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FOREWORD

The papers included in this edition of the Journal of the Australasian Tax Teachers Association (JATTA) are derived principally from papers presented at the 26th Annual Conference of the Australasian Tax Teachers' Association (ATTA) held between Monday 20 January and Wednesday 22 January 2014 at Griffith University, Brisbane, Australia.

The theme of the conference was 'The Politics of Tax', and the presenters were invited to submit papers that explore the way politics has influenced — and continues to influence — the tax system. While not all papers published in this edition reflect the conference theme, the published papers certainly reflect the breadth and depth of Australasian research with respect to taxation. Given the role of ATTA in supporting the work and professional development of tax teachers, it is also encouraging that a quarter of the papers explore themes that relate to the teaching and learning of tax.

I would like to thank Dale Pinto, the Editor-in-Chief, and Brett Freudenberg, the conference organiser, for all of their support and helpful advice throughout the process of publishing this journal. Thank you, too, to the authors for entrusting their papers to my hands. Commiserations to those who were not successful this time. A big vote of thanks goes to those unsung heroes of academic publishing, the anonymous peer reviewers — the wonderful people who take on the role of assessing and refining the research of their peers without any personal recognition. I am deeply indebted to you, as are the authors, for your valuable contributions. Last but certainly not least, a very big thank you goes to the wonderful Trischa Mann, whose input as a professional editor and ex-lawyer were invaluable in publishing this edition.

Lisa Samarkovski,
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TAX DEBT MANAGEMENT IN NEW ZEALAND AND AUSTRALIA

LISA MARRIOTT*

ABSTRACT

This study investigates approaches to the management of tax debt in New Zealand and Australia. Levels of tax debt are high in both countries: 12 per cent of total tax revenue collected in New Zealand and 9 per cent in Australia. While both countries have a wide range of options to collect debt, Australia uses more of the available options.

While tax authorities have a range of tools to assist with tax debt collection, the New Zealand and Australian tax authorities both hold large amounts of tax receivables. This suggests either that the current tools are not being utilised to the greatest extent to reduce tax debt or that the tools are insufficient to achieve the objective of collecting the maximum amount of tax revenue, taking into account available resources. Both countries have, as part of their debt book, large amounts of tax debt categorised by the tax authority as non-collectable. The rationale for retaining non-collectable debt as part of total debt is not evident.

The research suggests that in some cases tax debtors are treated leniently by the tax authorities in New Zealand and Australia. In both countries there are multiple opportunities for tax debt, penalties and interest to be remitted or reduced. When compared with other debtors to the state, tax debtors appear to receive preferential treatment.

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I INTRODUCTION

This study compares the approaches to debt management by the tax authorities in Australia and New Zealand. Tax debts held by each agency are high. In New Zealand, the value of total tax debt held by the Inland Revenue Department (IRD) is 12 per cent of total annual tax revenue.¹ In Australia, the equivalent value of tax debt held by the Australian Tax Office (ATO) is 9.1 per cent.² These are economically significant sums in both countries. However, large sums of debt are not collected, and significant amounts of penalties and interest imposed when tax is unpaid are also uncollected. This has a number of effects. First, it potentially undermines the integrity of the tax system. Second, it is likely to impact on the goodwill of compliant taxpayers towards the tax system, at least to the extent that they are aware of the large amount of tax that is not collected. Third, the impact of the penalty regime in encouraging taxpayers to pay their tax on time and in full is diluted when tax is frequently uncollected.

It is acknowledged that tax debt is not solely a function of tax debt management. A range of other factors combine to impact on total tax debt levels, including the numerous factors that impact on a taxpayer's decision of whether or not to pay tax, including their financial capacity to meet their obligations. However, tax debt management is an important function of tax administration, and tax debt collection is an economically significant activity in society.

In New Zealand and Australia, once tax debts are due they are deemed to be a debt to the government and payable to the tax authority. Where the debt is not settled at the due date, the tax authority will generally engage in some recovery action. This study investigates the debt management approaches in the two countries to see what lessons can be learned from the different methods adopted in each. In addressing this question, the study does not include compliance measures. Instead it considers the processes that exist to collect tax debts once taxpayers have outstanding obligations with the tax authority.

The article commences, in Part II, with some contextual information on tax debt in New Zealand and Australia. This is followed by parts III and IV, which explain the current approaches to debt management by the tax authorities in New Zealand and Australia, respectively. Part V engages in a comparative discussion of the different treatments of tax debt in New Zealand and Australia. It also compares the treatment of tax debtors with the treatment of other debtors to the state, and concludes that tax debtors may expect to receive preferential treatment. Final conclusions are drawn in Part VI.

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¹ Tax revenue collected in New Zealand in 2011/12 was NZ\$49.2 billion, while total tax debt is NZ\$5.9 billion. The total tax debt figure is used in this calculation, which includes debt that is assumed to be non-collectable.

² Tax revenue collected in Australia in 2011/12 was A\$301 billion, while tax debt is A\$27.5 billion. The tax debt figure used in the calculation includes all tax debt, including that which is subject to appeal or investigation, and also includes debt that is likely to be non-collectable.

II BACKGROUND

This part provides some background information on the tax debt situations of the two countries, commencing with New Zealand. It outlines the general approach to debt management adopted by the IRD and the ATO, together with current levels of tax debt in each country.

A New Zealand

The mission of the IRD is to '*contribute to the economic and social wellbeing of all New Zealanders by collecting and distributing money*'. The revenue collection function is the largest task of IRD, with responsibility for collecting approximately 89 per cent of government revenue.³ In 2011/12, the IRD collected tax revenue of NZ\$49.2 billion. The distribution function of IRD relates to some social assistance programs, such as Working for Families Tax Credits, Child Support and Paid Parental Leave. In addition, the IRD is involved in the collection and redistribution of funds relating to KiwiSaver superannuation savings schemes and collection of Student Loan repayments. The IRD has additional functions in relation to providing policy advice. The overriding obligations for the IRD are to maintain the integrity of the tax system and to collect the highest net revenue that is practicable within the law, having regard to available resources.⁴

IRD debt as at 30 June 2012, and for the two previous periods, is outlined in Table 1. Outstanding tax debt in 2011/12 was \$5.9 billion. This was approximately 12 per cent of the total tax collected in New Zealand in 2011/12.⁵ Of the total debt, NZ\$2.1 billion, or 36 per cent was classified as non-collectable.⁶ Debt categorised as collectable was 7.6 per cent of total revenue collected. A large proportion of total debt was made up of interest and penalties—at nearly 46 per cent in 2011/12.

Table 2 shows the aged debt of the IRD over the same three-year period. Most of the individual cases (55 per cent) were less than one year old. However, the majority of the value of the debt (61 per cent) was older than two years, with only 21 per cent of total debt value less than one year old. A large proportion of this amount comprised interest and penalties. In 2011/12 the proportion of older debt increased. This was due to the change of focus on early intervention and debt prevention by the IRD.⁷ Despite this focus, total overdue debt increased by NZ\$394 million (7 per cent) to NZ\$5.9 billion in the 2011/12 period.⁸ The average value of outstanding debt per tax debtor in 2011/12 was NZ\$14,479. The average value of debt per customer in debt has remained reasonably stable over time, with a small increase in the most recent period.

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³ Inland Revenue Department, 2008, Statement of Intent 2008–11, Available at <http://www.ird.govt.nz>.

⁴ *Tax Administration Act 1994*, (TAA) ss 6(1) and 6A(3).

⁵ This figure includes all tax debts, that is, debts from all entities as well as individuals. The IRD cannot provide a breakdown of debt by debtor type.

⁶ Non-collectable debt comprises deferred debt, debt under dispute in the courts, assessments raised by the IRD when a tax return has not been filed by a taxpayer or debt that is with the Official Assignee or Liquidator.

⁷ IRD, above, n 9, 24.

⁸ IRD, above, n 9, 25.

Table 1: Inland Revenue Department Debt (2009/10 to 2011/12)⁹

Debt type	2009/10 (NZ\$ million)	2010/11 (NZ\$ million)	2011/12 (NZ\$ million)
Debt under arrangement	\$937.7	\$1,146.6	\$1,176.3
Other collectable debt	\$2,548.6	\$2,663.5	\$2,582.7
Total collectable debt	\$3,486.3	\$3,810.2	\$3,759.0
Total non-collectable debt	\$1,664.3	\$1,711.9	\$2,157.4
Total debt	\$5,150.6	\$5,522.1	\$5,916.4
Penalties and interest	\$2,149.7	\$2,359.0	\$2,711.3
Penalties and interest (% of total debt)	41.7%	42.7%	45.8%
Customers in debt (cases)	363,814	389,947	408,606
Average value of debt per customer in debt	\$14,157	\$14,161	\$14,479

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⁹ Inland Revenue Department, 2012, *Annual Report 2011/12*, Available at www.ird.govt.nz, 45.

Table 2: Inland Revenue Department Aged Debt (2009/10 to 2011/12)¹⁰

	2009/10		2010/11		2011/12	
	NZ\$ mil	Cases	NZ\$ mil	Cases	NZ\$ mil	Cases
< 1 year	\$1,500.3	216,815	\$1,377.7	220,597	\$1,254.7	224,520
1–2 years	\$1,386.4	84,000	\$1,387.7	89,063	\$1,079.1	72,219
2–5 years	\$1,542.0	50,839	\$1,787.7	63,840	\$2,310.9	92,119
> 5 years	\$721.9	13,660	\$969.0	16,447	\$1,271.6	19,748
Total	\$5150.6	363,814	\$5,522.1	389,947	\$5,916.4	408,606

B Australia

Similarly to the IRD in New Zealand, the ATO is the primary revenue collection agency in Australia as well as acting in a redistribution role. The ATO has a broader range of tasks than the IRD, also being responsible for the key components of Australia's compulsory superannuation system, managing the business operations of the Australian Valuation Office, and being custodian of the Australian Business Register. One of the roles of the ATO is to '*ensure the community has confidence in the administration of Australia's taxation and superannuation systems*'.¹¹

Current levels of tax debt held by the ATO are outlined in Table 3. Similar to the IRD, the ATO has also experienced an increase in collectable debt.¹² Collectable debt in Australia in 2011/12 represented 5.5 per cent of total collections, as shown in the last row of Table 3.¹³ This figure has remained relatively steady over the past three periods. However, collectable debt increased by 18 per cent in 2011/12, while the number of collectable debt cases also increased by 10.5 per cent.¹⁴

¹⁰ IRD, above, n 9, 25.

¹¹ Australian Tax Office, 2013, About Us, Available at <http://www.ato.gov.au>, Retrieved August 2013.

¹² Australian Tax Office, 2012, *Annual Report 2011/12*, 8.

¹³ ATO, above, n 12, 8.

¹⁴ ATO, above, n 12, 53, 58.

Table 3: Australian Tax Office Debt (2009/10 to 2011/12)¹⁵

Debt type	2009/10 (A\$ billion)	2010/11 (A\$ billion)	2011/12 (A\$ billion)
Collectable debt	\$14.7	\$14.1	\$16.6
Debt subject to objection or appeal	\$8.9	\$8.1	\$8.9
Insolvency debt	\$3.9	\$5.3	\$6.2
Total debt	\$27.5	\$27.5	\$31.7
Ratio of collectable debt to total cash collections	5.8%	5.2%	5.5%

Modelling undertaken by the ATO looks at over six billion items of data each week to determine the likelihood of payment across approximately three million cases.¹⁶ The objective of this analytical process is to improve ways of interacting with taxpayers in debt situations. In addition, all debts are risk-scored to estimate a particular taxpayer's likelihood of repaying their debt, together with their capacity to do so.¹⁷

III THE NEW ZEALAND APPROACH TO DEBT MANAGEMENT

The IRD and the ATO have similar approaches to debt recovery, which is to maximise the collection of tax debt. Under the *Tax Administration Act 1994* (TAA) the Commissioner of Inland Revenue in New Zealand must collect the highest net revenue that is practicable within the law, having regard to: available resources; promotion of compliance by all taxpayers; and compliance costs incurred by taxpayers.¹⁸ However, recovery of tax must not place the taxpayer in a position of serious hardship or be an inefficient use of IRD resources.¹⁹

The IRD claims a '*customer-centred approach*' that focuses on: preventing debt from arising in the first instance; early intervention when debt does arise; and targeting collection efforts on the cases that have the greatest prospect of collection.²⁰ Where debt does arise, the IRD focuses its efforts on early settlement of debt. This is because penalties and interest can quickly accumulate, resulting in the debt becoming unmanageable for the taxpayer. Moreover, the debt becomes more expensive for the IRD to collect as it becomes older.²¹

¹⁵ ATO, above, n 12.

¹⁶ ATO, above, n 12, 84.

¹⁷ ATO, above, n 12, 124. This is achieved through the use of analytics to predict and analyse patterns of behaviour.

¹⁸ TAA, s 6A(3).

¹⁹ TAA, s 176(2)(a)-(b).

²⁰ IRD, above, n 9, 25.

²¹ IRD, above, n 9, 24.

The 2012 IRD annual report communicates '*a mix of new and innovative interventions for managing debt*'.²² These include sending text messages and online advertising, including on social media outlets such as Facebook, to remind customers of payment deadlines. When payments are not made on time, calls are made to customers including the use of automatic dialler technology. This technology, together with recruitment of extra specialist staff, is claimed to have '*significantly improved the capacity and effectiveness of our outbound calling campaigns*'.²³ In 2011/12, 81 per cent of tax due on 7 February was paid on time.²⁴

The IRD discloses priority areas for recovery and enforcement, which currently include audit-assessed debt, the top high-risk customers, and debt associated with large enterprises and high-wealth individuals.²⁵ The IRD also acknowledges that its best prospects for debt collection lie in these areas.

A Instalment Arrangements

An instalment arrangement may be entered into by the IRD and the taxpayer. Any taxpayer can request an instalment arrangement when they are unable to meet their tax obligations in full, and entering into an instalment arrangement is likely to assist in maximising tax debt collection. The advantage, for the IRD, of entering into instalment arrangements is that it provides some certainty of timing of revenue collection. Moreover, the earlier the collection process commences, the more likely it is that the debt will be collected, as additional penalties will not accrue while the instalment arrangement is being adhered to.²⁶ However, interest will continue to be charged throughout the duration of the instalment arrangement. The IRD will negotiate with the taxpayer to determine what method of payment best suits the tax debtor's financial circumstances.²⁷

The value of debt in instalment arrangements is currently NZ\$1.2 billion, or approximately 20 per cent of total current debt. As at June 2012, 53,187 taxpayers were paying their tax debt by instalment arrangement.²⁸

B Deduction Notices

Deduction notices may be used by the IRD under certain circumstances. A deduction notice requires a third party to make deductions from amounts that are '*payable or will become payable by that third party to a taxpayer who has tax arrears*'.²⁹ Deduction

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²² IRD, above, n 9, 24.

²³ IRD, above, n 9, 24.

²⁴ IRD, above, n 9, 24. The potential for inherent bias to exist in figures reported in annual reports is acknowledged. Inherent bias exists when assumptions or other factors may distort results presented.

²⁵ IRD, above, n 9, 25.

²⁶ Inland Revenue Department, 2011, Standard Practice Statement SPS 11/01 *Instalment arrangements for payment of tax* [22].

²⁷ IRD, above, n 26 [11]. This will also include frequency and method of payment [74].

²⁸ Data received under the *Official Information Act 1982*, 9 May 2013.

²⁹ Inland Revenue Department, 2011, Standard Practice Statement SPS 11/04 *Compulsory Deductions from Bank Accounts* [5].

notices can ‘*require any person*’ to deduct the amount owed in full or in part, and can require the deduction to be paid to the IRD.³⁰ Deduction notices may be used where taxpayers have defaulted on payment of income tax, interest, or civil penalties. The TAA places some limits on the amounts permitted to be deducted. For example, employer deductions must be the greater of (a) an amount which is the lower of 10 per cent per week of the income tax due or 20 per cent of the wages or salary payable; or (b) \$10 per week.³¹ Deduction notices are usually issued to banks or employers. The IRD can prosecute banks for non-compliance with a deduction notice.³²

An *Official information Act 1982* request was made to the IRD, asking for information about the number of deduction notices issued over the past three years. The IRD advised that it was unable to extract information from its systems to isolate only outstanding tax. For the purposes of this research, only deduction notices relating to outstanding tax were relevant—rather than, say, deduction notices issued in relation to child support or student loan debt. Therefore it has not been possible to ascertain how frequently deduction notices are used for the purposes of assisting with tax collection in New Zealand.

C Writing Off Penalties and Interest

Use-of-money interest is charged at 8.4 per cent on underpayments or non-payments of tax in New Zealand.³³ However, in a range of circumstances the IRD may write off penalties and interest. These remission provisions exist to allow the IRD to ‘*accommodate circumstances in which charging a penalty of interest is inappropriate*’.³⁴ Penalties and interest may be remitted where the events leading to their existence can be reasonably justified or where a ‘qualifying event’ exists.³⁵

The IRD will consider certain factors in deciding whether remission is appropriate. These include whether the penalty or interest was charged correctly. Situations where the IRD somehow contributed to the problem, such as by providing incorrect advice to the taxpayer or through a delay in processing, will also be taken into account.³⁶ In addition, consideration will be given to whether the penalty was the result of genuine oversight or a one-off situation. Certain shortfall penalties may be reduced by 50 per cent where the taxpayer has not been liable for certain other shortfall penalties in the previous two years.³⁷

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³⁰ TAA, s 157

³¹ TAA, s 157(3)(a)(i).

³² TAA, s 157(A)(1)(b).

³³ Rate applicable as at July 2014.

³⁴ Inland Revenue Department, 2005, Standard Practice Statement SPS 05/10 *Remission of penalties and interest* [13].

³⁵ IRD, above, n 34 [6]-[7]. There are a number of events that meet the criteria of a qualifying event, including where records have been destroyed or are unable to be accessed; or when other priorities created by a qualifying event result in taxpayers being unable to make payments or file returns, such as an earthquake or flood.

³⁶ IRD, above, n 34 [46].

³⁷ TAA, s 141FB.

Table 4: Penalties and Interest Applied, Collected and Written off in New Zealand (2009/10 to 2011/12)³⁸

	2009/10	2010/11	2011/12
	\$NZ million	\$NZ million	\$NZ million
Penalties applied	\$343.0	\$346.2	\$451.6
Penalties collected	\$110.0	\$121.9	\$146.1
Penalties written off	\$198.6	\$193.0	\$244.3
Interest applied	\$500.7	\$263.2	\$280.9
Interest collected	\$412.1	\$147.2	\$158.1
Interest written off	\$104.4	\$120.1	\$130.5
% Penalties collected	32.1%	35.2%	32.4%
% Penalties written off	57.9%	55.7%	54.1%
% Interest collected	82.3%	55.9%	56.3%
% interest written off ³⁹	20.9%	45.6%	46.5%

The amounts of penalties and interest that were applied, collected and written-off in New Zealand over the three most recently reported periods are outlined in Table 4. What is apparent from the highlighted rows is that in each of the three years, over half of the penalties applied were written off. Moreover, in the two most recent periods, nearly half of the interest applied was also written off.

Values of penalties and interest written off as a proportion of total tax collected are low at less than two per cent of total tax collected in each year. However, these values as a proportion of outstanding debt are reasonably high: penalties and interest are 16.4 per cent, 11 per cent and 12.4 per cent in 2009/10, 2010/11 and 2011/12 respectively.

In order for remission requests to be actioned, the tax that the penalty or interest applies to must have been paid.⁴⁰ In addition, there are some penalties where remission will not be considered, such as for shortfall penalties, except for those imposed under s 141AA of the TAA.⁴¹

³⁸ Data received under the *Official Information Act 1982*, 22 February 2013.

³⁹ Penalties and interest written off and collected will not total 100 per cent as there are timing differences in the year that the penalty is applied and the year that it is collected or written off.

⁴⁰ IRD, above, n 34 [10].

⁴¹ Section 141AA of the TAA relates to non-resident contractors.

D Writing Off Outstanding Debt

A further remission option for the IRD is to write off outstanding tax debt. While the duty remains to collect the maximum amount of tax revenue over time, in some situations the only cost-effective outcome is to write off all or some of the unpaid amounts—for example, in situations where it may use significant resources to pursue the tax debt. However, the IRD has a duty to protect the integrity of the tax system, and the Commissioner of Inland Revenue must have regard to the deterrence effect of the penalty and interest regime in promoting compliance by other taxpayers.⁴² Where tax has been remitted, interest will also be remitted.⁴³

Taxpayers may apply for financial relief when recovery of outstanding tax will place them in a position of serious hardship.⁴⁴ Similar to the criteria for remission of penalties and interest, outstanding tax cannot be written off where the taxpayer has been liable for a shortfall penalty for taking an abusive tax position under s 141D(2), or for tax evasion under s 141E(1), or a similar act, even where this will place the taxpayer in a position of serious hardship.⁴⁵

While all cases are decided on their own merit, some circumstances provide for the IRD to write off outstanding amounts. These circumstances are outlined in the TAA. In the first instance, the Commissioner may write off outstanding tax that cannot be recovered.⁴⁶ Specific circumstances include bankruptcy, liquidation, or when a taxpayer's estate has been distributed.⁴⁷ However, it is possible for tax debt to be reinstated after it has been written off if a taxpayer's financial circumstances change.⁴⁸

The IRD Standard Practice Statement relating to writing off outstanding tax outlines a number of factors established by case law as relevant to the decision. These include the circumstances that led to the tax debt; the nature and extent of co-operation and negotiation entered into by the taxpayer; the speed and extent of information provided by the taxpayer; and IRD duties under the TAA.⁴⁹

Tax debt written off over the past three years in New Zealand, and tax debt written off as a proportion of collectable debt, are shown in Table 5. Typically, around 10 per cent of collectable debt is written off in each year.

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⁴² TAA, s 183D(2).

⁴³ TAA, s 183E(a).

⁴⁴ TAA, s 177. Serious hardship is defined in section 177A of the TAA as including significant financial difficulties that arise due to the taxpayer's inability to meet minimum living expenses according to normal community standards; the costs of medical treatment; serious illness suffered by the taxpayer or the taxpayer's dependants; or the cost of education for the taxpayer's dependants.

⁴⁵ Inland Revenue Department, 2006, Standard Practice Statement SPS 06/02 *Writing off outstanding tax* [11] [75].

⁴⁶ TAA, 1994, s 177C(1). Small amounts, not exceeding \$100 will be written off (s 177C(1C)).

⁴⁷ TAA, s 177C(2)(a)-(c).

⁴⁸ TAA, s 177C(4).

⁴⁹ IRD, above, n 45 [42]. See also *Clarke & Money v Commissioner of Inland Revenue* (2005) 22 NZTC 19,165; *Raynel v CIR* (2004) 21 NZTC 18, 583.

Table 5: Tax Debt Written off in New Zealand (2009/10 to 2011/12)⁵⁰

	2009/10	2010/11	2011/12
Debt written off	\$316 million	\$424 million	\$435 million
Debt written off as a proportion of collectable debt	9%	11.1%	11.6%

E Other Options

Prosecution is a measure of last resort for the IRD. However, it may occur where *'flagrant and on-going failure to comply with the taxpayers' obligations and where recovery is dubious or is likely to result only in a relatively minor proportion of the overall outstanding debt being recovered'*.⁵¹ The IRD take only a small number of criminal prosecutions each year, generally averaging 60–70 cases per annum.

A further option for those who cannot meet their tax debts in New Zealand is to apply for bankruptcy or a 'no asset procedure'.⁵² Filing for bankruptcy or entering into a no asset procedure will prevent the IRD from seeking further payments from the taxpayer, and outstanding debts will be written off.⁵³ In the year ending June 2012, 578 taxpayers declared bankruptcy and had tax debts written off.⁵⁴

IV THE AUSTRALIAN APPROACH TO DEBT MANAGEMENT

Similar to New Zealand's approach, the approach of the ATO is to attempt to collect debt in its early stages, before it becomes unmanageable as a result of accumulated interest and penalties. The individual circumstances of each taxpayer will be taken into account when determining the options available to that taxpayer, including their historical patterns of payment and filing. A range of options is available to individual taxpayers and small businesses experiencing short-term financial difficulty. A key focus of debt management in Australia is small business, as debts in that sector account for some two-thirds of collectable debt.⁵⁵

Debt collection activity will normally commence with the issuance of a notice calling for payment of the outstanding amount.⁵⁶ This occurs prior to the debt being referred for collection activity. Three primary stages in the debt collection process follow. The first is

⁵⁰ Data received under the *Official Information Act 1982*, 3 May 2013.

⁵¹ IRD, above, n 45 [43].

⁵² A 'no asset procedure' is an alternative to bankruptcy for individuals who are insolvent.

⁵³ Inland Revenue Department, 2013, *Bankruptcy — Your tax obligations*, Available at www.ird.govt.nz, Retrieved March 2013.

⁵⁴ Data received under the *Official Information Act 1982*, 3 May 2013.

⁵⁵ ATO, above, n 12, 58.

⁵⁶ Australian Taxation Office, 2011, *Practice Statement Law Administration PS LA 2011/18: Enforcement measures used for the collection and recovery of tax-related liabilities and other amounts* [18].

early intervention, which includes telephone, written or text message contact with the taxpayer; entering into instalment arrangements; and may involve the engagement of an external debt collection agency. The second stage is firmer action, including garnishee notices, director penalty notices and statutory demands. The third and most serious stage is where legal action may be taken, including bankruptcy proceedings or liquidation. These, together with other options, are discussed below.

A Instalment Arrangements

Under s 255-15 of Schedule 2 to the *Tax Administration Act 1953*, the Commissioner of Taxation may '*permit you to pay an amount of tax-related liability by instalments under an arrangement between you and the Commissioner*'. Instalment arrangements are often referred to as 'tailored payment arrangements' by the ATO. As at 30 June 2012 there were 280,000 payment arrangements in place, with a total value of A\$3.8 billion.⁵⁷ Of these, 35,900 were interest-free arrangements worth A\$688 million.⁵⁸ Interest-free arrangements are discussed under heading C below.

When deciding whether to enter into an instalment arrangement with a taxpayer, the Commissioner of Taxation will make this decision in accordance with risk management guidelines established for the ATO.⁵⁹ A range of factors will be taken into account in making the decision, including the circumstances that led to the creation of the debt, the taxpayer's financial situation, the stage that legal recovery action has reached, ability to make payment, risk to the tax authority in accepting an instalment payment arrangement, solvency of the taxpayer, the historical pattern of compliance of the taxpayer, alternative collection options, and willingness of the taxpayer to enter into repayment arrangements.⁶⁰

For taxpayers with debts of less than A\$25,000 there is no need to speak to a tax officer to commence an instalment arrangement. This may be done online, with the use of online calculators to assist in calculating suitable payment arrangements. Where the taxpayer is a business, the ATO may require demonstration of business viability. This requires the provision of information on the financial performance and position of the entity to the ATO within an agreed timeframe. Additional information may be sought on how the debt arose and steps taken to mitigate the debt. For taxpayers with debts in excess of A\$25,000 it is necessary to talk to an ATO tax officer and provide information in relation to the debt, how it arose, details relating to capacity to pay instalments, income, expenses, assets and liabilities, other financing options, and details of debtors and other creditors where applicable.

B Deduction Notices

Section 260-5 of Schedule 2 to the *Tax Administration Act 1953* provides the Commissioner of Taxation with the authority to require a third party to pay money to

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⁵⁷ ATO, above, n 12, 44.

⁵⁸ ATO, above, n 12, 44.

⁵⁹ Australian Taxation Office, 2011, *Practice Statement Law Administration PS LA 2011/14: General debt collection powers and principles*.

⁶⁰ ATO, above, n 59.

the Commissioner of Taxation rather than paying it to the tax debtor. This is known as a 'garnishee power', and it is actioned by a garnishee notice. The garnishee notice will specify the timing and value of payments. The garnishee notice may be issued to an employer for deduction of a proportion of the taxpayer's wages or salary, or it may be issued to a financial institution for a lump sum amount. Garnishee notices may also be issued to parties such as solicitors.

Where the garnishee notice relates to wages or salaries, the ATO will not usually seek to garnish more than 30 cents in the dollar of the salary or wages payable.⁶¹ However, a higher proportion may be sought where the tax debtor has alternative sources of income or where it would be fair and equitable to do so.⁶²

A garnishee notice may also be served on a superannuation fund. However, this will not become effective until the tax debtor's benefits are payable under the rules of the fund, i.e. when the debtor reaches the age of retirement or dies. Similarly, a notice may be served in respect of the proceeds of life insurance policies⁶³ or a company in which the tax debtor holds shares.⁶⁴

Garnishee notices appear to be used reasonably frequently by the ATO. Table 6 shows the number of garnishee notices issued in 2007/08 and the two subsequent periods.⁶⁵

Table 6: Garnishee Notices Issued by the ATO

	2007/08	2008/09	2009/10
Garnishee Notices	10,356	10,761	9,428

⁶¹ ATO, above, n 56 [108].

⁶² ATO, above, n 56 [108].

⁶³ ATO, above, n 56 [118]-[119].

⁶⁴ ATO, above, n 56 [122].

⁶⁵ The data shown in Table 6 is the most recent data currently available for this measure.

C Writing-Off Penalties and Interest

The General Interest Charge, currently set at 9.69 per cent,⁶⁶ will accrue from the date the tax obligation is due until the amount is settled in full. However, s 8AAG of the *Tax Administration Act 1953* provides for remission of the General Interest Charge. The Commissioner of Taxation may only remit this under three circumstances:

- Where the circumstances that contributed to the delay in payment were not caused by an act or omission of the taxpayer, and the taxpayer took reasonable action to mitigate the effects of the circumstance.
- Where it would be fair and reasonable to remit all or part of the charge, having regard to the circumstances of the case.
- Where special circumstances exist that mean that it is fair and reasonable to remit the charge, or it is otherwise appropriate to do so.⁶⁷

Taxpayers must generate a request for all or part of the General Interest Charge to be remitted, and the onus is generally on the taxpayer to demonstrate that remission is warranted.⁶⁸ Factors that will be taken into account in the outcome are the individual circumstances of the taxpayer and the factors that generated the late payment.

Where the circumstances of the taxpayer do not qualify to have the General Interest Charge written off, interest will continue to accrue on outstanding amounts in most cases. However, small businesses may qualify for an interest-free repayment arrangement if they meet certain criteria. These criteria include having annual turnover under A\$2 million; tax debt of less than A\$50,000, which has been outstanding for less than 12 months; a good payment and filing record; inability to obtain short-term financing from other sources; ability to show that the business is a viable entity; and ability to enter into a repayment arrangement that will result in the outstanding debt being repaid within 12 months. The maximum time the taxpayer will qualify for the interest-free period is 12 months.

The value of penalties and interest written off in the most recently reported period was A\$2.0 billion.⁶⁹ The breakdown of penalties and interest applied, remitted and collected in Australia over the three most recent periods is outlined in Table 7. The results in Table 7 may be compared with the New Zealand equivalents in Table 4. Table 4 shows that some 30 per cent of penalties are collected in New Zealand, while just over 50 per cent, on average, are written off. A similar amount of penalties are collected in Australia, at about 30 per cent. However, penalties written off average about 30 per cent in Australia, as compared with 50 per cent in New Zealand. Proportions of interest collected in New Zealand and Australia are similar. However, interest written off in New Zealand is increasing (47 per cent in 2011/12), while it is reducing in Australia (34 per cent in 2011/12).

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⁶⁶ The General Interest Charge is updated quarterly. This is the rate for the July – September 2014 quarter.

⁶⁷ *Tax Administration Act 1953*, s 8AAG(1)–(5).

⁶⁸ Australian Taxation Office, 2011, *Practice Statement Law Administration PS LA 2011/12: Administration of general interest charge (GIC) imposed for late payment or under estimation of liability*.

⁶⁹ ATO, above, n 12, 62.

Table 7: Penalties and Interest Applied, Remitted and Collected in Australia (2009/12)⁷⁰

	2009/10	2010/11	2011/12
	A\$ million	A\$ million	A\$ million
Penalties applied	\$1,444.0	\$1,221.0	\$1,729.0
Interest applied	\$2,639.0	\$3,331.0	\$4,782.0
Penalties collected	\$440.0	\$270.0	\$564.0
Penalties written off	\$439.0	\$544.0	\$391.0
Interest collected	\$2,202.0	\$2,935.0	\$2,402.0
Interest written off	\$1,681.0	\$1,889.0	\$1,643.0
% Penalties collected	30.5%	22.1%	32.6%
% Penalties written off	30.4%	44.6%	22.6%
% Interest collected	83.4%	88.1%	50.2%
% interest written off	63.7%	56.7%	34.4%

D Writing Off Outstanding Debt

The Minister for Finance has the power to waive a tax debt. However, the Commissioner of Taxation can approve release from payment of some tax debts where ‘serious hardship’ exists. Taxpayers who are experiencing serious hardship have the right to apply for some relief of their tax liabilities. Serious hardship exists when ‘*you are unable to provide food, accommodation, clothing, medical treatment, education or other necessities for you or your family or other people for whom you are responsible*’.⁷¹ The most common condition under which debt relief is provided is where there is a moral obligation, rather than a legal obligation, to do so.⁷² Information on expenses, assets, income, and other supporting evidence is required to demonstrate that serious hardship exists for a taxpayer.

⁷⁰ ATO, above, n 12; and Australian Tax Office, 2011, *Annual Report 2010/11*, Retrieved from www.ato.gov.au. Due to the sampling approach used, and the differences in timing between the period penalties were applied, collected and/or remitted, the figures will not add up to 100% in any year.

⁷¹ Australian Taxation Office, 2009, *Application for release from payment of some taxation liabilities*. Fact Sheet for Taxpayers NAT 15080-12.

⁷² Australian Taxation Office, 2011, *Practice Statement Law Administration PS LA 2011/17: Debt relief*.

Where serious hardship is established, it is possible for taxpayers to apply for relief from payment of income tax, fringe benefit tax, pay-as-you-go instalments, and some of the penalties and interest associated with these taxes. This option is only available to individual taxpayers and taxpayers operating as sole traders; it is not available to companies, trusts and partnerships.⁷³ The tax release provisions do not apply to: amounts of pay-as-you-go deductions that have not been remitted or paid to the ATO; interest on judgment costs; legal costs; sales tax; company tax instalments; indirect taxes; higher education contributions; child support payments; and court imposed fines and costs, among others.⁷⁴

Where core tax debt is written off by the ATO, it may be because it has become irrecoverable (e.g. due to insolvency or bankruptcy) or uneconomical to collect (e.g. where the taxpayer has no assets and there is little chance of collection).⁷⁵ Factors that are taken into account in determining whether a debt is uneconomical to pursue include: the amount of revenue involved; the length of time the debt has been outstanding, including steps taken to recover the debt; the likely costs of continuing action to recover the debt, including likely recovery of any costs awarded; advice provided by the ATO solicitor; and the type of revenue involved.⁷⁶ Debts may be considered uneconomical to pursue where the debtor has no assets, where notification has been received from a trustee or administrator that the debtor's estate has insufficient assets to settle the debt; or where a company has ceased operating and no assets remain.⁷⁷

In 2011/12 the ATO wrote off A\$2.6 billion in tax debt.⁷⁸ In the previous period, 2010/11, A\$3.8 billion was written off. However, while debts may be written off, the Commissioner of Taxation retains the ability to reinstate debts where it becomes likely that recovery action may be successful.⁷⁹

E Other Options

The ATO uses external debt collection agencies to collect low-value debts. Debts are only referred to debt collection agencies where taxpayers have failed to work with the ATO to arrange settlement of the outstanding debt. In 2011/12, 300,020 cases, with a total value of A\$1.6 billion, were referred to debt collection agencies.⁸⁰ This resulted in collections of A\$1.3 billion.⁸¹

A further option that may be facilitated by the ATO where some or all of the tax debt is under dispute is known as a '50/50 arrangement'. The expectation is that the taxpayer will pay at least 50 per cent of any disputed amounts, in addition to other outstanding

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⁷³ Australian Taxation Office, 2013, *Guide to Managing your Tax Debt*, Available at <http://www.ato.gov.au>, retrieved July 2013.

⁷⁴ ATO, above, n 72.

⁷⁵ ATO, above, n 12, 59.

⁷⁶ ATO, above, n 72.

⁷⁷ ATO, above, n 72.

⁷⁸ ATO, above, n 12, 59.

⁷⁹ ATO, above, n 12, 238.

⁸⁰ ATO, above, n 12, 59.

⁸¹ ATO, above, n 12, 59

tax debts. The balance of payment may be deferred until the dispute is settled.⁸² Where the taxpayer's objection is unsuccessful, only 50 per cent of the General Interest Charge will be charged from the date that the 50 per cent payment was made. In situations where taxpayers have been selected as a test case and a 50/50 arrangement is entered into, the General Interest Charge remission is 75 per cent.

Legal action may also be taken by the ATO where tax debt remains outstanding despite attempts by the ATO to collect the amount. This may involve the ATO filing a claim or summons with the relevant court in the state of the taxpayer. This will result in the court recognising the debt, which allows the ATO to execute the judgment debt. One of the options that may result from this process is the ATO filing a bankruptcy notice. This requires the taxpayer to settle the obligation within 21 days. If that is not achieved, a creditor's petition may follow, which will result in the taxpayer being made bankrupt. Alternatively, the taxpayer may voluntarily declare bankruptcy.

The ATO may also issue a statutory demand where a company has not met its tax debts. This will require a company to settle its tax debt within 21 days; otherwise the ATO may use the act of non-payment as evidence that the entity is insolvent. In these situations, the ATO has three months from the compliance date specified in the statutory demand to file an application in the Federal Court to liquidate the company. The ATO will usually issue director penalty notices (discussed below) before seeking to have a company liquidated, where the debts are due to withholding tax provisions.⁸³

Table 8: ATO-Initiated Bankruptcy and Winding ups in Australia⁸⁴

	2009/10	2010/11	2011/12
ATO-initiated bankruptcies	397	462	519
Total bankruptcies	27,507	23,102	22,176
ATO-initiated bankruptcies as a percentage of total bankruptcies	1.4%	2.0%	2.34%
ATO-initiated liquidations	493	1,066	1,555
Total liquidations	9,365	9,780	10,818
ATO-initiated liquidations as a percentage of total winding-up	5.26%	10.9%	14.4%

Table 8 outlines the figures on ATO-initiated bankruptcy and liquidations in Australia. The figures indicate significant increases in the numbers of both ATO-initiated

⁸² ATO, above, n 59. Not all debts may be eligible for inclusion in a 50/50 arrangement. For example, debts arising under the *Superannuation Guarantee (Administration) Act 1992*.

⁸³ Australian Taxation Office, 2011, *Practice Statement Law Administration PS LA 2011/16 Insolvency — collection, recovery and enforcement issues for entities under external administration*.

⁸⁴ ATO, above, n 12, 45 and Australian Tax Office (2011) above, n 70, 85.

bankruptcies and company liquidations in Australia over the three-year period investigated. This pattern may reflect the harsher economic conditions over this period.

The ATO may issue 'director penalty notices' to company directors when a company fails to meet its pay-as-you-go and superannuation guarantee charge withholding obligations. In these situations, the director becomes personally liable for a penalty equal to the unpaid amount. The issuing of a director penalty notice allows the ATO to commence legal action to recover the penalty.

Part IVA of the *Tax Administration Act 1953* provides the Commissioner of Taxation with the power to issue a departure prohibition order, which will stop the tax debtor from leaving Australia until the tax obligation is settled in full, or acceptable repayment arrangements are established.⁸⁵ Certain conditions must exist for the Commissioner of Taxation to exercise this power, including the belief that a departure prohibition order is necessary to ensure that the tax debtor does not depart from Australia without discharging the tax liability or making arrangements to settle the liability.

Finally, a freezing order may be used when a tax debtor's actions in disposing of assets are likely to result in an unacceptable level of risk to payment of a tax liability or enforcement of a judgement.⁸⁶ A freezing order is '*a form of injunction that is used to restrain the respondent or their agents from removing assets from the jurisdiction or otherwise disposing of or dealing with those assets pending further orders by the court*'.⁸⁷ It appears that freezing orders are used infrequently in Australia. The ATO reports that only one of these injunctions was sought in 2007/08, five were sought in 2008/09 and nine were sought in 2009/10.⁸⁸

V DISCUSSION

This part starts with an analysis of the different approaches to tax debt management in New Zealand and Australia, addressing measures of efficiency under heading A and general approaches to tax debt management under heading B. It raises some issues with the current approaches to debt management under heading C.

A Efficiency

IRD expenditure on management of debt and outstanding returns in 2011/12 was NZ\$109 million.⁸⁹ The proportion of expenditure on debt management to outstanding debt in IRD was 1.84 per cent. From an efficiency of collection perspective, the IRD is very efficient at collecting debt. At June 2012, the tax debt recovery cost was \$2.86 to collect \$100 of overdue revenue.⁹⁰ The average amount owed per IRD debtor as at June 2012 was \$14,479.

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⁸⁵ ATO, above, n 56 [129].

⁸⁶ ATO, above, n 56 [171]. These are also known as *Mareva* injunctions or asset preservation orders.

⁸⁷ ATO, above, n 56 [172].

⁸⁸ These figures are the most recent that are currently available for this procedure.

⁸⁹ Vote Revenue, The Estimates of Appropriations 2012/13 B.5, 227.

⁹⁰ Data received under the *Official Information Act 1982*, 9 May 2013.

In 2011/12, IRD expenditure on taxpayer audit, which includes identifying risks to revenue and undertaking audit activities, was \$169 million.⁹¹ Expenditure on this category of expenditure as a percentage of total debt was 2.86 per cent for the IRD.

Collectable debt as a proportion of total tax revenue collected is higher in New Zealand than in Australia: 7.65 per cent in New Zealand and 5.5 per cent in Australia. While this measure may indicate that New Zealand is less efficient at debt collection than Australia, it is also influenced by other actions, such as the amounts of tax debt written off in each country. Moreover, the policy arrangements that influence overall tax compliance have a significant impact on the tax debt that is generated in the first instance, which similarly impacts on levels of tax debt. Collectable debt in New Zealand has remained similar over the past two periods, whereas it has increased by 18 per cent in Australia. The ATO suggests that this reflects the harsher economic conditions in recent periods.⁹² The IRD also report a stronger focus on collection of new debt and attempting to address debt as early as possible, which may impact on the level of new debt generated.

The total amount written off in New Zealand in 2011/12 was NZ\$809 million, and in Australia over the same period A\$4,634 million. These figures include interest and penalties written off, as well as core tax. The value written off in Australia was 5.7 times the amount written off in New Zealand, which appears to be reasonable, relative to the difference in population size. As a proportion of total tax collected, the New Zealand write-offs are slightly higher, at 1.65 per cent of total tax revenue collected, while Australia writes off 1.54 per cent of total tax revenue collected.

B General Approach to Debt Management

Both the IRD and the ATO have relatively straightforward systems to allow taxpayers to enter into instalment arrangements. In 2011/12, approximately 20 per cent of New Zealand's total outstanding debt was under an instalment arrangement. In Australia the proportion was lower, at around 12 per cent.

The IRD writes off higher proportions of penalties and interest than the ATO. In 2011/12, 54 per cent of penalties and 47 per cent of interest were written off in New Zealand. By way of comparison, 22 per cent and 34 per cent of penalties and interest, respectively, were written off in Australia in the same time period. This may, in part, be driven by the harsher penalty regime in New Zealand. As the combined annual late payment penalty and interest rate in New Zealand is 26.7 per cent in the first year that a debt is generated, debt related to penalties and interest accrues rapidly. This may be contrasted with the general interest charge of 9.69 per cent in Australia, where no additional late payment penalties apply. Thus, there may be greater willingness to write-off penalties and interest in recognition of the current harsh penalty scheme.

Similar proportions of core tax are written off in each country. In New Zealand, NZ\$435 million was written off in 2011/12, which is approximately 7.4 per cent of total debt. In Australia, a slightly higher proportion was written off, at 8.2 per cent of total debt.

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⁹¹ Vote Revenue, The Estimates of Appropriations 2012/13 B.5, 227.

⁹² ATO, above, n 12, 8.

In New Zealand, 578 taxpayers declared bankruptcy in 2011/12 and had tax debts written off as a result. This number is higher than the total number of ATO-initiated bankruptcies in Australia—519 in the same period. As the population of Australia is approximately 5.2 times that of New Zealand, it was expected that tax-related bankruptcies in Australia would be about five times greater than that in New Zealand, rather than less. When ATO-initiated liquidations are included, this totals 2,074 in 2011/12, which is still relatively lower than New Zealand when adjusted for the differences in population size.

Both New Zealand and Australia hold large amounts of ‘non-collectable debt’ in their debt books. In New Zealand, non-collectable debt accounts for 36 per cent of total debt in 2011/12—a value of NZ\$2.2 billion. In Australia, debt classified as collectible is 52 per cent of total debt, leaving 48 per cent of debt likely to be non-collectable—a value of A\$15.1 billion. Both countries annually write off relatively high amounts of tax debt, including interest and penalties. The writing-off of these non-collectable debts would result in significantly higher values written off by the respective tax authority. Debt is retained in a range of circumstances, including when court decisions are pending. However, at least some debt relates to bankruptcies and liquidations, where there appears to be little reason for retaining it in the debt book. Following the practice adopted under accounting standards, it would appear that at least some of these impaired debts should be written off, to the extent that they have been established to be unrecoverable.⁹³

In summary, both the IRD and the ATO have high levels of tax debt. However, debt held as a proportion of total tax revenue is higher in New Zealand than in Australia. Both tax agencies have similar tools available to them to address debt management. However, these tools appear to be used differently. The IRD has a significantly higher proportion of debtors in instalment arrangements. However, the ATO has higher usage of some of the more punitive forms of debt collection, such as director penalty notices. The ATO also appears to use a wider range of tools, such as external debt collection agencies. This may, in part, be the result of additional resources within the ATO. Notwithstanding this, the IRD initiates higher proportions of tax-related bankruptcies than the ATO.

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⁹³ Receivables are categorised for financial accounting as a financial asset. A financial asset is either cash or the contractual right to receive cash. Initial recognition of financial assets is established by IFRS 9 *Financial Instruments*. Under paragraph 9 of IFRS 36 *Impairment of Assets*, an entity should assess at the end of each reporting period whether an asset is impaired. When an asset is impaired, the recoverable amount should be estimated. IAS 39 *Financial Instruments: Recognition and Measurement* outlines factors that suggest a financial asset is impaired. One of these factors is default in payment. New Zealand Equivalent to International Financial Reporting Standard 9 *Financial Instruments (NZ IFRS 9)*. Issued November 2009 and incorporating amendments up to and including 30 June 2011. New Zealand Equivalent to International Accounting Standard 36, *Impairment of Assets (NZ IAS 36)* Issued November 2004 and incorporating amendments up to and including 30 June 2011. New Zealand Equivalent to International Financial Reporting standard 39 *Financial Instruments: Recognition and Measurement (NZ IFRS 39)*, Issued November 2004 and incorporating amendments up to and including 30 June 2011. Australian equivalents are AASB 9 *Financial Instruments*, AASB 136, *Impairment of Assets* and AASB 139 *Financial Instruments: Recognition and Measurement*.

C Debt Management Issues

What is apparent from the previous discussion in this article is that the tax authorities in both countries have a range of tools to assist with debt collection and debt management. Moreover, the legislation allows for what may be viewed as discretion to write off core tax debt along with penalties and interest. By way of illustration, in New Zealand a 50 per cent write-off of penalties is provided for in the legislation where taxpayers have not incurred previous penalties for similar certain activities over the past two years. Other allowances for remission of penalties and tax debt also exist. However, these tools and degrees of discretion, while provided for in the legislation, are not available to other debtors to the state. In particular, welfare debtors, who have incurred debts through legitimately incurred loans from the welfare agency in New Zealand, are not provided any opportunity to receive debt remission.⁹⁴ Conceptually the debts are similar: both are debts to the government, resulting in the state having fewer funds to provide services to society. Ideally, both forms of debt—tax debt and welfare debt—should be repaid to ensure systems are perceived as equitable. The article has outlined a number of mechanisms by which tax debtors may expect to receive assistance with their debts. In New Zealand, with the exception of instalment arrangements, none of these options are available to those with welfare debts.

Taxpayers in both New Zealand and Australia may apply for financial relief in certain circumstances when settling their tax debts may place them in a position of ‘serious hardship’. Serious hardship in New Zealand is defined as resulting in difficulties in the taxpayer’s ability to meet minimum living expenses according to normal community standards. A similar standard is evident in Australia. In these circumstances, establishing that repaying tax debt may place the taxpayer in a situation of serious hardship provides for the Commissioner of Taxation to release the taxpayer from part, or all, of the tax debt obligation. However, similar to the different treatments of remitting tax debt, this is not an option available to other debtors to the state. Again using welfare debtors by way of comparison, welfare debtors who are currently receiving beneficiaries will have repayments deducted from their currently paid benefits. Welfare debtors who are not receiving welfare benefits will be expected to repay the debt by instalment. Alternatively, the debt may be held until the debtor retires, at which point deductions will be taken from the universal pension.⁹⁵ The final option is that the welfare debt may remain until the debtor dies, when the debt will be recovered from the debtor’s estate. These final two, relatively punitive, options are not pursued for tax debtors.

In a final illustration of the preferential treatment of tax debtors in New Zealand, the *Social Security Act 1964* is in the process of amendment to allow for spouses and partners of those who engage in welfare fraud to be equally criminally liable for the fraud. In the explanatory note to the *Social Security (Fraud Measures and Debt Recovery) Amendment Bill*, it is claimed that ‘it will also ensure that the Ministry of Social

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⁹⁴ Welfare customers in New Zealand may request assistance from the Ministry of Social Development in the form of a Recoverable Assistance Loan. These loans exist to fund one-off expenses, such as paying for school uniforms or dentist bills. The loans are expected to be repaid and repayment arrangements are usually established at the time the loan is provided.

⁹⁵ A universal retirement pension (New Zealand Superannuation) is paid in New Zealand. The pension is not income- or asset-tested, with only a residency test to establish eligibility.

Development (MSD) recovers debt more effectively, while also allowing it to exercise sensible discretion in managing recovery in individual cases'.⁹⁶ Further actions related to debt recovery include:

- Imposing a duty on the Ministry of Social Development to take all reasonably practicable steps to recover debt.
- Allowing for the Ministry of Social Development (MSD) to have discretion relating to the method and rate of recovery. In '*exceptional circumstances, MSD may defer temporarily recovery of debt*'.⁹⁷

The differences between the debt management approach to welfare debt and tax debt are evident. The Ministry of Social Development has discretion only in relation to the way debt is recovered. There is no discretion on whether a debt is pursued. By comparison, the tax authorities have discretion relating to remission of debt. In addition, MSD is expected to take all reasonable steps to recover debt, while the tax authority is expected only to collect the maximum amount of tax revenue that is practicable within the law, taking into account available resources. These approaches provide for different treatments of debtors to the state, with tax debtors receiving more lenient debt collection treatment than welfare debtors.

While the focus of this study has been on the management of debts that are legitimately generated, some insights may be gained with reference to the illegal behaviour of tax evasion and welfare fraud. Numerous studies have shown that individuals see tax evasion as a less serious offence than other financial offending, such as welfare fraud.⁹⁸ Research also suggests that the way offending is viewed also impacts on the level of seriousness attached to the crime. For example, Cook observes that '*it is far easier to represent tax evaders as merely keeping their own money, than it is to represent them as taking money from the state (and fellow taxpayers). It is also simple to represent those who are already seen as takers (benefit claimants) as taking money from the hard-pressed taxpayer*'.⁹⁹ Moreover, there are differences in the way offenders are viewed. Marston and Walsh suggest that those who participate in tax evasion are considered to be '*indulgent*' while those who participate in welfare fraud are viewed as '*scroungers or cheats*'.¹⁰⁰ Thus, the different societal views on tax payment (or non-payment) and receipt of welfare may extend into more punitive treatment of those on welfare, merely because they are on welfare.

There are few differences between tax debt and welfare debt. Both are debts to government that result in the same outcome: fewer resources available to invest in

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⁹⁶ *Social Security (Fraud Measures and Debt Recovery) Amendment Bill*, Explanatory Note.

⁹⁷ *Ibid.*

⁹⁸ Australian Institute of Criminology, 'How the Public Sees Crime: An Australian survey' (1986) 2 *Trends & Issues in Crime and Criminal Justice* 1; Stewart Karlinsky, Hughlene Burton and Cindy Blanthorne, 'Perceptions of Tax Evasion as a Crime' (2004) 2(2) *eJournal of Tax Research* 226; Ranjana Gupta, 'Perceptions of Tax Evasion as a Crime: Evidence from New Zealand' (2006) 12 *New Zealand Journal of Taxation Law and Policy* 199.

⁹⁹ Dee Cook, *Rich Law, Poor Law: Differential response to tax and supplementary benefit fraud* (Open University Press, 1989) 14.

¹⁰⁰ Greg Marston and Tamara Walsh, 'A Case of Misrepresentation: Social security fraud and the criminal justice system in Australia' (2008) 17, 1 *Griffith Law Review* 285, 287.

goods and services for society. The majority of the debt held by each agency has been legitimately created, and there is no suggestion of fraud in relation to the majority of the debt held. However, as illustrated in this study, different processes exist for collection of this debt, with more punitive processes for those on welfare. There is no clear explanation for this situation. Despite the lack of evident explanation for the different treatments of those who hold tax debts and welfare debts, the practice would appear to warrant challenging and changing.

VI CONCLUSION

This study examines the mechanisms by which tax authorities in New Zealand and Australia manage and collect tax debt. The tax authorities have a range of tools available to assist with tax debt collection, and Australia appears to use a wider range of options than New Zealand. Despite having a range of collection methods, the New Zealand and Australian tax authorities both hold large amounts of tax receivables. Moreover, large values of non-collectable tax are held in their debt books. This suggests either that the current tools are not being utilised to achieve the best outcome or that the tools are insufficient to meet the objective of collecting the maximum amount of tax revenue taking into account available resources.

In comparing the treatments of tax debtors and other debtors to the state, the conclusion is reached in this study that tax debtors may expect to receive more lenient treatment than other debtors. Their debts and associated penalties are more likely to be written off, their partners and spouses will not be expected to take responsibility for the debts incurred, and where serious hardship is incurred, the legislation allows for taxpayer debts to be remitted. Conversely, welfare debtors in serious hardship may expect to have their debt deferred only under exceptional circumstances: remission of the debt is not an option.

As noted in the study, there are few differences between tax debt and welfare debt. Moreover there is no clear explanation for the more punitive treatment of welfare debtors than of tax debtors. Nonetheless, the practice of treating those with debts to the government differently, depending on whether the debt relates to tax or welfare, appears to warrant challenging and changing.

ARE YOU STILL HERE, MR HAASE? A STUDY OF AUSTRALIA'S TAX REBATES FOR RESIDENTS IN ISOLATED AREAS

ALEXANDER ROBERT 'LEX' FULLARTON*

ABSTRACT

In 1945, a tax concession was introduced to compensate the residents of remote areas of Australia for the 'uncongenial climatic conditions, isolation and high cost of living ... in comparison with other parts of Australia'.

Changes continued at reasonably regular intervals throughout the 1940s to the 1990s, with a particularly significant change in 1981. However, no further changes to the Zone Rebate have taken place since 1993.

This article suggests that the primary factor influencing the reluctance of Federal governments to address the tax concession is that the political capacity of remote voters has waned.

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I INTRODUCTION

Full of bright hopes, we rested in that land of Wait-a-while, speaking of the years to come, when the bush-folk will have conquered the Never-Never and lain it at the feet of great cities.

— Jeannie Gunn, Australian novelist, 1870–1961

This article looks broadly at the concept of reducing the tax liability of certain taxpayers to compensate those in a less favourable social or economic position than the general population of taxpayers.¹ Specifically, it looks at rebates of taxation, or tax offsets, granted to reduce the tax liability of taxpayers living or working in remote regions of Australia. In particular, it examines a tax rebate to grant those taxpayers

an income tax concession in recognition of the disadvantages to which [the residents of prescribed areas of Australia] are subject because of the uncongenial climatic conditions, isolation and high cost of living ... in comparison with [other] parts of Australia.²

That tax concession is generally referred to as the ‘Zone Rebate’,³ or more commonly the ‘Zone Allowance’.

When the £40 Zone A tax rebate was introduced in 1945, it was a significant concession.⁴ Subsequent reviews broadened its boundaries and changes were continued at reasonably regular intervals until the 1990s.

However, since 1993 no amendments to the tax concession have taken place. Some proposals have been made by rural and remote taxation practitioners and, in 2010, the final report of the Henry Review included a recommendation that ‘[t]he zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness’.⁵

However, those proposals were rejected by successive Federal governments. This article looks at some of those proposals, in particular that of Fullarton and Haase, which sought to tie Zone Rebate tax concessions to the relief of debts incurred under the higher education contribution scheme (HECS)⁶ for residents of remote zones. That proposal was dismissed outright by the then Federal Treasurer in 2007.⁷

This article suggests that the reluctance of Federal governments to increase taxation concessions to compensate for the uncongenial climatic conditions, isolation and high

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¹ CCH Australia Ltd, *Asprey Report — An Analysis* (1975) para 301.

² *Income Tax Assessment Act (1936)* (Cth) s 79A.

³ *Ibid.*

⁴ The original £40 rebate is worth approximately \$2,633 in 2013 values.

⁵ Ken Henry et al, Australia’s Future Tax System Review Panel, Parliament of Australia, *Australia’s Future Tax System: Final Report*, (May 2010) recommendation 6 (‘The Henry Review’).

⁶ The HECS was changed to the higher education loan program (HELP) in 2005 to assist students to pay tertiary education fees. It is now referred to as HECS-HELP.

⁷ Letter from Peter Dutton to Barry Haase, 19 January 2007 (held by author).

cost of living of remote Australian taxpayers is influenced solely by political expedience. Numerically, voters in those regions are now vastly outnumbered by, and of less political significance than, other Australians.

It concludes that the political factor of electoral influence is greater than the legal, or socio-economic, factors of equity or fairness, referred to as vertical equity,⁸ and considered to be an essential element of a 'good' taxation system, in defining government taxation policies.

II TAX REBATES FOR RESIDENTS OF ISOLATED AREAS IN AUSTRALIA

I love a sunburnt country,
A land of sweeping plains,
Of ragged mountain ranges,
Of droughts and flooding rains.

— Dorothea MacKeller, Australian poet, 1885–1968

To provide clarity as to the regions of Australia under scrutiny, the map shown in Figure 1 describes the region of Australia considered to be 'remote' by the Australian Bureau of Statistics (ABS).

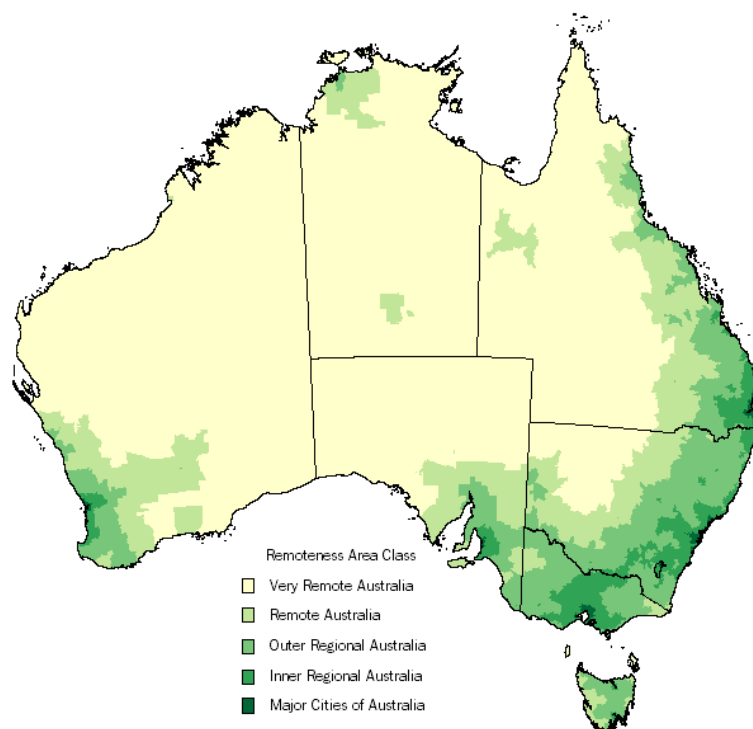


Figure 1: Map of Australia illustrating the 2006 Remoteness Structure

Source: ABS, the 2006 Remoteness Structure⁹

⁸ CCH Australia, above n 1.

⁹ Australian Bureau of Statistics, *The 2006 Remoteness Structure*, 10 June 2014 <<http://abs.gov.au/websitedbs/D3310114.nsf/home/remoteness+structure#Anchor2e>>.

It is no coincidence that the remote areas of Australia, as depicted in the map in Figure 1, are largely unpopulated. They are some of the harshest and most uncongenial physical environments in the world.

The analysis in this article is focused on the Pilbara region of Western Australia, a region included in the Federal seat of Kalgoorlie, and then Durack, which was represented by Mr Barry Haase. As shown in Figure 2, the Pilbara region of Western Australia has daily maxima in the summer months of over 40 °C—a most uncomfortable climate.

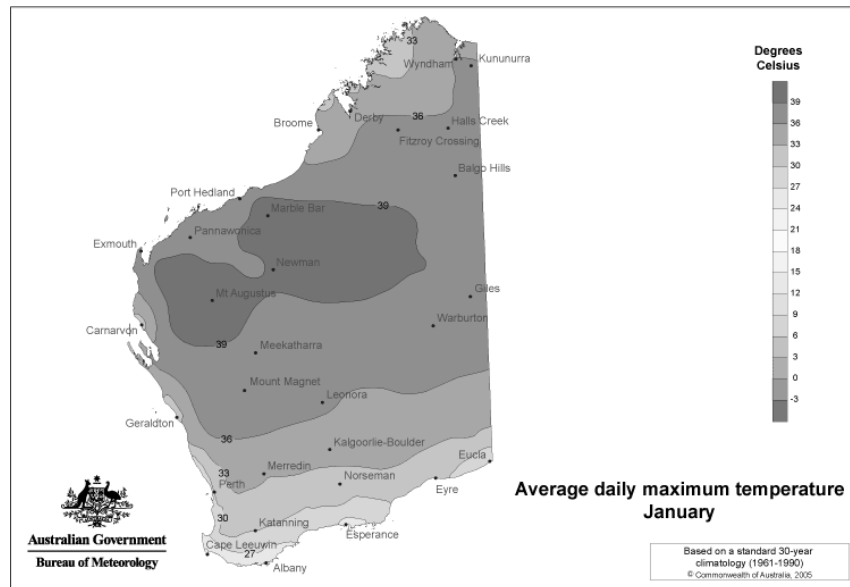


Figure 2: Western Australia's average daily maximum temperature for January

Source: Australian Government, Bureau of Meteorology¹⁰

Note: the original map is in colour. Isotherms are all above 24 °C and not under 18 °C (which are similar shades of grey in this reproduction)

The north-west of Western Australia is largely barren, a stony desert landscape with sparse vegetation. It has long periods of drought coupled with flooding rains when rotating tropical storms (cyclones) cross the northern coastline. At times, the desert is flooded, vegetation blooms and then the land returns to its parched state for months and sometimes years.

The cyclones bring rain, but they also bring devastating tempests and flash flooding to the region. The damage can be considerable: lives are lost, stock destroyed and communities isolated for days, sometimes weeks, due to damage to transport infrastructure.¹¹

¹⁰ Australian Government Bureau of Meteorology, Average maximum temperature for January 2014.

¹¹ Examples include the following: tropical cyclone 'Tracy', Darwin, December 1974, 65 killed, 650 injured, 35,000 evacuated, \$837 million insured damage total estimate over \$4.1 billion; tropical cyclone 'Bobby', Onslow, February 1995, seven killed; tropical cyclone 'Olivia', Pannawonica, April 1996, 10 injured, power installation and 55 houses destroyed; tropical cyclone 'George', Fortescue Metals campsite south east of Port Hedland, March 2007 two killed, 28 injured and \$8 billion

As indicated in Figure 3, tropical cyclones can cross the coast anywhere between Carnarvon and Broome, but the Pilbara region is under the greatest threat. As many as six cyclones a year can occur in the Pilbara.

Selected Tropical Cyclone Tracks

A	Ada	1970	L	Aivu	1989
B	Althea	1971	M	Onson	1989
C	Wanda	1974	N	Nancy	1990
D	Tracy	1974	O	Joy	1990
E	Trixie	1975	P	Fran	1992
F	Joan	1975	Q	Annette	1994
G	Ted	1976	R	Bobby	1995
H	Hai	1978	S	Chloe	1995
I	Hazel	1979	T	Rewa	1994
J	Kathy	1984	U	Ethel	1996
K	Winifred	1986	V	Olivia	1996



Figure 3: The pattern of tropical cyclone paths in Australia

Source: Australian Emergency Management Institute
Forum Hazards Disasters and Survival

Although tropical cyclones can cross the coast anywhere between Carnarvon and Broome, the Pilbara region is under the greatest threat. There can be as many as six cyclones a year occurring in this region.¹²

These seasonal cyclones bring another discomfort. The sudden influx of moist tropical air brought by the cyclones raises the humidity to extremely uncomfortable levels. Periods of high humidity can last for days, weeks or even months if successive cyclones pass through the region.

Therefore, despite recent population increases in parts of remote Australia due to the mining industry, the regions remain largely uninhabited. The inhospitable and uncongenial climate of Australia has encouraged population growth to focus on the more clement eastern seaboard and the south west of Western Australia.

The ABS has determined that 1 per cent of Australia's land mass contains 84 per cent of our population and that approximately half of our continent contains only 0.3 per cent of the population. This gross imbalance in the distribution of Australia's population is a source of ongoing concern due to problems of security when large sections of Australia remain uninhabited.

There has, in recent years, been a continuing population decline in rural areas due to internal migration, and population increases in fast-growing areas such as the coast of

insured damage: Emergency Management Australia, *Hazards, disasters and survival: a booklet for students and the community* (1997) 22–5.

¹² Ibid, 22.

northern Queensland and Darwin. Remote inland pastoral and agricultural communities are disappearing, making others even more isolated, while previously small coastal towns have become thriving cities.

In recognition of the physical and socio-economic disadvantages faced by the population of remote Australia, a concession to the taxation of their income was introduced by the Australian government. The concept of a reduction in taxation for residents of isolated areas, known as a 'Zone Rebate', was introduced in Australia in 1945 as an income tax concession that recognises the disadvantages to residents in 'specific areas'. According to the Australian *Income Tax Assessment Act*, these disadvantages include uncongenial climatic conditions, isolation and the high cost of living compared with those of other parts of Australia.

A map showing the areas of Zone Rebates as they applied in 1945 is depicted in Figure 4. A comparison with the map of remoteness (Figure 1) indicates that the tax zones reflect the remoteness of those regions as suggested by the ABS.



Figure 4: Australian tax rebate zones in 1945

Source: NATMAP NMP/84/002.24

In 1945, the 'specific areas' consisted of two zones. Zone A included nearly the entire continent above the 26th parallel and some offshore islands with the exception of approximately 50 per cent of eastern Queensland. Zone B, which is deemed to be less remote, includes the remainder of the continent except for highly populated areas.

When considered in light of the personal incomes and tax liabilities of the period, the £20 tax rebate was a significant concession indeed. There were further increases in the

1940s, while in the mid-1950s, boundaries were changed to broaden the application of the rebate.

Although reviews of the rebate paused in the 1960s, changes continued at reasonably regular intervals throughout the 1970s, 1980s and early 1990s. A particularly significant change took place under the stewardship of the then Liberal Party Federal Treasurer, John Howard, in 1981.

The 'Special Areas' of Zones A and B were further delineated within those zones to recognise the extreme uncongenial climatic conditions, isolation and high cost of living compared with conditions faced by the residents of the zones generally. The impact of the introduction of those Special Areas is reflected in Figure 5. The Zone Rebate for the taxpayers in these Special Areas was increased to \$750 per annum (and increased by 50 per cent of the individual taxpayer-dependent rebates).



Figure 5: Australian tax rebate zones in 1981

Source: NATMAP G 8961.E74 1984¹³

Taxpayers in the Special Areas of both zones were deemed to be 'most remote'. 'Most remote areas' are defined as those being more than 250 kilometres from the nearest urban centre with a population 2,500 or more, as at the 1981 census.¹⁴

¹³ This map is reproduced with the permission of Document Supply Services, National Library of Australia, ACT 2600.

¹⁴ *Income Tax Assessment Act (1936)* (Cth) s 79A (3D).

However, the 1981 amendments excluded the rest of Australia's remote taxpayers, who received no increase in compensation for the disadvantages described in s 79A.¹⁵

Since 1981, there have been some small increases in Zone Rebates, which currently consist of an amount of \$338 for Zone A, \$57 for Zone B and \$1,173 for Special Areas in both Zones. In addition, those rebates are increased by a further amount based on a percentage of certain rebates for dependents, being 20 per cent for Zone B and 50 per cent for Zone A and Special Areas. The calculation of the additional 'rebateable amount' can be complex, as it includes 'notional child rebates'. 'Notional child rebates' are not dependant rebates to the taxpayer as such but are considered solely for the purpose of calculating zone rebate entitlement. Additional complexity arises from the fact that time spent in higher zones may also be calculated on a *pro rata* basis to increase annual zone rebate amounts. However, for simplicity this article only considers the basic rebate to a single taxpayer.

Given that the corresponding rebates in 1981 were \$216 for Zone A, \$36 for Zone B and \$750 for the Special Areas in both zones, these increases have been very modest indeed.

Taxpayers in the zones now consider the fiscal compensation afforded to be extremely trivial. Fullarton noted a comment from an interviewee in his research whose opinion as to the impact of Zone Rebates as recompense for the uncongenial climate, isolation and high cost of living in the prescribed remote areas of Australia was certainly less than favourable:

It's not even the difference of a tank of fuel. Put it this way, for the amount of tax I was putting into the big bucket, I don't think that our concessions in the north-west matched those of people who had the benefits they had down south or anywhere.¹⁶

Manning also notes that 'in relation to average weekly earnings the current Zone A rebate is worth only a quarter of its value in 1948'.¹⁷

To provide an indication of the relative value of the rebate, Table 1 shows the average weekly Australian wage from 1945 to 2005.

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¹⁵ Ibid s 79A; \$338 per annum (and increased by 50 per cent of the individual taxpayer-dependent rebates) for those in Zone A; and \$57 per annum (and increased by 50 per cent of the individual taxpayer-dependent rebates).

¹⁶ Alexander Robert Fullarton, *Miners' motivation — the mass-marketed tax avoidance schemes of the 1990s in the Pilbara region of Western Australia* (PhD Thesis, University of New South Wales, 2013) 234.

¹⁷ Ian Manning, 'Income Tax Zone Rebates' (2013) 68 October, *National Institute of Economic and Industry Research* 1.para3 <<http://nieir.com.au/income-tax-zone-rebates/>>.

Table 1: Average Male Weekly 1945–2005

Year	Average Weekly Wage^{18, 19} (\$ per week)	Standard Rebate Zone A (\$ per week)
1945	12.03	1.53
1955	32.30	4.61
1965	51.70	10.38
1975	138.10	4.15
1985	391.40	4.85
1995	645.10	6.50
2005	1058.40	6.50

Sources: 1945 Australian Bureau of Statistics,²⁰ 1955–1995, Reserve Bank of Australia;²¹ 2005 Australian Bureau of Statistics²² Hicks²³

Table 1 includes the Zone A rebate (previously termed allowance) applicable to a single male without dependents, to provide a guide to the financial benefit of the concession. Note the negative change in the Zone rebate between 1965 and 1975.

The Zone rebate was reduced by the Whitlam Labor government from \$540 per annum to \$216 as part of its changes to social welfare policy, which increased family payments for the support of children. The changes included removing support by way of reduced taxation concessions, instead making payments directly to the child carer.²⁴ Discussion about those political and social issues is noted, but considered beyond the scope of this article.

How is it that this once ‘significant concession’ has been reduced to the value of a tank of fuel? This article suggests that the general drift in population away from remote regions towards urban areas has reduced the electoral influence that voters in the ‘Bush’ once had.

¹⁸ All figures converted to dollars. Australia converted from Sterling to Decimal currency in February 1966.

¹⁹ Average Weekly MALE Earnings.

²⁰ Australian Bureau of Statistics *Official Year Book of the Commonwealth of Australia* (1946) 466.

²¹ Reserve Bank of Australia Statistics at <<http://www.rba.gov.au/statistics/index.html>> 13 July 2014.

²² Australian Bureau of Statistics ‘Average Weekly Earnings’ Cat 6302.0 (2006) 4.

²³ Peter Hicks, ‘History of the Zone Rebate’, research note no 28, *Department of the Parliamentary Library Commonwealth Parliamentary Library* (2001).

²⁴ *Income Tax Assessment Act (No. 2) 1975* (Cth) s 10.

That there is little political gain in reviewing Zone Rebates is a possible explanation for John Howard's opposition to Zone Rebates as Prime Minister in 2006 — even suggesting that the rebate may be unconstitutional. This is contrary to views he expressed in 1981.²⁵

In April 2013 Julia Gillard, the then ALP Prime Minister, gave a similar answer to the same question, saying that the Zone Rebate may be unconstitutional.²⁶ In doing so, she implied support for a statement made by the Liberal Treasurer Mr Costello in 2006, namely that 'it is the preferred policy of the Government to cut taxes for all Australians ... rather than provide geographically targeted tax cuts through increases in the zone tax rebate'.²⁷

Concerns expressed by the Treasurer and Prime Minister as to the Zone Rebates being 'unconstitutional' appear to be based on the *Constitution*, which states 'The Parliament shall, subject to this Constitution, have power to make laws for the peace order, and good government of the Commonwealth with respect to: taxation; but so as not to discriminate between States or parts of States.'²⁸

Should this be the case, then s 79A of the *Income Tax Assessment Act 1936* (ITAA 1936) has been unconstitutional since 1945. It is curious to note that the legislation was introduced by the Parliament of Sir Robert Gordon Menzies, a noted barrister and scholar of the Constitution. Another constitutional scholar and radical reformer was Gough Whitlam, who, while making many attempts at constitutional change, did not view s 79A of the *ITAA 1936* as 'unconstitutional'. Indeed, in the time of the Whitlam government, s 79A was reviewed. Further, Malcolm Fraser, who achieved three constitutional changes and many taxation reforms, did not view s 51(ii) as an impediment to reviewing s 79A in 1981 and 1983.

Further reviews took place in 1991 and 1992, the latter under the Keating government. It seems therefore that if s 79A is 'unconstitutional' under sub-s 51(ii) of the *Constitution*, then the breach has existed for over 60 years through the administrations of no fewer than 12 Prime Ministers.

Given that the *Constitution* pre-dates s 79A of the *ITAA 1936* by some 36 years, either all those administrations, Liberal and ALP, have been acting unconstitutionally, or the current treasury advice is mistaken. Perhaps the reference to 'unconstitutionality' is merely politically expedient.

However, this article suggests that there are two alternatives as to why s 79A is not 'unconstitutional':

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²⁵ Letter from Peter Costello to Barry Haase, 21 February 2006 (held by author).

²⁶ Julia Christensen, Interview with Julia Gillard, Prime Minister of Australia (Darwin, 26 April 2013).

²⁷ Costello, above n 25.

²⁸ *Australian Constitution* s 51(ii).

- (a) It is not considered to be 'taxation', which would subject it to s 51(ii), but rather 'financial assistance' and falls under s 96 of the Constitution which provides that 'the [Federal] Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit' or
- (b) Unlike deductions, tax offsets are not taken into account in determining taxable income. Instead ... they reduce the 'basic income tax liability' on that taxable income ... The amount of any tax offset to which a taxpayer is entitled is independent of the level of the taxpayer's taxable income or marginal tax rate, although the separate net income of the dependant may be relevant.²⁹

In either case, s 79A reduces an individual taxpayer's liability to his/her tax debt and not to the taxation levied; therefore, it is outside the definition of 'taxation' in sub-s 51(ii) and the limitation does not apply.

If s 79A aims to grant to residents of the prescribed area an income tax concession in recognition of the disadvantages to which they are subject because of the uncongenial climatic conditions, isolation and high cost of living in comparison with other parts of Australia, then the rebate is clearly intended to serve as compensation for zone residents and not a penalty to those who are not.

An additional burden is what the writers of the *Constitution* also envisaged as treating states differently. This article suggests the Zone Rebate is therefore outside the scope of sub-s 51(ii), hence its 70-year existence.

III THE POLITICAL INFLUENCE OF TAXPAYERS IN REMOTE REGIONS

I am back from up the country — up the country where I went
Seeking for the Southern poets' land whereon to pitch my tent;
I have left a lot of broken idols out along the track,
Burnt a lot of fancy verses -- and I'm glad that I am back.

— Henry Lawson, Australian poet, 1867–1922

To illustrate the general rural/urban population shift in Australia, an investigation of ABS reports, shown in Table 2, indicates the following population distribution for Western Australia.

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²⁹ Robert L Deutsch et al, *Australian Tax Handbook* (Thomson Reuters 2008), 978.

