribing the treatments that could be used under functional approaches to improve levels of compliance (and to minimise compliance costs).

Planning processes became more sophisticated as the ATO undertook regular 'health of the system analyses' based on market segments and using multiple lenses. The three lenses involved a consideration of potential risks inherent across a revenue type, for example income tax or the Goods and Services Tax; across a segment or industry level; and at the entity level. In this way the ATO is able to identify material tax risks and to guide national resource allocation to areas of higher risk.

¹¹ Tax Tribune, Magazine of the Intra-European Organization of Tax Administrations, Issue 27, January 2011, p. 24.

¹² Anuhka Bakker and Sandor Kloosterhof, *Tax Risk Management: From Risk to Opportunity*, IBFD ed., 2009. See also Sagit Leviner, *A New Era of Tax Enforcement: From 'Big Stick' to Responsive Regulation*, Michigan Law School, 2006; and Valerie Braithwaite, 'Responsive Regulation and Taxation', *Law & Policy*, Vol. 29, No 1, January 2007.

¹³ See now the ATO's annual Corporate Plan and ATO Plan which flesh out the annual priorities for achievement of the organisation's strategic directions.

The ATO Plan was reviewed every year to meet the ATO's changing business and political environment, helping it to identify risks and to respond to them quickly with detailed market segment and Line plans.

The ATO's approach to risk management and risk differentiation is widely considered to be best practice.¹⁴

4. THE TAXPAYERS' CHARTER

In 1997 the Ombudsman wrote on the ATO's role in the Australian community:

The ATO administers an enormously complex body of law and it invests considerable resources in trying to make its operations as effective as possible within the constraints of the law. The ATO generally makes an honest attempt to balance the interests of revenue collection against the interests of citizens. That balance can be difficult, given the nature of revenue collection and the passions it can excite in individuals. The ATO has a variety of internal guidelines which are designed to minimise the possibility of individual officers taking inappropriate action.¹⁵

In 1997 the ATO also released its Taxpayers Charter and launched the ATO website.

The Taxpayers' Charter reaffirmed the ATO's commitment to providing the highest possible level of service to the community. This cultural signal was complemented by regular surveys of community attitudes to the ATO and the tax system. These surveys helped to identify ways to make the system easier, cheaper and more personalised for taxpayers.

The underpinnings of the Taxpayers' Charter were embedded into the ATO's culture:

Furthermore, at least so far, the charter approach to tax administration has continued in Australia and found support from both ATO staff and Australian taxpayers. In addition the Australian Taxpayers' Charter has moved on from a simple list of principles and become more embodied in the culture of the ATO. The survey evidence from Australian taxpayers is not only positive but also fits in with the way compliance policy is developing in the organisation.¹⁶

The ATO website made the ATO more accessible to taxpayers and their agents and started the trend towards self-service applications which in recent times have become a feature of leading tax administrations. The ATO has continued to upgrade the website as more and more taxpayers use electronic mediums as their first port of call. For example, the ATO website gives access to tax technical information including tax laws, rulings and determinations, it provides general guidance in plain English on taxpayer rights and obligations and on the supporting processes and procedures, and it

¹⁴ Anuhka Bakker and Sandor Kloosterhof, *Tax Risk Management: From Risk to Opportunity*, IBFD ed., 2009.

¹⁵ The Australian Ombudsman, cited in Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010.

¹⁶ Simon James, Kristina Murphy and Monika Reinhart, *Taxpayers' Charter: A Case Study in Tax Administration*, 7 *Journal of Australian Taxation*, 336 (2004).

increasingly makes use of calculators and other tools to ‘mask’ the underlying complexity of the tax law.

5. A NEW TAX OFFICE FOR A NEW TAX SYSTEM

The impetus for change was not just internally driven. In the late 1990s the government released details of its tax reform package, ‘Tax Reform, not a new tax, a new tax system’¹⁷. The significant aspects of the new system were the introduction of the Goods and Services Tax (GST); an Australian Business Number that would be a single identification number for government to business and business to government activities; a quarterly business activity statement; and pay as you go instalment and withholding systems that replaced previous arrangements.

To manage the introduction of the GST and other measures, the ATO went through yet another cycle of introspection and change under the mantra of ‘A new tax office for a new tax system’.

Responding to change was becoming part and parcel of the way the ATO operated. Over the next decade the ATO responded to major legislative changes, gaining in change management expertise as it learned from experience. For example, the Report to the Treasurer, *Australia’s Future Tax System*¹⁸ resulted in further legislative priorities for the ATO. In an ATO employee engagement survey undertaken in 2011, many staff commented that change in the ATO was business as usual for them.¹⁹

The introduction of the GST in 2000 was a particularly massive challenge for businesses and their agents who struggled to cope with the requirements of the new tax. The confidence of tax agents in the ATO reached a low ebb.

The ATO also felt the strain of implementing what was a politically charged tax package. The implementation of the reform initiatives required new IT systems and major modifications to the ATO’s legacy systems; and it required new processes and procedures, new guidelines and rulings, new educational material for businesses and for other affected taxpayers. A comprehensive communication and marketing strategy was implemented, and the change necessitated significant recruitment and the intensive training of staff.

A major new tax and the difficulties associated with its implementation reduced community confidence in the ATO. Something out of the box needed to be done. But what?

6. LISTENING TO THE COMMUNITY

The ATO looked outside itself for answers. It initiated a ‘Listening to the Community’ program which coalesced around three key objectives:

¹⁷ *A New Tax System* circulated by the Honourable Peter Costello, M.P., Treasurer of the Commonwealth of Australia, August 1998.

¹⁸ Report to the Treasurer, *‘Australia’s Future Tax System’*, December 2009, Commonwealth of Australia, 2010.

¹⁹ An echo of the sentiments in a speech by Commissioner Boucher, *‘We Eat Change for Breakfast.’*

- Improved compliance;
- Increased service and certainty; and
- Making people's experience 'easier, cheaper and more personalized'.

In many ways the ambitious, risky and largely self-funded Change Program initiated by Commissioner Carmody was critical to the achievement of each of these objectives. It was intended to be and proved to be a real and substantial reinvention of the ATO. In the words of Commissioner Carmody, it was intended to be transformational for the ATO. On the completion of the Change Program in 2010 it had achieved that objective and laid a firm platform for the future.

7. THE ATO'S CHANGE PROGRAM

The ATO decided to turn the need for new IT into an opportunity, an opportunity to make very significant improvements to its products and services. The goal of the Change Program was to improve services to Australians while streamlining the ATO's operations, and enhancing the ATO's compliance and intelligence capabilities. It was delivered in three major releases, together with other system initiatives:

- The Tax Agent Portal provided tax agents with a secure on-line interface with the ATO and revolutionised the relationship between tax agents and the ATO. Subsequently, the Business Portal allowed business to interact with the ATO on-line reducing compliance costs.
- Release 1 of the Change Program implemented a client relationship management system that improved client experiences.
- Release 2 replaced 187 case management systems with one national and integrated system with work flow capabilities which facilitated effective national risk management and monitoring.²⁰
- Release 3 is the largest information technology deployment ever undertaken by the ATO. The new integrated core processing system replaced the ATO's national taxpayer system.

The transformational nature of the Change Program also meant that new ways of thinking, behaving and perceiving were needed.

We are intent on transforming the Tax Office from an organisation-centric body into a user-centric one—putting the needs of the community first, standing in their shoes, getting to know them better and working with taxpayers and their representatives—tax agents and the IT industry and others—to work together in developing better services and products to make one of life's certainties just that much easier. It's a big departure from the past.²¹

²⁰ In relation to Release 1 and 2 of the Change Program, see ANAO, 'Tax Office's Implementation of the client contact – work management – case management system', 2010.

²¹ Greg Farr, former Second Commissioner of Taxation, speech to the Government Technology World Conference, 2006.

The Change Program reshaped the ATO's entire information technology infrastructure by replacing several systems (some 30 years old) with a single integrated information technology platform.

The change program has significantly revolutionised how the ATO develops and delivers its services to its customers ... [it] has provided the ATO with an integrated technology and business delivery capability that provides the basis of future efficiency dividends.²²

External reviews by Aquitaine Consulting²³ and CPT Global Limited²⁴ concluded that the change program realised the following benefits:

- over \$150 million annual savings as a result of efficiency gains,
- financial benefits to government through use of analytics in increased compliance and prevention of fraudulent refund payments,
- ability to deliver new policy changes faster through 'in pattern' changes,
- ability to resolve more client contact on 'first call' activities due to improved case management and improved analytics, and
- an enhanced ability to pre-fill returns, making it easier for registered tax agents and taxpayers to comply.

The change program also provided a basis for further realisation of benefits, such as improved fraud detection and analytics; greater leveraging of pre-filing opportunities; and the development of front-end user friendly applications to meet the contemporary needs of individuals and businesses.

In terms of scale, size and timeframe, the Change Program is unique in the world. The ATO is positioning itself for organisational capability that other tax administrations aspire to.²⁵

Parliament too recognised the importance of the Change Program for future tax administration:

Overall the Committee was pleased that the investment in the change program was beginning to pay dividends in reducing processing time and in identifying potentially fraudulent claims which would improve the integrity of the system.²⁶

The changes made to the way the ATO operates as a result of the Change Program were pervasive and in their totality provided a platform for innovation and for building comparative advantage for the ATO and Australia.

The pace of innovation did not falter, and even before the Change Program was completed in 2010 the ATO was developing its new *ATO On-line Strategy 2015*

²² CPT Global Limited, 'Report on Release 3 Income Tax', 2010.

²³ Aquitaine Consulting, 'Review of the Benefits from the Change Program', 2010.

²⁴ CPT Global Limited, 'Change program benefits realisation assessment', 2012.

²⁵ Gary Pascoe, CapGemini, 2010.

²⁶ Joint Committee of Public Accounts and Audit, Report 426, Ninth biannual hearing with the Commission of Taxation 23 November 2011, Commonwealth of Australia, 2011.

(designed to improve the community's interface with the ATO and to include tools to further empower taxpayers). The ATO On-Line Strategy focused on online services but was also about championing a digital Australia. The new On-Line Strategy was complemented by a structured program for the on-going enhancement of the ATO's IT capabilities.²⁷ For example, the ATO developed specifications for the extension of *e-Tax* to web-based platforms and worked on the introduction of an Individual's Portal (which could link with whole of government initiatives designed to provide the citizen with a one-stop shop).

Nevertheless, IT platforms on their own do not guarantee transformation without the engagement, commitment and innovation of people.

8. PEOPLE AND SKILLS

Ultimately it is people that in large measure govern the effectiveness of a public sector administration, particularly in the way they interact with the public and in the manner in which they gain the community's trust and confidence.

Graduates and call centre staff brought generational change and greater diversity to the ATO. They were less accepting of existing structures and processes than earlier generations had been and more positive in promoting themselves and their ideas. However, ATO values remained constant and second nature and almost all tax officers worked hard and were enthusiastic, skilful and committed to ATO goals.²⁸

The profile of the workforce of a public sector organisation depends on the nature of the tasks required of the agency. As the ATO had digitised many of its processing activities there was an increasing need for knowledge and intelligence based expertise in a wide range of disciplines.