Table 2: An Indication of the Increase in the Influence of Urban Voters in Western Australia 1901–2011

Year	Western Australian population	Perth population ³⁰	Urban percentage
1901	193,601	70,700	36.52
1947	502,480	298,471	59.40
1976	1,144,343	805,747	70.41
1981	1,273,624	898,918	70.58
1986	1,406,929	994,472	70.68
1991	1,586,825	1,143,249	72.05
1996	1,726,095	1,244,320	72.09
2001	1,832,008	1,325,392	72.35
2006	1,959,088	1,445,078	73.76
2011	2,239,170	1,670,953	74.46

Source: ABS Census Data³¹

Fullarton³² found that, despite the fact that the overarching Federal electorates — such as Kalgoorlie, which encompassed most of remote Western Australia — were held by the Liberal Party, State voting patterns indicate that electors in the extremely harsh and remote Pilbara and Kimberley regions were Australian Labor Party (ALP) supporters — something that was likely to exacerbate the alienation of taxpayers in these remote regions. This article suggests (below) that that was a key influence when the then Liberal Treasurer dismissed Haase's proposal for a review of Zone Rebates in 2007.³³

Not only has the Zone Rebate diminished in relative value, anomalies have developed since 1945. Not all of 'remote Australia' has remained remote. An example is Darwin.

³⁰ For a comparative analysis, the geographical region of Perth has been applied consistently. However, there has been an expansion of the Perth metropolitan area over 110 years. Areas once considered to be rural, such as Gosnells (once agricultural, now a suburb of the Perth metropolitan area), have been included in this population.

³¹ Australian Bureau of Statistics, *Census Data* 10 November 2013
<<http://www.abs.gov.au/websitedbs/D3310114.nsf/Home/Census>>.

³² Fullarton, above n 16, 28.

³³ Dutton, above n 7.

This city has a population of 120,586,³⁴ which includes an estimate of approximately 70,000 taxpayers.³⁵ The population of Darwin represents over 55 per cent of the entire Northern Territory population. However Darwin is included in Zone A, which allows its taxpayers to claim a \$338 rebate.

Darwin has an international airport, a thriving seaport, international hotels and a cost of living not far removed from that of southern capitals. With the completion of the Darwin to Alice Springs railway and regular flights to Asia, it can no longer be regarded as a remote area.

Three of Queensland's regional northern coastal cities each have a population in excess of 60,000. The ABS 2011 census data show Cairns to have a population of 224,436, Townsville 217,897 and Mackay 166,811.³⁶ They are all situated in the present Zone B and have a combined population of 609,144. This represents roughly 357,000 taxpayers,³⁷ which is more than half the estimated taxpayers entitled to a Zone B rebate.

Zone B provides an average individual taxpayer with a rebate of \$57 per year, and an average family taxpayer, with an employed spouse and two dependent children, with a rebate of about \$208 per year. These individual payments are insignificant to individual taxpayers. However, the total payment to 357,000 Zone B taxpayers, who are residents of those large cities, may represent an estimated annual cost of over \$25.5 million to Commonwealth revenue.³⁸

There are certainly remote communities in Zone B, the most deserving being those in the Special Areas in that Zone, which should retain a Zone Rebate concession. However, there remains a question as to how many other areas in Zone B should be considered to be remote, after taking into consideration improvements in transport and communications over the past two decades. Those that are genuinely remote should certainly receive a rebate that is more generous than that outlined above.

From a more general perspective, the review of Australia's future tax system for the 2006/07 financial year found that some 530,800 taxpayers received the zone and

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³⁴ Australian Bureau of Statistics, *Census Data 2011*, 5 May 2014
<<http://www.abs.gov.au/websitedbs/censushome.nsf/home/data?opendocument#from-banner=LN>>.

³⁵ This figure has been estimated by dividing the number of individual income tax returns lodged in 2011 provided by the Australian Taxation Office Taxation Statistics 20 June 2014
<<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2011-12/?page=8#Table4>> (12.6 m) by the entire Australian population for 2011 as provided by Australian Bureau of Statistics, *Census Data 2011* (above n34).

³⁶ Ibid.

³⁷ Ibid.

³⁸ This estimate is based on statistics provided by the Australian Government, *Architecture of Australia's tax and transfer system* (2010), which shows that 530,800 taxpayers received the zone and overseas forces tax offset to the estimated value of \$A225 m, in the 2006/07 financial year or an average of \$424 each. Given that that figure contains ALL taxpayers from ALL zones, the average Zone B rebate is estimated to be 57/338ths (Zone B/Zone A) of that figure. Further, Australian Taxation Office Taxation Statistics for 2011 show the average zone rebate to be \$450. Without analysing data from each specific district, the actual figure is difficult to estimate; however, for the purposes of this paper, the estimate is considered to be sufficient to demonstrate the point; Australian Taxation Office, above n 34.

overseas forces tax offset to the estimated value of \$225 million.³⁹ In 2010/11, those figures had risen to 605,540 taxpayers and the value to \$273 million,⁴⁰ a mere average of \$450 per annum or less than \$9 per week.

In Fullarton's interviewee's terms, that is around 260 litres of fuel in Pannawonica, or perhaps two Toyota Landcruiser tanks of fuel.⁴¹ To place that sum in a practical context, it would purchase sufficient fuel to travel to Perth from Pannawonica and half the return journey.

A further geographic anomaly is that of Pannawonica in Western Australia's Pilbara. It is considered to be in ordinary Zone A (\$338 plus 50 per cent of the dependent's rebate), yet it is one of the most isolated communities in one of the harshest climatic regions in Australia.

Fullarton suggests:

that the physically harsh living environment and heavy working conditions of the Pilbara region may have influenced the blue-collar workers' perceptions that their income tax rates were excessive and 'unfair'. Their physical isolation may have led to an increased perception of social distance, which in turn may have led to an increased resistance to paying tax.⁴²

Fullarton also noted that over 18 per cent of taxpayers resident in the Pilbara mining community of Pannawonica had engaged in the mass-marketed tax avoidance schemes of the 1990s. That was a rate nearly 46 times higher than that of the average Australian taxpayer.⁴³

Given that Pannawonica is one of the more remote communities of the Pilbara, and also endures a particularly uncongenial climate, the disproportionate participation rates in mass-marketed tax avoidance schemes by its taxpayers may have also been influenced by a perception of a poor level of compensation for these particularly harsh conditions.

Therefore, this article suggests that a review of Zone Rebates is urgently required to restore its relevance to addressing the imbalance of vertical equity caused by 20 years of its oversight by successive Federal governments.

However, it may be that the primary factor influencing the reluctance of Federal governments to address the now trivial tax concession is that the political capacity of rural and remote voters has waned. While it may be fair and equitable in a legal and

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³⁹ Australian Government, *Architecture of Australia's tax and transfer system* (2010) <http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_2-12.htm>.

⁴⁰ Australian Taxation Office, above n 35.

⁴¹ Toyota Landcruisers are by far the preferred vehicle for 'Bush' people. They are large, robust, four-wheel drive capable and have a high highway speed. Although modern technology has helped, they are not very fuel efficient and are often fitted with large fuel tanks. Other types of vehicles are rarely present in the parking areas of Pilbara hotels.

⁴² Fullarton, above n 16, 286.

⁴³ Data of 2001 survey distribution by postcode; Email from Kristina Murphy to Alexander Fullarton, 20 September 2007. Fullarton, above n 16, 5.

social sense to address the concession, it has little or no political benefit. In fact, it may be contrary to the interests of government to address the matter of Zone Rebates.

This article now considers the political impact of taxpayers resident in remote zones. Figure 6 shows the Australian Federal electorates and their respective voting results in the 2010 election.

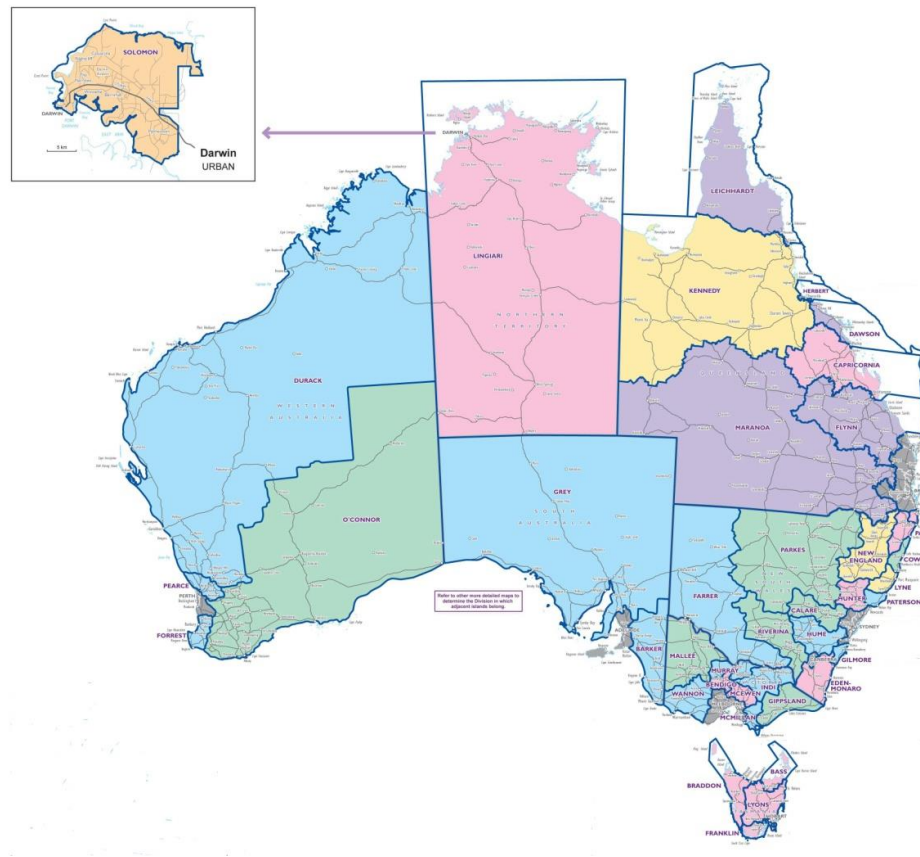


Figure 6: Map of Electoral Results, Australian Federal Election 2010

Source: Australian Electoral Commission⁴⁴

This article refers to the 2010–13 Labor government, as the current Liberal government was only elected in August 2013 and it is unfair to expect action as to a review of Zone Rebates from that administration at this time. It is also deemed to be pertinent as the Prime Minister of the Labor government expressed the same views about Zone Rebates⁴⁵ as did a previous Liberal Prime Minister in 2006.⁴⁶

The comparison of the map of the 2010 Australian Federal Election to the map of the Australian tax rebate zones in 1981, in Figure 5, shows that only 13 of the 150 members of the House of Representatives represent taxpayers in remote zones.

⁴⁴ Australian Electoral Commission, '2010 Federal Election House of Representatives Results Map' (25 October 2012) <http://www.aec.gov.au/Elections/federal_elections/2010/files/results-map-2010.pdf>.

⁴⁵ Christensen, above n 26.

⁴⁶ Costello, above n 25.

Table 3: Federal Representation of Remote Regions

Electorate⁴⁷	Held by⁴⁸	Margin (%)⁴⁹	Registered Electors⁵⁰	Percentage of Australian Electors⁵¹
Farrer (NSW)	Liberal	29.02	94,026	0.67
Parkes (NSW)	National	27.34	100,170	0.71
Capricornia (QLD)	ALP	24.16	91,961	0.65
Dawson (QLD)	Liberal/ National	4.86	94,533	0.67
Herbert (QLD)	Liberal/ National	4.34	91,044	0.65
Kennedy (QLD)	Independent	36.68	94,434	0.67
Leichhardt (QLD)	Liberal/ National	9.1	93,113	0.66
Maranoa (QLD)	Liberal/ National	45.78	97,892	0.69
Lingiari (NT)	Country Liberal	7.4	61,168	0.43
Solomon (NT)	ALP	3.5	59,891	0.43
Grey (SA)	Liberal	22.32	99,775	0.71
Durack (WA)	Liberal	27.34	85,811	0.61
O'Connor (WA)	WA Nationals	46.0	92,902	0.66
Total			1,156,720	8.21

⁴⁷ Capricornia, Farrer, Maranoa and Parkes are not included entirely in Zone B; therefore, the population contained in Zone B is inflated.

⁴⁸ Australian Electoral Commission, above n 44.

⁴⁹ Margin based on two-party preferred results, *ibid.*

⁵⁰ Total enrolled voters, *ibid.*

⁵¹ National total of enrolled voters 14,086 869, *ibid.*

Table 3 compares the population of remote electors with the national population. Apart from this being simply less than 10 per cent of parliamentary representation, it is also noted that only two of the 13 electorates were held by the government at that time.

Given that the electorates of Capricornia, Farrer, Maranoa and Parkes cover areas outside remote zones and that no seat is held by 100 per cent of the primary poll,⁵² the populations included in Table 3 are inflated by the number of electors within the electorate, but outside remote zones. In 2010, government supporters, with elected representatives, formed only 67,735 —less than one half of 1 per cent of the national population of electors.⁵³

Barry Haase, in the electorate of Durack, a Liberal and a supporter of Zone Rebate reviews, represented only about half that number (a little less than half); 26,155 of Durack electors had preferred the ALP representative.⁵⁴ Given those statistics, it is not surprising that the Federal government displays little interest in reviewing Zone Rebates.

An additional influencing factor is that most of the electorates in the remote areas are safe seats, generally represented by conservative politicians. Table 3 shows that only three seats are held by less than 5 per cent. An old adage of politics and policy making is that politicians tend to ignore voters who will *always* vote for them and voters who will *never* vote for them. The margins by which those seats are held indicate that policy makers may not focus on matters of concern to voters but specific to the remote regions. That focus may be of particular influence if it is thought that policy changes might be a negative influence in seats outside the remote regions.

Further, alienating 427,000 taxpayers/electors, as proposed by some of the submissions to Zone Rebate reviews examined later, is simply not in the interest of any major party wishing to form government. That situation applies in particular to the ALP, which would lose the electorate of Solomon, and to the Liberal/National party in relation to the electorates of Dawson and Herbert.

In 2006, when Barry Haase presented Fullarton and Winfield's proposal to increase Zone Rebates for the taxpayers of his vast and remote Western Australian electorate of Kalgoorlie to the then Liberal Treasurer of Australia, Mr Costello simply addressed the following points: 'How many [electors/taxpayers] are there? Do they vote for us?' On hearing Mr Haase's statistical estimate and electoral assessment, Mr Costello paused and replied 'Are you still here, Mr Haase?'⁵⁵

This article now moves on to review some of the proposals and calls for a review of Zone Rebates that have occurred since 1990.

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⁵² The electorates of Maranoa and O'Connor were held by a two-party preferred margin of nearly 73 per cent, and Durack and Farrer by over two-thirds of the poll. However, while very representative of their communities, none of those members was in government.

⁵³ Australian Electoral Commission, above n 44.

⁵⁴ Ibid.

⁵⁵ Interview with Barry Wayne Haase, Federal Member for Kalgoorlie (Telephone interview, 21 June 2006).

IV PREVIOUS REVIEW PROPOSALS

The odds were a trifle heavy — but he wasn't the sort to flinch,
So he opened fire on the army, did the boss of the 'Admiral Lynch'

— Andrew Barton 'Banjo' Paterson, Australian poet, 1864–1941

Some public appeals or formal submissions have been made for a review of Zone Rebates since 1990. Those that have tend to come from rural and remote local councils, politicians and accounting or taxation practitioners resident in the regions. This part examines some of those proposals.

In 2001 a research paper on the History of the Zone Rebate was presented to the Parliament of Australia.⁵⁶ It found that the average rebate for the 1997–98 financial year was \$407.⁵⁷

As to the real value of the rebate, it stated:

It is argued that the increases in the base amounts of the zone rebate have not been sufficient to offset the effects of inflation. For the rebate to have maintained the same value in real terms since its introduction, the ordinary rates for Zones A and B would have needed to be \$886 and \$147 respectively in 1999/2000 while the special rate would need to have been \$1710.⁵⁸

It then suggests, however, that '[a]lthough the base amount has not increased since 1993/94, the value of the rebate to taxpayers with dependents has increased because of the linkage with dependent spouse and sole parents rebates which are subject to annual indexation'.⁵⁹

That suggestion implies that despite the rebate being between one-third of its real value since its introduction (for Zones A and B) and two-thirds (for Special Zones), the linkage to other rebates would correct the discrepancy over time. As the increase due to the annual indexation of other rebates has resulted in an increase of just \$43 per annum or 80 cents per week 13 years later,⁶⁰ that implication seems to be unfounded.

However, the paper does acknowledge that the Zone Rebate has lost most of its original value in real terms. Despite that acknowledgement, no adjustments to the Zone Rebate took place.

In 2003, Winfield and Fullarton submitted a proposal for a Zone Rebate to Haase, the then member of the House of Representatives for the electorate of Kalgoorlie. The full submission is contained in Appendix A. Not only did it suggest a reconstruction of the regions for eligible taxpayers and an increase in Zone Rebates generally, but it also suggested that a discount be granted to university graduates who had HECS debts. The

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⁵⁶ Hicks, above n 23.

⁵⁷ Ibid.

⁵⁸ Ibid.

⁵⁹ Ibid.

⁶⁰ See above n 38 and accompanying text.

discount of HECS debts was to be evidenced by their eligibility for the Zone Rebate as service within remote zones.

The effect would be that graduates who were resident in a Remote Area would have had their HECS liability reduced by 25 per cent during their time of residency. Those that had become residents of Special Zones within the Remote Area would have had their HECS liability reduced entirely during the period of their residency.

All professionals would have been rewarded by outback service: the further outback, the greater the reward. This would have had a major impact, particularly on the health and education professions, where HECS debts ranged from \$29,995 for medical and law students to \$10,794 for teachers and nurses.

The proportion of professionals in the rural and remote regions is heavily weighted towards the lower end of the scale, as are the numbers of residents of Ordinary Remote Areas relative to those in Special Remote Areas. The cost to government revenue was, accordingly, most likely to be only \$2,698 per graduate over three years. This could be considered a small contribution compared with the encouragement of facilities and the existing cost to government in attempting to attract professionals away from cities.

The benefits by way of community enhancements and services were considered to be incalculable in terms of social and economic resources being lost to remote areas in the persistent drift towards the major cities of Australia. Once the flow of graduates to the outback became so great that the cities were struggling to retain professionals, the benefit could have been reduced or suspended.

A further factor in costing the proposal was that graduates in remote localities were remunerated at twice and sometimes three times the rate of their city counterparts and thus taxed at higher rates. The \$2,698 tax offset would have been more than recovered by the higher tax revenue, as these graduates reached the highest marginal rates of tax almost immediately, while their city counterparts would have spent many years in the 30 per cent taxation rate margin.

This proposal could have had a positive outcome for the government, the economy, graduates and the people of the outback. It was suggested to be a poignant and fitting time to enact such legislation in 'the year of the outback' (2002).

In 2008, a number of submissions suggesting a review of Zone Rebates were put to Australia's Future Tax System Review Panel.⁶¹ Fullarton's submission,⁶² which included the suggestion that these Zones be restructured to reflect the population changes to major cities within them and increases in tax offsets generally, included the connection to a reduction in HECS debts suggest by Winfield and Fullarton in 2003. That submission is contained in Appendix B.

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⁶¹ Henry et al, above n 5.

⁶² Alexander Robert Fullarton, Submission to Parliament of Australia, *Australia's Future Tax System Review Panel*, December 2008.

In 2011, Power suggested to the 2011 Tax Forum extensive changes to Zone Rebate boundaries, as illustrated in Figure 7.⁶³

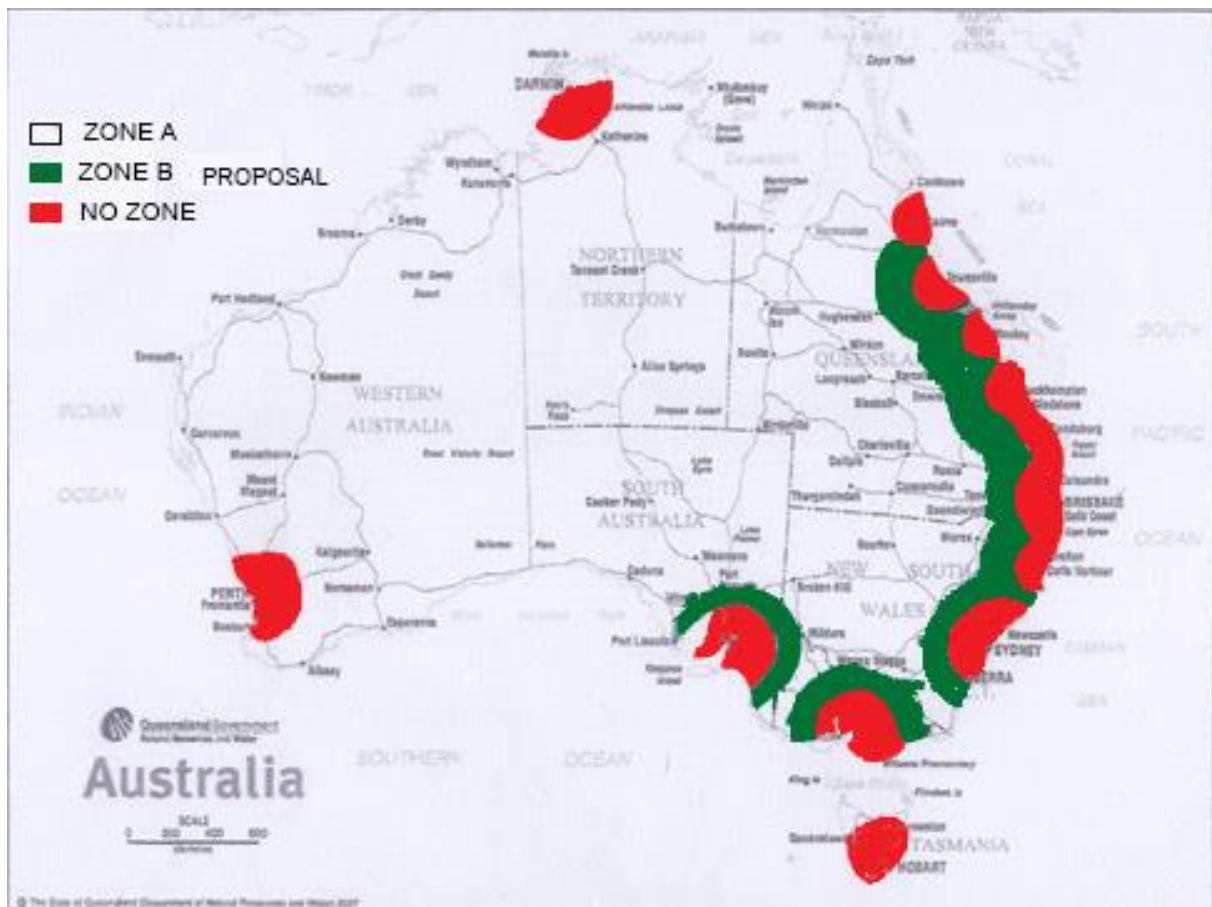


Figure 7: Map of Proposed Zone Boundary Changes — Power 2011

Source: Australian Electoral Commission⁶⁴

Those changes went a little further in their application than Fullarton's submissions, but were generally of similar intent. It was considered that certain communities within the existing zones were no longer as isolated or expensive, in comparison with other parts of Australia, as they were in 1945. In addition, as to the 'uncongenial climatic conditions', it was noted that many Victorians and New South Wales residents move, at least periodically, to Northern and Far Northern Queensland cities to 'enjoy the weather'. It is difficult to compare the lush tropical climate of Cairns with the harsh, hot, dry conditions of the Pilbara region of Western Australia.

Power, a chartered accountant from provincial Biloela in Queensland (Zone B), had been canvassing the cause of Zone Rebate reviews since 1981, when he made a submission to the Zone Allowances Inquiry⁶⁵ of that year. In that submission, he proposed the concept

⁶³ Trevor Kingston Power, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011.

⁶⁴ Australian Electoral Commission, above n 44.

⁶⁵ Trevor Kingston Power, Submission to Public Inquiry into Income Tax Zone Allowances (Australia), *Report / of the Public Inquiry into Income Tax Zone Allowances* (1981). [Cox Inquiry].

of Special Areas. It is noted that the Cox Inquiry⁶⁶ made a recommendation for the 'creation of 'special areas' for particularly isolated areas in each zone, with higher rebates for residents'.⁶⁷

This article now examines the remaining eight of the 214 submissions to the Tax Forum 2011 that referred to reviews for Zone Rebates. Apart from Regional Development Australia Far West NSW's radical proposal to discount taxation in the Broken Hill area by 20–50 per cent as a trial to quantify the effect of Zone Rebates on the impact of rural/urban population drift,⁶⁸ most merely note the devaluation and lack of effectiveness of Zone Rebates.

McElone, a representative of the National Farmers' Federation (NFF), noted '[t]here is a tax zone rebate system in place at the moment, but even the Henry Review ignored it and it's out of date, it needs to be relooked at and revamped to make sure that there is a real need for it'.⁶⁹ The NFF submission stated that '[t]he NFF welcomes this announcement while noting that the review does not suggest that Zone taxes are either good or bad, but rather that the system is outdated and in need of an upgrade'.⁷⁰

The NFF further suggested that 'the scheme [Zone Rebates] be extended to businesses. Such a reform would inject a major new incentive for people to live and work outside the capital cities'.⁷¹

The Western Australian government's submission also went a little further and suggested that

Western Australia's priorities for reform of existing Commonwealth taxes include the restoration of the current system of income tax zone rebates to a level that reflects the higher cost of living in remote regions.⁷²

It further stated:

Whether by enhancing the current rebate scheme, or replacing it with an alternative grant-based scheme struck at realistic levels, this reform offers part of the solution to attracting and retaining a skilled labour force in regions of high productivity, including where resource endowments are high.⁷³

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⁶⁶ Ibid.

⁶⁷ Hicks, above n 23, 3.

⁶⁸ Regional Development Australia Far West NSW, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011, 3.

⁶⁹ National Farmers' Federation, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011.

⁷⁰ Ibid 2.

⁷¹ Ibid.

⁷² Western Australian Government, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011, 3.

⁷³ Ibid.

The Western Australian Chamber of Commerce and Industry also considered reviewing the Zone Rebate to ensure 'that the incentives apply to those areas where workers are most needed. [Further] it may be necessary to extend the rebate beyond remote areas'.⁷⁴

Regional Development Australia Goldfields Esperance, Western Australia considered restricting Zone Rebates to bona fide residents. It suggested '[a]ny review should only apply to those persons legitimately residing in rural and remote areas, not for 'fly-in fly out' employees'.⁷⁵

It further suggested that

The review could remove access to the Taxation Zone Rebates to communities of [less than] 100,000 population as they would have the critical mass to create competition in retail, construction and service delivery etc that is not otherwise available at the same level in smaller communities.⁷⁶

O'Callaghan also stated that '[t]he [Zone] [R]ebate as it currently presents could not be regarded as an incentive to relocate to listed zones'.⁷⁷ However rather than reviewing Zone Rebates, she looked at providing

non-fiscal incentives, in the form of accelerated payroll deductions, zone or profit-linked rebates [to] enable employers to compete more readily for staff in the employment market. The resultant increase in rural and regional employment would act as a stimulus for growth in struggling sectors, ensuring a more resilient and growing private sector and stronger communities. An example would be in the primary industries sector where currently a lack of employees leads to underutilisation of resources and low productivity. Increased access to farm workers would revitalize the industry.⁷⁸

The submissions generally consider the Zone Rebate to have been eroded through the efflux of time and some suggest restoring its economic relevance. Others consider that the Zone Rebate may have some affect in retarding, or even reversing, the population drift towards urban centres. However, the Fullarton–Winfield proposal is unique in that it considers adding the benefit of reduced HECS/HELP debts to target professionals.

What they all have in common is that despite many recommendations by parliamentary inquiries, particularly the 'Henry Review', successive governments have chosen to ignore Zone Rebates. Instead, successive Prime Ministers have stated that 'it is the preferred policy of the Government to cut taxes for all Australians ... rather than provide geographically targeted tax cuts through increases in the zone tax rebate'.⁷⁹

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⁷⁴ Chamber of Commerce and Industry — Western Australia, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011, 18.

⁷⁵ Development Australia Goldfields Esperance, Western Australia, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011, 2.

⁷⁶ Ibid 3.

⁷⁷ Anne Marie O'Callaghan, Western Australia, Submission to Parliament of Australia, *A Tax Plan for Our Future: Tax Forum*, October 2011.

⁷⁸ Ibid.

⁷⁹ Costello, above n 25.

This article now considers the factors influencing that political viewpoint in its conclusion.

V CONCLUSION

‘You had better stick to Sydney and make merry with the ‘push’,
For the bush will never suit you, and you’ll never suit the bush’.

— *Andrew Barton ‘Banjo’ Paterson*, Australian Poet, 1864–1941

It is noted that during the period 2001–08 letters to some of the Vice Chancellors of Australia’s universities soliciting support for the Fullarton–Winfield proposal resulted in the expression of some sympathy, but generally they considered it none of their business.

The then Inspector-General of Taxation expressed a desire not to get involved, and accounting and taxation professionals showed little interest. Opinion was expressed that if the disparity of vertical equity for taxpayers in the ‘Bush’ was so upsetting to the few ‘Bush’ professionals, why then did they simply not move to the city, where a qualified professional could lead a ‘better’ lifestyle?

This article concludes that taxation principles and policies are inextricably linked to political expediency. It does not matter how rational the social and economic arguments may be as to the adoption of practices and policies for raising taxation revenue by a government, the government will ultimately prioritise the political impacts of that tax policy over social and economic rationalism.

This conclusion is further supported by the Henry Review of 2009, which included a recommendation that ‘[t]he zone tax offset should be reviewed’.⁸⁰ The ALP government of the day came to the same conclusion as its Liberal predecessors: there are simply not enough votes in it to make a difference — ‘Taxation is a very political thing’.⁸¹

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⁸⁰ Ken Henry et al, above n 5, recommendation 6.

⁸¹ A paraphrase of the theme of the Australasian Taxation Teachers’ Association 2014 Conference, held in Brisbane, Queensland in January 2014.

APPENDIX A

FULLARTON–WINFIELD SUBMISSION 2003

Summary of Recommendations

To tighten the definition of 'residency' in the tax legislation, so that the zone rebate/offset is available only to permanent residents of designated remote areas of Australia. To account for population shifts in Australia over the past two decades, which have rendered some areas less remote, by deleting all of, or some portions of, Zone B and the entire metropolis of the City of Darwin from the schedules of isolated areas.

To substantially increase the rebates/offsets available to the permanent residents of the present Zone A (except Darwin), any undeleted parts of Zone B and the Special Areas within Zone A and outside Zone A from their current inadequate level.

To provide an incentive for professional people to become residents of remote communities in the form of a rebate/offset of repayments due under the Higher Education Contribution Scheme and also of a generally higher zone rebate/offset.

To achieve the above objectives at a total cost equal to, or less than, the total cost of present rebates/offsets. This will require a considerable reduction in the number of taxpayers presently entitled to this concession.

EXPLANATORY MEMORANDUM

Introduction

In Australian taxation terminology, a 'deduction' is a dollar amount that reduces taxable income, while a 'rebate' is a dollar amount that reduces tax payable. In recent years, from 1999, the term 'tax offset' has been used to replace 'rebate' and both terms are still used interchangeably by tax professionals; consequently, they are referred to as rebates/offsets in This article.

The Income Tax Assessment Act states that the zone rebate/offset is 'an income tax concession in recognition of the disadvantages to which they (residents of prescribed areas) are subject because of the uncongenial climatic conditions, isolation and the high cost of living ... in comparison with (other) parts of Australia' (S 79A(1)).

The 'prescribed areas' consist of two zones, Zone A, which, apart from about 50 per cent of eastern Queensland, includes the entire continent above the 26th parallel and some offshore islands. Zone B, deemed to be 'less remote', includes the remainder of the continent except for the highly populated areas in the east, southeast and southwest as well as western Tasmania. There are also Special Areas in both zones, deemed to be 'most remote', which are more than 250 kilometres from the nearest urban centre (population 2,500 or more) (S 79 (3D) (a) and Schedule 2).

The zone rebate/offset currently consists of two parts: (i) a fixed amount of \$57 for Zone B, \$338 for Zone A and \$1,173 for the Special Areas in both Zones and (ii) an amount

based on a percentage of certain rebates/offsets for dependents, namely 20 per cent for Zone B and 50 per cent for Zone A and Special Areas.

Residency

The legislation defines a resident of a prescribed area as including a taxpayer who is actually in that area, not necessarily continuously, for a period of more than one half of the year of income (S 79A (3B) and (3C)). This can include tourists, casual visitors and workers on fly-in fly-out arrangements, all of which do little to add to the population infrastructure of a community. The fly-in fly-out system has been the principal reason for the depopulation of mining and mineral processing areas in the north of Australia.

This proposal recommends restricting the definition of resident to permanent residents who reside continuously in a remote area for more than half of the year of income. Current provisions for allowing a resident who moves from one remote area to another, or who spreads the period of residence over two tax years, to claim a rebate/offset should continue to apply.

Demographic Factors

'Half the area of the continent contains only 0.3 per cent of the population, and the most densely populated 1 per cent of the continent contains 84 per cent of the population ... concentrated in urban centres, particularly the State and Territory capital cities' (ABS (3)). This gross imbalance in the Australian population has been a source of concern because there are problems of security when large sections of the continent remain uninhabited.

There has also, in recent years, been a continuing population decline in rural areas due to internal migration, and population increases in fast growing areas on the coast of northern Queensland, in Darwin and in Kalgoorlie/Boulder (ABS(3)). The effect of the above movements has been that remote inland pastoral and agricultural communities have disappeared or become still more remote, while some previously small towns have become thriving cities.

Darwin, for example, capital of the Northern Territory, has a population of 90,000, which includes 42,000 taxpayers. This population is almost half that of the entire Territory (pop. 195,500), and the city has the fastest capital city growth rate of 2.3 per cent per year. Darwin has an international airport, a thriving seaport, international hotels and a cost of living not far removed from that of southern capitals. With the completion of the Darwin to Alice Springs railroad, Darwin should no longer be regarded as a remote area; it will in fact be less remote from the rest of Australia than Perth.

Three of Queensland's regional northern coastal cities each have a population that exceeds 50,000: Cairns (pop 115,000), Townsville (pop 130,000) and Mackay (pop 66,000). They are all situated in the present Zone B, have high growth rates and a combined population of 311,000. This represents about 165,000 taxpayers, more than half the estimated 317,000 taxpayers entitled to a Zone B rebate/offset (Appendix 1).

Zone B provides an average individual taxpayer with a rebate/offset of \$57 per year, and an average family taxpayer, with an employed spouse and two dependent children, with a rebate/offset of about \$208 per year. These individual payments are not significant.

However, the total payment to 165,000 Zone B taxpayers who reside in the above large cities represents an annual cost to Commonwealth revenue of about \$24 million.

There are certainly remote communities in Zone B, the most deserving being those in the Special Areas in that Zone, which should retain a zone rebate/offset concession. There remains a question as to how many other areas in Zone B should be considered to be remote after taking into consideration improvements in transport and communications over the past two decades. Those that are genuinely remote should certainly receive a rebate/offset that is more generous than that outlined above.

There seems to be little justification for the three degrees of 'remoteness' that form the basis of the present system. While the definition of Special Areas implies that these are very remote and requiring special treatment, one alternative in this proposal considers that the other parts of Australia considered to be remote should be part of one zone, which attracts a uniform rebate/offset.

The simplest approach could be to retain the present Zones and Special Areas but remove from the zone system all cities in Zone A and Zone B with a population exceeding 50,000 (Darwin and the three above Queensland cities). This would decrease the number qualifying for Zone A and Zone B entitlements by 42,000 and 165,000, respectively, to 101,000 and 152,000. There would continue to be 25,000 taxpayers in Special Areas (Appendix 1). This approach will be referred to as Zoning Alternative 1.

A second approach could be to remove Zone B entirely from the system on the basis that those residing in the lower part of Australia, with the exception of Special Areas, can no longer be considered to be remote. This could be justified by pointing out the very small amount of rebate/offset currently available to Zone B residents. This would leave only one remote zone, the present Zone A, less Darwin, and reduce the number of remote zone taxpayers to 101,000 plus the 25,000 in Special Areas (Appendix 1). This approach will be referred to as Zoning Alternative 2.

This proposal examines the cost of these two alternative zoning systems in Appendix 2.

The alternative zoning systems are

Zoning System Alternative 1 — The present zone system will be retained, but cities in Zone A and Zone B with populations exceeding 50,000 are deleted from remote area zoning. Special Areas remain.

OR

Zoning System Alternative 2 — The metropolitan area of Darwin is deleted from remote area zoning, and the complete Zone B is also deleted, but the Special Areas in the current Zone B are retained as Special Areas outside a remote zone.

Nomenclature

The name of Zone A then becomes inappropriate and it is recommended that the current Zone A, as amended, be renamed the Remote Zone.

Zone Offsets/Rebates

The effects of inflation and changing family structures have rendered the dollar amounts of offsets/rebates in the current system ineffectual in meeting the disadvantages accruing to permanent residents of the Remote Zone and Special Areas.

The fixed amounts are inappropriately low when average annual taxable incomes are around the \$35,000 level, and the cost of living in remote areas is considerably in excess of that in southern cities. To provide one example, fuel costs in remote areas range from 20 per cent to 50 per cent above southern city prices.

In the average Australian family, there are now slightly fewer than two dependent children and a partly or fully employed spouse earning a 'separate net income', which eliminates or reduces the dependent spouse rebate/offset. Consequently, few family taxpayers in remote areas can claim a significant rebate/offset for dependents, and this reduces the value of the 'base' part of the zone rebate/offset.

In this proposal, the dollar amounts of rebates/offsets for the residents of Zones A and B, or the Remote Zone, and Special Areas are raised to a level closer to meeting their locational disadvantages. However, because the number of potential claimants has been reduced, there will not be an increase in the total cost of providing these benefits. In fact, the demographic and calculation changes usually result in a total cost reduction (Appendix 2).

Two alternative methods of calculation will be examined:

Method A- This retains the present system of totalling fixed and base amounts, but the fixed amounts have been increased to \$600 for permanent residents of Zone A and \$100 for permanent residents of Zone B if Zoning Alternative 1 is adopted. If Zoning Alternative 2 is adopted, the fixed amount will be \$1,000 for permanent residents of the Remote Zone. Under both alternatives, the fixed amount is \$2,000 for permanent residents of Special Areas. The calculation of the base amounts has not changed.

OR

Method B- This calculates rebates/offsets as a percentage of the tax payable on taxable income (excluding the Medicare Levy). The percentages decrease as taxable income increases, as follows:

For permanent residents of Zone A (Zoning Alternative 1)

	Tax payable (%)
Taxable Income- \$1 to \$30,000	25
\$30,001 to \$60,000	15
\$60,001 to \$90,000	5
exceeding \$90,000, no rebate/offset on the excess	
For permanent residents of Zone B (Zoning Alternative 1)	
Taxable Income- \$1 to \$30,000	4
\$30,001 to \$60,000	3
\$60,001 to \$90,000	2
exceeding \$90,000, no rebate/offset on the excess	
For permanent residents of the Remote Zone (Zoning Alternative 2)	
Taxable Income- \$1 to \$30,000	30
\$30,001 to \$60,000	20
\$60,001 to \$90,000	10
exceeding \$90,000, no rebate/offset on the excess	
For permanent residents of Special Areas (both Zoning Alternatives)	
Taxable Income- \$1 to \$30,000	40
\$30,001 to \$60,000	30
\$60,001 to \$90,000	20
exceeding \$90,000, no rebate/offset on the excess	

HECS Rebate/Offset

Inherent in both methods is an additional rebate/offset of the annual compulsory repayment contribution, through the tax system, by a graduate who has an accumulated HECS debt. This is calculated as 25 per cent of the year's repayment contribution for permanent residents of Zones A and B, or the Remote Zone, and 100 per cent of the year's repayment contribution for permanent residents of Special Areas.

This provides an incentive for young professionals to relocate to remote areas and reduces the need for government to offer expensive cash incentives. Details of an estimate of the number of taxpayers who have incurred HECS Assessment Debts in Northern Australia are contained in Appendix 3.

A comparison of the cost of the rebates/offsets under the existing and proposed methods is contained in Appendix 2.

Method A is based on the current system, and it would consequently be more familiar to tax advisers and administrators. The fixed amount increases offered to taxpayers in Zones A and B are significant if Zoning Alternative 1, which reduces taxpayer numbers to 253,000, were adopted. However, Zoning Alternative 2, which reduces taxpayer numbers still further to 101,000, allows a more generous fixed amount to be incorporated into the rebate/offset for Remote Zone taxpayers.

Method B calculates the rebates/offsets as a percentage of tax payable, with these percentages decreasing in bands of increasing taxable income. It is a similar concept to HECS repayments through the tax system, where the percentage repayment increases through bands of increasing HECS repayment income (Appendix 2). The calculation is simple, and to a certain extent 'inflation proof', and it could be incorporated into the ATO's computer system.

The total cost of the HECS rebate/offset is currently negligible because only about 2 per cent of Remote Area taxpayers have currently incurred HECS debts, but it will probably increase over time (Appendix 2).

Both of the above calculation methods produce total costs, using an 'average taxpayer' model, close to the level of the total cost of the existing system. The tighter residential requirement recommended would also reduce the calculated total costs of the above-proposed rebates/offsets by several millions of dollars (Appendix 1).

Recommendations

Zoning

The two zoning systems have been designed to produce almost identical total costs. A decision on the best alternative depends on the perception of the degree of remoteness suffered by residents of the reduced Zone B.

Calculation

Zone Rebate/Offset

The writers are equally divided on the merits of each calculation method. Either would be acceptable.

HECS Rebate/Offset

There are reports of graduates leaving Australia in order to avoid HECS repayments. This will offer graduates an opportunity to continue to reside in this country and have the tax system make the repayments, without the need to live overseas.

Conclusion

The research, which has been involved in developing the above proposals, has shown that the current zone allowance system is in need of overhaul. It provides small benefits to the undeserving and mediocre benefits to the deserving. The above proposals, which delete the benefits applied to many city and southern residents and increase those applied to residents in remote communities, are an attempt to properly compensate residents for the disadvantages of their remote location and encourage more permanent residents to settle in northern Australia. This article has indicated that the proposals require little or no additional cost to revenue.

The proposals apply equally to members of the defence forces, who are already provided for in the legislation (s 79A).

R R Winfield, FCPA, M Com (UWA)

A R Fullarton, M Tax (Curtin), Reg Tax Agent

April 2003.

References

- 1 Australian Taxation Office, Taxation Statistics 1999–2000.
- 2 Commonwealth of Australia, Income Tax Assessment Act 1936, s 79A.
- 3 Australian Bureau of Statistics, Yearbook Australia 2002, Population distribution.

Appendix 1

Estimated Number of Taxpayers in Remote Areas

The Australian Taxation Office (ATO) publishes totals only for the most recent year (1999–2000) of the number of taxpayers (485,141) allowed zone rebates/offsets and the dollar amount (\$193 million) of these rebates/offsets.

The following is a broad estimate of the number of taxpayers in each Zone and in the Special Areas for that year based on published ATO statistics of rural and regional areas, part of each of which are in Zone B. Although three years have now passed since the above statistics were issued, there is no reason to believe that the proportion of taxpayers in each area has changed significantly.

Taxpayers in Rural and some Regional Areas (ATO statistics)		Estimation of Taxpayers in Zone B and Special Areas	
Area	Number	Percentage	Number (Approx)
NSW Rural	505,886	10	51,000
Qld Rural	423,651	20	85,000
Qld Regional	332,860	20	133,000
SA Rural	149,145	20	30,000
WA Rural	178,594	20	35,000

Estimated number of Taxpayers in Zone B and its Special Areas: 334,000

Actual number of Taxpayers in all remote zones (rounded): 485,000

The difference represents the est. no. in Zone A and its Spec. Areas: 151,000

Estimating that Special Areas account for 5 per cent of Zone Taxpayers:

Taxpayers in Zone A: 95 per cent of 151,000   143,000

Taxpayers in Zone B: 95 per cent of 334,000   317,000

Taxpayers in Special Areas: 8000 + 17,000   25,000

Total zone taxpayers for 1999–2000   485,000

Test these numbers by applying the 1999–2000 zone rebate/offset rates

Assume an ‘average’ taxpayer with an ‘average’ family consisting of a spouse who has a substantial separate net income and two dependent children who provide a notional tax offset of $(2 \times \$376)$ \$752, which represents an ‘average’ base amount of the zone rebate/offset. Assume also that 15 per cent of taxpayers do not have dependents.

The cost of the rebate/offsets for the above number of taxpayers in each Zone would be:

Zone A — (15 per cent of 143,000 × \$338)	Total Cost (\$ million)
+ (85 per cent of 143,000 × (\$338 + 50 per cent of \$752))	94.1
Zone B — (15 per cent × 317,000 × \$57)	
+ (85 per cent × 317,000 × (\$57 + 20 per cent of \$752))	58.6

Special Areas — (15 per cent × 25,000 × \$1173)	
+ (85 per cent × 25,000 × (\$1173 + 50 per cent of \$752))	37.3 million
Total estimated rebate/offset for 1999–2000	\$190.0 million
Actual rebate/offset amount for 1999–2000	\$193.0

The difference may be explained by the fact that the assumed percentage of taxpayers unable to claim for dependents may be a little too low.

By using the above numbers as a base, this proposal's remote area taxpayer numbers would be:

Zoning System Alternative 1

Zone A — (current Zone A less Darwin taxpayers)	
(143,000–42,000)	101,000
Zone B — (current Zone B less Cairns, Townsville & Mackay)	
(317,000–165,000)	152,000
Special Areas	25,000
Total	278,000

Zoning System Alternative 2

Zone A — (current Zone A less Darwin taxpayers)	
(143,000–42,000)	101,000
Special Areas (no Zone B)	25,000
Total	126,000

Owing to a lack of published data, it is not possible to calculate the effect of the tighter residency recommendation on the above numbers. The recommendation would almost certainly remove from the zone system all those taxpayers employed in a remote zone on a fly-in fly-out basis and also a considerable number who visit towns in a remote zone for some months during a year, but who are not zone residents. This could reduce the above numbers by from 2 to 5 per cent.

Appendix 2

Comparison of the total cost of the proposed rebates/offsets, using 1999–2000 estimated taxpayer numbers, with the cost of the present system

Based on the ‘average’ taxpayer example in Appendix 1, whose HECS repayment income equals a taxable income of \$35,000 for the year, with a consequent \$6,880 tax payable (at 2002 rates), and who has two child dependents. Assume that 15 per cent of taxpayers do not have dependents. Further assume that approximately 2 per cent of 1999–2000 remote taxpayers have incurred accumulated HECS debts (Appendix 3).

Zoning System Alternative 1

Estimated Taxpayer Numbers & Offset/Rebate Rates	(\$ million)
Method A — Zone A — (15 per cent × 101,000 × \$600)	
+ (85 per cent × 101,000 × (\$500 + 50 per cent of \$752))	\$92.88
Zone B — (15 per cent × 152,000 × \$100)	
+ (85 per cent × 152,000 × (\$100 + 20 per cent of \$752))	34.63
Special Areas — (15 per cent × 25,000 × \$2,000)	
+ (85 per cent × 25,000 × (\$2,000 + 50 per cent of \$752))	57.99
Total	\$185.5
HECS Offset — Zones A and B	
— (2 per cent × 253,000) × (25 per cent of 4.5 per cent × \$35,000)	2.0
— Special Areas	
— (2 per cent of 25,000) × (4.5 per cent of \$35,000)	0.8
	2.8
Total	188.3
Method B — Zone A — 101,000 × (15 per cent of \$6,880)	\$104.2
Zone B — 152,000 × (3 per cent of \$6,880)	31.4

Special Areas — $25,000 \times (30 \text{ per cent of } \$6,880)$	51.6
	\$187.2
HECS Offset — as above	2.8
Total	190.0

Zoning System Alternative 2

Method A — Remote Zone — $(15 \text{ per cent} \times 101,000 \times \\$1000)$	(\$ million)
+ $(85 \text{ per cent} \times 101,000 \times (\$1000 + 50 \text{ per cent of } \$752))$	133.3
Special Areas — $(15 \text{ per cent} \times 25,000 \times \$2,000)$	
+ $(85 \text{ per cent} \times 25,000 \times (\$2,000 + 50 \text{ per cent of } \$752))$	58.0
Total	191.3
HECS Offset — Remote Zone	
— $(2 \text{ per cent} \times 101,000) \times (25 \text{ per cent} \times 4.5 \text{ per cent} \times \$35,000)$	0.8
— Special Areas	
— $(2 \text{ per cent of } 25,000) \times (4.5 \text{ per cent of } \$35,000)$	0.8
	1.6
Total	192.9
Method B — Zone A — $101,000 \times (20 \text{ per cent of } \\$6,880)$	139.0
Special Areas — $25,000 \times (30 \text{ per cent of } \$6,880)$	51.6
	190.6
HECS Offset — as above	1.6
Total	192.2

Current System — as calculated in Appendix 1

	(\$ million)
Zone A	94.1
Zone B	58.6
Special Areas	37.3
Total	190.0

The above percentage of taxpayers who live in remote areas and who have incurred an accumulated HECS debt is simply a broad estimate (see below). It is probable that this debt would be incurred by a greater percentage of high-income young and middle-aged professionals and a much lower percentage of low- and middle-income taxpayers.

Appendix 3***Higher Education Contribution Scheme (HECS) Debtors in Remote Areas 1999–2000***

The ATO publishes details of the number of taxpayers from regional and rural areas of Australia who are carrying a HECS debt. In the same manner as in Appendix 1, a broad estimate of the number of these taxpayers resident in Zone B is calculated.

HECS Taxpayers in Regional and Rural Areas (ATO statistics)		Estimated No. of HECS Taxpayers in Zone B and its Special Areas	
NSW Rural	9279	10 %	928
Qld Rural	8020	20 %	1604
Qld Regional	6738	40 %	2695
SA Rural	2486	20 %	497
WA Rural	3044	20 %	609

Estimated number of HECS taxpayers in Zone B and its Special Areas: 6333

Estimated total number of taxpayers in Zone B and its Special Areas: 334,000

Percentage of HECS taxpayers to total taxpayers in Zone B and S.A. = 1.9 per cent.

Adopt 2 per cent as a reasonable percentage for all designated remote areas

(3.13 per cent of all individual taxpayers have a HECS assessment debt (ATO Statistics)).

APPENDIX B

FULLARTON SUBMISSION TO AUSTRALIA'S FUTURE TAX SYSTEM REVIEW PANEL 2008

Tax Zone Rebate

Explanatory Memorandum

INTRODUCTION

The Taxation Zone Rebate introduced in 1945 is an income tax concession that recognises the disadvantages to residents in 'specific areas' of Australia. These disadvantages, according to the Australian Income Tax Assessment Act, include uncongenial climatic conditions, isolation and the high cost of living compared with those of other parts of Australia.

These 'specific areas' consist of two zones. Zone A includes nearly the entire continent above the 26th parallel and some offshore islands with the exception of approximately 50 per cent of eastern Queensland. Zone B, which is deemed to be less remote, includes the remainder of the continent except for highly populated areas. There are also Special Areas in both zones that are deemed to be 'most remote', which are more than 250 kilometres from the nearest urban centre with a population of 2,500 or more, as at the 1981 census.

The Zone Rebate currently consists of two parts: (i) a fixed amount of \$57 for Zone B, \$338 for Zone A, and \$1,173 for Special Areas in both Zones and (ii) an additional amount based on a percentage of certain rebates for dependents, namely 20 per cent for Zone B and 50 per cent for Zone A and Special Areas.

RESIDENCY

A resident is defined as a taxpayer who spends time in the Tax Zone Rebate zones, but not necessarily continuous time. Entitlement to the rebate requires a combined residency period of 182 days minimum over two years.

The research, involved in developing This article has shown that the current zone rebate system is in desperate need of review. It presently allows large benefits to the undeserving fly-in fly-out residents and mediocre benefits to the deserving remote bona fide residents.

Fly-in fly-out, encouraged by the imposition of the Fringe Benefits Tax on company-provided housing, has been the principal reason for the depopulation of mining and mineral processing regions. This proposal recommends that for the purpose of Tax Zone Rebates, the definition of resident be restricted to permanent residents residing continuously in an area (those eligible to be enrolled are enrolled at that address). Current provisions allowing a resident who moves from one remote area to another, or who spreads the period of residence over two tax years, to claim a rebate should continue to apply.

An example of the disparity under the existing provision is that a fly-in fly-out mining engineer resident in the leafy suburb of South Perth, engaged at Leinster Western

Australia, could receive a tax rebate as high as \$2,975 per annum or \$57 per week (assuming a dependant spouse and four school-age children). On the other hand, a truck driver resident at the Gascoyne Junction is entitled to \$338 per annum or \$6.50 per week yet he/she lives over 160 km from an urban centre of fewer than 7,000 persons, in a community of fewer than 100 persons, without hospital, medical or police services, no general store and the community is often isolated by seasonal cyclones. Already this is inequitable without the consideration of the extreme climatic differences between Perth and Gascoyne Junction.

The proposal to exempt fly-in fly-out workers from the Tax Zone Rebate is based on the consideration of the extremely different circumstances workers are subject to. Typically, fly-in fly-out workers are transported to the area by air at no cost to the worker, picked up by company air-conditioned vehicles, housed in air conditioned accommodation, eat in an air-conditioned dining room, enjoy three meals a day with menu choices and then return to his/her permanent home environment. The remainder of the family have continued to enjoy a well-serviced environment, enjoying all manner of choices. Contrast this with the bona fide tax zone rebate area resident paying local uncompetitive prices for fuel and groceries and a meagre range of locally provided services. High fuel prices cut deep due to the great distances travelled to access medical services.

Removing the benefits now enjoyed by fly-in fly-out workers residing in populous cities and increasing benefits to residents in remote communities is an attempt to properly compensate them for the disadvantages of their remote location as well as encourage more permanent residents to settle in remote Australia. This article has indicated that these minimum proposals require little or no additional cost to revenue.

DEMOGRAPHIC FACTORS

The ABS determines that 1 per cent of Australia's land mass contains 84 per cent of our population and that approximately half of our continent contains only 0.3 per cent of the population. This gross imbalance in the distribution of Australian population is a source of ongoing concern due to problems of security when large sections of Australia remain uninhabited.

There has in recent years, been a continuing population decline in rural areas due to internal migration, and population increases in fast growing areas such as the coast of northern Queensland and Darwin. Remote inland pastoral and agricultural communities are disappearing, making others even more isolated, while previously small coastal towns have become thriving cities.

Darwin, for example, has a population of 117,400, which includes approximately 42,000 taxpayers. Darwin is included in the Zone Rebate under Zone A, allowing taxpayers to claim a \$338 rebate. This is 55 per cent of the entire Northern Territory population. Darwin has an international airport, a thriving seaport, international hotels and a cost of living not far removed from that of southern capitals. With the completion of the Darwin to Alice Springs railroad and regular flights to Asia, Darwin can no longer be regarded as a remote area.

Three of Queensland's regional northern coastal cities each have a population exceeding 60,000: Cairns (pop 120,000), Townsville (pop 171,000) and Mackay (pop 91,000). They

are all situated in the present Zone B, have high growth rates and a combined population of 291,800. This represents about 165,000 taxpayers, more than half the estimated taxpayers entitled to a Zone B rebate.

Zone B provides an average individual taxpayer with a rebate of \$57 per year, and an average family taxpayer, with an employed spouse and two dependent children, with a rebate of about \$208 per year. These individual payments are insignificant to individual taxpayers. However, the total payment to 165,000 Zone B taxpayers who reside in the above large cities represents an annual cost to Commonwealth revenue of about \$24 million.

There are certainly remote communities in Zone B, the most deserving being those in the Special Areas in that Zone, which should retain a Zone rebate concession. There remains a question as to how many other areas in Zone B should be considered to be remote, after taking into consideration improvements in transport and communications over the past two decades. Those that are genuinely remote should certainly receive a rebate that is more generous than that outlined above.

There seems to be little justification for the three degrees of 'remoteness' that form the basis of the present system. The definition of Special Areas implies that these are very remote and requiring special treatment.

This proposal recommends retaining the present Zones and Special Areas but removing from the zone system all cities in Zone A and Zone B with a population exceeding 60,000 (such as Darwin and the three above Queensland cities). This would decrease the number qualifying for Zone A and Zone B entitlements. There would continue to be approximately 25,000 taxpayers in Special Areas.

VALUE OF REBATE

The effects of inflation and changing family structures have rendered the dollar amounts of rebates in the current system ineffectual in meeting the disadvantages accruing to permanent residents of the Remote Zone and Special Areas.

The fixed amounts are inappropriately low when average annual taxable incomes are around the \$35,000 level, and the cost of living in remote areas is considerably in excess of that in southern cities. To provide one example, fuel costs in remote areas range from 20 per cent to 50 per cent above southern city prices.

In the average Australian family, there are now slightly fewer than two dependent children and a partly or fully employed spouse earning a 'separate net income', which eliminates or reduces the dependent spouse rebate. Consequently, few family taxpayers in remote areas can claim a significant rebate for dependents, and this reduces the value of the 'base' part of the zone rebate.

In this proposal, the dollar amounts of rebates for the residents of Zones A and B, or the Remote Zone, and Special Areas, are raised to a level closer to meeting their locational disadvantages. However, because the number of potential claimants has been reduced, there will not be an increase in the total cost of providing these benefits. In fact, the demographic and calculation changes result in a total cost reduction.

REVIEW OF ZONES

It is proposed —

- Zone B is abolished by deleting any reference to Zone B in s 79A and that the definition of Zone A is applied to a new zone, termed 'Ordinary remote', and the term Zone A also be abolished. This will modernise the terminology and bring it in line with the payment made under the Federal Social Security Legislation.
- The area described as Zone B in Part II of Schedule 2 be encompassed into the area described as Zone A in Part I of Schedule 2. There will then be only one Ordinary Remote Area, which will extend over areas of both Zones A and B as existing.
- That sub-s 79A(3) be deleted accordingly.

REVIEW OF REBATES

- To amend sub-s 79A(2)(a) by deleting the figure '\$1,173' and substituting the figure '\$2,000' and to increase the Tax Zone Rebate for the 'Special Remote' to reflect not only the ravages of inflation in the intervening period since the 1991 review, but also to provide an incentive for remote residency rather than a temporary period of visiting the areas.
- To amend sub-s 79A(d) by deleting the figure '\$338' and substituting the figure '\$500'. While the increase may not seem to be commensurate with the increase proposed for the existing Zone A, consideration has been given to the residents of Zone B, who will now benefit from the extension of Zone A.

HECS-HELP Rebate

It is also proposed that a graduate who has an accumulated Higher Education Contribution Scheme (HECS-HELP) debt receive a rebate through the tax system. This is calculated as 25 per cent of the year's repayment contribution for permanent residents of Zones A and B, or the Remote Zone, and 100 per cent of the year's repayment contribution for permanent residents of Special Areas.

This provides an incentive for young professionals to relocate to remote areas and reduces the need for government to offer further expensive cash incentives.

If imposed now, the cost of this change would be negligible because only about 2 per cent of remote area taxpayers have currently incurred a HECS-HELP debt.

The above produces costs using an 'average taxpayer' model close to the level of the total cost of the existing tax system. The tighter residential requirement recommended would reduce the calculated costs of the proposed rebates by several millions of dollars.

It has been reported graduates are leaving Australia in order to avoid HECS-HELP repayments. The changes proposed in this article will offer graduates an opportunity to continue to reside in this country and have the Australian tax system contribute to their repayments, without the need to live overseas. It will also provide an incentive for

graduates to reside in rural and remote Australia with an incalculable benefit to regional communities and the nation generally.

Many thousands of dollars are spent annually on medical practitioners' rural retention funds. The introduction of this scheme would not only extend rural retention incentives to all graduates, but also provide a method of reducing reliability on that direct cost.

SUMMARY OF RECOMMENDATIONS

1. To tighten the definition of 'residency' in the tax legislation, so that the zone rebate is available only to permanent residents of the designated remote areas of Australia. 'Permanent' is defined as being resident in a designated remote area or combination thereof for at least 182 consecutive days in the year and enrolled in those areas if entitled.
2. Residents continue to be eligible to claim the rebate when they reside in a zone for more than 182 days in any two years such that the rebate is only applicable in the second or subsequent year. This is necessary to accommodate teachers, police and other employees that start work in February and finish in November, with their employment split over two financial years.
3. Population movements have changed in Australia since 1945; some areas are now less remote and more amenable and competitive. All centres with populations of more than 60,000 persons, as at the ABS census of 2006, are deleted.
4. To combine the four zones, namely Zone A, Zone B and special Zone A and Special Zone B, into two zones, namely Ordinary Remote (Zones A and B) and Special Remote (Special Zone A and Special Zone B).
5. To substantially increase the rebate available to the permanent residents of the Ordinary Remote Zone and Special Remote Zone from their current inadequate level to \$500 and \$2,000, respectively. These rebates are to be reviewed every five years to guarantee that the result of the review does not reduce the rebate.
6. To provide an incentive for tertiary-qualified taxpayers to become residents of rural and remote communities in the form of a rebate of repayments due under the HECS-HELP scheme as well as a higher zone tax rebate. Taxpayers with HECS-HELP debts will have 25 per cent of their liability reduced for a year of residence in an Ordinary Remote Zone and 100 per cent of their liability reduced for a year in a Special Remote Zone.
7. Both the zone tax rebates and the HECS-HELP rebate be apportioned by the number of days actually residing in a zone.
8. Non-residents claiming the tax zone rebate solely as a result of accumulating 182 days on site will no longer be entitled.
9. The proposals also apply to members of the defence force, who are provided for in legislation (s 79A of the *Income Tax Assessment Act 1936*).

EQUITY IN THE AMORAL STATE: THE NEXUS BETWEEN CHARITIES, GAMBLING AND THE TAXATION-REDISTRIBUTION SYSTEM

JONATHAN BARRETT AND JOHN VEAL*

ABSTRACT

This article considers equity in the interactions between charities, electronic gaming machine ('EGM') operators and government, both in the technical sense, as used in taxation theory, and in the sense of overall justice in society. First, the New Zealand context of charity, gambling and government is sketched. An overview of relevant law and taxation is given, and the connections between charities, gambling and the tax-redistribution system outlined. Second, equity (horizontal and vertical) as used in taxation theory, is applied to EGM taxation. Another facet of fairness — geographical equity — is noted. Third, a broad concept of equity as overall justice in society is applied to the interactions between charity, gambling and government. It is concluded that governments' and charities' collusion with EGM operators is inequitable and morally indefensible.

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I INTRODUCTION

‘Arising out of religious or moral disapproval,’ Charles Clotfelter says, ‘sumptuary laws dating back to the ancient Greeks have been used to restrict or forbid certain kinds of consumption.’¹ Richard Musgrave conceives sumptuary taxes as the reverse of public subsidies for merit goods, and notes that subsidies for merit goods and taxes on demerit goods² both ‘interfere with consumer sovereignty’.³ Consistent with the neoliberal principle of respecting consumer sovereignty,⁴ New Zealand ostensibly pursues neutrality in its tax system⁵ — evident, in particular, in its ‘pure’ goods and services tax (GST) which, unusually, does not distinguish between merit and demerit goods and services.⁶ However, while we may encounter occasional references to ‘sin taxes’ in contemporary political discourse,⁷ such vestiges of moral opprobrium regarding the consumption of alcohol, gambling and tobacco are generally absent from tax policy debate. The confidence of previous generations of lawmakers that certain forms of consumption are morally wrong and therefore suitable for punitive tax or legal treatment may seem quaint from a contemporary perspective. However, it is submitted that gambling gives rise to acute moral and equity issues which do indeed call for non-neutral legal and tax treatment.

This article considers equity in the interactions between charities, government and gambling operators, specifically electronic gaming machine (EGM) trusts. Equity is considered both in the technical sense, as used normally in taxation literature, and in a broader sense of fundamental justice in society.⁸ First, the New Zealand context of charity, government and gambling is sketched. A brief overview of relevant law and

¹ Charles T Clotfelter, ‘Gambling Taxes’ in Sijbren Cnossen (ed), *Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, and Driving* (OUP Oxford, 2005) 84, 104.

² See Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice* (McGraw-Hill, 2nd ed, 1976) 65 on merit and demerit goods.

³ Richard A Musgrave, *The Theory of Public Finance* (McGraw-Hill Book Co, 1959) 178. Musgrave also notes that, from the perspective of ‘the broader framework of social values’, sumptuary taxes are not necessarily inefficient: see *ibid*.

⁴ Richard Epstein, a prominent libertarian philosopher and frequent guest and polemicist for the New Zealand Business Roundtable (since subsumed into the New Zealand Initiative), argues that taxes should ‘preserve the relative priorities that individuals attach to various activities’: see Richard A Epstein, ‘Taxation in a Lockean World’ in Jules Coleman and Ellen Frankel Paul (eds), *Philosophy and Law* (Basil Blackwell, 1987) 39, 55.

⁵ The absence of a general capital gains tax is the most significant breach of the neutrality principle in the New Zealand tax system.

⁶ See David White and Richard Krever, ‘Preface’ in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Brookers, 2007) vii, viii.

⁷ For example: ‘National’s coalition partner, the Maori Party, has taken a hard line on “sinners’ taxes”, and co-leader Tariana Tu wants the Government to increase the excise tax on tobacco’ reports Isaac Davison, ‘Cigarettes, Booze, in the Gun’, *The New Zealand Herald* (online), 16 May 2012 <http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10806947>.

⁸ The principal underpinning of this article is Aristotelian virtue ethics, which, as discussed in Part IV below, requires us to take account of others’ wellbeing. Compare with John Rawls’s concept of justice as fairness: see John Rawls, *A Theory of Justice* (The Belknap Press of Harvard University Press, rev ed, 1999) 10–15. Martha Nussbaum, whose thinking is central to the article, has developed Rawlsian liberalism through the prism of Aristotelian virtue ethics: see, generally, Martha C Nussbaum, *Frontiers of Justice* (Harvard University Press, 2006).

taxation is given. Second, well-established principles of equity in taxation are applied to EGM taxation. Beyond traditional conceptions of horizontal and vertical equity, a further potential facet of fairness — geographical equity — is noted. Third, a broad concept of equity as other-oriented morality or overall justice in society is applied to the interactions between charity, gambling and government; conclusions are then drawn.

II NEW ZEALAND CONTEXT

This part of the article outlines the context of gambling in New Zealand, with a focus on EGMs.

A Revenue and Tax

1 *History of Gambling in New Zealand*

State-sponsored gambling in New Zealand began in 1961 with the establishment of the Golden Kiwi lottery — but not before the government had struggled with the moral issues surrounding direct promotion of gambling.⁹ Until 1979, legal gambling was limited to the racing industry (TAB) and the New Zealand Lotteries Commission. The government introduced Lotto in 1987 and the first casino opened in Christchurch in 1994.¹⁰ From 1996, the TAB was able to accept bets on all sporting events.

In 1973,¹¹ the first gaming machines made ‘their way across the Tasman from Australia’ but remained technically illegal.¹² David Grant says:¹³

Despite the continuing confiscations of machines and the fining of operators, it was futile to stop their proliferation because they were so popular. Addicts played for hours, like robots, seemingly as dehumanised as the machines themselves. Finally, in October 1986, the Minister of Internal Affairs Peter Tapsell admitted that he was losing the battle, ruled against banning them and urged that they be authorised for use in hotels and sports clubs.

Despite amendments to the *Gaming and Lotteries Act 1977* (NZ), the *Gambling Act 2003* (NZ) was enacted ‘to counter the rapid, uncontrolled growth and rampant corruption in the gaming machine sector’.¹⁴ The Department of Internal Affairs (DIA) is the

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⁹ See David Grant, *On a Roll: A History of Gambling and Lotteries in New Zealand* (Victoria University Press, 1994) 221.

¹⁰ Expenditure on gambling in casinos increased from NZ\$40 million in 1995 to NZ\$509 million in 2012, an increase of 1172 per cent.

¹¹ Grant, above n 9, 288 notes that American-made ‘fruit’ machines first arrived in New Zealand in the 1930s but were soon declared illegal.

¹² Steve Deane, ‘Our Love of a Punt’, *The New Zealand Herald* (online), 29 August 2013 <http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=11115846>. See also John Markland, ‘Gaming in New Zealand’ (1996) 7 *Social Policy Journal of New Zealand* 79, 79–81.

¹³ Grant, above n 9, 289.

¹⁴ Deane, above n 12. See also the *Racing Act 2003* (NZ) which established the New Zealand Racing Board.

government agency charged with administration of the *Gambling Act*, which includes overt public health considerations.¹⁵

EGMs 'in New Zealand are operated by non-club gaming societies [which] operate gaming machines in commercial venues, and clubs [chartered clubs, Returned and Services' Associations (RSAs) and sports clubs] that typically operate gaming machines in their own premises'.¹⁶ In 2011, approximately one-fifth of non-casino EGMs were operated by clubs on their own premises.¹⁷ The number of non-casino EGMs increased from 7700 in 1994 to a peak of 24 221 in 2003 but, as at 31 March 2013, there were 17 542 such machines in New Zealand.¹⁸

2 *Gambling Expenditure*

In 2012, total gambling expenditure amounted to NZ\$2.065 billion, with NZ\$854 million being spent on non-casino EGMs — a seven-fold increase on 1991's NZ\$107 million expenditure.¹⁹ ('Expenditure' is the gross amount wagered less the amount paid out or credited as prizes or dividends, in other words, the amount lost by players or the gross profit of the gaming operator.)²⁰ For the quarter ended 30 June 2013, EGM profits by society type were as follows: non-club NZ\$179.97 million (87.4 per cent); sports clubs NZ\$2.96 million (1.4 per cent); chartered clubs NZ\$15.86 million (7.7 per cent); and RSA clubs NZ\$7.27 million (3.5 per cent) — a total of NZ\$206.06 million.²¹

3 *Gaming Duties*

In terms of the *Gaming Duties Act 1971* (NZ), separate duties are raised on totalisators,²² lotteries,²³ casinos²⁴ and EGMs. According to Inland Revenue Department (IRD)

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¹⁵ See *Gambling Act* part 4 but also see Peter J Adams and Fiona Rossen, 'A Tale of Missed Opportunities: Pursuit of a Public Health Approach to Gambling in New Zealand' (2011) 107 *Addiction* 1051, 1051–56 for an argument that the legislation is 'business as usual'.

¹⁶ Policy Group, 'The Distribution of Non-Casino Gaming Machine Profits in New Zealand' (DIA, 2012) 4.

¹⁷ *Ibid*, 5.

¹⁸ See *ibid* and DIA, 'Pokie Spending and Numbers Continue to Drop' (Press release, 24 July 2014).

¹⁹ DIA, *Gambling Expenditure Statistics* (2014)

<http://www.dia.govt.nz/diawebsite.nsf/wpg_URL/Resource-material-Information-We-Provide-Gambling-Expenditure-Statistics>.

²⁰ *Ibid*.

²¹ DIA, *Report 3: GMP by Number of Machines at Venue for Quarter to June 2013* (2013), <[http://www.dia.govt.nz/pubforms.nsf/URL/DetailedGMPdata-June2013.pdf/\\$file/DetailedGMPdata-June2013.pdf](http://www.dia.govt.nz/pubforms.nsf/URL/DetailedGMPdata-June2013.pdf/$file/DetailedGMPdata-June2013.pdf)>.

²² Totalisator duty is payable monthly, at the rate of four per cent of betting profits. Betting profits means all amounts received by the New Zealand Racing Board for totalisator racing betting, sports betting and fixed-odds racing betting less the amount of refunds paid less the amount paid as winning dividends: see *Gaming Duties Act 1971* (NZ) s 4.

²³ Lottery duty is payable at the rate of 5.5 per cent of the nominal value of all the tickets represented in the drawing of the lottery, whether the tickets have been sold or not: see *Gaming Duties Act* s 9.

²⁴ Casino duty is payable monthly, at the rate of four per cent of the 'casino win'. Casino win means the gaming income of the casino less the amount of gaming wins paid out and the amount of any casino losses from the previous period. Gaming income means all money paid to the casino to purchase chips or to play any casino gambling. Gaming wins means all money paid or returned by the casino to redeem chips or to pay out winnings: see *Gaming Duties Act* s 12N.

statistics, a total of NZ\$270.7 million in gaming duty revenue was collected in 2012.²⁵ EGM duty is payable monthly at the rate of 20 per cent of EGM profits. (EGM profits are the difference between total machine income and the total amount paid as prizes.)²⁶

4 *Problem Gambling Levy*

A problem gambling levy was introduced with effect from 1 October 2004.²⁷ The levy rates are set by Order in Council and reviewed every three years. The rates applying from 1 July 2013 are: casino operators' casino wins (0.74 per cent), non-casino gaming machine operators' gaming machine profits (1.31 per cent), New Zealand Racing Board's betting profits (0.60 per cent) and New Zealand Lotteries Commission's turnover less prizes paid and payable (0.30 per cent).²⁸

5 *Other Taxes*

Gambling supplies are subject to GST.²⁹ However, racing organisations and EGM operators are generally exempt from income tax.³⁰

B Distribution of EGM Profits

A non-casino EGM licence holder must annually distribute at least 37.12 per cent of its gross proceeds (exclusive of GST) for an 'authorised purpose'.³¹ An 'authorised purpose' in relation to Class 4 (EGM) gambling is a charitable purpose; a non-commercial purpose that is beneficial to the whole or a section of the community; and promoting, controlling, and conducting race meetings under the *Racing Act*, including the payment of stakes.³² Non-club gaming societies distributed approximately NZ\$252 million to community organisations in 2011.³³ Sporting organisations received NZ\$121 million (48 per cent of the total allocation of all funding by public societies) in 2011, with rugby union receiving the largest proportion (18 per cent). Horse racing, soccer, cricket and netball also received significant allocations. Social and community services together received 41 per

²⁵ IRD, *Revenue Collected, 2003 to 2012* (2013) <<http://www.ird.govt.nz/aboutir/external-stats/revenue-refunds/tax-revenue/>>. On 13 May 2013, the authors wrote to the IRD Duties Unit requesting a breakdown of the composite amount of gaming duties by duty type (totalisator, lottery, gaming machine and casino). IRD had not at the time of writing provided details of those amounts.

²⁶ *Gaming Duties Act* s 12C.

²⁷ See *Gambling Act 2003* (NZ) ss 317 to 325.

²⁸ For the period 1 July 2013 to 30 June 2016. Levy payments are subject to GST: see *Gambling (Problem Gambling Levy) Regulations 2013/190* (NZ).

²⁹ Gambling is 'the consideration in money is the portion of the amount of money a person pays to participate in the gambling (including a New Zealand lottery) that represents the proceeds (after deducting the amount of all prizes paid and payable in money) in respect of the gambling': see *Goods and Services Tax Act 1985* (NZ) s 10(14).

³⁰ See *Income Tax Act 2007* (NZ) ss CW 47 and CW 48 respectively.

³¹ *Gambling (Class 4 Net Proceeds) Regulations 2004* (NZ), reg 10(1). In 2012, the five largest EGM trusts (Infinity Foundation Ltd, Pub Charity, New Zealand Community Trust, The Lion Foundation and The Trusts Community Foundation Ltd) distributed 40.6 per cent of their profits (losses to gamblers).

³² *Gambling Act* s 4, definition of 'authorised purpose'. With regard to the last authorised purpose, it will be noted that EGM proceeds may be used to promote betting on horse races — gambling funding gambling.

³³ DIA, above n 19, 11.

cent of the total funding allocated by public societies (NZ\$104.4 million). Clubs allocated NZ\$50.6 million in EGM profits to authorised purposes in 2011. However, such allocations are typically for the clubs' own authorised purposes (notably club operating costs). DIA concludes that only a small percentage of this money was distributed in the form of grants to the wider community.³⁴

C Case study: What Happens to the Money Gambled on EGMs?

The following case study illustrates what happens (on average) to NZ\$100 gambled on an EGM.

\$90.70 is paid back to the pool of players as prizes.³⁵

The balance of \$9.30 is collected by the gaming machine operator and disbursed as follows:

	NZ\$
GST ³⁶	1.21
Gaming machine duty ³⁷	1.86
Problem gambling levy ³⁸	0.14
Venue payments ³⁹	1.24
Depreciation ⁴⁰	0.65
Other operating costs of operator ⁴¹	1.01
Available for distribution as grants ⁴²	3.19
Total	9.30

³⁴ DIA, above n 16.

³⁵ Derived from DIA, above n 19.

³⁶ NZ\$9.30 × 3/23.

³⁷ NZ\$9.30 × 20 per cent.

³⁸ NZ\$9.30 × 1.4 per cent. The levy decreased to 1.31 per cent with effect from 1 July 2013, so from that date the levy would be 12 cents.

³⁹ The figures for venue payments, depreciation and other operating costs are based on the latest available average figures for the five largest gaming machine operators (see above n 31).

⁴⁰ See *ibid*. Depreciation primarily relates to gaming machines owned by the operator.

⁴¹ See *ibid*.

⁴² The minimum distribution required is 37.12 per cent of the operator's GST-exclusive gross proceeds. In the above example, this would equate to \$3.00. See Gambling (Class 4 Net Proceeds) Regulations 2004 (NZ), reg 10(1). From the first financial year starting after 4 September 2014, the minimum distribution will increase to 40 per cent and will be raised to 42 per cent over five years: see Gambling (Class 4 Net Proceeds) Amendment Regulations 2014 (NZ), reg 4.

The distribution of funds can be summarised as:

	NZ\$
Returned to players as prizes	90.70
Paid to Government as taxes and levies	3.21
Operator expenses	2.90
Paid out as grants to charities and sports groups	3.19
Total	100.00

Of critical importance to note: first, nine-tenths of the money spent on EGM machines is randomly redistributed among the pool of EGM players. Although the same maybe true for other forms of discretionary spending, this amounts to roughly NZ\$2 billion a year that might be productively invested (and investment returns taxed); second, the distributable amount is split in roughly three equal ways between government, EGM operators, and community organisations. EGM trusts enjoy a veil of respectability by virtue of the community grants they make,⁴³ yet while the community grants are significant,⁴⁴ they constitute a negligible proportion of the money ‘wasted’ on EGMs.⁴⁵ Raising public benefit funds via EGM trusts also appears inefficient.⁴⁶

⁴³ A leading EGM trust, The Lion Foundation, has controversially used an MBA thesis to promote its distributions to community groups as an unalloyed public good. The thesis concluded: ‘Overall, it seems clear that New Zealand continues to be a country that benefits extraordinarily from the efforts of its volunteers and the funding support they receive from organisations such as the Foundation. We should celebrate and be proud of this.’ See Vicki Caisley et al, *The Impact of Grant Funding on Communities in New Zealand: A Case Study* (MBA Thesis, Massey University, 2013) 87. For a critique of the students’ methodology and the Lion Foundation’s use of the research, see comments reported in Steve Deane, ‘Pokie Group Faces Flak over Study’, *The New Zealand Herald* (online), 11 October 2013

<http://www.nzherald.co.nz/gambling/news/article.cfm?c_id=215&objectid=11138319>.

⁴⁴ In 2012, the five largest EGM trusts (see above n 31) distributed around NZ\$150 million.

⁴⁵ Playing EGM machines clearly provides some short-term pleasure for participants — as does, say, smoking — but, as psychologists recognise, wellbeing requires satisfaction of both hedonic (pleasure-based) and eudaimonic (virtue-based) aspects of happiness. Engagement in hedonic activities, such as playing EGM machines, ‘[does] not satisfy basic psychological needs [and] can at best only partially satisfy needs and at worst can distract from foci that would yield fulfilment’: see Richard M Ryan and Edward L Deci, ‘On Happiness and Human Potentials: A Review of Research on Hedonic and Eudaimonic Well-being’ (2001) 52 *Annual Review of Psychology* 141, 153.

⁴⁶ Based on the case study figures, only 34.3 per cent (3.19/9.30) of EGM trust revenue ends up in the hands of good causes. This proportion may be compared this with the New Zealand Red Cross which, in the year ended 30 June 2013, had fundraising income of \$32.16m and fundraising expenditure of \$3.7 million, giving a surplus of \$28.45 million (88.5 per cent). See *New Zealand Red Cross Annual Report 2013* (2013) <https://www.redcross.org.nz/yk-files/79b55226496ab238e18951f7eaa716a7/NZRC_Annual%20Report%202013.pdf>.

III EQUITY

A Technical Equity

Aristotelian distributive justice requires equal distribution of burdens and benefits among those equally situated and, by implication, unequal distributions among those unequally situated.⁴⁷ This form of justice may be characterised as ‘geometric’ equality, which ensures that distribution is made according to community members’ varying circumstances.⁴⁸ Following these principles, in taxation, horizontal equity lies in equally situated taxpayers paying the same amount of tax, whereas vertical equity lies in the different treatment of unequally situated taxpayers.⁴⁹ Vertical equity is normally considered to exist when those with greater ability to pay, pay more tax than those less able to pay. Conversely, regressive taxes are generally considered to be vertically inequitable.⁵⁰ Contemplating equity in relation to gambling taxes, Clotfelter says:⁵¹

Horizontal equity ... seems to be satisfied a priori, in that those who consume the taxed goods are subject to the same taxes and tax rates ... there is nothing in the administration of gambling taxes that would suggest the kind of discrimination implied by horizontal inequity. Gambling taxes ... may disproportionately take from those most susceptible to the urge to wager, but these differences do not appear to represent classifications on which horizontal equity should be judged, any more than the differences in tastes that cause other excise tax collections to differ among individuals. On the other hand, vertical equity ... is surely an important consideration, as demonstrated by the attention that distributional questions have received in the literature on gambling.

Empirical studies of the incidence of gambling taxes are virtually unanimous: ‘taxes on gambling are regressive’.⁵² Because those with lower incomes tend to gamble proportionately more of their incomes, particularly in relation to EGMs, they tend to pay proportionately greater amounts of gaming duty — whether or not they are aware of this — than those on higher incomes.⁵³ This phenomenon might be explained in terms of consumer preference but, because EGMs are addictive,⁵⁴ assertions of rational consumer choice are implausible. Furthermore, since non-casino EGMs are predominantly situated in poorer neighbourhoods,⁵⁵ the entire EGM set up can be seen as regressive.

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⁴⁷ R W M Dias, *Jurisprudence* (4th ed, Butterworths, 1976) 66.

⁴⁸ Eugene Kamenka, ‘What Is Justice?’ in Eugene Kamenka and Alice Erh-Soon Tay (eds), *Justice* (Edward Arnold, 1979) 1, 3.

⁴⁹ Bernard Herber, *Modern Public Finance* (5th ed, Irwin, 1983) 119.

⁵⁰ *Ibid*, 23.

⁵¹ Clotfelter, above n 1, 105.

⁵² *Ibid*, 106.

⁵³ It is a moot point whether the problem gambling levy is substantively regressive. It is submitted that, because the levy is based on risk of harm and funds are hypothecated to alleviating gambling harm, monetary regression is not an important consideration.

⁵⁴ See Roger Collier, ‘Do Slot Machines Play Mind Games with Gamblers?’ (2008) 179(1) *Canadian Medical Association Journal* 23, 23. Furthermore, as Adams and Rossen, above n 15, 1055 observe, ‘most [gambling] products — particularly EGMs — possess considerable leeway in the way contingencies can be manipulated to maintain addicted behaviour’.

⁵⁵ See Ministry of Health, *Problem Gambling Levy for 2013/14 to 2015/16: Regulatory Impact Statement* (2013) [55] < <http://www.health.govt.nz/system/files/documents/pages/regulatory-impact-statement-problem-gambling-levy-2013-14-2015-16.pdf>>.

B Geographical Equity

It is widely considered fair that EGM profits should be mostly hypothecated to the areas where the relevant EGMs are located.⁵⁶ This expectation may be described as an element of geographical equity. A disproportionate amount of EGM expenditure takes place in high-deprivation areas.⁵⁷ In 2009, 56 per cent of all EGM expenditure occurred in census area units with a decile rating of 8 or above (indicating high deprivation); Māori and Pasifika peoples are overrepresented in these areas.⁵⁸ Distributable EGM funds are commonly paid to community groups in the 'region' in which the EGM machines are located,⁵⁹ but, even if distributions were fully 'regionalised', some funds necessarily leave the community in the form of taxes and possibly operator fees.⁶⁰ Along with any transfers from high-deprivation communities to community organisations in wealthier areas, such leakage would constitute geographical inequity.⁶¹

The issue of EGMs and geographical inequity was highlighted in a series of investigative articles published in *The New Zealand Herald* in August 2013.⁶² From a policy perspective, the articles indicate that the concept of 'area' (in relation to the distribution of EGM funds) is problematic, and the system is open to abuse. In the first regard, the wealthy Auckland suburb of Remuera has a mere 23 EGM machines, yet Remuera's College Rifles Rugby Club has received more than \$1 million from EGM trusts, most of which have a significant presence in impoverished neighbouring suburbs in South Auckland.⁶³ In the second regard, in 2012, 'the Otago Rugby Union bought three South Auckland pubs then syphoned \$5 million in pokie profits out of the areas — mainly Manuera — to help prop up the failing Dunedin sporting body'.⁶⁴ While caution should be exercised in seeking to generalise from anecdotes, the potential for inequity and abuse is real.

⁵⁶ This expectation of geographical equity is evident from statements by EGM trusts (see, for example, below n 59) and proposed legislation and regulations (see below n 65).

⁵⁷ Ministry of Health, above n 55, [55].

⁵⁸ Francis Group, *Informing the 2009 Problem Gambling Needs Assessment: Report for the Ministry of Health* (2009) 9 <[http://www.moh.govt.nz/moh.nsf/pagesmh/1104/\\$File/informing-2009-problem-gambling-needs-assessment-may09.pdf](http://www.moh.govt.nz/moh.nsf/pagesmh/1104/$File/informing-2009-problem-gambling-needs-assessment-may09.pdf)>. 'Pasifika' is an umbrella term used to identify members of the 22 non-indigenous, Pacific Island communities in New Zealand: see Ministry of Education, *Pasifika Peoples in New Zealand Education: A Statistical Snapshot 2004* (Ministry of Education, 2004).

⁵⁹ See, for example, The Trusts Community Foundation Ltd, *Chairman's Report & Annual Review* (2013) <<http://www.ttcfltd.org.nz/chairmans-report-annual-review>> but see below n 64 on funds from impoverished Manuera being distributed in wealthy Remuera. Presumably, these contiguous but economically differently situated suburbs are considered to be in the same region.

⁶⁰ Ministry of Health, above n 55, [56]; Steve Deane, 'Pokie Cash: Robbing the Poor to Give to the Rich', *The New Zealand Herald* (online), 27 August 2013 <http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=11114737> notes that in 2009 the Otago Rugby Union bought three South Auckland taverns in order to gain control of their EGM machines.

⁶¹ Ministry of Health, above n 55, [57]. Distributions to organisations that typically benefit wealthier community members might not constitute geographical inequity but would have regressive effects.

⁶² Notably Deane, above n 60.

⁶³ See *ibid.*

⁶⁴ Brian Rudman, 'We're Relying on Money Poured through Pokies', *The New Zealand Herald* (online), 24 October 2012 <http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10842420>.

In response to various inequities arising from EGMs, Te Ururoa Flavell, a Māori Party Member of Parliament, introduced a private member's Bill which included a requirement that at least 80 per cent of distributable EGM funds should be returned to the areas in which the gambling took place. The National Party-controlled Commerce Committee decided that any such measures should be in the form of regulations rather than amendment to the principal Act, and *Gambling Act* s 114, as amended by *Gambling (Gambling Harm Reduction) Amendment Act 2013* (NZ) s 12, was enacted accordingly. Any further harm mitigation under the *Gambling Act* will be at ministerial discretion. In September 2013 DIA issued a consultation document inviting submissions on: increasing the transparency of grant-making decisions; increasing the minimum rate of return to authorised purposes; regulating local distribution of gambling proceeds; and changing the venue payments system for non-casino EGMs.⁶⁵

The Green Party withdrew support for Flavell's Bill at the Committee stage because a principal aim of the original Bill, which was to give councils and communities the power to cut the number of EGMs in their area or eliminate them altogether, had not just been 'watered down' but would 'actually restrict councils wanting to reduce the number of pokies in their area'.⁶⁶ Critically, the original Bill would have abolished EGM trusts and brought EGMs under council control and thus introduced some democratic oversight at a local level. It may be inferred that the Green Party assumed that, faced with the inequities of EGMs, local voters would pressurise councils to eliminate EGMs from their communities.⁶⁷

In sum, measured against the yardstick of vertical equity, gambling taxes are, in general, found to be regressive. Furthermore, if, following Liam Murphy and Thomas Nagel,⁶⁸ we look beyond specific taxes to consider the overall equity of the EGM tax-distribution system, and take into account issues of geographical equity, at the very least, the potential exists for gross inequity.

⁶⁵ See DIA, *Gambling Act 2003 Public Consultation on Four Class 4 Gambling Proposals* (2013) <[http://www.dia.govt.nz/pubforms.nsf/URL/Gambling_Public-consultation-on-four-Class-4-gambling-proposals_September-2013.pdf/\\$file/Gambling_Public-consultation-on-four-Class-4-gambling-proposals_September-2013.pdf](http://www.dia.govt.nz/pubforms.nsf/URL/Gambling_Public-consultation-on-four-Class-4-gambling-proposals_September-2013.pdf/$file/Gambling_Public-consultation-on-four-Class-4-gambling-proposals_September-2013.pdf)>. The first response has been to increase the minimum distribution requirement to 42 per cent over five years under Gambling (Class 4 Net Proceeds) Amendment Regulations 2014 (NZ), reg 4.

⁶⁶ See Green Party, 'Green Party No Longer Supports Flavell Gambling Bill' (media release), 17 June 2013 <<http://www.scoop.co.nz/stories/PA1306/S00280/green-party-no-longer-supports-flavell-gambling-bill.htm>>.

⁶⁷ Is such an assumption well-founded? Certainly, some local authorities have introduced or are considering EGM sinking lid policies. Auckland, for example, will not permit a new Class 4 venue to be established when an existing venue closes. Furthermore, existing Class 4 venues may not relocate from one part of the city to another: see Auckland Council, *Class 4 Gambling (Pokie) Venue Policy* (2013) <<http://www.aucklandcouncil.govt.nz/EN/planspoliciesprojects/councilpolicies/gamblingvenuepolicies/Documents/class4gamblingpokievenuepolicy.pdf>>. However, when Invercargill council was offered a significant donation on condition it banned EGMs, it rejected the offer, describing it as 'impossible' to accept: see Neil Ratley, 'Crimp Offer: \$500,000 for Race but Pokies Go', *The Southland Times* (online), 3 July 2013 <<http://www.stuff.co.nz/southland-times/news/8870240/Crimp-offer-500-000-for-race-but-pokies-go>>.

⁶⁸ Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2005) 131.

IV EQUITY AS VIRTUE IN SOCIETY

This part of the article departs from the forms of technical equity normally encountered in the tax literature to consider a fundamental manifestation of equity in society derived from virtuous, other-oriented moral behaviour.

A Universal Justice

In the Aristotelian classification, the distributive justice discussed in the preceding part is *particular* justice;⁶⁹ we now move to *universal* justice. For Aristotle, universal justice is the ‘whole of virtue in its other-regarding aspect’ so that ‘all branches of moral virtue involve our relations to others’.⁷⁰ Such universal justice might suggest something metaphysical, above or beyond us, but is, in fact, something that should be present in every interaction between people. Since empathy is the root of all ethics,⁷¹ other-regarding virtue simply requires us to reflect that radical sensitivity in our behaviour. As Alasdair MacIntyre says, doing the virtuous thing is doing ‘what anyone filling such and such a role ought to do’.⁷² For Rosalind Hursthouse, ‘[v]irtue ethics ... emphasizes the virtues, or moral character ... Suppose it is obvious that someone in need should be helped ... a virtue ethicist [would emphasise] the fact that helping the person would be charitable or benevolent’.⁷³ Hursthouse questions ‘[w]hether virtue ethics can be expected to grow into “virtue politics” — i.e. to extend from moral philosophy into political philosophy’ but concedes that Martha Nussbaum has plausibly indicated⁷⁴ ‘that Aristotelian ideas can, after all, generate a satisfyingly liberal political philosophy’.⁷⁵ It is submitted that if juristic persons — the State, charities, corporations and so forth — operate in the human moral sphere, they should be deemed moral agents and be held to the same virtue norms as people.⁷⁶

B Morally Distinguishable Institutions

The term ‘morality’, as used in this article, denotes ‘a code of conduct that, given specified conditions, would be put forward by all rational persons’.⁷⁷ The Golden Rule

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⁶⁹ In the Aristotelian scheme, particular justice is divided into distributive and corrective (or commutative) forms: see Dias, above n 47, 66.

⁷⁰ Lesley Brown, ‘Introduction’ in Aristotle, *The Nicomachean Ethics* (David Ross, trans, OUP Oxford, 2009) i, xxiv.

⁷¹ Bertrand Russell, *History of Western Philosophy and Its Connection with Political and Social Circumstances from the Earliest Times to the Present* (Routledge, 2nd ed, 1961) 738.

⁷² Alasdair MacIntyre, *After Virtue: A Study in Moral Theory* (Duckworth, 3rd ed, 2007) 184.

⁷³ See Rosalind Hursthouse, ‘Virtue Ethics’ in Edward N Zalta (ed) *The Stanford Encyclopedia of Philosophy* (Fall 2013 ed) <<http://plato.stanford.edu/archives/fall2013/entries/ethics-virtue/>>.

⁷⁴ See Nussbaum, above n 8, 216–23.

⁷⁵ Hursthouse, above n 73.

⁷⁶ It is not only morality that requires us and juristic persons to consider others. The law of torts can be characterised as a prohibition on causing harm to others: see, for example, W V H Rogers, *Winfield and Jolowicz on Tort*. (Sweet & Maxwell, 14th ed, 1994) 1–2. Of course, not all forms of harm to others give rise to actions in tort, thus the law recognises the concept of *damnum sine injuria* (wrong without a remedy) as illustrated by *Bradford Corp v Pickles* [1895] AC 587. It is submitted that moral obligation is not similarly determined by the existence of a remedy.

⁷⁷ See Bernard Gert, ‘The Definition of Morality’ in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* (2012) <<http://plato.stanford.edu/archives/fall2012/entries/morality-definition/>>.

invocation to treat others how you wish to be treated is, according to Simon Blackburn, 'found in some form in almost every ethical tradition'.⁷⁸ This basic and universal of idea of morality as virtuous regard for others allows us to distinguish different institutions on moral grounds. Charities may plausibly be characterised as *moral* institutions.⁷⁹ They are commonly motivated by a religious belief that promotes some or other conception of virtuous behaviour in relation to others; legally, they must promote a public benefit⁸⁰ and organisational interest-holders may not themselves directly benefit.⁸¹ In essence, charity subordinates immediate self-interest and promotes the interests of others in need. In contrast, neoliberal government may be characterised as *amoral*; generally, it holds no concept of the public good.⁸² Its interest in proscribing traditional 'sins', such as smoking, drinking and gambling, is limited to the extent that they may represent a costly public health hazard.⁸³ Finally, EGM operators may be characterised as *immoral* because they profit from the apparent economic irrationality of many others and the addiction of a significant few others.⁸⁴ In the EGM context, these morally distinguishable bodies necessarily interact with one another.

Charities fill the gaps in social provision left by the 'hollow state';⁸⁵ they receive grants from government to effectuate public goods and services,⁸⁶ and benefit from egregious tax concessions.⁸⁷ Despite this necessary collaboration with government, charities occasionally play the role of critic and conscience of State social policies⁸⁸ but the potential removal of grants may have a chilling effect on such morally-informed

⁷⁸ See Simon Blackburn, *Ethics: A Very Short Introduction* (Oxford University Press, 2003) 101 See also, generally, Harry J Gensler, *Ethics and the Golden Rule* (Routledge, 2013). Perhaps the boldest expression of concern for 'the other' in modern ethics is provided by Emmanuel Levinas: see, generally, Emmanuel Levinas, *Humanism of the Other* (Nidla Poller, trans, University of Illinois Press, 2003) [trans of: *Humanisme de l'autre homme* (first published 1972)].

⁷⁹ This is not to say that all charities always act ethically: see, for example, Rowena Sinclair, Keith Hooper and Marini Mohiyaddin, 'The Quality of Charities' Audit Reports in New Zealand' (2011) 9(2) *New Zealand Journal of Applied Business Research* 23, 23–41 on the sharp accounting practices of certain registered charities.

⁸⁰ See *Re Greenpeace of New Zealand Inc* [2014] NZSC 105 (6 August 2014).

⁸¹ See Preamble to the *Charitable Uses Act 1601* 43 Eliz I c 4; *Commissioner of Income Tax v Pemsell* [1891] AC 531; *Charities Act 2005* (NZ) s 13(1).

⁸² Critics might argue that unlike classical liberalism, which eschews any particular conception of the good, neoliberalism does indeed pursue a particular conception of the good — markets being imagined everywhere. As Patrick Fitzsimons observes, under neoliberalism, 'it is not sufficient that there is a market: there must be nothing which is not market': see Patrick Fitzsimons, 'Neoliberalism and Education: the Autonomous Chooser' (2002) 4 *Radical Pedagogy* (unpaged) <http://radicalpedagogy.icaap.org/content/issue4_2/04_fitzsimons.html>.

⁸³ But see arguments that health is the 'new morality', for example, Jonathan Metzl and Anna Kirkland, *Against Health: How Health Became the New Morality* (New York University Press, 2010). The online journal *Spiked* has consistently critiqued public health measures as disguised moralising: see, for example, Christopher Snowden, 'The Disease of 'Public Health'', *Spiked* (online), 4 November 2013 <http://www.spiked-online.com/newsite/article/the_disease_of_public_health/14204>.

⁸⁴ Immorality of this nature may also be seen in terms of sociopathy — a failure to empathise with others or at least a wilful continuation of harm to others.

⁸⁵ A phrase used by Colin Pollitt, *New Perspectives on Public Services: Place and Technology* (Oxford University Press, 2012) 3.

⁸⁶ New Zealand charities received government grants of NZ\$4.997 billion in 2011: see Charities Commission, *Annual Report 10/11* (Charities Commission, 2011) 7.

⁸⁷ See, in particular, *Income Tax Act* ss CW 41, CW 42, CW 43 and LD 3.

⁸⁸ See, for example, Social Policy and Parliamentary Unit, *The Growing Divide: A State of the Nation Report from the Salvation Army 2012* (Salvation Army New Zealand, Fiji and Tonga Territory, 2012).

critique.⁸⁹ In March 2014, the New Zealand government announced that it would cease funding the bulk of the Problem Gambling Foundation's funding (although funding was later extended until 2015). Opposition parties characterised this move as 'payback' for the foundation's trenchant criticism of the government's SkyCity deal.⁹⁰

Government establishes the regulatory structure for both charities and gambling operators;⁹¹ it taxes the latter⁹² and hypothecates some revenue to remedying the social mischiefs caused by gambling through the problem gambling levy.⁹³ But government does not simply benefit from gambling, statute law makes legal gambling possible in the first place.⁹⁴ Furthermore, the EGM profit distribution scheme relieves government of expenditure in social and cultural fields it might otherwise bear.⁹⁵

EGM operators may bring fleeting pleasure to many, but they also bring abject misery to a significant minority.⁹⁶ As noted, they make a significant contribution to the fiscal system. EGM trusts are also significant donors to non-for profit (NFP) organisations, including some charities.⁹⁷

⁸⁹ See, for example, David Sutton, Caroline Cordery and Rachel Baskerville, *Paying the Price of the Failure to Retain Legitimacy in a National Charity: the CORSO Story* (Working Paper No 47, Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2007).

⁹⁰ See, Stacey Kirk, 'Problem Gambling Foundation Loses Govt Funding', *The Dominion Post* (online), 21 March 2014) <<http://www.stuff.co.nz/national/politics/9853344/Problem-Gambling-Foundation-loses-Govt-funding>>.

⁹¹ See, the *Charities Act* and the *Gambling Act* respectively.

⁹² See, generally, the *Gaming Duties Act*.

⁹³ Charities, such as the Gambling Helpline and the Problem Gambling Foundation, may receive funding from the problem gambling levy. It is not suggested that there is any moral ambiguity in such organisations receiving such funding — that is what a hypothecated tax is designed to do. On the related issue of the moral dilemma for researchers who receive funding from gambling industry sources, see Peter J Adams, 'Ways in which Gambling Researchers Receive Funding from Gambling Industry Sources' (2011) 11(2) *International Gambling Studies* 145, 145–52; Peter J Adams, 'Should Addiction Researchers Accept Funding Derived from the Profits of Addictive Consumptions?' in Audrey R Chapman (ed), *Genetic Research on Addiction: Ethics, the Law and Public Health* (Cambridge University Press, 2012) 122, 122–38.

⁹⁴ *Gambling Act* s 9 provides that gambling is illegal unless permitted by that Act.

⁹⁵ Before the *Poor Law Act 1601*, 43 Eliz I, c 2, the burden of poverty relief in the English-speaking world lay with ecclesiastical charities. Since then, the welfare burden has been shared by government and civil society. Broadly, charities played a significant welfare role in colonial New Zealand; a lesser role under the condition of the mid-twentieth century Welfare State; and an increased role under the conditions of neoliberalism: see, generally, Kerry O'Halloran, *Charity Law and Social Inclusion: An International Study* (Routledge, 2007).

⁹⁶ We know the types of harm that gambling can cause: thus the Ministry of Building, Innovation and Employment (MBIE) observes that 'the cost of intervention services is ... only a fraction of the costs (harms) associated with problem gambling (such as suicide; family violence; children inadequately clothed and fed, and other examples of deprivation and poor parenting)': see MBIE, *Regulatory Impact Statement: New Zealand International Convention Centre* (2013) [93] <<http://www.treasury.govt.nz/publications/informationreleases/ris/pdfs/ris-mbie-nzic-jul13.pdf>>. However, the extent of the social misery is less certain. According to the Problem Gambling Foundation of New Zealand, '[a]s many as 500 000 are affected by the significant economic, health, personal, and social costs that gambling problems cause in New Zealand'. Graeme Ramsey, 'Pokies Main Cause of Problem Gambling Misery', *The New Zealand Herald* (online), 21 March 2012 <http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10872604>. Ramsey is the chief executive officer of the foundation.

⁹⁷ All charities are NFPs, but not all NFPs are charities. Like charities, the NFP sporting bodies which benefit most from EGM distributions promote various public goods but not public goods that are

What happens when charities as moral institutions and amoral government interact with immoral EGM operators? Certainly, EGM operators may be pressurised into behaving in less harmful, if not more virtuous, ways.⁹⁸ However, a more likely outcome is non-virtuous creep such that other institutions become tainted by immorality. Thus government may become reliant on gaming taxes as an 'invisible' source of revenue⁹⁹ and on EGM distributions as substitute allocations. Broadly, for every dollar an EGM trust takes for itself, government takes a dollar. And every dollar distributed to community groups (in total, a quarter of a billion dollars annually) is a dollar which government (local and national) is relieved of the expectation that it might otherwise fund through taxes. It is not suggested that moral absolutes are possible in practical governance but dependence on tainted sources of revenue is morally suspect. Furthermore, government may engage in Faustian bargains whereby the certainty of misery related to problem gambling is traded-off against the promise of construction and casino-related jobs.¹⁰⁰ Or, more generally, the vast amounts of money involved in the gambling industry and the pressure of lobbyists may simply corrupt government.¹⁰¹

When charities apply for contestable funds distributed by EGM trusts, they must, it seems, suspend their disbelief about the source of the funds.¹⁰² Furthermore, they may be required to withhold public criticism of gambling. Thus Jolyon White observes, 'the gaming trusts have been operating as a pro-pokie lobby and treating grant money as hush money against harming the pokie cause'.¹⁰³ White led the move for Anglican Church-related charities to desist from applying for EGM trust funding and thereby to present an example of a moral organisation quarantining itself from non-virtuous creep. But not all charities can, or are willing to, take a similar moral stance. Without an alternative funding mechanism, many would cease to function, with a consequent loss to society. Sports charities typically adopt a crude consequentialism or otherwise manifest

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recognised under the *Charities Act*. Nevertheless, for convenience sake, this article will refer to NFPs as though they were charities.

⁹⁸ For example, SkyCity Casino has agreed to introduce various harm-reduction mechanisms in exchange for being permitted to operate more EGMs: see MBIE, above n 95 [91].

⁹⁹ Compare with Jean Baptiste Colbert's aphorism: 'The Art of Taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.' Cited by Cedric Sandford, 'Introduction', in Cedric Sandford (ed), *Successful Tax Reform* (Fiscal Publications, 1993) 5 n 2.

¹⁰⁰ See Roger Dunstan, *Gambling in California*, California Research Bureau (1997) <<http://www.library.ca.gov/crb/97/03/crb97003.html#toc>>.

¹⁰¹ Julie Smith, 'Gambling Taxation: Public Equity in the Gambling Business' (2000) 33(2) *Australian Economic Review* 120, abstract. For a critical discussion of the National-led government's deal with the SkyCity Casino, see Jonathan Barrett and John Veal, 'Pokie Machines Ruined My Brother': Gambling Associated Harm from a New Zealand Policy Perspective' (2013) *Journal of Applied Law and Policy* <http://business.curtin.edu.au/local/docs/Barrett_Veal_Gambling-Associated_Harm.pdf>. See also Peter Adams, 'Remember Who Really Pays in SkyCity Deal', *The New Zealand Herald* (online), 5 March 2013 <http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10869158>.

¹⁰² Charities do not receive unsolicited cheques in the post from EGM trusts — they must submit applications and compete with other causes, notably sports clubs, for scarce funds.

¹⁰³ Tess McClure, 'Church Says No to "Hush Money"', *The Press* (online), 12 September 2013 <<http://www.stuff.co.nz/the-press/news/9154713/Church-says-no-to-hush-money>>.

a moral disconnection from the source of the funds. Thus *The New Zealand Herald* reports:¹⁰⁴

Sports bodies argue that while gambling may cause harm it does not follow that accepting [EGM trust] grants causes harm. So long as pokie machines are permitted, they point out, the revenue generated will be used for something. The more of it that has to be distributed for good purposes the better, and participation in sport is as worthy a purpose as any.

David Grant observes that ‘from the 1970s constraints on gambling dissipated ... Moreover, as evangelical tides weakened, gambling profits that satisfied a public philanthropic need prevailed over moral and social objections’.¹⁰⁵ Certainly Christian groups, particularly Protestant churches, were prominent among the anti-gambling lobby but secular women’s movements, whose ‘concerns were primarily social rather than morally doctrinaire’ also played a prominent role in the anti-gambling movement.¹⁰⁶ Any suggestion, then, that opposition to EGMs is a relic of religious intolerance or ‘wowserism’¹⁰⁷ is misplaced. Other-centred justice — the idea that we should not do or permit harm to be done to others — is a universal value, and it characterises the equitable society.

V CONCLUSION

This article has argued that adherence to fundamental moral values is largely incompatible with both the moral disinterestedness of neoliberal government in relation to EGMs and charities’ benefiting from EGM trust distributions. EGM trusts are immoral and should, as a transitional measure towards elimination, be replaced by democratically accountable bodies.¹⁰⁸ This may appear to be an absolute and idealist proposal and yet EGMs and the EGM trust distribution may already be in inexorable decline. Thus an editorial in *The New Zealand Herald* opined ‘the sinking lid on pokies means the sun is slowly setting on this source of social revenue. Sports know it, they are using grants to build facilities while the good times last. When eventually the flow of funding has ceased their conscience will be clear.’¹⁰⁹

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¹⁰⁴ ‘Editorial: Sport’s Moral Dilemma Will Solve Itself’, *The New Zealand Herald* (online), 29 August 2013. <http://www.nzherald.co.nz/sport/news/article.cfm?c_id=4&objectid=11116495>.

¹⁰⁵ Grant, above n 9, 287.

¹⁰⁶ Ibid, 79.

¹⁰⁷ See ibid, 56–98 on the politics of wowserism.

¹⁰⁸ See Flavell’s original Gambling (Gambling Harm Reduction) Amendment Bill Member’s Bill (209–2). Its provisions on local democratic control were rejected at the Committee stage.

¹⁰⁹ ‘Editorial: Sport’s Moral Dilemma Will Solve Itself’, above n 104.

BALANCE OF POWER POLITICS AND TAX REFORM

HELEN HODGSON*

ABSTRACT

Since 1978 it has been unusual for the Federal Government to have a majority in both houses of Parliament. Where the government does not have a majority in the Senate it must negotiate with the Opposition and minor parties to pass legislation. The issue is further complicated in relation to money bills as they are subject to specific constitutional requirements that limit the powers of the Senate to deal with such bills. The influence of the minor parties can be seen both in the process applied in dealing with money bills and in the policy outcomes of negotiations. This article* explores this influence through four case studies relating to tax legislation, and finishes by speculating on the passage of tax reform legislation through the Senate following the 2013 election.

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† The final version of this article was submitted 14 August 2014, and reflects the state of the Senate and Budget discussions at that date.

I INTRODUCTION

In modern Australian politics it is unusual for a federal government to have control of both houses of Parliament. Since the Second World War government in Australia has been dominated by the centre-right Liberal Party, usually in coalition with the National Party¹ (Coalition) and the Australian Labor Party (ALP). Thus Australia has been regarded as a two party system, with a government and a clear opposition.

The Commonwealth Government² is formed in the House of Representatives, but since 1950 it has been unusual for the government to also have control of the Senate. It has had an absolute majority in the Senate in only five parliaments over that time.³ Between 1950 and 1971 the most significant 'other voice' was that of the Democratic Labor Party, which emerged from a split with the ALP in 1954. The DLP tended to support the Coalition, and used its position primarily to leverage support for its constituents.⁴

Since the first election of the Australian Democrats (Democrats) in 1978, minor parties have become a significant voice in the Senate. The Democrats and the Greens have been influential in shaping the form of much legislation, including tax legislation. This article focuses on the effect that the Democrats and Greens have had on tax legislation over this period, during which they have been consistently represented in the Senate.

The first part sets out the balance of power equation, which may require a theoretical framework to examine the effectiveness of the minor parties, while the second part outlines the constitutional framework that applies to tax legislation. The paper then goes on to discuss four case where minor parties were influential in tax legislation: the 1981 and 1993 Budgets; A New Tax System in 1999, and the Carbon Pollution Reduction Scheme in 2009.

Finally, the paper applies this framework to the prospects of tax reform following the 2013 Federal election, at which the Palmer United Party was successful in winning representation in both houses of Parliament, holding the balance of power in the Senate from 1 July 2014.

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¹ The National Party was formerly known as the Country Party. State parties that identify with the Liberal, National or Country parties are included as such in this paper.

² This article will focus on the Commonwealth Parliament, as that is where the laws relating to the most significant Australian taxes are made: income tax, corporate taxes and excises.

³ Parliamentary Library, *43rd Parliamentary Handbook* (Australian Parliament, 2011).

⁴ Campbell Sharman, 'The Representation of Small Parties and Independents in the Senate' (1999) 34(3) *Australian Journal of Political Science* 353.

II HOW MINOR PARTIES WIELD INFLUENCE

A The Balance of Power Equation

The Australian parliamentary system is based on the Westminster system. Government is formed in the lower house, the House of Representatives, which is made up of 150 members of parliament. One member represents each seat, the boundaries of which are drawn on the basis of population. The Cabinet, the executive arm where government policy decisions are made, is drawn from government members of both houses of Parliament.

It is relatively unusual for a member of the House of Representatives to be elected without the backing of either the Coalition or the ALP, as the candidate elected is the first candidate to achieve more than 50 per cent of the vote, which may require distribution of preferences. Accordingly, relatively few cross-benchers are elected, although recently a number of high-profile members have been elected as independents or representatives of a minor party⁵ on the basis of the strong local profile of either the individual candidate or the party they represent. These cross-benchers may support the government of the day, offering either full support or committing to support the government on matters of confidence and supply while reserving their position on other matters.⁶

The Senate, which was constitutionally designed to represent the interests of the states, is made up of an equal number of senators from each of the six states, plus, since 1975, two from each of the Northern Territory and the ACT. The number of senators elected from in each state has been increased twice since federation: from six to ten in 1949, then twelve in 1984. Significantly, the requirement that half of the Senate face election every three years means that when changes in electoral support occur it may take two parliamentary terms to be reflected in the Senate. For example, although no Democrats were elected after 2001, they continued to influence the balance of power in the chamber until 2007. Further, senators serve fixed terms commencing on 1 July, but half-Senate elections are generally held in conjunction with House of Representative elections. This can result in a period of many months⁷ during which a new government is working with a Senate that is due to be reconstituted, influencing the timing of the government's legislative program, which may be accelerated or deferred.

The Senate is elected on a proportional representation system under which the elected senators must each obtain a quota, currently 14 per cent of the vote in a half-Senate election. Under the preferential system the votes of lowest achieving candidates are redistributed, as are the surpluses of candidates who achieve a quota in their own right.

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⁵ Notably following the 2010 election, the balance of power in the House of Representatives was held by four Independents and a Green.

⁶ For example, following the 2010 election cross-benchers entered into agreements with the Labor Government to support the Government on matters of confidence and supply coupled with agreements on particular policy and procedural matters
Greens <<http://democraticaudit.org.au/?p=618>>; Rob Oakeshott MP
<http://roboakeshott.com/system/files/images/letter_of_agreement.pdf>.

⁷ In 2010 the election was held on 21 August 2010, and the new Senators took their seats more than 9 months later, on 1 July 2011.

In 1983 when the size of the Senate was increased it was considered that electing an even number of senators would increase the probability that one political party would gain a majority at each election;⁸ however, changes in voter behaviour have disproved this prediction. The representation of minor parties has continued to increase, and as shown in Figure 1 (below), the government has only held a majority in the Senate in one Parliament since 1981: the final Howard term from 2005 to 2008.

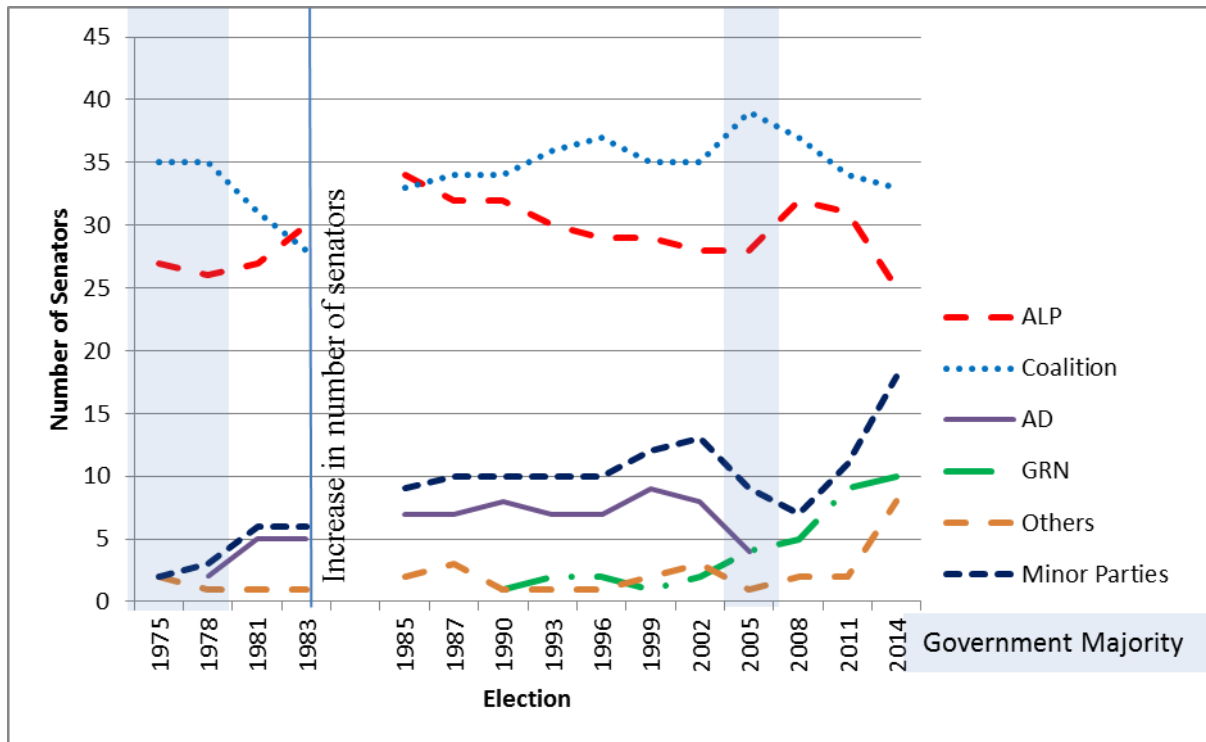


Figure 1: Political Party Representation in the Senate

The numbers in the Senate affect the outcome of legislation differently depending on whether the legislation needs to be passed, requiring a positive vote, or whether it is to be blocked. A range of combinations govern the impact of the minor parties. To pass legislation requires more than half of the members present and voting — up to 39 votes if all are present — to agree to the bill. If the numbers are even, the vote is determined in the negative. The President retains a deliberative vote in order to maintain the balance of states' rights in the Senate,⁹ but does not have a casting vote. An absolute majority, which is required for certain procedural matters, requires 39 votes, being half of the whole number of senators regardless of the number of senators present.

Therefore a range of scenarios may arise:

1. Where the government proposes legislation it requires a simple majority to be passed.
2. Legislation can be blocked if the government does not get the required majority. This can be at any of the three reading stages, although it is not usual practice to vote against a bill at the first reading.

⁸ Joint Select Committee on Electoral Reform, 'First Report' (Parliament of the Commonwealth of Australia, 1983), 143.

⁹ Rosemary Laing (ed), *Odgers' Australian Senate Practice* (Dept of the Senate, 13th ed, 2012), 277.

3. The bill may be amended. Following the second reading the bill is debated in committee, at which stage amendments may be proposed. Any proposed amendments require a simple majority, which dictates whether the non-government parties achieve changes to the bill. If the non-government parties are not successful in making changes they may decide to vote against the bill at the third reading stage.

The negotiation skills of the key players on both sides of the house are critical, particularly as the possible combinations have become more complex. In the simplest situation where the government and the opposition agree, the role of the minor parties is marginal. However where they do not agree, the complexity of the negotiation depends on whether there is a single party that has the required number of votes for the legislation to pass (or be blocked).

Section 57 of the Constitution sets out the procedure required to resolve a difference between the houses on legislation. If a bill is amended in the Senate the amendments must also be agreed by the House of Representatives. The bill is returned to the House, and if the amendments are agreed the bill is passed into law. However, if the amendments are rejected by the House, in the first instance the bill is returned to the Senate. If the Senate insists on the amendments the bill can be reintroduced after a three month waiting period, and the process commences again. The second rejection can trigger a double dissolution as long as it is not within six months of the expiry of the House of Representatives. The bill can then be presented again to the Parliament and, if not passed by the new Parliament, considered at a joint sitting of the two houses. A double dissolution election requires all senators to face the electorate.

The length of time required by this procedure is problematic for the Appropriation Bills, as it can restrict the ability of the government to continue to operate.¹⁰ If a Senate is regarded as obstructionist the government will often threaten to call a double dissolution election to regain control of the legislative process. It is common for a government to present a rejected bill to the Senate a second time without amendment in order to have a double dissolution trigger available, allowing it to ask the Governor-General to dissolve the Parliament within a shorter time frame.

However, a double dissolution election has not been held since 1987. The quota required for election reduces as the number of senators to be elected increases, and at a double dissolution election the quota reduces to 7.6 per cent of the vote. In a double dissolution campaign the focus is on the legislative program and the actions of each party in the Senate, and each party is expected to explain its position. Although this gives a tactical advantage to the government, the lower threshold allows various interest groups to coalesce around the candidates, and minor parties can more easily reach the lower quota. At the 1987 double-dissolution election the number of independents elected increased.

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¹⁰ As in the 1975 constitutional crisis, when the wages of Commonwealth employees were at risk of being unpaid.

B Minor Parties and the Mandate

The growth of the minor parties' numbers in the Senate has led to an increased involvement by the Senate in the policy-making process, raising the question of what the role of the Senate should be. Weller¹¹ identifies three alternative propositions for the role of the Senate, each of which is defensible on constitutional and electoral grounds:

1. The government is elected in the lower house, and the Senate should allow the government to enact its legislative agenda;
2. The Senate is a near equal partner in the legislative process; or
3. The Senate is a house of review, and as such will review and amend legislation but will not block supply.

The first proposition is based on the government having an electoral mandate, which gives it the authority to prosecute a particular policy agenda. The concept of the mandate is difficult to define, but has been summarised as: 'a simple version of the mandate implies that the party which wins a majority of seats in the House is entitled to govern and implement its previously stated policies'.¹² All elections give voters the opportunity to express an opinion on the government and its performance, but some elections are a clear endorsement of a particular political agenda.¹³ Following a resounding victory the incoming government will claim a mandate, arguing that the voters have accepted the proposed policy direction.

There are two major theories regarding the extent of an electoral mandate. Under a narrow interpretation, a specific mandate applies to the specific policies that the government took to the election, as these are the policies that the electors endorsed at the election. In British elections the manifesto has been an important feature of election campaigns since 1945, when the House of Lords stated that it would not prevent the passage of election promises that were part of the election manifesto.¹⁴ This form of mandate is based on the delegate theory of political representation,¹⁵ which sees the relationship between the voters and the government as based on promises made prior to the election, and expects the government to act within the scope of those promises.

The broader interpretation of mandate holds that the outcome of an election gives a government the right to govern, which includes the right to pursue a broad policy agenda.¹⁶ This power is vested in the executive — the Cabinet in the Australian system — and Parliament should not frustrate this right. As the government generally has a majority in the House of Representatives, any impediment is more likely to arise in the Senate. Proponents of this interpretation highlight the need for the government to be able to respond to circumstances as they arise: for example global economic or national

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¹¹ Patrick Weller, 'The Australian Senate: House of Review, Obstruction or Rubber Stamp?' (2006) 25(3) *Social Alternatives* 13.

¹² Hugh Emy, 'The Mandate and Responsible Government' (1997) 32(1) *Australian Journal of Political Science* 65, 65.

¹³ Michal Shamir, Jacob Shamir and Tamir Sheafer, 'The Political Communication of Mandate Elections' (2008) 25(1) *Political Communication* 47.

¹⁴ Meg Russell, 'Upper House Reform in the United Kingdom and Australia' (2001) 36(1) *Australian Journal of Political Science* 27, 33.

¹⁵ Emy, above n 12.

¹⁶ Ibid.

security issues do not correspond to the electoral cycle. Under this interpretation, the promises made prior to the election serve as a touchstone for policies and actions implemented during the term of the government.

The argument that a minor party has a mandate to intervene in a government agenda stems from the specific mandate that the party takes to the election. They will respond to key policies announced by the major parties during the election campaign, basing their claim of mandate on this manifesto: for example, as discussed in Case Study 3, in the 1998 federal election the Democrats published a response to the proposed imposition of a Goods and Services Tax (GST) in which the party opposed a GST on food. Policy ideas are a major factor in the role of minor parties, which are more likely to be motivated by particular policy views held by the members and supporters of that party; thus ideation is a major driver of change where minor parties have a voice in the parliamentary process.¹⁷ Where participants have an interest in the outcome of a particular policy they are more likely to engage in the process to influence the design of that policy.¹⁸

The second proposition, based on the US tradition, claims that as the Senate has near-equal legislative power under the Constitution, it acts as a partner in policy development. In a bicameral system the Senate has the power to thwart the government's legislative program, often relying on a separate mandate. A range of difficulties stem from competing mandates in a bicameral system.¹⁹ First, if the legitimacy of the Upper House is questionable, there could be concern over interference with the government agenda. However, the Australian Senate is a strong bicameral system: it is elected; there is no significant malapportionment of the vote; and the elections are held concurrently with those of the House of Representatives.²⁰

Second, minor parties tend to poll better in those upper houses where proportional representation is adopted,²¹ as they mobilise around particular campaigns that reflect the views of a significant minority of voters. The increased influence of minor parties in the Westminster system has been attributed to the extent to which such parties are able to focus on a particular policy area that reflects the concerns of a sector of the electorate²² and harvest the vote of that group of voters. Where there is a fundamental policy difference that cannot be reconciled, the minor parties will base their stand on their own mandate and negotiate from that base, becoming a partner in policy making. This was typical of the way the Australian Democrats operated, accepting that incremental change was more achievable than major reform.²³

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¹⁷ Christopher Rootes, Anthony Zito and John Barry, 'Climate change, national politics and grassroots action: an introduction' (2012) 21(5) (2012/09/01) *Environmental Politics* 677.

¹⁸ Mark Blyth, 'Structures Do Not Come with an Instruction Sheet: Interests, Ideas, and Progress in Political Science' (2003) 1(4) *Perspectives on Politics* 695.

¹⁹ Murray Goot, 'Whose Mandate? Policy Promises, Strong Bicameralism and Polled Opinion' (1999) 34(3) *Australian Journal of Political Science* 327.

²⁰ Ibid 332–3.

²¹ Note that state systems may differ, notably Queensland operates a unicameral system and the Tasmanian electoral system applies the Hare Clark system in the lower house.

²² Colin Copus et al, 'Minor Party and Independent Politics beyond the Mainstream: Fluctuating Fortunes but a Permanent Presence' (2009) 62(1) *Parliamentary Affairs* 4.

²³ Richard Mulgan, 'The Australian Senate as a 'House of Review' (1996) 31(2) *Australian Journal of Political Science* 191.

The third proposition is that the Senate is a house of review, but there is debate over how far that review should extend.²⁴ Referring back to mandate theory, arguably the role of the upper house is to ensure that the government acts in accordance with its own mandate, as epitomised by the early Australian Democrats, but without going to the point of disrupting or thwarting the government agenda. In the Australian context there is an additional dimension to the extent that voters deliberately vote differently in the two houses of Parliament, making their choice of a preferred government in the lower house but consciously voting differently in the upper house to ensure that the government is held accountable.²⁵ As most senators vote along party lines in the chamber unless there is a compelling reason to vote against their own party (crossing the floor), the election of senators that are not aligned with the government or the opposition provides voters with the reassurance that bills are being re-examined. The Senate Committee system, which was revitalised in the 1980s, also offers members of the public an opportunity to be heard in relation to legislation. Thus many voters see the Senate as a 'watchdog' that will ensure further scrutiny of legislation through a different lens than that applied in the House of Representatives.

The extent to which a minor party will negotiate as a partner with the government or act as a check on legislative excesses varies depending on the issue and the party. As noted previously, the Democratic Labor Party generally supported the conservative Coalition on legislative matters,²⁶ whereas the Greens are regarded as conviction politicians who are less likely to negotiate where a matter of principle is involved.²⁷

The Australian Democrats, who were part of the 'balance of power' equation over the period from 1981 to 2007, took the approach of working with governments of either persuasion to achieve incremental change²⁸ — a factor that contributed to their demise following the GST negotiations (see case study 3). They had a clear set of principles outlined by Senator Cheryl Kernot in 1997²⁹ as follows:

1. agreeing not to block supply (ie refusing to take the whole process of government hostage in order to achieve an outcome);
2. refusing to cross-trade on issues (ie refusing to trade-off a good outcome in one area for a bad outcome in another completely unrelated area); and
3. transparency in policy making (ie ensuring public reasons are given for all decisions, with the process as open as practicable).³⁰

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²⁴ Ibid.

²⁵ Sharman, above n 4.

²⁶ Ibid.

²⁷ Mulgan, above n 23, 195.

²⁸ Hiroya Sugita, 'Parliamentary Performance in the Senate' in John Warhurst (ed), *Keeping the Bastards Honest* (Allen & Unwin, 1997).

²⁹ Leader of the Australian Democrats from 1993 to 1997.

³⁰ Cheryl Kernot, 'Balancing Acts — Wielding the Balance of Power' (1997) 56(2) *Australian Journal of Public Administration* 32.

These principles guided the Democrats in their approach to negotiating legislation with the government of the day. Other parties, including the Greens, have adopted similar principles.

However, there were some issues where the party did claim a mandate — for example the decision by the party to block the sale of Telstra after the 1996 election generated extensive public debate over the meaning of mandate.³¹ The Australian Democrats claimed a mandate to block the sale based on the increased vote for its candidates at the election, which included a specific policy opposing the sale. However, the legislation was passed when, in an example of cross-trading on issues, the independent senator Senator Brian Harradine agreed to pass the legislation required to privatise Telstra if access to medical abortion through RU486 was restricted.³²

The Greens have been less willing to negotiate in legislation and more likely to claim a mandate to oppose legislation. Although they have not blocked supply (and following the 2010 election the party entered into an agreement with the Labor Government to support supply), as conviction politicians the party is more likely to hold their ground on core issues, making negotiation more difficult — particularly with conservative governments.³³ As can be seen in case study 4, they did negotiate with the Rudd ALP Government on the Carbon Pollution Reduction Scheme (CPRS), but when the final outcome was too far from their own policy mandate, they did not support the CPRS legislation.

The evidence shows that voters do vote intentionally to impose checks and balances on the government, and that they are willing to accept the actions of the Senate in blocking unpopular measures, regardless of claims of mandate.³⁴ Thus when claiming a mandate in the Senate two aspects need to be considered: if a party has been elected on a platform that supports a particular policy, the behaviour of that party in relation to that policy should be predictable, based on party ideology; however, when other matters come before the Parliament the party may be required act pragmatically to formulate a response or establish a set of principles to guide the decisions made — working in partnership with the government to achieve an outcome.

C Constitutional Requirements for Money Bills

Given that the voting system for the Australian Parliament facilitates election of minor parties in the Senate, it is important to understand the extent to which the Constitution constrains the powers of the Senate in relation to money bills.

Section 53 of the *Constitution* requires that Appropriation Bills and bills imposing taxation may not originate in or be amended by the Senate. However this does not mean

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³¹ J R Nethercote, 'Mandate: Australia's Current Debate in Context' (Research Paper No 19, Parliamentary Library, Parliament of Australia 1998-99).

³² Marian Sawyer, 'What makes the substantive representation of women possible in a Westminster parliament? The story of RU486 in Australia' (2012) 33(3) *International Political Science Review* 320.

³³ David Charnock, 'Can the Australian Greens Replace the Australian Democrats as a 'Third Party' in the Senate?' (2009) 44(2) *Australian Journal of Political Science* 245.

³⁴ Goot, above n 19, 347.

that the Senate cannot participate in the legislative process. The Senate must still pass the Appropriation Bills, and if it does not agree with the appropriation it can request that the House of Representatives amend the bills, or request further information — a procedure commonly referred to as ‘blocking supply’. This power has been regularly exercised by the Senate: between 1950 and 1975 there were 170 instances where the Senate requested amendments.³⁵ The most notorious instance was in 1975, when the impasse led to the Dismissal at which the Governor General terminated the commissions of Prime Minister Whitlam and all other ministers.³⁶

Section 53 is a procedural limitation that clarifies whether the amendment is one that can be made by the Senate or should be returned to the House of Representatives.³⁷ This power is moderated by the requirement that the Appropriation Bills must only appropriate for the ordinary services of government (s 54) and that bills imposing taxes must only impose one tax (s 55). This is the source of the separate tax assessment bills, and it allows the Senate to make changes that are not directly related to the imposition of the taxes or the appropriations.

Accordingly, the ability of minor parties to influence taxation measures arises in two ways: the ability to block supply and the ability to amend the assessment provisions, including the tax base and the tax unit but not (generally) the rate of tax.

The ability to block supply is further dependent on the numbers in the Senate. While the presence of minor parties in the Senate is now usual, the most common scenario is that the major parties vote together on legislation, thus limiting the ability of the minor parties to influence the outcome. This is particularly the case where a minor party is pursuing a special interest agenda that mainstream actors see as marginal. In these cases, minor parties may find that the only way to pursue that agenda is through negotiation outside the terms of the bill under consideration.

There are also instances where a reform agenda includes a taxation measure that falls outside the appropriation — for example a tax or charge is applied to address a market failure or undesirable behaviour. These Pigouvian taxes include various excises or, as discussed in case study four of this article, carbon emissions reduction proposals.

Where a major party sees a coincidence of interest with a minor party, the outcome will depend on whether a simple majority is required. A bill or amendment can be defeated by equal votes, as a tied vote is determined in the negative; but a majority is required to pass an amendment. This can lead to a range of parliamentary tactics: for example if an amendment is proposed in the committee stages but fails, there may be the opportunity to defeat the bill at the third reading.

When multiple groupings are possible, the inevitable outcome is that much of the negotiation over legislation happens outside the Parliament as the Manager of Government Business and the Opposition equivalent try to identify the position that

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³⁵ David A W Smith, ‘The Whitlam Government, the Dismissal and All That’ (2006) 18(1) *The Sydney Papers* 142.

³⁶ *Sir John Kerr’s Letter Of Dismissal* <<http://whitlamdismissal.com/1975/11/11/kerr-letter-of-dismissal.html>>.

³⁷ Laing, above n 9, 345.

each party will take, and the likelihood of reaching an acceptable compromise. The strong committee system in the Senate now examines most bills prior to debate, which facilitates this negotiation process.

III FOUR CASE STUDIES

A 1981: 'No Sales Tax on Necessities of Life'

The first of the four case studies examined in this paper is the 1981 Budget. The Australian Democrats had been formed in 1977, and following the 1980 election, the second that it contested federally, the party held 5 of the 64³⁸ seats. The Coalition held 30 seats, Labor 28 and the independent, Senator Harradine, held the remaining seat. Therefore the balance of power equation was relatively simple: the Coalition needed the agreement of either the ALP or the Democrats to pass bills. An important element of the Democrats' election platform, rooted in the events of 1975, was a pledge signed by candidates not to block supply or money bills if elected. Notably it was during this period that Senator Don Chipp, the party leader, described the role of the party as 'keeping the bastards honest' — articulating the role of the party as an accountability mechanism.

In 1981 the Fraser Government introduced a budget that would increase the rate of sales tax across a range of goods, which was contrary to both the policies of the Democrats and an election commitment of the Coalition Government. The Democrats took a position that rejected the imposition of 2.5 per cent sales tax on goods regarded as 'necessities of life', specifically clothing and footwear; wrappings that could affect the cost of food; building materials for private dwellings; and books and newspapers as they were medium for disseminating information. Significantly, on this instance the party acted as an agent of review, applying pressure to the government to keep its election commitments in accordance with the specific mandate conferred at the election.

It is worth noting that the form of the original bills³⁹ departed from the convention under which the imposition of the tax is separated from the machinery of the provisions that assess the tax, as each of the nine amendment bills was drafted to amend both the relevant *Sales Tax Act* and the *Sales Tax Assessment Act*. Senator Janine Haines, who was acting Leader of the Australian Democrats while Senator Don Chipp recovered from a heart attack, speculated that this was to 'frame the Bills in such a way that they would be clearly seen as money Bills and unamendable by the Senate',⁴⁰ which would leave the Senate no other option than to reject the bill, thus blocking supply. Accordingly the Senate passed a resolution to the effect that although it would deal with the bills that did not indicate that it accepted that the form was constitutional.

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³⁸ The number of seats in the Senate was increased from 64 to 76 with effect from 1985, in part to increase the likelihood that a major party would gain a majority at a half senate election — refer to n 8.

³⁹ Sales Tax Amendment Bills (Nos 1–9) 1981; Sales Tax Amendment Bills (Nos 1A–9A) 1981; Sales Tax Amendments and Classifications Bill 1981.

⁴⁰ Commonwealth, *Parliamentary Debates*, Senate 9 September 1981, 576 (Haines).

The bills were introduced into the Senate in August 1981 and the Senate made amendments to delete the clauses that imposed sales tax on the contentious items. The bills were then returned to the House of Representatives in September with a message asking that the relevant clauses be deleted. The amendments were rejected by the House of Representatives on 14 October. When the Senate received the message that the House of Representatives would not accept the changes, it voted to press the changes, triggering a three month delay before the bills could be reintroduced, during which time the Democrats planned to further consult the Australian public.⁴¹

The bills were reintroduced the following year, at which stage the position of the Democrats firmed to block, rather than attempt to amend, the bills. Accordingly on 10 March 1982 the reintroduced Bills failed to pass the second reading. This led to criticism of the Democrats who were regarded as having broken their election commitment to not block supply. A number of factors have been identified as contributing to the dilemma that the Democrats faced in 1981⁴²: the Democrat senators were inexperienced, and this was the first major balance of power crisis that they were required to negotiate; the most experienced senator and leader, Senator Don Chipp suffered a heart attack at a crucial point leaving the rest of the team to try to implement a strategy without his advice; and the election pledge was unduly restrictive in that it committed the party 'not to use the voting numbers ... to cause the blocking of supply or money bills'.⁴³ As discussed previously the concept of blocking supply does not necessarily extend to approving all of the measures in the budget, a distinction that was not yet fully understood.

From the perspective of the government, although it took a particular position to the election, the general mandate to govern, and the need to address economic issues, took precedence over the electoral mandate conferred the previous year. However the Senate took the view that the government had made a commitment and its role included holding the government to that commitment.

As a footnote, the 1982/83 Budget specifically excluded 'what some have regarded as the necessities of life'.⁴⁴ When the opposition attempted to block that budget the Democrats did not support that course of action.⁴⁵

B 1993: Lessons in Negotiation

The second case study was twelve years later in respect of the 1993 Budget. The composition of the Senate at this time was more complex due to the presence of the WA Greens⁴⁶: Senator Chamarette had filled a senate vacancy in 1992 and was joined by Senator Margetts following the 1993 election, accordingly both were regarded as parliamentary novices. The ALP Government held 30 seats in the Senate and the

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⁴¹ Commonwealth, *Parliamentary Debates*, Senate 20 October 1981, 1399 (Evans).

⁴² Liz Young, 'The Australian Democrats and the Budget Process' in John Warhurst (ed), *Keeping the Bastards Honest* (Allen & Unwin, 1997).

⁴³ Ibid, 179.

⁴⁴ Commonwealth, *Parliamentary Debates*, House of Representatives, 17 August 1982, 61 (Howard).

⁴⁵ Commonwealth, *Parliamentary Debates*, Senate, 20 August 1982, 1650 (Chipp).

⁴⁶ The Australian Greens were not formed until 1992. Prior to that date Senators were affiliated with state-based Green parties.

Coalition held 36, therefore the passage of legislation required eight votes from the ten senators that occupied the cross benches: Senator Harradine (independent), seven Australian Democrats and the two Greens. If the Democrats voted with the government, one further vote was still required to pass legislation.

The 1993 Budget was the year after the Prime Minister, Paul Keating, had referred to the Senate as 'unrepresentative swill'.⁴⁷ The ALP had promised tax cuts to middle income earners, and passed legislation prior to the 1993 election to implement these cuts — with Keating campaigning on the basis that they were already in place, and describing them as the L-A-W tax cuts. However in the face of an economic downturn it was also committed to a budget deficit reduction strategy. In the budget the Treasurer, John Dawkins, introduced a package of increases in indirect taxes, expenditure cuts and deferral of the promised tax cuts.

Again the form of the Bills was contentious. The original *Taxation (Deficit Reduction) Bill 1993* included amendments to the rates of a range of taxes, including income tax, fringe benefits tax and several categories of sales tax. Questions over the constitutional validity of the Bill were referred to the Legal and Constitutional Affairs Committee⁴⁸, and in order to limit the possibility of a constitutional challenge, the government presented a new set of Bills that addressed each subject of taxation separately. A test bill that increased two different taxes was passed in order to allow the question of what constitutes the imposition of a tax to be tested in the High Court, but after passage of the legislation no test case was taken.

Setting aside the constitutional issues, the content of the budget was electorally unpopular. In particular the deferral of the personal income tax cuts promised in the 1993 election campaign; increases in sales tax and petrol excise; and reductions in childcare and some Medicare benefits caused a backlash from the public. Once again the government was introducing measures that were contrary to its election commitments, calling into question whether it had a mandate to introduce these changes.

The Democrats and the Greens were concerned over what they regarded as inequitable changes in the tax mix, identifying the proposed personal income tax schedule coupled with increases in indirect taxes as regressive. The budget was tabled on 17 August, and Dr John Hewson, the Leader of the Opposition, which had campaigned in the 1993 election on the 'Fightback'⁴⁹ proposal for a GST, stated in the Budget reply that the Coalition would not support the budget measures. On 25 August the Treasurer, John Dawkins, announced that he was willing to discuss the details of the budget with the minor parties.

Over the following week the Democrats, under the leadership of Senator Cheryl Kernot, were able to negotiate four changes to the budget, worth about \$1bn:

- the proposed low income tax offset was increased;
- the tax on leave payments was not made retrospective;

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⁴⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 4 November 1992, 2547 (Keating).

⁴⁸ Laing, above n 9, 385–6.

⁴⁹ Liberal Party, 'Fightback: A Coalition Strategy for Growth and Jobs' (1992).

- Medicare rebates continued to apply to optometric services; and
- the difference in the fuel tariff between leaded and unleaded fuel was reduced.

These concessions, gained by negotiation outside the chamber, were unlikely to have been achieved by amendment in the Senate as they would not have gained the support of the Coalition.⁵⁰ The Democrats reserved their position on the proposal to increase the sales tax on wine, but agreed to support the remainder of the budget.

The Greens also entered into a process of negotiation with the government, however the position of the Greens was not resolved for nine weeks. Senator Dee Margetts had a background in green economics, which views economics through a different framework from the conventional rational economic approach of Treasury; accordingly they negotiated from a position that focused on sustainable development and distributive justice.⁵¹ When the budget was passed on 22 October 1993 the Greens had negotiated a further \$634m of concessions for low income earners.⁵²

This outcome needs to be put into context: the government had already secured the agreement of the Democrats for the budget, with the negotiated changes, and the Coalition was philosophically unlikely to support the policy direction of the Greens. Accordingly it was unlikely that the Greens would have achieved a better outcome by attempting to amend the budget in the Senate.

When the government entered into negotiations with the minor parties, it effectively acknowledged a partnership between the houses. Over the period of the negotiations the government and sections of the media were critical of the actions of the minor parties, portraying them as holding the government to ransom.⁵³ However, polling showed that voters regarded the minor parties as fulfilling the mandate of holding the government to account when it introduced legislation that was contrary to its election promises.⁵⁴ This was reinforced as the parties negotiated in accordance with a stated policy position, fulfilling the expectations of voters sympathetic to those policies.⁵⁵

C 1999: The GST Deal

The third case study examines the role of the Australian Democrats in negotiating with the Coalition Government in the design of the GST introduced in 2000.⁵⁶ The Democrats

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⁵⁰ Liz Young, 'Minor Parties and the Legislative Process in the Senate: A Study of the 1993 Budget' (1999) 34(1) *Australian Journal of Political Science* 7.

⁵¹ Stephen Ellis, 'Greens: What They Are On About', *Sydney Morning Herald* (Sydney), 4 September 1993.

⁵² Wilson daSilva, 'Greens Most Powerful Women in Australian Politics', *Reuters News* (Sydney), 10 November 1993.

⁵³ See, for example: Mike Steketee, 'Perils of Cheryls and Ferals', *Sydney Morning Herald* (Sydney), 7 September 1993 Amanda Buckley, 'Are These Two Women Running The Country? ', *Sunday Age* (Melbourne), 28 November 1993.

⁵⁴ Young, above n 42.

⁵⁵ Young, above n 50.

⁵⁶ During this period the author was the Leader of the Australian Democrats in the WA Legislative Council. In this role she observed, but was not directly involved in, the negotiations around the introduction of the GST.

reached the peak of their electoral popularity in the late 1990s under the leadership of Senator Cheryl Kernot, holding seats in the WA, NSW and SA Legislative Councils and the ACT Legislative Assembly as well as the Senate.

The balance of power equation in the Senate was still complex. The Democrats held seven seats after the Coalition Government was elected in 1996, with two Greens and two independents⁵⁷ also on the crossbenches, and although the Howard Government only needed two votes to pass legislation in its first term, the ideological positioning of the parties in the Senate meant that key legislation was frequently negotiated with the Australian Democrats to obtain its passage.⁵⁸ During this period the Australian Democrats claimed a mandate that went beyond the review and accountability function that characterised the 1981 stance; and the party was more active in negotiating legislation: notably the Telstra privatisation and the Workplace Relations legislation during the term of the first Howard Government.

It was clear that the Howard Government intended to introduce a GST, and in 1997 the Democrats initiated a consultation process within the party to clarify the party policy, culminating in a ballot of the revised policy. The outcome of that process was to endorse a rather ambiguous position on consumption taxes that did not support a broad based tax but allowed different rates of tax to be applied to different goods and services. The following year tax reform became a core theme of the 1998 election campaign with the Coalition Government publishing its proposal for a GST⁵⁹ and the ALP publishing a competing tax policy that rejected a GST. The Democrats responded by setting out the principles that they would apply in negotiating with the government if they held the balance of power after the election.⁶⁰

From 1 July 1999, following the 1998 election, the Australian Democrats held nine seats in the Senate. The government needed three votes to pass legislation: accordingly if it could not obtain the support of the Democrats it would have needed the votes of all three cross bench senators Harradine, Brown and Oldfield⁶¹ who came from disparate political ideologies. After Senator Harradine announced that he could not support a GST, the government needed the support of the Australian Democrats.⁶²

The Democrats entered into negotiations with the government, and ultimately achieved significant changes to the package.⁶³ Notably, food was exempted from the GST as were certain non-commercial educational, charitable and disability services. A compensation package also increased rent assistance and the government undertook to address the impact of the GST on low income earners who were not in receipt of government benefits; long-term residents of boarding houses and caravan parks; and the arts

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⁵⁷ Senator Colston represented the ALP until August 1996 then sat as an independent until 1999.

⁵⁸ For example the provisions of the *Workplace Relations Act 1996* were negotiated with the Australian Democrats who moderated some of the proposals in the initial legislation and subsequently voted against attempts to amend the legislation in 1999 and 2000.

⁵⁹ Australian Treasury, *Not A New Tax: A New Tax System* (AGPS, 1998).

⁶⁰ Australian Democrats, 'The Australian Democrats' Taxation Policy Response' (Australian Democrats, 18 September 1998) <www.parlinfo.aph.org.au>.

⁶¹ NSW Senator David Oldfield was elected from Pauline Hanson's One Nation.

⁶² Richard Eccleston, *The Thirty Year Problem The Politics of Australian Tax Reform*, Research Study No 42 (Australian Tax Research Foundation, 2004) 153–6.

⁶³ Ibid.

community.⁶⁴ Although the Democrats could not achieve an exemption for books generally, they did negotiate subsidies for textbooks. Assessed objectively, the outcomes were close to the 1981 stance of 'no tax on the necessities of life'. The 'New Tax System' bills were to come into effect from 1 July 2000, and they extended beyond the imposition of the GST to introduce new reporting and administrative requirements as well as a range of compensation measures.

Much has been written about the demise of the Democrats,⁶⁵ but ironically it was the party's ability to use its numbers to negotiate to moderate the GST that led to its decline. The GST deal is generally accepted as the point at which the Democrats political influence was at its greatest, but also the point from which the party's electoral decline commenced. Although there was only a minor drop in electoral support for the Democrats between 1998 and 2001, which was the first election after the implementation of the New Tax System measures, that election was the last at which a Democrat was elected to the Senate.

There were two major factors that affected the public perception of the Democrats after the GST negotiations. First, the electorate clearly perceived a change in the positioning in the political spectrum as the Democrats had not communicated clearly the commitment that the party took to the 1998 election: the policy to negotiate for a fairer tax policy was interpreted by sections of the electorate as a pledge to block the GST, and this was exploited by the opposition and the government who successfully portrayed the Democrats as being responsible for an inequitable and complex tax respectively.⁶⁶ Accordingly the involvement of the Democrats in negotiating the passage of the GST was interpreted as the party becoming a player in the system, contrary to the 'watchdog' role they had previously played.

This highlights the tension between the three constructs of mandate: in this instance the Democrats formal commitment was to review and moderate the legislation introduced, and they acted in accordance with this role; but the negotiation process established a partnership between the government and the Democrats. The voters interpreted the mandate differently to the party, leading to a breakdown of the relationship of trust that had developed over the previous 25 years.

Secondly, there was also unrest among the senators and party members, some of whom felt that the negotiated outcome was not consistent with the balloted party position. This culminated in a split within the party room with two senators voting against the GST,⁶⁷ and a lengthy period of leadership instability. This internal instability was arguably more significant in the electoral fortunes of the Australian Democrats,⁶⁸ coupled with the increasing profile of the Greens throughout Australia. Between 2001

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⁶⁴ John Howard, 'Letter to Meg Lees on the GST 22/06/1999' (1999) <<http://australianpolitics.com/1999/06/22/howards-commitments-to-meg-lees-on-the-gst.html>> accessed 28/03/2014.

⁶⁵ Scott Brenton, 'Policy traps for third parties in two-party systems: the Australian case' (2013) 51(3) *Commonwealth & Comparative Politics* 28; Anika Gauja, 'Evaluating the Success and Contribution of a Minor Party: the Case of the Australian Democrats' (2010) 63(3) *Parliamentary Affairs* 486; Don Chipp, *Keep the Bastards Honest* (Excelsior Press, 2004).

⁶⁶ Eccleston, above n 62, 157.

⁶⁷ Commonwealth, *Parliamentary Debates*, Senate, 28 June 1999, 6597 (Division).

⁶⁸ Chipp, above n 45 67–9.

and 2004 the senate vote collapsed dramatically from 7.25 per cent to 2.09 per cent, and no Democrat has been elected to any Australian parliament since the South Australian election the following year. Under the senate electoral system, with half of the Senate facing election every three years, the last Democrat senators gave their valedictory speeches in June 2008.⁶⁹

D 2009: Green Politics and Carbon Emissions

The final case study considers the role of the Greens in emission reduction policy. As the parliamentary representation of the Democrats declined, the number of Greens in the Senate increased. The Greens place a high priority on environmental policy, and accordingly claim a mandate to implement policies to control carbon emissions. In relation to the carbon tax, policy design was critical in negotiations.

During the last term of the Howard Government the government had an absolute majority in both houses of Parliament and did not need to negotiate legislation through the Senate. From 1 July 2008, following the election of the ALP Rudd Government in 2007, the Greens held five seats, the government held 32 seats and the opposition 37 with the remaining two seats held by Senator Nick Xenophon and Senator Steve Fielding of the Family First Party. Therefore to pass legislation the government needed the votes of all of the Greens and one of the two other senators.

Prior to the 2007 election the State Governments had commissioned a report into climate change, authored by Professor Ross Garnaut. The terms of reference required an analysis of the economic consequences of climate change,⁷⁰ and that the report be finalised by September 2008. In the time between the report being commissioned and finalised Kevin Rudd had been elected as Prime Minister and had ratified the Kyoto Protocol.

The Garnaut Report⁷¹ recommended that Australia implement an emissions trading scheme that would allow emissions trading permits to be traded on the developing international market. Part of the proceeds of the sale of permits would be applied to compensate low income earners who would bear part of the cost of the scheme. However if such a scheme was to be heavily compromised, Garnaut preferred a Pigouvian carbon tax. The Greens election policy favoured a 'polluter pays' emissions trading scheme with emission reduction targets,⁷² which was consistent with both ALP⁷³

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⁶⁹ The Democrats are still registered with the AEC, and continue to run candidates in federal and state elections.

⁷⁰ At <http://www.garnautreview.org.au/pdf/Garnaut_terms_of_reference.pdf>.

⁷¹ Ross Garnaut, *The Garnaut Climate Change Review* (Cambridge University Press, 2008).

⁷² Bob Brown and Christine Milne, 'IPCC Synthesis Report: Greens respond with comprehensive climate action plan' (18/11/2007) <http://pandora.nla.gov.au/pan/22488/200711260818/greens.org.au/election/downloads0/greens_1195426935.pdf>.

⁷³ ALP, 'Federal Labor's Clean Energy Plan To Help Tackle Climate Change' (14 Nov 2007) <pandora.nla.gov.au/pan/22093/20071124-0102/www.alp.org.au/media/1107/msloo143.html>.

and the Coalition⁷⁴ policies. Therefore it would seem that the implementation of such a scheme would be easily negotiated through Parliament.

The events that led to the defeat of the proposed *Carbon Pollution Reduction Scheme Bill 2009* (and associated Bills) have been detailed elsewhere.⁷⁵ Firstly, the original proposals were extremely broad, which mobilised industry stakeholders to secure major concessions, and communication strategies with the electorate were inadequate.⁷⁶ Based on the numbers in the Senate the government chose to firstly negotiate with the opposition to secure its support for the legislation at the time under the leadership of Malcolm Turnbull. Given the policies put forward during the campaign it seemed likely that a compromise could be reached, but within the Coalition party room there were a number of climate sceptics who had considerable influence, resulting in a change of leadership in the Coalition and the agreement that had been reached in relation to the legislation lapsed.

At this point the government entered into negotiations with the Greens however the positions of the various stakeholders could not be reconciled. In the third reading debate Senator Bob Brown stated that the core issue that the government would not negotiate was the targets for greenhouse gas reductions: the government target was 5 to 25 per cent; the Greens were seeking 25 to 40 per cent.⁷⁷ They also expressed concern over the extent of concessions to industry stakeholders. Accordingly the Greens voted against the legislation at the third reading, and the Bill was lost.

The package of bills was reintroduced the following February, and if rejected again could have been used as a trigger for a double dissolution. However by the middle of the year leadership instability within the ALP resulted in a change of Prime Minister. Following the 2010 election, in an exercise in second-best policy making, Julia Gillard introduced the *Clean Energy Future Bill 2010* which applied a Pigouvian style price on carbon emissions.

From a policy perspective the actions of the Greens in not passing the original Carbon Pollution Reduction Scheme was justifiable. It was in accordance with the policy that the party took to the election and the recommendations of the Garnaut Report⁷⁸ that preferred a carbon tax to a compromised emission trading scheme, and it appears that the stance taken in 2009 did not harm the party electorally. In the 2010 election the Greens vote in the Senate increased by 4 per cent to 13.11 per cent, and the party also elected a member of the House of Representatives.

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⁷⁴ Coalition, 'A Climate Resilient Future: A Clean Energy Plan for Australia' (2007) <<http://pandora.nla.gov.au/pan/22107/20071129-346/www.liberal.org.au/about/documents/CleanEnergy.pdf>>.

⁷⁵ See Ian Ward and Andrew Bonnell (eds), 'Special Issue: The Politics of Climate Change in Australia' (2013) 59(3) *Australian Journal of Politics & History* 331–500; Christopher Rootes, 'Denied, deferred, triumphant? Climate change, carbon trading and the Greens in the Australian federal election of 21 August 2010' (2011) 20(3) *Environmental Politics* 41; Ian Bailey et al, 'The fall (and rise) of carbon pricing in Australia: a political strategy analysis of the carbon pollution reduction scheme' (2012) 21(5) *Environmental Politics* 691.

⁷⁶ Bailey et al, above n 75.