The ATO graduate program played its part in meeting the skills required for the sustainability of a leading tax administration.²⁹ This was supplemented by the melding of private and public sector expertise within the ATO. For example, in 2012, the ATO had a good balance of public and private sector expertise, with 35 per cent of its senior leadership having substantial private sector experience.

An emphasis on having people with the right skills, training and values in the right place saw the ATO lift its standards of professionalism and the expectation of the organisation and of staff themselves as to what amounted to superior performance. The investment in people and in their level of professionalism was facilitated by the progressive enhancement of performance management and development practices essential to the efficient operation of a large organisation. For example, the ATO made

²⁷ See Commissioner of Taxation, Annual Report 2011-12.

²⁸ Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p250.

²⁹ For example, the ATO's graduate program was ranked third in the 'Aspirational employer of choice' category in the Australian Association of Graduate Employers *Candidate survey 2011*. In 2012, the ATO was the only government agency to make the top 10 in the 'Aspirational employer of choice' category; and for the third year in a row, the ATO's graduate development program was recognised as the 'Best graduate program'. It also ranked seventh in the 'Best recruitment process' and 'Best opportunities for graduates' categories in 2012.

performance management an essential element of the role of team leaders and managers. Performance management and development at the ATO included an assessment of staff performance against professional standards, coaching, 360 degree feedback, comparison with qualitative and quantitative data from the rest of the organisation, and feedback from taxpayers and their agents. A survey of ATO staff showed that they rated well by these criteria against private and public sector benchmarks and this focus on professionalism significantly improved the tone, standards and productivity of ATO people.³⁰

9. THE ATO'S INTEGRITY FRAMEWORK

The integrity of a tax administration and of its staff is fundamental to maintaining community trust and confidence.

Internal integrity was ensured by the ATO's integrity framework that won a global award for governance in 2007, and by an internal investigation unit supported by a fraud and ethics team that had long existed to detect and deal with staff dishonesty.³¹

As at 2012, the ATO's integrity framework included a wide range of integrity indicators and a program of certificates of assurance, complemented by internal audit and fraud prevention functions. As part of this framework the ATO:

- set ethical standards for employees, including adherence to the ATO and Australian Public Service values;
- told the community how they could raise concerns or make complaints;
- had an independent Integrity Adviser to provide advice directly to the Commissioner;
- had systems to prevent and control fraud; and
- used its corporate governance committees to consider and monitor integrity.

Rules and regulations as well as processes to monitor adherence to those rules work best in an environment where the culture and values of its staff reflect an integrity-based organisation. A focus on nurturing the right culture is at the centre of building a world class tax administration.

10. VALUES AND ENGAGEMENT

Getting people to do their work well is only the start of staff engagement with the goals and values of the organisation and with the community they serve. The objective at the ATO became to embed within the organisation a virtuous circle of care, integrity and commitment by staff to the important work of the ATO, to continuous

³⁰ Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p253-4.

³¹ Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p240.

improvement and top down and bottom up innovation, to new thinking and new ideas, and to success. Success in turn leads to increased engagement and alignment with organisational goals and values, which in turn spin another cycle of success for the agency and the community.

An important part of this focus on values was the development of personal empathy between tax officers and taxpayers to dissolve the barriers that separated the ATO and the community, as much as possible.³² This was reflected in the ATO Strategic Statement 2010–15 and the associated linkage of proper participation in Australia's tax system with good citizenship.³³

Placing emphasis on the concept of corporate values and on trying to treat people as you would want to be treated yourself supported a culture conducive to the making real and tangible the ATO's strategic themes. The ATO culture was of "a community of people bound together by the shared knowledge that they were doing important work for the Australian community and a sense of shared professionalism".³⁴

11. ATO'S SERVICE INITIATIVES AND REDUCING COMPLIANCE COSTS

New technologies allowed the ATO to provide contemporary services. They included online access to information such as rulings and publications, online registration for an Australian Business Number, improvements to the ATO website's search capabilities, and social media such as Facebook. Electronic lodgment, called *e-tax*, facilitated electronic lodgement of returns by individual self-preparers and was progressively upgraded to include pre-filling of returns with details provided by third parties.

The ATO's call centres responded to over 11 million calls in 2011–12 and were recognised as amongst the nation's best.³⁵ In the same year the ATO started using new technology to better understand taxpayers' needs, to improve service and to detect potential risks. This technology scans for key words and phrases in millions of call recordings and allows the ATO to respond to emerging trends in a timely manner. By better understanding the volume and nature of these enquiries the ATO is able to improve the way it communicates and responds to them, including improving end to end services.

Notwithstanding these significant service improvements, a major ATO initiative that commenced in 2011 was the wholesale review of the ATO's service standards.³⁶ The

³² Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p240.

³³ 'Tax and Citizenship', Presentation by Michael D'Ascenzo, Harvard Kennedy School and Irish Tax Institute - Global Tax Policy Conference, Dublin, October 2013.

³⁴ Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p253.

³⁵ For example, the ATO's integrated quality framework for quality assessment of call centres, recorded telephony quality for 2011–12 at 96.4% against a benchmark of 90%. In 2012 the ATO's Chermside contact centre was awarded the Australian Teleservices Association contact centre of the year for Queensland. The ATO was also a finalist at the NSW Australian Teleservices Association awards.

³⁶ Service Standards were first introduced by the ATO in 1997 with the implementation of the Taxpayers' Charter. See also the ATO submission to Joint Committee of Public Accounts and Audit hearing, Friday 14 September 2012.

intent of the review was to provide a roadmap of progressive implementation of new standards and approaches under the banner of five service commitments:

- Helpful and accurate: You help me by giving me accurate information that I can rely on and understand.
- Easy to deal with: You make it easy for me to access the services and information I need.
- Timely: The time taken in my dealings with you is acceptable to me.
- Keep me informed: I am informed of what I need to do and you let me know of status or delays.
- Be professional: You are professional because you treat me respectfully, courteously, and you are knowledgeable in my dealings with you.

12. THE 3Cs AND USER-BASED DESIGN

In seeking to make the system easier cheaper and more personalised for taxpayers, the ATO pioneered two closely related concepts:

- User- Based Design; and
- The 3Cs of ‘consultation’, ‘collaboration’ and ‘co-design’.

Bringing these concepts to life helps to make the tax system easier, cheaper and more personalised for taxpayers.³⁷

The 3Cs became formal elements of the ATO’s 2006–2010 Strategic Statement and were prominent in the values and themes that underpinned the ATO’s 2010–15 Strategic Statement.

As one ATO officer put it:

I think the 3Cs has improved our ability to do this and inspires confidence among those who want to know about what we do...

User-based design allows us to view the world from the taxpayer’s perspective. Using this approach we will get better outcomes because the materials we produce for the community will be written in **their** words not ours, using their thinking and not ours, and fitting with their natural systems, not ours. If we apply these principles, compliance becomes the norm because it is easy.³⁸

³⁷ Commissioner of Taxation, ‘Making a difference - the intent behind our strategic statement 2010 – 2015’, (which accompanied the release of the ATO’s Strategic statement 2010–15).

³⁸ Michael Strong, ATO National Director, Excise Change and Product Management, in Case Study—Improving our products and services through the 3Cs – consultation, collaboration and co-design, in Making it Easier to Comply, ato.gov.au.

These comments illustrate how bringing to life the ATO's corporate values in its 2010–15 Strategic Statement helped to create a community first tax administration.³⁹

13. TAX AGENT ACTION PLAN

In recent years the registration and regulation of tax practitioners in Australia has been strengthened by the introduction of a new national Tax Practitioner Board (TPB). The TPB is a national body responsible for the registration and regulation of tax practitioners and for ensuring compliance with the *Tax Agent Services Act 2009* (TASA), including the *Code of Professional Conduct* (Code). This is achieved by:

- administering a system to register tax and BAS agents, ensuring they have the necessary competence and personal attributes
- providing guidelines and information on relevant matters
- investigating conduct that may breach the TASA, including non-compliance with the Code, and breaches of the civil penalty provisions, and
- imposing administrative sanctions for non-compliance with the Code.

The new arrangements help to promote a capable and well regulated tax profession of high integrity. This makes tax agents a key leverage point for the effective operation of the tax system.

Overall, tax agents in Australian have been a positive influence on the proper compliance with the law by their clients. For the ATO the operating premise has been that tax practitioners and other intermediaries play a positive and integral part in the effective operation of the tax system. However they too benefit from the assistance and streamlined processes that the ATO provides to them, including the tax agent portal. Moreover, their needs for assistance change with market expectations, frequent amendments to the tax laws, and the opportunities and challenges of new technology. In 2011 the ATO launched its *Tax Practitioner Action Plan* to refresh the relationship with this important stakeholder group.⁴⁰

14. TAX TECHNICAL DECISION MAKING

Tax technical decision making is at the centre of the ATO's responsibilities. The ATO took a purposive approach to the interpretation of the law and this flowed through the practical and common sense application of the law to relevant facts. By applying the rule of law, which delineates the extent of the ATO's powers,⁴¹ the ATO provided a

³⁹ Commissioner of Taxation, "*Creating a community first culture in the Tax Office*", Australian Public Service Commission – Leadership Development Network, 15 November 2006.

⁴⁰ Tax Practitioner Action Plan, ato.gov.au.

⁴¹ Bruce Quigley, former Second Commissioner of Taxation, '*The Commissioner's powers of general administration: how far can he go?*', 24th Taxation Institute of Australia, National Convention, Sydney, 12 March 2009.

high degree of certainty and consistency conducive to a positive business and investment climate.

In addition the ATO took steps to make it easier for taxpayers and their advisers to access its technical experts in a timely manner and to streamline the tax decision making process by:

- designing flexible processes to support staff making decisions at the front line,
- removing barriers to engaging with the ATO's tax technical experts and decision makers,
- ensuring the reasons for decisions are known and understood by everyone, and
- establishing early engagement mechanisms such as dedicated triage teams.

The ATO used its best tax technical specialists (including its Tax Counsel Network) to help ensure good decision making up-front in the application of the tax law to significant issues. This provided taxpayers up-front with the authoritative ATO view of the application of the law on precedential and complex matters rather than it being developed sequentially through internal review processes. The intent was to reduce the time taken to resolve disputes either administratively or through the courts.

15. ATO REFINEMENT OF ITS COMPLIANCE APPROACH

In developing the compliance model, which differentiates between the economic, psychological, and social circumstances of taxpayers, the ATO has been a global innovator.