⁷⁷ Commonwealth, *Parliamentary Debates*, Senate 30 November 2009, 9582, (Brown).

⁷⁸ Garnaut, above n 71.

Comparing the impact of the CPRS with the impact of the GST on the Democrats supports the thesis that the damage done to the Democrats was largely the result of the leadership instability that followed. In 2010 the leadership instability occurred in the Labor Party, and there was a significant electoral backlash against the ALP in the election that year resulting in a hung parliament in the House of Representatives as well as the Senate. Much of the increase in the Green vote at that election has been attributed to leakage from the ALP.⁷⁹ The instability continued through the term of the 43rd Parliament, allowing the opposition to campaign heavily on the negative aspects of the carbon tax, which was portrayed as a Labor-Greens initiative. In the 2013 election the Greens vote dropped to 8.65 per cent.

The incoming Abbott Government has now repealed the carbon tax. Although the position taken by the Greens was based on the ideals of the party and its own electoral mandate, the question remains: if the Greens had compromised to save the emissions trading scheme, what would the outcome have been? Although the Coalition would have still campaigned against the CPRS would such a campaign have been as effective as the campaign against the carbon tax, and could the Abbott Government claim it has a mandate to repeal the tax?

IV PROSPECTS FOR THE 44TH PARLIAMENT

The Coalition Government that was elected at the 2013 election campaigned on repeal of the carbon tax and the Mineral Rent Resources Tax (MRRT). It also instituted a Committee of Audit to review government expenditure, and has promised a tax review during the first term of government.

The *Minerals Rent Resources Tax Repeal and Other Measures Bill 2013* included the repeal of the associated spending measures, some of which were targeted to assist specific groups of recipients. The repeal bills came before the Senate before the changeover on 1 July 2014, and the ALP and Greens voted together to defeat the bills. Accordingly the government reintroduced the Bills and presented them to the Senate in the first sitting week of the new Senate.

The 2013 election was distinguished by the number of political parties that contested the senate election. Many of the 51 parties that contested the election campaigned on a single policy and made no statements regarding tax policy however 32.2 per cent of the vote was not directed to the ALP or the Coalition. Some of these micro-parties appear to have been formed in order to harvest preferences to be distributed to other parties, leading to commentary⁸⁰ that the system of voting in the Senate needs to be reformed.

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⁷⁹ Antony Green, *The Greens versus Labor — Geographic and Educational Dimensions* (10/09/2012) ABC <<http://blogs.abc.net.au/antonygreen/>>.

⁸⁰ Lenore Taylor, 'Liberal Party Director Flags Reform of Senate Voting After Rise of Micro Parties' (23 October 2013) <The Guardian <http://www.theguardian.com/world/2013/oct/23/liberal-party-director-flags-reform-of-senate>>.

The Senate election needed to be run again in WA⁸¹, and following that ballot the Senate is the most fragmented in Australian parliamentary history. The Greens are the largest voting group after the opposition, with ten senators, and as the Coalition does not have an absolute majority in the Senate, with 33 votes, the Greens have the balance of power to pass government legislation. If neither the Greens nor the ALP support government legislation, the government needs the support of at least six of the remaining eight senators. Of these, four have had no previous parliamentary experience, including the three new senators from the Palmer United Party (PUP). The Liberal Democratic Party (LDP) supports lower taxes, so could be assumed to be amenable to the government agenda — but the Democratic Labor Party's Senator John Madigan (DLP) has said that he will not support the removal of benefits to families and businesses.⁸² The Australian Motoring Enthusiast Party, with one senator elected from Victoria, has entered an alliance with PUP, agreeing to work together where practical but reserving the right not 'to vote for legislation that is against his or her party's policies and principles, or against their conscience',⁸³ thus the position of the PUP with four votes will be critical but does not give PUP the sole balance of power to either block or pass legislation.

The PUP tax policy, as taken to the election, supported the repeal of the carbon tax and the MRRT. Other tax policies that PUP advocate include the abolition of quarterly PAYG instalments by companies, and tax deductibility for interest on home loans. It is difficult to see how these policies can be accommodated in future budget negotiations.

The *Clean Energy Legislation (Carbon Tax Repeal) Act 2014* was passed on the 17th July 2014, but the PUP support for the repeal of the MRRT was not unconditional. Although the party supported the repeal of the tax, it did not support the removal of three of the associated measures included in the repeal bill: the Low Income Superannuation Contribution, the income support bonus and the schoolkids bonus, each of which assists low income earners. The Senate amended the MRRT Repeal Bill on 17th July to excise these measures, and returned the Bill to the House of Representatives.

At this stage it is not clear whether the PUP will apply a coherent policy framework across the legislative program, or whether it will adopt a populist agenda, responding to legislation on an ad hoc basis, based on public opinion.⁸⁴ Accordingly the government is facing difficulties in negotiating legislation through the Senate in the 44th Parliament. If it cannot obtain the support of the opposition it will need to negotiate with the Greens, who apply a policy framework that is frequently unsympathetic to the government; PUP who have not yet demonstrated whether they can reach an agreement and whether it

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⁸¹ Due to the loss of 1370 votes between the original count and a recount, the Court of Disputed Returns ordered that a new election should be held. That election was held on 5 April 2014.

⁸² Phillip Coorey, 'Senators wary of cuts tied to mining tax repeal' (26/10/2013) *The Australian Financial Review* <http://www.afr.com/p/national/senators_wary_of_cuts_tied_to_mining_nxE3nngrYqHwQsd3tr2MPI>.

⁸³ Palmer United Party, 'Memorandum of Understanding between the Australian Motoring Enthusiast Party and the Palmer United Party' (6 October 2013) <http://australianpolitics.com/downloads/palmer-united-party/2013/13-12-30_mou-pup-amep.pdf (accessed 30/3/2014)>.

⁸⁴ David Denemark and Shaun Bowler, 'Minor parties and protest votes in Australia and New Zealand: locating populist politics' (2002) 21(1) *Electoral Studies* 47.

will be based on policy ideals or pragmatism; and individual senators who may have different demands based on disparate policy goals.

V CONCLUSIONS

The role of the minor parties on tax legislation can be separated into two types of influence: process and policy. In the first two case studies their influence was on the design and constitutional validity of the legislation as well as the underlying policy principles, consistent with the development of the Senate as a house of review over the two decades following the dismissal of the Whitlam Government. The 1975 constitutional crisis provoked a rethink of the role of the Senate in relation to legislative review, particularly the limitations on supply bills. In 1981 the form of the legislation could have caused the supply bills to be invalid, but the question was not resolved until the 1993 budget when the Legal and Constitutional Affairs Committee requested that the Bills be split to avoid constitutional concerns.⁸⁵ Although the High Court was not asked to rule on the matter, tax legislation since 1993 has been drafted in accordance with the opinion expressed by the Committee.

In all four cases examined here, the minor parties have acted from an ideological basis in seeking modifications that were in accordance with their policy manifesto. In the first three cases, which dealt directly with tax legislation, the goal was to seek a fairer distribution of the tax burden. The minor parties were concerned over the equity of consumption taxes and the debate can be seen as one of trade-offs between efficiency and equity. The final case study did not deal with purely fiscal legislation, but the use of taxes and markets to mitigate a negative externality — carbon emissions — and can be seen as an example of negotiations between stakeholders that have different policy mandates.

In Australia it appears that the electorate now accepts that parties elected to the Senate can have a specific mandate on particular issues, and that mandate extends beyond the review function. The first significant negotiation between the government and the minor parties on tax legislation was in 1993: in 1981 the failure to negotiate resulted in the legislation failing. It is at this point that the trade-off between ideals and pragmatism becomes electorally risky for the minor parties. As long as minor parties are negotiation within the terms of their mandate, and can communicate this to voters, they can maintain their influence in the Senate through the electoral process. This requires the parties to assess the point at which the political pragmatism of accepting second best, negotiated, solutions becomes unjustifiable.

Where measures are politically unpopular — as is frequently the case with tax measures- electors do not differentiate between the review function and the ability to negotiate as equal partners within their mandate. The review function restrains the government from exceeding its own mandate while the minor party pursues its own electoral mandate.

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⁸⁵ Laing, above n 9 385–6.

Electoral danger to minor parties can arise when negotiating with the government as a partner in the policy process. If the outcome is seen as beyond the scope of the mandate bestowed upon it by the electorate, the senators are exposed to electoral backlash and vulnerable to political manoeuvring against them by the government and the opposition.

Arguably the Democrats crossed that line when negotiating the GST as they were unable to maintain consensus within the party, resulting in confusion in the electorate over what the party actually stood for, resulting in their electoral decline. In contrast, in 2009 the Greens maintained their stance against the flawed ETS and accepted the second-best option of the carbon tax, while the ALP was seen to be in disarray. Their vote declined in the most recent election but it is too soon to say whether this is more than a normal fluctuation in the electoral cycle and with ten senators they will remain influential for at least the next two Parliaments.

Ultimately, unless there are significant changes to the Senate electoral system it is likely that governments will continue to need the support of minor parties to pass tax legislation, ranging from Budgets to more complex policy issues that involve tax design; potentially resulting in second-best solutions that could compromise the effectiveness of the policy.

APPENDIX

COMMONWEALTH OF AUSTRALIA CONSTITUTION ACT

SECTION 53 Powers of the Houses in respect of legislation

Proposed laws appropriating revenue or moneys, or imposing taxation, shall not originate in the Senate. But a proposed law shall not be taken to appropriate revenue or moneys, or to impose taxation, by reason only of its containing provisions for the imposition or appropriation of fines or other pecuniary penalties, or for the demand or payment or appropriation of fees for licences, or fees for services under the proposed law.

The Senate may not amend proposed laws imposing taxation, or proposed laws appropriating revenue or moneys for the ordinary annual services of the government.

The Senate may not amend any proposed law so as to increase any proposed charge or burden on the people.

The Senate may at any stage return to the House of Representatives any proposed law which the Senate may not amend, requesting, by message, the omission or amendment of any items or provisions therein. And the House of Representatives may, if it thinks fit, make any of such omissions or amendments, with or without modifications.

Except as provided in this section, the Senate shall have equal power with the House of Representatives in respect of all proposed laws.

SECTION 54 Appropriation Bills

The proposed law which appropriates revenue or moneys for the ordinary annual services of the government shall deal only with such appropriation.

SECTION 55 Tax Bill

Laws imposing taxation shall deal only with the imposition of taxation, and any provision therein dealing with any other matter shall be of no effect.

Laws imposing taxation, except laws imposing duties of customs or of excise, shall deal with one subject of taxation only; but laws imposing duties of customs shall deal with duties of customs only, and laws imposing duties of excise shall deal with duties of excise only.

SECTION 56 Recommendation of money votes

A vote, resolution, or proposed law for the appropriation of revenue or moneys shall not be passed unless the purpose of the appropriation has in the same session been recommended by message of the Governor-General to the house in which the proposal originated.

SECTION 57 Disagreement between the houses

If the House of Representatives passes any proposed law, and the Senate rejects or fails to pass it, or passes it with amendments to which the House of Representatives will not agree, and if after an interval of three months the House of Representatives, in the same or the next session, again passes the proposed law with or without any amendments which have been made, suggested, or agreed to by the Senate, and the Senate rejects or fails to pass it, or passes it with amendments to which the House of Representatives will not agree, the Governor-General may dissolve the Senate and the House of Representatives simultaneously. But such dissolution shall not take place within six months before the date of the expiry of the House of Representatives by effluxion of time.

If after such dissolution the House of Representatives again passes the proposed law, with or without any amendments which have been made, suggested, or agreed to by the Senate, and the Senate rejects or fails to pass it, or passes it with amendments to which the House of Representatives will not agree, the Governor-General may convene a joint sitting of the members of the Senate and of the House of Representatives.

The members present at the joint sitting may deliberate and shall vote together upon the proposed law as last proposed by the House of Representatives, and upon amendments, if any, which have been made therein by one house and not agreed to by the other, and any such amendments which are affirmed by an absolute majority of the total number of the members of the Senate and House of Representatives shall be taken to have been carried, and if the proposed law, with the amendments, if any, so carried is affirmed by an absolute majority of the total number of the members of the Senate and House of Representatives, it shall be taken to have been duly passed by both Houses of the Parliament, and shall be presented to the Governor-General for the Queen's assent.

THE MEANING OF 'MARKET VALUE' IN AUSTRALIA'S *INCOME TAX ASSESSMENT ACT 1997*

NICHOLAS AUGUSTINOS*

ABSTRACT

The article examines the use of the term 'market value' in certain sections of Australia's *Income Tax Assessment Act 1997*. It highlights the significant disparity which potentially arises between the hypothetical market context, which established legal principle suggests should be applied to market value determinations, and real-world market scenarios faced by taxpayers. As shown by the court and tribunal decisions examined in the article, inconsistency exists as to the extent to which market forces operating in the real world impact upon market value determinations. As a result, there is an absence of clear guidance from the courts and the Administrative Appeal Tribunal (AAT) on a key issue — how market factors faced by taxpayers in the actual market in which they engage should feed into the assumptions underlying the hypothetical market by which market value determinations are made. This is the source of significant uncertainty and confusion for taxpayers. The article sheds some light on this problem and suggests a possible solution.

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I INTRODUCTION

This article examines the use of the term ‘market value’ in certain sections of Australia’s *Income Tax Assessment Act 1997* (ITAA97). Although this term is used in a number of sections in the Act, the Act does not provide a sufficient definition of what the term actually means. The result is that interpretation of the term is open to dispute between the Australian Taxation Office (ATO) and taxpayers, leading to uncertainty in the enforcement of Australian taxation law.

The article focuses on the use of the term in the capital gains tax provisions (ss 110-25(2)(b) and 116-20(1)(b)), the trading stock provisions (ss 70-30 and 70-90) as well as in the application of the CGT small business relief concession in Division 152 (especially s 152-20(1)). It examines the guidance that might be obtained on the interpretation of the term from various court and Administrative Appeal Tribunal (AAT) decisions as well as from the ATO itself.

A number of questions arise. In determining ‘market value’, do we consider a seller’s market or a buyer’s market? Do we consider the group price which is set when a number of products are sold together or do we apply an individual product price? What about the retailer setting the price — do we take into account the price that might be offered by a new retailer entering the market or do we apply the price set by an established retailer? These are some of the questions which taxpayers have had to grapple with without clear guidance from the Act. This article attempts to shed some light on these questions.

In doing so, the analysis conducted in this article reveals that a significant disparity potentially arises between the hypothetical market context which established legal principle suggests should be applied to market value determinations and real-world market scenarios faced by taxpayers. As shown by the court and tribunal decisions examined in this article, inconsistency exists as to the extent to which market forces operating in the real world impact upon market value determinations. As a result, there is an absence of clear guidance from the courts and the AAT as to the way in which real-world market factors faced by taxpayers should be taken into account in the hypothetical market by which market value determinations are made. This is the source of significant uncertainty and confusion for taxpayers.

This article therefore argues for a clearer statement of principle from the courts and the AAT on the connection which should be made between the hypothetical market applied to market value determinations and the actual market faced by the taxpayer. The article also points out that, in order for the courts and the AAT to be in a position to do so, it may be necessary for statutory valuation principles to be incorporated into the ITAA97.

II LEGISLATIVE CONTEXT

Section 110-25(2)(b) of the ITAA97 concerns the first element of cost base of a CGT asset and the way in which that element is determined when property instead of money is given in order to acquire the relevant asset. According to the section, one must work out the market value of that property at the time of acquisition.

Section 116-20(1)(b) concerns the determination of the capital proceeds received by a taxpayer for a CGT event when property instead of money is received. According to the section, one must work out the market value of that property at the time of the CGT event.

Both sections envisage that the relevant property that is given or received has a monetary value to be determined as if that property had been traded on a market applicable to that property at the time of acquisition or at the time of the CGT event. No guidance is given in the legislation as to the features of that market.

Section 70-30 triggers a notional transaction for the taxpayer when that taxpayer starts to hold as trading stock an item that the taxpayer already owns. Under this notional transaction, the taxpayer is treated as if, just before the item became trading stock, the taxpayer had sold the item to someone else (at arm's length) and immediately bought it back for its cost or market value (whichever the taxpayer elects). This monetary amount is normally a general deduction under s 8-1 as an outgoing in connection with acquiring trading stock. The amount is also taken into account in working out the item's cost for the purposes of s 70-45 (which concerns valuing trading stock at the end of the income year).

Section 70-90 specifies that, if a taxpayer disposes of an item of trading stock outside the ordinary course of business that the taxpayer is carrying on and of which the item is an asset, then the assessable income of the taxpayer includes the market value of the item on the day of disposal.

Once again, under the abovementioned trading stock provisions, it is envisaged that, at the time of holding the relevant item as trading stock or at the time of disposal, a monetary value for the item of trading stock is determined as if the item had been traded on a market. The characteristics of that market are not specified.

Finally, some mention should also be made of the application of the CGT small business relief concession in Division 152. Under s 152-10(1)(c)(ii), a capital gain which a taxpayer makes in respect of the occurrence of CGT event in relation to a CGT asset of the taxpayer, may be disregarded if the taxpayer satisfies the maximum net asset value test. By means of s 152-20(1), the sum of the market values of the assets of the taxpayer is taken into account when conducting the test. Despite the fact that the taxpayer does not actually dispose of or exchange any assets, the application of the test involves some consideration of the value the taxpayer would have received if the taxpayer's assets had been individually traded on a market.¹

From the above discussion it can be seen that it is only in the case of the operation of s 70-90 that a possibility exists of a monetary price being received in connection with an actual sale. In determining whether that monetary price was at market value, the

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¹ Section 152-20(1) uses the words 'the sum of the market values of those assets'. Similar wording is also used in s 855-30(2) concerning the application of the 'TARP' test. The operation of s 855-30(2) was recently considered by the Federal Court in *Resource Capital Fund III LP v FCT* [2013] FCA 363. Edmonds J (at [94]-[97]) confirms the view that the test applies on an individual asset basis (and does not contemplate the value the taxpayer would have received if all of the taxpayer's assets had been traded together on a market on a going concern basis).

relevant enquiry will be to determine the extent to which the actual circumstances underlying the transaction conform to the hypothetical market context traditionally applied by the courts to determine market value. In particular, it will be necessary to determine whether the seller and buyer were willing, not anxious and properly informed arm's length parties.²

In the case of the operation of all the other sections mentioned above, no monetary price as such is received. Either property is exchanged for property (ss 110-25(2)(b) and 116-20(1)(b)) or the taxpayer maintains ownership of the relevant property and no actual exchange takes place (ss 70-30 and 152-20(1)). Nevertheless, despite the absence of some monetary price, the relevant sections call for an assessment to be made of that property's market value. As mentioned above, this presupposes that some assessment be made as to the monetary price that would have been received had the property been traded (notionally) on some form of market. The precise terms of the operation of that market are not specified. According to extensive case authority, in this instance, it may be useful to consider the price at which that asset or a comparable asset was sold either before or after the relevant date in an arm's length dealing. Unless there are exceptional circumstances, such a sale price will be a good indicator of market value in the hypothetical market place traditionally applied by the courts to determine market value.³

The next part of this article will examine the way the abovementioned 'gaps' in the legislation are filled in by the courts. In particular, it will examine the way the courts determine the general features of the hypothetical market in which the notional trades referred to above are considered to have occurred.

III GENERAL PRINCIPLES

The relevant question to be asked in determining the market value of an asset is 'what would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?'⁴ This was expanded on by Isaacs J, who stated that:

to arrive at the value of the land at that date, we have ... to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land and cognisant of all circumstances which might

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² Bernard Marks, 'Valuation Principles in the Income Tax Assessment Act' (1996) 8 *Bond Law Review* 114, 130.

³ *Syttadel and Holdings Pty Ltd v Commissioner of Taxation* [2011] AATA 589; *McDonald v The Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231, 238; *Cordelia Holdings Pty Ltd v Newkey Investments Pty Ltd* [2004] FCAFC 48, [128]; *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73, [31]; *Psarreas v Secretary, Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670, [27]; *Kirkovski v Secretary, Department of Family and Community Services* [2004] FCA 790, [8]; *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234, [26]; *Orica Ltd v Commissioner of Taxation* [2010] FCA 197.

⁴ *Spencer v the Commonwealth of Australia* (1907) 5 CLR 418, 432.

affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood as then appearing to persons best capable of forming an opinion, of a rise or fall for what reasons so ever in the amount which one would otherwise be willing to fix as to the value of the property.⁵

It appears then that the hypothetical market context to be applied to the determination of market value involves a notional one-to-one transaction between a single buyer and a single seller. This principle is not only confirmed by *Spencer*. In the High Court case of *Abrahams v FCT* it was held that the applicable 'value' (for estate duty purposes) was 'the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay ... if the vendor and purchaser had got together and agreed on a price in friendly negotiation'.⁶ In addition, in the High Court case of *Commissioner of State Revenue (Vic) v Pioneer Concrete (Vic) Pty Ltd* it was held that, in determining the applicable 'value' (for stamp duty purposes), 'there is no warrant, either in the language of the statute or in principle, for departing from the hypothetical inquiry as to the point at which a desirous purchaser and not unwilling vendor would come together'.⁷ Similarly, in *Case 2/99* the AAT held that the best evidence of market value was what parties dealing at arm's length, at the conclusion of business negotiations, have themselves agreed upon.⁸

The value of the asset must be determined by considering its optimal value, where the asset is used for its 'highest and best use'. This principle has been confirmed in a number of case and tribunal decisions.⁹

The result of these considerations is that the actual sale price may not necessarily inform the market value of the asset where there is a disparity in the bargaining power of the buyer and seller, or where the asset is being valued considering a use other than its highest and best use.¹⁰

When there are buyers who are willing to pay more for an asset than its intrinsic value there is the issue as to how to deal with these special buyers. The value which they are willing to pay includes some 'special value' which is the additional value a purchaser is prepared to pay and may reflect many factors including economies of scale, reduction in competition, securing of a source of supply or outlet for products and additional value which is unique to the purchaser.¹¹

How to deal with these purchasers in Australia is not entirely clear. One decision held that all possible purchasers be taken into account, even a purchaser prepared for his own reasons to pay a fancy price.¹² A question also arises as to whether the purchaser

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⁵ Ibid 441.

⁶ (1944) 70 CLR 23, 29 (Williams J).

⁷ (2002) 209 CLR 651, 667.

⁸ 99 ATC 108, 132.

⁹ *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73; *Marion Elizabeth Collis v Federal Commissioner of Taxation* 96 ATC 4831; *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269.

¹⁰ This issue is explored in further detail below in Part V.

¹¹ Marks, above n 2, 135.

¹² *Brisbane Water County Council v Commr of Stamp Duties* (NSW) [1979] 1 NSWLR 320, 324.

who pursues the special market value would make a bid which reflects that complete value or whether he or she would bid just enough to outbid those interested purchasers for whom the asset had no special value. Marks points out that the 'one more bid' contention on the part of the special purchaser has been considered but rejected in both taxation and compulsory acquisition cases.¹³

These then are the key assumptions underlying the hypothetical market which is applied by courts to market value determinations. It is apparent, however, that these assumptions may have no grounding whatsoever in the actual real-world markets in which taxpayers operate. The question therefore arises — does the construction and application of this hypothetical market place allow for any input from the real world of the taxpayer?

It is submitted that the answer to this question is not entirely evident from the cases. Various principles have been stated in the cases, but these do not draw a clear picture of the connections to be made between actual markets and the market value hypothetical.

First, in *Commissioner of State Revenue (Vic) v Pioneer Concrete (Vic) Pty Ltd*¹⁴ it was stated that 'it follows that the exercise required by par (B) is a determination of the amount for which such an estate might reasonably have been sold if it had been sold, free from encumbrances, in the open market on the date of the sale'. The High Court did not, however, provide an explanation as to the features of this 'open market' and its connection to the actual market that would ordinarily be faced by the taxpayer. Similarly, in *Brisbane Water County Council v Commissioner of Stamp Duties (NSW)* it was held that market value is 'the best price which may reasonably be obtained for the property to be valued if sold in the general market'.¹⁵ These comments suggest that we are called upon to apply a wide and general market rather than a specialised market in which the best possible price might be limited. While this helps to shed further light on the circumstances applying on the demand side of the market, the supply side of the market is left unclear. Are we entitled to consider the possibility of a number of sellers in the market chasing a few purchasers?

Case authority in fact suggests that the demand side of the market will be consistent with real-world demand. This understanding is supported by the UK case of *Estate of Lady Fox v IR Commrs* [1994] STC 360, where Hoffman LJ held that, while the hypothetical seller was anonymous the 'hypothetical buyer is slightly less anonymous' and that he 'reflects reality in that he embodies whatever was actually the demand for that property at the relevant time'.¹⁶ This understanding has not been consistently applied in Australian cases.¹⁷

The understanding that we consider the 'open' or 'general' market when determining market value and that we do not consider the operation of a specialised market in which a taxpayer might trade does not have application in all circumstances. The terms of a particular legislative provision may in fact require that we refer to a specialised market

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¹³ Marks, above n 2, 158.

¹⁴ (2002) 209 CLR 651, 667.

¹⁵ [1979] 1 NSWLR 320, 324.

¹⁶ [1994] STC 360, 372.

¹⁷ As shown in the discussion in Part V.

when determining market value. This appears to be the case when interpreting trading stock provisions. There is a line of case authority which suggests that when dealing with the valuation of stock, we look to the actual market that would ordinarily be engaged by the taxpayer for guidance. For instance, in *Australasian Jam Co Pty Ltd v FCT* it was held by Fullagar J of the High Court¹⁸ that

it is not to be supposed that the expression 'market selling value' contemplates a sale on the most disadvantageous terms conceivable. It contemplates, in my opinion, a sale or sales in the ordinary course of the company's business — such sales as are in fact effected. Such expressions in such provisions must be interpreted in a commonsense way with due regard to business realities, and it may well be — it is not necessary to decide the point — that, in arriving at market selling value, it is legitimate to make allowance for the fact that normal selling will take place over a period.

Similarly, in *BSC Footwear Ltd v Ridgway* the House of Lords held that 'market value' means the price at which the stock could be expected to be sold in the market in which the trader sold; in the case of a retail trade that market must be the retail market.¹⁹

The valuation of stock and the connections which apply between the hypothetical market and the taxpayer's actual market were also considered by the AAT in the case of *NT1997/305 v Commissioner of Taxation*.²⁰ Senior Member Block conducted an examination of relevant authorities including the cases of *Inland Revenue NZ v Edge* (1956) 11 ATD 91, *Case J43 9 T.B.R.D.* (Commonwealth Taxation Board of Review No. 1), and *Charrington & Co Ltd v Wooder* (1914) AC 71. Based on these authorities, Senior Member Block applied two key principles to the market value determination.²¹ Firstly, the appropriate market was the market in which the goods would normally be sold. Secondly, market value was to be determined in the light of the circumstances under which a particular sale takes place.

While this line of authority may require a distinction to be drawn in certain circumstances between the open/general market and the particular market engaged by the taxpayer, there is a lack of clarity, however, as to the next step to be made after considering this particular market. Are we somehow called upon to 'graft' onto that market the various hypothetical assumptions mentioned in *Spencer* and to make a theoretical market value determination? The cases suggest that real-world market factors do have a role to play in the hypothetical market exercise conducted by the courts when determining market value. While this role is asserted in general terms, the precise nature of the role is left unclear.²²

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¹⁸ (1953) 88 CLR 23, 31.

¹⁹ [1972] AC 544, 545.

²⁰ [1999] AATA 130.

²¹ *Ibid* [21]-[22].

²² Waddell J of the NSW Supreme Court put forward his own view in *Brisbane Water County Council* as to how the line of authority concerning market value determination in a particular market might be reconciled with that authority concerning market value determination in a general market. At p 326 of his judgment, Waddell J draws a distinction between price and value. In his view, the particular market authorities concern the determination of market price in a particular market for the purposes of a legislative provision. This is to be distinguished from determinations of 'value' which 'points to something inherent in the item in question, rather than to the price at which it might change hands in particular circumstances. It may be more difficult to read 'market value' as meaning value in a particular market.'

This view is also supported by comments made in the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*. In paragraph 10.77 of that Memorandum it is pointed out that, in working out market value, the courts will make appropriate assumptions about the market in question. These assumptions can be affected by the actual transaction under consideration. For example a large volume of goods sold could be expected to attract a discount. Each item would have a lower market value in such a situation than if it had been sold alone. Apart from this example, however, the Memorandum does not provide much detail on how circumstances underlying actual transactions under consideration will impact upon the hypothetical market assumptions.

We therefore have limited guidance from Parliament, the courts and the AAT as to how real-world market factors impacting on taxpayers feed into the hypothetical market assumptions which underlie market value determinations. This understanding becomes particularly apparent when Australian case authority is examined in the context of certain specific real-world market scenarios.

The final point to be made in this part of the article concerns the jurisprudential origins and applications of the abovementioned general principles concerning the determination of market value. The *Spencer* case concerned the compulsory acquisition of property by government. The test in *Spencer* has also been applied in cases of state probate and succession duty, federal estate duty, land tax, and has long since been assumed to apply to the valuation of property for state stamp duties.²³ It has also been applied in cases concerning the application of assets tests in the context of social security and pension entitlements.²⁴ The courts have consequently intermixed valuation precedents from a variety of statutes into a single body of valuation jurisprudence, regardless of whether the relevant term has been 'value' or whether it has been qualified by the terms 'market', 'fair market' or 'open market'.²⁵ Principles derived from statutory interpretation conducted by the courts of a number of different statutes have all been stirred together in the same pot. Given, however, the confusion which this situation has generated for taxpayers, it may be necessary for clear and separate statutory valuation principles to be incorporated into the ITAA97.

IV VIEW OF THE AUSTRALIAN TAXATION OFFICE

The ATO's website provides a guide to taxpayers and their advisers (including valuers) on the processes to be followed when establishing market value for taxation purposes.²⁶

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²³ Marks, above n 2, 121.

²⁴ *Re Jack Woodhouse and Joyce Woodhouse v Secretary Department of Social Security* [1987] AATA 73; *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234; *Kirkovsky v Secretary Department of Family and Community Services* [2004] FCA 790; *Psarreas v Secretary Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670; *Evans v Secretary Department of Social Security* [1993] AATA 497; *Blaszczyk v Secretary Department of Family and Community Services* [2005] AATA 1224.

²⁵ Marks, above n 2, 118.

²⁶ Australian Taxation Office *Market Valuation for Tax Purposes* (23 June 2014) <<http://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/Market-valuation-for-tax-purposes/>>.

The ATO's market valuation guidelines are also discussed by Churchill and Sammut.²⁷ This part of the discussion will briefly examine the relationship between the ATO guidelines and the general principles discussed in Part III above, and identify those particular approaches of the ATO which relate to key issues and themes considered further in parts V and VII below.

Under the heading 'What "market value" means', the ATO emphasises that the meaning of the term 'will depend on its statutory context' and that 'in each instance you need to take into account the context in which the term is used, and pay particular attention to its definition and any specific requirements in that context.' Although this approach to the interpretation of 'market value' where used in the ITAA97 is strictly correct, it ignores the point made in Part III above that, in reality, the courts have intermixed valuation precedents from a variety of statutes into a single body of valuation jurisprudence.

Under the same heading, the ATO then proceeds to state that 'business valuers in Australia typically define market value as the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length.' Reference is also made to the way 'value' is described in the International Valuation Standards. While these comments are helpful, the ATO fails to clarify why the approach taken by valuers to the interpretation of market value is relevant to the statutory interpretation exercise which needs to be conducted in the context of the ITAA97. To what extent are the understandings of the valuers which the ATO refers to grounded in Australian judicial interpretation of the ITAA97? Are these standards perhaps being developed and applied by representative professional bodies to which valuers belong in a manner which does not precisely reflect and adapt to developments in established Australian legal principle?²⁸

Under the heading 'Judicial Interpretation', the ATO quotes the same judgment extracts from *Spencer* as are referred to in Part III above. From *Spencer*, the ATO in fact derives the following general principles concerning the interpretation of market value:

- the willing but not anxious vendor and purchaser;
- a hypothetical market;
- the parties being fully informed of the advantages and disadvantages associated with the asset being valued (in the specific case, land); and
- both parties being aware of current market conditions.

The last bullet point mentioned above requires further examination. It was shown in Part III that case law suggests that the demand side of the hypothetical market will be consistent with real-world demand. The supply side of the market is left unclear. The ATO appears to be of the view, however, that both should reflect real-world

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²⁷ Michael Churchill and Kalem Sammut, 'ATO market valuation guidelines: risky business' *Taxation in Australia* November 2013, 272.

²⁸ This issue is explored in more detail in Part VII.

circumstances and that both assumed actors in the hypothetical market by which market value is determined should be treated as being aware of these current circumstances. The precise basis on which this understanding is extracted from *Spencer* is not made clear by the ATO. In addition, as was mentioned in Part III, the understanding that the hypothetical buyer embodies current real-world demand has not been consistently applied in Australian cases.

The ATO's market valuation guidelines, as published on the ATO's website, also provide specific guidance on the processes which should be adopted when determining market value in the hypothetical market. One of the key processes highlighted by the ATO is based on the understanding that the assumed actors in the hypothetical market should be transacting on the basis of the relevant asset's 'highest and best use'. Under the heading 'Highest and best use' the ATO points out that:

you should assess market value at the 'highest and best use' of the asset as recognised in the market. The concept of 'highest and best use' takes into account any potential for a use that is higher than the current use. The current use of an asset may not reflect its optimal value. Optimal value is defined by the IVSC as: ...the most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

Consideration of an asset's 'highest and best use' raises an important question. Given that, in determining market value, we are to conduct a hypothetical transaction between assumed market actors with knowledge of the relevant asset's 'highest and best use', what is the relationship that should apply between that use and real-world market forces? Must there be actual demand for the highest and best use in the real world in order for it to be reflected in market value? Or is this a mere theoretical demand which underpins the abovementioned hypothetical transaction? The extract from the ATO's website quoted above mentions that the highest and best use must be 'as recognised in the market'. This suggests that, in the ATO's view, the demand for highest and best use is not merely theoretical but that it must be backed up by actual demand for this use in the relevant real-world market. There is, however, contradictory case authority on this issue.²⁹

Another procedural matter concerns the effect which the existence of 'special value' for a market participant should have on the determination of market value. According to the ATO's website, under the heading 'Special Value':

It is sometimes argued that an asset has special value to a particular buyer. Usually this is not relevant in deriving market value. Where there is clear evidence that the special value is known or available to the wider market, this would be reflected in an objective valuation of the asset. However, even where the seller knows that you value the item in a special way, this usually only means that the item will sell (and the market value will be) at the higher end of the usual market value range. On the other hand, if two or more hypothetical purchasers were assumed to exist, both having a special use for the item, the special value may be reflected in the market value.

The general principles applying to the determination of market value when a special purchaser is active in the relevant market were considered in Part III above. The

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²⁹ As shown in Part V below.

abovementioned views of the ATO appear to be an acceptance of the 'one more bid' approach, namely, that the presence of the special purchaser in the market should not have a significant upward influence on the determination of market value because, rather than making a bid which fully reflects the special value, all that the special purchaser would do is to bid just enough to outbid those interested purchasers for whom the asset had no special value. It was shown in Part III that this understanding has been rejected by case authority. Even if one special-value buyer is assumed to exist in the hypothetical market, the seller would hold out and would not sell to that buyer until an offer was made which reflected the special value.³⁰

A further procedural matter concerns the determination of market value at times where there are major fluctuations in equity markets or the economy. On its website, under the heading 'Prospective Market Value', the ATO points out that, because of the effect of economic fluctuations and other market changes, it does not rule prospectively on market value if there is no reliable method for approximating the market value at the future time. The commentary under this heading in fact makes clear that the ATO makes a determination after the event giving rise to the market value has occurred. The commentary suggests that this post-event determination will take into account the effect of any underlying economic fluctuations. This approach, however, potentially conflicts with case authority suggesting that market value determinations are to be made on the basis of a stable market in which major economic fluctuations in the economy are ignored.³¹

A final point to be made in this part of the discussion concerns the comments made by the ATO on its website under the heading 'Who may undertake a market valuation?' According to the ATO, 'except for the most straightforward valuation processes, valuations undertaken by persons experienced in their field of valuation would be expected to provide more reliable values than those provided by non-experts.' This comment clearly places the onus on the taxpayer to utilise the services of experienced valuation experts when making market value submissions — a process that imposes significant administrative cost on the taxpayer. This administrative cost is further exacerbated by the fact that in court and tribunal proceedings examining market value determinations, it is the taxpayer who carries the burden of proving the unreliability of the Commissioner's valuation.³²

V SCENARIOS FOR CONSIDERATION

The next part of this article will examine the likely determinations of market value to be made when the real-world market in which the taxpayer operates is characterised by certain specific scenarios.

The first scenario is that of a 'buyer's market'. Such a market would exist when there are many sellers willing to sell the property but few willing buyers. Should this real-world feature of the market be allowed to impact upon the determination of market value?

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³⁰ Refer to discussion of *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73 in Part V below.

³¹ Discussed in Part V below.

³² This issue is explored in more detail in Part VII below.

The second scenario is similar to the first but considers the reverse side of the coin — a ‘seller’s market’. This would be one where there are few sellers willing to sell but many willing buyers. Does the concept of ‘market value’, as applied by the courts and the AAT, take into account this supply/demand equation?

The third scenario considers the question of how market value is to be determined when in the real world applicable to the taxpayer the relevant property is ordinarily traded on a ‘group discount’ basis. Do we apply the discounted group price in determining market value or do we set an individual product price which does not take into account the volume discount?

The fourth scenario examines the final question raised in the introduction to this article — should the identity of the seller (whether an established market player or new seller keen to enter a market) be allowed to impact upon the market value determination?

A Scenarios 1 and 2 — Buyer’s Market/Seller’s Market

Ordinarily, the market price of an item reflects the price point at which demand meets supply. Therefore, one would expect a higher market value to apply in a seller’s market and a lower market value to apply in a buyer’s market.

There is, however, conflicting authority on the question of whether effect should be given to the interplay of real-world market supply and demand forces when determining market value.

On the one hand, Isaacs J’s comment in *Spencer* refers to the ‘then present demand for land’.³³ This implicitly suggests that the contemporaneous state of demand at the time of valuation should be taken into consideration when determining market value. This view is also supported by the *Estate of Lady Fox* case. In addition, cases such as *BSC Footwear, Edge* and *NT1997/305* all suggest that (especially in the case of trading stock valuations) market value is to be determined in light of the particular circumstances under which a particular sale takes place. On the basis of these authorities one could conclude that if the normal market in which the taxpayer would trade the relevant asset is affected by market factors such as those pertaining to a buyer’s market or to a seller’s market, then these factors are to be given effect in the market value determination.

On the other hand, it would appear that these understandings were not applied by the AAT in the case of *BHP Australia Coal v Federal Commissioner of Taxation*.³⁴ In that case, the AAT was required to determine the market value of the housing fringe benefits provided by the taxpayer to its employees. The taxpayer provided housing for its mining workers in a variety of towns, including that of Emerald. The AAT agreed with the taxpayer that in Emerald, normal demand conditions for housing did not exist as a result of the electrification of the railway and the construction of the TAFE College. Accordingly, the AAT found that, due to these factors, rental market demand in Emerald was temporary inflated and consequently disregarded market prices when determining

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³³ (1907) 5 CLR 418, 441.

³⁴ [1993] AATA 156.

the market value of the housing fringe benefit.³⁵ Figures from markets where normal supply and demand conditions were in operation were applied.³⁶

This approach was also followed in the AAT decision of *Marion Elizabeth Collis v Federal Commissioner of Taxation*.³⁷ In that case it was suggested that where anxious prospective purchasers are in heated competition, leading to an inflated result, this should be disregarded when determining market value of the relevant asset. Compelling evidence of the existence of such a situation, however, is required.³⁸

It would appear then that there is no clear direction from the courts/AAT as to the weight to be given to the contemporaneous state of demand and supply for a particular asset when determining its market value. It is submitted, however, that there may be a way in which the abovementioned apparently conflicting decisions might be reconciled. This becomes apparent when one considers the NSW Court of Appeal decision in *MMAL Rentals v Bernard John Bruning*.³⁹

It was mentioned in Part III above that the valuation jurisprudence applying to the interpretation of market value in the ITAA is derived from a variety of statutory contexts where differences in wording such as 'market value' and 'fair market value' have been glossed over. In *MMAL Rentals*, however, the NSW Court of Appeal drew a distinction between the concepts of 'market value' and 'fair market value'. That case concerned the interpretation of a contract under which the majority shareholder in a car rental business could exercise a right in certain circumstances to purchase the shares of the minority shareholder for 'fair market value'. In making this distinction, the court implicitly acknowledged that 'market value' may reflect the effect of certain market factors such as whether a particular asset is thinly traded or the effect of market distortions, while such factors would not be taken into account when determining 'fair market value'.⁴⁰ Accordingly, the case suggests that while the operation of a buyer's market or seller's market should be taken into account when determining 'market value', such factors should perhaps be ignored in the determination of 'fair market value'. On the basis of this approach, one could perhaps argue that the AAT's thinking in *BHP Australia Coal Limited* and in *Collis* reflected a 'fair market value' interpretation rather than a 'market value' interpretation.

A qualification needs to be made, however, to the understanding that existing market demand and supply forces should be given effect in determining 'market value'. What if all buyers are not aware of the asset's highest and best use and consequently, the price set in the market place does not reflect the asset's optimal value? Would a court intervene in this instance to set a value which reflects a hypothetical market whereby all buyers are fully informed? The High Court case of *Marks and Others v GIO Australia Holdings Limited and Others* suggests that a court should intervene in this way.⁴¹

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³⁵ Ibid [25].

³⁶ Ibid [28].

³⁷ 96 ATC 4831.

³⁸ Ibid 4843.

³⁹ [2004] NSWCA 451. This case was also considered and applied by the Victorian Court of Appeal in *Toll (FHL) Pty Ltd v PrixCar Services Pty Ltd* [2007] VSCA 285.

⁴⁰ Ibid [57]–[58].

⁴¹ (1998) 196 CLR 494, 514 (McHugh, Hayne and Callinan JJ).

This is also confirmed by the AAT decision in *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security*.⁴² That case concerned the value to be placed on land held by aged pensioners for the purposes of the application of the assets test under the Social Security Act 1947. The pensioners had in fact gone 'to market' and had attempted to sell the land by public auction. They refused to sell the land, however, as they did not receive an offer which was anywhere near the valuation which the government⁴³ had placed on their land for the purpose of the assets test. Various offers and bids were made but the AAT found that the highest of these did not represent the 'market value' of the land.⁴⁴

So what did the AAT find was the market value of the land? In setting the market value, the AAT relied on the theoretical market constructed by the ATO's valuation expert. That theoretical market was based on the ATO's understanding of the highest and best use of the land (a multi-dwelling development) and the existence of a willing but not anxious seller who is not forced to sell but who can hold on and negotiate with an interested buyer so that buyer in fact ends up making an offer which approaches the value reflected by the highest and best use of the land. The AAT in fact ignored the outcome suggested by actual demand forces operating in the relevant real estate market at the time and instead applied a theoretical demand (based on an understanding of the highest and best use) to set the market value, irrespective of whether that theoretical demand bore any connection with actual demand.⁴⁵ The AAT further concluded that demand is not required in order to determine a market value.⁴⁶

This conclusion, however, is contradicted by the Federal Court decision in *Marion Elizabeth Collis v Federal Commissioner of Taxation*.⁴⁷ In that case, two adjacent blocks of land were sold by the taxpayer to the same purchaser under two separate contracts. A question arose as to whether the price set for one of the blocks of land reflected an arm's length transaction, and the Commissioner applied the former s 26AAA ITAA36. The Federal Court found that a consideration of the block's highest and best use would take into account the special development potentialities that would come into play if the block was amalgamated with the adjacent block. The Federal Court further found that in applying such a consideration to the determination of the block's market value, there had to be evidence of the existence of demand for such a use in that area at that time.⁴⁸ In affirming this principle, the court applied the case of *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269 where it was held that there needed to be actual demand in existence for an asset's special potentialities, if such potentialities were to be taken into account in determining the asset's market value.⁴⁹

There is thus a contradiction in the case authorities as to the necessary connection to be made between real-world market demand and the theoretical demand for highest and

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⁴² [1987] AATA 73.

⁴³ It is interesting to note that in this case the Department of Social Security submitted valuation evidence utilising the services of an ATO valuer.

⁴⁴ *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73 [33].

⁴⁵ *Ibid* [23].

⁴⁶ *Ibid* [32].

⁴⁷ 96 ATC 4831.

⁴⁸ *Ibid* 4832.

⁴⁹ *Ibid* 4841.

best use to be applied when determining market value. Given that *Collis* is a Federal Court decision, it would override the conclusion drawn by the AAT in *Woodhouse*.

B Scenario 3 — Group Price/Individual Product Price

There are conflicting views on how market value is determined when the seller has the option of trading the relevant property on a group basis.

According to Marks, 'the hypothetical market place assumes that the particular asset will be sold in the best possible way, that is, to obtain the best price for the seller. Thus two or more items may be sold either together or separately to ensure the best price.'⁵⁰ If the group sale does not secure the best price for the individual item, then in Marks' view the item's market value will not reflect the group discount price.⁵¹

This understanding is contradicted by the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*. In paragraph 10.77 of that Memorandum it is stated that the assumptions made by a court when determining market value would be affected by the actual transaction under consideration. Accordingly, a large volume of goods sold could be expected to attract a discount. Each item would have a lower market value in such a situation than if it had been sold alone. This view is also supported by the AAT case of *NT 1997/305*.

C Scenario 4 — Identity of Seller — New Entrant or Established Participant?

Where one of the market participants is willing to lower the price of the item it is selling into the market in order to increase its market share, that participant should be regarded as a 'special value' participant and the comments made in Part III above concerning the determination of market value in markets involving such participants would apply. If we follow the approach suggested by *Brisbane Water County Council* and include the special-value participant in the hypothetical market, this would lead to a lower market value determination in that context.

VI RELEVANCE OF OFFERS

Another feature of real-world markets is the making of offers by interested parties to owners where the offers do not necessarily lead to an actual sale. Should such offers be accepted as an indication of market value? This question is particularly relevant to the interpretation of market value in those provisions where the taxpayer maintains ownership of the relevant property and there is no actual exchange or trade involving the property (s 70-30 and Division 152 ITAA97).

From 1915, there was clear authority from the High Court that offers are not to be taken into consideration when assessing market value.⁵² Given the absence of a concluded transaction, there is no basis upon which to find that the offered price is in fact the

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⁵⁰ Marks, above n 2, 125.

⁵¹ Ibid.

⁵² *McDonald v The Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231, 238.

market price. This principle has in fact been upheld in a number of court and tribunal decisions.⁵³

At the same time, there are court and tribunal decisions which, without referring to *McDonald*, have given considerable weight to evidence of offers.⁵⁴

The *McDonald* decision was examined by Wilcox J in *Goold & Rootsey v The Commonwealth*.⁵⁵ In his judgment, Wilcox J points out that the abovementioned principle from *McDonald* is derived from obiter comments made by Isaacs J and that Isaacs J should not be understood to have intended to exclude all offer evidence in all cases.⁵⁶ According to Wilcox J:

But it seems to me that, once the court is satisfied about genuineness, an offer made by an arms-length party to purchase the land under valuation is something that the judicial valuer ought to take into account in considering the possibility of a sale at a price different from that indicated by conventional evidence, such as an analysis of comparable sales, or of a hypothetical development, or a calculation of the capitalised value of the rental return. How much weight should be given to such an offer is a question to be determined by reference to the facts of the particular case. In some cases, the appropriate weight may be minimal; in others considerable.⁵⁷

Wilcox J's reasoning was considered and supported by the Court of Appeal of New South Wales in *MMAL Rentals*.⁵⁸ In that case the court also indicated that it was not entirely convinced by the interpretation of the Full Court of the Federal Court in *McDonald* in *Cordelia Holdings*.⁵⁹

From the above examination of case authority, it can be seen that we do not have clear guidance as to whether offers are relevant indicators of market value.

VII PROCEDURAL FACTORS

A further point to be made concerns the underlying evidentiary process adopted in the court and tribunal decisions. The onus is on the taxpayer to prove that the Commissioner's valuation is incorrect. Failure to submit sufficient evidence as to the unreliability of the Commissioner's valuation will ensure that the taxpayer would not have discharged the burden of proof.⁶⁰ Any technical flaws in the taxpayer's valuation

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⁵³ *Cordelia Holdings Pty Ltd v Newkey Investments Pty Ltd* [2004] FCAFC 48, [128]; *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73, [31]; *Syttadel and Holdings Pty Ltd v Commissioner of Taxation* [2011] AATA 589.

⁵⁴ *Venturi v Commissioner of Taxation* [2011] AATA 588, [72]; *Marion Elizabeth Collis v Federal Commissioner of Taxation* [1996] FCA 1717, [18] citing *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269, 274-278.

⁵⁵ [1993] FCA 157, [28]-[32].

⁵⁶ *Ibid* [32].

⁵⁷ *Ibid* [30].

⁵⁸ [2004] NSWCA 451, [86]-[87].

⁵⁹ *Ibid* [95].

⁶⁰ *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234, [23]-[25].

(such as lack of valuation experience on the part of the taxpayer's valuer,⁶¹ or accounting errors)⁶² will often lead to a finding for the Commissioner by default. As a result, there is little analysis in the decisions as to the appropriate principles that taxpayers should adopt when conducting their valuations and especially on the question of the relationship between real-world market factors and the assumptions underlying the hypothetical market.

The significant reliance on evidence given by expert valuers raises a further issue which is relevant to the development of valuation principle by the courts and the AAT. Expert valuers belong to professional bodies which have developed their own valuation standards and especially their own interpretation of how 'market value' determinations should be made.⁶³ While these standards provide a more detailed explanation of the market value concept and how it is to be applied, the relationship between these standards and applicable Australian case authority is not entirely clear. It appears that we may have a situation where, rather than the standards adapting to developments in established Australian legal principle, the AAT may be simply confirming the views of the expert valuer who, on the day, is most convincing in applying the separate standards developed by his or her own professional body.⁶⁴

VIII CLEARER STATEMENT OF PRINCIPLE

Before proceeding to consider a possible solution to the problems in the way 'market value' is interpreted and applied in the context of the ITAA97, it would be helpful to briefly recap and summarise the key inconsistencies in the decisions of the courts and the AAT which this article has highlighted and which reinforce the need for a clearer statement of principle from the courts and the AAT.

First, in Part III above (General Principles) it was pointed out that we refer to the 'open' or 'general' market when determining market value (unless the terms of a particular legislative provision direct us to refer to a specialised market) and that the demand side of that market should reflect real-world demand. However, it was shown in Part V(A) (Scenarios for Consideration — Buyer's Market/Seller's Market) that this understanding was not applied by the AAT in *BHP Australia Coal* and in *Collis*, with the result that there is an absence of clear direction from the courts/AAT as to the weight to be given to the contemporaneous state of demand and supply for a particular asset when determining

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⁶¹ *Psarreas v Secretary, Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670, [32]; *BHP Australia Coal Limited v Federal Commissioner of Taxation* [1993] AATA 156, [28].

⁶² *Ciprian and Ors v Commissioner of Taxation* [2002] AATA 746, [17].

⁶³ See for instance The International Valuation Standards which have been developed by The International Valuation Standards Council and which are applied by the Australian Property Institute and the Property Institute of New Zealand (2007) <http://propertystandards.propertyinstitute-wa.com/documents/InternationalValuationStandards-4_000.pdf>. Please note that the website reference is based on IVS 2007, which has since been superseded by IVS 2013.

⁶⁴ See for instance the recommendation made in paragraph 7.2 of APES 225 by the Accounting Professional and Ethical Standards Board to members involved in the provision of valuation services. Churchill and Sammut (above n 27, 272) also refer to the guidance which various professional bodies have issued on aspects of the valuation process.

its market value. On this point it was further suggested that the courts/AAT should clarify whether it is only when a concept of 'fair market value' is applied (as distinct from 'market value') that normal demand and supply conditions are to be assumed and that real-world, contemporaneous market conditions are to be ignored.

Secondly, in Part V(A) (Scenarios for Consideration — Buyer's Market/Seller's Market) it was shown, through an analysis of *Marks*, *Woodhouse*, *Collis* and *Hustlers* that there is a contradiction in the case authorities as to the necessary connection to be made between real-world market demand and the theoretical demand for 'highest and best use' when determining market value. On the one hand, *Marks* and *Woodhouse* suggest that market value should reflect an asset's highest and best use even though no actual buyer in the market may be pursuing that use. *Collis* and *Hustlers*, however, suggest that there needs to be actual demand in existence for an asset's special potentialities, if such potentialities are to be taken into account in determining that asset's market value. Again, this inconsistency requires clearer resolution by the courts/AAT.

Finally, in Part VI (Relevance of Offers) it was shown through an analysis of various court and tribunal decisions that further clarification is required of the weight to be given to offers by interested parties to owners which do not necessarily lead to an actual sale. This issue is of particular relevance to the interpretation of market value in provisions such as s 70-30 and Division 152 ITAA97, where the taxpayer maintains ownership of the relevant asset and there is no actual exchange or trade involving that asset.

IX INCORPORATION OF STATUTORY VALUATION PRINCIPLES INTO THE ITAA97 — THE WAY FORWARD?

In light of this article's call for a clearer statement of principle from the courts/AAT, a key question arises: given the varied contextual origins and applications of valuation jurisprudence, can we rely on the courts and the AAT to continue to develop this jurisprudence in a way which will provide, for the purposes of the ITAA97, a clearer statement of principle which will resolve the inconsistencies highlighted by this article?

Taxation and rating statutes in Australia, the United Kingdom, the British Commonwealth and the United States have traditionally provided the barest of valuation criteria and legislators have consequently relied on judicial common sense for establishing valuation rules.⁶⁵ However, administrators in the United States have taken this one step further and have actually codified judicially developed taxation rules into regulations.⁶⁶ Would application of this approach in Australia help to resolve the problems this article has highlighted? It is the author's view that incorporation of statutory valuation principles into the ITAA97 is a possible solution which would be of assistance to taxpayers and which would help to reduce the administrative cost imposed by the current regime. In particular, Australia should expressly address four matters:

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⁶⁵ Marks, above n 2, 115.

⁶⁶ Ibid.

- the question of how real-world market factors should impact upon market value determinations and the distinction to be made between 'market value' and 'fair market value';
- the effect that should be given to market demand and supply forces;
- the influence on market outcomes of particular market participants; and
- the weight to be given to unaccepted offers made to sellers by interested parties.

The valuation standards developed by professional bodies can play a helpful role in this exercise. For instance, it is worthwhile examining the guidance given by the International Valuation Standards Council (IVSC) on some of the issues mentioned above. In its International Valuation Standards 2013,⁶⁷ the IVSC defines 'Market Value' as:

The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion

Useful definitions are also provided for the terms 'Special Purchaser' and 'Special Value'.

A section at the beginning of the standards is dedicated to a discussion of the 'IVS Framework'. The discussion here makes clear the nature of the hypothetical exercise which underlies the determination of market value. According to the IVSC, 'value is not a fact but an opinion of either: (a) the most probable price to be paid for an asset in an exchange, or (b) the economic benefits of owning an asset' and that 'a value in exchange is a hypothetical price and the hypothesis on which the value is estimated is determined by the purpose of the valuation' (para 8).

In the discussion under Part III above, reference was made to the distinction drawn between price and value by Waddell J of the Supreme Court of New South Wales in *Brisbane Water County Council*. A similar distinction is in fact also drawn by the IVSC. According to the IVSC, 'price is the amount asked, offered or paid for an asset. Because of the financial capabilities, motivations or special interests of a given buyer or seller, the price paid may be different from the value which might be ascribed to the asset by others.'⁶⁸

Having supported the distinction between price and value and having clarified the hypothetical nature of the valuation determination, the IVSC then proceeds to clarify the way the real world feeds into this determination. Contrary to the position taken in *BHP Australia Coal* and in *Collis*, the IVSC does not support an approach whereby normal demand and supply conditions are to be assumed and real-world, contemporaneous market conditions are to be ignored. Rather, it specifies that 'references in IVS to the market mean the market in which the asset or liability being valued is normally

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⁶⁷ International Valuation Standards Council, *International Valuation Standards 2013 Framework and Requirements* (1 January 2014) <<http://www.ivsc.org/download-docs/?nid=733&nidc=6c29793a140a811d0c45ce03c1c93a28>>.

⁶⁸ Ibid [6].

exchanged on the valuation date and to which most participants in that market, including the current owner, normally have access'.⁶⁹ It further specifies:⁷⁰

Markets rarely operate perfectly with constant equilibrium between supply and demand and an even level of activity, due to various imperfections. Common market imperfections include disruptions of supply, sudden increases or decreases in demand or asymmetry of knowledge between market participants. Because market participants react to these imperfections, at a given time a market is likely to be adjusting to any change that has caused disequilibrium. A valuation that has the objective of estimating the most probable price in the market has to reflect the conditions in the relevant market on the valuation date, not an adjusted or smoothed price based on a supposed restoration of equilibrium.

Part V above conducted an extensive analysis of the likely determinations of market value to be made by the courts and the AAT when the real-world market in which the taxpayer operates is characterised by certain specific scenarios. It is a useful exercise to compare these determinations with the specific guidance given by the IVSC in its standards. As regards the Buyer's Market/Seller's Market scenarios, the IVSC clearly states that the interplay of real-world market supply and demand forces should be given effect when determining market value.⁷¹ As regards the Group Price/Individual Product Price scenario, the IVSC's view is that the outcome depends on a case-by-case analysis whereby an examination is conducted as to whether the relevant item is normally traded on a group basis by market participants (thereby transferring the related synergies to all market participants) or whether the synergies arising from the volume sale are entity specific. If the volume sale constitutes a factor that is specific to a particular participant and is not available to market participants generally, then it should be excluded from the inputs used in the market-based valuation.⁷² Finally, as regards the Identity of the Seller — New Entrant or Established Participant Scenario, the IVSC would clearly view this scenario as raising a special value/entity-specific factor that, contrary to the approach taken in *Brisbane Water County Council* and *Woodhouse* as well as by the ATO in its guidelines, should be altogether excluded from the inputs used in a market-based valuation.⁷³

The IVSC's statements on the incorporation of an asset's 'highest and best use' into the market value determination process are also of interest.⁷⁴ As regards the question of whether it is necessary for an actual market participant to be pursuing the 'highest and best use' in order for it to be taken into account in the market value determination, the IVSC does not state a clear position. It simply states that such use 'is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid'⁷⁵ and that 'to establish whether the use is possible, regard will be had to what would be considered reasonable by market participants'.⁷⁶ Contrary to the position taken in *Collis* and *Hustlers*, these comments leave open the

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⁶⁹ Ibid [13].

⁷⁰ Ibid [14].

⁷¹ Ibid [11], [16], [17], [30(d)] and [30(e)].

⁷² Ibid [20] and [21].

⁷³ Ibid [20].

⁷⁴ Ibid [30(h)], [32] and [34].

⁷⁵ Ibid [32].

⁷⁶ Ibid [34].

understanding that 'highest and best use' can still be applied as a theoretical demand to the market value determination exercise, provided that such demand would be considered 'reasonable' by participants (even though no participant is actually pursuing that demand).

A further matter to be cross-checked against the IVSC Standards concerns the relevance of offers (as discussed in Part VI above). It is submitted that, although the IVSC does not state a specific position on this matter, its approach to the determination of market value leaves open the possibility that use might be made of an unaccepted offer as an input in a market-based valuation. This particularly becomes apparent when the IVSC's understanding of a 'willing seller' is considered.⁷⁷ This understanding does not depend on reference to an actual concluded transaction. According to the IVSC:

'and a willing seller' is neither an over eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price attainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner;

While the IVSC Standards operate on the basis that 'at any given date it is only assumed that there is a willing buyer, not a particular willing buyer',⁷⁸ to the extent that the unaccepted offer conforms with the best price attainable in the open market after proper marketing, it could nevertheless constitute a relevant indicator of market value.

Finally, the IVSC Standards also provide guidance on another key observation made in the analysis conducted in Part V of this article, namely, the distinction to be made between 'market value' and 'fair market value'. 'Fair value' is treated as being an entirely separate concept from that of 'market value' in the standards.⁷⁹ The key difference is that special value and special participants are disregarded in market value determinations, while they are taken into account in determinations of fair value.⁸⁰ At the same time, the standards reveal a likely reason why confusion may exist on this issue. International accounting bodies such as the IFRS also apply an understanding of 'fair value'. The IVSC points out, however, that the IFRS concept of fair value is different from that of the IVSC, and in fact is generally consistent with the IVSC's understanding of market value.⁸¹

This observation suggests a further improvement that might be considered as part of any statutory amendments made to the ITAA97 to deal with the question of market value: namely, the use of a consistent term throughout the legislation so that differences between market value and fair market value or other terms are minimised.

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⁷⁷ Ibid [30(e)].

⁷⁸ Ibid [45].

⁷⁹ Ibid [38].

⁸⁰ Ibid [41], [45] and [46]. It should also be noted that such an approach is contrary to *Brisbane Water County Council* and the case authority identified by Marks as supporting the inclusion of the special participant in the hypothetical market by which market value determinations are made (above n 2, 160).

⁸¹ Ibid [39].

Having examined the guidance to be obtained from the IVSC Standards on those issues which were summarised in Part VIII of this article as requiring a clearer statement of principle from the courts and the AAT, it can be seen that this analysis could serve as a useful starting point for the drafting of statutory valuation principles to be incorporated into the ITAA97. A key issue which this drafting exercise would need to address, however, is inconsistency between the standards and case authority. A further issue to be addressed is how the principles might be incorporated into the ITAA97, given the almost unlimited set of circumstances in which taxpayers may find themselves in trying to make the valuation. Once again, the IVSC Standards provide some direction on this issue. The analysis conducted in this part of the article has focused almost entirely on the points made by the IVSC at the beginning of its standards under the heading 'IVS Framework'. The IVS Framework provides the fundamental conceptual understandings which underlie the appropriate reference to be made to real-world market factors as 'inputs' in the hypothetical market value determination process. In a similar way, in the context of the ITAA97, the objective of the exercise would not be to attempt to draft an exhaustive list of suggested market value approaches for each conceivable circumstance arising in the ITAA97. Rather, the principles could be incorporated as a 'Market Value Framework' which would give clear conceptual guidance to taxpayers, the ATO, the courts and the AAT on the appropriate treatment to be given to real-world market factors as 'inputs' in the market value determination process and thereby overcome the inconsistencies and problems highlighted by this article. It is submitted that clarification of this 'input' issue is relevant to most, if not all, circumstances in which a market value determination is required to be made under the ITAA97 and would justify statutory amendment.

X CONCLUSIONS

The analysis conducted in this article has highlighted a number of problems in the way the term 'market value' is interpreted and applied in the context of the ITAA97. Using specific real-world market scenarios as a starting point, the article has shown that case authority does not provide clear guidance as to how market value is to be determined when such scenarios impact on taxpayers. In addition, the article has shown how the views of the ATO on the application of this term not only impose significant administrative cost on taxpayers but also are not entirely consistent with case authority. The absence of clear guidance from parliament, the courts and the AAT on how real-world market factors should feed into assumptions underlying the hypothetical market by which market value determinations are made has been a recurring theme of the analysis.

In addition to highlighting these problems, the analysis has also outlined a possible solution. While ideally it should be left to the courts and the AAT to continue to develop valuation jurisprudence in a way which will provide a clearer statement of principle, this article has recommended the incorporation of certain statutory valuation principles into the ITAA97 as a means of assisting this process.

As pointed out in Part IX, the objective of the exercise would be the establishment of a clear conceptual framework dealing with the fundamental question of how real-world market factors arising in markets engaged by taxpayers should be treated as 'inputs' in hypothetical market value determinations. While not specifying a specific approach for

the almost unlimited set of circumstances in which taxpayers may find themselves in trying to make a valuation, this exercise would nevertheless seek to provide a conceptual framework that would guide a response to a fundamental 'input' question relevant to most, if not all, such circumstances.

This article has also suggested that as part of this exercise, consideration should also be given to the use of a consistent term throughout the legislation so that differences between market value and fair market value or other terms are minimised.

Apart from assisting the courts and the AAT, such statutory amendments would also help to demystify the market value determination process for ordinary taxpayers, thereby helping to reduce the administrative cost imposed by the current regime.

THE ROAD TO FREEDOM? HAYEK AND NEW ZEALAND'S TAX DEPRECIATION

ROB VOSSLAMBER*

ABSTRACT

Tax depreciation provides an opportunity for governments to enact discretionary policy to promote specific social and economic goals. In the years following the Second World War a number of specific depreciation measures were enacted to supplement the general allowance in order to promote full employment and economic development. Since the market-based reforms of the 1980s, the New Zealand government has largely abandoned such measures in order to promote economic efficiency. This change reflects an underlying change in taxation philosophy.

This article interprets the development of tax depreciation in New Zealand from the perspective of the philosophical thought of Friedrich Hayek (1899–92). Hayek's writings are summarised to provide a normative basis upon which the development of New Zealand's tax depreciation is then discussed. The article contributes to the literature on New Zealand tax policy in general, and also illustrates several benefits of understanding and addressing taxation policy and policy change from a specific philosophical perspective.**

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I INTRODUCTION

Changes in taxation policy and practice indicate a lack of consensus about how best to tax. Lists of general principles of taxation, such as Adam Smith's four maxims, may be used to justify a range of divergent tax policies. Rather than focus on abstract principles, this article reviews the writings of a single author, Friedrich Hayek (1899–92), and considers how these may inform discussion of taxation policy and enhance understanding of the practice of taxation.¹ The development of tax depreciation in New Zealand's income tax legislation is used to illustrate Hayek's views.

This article extends the literature on taxation policy by detailing and applying a specific philosophical view to the discussion of taxation, and addresses calls for discussion as to what taxation policy should look like at the philosophical, and not merely the pragmatic, level.² It also extends discussion of the development of, and changes in the practice of, tax depreciation, which is an area that provides opportunities for governments to adapt taxation policy to achieve non-fiscal ends.

The article is structured as follows. The first two parts discuss Hayek's thought as he presented it in his major works, and summarise the development of New Zealand taxation. New Zealand tax depreciation history is then discussed through the lens of Hayek's thought. Part V summarises and concludes the article and suggests further avenues of research.

II HAYEK AND PLANNING

Macro-economic planning and government-led industrial policy became the norm in Western economies in the years following the Second World War, and fiscal policy played a significant part in giving effect to government policy. However, these policies were not without their critics. Among these, Friedrich Hayek warned of the danger he believed planning posed to liberty in his 1944 work entitled *The Road to Serfdom*.³ In his subsequent works *The Constitution of Liberty*⁴ and *Law Legislation and Liberty*,⁵ Hayek distinguished between a liberty sought in spontaneity and the absence of coercion, and one sought in government and collective purpose; one based on empiricism and trial and error, the other based on rationalism and prescribed pattern; one based on the Rule of Law, the other on arbitrary rules.⁶ Hayek promoted a constitutional approach — 'a higher law governing current legislation'⁷ — that limited the legislature to setting 'rules

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¹ An example of this approach is Harold M Groves, *Tax Philosophers: Two Hundred Years of Thought in Great Britain and the United States* (University of Wisconsin Press, 1974).

² Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002), 4 call for philosophical reflection to replace 'specious rhetoric' concerning taxation policy.

³ Hayek, *The Road to Serfdom: Text and Documents: The Definitive Edition* (Bruce Caldwell (ed)), (University of Chicago Press, 2007) (hereinafter 'RTS').

⁴ Friedrich A Hayek, *The Constitution of Liberty* (Routledge Classics, 1960) (hereinafter 'CL').

⁵ Friedrich A Hayek, *Law, Legislation and Liberty* (Routledge Classics, 1982) (hereinafter 'LLL').

⁶ RTS, above n 3, 113.

⁷ CL, above n 4, 156.

of just conduct'⁸ in order to promote human flourishing. This section outlines and illustrates aspects of Hayek's philosophy by reference to his works.

The publication of *The Road to Serfdom* brought Hayek to public attention, especially after it was condensed and distributed by *Reader's Digest*.⁹ Hayek expressed alarm that,

There exists now [in England and the United States] certainly the same determination that the organisation of the nation we have achieved for purposes of defence shall be retained for the purposes of creation.¹⁰

Hayek thought that the very anti-liberal enemy against which Britain was then fighting was now being embraced by its economic policy.¹¹ He considered economic planning to be a move towards socialism, which, though it might seem benign, would inevitably lead to slavery; he argued that 'We have progressively abandoned that freedom in economic affairs without which personal and political freedom has never existed in the past.'¹² Against this, Hayek described his position as 'liberal', in contrast to both conservatism and socialism.¹³

A Hayek on Law

1 Rules and the Rule of Law

Basic to Hayek's argument is the distinction between arbitrary rules and the Rule of Law. He commented that, 'Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law.'¹⁴

Under the Rule of Law, governments are confined to fixing general and formal rules, which Hayek referred to as 'rules of just conduct.'¹⁵ Rules of just conduct are intended to be merely instrumental in the pursuit of people's various individual ends, enabling people to predict the behaviour of those with whom they must collaborate.¹⁶ Hayek approvingly cited Lord Mansfield's (1705–93) dictum that the common law 'does not consist of particular cases, but of general principles, which are illustrated and explained by these cases.'¹⁷ In contrast, economic planning of the collectivist kind 'must provide

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⁸ David Sanz Bas, 'Hayek's critique of *The General Theory*: A new view of the debate between Hayek and Keynes', (2011) 14:3 *Quarterly Journal of Austrian Economics* 288.

⁹ *Reader's Digest*, April 1945. A cartoon adaptation by General Motors was also published by *Look* magazine in 1945 <<http://mises.org/books/TRTS/>>.

¹⁰ Hayek, RTS, above n 3, 58.

¹¹ In a 1933 memorandum entitled *Nazi-Socialism*, Hayek argued that 'National Socialism is a genuine socialist movement, whose leading ideas are the final fruit of the anti-liberal tendencies which have been steadily gaining ground in Germany since the later part of the Bismarkian era' (RTS, above n 3, 245).

¹² Hayek, RTS above n 3, 67, 78.

¹³ Hayek, CL, above n 4, see especially 'Postscript: Why I am not a Conservative.'

¹⁴ Hayek, RTS, above n 3, 112, cf Harry W Jones, 'The Rule of Law and the welfare state' (1958) 58(2) *Columbia Law Journal* 143.

¹⁵ Hayek, LLL, above n 5, esp. ch 8.

¹⁶ *Ibid*.

¹⁷ *Ibid* 82, referring to *R v Bembridge* (1783) 3 Doug. 327 at 332, 99 ER 679 (KB).

for the actual needs of people as they arise and then choose deliberately between them.’¹⁸ For Hayek, a liberal society is a society under law, not regulation, and law ought not to discriminate between persons.¹⁹

Non-discrimination followed from the fact of ‘the inevitable ignorance of all of us concerning a great many of the factors on which the achievement of our ends and welfare depends.’²⁰ Detailed planning by the state increases the difficulty of planning for the individual. Since the individual best knows his or her own circumstances and is thus more likely to succeed in their ends, Hayek argued that the actions of the state should be predictable, that is, ‘they must be determined by rules fixed independently of the concrete circumstances which can be neither foreseen nor taken into account beforehand: and the particular effects of such actions will be unpredictable.’²¹ Humankind must keep in mind ‘the necessary and irremediable ignorance on everyone’s part of most of the particular facts which determine the actions of all the several members of human society.’²²

2 *Evolution and Progress*

Hayek’s focus on human ignorance reflected his belief that an effective social order was not the result of conscious planning, but of social evolution.²³ For Hayek, the basic philosophical difference in social ethics was between what he termed an evolutionary, as opposed to a constructivist, rationalism.²⁴ He rejected the latter, arguing that the view that social institutions had been deliberately designed to serve human purposes was ‘rooted originally in a deeply ingrained propensity of primitive thought to interpret all regularity in phenomena anthropomorphically, as the result of the design of a thinking mind.’²⁵ In contrast, Hayek maintained that the ‘orderliness of society which greatly increased the effectiveness of individual action’ was largely due to evolution — ‘a process in which practices which had at first been adopted for other reasons, or even purely accidentally, were preserved because they enabled the group in which they had arisen to prevail over others.’²⁶ The emergence of order as the result of adaptive evolution, rather than design by either a higher supernatural intelligence or a designing human intelligence, accounted for the order evident in the world.²⁷ Anticipating the

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¹⁸ Hayek, RTS, above n 3, 113.

¹⁹ Hayek distinguishes between law and legislation in LLL, above n 5, vol 1. His proposed Model Constitution proposes two legislative bodies: one responsible for ‘law’, the other for ‘legislation’.

²⁰ Hayek, CL above n 4, 27. CL ch 2 discusses this in more detail, as does LLL 12, headed ‘The permanent limitation of our factual knowledge’.

²¹ RTS, above n 3, 114.

²² Hayek, LLL, above n 5, 13.

²³ Alan O Ebenstein, *Friedrich Hayek: A Biography* (Palgrave, 2001) 151.

²⁴ Hayek, LLL, above n 5, 5. Elsewhere Hayek refers to these as an Anglican versus a Gallican view of liberty: Hayek, CL, above n 4, 49f.

²⁵ Ibid 10.

²⁶ Ibid.

²⁷ Hayek, CL, above n 4, 53. Hayek includes religious belief as one such anthropomorphical attitude. It is therefore rather surprising that some on the religious right seem quite so keen on Hayek. Based on his research into Puritan America, Valeri (2010) suggests discontinuities between the religious traditions and the economic ethics of ‘contemporary claimants to Reformed Christianity who revere capitalism’, see Mark Valeri, *Heavenly Merchandize: How Religion Shaped Commerce in Puritan America* (Princeton University Press, 2010) 249.

criticism that this was consistent with what he termed ‘the error of “Social Darwinism,”’ Hayek argued that his thesis ‘concentrated on the selection of institutions and practices rather than on the evolution of individuals, and on the selection of innate rather than on culturally transmitted capacities of the individuals.’²⁸

An implication of Hayek’s evolutionary assumption and his emphasis on human ignorance is that social and intellectual evolution is incremental and proceeds by trial and error:

As in all other fields, advance [in intellectual evolution] is achieved by our moving within an existing system of thought and endeavouring by a process of piecemeal tinkering, or ‘immanent criticism’, to make the whole more consistent both internally as well as with the facts to which the rules are applied.²⁹

In the absence of central direction, how do individuals know how to act, and how is welfare maximised? Hayek argued that prices or wages play a key role in signalling to market participants the need to change or to maintain the direction of their efforts.³⁰ However, where governments intervene, price signals are distorted by altering the relative costs of competing opportunities. As its relative cost falls due to government intervention, investment may flow into areas that would otherwise be uneconomic or unsustainable, and, conversely, otherwise preferable investments may not be made. Moreover, since an intervention is likely to have only a short-term effect and cannot account for unforeseen consequences, further intervention will be required in the future, along with a degree of coercion to achieve the intended end.

In contrast to intervention, Hayek argued that the market best serves human flourishing by increasing the chances or prospects of gaining a greater command over various goods than might be secured in any other way.³¹ In a market order, outcomes are unknown. However, what may be known are the ground rules (ie the ‘rules of just conduct’) which create a level playing field for all participants. Where these are pre-specified and change incrementally, participants in an economy are able to plan for the future. In contrast to central planning, Hayek argued that the task of such rules is ‘to tell people which expectations they can count on and which not’,³² rather than to guarantee or even promote specific outcomes.

Clear *ex ante* expectations provided by end-independent rules do not provide certainty that plans will be successful; like social institutions in general, the market is a place where the fittest survive. Rather than the *success* of all, the aim of the law should be to improve equally the *chances* of unknown persons.³³ Moreover, it is desirable that participants be permitted to succeed *or* fail for social progress to be made.³⁴ Long-term development depends upon market participants receiving clear signals so that they can alter their behaviour for their own benefit, and ultimately for the common good. Hayek summarises:

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²⁸ Hayek, LLL, above n 5, 23.

²⁹ Ibid 113.

³⁰ Ibid 235.

³¹ Ibid 267.

³² Ibid 97.

³³ Ibid 288.

³⁴ Ibid ch 10.

[I]n the absence of a unified body of knowledge of all the particulars to be taken into account ... it becomes clear that the role of government in that process cannot be to determine particular results for particular individuals or groups, but only to provide certain generic conditions whose effects on the several individuals will be unpredictable.³⁵

Government policy should therefore reflect, rather than create, current social practice. In contrast to planning, the role of government is constitutive, and should promote stable ground rules rather than aim at specific ends. This results in clearer information being provided to market participants, and permits them to plan for the future without the risk that evolving social knowledge or expectations will be upset by unexpected government intervention. Indeed, Hayek argued that historically, 'The aim of constitutions has been to prevent all arbitrary action ... The test of whether a constitution achieves what constitutions are meant to do is indeed the effective prevention of arbitrariness'.³⁶

3 *The Role of Government*

Despite the limits Hayek would place on government, he was no anarchist or libertarian; he was not opposed to government or to taxation. While governments are ineffective in, if not detrimental to, the achievement of specific ends, they:

can enhance the chances that the efforts of unknown individuals towards equally unknown aims will be successful by enforcing the observance of such abstract rules of conduct as in the light of past experience appear to be the most conducive to the formation of a spontaneous order.³⁷

To achieve this, Hayek noted that it was 'unquestionable that in an advanced society government ought to use its power of raising funds by taxation to provide a number of services which for various reasons cannot be provided, or cannot be provided adequately, by the market.'³⁸ This included providing a range of services 'to preserve peace and to keep out external enemies',³⁹ as well as those services where the market is not the most effective method of provision.⁴⁰ Governments should also provide 'some security against severe deprivation'⁴¹ for 'those who for various reasons cannot make their living in the market, such as the sick, the old, the physically or mentally defective, the widows and orphans'.⁴² Coleman aptly notes that in Hayek's view:

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³⁵ Ibid 178.

³⁶ Ibid 378.

³⁷ Friedrich A Hayek, 'The principles of a liberal social order' in Friedrich A Hayek, *Studies in Philosophy, Politics and Economics* (Routledge and Kegan Paul, 1967) 160, 162.

³⁸ Hayek, LLL, above n 5, 382f.

³⁹ Ibid 119.

⁴⁰ Ibid 383.

⁴¹ Ibid 294.

⁴² Ibid 395.

the state is not inert or absent; it is not the night-watchman state suggested by classical liberalism and 'market success' propositions but a *rule-bound* state; one encumbered by a constitution, and unendowed with a perpetual hunting licence to shoot 'problems'.⁴³

While governments must use coercion to raise finance (ie taxation) and have a role where the market cannot function, government provision is 'an *inferior* method of providing those services'.⁴⁴ Where the government does provide services, it must not do so 'in a manner which impairs the functioning of the spontaneous market order on which we remain dependent for many other and often more important needs',⁴⁵ for:

every step made in this direction [of growing public intervention in the market] means a transformation of more and more of the spontaneous order to society that serves the varying needs of the individuals, into an organisation which can serve only a particular set of ends determined by the majority — or increasingly, since this organization is becoming far too complex to be understood by the voters, by the bureaucracy in whose hands the administration of these means is placed.⁴⁶

B Hayek and Tax Expenditures

Specific depreciation provisions are intended by government to affect the functioning of the market by altering the cost of investment. These provisions are a type of tax expenditure, a concept coined by former United States Assistant Secretary of the Treasury for Tax Policy Stanley Surrey, and defined by him as 'those revenue losses attributable to provisions of the [...] tax laws which allow a special credit, a preferential rate of tax, or a deferral of tax liability'.⁴⁷ Tax expenditures are significantly motivated by policy goals other than revenue raising.⁴⁸

Since general depreciation rules are 'end-independent and refer only to facts which those who are to obey them can know or readily ascertain',⁴⁹ they contribute to providing a context in which an entrepreneur may plan for the future. Such rules must apply to an unknown number of future instances, where both those who create the rule and those who are subject to it are ignorant of the particular circumstances in which the rule will apply. In contrast, depreciation rules which discriminate on the basis of activity or location provide little certainty, since they could be changed at any time, being subject to administrative discretion. Moreover, such rules may protect particular

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⁴³ William Coleman, 'What was "new" about neo-liberalism' (2013) 33(1) *Economic Affairs* 78 89 (emphasis in original).

⁴⁴ Hayek, LLL, above n 5, 387 (emphasis in original).

⁴⁵ Ibid.

⁴⁶ Ibid 393. Hayek refers to Wagner's Law of Growing Government expenditure, see Adolph Wagner, 'Three extracts on public finance' in Richard A Musgrave and Alan T Peacock (eds), *Classics in the Theory of Public Finance* (Macmillan, 1967) 7f.

⁴⁷ Stanley S Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Harvard University Press, 1974). While noting that, 'In practice, defining tax expenditures is difficult', the OECD proposed a definition of tax expenditures as 'provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax: OECD, *Tax Expenditures in OECD Countries* (OECD, 2010), 12.

⁴⁸ Craig Fookes, *Spending through the Tax System: Tax Expenditures* (New Zealand Treasury Policy Perspectives Paper 09/01), (New Zealand Treasury, 2009) 4.

⁴⁹ Hayek, LLL, above n 5, 205.

interests and privilege,⁵⁰ foster corruption,⁵¹ and enhance the power of pressure groups.⁵²

Whereas efficiency and equity are regarded as principles of a good tax system,⁵³ Hayek suggested that discriminatory (tax) policies such as targeted depreciation policies are likely to be both inefficient and inequitable. They are *inefficient*, since it is not possible to preserve a market order while imposing on it a particular pattern of remuneration by an authority possessing the power to enforce it.⁵⁴ Since both individuals and governments operate under a veil of ignorance,⁵⁵ it is impossible for governments to enact effective end-focused depreciation laws. Since they distort pricing signals, such laws may alter investment patterns in the short-term, but do not provide a consistent order which will encourage human innovation in the longer term. According to Hayek, 'governments notoriously fail, for reasons inherent in non-competitive bureaucratic organizations',⁵⁶ to direct investment in the most effective ways.

Discriminatory tax policies are also *inequitable*, since a government disturbs previous expectations when it enacts laws that favour one group over another. Social change and technical obsolescence may result in some taxpayers suffering failure, but such failure provides signals available to all whereby they may adapt their behaviour. Failure that results from changing conditions in circumstances open to all does not constitute injustice. As it is the essence of justice that the same principles are universally applied, 'it requires that a government assist particular groups only in conditions in which it is prepared to act on the same principle in all similar circumstances.'⁵⁷ Discrete depreciation policy which interferes with the market is thus unfair.

C Summary

Hayek summarised his 'liberal' vision of society as follows:

The central concept of liberalism is that under the enforcement of universal rules of just conduct, protecting a recognizable private domain of individuals, a spontaneous order of human activities of much greater complexity will form itself than could ever be produced by deliberate arrangement, and that in consequence the coercive activities of government should be limited to the enforcement of such rules, whatever other services government may at the same time render by administering those particular resources which have been placed at its disposal for those purposes.⁵⁸

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⁵⁰ Ibid 184, 372.

⁵¹ Ibid 354.

⁵² Ibid 420, 472.

⁵³ The 2010 Tax Working Group listed efficiency and equity as the first two of six principles of a good tax system, while recognising difficulties in reconciling the two: Tax Working Group, above n 53 at 15, 55f. Okun discusses the inherent conflict between these two principles: Arthur M Okun, *Equality and Efficiency: The Big Tradeoff* (Brookings Institution, 1975).

⁵⁴ Hayek, LLL, above n 5, 232.

⁵⁵ Cf John Rawls *A Theory of Justice* (Clarendon, 1972). Hayek refers to the work of John Rawls at various points, eg LLL, above n 5 at 261, 335.

⁵⁶ Hayek, LLL, above n 5, 260.

⁵⁷ Ibid 300.

⁵⁸ Hayek, above n 37, 160 at 162.

Applied to tax policy, this suggests that governments should frame tax rules (ie the legislation itself, but also associated regulations and practice) generally, and apply them to all taxpayers indiscriminately, rather than endeavouring to favour particular taxpayers to achieve specific social or economic ends. This would provide a context in which taxpayers may then plan their activities for the long term, without fear that these ground rules will be arbitrarily changed.

Since tax depreciation policy has reflected the overall emphases of government policy in New Zealand, the following section briefly summarises the role of government in the New Zealand economy. This provides a context for the subsequent discussion of tax depreciation in light of Hayek's views.

III CONTEXT

Before the middle of the twentieth century, New Zealand's central government played an important but limited role in economic affairs, providing the night-watchman functions of internal and external security, as well as developing the country's infrastructure,⁵⁹ but offering only limited welfare provision.⁶⁰ The Depression of the 1930s, followed by the election of the First Labour Government in 1935, motivated a significant increase in government involvement in the economy.⁶¹ Contrary to the received economic wisdom, the mass unemployment of the 1930s suggested that either an economy would not reach a stage of equilibrium at full employment over time, or that the human cost of leaving the market reach equilibrium was unacceptable and so the government should intervene.⁶² The subsequent war years of 1939–45 involved a mass mobilisation of manpower and resources, and the wartime command economy became the peacetime controlled economy.⁶³

Full employment became a key goal of government economic policy following the Second World War in New Zealand and overseas.⁶⁴ The Industrial Development

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⁵⁹ For example, during the 1870s, Premier Julius Vogel borrowed significant sums from overseas to enhance New Zealand's infrastructure: Raewyn Dalziel, 'Vogel, Julius 1835–1899', in *Dictionary of New Zealand Biography* (Ministry for Culture and Heritage, 2007) <<http://www.dnzb.govt.nz>>.

⁶⁰ David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland University Press, 1998) described Colonial New Zealand as 'a world without welfare'. Similarly, Margaret McClure, *A Civilised Community: A History of Social Security in New Zealand 1898–1998* (Auckland University Press, 1998), 6 described welfare provision in New Zealand prior to the passage of *Social Security Act 1938* as 'niggardly'.

⁶¹ For an overview of the period refer Gary Hawke, 'Economic trends and economic policy, 1938–1992', in Geoffrey W Rice (ed) *The Oxford History of New Zealand* (Oxford University Press, 1992) 412. A similar trend was evident in Britain: see Jim Tomlinson, 'Managing the economy, managing the people: Britain c. 1931–70' (2005) 58(3) *Economic History Review* 555. Tomlinson suggests that the role of the British State's fighting of a 'total war' during the First World War presaged the shift to a managed economy in Great Britain. This shift was confirmed by the needs of the Great Depression and the Second World War.

⁶² Nicholas Wapshott, *Keynes Hayek: The Clash that Defined Modern Economics* (Norton, 2011) 31.

⁶³ Gary R Hawke, *The Making of New Zealand: An Economic History* (Cambridge University Press, 1985), 163 refers to New Zealand's 'controlled economy, from 1938 to 1968 and after.'

⁶⁴ See Monica Prasad, *The Politics of Free Markets: The Rise of Neoliberal Economic Policies in Britain, France, Germany, and the United States* (Chicago: University of Chicago Press, 2006) 2; Alan Booth 'The "Keynesian" revolution in economic policy-making' (1983) 36(1) *Economic History Review* 103; Jim Tomlinson, "'Decline": The falling behind of the British economy in the post-war years' (1996)

Conference held in Wellington in 1960 specifically ‘endorsed the policy of full employment which is included in the full use of all resources.’⁶⁵ The Conference noted that ‘the basic aim in New Zealand’s monetary and fiscal policy should be the maintenance of full employment, high and rising living standards, and the economic development of all resources, coupled with sufficient restraints to ensure reasonable stability in costs and prices.’⁶⁶ To this end, the Conference endorsed an increased role for the government in providing incentives to industry,⁶⁷ including an enhanced use of tax provisions such as the accelerated writing off of capital costs⁶⁸ and regional incentives.⁶⁹

The post-war extension of the role of government intervention in the economy is popularly referred to as Keynesianism,⁷⁰ after the British economist John Maynard Keynes (1883–1946). In his 1936 magnum opus, *The General Theory of Employment, Interest and Money*, Keynes had advised that ‘the central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government.’⁷¹ As regards investment, Keynes concluded that, ‘we must recognise that only experience can show how far the common will, embodied in the policy of the state, ought to be directed to increasing and supplementing the inducement to invest’.⁷² Keynes’s economic views were popularised by Paul A Samuelson in the successive editions of his textbook, *Economics*.⁷³

New Zealand’s ‘Keynesian’⁷⁴ post-war settlement⁷⁵ ended after 1984 following the election of New Zealand’s Fourth Labour Government,⁷⁶ which adopted a range of market-based economic policies. Rankin commented that, since 1984 the New Zealand

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49(4) *Economic History Review* 731; Hugh Dalton, *Principles of Public Finance* (4th ed, Routledge and Kegan Paul, 1954), Margaret Weir, ‘Ideas and politics: The acceptance of Keynesianism in Britain and the United States’, in Peter A Hall (ed) *The Political Power of Economic Ideas: Keynesianism across Nations* (Princeton University Press, 1989) 53.

⁶⁵ Industrial Development Conference, *Report: Industrial Development Conference, June 1960* (Government Printer, 1960) 79.

⁶⁶ Ibid 143.

⁶⁷ Ibid 89.

⁶⁸ Ibid 147.

⁶⁹ Ibid 121.

⁷⁰ McAloon comments that ‘Keynesianism is a convenient shorthand term for a broad and general approach to economic policy, and inevitably the use of shorthand obscures more than it explains unless definitions are made clear’: Jim McAloon, *Judgements of All Kinds* (Victoria University Press, 2013), 21. Since this article focuses on Hayek and not Keynes, it provides only a limited discussion of Keynes to provide context.

⁷¹ John Maynard Keynes, *The General Theory of Employment, Interest and Money* (BN Publishing, 2008), 237.

⁷² Ibid 235.

⁷³ Robert H Nelson, *Economics as Religion: From Samuelson to Chicago and Beyond* (Pennsylvania State University Press, 2001), 34: ‘Samuelson’s *Economics* would be the means by which the Keynesian gospel was communicated to millions of American college students in the post-war years’.

⁷⁴ The label ‘Keynesian’ obscures as much as it reveals, since ‘the Keynesian tradition has always encompassed a broad range of individual positions’: Bryan S Roper, ‘Neo-liberalism: A radical critique’ in Raymond Miller (ed), *New Zealand Government and Politics* (Oxford University Press, 1985) 578, 585.

⁷⁵ McAloon, above n 70, 21.

⁷⁶ Ibid ch 9.

economy took a 'diametrically opposite direction from the 1938 to 1975 strategies.'⁷⁷ According to Evans et al, 'the key theme of the macroeconomic approach of both the monetary and fiscal authorities through the [post-1984] reform period has been to provide stable policies rather than stabilisation policies.'⁷⁸

IV HAYEK AND THE DEVELOPMENT OF TAX DEPRECIATION IN NEW ZEALAND

Hayek argued that his views were consistent with nineteenth-century liberalism; however, following the Second World War and prior to the economic crises of the 1970s, Hayek, like other critics of planning, was 'far out of the field of vision of mainstream scholars'.⁷⁹ While 'Keynesian' approaches dominated policy in democratic states after 1945, Hayek's prescriptions, if not his philosophy,⁸⁰ became evident in the economic policy of many Western countries from the late twentieth century. Hayek's ideas were known in New Zealand in the 1940s and became evident in policy after 1984.⁸¹

Hayek's writings provide a means to make sense of New Zealand's economic and taxation history. However, rather than discuss the whole economy, this section focuses on a smaller domain to provide an insight into the development of an economy and its taxation. Tax depreciation provides a context in which to discuss these changes in tax policy. Three distinct phases may be discerned in the development of tax depreciation in the New Zealand income tax, and these are discussed sequentially.

⁷⁷ Keith Rankin, 'Ideas for New Zealand Industry' in Rodin Genoff and Roy Green, *Manufacturing Prosperity: Ideas for Industry, Technology and Employment*, (Federation Press, 1998), 211.

⁷⁸ Lewis Evans, Arthur Grimes, Bryce Wilkinson, and David Teece, (1996), 'Economic reform in New Zealand 1984-95: The pursuit of efficiency' (1996) 34 *Journal of Economic Literature*, 1856, 1863.

⁷⁹ Prasad, above n 64, 2 notes that 'in 1967 Eric Hobsbawm called Hayek — correctly — a "prophet in the wilderness"'.
⁸⁰ Ibid 21.

⁸¹ Jim McAloon, above n 70 at 9, 28, 82; see also Roper, above n 74. Despite this, Hayek's name was rarely invoked and the extent of *direct* influence may be questioned. Don Brash, the Reserve Bank Governor from 1988, noted that his own shift from Keynesianism and Fabian socialism was based not on Hayek's writings (which he had not read) but on observation: Donald T Brash, *New Zealand's Remarkable Reforms; Fifth Annual Hayek Research Lecture* <http://www.rbnz.govt.nz/research_and_publications/speeches_/1996/0031201.html>. Nor is it evident from his writings that Roger Douglas, the Labour Minister of Finance responsible for New Zealand's pro-market reforms of the 1980s, had done so. Rather, his views and policy developed over the years, shifting from interventionist and regulatory policies to the market. James comments that Douglas did not promote his policy approach 'out of an ideological belief in the market or individual freedom, but because he saw it was a practical means to generate greater wealth and welfare, given what he saw as the rigidities of centrally planned and controlled economic management and its consequent failure to generate growth. Rogernomics was liberal in content rather than libertarian, practical, rather than doctrinal': Colin James, 'Overview', in Simon Walker, *Rogernomics: Reshaping New Zealand's Economy* (Centre for Independent Studies, 1989) 11. In contrast, two Ministers in the subsequent National Government (1990–99), Ruth Richardson (Minister of Finance) and Simon Upton, were both members of the Mont Pelerin Society, see Ruth Richardson (1995), *Making a Difference* (Shoal Bay Press, 1995); Simon Upton, *The Withering of the State* (Allen and Unwin, 1987).

A From 1894 to the End of the Second World War

New Zealand's first successful income tax was enacted in 1891.⁸² While the legislation differed from its British progenitor in several respects, New Zealand inherited the common law, and British precedent applied in New Zealand. Since the common law applied unless overridden by statute, New Zealand's initial 1891 income tax legislation was short and provided little detail. In particular, the original Act made no mention of depreciation. A strict application of the capital/revenue distinction would mean that no depreciation should be allowed against assessable income, since 'the allowance for depreciation is an allowance in respect of exhausted capital, hence in the absence of express provision in the Act, no allowance could be made to cover the loss arising therefrom.'⁸³ In fact, there was no need to legislate for depreciation since it was common commercial practice to allow for depreciation in the determination of profits, and it 'was already the practice of the Commissioner and the accounting profession at that time ... to deduct from income a sinking fund for the replacement of assets.'⁸⁴ The common law allows for adaptation to changing circumstances.

Parliament subsequently amended the 1891 Act in 1894 by adding a proviso to Schedule F of the Act. This specifically permitted the Commissioner to allow a deduction for depreciation on 'any implements, utensils, or machinery as he may consider just in respect of the diminished value during any year by reason of fair wear and tear' that did not result from obsolescence or could not be made good by repair.⁸⁵

This provision was subsequently amended in 1900 to permit a deduction for an asset that had become obsolete or useless.⁸⁶ A deduction for the depreciation of buildings was finally permitted in 1917.⁸⁷ The previous disallowance of building depreciation may reflect the legacy of the capital/revenue distinction, since land and buildings are capital assets par excellence. The Commissioner's ability to recover depreciation on the sale of an asset was confirmed in 1920.⁸⁸ Even after these amendments, until 1945 there was a single section in the Act pertaining to depreciation.

Although the depreciation regime operated at the Commissioner's discretion, the Commissioner published allowable rates of depreciation for classes of assets in broad bands which applied to all taxpayers. Distinctions in rates reflected differences in the actual reduction in value of the asset itself or the circumstances in which it was used, and so provided an approximation of the actual (ie economic) depreciation of the asset. Moreover, the rates changed infrequently.

The 1924 Royal Commission into Land and Income Taxation in New Zealand confirmed the expectation that depreciation, like taxation itself, should be subject to general rules, noting that:

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⁸² *Land and Income Assessment Act 1891*.

⁸³ H A Cunningham, *Land and Income Tax Law in New Zealand* (Butterworth, 1933) [397].

⁸⁴ Valabh Committee, *Tax Accounting Issues* (New Zealand Consultative Committee on the Taxation of Income from Capital, 1991) [8.4.1].

⁸⁵ *Land and Income Assessment Acts Amendment Act 1894* s 18.

⁸⁶ *Land and Income Assessment Act 1900* s 66(1).

⁸⁷ *Finance Act 1917* s 30.

⁸⁸ *Land and Income Tax Amendment Act 1920* s 17.

The base on which income-tax revenue is raised should be made as broad as possible in order to lighten the weight of the tax. Every decision to free from tax, or tax lightly, some source of income carries with it a decision to tax some other source at a higher rate than would otherwise be necessary.⁸⁹

This suggests a broad-base, low-rate basis of income tax and an aversion to discretionary policy. The Commission did recommend that ‘a more reasonable allowance be made for depreciation of certain assets used in sawmilling and mining ventures’,⁹⁰ but this was not in order to favour these industries, but rather on the grounds that the existing allowance did not reflect economic reality, and in fact discriminated against these industries.

Prior to the Second World War, New Zealand’s depreciation policy was largely consistent with what Hayek referred to as ‘liberalism’,⁹¹ namely, the preference of universal over particular rules, and an aversion to end-focussed rules. The depreciation provision in the income tax legislation was short and simple, and was intended to apply indiscriminately to all taxpayers. Rather than being an imposed novelty, it reflected and was informed by evolving commercial practice. Since asset classifications were broadly defined, and the rates themselves changed infrequently, the Act provided a degree of certainty to taxpayers so that they could make plans based on an expectation that the effect of tax depreciation on the cost of investment was not likely to change in the foreseeable future; that is, the government would not capriciously alter long-standing policy or distort price signals and thereby frustrate business plans. Nor was there an indication that depreciation policy was intended to achieve any particular ends aside from setting the general rules for income taxation.

B From the Second World War to 1984

Economic policy responded to crisis. To prevent a recurrence of the depredations of the Great Depression of the 1930s, the government pursued a policy of full employment, and the experience of planning and control for the Second World War provided a pattern that was followed into peacetime.⁹² Policy shifts at the macro level were reflected in changes to depreciation policy at the micro level. This was evident in the report of the 1951 Taxation Committee which now included as purposes of taxation, ‘the protection of industries or control of spending’, and ‘the promotion of employment.’⁹³

A policy of ‘planned capitalism’ was pursued in the ensuing decades — ‘a curious blend of communitarian Christian ethics with the individualism and belief in progress of the Enlightenment’.⁹⁴ Taxation policy was critical to the success of this pursuit. Tax revenue,

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⁸⁹ WA Sim, ‘Report of the Royal Commission appointed to inquire into the subject of land and income taxation in New Zealand’ (1924) I AJHR B-5 [5].

⁹⁰ Ibid [8u].

⁹¹ Hayek discusses his unease with the term ‘Liberal’ and discusses his understanding of the term in his postscript to CL above n 4 entitled ‘Why I am not a conservative.’

⁹² Hawke, above n 63.

⁹³ Tony N Gibbs, ‘Report of the Taxation Committee’ (1951) I AJHR B-8 [60].

⁹⁴ Prasad, above n 64, 2.

which had reached record levels during the war, was maintained at high levels after the war, as the welfare state, introduced in 1938,⁹⁵ was implemented.⁹⁶

Throughout this period, the basic depreciation provision in the *Income Tax Act* remained largely unchanged. However, from 1945 a number of additional sections supplemented this provision. As a result, New Zealand had a 'dual system' of depreciation;⁹⁷ while the basic depreciation rules remained largely unchanged from those enacted in 1894, specific provisions were enacted to further the government's economic and social policies. Two such measures were accelerated depreciation introduced in 1945 by the Labour Government, and investment allowances introduced in 1963 by the National Government. Intervention in the economy enjoyed cross-party support.

1 *Accelerated Depreciation*

The Labour Government's 1945 Budget was delivered following Victory in Europe (May 1945), and with Victory over Japan (August 1945) anticipated. In his budget, the Minister of Finance noted that 'the Government's policy is one of full employment.'⁹⁸ This policy would enhance purchasing power, but 'it cannot be too strongly emphasized that the standard of living depends upon the volume of goods produced and services made available.'⁹⁹ The Minister confirmed that the predominant objective in the government's post-war activities must be to encourage a rapid expansion of production. Not only did the budget set out the objective of policy, it also indicated that the government would actively promote policies to achieve it.

Accelerated depreciation was a means to this end, and permitted a taxpayer to claim additional depreciation on certain assets beyond scheduled rates during the first five years of a specified asset's life. The policy was intentionally end-focused; the Minister of Finance advised that the purpose of accelerated depreciation was:

to encourage manufacturers and others to buy new plant; to demolish old buildings, to demolish unscientifically lit buildings, and even to scrap plant that has only been operating a few years, if they can see new machinery that would do the job more economically.¹⁰⁰

This measure could affect investment decisions in several ways. Since the measure initially applied for only a three year period (but was subsequently extended), it might encourage businesses to bring forward their investment plans to take advantage of the provision. It altered the relative returns of new as opposed to existing plant, resulting in a changed allocation of resources by businesses, or an inefficient scrapping of perfectly serviceable assets. It also discriminated between taxpayers, since the provision applied to certain assets only. Moreover, as with depreciation generally, accelerated depreciation was at the discretion of the Commissioner. Not only did this create a lot of

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⁹⁵ *Social Security Act 1938*.

⁹⁶ See Rob Vosslander, 'How much? Taxation on New Zealanders' employment income 1893–1984' (2009) 15(4) *New Zealand Journal of Taxation Law and Policy* 299.

⁹⁷ Gibbs, above n 93 [284].

⁹⁸ (9 August 1945) 269 NZPD 114.

⁹⁹ Ibid.

¹⁰⁰ (3 December 1945) 272 NZPD 289f.

paperwork, it reduced certainty, which is a hallmark of not only a good tax system, but also of the Rule of Law.

Accelerated depreciation was extended to a larger range of assets and businesses before it was repealed in the 1990s, including plant, machinery, or equipment or employee accommodation provided for the purpose of any farming or agricultural business in New Zealand,¹⁰¹ and worker's accommodation other than for farming or agricultural employees.¹⁰² Moreover, both the rates and the extent of accelerated depreciation were subject to frequent adjustment.

2 *Investment Allowances*

Like his Labour counterpart, National's Minister of Finance accepted the government's role in steering the economy. The objective of his 1963 budget was 'to provide the added incentives which will help to accelerate New Zealand's progress — incentives for development, for production, for exporting.'¹⁰³ In the Minister's view, 'investment in both industrial and agricultural plant and equipment is not large enough.'¹⁰⁴ This justified a series of tax concessions to agricultural and industrial producers. The government introduced investment allowances to promote investment in particular regions or industries by permitting an upfront deduction of a percentage of the cost in addition to ordinary depreciation. In effect, a taxpayer could deduct more than 100 per cent of the cost base of an asset over its life.¹⁰⁵

Investment allowances initially applied only to new manufacturing and agricultural plant and machinery, and to investments in redevelopment projects on the economically depressed West Coast. As with accelerated depreciation, investment allowances were intentionally end-focused. This was recognised by the government a decade later, which advised that:

the present broad range of first year depreciation allowances on plant and machinery should be replaced by a more selective system of incentives designed to emphasise both export production and regional development, and to encourage industries to plan their development in a co-ordinated fashion.¹⁰⁶

Accelerated depreciation and investment allowances supplemented ordinary depreciation with measures that were intended to alter taxpayer behaviour. Rather than leaving it to the market, via the price system, to inform decision-making, these measures were aimed at achieving or promoting particular outcomes by altering the incentives (ie

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¹⁰¹ *Land and Income Tax Amendment Act (No. 2) 1950* s 8.

¹⁰² *Land and Income Tax Amendment Act 1953* s 12.

¹⁰³ (11 July 1963) 335 NZPD 501.

¹⁰⁴ *Ibid* 505.

¹⁰⁵ Simcock advised that Investment Allowances 'are not to be confused with depreciation which may fairly be described as an allowance which takes regard of the wear and tear, obsolescence factor and other items associated with the use of plant and other assets in a business': J Simcock, 'Tax notes — 1963 budget proposals' (1963) 42(2) *Accountants Journal* 65 66. However, accelerated depreciation and investment allowances have a similar effect in accelerating the speed with which a business can claim the cost of capital investments against its tax liability.

¹⁰⁶ Cited in Charles A Staples, *A Guide to New Zealand Income Tax Practice 1976/77* (Sweet and Maxwell, 37th edition, 1976) [693].

the pricing information) available to taxpayers. Moreover, unlike general depreciation, these measures were subject to change, and, in contrast to the general depreciation provisions, the legislation was described as 'rather long and somewhat complicated.'¹⁰⁷

While special depreciation and investment allowances remained until the early 1990s, the 1967 Taxation Review Committee noted that these allowances 'discriminate between taxpayers and between particular kinds of investment and as a result distortions are introduced into the economy. Tax concessions of this nature are also open to criticism on the grounds of equity.'¹⁰⁸ Hayek would agree. However, the Committee concluded that these allowances should continue at the discretion of the Minister of Finance where an 'approved project was deemed to be in the national interest.'¹⁰⁹

3 Summary

Like other selective depreciation measures, accelerated depreciation and investment allowances contrast with Hayek's views. These measures were discriminatory, favouring particular taxpayers over others, and potentially led to an inefficient allocation of resources and the favouring of special interests. Rather than reflect and promote spontaneous activity, they were imposed at the whim of the government. Frequent amendments to such policies (eg by adjusting eligibility criteria or rates) could lead to short-term rather than long-term planning and hinder innovation. Overall, such policies were end-focused, and thus uncertain to succeed, since in the absence of perfect knowledge it is impossible to plan on the basis of uncertain ends. These measures evince the planning focus of the post-war years, which, Hayek had argued, was a road to serfdom.

Moreover, as measures of end-focused law-making, these measures contrasted with the general depreciation provision which, like the common law, was end-independent. There was a shift in tax law policy from general principles accepted by all, to discretionary law in which 'the accent is heavily on incentives which are designed by the Government in terms of its policy to increase production in New Zealand and to increase export receipts,'¹¹⁰ and which applied to (and favoured) only some. While the Opposition Labour Party 'support[ed] incentives and believe[d] they are a good thing, particularly in relation to exports,'¹¹¹ its Finance Spokesperson expressed the concern that:

The incentives provided in the Bill take us further away from some of the established canons of taxation ... the canons of equity, certainty, convenience, and economy. Some of the provisions of this Bill are contrary to these canons, although I know it is difficult, in trying to provide an incentive for a special group, to adhere strictly to them.¹¹²

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¹⁰⁷ (18 October 1963) 337 NZPD 2604.

¹⁰⁸ L N Ross, *Taxation in New Zealand: Report of the Taxation Review Committee*. (New Zealand Government Printer, 1967), [631].

¹⁰⁹ Ibid [634].

¹¹⁰ (18 October 1963) 337 NZPD 2603.

¹¹¹ Ibid 2607.

¹¹² Ibid.

The New Zealand Parliament was prepared to supplement, if not supplant, almost two centuries of generally accepted principle to achieve pragmatic goals.

C After 1984

Before the 1984 General Election, Robert Muldoon had been both the National Party Prime Minister and the Minister of Finance for nine years. Muldoon was not averse to intervention. After losing power, he wrote disparagingly of the economic reforms of the subsequent Fourth Labour Government (1984–90), commenting that:

intervention by the government in the economy was a normal procedure in New Zealand as it is and has been in every country around the world. The whole concept of government is based on intervention ... Intervention is what government is about, and in a democracy it is the people who decide whether that intervention is acceptable and if they say, 'No, it is not,' then they proceed to change the government.¹¹³

Muldoon's view contrasted starkly with the policies adopted by his successors.

Like the First Labour Government elected in 1935, the Fourth Labour Government introduced radical reforms. New Zealand was economically challenged: Britain's joining the Common Market in 1973, two oil shocks, the breakdown of the Bretton Woods agreement, and stagflation had contributed to the end of post-war prosperity. Domestic economic policy included high inflation to offset wage growth; high marginal tax rates; price, wage and interest rate freezes; and direct investment by the government in a range of ill-fated 'Think Big' projects in the early 1980s in an attempt to promote import substitution and economic growth, diversify the New Zealand economy, and offset rising unemployment.¹¹⁴

While Muldoon was still in office, the 1982 McCaw Committee had expressed concern as to the benefits of tax expenditures, urging that these be subject to more explicit accounting, and recommended 'that the Government should undertake without delay a rigorous assessment of major tax incentives to ascertain whether or not their continued (and uncertain) cost can be justified relative to the benefits.'¹¹⁵ This reflected a concern already alluded to by the 1967 Taxation Review Committee.¹¹⁶

In its briefing to the incoming Labour Government after the 1984 General Election, the New Zealand Treasury argued that, 'The New Zealand tax system is unsatisfactory in many respects.'¹¹⁷ In particular, 'many of its features are contrary to any reasonable efficiency and equity criteria. Rectification of these defects will require significant structural changes.'¹¹⁸ In respect of taxation incentives, Treasury sounded a Hayekian note:

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¹¹³ Robert D Muldoon, *The New Zealand Economy: A Personal View* (Endeavour Press, 2005) 119.

¹¹⁴ See further Barry Gustafson, *His Way: A Biography of Robert Muldoon* (Auckland University Press, 2000) 277-89.

¹¹⁵ Peter M McCaw, *Report of the Task Force on Tax Reform* (Government Printer, 1982) [4.18].

¹¹⁶ Ross, above n 108, ch 41.

¹¹⁷ Treasury, *Economic Management* (1984), 210.

¹¹⁸ *Ibid.*

industry specific tax concessions, incentives and exemptions alter relative pre- and post-tax rates of return and distort investment choices. For example, investment allowances discriminate arbitrarily between different types of asset ... To achieve efficiency, the tax system should be neutral with respect to business decisions, such as investment choices ....¹¹⁹

Treasury identified accelerated depreciation measures and investment allowances as tax expenditures and noted that, 'Frequently the tax system is a very poor method of targeting assistance, assuming that assistance is justified in the first place.'¹²⁰ From the 1980s governments undertook substantial tax reforms to broaden the tax base and lower tax rates.¹²¹ Depreciation was not exempted from these reforms. In particular, both accelerated depreciation¹²² and investment allowances¹²³ were phased out in the early 1990s.

In 1993 the government significantly reformed the depreciation provisions in the *Income Tax Act*. While these reforms were largely administrative, they also introduced the concept of 'economic rates of depreciation',¹²⁴ signalling that depreciation was but one business deduction among many and should be allowed on the same basis. This was consistent with the recommendation of the 1991 Valabh Committee that the criteria that the Commissioner applied when determining rates of depreciation be explicitly stated.¹²⁵ *Ex ante* and non-discriminatory rules replaced arbitrary and discriminatory policy.

The depreciation rules were further reformed following the release of the report of the Tax Working Group in 2010, which noted that 'New Zealand's tax depreciation rates ... are higher than economic depreciation rates. This tends to bias investments into certain depreciable personal property and creates capital allocation distortions.'¹²⁶ In particular, a 20 per cent loading on depreciation rates was 'distorting investment decisions and the neutrality of the tax system would be improved by removing it.'¹²⁷ The government removed the loading,¹²⁸ and also disallowed a depreciation deduction on buildings with an estimated useful life of 50 years or more, as neither provision reflected economic reality.¹²⁹

According to the Tax Working Group, a good tax system should, inter alia, 'minimise the harm it does to growth', and 'minimise distortions to investment allocation decisions'.¹³⁰ The current broad-base, low-rate focus of New Zealand tax policy¹³¹ contrasts with the

¹¹⁹ Ibid 220.

¹²⁰ Ibid 227.

¹²¹ Maples provides a list of the tax reforms undertaken since 1984: see Andrew Maples, 'The history of taxation' in Rob Vosslander (ed), *New Zealand Taxation 2013: Principles, Cases and Questions* (Thomson Reuters, 2013) [2.2.8].

¹²² *Income Tax Amendment Act 1993* s 27(b).

¹²³ *Income Tax Amendment Act (No 2) 1990* s 63.

¹²⁴ Inserted by *Income Tax Amendment Act 1993* s 2(1), currently *Income Tax Act 2007* ss EE 26ff.

¹²⁵ Valabh, above n 84 [8.6.3].

¹²⁶ Tax Working Group, above n 53, 54.

¹²⁷ Ibid.

¹²⁸ *Taxation (Budget Measures) Act 2010* s 77.

¹²⁹ Ibid s 81.

¹³⁰ Tax Working Group, above n 53, 59.

¹³¹ Ibid 14.

approach evident in depreciation policy in the decades following the Second World War. New Zealand returned to a single system of tax depreciation, intended to reflect the economic loss in the value of an asset.¹³² In contrast to overseas jurisdictions, few incentives remain.¹³³ The 2001 Tax Review had already indicated the extent of change in tax philosophy in New Zealand:

The current system developed over the years since McCaw [1982] represents the broad-base, low-rate model. The [previous] system represents the narrow-base, high-rate model. ... we do not think there is any support for paying for such concessions by reintroducing the pre-1988 tax scale with individual rates up to 48 per cent.¹³⁴

Since 1984, New Zealand tax depreciation policy has increasingly removed post-war end-focused depreciation policies. The current (2007) *Income Tax Act* provides a general depreciation policy which applies to all, rather than discrete policies that discriminate between taxpayers. Changes to allowable rates should be justified on economic rather than policy grounds and reflect economic reality, rather than the preferred outcomes of the government. Rather than engaging in game-playing, or suffering frustration of their expectations, depreciation policy is intended to assist taxpayers in planning for the future. While the outcome of a business venture will always be uncertain, one aspect of uncertainty — arbitrary government policy — is mitigated when general rather than specific provisions are in force and change slowly. Moreover, depreciation policy is set *ex ante*, and the permitted depreciation is end-independent; as long as the expenditure on assets meets the general deductibility provision of the *Income Tax Act*, depreciation may be claimed irrespective of the type of activity in which the asset is used.

V DISCUSSION AND CONCLUSION

The shift from a single system of depreciation that reflected a shift from extant commercial practice prior to the Second World War, to an ends-focused policy following that War, and then back towards a means-based approach after 1984, is indicative of broader changes in New Zealand society. Indeed, in the modern world, taxation reflects the social contract.¹³⁵ Moreover, tax depreciation provides a case study of the effects of two contrasting policy perspectives on taxation policy: a principles-based approach as advocated by Hayek, and a pragmatic, goal-focused approach. In general terms, tax depreciation policy in New Zealand reflected the former until 1945, the latter until the mid-1980s, and since then has again increasingly conformed to the former.

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¹³² *Income Tax Act 2007* s EE 30 provides a formula for calculating economic rates of depreciation, which is based on the residual value and estimated life of the asset.

¹³³ The 2013 Tax Expenditure Statement lists several tax expenditures where taxation may be deferred, including in the forestry, film and mining industries, see Treasury, 2013 Tax Expenditure Statement (Treasury, 2013) <<http://www.treasury.govt.nz/budget/2013/taxexpenditure>>.

¹³⁴ Robert McLeod, David Patterson, Shirley Jones, Srikanta Chatterjee, and Edward Sieper *Tax Review 2001: Final Report*, (Wellington: New Zealand Treasury, 2001) [1.44f].

¹³⁵ Isaac W Martin, Ajay K Mehrotra and Monica Prasad, 'The thunder of history: The origins and development of the New Fiscal Sociology' in Isaac W Martin, Ajay K Mehrotra and Monica Prasad, *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective* (Cambridge University Press, 2009) 1.

Several implications may be drawn. First, ideas matter. Both the shift to planning and incentives following the Second World War, and the shift back to the market after 1984, reflect a philosophical basis. Even if Hayek or his opponents were not mentioned by name and their works were not read by politicians and officials, their ideas affected policy. The broad-base, low-rate approach to tax policy has theoretical underpinnings which could provide a more explicit 'conceptual framework'¹³⁶ for taxation policy development. An appreciation of contrasting philosophical approaches leading to an understanding of tax history should enhance understanding, criticism and improvement of tax policy.

Secondly, context matters. The shift towards planning was a means to achieve full employment, and this policy goal was itself a consequence of the unacceptable deprivations of the Great Depression and the experience of an economy shifting from the controlled wartime economy. Likewise, the later shift from intervention was in part a reaction against the failings of this post-war policy in a changing world where inflation and unemployment seemed untameable. An understanding of taxation policy requires an interdisciplinary context, such as that advocated by proponents of the New Fiscal Sociology,¹³⁷ to help clarify why particular ideas and hence policies are adopted.

Ideas and context affect tax policy; yet there is a lack of discussion of the philosophy of taxation. While contested, taxation is largely taken for granted. Murphy and Nagel lamented the gap or at least under-populated area in philosophical discussion of the ethical dimensions of public policy.¹³⁸ This is also true of tax policy in general. While explicit statements of tax philosophy might be castigated as 'ideological', all policy reflects a tacit or latent ideology. Viewing policy through the perspective provided by a particular author provides a lens the better by which to understand the policy — irrespective of whether one agrees with the author or not. An appreciation of philosophy — Hayek's or another's — may enhance our understanding of taxation policy.

Finally, Hayek and other philosophers provide a means to introduce philosophy into the teaching of taxation, and to extend the focus of tax teaching from the 'how?' of taxation to questions of 'why?' and 'what if?' This may prepare students to evaluate taxation as socially constructed and contestable, rather than as a given to be complied with or avoided, and better equip them to evaluate and critique policy.

A Further Research

This article is based on one country, one philosopher and a limited range of archival sources. Further research could extend each of these areas. Given that a number of Western nations, including the United States of America under President Reagan, and the United Kingdom under Prime Minister Thatcher, followed a similar interventionist path after the Second World War and a neo-liberal path after 1980, international

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¹³⁶ Geoffrey W Lewis, 'Comments on the Task Force Report on Tax Reform', (1982) 16 *New Zealand Economic Papers* 41, 42.

¹³⁷ Martin et al, above n 135. See also Margaret Lamb, 'Interdisciplinary Taxation Research — An Introduction' in Margaret Lamb, Andrew Lymer, Judith Freedman, and Simon James (eds) *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press, 2005).

¹³⁸ Murphy and Nagel, above n 2.

comparisons could provide further evidence as to the role of ideas in tax policy, as well as of the flow of these ideas.

This article is also limited to a review of the views of one philosopher. A discussion of differing views would enhance understanding of the development of tax policy. Furthermore, this article describes, but does not critique, Hayek's philosophy; for example, his apparent assumption that evolution precludes human intervention is questionable; why should humans not intervene to improve matters? Moreover, since Hayek does not discount all government intervention, why should the line be drawn where he placed it?

A review of additional sources, especially government policy papers in relation, for example, to accelerated depreciation and investment allowances (if these are available), as well as the public reaction to these measures (eg in the newspapers), would also provide a fuller understanding of the role of taxation in the past and in society.

**TAXATION AND THE RATIONAL THEORY OF SIZE OF GOVERNMENT
IN MULTI-ELECTORATE POLITICAL SYSTEMS: THE MEDIAN OF THE MEDIANS IS KING**

ALEX ROBSON*

ABSTRACT

Standard treatments of the politics of taxation and the determinants of the size of government draw on the median voter theorem, which assumes that the voting population is effectively a single electorate (see, for example, Meltzer and Richard, 1981). However, in a multi-electorate political system such as Australia's, the policy preferred by the median voter of the entire population will not be stable — the bliss point of the overall median voter will not emerge as a Condorcet winner in a series of pairwise multi-electorate contests. Instead, the Condorcet winner is found by identifying the median voter in each separate electorate, arranging these medians in increasing order, then identifying the median of these medians. The policy distance between this 'median of medians' and the overall median can be very large. In other words, it is possible for 'extreme' policies to emerge as political equilibria. The article discusses the implications of these results for political competition, taxation policy and the size of government

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I INTRODUCTION

The relative economic size of government in Australia has increased by about a factor of six since Federation (Figure 1). What main factors are likely to have caused this growth? A range of explanations have been proposed in the literature.¹ For example, Wagner's Law argues that the income elasticity of publicly provided goods exceeds unity, so that the relative size of government will tend to grow as societies become wealthier. Another strand of literature argues that relative costs tend to rise in the public sector (for example, in health and education), and that this relatively low productivity growth — combined with inelastic demand for publicly provided goods — leads to a growing share of government spending in national income (this is known as the Baumol effect).

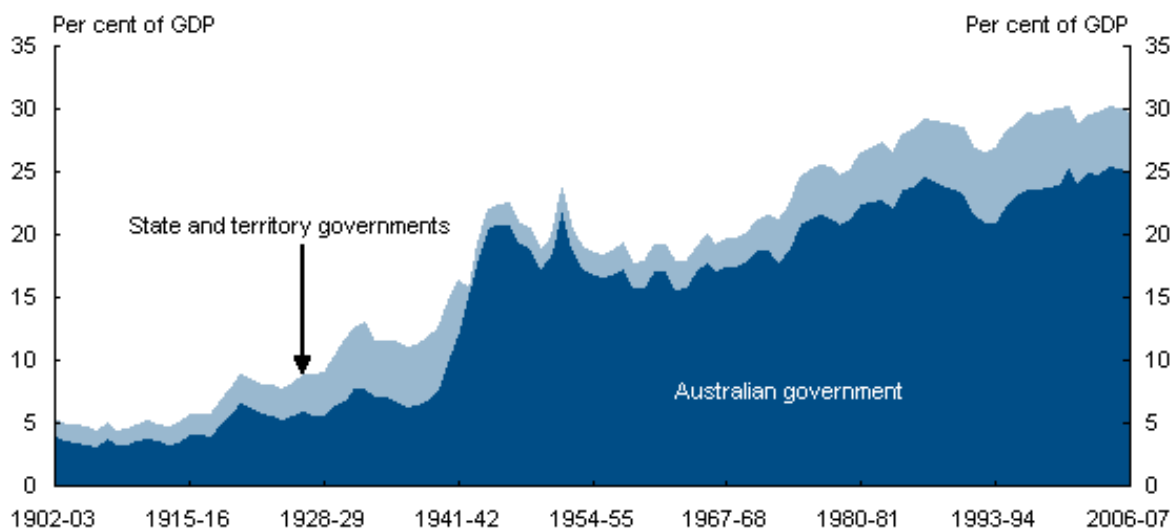


Figure 1: Government Taxation as a Share of GDP, Australia 190 007

Source: AFTS (2008) Architecture of Australia's Tax and Transfer System, Figure 4.1.

Both explanations focus on the demand and supply-side properties of government-supplied goods and services. A third stream of literature focuses on the effect of electoral institutions on the allocation of resources.² Within this literature, a number of papers, beginning with Meltzer and Richard,³ examine government's role as a redistributor of income (either by direct cash payments or by redistribution in kind), and argue that in democracies the amount of redistribution (and therefore the relative

¹ The literature is surveyed and summarised in Dennis C Mueller, *Public Choice III* (Cambridge University Press, 3rd ed, 2003).

² The classic references are Howard R Bowen, 'The Interpretation of Voting in the Allocation of Resources' (1943) 58(1) *Quarterly Journal of Economics*, 27; Theodore Bergstrom, 'When Does Majority Rule Supply Public Goods Efficiently?' (1979) *Scandinavian Journal of Economics* 216; and Theodore Bergstrom, 'Do Governments Spend too Much?' (1979) 32(2) *National Tax Journal*, 81.

³ Allan H Meltzer and Scott F Richard, 'A Rational Theory of the Size of Government' (1981) 89 *Journal of Political Economy* 914.

size of government) will tend, *ceteris paribus*, to increase as the relative productivity of the median voter declines.⁴ Specifically, Meltzer and Richard argue that:

The principal reasons for increased size of government ... are extensions of the franchise that change the position of the decisive voter in the income distribution and changes in relative productivity. An increase in mean income relative to the income of the decisive voter increases the size of government.⁵

In the Meltzer–Richard approach the ‘decisive voter’ is synonymous with the median voter of the overall voting population. As this median voter becomes relatively less productive and earns less income relative to the average income earner, their gains from redistribution increase, while the personal costs of redistribution decline. Hence, assuming that the productivity of the median voter has declined over time, it follows that they will be willing to impose higher rates of taxation on the rest of the population. As a result, tax rates and the size of government (as measured by the amount of redistribution) will tend to rise over time due to these majoritarian electoral forces.

However, even the most casual follower of Australian politics would be familiar with the tendency of politicians to appeal to the narrow interests of voters in a small number of marginal electorates, rather than putting forward policies preferred by the majority of the population as a whole. Thus, although the data in Figure 1 suggests that the amount of redistribution undertaken by Australian governments has certainly increased over time, it raises a number of questions for the Meltzer–Richard approach. In particular, the data suggest that the greatest increase in the size of government occurred during the Second World War (and this increase was not reversed); the size of government also jumped in the early 1970s. Did the majority of voters in Australia become relatively less productive during these periods — or are there other, more plausible explanations of the historical evolution of aggregate taxation and spending?

This article examines the role of one of the key assumptions of Meltzer and Richard’s analysis: the assumption that the relevant electorate is the entire voting population (ie there is effectively a single electorate). The analysis demonstrates that even if all other assumptions of the standard median voter theorem hold, in a multi-electorate political system such as Australia’s (in which the winner must gain a majority of votes in a majority of electorates), the equilibrium policy can differ dramatically from the policy preferred by the overall majority. The implication of this result is that a fall in the relative productivity of the median voter is neither necessary nor sufficient for taxation and the size of government to increase over time. If we are seeking to explain the increase in the size of government in Australia, looking at the productivity of the overall median voter is unlikely to be very helpful.

The basis of this critique is not new, but appears to have been ignored in most studies which have used the median voter theorem as the basis for predictions regarding

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⁴ See also Allan H Meltzer and Scott F Richard, ‘Why Government Grows (and Grows) in a Democracy’ (1978) 52 *Public Interest* 111 and Allan H Meltzer and Scott F Richard, ‘Tests of A Rational Theory of the Size of Government’ (1983) 41 *Public Choice* 403.

⁵ Meltzer and Richard above n 3, 914.

political equilibrium. In particular, Hinich and Ordeshook⁶ studied the median voter theorem in the context of the US Electoral College, and argue that candidates will converge on the policy chosen by the median voter in the median state, where states are ranked in increasing order of their Electoral College votes. The above result is therefore a special case of their more general result, applied to the determination of tax rates and the size of government. Although Hinich and Ordeshook's result was published many years before the Meltzer–Richard paper and other political analyses of tax policy, the main lessons of Hinich and Ordeshook appear to have been largely ignored in many applied settings.

II THE MELTZER–RICHARD RESULT

A Synopsis of the Meltzer–Richard Model

Meltzer and Richard study a single electorate with many voters, each of whom has preferences for consumption and leisure.⁷ Wage income is assumed to be taxed at a constant rate for all individuals. They show that for any given tax rate, an individual will, under a particular set of assumptions, work a longer number of hours if their productivity is higher.⁸ Moreover, individuals who work longer hours prefer lower tax rates. And since there is an increasing, one-to-one relationship between hours worked and productivity, more productive individuals will prefer lower tax rates. Finally, they are able to demonstrate that under their assumptions, preferences over tax rates are single-peaked, so that the conditions of the standard median voter theorem is satisfied. Hence, in a single electorate, τ^m , the tax rate preferred by the median voter has the property that it cannot be defeated in a pairwise majority election against any other alternative.⁹

The proof of the median voter in the context of taxation is straightforward and well known. Rowley and Schneider¹⁰ explain it as follows:

This tax rate and the implied subsidy level maximise the welfare of the median voter – the voters preferred tax rate is that the median of those most desired by each voter ... If the median voter's income is below the average, the median voter demands and receives a positive tax rate and corresponding subsidy.

To see the argument more formally, suppose there was a majority voting contest between τ^m and any other tax rate, τ' . Suppose further, without loss of generality, that $\tau' > \tau^m$. Since τ^m is the policy preferred by the median voter and since all voters with

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⁶ Melvin J Hinich and Peter C Ordeshook, 'The Electoral College: A Spatial Analysis' (1974) 1(3) *Political Methodology* 1.

⁷ Torsten Persson and Guido Tabellini, *Political Economics: Explaining Economic Policy* (MIT Press, 2000) 118–21 set out a simple version of the Meltzer–Richard model.

⁸ One assumption that produces this result is that an increase in productivity is equivalent to an increase in the amount of effective time available to a worker. An increase in effective time then leads to an increase in both the number of hours worked and the number of hours of leisure consumed.

⁹ In the language of social choice theory, the tax rate preferred by the median voter is a *Condorcet winner*.

¹⁰ Charles K Rowley and Friedrich Schneider (eds) *Encyclopedia of Public Choice* (Kluwer, 2004) 178.

productivity greater than the median will prefer τ^m to $\tau' > \tau^m$, it follows that more than half the voting population will prefer τ^m to $\tau' > \tau^m$. Hence τ^m will defeat τ' in a pairwise majority contest. Since this argument holds for any $\tau' \neq \tau^m$, it follows that τ^m is the Condorcet winner.

The implications of this result for policies proposed under two-party Downsian political competition¹¹ are also straightforward. In a plurality (simple majority) contest between two candidates or political parties whose only objective when choosing policy platforms is electoral victory, there is a unique Nash equilibrium. In this equilibrium, both candidates will choose τ^m , the tax rate preferred by the median voter. Hence the tax rate that will emerge in a political contest will be that which is preferred by the individual with the median level of productivity.

These results can be applied to explain changes in the size of government and overall taxation. As the voting population changes, the distribution of productivity levels in the voting population also is also likely to change. In particular, if the relative productivity (and hours worked) of the median voter declines, the equilibrium tax rate, as well as the size of government should, *ceteris paribus*, also increase. The main contention of Meltzer and Richard is that the relative productivity of the median voter has declined, and that this was one of the main drivers of the increase in the amount of redistribution and the size of government over the last century. The empirical prediction of this model for Australia is very clear: the model hypothesises that the increase in the size of government shown in Figure 1 above has been driven, in large part, by a decline in the relative productivity of the median voter.

B A Problem with the Meltzer–Richard Explanation

One possible problem with the standard Meltzer–Richard explanation is that it relies on the median voter theorem, which states that under certain institutional arrangements (and under the assumptions of a unidimensional policy space and single-peaked voter preferences), the policy chosen by the median voter will be a Condorcet winner (ie will remain undefeated in a series of pairwise majority voting contests against all other alternatives). Clearly Australia's electoral institutions are far richer than those envisaged by the simple median voter theorem — but exactly how do our voting arrangements affect the predictions of the standard result?

The assumption of a single electorate is crucial to the result. To see why, consider the following simple numerical example. Suppose there are three electorates with seven voters in each electorate. The policy space is assumed to be unidimensional, and voters have single-peaked preferences. Voter bliss points are set out in Table 1 below. Now suppose that there is an election between two candidates, A and B. The winner must gain a majority of votes in a majority (ie at least two) electorates. Suppose that candidate A, in accordance with the predictions of the standard median voter theorem, proposes the policy preferred by the overall median voter (5) as the policy they will implement. Then candidate B will defeat candidate A by proposing policy 6.5. To see this, note that although a majority of voters in electorate 1 will prefer policy 5 to 6.5,

¹¹ See Anthony Downs, *An Economic Theory of Democracy* (Harper & Row, 1957).

voters in electorates 2 and 3 will prefer policy 6.5 to 5. Hence the overall median is not a political equilibrium in this example, and party B could win the election by proposing a policy that differs from the overall median for the entire population, provided that the policy proposed appeals to a majority of voters in a majority of electorates.

Table 1: Failure of the Median Voter Theorem in a Multi-Electorate System

	Electorate 1	Electorate 2	Electorate 3
	1	1	1
	2	2	2
	3	3	3
	5	6	7
	5	9	7
	6	10	8
	7	11	9
Median in Each Electorate	5	6	7
Median of Entire Population	5		

Note that in this multi-electorate political system, a policy is a Condorcet winner if it cannot be defeated by any other alternative in a series of pairwise multi-electorate majority contests. The unique Condorcet winner in the example in Table 1 is 6. As a general rule, in such voting systems the policy preferred by the median voter of the entire population will not be a Condorcet winner. And, as a result, under Downsian competition between two parties, the standard median voter theorem fails to hold. In the next section we extend the Meltzer–Richard result to a multi-electorate system and explore the implications for redistribution, taxation and the size of government.

III EQUILIBRIUM TAX RATES IN A MULTI-ELECTORATE POLITICAL SYSTEM

In contrast to the single-electorate setting envisaged by Meltzer and Richard, Australia has a multi-electorate system. Parties are elected to government only if they are able to obtain a majority of votes in a majority of electorates. This section argues that the Meltzer–Richard result is not generalisable if political institutions are such that equilibrium policies must be supported by a majority of voters in a majority of electorates.

To see this in the standard Meltzer–Richard framework, assume that there are $j = 1, \dots, J$ electorates of equal size. In each electorate we assume there is a continuum of voters. Normalise the mass of each electorate to 1. Hence the size of the total voting population is J . To find the Condorcet winning tax rate in this case, in each electorate j , arrange voters in increasing order of preferences over taxation. Then let τ^{mj} be the preferred policy of the median voter in electorate j . Now arrange these medians in increasing order, and let τ^{mm} be the median of these medians. Call the electorate in which this voter is located the median electorate. If there are J electorates then τ^{mj} , the tax rate preferred by the median voter in the median electorate is the unique Condorcet winner.

To see why this must be the case, we follow the reasoning use earlier to explain the Meltzer–Richard analysis. Suppose there is a pairwise contest between τ^{mm} and any other tax rate, τ' , and suppose, without loss of generality, that $\tau' > \tau^{mm}$. Since τ^{mm} is the policy preferred by the median voter in the median electorate, all voters in the median electorate with productivity higher than the median will prefer τ^{mm} to $\tau' > \tau^{mm}$. Moreover, since τ^{mm} is the policy preferred by the median voter in the median electorate, a majority of voters in all electorates to the left of the median electorate will prefer support more than all voters in the median electorate with productivity below the median will prefer τ^{mm} to $\tau' > \tau^{mm}$. In other words, τ^{mm} will win majority of votes in a majority of electorates against $\tau' > \tau^{mm}$. Since this argument holds for any $\tau' \neq \tau^{mm}$, it follows that τ^{mm} is the Condorcet winning tax rate.

The argument is illustrated diagrammatically in Figure 2 below, where we have assumed that there are five electorates and that electorate 3 is the median electorate. We claim that τ^{3m} , the tax rate preferred by the median voter in electorate 3, is the unique Condorcet winner. To see why, consider $\tau' > \tau^{3m}$. By construction of the medians in each electorate, more than half the voters in electorates 1, 2 and 3 will prefer τ^{3m} to τ' . Hence τ^{3m} must defeat τ' in a pairwise multi-electorate contest.

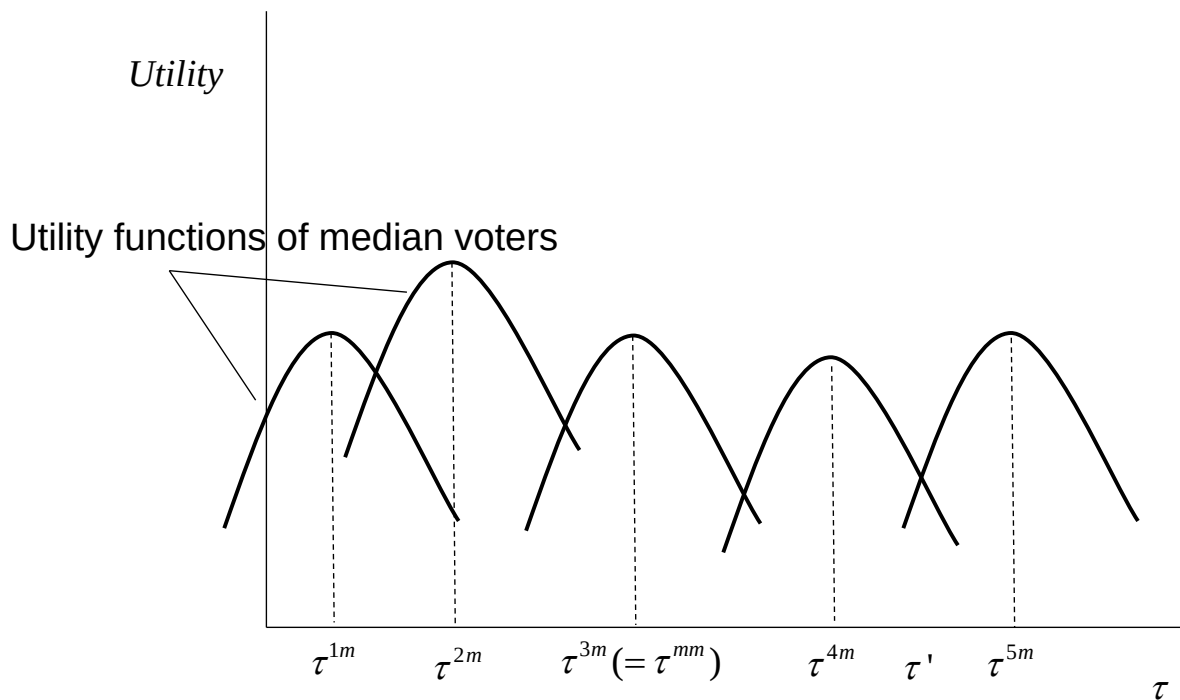


Figure 2: The Median of the Medians is King

IV IMPLICATIONS FOR THE RATIONAL THEORY OF THE SIZE OF THE SIZE OF GOVERNMENT

A Instability of the Overall Median

How does this compare with the standard result which seeks to explain changes in the size of government? One immediate implication is that if τ^m is the policy preferred by the median of the overall population of voters, then in general, $\tau^m \neq \tau^{mm}$. Moreover, τ^{mm} will defeat τ^m in a pairwise multi-electorate contest. In other words, in a multi-electorate system, the tax rate preferred by the overall median voter is not politically stable.

This result also has interesting implications for the choice of tax platforms in a political contest between national candidates or political parties in a multi-electorate system. In particular, since τ^{mm} is a Condorcet winner, in a contest between two parties both will choose this tax rate, rather than τ^m . Again, this happens because of the institutions in which voting actually takes place – since voters are split into electorates, the popular vote is irrelevant to individual candidate incentives, and this affects candidate policy behaviour.

To confirm that τ^{mm} is a Nash equilibrium, suppose that both candidates choose it as a policy platform. Then they each have an equal chance of winning the election. If either candidate deviated from this choice while the other continues to propose τ^{mm} , the candidate that continues to propose τ^{mm} would win the support of a majority of voters in a majority of electorates and so would win the electoral contest with certainty. Hence any deviation from τ^{mm} cannot improve a candidate's payoff. Hence τ^{mm} is a Nash equilibrium. To see that τ^{mm} is unique, note that if one of the candidates chooses $\tau' \neq \tau^{mm}$, the other could always propose τ^{mm} and win. Hence there is no other equilibrium.

The practical implication of this result is clear: in designing tax policy, politicians will have an incentive to appeal to a narrow set of voters in the median or marginal electorate, rather than targeting policies preferred by the majority of the overall population. As a consequence, for multi-electorate systems, empirical predictions regarding tax rates which are based on the standard median voter model will, in general, almost certainly be wrong — even if we assume that all of the standard assumptions of the median voter theorem hold. The simple lesson is that in multi-electorate systems, the size of government will be determined by the amount of redistribution desired by the median voter in the median electorate, not by the level of redistribution desired by the median voter of the overall population.

B Policy Extremism

An important characteristic of standard median voter results is that equilibrium policies cannot be 'extreme' – parties locate in the middle of the overall distribution of voter preferences, and any deviation from this means certain defeat. In contrast, a second important lesson from our analysis of multi-electorate systems – and one that is more disturbing — is that 'extreme' policies (ie policies located far away from the preferred point of the overall median of the population) may emerge as equilibria in political competition in multi-electorate systems.

Consider, for example, our earlier example with three electorates. In that example, the median of the medians was 6, which was not that far from 5, the overall median. This example can be changed in a relatively minor and seemingly innocuous way to generate an ‘extreme’ policy as an equilibrium. This is shown in Table 2 below. In this table, only the cells in red have been changed. The overall median, as in the earlier example, is 5. However, the median voters in electorates 2 and 3 are now ‘extreme’ in the sense that their preferred policy differs markedly from that preferred by the overall median. The median of the medians is now 8, which is on the far right fringe of the policy space.

Table 2: Modification of the Example in Table 1

	Electorate 1	Electorate 2	Electorate 3
	1	1	1
	2	2	2
	3	3	3
	5	9	8
	5	9	8
	6	10	9
	7	11	9
Median in Each Electorate	5	9	8
Median of Entire Population	5		

In other words, a majority of voters oppose the Condorcet winner in this example, but because the preferences of ‘extreme’ electorates must be respected, this can happen in equilibrium. A natural question is: just how ‘extreme’ can political equilibria get? We can modify the above example to show that in principle, just about anything is possible. Consider Table 3 below, for example. In this example, the overall median is still 5 but the median voter in the median electorate prefers the policy of 499, which is very far from the median.

Table 3: Modification of the Example in Table 2

	Electorate 1	Electorate 2	Electorate 3
	1	1	1
	2	1	1
	3	1	1
	5	500	499
	5	500	499
	6	500	499
	7	500	499
Median in Each Electorate	5	500	499
Median of Entire Population	5		

Thus, depending on the preferences of voters, and their distribution among electorates, in a multi-electorate system ‘extreme’ policies (those that are a long distance from the overall median) can emerge as political equilibria.

In particular, a key implication of this observation is that the overall median and the median of the medians could move in completely different directions, with different implications for political equilibria and the size of government. In other words, the overall median voter is likely to be largely irrelevant for determining the political direction of tax policy — in a multi-electorate system such as Australia's, a fall in the productivity of the overall median voter is neither necessary nor sufficient to generate an increase in tax rates or the size of government. Even if all other restrictive assumptions of the standard median voter theorem hold, the theory has little — if any — hope of explaining changes in the size of government over time in constitutional democracies where governments are elected on the basis of a majority of voters in a majority of electorates.

V CONCLUSION

The notion that a fall in the relative productivity of the overall median voter has been a key driver of observed growth in the size of government is a popular one in the public choice literature, but it does not sit well with reality, at least in Australia. Politicians in Australia have an incentive to target voters in marginal electorates — not the median voter in the overall population. This paper has examined the equilibrium determination of tax rates in a standard median voter model under the more realistic assumption that there is more than one electorate. Assuming a unidimensional policy space, and in contrast to the standard Meltzer–Richard result, we showed that the Condorcet winning tax rate is found not by finding the overall median, but is determined by identifying the median voter in each separate electorate, arranging these medians in increasing order, and then identifying the median of these medians. This tax rate will, in general, be very different from the tax rate preferred by the overall median.

The paper also developed a series of simple examples which demonstrate that the policy distance between this 'median of medians' and the overall median can be very large; in other words, it is possible for extreme policies to emerge as equilibria. Hence, in multi-electorate political systems such as Australia's, where governments are elected on the basis of a majority of voters in a majority of electorates, the overall median is at best irrelevant, and is likely to be a poor predictor of equilibrium tax rates and the evolution of the size of government spending over time.

DATA CHOICE IN CAPITAL GAINS REALISATION RESPONSE STUDIES — A REVIEW

JOHN MINAS*

This article reviews the literature from the United States on capital gains realisation response studies. The studies reviewed use the econometric technique of regression analysis to estimate the responsiveness of capital gains realisations to tax rates, and this is reported as an elasticity point estimate. The literature review reveals that the use of cross-sectional tax return data for only one tax year is the least preferred of three data types considered. In concluding, the article considers the implications of the reviewed literature for a forthcoming Australian study on capital gains realisation response.

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I INTRODUCTION

The focus of this article is upon the choice of three types of data used in capital gains realisation response studies.¹ In particular, it reviews the strengths and weaknesses of various types of data used in such studies. The article refers primarily to literature on studies undertaken in the United States.² Its principal motivation is to establish which of these types of data would be most appropriate for a contemporary Australian study of capital gains realisation response. This is a highly relevant and topical tax policy consideration for Australia.

Capital gains realisation response studies are concerned with how responsive realisations of capital gains are to a change in the tax rate applying to those capital gains. In the research to date, an elasticity³ point estimate is the most common means of measuring the realisations response. Elasticity in the context of capital gains describes the percentage change in realisations divided by the percentage change in the tax rate.⁴

Typically, empirical studies of the capital gains realisation response use the statistical technique of regression analysis. This technique applies a regression equation which estimates the mean value of a dependant variable in terms of the known values of the independent variables. In capital gains realisation response studies undertaken to date, the dependent variable is usually a measure of capital gains realisations, and the independent variables consist of a measure of the marginal tax rate on capital gains, as well as a number of other non-tax factors that are seen as influencing capital gains realisations.⁵

The three types of data approaches considered in this article are cross-section, aggregate time series and panel data.⁶ The choice of data type is an important consideration given the wide range of responses that have been estimated in the United States econometrics literature — ranging from no significant response to 4 or 5 in absolute value.⁷ A review of the literature indicates that while early research on capital gains realisation response used a cross-sectional approach, the problems inherent in this method are such that research that is more recent has not contemplated the use of this method.

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¹ Also referred to as elasticity studies.

² The article is principally limited to studies conducted in the United States, since this is where most of the realisation response studies have been conducted. Recently, a study using a long panel was undertaken in Sweden, however, that study has not been extensively reviewed in this article. See Martin Jacob, 'Taxes and life cycle capital gains realizations' (2013) 20(12) *Applied Economic Letters*, 1130.

³ The percentage change in one variable resulting from a one per cent change in another variable.

⁴ Jane Gravelle, *The Economic Effects of Taxing Capital Income* (MIT Press, 1st ed, 1994) 144.

⁵ George Zodrow, 'Economic Analyses of Capital Gains Taxation: Realizations, Revenues, Efficiency and Equity' (1993) 48(3) *Tax Law Review* 419, 431–2.

⁶ 'Panel data' can refer to several types of data; the references to 'panel data studies' in this article are to studies that track the same taxpayers over the time of the study. Another type of study that some of the literature refers to as panel data is a pooled cross-section time-series, which includes several taxpayers for a number of years but does not track the same taxpayers over time.

⁷ Gravelle, above n 4, 148. An elasticity point estimate of this magnitude represents a very significant realisation response.

The literature identifies a trend in the relative estimates of realisation responses: generally, the estimates of elasticity are relatively small in time series studies while cross-section estimates are relatively large.⁸ A United States Congressional revenue estimate prepared by the Joint Committee on Taxation (JCT) in 1990 asserted that estimates of realisation elasticity from time series data better described how taxpayers responded to a permanent change in the tax rate.⁹ The United States Treasury, however, has argued that time series studies may underestimate realisations elasticity.¹⁰

The methodology used in econometric studies to estimate realisations response appears to have developed and improved over time. The literature includes references to various econometric problems that have been a limitation of some studies.¹¹ An example of one such limitation is that some of the econometric analysis of capital gains realisation behaviour has weak theoretical economic foundations;¹² more specifically, few predictions are made in the theoretical literature about how and why capital gains are realised.¹³ Furthermore, the type of data that is adequate for answering policy makers' questions can be difficult to determine.¹⁴

The literature also reveals that capital gains realisations response studies have tended to produce a wide range of elasticity point estimates, due to the model specification being sensitive to minor changes. In some cases, the differences in results can be significant.

One of the limitations of this article is that it does not consider the question of whether regression analysis is the best tool for estimating the capital gains realisation response. Because the article is concerned with the choices of data type in the capital gains econometric studies, there is an implicit assumption that these can be a useful tool for examining the realisation response question.

This article reviews some of the literature that uses an econometric approach to modelling the capital gains realisations response. The purpose of the literature review is to compare the available data choices available for econometric analysis of capital gains realisations response. Notwithstanding that the number of studies undertaken indicates that econometric analysis is a common approach to estimating realisation response, the

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⁸ Leonard Burman, *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed* (Brookings Institution Press, 1999) 62.

⁹ Gerald Auten and Joseph Cordes, 'Policy Watch: Cutting Capital Gains Taxes' (1991) 5(1) *The Journal of Economic Perspectives*, 185. The estimates of the JCT are used by Congress to inform their decisions. US Treasury are part of the Executive Branch and it may be that it is subject to more political pressure than the JCT. This might lead, on occasion, to choices that are more partisan than those of the JCT. See Jane Gravelle, 'Limits to Capital Gains Feedback Effects' CRS Report for Congress (1991) for a notable example of different revenue estimates between JCT and Treasury. Specifically, in 1990, the JCT estimated that a 30 per cent capital gains exclusion would cost US\$10.6 billion in revenue between 1991 and 1996, whereas Treasury estimated a US\$9.5 billion revenue gain over the same period.

¹⁰ Auten and Cordes, above n 9, 186.

¹¹ Ibid.

¹² Gerald Auten, Leonard Burman and William Randolph, 'Estimation and Interpretation of Capital Gains Realization Behaviour: Evidence from Panel Data' (1989) 42(3) *National Tax Journal* 353.

¹³ Zodrow, above n 5, 433.

¹⁴ Auten et al, above n 12.

tax literature refers to the long-run realisation response as an issue surrounded by considerable uncertainty.¹⁵

For researchers contemplating a study on capital gains realisation response that uses Australian data, it is important to consider institutional differences between the capital gains tax systems of the United States and Australia. One such example is the event of death, where capital gains bequeathed to heirs receive a step-up in basis (cost base) in the United States. In Australia, however, the cost base of the inheriting taxpayer will be the same as the original cost base of the asset (unless it was a 'pre-CGT' asset in the hands of the deceased, in which case cost base will be market value).¹⁶ The US treatment of capital gains at death appears to act as a disincentive to realise capital gains as a taxpayer's age increases.¹⁷ A second notable difference between the two tax systems is in the treatment of capital losses. In the United States, a taxpayer can offset up to US\$3,000 against ordinary income, before applying the remainder to capital gains. In Australia, capital losses can only be offset against capital gains. It therefore appears that taxpayers in Australia with a relatively small amount of capital losses would have an increased incentive to realise capital gains, compared to US taxpayers with the same amount of capital losses.¹⁸ These differences should not influence the choice of data type, of themselves, but they might result in modifications to the variables in an empirical study using Australian data.

The elasticity point estimates that realisation response studies report is of interest to tax policy makers, given its usefulness in determining the revenue effects associated with a change in the CGT rate. Such information may inform the decision of policy makers involved in determining an appropriate CGT rate. However, it does not follow that an elasticity point estimate will be predictive of future capital gains realisation behaviour.

There is an absence of any publicly available empirical study on the realisation response of capital gains in Australia. Surprisingly, the tax policy question of the revenue effects of the 50 per cent CGT discount¹⁹ has received minimal attention from policy makers in Australia, despite the fact that the discount had an estimated revenue cost of over \$4 billion in 2013–14.²⁰ At the time of its introduction, some policy makers had an optimistic view of its revenue effects.²¹

If capital gains realisations are not very responsive to a reduction in the CGT rate, the government might be forgoing large amounts of CGT revenue unnecessarily. This point is highly relevant to the Australian context, notwithstanding that the tax literature is

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¹⁵ Matthew Eichner and Todd Sinai, 'Capital Gain Tax Realizations and Tax Rates: Evidence from Time Series' (2000) 53(3), *National Tax Journal* 665.

¹⁶ *Income Tax Assessment Act 1997* (Cth) s 12-5(4).

¹⁷ Gravelle, above n 4, 125.

¹⁸ Specifically, US taxpayers with capital losses below \$US 3,000 do not have to realise an equivalent amount of capital gains in an income tax year in order to reduce their tax liability. Australian taxpayers with the equivalent amount of capital losses can only use these capital losses when they realise capital gains.

¹⁹ The 50% CGT discount is effectively a capital gains inclusion rate which results in a CGT rate preference.

²⁰ Australian Treasury, *Tax Expenditures Statement*, Canberra (2013).

²¹ See for example Commonwealth, *Parliamentary Debates*, Senate, 29 November 1999, 10894 (Brian Gibson).

critical of the 50 per cent CGT discount for a number of tax policy reasons other than revenue considerations. In the event that capital gains realisations were relatively unresponsive to tax rates, there might be a justification for increasing the prevailing CGT rate²² for personal taxpayers in Australia, which could increase tax revenue.

A review of the literature on capital gains realisation response indicates that a relatively high number of studies, completed over a long period, have been conducted in the United States compared with other countries. Although there were numerous articles from the 1980s and 1990s on capital gains realisation response, there appear to be relatively few from 2000 and later.

The remaining parts of this article consider each of the three data approaches separately, and in doing so review some of the studies in the tax literature for each. Part II is a review of cross-sectional studies, Part III is a review of time series studies, and Part IV is a review of panel data studies. Part V then considers the implications of the review of these data approaches for future research in Australia on the capital gains realisation response.

II REVIEW OF CROSS-SECTIONAL CAPITAL GAINS REALISATION RESPONSE STUDIES

A cross-sectional capital gains realisation response study uses tax return data for a sample of taxpayers for a single year. Although the first econometric study of capital gains realisation response used cross-section data, the more recent tax literature has not contemplated use of this data type in realisation response studies. Although this part includes a brief review of two cross-sectional studies, there is no suggestion that cross-sectional data should be considered for any future capital gains realisation response studies: the articles are reviewed to provide some context and background to how the approach to the realisation response question has developed over time.

Feldstein Slemrod and Yitzhaki (1980)²³ is a US cross-section elasticity study for the year 1973;²⁴ most of the analysis is limited to high-income taxpayers and the only capital gains asset considered is corporate stock. Given that the tax return information itself contained no information about the portfolio value of individual taxpayers, Feldstein et al used the amount of dividends received to impute taxpayer wealth.²⁵ The main analysis of the study was limited to those taxpayers who had dividends of at least US\$3 000 in the sample year.²⁶

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²² In the Australian context, the mechanism for a CGT rate increase would be reducing the rate of the 50 per cent CGT discount. The Henry Review recommended reducing the discount from 50 per cent to 40 per cent; see Review Panel, *Australia's Future Tax System: Report to Treasurer — Part One: Overview* (2009).

²³ Martin Feldstein, Joel Slemrod and Shlomo Yitzhaki, 'The Effects of Taxation on the Selling of Corporate Stock and the Realization of Capital Gains' (1980) 94(4) *The Quarterly Journal of Economics* 777.

²⁴ Using data from a sample of tax returns known as the Capital Assets Study. This dataset contains detailed information on asset sales and it oversamples high-income tax returns.

²⁵ Feldstein et al, above n 23, 780.

²⁶ However, when Feldstein et al fitted regression equations for the entire population, they found that there was no tax rate effect.