Progressively the ATO has sought to shift its thinking and that of the community to prevention rather than cure strategies. The ATO has focused increasingly on early engagement, greater differentiations, and encouraging, supporting and championing mutual transparency through enhancing its relationships with taxpayers and their advisers. Taking this approach, particularly with large business, the ATO has sought to foster a 'no surprises' approach with those taxpayers who see advantages in reciprocating a more open and constructive relationship with the ATO.⁴²

Today many leading tax administrations are adopting the concept of co-operative compliance to develop an enhanced relationship between business, tax practitioners, corporate advisors and tax authorities.⁴³

Segmentation into broad market sectors is useful because different market segments have different service needs and give rise to different risks. In addition the ATO has recognised that analytics can provide a more granular understanding of taxpayer needs and risks and has invested in this capability.⁴⁴

⁴² Commissioner of Taxation, *'Mitigating risk'*, 10th International Tax Administration Conference (ATAX), Sydney, 2 April 2012.

⁴³ OECD Forum on Tax Administration, 'OECD Tax Intermediaries Study, Working Paper 6 – The Enhanced Relationship', July 2007.

⁴⁴ Reflecting the theme of "Enhancement"—one of the 5 themes that underpinned the ATO's Strategic Statement 2010–15.

The ATO values as described in *'The Intent behind the 2010-15 Strategic Statement'* are also at play in the ATO's approach to compliance. For example, the ATO is using collaborative approaches, both at domestic and international levels, to contribute to breakthrough solutions. This is all part of a vision of making a difference—encouraging and supporting willing participation in Australia's tax system, protecting the community from those who are not willing to meet their civic and legal responsibilities, and continuously improving the ATO's capabilities in order to champion community interests.

16. CONCLUSION

"In 100 years Australia had changed beyond the imagining of the politicians who fought the 1910 election over issues including the land tax...It was [in 2010] an entirely different world from the one into which the ATO had been born. It had begun as a tool of social change in a world of hierarchies, controls and parochialism and survived and grown over 100 years as the result of decades of hard work and the dedication and values of its people. As a result, most Australians no longer saw the ATO as a large, alien and authoritative organisation, but as a friendly, firm but fair and necessary part of Australian life that existed to serve the community. This close relationship with the community was the view of its role that the ATO unveiled in June 2010 as its strategic statement for the years ahead, marking the beginning of the ATO's second century of working for all Australians."⁴⁵

If I had to put my finger on what enabled the ATO's transformation I would have to give credit to the leadership of my predecessors and the engagement, commitment, innovation and integrity of the ATO's people.

The Joint Committee of Public Accounts and Audit's (JCPAA) in its 2011 Report 426 and 2012 Report 434 noted "the many improvements that have occurred in Australian tax administration."⁴⁶ The JCPAA's Report 426 in particular highlights the trust that has been built over time, bridging the gap between the ATO and its stakeholders:

The Committee found that the administration of Australia's tax system is robust. Overall it is well managed, providing a trusted foundation for Australia's people, business and government.⁴⁷

⁴⁵ Leigh Edmonds, 'Working for all Australians 1910-2010: A brief history of the Australian Taxation Office', 2010, p256.

⁴⁶ The Joint Committee of Public Accounts and Audit, Report 434, Tenth biannual hearing with the Commissioner of Taxation, November 2012, *Foreword* by Chair Rob Oakshott MP at vi.

⁴⁷ Joint Committee of Public Accounts and Audit, Report 426, Ninth biannual hearing with the Commissioner of Taxation, November 2011. See also, the Joint Committee of Public Accounts and Audit, Report 434, Annual Public Hearing with the Commissioner of Taxation – 2012, November 2012.

17. ATTACHMENT A: CHANGE PROGRAM TIMELINE

2002	'Listening to the community' program helped the ATO develop ideas to make it easier and cheaper for people to comply with their tax obligations.
2004-05	Business case for the change program approved in December 2004. Accenture contracted in December 2004 to deliver a single integrated system through three releases. Release 1 sees the implementation of a single client relationship management system. This provided improved efficiencies for 2,500 ATO employees and improved client experiences.
2006-07	Release 2 enables over 13,000 staff in over 1,000 teams across 60 sites to fundamentally change the way they carry out their work.
2008-10	Release 3 is the largest information technology deployment ever undertaken by the ATO. It provided a single way of working across the ATO and involved rolling out a new Integrated Core Processing system. Revised change program schedules and budgeted costs approved to reflect Super Simplification reforms, other legislative changes, annual provision for tax time and scope changes. Australian National Audit Office report on 'Performance audit of the ATO's implementation of the Change Program: Strategic overview of benefits and costs' tabled in October 2009.
2010	The change program was officially closed in July 2010. <i>Review of the Benefits from the Change Program</i> developed by Aquitaine Consulting in September 2010. ANAO report on 'Tax Office's implementation of the client contact - work management - case management system' tabled in September 2010.
2011-12	Inspector-General of Taxation report on 'Review into the ATO's Change Program' was released in May 2011. <i>Change program benefits realisation assessment</i> developed by CPT Global Limited in June 2012.

Effective engagement: Building a relationship of cooperation and trust with the community

Jo'Anne Langham^{1,2} and Neil Paulsen³

Abstract

To the mainstream population, a taxation authority is an enigmatic and remote force. Most citizens would prefer to have little, if any interaction with such an organisation. The Australian Taxation Office (ATO) is no exception. The ATO is the sole Commonwealth government agency assigned the role to administer the taxation and superannuation systems. The lesser known focus in the ATO on consultation and collaboration with taxpayers has been the poor cousin to the alter ego of the 'firm enforcer'. Recently, a focus on improved engagement between the ATO and the taxpaying population led to the development of a prototype community engagement framework. The framework bridges the division between enforcement and collaboration, demonstrating that engagement is a spectrum of professionalism and service delivery. This paper discusses the development of the Effective Engagement Framework, which utilized the ATO's own co-design methodology. The implementation and evaluation of the methodology are outlined, as well as suggestions for the application of the framework to tax authorities or other compliance agencies in removing the obstacles to improved engagement with the community.

Keywords: taxation; compliance; effective community engagement; taxpayer engagement; collaboration; co-design

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1. INTRODUCTION

Contemporary taxation authorities are heavily invested in genuine engagement with the community. Taxation is a complex socio-economic phenomenon that is a great deal more than just economics and fiscal policy. The citizens' willingness to voluntarily comply with their tax obligations is directly related to the salience of their relationship with the revenue authority. Engagement is therefore critical to successful administration as it improves efficiency, reduces the cost of administration and enhances compliance.

Nonetheless, taxation administration has a history steeped in rigid economic thinking. Tax agencies around the world have rigorously applied Expected Utility theory (Schaub, 2004) for building their compliance management models. However, research overwhelmingly demonstrates that humans do not behave as the idea of a rational economic man (REM) would suggest (Allingham & Sandmo, 1972; Cullis, Jones, & Lewis, 2006). Therefore, strategies designed to leverage these concepts have been counterproductive (Bergman & Nevarez, 2006; Johnson, Masclet, & Montmarquette, 2010; Kirchler, 2007; Mittone, 2006). A substantial body of evidence suggests that enforcement is ineffective as the predominant method for guaranteeing payment of taxes. Alternative strategies directed at enhancing voluntary compliance through reward or reinforcement are limited.

Successful management of taxation compliance requires high levels of participation and engagement of taxpayers in the tax system. However, willingness and engagement does not equal compliance. Similarly, it cannot be assumed that taxpayers who are non-compliant are all attempting to evade. Many explanations are offered as to why good and well-meaning taxpayers become unintentionally non-compliant. However, two reasons predominate: a lack of strong intention to comply or an inability to comply (Langham, Paulsen, & Härtel, 2012). Poor intention may be caused by perceptions that it is unnecessary or socially unacceptable to meet tax obligations, leading to laziness or negligence. An inability to comply can result from a lack of knowledge or the imposition of unforeseen obstacles created by the tax system itself. The more problematic of the two causes is an inability to comply. Legal or administrative complexity creates obstacles that the taxpayer or their intermediaries are unable to overcome with their limited resources (Langham, 2012). Improved administrative design will support increased compliance.

Hoelzl, Kirchler and Wahl (2008) investigated the underlying factors of social responsibility, empowerment and control and reported that high levels of tax compliance are not maintained by force, but instead by willingness and cooperation between the authority and the people. Therefore, strategies of partnership with the community and reinforcement of voluntary participation are critical in tax administration.

Before such strategies can be implemented, the modern taxation authority must concede that the majority of compliance issues do not occur because of taxpayers' deliberate will to evade; instead they occur as a result of complexity in the law or a complicated and costly tax compliance burden. Tax evasion involves deliberate unlawful actions to reduce tax, commonly under-declaring income or over-declaring deductions and implies a conscious, premeditated action. In many cases, taxation authorities, including the Australian Taxation Office (ATO), evolved as enforcement agencies whose job it was to expose those who had evaded their tax responsibilities; very much a game of "cat-and-mouse" (Rothengatter, 2005). Staff capabilities and organisational structures tend to support this view. However, taxation authorities now

recognise that encouragement and cooperation with taxpayers are the directions they must take to make substantial improvements in voluntary tax compliance. The new public governance literature reinforces the view that public services are no longer manufactured and delivered but are instead co-produced (Osborne, Radnor, & Nasi, 2013). Purposeful engagement with the community is a necessity.

In this paper, we describe the context and development of a prototype engagement framework recently developed in the ATO. This framework emerged from an increased focus on improving engagement, cooperation and trust between the ATO and the taxpaying population. This framework is designed to shape interactions with the community by building on the principles of the Taxpayer's Charter and the concepts of co-creation and co-production. The framework also bridges the division between enforcement and collaboration, demonstrating that engagement is a spectrum of professionalism and service delivery. We outline below the process for the design and evaluation of the framework and make suggestions for how the framework can be used by taxation authorities can enhance improved engagement with the community of taxpayers.

1.1 The context

In the Australian context, the ATO is the sole national government agency assigned the role to administer the taxation and superannuation systems. In 2012–13 the ATO collected \$311.7 billion in net tax to support the Australian community (Australian Taxation Office, 2013a). Yet to the mainstream population, the ATO is an enigmatic and remote force. Most citizens would prefer to have little, if any interaction with the organisation due to fear and folklore perceptions of the bureaucracy. Despite such perceptions, the ATO collects the majority of revenue from willing participation in the system.

Such beliefs and attitudes have a direct influence on the ability of the ATO to facilitate compliance with the majority of the well-meaning and willing taxpaying population. Taxpayers are often afraid to approach the ATO when in genuine need of a cooperative relationship, establishing payment arrangements, or understanding and translating complex legislation without any bias (Young, 2013). Additionally, taxpayer apprehension or alternatively resentment created by perceived unfairness of the law, undermine the ability of the organisation to work with the citizens to improve or rectify issues inherent in the system.

However, the ATO has a dualistic relationship with the community. The lesser known but highly important focus on consultation and collaboration with taxpayers at times has been the poor cousin to the alter ego of the 'firm enforcer'. For many years, the ATO has attempted to actively engage, consult and collaborate with the Australian population to improve the taxation system and make it easier for them to comply with their tax obligations.

The ATO is increasingly aware of its role in facilitating, rather than enforcing taxpayer compliance. In 2000, a large community engagement project was conducted known as 'Listening to the community'. From this project, a number of new measures were developed and implemented. The introduction of the Compliance Model (Braithwaite, 2003) in 2000 reinforced the view that only a wily minority of taxpayers deliberately choose to avoid their obligations. The introduction of this model provided the catalyst for a number of organisational changes. Support and education tools for taxpayers were developed as well as the recognition that a system designed with the people who had to use it, would encourage ownership and make it easier to comply.

A substantial design capability was established during this period including specialist ‘design facilitators’, ‘usability researchers’ (user-centred designers) and ‘information designers’ as well as traditional system (or ‘solution’) designers (Australian Taxation Office, 2012). This area is known as Integrated Tax Design (ITD). ITD employs user-centred design techniques, known within the ATO as ‘co-design’ and is focussed on developing well designed systems to support and shape organisational policy implementation. ITD work with internal and external stakeholders (such as Treasury staff) as well as with the users themselves to design improved systems. User-centred design (or ‘co-design’) has grown in use over the years and has shaped the development of ‘better superannuation’, individual tax compliance (eTax), and the ongoing evolution of tools such as the business and tax agent portals.

However, the rapid pace of technology evolution has meant that the ATO must exist in a constant state of change. The development of hand-held mobile devices, social networking and modern communications means that the ATO must also commit to doing business in line with contemporary practice. The Australian Public Service Commission (APSC) capability review noted that these technology drivers present a challenge for the ATO.

ICT was an area of frustration often mentioned by staff and the community throughout the review. Internal stakeholders feel that all too often, the ability to progress aspects of their business is stifled by a lack of capacity in the ICT forward work plan to accommodate demand. This affects immediate needs and future-focused innovation. External stakeholders have commented that the ATO is falling behind community expectations and forward-thinking overseas revenue agencies with its electronic service offerings. (Australian Public Service Commission, 2013, p. 9).

In response, the Commissioner of Taxation created a sense of urgency for improved technology and interactions with the community, and for keeping pace with change in the community. The current Commissioner was appointed in early 2013. He is a former Chairman of KPMG (NSW) and also Chairman of the Board of Taxation, and brings a commercial perspective and a deep understanding of the issues confronting tax professionals and taxpayers when interacting with such a large bureaucracy. The Commissioner moved quickly to make positive changes as the ATO moves towards delivering a 2020 vision of contemporary client service (Australian Taxation Office, 2013).

Facilitating voluntary compliance is not an easy task, particularly for a large geographically-dispersed organisation that has been historically perceived as the revenue sentinel. Fear and uncertainty have been the historical attitudes of the general community to the ATO (Hobson, 2002). Loss of confidence in the taxation authority is one of the primary reasons for non-compliance (Kirchler, 2007, pp. 202-206). Voluntary compliance relies on trust: trust that is built on cooperation between the authority and the people, coupled with a sense of fairness in policy, procedure and penalties. Citizens need to feel respected and treated fairly. Where citizens feel a loss of autonomy or restriction in their freedom to make decisions, they may resist compliance due to psychological reactance (Brehm, 1966; Carver & Scheier, 1998, p. 55). The more coercion required, the less trustworthy the authority becomes (Kirchler, 2007, pp. 204-205). Given the balance of these forces, the tax authority must remain vigilant in maintaining and reinforcing an image of fairness (Hoelzl et al., 2008).

The focus on trust and cooperation is central to the new service delivery approach to modern tax authorities. The enforcement or ‘cops and robbers’ approach is costly and although it limits the ability of some taxpayers to evade, it cannot ensure that the majority of taxpayers comply. The new approach towards a partnership with the community involves a greater focus on engagement and working with taxpayers to improve the systems with which they interact. Whilst still attempting to improve the systems, the ATO has redirected its focus and vision for the year 2020 towards a stronger relationship with the community, responsive practices and a high level of supportive engagement approaches (Australian Taxation Office, 2013).

2. WHY DEVELOP AN ENGAGEMENT FRAMEWORK?

Disengagement from the system by taxpayers is an endemic risk for tax authorities. The strategy to control or mitigate the risk involves building relationships of trust and cooperation with the community, developing products and processes collaboratively, and providing differentiated treatments to facilitate compliance. The ATO invests significant resources in attempting to prevent community disengagement from the tax system. The ATO publishes material on understanding the rules, develops self-support tools, maintains call centres, provides public and private rulings, and works with software developers to keep commercially related software support up-to-date. For these tools to support taxpayers and their intermediaries, the ATO must continually test and design services to meet the needs of users. Good design requires engagement and interaction with the users to ensure the value of the products. While community participation in the design process creates trust and cooperation, more importantly it creates better outcomes. Through working with the users of products (taxpayers or intermediaries), designers are able to understand the real user context of policy, products and systems. Increased understanding of taxpayer behaviour, their issues and the complexity of applying tax law in the real world, provides insights and potential solutions that are not overtly apparent to policy makers. Designers can also leverage knowledge about existing processes and tools to trigger or reinforce desired taxpayer behaviours.

However, the process of leveraging community engagement requires co-ordination, quality and integrity guidelines, and controls. The development of an engagement framework provides the basis for planning and evaluation of engagement activities. A framework also creates a shared understanding for staff of the values and the organisation’s approach to working with the community. The implementation and publication of such a framework demonstrates a commitment to public participation in the design of the tax administration.

The ATO commenced a number of measures during 2011–2012 to improve the use and management of the relationship with the community. One area within the ATO decided to foster an approach to enhanced engagement approaches with the community using a governance framework. Along with the development of the framework, a small team with responsibility for providing related expertise and skills for conducting engagement activities was also created. Initial responsibilities of the group included exploring and scoping the requirements for a systematic approach to community engagement, as well as understanding and developing a framework. Such efforts would complement the existing robust active compliance (audit) capability. The framework was intended to be flexible and not overly prescriptive, but also should enable a more co-ordinated and integrated approach to community engagement.

The Inspector General of Taxation Report (2012) into the ATO approach to dealing with small and medium enterprises revealed a number of weaknesses in the engagement approach towards these taxpayers. The 2012 report recommended greater visibility and expectation setting around service standards and ATO staff behaviours, as well as increased consultation and involvement of the community in shaping the administrative system.

An internal literature and operational review was conducted to understand the current research and applications of public participation and community engagement. The review was followed by an evaluation of the relationship between the ATO and the Small and Medium Enterprise community. Issues were also identified with the related tax agents. The research revealed that although this particular area of the ATO had focussed engagement activities, such as the ongoing use of the SME Community Forum⁴, a number of additional strategies could improve the relationship with the community. The issues identified by the review (see Table 1), and the growing awareness that community engagement was critical to the success of voluntary compliance, provided sufficient impetus within the business area leadership to agree to the development and implementation of the Effective Engagement Framework.

Table 1: Key issues identified in the review on engagement

-
- Lack of consistent and shared view of engagement
 - Lack of integration of engagement activities with other compliance activities
 - Lack of appropriate co-design methods
 - Lack of integration of the co-design capability with other core capabilities
 - Ambiguous ownership and sponsorship of engagements with the community
 - Insufficient resource capacity
 - Insufficient succession planning
 - Inappropriate effectiveness indicators
-

A framework for engagement enables the evaluation of community interaction effectiveness, as well as provides assurance for research and engagement processes. The ATO has a strong commitment to the use of the Compliance Effectiveness Methodology (now known as the Effectiveness Methodology) (Australian Taxation Office, 2008). This methodology was a strong influencing factor in the development of the Effective Engagement Framework. The development of the framework was also supported by a cross business area internal committee that committed to, dependent on the success of the pilot, implementing the framework more broadly within the organisation.

3. FRAMEWORK DEVELOPMENT PROCESS

The engagement framework was developed over a six month period from April-October 2012. The design process followed the ATO user-centred design approach:

⁴ The SME Community Forum was a closed online community, enabling discussion between ATO guest speakers and registered participants. The forum was superseded in 2013 by the new site “Talking Tax”: www.govspace.gov.au/talkingtax.

Integrated Administrative Design (IAD) or ‘co-design’. This iterative methodology has five stages, involving the development of a prototype, followed by testing and evolution of the design products through use and evaluation by users.

A search of existing literature on community engagement identified several existing approaches including frameworks and support materials from both the government and private sector in Australia (Department of Communities, 2007; Department of Sustainability and Resources, 2005; Industry Skills Council, 2009, 2012; Ministerial Council on Mineral and Petroleum Resources, 2005). The two most relevant approaches were guidelines from the South Australian State Government Department of Family and Communities (Department for Families and Communities, 2006) and the International Association for Public Participation Australasia (IAP2) (International Association for Public Participation: Australasia, 2009).

The International Association for Public Participation (IAP2) *Spectrum of Engagement* is a core component for the development of the ATO framework. The Spectrum identifies the range of activities and outcomes that could be used when engaging with the public (Figure 1). The IAP2 *Spectrum of Engagement* has been utilised in existing evaluation of engagement activities for many of the Australian State Governments (International Association for Public Participation: Australasia, 2010). The spectrum provides a suitable backdrop for use within a public service engagement framework. The ‘inform, consult, involve, collaborate and empower’ concepts were used as a basis for the ATO framework.

Figure 1: IAP2 Spectrum (adapted from International Association for Public Participation, 2009)



Concurrent with the literature search, a project team⁵ conducted the design process with stakeholders and potential users of the framework. The first stage of the IAD process included the development of a prototype. The project had a number of

⁵ The first author was the facilitator of the project team.

additional deliverables such as a governance process, planning for the 2013 and 2014 years, capability development and communications activities, as well as the engagement framework itself. Following a brief description of the process to develop the prototype, we outline the research methods and data used for user testing and design, finalisation and evaluation of the framework.