The Feldstein et al study found a capital gains realisations elasticity of 3.75 in absolute value. This result is in the upper range of reported elasticity point estimates.²⁷ Notably, several commentators have disagreed with the high elasticity found in the study, asserting that it is inconsistent with observation. The elasticity in Feldstein et al implies that a 10 per cent cut to the CGT rate would increase realisations by 37.5 per cent. However, the actual experience in the United States of a small increase in the CGT rate did not cause a virtual cessation of capital gains realisations, as the 3.75 elasticity point estimate in the Feldstein et al study implies.²⁸

One of the limitations of the Feldstein et al study is that, because it uses cross-sectional data, the effect of a CGT rate cut may be overstated. Because cross-sectional studies include only one year of data, there is no way of ascertaining to what extent the elasticity point estimate is a measure of timing behaviour by individual taxpayers. Feldstein et al recognised the potential for overstatement of the sensitivity of realisations to a temporarily low tax rate, and they referred to this in their discussion of the results. Cross-sectional studies may reveal more about timing strategies than about the response to statutory changes in tax rates that are expected to be permanent or long-lasting.²⁹

A criticism of the Feldstein et al study is the choice of tax rate. This choice is one of the problems that those conducting research on the capital gains realisation response face; this may be one of a 'first dollar' or 'last dollar' CGT rate or another type of CGT rate. In a capital gains realisations response study, the first-dollar CGT rate is the rate that applies to the first dollar of capital gains that the taxpayer realises. The advantage of the first-dollar CGT rate is that it is exogenous; that is, it is independent of the taxpayer's decision on the amount of capital gain to realise.³⁰ The last-dollar CGT rate is the rate incurred in the event that the taxpayer had increased their actual capital gains realised by one dollar. Feldstein et al consider that it is more appropriate to use a last-dollar CGT rate than a first-dollar rate. This is partly because, in the case of very wealthy taxpayers, there is the potential for substantial differentiation between the first-dollar CGT rate and the tax rate at which marginal decisions concerning capital gains realisations are made.³¹ In the Feldstein et al study, an instrumental variable estimation procedure was used, whereby the average capital gains for taxpayers at a particular income level were used to predict the last-dollar CGT rate. The dependent variables used were the ratio of shares to dividends, the ratio of long-term gains on shares to dividends and a dummy variable for the sale of shares. The instrumental variables were the first-dollar CGT rate and the last dollar CGT rate.

A subsequent study by Minarik, from 1981³² presents an alternative functional form using the same data as Feldstein et al and a weighted rather than unweighted least

²⁷ An example of an even higher elasticity is the 5.84 reported in: Joel Slemrod and William Shobe, 'The Tax Elasticity of Capital Gains Realizations: Evidence from a Panel of Taxpayers' (NBER Working Paper Series, No. 3237, 1990).

²⁸ Gravelle, above n 4, 145.

²⁹ Burman, above n 8, 60.

³⁰ Feldstein et al, above n 23, 780.

³¹ Ibid 781.

³² Joseph Minarik, 'The Effects of Taxation on the Selling of Corporate Stock and the Realization of Capital Gains: Comment' (1984) 99(1) *The Quarterly Journal of Economics* 93.

squares regression technique. After recapping the Feldstein et al methodology and findings, Minarik uses a series of steps to present and apply what he considers a superior methodology and subsequently finds a significantly lower elasticity point estimate. According to Minarik, the high elasticity found by Feldstein et al was due largely to the way the observations were weighted; it is Minarik's view that using similar data and a different weighting method would produce a significantly lower elasticity point estimate.³³

Minarik notes that the elasticity point estimate of the Feldstein et al study implies that an increase in the CGT rate of 0.6 per cent from 20.6 to 21.2 per cent would cause the average shareholder with at least US\$1.5million of shares to stop realising capital gains on those shares.³⁴ Minarik also notes that the Feldstein et al elasticity point estimate implies that in the event of a 0.6 per cent CGT rate cut from 20.6 to 20 per cent, the same taxpayer would double their realisations.³⁵ According to Minarik, the use of a last-dollar tax rate by Feldstein et al is not appropriate, given that this is relevant to the taxpayer's decision to realise additional gains rather than a CGT rate that reflects the amount of capital gains they did realise.³⁶ According to Minarik, the use of an average tax rate for predicted gains would have been more appropriate. The literature notes that although Minarik's comment on the rate used in Feldstein et al highlights the difficulty of having to use a single tax rate in an elasticity study to represent an entire tax schedule, there is no theoretical justification for any one type of such a tax rate.³⁷

Minarik is one of several researchers disputing the Feldstein et al finding on capital gains realisations being as highly responsive to changes in tax rates as their -3.75 elasticity implies.³⁸ After applying all of his suggested changes to the Feldstein et al equation, Minarik finds an elasticity of realisations of long-term capital gains of -0.6; this implies a level of realisations response that is too low to cause an increase in CGT revenue overall in the event of a small rate decrease.

Although cross-sectional studies have a higher number of observations than time series studies, this, in itself, does not justify using cross-sectional data, given its many disadvantages. Perhaps the main shortcoming of cross-section studies is that they are unable to account for the dynamics of the capital gain realisations response.³⁹ Other more specific criticisms of cross-sectional studies include, first, that they fail to distinguish between transitory and permanent effects; secondly, that they include effects specific to individual taxpayers and thirdly, that they fail to include a measure of accrued unrealised capital gains.⁴⁰ Furthermore, there is a fourth problem of the need to separate the income and price effects as well as a fifth problem of a lack of information about the components of the model specification and a sixth problem of 'heterogeneity

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³³ Ibid.

³⁴ Ibid, 95.

³⁵ Ibid, 96.

³⁶ Ibid, 109.

³⁷ Alan Auerbach, 'Capital Gains Taxation in the United States: Realizations, Revenue, and Rhetoric' (Brookings Papers on Economic Activity No 2, 1988) 614.

³⁸ See for example Auten and Cordes, above n 9.

³⁹ Auten et al, above n 12.

⁴⁰ Gravelle, above n 4, 147.

bias'. Gravelle has noted that the problems inherent in cross-section studies are such that the results do not adequately estimate the realisations response.⁴¹

Given the absence of taxpayer data in cross-sectional studies, the only way to estimate the relationship of the tax rate to the taxpayer's tax rate in other years is to compare it with the tax rates of otherwise similar taxpayers in the same sample and year.⁴² The results of cross-section studies can show a negative relationship between CGT rates and realisations even in instances where there is no permanent effect. Specifically, part of the realisation response captured in the results of cross-section studies may be due to timing effects pertaining to a taxpayer facing an atypically low marginal tax rate in that year rather than a measure of the, more important, long-run or permanent effect. On this basis alone, the cross-section methodology is inferior to the alternative methodologies, both of which use more than one year of data.

Cross-sectional data studies overstate the elasticity of capital gains realisations to the extent that they include transitory, individual-specific effects as part of the elasticity point estimate. The unreliability of cross-sectional studies is such that revenue-estimating agencies in the United States have chosen not to rely on the results of such studies that reported very high elasticity point estimates.

Furthermore, cross-section studies suffer from the problem of heterogeneity bias, which results from the absence of a variable in the estimating equation to control for the investment preferences of individual taxpayers. The problem, more specifically, is that observed changes in the tax rate variable are not independent (or exogenous), but are rather dependent on (determined endogenously by) differences in individual behaviour reflecting differences in taxpayer investment preferences that are not captured by the explanatory variables in the equation.⁴³ The endogeneity of the explanatory variable is more problematic in cross-section studies, where much of the variation is due to circumstances of the individual taxpayer; this is in contrast with time series studies where the problem is not as apparent because the major source of variation is due to CGT rate changes.⁴⁴ The literature notes that, in a cross-sectional study, because the individual's tax rate is endogenous to their behaviour, this can result in a spurious correlation between tax rates and realisations.⁴⁵ One way the literature explains this problem is that the difference in taxpayers' investment preferences can simultaneously affect a taxpayer's tax rate and the amount of their capital gains realisations; thus the independent variable—the tax rate—is dependent on taxpayer behaviour.⁴⁶

In short, cross-section capital gains realisation response studies are now considered to be a discredited approach: they are unreliable in estimating the permanent elasticity of capital gains realisations, as confirmed in the wide range of results they have produced and the known problems with the methodology used. It is apparent from the review of

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⁴¹ Ibid.

⁴² Auerbach, above n 37, 616.

⁴³ Auerbach, above n 37.

⁴⁴ Jane Gravelle, 'Capital Gains Tax Options: Behavioral Responses and Revenues' (CRS Report for Congress, No 700, 10 August 2010), 13.

⁴⁵ William Bogart and William Gentry, 'Capital Gains Taxes and Realizations: Evidence from Interstate Comparisons' (1995) 77(2) *The Review of Economics and Statistics*, 267.

⁴⁶ Jane Gravelle, 'Can a Capital Gains Tax Cut Pay for Itself?' (1990) *Tax Notes*, 214.

the literature on cross-section studies that timing behaviour is an important consideration in capital gains realisation response studies. Without data spanning several tax years, it is not possible to ascertain whether taxpayers in the sample are responding to the statutory CGT rate or the fact that their income in the year of the sample might be atypically low.

III TIME SERIES REALISATION RESPONSE STUDIES

A capital gains realisation response study using a time series approach relates total capital gains realisations, on a year-by-year basis, over several years to the CGT rate in each particular year. Time series studies use aggregate tax return data rather than individual tax return data and this, to some extent, may be considered one of their limitations.

In the United States, time series studies have tended to report elasticity point estimates that are lower than those reported in cross-section studies. The range of results from time series studies typically range from those estimates that are not statistically significant, to an elasticity of approximately 1, in absolute value.

One of the advantages of a time series study is that—unlike cross-section studies—it is based on responses to actual tax rate changes.⁴⁷ According to some of the literature, time series studies provide a better mechanism to identify behavioural responses resulting from tax changes than for micro-data.⁴⁸

On the other hand, criticisms of aggregate time series studies include concerns about the limited number of observations and problems with the imperfect aggregation of tax rates.⁴⁹ In the United States, time series studies have guided capital gains tax policy⁵⁰ and this may be due to the lower elasticity estimates that they tend to produce. That is, from a policy perspective, in a deficit budget environment, it may be more prudent to underestimate revenue gains, resulting from a behavioural response, rather than to overestimate such revenue gains.

Policy makers should be cautious about basing tax policy prescriptions on any time series estimate from an individual study.⁵¹ Nevertheless, there is no empirical evidence to support the view that an average of several elasticity point estimates, reported in separate time series studies, is useful in informing capital gains tax policy. Considering the diversity of approaches used in each study an average may not be apt for informing CGT policy. Furthermore, time series studies are highly sensitive to minor changes in specification and sample period.⁵² The literature warns that because of this, revenue estimators must necessarily supplement any conflicting statistical from such studies with their own judgement as to how markets are likely to work.⁵³ Time series studies are

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⁴⁷ Alan Auerbach, 'Capital gains taxation and tax reform' (1989) 42(3) *National Tax Journal* 391, 392.

⁴⁸ Eichner and Sinai, above n 15, 665.

⁴⁹ Gravelle, above n 4, 147.

⁵⁰ Eichner and Sinai, above n 15, 664.

⁵¹ Zodrow, above n 5, 452.

⁵² Ibid, 453.

⁵³ Congress of the United States, Congressional Budget Office, *How Capital Gains Tax Rates Affect Revenues: The Historical Evidence*, 1988, 3.

also sensitive to the sample period and in some studies, where data for an additional year was included there was a significant change to the elasticity point estimate.⁵⁴

Furthermore, because time series studies include a smaller number of observations than the studies using micro-data,⁵⁵ there is a high dependency on factors other than tax rates that are hypothesised to influence realisations of capital gains.⁵⁶ The small number of observations in time series studies limits the number of variables that can be included in the equation, which, in turn, leads to an incomplete representation of the dynamics of adjustment.⁵⁷ There is a view in the literature that, in many cases, where important variables are omitted from a time series study, the resulting tax rate variable will be too large and will thus overestimate the realisations response.⁵⁸

Another problem the literature identifies is that of heterogeneity bias arising from the fact that aggregate taxpayer data will not allow for the marginal CGT rate to vary according to the situation of individual taxpayers.⁵⁹

According to some of the literature, time series studies cannot be relied on to produce a definitive elasticity estimate since the elasticity can be large or small according to the estimating equation specification.⁶⁰ However, this view may apply whatever the data type used in a study. The United States JCT has previously stated that elasticity estimates derived from time series studies are the most appropriate for revenue estimating.⁶¹ An alternate view is that because of the statistical uncertainty of time series estimates, it would be more prudent to use estimates from panel or cross-section studies in combination with those from time series studies.⁶²

The first of the articles considered in this section is Auerbach (1988); after a brief commentary on the time series evidence available at the time, the article refers to the problem of how to model the effects of tax rates on realisations in order to permit a realistic characterisation of taxpayer behaviour.⁶³ It also refers to the nonstationary nature of both capital gains realisations and the variables used to explain realisations;⁶⁴ it follows that the estimating equation used must take into account the fact that these vary systematically with time. Auerbach finds that after correcting time series equations for nonstationarity and correctly accounting for expectations of changes in tax rate, there is, essentially, no measurable response of capital gains realisations to changes in CGT rates.⁶⁵

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⁵⁴ See for example Auerbach, above n 37.

⁵⁵ Usually individual tax returns.

⁵⁶ Congress of the United States, above n 53.

⁵⁷ Gravelle, above n 46, 214.

⁵⁸ Ibid.

⁵⁹ Auerbach, above n 37, 613.

⁶⁰ Jonathan Jones, 'An Analysis of Aggregate Time Series Capital Gains Equations' (1989) OTA Paper 65, Office of Tax Analysis, Washington DC, 1.

⁶¹ Joint Committee on Taxation (United States) *Explanation of Methodology Used to Estimate Proposals Affecting the Taxation of Income from Capital Gains* (1990).

⁶² Jones, above n 60, 20.

⁶³ Auerbach, above n 37, 603.

⁶⁴ Ibid, 603–4.

⁶⁵ Ibid.

Auerbach also highlights the difficulty in ascertaining the theoretical importance of the lagged tax rate variable, which is a feature of the equation in several time series studies. In previous studies, the inclusion of a lagged tax rate variable has been justified according to its usefulness in determining to what extent the CGT rate responsiveness of capital gains is temporary rather than permanent.⁶⁶ A second reason for the inclusion of a lagged tax rate variable is as a proxy for the past realisation behaviour of taxpayers.⁶⁷ Auerbach notes that the theoretical importance of such a variable is difficult to ascertain, given that it does not play a clear role in the individual taxpayer's problem of the trade-off between the gains of portfolio adjustment and the tax costs of realisation.⁶⁸

Auerbach finds that although tax considerations are a strong influence on taxpayers' decisions on when to realise capital gains, the timing effect is most noticeable, and there is a lack of convincing evidence of a strong permanent effect.⁶⁹

Auerbach demonstrates that, in time series studies, the responsiveness of capital gains realisations to tax rates decreases when the specification incorporates expected tax rate changes.⁷⁰ More specifically, when controlling for tax rate changes, it is considered impossible to reject the hypothesis that the tax rate has no effect on realisations in the long run.⁷¹ This implies that time series studies may not be robust to minor specification changes.⁷²

Eichner and Sinai is a 2000 time series study that includes aggregate tax return data from 1986 to 1997. According to the authors, time series studies are the best way to estimate the long-run realisation elasticity, one reason being that panel data typically span a lesser number of years than time series, so the former are not as useful for separating out long-run and transitory elasticities.⁷³ They also note that, in the United States, time series studies guided the policy process over the decade preceding their article.⁷⁴ Eichner and Sinai refer to the sequence of previous tax changes as an influence on the level of accrued capital gains taxpayers can realise.⁷⁵ That is, where previous tax changes encouraged realisations of capital gains, the stock of capital gains remaining in later years is diminished and fewer asset portfolios are in need of rebalancing.⁷⁶ Eichner and Sinai find a long-run realisation elasticity of between -0.8 and -1.3, and note that this estimate is higher than many previous time series studies.⁷⁷ However, they also note that their estimate is sensitive to the inclusion of 1986, a year in which there was an extraordinarily high level of capital gains realisations due to the pre-announced increase to the CGT rate. Eichner and Sinai find that, by including a dummy variable for 1986 — effectively excluding that year from the regression — the elasticity point estimate is -

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⁶⁶ Ibid, 604–05.

⁶⁷ Ibid, 608.

⁶⁸ Ibid, 605.

⁶⁹ Ibid, 597.

⁷⁰ Ibid, 632.

⁷¹ Ibid, 632–3.

⁷² Ibid, 633.

⁷³ Eichner and Sinai, above n 15, 665.

⁷⁴ Ibid, 664.

⁷⁵ Ibid.

⁷⁶ Ibid, 674.

⁷⁷ Ibid, 664.

0.45.⁷⁸ It may be that the latter model specification is preferred, especially considering that timing effects are known to have influenced the realisations that occurred in 1986 before TRA86 took effect in 1987.

The Eichner and Sinai study also examines the specific question of the revenue effects of the *Taxpayer Relief Act* of 1997 (TRA97), under which there was a reduction of the top CGT rate from 28 to 20 per cent and the 15 per cent rate to 10 per cent. The authors use a range of elasticity point estimates to examine revenue effects of the 1997 CGT rate reductions. The authors find that although there was an increase in realisations in 1997 compared with 1986, there was also a significant decrease in the average tax rate weighted by predicted 1986 realisations—from 23.4 per cent to 16.5 per cent.⁷⁹ Eichner and Sinai consider the offsetting effects of TRA97 leading to additional capital gains realisations and the decrease in revenue collected as a result of the CGT rate change and conclude that the net revenue loss for 1997 was \$US2.8 billion per year, approximately 5 per cent of 1996 CGT revenue.⁸⁰ Eichner and Sinai note the unusual realisation dynamics of the years around TRA86 resulting from the pre-announcement of the higher CGT rates to take effect in 1987. Specifically, even though US\$165.5 billion of capital gains realisations in 1985 was a record at that time, taxpayers realised US\$317 billion of capital gains in 1986 in order to take advantage of the lower rate relative to the increased CGT rate to take effect in the following year.⁸¹ According to the authors, there is evidence of some of these realisations in 1986 being a result of timing behaviour. A tax year with an atypically large timing response may interfere with the measurement of estimated long-run elasticity. That is, although the aggregate data imply that periods of low tax rates are associated with higher realisations, and periods of high tax rates are associated with lower realisations, the true situation may be a re-shuffling of the timing of capital gains realisations with no effect on the aggregate amount realised over the years concerned.⁸²

Eichner and Sinai refer specifically to the issue of ‘path dependence’, which describes the dampening effect of previous CGT rate reductions on the future unlocking effects in subsequent years of additional rate reductions. It follows that a failure to consider path dependence in an elasticity equation for a period during which there are several CGT rate cuts means there will be an overstatement of the elasticity point estimate for the later years of the study. By way of example, Eichner and Sinai explain that a CGT rate reduction in the United States shortly after TRA86 may not generate the same realisation response as a comparable rate reduction in 1997, given the relative amounts of capital gains that taxpayers realised in the years preceding 1986 and 1997 respectively.⁸³

Eichner and Sinai identify another factor which in their view caused a lowering of the sensitivity of capital gains realisations to the CGT rate over the period of their study, namely, the increase in the share of household equity held in mutual funds.⁸⁴ They

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⁷⁸ Ibid.

⁷⁹ Ibid, 676.

⁸⁰ Ibid.

⁸¹ Ibid, 668.

⁸² Ibid.

⁸³ Ibid, 665.

⁸⁴ Ibid, 664.

believe this is suggestive of mutual fund managers realising more gains than would individual taxpayers, which may lead to the conclusion that fund managers are not as tax efficient as individual investors.⁸⁵ However, other literature notes that mutual stock funds have higher turnover rates because of their professional management and lower brokerage fees.⁸⁶ Eichner and Sinai explain that extending their sample causes the elasticity point estimate to fall, and that this is consistent with mutual funds comprising only a small proportion (5.8 per cent) of equities between 1954 and 1985 and a larger proportion (22.8 per cent) of equities after 1985.⁸⁷

In their conclusion, Eichner and Sinai note the sensitivity of their results to the way 1986 is modelled, and they identify a need for future research using micro-data, rather than time series data, in a structural framework.⁸⁸

The review of the literature has revealed that time series studies have been used in several capital gains realisation response studies in the United States and that there is a mass of elasticity point estimates between -0.5 and -0.9. One of the benefits of a time series study is that the required taxpayer data is more likely to be publicly available than a panel of individual tax returns. However, two of the main potential shortcomings of a time series study relate to the possibility for aggregation bias and the low number of observations. The number of observations, however, is not the only consideration, and the literature considers time series studies to be superior to cross-section studies. Aggregation bias in time series has serious implications for the results, given that the relationship between capital gains realisations and marginal tax rates is not linear, which in turn means that the aggregate response to CGT rate changes is not the sum of individual responses.⁸⁹

IV PANEL DATA CAPITAL GAINS REALISATION RESPONSE STUDIES

Panel data studies, as defined in this article, use tax return data for a number of consecutive years. In these studies, the same taxpayers are tracked over the years of the study. The literature considers panel data studies as an improvement on cross-section studies insofar as they attempt to address the problem of reporting of a transitory effect⁹⁰ rather than the effect of when the CGT rate is lowered permanently.⁹¹ According to the literature, however, some of the earlier panel data studies that attempted to separate permanent and transitory effects were not completely successful in achieving this, as the panels used were too short.⁹² The remainder of this section reviews some of the panel data studies in the literature.

Auten and Clotfelter is a seven-year panel data study which used a random sample of individual taxpayers from 1967 to 1973. The study is notable as one the first to

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⁸⁵ Ibid.

⁸⁶ Gravelle, above n 46, 215.

⁸⁷ Eichner and Sinai, above n 15, 673.

⁸⁸ Ibid, 678.

⁸⁹ Auten, Burman and Randolph, above n 12, 356–7.

⁹⁰ Specific to the individual taxpayer's income being relatively lower in a particular year.

⁹¹ Gravelle, above n 46, 213.

⁹² Ibid.

separately measure the permanent and temporary responses to changes in the tax rate. It found a permanent elasticity of between -0.37 and -0.55.⁹³

Auten and Clotfelter distinguish between transitory and permanent tax effects using their panel data set,⁹⁴ noting that it is important to include both permanent and transitory components of income as explanatory variables in their equation, as movements in transitory income can cause movements in marginal tax rates.⁹⁵ The Auten and Clotfelter study uses capital gains from all sources as its dependent variable, part of the rationale being that the data set did not contain information on the type of capital gains asset.⁹⁶ The explanatory variables in the study are permanent and transitory income, current capital income, age, retirement, marital status and the carryover of long-term capital losses.⁹⁷ The panel of tax returns used in the study included information on the exact age of taxpayers.

As part of their study, Auten and Clotfelter examined the extent to which marginal tax rates varied over time, given the importance of transitory effects and the timing of realisations by taxpayers when their tax rate is temporarily low. Auten and Clotfelter use a basic income measure as a value in their study, a predicted Adjusted Gross Income (AGI), intended to be independent of the capital gains for an individual taxpayer.⁹⁸ The predicted Adjusted Gross Income is AGI minus capital gains plus the average capital gains of the taxpayer's income class. Auten and Clotfelter use the predicted AGI to calculate a measure of permanent income: the logarithm of the average value of the predicted AGI for the current and previous two years.⁹⁹ The Auten and Clotfelter study includes dummy variables for individual years for exogenous factors affecting capital gains realisations such as the change in share prices.¹⁰⁰

The Auten and Clotfelter study calculates the individual taxpayer's marginal tax rate as the total of their 'normal' marginal rate and a transitory component. The normal marginal rate is a simple three-year average of the individual's tax rate and the transitory component is the difference between the taxpayer's tax rate in the year of income and their normal tax rate.¹⁰¹

Auten and Clotfelter find that the elasticity for all asset types is not as large as the elasticity for company shares, as estimated in previous studies such as Feldstein et al.¹⁰² Auten and Clotfelter use several additional equations in order to estimate the variation in responsiveness to marginal tax rates for different taxpayer groups. One of their findings here was that the transitory and permanent tax rate effects were larger for taxpayers under 65 than for the total sample.¹⁰³ The sample was also divided into two

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⁹³ Gerald Auten and Charles Clotfelter, 'Permanent versus Transitory Tax Effects and the Realization of Capital Gains' (1982) 97(4) *Quarterly Journal of Economics* 613, 614.

⁹⁴ Ibid.

⁹⁵ Ibid, 620.

⁹⁶ Ibid.

⁹⁷ Ibid.

⁹⁸ Ibid.

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Auten and Clotfelter, above n 93, 620.

¹⁰² Ibid, 628.

¹⁰³ Ibid.

classes of taxpayer income — taxpayers with income¹⁰⁴ of less than US\$25,000 and those with income of more than US\$25,000. Here, the transitory tax rate effect was slightly higher for the high-income group, whereas the permanent tax rate effect was only significant for the low-income group.¹⁰⁵ The authors consider this result somewhat unexpected and they explain that it may reflect that few high-income taxpayers are included in their panel, which may in turn make the results for these taxpayers less reliable and more sensitive to extreme values.¹⁰⁶

In their conclusions, Auten and Clotfelter identify some of the difficulties in undertaking empirical research on tax-induced behaviour. First, there is the problem of attempting to calculate a correct marginal tax rate. In the US context, such a calculation requires assumptions about the order in which taxpayers realise their short-term and long-term gains as well as their use of loss carryovers.¹⁰⁷ Auten and Clotfelter note that taxpayers may not be able to estimate the tax consequences of a particular transaction, given the complexity of the capital gains tax law.¹⁰⁸ This point may have implications for this type of research generally, to the extent that it is correct.

Auten and Clotfelter found that capital gains taxes cause a significant effect on the timing of realisations as reflected by the transitory effect that they estimated; they also concluded that it is likely there is a permanent lock-in effect of capital gains taxes, but that the coefficient is not always significant.¹⁰⁹ They conclude that the absolute level of realisations increases with permanent income, but that the increase is not proportionate.¹¹⁰ They estimate short-run elasticities for a range of specifications as well as a long-run elasticity of -0.5.

One of the limitations of the Auten and Clotfelter study is that because it uses a three-year average of federal tax rates, there is a correlation with the transitory component of the tax rate, meaning that the permanent and transitory rates cannot be separately estimated, since the three-year average constitutes a combination of the two.¹¹¹ According to Auten and Clotfelter it is important to determine how much marginal tax rates vary over time given the importance of transitory effects.¹¹² Auten and Clotfelter find, in conclusion, that although CGT rate reductions may produce increases in realisations of long-term capital gains, their study does not provide strong support for the hypothesis that such rate reductions lead to increased revenue for the Treasury.¹¹³

Auten, Burman and Randolph (1989) is a five-year panel data study. These authors refer to a number of advantages of panel data over cross-section data. One is that panel data allows the dynamics of the individual response to CGT rate changes to be estimated due

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¹⁰⁴ Adjusted gross income less capital gains.

¹⁰⁵ Auten and Clotfelter, above n 93, 629.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid, 627.

¹¹⁰ Ibid, 621.

¹¹¹ Leonard Burman and William Randolph, 'Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data' (1994) 84 *American Economic Review*, 794, 800.

¹¹² Auten and Clotfelter, above n 93, 619.

¹¹³ Ibid, 630.

to the availability of lagged data.¹¹⁴ Another is that panel data provides information about permanent income of taxpayers and allows for corrections for individual-specific fixed effects.¹¹⁵

Auten et al consider taxpayer wealth to be an important component of a model that measures elasticity and they note that such information is not available from tax returns. The authors used the results of the '1981–82 US Treasury Estate-Income Tax Match Study' to impute the total wealth of the taxpayers in their sample since there was no direct information on taxpayer wealth available in the tax return data they used.¹¹⁶ Auten et al include a number of demographic variables in their equation in an attempt to control for variances in trading strategies as a result of taxpayer preferences. For wealthier taxpayers there is a decision of whether or not to realise capital gains — which is distinct from the decision on the amount of capital gains to realise — and the failure to model this distinction may have led to biased estimation results in some previous micro-data studies.¹¹⁷

Auten et al note that previous studies that used a fixed marginal tax rate may have overstated the response of taxpayers to changes in CGT rates. Further, they note that focusing on individual capital gains realisation behaviour may ignore some important determinants of the aggregate revenue effects of CGT rate changes.¹¹⁸

Part of the purpose of the Auten et al study was to gain an understanding of why capital gains realisations equations from previous studies have yielded a wide range of varying results as well as the relevance of panel data to answering this question.¹¹⁹ The results of the Auten et al study suggest that one of the main reasons for the past variance in elasticities could be the simultaneity between marginal tax rates and capital gains realisations and the failure of previous studies to correctly deal with bias in sample selection.¹²⁰ Auten et al use a simulation method to examine the effect of changes in the individual income tax on aggregate capital gains and tax revenue.¹²¹ Jonathan Jones confirmed the problem of simultaneity between realisations and tax rates in a 1989 study.¹²²

Auten et al identify that using a lagged tax rate detected a short-term capital gains realisation response that was significantly greater than the long-run response.¹²³ They argue that data from a long panel are essential to separate the components of capital gains realisation responses that are due to tax policy from those due to individual-specific factors.¹²⁴ They also note that the five-year panel in their study is probably not

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¹¹⁴ Auten, Burman and Randolph, above n 12.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ibid.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Jones, above n 60.

¹²³ Auten, Burman and Randolph, above n 12.

¹²⁴ Ibid.

long enough, and that one of the problems this poses is that it cannot identify the differential between capital gains tax rates and other income.¹²⁵

Auten et al also identify deficiencies associated with panel data per se that a longer panel would not remedy, for example that focusing on individual capital gains realisation behaviour may ignore some important determinants of the aggregate revenue effects of capital gains tax changes.¹²⁶ This is notwithstanding another point they make, that panel data has the advantage of a lack of aggregation bias.

In their discussion of the estimation results, Auten et al note that older taxpayers are more likely to realise capital gains than younger taxpayers, but that older taxpayers realise lower levels of capital gains.¹²⁷ They also note that taxpayers with higher permanent income are more likely to realise higher amounts of capital gains.¹²⁸ As part of their study, Auten et al use a simulation model they developed to examine the effects of changing the inclusion rate on long-term capital gains. They found that where there was a small change in the inclusion rate, long-run elasticity was -1.63 and short-run elasticity was -1.98.¹²⁹ In the case of increasing the inclusion rate to 60 per cent, long-run elasticity was -1.67.¹³⁰

Auten et al call for more research to be undertaken on the effects of CGT policies on growth and rates of return in financial markets; they note that predictions about CGT revenue consequences CGT are tenuous in the absence of an understanding of the effects of CGT on Gross National Product, interest rates, dividend payouts and asset values.¹³¹

Slemrod and Shobe (1990) is a six-year panel data study. In their discussion of heterogeneity bias, the authors note that capital gains realisations behaviour is influenced by factors that are not observable by the econometrician and that unobservable explanatory variables can lead to inconsistent estimates of parameters.¹³² Notwithstanding this, Slemrod and Shobe assert that where the unobserved influences are specific to the individual taxpayer, it may be possible to minimise or avoid heterogeneity bias in panel data studies.¹³³ They attempt to achieve this by using a fixed-effects model to control for differences in permanent tax rates and other unobservable fixed effects that may have an effect on parameter estimates.¹³⁴

The panel used in Slemrod and Shobe was non-stratified and randomly selected. The number of individual taxpayers present in all six years of the initial sample was 6,152. The authors, however, limit their study to a 5 per cent subsample of tax returns consisting of 307 taxpayers. They selected the 5 per cent subsample based on their having the highest values of real positive income, excluding capital gains, when averaged

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¹²⁵ Ibid.

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Ibid, 363.

¹²⁹ Ibid, 366.

¹³⁰ Ibid.

¹³¹ Ibid, 371.

¹³² Slemrod and Shobe, above n 27.

¹³³ Ibid.

¹³⁴ Burman and Randolph, above n 111, 800.

over the six-year study period.¹³⁵ The 5 per cent subsample in the study realised 52 per cent of total net capital gains.¹³⁶ The authors explain two considerations that motivated their focusing on the highest income taxpayers in the sample. First, most capital gains are realised by higher-income taxpayers, with most lower-income taxpayers realising no capital gains.¹³⁷ Secondly, focusing on the top 5 per cent of taxpayers avoids a potentially serious econometric problem whereby a regression equation is estimated for which a large proportion of the observations on the dependant variable are zero.¹³⁸ Using the top 5 per cent allows for the linearity of the model and the normality assumption to be maintained with a minimal effect on the results.¹³⁹

Slemrod and Shobe analyse the panel data using a slightly modified version of the model estimated in Feldstein et al (1980). The dependent variable in the study is the long-term gains or losses divided by the sum of dividends and interest receipts.¹⁴⁰ Although it is a panel data study, they do not attempt to separately identify the transitory and permanent responses. The study uses ordinary least squares as the method of estimation for all four of their specifications.¹⁴¹

Slemrod and Shobe conclude that there is consistent support for an inverse response of capital gains realisations to changes in their rate of taxation.¹⁴² Although the elasticity estimates in Slemrod and Shobe are high, greater than 1 and greater than 5 in some cases, the authors qualify their findings by reference to a standard error quantum whereby even in the case of an elasticity that is in excess of 1, the coefficient may not be statistically different from zero.¹⁴³ Commentary on the study refers to possible limitations including that it appears to have captured transitory effects, as well as its use of the Feldstein et al (1980) methodology.¹⁴⁴ Slemrod and Shobe themselves refer to some limitations, such as the fact that their study is restricted to higher-income taxpayers and that elasticity studies generally are very sensitive to many dimensions of specifications.¹⁴⁵ They acknowledge that their results may capture some transitory effects.

Burman and Randolph (1994) is a panel data study in which the equation models the long-run relationship between capital gains realisations and rates as well as two transitory or timing effects. One of these transitory effects considers the tax cost of realising a capital gain in the current year, compared with waiting to do so in a later year. The second transitory effect relates to the influence of prior-year CGT rates on realisations. The rationale for the inclusion of this effect appears to be that past CGT rates can be an influence the stock of unrealised capital gains.

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¹³⁵ Slemrod and Shobe, above n 27, 13.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ Ibid.

¹³⁹ Ibid.

¹⁴⁰ Ibid, 16.

¹⁴¹ The four specifications are full sample and high income only for 1981–84 and full sample and high income only for 1979–84.

¹⁴² Slemrod and Shobe, above n 27, 24.

¹⁴³ Ibid.

¹⁴⁴ Gravelle, above n 4, 14.

¹⁴⁵ Slemrod and Shobe, above n 27, 24.

Burman and Randolph separated the transitory and permanent responses by using the variation in state tax rates to estimate the permanent elasticity; they considered state tax rates to be an easily measurable exogenous source of variation.¹⁴⁶ The study found a very large transitory elasticity of 6.42 and a very small permanent elasticity of 0.18.¹⁴⁷ Although the transitory elasticity is a large in comparison with most estimates of other studies at that time, it is consistent with the volume of the increase in realisations that occurred as a result of the *Tax Reform Act 1986*.¹⁴⁸ Burman and Randolph note that given the relatively large standard error, the hypothesis that permanent changes in CGT rates have no long-term effect on capital gains realisations cannot be rejected.¹⁴⁹

The data used in the Burman and Randolph study was taken from a panel of approximately 11,000 individual income tax returns for the years 1979–83.¹⁵⁰ Generally, a panel study of five years is considered to be short. The sample of taxpayers was stratified according to income and although unweighted data was used in the study, testing was conducted to ascertain whether endogenous stratification biased the estimates.¹⁵¹

Burman and Randolph's elasticity point estimates imply that the permanent elasticity is significantly less than the transitory response.¹⁵² Burman and Randolph use a lagged tax rate as a proxy for the unobservable size of accrued gains; they note, by way of example, that if the previous year's CGT rate was unusually high, then accrued gains in the current year should be higher than usual, given that the taxpayer would have postponed a proportion of realisations.¹⁵³ The sample includes the year 1981, in which the Economic Recovery Tax Act reduced the tax rates on ordinary income and capital gains.¹⁵⁴ The authors identify an advantage and disadvantage of including this year. The advantage is that significant variation in tax rates is introduced into the study, while the disadvantage is that some of the response to the CGT rate reduction may have been transitory.¹⁵⁵

Observations on individual taxpayers were included in the study whenever the current and lagged data were considered valid, and this process yielded 42,406 included observations.¹⁵⁶ The dependent variable in the study was net long-term capital gains before the carryover of prior-year losses.¹⁵⁷ The tax rate measure used in the study was determined with reference to the taxpayer's income and deductions and the applicable tax law for the year concerned.¹⁵⁸ Burman and Randolph calculated the marginal tax rate on capital gains transactions using defined realisation transactions rather than a single dollar of capital gains. The capital gain on each defined transaction was the maximum of

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¹⁴⁶ Burman and Randolph, above n 111, 795.

¹⁴⁷ Ibid, 805.

¹⁴⁸ Ibid.

¹⁴⁹ Ibid.

¹⁵⁰ Ibid, 801.

¹⁵¹ Ibid.

¹⁵² Ibid, 795.

¹⁵³ Ibid, 797.

¹⁵⁴ Ibid.

¹⁵⁵ Ibid.

¹⁵⁶ Ibid, 801.

¹⁵⁷ Ibid.

¹⁵⁸ Ibid.

US\$1,000 or the square root of imputed wealth.¹⁵⁹ The authors imputed permanent income by using the panel sample to regress the logarithm of a five-year average of real positive income on taxpayer characteristics.¹⁶⁰

Burman and Randolph note that previous micro-data studies lacked appropriate instruments for the permanent tax rate and that the estimates of tax effects in those studies could only be considered consistent if transitory and permanent responses were the same.¹⁶¹ Burman and Randolph find that capital gains realisations are significantly positively related to permanent income, but negatively related to transitory income, which suggests a consumption motive for realisations.¹⁶² They also conclude that wealthier taxpayers are much more likely to realise capital gains and that this demographic realises larger capital gains than average.¹⁶³ The study found that the composition of capital gains assets was also an influence on whether taxpayers were more likely to realise gains; that is, where shares comprised a larger share of the overall asset portfolio, the taxpayer was more likely to realise capital gains.¹⁶⁴ Burman and Randolph estimated an elasticity of 0.18 at an 18 per cent CGT rate.

Burman and Randolph concluded that there is a large and statistically significant difference between the transitory and permanent responses to CGT rate changes.¹⁶⁵ They used a first-dollar tax rate to estimate the transitory effect and they conclude that the lagged tax rate coefficient in their study is insignificantly small and that this implies that lagged taxed rates do not affect capital gains realisation decisions, provided current and permanent tax rates are held constant.¹⁶⁶

Burman and Randolph identified a number of limitations of their study. First, the effects of CGT on the cost and allocation of capital are ignored.¹⁶⁷ Secondly a reduced form model is used, as per other elasticity studies and this has the limitation of the estimated parameters being subject to change over time since they are a function of the macroeconomic environment and the tax law.¹⁶⁸ Secondary commentary on Burman and Randolph suggests imprecision caused by using the same set of explanatory variables in modelling the decision to realise capital gains as well as the amount of capital gains to be realised.¹⁶⁹

Auerbach and Siegel (2000) is a panel data study that uses the same empirical model as Burman and Randolph (1994), applying it to a different panel of taxpayers over the years 1985 to 1994 (a different period). For their main equation, Auerbach and Siegel

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¹⁵⁹ Ibid, 802.

¹⁶⁰ Ibid.

¹⁶¹ Ibid, 798.

¹⁶² Ibid, 806.

¹⁶³ Ibid.

¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid, 803.

¹⁶⁷ Ibid.

¹⁶⁸ Ibid.

¹⁶⁹ Tim Dowd, Robert McClelland and Athiphat Muthitacharoen, 'Heterogeneity in the Tax Responses of Personal Capital Gains Realizations' (2012) 65(4) *National Tax Journal* 827,833.

find a long-run elasticity of 0.34 and a transitory elasticity of 4.91;¹⁷⁰ however their study does not report the marginal tax rate used in determining the elasticities. They refer to the improved precision of their elasticity estimate compared to some earlier studies (such as Burman and Randolph) due to the large sample size and the improved spread of state tax rates over the sample period.¹⁷¹ The authors note that they are able to reject an elasticity of zero with a high confidence level, but that they can also exclude much above 0.5.¹⁷²

Auerbach and Siegel also run an alternative specification under which the elasticity point estimate increases from 0.34 to 1.75. This may be considered a high elasticity point estimate and its magnitude is similar to some of the panel and cross-section studies of the 1980s. The higher elasticity estimate may have been caused in part by the inclusion of a current first-dollar tax rate, which is likely to add a transitory element to the measurement of the permanent tax rate.¹⁷³

One of the most recent studies on the capital gains realisation response using panel data is a 2012 article by Dowd, McClelland and Muthitacharoen.¹⁷⁴ The authors explain their methodology, which improves the identification of elasticities by including a variable that affects the decision to realise capital gains, but not necessarily the amount of capital gains realised.¹⁷⁵ Dowd et al uses the term 'persistent elasticity', rather than permanent elasticity referred to in several previous studies, persistent elasticity is described as a measure of a tax rate increase that has persisted over the previous year and is expected to persist in the next year.¹⁷⁶ Dowd et al note that any attempt to decompose elasticities into those attributable to permanent changes in tax rates and those attributable to transitory changes in tax rates presupposes the existence of a permanent tax rate.¹⁷⁷ Dowd et al find a 'persistent' elasticity of 0.792.¹⁷⁸

The panel data studies have a compelling advantage over times series in that they include significantly more observations. If the panel includes information on asset types, it will also allow the researcher to identify differences in the behavioural responses between different types of investors and for realisations of different types of assets.¹⁷⁹ One of the weaknesses of panel data studies is the attrition of the population, with taxpayers in the panel who exit not replaced. Reasons for this attrition include the death of some members, the fact that some are no longer required to lodge tax returns due to incomes falling below the tax-free threshold, and because some tax returns may be lost

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¹⁷⁰ Alan Auerbach and Jonathan Siegel, 'Capital-Gains Realizations of the Rich and Sophisticated' (2000) 90(2) *American Economic Review* 276, 279.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Gravelle, above n 4, 16.

¹⁷⁴ Tim Dowd, Robert McClelland and Athiphat Muthitacharoen, 'New Evidence on the Tax Elasticity of Capital Gains' (2012), CBO Working paper 2012-09.

¹⁷⁵ Ibid, 4.

¹⁷⁶ Ibid.

¹⁷⁷ Dowd, McClelland and Muthitacharoen, above n 169, 834.

¹⁷⁸ Dowd, McClelland and Muthitacharoen, above n 174, 24.

¹⁷⁹ Auerbach, above n 18, 613.

due to processing errors.¹⁸⁰ Furthermore, the aging of a panel population is a contributor to the problem of nonstationarity.¹⁸¹

V CONCLUSIONS AND IMPLICATIONS FOR FUTURE AUSTRALIAN RESEARCH

Although capital gains realisation response studies from the United States have produced elasticity point estimates that vary widely, the literature identifies a core of time series studies with elasticity point estimates between 0.5 and 0.9 in absolute value. Some of the literature considers time series studies to be less variable overall and therefore more reliable. However, some of the consistency in the results of time series studies could relate, in part, to the fact that there is more similarity in the taxpayer data for time series.¹⁸²

According to some of the literature, time series studies are the best method of estimating long-run elasticity, despite the known problem of aggregation bias.¹⁸³ The Congressional Budget Office (CBO) considered the specific issue of aggregation bias in a 1988 study, which included separate estimates for the top one per cent and bottom 99 per cent of the population; the CBO found the effect of aggregation to be statistically insignificant.¹⁸⁴ Although aggregation bias is not a characteristic of studies that use micro-data, these types of studies have their own shortcomings, and this is particularly the case with cross-section studies. That is, where the data used does not allow the identification of, separate, timing effects they may result in an overstated elasticity estimate.

It appears that, irrespective of that data type chosen, the elasticity point estimate is sensitive to the specification of the estimating equation. Some of the capital gains realisation response studies reviewed included a sensitivity analysis as a way of testing the robustness of the results. The literature also notes the problem of choosing an appropriate tax rate to use in time series studies. The choice can be seen as something of a compromise given that, although a single tax rate must be decided on for the purpose of these studies, in practice, realisations decisions are made by many personal taxpayers who collectively face a wide range of tax rates on their capital gains realisations. Furthermore, the literature explains that elasticity will not necessarily be constant at all marginal tax rates or for all capital gains asset types.

While the review of the literature has confirmed there is no possible justification for the use of cross-sectional data, there are several arguments for and against the use of time series and panel data.

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¹⁸⁰ Alan Auerbach, Leonard Burman and Jonathan Siegel, 'Capital Gains Taxation and Tax Avoidance: New Evidence from Panel Data' in Joel Slemrod (ed), *Does Atlas Shrug* (Harvard University Press, 2000) 355, 359.

¹⁸¹ Ibid.

¹⁸² That is, differences in taxpayer data are more likely to arise from the years chosen for the time series study. In theory, two studies spanning the same years would have little or no difference in the taxpayer data.

¹⁸³ Eichner and Sinai, above n 15, 665.

¹⁸⁴ Gravelle, above n 46, 214.

The literature refers to the consistency of the time series estimates and the fact that many of these studies report elasticities that are lower than 1 in absolute value. The consistency of the estimates and their tendency to be relatively low in some cases may be appealing to revenue estimators. However, panel data appears to be a superior data choice for decomposing the permanent and transitory responses. This is because the problem of the loss of important information about timing responses through aggregated time series data appears to be quite difficult to overcome.

The case for using panel data in an Australian elasticity study, while compelling, must also consider the main practical impediment, being the non-availability of a suitable taxpayer panel data set.¹⁸⁵ A possible means of overcoming this issue is to stratify the aggregate time series data by taxpayer income classes.¹⁸⁶ Although this would not represent a panel of individual tax returns, each income class could count as a separate observation in each year. Although this method is not commonly used in regression analysis on capital gains realisations, part of the justification — apart from its increasing the number of observations — is that the elasticity of capital gains realisations is not necessarily constant at all levels of taxable income. The literature notes that generally, there would be a higher elasticity at higher tax rates.¹⁸⁷

In conclusion, panel data appears to be the most appropriate data type for separating permanent and transitory effects. In the absence of suitable panel data, the publicly available time series data can be utilised by researchers concerned with capital gains realisation response in the Australian context. The results of such a study would be useful for informing CGT policy in Australia.

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¹⁸⁵ Specifically, there is currently no panel data set of taxpayer returns available to researchers spanning years before and after the introduction of the 50 per cent CGT discount for personal taxpayers. Pooled data is available for several years after the CGT discount, but this may not be as useful as a long panel for separating the permanent and transitory responses to the introduction of the CGT discount.

¹⁸⁶ For example, the dataset could be stratified according to the marginal tax rate brackets for individuals. An issue that may confound the treatment of each income class as an observation is the fact that, over time, there have been several changes to the marginal tax rates and the thresholds at which these rates commence.

¹⁸⁷ Ibid.

**CHANGING USE OF BUSINESS STRUCTURES:
HAVE UNIVERSITY BUSINESS LAW TEACHERS FAILED TO REFLECT THIS IN THEIR TEACHING?**

BRETT FREUDENBERG AND DALE BOCCABELLA*

ABSTRACT

The use of business structures has changed over the last 20-years in Australia, with growing use of discretionary trusts and self-managed superannuation funds. Anecdotal evidence indicates that the business law curriculum within undergraduate Accounting degrees does not reflect this changing use. This article reports the results of a survey of business law teachers at Australian universities about the coverage of the law of the various business structures in undergraduate commerce degrees. Questions will be raised as to how adequately prepared accounting graduates are to deal with the different business structures they will confront in practice.

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I INTRODUCTION

At times there have been criticisms of academia in terms of the currency of the theories taught as well as its relevance and reflectiveness of current practice.¹ There have been arguments that the work of academia, including accounting, can lack relevance to what is practised.² This relevance can relate to the research undertaken as well as the education curriculum.³ O'Neil, Weber and Harris argue that it is important for tertiary accounting education to have content that is relevant and reflects current accounting practice.⁴

The study by Macdonald and Richardson found a lag between the content of the academic literature and the professional literature.⁵ While on average it was 2.48 years, there was a wide range in the time lags.⁶ Also they did find that this lag time had grown significantly from the mid-1980s to the end of the 1990s, from 0.9 years to over 6 years.⁷ One of the reasons suggested for this lag was that academics were out of touch with practice.⁸ Concerns continue to be raised, as Ahadiat questioned accounting faculties' continued emphasis on traditional accounting topics, contrary to the concerns of practitioners.⁹

Palm and Bisman have argued there can be a perception that accounting education is 'essentially stagnant'.¹⁰ Palm and Bisman contend that this lethargy means that

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- ¹ Richard Fleischman, 'Completing the Triangle: Taylorism and the Paradigms' (2000) 13(5) *Accounting, Auditing and Accountability Journal* 597.
  - ² Mark Hirst, 'Accounting Education and Advanced Cost Management Systems' (1990) (December) *Australian Accountant* 59; Gary Siegel, and C S 'Bud' Kulesza, 'The Practice Analysis of Management Accounting' (1996) April *Management Accounting* 20; Ellen Heffes, 'Making Accounting Relevant and Attractive' (2001) 17(3) *Financial Executive* 49.
  - ³ American Institute of Certified Public Accountants (AICPA), *Schism Committee Report* (American Institute of Certified Public Accountants (AICPA, 1978); Gary Sundem, *The Accounting Education Change Commission: Its History and Impact* (Accounting Education Change Commission and American Accounting Association, 1999).
  - ⁴ Cherie O'Neil, Richard Weber and David Harris, 'Assessing the Impact of the AICPA Model Tax Curriculum on the First Tax Course Taught at AACSB-Accredited Institutions' (1999) 30(8) *The Tax Adviser* 596.
  - ⁵ Laura MacDonald and Alan Richardson, 'Does academic management accounting lag practice? A cliometric study' (2011) 16(4) *Accounting History* 365.
  - ⁶ Ibid, 373.
  - ⁷ Ibid, 375.
  - ⁸ H Thomas Johnson and Robert Kaplan, *Relevance Lost: The Rise and Fall of Management Accounting* (Harvard Business School Press, 1987).
  - ⁹ Nas Ahadiat, 'In Search of Practice-Based Topics for Management Accounting Education' (2008) 9(4) *Management Accounting Quarterly* 42.
  - ¹⁰ Chrisann Palm and Jayne Bisman, 'Benchmarking Introductory Accounting Curricula: Experience from Australia' (2010) 19(1&2) *Accounting Education: An international Journal* 179, 3 citing W Steve Albrecht and Robert Sack, *Accounting Education: Charting the Course through a Perilous Future* (AAA, 2000).; David Cooper, Jeff Everett and Dean Neu, 'Financial Scandals, accounting change and the role of accounting academics: a perspective from North America' (2005) 14(2) *European Accounting Review* 373; Michael Diamond, 'Accounting Education, research and practice: after Enron, where do we go?' (2005) 14(2) *European Accounting Review* 353; Sue Ravenscroft and Paul Williams, 'Rules, rogues, and risk assessors: academic responses to Enron and other accounting scandals' (2005) 14(2) *European Accounting Review* 363.

there can be a 'mismatch' between accounting education and the reality in which practitioners work.¹¹

Ravenscroft and Williams, in their discussion about accounting education post-Enron in the United States, have argued that:

there are currently serious omissions from the accounting curriculum that need to be rectified, and that accounting students are miss-educated in certain critical areas. In these areas the tendency is to inculcate students with a convenient mythology rather than to educate.¹²

Similar concern has been reiterated in Australia, and even large accounting scandals appear to have had little impact on the curricula at universities.¹³ While these concerns may relate to the accounting discipline generally in terms of accounting concepts, they may suggest an overall sluggishness of the accounting curricula in moving to reflect modern practices.

In a thought-provoking article in the American context, Friedman raises concerns about the current coverage of business structures at university law schools, in particular the increasingly prevalent new business structure, the Limited Liability Company ('LLC').¹⁴ Friedman implies that academics have neglected to ensure that the curriculum (and textbooks) remain up-to-date by reflecting current business practices. At the time of his writing LLCs represented 45 per cent of new business structures, but this popularity was not similarly reflected in law schools' curriculum, publications or bar examinations. It was argued by Friedman that the delay by academia in teaching about LLCs in American law schools has 'created significant costs through suboptimal legal education'.¹⁵ Friedman contends that the next generation of lawyers is being 'poorly served' and are 'leaving law school without an understanding of the details or the importance of LLCs'.¹⁶

In a similar vein, concerns are raised about the coverage of the law of trusts in the Australian university accounting curriculum, given the rise in the use of trusts and self-managed superannuation funds (SMSFs) in the commercial world. This concern is based, in part, on the large role accountants play in the ongoing compliance work and advisory work of the various business structures used in Australia. Cooper argues that 'one of the distinctive features of the Australian economy is the amount of economic activity undertaken using trusts, rather than

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¹¹ Ibid, 3.

¹² Sue Ravenscroft and Paul Williams, 'Accounting Education in the US post-Enron' (2004) 13 (Supplement 1) *Accounting Education: An international journal* 7, 8.

¹³ Lee Parker, 'Corporate governance crisis down under: post-Enron accounting education and research inertia' (2005) 14(2) *European Accounting Review* 383.

¹⁴ Howard Friedman, 'The Silent LLC Revolution — The Social Cost of Academic Neglect' (2004) 38(1) *Creighton Law Review* 35.

¹⁵ Ibid, 81.

¹⁶ Ibid, 81.

companies'.¹⁷ Also over the last two decades there has been a staggering growth in SMSFs.

There is currently little empirical evidence and information about the business law curriculum in Australian business law and accounting schools. This article has two aims. First, it determines the extent to which accountants, as a profession, deal with or are involved with the various business structures used in the Australian commercial landscape. It is suggested that the accounting profession is the main profession associated with the compilation, management and auditing of the financial performance of business structures' activities.

Against this background, the question arises as to the extent to which the curriculum in Australian business degrees (major in accounting) adequately addresses the education needs of future accountants about the legal (and tax) issues surrounding the business structures used, in particular the growing utilisation of trusts and SMSFs. This article explores the extent to which Australian accounting students are taught about the law governing the various business structures. The article concludes that the legal curriculum of Australian commerce degrees has not kept up with Australian commercial practice in the use of the various business structures.

Aside from this introduction and the conclusion, the article is in four parts. The first part will discuss in broad terms concerns with academic curriculum per se. The second part outlines the utilisation of the different business structures in Australia and in particular highlights the prevalent use of trusts and SMSFs. The third part of the article considers the level of engagement that accountants have with the various business structures, including for example, their role in recommending a particular business structure to utilise and ongoing advice to business structures. In the fourth part of the article evidence will be outlined of the current amount of time devoted to the teaching of the law of business structures in Australian accounting degrees. Thereafter, recommendations will be canvassed before finally concluding.

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¹⁷ Graeme Cooper, 'Reforming the Taxation of Trusts: Piecing together the Mosaic' (Paper presented at the Australasian Tax Teachers Association Conference, Sydney University, 16–18 January 2012), 1.

II CONCERNS ABOUT ACADEMIC CURRICULA

O'Neil, Weber and Harris have argued that 'for tax education to be relevant the content must be relevant to accounting practice'.¹⁸ We suggest that the tenor of this argument is relevant to all of the accounting curriculum, as it is essential for it to reflect current practice. For example, in terms of management accounting Johnson and Kaplan argued that American academia had been disengaged from industry practice through the larger part of the twentieth century.¹⁹ This criticism was raised both in terms of teaching and text books. Johnson and Kaplan argued that due to outdated techniques, there was a reduction in the competitiveness of the United States.²⁰

Concerns have been raised about the whether the curriculum taught at American universities adequately reflects business practices. Ravenscroft and Williams highlight how critical it is for accounting students to understand the role of the business structure, in particular the corporation, as 'modern societies ... are now completely dependent on them for our sustenance; their activity has pervasive effects'.²¹ They argue that in terms of 'content', there needs to be consideration given to the historical concept of a corporation, the role of investors, as well as ethics and the role of accounting reports.²² Also Friedman has questioned whether law schools, law professors, law publishers and bar examiners have neglected to alter curriculum to reflect the increasing use of a new business structure that is challenging the corporation, the LLC, in that jurisdiction.²³

The Australian research into expectation gaps between accounting graduates and employers by Jackling and De Lange largely only considers graduate skills and does not unfortunately survey the content knowledge required.²⁴ In the research project funded by the Australian Learning and Teaching Council 'Accounting for the future: more than numbers' that considered the skill set for professional accounting graduates there was some consideration of 'content/technical' as opposed to graduate skills.²⁵ This research found that the most frequently mentioned technical skills were tax, debits and credits, auditing, understanding financial reports and preparing financial statements.²⁶ The report noted that 'employers expected rudimentary knowledge of technical skills and not much more....based on a solid framework of theoretical understanding gained at university'.²⁷ The report notes

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¹⁸ O'Neil, Weber and Harris, above n 4, 600.

¹⁹ Johnson and Kaplan, above n 8.

²⁰ Ibid.

²¹ Ravenscroft and Williams, above n 12, 8.

²² Ibid.

²³ Friedman, above n 14.

²⁴ Beverley Jackling and Paul De Lange, 'Do Accounting Graduates' Skills Meet The Expectations of Employers? A Matter of Convergence or Divergence' (2009) 18(4–5) *Accounting Education* 369.

²⁵ Phil Hancock et al, *Accounting for the future: more than numbers (Vol. 1: Final Report)* (Australian Learning and Teaching Council, 2009).

²⁶ Ibid, 51.

²⁷ Ibid, 51.

there were frequent comments about superannuation, tax and trusts and companies by employers, with a need for ongoing training.²⁸

Prentice in America has argued for greater legal training for accountants,²⁹ which Gunz and McCutcheon have in part attributed to recent accounting scandals.³⁰ The focus for increased legal education is said to be needed because of the role that law plays in society, with business structures and in ethical decision making.³¹

Currently, the two main accounting professional bodies require graduates to complete the following business law courses in their undergraduate degrees: Introduction to Law, Law of Business Associations and Taxation Law.³² Kocakulah et al. have argued that in the American context, 'business law education of accounting students is not as strong as the education of accounting students in other areas tested on the CPA examinations'.³³ Kocakulah et al. contend that one of the reasons for this is due to the minor involvement of accounting chairpersons in developing and establishing business law curriculum.³⁴ This is despite the fact that more than three-quarters of accounting chairpersons considered that there should be greater collaboration and discussion between business law and accounting academics as to the legal topics to be taught to accounting students.³⁵

In terms of which areas of business law were seen as important by American accounting chairpersons three of the top eight areas concerned business structures (corporations ranked 3rd; LLCs and LLPs ranked 5th and sole proprietors and partnerships ranked 8th).³⁶ This would tend to indicate that in America the teaching of business structures is seen as an integral part of business law education for accountants. Other top ten topics were: (1) Accountants' liability; (2) Contracts; (3) Privileged communication and confidentiality; 6th: Securities regulation; 7th: Debtor-creditor relationships; 9th: Agency and 10th: Negotiable instruments.³⁷

In terms of volume or time devoted to covering business structures in America, Kockakulah et al, (2008) questions whether there is adequate coverage of business structures for accounting students if there is only one chapter dedicated to the topic in the textbook.³⁸

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²⁸ Ibid, 54 and 58.

²⁹ Robert Prentice, 'The case for education legally-aware accountants' (2001) 38(3) *American Business Law Journal* 597.

³⁰ Sally Gunz and John McCutcheon, 'The AICPA in crisis and how it impacts the business law dispute' (2002) 20(2) *Journal of Legal Studies Education* 203.

³¹ Ibid.

³² Note that the Institute of Chartered Accountants of Australia (ICAA) requires the three courses listed to be undertaken, but CPA Australia allows the Taxation Law course to be undertaken in a candidate's professional examination process.

³³ Mehmet Kocakulah, A David Austill and Brett Long, 'The Business Law Education of Accounting Students in the USA: The Accounting Chairperson's Perspective' (2008) 17(Supplement) *Accounting Education: An international journal* 17, 19–20.

³⁴ Ibid, 20.

³⁵ Ibid, 28.

³⁶ Ibid, 26.

³⁷ Ibid.

³⁸ Ibid, 27.

A Business Structures and Tax

Concerns with the coverage of business structures have also been raised in respect of tax education of accountants. In respect of the American tax curriculum, studies by Schwartz and Stout³⁹ and Sage and Sage⁴⁰ found that there was a gap between what educators emphasised compared to what practitioners desired with educators spending more time on individual tax matters compared to corporate tax matters. The study by O'Neil, Weber and Harris into the tax curriculum found a continuation of the dominance of the focus on individual taxpayers.⁴¹

A UK study by Miller and Woods about the expectation gap between tax educators and tax professionals concluded that professional bodies can influence the content and structure of courses.⁴² In New Zealand — a jurisdiction similar to Australia — Tan and Veal examined the content coverage of the first tax course in that country.⁴³ One of their findings was that practitioners thought more conceptual and technical ability was required in terms of trusts, while educators had lower requirements.⁴⁴ Indeed, one of the largest expectation gaps in conceptual knowledge between practitioners and educators concerned trusts, with practitioners wanting more.⁴⁵

III BUSINESS STRUCTURE USE IN AUSTRALIA

Morse observed that following the early 1900s the creation of new business structures remained substantially free from parliamentary activity,⁴⁶ although the regulatory and tax regime(s) applicable to these traditional business structures has altered.⁴⁷ After this period of inactivity, there has been considerable movement in recent years in Australia:

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³⁹ Bill Schwartz and David Stout, 'A Comparison of Practitioner and Educator Opinions on Tax Education Requirements for Undergraduate Accounting Majors' (1987) 2 *Issues in Accounting Education* 112.

⁴⁰ Judith Sage, and Lloyd Sage, 'CPA Firm Recruiters' Views of the Tax Curriculum as it Relates to the 150 Hour Requirement' (1987) 52(1) *South Dakota Business Review* 1.

⁴¹ O'Neil, Weber and Harris, above n 4.

⁴² Angharad Miller and Christine Woods, 'Undergraduate Tax Education: a comparison of Educators' and Employers' Perceptions in the UK' (2000) 9(3) *Accounting Education* 223.

⁴³ Lin Mei Tan and John Veal, 'Tax Knowledge for Undergraduate Accounting Majors: Conceptual v Technical' (2005) 3(1) *eJournal of Tax Research* 28.

⁴⁴ *Ibid*, 37.

⁴⁵ *Ibid*, 38.

⁴⁶ The United Kingdom offered businesses effectively four generic business forms: the sole trader, the general partnership, the limited partnership and the corporation. The limited partnership was the last to be introduced; by the *Limited Partnership Act* 1907 (UK).

⁴⁷ Geoffrey Morse, 'Limited Liability Partnerships and Partnership Law Reform in the United Kingdom' in Joseph McCahery, Theo Raaijmakers and Erik Vermeulen (eds), *The Governance of Close Corporations and Partnerships: US and European Perspectives* (Oxford University Press, 2004). For example, Australia's regulatory laws governing corporations have been altered a number of times, with extensive reforms in the 1990s, which saw the introduction of the *First Corporate Law Simplification Act* 1995 (Cth).

the trust form is pervasive and manifests itself in different ways and to differing effect in the large business segment, the small business environment and in the family / household sector.⁴⁸

And, from another commentator:

Australia is a country of 22.3 million people so this means there is approximately one trust for 20 people and one company per 29 people.⁴⁹

The ‘traditional business structures’ could be described as sole proprietors (or sole traders), general partnerships and corporations (and to a lesser extent limited partnerships). It is argued that these business structures, particularly general partnerships and corporations, that have dominated the academic consciousness in the design and delivery of accounting degrees. However, unlike other jurisdictions, Australian businesses have been utilising another form — the trust — for trading activities.⁵⁰ Also, SMSFs have increased in number due to the government’s push for self-funded retirement. Even though a SMSF is not a business operating entity but rather a retirement savings vehicle, we will refer to the SMSF within the framework below due to their growing utilisation and importance in Australia.⁵¹

The use of trusts varies from deceased estates, charitable foundations to active business and investment activities conducted by small and medium enterprises, retail collective investments (which can be listed on the stock exchange), funds management, and superannuation/pension funds.⁵² Vann considers that there was a large scale shift from corporations to trusts in the mid-1970s based on trusts perceived superiority for tax and non-tax reasons.⁵³

When considering income tax return data, of the 2,999,190 taxpayers in 2012 who indicated that they were conducting a business, 36 per cent were sole proprietors, 27 per cent corporations, 25 per cent trusts and 12 per cent partnerships: Table 1.

Table 1: AUS: Lodgement of Tax Returns — Business

Entity	2009-10	2010-11	2011-12
Individual (sole proprietor)	1,044,386	1,057,392	1,067,700
Company	779,250	788,985	817,855
Partnership	382,400	370,000	359,905

⁴⁸ Cooper, above n 17, 3.

⁴⁹ Richard Vann, ‘*Taxation of small business — Working paper*’ (University of Sydney, 2012), 20.

⁵⁰ Note that the trust is not a separate legal entity.

⁵¹ For many small business owners, assets built-up in an operating entity is an indication that the entity is being used as a retirement savings vehicle. The tax rules effectively accept this (eg the presence of the \$500,000 lifetime exemption for capital gains in Subdivision 152-D of the ITAA 1997).

⁵² Cooper, above n 17, 1.

⁵³ Vann, above n 49, 9.

Trust	702,080	729,620	753,730
Total (excluding super)	2,908,116	2,945,997	2,999,190
Self-managed super fund	373,195	391,165	424,360
APRA and other funds	4,500	4,100	3,695

Source: Australian Taxation Office, *Taxation Statistics 2012*, (Australian Taxation Office, 2014), Table 1. *Limited partnerships are not recorded separately and are included in the corporation figure. In 2010 there were 386 limited partnerships with taxable income greater than \$0: Table 3.10, 26.

In terms of size, 99.6 per cent of sole proprietors have less than \$2 million in turnover: Table 2.

Excluding those taxpayers who have 'nil business income' and superannuation funds, of the businesses with less than \$10 million income (categorised by the Australian Taxation Office (ATO) as 'small'), 45 per cent are sole proprietors, 29 per cent corporations, 12 per cent partnerships and 13 per cent trusts. According to statistics for Australian Business Numbers, there are currently 2,684 limited partnerships registered with an Australian business number.⁵⁴ There appears to be decline in the number of partnerships, which is similar to overseas jurisdictions.⁵⁵ For taxpayers with business income greater than \$10 million, the corporation is the most popular (74 per cent), followed by trusts (19 per cent), partnerships (5 per cent) and sole proprietors (2 per cent).

Table 2: AUS: Lodgement of Tax Returns — Size

Entity size	Individuals	Companies	Super funds	Partnerships	Trusts	Total
Loss (< \$0)	1,400	1,790	35	275	735	4,235
Nil (ie not in business)	11,668,330	110,405	59,290	69,170	436,105	12,343,300
Micro (> \$0 but < \$2M)	1,062,640	635,150	368,410	281,690	290,480	2,638,375

⁵⁴ At <www.abr.business.gov.au/StatisticalSearchResult.aspx> 27 July 2012. Note that the formation, operation, etc, of limited partnerships is governed by state and territory law. The statistics available as to the number of limited partnerships in each jurisdiction are as follows: Queensland: 276 (unincorporated) and 10 (incorporated); New South Wales: 844 (unincorporated) and 119 (incorporated); Tasmania: 123; Australian Capital Territory: 1; Northern Territory: Zero; Other States: Western Australia, South Australia and Victoria do not have a central register of limited partnerships. Limited partnerships can be registered with a number of bodies, which keep different databases. Additionally, partnerships may be registered with more than one body. As such, it is not possible to obtain figures for these three states.

⁵⁵ Robert Hillman, 'Limited Liability and Externalization of Risk: A Comment on the Death of Partnership' (1992) 70 *Washington University Law Quarterly* 477.

Small (>\$2M but <\$10M)	3,285	53,805	120	7,615	22,070	86,900
Medium (>\$10M but < \$100M)	360	14,535	100	1,050	4,150	20,200
Large (>\$100M but < \$250M)	10	1,185	40	65	150	1,450
Very large (> \$250M)	0	1,010	60	40	35	1,150
Total	12,736,030	817,885	428,055	359,905	753,730	15,095,605

Source: Australian Taxation Office, *Taxation Statistics 2012*, (Australian Taxation Office, 2014), Table 2.

With the figures above it needs to be highlighted that for corporations the numbers are inflated, as a number of business structures are deemed for tax purposes to be corporations (eg limited partnerships and public unit trusts). Also, a large number of trusts, such as superannuation funds, which are essentially a trust relationship, are not reported. In particular the number of SMSFs has grown with the push for self-funded retirement.

Table 3 sets out the number of SMSFs that are regulated by the ATO for compliance with prudential standards along with the smaller number of APRA-regulated small superannuation funds.

Table 3: Number of SMSFs and APRA Regulated Small Superannuation Funds

Entity	2009-10	2010-11	2011-12
Self-managed super fund	373,195	391,165	424,360
APRA and other funds	4,500	4,100	3,695

Source: Australian Taxation Office, *Taxation Statistics 2012*, (Australian Taxation Office, 2014), Table 1. APRA and other funds: includes funds regulated by APRA, funds that nominated 'other' on their tax return, and non-regulated funds.

While the term 'trust' may seem to indicate a homogeneous business structure, there are in fact various types of trusts. Table 4 demonstrates the different types of trusts; discretionary trusts account for over three-quarters of them. Discretionary trusts as an alternative business structure are used in a variety of sectors:⁵⁶ 39 per cent are in the property industry, 29 per cent in finance, insurance, real estate and business services, and six per cent in each of retail trade and primary production.

⁵⁶ Coopers and Lybrand and the Property Council of Australia, *The taxation of trusts — Dispelling the Myth* (1997), available at <http://www.propertyoz.com.au/data/national/advoc/subs/971119tt.pdf>.

Table 4: AUS: Types of trusts

Type of Trust	2009–10	2010–11	2011–12
Discretionary trust-main source from investment	303,650	305,390	303,045
Discretionary trust-main source from service-management	41,050	40,850	38,865
Discretionary trust-main source from trading	244,890	249,190	244,575
Cash management unit trust	610	640	600
Hybrid trust	10,600	10,415	9,330
Fixed unit trust	86,035	86,900	83,900
Other fixed trust	18,085	18,640	17,785
Public unit trust-listed	410	380	345
Public unit trust-unlisted	5,085	4,885	3,535
Deceased estate	49,130	51,085	48,595
Other	4,560	11,970	3,160
Total	764,105	780,345	753,735

Source: Australian Taxation Office, *Taxation Statistics 2012*, (Australian Taxation Office, 2014).

While the taxation of trusts has been described as a 'relatively sleepy backwater of tax law for almost 60 years' in the last 15 years there has been abundant activity.⁵⁷ The significant growth in the use of trusts from the late 1980's where there were around 100,000 to nearly 800,000 by 2012, around twenty years later, is demonstrated in Figure 1.⁵⁸

⁵⁷ Cooper, above n 17, 5.

⁵⁸ Note the period of no growth between 1998 to 2001 correlates to the time of the government's proposed fundamental changes to the taxation of trusts which would have seen them taxed as corporations. These proposed reforms were subsequently discarded, which then saw the growth of trusts continue. See: Brett Freudenberg, 'Entity Taxation: The inconsistency between stated policy and actual application' (2005) 1(2) *Journal of the Australasian Tax Teachers Association* 458.

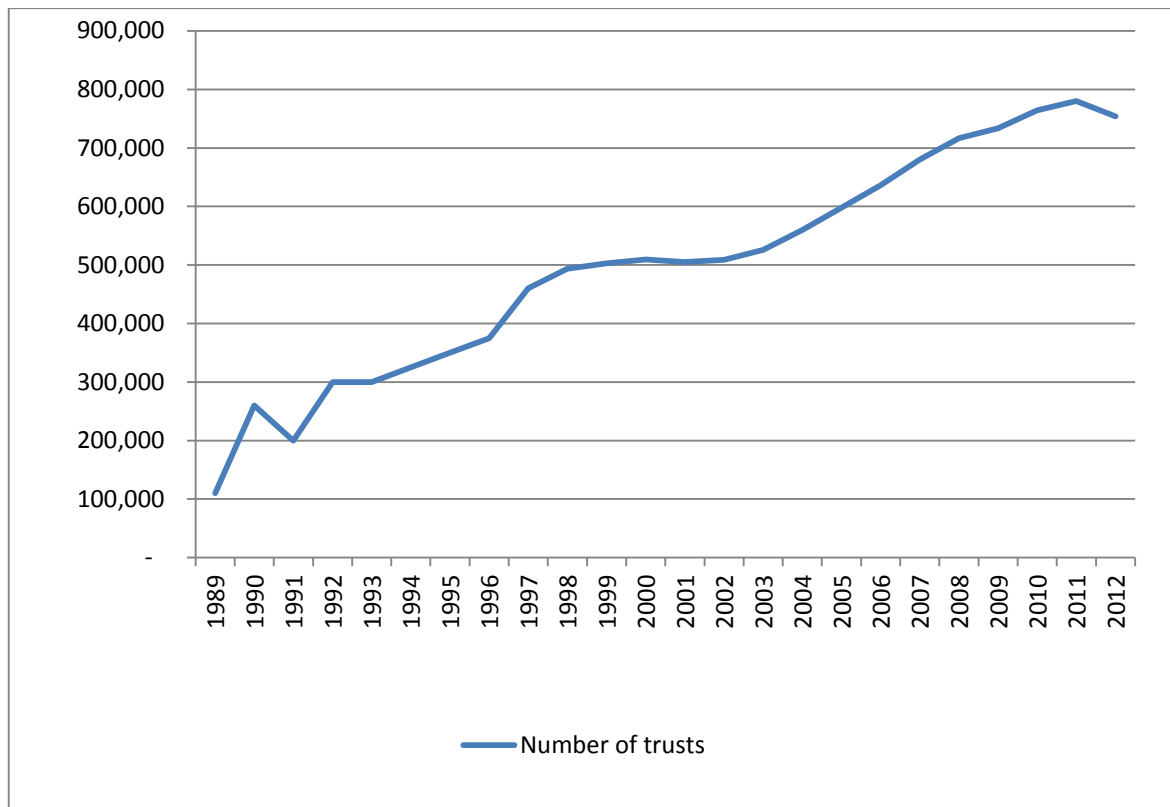


Figure 1: AUS: Number of trusts

Source: Board of Taxation, *Taxation of Discretionary Trusts: A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer* (AGPS, 2002), 25 and Australian Taxation Office, *Taxation Statistics 201 2*, (Australian Taxation Office, 2014).

Consequently, these figures demonstrate that in Australia there is a variety of business structures used, with a growing utilisation of trusts and SMSFs, beyond the 'traditional' business structures of corporations, general partnerships and sole traders. However, to what extent do accountants interact with these business structures in their practice?

IV ROLE OF ACCOUNTANTS IN BUSINESS STRUCTURES

It is suggested that accountants play an important role in the utilisation of business structures throughout the life-cycle of a business, from: (1) formation to (2) operation and (3) dissolution.

The focus here is on public practice accountants advising clients that use the various entities to own and/or operate commercial activities. The three life stages of an entity are not discrete, and should not be seen as discrete. The reason is that once a choice of entity is made, that necessarily 'locks in' the rules applicable to that entity at the operation and dissolution (exit) stages. Accordingly, the formation stage must be seen as the most important. On the other hand, the restructure of an operating entity (such as from partnership to company) during the operating phase also highlights the overlap between the stages (for example, this is a formation in one sense). In light of this, we will divide the analysis into the three stages.

Within each stage, and for convenience, we will also create a further division of non-tax and tax. Like the stages of an entity, at times the non-tax and tax division also is not discrete and overlaps. For example, an accountant who is advising a trustee on the allocation of income (profits) of a discretionary trust and the timing of that allocation must be aware of the central terms of the relevant trust deed in order to be able to advise in a tax-effective manner.⁵⁹ A similar point can be made in regard to a company that has different classes of shares. In spite of this overlap, as far as practically possible, we will maintain this division.

A Formation

The choice of business structure or property-owning asset form will usually be a complex question that needs to take account of a range of tax and non-tax issues most relevant to the particular client and/or the client's family. It is very likely that more than one professional advisor will be involved in the provision of advice associated with such a decision. However, it is very unlikely that a client faced with a choice of business structure decision would seek out advice solely from a legal practitioner. Indeed, it is submitted that overwhelmingly, an accountant would be the first point of contact on this question, and at times, the only point of contact. However, it is likely that the accountant (on behalf of the client) may seek input from a legal advisor (legal practitioner) and from a tax advisor (who may be a legal practitioner or accountant). The advice itself could be fairly expensive. If drafting a constituent document for the entity is required (such as a trust deed), it is likely that this service must be obtained from a legal practitioner, and not an accountant.

Even where an accountant refers higher-level specialist advice to another professional, it is submitted that clients will still look to their accountant for an explanation of the specialist advice. This suggests that the accountant must appreciate, to an 'explainable extent', the specialist advice.

Studies from the United Kingdom demonstrate that accountants have an active and large role in small business advice about which business structure to utilise. In a United Kingdom study in the early 1990s, Hicks et al sought to investigate why small businesses chose to incorporate, what the role of advisors was in this decision, and what the consequences were of such decisions.⁶⁰ The role of accountants in assisting with incorporation was found to be great, as 70 per cent of corporations were formed by accountants, 13 per cent by company registration agents and only 12 per cent by solicitors.⁶¹ Also, even though formal advice

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⁵⁹ There are a number of cases where a trustee has purported to make a distribution to a person who is not a beneficiary (object) of the relevant trust (see: *Hopkins & Anor v FCT* 2012 ATC 10-249, 14).