3.1 Development of the prototype

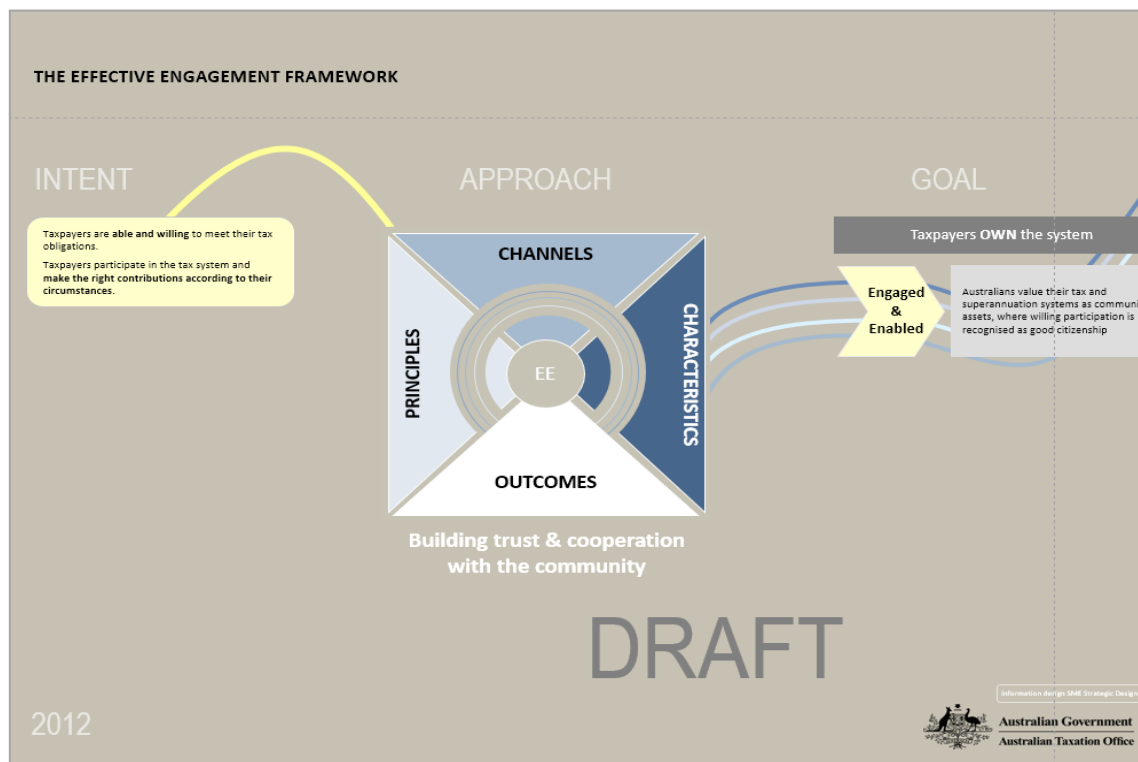
An initial workshop with ATO executive stakeholders was conducted to develop an intent statement,⁶ a set of goals and measurable indicators of success. The two primary goals identified by the group were to have ‘engaged taxpayers’ and ‘enabled taxpayers’. The following statement describes engaged taxpayers: “Taxpayers want to meet their obligations and engage in ongoing open and honest dialogue and interaction to remove obstacles and facilitate compliance. An environment where participation is nurtured and feedback is welcomed”. Enabled taxpayers were described as follows: “Taxpayer compliance facilitated by providing verification and certainty around obligations. We ensure that the services that we provide to the community to meet their obligations, prevent errors, provide certainty, are seamless, unobtrusive and cohesive” (Australian Taxation Office, 2012). The first prototype also established a set of mutual commitments by the executive group and their expectations of the community. This list was reviewed and refined with a wider group of executive stakeholders and was used to form the first version of the framework prototype.

Three predominant goals characterised both the framework as well as the area approach to effective engagement. These were:

- We are efficient and effective with our engagement with the community
- Taxpayers understand and meet their obligations
- Taxpayers own the tax system

Following this process, the first version of the prototype was developed. The prototype identified three key components: Principles, Focus Areas and Levels of Impact. This first version of the framework was reviewed by a number of internal ATO committees. Further refinements were made to ensure that the prototype captured the intent of the work conducted to date. A second version of the prototype was developed over a period of four weeks. The updated framework included a new component: Channels (see Figure 2). Further workshops were held with key stakeholders to develop a set of indicators for evaluation. These indicators were directly related to the goals of the Framework (as noted above).

⁶ This statement is a requirement in the Integrated Administrative Design (IAD) methodology. An intent statement is a single statement outlining the purpose of the focus product, tool or service.

Figure 2: Coversheet of version two of the Effective Engagement prototype

This version of the prototype was used as the basis for further development of the engagement framework. The following sections of the paper describe the methods and processes used to develop the framework, as well as an outline of the final version of the framework.

3.2 Research design process

Extensive testing of the framework was required to ensure that it was usable as well as easily applicable for a range of internal stakeholders. Several exploratory design activities were also required to develop the support products for staff use. To ensure that the evaluation was comprehensive, but conducted within a limited timeframe, concurrent research activities were planned. The research design was developed around a five step process. The results were triangulated to understand the overall refinements required for the product.

Step 1: This step involved the selection of participants to be involved in the user research, interviews, focus group, and online testing process. Since the ownership and implementation of effective engagement involved all staff, it was imperative that staff across all capabilities were invited to take part in this process. All staff in the focal business services area received an email invitation to be part of the consultation process. In order to get a wider view across the ATO, an invitation was also extended to staff in complementary compliance areas and capabilities to take part in this process. The final online usability and comprehension testing was conducted using a sample of staff from the entire population of the participating business lines. Details of the numbers of staff involved in each of these activities are included in the following section (Study sample).

Step 2: The second step included the development of interview questions and focus group activities. The project team developed the interview and focus group questions and tested them with sample groups of interviewees and focus groups in two geographically separate offices. The focus group process was evaluated using video conference facilities to determine the effect that the medium would have on group conversations. Although face-to-face focus groups have important advantages, the video conferences provided an acceptable level of interaction and discussion with participants and also reduced project costs.

The online usability and comprehension testing questions were developed based on the results of the face-to-face usability testing sessions. The questions in this stage of the research were focussed specifically on the critical concepts of the framework.

Step 3: The third step involved conducting the planned research activities. One-on-one interviews and focus groups were used to explore the issues outlined in the research objectives. The advantages of interviews are that they enable participants to freely discuss issues that are potentially sensitive and provide feedback in a confidential environment. Interviews enable the capture of stories or narratives and form a rich source of qualitative data. Focus groups are used to discuss issues and debate topics where alternative views may exist.

Interviews were conducted either via phone or face-to-face. Focus groups were conducted either face-to-face or via videoconference in keeping with corporate financial prudence. All sessions were limited to maximum of two hours in duration to minimise the impact of fatigue and also limit the loss of productivity, and acknowledging other work priorities.

The project team scheduled nominees for interviews and focus group sessions and provided them with further information and informed consent agreements. The documents outlined the voluntary, confidential nature of the discussions. Group sessions were coordinated according to site, capability and classification levels to ensure a cross-section of perspectives. To ensure participants' ability to provide open and honest feedback, no participant was in the same focus group session with their direct manager.

Interviews were conducted with a range of staff across various capabilities that interact with the public. The engagement designers conducted phone interviews and visited audit teams to discuss their approach to interacting with taxpayers and tax agents, identified issues and the important values required to develop partnerships and improve compliance. Staff were asked to provide stories of interactions that worked well, as well as incidents that had caused longer term issues. Staff described tactics they had used to improve relationships and also described how various interactions with taxpayers had shaped their current approaches. The user research was used to understand important support tools for staff, when and how they would be accessed and the topics that the framework content should address.

As indicated above, a number of the focus groups were conducted across the country in eight sites using video conference facilities to reduce project travel costs. The focus groups enabled the engagement team designers and researchers to understand the opinions, perceptions and attitudes of staff on key concepts identified through the user research. The facilitator of the focus groups used cue cards and images to prompt discussion. The cards depicted relationships between taxpayers and ATO staff in various scenarios. Example cue cards from the focus groups are shown in Appendix B. Staff were asked to discuss the values that had been developed by the executive group and explain how the values applied in practical situations. A secondary consideration

of the consultation sessions was to explore implementation issues as well as staff normative beliefs that may reduce the effectiveness of the framework.

Within the focus group sessions, the consultation team undertook the roles of facilitator and observers according to their technical knowledge and skills base. Sessions followed the set format of context setting including explanation around the purpose of the consultation and discussion of participant rights and obligations (as set out in the participant agreement forwarded previously) and then the facilitator led the discussion in reference to questions as set out in the focus group and interview templates. At the close of the session participants were asked for feedback on the consultation process and to indicate their preference for future consultation processes around the Effective Engagement Framework.

In-depth, facilitated one-on-one usability testing of some initial support products (intranet site, user guide and the framework toolkit) were conducted with 12 staff for consistency of messaging and to ensure the ease of use of the product interface. The face-to-face usability testing was followed by an online comprehension and usability test of the key concepts with staff. The survey instrument provided screens relating to the products and asked comprehension and usability questions. An example usability and comprehension screen is shown at Appendix C. The facilitated usability testing sessions took place at the participant's normal work setting and involved the facilitator walking through a series of products and interfaces using an activity based scenario. Observations, expectations of the users and areas of lack of comprehension were captured by the facilitator. The final online usability and comprehension survey utilised the Qualtrics survey tool.

Step 4: The next step in the process involved the capture and coordination of responses derived from the above methods. As research activities progressed, information and comments from participants were captured at each session, using either audio and/or written notes. Both the facilitator and the session observers undertook this information capture to ensure technical accuracy and context. Data from the online usability testing was captured through the Qualtrics survey. The project team progressively and iteratively worked through these data to understand the issues raised by staff in assessing the usability of the proposed framework in order to provide recommendations for improving the final engagement framework.

Step 5: The final step in the process included the analysis and reporting of findings and recommendations. The facilitator, observers and an independent design analyst took part in the assessment of the qualitative information captured. Affinity diagramming⁷ was used to cluster the results and also determine themes through the observations. The final report was compiled from the analysis of results from the above activities. The report was reviewed by members of both the Effective Engagement and Strategic Design project teams for consistency and quality. A summary of the key results from the analysis is provided later in the paper.

⁷ Also known as the KJ-technique was developed by Jiro Kawakita in 1960 as a method to logically categorise large amounts of data and receive group consensus. (Curedale, 2013, p. 95).

4. STUDY SAMPLE

An email invitation to participate in the evaluation of the framework was sent to all primary business line staff on the 30th July 2012. Staff at all levels were invited to self-select for the consultation process. This method was chosen due to the nature of the consultation and the subject matter which relates to staff engagement. It was deemed appropriate for staff to self-select for these activities. A total of 53 nominations were received from staff across various capabilities and classification levels.

Table 2 reports the Australian Public Service classifications of research participants (expressed as a percentage of the 53 participants) compared to the percentage of classifications of all staff in the primary business line. The relatively higher percentages of APS6 and EL1 staff in the sample compared to other classifications represent a similar distribution of these classifications in the business line. The sample was therefore considered representative of the population.

Table 2: Percentage APS classifications of participants compared to total unit staff

	APS4	APS5	APS6	EL1	EL2.1	EL2.2	SES1	SES2
Sample	6.5%	8.7%	23.9%	32.6%	26.1%	2.2%	0.0%	0.0%
Total Staff	10.9%	12.2%	29.0%	31.0%	11.1%	3.3%	1.0%	0.1%

An additional 50 nominations were received from staff across various capabilities and classification levels in four related business service areas. Of these staff, 32 actively participated in the sessions. In total 85 staff from four different ATO business service lines participated in focus groups and interviews.⁸

The names of all participants were recorded in a spreadsheet against their location, capability and APS level. From the sample, participants were clustered by site into focus group sessions ensuring a cross section of level and capability. If insufficient numbers for focus groups were available in a particular site, individuals were automatically assigned for interview sessions.

Facilitated usability of subsequent products was limited due to resource and budget constraints. Snowball sampling was used to recruit six participants from two separate offices to participate in the facilitated usability testing of the product interfaces. These usability testing sessions followed standard verbal protocol analysis or 'think-out-loud' techniques and utilised activity scenarios to focus the session.

All staff in the four contributing business service lines were invited to participate in the online usability and comprehension survey. As indicated earlier, this survey focused on evaluating the critical concepts in the framework. A total of 762 staff participated in the online survey and usability testing of the Effective Engagement Framework (Table 3).

⁸ Names of the ATO business lines have been anonymised for confidentiality reasons.

Table 3: Respondents to the online usability staff survey by business service area

Business area	No of respondents
Primary area	288
Business area A	62
Business area B	152
Business area C	260
Total	762

4.1 Key findings

Participants in the sessions were eager to provide input and to be involved in the conversations around engagement with the community. A number of core themes emerged from the discussions. Staff relayed the importance of good communication in the implementation process of the framework. Participants perceived the endorsement of the senior leadership group, as well as actual delivery of the framework as essential for successful engagement. Staff expected the leaders to demonstrate the values and be visible in their support of the framework. Participants also emphasised the importance of incorporating the content of the framework into the rest of the business so that practical steps were integrated and not seen as an additional burden in their existing work processes.

Staff related strongly to a number of the principles such as mutual obligations and working collaboratively with the community. However, staff demonstrated wide variability in their understanding of what the terms ‘collaboration’ and ‘empowerment’ meant when working with taxpayers. Several staff were apprehensive about empowering taxpayers and suggested that ‘empowered taxpayers’ may abuse the tax laws. The values in the framework provide subtle distinctions between facilitating compliance and preventing evasion. While many staff acknowledged the support they must provide to the community to improve compliance, their focus was on protecting the revenue system.

Many staff were able to recite values of collaboration and cooperation with the community but were unable to translate these values into actions. ‘Collaboration’ was seen as negotiating with taxpayers to collect revenue and less about working together to achieve mutual outcomes for the community. Conversations with staff were influenced by issues occurring at the team level. These results demonstrated a need for greater connection between the strategic objectives of the organisation and the practical implementation of effective engagement. Participants identified staff engagement and communication between teams and different business service areas as important contributors to successful engagement with the community.

A number of visual design and branding elements of the framework were modified as a consequence of the discussions with staff. These elements included emphasising the dynamic relationship between staff values and successful engagement. Visually, this message was conveyed through the removal of the linear elements, which were seen as ‘very structured and rigid’ and converting these to a circular, fluid image. This revised image also emphasised the ripple effect of the values from the ATO into the community and how these are reflected back into the organisation.

5. USABILITY TESTING AND SURVEY RESULTS

The online usability and comprehension testing was used to identify weaknesses in the communication of the key concepts and understanding of the application of the framework. Overall, results of the usability testing indicated that most participants understood that the Effective Engagement Framework was designed for planning and evaluating engagement activities. The majority of participants also understood the purpose of the framework, which was improving engagement with the community.

Comprehension of the main components of the framework was generally high. However, when ambiguity about particular items or content emerged, changes were recommended to improve staff understanding. For example, Question 6 of the survey asked participants to rate whether the Framework would be used by project managers. 53 per cent agreed with the statement whereas 47 per cent disagreed. The aim of the message in the related text provided in the survey was that the framework was a tool for all staff (including project managers). This result revealed that the message was not understood. Changes were made in the related message to enhance the communication of this point. Based on the usability testing process, a number of modifications were made to the prototype to finalise the core components of the framework as 'Purpose', 'Guidelines', 'Channels', and 'Evaluation'.

Outcomes vs Purpose: In the prototype, outcomes were displayed as a spectrum of activities ranging from a unidirectional approach: from engagement (inform) to a more collaborative engaged approach to decision making (empower; see also Figure 2, IAP2, 2010). These outcomes were designed to reflect different levels of community participation. However, while participants agreed that the terms the range of terms starting with 'inform' and ending in 'empower' represented increasing levels of engagement, they did not believe the title 'outcome' related to the listed sub-headings. Instead, participants viewed this component of the framework as relating to the 'nature of engagement' rather than outcomes achieved for engagement. For this reason, the title of this section was changed to 'purpose (of engagement)'.

Principles vs guidelines: Participants inconsistently interpreted the meaning of 'principles' as depicted in the prototype. Participants alternatively described the content as the 'rules of engagement' for the framework, incorporating terms such as 'shared understanding', 'mutual obligations', 'certainty', 'getting it right', 'good governance', and 'listening and doing'. As a result, the final version of the framework reworded this section as 'guidelines': in the sense of guiding principles.

Participants also suggested the language of the guidelines should include 'behaviours' or 'values'. Participants agreed that the guidelines should use terminology consistent with other 'value' frameworks, such as the Taxpayer Charter and Public Service values, which in turn would provide connections between organisational strategy and practical implementation. The majority of participants agreed that the various components that underpin the principles were relevant, important and valuable.

Channels: The initial prototype included a section to identify those channels through which engagement may occur. The project team sought feedback from participants on whether the list of channels in the framework was comprehensive, whether the channels were appropriate for effective engagement, and whether other channels should be considered.

Participants discussed the various channels and agreed the list was appropriate. However, the overriding message was that face-to-face interaction is the most effective channel for engagement and that it 'depends on the product, the client and

the circumstance'. The following observations by participants highlight the importance of choosing the right channels fit for purpose.

The type and timing of an interaction have a significant effect on the client experience. For example, if the ATO is undertaking a review which may be conducted over an extended period of time with a client, a 'quicker' and more direct interaction might be preferable such as a face-to-face or phone contact. Alternatively, the use of an online channel, such as the ATO website, may be more appropriate when making available general education material to taxpayers across the Small and Medium Enterprise market. Furthermore, if an interaction occurred through a channel that was inconvenient to the taxpayer it might adversely affect their relationship with the ATO. As one participant observed, many sectors of the population may not have access to a particular channel at all (for example online services in some rural areas and within some indigenous communities).

Characteristics vs evaluation: 'Characteristics' was the least understood component of the prototype. The heading was ambiguous and did not appear to have a specific meaning in this context for participants. As the content of the component related to assessing the success of the engagement activity, participants suggested that the heading be changed to 'evaluation'.

More specifically, the term 'foundations' was not recognised by participants. The section named 'foundation' related to the manner in which the engagement activity was conducted including quality controls. Possible alternative titles are 'quality control', 'methods' or 'approach'. The final version of the framework adopted the word 'approach' and was integrated along with reach, quality, and impact as key criteria for evaluation of the engagement activity.

The majority of participants nominated marketing and communications areas as their first contact for help. Next most popular response was their manager/team leader. Only seven people nominated the Effective Engagement team (the area created to support engagement activities). Thus one of the recommendations was to closely align the communications, design and engagement capabilities.

Participants were asked what they would change if they could modify one thing about how the ATO engaged with the community. The majority of comments (45%) related to 'improving the manner in which we communicate'. Participants suggested increasing face-to-face interactions, utilising contemporary communications (such as, online channels), being less technical, and improving collaboration with the public. The next most common suggestion centred on improving the ATO's external image by generating more positive media coverage and being able to report the ATO side of cases as this would assist in providing more balanced media reports.

5.1 Final step: The Effective Engagement Framework

After the above processes were completed, the final version of the Effective Engagement Framework was developed. The purpose of the Effective Engagement Framework is to guide a repeatable, consistent and integrated approach to maintaining and improving engagement with the community. It also provides assurance for the maintenance of activities that support the existing good relationship between the tax authority and the community. The framework addresses potential areas of weakness in intervention strategies through ensuring robust planning and evaluation of compliance strategies. The final version of Effective Engagement Framework contains four components for general reference and to enable effective planning and

evaluation of engagement activities. Table 4 outlines the key components of the framework.

Table 4: Key components of the framework

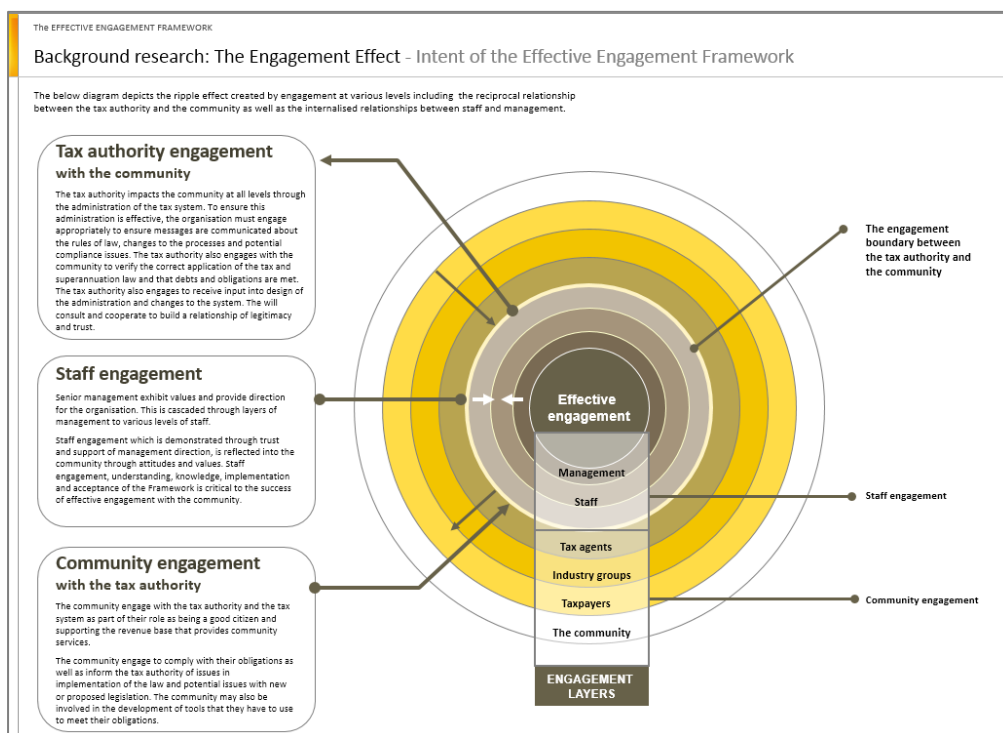
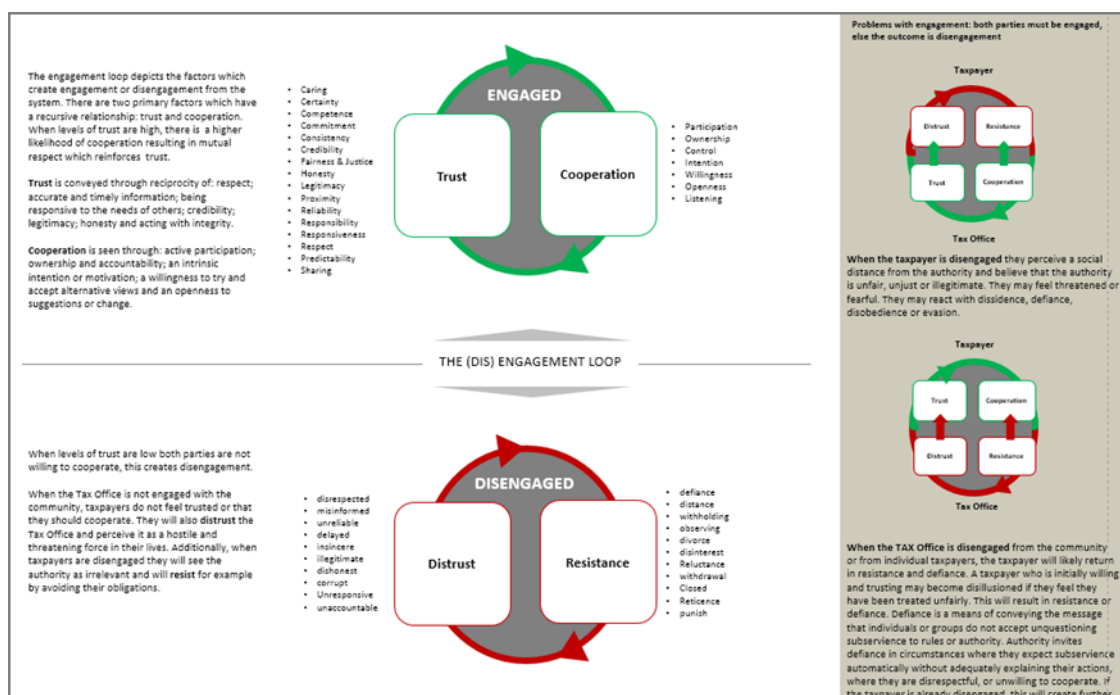
Purpose ⁹	Inform, Consult, Involve, Collaborate, Empower	The level of engagement should be clearly defined, shared and understood by all involved.
Guidelines	Shared understanding, Mutual obligations, Certainty, Getting it right, Good governance, Listening & doing	These guiding principles apply to all engagement activities to ensure a consistent and professional approach to interactions.
Channels	Online, Social Media, Phone, Paper, Face to Face	To meet shifts in the market and stay up to date with market trends, it is critical we utilise the latest communication channels favoured by the community.
Evaluation	Approach, Reach, Quality, Impact	Evaluation is critical for monitoring progress, assessing success, improving any future engagement activity.