⁶⁰ Andrew Hicks, Robert Drury and Jeff Smallcombe, 'Alternative Company Structures for the Small Business,' in *ACCA Research Report No 42*, (Certified Accountants Educational Trust, 1995). The method adopted was a combination of extensive questionnaires followed by in-depth face-to-face interviews. This resulted in 152 completed responses from businesses and interviews with 30 advisors across England. In terms of business forms, 32 sole traders were represented, 30 partners and 90 directors of corporations. The advisors were 16 accountants, 10 lawyers and four business advisors.

⁶¹ *Ibid*, 16.

occurred only in approximately one-third (36 per cent) of cases, 97 per cent of this advice was from accountants, with the remaining 3 per cent from solicitors.⁶²

When it came to general partnerships, lawyers had a more prominent role; 85 per cent of these were drawn up by a solicitor and 15 per cent by an accountant.⁶³ The difference between corporations and general partnerships may have to do with reforms that make setting up a corporation relatively easy, so that no legal qualification is required to purchase a corporate shell. For sole traders, when formal advice was obtained, 50 per cent was from accountants and 30 per cent from solicitors.⁶⁴

In another study it was found that the three most satisfactory sources of advice in terms of business structure advice was received from accountants (45.6 index score), business colleges (15.6) and solicitors (8.3).⁶⁵ Hicks et al concluded that the reason accountants were so heavily involved in the decision to incorporate (as well as the other business structures considered) could be due to 'the close involvement of accountants with small business, and their detailed knowledge of the financial and tax affairs of their clients'.⁶⁶ It is suggested that Australia could be similar, in relation to the accountant being dominant in the role of giving business structure advice, particularly when businesses are commencing.

The findings of an Australian study regarding entrepreneurship tends to support the use of accountants rather than lawyers for advice about the choices available for of business formation, as chartered accountants were found to be the most important type of paid consultant.⁶⁷ One finding was that 46 per cent of firms had retained an accountant, whereas only 17 per cent had retained a lawyer.⁶⁸ This is despite the fact that some of this formation advice could be considered legal advice, which accountants are not permitted to provide for a fee.

(a) *Non-tax*

In a recent study about what Australian accounting practitioners thought was the most important factor determining the choice of business structure, it was found that asset protection, which relates to, or encompasses such things as limitation of liability of investors and insurance against 'economic predators and gold-diggers', is the most important non-tax consideration.⁶⁹ This requires an appreciation of the liability exposure rules associated with each entity and 'entity owners'. While the

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⁶² Ibid, 16.

⁶³ Ibid, 23.

⁶⁴ Ibid, 23.

⁶⁵ Alan Southern and James Meyrick, *Owner-Managed Business and their Tax: An interim report on the views of small businesses* (Houses of Parliament, 2004), 10.

⁶⁶ Hicks, Drury and Smallcombe, above n 60, 28.

⁶⁷ Per Davidsson, Paul Steffens and Scott Gordon, 'Comprehensive Australian Study of Entrepreneurial Emergence (CAUSEE): Design, Data Collection and Descriptive Results' in Kevin Hindle and Kim Klyver (eds), *Handbook of Research on New Venture Creation* (Edward Elgar, 2011), 24.

⁶⁸ Ibid, Table 6.

⁶⁹ Brett Freudenberg, 'Tax on my mind: Advisors' recommendations for choice of business form' (2013) 42(1) *Australian Tax Review* 33.

rules for sole traders and partnerships and companies⁷⁰ are fairly straightforward in most situations, this cannot be said for fixed/unit trusts and discretionary trusts.⁷¹ Further, the rules in regard to protecting assets from inclusion in the property pool, among other things, on relationship breakdown, and the rules regarding 'clawback' for testator family provision claims are also not straightforward. Again such advice borders on legal advice, which clients should seek advice from a qualified legal practitioner.

Unless a client's accountant was able to narrow the range of services he/she offers clients, it is difficult to see how accountants can limit their involvement in regard to asset protection issues with clients completely, even if it is only as a conveyor of specialist advice. Accordingly, it is submitted that a skill set that does not include an appreciation of asset protection issues associated with each of the main entity types would be a substandard situation.

It is also submitted that control of the entity, or the operations of the entity, will feature highly. Clients who have produced wealth are very unlikely to want to give up control over wealth already created. A similar point could be made in regard to future income from current wealth. Control would usually be reflected in constituent documents of entities and/or by virtue of holding an 'office'. Again, and especially because of the link between control of an entity's operations and tax outcomes, the accountant would want to have a good appreciation of control mechanisms for the entity. Complying with the legal formalities associated with the successful establishment of each type of entity would also seem to be a required skill set at the formation stage of an entity (such as settlement sum for a trust).

(b) Tax

It is submitted that tax minimisation ranks close to asset protection where the choice of business structure is involved, and this is supported by a recent Australian empirical study.⁷² Australia's income tax system does not provide a high degree of tax neutrality between the various business structures. The sole trader and the general law partnership provide for flow-through taxation. The trust vehicle and the company vehicle do not provide for full flow-through taxation even though look-through taxation can apply to profit distributions. The discretionary trust will generally be the most advantageous vehicle in terms of lowering income tax on a given amount of taxable income. In addition, the rules are not identical in terms of capital gains made by the various business structures.

It is clear that accountants are heavily involved in managing the tax affairs of their clients. Furthermore, subject to a particular provision, the tax law operates on the general law outcome of transactions and/or business structures. This suggests that

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⁷⁰ Companies that have discretionary dividend shares (often called dividend access shares) add a layer of complexity in terms of the limitation of liability issue.

⁷¹ The rules surrounding a trustee's right of indemnity against trust assets and beneficiary assets, and the all-important rights of trust creditors to 'piggyback' on this right are the subject of a complex array of rules.

⁷² Freudenberg, above n 69.

the required skill set for this task is not merely the tax rules that apply to the various entities. Rather, an appreciation of the non-tax rules associated with each entity and entity owner would also be required.

B Operation

(a) Non-tax

At the operation stage of an entity's life, one would expect some or a number of regulatory reporting requirements to be met. For example, for companies there could be Australian Securities and Investments Commission (ASIC) returns and for SMSFs, there could be returns required to be lodged with the ATO, the regulator of SMSFs. Sole traders, general law partnerships and private trusts would not seem to have regulatory reporting obligations. The skill set associated with each reporting obligation will vary but the SMSF entity would have the most onerous requirements because of the need to comply with the superannuation supervisory laws in order to be able to access concessional income taxation treatment.

In Australia, concerns about the role of accountants and other service providers in dealing with governance documents involving trusts has been raised by Hor, highlighting that accountants may not have 'the expertise or experience to properly understand the trust deeds that they are reviewing'.⁷³ Hor notes that the involvement by accountants in amending a trust deed itself for a client may constitute the provision of 'legal advice, which it is illegal for an unqualified person to provide for a fee'.⁷⁴

(b) Tax

Overwhelmingly, accountants are involved in tax return preparation for all types of entities. However, for many entities, accountants are also involved in the preparation of the tax returns of entity owners. Importantly, that role inevitably means accountants are involved in 'managing distributions' to entity owners in a tax effective way.

While a necessary appreciation of the tax rules is required for effective management of distributions, what is also required is an appreciation of the non-tax rules associated with the creation of the desired non-tax law entitlements of entity owners.

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⁷³ Brian Hor, 'Reviewing family trust deeds — it's not just about tax!' (2012, August) *Taxation in Australia* 90, 90.

⁷⁴ *Ibid*, 91.

C Dissolution⁷⁵

(a) *Non-tax*

The client would want to ensure the sale transaction is effective. And, the client would want to be assured about the status of continuing liabilities from the investment.

(b) *Tax*

The different ways in which a client can realise or exit from an investment can give rise to different tax outcomes. Considerable tax advice is sought and obtained about this decision. The small business capital gains tax concessions provide an important and high-profile example of this. This also means that the accountant will want to be familiar with the non-tax rules applicable to each avenue of exit from an investment so that the tax law can operate as desired.

V SURVEY

The research detailed in this part of the article explored the extent to which Australian undergraduate accounting students are taught about the various traditional business structures, as well as trusts (both unit and discretionary) and SMSFs. To some extent this study follows the methodology utilised by Thompson in his empirical study into the methods and content of basic Business Associations courses taught in American law schools.⁷⁶

To address this research aim, a quantitative survey was implemented. A survey instrument was developed, with a focus on trying to elicit the time spent on teaching the various business structures, as well as the areas of content actually covered. The wording of the survey instrument was developed from pilot groups and feedback obtained. The final survey instrument consisted of a number of parts. The first part sought broad demographic detail about the Australian institution the academic worked at, which business law course was taught and the role of the person with that course. Another section then explored to what extent there was coverage of the business structures of sole proprietors, general partnerships, limited partnerships, corporations, unit trusts, discretionary trusts and SMSFs. Only participants who did have some exposure to teaching one or some of the business structures were then asked additional questions about course content. There were also questions about tutorial and assessment coverage of these business structures. There was also a question about the sources of influence about topic coverage in the course.

To facilitate data collection, searches of the internet were conducted of all 38 universities to consider which universities provided accounting degrees and which

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⁷⁵ This can also mean exiting the investment.

⁷⁶ Robert Thompson, 'The Basic Business Associations Course: An Empirical Study of Methods and Content' (1998) 48(3) *Journal of Legal Education* 438.

academic staff were involved in accounting degrees, and in particular the teaching of business law courses. Then a network of academics were emailed to request their participation in the survey. E-mail invitations with the link to the web survey were sent to the target population. In addition, the research was promoted through academic bodies such as the Australasian Tax Teachers Association and the Corporate Law Teachers Association with the link to complete the web based survey. Also the survey was completed by a small number of non-business law accounting academics from a number of Australian universities. This was done to give a sense as to whether the law of business structures was taught in other courses offered in the accounting degree. The other accounting courses surveyed included: Corporate Accounting; Accounting Principles; Financial Accounting; Auditing; Strategic Management Accounting; Management Accounting; Corporate Finance; Advanced Financial Accounting; Accounting; Accounting Information for Managers; Accounting in Organisations and Society and Financial Accounting Issues.

From this process, a total of 154 Australian academics commenced the survey with 138 completing it entirely, demonstrating 89 percent of usable survey responses. One hundred and ten of these survey respondents were those teaching in 'business law courses' and 28 were respondents teaching in other 'accounting courses'. The sample is well distributed in terms of universities across Australia — with participants from 36 Australian institutions.

A Coverage in Lectures

In terms of business law courses the survey specified seven specific types of courses likely to be taught, as well as the option for participants noting an 'other business law course'. Participants were asked to indicate which of their courses were mandatory within the accounting degree. Through this it became evident that five business law courses were generally mandatory (note it is likely that within each accounting degree there is only three or four mandatory business law courses, but there can be different names used to describe the course).

Table 5 lists the five common mandatory courses, being:

- Introduction to Law/Foundations of Law ('Intro to Law');
- Introduction to Business Law ('Intro to Business Law');
- Law of Business Associations/Law of Commercial Associations ('Law of Business Associations');
- Company/Corporations Law — Introduction ('Company Law'); and
- Taxation Law — Introduction ('Tax Law').

Participants generally had a senior role with the course as the course convenor or lecturer in charge.

Table 5: Mandatory Business Law Courses

Course Name	Response Count	Is it a 'mandatory' course within the Accounting Degree?	What is your role with the course? (tick ALL that apply)		
			Course Convenor/ Lecturer in Charge/Overseer of Course	Lecturer	Tutor
	(Number)	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	25	92.3	69.2	53.8	73.1
Introduction to Business Law	40	89.2	64.9	54.1	62.2
Law of Business Associations/Law of Commercial Associations	22	81.8	77.3	54.5	59.1
Company/Corporations Law — Introduction	26	88.5	57.7	26.9	61.5
Taxation Law — Introduction	30	86.7	90.0	53.3	46.7

The other non-mandatory (elective) business law courses tended to be:

- Company/Corporations Law — Advanced ('Advanced Company Law');
- Taxation Law — Advanced ('Advanced Tax Law'); and

Other Business Law type course ('Other Business Law') (See Table 6).

Table 6: Elective business law courses

Course Name	Response Count	Is it a 'mandatory' course within the Accounting Degree?	What is your role with the course? (tick ALL that apply)		
			Course Convenor/ Lecturer in Charge/Overseer of Course	Lecturer	Tutor
	(Number)	(%)	(%)	(%)	(%)
Company/Corporations Law — Advanced	3	33.3	67	100	67
Taxation Law — Advanced	12	15.4	92	69	39
Other 'business law type courses'	18	15.8	74	68	37

To ascertain the extent of coverage of the law of the various business structures, participants were then asked to note the time spent in their courses discussing the various business structures in lectures and tutorials, as well as the percentage of assessment devoted to the various business structures. The results of these questions in relation to each of the business structures are reported in Tables 8 to 16 in the Appendix (which details each of the business structures with their coverage in mandatory law courses, elective law courses and accounting courses). Overall, the results illustrate that the business structure that has the greatest

emphasis consistently throughout lectures, tutorials and assessment is the company. The business structures with the next greatest coverage are the general partnership and sole trader. There is low coverage of discretionary trusts and limited partnerships. There is little consideration at all of unit trusts and SMSFs. Overall, these results are consistent with the overriding concern that there is largely an omission of trusts and SMSFs from the accounting curriculum in any meaningful detail. Below is a detailed analysis of the results in terms of each business structure in lectures, tutorials and assessment.

In regard to the coverage of sole traders in mandatory business law courses, one-third of courses covered sole traders for less than 5 minutes if at all, and nearly three-quarters of courses spent less than 30 minutes teaching about sole traders (Table 8). For the elective business law courses the coverage is similar. For the accounting courses surveyed on average less than 5 minutes or nothing was spent on sole traders in 61 per cent of courses, with 86 per cent of courses spending less than 30 minutes. Ten per cent of tax law courses spent greater than five hours on sole traders.

For general partnerships there appeared to be more coverage in the mandatory business law courses, with nearly 50 per cent of courses spending more than 30 minutes in lectures covering them. The course which on average had the greatest coverage was the Law of Business Associations course with 15 per cent having greater than five hours of coverage (Table 9). For the elective business law courses there was a smaller emphasis on general partnerships with nearly two-thirds spending less than 30 minutes in lectures on them. For accounting courses, three-quarters spent less than 5 minutes or no time in discussing the law of general partnerships.

Perhaps not surprisingly there appeared to be less coverage about the law of limited partnerships (Table 10). For the mandatory business law courses on average over three-quarters of courses spent no time or less than 5 minutes discussing them, and nearly 100 per cent spent less than 30 minutes. Again Law of Business Associations spent the greatest time discussing this business structure with 5 per cent of courses spending greater than five hours. For the elective business law courses nearly 90 per cent spent less than five minutes discussing limited partnerships. It was a similar position for the accounting courses (with 93 per cent spending less than 5 minutes).

From the survey results, the business structure that gains the greatest attention in terms of time spent is the law relating to companies (Table 11). On average over 70 per cent of the mandatory business law courses spent greater than 30 minutes, with 34 per cent spending greater than 5 hours discussing companies. The courses with the greatest emphasis on companies were the Law of Business Associations and Company Law courses, with three-quarters of both courses spending greater than five hours. The elective business law courses and the accounting courses also on average had greater coverage with nearly 20 per cent spending greater than five hours in discussing them.

For unit trusts, the study illustrates that nearly two-thirds of mandatory business law courses spend no time or less than five minutes discussing them (Table 12).

For the elective business law courses, the greatest coverage of the law of unit trusts is demonstrated by the Advanced Tax Law course, with about 70 per cent of Advanced Tax courses on average spending somewhere between 30 minutes and five hours discussing them. There is virtually no coverage of unit trusts in the accounting courses, as 93 per cent spend less than five or no minutes discussing them in lectures.

The coverage of discretionary trusts appears to be slightly greater than unit trusts, with approximately 45 per cent of mandatory business law courses spending greater than five minutes discussing them (Table 13). There were a small percentage (5 per cent) of courses (Law of Business Associations and Company Law) that spent greater than five hours discussing discretionary trusts. There was a large coverage of the law relating to discretionary trusts in the taxation courses as approximately 50 per cent of them spent somewhere between 30 minutes to five hours discussing them. For the elective business law courses, it was the Advanced Tax Course that had the greatest coverage of discretionary trusts with 75 per cent of courses spending between 30 minutes and five hours discussing them. There appeared to be barely a mention of discretionary trusts in the accounting courses, as 97 per cent spent less than five minutes discussing them.

The form that had the least coverage in the courses surveyed was the SMSF, as on average 93 per cent of mandatory business law courses spent no time or less than five minutes discussing them (Table 14). There was slightly greater coverage in the elective courses, especially Advanced Tax, with an average of 50 per cent of courses spending on average somewhere between 30 minutes and five hours discussing them. The accounting courses show scant coverage of the SMSF with 93 per cent spending no time or less than five minutes discussing them.

The responses from the sample of accounting courses would tend to indicate that the only business structure covered in any detail is the corporation, with some coverage of sole traders and general partnerships — but the other business structures are largely neglected. Consequently, it is only the coverage in business law courses that would expose accounting students to other business structures.

B Coverage in Tutorials

Participants were also asked to consider the time spent in tutorials discussing the various business structures. As might be expected the results are largely consistent with the coverage in the lectures. (Table 15)

In terms of tutorial time between 30 minutes to 2 hours, there is more likely to be discussion of the following business structures in the following mandatory business law courses:

- Sole Traders: Law of Business Associations (30 per cent), Tax Law (21 per cent), Intro to Law (14 per cent);
- General Partnerships: Law of Business Associations (60 per cent), Intro to Business Law (41 per cent), Intro to Law and Tax Law (36 per cent each);
- Limited Partnerships: Law of Business Associations (25 per cent), Intro to Law (9 per cent), Intro to Business Law (9 per cent);

- Corporations: Tax Law (39 per cent), Intro to Business Law (25 per cent), Law of Business Associations (25 per cent),⁷⁷
- Unit Trusts: Law of Bus Associations (30 per cent), Intro to Law (9 per cent), Tax Law (7 per cent);
- Discretionary Trusts: Law of Business Associations (30 per cent), Tax Law (29 per cent), Intro to Law (9 per cent); and
- SMSFs: Tax Law (7 per cent), Intro to Business Law (6 per cent) and Intro to Law (5 per cent).

In terms of substantial coverage of the business structures in tutorials, few mandatory business law courses spent on average greater than five hours as demonstrated in the following:

- Sole Traders: Tax Law (11 per cent);
- General partnerships: no courses;
- Corporations: Intro to Law (14 per cent), Intro to Business Law (3 per cent), Law of Business Associations (60 per cent), Company Law (48 per cent);
- Unit Trusts: no courses;
- Discretionary Trusts: no courses; and
- SMSFs: no courses.

This demonstrates that of all business structures it is the corporation that will have the most substantial coverage in tutorials. On average none of the accounting courses spent greater than five hours in tutorials discussing any of the business structures, nor did the elective business law courses.

C Coverage in Assessment

To get a sense about whether accounting students are assessed on their knowledge and application about the law relating to the various business structures, the survey asked questions about the percentage of assessment attributable to the different business structures (Table 16). Apart from the mandatory courses listed below, two-thirds or more had less than 5 per cent of assessment dedicated to the relevant business structures:

- Sole Traders: Law of Business Associations and Tax Law;
- General Partnerships: Intro to Law, Intro to Business Law, Law of Business Associations and Tax Law;
- Limited Partnerships: no courses;
- Corporations: all courses;
- Unit Trusts: no courses;
- Discretionary Trusts: Tax Law; and
- SMSF: no courses.

Apart from the assessment of corporations, it can be seen for the accounting courses on average nearly 90 per cent or more of them have minimal (less than 5

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⁷⁷ The reason that Company Law does not feature in the top three is that there is on average more than 2 hours spent on corporations in the tutorials for company law.

per cent) of assessment of the business structures. Few of the mandatory law courses had substantial assessment directed towards business structures. On average only 10 per cent or more of the following courses had assessment 20 per cent or greater about business structures: (a) Sole Traders — Intro to Law, Tax Law; (b) General Partnerships — Intro to Law, Intro to Business Law, Law of Business Associations, Tax Law; (c) Limited Partnerships — no courses (d) Corporations — all courses; (e) Unit Trusts — no courses (f) Discretionary Trusts — Tax Law; and (g) SMSFs — no courses. These results reinforce the finding that the main focus is on corporations, and general partnerships.

D Input into Courses

To gain an understanding about the design of the business law courses, participants were asked a number of questions about communication between business law academics and accounting academics, as well as with industry. Table 7 illustrates a split among business law academics as to whether there is communication between tax lecturers and other business law lecturers, with approximately 35 per cent either positive (agree or strongly agree) and 36 per cent negative (disagree or strongly disagree). Only a small percentage (14 per cent) of the accounting academics surveyed affirmed (agree or strongly agree) that there was communication between themselves and business law academics generally in terms of the content of their courses.

A strong response from both business law and accounting academics was present with regard to the input of industry into the development of their course, with 45 per cent and 50 per cent respectively agreeing or strongly agreeing that industry input was sought for their course.

Table 7: Input into courses

Questions	Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree	
	Law	Acc	Law	Acc	Law	Acc	Law	Acc	Law	Acc
	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
There is communication between tax lecturers and other business law lecturers in terms of the content of their courses.	16		20		29		29		6	
There is communication between business law lecturers and accounting lecturers in terms of the content of their courses.		18		21		46		14		0
There is input from industry (practitioners) in the development of your course.	9	7	18	18	29	25	40	29	5	21

Key: Law = Business Law academics' responses; Acc = Accounting academics' responses

In comments at the end of the survey from business law academics in response to the question, 'describe the factors that influence the current content of your course' there was a strong influence of the requirements of the accounting professional bodies (ICAA and CPA Australia), as well as a few mentioning the Tax Practitioners Board — (50 per cent of responses of business law academics). There was also mention of ensuring that the course content was relevant to practice — approximately 25 per cent of responses of business law academics. Similarly the accounting academics also referred to the influence of the professional bodies (33 per cent of responses) and industry (15 per cent of responses). This would tend to suggest that any changes to the curriculum taught to accountants regarding business structures would need to have the backing and support of the professional bodies.

VI LIMITATIONS OF RESEARCH AND FUTURE RESEARCH

It is acknowledged that this research has only a small sample size in terms of academics teaching in accounting courses. However, it is very unlikely that any or much substantive law in regard to entities is being taught within accounting departments at Australian universities. Also, a low number of respondents taught Company Law, Advanced, although this may mean that reported coverage of the law relating to companies could be under-reported in these results.

This research has established that the law of the business structures taught to commerce students does not reflect the types of business structures that qualified accountants are working with in the commercial world. The next stage of this research is really a *does it matter* question. In particular, the research requires an in-depth analysis as to whether disciplinary knowledge or vocational knowledge and related skill sets should be part of a university-level education for those seeking to enter a particular vocation. This has numerous aspects including the role of accreditation of university courses and the capacity for post-university education to deliver the required skill sets. Future research could explore the expectation gaps (if any) between educators and industry in terms of what the coverage of business structures should be in Accounting degrees. Also, given the growth of financial planning degrees, it would be interesting to explore the extent to which these degrees cover those business structures used for investment purposes, especially trusts and SMSFs. Further research could examine the actual content of degrees to see whether these align with reported coverage.

Future research could survey accounting practitioners (prospective employers of graduates) about what they consider the fundamental elements of trust law (regulation and tax) that they would want an accounting graduate to cover in their degree.

VII CONCLUSION

Chua and Petty argue that if there is a lag in knowledge between academic teaching and practice, there is a great chance that what is being taught is irrelevant.⁷⁸ In 2011, Justice Michelle Gordon gave a speech that highlighted the issues about how best to teach tax law in the context of a law degree, noting that tax is a multi-faceted area that touches upon (potentially) so many areas of the law, society, politics and economy.⁷⁹ One area that Justice Gordon focused on was the area of trust law, particularly the case of *Bamford v Commissioner of Taxation*,⁸⁰ explaining that it would not be possible for a lawyer to advise the client 'without a detailed understanding of the law of trusts and the intended operation of the taxing act'.⁸¹ While this speech focused on lawyers' education, this article raises concerns about the extent to which Australian accounting students are taught about the law of trusts in any meaningful way. We raise this concern not only in terms of understanding the interplay between the tax law and the law of trusts, but also more broadly in regard to the widespread commercial use of trusts and the central roles that accountants play with them. Commentators have raised concerns about the legal issues (and the complexity) that can arise due to the use of trusts in commercial operations.⁸²

The results of this research demonstrate that the course Law of Business Associations is important in providing a platform for accounting students to learn about the law of the different business structures. Also, this research demonstrates the dominance of the focus on corporations in the Australian accounting curricula. While it is acknowledged that corporations are an important business structure for commercial operations, the trust also features prominently in Australia — especially for small and medium operations. Given the survey results, it is questioned whether there is adequate coverage of the law of trusts, including SMSF, which appears to be largely absent from the accounting curricula.

It is very likely that Australian accounting students need a better understanding and appreciation of the trust vehicle. While it is possible that their education continues while in practice, it is questionable whether this occurs in a systematic, comprehensive and coherent manner. It is important that the Australian accounting curricula reflects current industry practices, otherwise higher education providers may be failing the next generation of accounting practitioners.

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⁷⁸ Wai Chua and Richard Petty, 'Mimicry, Director Interlocks and the Interorganizational Diffusion of a Quality Strategy: A Note' (1999) 11 *Journal of Management Accounting Research* 93, 94.

⁷⁹ Michelle Gordon, 'Tax is more than numbers — but it is also more than tax' (Paper presented at the 23rd Australasian Tax Teachers' Association Conference, University of Melbourne, January 2011).

⁸⁰ *Bamford v Commissioner of Taxation* (2010) 240 CLR 481.

⁸¹ Gordon, above n 79, 3.

⁸² Nuncio D'Angelo, 'The trust: Evolution from guardian to risk-taker, and how a lagging insolvency law framework has left financiers and other stakeholders in peril' (2009) 20 *Journal of Banking and Finance Law and Practice* 279.

APPENDIX

Table 8: Coverage of Sole Traders

Course Name	'Sole Traders/Sole Proprietors' in the LECTURES			
	Total Not Covered or < 5 mins (%)	Total > 5 mins but < 30 mins (%)	Total > 30 mins but < 5 hrs (%)	Total > 5 hrs (%)
Introduction to Law/Foundations of Law	38	27	31	4
Introduction to Business Law	46	43	11	0
Law of Business Associations/Law of Commercial Associations	27	41	27	5
Company/Corporations Law — Introduction	41	45	9	5
Taxation Law — Introduction	30	20	4	10
Average for mandatory courses	36	35	24	5
Company/Corporations Law — Advanced	67	33	0	0
Taxation Law — Advanced	25	0	75	0
Other 'business law type courses'	61	17	22	0
Average for elective business law courses	51	17	32	0
Accounting courses	61	25	14	0

Table 9: Coverage of General Partnerships

	'General (Law) Partnerships' in the LECTURES			
	Total Not Covered or < 5 mins	Total > 5 mins but < 30 mins	Total > 30 mins but < 5 hrs	Total > 5 hrs
Course Name	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	28	12	52	8
Introduction to Business Law	31	23	43	3
Law of Business Associations/Law of Commercial Associations	10	25	50	15
Company/Corporations Law — Introduction	48	28	19	5
Taxation Law — Introduction	21	24	55	0
Average for mandatory courses	27	23	44	6
Company/Corporations Law — Advanced	33	67	0	0
Taxation Law — Advanced	0	8	92	0
Other 'business law type courses'	61	17	17	6
Average for elective business law courses	31	31	36	2
Accounting courses	79	14	7	0

Table 10: Coverage of Limited Partnerships

	‘Limited Partnerships’ in the LECTURES			
	Total Not Covered or < 5 mins (%)	Total > 5 mins but < 30 mins (%)	Total > 30 mins but < 5 hrs (%)	Total > 5 hrs (%)
Course Name				
Introduction to Law/Foundations of Law	71	21	8	0
Introduction to Business Law	82	12	6	0
Law of Business Associations/Law of Commercial Associations	65	20	10	5
Company/Corporations Law — Introduction	81	14	5	0
Taxation Law — Introduction	90	7	3	0
Average for mandatory courses	78	15	6	1
Company/Corporations Law — Advanced	100	0	0	0
Taxation Law — Advanced	75	25	0	0
Other ‘business law type courses’	89	6	6	0
Average for elective business law courses	88	10	2	0
Accounting courses	93	3.5	3.5	0

Table 11: Coverage of Corporations

	'Corporations/Companies' in the LECTURES			
	Total Not Covered or < 5 mins	Total > 5 mins but < 30 mins	Total > 30 mins but < 5 hrs	Total > 5 hrs
Course Name	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	35	9	43	13
Introduction to Business Law	32	24	38	6
Law of Business Associations/Law of Commercial Associations	5	5	15	75
Company/Corporations Law — Introduction	0	0	24	76
Taxation Law — Introduction	21	14	65	0
Average for mandatory courses	19	10	37	34
Company/Corporations Law — Advanced	33	0	67	0
Taxation Law — Advanced	0	0	83	17
Other 'business law type courses'	50	6	39	6
Average for elective business law courses	28	2	63	7
Accounting courses	46	11	25	18

Table 12: Coverage of Unit Trusts

	'Unit Trusts/Fixed Trusts' in the LECTURES			
	Total Not Covered or < 5 mins	Total > 5 mins but < 30 mins	Total > 30 mins but < 5 hrs	Total > 5 hrs
Course Name	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	68	18	14	0
Introduction to Business Law	78	19	3	0
Law of Business Associations/Law of Commercial Associations	45	30	20	5
Company/Corporations Law — Introduction	67	28	5	0
Taxation Law — Introduction	48	35	17	0
Average for mandatory courses	61	26	12	1
Company/Corporations Law — Advanced	67	33	0	0
Taxation Law — Advanced	17	17	67	0
Other 'business law type courses'	83	0	17	0
Average for elective business law courses	55	17	28	0
Accounting courses	93	7	0	0

Table 13: Coverage of Discretionary Trusts

	'Discretionary Trusts' in the LECTURES			
	Total Not Covered or < 5 mins (%)	Total > 5 mins but < 30 mins (%)	Total > 30 mins but < 5 hrs (%)	Total > 5 hrs (%)
Course Name				
Introduction to Law/Foundations of Law	59	23	18	0
Introduction to Business Law	78	19	3	0
Law of Business Associations/Law of Commercial Associations	45	40	10	5
Company/Corporations Law — Introduction	76	19	0	5
Taxation Law — Introduction	24	24	52	0
Average for mandatory courses	56	25	17	2.0
Company/Corporations Law — Advanced	67	33	0	0
Taxation Law — Advanced	8	17	75	0
Other 'business law type courses'	89	6	6	0
Average for elective business law courses	55	18	27	0
Accounting courses	97	3	0	0

Table 14: Coverage of SMSFs

	'Self-Managed Superannuation Funds' in the LECTURES			
	Total Not Covered or < 5 mins	Total > 5 mins but < 30 mins	Total > 30 mins but < 5 hrs	Total > 5 hrs
Course Name	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	91	0	9	0
Introduction to Business Law	97	0	3	0
Law of Business Associations/Law of Commercial Associations	95	5	0	0
Company/Corporations Law — Introduction	100	0	0	0
Taxation Law — Introduction	83	7	10	0
Average for mandatory courses	93	2	5	0
Company/Corporations Law — Advanced	100	0	0	0
Taxation Law — Advanced	33	17	50	0
Other 'business law type courses'	94	0	6	0
Average for elective business law courses	76	6	18	0
Accounting courses	93	0	7	0

Totals in tables may not add up to 100% due to rounding.

Table 15: Coverage of business structures in tutorials

Course Name	Sole Traders/ Sole Proprietors		General (Law) Partnership		Limited Partner- ships		Corporations/ Companies		Unit Trusts/ Fixed Trusts		Discretionary Trusts		SMSFs	
	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs	Not covered or < 5 mins	30 mins to < 2 hrs
	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	50	14	32	36	68	9	41	23	73	9	68	9	91	5
Introduction to Business Law	56	9	41	41	72	9	44	25	84	6	78	6	94	6
Law of Business Associations/Law of Commercial Associations	25	30	15	60	45	25	10	25	60	30	55	30	100	0
Company/Corporations Law — Intro	76	5	71	0	76	5	33	5	81	5	90	5	100	0
Taxation Law — Introduction	39	21	32	36	82	0	29	39	71	7	29	29	82	7
Average for mandatory courses	49	16	38	35	69	10	31	23	74	11	64	16	93	4
Company/Corporations Law — Advanced	33	33	33	33	33	0	33	33	33	0	33	0	100	0
Taxation Law — Advanced	33	58	17	50	92	0	17	58	42	17	33	25	50	33
Other 'business law type courses'	78	11	78	11	83	6	61	17	83	6	94	0	100	0
Average for elective business law courses	48	34	43	31	69	2	37	36	53	7	54	8	83	11
Accounting courses	48	7	43		69	4	37	0	53	11	54	0	83	0

Table 16: Coverage of business structures in assessment

Course Name	Sole Traders/Sole Proprietors			General (Law) Partnerships			Limited Partnerships			Corporations/Companies			Unit Trusts/Fixed Trusts			Discretionary Trusts			SMSFs		
	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%	0% < 5 %	5% < 20%	>20%
	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Introduction to Law/Foundations of Law	77	9	14	36	50	14	86	9	5	50	27	23	86	14	0	86	9	5	91	5	5
Introduction to Business Law	74	23	3	45	35	19	84	16	0	52	35	13	90	10	0	87	13	0	97	3	0
Law of Business Associations/Law of Commercial Associations	58	42	0	37	42	21	89	11	0	11	11	79	79	21	0	74	26	0	100	0	0
Company/Corporations Law — Introduction	71	29	0	67	33	0	81	19	0	14	14	71	90	10	0	86	14	0	100	0	0
Taxation Law — Introduction	29	50	21	36	54	11	93	0	4	32	46	21	79	21	0	32	32	11	93	4	4
Average for mandatory courses	62	31	8	44	43	13	87	11	2	32	27	42	85	15	0	73	19	3	96	2	2
Company/Corporations Law — Advanced	33	67	0	33	67	0	67	33	0	33	0	67	100	0	0	100	0	0	100	0	0
Taxation Law — Advanced	25	67	8	25	58	17	100	0	0	17	58	25	58	33	8	33	50	17	75	17	8
Other 'business law type courses'	65	35	0	53	41	6	88	12	0	41	35	24	76	24	0	88	12	0	100	0	0
Average for elective business law courses	41	56	3	37	55	8	85	15	0	30	31	38	78	19	3	74	21	5	92	6	3
Accounting courses	89	11	0	93	7	0	100	0	0	68	18	14	100	0	0	100	0	0	100	0	0

UNIVERSITY TEACHING: A REFLECTION ON TAX TEACHING AND CULTURAL DIVERSITY

DIANE KRAAL*

ABSTRACT

This article concerns a reflection upon selected aspects of two tax topics taught in a lecture/tutorial arrangement as part of an Australian tax law unit, in a higher education business course setting. The article enquires into the effectiveness of modifications in the teaching practice for a culturally diverse international–domestic student cohort. A particular focus is on tax law students whose second language is English. The article draws upon pedagogical literature as the first step to embark on the journey of reflection and to devise a teaching practice intervention.

The methodological design is essentially non-positivist for its constructivist sense-making of the information gathered and its use of methods complementary to reflective practice. The analysis of the relational processes in tax teaching is undertaken through the lens of Pierre Bourdieu's social practice theory, which includes the concepts of *field*, *habitus* and *doxa*. The article contributes to the use of reflective practice in higher education and acknowledges culturally mixed learning groups as a way of furthering professional practice in tax teaching.

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I INTRODUCTION

Don Aitkin was appointed the first Chairman of the Australian Research Council in 1988,¹ but ironically is now on the public record for his view that 'research has become too important in higher education ... teaching students and the dissemination of knowledge are the core functions' of a university.² Some academic responses to Aitkin's research 'outing' have been resolutely against any shift away from the research imperative. Perhaps these respondents are influenced by their research in politically favoured areas,³ or their acceptance that research is a primary factor in the global rankings of higher education. Nonetheless, behind the scenes, Australian universities are facilitating proficiency in teaching by requiring new staff to undertake certificate courses.⁴

This article concerns reflections and interventions into the author's teaching practice of topics in an Australian tax law unit under a lecture/tutorial arrangement in a higher education business course setting. The topics selected for this process are the Goods and Services Tax (GST) and Fringe Benefits Tax (FBT), which are required for course accreditation with professional bodies.⁵ The aim is to consider the effectiveness of the author's teaching to tax law students by asking, 'What teaching practice changes need to be made?' This seemingly straightforward query is, however, compounded by classroom diversity. The strong and progressive rise of mixed international-domestic cohorts of tax law students in metropolitan higher education institutions is a recent phenomenon; some classes comprise fifty per cent, or more, international students.⁶ Given that the author's classes are mixed cohorts, an ancillary focus of this research is on higher education students who had their secondary education in countries where English is not the main medium of instruction, for this factor arguably makes the prospect of teaching changes more complex. Are other teachers concerned or even addressing this phenomenon in higher education? Indeed, Rupert Murdoch, a controversial figure, delivered a keynote speech in 2013 exhorting Australia prepare for the status quo to be 'disrupted' whether in manufacturing, media or *education* — as a result of participating in the global economy.⁷

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¹ In 1988 the Hawke federal government announced that Australian Commonwealth grants for research would be allocated to the competitive submission programs of the Australian Research Council (ARC).

² Don Aitken, *Higher Education Lower Morale* (26 July 2013) <<http://donaitkin.com/higher-education-lower-morale/>>.

³ See, for example, the successful Australian Laureate Fellowships proposals for 2013 ARC funding were dominated by the sciences, <http://www.arc.gov.au/ncgp/laureate/laureate_outcomes.htm>.

⁴ There are currently 33 'higher education' teaching certificate programs run by Australian universities, see <<http://opvclt.monash.edu.au/educational-excellence/gcap/rpl-quals.html>>.

⁵ Accounting profession accreditation bodies include CPA Australia and the Institute of Chartered Accountants Australia.

⁶ Sophie Arkoudis, 'English Language Standards and Claims of Soft Marking' in Simon Marginson (ed), *Tertiary Education Policy in Australia* (Centre for the Study of Higher Education, 2013) 123; Nadine Dolby and Aliya Rahman, 'Research in International Education' (2008) 78 (3) *Review of Educational Research* 676.

⁷ Rupert Murdoch, 'Tenth Anniversary Lowy Lecture' (Paper presented at the Lowy Lecture, Sydney Town Hall, 2013). See <<http://www.lowyinstitute.org/events/2013-annual-lowy-lecture-dinner-rupert-murdoch-ac>>.

While motivated by Aitkin's call to arms to re-elevate university teaching, this research draws upon pedagogical literature as the first step in the journey of reflection to connect to the 'other', that is teaching. The reflective practice approach is used.⁸ The object of the author's planned teaching intervention is to facilitate more even student outcomes across all tax topics.

The next sections cover the relevant literature, the reflection framework and more detail on the selected methodology. Context is given by a description of the intervention setting, which includes consideration of the learners and their tasks. The author's reflective journal extracts, notes on interventions and student feedback are given, followed by intervention evaluations, the conclusion and possibilities for future research.

II LITERATURE REVIEW

Schwartz argues that much law teaching in the United States remains locked in Langdell's instructional methodology, which Schwartz characterises as the vicarious/student self-teaching method.⁹ For example, a student learns legal concepts vicariously, that is, in a second-hand or indirect manner, by observing the one-on-one dialogue between the instructor and a selected student in a teaching session. By 'osmosis', the observation process is supposed to deliver the learning outcomes to non-selected students, who are 'enabled' to learn and think like practitioners. The Langdell tradition relies on the 'case method', based on appellate court decisions, which Christopher Langdell pioneered during his time at the Harvard Law School in the 1870s. The Langdell instructional methodology requires little teacher training and minor class preparation time: it suits the modern commercial model seen in legal education in some universities.¹⁰

Are tax law teaching methods in Australia similarly moribund, as Swartz suggests, or is Langdell's 'Socratic' approach under challenge by teachers? Papers from recent Australasian Tax Teachers' Conferences and tax journals show that experimentation for new insights is ongoing. For instance, Kenny's research investigates the merits of online instruction for tax law and finds that face-to-face teaching in a blended learning environment that incorporates online methods offers important advantages to students.¹¹ By contrast, Tan finds that the use of online quizzes is not a good predictor of examination scores because only lower cognitive skills are tested.¹² Morgan and Wilson-Rogers report on the utilisation of a study tour to teach additional aspects of tax law. The

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⁸ See, for example, John Dewey, *How We Think: A Restatement of the Relation of Reflective Thinking to the Educative Process* (D.C. Heath, 1933); Paulo Freire, *Pedagogy of the Oppressed* (Penguin, 1996); Donald A. Schön, *The Reflective Practitioner: How Professionals Think in Action* (Arena, 2nd ed, 1983/1991); Donald A. Schön, *Educating the Reflective Practitioner* (Jossey-Bass, 1987); Gillie Bolton, *Reflective Practice: Writing and Professional Development*, vol 3 (Sage, 2010).

⁹ Michael H Schwartz, 'Teaching Law by Design: How Learning Theory and Instructional Design Can Inform and Reform Law Teaching' (2001) 38 (2) *San Diego Law Review* 347, 350.

¹⁰ See, for example, Susan Fitzpatrick, 'The Challenge of Teaching Law Subjects with Large and Diverse Student Cohorts' (2009) 2 (1) *Journal of the Australasian Law Teachers' Association* 113, 114.

¹¹ Paul Kenny, 'Meeting the Online Competition for Undergraduate Tax Law Students: Innovate or Detonate?' (Paper presented at the Australasian Tax Teachers' Conference, Auckland, 2013).

¹² Lin Mei Tan, 'Using On-Line Assessments in a Distance Learning Taxation Course: Effects on students' performance' (2012) 7 (1) *Journal of the Australasian Tax Teachers' Association* 153, 168.

aim was for students to enjoy a deeper, more comprehensive and engaging learning experience.¹³ The tour was one way of promoting ongoing student interest in taxation. Boccabella argues that Australia's core tax rules have a conceptual structure and coherence. He advocates a teaching approach that takes account of this structure and coherence as a device for better problem solving.¹⁴ In terms of assessment changes, Minas et al apply the principles of 'assessment for learning' by introducing one-on-one student interviews as a tool for assessment.¹⁵ They claim that the interviews encourage students to learn independently rather than copying from others. Fitzpatrick, an academic who teaches a large and diverse general law subject, also reports on the need for further experimentation into non-traditional teaching and assessment methods.¹⁶ It can be seen that some tax law teachers are experimenting with teaching methods and assessment, but there is a specific gap in the tax teaching literature on the issue of student cultural diversity.

By contrast, issues arising from student cultural diversity can be found in education discipline literature generally. For example, Arkoudis et al suggest that academics harness the potential of student diversity.¹⁷ For learners, the findings show that peer interaction benefits include increased awareness and understanding of the different perspectives of individuals; better preparation for the workplace; improved English language skills of international students; and a greater feeling of belonging. From the teaching perspective, Arkoudis et al find that the main impediments to harnessing diversity were limited time in large classes to foster interaction and content heavy programs. This author agrees with both findings on time and intense content issues as characteristic impediments of a student's successful mastering of a tax law curriculum.

Arkoudis and Tran address the issue of academic writing in the discipline to support international students.¹⁸ Their intervention strategies include liaison with external language support departments, ensuring expectations are clear on assessment items, and checks on the level of language skills required in the discipline. The author notes that Arkoudis and Tran's suggestion of external departmental liaisons for cohorts with large numbers of international students may be problematic for large tax law classes. Importantly, systemic language problems might not be uncovered until too late, as tax law assessment typically places a higher marks weighting on the final exam — a factor driven by professional accreditation. This article now turns to discuss the basics of reflection.

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¹³ Annette Morgan and Nicole Wilson-Rogers, 'The Use of a Study Tour and Reflective Journals: Embedding Alternative Delivery and Assessment Methods into a Traditional Tax Curriculum' (Paper presented at the Australasian Tax Teachers Association, Auckland, New Zealand 2013).

¹⁴ Dale Boccabella, 'An Ordered Approach to the Tax Rules for Problem Solving in a First Australian Income Taxation Law Course Can Improve Student Performance' (2012) 10 (3) *eJournal of Tax Research* 621.

¹⁵ John Minas, Sonia Shimeld, and Simone Bingham, 'Using One-On-One Interviews in Tax Teaching' (2013) 8 (1) *Journal of the Australasian Tax Teachers' Association* 1.

¹⁶ Fitzpatrick, above n 10.

¹⁷ Sophie Arkoudis et al, 'Finding Common Ground: Enhancing interaction between domestic and international students' (2013) 18 (3) *Teaching in Higher Education* 222.

¹⁸ Sophie Arkoudis and Ly Tran, 'Writing Blah, Blah, Blah: Lecturers' Approaches and Challenges in Supporting International Students' (2010) 22 (2) *International Journal of Teaching and Learning* 169.

III FRAMEWORK OF REFLECTION

This article's concern is a reflection on tax teaching for business courses in higher education, facilitated through a framework of non-positivist enquiry. In other words, the knowledge generated by this research is not analysed by the positivity of numbers, as found in the scientific method; rather, it is evaluated by a qualitative, non-positivist approach. Although some statistics are used, the claim is that the gap in knowledge about remedying problematic aspects of tax teaching and necessary intervention cannot necessarily be closed solely through empirical enquiry. Thus the non-positivist framework of reflection is selected as being more appropriate to specifically address the *doxa* in the tax field, or what has been taken for granted, in the author's current teaching practice for the GST and FBT.¹⁹

This article considers a range of key contributors to reflexivity in education; for example, John Dewey, Zygmunt Bauman, Paulo Freire and Donald Schön. The author is mindful of Dewey's analysis of both traditional and progressive education and his claims that neither is adequate as one first 'learns by doing.'²⁰ Traditional education tended to ignore a student's personal impulse, as its main objective was preparing the young for future responsibilities. Books hold the lore of wisdom, and teachers, the agents of knowledge. Progressive education is a product of discontent with traditional education and emphasises the importance of student participation in the formation of the purposes that direct the learning process. There is agreement with Bauman's observations on the temporal nature of the consumer society and its information-saturated impact on education, which require reflection, and adjustment to teaching practice.²¹ Bauman acknowledges the liquid state of education that uses blended, student-centred learning, which is a departure from the old orthodoxy of rote learning. Teacher-student relations in the liquid-modern setting need reappraisal. Bauman acknowledges that Bourdieu put forth similar propositions in his call for reflexive practice.²²

Freire's discourse on education in unjust societies, and differentiation between the oppressor and the oppressed, seem not directly applicable to this author's teaching setting of affluent, fee-paying students — although there are parallels to the forces of conformity; such as, the stringing of student (puppets) in higher education to complete timed-online quizzes driven by computer technology.²³ The author is drawn to Freire's thoughts on the need for 'problem-posing education', whereby teachers encourage students to develop their own power to perceive critically that is a combination of action and reflection; this contrasts with the 'banking concept of education' where students are

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¹⁹ Cecile Deer, 'Doxa' in Michael Grenfell (ed), *Pierre Bourdieu: Key Concepts* (Acumen Publishing, 2008) 119.

²⁰ John Dewey, *Experience and Education: the 60th Anniversary Edition* (Kappa Delta Pi, 1938/1998) 3–4.

²¹ Zygmunt Bauman, 'Education in the Liquid-Modern Setting' (2009) 1 (2) *Power and Education* 157, 163–6.

²² Pierre Bourdieu and Loic J D Wacquant, *An Invitation to Reflexive Sociology* (University of Chicago Press, 1992) 78.

²³ Freire, above n 8, 64–7.

mere receptacles of information.²⁴ Here the teacher (like a bank clerk) didactically fills the student's mind, like an empty deposit box; facts are dispensed and not questioned.

While the works of Dewey, Bauman and Freire still drive thinking in reflective practice, their research does not address the unique issues that arise for a normative curriculum in tax law in higher education. The elements are: (1) dissemination of the basic tax law principles based on case law, that is, technical-rational knowledge; (2) inductive application of tax law principles to given scenarios; and (3) practicum exercises to address everyday problems of tax law practice, which draw in tacit as well as explicit knowledge.

In Australia, tax law is taught either through a law school, which generally teaches elements (1) and (2), recognising that knowledge is valid if based on a theory; or a business school, which generally teaches elements (1), (2) and (3). Business schools can be found in research and non-research universities, but the difference is that research universities are known to emphasise elements (1) and (2) over element (3).

Donald Schön's research on professional education may have a parallel with this article's issues to do with teaching tax law in business courses. His career's work has been spent on researching the way professionals work and gain technical competence; for example, knowledge of the principles of tax law can be combined with the concept of artistry to fuse professional confidence and professional judgement.

IV METHODOLOGY

The methodology chosen for this research is action learning, and it uses Schön's reflection-in-action model.²⁵ Schön defines reflection in action as the process by which a 'new response is generated in a situation of surprise and under conditions of uncertainty ... it requires on-the-spot experimentation that does not necessarily take place in words'.²⁶ Erlandson and Beach support Schön's description of a practitioner as reflecting 'on professional action at the same time as they carry the action out'.²⁷

Schön observes the regular occurrence of experienced practitioners depending less on established theories, for in mid-task they use 'artistry', to rapidly construct new theories 'on the spot'.²⁸ He posits that an experienced practitioner uses artistry in thinking and learning by doing, which triumphs over the roughness of trial and error. For instance, the judgement to determine similarity between a precedent and the facts of a new case ultimately seems to involve a kind of artistry. Schön's theory of 'reflection in action' is selected because his case studies show parallels to the teaching of tax law and its practice.²⁹ He contends that experienced teachers are able to think, almost subconsciously, while teaching. Such teachers can reflect in action by purposefully

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²⁴ Ibid, 52–67.

²⁵ Schön, above n 8, 49–69.

²⁶ Donald A. Schön, 'Educating the Reflective Legal Practitioner' (1995) 2 (1) *Clinical Law Review* 231, 247.

²⁷ Peter Erlandson and Dennis Beach, 'The Ambivalence of Reflection: re-reading Schön' (2008) 9 (4) *Reflective Practice: International and Multidisciplinary Perspectives* 409, 411.

²⁸ Schön, above n 26, 240.

²⁹ Schön, above nn 8 and 26.

observing what is going on both inside and around them, and at the same time be actors engaged in teaching.³⁰ An alternative to Schön might be Norton, who provides a primer on action learning methodologies for use in higher education, but the methods range from qualitative to quantitative, and seem to lack a nexus with tax law.³¹

The Crosling and Heagney higher education research uses qualitative methods of reflective practice in the specific area of improving student retention.³² These authors isolate the need for a *greater understanding* of student diversity, albeit thinly supported in their inquiry. Thus this article asks about the need to develop that factor of a *greater understanding* of student diversity, while it acknowledges caution about generalising, on say, Asian versus western approaches to learning.³³

Another methodological tool is the concept of 'gratitude', which could foster real learning engagement in a mixed cohort as it is observed that students learn from each other and many of us, both teachers and students, have forgotten that education is a gift:

By encapsulating the relationship between giver, receiver and gift, gratitude is highly relevant to the educational context. The receiver of education recognises that what they receive is a gift, and this prompts them to give back. When the giver of the gift of education sees that what they give is perceived as a gift, they are motivated to give and give, without necessarily wanting anything in return. A true dynamic is restored where education encompasses a healthy flow of giving and receiving amongst all parties.³⁴

Gratitude is the antithesis of resentment. The current education model of teachers as 'customer service' and students as 'clients', results in the pervasiveness of student resentment towards study, prevalent student attitudes of entitlement on payment of fees, and the culture of complaint. The practice of gratitude, broadly defined as 'the giving of thanks', has long been discussed in fields as diverse as anthropology, sociology, ethics, moral philosophy, theology and political economy studies.³⁵ Indeed Enlightenment economist, Adam Smith, in his 'theory of moral sentiments', ruminated on gratitude as a crucial antidote to self-interest to facilitate a healthy political economy.³⁶ The benefits of pedagogically applying gratitude can be seen studying information-dense subjects such as tax law, economics and psychology.

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³⁰ Schön, above n 8.

³¹ Lin S Norton, *Action Research in Teaching and Learning: A Practical Guide to Conducting Pedagogical Research in Universities* (Routledge, 2009) 87–114.

³² Glenda Crosling and Margaret Heagney, 'Improving Student Retention in Higher Education' (2009) 51 (2) *Australian Universities Review* 9, 15–6.

³³ Doris Leung, Paul Ginns, and David Kember, 'Examining the Cultural Specificity of Approaches to Learning in Universities in Hong Kong and Sydney' (2008) 39 (May) *Journal of Cross-Cultural Psychology* 251.

³⁴ Kerry Howells, *Gratitude in Education: A Radical View* (Sense Publishers, 2012) 8.

³⁵ Ibid.; Kerry Howells and Jessie Cumming, 'Exploring the Role of Gratitude in the Professional Experience of Pre-Service Teachers' (2012) 23 (1) *Teaching Education* 71. See also Kerry Howells, 'Gratitude in Education', at *Mind & Its Potential* 2012, <<http://www.youtube.com/watch?v=47hd5HTQV1E>>; and 'Effective Learning and Teaching: Dr Kerry Howells Interviewed by Dr Jan Libich', 24 August 2012, <<http://www.youtube.com/watch?v=va73r1ERu3U>>.

³⁶ Adam Smith, *The Theory of Moral Sentiments* (Millar Kincaid Bell, 1759).

A method for this article's reflection framework might be narrative inquiry, which is an analytical tool used on materials from sources including personal journals, field notes or interviews.³⁷ However, together with Schön's reflection-in-action model, the author has preferred the methods of reflective journals, experimentation in the practice of gratitude, and student feedback. These are the tools to gather data on the questions of overall tax teaching effectiveness and student diversity.

V THE INTERVENTION SETTING

From here, a shift is made to the mode of first person, which is an appropriate writing style for the interpretive nature of reflective practice. It is a departure from the dominant instrumentalist style of writing found in the law discipline's doctrinal research.

I teach Australia's GST and FBT, which are two minor topics in my university's introductory tax law curriculum. I normally schedule these topics towards the end of the tax law unit. Bourdieu noted that agents naturalise certain dominant practices, making them appear as self-evident, fundamental and a universal way, or what is taken for granted.³⁸ I typically characterise GST and FBT as 'administratively burdensome', given their long plumes of 'technical' rulings. Students might thus receive a negative message about the 'importance' of these topics.

The cursory dissemination of the GST and FBT in teaching is normal for tax academics, such as myself, who aspire to a higher trajectory in tax for the field rewards international tax research rather than local tax expertise.³⁹ Further, my lesser emphasis on certain topics may be the result of my *habitus*, 'the socially constructed principle of perception'.⁴⁰ Pierre Bourdieu's 'habitus' concept is a useful tool, as it is claimed that social practice theories can 'improve our understanding of tax as a social and institutional practice'.⁴¹ Could there be a *class distinction* between those lecturers (such as myself) who take up the dilettante's choice of international income tax to differentiate themselves from the 'tax hack', whose leaning is to the GST and FBT?⁴² The GST and FBT topics are relegated to the tail-end of my tax law unit — almost as scraps for those students who want the extra marks and are prepared for the 'hard yards' of performing calculations. Most tax law students in commerce courses seem to prefer spending time on loftier discourses concerning case law principles. This perverse finding is based on exam results, and warrants further investigation.

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³⁷ See, for example, D Jean Clandinin, (ed), *Handbook of Narrative Inquiry: Mapping a Methodology* (Sage Publications, 2007); D Jean Clandinin and F Michael Connelly, 'Rhythms in Teaching: The narrative study of teachers' personal practical knowledge of classrooms' (1986) 2 (4) *Teacher and Teaching Education* 377.

³⁸ Pierre Bourdieu, *Outline of a Theory of Practice* (Cambridge University Press, 1977) 64.

³⁹ Bourdieu and Wacquant, above n 22, 99.

⁴⁰ Ibid, 20.

⁴¹ Louise Gracia and Lynne Oates, (eds), *Taxation: A Fieldwork Research Handbook* (Routledge, 2012) 119; Diane Kraal, 'Paul Keating, Tax Alchemist? A study proposing the interpretive tools of Pierre Bourdieu' (2013) 8 (1) *Journal of the Australasian Tax Teachers Association* 1.

⁴² Pierre Bourdieu, *Distinction: A Social critique of the Judgement of Taste* (Harvard University Press, 1979).

Despite having identified the likely reasons for my attitude to the GST and FBT, which only seems to add to the torment of an already crowded tax law curriculum, these topics are still required to be taught.

I have observed in my teaching practice, for instance, that students can get confused with the unusual terminology used in the GST legislation; for example, 'creditable acquisition'. Even students, who have studied accountancy since secondary school, find challenges in understanding the theoretical GST concepts and terminology. The issue of low performance by students on the GST and FBT exam questions has been noted by my tutors/markers in past tax exam papers; for example:

During the semester, I think more time should be allocated to FBT during the tutorial session ... I found that I had the greatest amount of students hanging around after the tute asking me questions, and we run out of time.⁴³

I agree ... that FBT is a problem area and that probably more calculation question/examples would help a lot. Tutorial tests are vital, but in the area of FBT the test alone may not be sufficient for their learning of such a complex topic.⁴⁴

At the start of last semester I resolved to intervene into my teaching of the GST and FBT through reflective practice and facilitate more even student exam outcomes across all topics. I planned to adopt Schön's reflection-in-action method, that professional education should be centred on enhancing the practitioner's ability to overcome situations where 'textbook' approaches are found to be inadequate. Schön's most quoted case study⁴⁵ concerns an architect, Quist, who is masterfully able 'on the spot' to solve complex technical problems — the same issues that leave his inexperienced assistant, Petra, floundering. Schön uses this case, and other professional practice scenarios, to demonstrate that higher education does not adequately equip students with the skills necessary to deal with the complex problems that confront practitioners in the 'real world'.⁴⁶

For example, the GST legislation has a range of regulations specifically for Australia's burgeoning financial services sector. The minutiae of the regulations and associated rulings are not in my prescribed text book, nor in the lecture, due to time constraints.⁴⁷

Given my mixed international–domestic cohort of tax law students, I anticipated a *pot pourri* of issues to address from my proposed investigation into the effectiveness of my teaching practice. I certainly did not envisage a neat solution of 'one size fits all'.

A The Learners

Schwartz calls for an assessment of the learner group as part of a teaching plan. The learners under focus for this article are my recently completed 2013 postgraduate

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⁴³ Marker A, tax law exam, email 14/7/13.

⁴⁴ Marker B, tax law exam, email 18/7/13.

⁴⁵ Erlandson and Beach, above n 27, 411.

⁴⁶ Schön, *The Reflective Practitioner*, above n 8.

⁴⁷ See, for example, *A New Tax System Goods and Services Tax Regulations 1999* (Cth), Division 70 Financial Supplies.

business course candidates.⁴⁸ The cohort of 86 students exhibited a range of social characteristics, such as preferences varying from collective to individualistic learning. Most students were from mainland China (45 per cent), followed by Australian residents (23 per cent), those from south-east Asian countries (15 per cent); and other countries (16 per cent). Although physiologically the students were all older than twenty years of age, few had work experience relevant to the unit topics being taught, so no curriculum adjustment was made for the age factor. It was assumed that the main 'affective' characteristic, motivation, would not be an issue for a postgraduate group. Further, I did not know enough about the cohort in terms of anxiety levels or student attributions of success/failure to influence the design of my curriculum.⁴⁹

B The Learning Tasks

My Australian tax law unit has learning goals that satisfy the first of two requirements (the next requirement being Advanced Tax) for registration as a tax agent. The goals are met through the unit content and its delivery via learning tasks. Fundamental tax concepts, legislation, case law and examples were provided via a two hour lecture and prescribed readings, which I acknowledge is a passive mode of knowledge transfer. Active learning was the plan for tutorials, and evident in online quizzes and group assignments. As Schwartz observes, instructional designers pay particular attention to determining the learning involved for each type of goal in conjunction with an analysis of the mental steps involved in each type of goal.⁵⁰ He notes that prerequisite skills for a subject should also be identified, which my students have arguably met by completion of an introductory unit in business law.

The next section covers extracts from my reflective journal notes, written during the last semester of 2013, and my resulting interventions.

C Reflective Journal Extracts

(a) Reflection on GST lecture preparation, 29 July 2013

I have shifted part of the GST to the first lecture, with the balance of the topic to be covered in weeks 10 and 11. In the lecture I will emphasise GST's importance in relation to other tax topics, such as income tax. I have critically reviewed my GST lecture slides and made adjustments. I have thought about my audience of predominantly international students, and the need for clarity. No fogs of technical and colloquial terms. I mentally note the centrality of good delivery of the GST's pizza of technical terms, together with worked examples.

I will introduce 'gratitude', for according to Howells it is a pedagogy that can support effective teaching. The aim is to briefly explain the concept to students and emphasise its place in a secular education setting in conjunction with the promotion of exam skills, critical thinking, overcoming procrastination and reading strategies.

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⁴⁸ Schwartz, above n 9, 386.

⁴⁹ See, for example, *ibid*, 388.

⁵⁰ *Ibid*, 392.

(b) Reflection on (post-lecture) tutorial class, Group A, 5 August 2013

I found it difficult to generate a GST discussion with the international students, mainly because of my assumption of their educational backgrounds being overwhelmingly 'master/student', 'rote' and 'copy and reproduce'. Lack of students' prior preparation was also an issue, despite this specified requirement in my Unit Guide. I presented the questions and provided most of the answers. Not a good start! Nonetheless, this small cohort of eight students seemed keen. The setting of a good-sized room and computer facilities was useful.

(c) Intervention based on GST tutorial, Group A, 6 August 2013

For my next (larger) tutorial class with Group B, I will change my approach and get students into groups of 2–3 to identify and write down the sections of the GST legislation and discuss the answers. I plan to move around the class, from group to group, and help — and not give a didactic presentation of the answers.

(d) Reflection on (post-lecture) tutorial class, Group B, 7 August 2013

The tutorial for Group B was a large cohort of 27 students. Time was spent asking some students to shift to the smaller tutorial for the next week. This administrative action did not set the scene for a good first rapport with adult learners.

The setting was a room with battalion lines of tables, along which one squeezed in sideways to a chair. This configuration precluded my attempts to move around and talk to individual students. The small room was not conducive to the planned group discussions due to noise build-up, thus a 'cone of silence' was required when I spoke. There was no computer. Instead, there was a twentieth-century transparency projector needing space to be shunted back to adjust image size: but this was not possible.

I outlined my requirement for GST group discussions. Those students lucky enough to secure seats at the front took on the challenge, but I could not help those students seated in the back corners, who seemed lost (perhaps shy) as they cast around for a discussion partner. It soon became evident that my plan for group discussions was stymied by the physical layout, making it an effort to get through all the pre-set tutorial questions. I needed to undertake Schön's reflection-in-action, but the 50 minutes was up and also too late to revert to a 'chalk and talk' approach.

(e) Intervention based on GST tutorial, Group B, 8 August 2013

I will now change some variables for Group B. The first change will be a swap to a larger room. Next, I will ensure that the overflow students be contacted and shifted to the smaller class. I will try again for a group discussion approach next time.

However, upon further reflection there is still the issue of cultural difference to be addressed, which seems a fixed, intricate problem. My anecdotal understanding of international students is that they prefer the 'copy and reproduce' mode of instruction. Who am I to impose my western style of teaching on these high fee-paying 'clients'?

Should domestic students be streamed? Are students entitled to a tailored teaching service? Do I care about the teaching ratings that my students deign to give me?

Student Survey Feedback, 7–9 October 2013

I asked for anonymous student feedback on their learning experience for the GST and FBT topics for which I received 66 returns, a representative sample from the cohort of 86 students. The survey instrument is attached as an Appendix. The open questions had some examples provided as prompts. The written responses for Question 1 is summarised quantitatively in Table 1.

Table 1: Responses to Question 1

Question 1. What was your learning experience regarding the taxation law topics: the <i>Goods and Services Tax</i> and <i>Fringe Benefits Tax</i> topics (only)? You may want to comment on how you used the materials, made sense of the explanations, or the usefulness of the related tutorial/lecture examples.												
	Aus	China	Japan	Vietnam	Indonesia	Hong Kong	India	Sri Lanka	Singapore	Malaysia	Other	TOTALS
Hard to put theory into practice. More Q & As	7	3			1	1		1			4	17
Text book /slides/PTL qs/online quiz; all good.	5	8	1	4			1		1	1	7	28
FBT easier than GST	1			1								2
Found FBT difficult	1	1										2
Both GST and FBT difficult		7									1	8
GST & FBT are useful topics		2			1						1	4
Too text-book based		1									1	2
PTL text book compared to lecture slides were different.	1	1										2
Tests not related to PTL	1											1
	16	23	1	5	2	1	1	1	1	1	14	66
												100%

Students want model answers to questions (26 per cent); this is a recurring theme from the previous semester, which I interpret as a gap between theory and calculations practice, as no case law principles are prescribed for this topic. As this question was 'open' whereby students could raise individual issues, thus it cannot be deduced that 74 per cent found no difficulty in calculations. I have reflected on this outcome, noting that if I simply provide the answers for the pre-set tutorial questions, then students will have no incentive to attend class: Pavlov's behavioural psychology. I accept the need to add more examples and answers to my lecture slides and provide more Q & As online. This feedback could explain why FBT and GST calculations in exams show poorer than expected results for *business* students: the students need more practice. I plan to more vigorously promote the use of library copies of an alternative textbook for practice (it has problem questions with solutions). As one student wrote, 'I found the theory hard to put into practice...I need to be able to check up if my answer is correct'.

Students found GST and/or FBT difficult (18 per cent). I now accept that many humanities and engineering students who join postgraduate business courses find that explanations which use parallel accounting concepts have limited usefulness. Alternative practical ways of explaining these concepts need to be explored. For instance, a humanities major student wrote, 'Capturing the interaction between GST and FBT ... can be challenging.' I received student email requests for the online quiz answers, despite the textbook's page references having been given with answers, for example:

Since my online quiz result is not really good as I expected, and I want to make sure of the answers after reading the book, may I get a solution for the quiz and how to get it?⁵¹

⁵¹ Email from 'Lucy', student, 5 August 2013. The student was then advised to do another practice online quiz, and also encouraged to use the alternative text book that had questions *and* solutions. The student reported back that the extra materials helped.

The written responses for Question 2 on 'learning backgrounds' are summarised quantitatively in Table 2, which shows a variety of student experiences. Australian tax law is taken as an elective unit in the second part of a postgraduate business course and the survey results show a mixture of learning styles.

Table 2: Responses to Question 2

Question 2. How would you describe your learning background prior to Monash university?								
	Memory-based learning*	Drills or use of practice questions	No discussion in class	Mainly textbook learning	Lots of individual presentations of work to class	Participation in class discussion groups	Independent project-based tasks	Totals
Australia	3	3		1		8		15
China	9	6		4		5	1	25
Vietnam	2	3				4	1	10
Indonesia	1						1	2
Hong Kong	1							1
Japan							1	1
India		1					1	2
Malaysia	1							1
Oth	3	3		1		6		13
	20	16		6		23	5	70
	29%	23%	0%	9%	0%	33%	7%	100%
* Memorisation is important in law, see Smith and Ragan, "Instructional Design", 1999, p.136.								

The written responses for question three on student adaption to Australian university teaching styles were positive (73 per cent). One student wrote, 'My learning background was only an issue...in my undergraduate years ... I am now familiar with the [current] teaching style.' Responses were generally positive to the group assignment on a tax return, a student-centred practicum, for instance a student noted, 'I was not [familiar] with group assignments...but I learned a lot from my group mates.' Another student wrote, 'We worked on the assignment together and discussed the issues we faced ... it was useful to do the assignment better.'

D Semester 2, 2013, Intervention Evaluation

My intervention of changing room settings was straightforward. Further, I now conduct carefully tailored tests in tutorials on FBT and GST that are specifically different in format from examples the text book. I found that students appreciated the tests as they have an element of reflection in action, but I acknowledge it only addresses lower cognitive skills.⁵² However, the success of my encouragement for students to access extra practice materials for reinforcement of theory can only be measured later, through exam results and marker reports. Although this article has not included in my journal reflection and intervention into the FBT topic, the process was similar to that of the GST. I have barely scratched the surface on the issue of effectiveness of my teaching practice, much less the thorny question, 'why the need for greater understanding of student diversity?' Perhaps it is best not to put the cart before the horse, and get the basics right in terms of the learning required for each topic's goals. I use a blended learning approach, that is, face-to-face teaching and online multiple-choice testing. A later intervention option could be to investigate international student preferences for either

⁵² Tan, above n 12.

or both these teaching modes. Adam and Nel's longitudinal study suggests that richer teaching delivery modes 'better accommodate student cultural diversity'.⁵³

The concept 'gratitude' was introduced in the first lecture, but I found it hard to generate the appropriate sincerity of the 'beneficent circle of gratitude' to such a large audience of students, as beneficiary/benefactor normally generally involves two people.⁵⁴ I imbedded the concept in my weekly broadcast emails to students, but such channels of communication are not conducive to reciprocity. The gratitude strategy might best work in tutorials, which will require pre-training of tutors.

VI CONCLUSION AND FUTURE RESEARCH

During semester I barely got to know my students' true abilities, much less any academic improvement that might have resulted from my in-semester interventions, as the marks weighting is on the final exam; by this time it's all over — they've gone. The analysis of the exam results will help plan the teaching for my next cohort.

The use of the practice of gratitude is still only at a rudimentary stage and there is a need to explore it further to be an appropriate strategy to build into my teaching practice and help bridge cultural divides between my students. It is noted that a workable definition of gratitude is required to convey to students; the acquisition of gratitude will require some experimentation; to recognise there is the possibility of the inability to practise gratitude at certain times; that one must avoid being prescriptive; and sincerity of intention is a 'must' to promote gratitude in teaching.⁵⁵

More work is required on the appreciation of differing learning styles, eastern versus western.⁵⁶ I have started 'best practice' tax law teacher interviews on the topic of teaching to mixed cohorts in the Britain and New Zealand; and will extend the interviews to the United States. The plan is to categorise the results and analyse trends.

Anecdotally, there is a split in western teaching of tax law in business schools; one camp maintains that only tax law principles and inductive application should be taught to students in elite institutions to the exclusion of practicums (being too practical). The opposing camp calls for a balance between theory and practice. Thus this preliminary research focusing on tax teaching in an Australian institution could be extended to other western countries to find out what is being taught, how it is being taught and to who it is being taught.

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⁵³ Stewart Adam and Deon Nel, 'Blended and Online Learning: student perceptions and performance' (2009) 6 (3) *Interactive Technology and Smart Education*, 154.

⁵⁴ Patricia White, 'Gratitude, Citizenship and Education' (1999) 18 (1) *Studies in Philosophy and Education* 43.

⁵⁵ Howells and Cumming, above n 35, 75.

⁵⁶ See, for example, Shane N Phillipson, KYL Ku, and S Phillipson, (eds), *Constructing Educational Achievement: A Sociocultural Perspective* (Routledge 2013); Shane N Phillipson and Bick-Har Lam, *Learning and Teaching in the Chinese Classroom: Responding to Individual Needs* (Hong Kong University Press, 2011).

APPENDIX

Questions for taxation law feedback

(Survey instrument for students only)

Note:

This survey is voluntary and your name is NOT required. Please deposit completed surveys in the drop box at the exit to the lecture theatre/classroom for the collection. Students who do not want to complete a survey can deposit a blank form.

In a few sentences, would you answer the following questions:

What was **your learning** experience regarding the taxation law topics: the *Goods and Services Tax* and *Fringe Benefits Tax* topics (only)? You may want to comment on how you used the materials, made sense of the explanations, or the usefulness of the related tutorial/lecture examples.

How would **you describe** your **learning background** prior to Monash University?

(For example: memory-based learning; drills or use of practice questions; no discussion in class; mainly textbook learning; lots of individual presentations of work to class; participation in class discussion groups; independent project-based tasks.)

Has **your learning background** been an issue with adapting to the teaching style of tax law at Monash University? For example, the tax return assignment. Explain.

Was your secondary schooling in Australia? If not, which country?

**USING SCHEMAS TO DEMONSTRATE THE METHODOLOGY OF SOLVING COMPLEX TAX PROBLEMS:
A CASE STUDY**

ANNA MORTIMORE AND JENNIFER DICKFOS^{*}

ABSTRACT

Two common misconceptions held by tax law educators are that students have the necessary cognitive ability to understand the Australian taxation system and that they have the legal comprehension necessary to develop a methodology to resolve complex tax problems. Graphical schemas, which are conceptual frameworks that help organise and interpret information, include concept maps and flowcharts. They may assist in addressing these misconceptions. This case study provides preliminary evidence that by using graphical schemas, complex tax laws are not only clarified, but simplified into a sequence of steps, providing a methodology, as well as the motivation and confidence for students to solve complex tax problems.

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I INTRODUCTION

Students in undergraduate taxation law courses may be at risk of being overwhelmed by the volume of material referred to in their tax courses. Although prescribed reading of textbooks¹ is the central means of conveying information quickly,² recent research³ has recognised that students rely substantially on their instructors for knowledge and understanding, rather than their textbooks, which are primarily seen as reference material.

However, cognitive research suggests effective teaching and learning, leading to understanding, is not simply a process of relaying knowledge to students.⁴ Many educators wrongly assume students have the necessary cognitive schemas to understand challenging intellectual topics: For example, teaching complexity science and complex systems requires thoughtful approaches to help students comprehend the content.⁵ Similarly, while it is not a complex system in that sense, the legal framework does include webs of complex (complicated) rules that are difficult to comprehend and the Australian taxation system is a good example. A further misapprehension on the part of educators may be that students have the legal comprehension skills⁶ to identify taxation issues, essential in resolving complicated tax problems. Providing too much information and failing to recognise students' lack of cognitive conceptual development may then impact on students' self-efficacy levels, cause undue stress and ultimately result in poor grades.

A challenge then for taxation law educators is to meet students' expectations for effective content delivery of complex taxation laws within a two hour weekly lecture, to large cohorts of students with varying reading, comprehension and problem-solving skills.

To address this challenge and to provide a methodology for problem solving in taxation law, the article's lead author has developed a comprehensive set of schematic diagrams:

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¹ Additional materials may include Income Tax legislation, PowerPoint slides, review questions and answers, exemplars, study guides, and tutorial questions.

² See, for example, W Steve Albrecht and Robert J Sack, 'Accounting education: Charting the course through a perilous future' (2000) 16 *Accounting Education Series* (American Accounting Association, 2000); John Beegle and David Coffee, 'Accounting instructors' perceptions of how they teach versus how they were taught.' (1991) 67 (2) *Journal of Education for Business* 90; Shirley Dennis-Escoffier, Beth Kern, and Shelley Rhoades-Catanach, 'The revised model tax curriculum' (2009) 24(2) *Issues in Accounting Education* 141; Beth Kern and Shirley Dennis-Escoffier, 'Current tax status of the tax curriculum in accounting programs.' (2004) (November) *The Tax Advisor* 712.

³ See, for example, Barbara J Phillips and Fred Phillips, 'Sink or skim: Textbook reading behaviours of introductory accounting students' (2007) 22(1) *Issues in Accounting Education* 21; Jefferson Jones, 'Enhancing student learning: An examination of the student use of textbooks in financial accounting' (2011) 1(1) *American Journal of Business Education* 29; Nell Adkins, B Charlene Henderson and Kimberly G Key, 'Graphical organizers in tax education' (2012) 30 *Journal of Accounting Education* 2.

⁴ John D Bransford, Ann L Brown and Rodney R Cocking (eds), *How People Learn: Brain, Mind, Experience, and School* (National Research Council [USA], Committee on Developments in the Science of Learning, Commission on Behavioral and Social Sciences and Education, 1999).

⁵ Cindy E Hmelo-Silver and Roger Azevedo, 'Understanding complex systems: Some core challenges' (2009) 15(1) *Journal of the Learning Sciences* 53.

⁶ James F Stratman, 'When law students read cases: Exploring relations between professional legal reasoning roles and problem detection' (2002) 34 *Discourse Processes* 57.

flowcharts paired with step-by-step (SBS) conceptual schemas in tabular form for teaching and assessing key content areas in a final year undergraduate taxation law course at an Australian university.

Mental or cognitive schemas⁷ have been theorised as cognitive frameworks or mental structures by which the brain itself organises and interprets information.⁸ There is a substantial body of literature on cognitive schemas in several fields within cognitive science, including educational psychology and cognitive anthropology.

Diagrammatical schemas or 'graphical organizers'⁹ are ways to classify problems into particular classes, which can then be solved by using a set of general procedures relevant to that particular class of problem.¹⁰ The benefits of using graphical schemas in tax education¹¹ have been outlined previously. Adkins, Henderson and Key¹² describe the benefits of using schemas as follows:

- Reducing cognitive effort to understand complex relationships;¹³
- Reducing stress on working memory;¹⁴
- Assisting readers to organise and integrate related elements to see the 'big picture';
- Assisting students with low verbal ability in the language of instruction, such as ESL students.¹⁵

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⁷ Theorist Jean Piaget popularised the use of the term 'schema' in his stage theory of cognitive development in children. In terms of Piaget's theory as experiences happen and new information is presented, children develop new mental schemas and old schemas are changed or modified. See, for example, Jean Piaget, 'Piaget's theory' in Paul H Mussen (ed) *Manual of child psychology* (Wiley, 1970) 703.

⁸ Robert J Dufresne, William J Gerace, Pamela T Hardiman and Jose P Mestre, Constraining novices to perform expert-like problem analyses: Effects on schema acquisition (2009) 2(3) *Journal of Learning Sciences* 307.

⁹ The terms 'graphical schema' and 'graphical organiser' are used interchangeably in the body of this paper. See Nell Adkins, B Charlene Henderson and Kimberly G Key, 'Graphical organizers in tax education' (2012) 30 *Journal of Accounting Education* 2, 3. Graphical schemas and organisers encompass many forms of representation, but exclude aids without spatial representation, such as lists and outlines and aids containing non-verbal information such as pictures, and geographic maps.

¹⁰ See, for example, Mary L Gick and Keith J Holyoak, 'Schema induction and analogical transfer' (1983) (14) *Cognitive Psychology* 1; John D Bransford and Daniel L Schwartz, 'Rethinking transfer: A simple proposal with multiple implications' (1999) 24 *Review of Research in Education* 61.

¹¹ See, for example, Nancy B Nichols, John O Everett and Richard Boley, 'Instructional resources for tax education: Communicating the complexities of capital gains for individuals after the 1997 and 1998 tax acts' (1999) 14 (1) *Issues in Accounting Education* 117; Adkins, et al, above n 9.

¹² Adkins, et al, above n 9.

¹³ See, for example, Peter C H Cheng, Ric K Lowe and Mike Scaife, 'Cognitive science approaches to understanding diagrammatic representations' (2001) 15(1 -2) *Artificial Intelligence Review* 79; Mike Scaife and Yvonne Rogers, 'External cognition: How do graphical representations work?' (1996) 45 (2) *International Journal of Human Computer Studies* 185.

¹⁴ Douglas D Dexter and Charles A Hughes, 'Graphic organizers and students with learning disabilities: A meta-analysis' (2011) 34(1) *Learning Disability Quarterly* 51.

¹⁵ ESL students are those for whom English is a second language. Adkins, Henderson and Key, above n 9, 3 'citing John C Nesbit and Olusola O Adesope, 'Learning with concepts and knowledge maps: A meta-analysis' (2006) 76 *Review of Educational Research* 413'; Mark S Stensvold and John T Wilson,

While it is acknowledged that use of graphical schemas improves student performances and reduces cognitive effort,¹⁶ little examination has been made of the types of schemas that may impact students' motivation to learn.¹⁷ This article is a case study that attempts to address this gap. The article also extends and complements previous studies by providing preliminary evidence that the set of schemas developed by the lead author are not only a cognitive mechanism for the efficient teaching of taxation law, but they also impact on learning by motivating students through increased levels of confidence and self-efficacy in solving complex tax problems.

The remainder of this article is organised as follows. Part II provides a theoretical background describing the skills required to understand complicated intellectual topics; graphical schemas and their use in simplifying complex concepts; the general importance of confidence and self-efficacy in acquiring technical skills; and the use of graphical schemas as a role-modelling and mastery tool to increase students' confidence and self-efficacy levels in solving complex tax problems. Part III briefly describes and illustrates the design of the schemas. Part IV describes the research method used. Part V presents the preliminary qualitative and quantitative results. Finally, consideration is given to the limitations of the current research, the potential for further research, ending with the article's conclusions.

I THEORETICAL BACKGROUND

A Learning Complex Intellectual Topics

Making sense of a complicated tax system is a difficult task, because it is not predictable, it may require one to think abstractly and often challenges current beliefs on certain concepts that may be in conflict with a learner's prior experience. Anecdotal evidence exists of students' struggles with the study of taxation law courses, which may be attributed in part to the complexity of the taxation system. Understanding and reasoning within taxation law, is challenging, not only because legal reasoning is a complex cognitive skill and places a huge burden on working memory.¹⁸ Difficulties in cognitive

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'The interaction of verbal ability with concept mapping in learning from a chemistry laboratory activity' (1990) 74 *Science Education* 473; Xiangying Jiang and William Grabe, 'Graphic organizers in reading instruction: Research findings and issues' (2007) 19(1) *Reading in a Foreign Language* 34.

¹⁶ Such results are accounted for by the expansion of the transfer of learning theory beyond the application of the 'classic' prior knowledge approach. See, for example, John D Bransford, and Daniel L Schwartz, 'Rethinking transfer: A simple proposal with multiple implications' (1999) 24 *Review of Research in Education* 61; James G Greeno, 'Authoritative, accountable, positioning and connected general knowing: Progressive themes in understanding transfer.' (2006) 15 *Journal of the Learning Sciences* 537; Joanne Lobato, 'Alternative perspectives on the transfer of learning: History, issues, challenges for future research' (2006) 15 *Journal of the Learning Sciences* 431; Daniel M Belenky and Timothy J Nokes-Malach, 'Motivation and transfer: The role of mastery-approach goals in preparation for future learning' (2012) 21(3) *Journal of the Learning Sciences* 399.

¹⁷ Similarly, little examination has been given to the role of motivation as a factor in the theory of the transfer of learning. See Daniel M Belenky and Timothy J Nokes-Malach, 'Motivation and transfer: The role of mastery-approach goals in preparation for future learning' (2012) 21(3) *Journal of the Learning Sciences* 399.

¹⁸ Stratman, above n 6.

processes are not limited to legal problem solving, but extend to reading processes of legal texts, including cases.¹⁹

Legal educators may make the faulty assumption that their students have the cognitive and meta-cognitive skills to process all the information provided in the course, identify the important issues, successfully apply legal reasoning to resolve complex tax problems and maintain motivational skills. All of these are required to sustain learning of the complicated, intricately interwoven tax system. This case study classifies those students who have such skills as 'experts', those who lack such skills, are classified as 'novices'. Experts are able to work through all the material provided in their course and learn to classify problems into particular classes which can be solved using the same basic approach.²⁰ Novices, on the other hand, have a less organised knowledge structure and may only apply what they have learned to similar situations following routine procedures, as they have little understanding of how the system works.²¹

B The Role of Conceptual Knowledge

It has been suggested that possessing accurate conceptual knowledge is a prerequisite for accurate legal reasoning, as conceptual knowledge is required at all stages of the legal problem solving process.²² First, conceptual knowledge is required to understand the legal problem: to decide what information in the particular case is important and what is irrelevant. Second, conceptual knowledge determines what rules or jurisprudence should be researched: by distilling the relevant rule of law from reading cases, or searching for exceptions in external information sources such as law books. Third, conceptual knowledge is needed to interpret and accurately apply the law once found.

A recent study by Nievelstein et al²³ found the availability of information sources improved legal reasoning for expert students, but not for novice students. Novice

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¹⁹ Ibid 59. Stratman emphasises 'how can we know the difference between when students are having difficulties as critical readers and when they are having difficulties as contextually sensitive legal problem solvers, or when in fact they are having difficulty connecting these two processes with each other?'

²⁰ Hmelo-Silver and Azevedo, above n 5.

²¹ See, for example, C E Hmelo-Silver and Merav G Pfeffer, 'Comparing expert and novice understanding of a complex system from the perspective of structures, behaviours and function' (2004) 28 *Cognitive Science* 127; Cindy Hmelo-Silver, Surabhi Marathe, and Lei Liu, 'Fish swim, rocks sit and lungs breathe: Expert-novice understanding of complex systems' (2007) 16(3) *Journal of Learning Sciences* 307.

²² See Mary A Lundeborg, 'Metacognitive aspects of reading comprehension: Studying understanding in case analysis' (1987) 22 *Reading Research Quarterly* 407; Susan M Williams, 'Putting case-based instruction into context: Examples from legal and medical education.' (1992) 2 *Journal of the Learning Sciences* 367; Dorothy H Deegan, 'Exploring individual differences among novices reading in a specific domain: The case of law' (1995) 30 *Reading Research Quarterly* 154; Lars Lindahl, 'Deduction and justification in the law: The role of legal terms and concepts' (2004) 17 *Ratio Juris* 182; Fleurie Nievelstein, Tamara van Gog, Henny P A Boshuizen, Frans J Prins, 'Effects of conceptual knowledge and availability of information sources on law students' legal reasoning' (2008) 38 *Instructional Science* 23.

²³ Nievelstein, et al considered 'the lack of conceptual knowledge and lack of knowledge of how information sources are organized, both by themselves or in combination, indeed seemed to lead to ineffective search processes when using the information sources. Such processes impose a high

students, who lack the conceptual knowledge to distil the relevant information from case studies or hypothetical problems, find legal reasoning difficult to understand or formulate.

Practically, this manifests in students' complaints regarding the time taken in understanding the law and applying the law to solve complex tutorial tax problems.

Nievelstein et al²⁴ further suggest that law education's reliance on the idea that students learn to reason and solve cases by engaging in solving cases with the aid of external sources is of little value to novices and a sub-optimal instructional method for such students. Instead, Nievelstein et al²⁵ suggest that novice law students may need forms of instructional guidance such as scaffolding conceptual knowledge to assist them to effectively learn to solve complex law problems. Nievelstein et al's investigation focused on law students. If novice law students experience such difficulties, then it is the authors' contention that novice commerce students (including (ESL) students) may find studying complex law systems such as taxation extremely arduous.

Using worked examples, review questions and tutorial solutions may be effective in the initial stages of skill acquisition for such novices, but do not necessarily provide the deep conceptual understanding needed to apply complex taxation laws as discussed above. Novice commerce students, relying on such material, perform poorly when the tax problem questions are varied, as such materials do not provide the scaffolding necessary to solve problems in a complex tax system. Thus there is a need²⁶ for tax law educators to understand the complex nature of learning, to support learning and to determine what scaffolds are necessary to support student learning and how they should be applied.

This article provides preliminary evidence of the use of graphical schemas as a way to help students develop the cognitive resources to understand and apply what are rather difficult and complicated taxation laws.

C Multiple Educational Uses of Graphical Schemas

Graphical schemas have multiple educational uses. First, they may be used as pre-lecture preliminary materials. By condensing large amounts of information and showing their inter-component relationships and sequences, a broad conceptual understanding of complex topics and overview of knowledge is provided. Secondly, they may be used as problem-solving tools because they provide a framework for a more detailed and proficient analysis of a complex topic.²⁷ Where the tax system relies upon the satisfaction of a series of conditions, an accurately constructed graphical schema in the

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additional and ineffective load on working memory.' F Nievelstein et al, 'Effects of conceptual knowledge and availability of information sources on law students' legal reasoning' (2008) 38 *Instructional Science* 23, 32.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Identified by Hmelo-Silver and Azevedo, above n 5, 55.

²⁷ See, for example, Philip T Senatra, 'The statement of changes in financial position: A flow-chart approach to teaching concepts and procedures' (1983) 1 *Issues in Accounting Education* 95; Robert J Dufresne et al, above n 8.

form of a flowchart provides the means to sequentially analyse the information and solve the problem. Thirdly, graphical schemas might contribute to students' own motivation to engage in deeper conceptual understanding of complex tax laws, which can influence their attitude to their learning. Applying Bandura's²⁸ theory of self-efficacy, encouraging students to successfully use schemas in tutorials and exams to solve complex tax problems may increase their students' confidence and self-efficacy levels in their tax problem-solving abilities.

D Using Schemas to Increase Students' Self-Efficacy

Bandura defines self-efficacy as 'the judgements of one's capabilities to organise and execute the courses of action required to produce given attainments.'²⁹ Put simply, self-efficacy is an individual's estimation of their ability to perform a specific task. Thus the level of self-efficacy impacts on technical skill performance because it influences the choices, effort and persistence of human behaviour.³⁰ For example, a student with low self-efficacy for solving complex tax problems may avoid, or discontinue their attempts at solving complex tax problems.³¹ Whereas, if that student's self-efficacy can be increased, they may persist in their attempts to solve a challenging tax problem, eventually overcoming their inhibitions or fears.

Fortunately, students' self-efficacy beliefs can be increased by the impact of each of the following four factors: mastery experiences, modelling, feedback and physiological states.³² Mastery experiences increase self-efficacy as the successful accomplishment of a specific performance strengthens an individual's belief in their ability. Modelling builds self-efficacy. By observing the performance of others, seeing their success through sustained effort and making social comparisons, students' self-belief is increased. Receiving realistic encouragement or feedback from credible persuaders³³ also increases self-efficacy as recipients are motivated to make a greater sustained effort and become successful.³⁴ Improving physical or emotional conditions such as reducing stress levels can also impact on a person's perceived capability to perform tasks and thereby increase their self-efficacy.

Provision of graphical schemas in the undergraduate taxation law course seems to increase the self-efficacy of students' complex tax problem solving skills. They support subject mastery and provide modelling experience for students. Further, their use provides feedback and reduces students' stress levels, as discussed in Part IV.

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²⁸ Albert Bandura, 'Self-Efficacy mechanism in human agency' (1982) 37(2) *American Psychologist* 122.

²⁹ Albert Bandura, *Self-efficacy: The exercise of control* (Freeman, 1997) 3.

³⁰ See, for example, Bandura, above n 29; Dale H Schunk, 'Metacognition, Self-Review, Self-Regulation and Self-Regulated Learning: Research Recommendations' (2008) 20 (4) *Educational Psychology Review* 463.

³¹ Albert Bandura, and Nancy E Adams, 'Analysis of self-efficacy theory of behavioural change' (1977) 1(4) *Cognitive Therapy & Research* 287.

³² Robert Wood and Albert Bandura, 'Effect of perceived controllability and performance standards on self-regulation of complex decision making' (1989) 56 (5) *Journal of Personality and Social Psychology* 805.

³³ Barry J Zimmerman, 'Self Efficacy: An Essential Motive to Learn' (2000) 25 *Contemporary Educational Psychology* 82.

³⁴ A Bandura and Daniel Cervone, 'Self evaluative and self efficacy mechanisms governing the motivational effects of goal systems' (1983) 45(5) *Journal of Personality and Social Psychology* 1017.

E Using SBS Schemas in a Limited Teaching Timeframe

Students' reliance upon their instructor as their principal source of learning both technical and generic skills severely limits course content coverage within the single undergraduate taxation law course. It is the authors' contention that the multi-educational uses of flowcharts and SBS schemas addresses this limitation by facilitating efficient content delivery: schemas are used to teach taxation concepts in lectures, to summarise taxation laws for exam revision purposes and to guide students in solving complex tax problems in tutorials, assignments and exams.

Schemas in the form of flowcharts may be found in Australian taxation law textbooks and the Australian income tax legislation. Yet students only benefit if they read the textbook and view the schema. Textbook readings maybe disregarded by students, if the lecturer provides printed materials, which may serve as the primary communication of content to students.³⁵ Similarly, students' motivation to read the textbook may wane during the semester. A study of undergraduate students' reading behaviours indicates that reading is a motivated behaviour, such that the amount of time spent engaging in reading, from in-depth reading to skimming, varies among academically strong and weaker students and the percentage of students who read the material prior to class declines as the semester progresses.³⁶ The subsidiary importance placed on textbooks as a source of learning by students is reinforced by Jones who states 'while students felt that both time spent in completing their assignments and the instructor added value, the textual material in the textbook does not appear to be of major importance.'³⁷

Textbook flowcharts may omit key content areas in undergraduate taxation law courses and may fail to highlight the methodology required to solve complex tax problems. The set of schemas described in Part III addresses these possible failures by combining flowcharts with a series of steps to provide students with a methodology for solving complex tax problems.

II DESIGN OF FLOWCHART AND 'STEP BY STEP' SCHEMAS

To improve students' understanding of the methodology of interpreting, organising and applying complex tax laws, combined flowchart and 'step by step' (SBS) schemas were developed and used in the undergraduate tax law course.

A Flowcharts

Butcher's³⁸ study on the use of text as opposed to (1) simplified diagrams and (2) detailed diagrams found that both types of diagrams supported student learning and

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³⁵ Adkins, Henderson and Key, above n 9.

³⁶ Barbara J Phillips and Fred Phillips, 'Sink or skim: Textbook reading behaviours of introductory accounting students' (2007) 22(1) *Issues in Accounting Education* 21.

³⁷ Jefferson P Jones, 'Enhancing student learning: An examination of the student use of textbooks in financial accounting' (2011) 4(1) *American Journal of Business Education* 29.

³⁸ Kirsten R Butcher, 'Learning from text with diagrams: Promoting mental model development and interference generation' (2006) 98(1) *Journal of Educational Psychology* 182. Butcher's study was on student learning of the heart and circulatory systems (a complex system).

reduced comprehension error over text only learning. Groomer and Heintz³⁹ identified the benefits of flowcharts over the narrative or tabular communication as:

- mapping mental processes in a way that make decision points and consequences clearly identifiable;
- facilitating organisation and prioritising of issues that must be addressed; and
- offering efficient, comprehensive coverage in a single place.

Although the concept of flowcharts is not new, not all flowcharts are effective as conceptual schemas that help in building self-efficacy and motivation. Some may be poorly designed, as discussed in Part II. Flaws in the design of the diagram may hinder rather than assisting with the multiple educational goals discussed in Part II — for example their visual impact may be distracting, so as to hinder learning. To be effective, flowcharts must assist students to organise and integrate related areas of the law to see the 'big picture'.⁴⁰

The sample flowchart in Appendix A offers a schematic approach to determining the tax deductibility of expenditure incurred for repairs under s 20 of the *Income Tax Assessment Act 1997* (Cth) (ITAA1997). The flowchart supports the cognitive processing of complex tax law by stepping the student through the process of reading the statutory law provision and visually simplifying the intent of the statutory tax provision by identifying the critical areas of the law.

The flowchart in Appendix A adheres to the recommendations of Dexter and Hughes⁴¹ and Vekiri⁴² that flowchart schemas should not be clustered with a lot of information so that students may easily perceive the relations that are important. The flowchart should only include keywords (over completeness) and use simple drawings.⁴³ Hence, the flowchart shows the 'instructional goal' in the application of s 20 of the ITAA1997 to determine the tax deductibility of expenditure incurred for repairs to premises or repairs to a depreciating asset. Adhering to the 'coherence principle' described by Clark and Mayer⁴⁴ the flowchart avoids the insertion of any material that does not support the 'instructional goal' which only creates additional cognitive processing.

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³⁹ S Michael Groomer and James A Heintz, 'Teaching audit reports: A flowchart approach' (1991) 9(2) *Journal of Accounting Education* 291.

⁴⁰ Matthew T McCrudden, Joseph P Magliano, Gregory Schraw, 'The effect of diagrams on online reading processes and memory' (2011) 48 *Discourse Processes* 69.

⁴¹ Douglas D Dexter and Charles A Hughes, 'Graphic organizers and students with learning disabilities: A meta-analysis' (2011) 34(1) *Learning Disability Quarterly* 51, 55.

⁴² Ioanna Vekiri, 'What is the value of graphical displays in learning?' (2002) 14(1) *Educational Psychology Review* 27.

⁴³ See, for example, Joseph R Boyle and Noranne Yeager, 'Blueprints for learning: Using cognitive frameworks for understanding' (1997) 29(4) *Teaching Exceptional Children* 26; Vekiri, above n 42; Douglas A Wiegmann, Donald F Dansereau, and Edward C McCagg, Kirsten L Rewey 'Effects of knowledge map characteristics on information processing' (1992) 17(2) *Contemporary Educational Psychology* 136.

⁴⁴ Ruth C Clark and Richard E Mayer, *E-Learning and the science of instruction: Proven guidelines for consumers and designers of multimedia learning* (Pfeiffer, 3rd ed, 2011)151.

The flowchart in Appendix A applies the 'segmenting principle'⁴⁵ by breaking down the meaning and interpretation of taxation law into more manageable 'steps' because 'certain tax law cannot be easily simplified by omitting definitions, rules and exceptions without damaging the integrity of the tax treatment of the law.'⁴⁶ However, the application of the steps first identified in the flowchart schema is detailed and explained in the 'step by step' (SBS) tabular schema as shown in Appendix B. The SBS schema systematically guides the student 'step by step' in applying the law; and considers whether other tax law provisions need to be consulted in order to solve the tax problem.

B SBS Tabular Schema

Each step of the SBS tabular schema provides the kind of scaffolding that researchers in educational psychology advocate to support meta-cognitive processes such as the legal reasoning skills that are critical to support the learning process of problem solving in the taxation system. The SBS schema reinforces the critical areas of the law identified in the flowchart, assisting students' cognitive processing by detailing in 'step by step' order how the law is to be applied to the tax problem, and what must be discussed: case law, taxation ruling and other relevant information referred to in weekly lectures. This progression from simple, as shown in the flowchart schema to more complex, as in the SBS schema, is consistent with most instructional design theories.⁴⁷ The advantage of the SBS schema is that it prompts the student to read the facts of the tax problem, and identify the issue, apply the segmented law step by step, determining whether each step does or does not apply and to consider whether other areas of law may be relevant. Each step ensures the student has considered and addressed the critical areas of the law and any conditions and exceptions that may be relevant. For example, the SBS schema in Appendix B details the steps identified in Appendix A for the application of s 25-10 of the ITAA1997. In Appendix B, the SBS schema prompts the student, using a series of questions, to examine the facts of their hypothetical tax problem and determine first: whether the 'repaired' premises or the 'repaired' depreciating asset, were in need of repair? If the premises or asset were not in need of repair, the student will then write their findings (to Step 1a), and state why the law does not apply. For example, the expenditure is not deductible under the statutory provision s 20 ITAA1997 because the premises or the depreciating asset were not in need of repair? The student is then 'prompted' to proceed to 'Step 6' and then directed to another provision of the ITAA. Alternatively, the student will state that the premises or depreciating asset were in need of repair, (Step 1a) and then continue to apply the remaining 'steps' shown in Appendix B. The combined flowchart and SBS schema demonstrates the 'legal reasoning skills' and the 'methodology' used by experts to process the large volumes of law resources provided in the course and to interpret, and apply such resources to resolve tax problems. Novices, who lack this methodology, are provided with scaffolding to assist their understanding of the legal reasoning skills and the methodology required to problem solve in complex systems such as taxation law. Thus reducing their dependence on suggested answers and routine procedures as discussed above.

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⁴⁵ Adkins, et al, above n 9.

⁴⁶ Ibid, 10.

⁴⁷ Adkins, et al, above n 9.

III PRELIMINARY QUALITATIVE AND QUANTITATIVE RESULTS

Preliminary qualitative and quantitative results have been obtained to address the research question: Does the use of the flowchart and SBS schema influence students' tax problem-solving skills and self-efficacy, and if so why?

In 2012, a survey instrument was administered in class, at the end of the teaching period, to fifty-seven commerce and law students enrolled in the introductory undergraduate taxation course (Revenue Law). The survey instrument included three sections: demographic information; student use of the flowcharts and SBS schemas; perceptions of self-efficacy in understanding and applying complex taxation laws. Mark sense cards were used to record student responses. Students indicated the flexibility of the flowcharts and SBS schemas as a scaffolding tool by identifying how they used the flowcharts and SBS schemas: revising in private study; applying the law and preparing answers to tax hypotheticals. Students rated the strength of their self-efficacy using a 5 point Likert scale from 1 (not confident at all) to 5 (very confident).

Students also provided additional written commentary on what they considered were the benefits of using the flowcharts and SBS schemas. The survey results and additional student commentary supports the authors' contention that the flowchart and SBS schemas provide conceptual knowledge scaffolding to assist students to solve complex law problems and increase students' motivation and self-efficacy levels.

A Impact of the Flowcharts and SBS Schemas

(a) Scaffolding tool

The initial survey results and student commentary confirm the flowchart and SBS schemas use as a scaffolding tool to understand and apply complex taxation laws.

Table 1: Flowcharts and SBS Schemas Survey: Benefits to Students

Perceived Benefit	Students who agreed (%)
The flowcharts and SBS schemas simplify my understanding of taxation laws	86
By using the flowcharts and SBS schemas I have developed a methodology for solving hypothetical tax problems	89

Approximately 86 per cent of the student cohort considered the flowcharts and schemas had simplified their understanding of complex tax laws and assisted them in developing a methodology for solving hypothetical tax problems.

The 'steps' are successful in that they decrease the volume of information that is presented, whereby only relevant or typical scenarios are covered, but in such a way that technical accuracy is not compromised. (Student)

The 'steps' provide a roadmap for understanding complex taxation issues. They allow one to 'step' through the essential elements of the law and to arrive at a conclusion regarding the correct taxation treatment of a particular circumstance. (Student)

(b) Increased self-efficacy

Having gained a methodology and an understanding of complex tax laws, the survey shows that students were motivated to continue to use the flowcharts and schemas in lectures, and tutorials to successfully answer complex tax law problems and for private study purposes.

Table 2: Flowcharts and SBS Schemas Survey

How the Flowchart and SBS Schemas were used by students	Students who agreed (%)
When applying relevant tax law to hypothetical tax problems	89
When preparing answers to hypothetical tax problems	98
For private study and revision	96

Continual use of the flowcharts and SBS schemas by both teaching staff and students provided both a modelling and mastery experience for students which increased their confidence levels in understanding and applying complex taxation laws.

Table 3: Flowcharts and SBS Schemas Survey

Self-efficacy and Motivation Levels

Self-efficacy: how confident are you in your ability to:	5 (%)	4 (%)	3 (%)	2 (%)	1 (%)	Average Ranking
Understand Taxation Law	2	16	39	37	6	2.71
Apply Taxation law to hypothetical problems	0	16	42	32	10	3.54

At the conclusion of the teaching semester, 57 per cent of the student cohort were either moderately, substantially, or very confident in their understanding of taxation laws. Similarly, 58 per cent of the student cohort were either moderately, substantially, or very confident in applying taxation laws to resolve hypothetical tax problems.

In some students this increase in confidence and self-efficacy in legal reasoning was considered transferable to other areas of law

I personally believe that one may draw maximum utility from the 'steps' by viewing them as dynamic documents that can be tailored by each individual to suit his or her preferences and level of technical knowledge. It is through this customisation process that one truly begins to unlock their power as a learning tool. (Student)

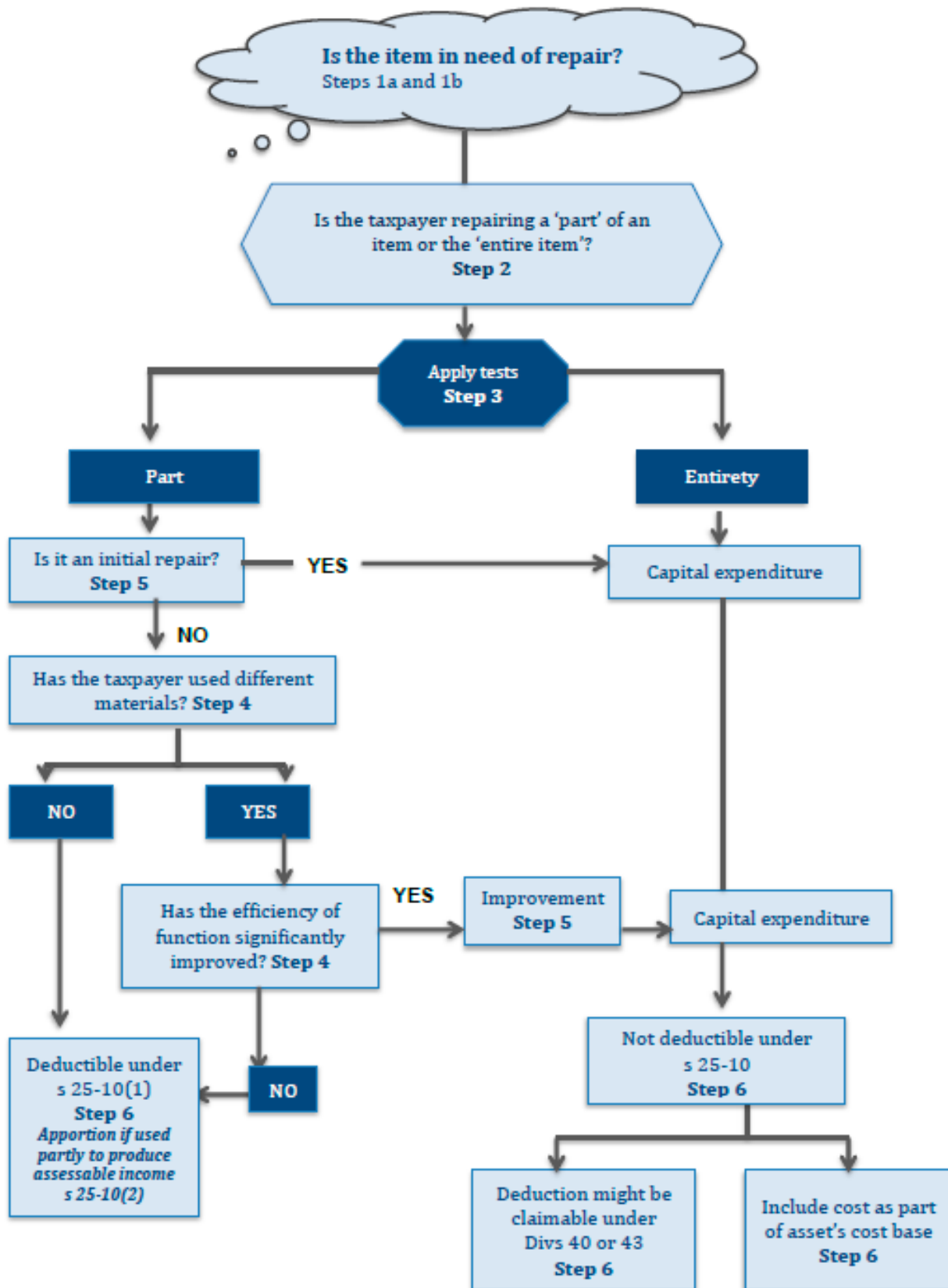
IV LIMITATIONS AND FUTURE RESEARCH

The primary methodological limitations of this study include the small sample size of the survey, the preliminary nature of the evidence and the short-timeframe of the analysis. These shortcomings will be addressed in future research, currently being conducted by the authors. It is their intention to conduct two surveys: pre- and post- flowchart and SBS schema, over a number of student cohorts, so as to measure the increase in student self-efficacy and confidence levels after using the flowchart and SBS schema methodology to answer complex tax problems. Future research will also consider postgraduate students' use of the schemas in their employment and postgraduate studies. Further research could also entail law educators using the flowchart and SBS schema in tabular form and reporting on their impact in terms of developing methodologies for understanding and applying other complex areas of law in their courses.

V CONCLUSION

This article provides preliminary evidence that the use of the combined flowchart and tabular SBS schemas are an effective and efficient teaching and learning tool in helping students acquire the cognitive ability to understand the methodology of problem solving in a taxation law course. Simplifying and clarifying complex taxation laws into a sequence of steps can reduce students' stress, increase their confidence and self-efficacy and motivate them to use their newly acquired technical skills to solve complex tax problems. The schemas' multi-educational uses, as described in the article, make them a worthwhile tool for teaching staff faced with the challenge of teach and assessing complex taxation law concepts within a single-semester undergraduate taxation course. Conceptual schemas address the need of students (experts and novices alike) for a methodology to help them solve complex problems in taxation law.

APPENDIX A: SCHEMATIC APPROACH TO SECTION 25-10 ITAA 1997, REPAIRS (FLOWCHART)



APPENDIX B : ALTERNATIVE SCHEMATIC APPROACH TO REPAIRS: STEP-BY-STEP IN TABULAR FORM

Steps to answering questions on 'repairs'

THE ISSUE:

Can the expenditure incurred by the taxpayer be deducted as a 'repair' under s 25-10 of the ITAA 1997?

THE LAW:

Section 25-10 Repairs

- (1) You can deduct expenditure you incur for repairs to premises (or part of premises) or a*depreciating asset that you held or used *solely* for the *purpose of producing assessable income.

Property held or used partly for that purpose

- (2) If you held or used the property only *partly* for that purpose, you can deduct so much of the expenditure as is reasonable in the circumstances.

No deduction for capital expenditure

- (3) You cannot deduct capital expenditure under this section.

INSTRUCTIONS:

Students, apply the following Steps in the order shown. If the Step does not apply to your facts, then state that in your answer. If the Step does apply, then continue applying the Steps as shown. As you proceed through the Steps, you will be writing up your answer. Remember to cite the law and explain how the law does or does not apply to your facts.

STEPS IN APPLYING S 25-10	APPLY THE FOLLOWING LAW
STEP 1(a) Is the item in need of repair?	The item must be in need of repair in order to claim a deduction under s 25-10. If not, it is a capital improvement. For example shortening an awning that is too long. <i>Students: if the item is NOT in need of repair, a deduction cannot be claimed under s 25-10. Refer to Step 6.</i>
STEP 1(b) What is a repair?	Meaning of 'repair' is not defined in the <i>Income Tax Assessment Act</i> (ITAA). <i>Students: if there is a 'gap' in the legislation, identify whether applicable case law exists.</i>

STEPS IN APPLYING S 25-10	APPLY THE FOLLOWING LAW
STEP 2 How does case law interpret what is a 'repair'? Cite the case law and precedent in your answer.	Courts have defined the essential attributes of a repair as: • A repair involves a restoration of a thing to a condition it formerly had without changing its character: <i>W Thomas & Co Pty Ltd v FC of T</i> (1965) 115 CLR 58. It restores it to its former efficiency, rather than an exact repetition of form and substance • A repair involves replacement or renewal of part of an item, rather than the entire item: <i>Lurcott v Wakely and Wheeler</i> (1911) 1 KB 905. If the entire item is replaced, this is not a repair, but a capital addition or improvement. For example: replacing a broken window, repairs to a wall or wooden floor, repainting a wall. Although oiling, brushing or cleaning items, which are in a good working order is not a repair. Such expenses are deductible under s 8-1(1) <i>TR97/23 (paragraph 13) Remediating or making good defects in damage to, or to deterioration of property to be repaired.</i>
STEP 3 Is the taxpayer repairing a 'part' or an 'entirety'? Refer to Commissioner's Ruling TR97/23 paragraphs 120 to 124 Paragraph 37 The Commissioner states that there is no correct test – the question is one to be answered in light of all circumstances.	<i>Students: Apply the following tests to your facts and determine if the taxpayer is replacing a 'thing' (part) or 'entirety'? Choose whichever of the following precedents of law apply to your facts:</i> 1. What is the 'functional entity'? That is, is it capable of performing a separate function? <i>Phillips v Whieldon Sanitary Potteries Ltd</i> (1952) 33 TC 213. 2. Is it a substantial item of equipment or an 'inseparable part of a larger unit'? <i>Lindsay v FCT</i> (1960-1961) 106 CLR 377 3. Is it physically commercially and functionally an inseparable part of a larger unit', which is an entirety. <i>Samuel Jones & Co (Devondale) Ltd v IR Commrs</i> (1951) 32 TC 513 <i>Students: in applying the above tests determine:</i> • If the tests indicate the work performed is replacing an 'entirety' it is an improvement — refer to Division 43 for deductibility on 'capital works'. • If the tests indicate that the work is restoring a 'part' then it is a repair <i>unless</i> the taxpayer has used different materials, and improved efficiency of function. Refer to Step 4.

STEPS IN APPLYING S 25-10	APPLY THE FOLLOWING LAW
STEP 4 If it is a 'part', can the taxpayer use different materials?	Taxpayer can use 'different materials' providing the efficiency of function has not improved. (Refer to TR97/23 paragraph 48) ie, use of 'different materials' will be an 'improvement' and not a 'repair' if: • 'there has there been a significant increase in the efficiency of function' <i>Students: this will apply, if you can establish from the facts of the case:</i> • Not only has there been a significant reduction in future repairs (<i>Western Suburbs Cinema 1952</i>) but • More importantly a new, different, additional function.
STEP 5 Conclude	<i>Students: make sure you conclude whether the item of expenditure IS/IS NOT deductible under s 25-10. If the item is not deductible as a 'repair' under s 25-10, then refer to Step 6.</i>
STEP 6 The expenditure is of a capital nature if it is: • an initial repair • an addition • an improvement	Initial repairs will be deemed to be capital, regardless of whether the purchase price was discounted because the asset was in a state of disrepair. There is no guidance about how long you need to own the property for it not to be an 'initial repair'. The ATO may look at claims within the first few years of owning a property. Additions such as building an extra room are capital. Improvements: where the repair has improved or created an <i>additional function</i> it is capital. The capital expenditure may be deductible under: • Division 40 (Capital Allowance) or • Division 43 (Capital Works) If not, the capital expenditure may be included in the cost base of the asset for CGT purposes under Division 110.

CAN TEACHING AND LEARNING TAXATION BE FUN WHILE STILL MAINTAINING STANDARDS?

HEATHER BUCHAN AND KARIN OLESEN*

ABSTRACT

The study examines the changing perceptions of students when learning methods are altered in an undergraduate taxation course. In this study a qualitative case study involving five separate cohorts of third year business students using learning methods such as a moot court with discussions, filming and direct observation was undertaken. The study found that there was a change in perception from taxation being “as dry as toast” to being an enjoyable subject. The students preferred the moot courts that were used as one of the summative assessments, as opposed to the traditional summative assessments of assignments and exams.

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I INTRODUCTION

Extant literature indicates that teaching should be delivered in a manner that caters to learners' different learning styles. In general, most people react adversely when the term 'taxation' is mentioned, and students are no exception. For tertiary students, the content of taxation studies depends on the specific programme criteria. For some students the level 7 taxation degree course is compulsory, while for others it is an elective course. Regardless of the students' motives for studying taxation, it is important that they become engaged with the subject matter in order to master and remember the relevant taxation rules.

The composition of the taxation student cohort is extremely varied. On average the cohort comprises a combination of the following categories of students: Māori, Pasifika, international, postgraduate and students less than 25 years old. The significance of this research lies in the fact that for most of the students in the taxation cohort, English is not their first language, thus making taxation's 'legislative language' challenging. The majority of the students are Māori and Pasifika and under 25 year old.

In addition, the students have different educational backgrounds, learning styles and cultural backgrounds, all of which need to be addressed if they are to be successful. The focus of this article is on teaching taxation to tertiary students in an interesting and meaningful manner while still meeting the learning outcomes of the course.

To achieve this with such a diverse taxation student cohort requires an in-depth analysis of the teaching and learning process. Since 2007, the first author has been involved in delivering all the taxation courses at a tertiary institute. It is incumbent on the teaching staff to ensure that students' different learning styles are accommodated, while making the subject of taxation interesting and meeting the learning outcomes of the course. Specifically, the research questions of this study are:

- How can taxation compliance and administration be taught to students in an enjoyable manner?
- Will the learning outcomes of the course still be met?

Accordingly, this article explores possible approaches to topics that are traditionally perceived as being 'dry as toast' to determine if they can become something as enjoyable as tiramisu, while the prescribed learning outcomes are still achieved in the process.

In Part II the teaching and learning process will be discussed, together with a review of the relevant literature. This will be followed by the first author's approach to the teaching and learning process in relation to the moot.

II LITERATURE REVIEW

A review of the literature relating to adult learning was conducted to see how adult learning could be applied to the delivery of taxation courses and the rationale for

choosing certain approaches. We use the statement 'You never see the 'ingredients', just the cake'¹ to discuss the ingredients of teaching, namely, the needs assessment; the experiential learning cycle model; and facilitation.

A The Needs Assessment

Adult learning is 'The approach ... that adults have enough life experience to be in dialogue with any teacher, about any subject, and will learn new knowledge or attitudes or skills best in relation to that life experience.'²

Thus the key to effective adult learning is dialogue. Vella³ describes twelve principles for effective adult learning. She states that each of the twelve principles is interconnected and that each one is a mechanism to commence, sustain and foster dialogue. The Needs Assessment is the most important of the twelve principles. The Needs Assessment considers Hutchinson's WWW principle: *who* needed *what* as defined by *whom*. In other words, one needs to get to the 'coal face' and talk to the 'workers' to find out their needs.

B Experiential learning cycle model

Kolb's 'Experiential Learning Cycle Model'⁴ has the following components: idea/understanding; test; experience; reflection; and re-evaluation, which can be started anywhere in the cycle. The relevance of this model is that to meet the needs of learners, a teacher needs to constantly ask the following: ***Who's making decisions? About What? and On behalf of Whom?***

C Facilitation

The facilitator 'guards and guides the process' and does not control the process. An effective facilitator should not impose their views on others. Instead, a facilitator should respect other people's processes because 'learning is a personal construction'.⁵ Facilitators can model participation early in a course by controlling how much they themselves speak, thereby giving a voice more frequently to other group members.⁶ Effective facilitators should not intervene in the learning process, instead they should steer it and ensure that it remains on target. An effective facilitator will not necessarily be remembered for the subject matter of the course, but rather for themselves, as being humane, as having believed in the students and for having made a difference in their lives.

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¹ Dean Nugent, Class Discussion, on 19 November 2004.

² Jane Vella, *Learning to Listen, Learning To Teach* (Jossey-Bass, 1997) 3.

³ Ibid.

⁴ David Kolb, *Learning Style Inventory: Technical Manual* (McBer & Co, 1976).

⁵ Hadrian Lankiewicz and Emilia Wąsikiewicz-Firlej (eds), *Languaging Experiences: Learning and Teaching Revisited*. Chapter 1: From the Concept of Languaging to L2 Pedagogy, Hadrian Lankiewicz, (Cambridge Scholars, 2014) 13.

⁶ Stephen D Brookfield and Stephen Preskill, *Discussion as a Way of Teaching* (SRHE and Open University, 1999).

As well as being an effective facilitator it also calls for effective learners.. An effective learner should have the following attributes: a commitment to the study programme, an enquiring mind, an ability to put theory into practice, a flexible attitude in order to cope with change and the unexpected, a collegial attitude to aid and to learn from other learners, and the confidence to admit that they do not understand an issue.⁷

D Learning and teaching styles

There are different learning and teaching styles and there are advantages and disadvantages of teacher directed versus student-centred teaching. According to Honey and Mumford⁸ there are four different learning styles: activists, reflectors, theorists and pragmatists. *Activists* are impetuous and will attempt anything once. They enjoy 'living on the adrenalin rush' and as soon as the action is over they seek new challenges. They do not like repetitive tasks. *Reflectors* are quiet, thoughtful, meditative and observant, absorbing all that there is to possibly know before making any decisions. They are the antitheses of Activists. *Theorists* are perfectionists by nature (not by heart), whose approach is logically systematic and rational. They masterfully integrate unrelated, complex issues into a perfectly completed jig-saw puzzle. They do not like anything that is frivolous. *Pragmatists* are confident and practical. To them, theory is a means to an end and they prefer to apply the theory and see its application in use. They are not procrastinators and they do not enjoy regurgitation of previous facts; instead, they like solving problems and making decisions.

One of the advantages of teacher-directed learning is that all the information provided is correct and complete. *Theorists* in particular, who are perfectionists, will be satisfied that all the logical and relevant issues have been addressed and the outcome is objectively measurable. *Reflectors* too will benefit from teacher-directed learning as they like to consider all the possibilities and the teacher will have provided these.

One of the disadvantages of teacher-directed learning is that *Activists* and *Pragmatists* may become frustrated and bored as they are not actively involved in the teaching process but instead act like sponges, and are expected to absorb the information provided. They would be better off trying out new ideas and solving problems on their own initiative.

The advantage of student-centred learning is that *Activists* and *Pragmatists* will thrive in this environment, as it is very much 'hands on' and action orientated. However, the disadvantage is that *Theorists* and *Reflectors* will not be comfortable in this situation.

In order to get the best results the *Theorists* and *Reflectors* will need to work together with the *Activists* and *Pragmatists*. Being such a diverse team they need to cooperate in

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⁷ Sarah Clark, *The 5 Attributes of an Effective Learner*, (31 December 1969) <<http://www.worldwidelearn.com/education-articles/effective-learner.htm>>.

⁸ Peter Honey and Alan Mumford, *The Manual of Learning Style* (Maidenhead, 1992), Nick Zepke, Dean Nugent, Linda Leach (eds), *Reflection to transformation a self-help book for teachers* (Dunmore Press, 2003).

order to be successful. Tertiary students experience the importance and the benefits of cooperation during their studies. Cooperation better equips them for their jobs in any enterprise where cooperation is a necessity.

The importance of cooperation in an enterprise can be equated to the importance of communication between a teacher and a student, which is a cooperative process. There has to be a commitment from both the teacher and the student, otherwise the result is dysfunctional. The teacher in the first instance needs to establish that the student's interpretation and understanding of the information delivered is indeed correct.

Even though there are four different learning styles it is well known that if students perform tasks they acquire knowledge and skill. This is shown in a Confucius quote declared over 2,400 years ago (as cited in Silberman):

What I **hear**, I forget. What I hear and **see**, I remember a little. What I hear, see, and **ask questions about** or **discuss** with someone else, I begin to understand. What I hear, see, discuss, and **do**, I acquire knowledge and skill. What I **teach** to another, I master ⁹ (emphasis added by authors).

Discussing different approaches to learning such as the VARK model can also be shown to align with the approach of 'learning by doing' recommended by Silberman. The acronym VARK was proposed by Fleming for four learning styles based on sensory pathways: V refers to visual learners, A refers to aural learners, R refers to read/write learners and K refers to kinaesthetic/tactile learners. This approach by Silberman meets all four of the different learning styles discussed by Fleming¹⁰ in the VARK model. Students have to multi-task during a lecture. As stated by Biggs, 'We teachers have one task, sharing our recent thinking in an erudite and stimulating lecture, but the students have two: to comprehend what they are hearing, and to write their notes and commentary for later reference'.¹¹ As teachers, we follow the common sense approach of getting feedback from the students to ensure that they have understood what is being taught; we ask them questions.

Biggs¹² discusses teaching international students (ISs) and explains the focus needs to be on what the student does, namely, that they use their cognitive processes. Accordingly, we accept that ISs are fundamentally no different from our local students. The reason for this statement is that many of our 'local' students are of Māori and Pacifica origin and English is not their first language. Therefore the theoretical and practical aspects of teaching ISs is relevant to teaching local students in this case. The difference lies in our approach and attitude to the ISs. The focus should be on a 'student-centred lesson'. There are several ways in which student participation can be elicited. Biggs¹³ and Silberman¹⁴ suggest putting questions to the students. Silberman even suggests activities such as role-play.

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⁹ Mel Silberman, *Active Learning: 101 Strategies to Teach Any Subject* (Allyn and Bacon, 1996) 1.

¹⁰ Neil Fleming, *Teaching and Learning Styles VARK Strategies* (1st ed, 2001).

¹¹ John Biggs, *Teaching for Quality Learning at University* (Open University, 1999) 107.

¹² Ibid, 59.

¹³ Ibid, 108.

¹⁴ Silberman, above n 9, ix.

First impressions are generally lasting; however, they can often be misleading. It is not always possible to determine a student's learning style as Activist, Theorist, Reflector or Pragmatist. A student often has a combination of learning styles, although one learning style may be dominant. As a teacher you cannot be everything to everyone, so there is a tension between teaching according to your own preferred learning style and trying to accommodate the other styles of learning, particularly when teaching taxation. Taxation legislation is a complex subject which at times may be perceived as boring for some students. Accordingly it needs to be delivered in a manner that will meet the different learning styles of all students.

III METHODOLOGY

A qualitative case study using a Moot Court (simulated court case), discussions, filming and direct observation was undertaken. The site selection was confined to a tertiary institute in New Zealand. The participants were five separate cohorts of third-year business students from Semester 2, 2010 to Semester 2, 2012 as well as staff from the institute.

Feedback received from student evaluations of the course from prior semesters was used in order to select the tasks to be studied for this case study. The prior feedback indicated that certain topics were considered boring. The topics identified as boring were: taxation compliance and administration, particularly in the following areas:

The dispute resolution process with its concomitant procedures and forms, namely:

- 1 Notice of Proposed Adjustment (NOPA)
  - (a) Notice of Response (NOR) and
  - (b) Statement of Position (SOP).
- 2 The Shortfall Penalties Regime:
  - (a) Lack of reasonable care,
  - (b) Unacceptable tax position,
  - (c) Gross carelessness,
  - (d) Abusive tax position and
  - (e) Evasion.
- 3 The filing and payment of different taxes and tax returns, and their respective due dates.

The taxation compliance requirements for the disputes resolution process are prescribed in ss 89A to 890 of the legislation.¹⁵ In addition, prescribed documentation must be completed in accordance with these provisions. The completion and submission of these forms must be made with due regard to the respective time bars applicable at each stage of the process.

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¹⁵ *Tax Administration Act 1994* (New Zealand).

The first author endorses Confucius' declaration, as well as Honey and Mumford's four different learning styles and Fleming's VARK model. Accordingly, having different students with different learning styles necessitates the use of a variety of different teaching and delivery techniques as a means to an end.

A detailed mark plan¹⁶ is given to the students, together with their respective topics for their Moot Court cases. This enables the students to be fully informed about the manner in which marks are allocated. In addition, students are also made aware of the fact that each member's contribution to the group must be allocated a mark for their contribution to the group's work. A rubric is used so that each team member can determine a fellow team member's contribution. The students are required to sign the student declaration in the presence of one another so that each one of their respective fellow team members knows how their contribution has been awarded. Certain steps are taken to ensure that students feel comfortable with this student-centred activity. First, students are advised that participation is voluntary but that everyone's contribution would be welcomed. Secondly, everyone must show respect for their fellow students and there is no such thing as a stupid question. 'Incorrect' answers may not necessarily be incorrect as they may simply reflect a different view on an issue.

The statement of learning outcomes¹⁷ and graduate capabilities was carefully examined and constantly revisited to ensure that they were being adhered to.

Taxation legislation is complex, so needs to be presented in a manner that the students can understand. This is done by changing difficult terminology into plain English and into a context to which they can relate, make a connection with and understand. Using everyday life experiences and current affairs in teaching is important in order to explain taxation issues. Students remember course content far better when they can make a connection with it, for example, by using issues such as the Crafar Farms, Auckland Energy Consumer Trust (AECT), Vector Limited, South Canterbury Finance, Allan Hubbard [now deceased], and Versalko, the ASB Bank fraudster. Using examples of familiar people and entities illustrates the impact that taxation has on them. Most students are interested in AECT because they are beneficiaries of this trust and receive a \$320 dividend each year through having an electricity account within Vector Limited's network.

Learning resources consist of tangible and intangible resources. Tangible resources that are frequently used include data presentations, white board, YouTube video clips relating to taxation issues, wireless keyboard, mouse and 'magic' clicker. Publications such as *The New Zealand Tax Legislation for Students*, *New Zealand Master Tax Guide for Students*, *The Chartered Accountants' Journal of the New Zealand Institute of Chartered Accountants*, Inland Revenue Department Publications, New Zealand newspapers such as the *New Zealand Herald* and *The Independent Business Weekly*, and websites such as Treasury and The NZ Companies Office website also provide useful information. Using these resources enables the students to embed their course work into practice in the work place.

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¹⁶ Appendix 7.2 Moot Court Presentation and Documentation Marking Guide.

¹⁷ Appendix 7.3 Statement of Learning Outcomes and Graduate Capabilities, per Course Descriptor, Advanced Taxation, 311.723.

Intangible resources such as facilitation are extremely powerful. Intangible resources allow the facilitator to model participation early in a course by controlling how much they themselves speak, thereby giving a voice more frequently to other group members.¹⁸ Striving to facilitate meaningful dialogue and to build a rapport with students should be the aim of any course. Accordingly, students are treated with respect and dignity and there is interaction with the facilitator as well as with their tax class peers. Their measure of success is a pass, and as teachers our success is knowing that they have achieved their goals. This can be achieved by giving encouragement to them at all times, and being very strict but fair, giving students mini-breaks during their class to keep them alert, interested and focused. Caring about their progress and success sometimes means rebuking them to improve their work ethic. Using a sense of humour, and making them laugh sometimes, makes learning easier and more memorable — they can associate the content with something pleasant, and this makes it a positive experience.

In student-centred lessons, posing questions, disagreeing with students' answers to test whether or not they are really confident about their original answers is important. This 'disagreement' with their answers has forced students to carefully evaluate the validity of their answers. Taxation is technical at best and confusing at worst, notably when facing the complexities of the taxation legislation.

Taking to heart Confucius' declaration that 'a picture is worth a thousand words',¹⁹ rough drawings are made on the whiteboard to aid explanation of taxation concepts. Furthermore, continuing to ask the students questions about the topic, engaging them in discussions and giving them problems to answer is done in order to test their understanding of the relevant subject matter.

To accommodate all four learning styles, students are required to do a Moot Court during Week 5 of the semester.

Moot Court presentations are designed to allow groups of students to research specific taxation issues, prepare the required documentation and prepare a typed summary of their court case for a hearing in the Moot Court. Within each group there are two subgroups, one of which represents the Commissioner of Inland Revenue (CIR), while the other represents the taxpayer on a current topical taxation issue. Topics for the Moot Court are given to students during their first class.

Each separate cohort is given the same series of tasks to perform; however, the topics for groups of student in each cohort are not the same.

The tasks common to each group of students and to each cohort are:

- Students have to choose their own team members and form groups of either two or four.
- Half the team represents the CIR and the other half represents the taxpayer (the students must make these decisions). In the event that there are more than four

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¹⁸ Brookfield and Preskill, above n 6.

¹⁹ Silberman, above n 9.

students in a group due to larger class sizes or uneven class numbers, the students then decide who the other team members will be (eg taxpayer's advisor or taxpayer's Tax Agent).

- Each group has to research their topic and present their findings to the class.
- The rest of the class provides feedback to the group presenting in terms of the validity, relevance and technical accuracy of their particular arguments.
- Regardless of whether the particular group represents the CIR or the taxpayer, the facilitator provides guidelines to ensure that the groups remain on target and provide the requisite 'evidence' to support their topic which will become their moot court case.
- It must be remembered that these are business degree students, not law students. Accordingly, the emphasis is on ensuring that the legislative requirements of the taxation laws and concomitant court cases are correctly applied to their particular topic — so that it is 'on all fours' with their chosen court cases, or if it is not on 'all fours' then they need to know how to distinguish it and arrive at a different ratio decidendi in order to support their topic.
- Once each of the groups has completed their research and identified the relevant court cases to support their particular topic they send a draft to the Lecturer as a formative assessment.
- The Lecturer provides feedback to the students on their drafts.
- The students then reflect on the feedback provided by the Lecturer and revise their work. The students are then required to complete the following documentation which forms part of their presentation at the Moot Court. Each group has to complete:
- The Moot Court Case Documentation, namely, items (a) to (g) inclusive.
  - a) Notice of Proposed Adjustment [NOPA (IR 770)]
  - b) Notice of Response [NOR (IR 771)]
  - c) Conference stage proceedings and outcome
  - d) Disclosure notice
  - e) Statement of Position [SOP (IR 773)]
  - f) Adjudication proceedings and outcome
  - g) A summary of their Moot Court case (in no more than 400 words) [The purpose of this brief summary is so that one member of the group introduces their topic to the jury and the judge so that everyone knows what the case is going to be on before it commences.]
- The groups comprising the CIR and the taxpayer then has to present their case at the Moot Court.
- At the conclusion of each Moot Court case presented, the Advanced Tax students act as the jury for that case. The teacher (and first author) acts as the judge for each Moot Court case.

In order to prepare the students for their moot court cases a class structure is set up. In addition a summary is provided to all the students in the cohort, setting out the way the Moot Court lessons would progress.

The seating is arranged in a 'U' shape as this enables all the students to see one another. Each of the respective groups is divided into two groups, which sat opposite each other so that there was a sense of two opposing teams. In Week 1, the Moot Court case topics were given to each of the respective groups. Each group had a different topic which they have to prepare for their Moot Court case. The Moot Court preparation takes place in class, during tutorial time.

The lesson begins with the different groups asking each other about their ideas for the court case that had been assigned to their group — excitedly, in the sessions held in the past. The Activist/Pragmatist type learners asked for input from the Theorist/Reflector type learners and discussion took place while they searched the resources for other similar court cases. The groups were animated and deeply engrossed in their discussions throughout this stage of the lesson. Checking for readiness for assessment through, for example, observation and/or questioning was done while monitoring the groups to check the progress of their discussions and to see if they were keeping to their required discussion topics/guidelines. The first author paused at each group to give them the opportunity to ask questions that they may have wanted clarification on. Feedback on learning was provided, while responses were recorded on the whiteboard and were commented on. Students were also commended for the depth of their discussions and arguments.

A discussion of the assessment activity enables a discussion of the views by the different Moot Court groups and provides an opportunity to expand on these, and to give feedback to the relevant group during the tutorial. Other court cases which they need to rely on to support their particular topic for their Moot Court Case presentation are then discussed in class. Each student receives an evaluation form, the purpose of which is to gauge what they feel they have gained from the discussion.

Students at undergraduate level have experienced peer teaching during the four week preparatory stages leading up to their Moot Court presentations. The peer teaching is as a direct result of their own research, discussions, presentations to their fellow colleagues and critiquing by their colleagues as well as facilitation, as required by the first author. This enables the students to evaluate their research, reflect on it and produce a revision of their work for final presentation at the Moot Court. The students have to become 'masters' of their subject matter.

The peer teaching is followed by tutorial questions and discussions during the tutorial time. The tutorial questions and suggested solutions are provided by the students, based on their own research of their topics. Cooperation is critical to success, so each student needs to cooperate in order to make their team successful, that is, achieve a pass mark of 50 per cent for their Moot Court. Irrespective of whether a student is an Activist, Pragmatist, Theorist, Reflector, Visual, Aural, Read/Write or Kinaesthetic learner they need to learn together to achieve success in the course.

The moot courts are attended by the entire student taxation cohort and various staff members. In addition, a staff member from a different department, along with their students, is involved in the filming of each of the Moot Court cases. This not only encourages collaboration, but also integrates various disciplines across departments. The

individual contributions, as well as the group contributions, are measured and assessed in accordance with the detailed instructions provided.²⁰

Only after the students have received their marks for the assessment are the filmed moot courts shown to them. The purpose of this is to enable them to reflect on their performances individually, as well as collectively, and to use that visible evidence as a formative assessment to assist in their preparation for similar situations in the future. In the past the students have found this stage invaluable.

IV FINDINGS FROM MOOT COURTS 2010–12

Silberman²¹ suggests that student-centred lessons such as role play are an efficient tool. Accordingly, in the Moot Court the students had to argue either for the CIR or for the taxpayer. This was extremely successful, as it resulted in a very active form of engagement with the class. The topics were based on current affairs and required an application of the students' knowledge to the specific facts in their topic. This created an awareness of missing pieces of understanding in their knowledge base and provided the requisite link between theory and practice.

As a result of different learning styles, a balance needs to be obtained between feeling comfortable about the way you instruct, about personal teaching styles/methods, and accommodating students' preferred learning styles. Accordingly, student-centred learning was combined with some teacher-directed learning during the lecture. The first author's observations are that the combination of these aforementioned learning methods resulted in cohesive groups of students in each of the Moot Court groups. The student-centred method is the most appropriate method to teach taxation because it develops an enquiring mind, it stimulates interest in the subject and it broadens the students' horizons by making them aware of issues that they would not normally consider. Student-centred teaching also creates a collaborative learning environment through the exchange of ideas and beliefs. The exchange of ideas and beliefs then provides the opportunity for some teacher directed learning to occur.

The results of the Moot Court assessment were recorded via a summative assessment. Each student received a detailed report and mark sheet with feedback.²² At the conclusion of the presentation of each Moot Court case, the Advanced Tax students acted as the jury for that case, while the first author acted as the judge. It was found that one group was far superior, and the remainder of the class stated that they would want them (the superior group) to be their tax advisors. The students are to be commended for their commendation of their peers. Feedback to students on their Moot Court assessment results was given, along with thanking them for their input and complimenting them on their excellent responses and discussions. Brookfield and Preskill²³ provide the justifications for assessment decisions made in this study; as they observe: *'Our*

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²⁰ Appendix 7.1 Instructions on how to complete the signed declaration (for group work). Appendix 7.2 Moot Court Presentation and Documentation Marking Guide.

²¹ Silberman, above n 9.

²² Appendix 7.2 Moot Court Presentation and Documentation Marking Guide.

²³ Brookfield and Preskill, above n 6, 8.

experience is that when students know that there are fair and democratic ground rules that frame how people speak, there is a much better chance of getting them involved. Class and small group discussions are the optimal ways to 'flesh out' an abstract concept and the best way to assess understanding of an abstract concept is by posing a question. The question posed results in further questions being asked, which brings to the fore various possibilities for further discussion. With regard to using a student-centred method, educators suggest that students' prior learning be checked first. However, to the first author's mind, the best way to gauge a student's prior knowledge is by simply giving them a statement to discuss and see what response it evokes. Generally, this results in a lot of questioning, which stimulates discussion right from the outset. The standard result from the Moot Court presentations was that the students really enjoyed themselves and found it to be a lot of fun.

V ANALYSIS OF RESULTS AND DISCUSSION OF FINDINGS

The literature indicates that teaching should be delivered in a manner that caters to learners' different learning styles. The Moot Court addresses all of these issues. This article also highlights the benefits of both self-directed and peer learning. Based on lecturer evaluations, as well as the course evaluations²⁴ received from the students on the taxation course, there is strong evidence to support the claim that the students enjoyed the course as well as the way in which it was delivered. In addition, the learning outcomes and the graduate capabilities stated in the course descriptor were met. As well as the prior activities, an open-door policy made the students feel comfortable about approaching the teacher.

The students were encouraged to submit drafts of their assessments for formative purposes. Those who availed themselves of the opportunity were more successful than those who did not. Although students found the assessments challenging for their respective levels of study, the first author has found it very rewarding to see their comprehension levels improving as they grasped the complexities. Group work and group presentations gave the students the opportunity to hone their presentation skills, improve their confidence and to develop empathy as they worked with students from other backgrounds. Students needed to draw on their lower-level taxation knowledge and do research in order to ask and answer questions and successfully present their tax cases in the Moot Court.

The Moot Court cases are an application of various taxation principles, legislation and case law. They require students to demonstrate their interpretive, analytical, critical and deductive skills. The major advantage of the Moot Court is that it is not a controlled situation like a test or exam, so students are able to provide a better quality outcome with their submissions, and gain a deeper understanding of the relevant issues.

The Moot Court requires students to collate all the relevant taxation knowledge and to present it in a technically correct and logical sequence. They are also required to demonstrate sound reasoning abilities to be able to counter an argument from the

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²⁴ See Appendix 7.5 for course and lecturer evaluations.

opposition in the Moot Court. Besides presenting their tax case in the Moot Court there are various Inland Revenue Department forms and documents that have to be prepared as admissible evidence in court, to support the tax position that they have adopted and there are strict time restrictions within which all the admissible evidence must be submitted.

Taxation administration and compliance is very complex and may be perceived as boring, but by engaging with the students in the form of the Moot Court they are unaware that they are learning. The Moot Court presentations are of a very high standard and from the comments raised by various students it is obvious that learning has taken place. What is more remarkable is that students are teaching their peers a complex and seemingly uninteresting topic and that both the teachers and the peers are enjoying it. If the taxpayer does not voluntarily comply with the taxation law, the tax penalties and interest charges can often exceed the original amount of tax owing, so taxation knowledge is priceless. Students often brought media articles to class to discuss their taxation consequences, which demonstrated that they were engaging with the first author and their peers, and that learning and cooperation was taking place with their taxation course.

The Moot Court has been hugely successful, as it develops a very active form of engagement with the class. It has also developed students' interpersonal skills and their awareness that almost everything has a tax consequence.

The Moot Court cases achieved this by combining student-centred learning and some teacher-directed learning during the lectures. This article also highlights the benefits of both self-directed and peer learning. Staff and students alike found the subject matter of taxation to be enjoyable. The Moot Court cases demonstrated that topics which are traditionally seen as uninteresting can become enjoyable and interesting, and that the prescribed learning outcomes can also be achieved in the process.

The teaching and learning approaches which were adopted catered for each of the students in the VARK model. In addition, synergies were achieved by the integration of several taxation topics. The only limitations of this research are that staffing and larger class sizes may negatively impact the approach followed. Additionally, consistency in the assessment and delivery of this type of activity may also be affected by staffing or larger class sizes.

VII CONCLUSION

Effective learners need to be willing participants in any program of study. An effective facilitator is someone who has an innate ability to adapt to the 'mind and body rhythms' of the students and to guide them if they lose their sense of direction or perspective. Learning and teaching styles are varied. Activists rush in while Reflectors consider every detail before doing anything. Theorists strive for perfection and they integrate complex and disjointed data into a complete whole. Pragmatists are very practical and enjoy problem solving and decision making. Changes in our thinking about teaching and changes in our teaching practice require changes to our style of teaching and delivery. What the literature expounds is merely an affirmation of existing thinking and teaching practices.

The study found that there was a change in perception from taxation being 'as dry as toast' to being an enjoyable subject. The students preferred the moot courts that were used as one of the summative assessments as opposed to the traditional summative assessments of assignments, tests and exams. The overall outcome was that both students and staff alike found the subject matter of taxation enjoyable:

Extant literature indicates that teaching should be delivered in a manner that caters to learners' different learning styles. The Moot Court addresses all these issues. This article also highlights the benefits of both self-directed and peer learning. 'Teaching is like Theatre ... it involves the head, (knowledge), the heart, (attitude) and the hands (skills)'.²⁵

This analogy is epitomized in the following quotes from Dean Nugent, which are particularly useful: 'I consider ... it useful to view 'teaching methods' as 'learning activities', as well as 'In today's session, we'll be looking at ...' (must knows)'; 'And if we have time, we can examine ...' (should knows).²⁶

The reason these quotes are meaningful is that they force the teacher to recognise that students have to multi-task during lessons. Accordingly, the teacher needs to choose the appropriate delivery style, and content volume to engage all the students' faculties within the prescribed timeframe, if the learning activities are to be properly managed.

Also to successfully manage learning activities requires the constant application of Kolb's

'(The) Experiential Learning Cycle Model'. During the lessons the first author constantly applied the 'The Experiential Learning Cycle Model' by testing students' ideas, understanding, experiences, reflections and re-evaluations of their respective moot court cases. Student-centred learning combined with some teacher directed learning enabled this process. And in order to meet the needs of learners a teacher needs to constantly ask the following: Who's making decisions? About What? and On behalf of Whom?

The Faculty of Business and Information Technology requires students to anonymously complete an evaluation of the lecturer as well as an evaluation of the taxation course.

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²⁵ Dean Nugent, Class Discussion, on 5 November 2004.

²⁶ Ibid.

These two evaluations are completed by the students in the presence of an independent third party Evaluator. The completed evaluations are collected from each student and placed into an envelope by the independent Evaluator and the envelope is sealed in the students' presence. The sealed envelope is then given to the Faculty administrator and another independent third party is then given the task of collating all the students' evaluations. The collated evaluations are then provided to the lecturer.

The feedback received from the taxation students regarding their evaluations of the first author as well as the taxation course strongly support the fact that the learners had an enjoyable learning experience and appreciated the different teaching and learning methods used. In addition, those evaluations provide evidence that taxation compliance and administration can be taught to students in an enjoyable manner while still meeting the learning outcomes of the course.

Finally, a balance needs to be reached between feeling comfortable about the way of teaching and accommodating students' preferred learning styles. If you are not true to yourself you cannot expect to gain the respect and confidence of others and this will show in your 'performance'. Further research opportunities exist to explore the benefits of collaborative learning.

APPENDIX**INSTRUCTIONS ON HOW TO COMPLETE THE SIGNED DECLARATION (FOR GROUP WORK)**

Each group member must record the percentage participation out of 100 that they have awarded to their fellow team member. Students submit only one completed grid like the example below, together with the completed Moot Court documentation.

Example: Signed Declaration

Person	A	B	C	D
A	nil	100	90	60
B	80	nil	100	50
C	100	100	nil	100
D	100	90	80	nil
Total	280	290	270	210
Average	93.33	96.67	90	70
Assume that the group mark awarded is: 68%				
Individual mark	63.46	65.74	61.2	47.6

The lecturer will:

Average the group participation percentage as submitted by individual group members; (see the example in the table above)

Multiply the average participation rate by the group score for the assignment; and

The result will be the individual's mark for the group assignment.

MOOT COURT PRESENTATION & DOCUMENTATION MARKING GUIDE

MOOT COURT PRESENTATION [20 marks]

Each group member is required to participate in the Moot Court. Each group will be marked on their participation as indicated below.

	MARKING GUIDE		
	Group's Moot Court Case Presentation	Marks Available	Marks Awarded
1	Presentation — Skills	4	
	Clearly spoken; Confident		
2	Technical Understanding	12	
3	Presentation — Delivery		
	Professional; Engage the audience's attention	4	
	Total	20	

MOOT COURT DOCUMENTATION [30 marks]

Item	MARKING GUIDE	Possible Marks	Marks actually awarded to each individual			
			Name	Name	Name	Name
1	NOPA IR770 (properly completed within the time bar and submitted)	5				
2	NOR IR771 (properly completed within the time bar and submitted)	5				
3	Conference stage (brief summary of issues discussed)	2				
4	Disclosure notice	1				
5	Statement of Position (SOP) IR773 (properly completed within the time bar and submitted)	5				
6	Adjudication (brief summary of issues discussed)	2				
7	Summary of Moot Court Case (in no more than 400 words)	5				
8	OVERALL PRESENTATION of all of the required items, including: Correct Sequencing; Referencing; Grammar and Spelling	5				
9	Moot Court Case CLASS PRESENTATION (Each group will be awarded a mark for their presentation during the Moot Court proceedings)	20				
	Total	50				

STATEMENTS OF LEARNING OUTCOMES & GRADUATE CAPABILITIES PER COURSE DESCRIPTOR, ADVANCED TAXATION 311.723

Course Title	Advanced Taxation						
Course Code	311.723						
Level	7						
Credits	MIT credits		15		NQF		
Course Hours	Interactive sessions	45	Blended		6	Self-directed	99
Total Learning Hours	150			Attendance Requirement			
MOE Classification 1, 2, 3 or 4	3			Mode of delivery Intramural, distance, blended		Blended	
Pre- requisite	311.642 Taxation						
Purpose	The purpose of this course is to enable students to demonstrate an understanding of taxation compliance within statutory and professional requirements and apply this understanding to current and international taxation issues.						

MIT Graduate Capabilities	The following MIT Graduate Capabilities (GC) will be developed in this course: a) Motivation Ethical behaviour Critical thinking Problem solving Reading literacy Information literacy Professional conduct Team work Adaptability Entrepreneurship Interpersonal skills

LEARNING OUTCOMES - FROM THE NZICA STATEMENT OF LEARNING OUTCOMES	OUTLINE OF CONTENT	LEARNING AND TEACHING METHODS	ASSESSMENT VALID/RELIABLE	RESOURCES REQUIRED TEXT, WEB LINKS, EQUIPMENT, COMPUTER LABS ETC AS APPLICABLE
LO 1: Determination and administration of New Zealand taxation: • discuss the administration of taxation in New Zealand. • determine taxation obligations for different business structures, including groups of companies and partnerships to meet required legislation. • determine taxation obligations for an individual. GC a4, b4, c4, d4, e4, f4, g3, h4, j3, k3, l2.	Disputes Resolution procedure. GST, FBT, Rules and returns. Income tax liabilities and losses of individuals, complying trusts, companies, (including groups of companies) and partnerships.	Interactive sessions will be one hour per week and will introduce both theoretical and practical knowledge; these will be as interactive as is practical. During this time theory will be explained and examples from current news articles, court cases and Inland Revenue Department (IRD) forms demonstrated. Students will put into practice the examples demonstrated. Students will be required to subscribe to IRD's Policy Advice Division (P.A.D.) website and keep abreast of current and proposed tax changes. Students will also be required to download various newspaper articles and IRD forms and guides, podcasts and access the NZ Companies Office to apply their theoretical knowledge to practical issues.	Formative assessment Case studies and problems/exercises/tasks about problems (both practical and theoretical) will be used during tutorials to enable students to master the learning outcomes. Students will be given suggested answers in class or the suggested solutions will be made available on LMS. During tutorial sessions lecturers give individual feedback to students on the exercises they practise. Summative Assessment	Prescribed Textbooks: NONE Recommended Readings: (current year). <i>New Zealand Tax Legislation for Students</i>, Auckland: CCH New Zealand Ltd. <i>New Zealand Master Tax Guide (current year) for Students</i>. Auckland: CCH New Zealand Ltd. Thomson Reuters (Current year). <i>New Zealand Taxation: Principles, Cases and Questions</i>.

LO 2: Impact of taxation on the individual, the entity and the economy: • discuss taxation as an instrument of fiscal, social and environmental policy. • analyse and evaluate the impact of taxation policy on market, finance and investment decisions by entities. • determine advice for clients on matters of taxation control and compliance. • evaluate tax planning opportunities for various business transactions. GC a5, b5, c5, d4, e4, f4, g3, h3, j3, k3, l2.	Land Transactions. Dividends and dividend reinvestment plans. Tax avoidance and tax planning. Double Taxation Agreements. Current international tax issues.	Material delivered during interactive sessions will be applied and consolidated in tutorial sessions (two hours per week), where students will, as appropriate, integrate theory with practice by discussing, debating and solving various taxation problems. Tutorials will allow students to put their knowledge into practice. Moot Court presentations (simulated court cases) are designed to allow groups of students to research specific taxation issues, prepare the required documentation and prepare a	Moot Court: (25%) (SLOs 1–3) <i>CIR v The Taxpayer</i> or <i>The Taxpayer v the CIR</i> The respective groups will represent either the CIR or the taxpayer on a predetermined taxation issue. The students also have to submit a summary of their court case together with the relevant documentation. Case Study One (25%) (SLOs 1- 3) A case study is handed out in week one. Students need to determine and discuss the relevant taxation issues of a given entity and complete the relevant tax returns.	Websites: LMS http://my.manukau.ac.nz/index.html Inland Revenue Department

LO 3: Legal and ethical issues of taxation in New Zealand and internationally: analyse cases, identify whether they involve avoidance or evasion, and substantiate the decision with reference to current law and practice. discuss statutory and professional (ethical) requirements. discuss international tax issues affecting individuals and businesses in New Zealand. GC a4, b5, c2, d3, e4, f4, g3, h2, j3, k3, l2.		typed summary of their court case for a hearing in the Moot Court. Within each group there are two subgroups, one of which will represent the Commissioner of Inland Revenue (CIR) and the other group will represent the taxpayer on a current topical taxation issue.	Case Study Two (50% — Mandatory) (SLOs 1–3) A case study will be handed out in week one. Students determine and discuss the relevant taxation consequences to various taxpayers. Corporate and International tax issues are the major focus of Case Study 2. The relevant tax returns also need to be completed. Consideration also has to be given to taxation as an instrument of fiscal, social and environmental policy.	http://www.ird.govt.nz/ New Zealand Legislation http://interim.legislation.govt.nz/ NZICA www.nzica.com New Zealand Companies Office: www.companies.govt.nz

LECTURER EVALUATIONS (VERBATIM)

Extracts from the feedback which the first author received in her lecturer evaluations from the students appears below and is quoted verbatim.

The statement in the Lecturer Evaluation was: 'Please suggest things about the lecturer's teaching which are particularly helpful to you.'

Student responses were:

She uses lots of practical examples in her Illustrations in class and this helps me learn quickly.

Heather's given notes (handouts) in class are so helpful. When she teaches she asked questions and we as students help her answer it.

PARTICIPATION. She strived for excellent and encourage her students to do better in their internal assignments and assessments.

Providing lecture notes and opportunity to work in groups really encourage me. Sharing ideas and opinions during group work was very helpful for me.

She explains everything in a simple and effective manner that can be understood.

Very helpful in encouraging students to ask questions. Always willing to explain things when students ask.

USES PRACTICAL EXAMPLES WE CAN RELATE TO.

Relevant (current news issues) covered in course.

Relating Course WORK to Actual Life Situations.

COURSE EVALUATIONS

Extracts from the feedback which the first author received for the course evaluations from the Students appears below and it is quoted verbatim.

The question in the Course Evaluation was: 'What did you like best about this course?'

Student responses were:

Content.

Gave me a broad understanding of tax & tax issues. How to apply tax & what the compliance was.

Interesting, relevant and current information and examples used. Assignments were difficult and required self-learning and development which was very rewarding at completion;

Learning about Taxation. The implications of it and how it deals with the investment Properties — The changes relating to Tax Rate.

New topics — Current Affairs & implication of Tax policy Enjoyed Lecture, conversational.

Relate to real-life cases.

Tax policy

The lecturer — she made what could be a very dry topic interesting & enjoyable.

The teacher tried her hardest to help us understand this rather technical paper.

This course is practical, motivating. The leader's comments of assignments are very helpful.

Applicable of theories to actual use of IRD forms. Moot Court was nice because this encouraged the student to understand the theories or lecture and apply.

Course was structured in a challenging, but interesting manner, ie Moot Court, Case Study assignments.

Get to do practical stuff @ an advance level which is very useful to me. Getting to know about AECT and Vector Ltd is Fascinating and interesting. I LOVE IT!!

Taxation is one of my favourite papers. It helps me understand NZ taxation more.

Group exercise

Highlighted all the relevant tax issue and the impact of a situation on the individual, entity and the economy. Hands on knowledge about the various IRD forms. The moot court was great, gave experience of a tax court case.

The court — interaction with other students & playing out as if we were in a real court.

It gives me an understanding more about the nature of NZ taxation and I can see the differences between my country's taxation and NZ taxation.

Variety in teaching method + techniques.

I really found this paper more interesting because of the research required to complete assessments.