This version of the framework included a set of guidelines for applying the various components of the framework. When conducting an engagement activity with the community, or when determining how best to interact with the community to solve a problem, the guidelines encourage staff to apply the core principles of the framework during the design of any engagement activity.

Drawing on the background research, a number of additional tools were designed to communicate visually the intent and application of the engagement framework. For example, the ripple effect diagram (Figure 3) was developed to explain to staff and stakeholders the direct and indirect effect that staff values and interactions have on the community. The diagram also depicts the inverse flow of information from the community back into the organisation. The ripple effect visualisation is a communication tool designed to show the goals of engagement for each of the user groups: the organisation; staff and the community. The intent is to convey to staff the importance of their relationship and interaction with members of the community and the overall impact that this has on engagement.

The engagement loop is a simplified visualisation of the concepts discussed by Braithwaite and Levi (Braithwaite, 2009; Braithwaite & Levi, 1998) in regards to the relationship between government and citizens. The diagram (Figure 4) can also be used in conversations with staff when discussing case studies of interactions on particular taxpayer issues and can be used to guide conversations toward different outcomes. The diagram is not meant to be comprehensive, but is instead a short-hand guide for understanding behavioural indicators to improve trust and cooperation between staff and the community.

⁹ Original source – IAP2 Public Participation Spectrum

Figure 3: The community engagement ripple effect**Figure 4: The engagement loop**

5.2 Implementation and ongoing evaluation

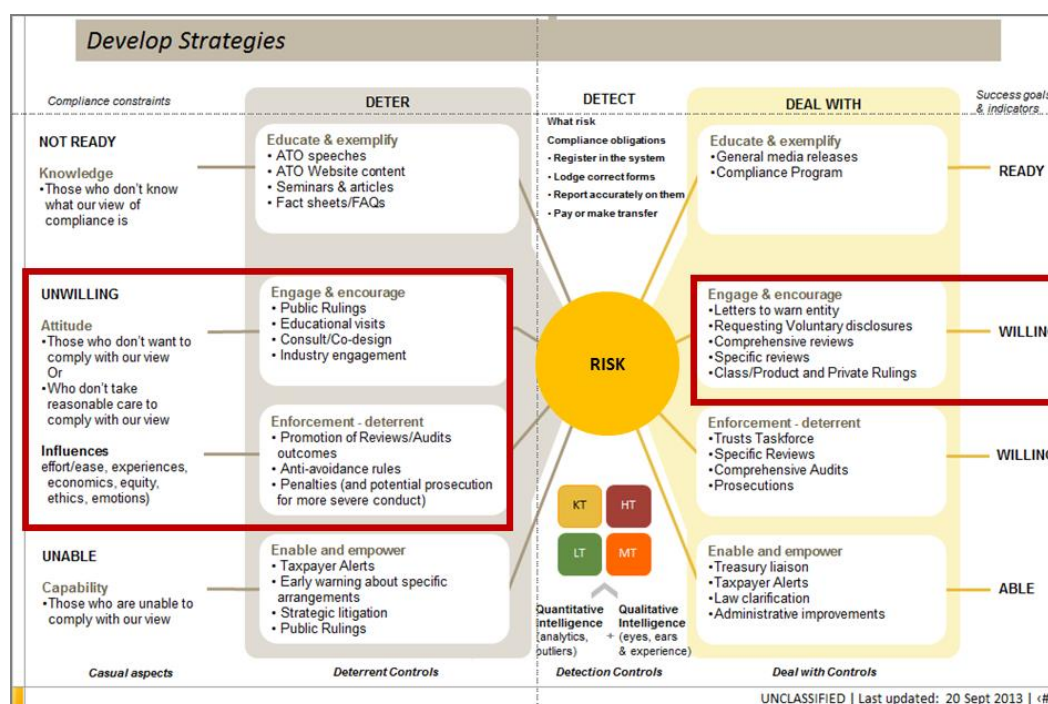
As a consequence of the development of the framework, a cascade of engagement communication and planning occurred within the primary business line. Key stakeholders in the business line developed a specific set of strategies for community engagement relevant to the activities of the business line. The Effective Engagement Framework encouraged the group to set a clear purpose and intent for their activities: “The purpose of our engagement strategy is to provide a clear direction for the ATO to effectively engage and influence the compliance behaviour of taxpayers and their intermediaries in the (business line) sector.” The strategy included a set of key success goals and indicators for success relevant to the taxpayers and intermediaries in the business line sector. Indicators for success provided a framework for later evaluation of the engagement activities. A document, presented in a ‘strategy on a page’ format, also included engagement focus areas for the upcoming year.

Risk management strategies in the business line have been adapted following the release of the Effective Engagement Framework. Risk strategies have an additional focus on how the risk is affected by communication and engagement with the community. Supporting documents and templates for risk management include sections that require the identification of engagement approaches or goals. The introduction of the framework and related strategies has meant that risk managers are more mindful of engagement either as a relationship management approach or for communication and feedback in their planning.

Risk management includes an investment in preventative strategies, up front engagement with taxpayers and their agents as well as consultation on changes in the policy and the administration of the policy. One such example is the Risk Management Bow-tie (Figure 5; based on the work of Hamilton, 2011). This concept provides a structured way for risk managers to plan an end-to-end strategy around their risk area. Additionally, the bow-tie includes specific areas for consideration around ‘engage and encourage’ as well as techniques such as consulting or co-designing.

As the framework has only been in place for a short period of time, an evaluation test case was created to demonstrate how the framework could be used in governance and assessment of compliance intervention effectiveness. The example demonstrated a holistic approach to planning and evaluation of a suite of engagement activities. The process of applying the framework highlighted weaknesses in the related strategies and also demonstrated insights into how to improve the overall strategy approach. At the time of writing, a comprehensive evaluation of the effectiveness of the framework and its use with staff is in the planning stages.

Figure 5: Risk management bow-tie, including a focus on engagement with taxpayers



6. CONCLUSION

The often overlooked aspect of taxation administration is the immense effort applied to building a partnership with the community to facilitate and improve voluntary compliance. The process for developing the Effective Engagement Framework in the ATO highlighted the significant challenges in developing a comprehensive and agreed understanding of what constitutes effective engagement in the taxpaying environment. Shortcomings in the ability of staff and key executives to integrate engagement strategies into the everyday business of the organisation became apparent during the process. The guidelines and support materials that formed part of the final framework assist in ensuring that effective engagement strategies are strategically planned and implemented.

Significant revisions to the initial concept of engagement were only possible because of the involvement of a significant number of staff and key stakeholders in the process. Recommendations for improvements to the framework were possible as understandings and perceptions about effective engagement emerged in discussions and feedback. Usability testing of prototype designs demonstrated the need for increased clarity around the purpose, guidelines, and channels for engagement, as well as effective means for evaluating whether desired outcomes are achieved. Recommendations for changes in these areas were incorporated into the framework before it was released for further use and evaluation. These outcomes demonstrate the importance of involving key stakeholders in final product design and emphasise the value of the co-design process.

The Effective Engagement Framework is only one of a vast array of strategies that the ATO is evaluating to support its staff and improve its services. The Framework is currently used in several compliance business lines in the ATO to assist staff in

planning and conducting engagement activities with the community. The Engagement Framework has been employed by staff in designing the community engagement approach for the 'Reinventing the ATO' program (Jordan, 2014). Connectedness and consultation with the community has become the mantra of the ATO leadership group, which is leading widespread staff cultural change. Whilst the ATO has some way to go to make tax compliance simple, some demonstrable improvements will support and make it easier for taxpayers to comply.

The ATO takes a purposeful approach to consultation with the community through refreshed consultation committees and a consultation register. Ongoing feedback from the community has influenced the simplification of the language used in publications and in primary communication tools such as the ATO website. The ATO has also published guidelines for interaction with the Small and Medium Enterprises sector (Australian Taxation Office, 2013c) and the large business sector (Australian Taxation Office, 2013b). These publications describe the ATO's risk management approach, the areas of focus and what to expect during an audit. These examples are a small sample of the changes being made to demonstrate a commitment to improved service delivery and engagement with the community.

The importance of effective engagement with the community is perhaps well known in the taxation environment and amongst many taxation authorities across the world. The Effective Engagement Framework was developed specifically within the ATO context and adopts language and tools that make sense for that organisation's way of doing business. Nonetheless, the primary framework is written generically such that it can easily be adapted to different taxation environments. While a particular tax authority may wish to conduct its own design process to ensure local applicability and relevance, the current framework provides an excellent starting point for streamlining those activities. We believe the framework offers great potential for adaptation and application in the wider taxation environment. Furthermore, with limited effort, the framework could be adapted to support the engagement activities of other compliance based agencies.

The research outlined also contributes to the growing new public governance literature. The Effective Engagement Framework is a manifestation of the value placed on the intangible relationship public servants have with the community. As Osborne, Radnor and Nasi (2013) argue, the critical moment in public service delivery is when the citizen interacts with the public servant. This interaction is not about client satisfaction but about an improved client experience. Improved client-experiences create improved public service outcomes.

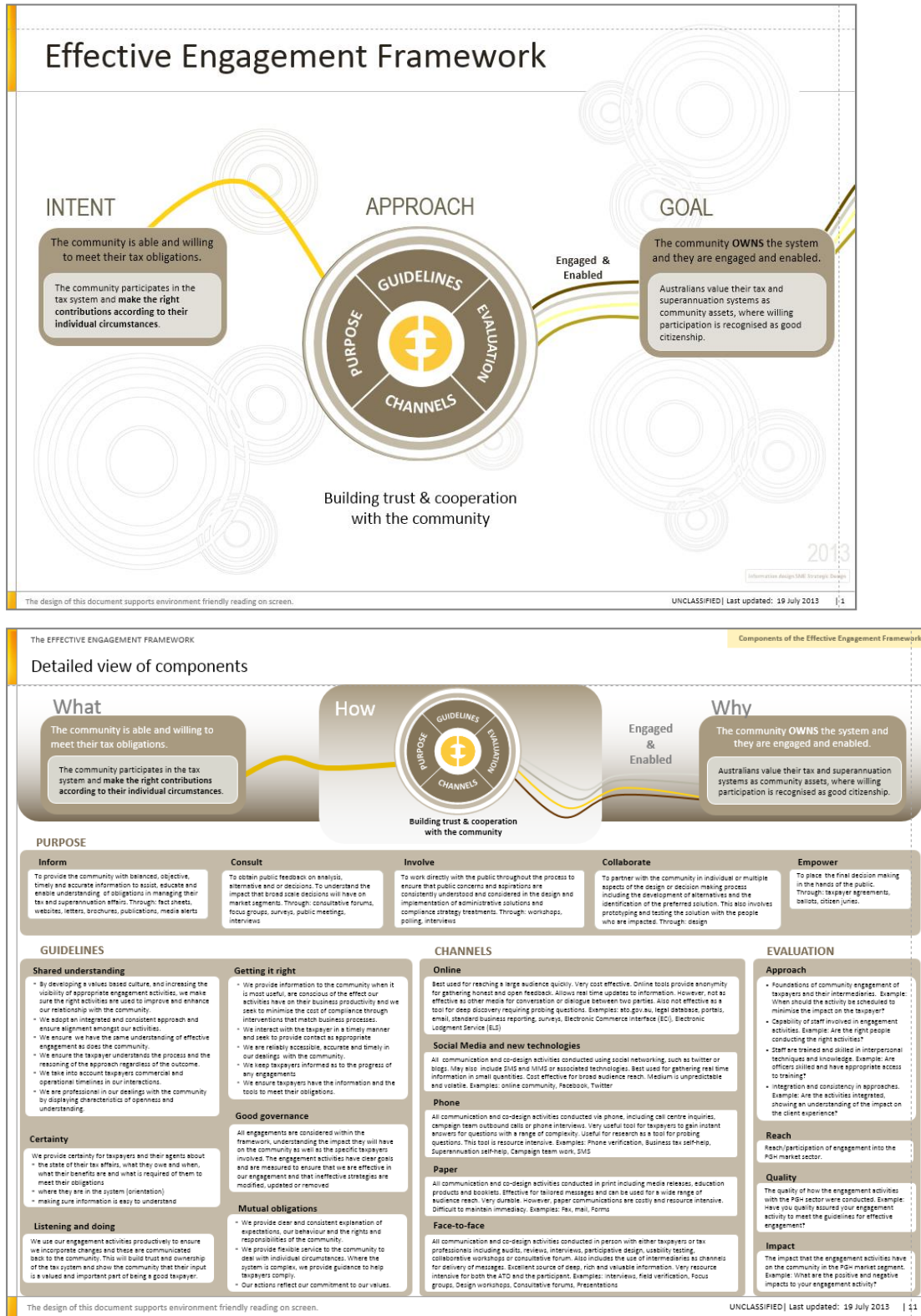
The ultimate goal of the Engagement Framework is to develop a high level of connection with the taxpaying community. Maybe in the longer term, the requirement for a framework will cease to exist. From a community point of view, contact and engagement with tax authorities should become unobtrusive, targeted and for most taxpayers non-existent, as we move to the light-touch or preferably 'no touch' approach. Engagement in the future may be a completely different concept. Despite the method, the journey will be one that tax authorities should take in partnership and collaboration with their taxpaying communities.

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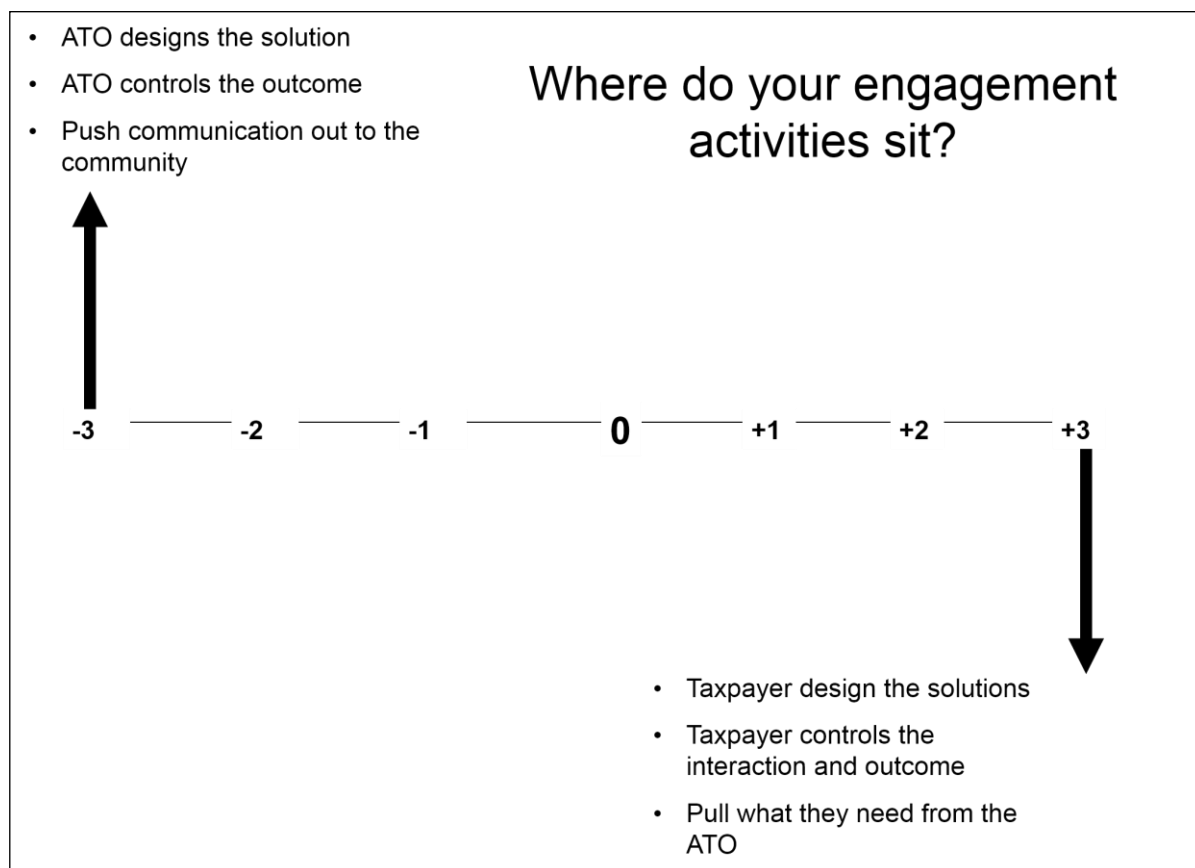
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8. APPENDIX A: EFFECTIVE ENGAGEMENT FRAMEWORK 2013



9. APPENDIX B: EXAMPLE CUE CARD FROM THE FOCUS GROUP SESSIONS WITH ATO STAFF



10. APPENDIX C: EXAMPLE SCREENS FROM THE ONLINE USABILITY AND COMPREHENSION TESTING OF THE ENGAGEMENT FRAMEWORK

Effective Engagement Framework - Survey and comprehension evaluation

Please read the text below carefully. We will then evaluate your understanding of the "purpose" of engagement planning. When engaging with the community we need to determine the purpose and also the related approach of the interactions. "Purpose" ranges from activities that are used to inform to those which empower taxpayers.

PURPOSE	
Inform	To provide the community with balanced, objective, timely and accurate information to assist, educate and enable them to understand their obligations, requirements, issues and possible solutions in managing their tax and superannuation affairs.
Consult	To obtain public feedback on analysis, alternative and or decisions. To understand the impact that broad scale decisions will have on market segments.
Involve	To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered in the design and implementation of administrative solutions and compliance strategy treatments.
Collaborate	To partner with the community in individual or multiple aspects of the design or decision making process including the development of alternatives and the identification of the preferred solution. This also involves prototyping and testing the solution with the people who are impacted.
Empower	To place the final decision making in the hands of the public.

1. Which of the above elements requires the lowest level of engagement and ownership by the public?

☐ Inform
☐ Consult
☐ Involve
☐ Collaborate
☐ Empower

0% 100%

Effective Engagement Framework - Survey and comprehension evaluation

Please read the text below carefully. We will then evaluate your understanding of "Guidelines". The "Guidelines" are used to guide our behaviour when interacting with the community. They represent values for interactions.

GUIDELINES	
Shared understanding	By developing a values based culture, and increasing the visibility of appropriate engagement activities, we make sure the right activities are used to improve and enhance our relationship with the community.
Mutual obligations	<ul style="list-style-type: none"> We provide clear and consistent explanation of expectations, our behaviour and the rights and responsibilities of the community. We provide flexible service to the community to deal with individual circumstances. Where the community has difficulty in understanding obligations, we provide guidance to help them comply. Our actions reflect our commitment to our values.
Certainty	<p>We provide certainty for taxpayers and their agents about the state of their tax affairs, what they owe and when, what their benefits are and what is required of them to meet their obligations.</p> <p>We provide certainty for taxpayers or their agents in where they are in the system (orientation) and what is expected of them and when.</p>
Getting it right	We provide information to the community when it is most useful, are conscious of the effect that our activities have on their business productivity and we seek to minimise the cost of compliance through interventions that match business processes.
Good governance	All engagements are considered within the framework, understanding the impact they will have on the community as well as the specific taxpayers involved. The engagement activities have clear goals and are measured to ensure that we are effective in our engagement and that ineffective strategies are modified, updated or removed.
Listening and doing	We use our engagement activities productively to ensure we incorporate changes and these are communicated back to the community. This will build trust and ownership of the tax system and show the community that their input is a valued and important part of being a good taxpayer.

2. Considering the "Guidelines", describe in your own words what you think it means to provide "certainty" for a taxpayer?